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Meeting of the American Institute of CPAs Atlanta, Georgia,
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THE OTHER ACCOUNTING STANDARDS BOARD

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by R. K. Mautz

I appreciate this opportunity to speak to you about the Cost Accounting Standards Board for a number of reasons. First, the Board is not nearly as well known to most CPAs as it should be. The standards promulgated by the Board are of major significance to defense contractors under terms of the law which created the Board, but they may also have implications for others. Some nondefense agencies of the Federal Government have accepted cost accounting standards as authoritative for their purposes; some state and local governments may also decide to use them; and many contractors dislike "two sets of books," to use their term, so they wish to use cost accounting standards for their commercial work as well as for defense work. Thus the CASB could have a significant impact on cost accounting, a part of the total accounting subject matter that has never received such attention before.

A second reason for welcoming this opportunity is the obvious conclusion that there is some potential for overlap between the work of the CASB and that of other authoritative bodies engaged in the establishment of accounting standards. The line between cost accounting and financial accounting is so unclear that some overlap can scarcely be avoided.

My procedure today will be first to provide you with some factual background about the Cost Accounting Standards Board itself; second, to describe the procedure which the Board follows in developing and promulgating cost accounting standards; and third, to present some personal views on the development of accounting standards in general. The last of these is not called for by my assignment but the opportunity is too good to miss.

The CASB and Its Staff. The Cost Accounting Standards Board was created as an agent of the Congress by Public Law 91-379 in August of 1970. It was formally organized and commenced work in January of 1971. As stated in the Act,

"The Board shall from time to time promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts."

This statement of purpose has seemed sufficiently precise to the members of the Board so that we have felt no need for a special committee to define our objectives even though some of our critics occasionally disagree with our interpretations of the nature of "cost-accounting standards" and the meaning of "uniformity" and "consistency."

By law, the Comptroller General of the United States is the Chairman of the Cost Accounting Standards Board and appoints the four other members. One of those members is required to be appointed from a department or agency of the Federal Government, one shall be a representative of industry, and two shall be from the accounting profession. Members are appointed for four-year terms and there is no provision made for staggered appointments.

Board members serve on a part-time basis. We customarily meet for one or two days a month, although we have had longer meetings. In addition, of course, we have a good deal of reading to do and are kept informed on research projects by our staff.

The Board has a competent, well qualified, and enthusiastic staff. Mr. Arthur Schoenhaut, our Executive Secretary, is assisted by a general counsel and four project directors. The staff totals 22 full time professionals in addition to secretarial help. It includes representatives of

the accounting profession, government, industry, and academia - some of the staff members having experience in more than one field. Overall, it is an excellent group of people, well qualified to cope with the problems assigned to us.

Procedure in Developing Standards. The procedure followed by the Board in promulgating cost accounting standards is a combination of steps required by the enabling legislation and practices which the Board in its brief experience has found useful.

Proposals for research on possible cost accounting standards are brought to the Board by the staff, reviewed by the Board, and either approved or rejected. If approved, they go on the active agenda and research is commenced.

Research typically begins with a thorough study of library materials in an effort to screen out items of little consequence and to prepare a bibliography of useful references. Some library studies are conducted by members of the staff, others are contracted out to consultants. While the library study is in process, visitations by members of the staff are arranged with those contractors who have indicated an interest in our work and who appear to be knowledgeable on the specific subject. Typically, two staff members will go together to discuss with financial officers of the contractor's staff the necessity and possibility of devising a useful standard on the topic at issue. A number of interviews will be scheduled and completed before proceeding with the research.

Based upon the library study and interviews, the project director and his assistants will consider the research approach most useful for their

purposes. Depending upon the nature of the subject, they may devise a questionnaire, circulate a point sheet asking for comments, or extend the interview procedure to acquaint themselves more fully with the various subsidiary issues that must be solved before a standard can be drafted. A sincere effort is made to obtain as complete a practical understanding of the problems involved in the given cost accounting question as possible before any attempt is made to draft a standard. The research program adopted is designed with this as an important goal.

At some point as they work toward completion of the research program, the project director and his assistants will feel that they are ready to draft a cost accounting standard and will proceed to do so. After review with the staff, this draft standard will be circulated to those contractors who have already cooperated in the project and as many more as the project director thinks might be helpful at this stage in the research. Their comments will be solicited and used by the project director in revising the proposed standard.

Note that, at this point, the members of the Board have not been brought into the process to any significant extent. They may have seen copies of the questionnaire as a matter of information and their advice may have been asked with respect to the suitability of the proposed standard for circulation, but we have no requirement to this effect. Such exposure of the proposed standard as has taken place makes clear that this is a draft standard by the staff and does not in any way either commit the Board or necessarily indicate the direction of its thinking.

Depending upon the nature of the comments received, the project director, in consultation with other members of the research staff, may

decide that a revised draft standard should also be distributed for comment. In time, after exposure of one or more staff drafts, he will come to the conclusion that he has gone about as far as he can with research and he will feel that his proposed standard is ready for scrutiny by the Board. It will then be distributed to the Board members together with a thorough explanation of the research completed to date and will be marked for discussion at a meeting of the full Board.

The project director may ask the Board merely for additional advice, or he may recommend to the Board that the proposed standard be published in the Federal Register. Board permission is required for such formal exposure. If the recommendation is for publication in the Federal Register, the proposed standard will have received exhaustive examination in meetings of the entire research staff so that when it comes to the Board, it has been subjected to intensive scrutiny.

Publication of proposed standards in the Federal Register is required by the legislation which created the Board. We regard exposure through the Federal Register as a part of our research procedure. It provides us with a means of getting responses from a broad cross section of the government contracting industry and others. Our experience has been that trade associations, professional organizations, individual contractors, academicians, consultants, and others will be moved to respond, many of them at length. We typically get a substantial number of letters, generally more than one hundred, which will be summarized for us by the staff and presented for discussion at a subsequent meeting along with the staff's reaction to the comments and perhaps a proposal for a revised standard.

The Board members insist that each of us receive a copy of every letter and my understanding is that each Board member reads every one of those letters.

Based upon the response to the Federal Register exposure, the staff brings to the Board another revision of the standard which the Board will discuss exhaustively. Depending upon the nature of the comments received, the staff may recommend a substantial rewording or modification of the standard or it may hold to its original proposal. The Board, in turn, will discuss the comments received and members of the Board will express their views as to how the standard might be modified. This may take one or more meetings with some intervening time for staff work. Ultimately a draft is developed on which a formal vote is taken and the standard is or is not approved for promulgation. The formal vote is recorded in the minutes together with any dissents which members of the Board wish to record. Our minutes are a matter of public record.

Upon approval by the Board, the standard is promulgated by publication of the final wording in the Federal Register. Our practice is to include a point by point response to significant comments on the exposure draft, when the final standard is published.

Standards so promulgated are transmitted to the Congress, where they remain for a period of 60 days of continuous session. Within that sixty days, the two houses of Congress can pass a concurrent resolution stating in substance that the Congress does not favor the proposed standard, rules, or regulations, in which case, of course, they would be withdrawn or modified. Once this period passes without comment from Congress, the

cost accounting standard has the full force and effect of law, and it is then required to be included in negotiated defense contracts over \$100,000.

Interaction with Industry. Please note that in the procedure described above, there are a number of opportunities for concerned people in industry and elsewhere to participate in the standard-setting procedure. From the time a possible standard is placed upon the Board's active agenda, the staff is encouraged to have maximum interaction with industry and others so that all concerned have an opportunity to express their views. The response to this approach has been very encouraging. We have had great cooperation from both industry and the accounting profession, much of it from concerned individuals. This is not to say that our standards are accepted with enthusiasm by everyone. On the contrary, we have some very disappointed and critical opponents. We have also had a substantial and useful exchange of views with those most affected by cost accounting standards.

Do we get any political pressure? This depends upon what you mean by political pressure. We do get letters from members of the Congress from time to time and we find nothing inappropriate in this. When a contractor writes to his Congressman expressing displeasure with a prospective or actual promulgation by the Cost Accounting Standards Board, the Congressman is very likely to send a copy of that letter to the Board chairman with a request for comment. The Board's practice is to respond to such letters fully, explaining in detail the present status of the standard, the research conducted by the Board, and the reason why the Board's position, proposed or final, is in opposition to that expressed by the Congressman's constituent. If we can not provide objective evidence supporting the position we have taken in any standard, we should be called to account. This is both one of the

burdens and one of the real strengths of operating in the public sector - but more of that later.

Pronouncements to Date. What has the Board done to date? An early effort devised a disclosure statement which is required by the law that established the Board. Our disclosure statement is a questionnaire in which contractors obliged to file it indicate in some detail the cost accounting practices which they follow. This requirement was first limited to contractors who had prime contracts of \$30 million or more in fiscal year 1971. Since some companies contract with the government through a number of subsidiary organizations and since each such organization must file a disclosure statement, something over 900 disclosure statements were received from 92 companies on this basis. We have currently proposed lowering the disclosure statement requirement to companies having prime contracts of \$10 million or more in either fiscal 1972 or 1973.

Our staff is currently tabulating and processing the responses to the disclosure statements. We expect to obtain a great deal of very useful information about industry practices from this tabulation.

Filing a disclosure statement commits the contractor to follow his disclosed practices for all defense contracting purposes unless he files an amendment.

The Board has also promulgated the following standards:

- #401 Consistency in Estimating, Accumulating and Reporting Costs.
- #402 Consistency in Allocating Costs Incurred for the Same Purpose.
- #403 Allocation of Home Office Expenses to Segments.
- #404 Capitalization of Tangible Assets.
- #405 Accounting for Unallowable Costs.

These standards have all been accepted by the Congress and are in force, except #405, which has just been transmitted to the Congress. In addition, the Board has on its active agenda possible standards concerned with depreciation, standard costs, the allocation of overhead costs to contracts, accounting for scrap, accounting for pensions, determination of a cost accounting period, accounting for inventory, and other subjects.

Overlapping Authorities. The potential for overlapping with the work of other authoritative bodies is apparent. We have tried to establish working relations with the Financial Accounting Standards Board, the Securities and Exchange Commission, the Internal Revenue Service, and other concerned organizations. Liaison arrangements have been completed and all concerned have agreed to work out any differences as peacefully as possible. At the same time, it should be noted that the Financial Accounting Standards Board is in the private sector, the Securities and Exchange Commission is a regulatory agency of the Federal Government, the Internal Revenue Service is in another executive agency, and the Cost Accounting Standards Board is included in the legislative branch of the government. The problem of arbitrating among these variously placed bodies, should any real conflict arise, boggles the mind.

The Politics of Standards Setting

Having discharged my understanding of my responsibilities this afternoon, let me take advantage of this opportunity to say a few words about the politics of establishing accounting standards. How should standards be determined?

One possibility is to seek a solution in accounting theory. The committed theorist is concerned with the search for truth. The purpose of research is to discover truth and he is likely to feel that if he conscientiously and thoroughly researches a subject, he can reach and discover ultimate answers. This is not so much conceit on his part as a strong belief in the potential of research and the strength of the methods he follows. Once he has applied established research procedures and reasoned rigorously from his research data to logical conclusions, he may well feel that the validity of his results is unassailable.

But any individual seeking truth in this way labors under limitations. His own factual knowledge and experience are finite and, at the same time, crucial to his ability to reason to sound conclusions. If his experience and empirical research together fail to expose him to all facets of the problem, it is unlikely that his conclusions will be valid for all sets of circumstances. Any limitations in his knowledge, any fallacies in his assumptions, any unawareness of the total ramifications of the problem at hand weaken his conclusions, no matter how careful his rationalization. Experience is convincing that very few people working alone have the breadth and depth of background necessary to deal realistically with the establishment of accounting standards, either in general or specific terms. Yet many try - and then find that their best efforts at research on accounting standards are not well received. This is a frustrating experience for the committed theorist and explains to some extent why so many of them have become disillusioned with the progress - or lack of progress - achieved by the profession in the establishment of accounting principles.

Whatever you think of this method, note that historically the profession's approach has been very much the same. Instead of trusting to an individual to find the ultimate truth on which standards should be based, however, we have selected a group of experts and asked them to use their combined knowledge and experience in reasoning to a conclusion. To help them in this, substantial amounts of research funds have been expended to provide them with facts and counsel as needed. Yet, other than relying on a group rather than an individual, the profession's approach has been essentially the same as the theorist's. We have told our selected experts to take whatever steps are necessary to discover ultimate truth - or its equivalent, the "best" procedure - and then to establish it as an accounting principle.

This was the process recommended by the special committee on accounting research which devised the Accounting Principles Board procedure, a process accepted and implemented by the Council of the Institute.

Setting Standards in a Democratic Society. Now let me propose the argument that such an approach is authoritarian, contrary to democratic procedures, and therefore unlikely to succeed in this country.

The first essential to such an argument is to recognize the nature of accounting standards and the standard setting process. Establishment of an accounting standard imposes a requirement on some people for the benefit of others. It is likely to have economic effects on those subject to the requirement and may provide at least indirect economic benefits to others. Thus the standard setting body is engaged in a legislative process that has significant economic implications. In a democratic society, legislative bodies have responsibilities to those affected economically by their legislation.

In the past, this fact has received scant recognition. We have generally proceeded in our search for principles and standards on the assumption that some sort of higher truth exists which, if discovered, will show us how any accounting problem should be solved. If through research or otherwise we can discover this higher truth, its inherent rightness will be manifest. To discover and identify truth, we select a small number of outstanding accountants, provide them with adequate research and other assistance, insulate them from economic and similar pressures, and rely on them to reveal, if not ultimate truth, at least a reasonable approximation which will be accepted as authoritative by all right-thinking people.

Because the higher truth we seek pertains to accounting, we have concluded that accountants should do the seeking. And then we take the big step and hold that once our accounting expertise establishes truth, the rest of the world should accept the decision. Because we are establishing truth in the public interest and after extensive study, we tend to view any person who questions or opposes such accounting standards as rejecting what is undeniably right and good.

Consider how authoritarian such an attitude is. Accountants will decide what is right and others should accept our decisions - even if it hurts. But views of "what is right" vary from person to person and from group to group depending on the way in which the proposed standard affects personal interests, monetary or otherwise. In the history of the world, no one has yet been able to establish a universally acceptable guide to the recognition of truth. Why should we think that accountants can do so now?

Also, investing such a group with the authority necessary to establish its pronouncements as binding is nearly impossible. Given the

alternative which democracy provides, people will tend to reject standards which they find opposed to their personal interests - unless constrained by the will of the majority to accept them. In a democracy there is no authority strong enough to maintain an unacceptable accounting standard. If the majority of those affected by any legislative action refuse to support that action, it becomes unenforceable.

An accounting standard is a social agreement that must be acceptable to the majority to be effective. It is a piece of legislation and, like any other legislation, it gains its authority from acceptance by those affected. It may fall short of giving any group in the society, indeed any individual, precisely what he thinks is ultimate truth. Because interests and views differ, a standard may be nothing more than the best compromise that can be reached at the time and under the existing conditions. A democracy progresses by inching forward from one compromise to another.

During the heated debates when the APB was wrestling with the business combinations issue, some rather snide remarks were made about the APB seeking "truth through compromise." Truth, no; compromise, yes. In a democracy, the legislature that is not responsive to its constituency loses support and ultimately its authority. When the APB evidenced a refusal to respond to the wishes of industry on its proposed opinion on accounting for the investment credit, those affected appealed to a higher authority and Congress effectively overruled the Board. However catastrophic you may view that action from the standpoint of accounting, it is an example of democracy in action. If a group believes in the merits of its case and that the treatment accorded it is unfair, it can take the issue to the highest authority in the land and seek better treatment. If it is a minority, it may fail; if it can obtain majority support, it will succeed.

Problems in Applying Democratic Principles to Accounting Standards.

Of course there are immediate responses to such a line of reasoning. Some will contend that our democratic government just doesn't work all that well, that economic pressure rather than majority support will often carry the day. But short of a dictatorship by righteous accountants, to what other system would you entrust final authority? Even if you would make a change, indications are that the existing situation will continue. The claim that accountants are a special group whose views should be accepted because of their expertise and independence is unlikely to gain much support. In this country, accounting matters are as subject to democratic processes as other issues.

A second objection might be that accounting is a highly technical subject, that very few people are able to understand its problems, and that to submit technical accounting issues to a "vote of the people" would be disastrous. Of course. Would anyone seriously recommend a popular vote on such a technical matter as the method of calculating earnings per share, or accounting for pension costs, or allocating general and administrative expenses to final cost objectives? But given that conclusion, how can the establishment of accounting standards be brought within the democratic process? We seem to be in a quandary - we are subject to a democratic process which we support conceptually but which can frustrate our best efforts so that we find it to be more of a menace than a help in establishing accounting standards.

Is there any alternative? Is there some way to bring to bear on the problem of establishing accounting standards the expertise necessary to deal with its technical issues and at the same time avoid the possibility that democratic procedures may be used by selfish interests to defeat the best efforts of accounting experts? I think there is - and the Cost Accounting

Standards Board may have found it. Part of the answer is a recognition of the role of accounting research; another part is found in a more pragmatic attitude toward what is meant by progress in accounting principles.

Two-fold Role of Accounting Research. Accounting research has a two-fold function. First, it must discover as best it can, and taking into account all available information, the theoretically preferred solution to the issue at hand. This requires development of an overall structure of theory so that the specific issue can be placed in perspective; it also requires identification and evaluation of the various ways in which the specific issue might be resolved. Second, and this is an indispensable part of applied research, steps must be taken to determine just how far in the direction of that preferred solution a standard can go and still be acceptable to a majority of those concerned. What are the various interests? What impact will alternative solutions have upon them? Of the various solutions that can be reconciled with the overall theory, which provide the greatest total benefit at least cost?

A theoretically ideal solution that is unacceptable to the majority affected is unlikely to achieve progress. A solution that offends no one is likely to be so innocuous that progress is nil. In setting standards we must seek a middle ground, a solution that carries us some significant distance toward our goal and yet which we can defend sufficiently to gain general acceptance. Identifying that ground is not an easy role for research to fulfill, but it is a realistic and necessary one.

At a recent meeting, Professor Charles Horngren recommended that a substantial portion of the FASB's research effort be dedicated to a form of lobbying in Washington so that financial accounting standards promulgated

by the FASB would have friends in Congress who would support them.⁽¹⁾ Although I sympathize with Professor Horngren's intent, my solution would be of another kind. I would spend the same effort on applied research before promulgation. With adequate research, lobbying is unlikely to be needed or helpful. At the CASB, we feel we should have a good idea from our research what is and what is not an undue burden on those affected, what is and what is not likely to be accepted before we reach a final resolution of the issue. Our exposure process is designed to help us determine how far we can go in what we consider to be the theoretically correct direction and still gain enough acceptance to make the standard stick. And we want to have that information before us while we are formulating final wording.

The attitude of a standard-setting body must be pragmatic. Certainly we must have goals and a theoretical rationale, but we should recognize that ours is partly a political - using that term in its finest sense - type of activity, and that unless we have support for what we do, our authority, however strong it may be legally, will be eroded with every unresponsive action. An operational definition of "the public good" is not what we think is good for the public, it is what the majority, however influenced, accepts as tolerable.

My personal experience in a number of difficult research assignments and with the CASB activities convinces me that research is essential to progress but that progress does not always flow easily from research. Research conclusions, no matter how rigorously reasoned and supported, are no more than a basis for working toward a solution. In a democratic environment, one man's view of what is right is as good as another's. Absolute

(1) See Journal of Accountancy, July 1973, p. 20

confidence on a standard-setter's part counts for little if the majority remains unconvinced.

We have a built-in advantage at the CASB. We know that Congress is looking over our shoulder all the time. It demands progress, but it gives us no carte blanche for "progress at any price." On the contrary, Congress provides those who object to our standards a ready hearing. Like Congress itself, we are responsible for the "legislation" we advocate. It is our good fortune that we have little choice but to be thorough, responsive, and pragmatic as we go about attempting to establish cost accounting standards in what I surmise is as democratic an environment as can be found anywhere.

Yes, the CASB still has critics, some of them bitter. But we are learning from every experience - learning how to press as far as we can without arousing overwhelming opposition.

Concluding from our CASB experience, may I suggest that those engaged in promulgating accounting standards need firmness in requiring exhaustive and balanced research, patience to listen to critics (even ad nauseam), empathy to understand the views of those affected, courage to reject unfounded or unreasonable objections, wisdom to accept and appreciate whatever progress is possible - and an insatiable appetite for more.