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Theory & Practice

1976 Standards, Rules and Statements

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Remember 1975, particularly the last few months of it, when it seemed that there was a contest going on between the Office of the Chief Accountant of the Securities and Exchange Commission and the Financial Accounting Standards Board to see which would issue the most pronouncements on accounting and reporting within the year? At this time (about six weeks from year-end), 1976 might be considered comparatively dull.

The SEC's 1976 contributions to increasing the workload of registrants' corporate accounting departments and their independent auditors were Accounting Series Release No. 177, Notice of Adoption of Amendments to Form 10-Q and Regulation S-X Regarding Interim Financial Reporting, (issued in late 1975 but effective for various dates in 1976) and ASR No. 190, Notice of Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data, (issued in March 1976 and effective for years ending on or after December 25, 1976 for those registrants to which it applies).

During 1976 the FASB devoted the greater part of its resources to the project on Conceptual Framework for Accounting and Reporting and has not actually adopted any Financial Accounting Standards. The Board did issue six interpretations relating to Statements No. 5, 8 and 12 in September. Exposure drafts of proposed Statements on Accounting for Leases (revision of earlier draft) and on Prior Period Adjustments, an exposure draft of a proposed interpretation of APB Opinion No. 28 on Accounting for Income Taxes in Interim Periods and a discussion memorandum on Business Combinations and Purchased Intangibles have also been issued. Other projects for which discussion memoranda were issued in earlier years are Criteria for Determining Materiality, Accounting for Employee Benefit Plans and Accounting for Restructured Debt. The public hearing has been completed on each of these. A draft of the final Standard on Financial Reporting by Segments of a Business Enterprise is reportedly near completion. Projects for which a discussion memorandum is being drafted are Accounting for Interest Costs, Including Interest Capitalized, Accounting and Reporting in the Extractive Industries and Interim Financial Statements. Also, an exposure draft concerning disclosure of payments scheduled for redeemable preferred stock is being prepared.

The Accounting Standards Division of the American Institute of Certified Public Accountants issued two Statements of Position in August 1976. The first was Accounting Practices in the Record and Music Industry and the second was Accounting for Origination Costs and Loan and Commitment Fees in the Mortgage Banking Industry. There are proposed SOPs on Accounting for Employee Stock Ownership Plans, Hospital Accounting (Application of FASB No. 12 to Hospitals and Accounting and Auditing Considerations Regarding Hospitals That Self-Insure against Mal-Practice Claims) and Financial Accounting and Reporting by Investment Companies (Problems Regarding Money-Market Funds, Put and Call Options, Organization Expenses, Amortization of Deferred Costs, Payment of Fees for Research and the Valuation of Short-Term Investments). A report has been prepared for distribution on GAAP for Small Businesses. Other topics under consideration are Revenue Recognition for Future Service Agreements, Required Disclosures in Interim Financial Statements (relates to concerns arising from ASR No. 177), Accounting and Auditing for Construction Costs and Contract Accounting, Accounting Principles for Non-Profit Organizations and Valuation of Real Estate in Cases of Repossession (issuance of an SOP will probably be deferred until the FASB has settled the restructured debt problem).

The AICPA's Auditing Standards Executive Committee issued two Statements on Auditing Standards earlier this year. These were SAS No. 12: Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments and SAS No. 13: Reports on Limited Review of Interim Financial Information. SAS No. 13 relates to reporting on interim financial information in conjunction with the requirements of ASR No. 177. Exposure drafts of several proposed Statements have been issued; namely, Special

Reports, Illegal Acts by Clients, The Independent Auditors' Responsibility for the Detection of Errors or Irregularities and Reports on Comparative Financial Statements. The first three of these are now in the "ballot draft" stage. Some of the other subjects under consideration and in various stages of completion are Preferability of Accounting Principles (an interpretation of APB No. 20), Planning and Supervision, Required Review of Internal Control, Contingencies and Reporting on Uncertainties, Representation Letters, Replacement Cost relates to ASR No. 190), and an Interpretation Relating to Reporting on Pension Funds where the plan is administered by a bank or insurance company.

Limitations of space prohibit analyzing each pronouncement or proposal. It is hoped that mention of the subject matter will suffice as a reminder of the existence of a pronouncement or proposal applicable to a specific area of practice. A few of the pronouncements affecting year-end work will, however, be described to some extent.

ASR No. 177

As indicated by its title, this release encompassed both the amendment of Form 10-Q and the amendment of Regulation S-X. Form 10-Q was expanded to require not only results of operations for the first three quarters of a registrant's fiscal year but also a condensed balance sheet and statement of changes in financial position. Since the revised instructions were effective for quarters beginning after December 25, 1975, the new requirements should now be well-known. The Regulation S-X amendment added Rule 3-16(t) which requires of certain registrants disclosure in a note to the financial statements of net sales, gross profit, income before extraordinary items and cumulative effect of a change in accounting, net income and related per share data for each full quarter within the two most recent fiscal years and any subsequent interim period for which income statements are presented. Although the rule mentions two fiscal years, the effective date of the amendment is such that quarterly data for quarters beginning prior to December 25, 1975 are not required in any event. Only registrants who meet both tests set forth in the rule are required to furnish quarterly data. Technically the data is to be furnished only in filings with the SEC; however, the SEC has made it known that it expects the quarterly data in the notes to financial statements in the registrant's Annual Report to Stockholders. The tests mentioned above represent an amendment adopted in September 1976 of Rule 3-16(t) as originally adopted in 1975. The first test contained several detailed requirements relating to the trading of the registrants's stock and should be read carefully. To meet the second test, the registrant and its consolidated subsidiaries must either have had net income after taxes, but before extraordinary items and cumulative effect of an accounting change, of at least $250,000 for each of the last three fiscal years or had total assets of at least $200 million for the last fiscal year-end.

Also adopted in ASR No. 177 was Rule 2-02(e) which states "if the financial statements covered by the accountant's report designate as 'unaudited' the note required by Rule 3-16(t), it shall be presumed that appropriate professional standards and procedures with respect to the data in the note have been followed by the independent accountant who is associated with the unaudited footnote by virtue of reporting on the financial statements in which it is included." SAS No. 10, Limited Review of Interim Financial Information, sets forth the nature, timing and extent of procedures the independent auditor should apply to interim financial information and SAS No. 13, Reports on a Limited Review of Interim Financial Information, describes when it is necessary for an auditor to refer to the unaudited note in the report on the examination of the registrant's financial statements.

It should also be noted that the SEC issued a Staff Accounting Bulletin (No. 6) containing interpretations of ASR No. 177 with regard to both the Form 10-Q and the unaudited note.

ASR No. 190

Rule 3-17 of Regulations S-X, adopted in ASR No. 190, required current replacement cost information relative to inventories and productive capacity on hand at the end of each fiscal year for which a balance sheet is required and to cost of sales and depreciation, depletion and amortization for the two most recent fiscal years. The information is to be shown in a note to the financial statements or as part of a separate section of the financial statements following the note. The note or the separate section may be designated "unaudited."

When issuing this release, the SEC formed an advisory committee to consider questions submitted by registrants and their independent auditors and to formulate interpretations for implementation of the requirements. Thus far, SAB No. 7,9,10 and 11 have been issued containing these interpretations.

Only a registrant whose consolidated balance sheet at the beginning of the most recently completed fiscal year reflects inventories and property, plant and equipment before deduction for depreciation, depletion and amortization totaling $100 million or more are required to disclose replacement cost information. In addition, the information is not required for registrants whose total inventories and properties do exceed $100 million when this amount is less than 10 per cent of total assets in the same beginning balance sheet. There are also certain exceptions relative to the effective date which are set forth in ASR No. 190.

FASB INTERPRETATIONS

Interpretations of Statement No. 12, Accounting for Certain Marketable Securities, effective for periods ending after October 15, 1976 are:

No. 10 - Provisions of Statement No. 12 are applicable to personal financial statements of individuals prepared in conformity with generally accepted accounting principles.

No. 11 - Changes in market value, if other than temporary, occurring after the balance sheet date are to be considered and the security written down to a new cost basis; the write-down, which cannot exceed the difference between market value at the balance sheet date and cost, is to be accounted for as a realized loss.

No. 12 - Allowances for market decline established prior to the effective date of Statement No. 12 are to be eliminated and the valuation allowance account required by the Statement established.

No. 13 - Contains procedures to be followed and the disclosure required for marketable securities reported in consolidated financial statements which include subsidiaries whose fiscal year-ends are different from that of the parent.

Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, is an interpretation of the second condition specified in Statement No. 5, Accounting for Contingencies, which condition is that the amount of the loss can be reasonably estimated. The interpretation specifies that when the first condition is met and the estimated amount of loss is a range of amounts, the second condition is also met and a loss shall be accrued. If some amount in the range is a better estimate of the loss than any other amount, that amount is accrued or if no one amount is a better estimate of the loss than the any other amount, the minimum amount in the range is accrued. This interpreation is effective for annual and interim periods beginning after October 15, 1976.

Interpretation No. 15, Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company, is an interpretation of Statement No. 8, Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements. The interpretation provides that such costs are to be translated at historical rates and that a stock life insurance company shall make a computation of a foreign subsidiary's reserve deficiency in dollars after translation. An adjustment of the reserve deficiency as computed by the foreign subsidiary may be required. The interpretation is effective for all unamortized policy acquisition costs reported in financial statements for annual and interim periods ending after December 15, 1976.

Legal Developments

Social Security: The Promises, Problems and Possibilities — Part II

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In Part I of this column, it was shown that the present Social Security system is woefully inadequate in several areas — including the areas of funding and purpose.

Since social security is on a pay-as-you-go basis (it is *not* a funded annuity arrangement) and because of the declining birth rate, the increasing life expectancies, and earlier retirement, the fund is practically bankrupt, even though the tax has increased astronomically in the last twenty years. Each year $75 *billion* more is paid out than is collected. At this rate, the $40-billion trust fund from which these deficits have been financed will be nonexistent in 1981,[1] in spite of new tax increases passed by the Ford Administration to offset the deficit. Furthermore, the problem is being compounded by state and local governments pulling out of the system in favor of private plans. Social security is mandatory for all workers except employees of the U.S. federal government, state and local governments, and charitable organizations. The federal government has never participated in social security and hundreds of other governmental units are now rejecting social security. For example, the employees of neither the State of Alaska nor New York City (since March, 1976) are participating in social security.[2] Furthermore, those employees are winding up with greater benefits under their private plans than are those workers who are manditorily covered by social security. For example, if a thirty-five year old worker, making $18,500 per year, were to put the $21 per week social security into a plan offered by the Insurance Company of North America, the fund at age sixty-five would be $122,245, resulting in a pension of $1,002 per month for life, compared with $366 per month for life under social security which costs the same.[3]

The huge difference can be explained, in part, by the welfare function, as opposed to the annuity function, of social

Notes to social security

[1] "Private Retirement Plans Outshining Social Security," *The Seattle Times,* May 3, 1976, p. D-18.

[2] *Ibid.*

[3] *Ibid.*

[4] Warren Weaver, "A Widower Wins Case on Child Care," *Seattle Post Intelligencer,* March 20, 1975, p. A-7.

[5] Public Law 93-647, 93rd Congress, H. R. 17045, January 4, 1975.

[6] Lou Cottin, *The Seattle Times,* August 29, 1976, p. C-3.

[7] *Seattle Post Intelligencer,* April 14, 1975, p. B-3.

[8] Peat, Marwick, Mitchell & Co., *Tax Reform Act of 1976, Tax Considerations for Individuals,* p. 30-31.

[9] See Part I in the last issue of the *Woman CPA.*

[10] Warren Shore, *Social Security: The Fraud In Your Future,* New York: Macmillan Publishing Co., Inc., 1975, pp. 127-139.