10-1980

PCPS Reporter, Volume 1, Number 4, October 1980

American Institute of Certified Public Accountants. Private Companies Practice Section

Activities of the Private Companies Practice Section

PCPS

OCTOBER 1980 Vol. 1 No. 4

Reporter

Published by and for the Members of the Private Companies Practice Section of the AICPA Division for CPA Firms

Editor: *John R. Mitchell*

Inspection Should Precede Peer Review

The Quality Control Standards Committee recently issued its Interpretation No. 2, which says, in part, that "a firm's inspection policies and procedures may provide that a peer review . . . fulfills the firm's annual inspection requirements *for the year covered by the peer review.*" Nevertheless, if a firm had not conducted any inspection procedures before its first peer review, the reviewer would not be in a position to opine that the firm's system of quality control "was being complied with during the year then ended"—that is, the reviewer could not issue a "clean" report.

When a review is first being arranged, the staff of the Quality Control Review Division routinely notifies the firm of this so the firm will have an opportunity to conduct an inspection before the review starts.

In a recent discussion of the requirement that inspection precede a firm's first peer review, members of the Executive Committee noted that it is primarily a transitional problem, affecting the first reviews of firms that have documented their quality control systems fairly recently. However, this should not affect the timing of a firm's first peer review. One member pointed out that the requirement did not impose any substantial burden on his own firm, since in preparing for his review and assuring himself that his firm was ready he had evaluated his quality control system and inspected selected engagements for conformity to the profession's technical standards. A file memorandum recording this, along with a note of any resultant improvements made or to be made, was prepared for peer review purposes. The memorandum did not identify the specific engagements he inspected.

Most PCPS firms with up to 20 professionals are electing to have "engagement-oriented" reviews. The guidelines for these reviews identify the minimum documentation required for inspection as "memoranda summarizing inspection results and the actions taken on those findings." The documentation required for system-oriented reviews has not been specifically identified, since it depends on the firm's size, organization and number of offices, and on the nature of its practice. □

More On Preparer Penalties

The July *Reporter* announced the Technical Issues Committee's recommendation that members aggressively challenge Sec. 6694 penalties, partially to avoid the possibility of subjecting the preparer's other returns to special scrutiny.

Such use of lists of preparers on whom penalties have been imposed seems inconsistent with IRS policy, as reported in the July *Tax Adviser* (page 428) and the August *Journal of Accountancy* (page 32). The AICPA's Federal Tax Division requests that, if any member sees an indication that the IRS or any of its offices is using for this purpose a list of preparers on whom penalties have been imposed, the member notify that Division promptly (℅ AICPA, 1620 Eye Street NW, Washington DC 20036). The Division intends to bring any such situations to the IRS's attention. □

PCPS Comments on Two Issues

At its September meeting the Executive Committee authorized Chairman Robert A. Mellin to comment formally on two separate topics.

Academic independence. In a letter to the American Accounting Association, Mr. Mellin expressed the PCPS's serious concern about certain aspects of this issue, particularly the apparent tendency of some educators to overlook the rewarding career opportunities available to graduates in local firms.

An AAA committee has been researching the academic independence issue. Published reports have suggested that some members of the committee do not feel that a problem exists.

Mr. Mellin's letter reviewed the techniques that some CPA firms use to gain a favorable image among educators, but pointed out that these are "often impossible for smaller firms which, individually, hire fewer staff members each year, and which have limited financial

Continued on page 5

New Distribution Policy for *PCPS Reporter*

In order to facilitate communication with the key people in the PCPS, the Executive Committee has directed that each firm be sent one copy of the *Reporter* for each proprietor, partner or shareholder, with a maximum of 10 copies per firm. The number of copies is based on the membership application or annual report that each member submits.

The *Reporter* is also sent to the AICPA's educator members and to designated state society liaison committee chairmen. No paid subscriptions are available. □

The "GAAP II" Movement: Now Or Never?

Conventional approaches to solving the Big GAAP/Little GAAP dilemma focus on eliminating, for smaller privately held companies, the disclosure requirements that were developed for public entities but seem too costly and complicated for most clients. Some accountants have also advocated exemption from certain measurement requirements, such as lease capitalization and tax deferral.

Another proposed approach to providing needed relief is to develop a completely new set of accounting standards that are specifically designed for smaller entities. Proponents maintain that only in this way can the profession avoid the endless soul-searching and controversy over just what exemptions from Big GAAP should be provided. (The approach recently recommended by the Derieux Committee is to develop further the existing SAS 14 concepts of comprehensive bases of accounting. In effect this would seem to lead to a separate set of standards that would be called something other than GAAP.)

A current approach is to mandate that certain supplementary information be presented in the published annual *reports* of larger entities, but not in the financial *statements* themselves. Since most smaller companies do not issue annual reports, they would automatically be exempted. But this approach can only provide relief from disclosure requirements, not from measurement standards. And to some it resembles altering a heavyweight boxer's wardrobe to fit a jockey—no matter how you trim and sew it will just never fit.

The *GAAP II* movement is not new. What *is* new is that it is being mentioned publicly, and seemingly endorsed, by recognized leaders of the profession. These mentions have varied from tentative feelers and trial balloons to more definitive espousal, and it seems likely that this approach will receive serious study in the 1980s.

Some believe that one of the profession's most significant accomplishments in the 1970s was the development of standards for compilation and review services, which apply only to nonpublic entities. Now there seems to be a real possibility that the 1980s will feature dramatic developments in accounting standards for these entities.

The issue is both complex and controversial. Some fear that separate accounting standards for smaller clients would lead to a separate class of CPAs, and cause serious problems for growing companies when they decide to go public. They argue that two different sets of GAAP would confuse users, and they question whether the private sector could retain control of Big GAAP if it were applicable only to SEC registrants.

Others maintain that the continuing pressures on publicly held companies for more extensive disclosures and more complex measurements will make it impossible for a single set of measurement GAAP to be applied to all companies. And if Big GAAP pronouncements were to be applicable only to large public companies, they could be even more responsive to the needs of users of these companies' financials, since they would not have to be diluted to avoid fallout effects on smaller entities.

For an early glimpse of what might lie ahead, your *Reporter* asked a number of prominent CPAs, most of whom are active at high levels in the AICPA, to comment briefly on the prospects for and merits of developing a separate set of accounting measurement and disclosure standards for smaller, nonpublic entities. Here are their responses:

George D. Anderson, Vice Chairman, AICPA:

The development of two sets of standards based solely on ownership of business entities has been overemphasized. Generally accepted accounting principles and generally accepted auditing standards should be the same regardless of ownership of a business entity; the important consideration should be the materiality of the principle or standard in assuming a fair presentation of the financial information. Application of GAAP and GAAS must be judged based on presenting to the user of the financial information a usable and meaningful product. Rather than promulgating two separate sets of standards, developing better definitions and interpretations of when and how to apply existing standards could go far towards solving this problem.

Dennis R. Beresford, Chairman, Accounting Standards Executive Committee:

There is no question in my mind that disclosure overload is reaching the critical stage for *all* business. This burden, of course, weighs more heavily on smaller companies. At the same time, we should recognize several recent efforts to reduce this burden. The AICPA's special reports on cash and tax bases, the FASB's suspension of EPS and segment disclosures and its conceptual framework disclosure study, and the SEC's reduction of registration requirements all are moves in the right direction.

I firmly support the concept of *differential disclosure,* but I believe different *measurement bases* would be inappropriate as well as unduly costly to business and CPAs. Some of the numerous practical problems are:

—How would a given company determine which principles to follow?

—How would CPA reports distinguish between GAAP-I and -II?

—Who would educate users and would they accept dual standards?

—Who would develop the new rules and who would pay for their development?

I support the quest for more "disclosure relief," but I question whether GAAP-II is desirable.

John C. Burton, Arthur Young Professor of Accounting & Finance, Columbia University:

I have long favored "differential disclosure," which contemplates an approach whereby the magnitude of required disclosures will vary depending upon the users toward which the disclosures are aimed and the cost/benefit considerations applicable to various disclosing entities. The basic accounting measurement model, however, should be applicable to all financial statements.

William R. Gregory, Immediate Past Chairman, AICPA:
Accounting has been defined as the language of business; ergo, communication. It is fundamental that we consider the audience with whom we communicate; i.e., the users of our financial reports. Unfortunately, in establishing accounting standards, there is a tendency to communicate with the most sophisticated and knowledgeable audience such as financial analysts. Furthermore, most present-day accounting standards are established in response to the accounting issues of large, publicly-held companies.

If we are to achieve meaningful communication with the users of financial statements of smaller, privately-held business, we need to develop standards that are useful, relevant, and appropriate for them. We need to recognize that there are significant differences in the needs of users of General Motors' financial statements and the users of the local entrepreneur's financial statements whose only public may be his local banker.

SAS 14's other comprehensive bases of accounting have not caught on. However, an approach along these lines might be a realistic solution to a serious problem in the profession. Therefore, I urge a pragmatic examination of the needs of users of financial statements of privately-held companies and development of accounting standards that address those needs, including reporting that will clearly distinguish them from GAAP.

Francis A. Humphries, Chairman, PCPS Executive Committee:

A completely new set of GAAP for smaller entities is neither necessary nor desirable. Instead, a need for examination of each principle, both disclosure and *measurement,* for applicability to private companies is indicated. The examination should be from the viewpoints of practicality and usefulness to financial statement users. Prospects for accomplishing this goal might depend upon the ability of CPAs serving private companies to speak to the issues with a unified voice. The Technical Issues Committee of PCPS is designed to meet both needs.

Exemptions from certain accounting principles for private companies do not create separate classes of CPA firms. A first-class CPA firm is one which prepares itself professionally to effectively meet the needs of its clients—regardless of the accounting principles applicable to their financial reporting.

James J. Leisenring, Chairman, Auditing Standards Board:
Measurement requirements of generally accepted accounting principles should be the same regardless of the size or ownership of an entity. Certain disclosures could appropriately be differentiated between entities, perhaps by size, but I believe preferably by ownership. This is, of course, the direction of the FASB project on Financial Statements/Financial Reporting, of which I am generally supportive.

To develop another class of GAAP would be very costly, confusing to financial statement users, and would ultimately exacerbate the division that exists between small and large firms. Furthermore, any entity may elect to report on an income tax basis of accounting consistent with SAS No. 14, which would seem to be quite suitable for the purposes of very small entities.

The failure to recognize that GAAP should apply to all entities would be a major step backward for our profession, which has struggled to enhance user understanding of financial statements and the various reports on those statements.

Robert A. Mellin, Immediate Past Chairman, PCPS Executive Committee:
A constructive solution to the problem requires completing the conceptual framework project. Hopefully, this will assess the current environment of overall financial reporting and relate it to how both small and big business fit therein. Other aids would include a better definition of materiality, specifically identifying a small and closely held business, and perfecting another comprehensive basis of accounting.

In the meantime, disclosure simplification may well be directed to enlarging the supplementary information area and eliminating certain disclosure items for smaller companies such as was the case with segment information.

Tinkering with measurement standards in the light of present day knowledge could erode respect for accounting. It would be very difficult to justify the rationale whereby the day a company reaches a certain level of assets, sales or shareholders, the accounting for leases and taxes is to be completely changed.

Robert D. Miller, Chairman, Accounting and Review Services Committee:
Rather than attempting to fit all users' needs within one predetermined framework, we should expand the alternatives available to meet those needs. I continue to believe that the same measurements should apply to *general purpose* statements of all entities. However, since *some* GAAP measurements aren't relevant to *some* users, why not provide for meeting those special needs *apart from* the framework of general purpose statements?

Based on perceived need for assurance, nonpublic entities choose among an audit, review or compilation report. In each type, the report's *objective* differs. Why not a similar distinction when the objective of the *statements* is to meet an identified user's needs? (Use of "other comprehensive bases of accounting" is a first step in this direction.)

Obviously, information so presented would have to be clearly labeled to distinguish it from "general purpose financial statements," and a major effort would be needed to educate users. We should be willing to respond to that challenge!

Sandra A. Suran, Chairman, PCPS Technical Issues Committee:
A totally different set of accounting principles may be the only way to make financial statements truly meaningful and useful to the smaller company. We certainly would end up with a better product than if we attempt to "cut and paste" current principles to adapt them for smaller companies. And we have a natural cutoff — SEC regulated vs. non-regulated companies. SSARS set a precedent for using that basis for differentiating the companies which would be eligible to use the new principles. There would be many questions to answer and many problems to solve, of course. But I don't think there is any easy way to resolve the current "overload" problems for smaller companies and also make their financial statements more useful. And if the AICPA and its standard setting bodies don't become more responsive to the needs of smaller companies and their CPAs, we may face a split in the profession anyway. □

PCPS Committee Rosters

In response to a number of requests, the rosters of the Committees are presented here. In appointing these committees, every effort is made to have them reflect the Section's membership in terms of geography and firm size.

These committee members are your representatives, and they will welcome your suggestions, comments and questions. (If you want to bring something to the attention of a full committee, address your communication in care of the Director, PCPS, at the AICPA's offices in New York.)

Executive Committee

Francis A. Humphries, Chairman, Gamble, Humphries, Givens & Moody, 205 King Street, Charleston SC 29401.

Dennis R. Baumert, Marvin E. Jewell & Co., 405 Executive Building, Lincoln NE 68508.

Monte R. Bluske, Bertelson & Co., 713 Kenney Avenue, Eau Claire WI 54701.

W. Thomas Cooper, Jr., Frerman & Smiley, 621 West Main Street, Louisville KY 40202.

Ward F. Junkermier, Junkermier, Clark, Campanella & Stevens, PC, 600 Central Plaza, Suite 208, Great Falls MT 59401.

Jack R. Lesher, Kuntz, Lesher, Siegrist, Martini & Associates, P.O. Box 4423, 131 Centerville Road, Lancaster PA 17604.

James P. Luton, Jr., Luton and Company, Pavilion Building, Suite 222, 6701 North Broadway Ext., Oklahoma City OK 73116.

Richard B. McCormick, Lathan, Lumsden, McCormick and Co., 120 Delaware Avenue, Buffalo NY 14202.

Charles McMonigle, Monroe, Shine & Co., P.O. Box 700, New Albany IN 47150.

Edwin E. Merriman, Edwin E. Merriman & Company, P.O. Box 48, Lubbock TX 79408.

Kikuo Nakahara, Greene, Nakahara & Arnold, 1939 Harrison Street, Suite 500, Oakland CA 94612.

Donald E. Schmaltz, Schmaltz & Company, 470 American Center Building, Southfield MI 48034.

Donald L. Schoedel, Schoedel & Schoedel, 1420 Old National Bank Building, Spokane WA 99201.

A. Marvin Strait, Strait, Schulz & Company, Holly Sugar Building, Suite 1110, Colorado Springs CO 80903.

D. Harold Sullivan, Sullivan, Bille & Company, 500 Clark Road, Tewksbury MA 01876.

James W. Thokey, Bourgeois, Bennett, Thokey & Hickey, 925 Hibernia Bank Building, New Orleans LA 70112.

G. W. Tonkin, Tonkin, Johnson & Associates, 1419 West Bannock Street, Suite B, Boise ID 83706.

C. Eugene Toothman, Toothman, Rice & Company, P.O. Drawer 2408, Goff Building, Clarksburg WV 26301.

Alfred M. Walpert, Walpert, Smullian & Blumenthal, The Lafayette Building, Suite 300, 40 West Chesapeake Avenue, Baltimore MD 21204.

Robert F. Warwick, Lowrimore, Warwick & Co., 321 North Front Street, P.O. Box 661, Wilmington NC 28401.

Thomas S. Watson, Jr., Watson, Rice & Company, Citizens Federal Tower, Suite 1200, Cleveland OH 44114.

Peer Review Committee

Morris I. Hollander, Chairman, Weinberger & Co., 4675 Ponce de Leon Blvd., Suite 305, Coral Gables FL 33146.

Bruce S. Botwin, Bruce S. Botwin & Company, 1060 Kings Highway North, Suite 315, Cherry Hill NJ 08034.

Francis J. Candia, Holtz, Rubenstein & Co., 445 Broad Hollow Road, Melville NY 11747.

Dennis R. Carson, Eide, Helmeke, Boelz & Pasch, 500 National Bank of South Dakota Building, Sioux Falls SD 57102.

Arthur Wm. Hoffman, Mayer Hoffman McCann, 800 West 47 Street, Kansas City MO 64112.

Fred G. McCulloch, Boyd, Olofson & Co., 102 S. Naches Avenue, Yakima WA 98907.

Lewis R. Oyler, 812 South Washington Street, P.O. Box 1376, Marion IN 46952.

David E. Peeler, Vilmure, Peeler & Boucher, 13215 East Penn Street, Suite 615, Whittier CA 90602.

James L. Pioso, Nankin, Schnoll & Company, SC, 700 West Michigan Street, Milwaukee WI 53233.

Clinton J. Romig, LaPorte, Sehrt, Romig and Hand, 2475 Canal Street, New Orleans LA 70119.

John T. Schiffman, Smith, Batchelder & Rugg, Lyme Road, Hanover NH 03755.

Noel D. Thorn, McKnight, Frampton, Buskirk and Company, P.O. Box 220, 155 King Street, Charleston SC 29402.

Barry E. Vallee, Rehmann, Robson, Osburn & Co., 2806 Davenport, Saginaw MI 48602.

Philip Vogel, Philip Vogel & Co., 800 Hartford Building, Dallas TX 75201.

Douglas C. Warfield, Stoy, Malone & Company, 201 Thomas Johnson Drive, Frederick MD 21701.

Technical Issues Committee

Sandra A. Suran, Chairman, Suran & Company, 1600 SW Cedar Hills Blvd., Suite 100, Portland OR 97225.

Lucius A. Ashby, Jr., Ashby, Armstrong, Johnson & Co., Suite 800, 655 Broadway, Denver CO 80203.

James Castellano, Rubin, Brown, Gornstein & Co., 230 South Bemiston, St. Louis MO 63105.

Donald M. Dale, Goodman & Company, 500 Plume Street East, Norfolk VA 23510.

Sandra S. Eastham, Schmidt & Co., Chartered, 150 East Palmetto Park Road, Boca Raton FL 33432.

William G. Farrow, Gallant, Farrow & Greene PC, 3603 N. Seventh Avenue, Phoenix AZ 85013.

Steven N. Fischer, Urbach, Kahn & Werlin PC, 66 State Street, Albany NY 12207.

Continued on page 5

Committee Members Honored

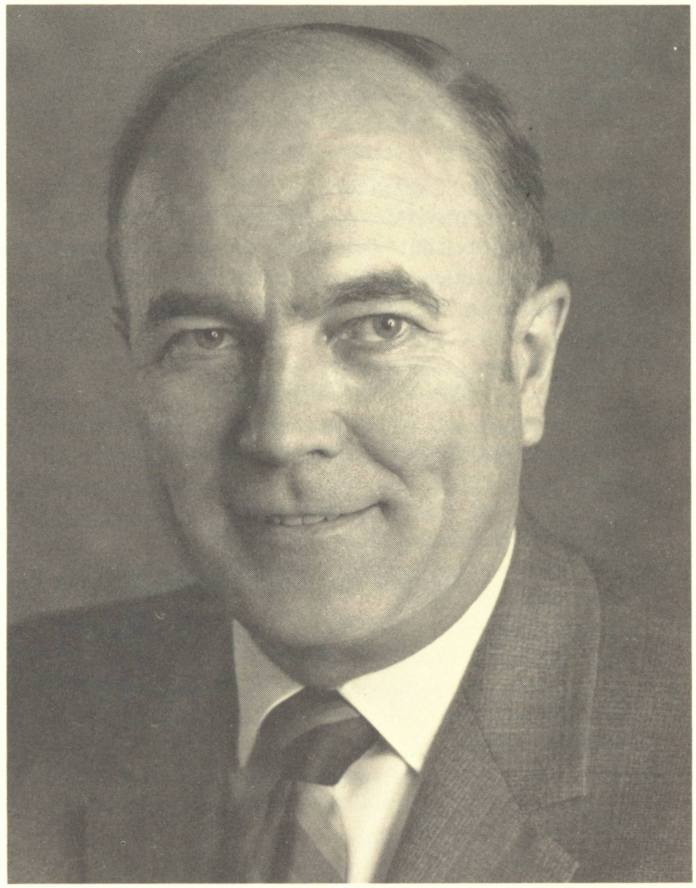
In a special ceremony at the close of its last meeting, the 1979-80 PCPS Executive Committee honored its seven members who had served continuously since the inception of the PCPS, and whose terms have now expired:

Dale M. Blocher, West Palm Beach, Florida
Duane W. Kuehl, Menomonee Falls, Wisconsin
Harry M. Linowes, Washington, DC
Robert A. Mellin, San Francisco, California
Mahlon Rubin, St. Louis, Missouri
Robert S. Siskin, Hartford, Connecticut
Sandra A. Suran, Portland, Oregon

All seven had been present at the Committee's first meeting, December 1-2, 1977, eleven weeks after Council first authorized the Section. They had attended almost all subsequent meetings, and each had contributed importantly to developing PCPS's organization and implementing its objectives. Many had been members of the AICPA's Advisory Group A, which represented local practitioners. In the spring of 1977, Group A developed recommendations that were one of several factors that led to the Section's establishment.

Francis A. Humphries of Charleston, South Carolina was also one of the Committee's "founding members." Mr. Humphries has been elected PCPS Chairman, and has been appointed to a second term on the Committee.

The Committee then paid a very special tribute to Robert A. Mellin, who has served the Committee for the past two years as chairman, leader, spokesman, innovator and (on occasion) mediator. □



Robert A. Mellin

PCPS COMMENTS ON TWO ISSUES

Continued from page 1

resources." The letter outlined the advantages of working with a local CPA firm, and concluded: "The rewarding career opportunities available in local firms, and the benefits to the accounting profession of having your members' students take advantage of these opportunities, are too important to be inadvertently overlooked."

CPAs in government. Mr. Mellin's second letter urged the AICPA to actively encourage CPAs to seek appointive positions in the federal government and on regulatory bodies, and to assist qualified members in securing suitable appointments. It stated that "we recognize that the Institute has generally encouraged CPAs to participate in government. However, we believe that this encouragement should now be more active and more visible than it ever has been." The letter pointed out that "there would be many tangible benefits to having CPAs serve as government officials and members of regulatory bodies. At the very least this would enhance agencies' understanding of the realities of the business world. It would also improve the quality of governmental actions and proposals affecting our profession. The CPAs could provide information and insights during the formative stages—long before proposals are exposed for comment, and before viewpoints have crystallized."

On other matters, the Executive Committee authorized the Technical Issues Committee to present comments on behalf of the PCPS without prior approval; and approved special procedures for peer reviews of member firms that have little or no "accounting and audit practice" as defined on page 24 of the *Peer Review Manual* booklet. □

PCPS COMMITTEE ROSTERS

Continued from page 4

Earl D. Harriman, Windes & McClaughry AC, 444 W. Ocean Blvd., Long Beach CA 90802.

Vaughn L. Hersey, Jr., Brooks & Carter, P.O. Box 1167 Merrill Center, Bangor ME 04401.

William W. Kidd, Mauldin & Jenkins, 1208 Georgia Power Bldg., Macon GA 31201.

Benjamin F. Rose, Broadmoor Shopping Center, Hobbs NM 88240.

Chester D. Stocker, Rea & Associates, 122 Fourth Street NW, New Philadelphia OH 44663. □