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A Mosaic By Many Artisans

By Ralph B. Tower

Dramatic changes have occurred during the past fifteen years in the scope and content of professional accounting standards. Writers have devoted considerable attention to the growth in general reporting requirements. Virtually unnoticed, however, has been the rapid expansion in the number of industry-related standards. Today they greatly influence financial reporting in many segments of the economy.

Industry accounting standards represent only one of several bases of reporting presently in use. Each of them has significant support within the business community. Therefore, an important consideration in this discussion will be the relationship of industry accounting standards to other types of reporting. The purpose of this article is (1) to review the various accounting bases now in use, (2) to analyze the authoritative support accorded each of them. (3) to explore efforts to improve the effectiveness of professionally supported standards, and (4) to discuss the future role of such standards.

Bases of Accounting

Specialized industry reporting practices have come from four sources: (a) state and federal regulatory agencies, (b) trade associations, (c) academics and practitioners, and (d) professional accounting bodies. The objectives served by these different accounting bases are not always the same. As a result, more than one of them may be in use in a single industry. The standards supported by the accounting profession are recent in origin and have often superseded the other bases of accounting. Acceptance of the new standards has generally been good, although resistance still remains in some industries.

Regulatory Agencies

Regulatory agencies were the first group to develop industry accounting practices. They have been employed to monitor financial activities and to develop equitable charges for products and services. Although state involvement in regulatory accounting began about 1850, most reporting requirements originated during the period 1900 — 1940. Banking, insurance, transportation, public utilities, and local governmental units have been the industries most frequently subject to control.

Federal participation in regulatory accounting started in 1906 with the passage of the Interstate Commerce Act. This law, among other things, provides for uniform reporting practices by the nation's railroads and steamships. In 1929 the ICC expanded its jurisdiction to motor carriers. Other federal agencies which have received regulatory powers include the Civil Aeronautics Board (1926), the Federal Communications Commission (1929), the Securities and Exchange Commission (1934 and 1940), the Federal Power Commission (1935), and the Social Security Administration (1964) [Chatov, 1975]. A listing of some of the better known state and federal regulatory accounting manuals is presented in Table 1.

The ability of state and federal regulations to provide meaningful financial reporting standards has long been questioned. Often the requirements have become archaic and self — serving [Coleman, 1970]. One notable exception to this generalization has been the Securities and Exchange Commission. Its industry-related accounting series releases and its reporting requirements for brokerage houses and regulated investment companies have commonly been accepted without severe or extended criticism. The reason for the SEC's success, however, has been its willingness to encourage accountants and members of the industry to make their own changes in accounting standards, rather than to initiate such changes itself.

Trade Associations

Trade associations have exerted considerable influence over regulatory reporting requirements. Thus the role of such groups in establishing industry reporting practices parallels, to some degree, the development of regulatory accounting. Trade associations have also acted independently, providing books and manuals on accounting to their membership. Much of this work occurred during the period 1920 — 65 when the need for financial information was expanding rapidly and concern over the appropriateness of industry reporting practices was limited. Table 2 gives some examples of industry sponsored publications.

In recent times pronouncements of the American Institute of Certified Public Accountants, and the Financial Accounting Standards Board have achieved wide public acceptance and have reduced considerably the reliance on industry-based publications. Such reporting practices continue in use today but mainly in lines of

Table 1

STATE AND FEDERAL REGULATORY ACCOUNTING PUBLICATIONS

Industry	Name of Publication	Regulatory Body
Airlines	*Uniform System of Accounts*	Civil Aeronautics Board
Electric Utilities	*Uniform System of Accounts for Class A and B Electric Utilities*	National Association of Regulatory Utility Commissioners
Gas Utilities	*Uniform System of Accounts for Class A and B Gas Utilities*	National Association of Regulatory Utility Commissioners
Life Insurance Companies	*Convention Statement*	National Association of Insurance Commissioners
Motor Carriers	*System of Accounts for Class I and II Contract Motor Carriers*	Interstate Commerce Commission
Railroads	*Uniform System of Accounts for Railroads*	Interstate Commerce Commission
Natural Gas	*Accounts and Reports for Natural Gas Companies*	Federal Power Commission
Regulated Investment Companies	*Rule 31 a-1 of the Investment Act of 1940*	Securities and Exchange Commission

Table 2

INDUSTRY SPONSORED ACCOUNTING PUBLICATIONS

Industry	Name of Publication	Name of Publisher
Advertising Agencies	*Manual of Advertising Agency Accounting*	American Association of Advertising Agencies
Coal	*Survey on Accounting Principles and Procedures Practiced in the Coal Industry*	National Coal Association
Colleges and Universities	*College and University Business Administration*	American Council on Education
Governmental Units	*Governmental Accounting Auditing and Financial Reporting*	National Council on Governmental Accounting
Hospitals	*Chart of Accounts for Hospitals*	American Hospital Association
Information Processing	*Recommend Uniform Accounting System for the Computer Services Industry*	Association of Data Processing Service Organization
Petroleum	*Outline of Petroleum Industry Accounting*	American Petroleum Institute
Retailing	*Retail Accounting Manual*	National Retail Merchants Association
Trade Associations	*Financial Management Handbook for Associations*	Chamber of Commerce of the United States
Voluntary Health and Welfare Organizations	*Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations*	National Health Council

Table 3

PUBLICATIONS BY ACADEMICS AND ACCOUNTING PRACTITIONERS

Author(s)	Title	Publishers
Ellis	*Church Treasurer's Handbook*	Judson Press
Gross and Jablonsky	*Principles of Accounting and Financial Reporting for Non Profit Organizations*	John Wiley & Sons
Holek and Holek	*Complete Handbook of Church Accounting*	Prentice-Hall
Horwath	*Hotel Accounting,* 4th ed.	John Wiley & Sons
Irving and Draper	*Accounting Practices of the Petroleum Industry*	Ronald Press
Moscarello, Grau and Chapman	*Retail Accounting and Financial Control,* 4th ed.	John Wiley & Sons
National Society of Public Accountants	*Portfolio of Accounting Systems for Small and Medium-Sized Businesses,* revised ed.	Prentice-Hall
Porter	*Petroleum Accounting Practices*	Mc-Graw
Prescow, ed.	*Encyclopedia of Accounting Systems,* revised and enlarged	Prentice-Hall
Wilcox	*Mine Accounting and Financial*	Sir Isaac Pitman

business where other alternatives do not exist. Most trade associations have cooperated with professional accounting bodies in developing industry standards. Some, however, such as local governmental units and petroleum companies, have refused to fully endorse the new requirements. Regardless of their position, trade associations have less influence at the present time than they had in the past. Their independence has been questioned and their expertise placed in doubt.

Academics and Accounting Practitioners

Many trade associations have not established specific reporting procedures for their industry. The membership may have considered such a project too expensive or perhaps unnecessary. Academics and accounting practitioners met the need for sound reporting by summarizing the most desirable features of existing practice. Some writers examined the accounting procedures of a single industry. Because of the thorough coverage of the subject matter, these works have commanded considerable respect from industry member and professional accountant alike. The principal weakness of such books is that, without revision, they frequently become out of date.

Existing industry practices have also been summarized in single or multi-volume compendiums. In common use for the past sixty years, they remain popular because they provide information on industry reporting practices that would otherwise be difficult to obtain. Compendiums have two principal drawbacks; the treatment of individual industries is limited and the coverage may not reflect important changes in business methods. Table 3 furnishes a list of well known works by academics and practitioners.

Professional Standards

The number of professionally-supported industry accounting standards grew slowly at first but has since expanded very rapidly. The first requirements applied to construction firms. The American Institute of Certified Public Accountants in 1955 issued *Accounting Research Bulletin No. 45, Long-term Construction-type Contracts,* which suggested acceptable alternatives for recording construction revenue. In 1959 coverage was expanded in the Institute publication, *Generally Accepted Accounting Principles for Contractors,* to include required disclosures and possible financial statement formats. The AICPA subsequently combined this work in 1965 with a companion volume, *Auditing the Construction Industry,* to create the first AICPA audit guide: *Audits of Construction Contractors.* These guides have served two purposes: (1) to outline necessary audit procedures and (2) to provide specific industry accounting standards. During the ten years subsequent to the publication of *Audits of Construction Contractors,* various committees of the Institute have issued fourteen pronouncements of this type as well as four industry-related accounting guides. (A complete listing is provided in Table 4). The Accounting Principles Board, during its existence, also released a number of opinions which dealt wholly or in part with industry matters. However, these pronouncements have limited significance since they have been incorporated into the guides.

In 1973 the Financial Accounting Standards Board came into being and assumed the role of standard-setter formerly held by the Institute. The Board's contribution to the development of industry reporting requirements is currently limited to statements No. 14, "Financial Reporting of Business Segments" and No. 19, "Financial Accounting and Reporting of Oil and Gas Producing Companies." (subsequently suspended in part by Statement No. 25). On the other hand, the AICPA, through its Accounting Standards Division, has issued a large volume of industry-related statements of position. Nineteen of these pronouncements have been released since 1974, ten of which relate to lines of business not previously covered. [AICPA Professional Standards] In addition, the Institute has in process twenty five projects (five in new industries) that deal directly or indirectly with specialized reporting requirements [Ernst & Ernst, 1978]. Table 5 provides a summary of Statements of Position for industries not covered by AICPA industry guides.

The AICPA — and FASB — sponsored standards came into existence because of the weaknesses of previous accounting practices, the lack of independence, the inadequacies in theoretical support, and the diversity of acceptable alternatives. Professional accounting standards have resolved these problems to some extent. Nevertheless, dissatisfaction with this approach exists and some individuals have suggested that the Securities and Exchange Commission or a new government agency assume responsibility. The role of the commission will be examined in greater depth later in this paper.

Table 4

AICPA INDUSTRY AUDIT AND ACCOUNTING GUIDES

Audit Guides

Audits of Banks, Including Supplement
Audits of Brokers and Dealers Securities
Audits of Colleges and Universities
Audits of Construction Contractors
Audits of Employee Health and Welfare Benefit Funds
Audits of Finance Companies
Audits of Fire and Casualty Insurance Companies
Audits of Investment Companies
Audits of Personal Financial Statements
Audits of Savings and Loan Associations
Audits of State and Local Governmental Units
Audits of Stock Life Insurance Companies
Audits of Voluntary Health and Welfare Organizations
Hospital Audit Guide
Medicare Audit Guide

Accounting Guides

Accounting for Motion Picture Films
Accounting for Retail Land Sales
Accounting for Franchise Fee Revenue
Accounting for Profit Recognition on Sales of Real Estate
Note: Accounting guides do not contain an outline of audit procedures.

Authoritative Support

In examining an entity's financial statements, the auditor is commonly concerned with their conformity with generally accepted accounting principles. Under Rule 203 of the AICPA Code of Ethics, he or she, with rare exception, cannot express an opinion on such statements if any material departure from professionally established accounting requirements exists. Therefore, the authoritative support accorded a given reporting technique is an important consideration.

Statement on Auditing Standards No. 5, issued by the Institute in 1975, differentiates between those documents which represent generally accepted accounting principles and those which are only possible sources of GAAP. Financial Accounting Standards Board statements and interpretations. Accounting Principles Board opinions, and AICPA accounting research bulleins belong to the first category. Unfortunately, few of these relate to specific industries. The second group includes Institute audit and accounting guides and Statements of Position, SEC pronouncements, trade association publication, accounting textbooks and articles. Most industry reporting practices come from these sources.

Statement on Auditing Standards No. 14, released in December 1976, removed from consideration one possible basis of generally accepted accounting principles. Among other things this pronouncement provided that the auditor's standard report on conformity to GAAP did not apply to financial statements which complied with the requirements or reporting provisions of government agencies. This action effectively eliminated non — SEC regulatory accounting from consideration. Most of the commission's reporting requirements, however, would still be relevant because they usually coincide with the standards supported by the accounting profession.

Determination of an appropriate accounting basis for a given industry remains a difficult problem. Although the reporting standards contained in the AICPA audit guides and Statements of Position are superior theoretically and are widely accepted, they have no greater authority than other alternatives. Therefore, frequently no clear choice exists.

Much work in improving the effectiveness of industry accounting standards remains to be done if professional standards are to be effective. An important consideration is the need to upgrade the authority of AICPA — sponsored industry reporting requirements. As mentioned previously, most of these pronouncements do not constitute generally accepted accounting principles. As informal standards, they must compete with less desirable alternatives — most commonly, trade association's reporting practices. This situation obviously damages financial statement comparability. With such a variety of possibilities, no definite basis for statement evaluation exists. This policy also benefits individual entities at the expense of the business community as a whole, for financial statement preparers may select reporting practices approved by themselves and their fellow industry members.

Developing a clear definition of standard-setting responsibilities is a second consideration. The Financial Accounting Standards Board has the sole authority to establish formal accounting standards. However, in the past the Board dealt mainly with general reporting requirements and allowed the AICPA to issue industry-related statements of position. As demands for specialized industry information grew, the number and scope of these Institute pronouncements also

Table 5
AICPA STATEMENTS OF POSITION — INDUSTRY ACCOUNTING STANDARDS

SOP Number	Title
74-12	Accounting Practices in the Mortgage Banking Industry
75-2	Accounting Practices of Real Estate Investment Trusts
75-5	Accounting Practices in the Broadcasting Industry
76-1	Accounting Practices in the Record and Music Industry
76-2	Accounting for Origination Costs and Loan and Commitment Fees in the Mortgage Banking Industry
78-3	Accounting for Costs to Sell and Rent, and Initial Rental Operations of, Real Estate Projects
78-4	Application of the Deposit, Installment, and Cost Recovery Methods for Sales of Real Estate
78-6	Accounting for Property and Liability Insurance Companies
78-9	Accounting for Investments in Real Estate Ventures
78-10	Accounting Principles and Reporting Practices for Certain Nonprofit Organizations

increased. To assure the reasonableness and equity of these new standards, the Institute adopted extensive "due process' procedures which parallel those used by the FASB. In addition, the Securities and Exchange Commission, seeing the need for sound reporting requirements, indorsed the Statements of Position as "preferable accounting" unless and until the FASB issued pronouncements on the subject. Thus the Institute in effect became an informal standard-setting body. Given the circumstances surrounding the development of the Financial Accounting Standards Board, the present state of affairs seems unavoidable. However, general agreement exists that only one organization, namely the FASB, should have standard-setting responsibility. This position is supported by both the Board and the American Institute of Certified Public Accountants.

Efforts are under way at the present time to resolve these problems. The FASB has proposed adoption of a program to upgrade the AICPA — sponsored industry standards to generally accepted accounting principles and to assume responsibility for any future changes in such standards. Specifically the Board plans to modify its operating policies and procedures to enable it to "gradually adopt with few if any substantive changes the existing AICPA Industry Audit Guides and Industry Accounting Guides, and Statements of Position, after exposure for public comment, as FASB Statements of Financial Accounting Standards and thereafter to assume responsibility for amending or interpreting them." [FASB Exposure Draft]

The Institute's Board of Directors has agreed in general with the FASB's proposal. Implementation, however, could still be difficult. Three areas cause special concern. The first is the Financial Accounting Standards Board's ability to efficiently adopt the existing industry standards. Reviewing them and exposing them to public comment could make the process unmanageable. The second is the need to define clearly the Board's standard-setting responsibilities. The proposal, for example, does not discuss the treatment of accounting matters for industries not covered in existing AICPA guides or statements of position. Finally the FASB may have difficulty in establishing an effective standard-setting mechanism. Previous experience would appear to have limited value in dealing with an area as diverse and complex as industry accounting.

Future Role of Industry Accounting Standards

In spite of the challenges faced by the new FASB proposal, its chances of eventual success are quite high. The objectives suggested are strongly desirable to both the accounting profession and the financial community. Furthermore, man groups have expressed their support for the program's overall goals.

Realization of the FASB's plans would have far-reaching implications. For example, preparers of specialized industry financial statements under GAAP will have fewer reporting options available to them than they have had in the past. Establishing formal reporting requirements makes justification of alternative approaches more difficult. In addition, CPA's will be subject to an additional large and complex body of professional standards. Emphasis on technical study programs and quality control should continue to increase. Also accounting educators will need to consider curriculum revisions to give greater attention to the new reporting requirements.

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Familiarity with this area seems essential to the professionally oriented accounting student.

The impact of this proposal on the AICPA and FASB itself is hard to measure. However, several changes seem apparent:

1. The Board's responsibilities for industry accounting matters will be redefined. The ultimate authority for reporting standards will rest with the FASB, the AICPA, and other groups participating in any of the standard-setting process.
2. The Board will place greater emphasis on the tentative resolution of accounting issues and the evolution of the results. The conceptual approach presently used is not practical in dealing with specialized industry reporting problems.
3. The stature of the FASB as a standard-setting body should be enhanced. Much of the confusion caused by the AICPA's informal requirements and by the competing bases of accounting will be eliminated.

The Securities and Exchange Commision's role in industry accounting matters depends, to some extent, on the success of the Financial Accounting Standards Board. However, suggestions that SEC assume authority for standard setting seem premature. The commission lacks the financial resources and personnel to carry out such an undertaking at the present time. Also, support for such action seems unlikely from a budget-minded Congress. A more likely possibility would be that the SEC will continue to exert a strong influence over the standard-setting process. The commission's recent actions on the FASB's oil and gas accounting standards serve as one illustration. Another is the increasingly large number of agency rules and pronouncements that deal with industry matters.

Regardless of the particular outcome of the FASB proposal, the future of formal industry reporting standards seems secure. Too many interests believe in the benefits derived from such requirements to allow them to disappear. The possibility for expanded industry coverage also appears high, although the lack of adequate resources for setting the requirements may be a limiting factor. Industries which have serious reporting problems or a close association with existing standards seem the areas most likely for growth. ■

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