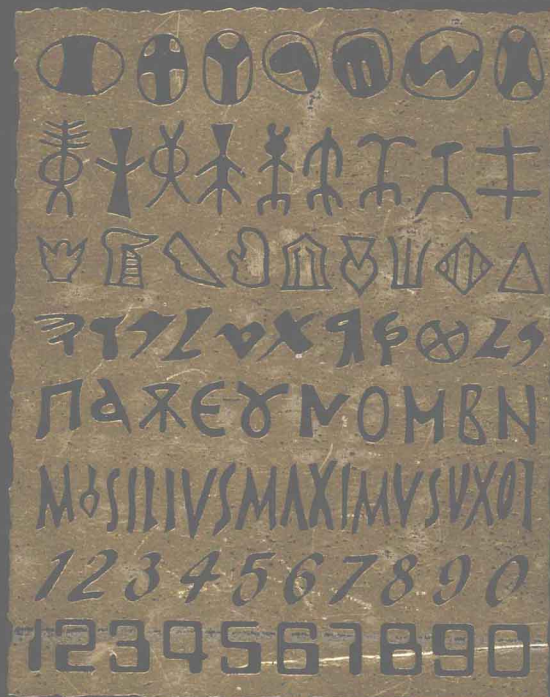


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# Accounting Standards in Evolution

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Ross M. Skinner

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**Ross M. Skinner**

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# Preface

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This book has three principal objectives. The first is to recount in an organized fashion the standards that govern financial reporting today. The second is to explain why they take the form that they do—that is, to explore the general theory underlying today's standards and the particular thinking that has influenced the form taken by individual standards. The third is to evaluate the standards and underlying theory critically—to appraise strengths and weaknesses with a view to stimulating discussion and possible improvement.

Forty years ago, when I entered accounting practice, we were still fighting battles to require a systematic provision for depreciation regardless of whether a year's results were good or bad and to prevent the charging of arbitrary provisions for "reserves" against income. Now, forty years later, the issues have changed radically but the struggle for better financial reporting continues. Accounting standards today cover much more territory and deal with much more complex issues. Yet no one would claim that we are close to resolving all possible points of contention. Accounting standards have evolved over time and will continue to evolve—hence the title of this book.

My strong belief is that an understanding of the past development of ideas will help us in the present and future. All of us have our ingrained mind-sets, and it is instructive to look back to see how much of previous conventional wisdom appears strange in retrospect. That is why Part I of this book consists of an excursion, unfortunately all-too-brief, through the history of accounting. Accountants, and particularly those involved in setting accounting standards, would do well to devote more time to the study of the history of their discipline and the way it has responded to changes in its environment.

Part II, the longest part of this book, examines the state of current accounting standards. The majority of these standards spring from practice and are described, somewhat misleadingly, as "generally accepted accounting principles." That description is misleading because, not infrequently, those responsible for setting accounting standards prescribe treatments that are substantially contrary to existing practice. That fact suggests that standard-setters have some conceptual framework in their minds which they use to arrive at their recommendations. It is apparent that the theory of historical cost accounting provides much of that framework. Historical cost accounting reached its zenith of acceptance and respect around 1960. Yet, even at the height of its influence, it never came close to providing answers to all financial reporting questions. It was oriented to business organizations and had little to say about the accounting of nonbusiness entities and governments. Among business organizations, it concentrated on product-handling industries and was poorly adapted to the financial reporting needs of such important sectors of the economy as financial institutions, investment companies, service industries, and the extractive industries. Because of these and other shortcomings, we stand on shaky ground in attempting to improve existing accounting standards. The final chapter of Part II contains some suggestions for doing so without radical departure from the basic approach of historical cost accounting.

Part III chronicles the efforts made to replace or revise historical cost accounting so as to better portray the effects of changing prices in financial reports. By now it is clear that those efforts have failed. There are several contributing reasons.

One important reason is that accounting theoreticians could not agree on the superiority of any one model for price-change accounting. Their disagreements were fundamental, extending even to their premises as to the objectives of financial reporting. On the practical side, preparers of financial statements were uneasy about the degree of value estimation required in most models of price-change accounting and users of financial statements evinced a lack of interest in the whole subject. In view of the likelihood of a repetition of price instability at some future time—whether five, ten, or twenty-five years hence—standard-setters would do well to ponder the lessons of this experience and be better prepared to act another time.

Periodically, the gaps and weaknesses in historical cost accounting stimulate accountants to wonder if we could articulate a better conceptual framework. The first chapter of Part IV builds upon the literature in this field to suggest a structure of thought. Although such an exercise has value, not too much can be expected from it. No matter how clear the objectives of financial reporting, it will always be necessary to make significant trade-offs between the information that is desired and the information achievable with reasonable reliability of measurement. Thus, it seems likely that accounting standards will have to continue to deal with issues in considerable detail rather than be confined to broad statements of principle.

The final chapter in the book deals with the mechanics of setting accounting standards. Several different arrangements are possible. The claim of the accounting profession for primacy in the task rests upon its competence and experience in dealing with financial reporting issues. Yet, the record suggests that standard-setting requires some measure of legal support to be workable. To deserve such support the profession must be seen to be acting in the public interest and must perform effectively. While the CICA performance has been creditable, improvements could be made in dealing with emerging issues and monitoring the performance of standards already issued. Some action is also necessary to stem the proliferation of accounting methods in Canada attributable to the fact that new U.S. practices are usually accepted here without question. Meeting these demands might require modification of the existing standard-setting structure.

This book could not have been completed without the support and assistance of my firm, Clarkson Gordon. I am particularly grateful for suggestions and critical comments on drafts of large sections of the book by partners of the firm, D.W. Lay, and J.A. Milburn. Drafts of individual chapters also benefited materially from the comments of H. Bierman, Jr., G.W. Braum, H.F.C. Graham, D.A. Leslie, L.S. Rosen, J.N. Ross, W.G. Ross, W.K. Strelloff, and some fifteen members of the National Accounting Standards department of Clarkson Gordon. Karen Montano both commented on content and provided major assistance in editing. The last word, appropriately, belongs with Pearl Newbold. Without her cheerful dedication and superb efficiency at the word processor I might never have reached the end of this work.

Toronto 1986

R.M. Skinner

## Ross M. Skinner

A chartered accountant since 1949, Ross Skinner joined the firm of Clarkson Gordon in 1945 and became a partner in 1954. He served as National Director of Accounting Standards for the firm for fifteen years and although officially retired, he remains active in the field of accounting research and standards.

His love of the profession is demonstrated by his involvement over the years. He has been a member of, and chaired, many professional and academic committees, including the Accounting and Auditing Research Committee of the Canadian Institute of Chartered Accountants and the Financial Disclosure Advisory Board of the Ontario Securities Commission.

*Accounting Standards in Evolution* is the latest in a long line of prestigious accomplishments. As an author of accounting and auditing textbooks and articles, Ross Skinner is unsurpassed in Canada. Among his works are *Analytical Auditing*, *Accounting Principles: A Canadian Viewpoint*, *Pension Accounting*, and *Canadian University Accounting*. *Accounting Standards in Evolution* will undoubtedly become the authoritative accounting reference text in Canada.

Ross Skinner was recognized for his outstanding achievements by the conferring of an honorary doctorate in 1979 by Brock University. In 1984, he was awarded the highest honor of the Institute of Chartered Accountants of Ontario: the Award of Outstanding Merit, and in 1985, the Certificate of Merit of the Canadian Institute of Chartered Accountants. In 1987, he was appointed Adjunct Professor and Director of the Centre for Accounting Studies in the Faculty of Management Studies at the University of Toronto.

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# Abbreviations

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The following abbreviations are used in this book:

## Accounting and business terms

ACM	Actuarial cost method
AFUDC	Allowance for funds used during construction
CCA	Capital cost allowance (chapter 14)
CCA	Current cost accounting (chapters 29, 30)
COP	Current operating profit
CRVA	Current realizable value accounting
CVA	Current value accounting
D&D	Depletion and depreciation
DCF	Discounted cash flow
EPS	Earnings per share
EV	Economic value
FIFO	First in, first out
GAAP	Generally accepted accounting principles
HOPAM	Higher of proceeds and market value
ITC	Investment tax credit
LIFO	Last in, first out
LOCAM	Lower of cost and market value
MWCA	Monetary working capital allowance
NRV	Net realizable value
R&D	Research and development
RC	Replacement cost
RCA	Replacement cost accounting
SAR	Stock appreciation right
SCF	Statement of cash flow
SCFP	Statement of changes in financial position
SFAS	Statement of financial accounting standards (U.S.)
SSAP	Statement of standard accounting practice (Great Britain and Ireland)
VF	Value to the firm

### Institutions and associations

AAA	American Accounting Association
AIA	American Institute of Accountants (former name of AICPA)
AICPA	American Institute of Certified Public Accountants
AISG	Accountants International Study Group
APB	Accounting Principles Board (U.S., 1959 to 1973)
CAP	Committee on Accounting Procedure (U.S., 1939 to 1959)
CICA	Canadian Institute of Chartered Accountants
CIPREC	Canadian Institute of Public Real Estate Companies
FASB	Financial Accounting Standards Board (U.S., 1973—)
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
NYSE	New York Stock Exchange
SEC	Securities and Exchange Commission (U.S.)

### References to professional literature

The content of this book does not take into account professional recommendations subsequent to:

- Release No. 50 of the *CICA Handbook*, dated April 1986.
- Statement of Financial Accounting Standards No. 88 by the FASB, dated December 1985.



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