

EUROPEAN PARTNERS MEETING

RECENT AND COMING DEVELOPMENTS IN ACCOUNTING & AUDITING

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ROME - APRIL 1974

IN PREPARING FOR THIS MEETING I ASKED ONE OF OUR U.S. PARTNERS WHO HANDLES SEVERAL OF OUR LARGE INTERNATIONAL COMPANIES WHAT POINTS I SHOULD EMPHASIZE TODAY IN VIEW OF THE DIFFICULTY OF MY COVERING ALL MAJOR DEVELOPMENTS IN ACCOUNTING AND AUDITING TO WHICH YOU WERE EXPOSED THIS PAST YEAR END. HE SUGGESTED THAT I EMPHASIZE TO YOU THAT THE U.S. ACCOUNTING PROFESSION HAS NOT LOST ITS MIND ON THIS MATTER OF ACCOUNTING DISCLOSURES - THAT 1973 WAS JUST AN UNUSUAL YEAR INsofar AS DEVELOPMENTS IN ACCOUNTING AND AUDITING ARE CONCERNED. I HAVE DECIDED NOT TO SPEAK TO THE ISSUE OF WHETHER WE HAVE LOST OUR MINDS SINCE MY TAKING A POSITION ON THAT WOULD OPEN THE ISSUE FOR REBUTTAL BY JOHN ANDERSON AND PERHAPS OTHERS AND I DON'T CARE TO RISK THAT DEBATE. I BELIEVE I CAN SAFELY SPEAK TO THE ISSUE OF WHETHER 1973 WAS AN UNUSUAL YEAR. IN 1973, THE APB WAS PHASING OUT OF EXISTENCE, THE FASB WAS EMERGING INTO EXISTENCE AND THE SEC WAS MOVING AGGRESSIVELY TO PICK UP AND RUN WITH ANY BALLS THEY THOUGHT WERE DROPPED IN THAT PROCESS. AS YOU ARE AWARE, OUR U.S. SYSTEM FOR SETTING ACCOUNTING STANDARDS HAS BEEN AND CONTINUES TO BE ONE INVOLVING THE SETTING OF STANDARDS IN THE PRIVATE SECTOR WITH THE GOVERNMENT, THROUGH THE SEC, PROVIDING AN ENFORCEMENT MECHANISM FOR SUCH STANDARDS INsofar AS FINANCIAL STATEMENTS OF PUBLIC COMPANIES FILING WITH IT ARE CONCERNED.

NEVERTHELESS, THE SEC UNDER AUTHORITY GIVEN TO IT UNDER THE SECURITIES LAWS RETAINS THE RIGHT TO OVERRULE THE PRIVATE SECTOR STANDARDS OR TO SET ITS OWN STANDARDS IF IT CHOOSES TO DO SO. THIS IN FACT OCCURRED IN AN UNUSUAL NUMBER OF INSTANCES IN 1973.

DURING 1973, ACTIVITIES OF THE APB WERE LIMITED TO CLEANING UP A NUMBER OF ODDS AND ENDS THAT HAD BEEN ON ITS AGENDA FOR SOME TIME AND IT DID NOT CONSIDER IT WAS IN A POSITION TO ACT ON SOME HIGHLY CONTROVERSIAL MATTERS. IT CHOSE TO LEAVE THESE FOR THE FASB. THE FASB'S ACTIVITIES DURING 1973 WERE LIMITED TO GETTING ORGANIZED, DETERMINING ITEMS IT SHOULD DEAL WITH AND CONDUCTING RESEARCH ON THOSE PROJECTS. THE FASB DETERMINED NOT TO RULE ON NEW ACCOUNTING TOPICS UNTIL AFTER ADEQUATE RESEARCH HAD BEEN PERFORMED BY ITS STAFF AND REVIEWED BY A TASK FORCE COMPRISED OF REPRESENTATIVES OF VARIOUS SEGMENTS FROM THE PUBLIC AND PRIVATE SECTORS AND UNTIL AFTER APPROPRIATE PUBLIC HEARINGS HAD OCCURRED AND EXPOSURE DRAFTS ISSUED FOR COMMENT. THIS MODE OF OPERATION OF OUR FORMER AND NEW ACCOUNTING STANDARDS SETTING GROUPS LEAD TO A SITUATION IN WHICH CERTAIN CHANGES IN STANDARDS SOUGHT BY THE SEC CAME TOO LATE FOR THE APB TO DEAL WITH AND TOO EARLY FOR THE FASB TO DEAL WITH AND SO A NUMBER OF SEC ACCOUNTING SERIES RELEASES WERE ISSUED TO SOLVE PROBLEMS IN THE INTERIM. SOME RELEASES WERE INTENDED TO ESTABLISH NEW STANDARDS APPLICABLE ONLY TO FILINGS WITH THE SEC, WHILE OTHERS WERE INTENDED TO APPLY BROADLY TO ALL REPORTS OF COMPANIES SUBJECT TO THE SEC, WHETHER FILED WITH IT OR NOT.

THE TREND OF EVENTS IN 1973 WAS NOT DUE ENTIRELY TO THE APB/FASB TRANSITION PROBLEMS. JOHN C. (SANDY) BURTON, THE NEW CHIEF ACCOUNTANT OF THE SEC SINCE 1972, MADE IT CLEAR THAT HE DID NOT TAKE THAT JOB IN ORDER TO SIT BACK AND WATCH THE ACTION. SANDY MOVED AGGRESSIVELY TO NOT ONLY URGE THE PROFESSION TO SET HIGHER STANDARDS BY ITS OWN ACTIONS, BUT ALSO TO CHART CERTAIN ACCOUNTING WATERS FOR HIS OWN. HE PERCEIVED THAT WHILE THE SEC SHOULD RETAIN ITS TRADITIONAL ROLE OF DEFERRING TO THE PRIVATE SECTOR INSOFAR AS ACCOUNTING MEASUREMENT STANDARDS WERE CONCERNED, ACTION BY THE SEC IN THE ACCOUNTING DISCLOSURES AREA WOULD BE COMPLETELY CONSISTENT WITH THE COMMISSION'S STATUTORY RULE OF ASSURING FULL AND FAIR DISCLOSURE TO INVESTORS. APPLYING THIS PHILOSOPHY TO THE MATTER OF ACCOUNTING FOR LEASES, HE CONCLUDED THAT THE SEC SHOULD NOT ATTEMPT TO SET STANDARDS FOR CAPITALIZATION OF LEASES IN FINANCIAL STATEMENTS, BUT THEY SHOULD UPGRADE DISCLOSURE STANDARDS BY REQUIRING DISCLOSURE OF WHAT THE EFFECT WOULD BE ON FINANCIAL STATEMENTS IF CERTAIN TYPES OF LEASES, SPECIFICALLY FINANCE LEASES WERE CAPITALIZED.

NOT ONLY DID THE SEC MOVE TO CARRY OUT THIS POLICY OF ACTING ON ITS OWN IN MATTERS OF ACCOUNTING DISCLOSURE, BUT IT CONCLUDED THAT FINANCIAL STATEMENT DISCLOSURES IN FILINGS WITH IT SHOULD GO BEYOND THOSE TRADITIONALLY NEEDED BY THE MYTHICAL "AVERAGE PRUDENT INVESTOR" BY ALSO SERVING THE NEEDS OF FINANCIAL ANALYSTS AND OTHER PROFESSIONAL INVESTORS. HE CONCLUDED THAT SINCE THE PROFESSIONAL INVESTORS WERE COMPETENT TO EVALUATE THE SIGNIFICANCE OF INFORMATION SUCH AS COMPENSATING BANK BALANCE

REQUIREMENTS AND DEVIATIONS FROM NORMAL EFFECTIVE TAX RATES, THEY SHOULD BE SUPPLIED SUCH INFORMATION THROUGH THE MEDIA OF EXPANDED DISCLOSURES IN FILINGS WITH THE SEC.

BEHIND THE SEC'S TENDENCY TO ACT RATHER THAN TO WAIT FOR THE ACCOUNTING PROFESSION TO ACT WAS THE OCCURRENCE OF SOME NOTABLE FRAUDS OF MULTIMILLION DOLLAR DIMENSIONS SUCH AS THE EQUITY FUNDING CASE AND OTHER BUSINESS FAILURES OR REVERSALS WHICH COULD BE CLOSELY RELATED TO ACCOUNTING ISSUES. ACCOUNTING AND AUDITING ISSUES HAVE BECOME SO NEWSWORTHY THAT FORBES MAGAZINE, ONE OF THE PRINCIPAL BUSINESS PERIODICALS IN THE U.S., NOW DEVOTES A COLUMN ENTITLED "THE NUMBERS GAME" TO ACCOUNTING AND AUDITING TOPICS. INCIDENTALLY, THE TITLE OF THE MOST RECENT COLUMN IS "EVERYBODY PICKS ON US." THAT IS ONE PERSPECTIVE WHICH MIGHT BE GIVEN TO RECENT DEVELOPMENTS IN ACCOUNTING AND AUDITING, BUT NOT ONE I WOULD CHOOSE MYSELF. A FAIRER ANALYSIS WOULD BE THAT ACCOUNTING AND AUDITING STANDARDS AND THE PERFORMANCE OF ACCOUNTANTS ARE BEING SUBJECTED TO THE MOST CRITICAL SCRUTINY THAT THE PROFESSION HAS EXPERIENCED. IT HAS RESULTED IN AN EVEN GREATER EFFORT THAN IN THE PAST TO IMPROVE STANDARDS OF ACCOUNTING AND AUDITING. THIS TREND SHOULD PREVAIL FOR THE INDEFINITE FUTURE SO IT SEEMS CLEAR THAT ALL OF US WILL HAVE TO BE PREPARED TO ACCOMMODATE TO A RATE OF CHANGE NOT HERETOFORE EXPERIENCED.

WITH THIS BACKGROUND, I WOULD LIKE TO COMMENT MORE SPECIFICALLY ON SOME RECENT AND COMING DEVELOPMENTS IN ACCOUNTING

AUDITING IN ORDER TO COMPLETE THE U.S. PERSPECTIVE. JOHN ANDERSON WILL HAVE A FEW COMMENTS ON THE EUROPEAN PERSPECTIVES ON THESE ISSUES AND ON THE LATEST ACTIVITIES OF THE ACCOUNTING AND AUDITING STANDARDS COMMITTEE OF IY INTERNATIONAL. AFTER THAT, I WILL BE GLAD TO ENTERTAIN QUESTIONS ON ACCOUNTING AND AUDITING TOPICS OF YOUR CHOOSING.

ACCOUNTING DEVELOPMENTS

IN THE ACCOUNTING AREA, MOST OF YOU ARE AWARE THAT THE APB WENT OUT OF EXISTENCE WITH A FLURRY OF ACTIVITY IN 1973. ALTHOUGH TIME WILL NOT PERMIT A DETAILED REVIEW OF THAT ACTIVITY TODAY, PERHAPS A FEW COMMENTS ON THE HIGH SPOTS AND THE IMPACT THEY HAD ON 1973 FINANCIAL STATEMENTS WOULD BE RELEVANT:

OPINION NO. 28 COVERING INTERIM FINANCIAL REPORTING WAS THE PROFESSION'S FIRST FORMAL STEP IN CONSIDERING HOW AND WHETHER ACCOUNTING PRINCIPLES SHOULD BE MODIFIED FOR PURPOSES OF REPORTING ON PERIODS OF LESS THAN A FULL CALENDAR YEAR. THE^S OPINION GOES INTO EFFECT IN 1974, AND ALTHOUGH IT WILL REQUIRE SOME ADJUSTMENT IN INTERIM REPORTING TECHNIQUES BY SOME COMPANIES, ITS EFFECTS SHOULD NOT BE REVOLUTIONARY. IN GENERAL, THE OPINION PROVIDES FOR A MORE REFINED APPLICATION OF THE INCOME/EXPENSE MATCHING PROCESS FOR PURPOSES OF INTERIM REPORTING, ~~BUT~~ IT DOES NOT PERMIT ARBITRARY ALLOCATIONS OF COSTS AND EXPENSES SOLELY FOR THE PURPOSE OF SMOOTHING INTERIM REPORTED RESULTS. YOU WILL NO DOUBT FIND IN PRACTICE THAT THE DIVIDING LINE BETWEEN A MORE REFINED INCOME AND EXPENSE MATCHING PROCESS AND ARBITRARY SMOOTHING IS QUITE DIFFICULT TO DISTINGUISH. SINCE WE DO NOT GENERALLY BECOME INVOLVED

IN AUDITING INTERIM REPORTS - ALTHOUGH THAT SITUATION COULD CHANGE AS I WILL DISCUSS LATER - MOST PROVISIONS OF THE OPINION MAY NOT MATERIALLY AFFECT OUR PRACTICE. HOWEVER, ONE PROVISION OF THIS OPINION REQUIRES CONSIDERATION IN CONNECTION WITH ANNUAL REPORTING. THAT IS A PROVISION REQUIRING PUBLICLY HELD COMPANIES ISSUING QUARTERLY REPORTS - BUT NOT A FOURTH QUARTER REPORT - TO DISCLOSE IN THEIR ANNUAL REPORTS ANY UNUSUAL ADJUSTMENTS ARISING IN THE FOURTH QUARTER. THE PURPOSE OF THIS REQUIREMENT IS TO PREVENT STOCKHOLDERS WHO ESTIMATE FOURTH QUARTER EARNINGS TRENDS BY DEDUCTING THE THIRD QUARTER REPORT FROM THE FULL YEAR REPORT FROM BEING MISLEAD BY THE EFFECTS OF UNUSUAL ADJUSTMENTS ARISING IN THE FOURTH QUARTER.

APB OPINION NO. 29 - ACCOUNTING FOR NONMONETARY TRANSACTIONS HAS PROVIDED SOME GUIDELINES FOR COMPANIES WHICH LIKE TO BUY THINGS WITHOUT SPENDING MONEY. THE OPINION IS INTENDED TO SET STANDARDS FOR EXCHANGE TRANSACTIONS NOT INVOLVING CASH, RECEIVABLES OR PAYABLES BUT INVOLVING ONLY NONMONEY ITEMS SUCH AS PROPERTY. IN GENERAL, THE OPINION PERMITS RECOGNITION OF GAINS IN SUCH TRANSACTIONS IN ONLY A LIMITED NUMBER OF INSTANCES. THE APPROACH TAKEN IN THE OPINION RESULTS FROM ONE OF THE MORE SIGNIFICANT CONFLICTS OF ACCOUNTING PHILOSOPHIES WHICH FACE US TODAY. ONE PHILOSOPHY URGES GREATER RECOGNITION OF CURRENT VALUES WHILE THE OTHER URGES A MORE CAUTIOUS APPROACH TO INCOME RECOGNITION. YOU WILL UNDOUBTEDLY NOTICE THAT THIS CONFLICT BETWEEN THE DESIRE TO GIVE PROMPT RECOGNITION TO CURRENT VALUES IN THE BALANCE SHEET AND THE CONCERN FOR CREATING LIBERAL INCOME RECOGNITION STANDARDS WILL APPEAR IN MANY OF THE ACCOUNTING ISSUES WE WILL BE DEALING WITH IN THE NEXT FEW YEARS.

OPINION NO. 30 COVERING THE REPORTING OF EXTRAORDINARY AND UNUSUAL ITEMS REPRESENTS ANOTHER CHAPTER IN THE CONTINUING STRUGGLE TO MAKE INCOME STATEMENTS MORE USEFUL FOR PREDICTIVE PURPOSES. AT THE SAME TIME IT ATTEMPTS TO RESTRAIN MANAGERMENTS WHO ARE INCLINED TO REPORT THE EFFECTS OF ADVERSE DEVELOPMENTS IN A WAY WHICH UNDERSTATES THEIR SIGNIFICANCE. THE OPINION WAS PROMPTED WHEN THE RECURRENCE OF EXTRAORDINARY ITEMS IN SOME COMPANIES RAISED QUESTIONS OF WHETHER THE EXISTING CRITERIA FOR EXTRAORDINARY ITEM TREATMENT WERE EITHER TOO LIBERAL OR WERE BEING INTERPRETED TOO LIBERALLY. THE OPINION RESTRICTS THE USE OF THE EXTRAORDINARY ITEM DESIGNATION BUT AT THE SAME TIME PROVIDES FOR A MORE DESCRIPTIVE REPORTING WITHIN THE INCOME STATEMENT OF RESULTS OF DISCONTINUED BUSINESS OPERATIONS AND UNUSUAL ITEMS. PERHAPS THE FINAL SOLUTION TO THE PROBLEM OF MAKING THE INCOME STATEMENT MORE USEFUL FOR PREDICTIVE PURPOSES WILL BE THE SEGREGATION WITHIN THE INCOME STATEMENT OF ITEMS WHICH OCCUR EVERY YEAR FROM ITEMS WHICH DO NOT OCCUR EVERY YEAR. ANOTHER APPROACH WOULD BE THE SUPPLEMENTING OF CURRENT YEAR INCOME STATEMENT WITH THE FORECAST FOR THE FORTHCOMING YEAR. ALTHOUGH THERE MAY BE SOME FURTHER INTERPRETATIONS ISSUED ON THE SUBJECT OF INCOME STATEMENT CLASSIFICATION, I WOULD NOT EXPECT ANY MAJOR REVISION OF THIS APPROACH IN THE NEAR FUTURE.

OPINION NO. 31 - DISCLOSURE OF LEASE COMMITMENTS BY LESSEES. THIS OPINION REPRESENTS THE MOST THE ACCOUNTING PRINCIPLES BOARD BELIEVED IT COULD DO SHORT OF EXPANDING LEASE CAPITALIZATION REQUIREMENTS. THE OPINION ENCOURAGED BUT DID NOT REQUIRE DISCLOSURE OF THE PRESENT VALUE OF LEASE COMMITMENTS. THE SEC CONCLUDED THAT THE DISCLOSURE OF THE PRESENT VALUE OF FINANCING

LEASES SHOULD BE OBLIGATORY AND IT ACTED TO REQUIRE SUCH DISCLOSURE.

INDUSTRY ACCOUNTING AND AUDIT GUIDES

A LARGE NUMBER OF PUBLICATIONS ON ACCOUNTING AND AUDITING ISSUES UNIQUE TO ONLY CERTAIN INDUSTRIES WERE ISSUED IN 1973. A CAREFUL READING OF ALL OF THESE COULD REQUIRE A SUSPENSION OF MANY OF YOUR CHARGEABLE ACTIVITIES AND THEREFORE I WOULD NOT RECOMMEND IT. I WOULD RECOMMEND, HOWEVER, THAT YOU READ CAREFULLY THE ACCOUNTING GUIDE ON PROFIT RECOGNITION ON SALES OF REAL ESTATE IF YOUR CLIENTS HAVE OR PROPOSE TO ENTER INTO EVEN ONE REAL ESTATE TRANSACTION. A HIGH PERCENTAGE OF THE CASES IN WHICH U.S. AUDITORS HAVE BEEN EITHER SUED, CENSORED OR DISCIPLINED HAVE INVOLVED ACCOUNTING FOR REAL ESTATE TRANSACTIONS AND IT SEEMS TO BE AN AREA WHERE AUDITORS ARE DECEIVED MORE THAN ANY OTHER. THE STANDARDS IN THE GUIDE REFLECT THE EFFECTS OF THOSE HARD EXPERIENCES WE HAVE HAD AND SET VERY RIGID AND HIGH STANDARDS FOR PROFIT RECOGNITION ON REAL ESTATE SALES. THE GUIDE DOES NOT PROVIDE ALL OF THE ANSWERS TO REAL ESTATE ACCOUNTING SUCH AS QUESTIONS CONCERNING ALLOCATION OF COSTS, IMPUTATION OF INTEREST AND BALANCE SHEET CLASSIFICATION OF TRANSACTIONS THAT DO NOT QUALIFY FOR PROFIT RECOGNITION. NEVERTHELESS, IT IS AN IMPORTANT STEP FORWARD IN THIS TROUBLESOME AREA.

EXIT THE APB - ENTER THE FASB

THIS FULL-TIME BODY OF SEVEN, COMPRISED OF FOUR CPAs, TWO FORMER FINANCIAL EXECUTIVES, ONE FORMER FINANCIAL ANALYST, AND ONE FORMER ACCOUNTING EDUCATOR HAS BEEN IN BUSINESS FOR

THE BETTER PART OF A YEAR. THEY ARE NOT UNDER THE DIRECT CONTROL OF THE PROFESSION OR THE SEC AND HAVE MADE IT CLEAR THAT THEY EXPECT TO CHART THEIR OWN COURSE. THEY ARE SUPPORTED BY A SUBSTANTIAL RESEARCH STAFF AND, AS YOU WILL SEE THIS YEAR, THEY WILL STUDY AND EVALUATE THE ALTERNATIVE SOLUTIONS TO VARIOUS ACCOUNTING ISSUES IN GREAT DEPTH. THEIR OPERATING PROCEDURES CALL FOR A PREPARATION OF A DISCUSSION MEMORANDUM INDICATING THE PROS AND CONS OF THE VARIOUS SOLUTIONS TO EACH ISSUE THEY UNDERTAKE TO SOLVE, THE HOLDINGS OF PUBLIC HEARINGS TO SECURE VIEWS, AND THE ISSUANCE OF EXPOSURE DRAFTS OF PROPOSED STANDARDS. THE ENTIRE PROCESS TAKES FROM EIGHT TO TWELVE MONTHS IF EVERYTHING GOES RIGHT AND ACCORDINGLY WE HAVE NOT SEEN, NOR DID WE EXPECT TO SEE, MUCH PRODUCTION IN THE WAY OF DEFINITIVE STANDARDS FROM THE GROUP IN 1973. ONE STANDARD CONCERNING DISCLOSURE OF THE TRANSLATING OF FOREIGN WAS ADOPTED, FOUR DISCUSSION MEMORANDA HAVE BEEN ISSUED AND TWO PUBLIC HEARINGS HAVE NOW BEEN HELD. SEVERAL MORE DISCUSSION MEMORANDA ARE EXPECTED TO BE ISSUED BEFORE THE YEAR IS OVER AND THERE WILL BE AT LEAST THREE OR FOUR MORE PUBLIC HEARINGS. ALL OF THIS IS EXPECTED TO PRODUCE AT LEAST SEVERAL NEW STANDARDS THIS YEAR. IN ORDER THAT YOU MAY KNOW WHAT TO LOOK FOR, I WILL GIVE YOU A FEW HIGHLIGHTS ON EACH ISSUE:

1. ACCOUNTING FOR RESEARCH AND DEVELOPMENT AND SIMILAR COSTS - A DISCUSSION MEMORANDUM HAS BEEN ISSUED ON THIS SUBJECT AND A PUBLIC HEARING HELD. ABOUT 250 PEOPLE ATTENDED THIS FIRST PUBLIC HEARING HELD IN NEW YORK BY THE FASB AND THERE 14 ORAL PRESENTATIONS MADE. THE PRESENTATIONS MADE RAN THE GAMUT FROM PLEAS FOR CAPITALIZATION OF ALL R & D COSTS TO PROPOSALS TO

EXPENSE ALL SUCH ITEMS. THE "EXPENSE" ADVOCATES WERE IN THE GREAT MAJORITY, SOME WITH VARIATIONS CALLING FOR SELECTIVE CAPITALIZATION OF ONLY CERTAIN COSTS WITH A HIGH EXPECTATION OF RECOVERY AND A FEW SUGGESTED THAT WHILE ALL COSTS SHOULD BE INITIALLY EXPENSED, THOSE WHICH LATER PROVED TO BE ASSOCIATED WITH SUCCESSFUL PROJECTS SHOULD THEN BE CAPITALIZED. A STANDARD IS EXPECTED TO BE ISSUED ON THIS SUBJECT THIS YEAR AND IF IT IS RESPONSIVE TO THE INPUT THE FASB HAS RECEIVED THUS FAR, IT WILL NOT CHANGE STANDARDS FOR CAPITALIZATION SIGNIFICANTLY, BUT IT WILL PROVIDE FOR MORE EXTENSIVE DISCLOSURE OF RESEARCH AND DEVELOPMENT COSTS.

A SIGNIFICANT SUB-ISSUE UNDER THIS TOPIC IS THE TREATMENT OF COMPANIES IN THE DEVELOPMENT STAGE. A POSITION PAPER SUBMITTED BY THE AICPA PROPOSES THAT ALL COSTS INCURRED DURING DEVELOPMENT STAGE BE CAPITALIZED EXCEPT FOR THOSE WHICH ARE ATTRIBUTABLE TO ABANDONED PROJECTS.

PRICE LEVEL ACCOUNTING

THE HIGH DEGREE OF INFLATION IN THE UNITED STATES IN 1973 HAS STIMULATED INTEREST IN THIS SUBJECT AGAIN. THE ACCOUNTING PRINCIPLES BOARD HAD ISSUED A STATEMENT ON THIS SUBJECT IN 1969 PRESCRIBING A TECHNIQUE FOR PREPARING PRICE LEVEL ADJUSTED FINANCIAL STATEMENTS AND RECOMMENDING THAT COMPANIES DISCLOSE SUCH INFORMATION ON A SUPPLEMENTAL BASIS WITH THEIR HISTORICAL FINANCIAL STATEMENTS. THAT RECOMMENDATION DID NOT CATCH ON, PERHAPS DUE TO THE LOWER DEGREES OF INFLATION THAT PREVAILED IN THE EARLY 1970s.

A HIGHER RATE OF INFLATION IN 1973 AND PREDICTIONS OF CONTINUATION OF INFLATION AT A 6 -9% ANNUAL RATE IN THE MID-1970s HAS STIMULATED A GREAT DEAL OF INTEREST IN THE SUBJECT. THE WALL STREET JOURNAL RECENTLY STATED:

CORPORATE REPORTING THAT MAKES NO ALLOWANCE FOR PRICE INFLATION IS BECOMING MEANINGLESS. SUCH REPORTING HAS BEEN MADE IMPERATIVE BY THE PRESENT RATE OF INFLATION. IT IS A TIME FOR REALISM ABOUT INFLATION. CORPORATE OFFICERS CAN HARDLY BLAME POLITICIANS FOR NOT FACING THE FACTS WHEN THEY THEMSELVES ARE PARTLY TO BLAME FOR OBSCURING THEM.

THE SEC ISSUED AN ACCOUNTING RELEASE IN LATE 1973 EXORTING COMPANIES TO DISCLOSE THE AMOUNT OF THEIR PROFITS APPLICABLE TO HOLDING INVENTORY DURING PERIODS OF RISING PRICES. THE SEC PROPOSAL WAS NOT A MANDATORY REQUIREMENT AND DUE TO ITS LATE ISSUANCE DATE AND THE LACK OF GUIDELINES FOR IMPLEMENTATION IT DID NOT RESULT IN MUCH DISCLOSURE OF THE EFFECT OF INFLATION ON 1973 PROFITS. IN RESPONSE TO THE FASB REQUEST FOR INPUT ON THIS SUBJECT, THE AICPA AND MANY MAJOR ACCOUNTING FIRMS, INCLUDING OUR OWN, HAVE RESPONDED URGING THAT PRICE LEVEL ACCOUNTING INFORMATION BE DISCLOSED SUPPLEMENTARILY TO HISTORICAL FINANCIAL STATEMENTS. MOST SUGGESTIONS PROPOSE AN IMPLEMENTATION DATE OF NOT EARLIER THAN DECEMBER 31, 1975. THEREFORE, IF A STANDARD IS ISSUED AND IF THE FASB HEEDS THIS ADVICE, OUR INVOLVEMENT WITH CLIENTS IN THIS AREA IN 1974 WILL BE LIMITED TO THOSE SITUATIONS IN WHICH THE CLIENT DECIDES TO MAKE VOLUNTARY DISCLOSURE OF THE PRICE LEVEL ADJUSTED INFORMATION. A MAJOR IMPLEMENTATION PROBLEM FROM THE FOREIGN OPERATION POINT OF VIEW IS WHETHER, FOR PURPOSES OF CONSOLIDATION WITH THE U.S. DOLLAR STATEMENTS, THE FOREIGN FINANCIAL STATEMENTS SHOULD FIRST BE TRANSLATED TO U.S. DOLLARS AND THEN ADJUSTED FOR THE U.S. RATE OF INFLATION - AN EXERCISE READILY APPLIED IN THE U.S. - OR WHETHER THE FOREIGN CURRENCY FINANCIAL STATEMENTS SHOULD FIRST BE RESTATED TO GIVE EFFECT TO THE LOCAL DEGREE OF INFLATION AND THEN TRANSLATED TO U.S. CURRENCY AT A CURRENT RATE. THE ANSWER PROBABLY HINGES UPON THE APPROACH TAKEN TO TRANSLATING FOREIGN CURRENCY FINANCIAL STATEMENTS WHICH IS ANOTHER ITEM ON THE FASB'S AGENDA THIS YEAR. OF ALL THE SUBJECTS UNDER CONSIDERATION BY THE FASB, I BELIEVE

THE SUBJECT OF PRICE LEVEL ACCOUNTING IS THE ONE WHICH MAY HAVE THE GREATEST IMPACT ON FINANCIAL REPORTING IN THE NEXT FEW YEARS. IT IS A TOPIC THAT YOU SHOULD BE PREPARED TO DISCUSS WITH CLIENTS BEFORE THE YEAR IS OVER.

ACCOUNTING FOR FOREIGN CURRENCY TRANSLATION

ACCOUNTING IN THIS AREA, AS YOU ARE AWARE, HAS BEEN IN A STATE OF DISARRAY SINCE THE DOLLAR WAS FIRST FLOATED IN 1971. ALTERNATIVE ACCOUNTING METHODS AVAILABLE FOR TRANSLATION PROBABLY EXCEED IN NUMBER ALTERNATIVES AVAILABLE IN ANY OTHER AREA OF ACCOUNTING. AN FASB PUBLIC HEARING ON THIS TOPIC IS SET FOR JUNE 1974 AND IT IS SOMEWHAT EARLY TO PREDICT THE DIRECTION WHICH THIS ISSUE MAY TAKE OR THE EFFECT OF THE STANDARD TO BE ISSUED LATE IN THE YEAR. NEVERTHELESS, I CAN ADVISE THAT BASED ON CONVERSATIONS I HAVE HAD WITH OTHERS AND BASED ON THE TREND OF THINKING OF SOME OF THE LEADING ACCOUNTANTS ON THIS SUBJECT, THE CHOICES APPEAR TO BE NARROWING DOWN TO THE MONETARY/NONMONETARY METHOD WITH IMMEDIATE WRITEOFF OF TRANSLATION GAINS OR LOSSES AND THE CURRENT RATE METHOD WITH SOME TECHNIQUE FOR AMORTIZING TRANSLATION GAINS OR LOSSES OVER FUTURE PERIODS. THE CURRENT RATE METHOD SEEMS TO BE GAINING A LARGE NUMBER OF SUPPORTERS IN THE U.S. IN RECENT YEARS, THE INCREASE IN NUMBERS OF SUPPORTERS EACH YEAR BEING INVERSELY PROPORTIONATE TO THE EXTENT OF DEVALUATION OF THE DOLLAR.

ANOTHER IMPORTANT ISSUE WHICH SHOULD BE RESOLVED BY THE PROPOSED STANDARD WILL BE THE TREATMENT OF CHANGES IN EXCHANGE RATES WHICH OCCUR SHORTLY AFTER THE BALANCE SHEET DATE. THERE WAS SOME SENTIMENT AMONG U.S. ACCOUNTANTS THIS PAST JANUARY THAT THE DECLINES IN THE VALUE OF THE YEN AND FRENCH FRANC SHOULD BE REFLECTED IN 1973 FINANCIAL STATEMENTS. THE MORE WE TALKED ABOUT

IT, THE WEAKER THE DOLLAR BECAME AND BY THE SIGN-OFF TIME ON MOST 1973 ANNUAL REPORTS, MOST FOREIGN CURRENCIES WERE BACK NEAR THEIR DECEMBER 31ST LEVELS. IF THERE IS A LESSON TO BE LEARNED FROM THIS SITUATION, IT IS THAT THE EXCHANGE RATE PREVAILING ON THE LAST DAY OF THE YEAR IN FREE EXCHANGE MARKETS IS AT LEAST AS GOOD AN INDICATOR OF THE VALUE OF A CURRENCY AT THAT DATE AS A RATE PREVAILING BEFORE OR IMMEDIATELY AFTER THE BALANCE SHEET DATE.

ACCOUNTING FOR FUTURE LOSSES IS AN ISSUE WHICH SOME ACCOUNTANTS SAY IS SELF ANSWERING. THAT IS, IF THE LOSS IS A FUTURE LOSS, ONE SHOULD RECOGNIZE IT IN THE FUTURE. THIS TOPIC CAME TO THE FOREFRONT AS A RESULT OF SOME U.S. PROPERTY AND CASUALTY INSURANCE COMPANIES PROVIDING RESERVES FOR FUTURE CATASTROPHE LOSSES UNDER POLICIES WHICH THE INSURER CHOSE NOT TO REINSURE WITH OTHER UNDERWRITERS. THE TOPIC WILL ALSO ENCOMPASS RESERVES FOR SELF INSURANCE PROVIDED BY NONINSURANCE COMPANIES, RESERVES FOR EXPROPRIATION OF FOREIGN ASSETS AND OTHER FOREIGN OPERATION CONTINGENCIES AND OTHER PROVISIONS FOR POSSIBLE LOSSES THAT BOARDER ON BEING CONTINGENCY RESERVES. THE ISSUE SEEMS TO BRING INTO FOCUS THE QUESTION OF THE DIVIDING LINE BETWEEN APPROPRIATE MACHING OF REVENUES AND RELATED COSTS AND ARBITRARY SMOOTHING OF INCOME.

LEASES

I HAVE ALREADY MENTIONED THAT THIS THE TOPIC OF CAPITALIZATION OF LEASES WAS ONE OF THE TOPICS PASSED ON FROM THE APB TO THE FASB. IT WILL UNDOUBTEDLY PROVIDE THE FIRST MAJOR CHALLENGE TO THE ABILITY AND DETERMINATION OF THE FASB TO COPE WITH HIGHLY CONTROVERSIAL ISSUES. VERY LIMITED ACTIONS BY THE APB IN THIS

LINE OF BUSINESS REPORTING

LOB REPORTING HAS BEEN REQUIRED BY THE SEC FOR A NUMBER OF YEARS NOW AND MOST U.S. COMPANIES HAVE BEEN VOLUNTARILY DISCLOSING IT. IN SEC REPORTS, THE LINE OF BUSINESS INFORMATION CALLED FOR HAS NOT BEEN AN INTEGRAL PART OF THE FINANCIAL STATEMENTS NOR HAS IT BEEN REPORTED UPON BY CPAs. THE FASB STUDY WOULD BE DIRECTED TOWARDS DETERMINING WHETHER LOB INFORMATION SHOULD BE AN ESSENTIAL AND INTEGRAL PART OF FINANCIAL STATEMENTS. IF THEIR DECISION IS THE AFFIRMATIVE, THERE MAY WELL BE A REQUIREMENT FOR THE AUDITORS TO REPORT ON THE LINE OF BUSINESS INFORMATION ON SOME BASIS, POSSIBLY ON A BASIS WHICH WILL EXTEND THE SCOPE OF SOME AUDITS.

MATERIALITY

THIS STUDY WILL ATTEMPT TO ESTABLISH MORE SPECIFIC GUIDELINES FOR DETERMINING MATERIALITY. WE ARE PRESENTLY OPERATING UNDER A LARGE NUMBER OF RULES OF THUMB RANGING FROM 3% TO 10%. I SUSPECT THE ULTIMATE ANSWER WILL NOT BE A SIMPLE PERCENTAGE OR SET OF PERCENTAGES. REGARDLESS, ANY PROGRESS IN THIS AREA WILL BE HELPFUL.

CONCEPTUAL FRAMEWORK FOR ACCOUNTING AND REPORTING - OBJECTIVES, QUALITATIVE CHARACTERISTICS AND INFORMATION

THE REPORT OF THE STUDY GROUP ON OBJECTIVES OF FINANCIAL STATEMENTS WAS ISSUED IN OCTOBER 1973 AND IT WILL SERVE AS THE BASIS FOR FURTHER STUDY OF THIS AREA BY THE FASB. THE REPORT HAS BEEN DESCRIBED AS USEFUL, BUT IT IS FAR FROM A DETAILED

ROADMAP TO THE SOLUTION OF MOST OF THE UNRESOLVED PROBLEMS WE HAVE IN ACCOUNTING TODAY. SOME CONCLUSIONS OF THE STUDY ARE:

1. THAT THE BASIC OBJECTIVE OF FINANCIAL STATEMENTS IS TO PROVIDE INFORMATION USEFUL FOR MAKING ECONOMIC DECISIONS.
2. THAT INFORMATION CONCERNING PRESENT AND POTENTIAL CASH FLOWS IS OF GREAT SIGNIFICANCE TO INVESTORS.
3. THAT CURRENT VALUES SHOULD BE REPORTED WHEN THEY DIFFER SIGNIFICANTLY FROM HISTORICAL COSTS.
4. THAT FINANCIAL FORECASTS SHOULD BE PROVIDED WHEN THEY WILL ENHANCE THE RELIABILITY OF USERS PREDICTIONS OF FUTURE FINANCIAL RESULTS.

YOU WILL BE HEARING A GREAT DEAL MORE ABOUT THESE SUBJECTS AND THE FASB DURING THE BALANCE OF THE YEAR AND IN FUTURE YEARS. IT IS POSSIBLE THAT SOME OF THE STANDARDS THAT IT ADOPTS THIS YEAR WILL GO INTO EFFECT FOR CALENDAR YEAR 1974. IT IS MORE LIKELY THAT MOST OF THE STANDARDS ISSUED IN 1974 WILL GO INTO EFFECT IN 1975. IN EITHER EVENT, IT WILL BE IMPORTANT FOR YOU TO RECOGNIZE THE IMPLICATIONS OF THE PROPOSED NEW STANDARDS ON THE FINANCIAL RESULTS OF OUR CLIENTS' EUROPEAN OPERATIONS. NOW THAT THE SMOKE IS CLEARING ON THE 1973 YEAR ENDS, ATTENTION WILL FOCUS ON THE 1974 YEAR AND THE IMPLICATIONS OF ACCOUNTING CHANGES IS CERTAIN TO BE A HOT TOPIC.