



Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED
2006/2007 Edition

ACCOUNTING STANDARDS

as of June 1, 2006

VOLUME III

AICPA PRONOUNCEMENTS
FASB INTERPRETATIONS
FASB TECHNICAL BULLETINS
FASB STAFF POSITIONS
FASB CONCEPTS STATEMENTS
TOPICAL INDEX/APPENDIXES



JOHN WILEY & SONS, INC.

New York • Chichester • Brisbane • Toronto • Singapore



Financial Accounting Standards Board

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

ORIGINAL PRONOUNCEMENTS

**AS AMENDED
2006/2007 Edition**

ACCOUNTING STANDARDS
as of June 1, 2006

VOLUME III

**AICPA PRONOUNCEMENTS
FASB INTERPRETATIONS
FASB TECHNICAL BULLETINS
FASB STAFF POSITIONS
FASB CONCEPTS STATEMENTS
TOPICAL INDEX / APPENDIXES**



Published by the
Financial Accounting Standards Board

Copyright © 2006 by Financial Accounting Standards Board. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Financial Accounting Standards Board.

This volume contains quotations and uses materials copyrighted by the American Institute of Certified Public Accountants (AICPA). Such material has been used by the Financial Accounting Standards Board with the permission of the AICPA.

NOTICE TO USERS OF THE *ORIGINAL PRONOUNCEMENTS*

This year's edition of the Financial Accounting Standard Board's (FASB) *Original Pronouncements* has been revised and updated to include the following new pronouncements:

FAS155: Accounting for Certain Hybrid Financial Instruments

Statement 155, issued in February 2006, improves the financial reporting of certain hybrid financial instruments by providing a means to simplify the accounting for these instruments and eliminating the exemption for beneficial interests in securitized financial assets.

Statement 155 enables an entity to avoid bifurcation and separate accounting for a derivative embedded in a hybrid financial instrument provided that the entity elects at its inception to report that hybrid instrument at fair value with related changes recognized in earnings as they occur.

Statement 155 also:

1. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
2. Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation
3. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives
4. Amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

FAS156: Accounting for Servicing of Financial Assets

Statement 156, issued in March 2006, amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to simplify the accounting for servicing assets and servicing liabilities, such as those common with mortgage securitization activities.

Specifically, Statement 156 addresses the recognition and measurement of separately recognized servicing assets and servicing liabilities. Statement 156 permits a servicer that uses derivative financial instruments to mitigate risks inherent in its servicing assets and servicing liabilities to report both the derivative financial instrument and related servicing asset or servicing liability by using a consistent measurement attribute—fair value.

The standard also:

1. Clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability
2. Requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable

3. Permits an entity with a separately recognized servicing asset or servicing liability to choose either of the following methods for subsequent measurement
 - a. Amortization Method
 - b. Fair Value Method

FASB Staff Positions

FSP APB18-1: Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence

FSP FAS13-1: Accounting for Rental Costs Incurred during a Construction Period

FSP FAS115-1/124-1: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

FSP FAS123(R)-1: Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)

FSP FAS123(R)-2: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)

FSP FAS123(R)-3: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards

FSP FAS123(R)-4: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event

FSP FAS140-2: Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140

FSP FAS143-1: Accounting for Electronic Equipment Waste Obligations

FSP FAS150-5: Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable

FSP FIN45-3: Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners

FSP FIN46(R)-6: Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)

FSP FTB85-4-1: Accounting for Life Settlement Contracts by Third-Party Investors

FSP SOP78-9-1: Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5

FSP SOP94-6-1: Terms of Loan Products That May Give Rise to a Concentration of Credit Risk

FSP AAGINV-1/SOP94-4-1: Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans

AN INTRODUCTION TO THE *ORIGINAL PRONOUNCEMENTS*

Volumes I and II contain the Statements of Financial Accounting Standards issued by the Financial Accounting Standards Board (FASB) from its inception in 1973 to June 1, 2006. Volume III contains the following materials issued by the American Institute of Certified Public Accountants or its committees and the Accounting Principles Board through June 1973 and by the FASB to June 1, 2006:

- Accounting Research Bulletins
- Accounting Principles Board Opinions
- Interpretations of Accounting Research Bulletins and Accounting Principles Board Opinions
- FASB Interpretations
- FASB Technical Bulletins
- FASB Staff Positions
- FASB Statements of Accounting Concepts

In this edition, all pronouncements amended by subsequent pronouncements reflect those amendments. Unless a complete paragraph or footnote has been deleted or added, additions and deletions as a result of amendments are not identified. The numerical sequence of the paragraphs or footnotes has not been changed as the result of any amendments; consequently, where complete paragraphs or footnotes have been deleted as a result of an amendment, that deletion is noted as follows:

[This paragraph (footnote) has been deleted. See Status page.]

Additionally, where new paragraphs have been added as the result of an amendment, they are numbered with the number of the preceding paragraph and a capital letter, such as 59A, and where new footnotes have been added they are numbered with the number of the preceding footnote and a lowercase letter, such as 3a.

The Introduction, Background Information, and Basis for Conclusions sections have not been changed to reflect amendments made to the pronouncements. Those sections remain as issued.

In rare instances, brackets have been used to show material that has been effectively amended by a subsequent pronouncement or for editorial changes that have been made to make the sentence read more smoothly.

Pronouncements that have been superseded but are still applicable for some entities due either to delayed effective dates of the superseding pronouncement or to scope exceptions have been updated for any amendments and are shaded to indicate that they have been superseded. Pronouncements that have been completely superseded and may no longer be applied are omitted from this edition; however, a Status page is retained for those omitted pronouncements.

A Status page at the beginning of each pronouncement identifies (a) the source of the changes to the pronouncement, (b) other pronouncements affected by that pronouncement, and (c) the principal effective date. The Status page can be used to identify which pronouncement (and paragraph within it) created an amendment. The pronouncement creating the amendment must be reviewed to see the amendment as it was originally issued and, if applicable, subsequently amended. For users who need to determine the provisions of a pronouncement at a particular point in time, the original pronouncements as they were originally issued, which are

marked with shading and sidebars to indicate deletions and additions, can be found in the electronic Financial Accounting Research System (FARS) or the loose-leaf edition of *Original Pronouncements*.

The Status page also identifies, where applicable, other interpretive pronouncements and releases (including Special Report implementation guidance and FASB Staff Positions) that further clarify that pronouncement. Where applicable, the Status pages also identify related Accounting Standards Executive Committee (AcSEC) pronouncements, which include both Statements of Position (SOPs) and Practice Bulletins (PBs). In addition, the Status pages of applicable pronouncements reflect either the impact of a given pronouncement on an Emerging Issues Task Force (EITF) Issue (for example, resolves, nullifies, or affects that Issue) or the relationship of an EITF Issue to a given pronouncement (for example, interpretive of or related to). An interpretive Issue is one in which the Task Force reached a consensus that interprets certain guidance in an existing *Original Pronouncements* document. A related Issue is one in which the topic of the Issue is related to the topic of the *Original Pronouncements* document but either there was no consensus reached or the consensus is not interpretive.

The appendixes and Topical Index (included in Volume III) refer to the pronouncements contained in all three volumes. Appendix A presents a current list of AICPA Practice Bulletins, audit and accounting Guides, and Statements of Position. Appendix B presents a schedule of all amended and superseded standards. Appendix C lists the effective dates of all pronouncements included in the *Original Pronouncements*. That appendix also presents the complete effective date and transition paragraphs of more recent pronouncements whose effective dates and transition provisions are such that they might initially be applied in annual financial statements issued on or after June 1, 2006. Appendix D lists all EITF Issues discussed to date and their current status.

**COMMITTEE ON
ACCOUNTING PROCEDURE**

Accounting Research Bulletins

Volume III
ORIGINAL PRONOUNCEMENTS
As Amended
as of June 1, 2006

TABLE OF CONTENTS

	Page
Committee on Accounting Procedure Accounting Research Bulletins (ARB)	ARB-1
Accounting Principles Board Opinions (APB)	APB-1
AICPA Accounting Interpretations (AIN)	AIN-1
FASB Interpretations (FIN)	FIN-1
FASB Technical Bulletins (FTB)	FTB-1
FASB Staff Positions (FSP)	FSP-1
FASB Concepts Statements (CON)	CON-1
Appendixes	
Appendix A—AICPA Practice Bulletins, Audit Guides, Accounting Guides, and Statements of Position	A-1
Appendix B—Schedule of Amended and Superseded Accounting Pronouncements	B-1
Appendix C—Effective Dates of Pronouncements	C-1
Appendix D—Issues Discussed by the FASB Emerging Issues Task Force	D-1
Topical Index	INTRO-1

ACCOUNTING RESEARCH BULLETINS (ARB)

TABLE OF CONTENTS

	Page
Foreword to Accounting Research Bulletins	ARB-2
No.	Title
43	Restatement and Revision of Accounting Research Bulletins (see page ARB43-3 for separate table of contents)..... ARB43-1
44	Declining-Balance Depreciation ARB44-1
44(Rev.)	Declining-Balance Depreciation ARB44(Rev.)-1
45	Long-Term Construction-Type Contracts ARB45-1
46	Discontinuance of Dating Earned Surplus..... ARB46-1
47	Accounting for Costs of Pension Plans ARB47-1
48	Business Combinations..... ARB48-1
49	Earnings per Share ARB49-1
50	Contingencies..... ARB50-1
51	Consolidated Financial Statements ARB51-1

FOREWORD TO ACCOUNTING RESEARCH BULLETINS

SEPTEMBER 1961

The committee on accounting procedure and the committee on terminology of the American Institute of Certified Public Accountants were superseded on September 1, 1959, by the Accounting Principles Board. At its first meeting, on September 11, 1959, the Board approved the following resolution:

The Accounting Principles Board of the American Institute of Certified Public Accountants on September 1, 1959, assumed the responsibilities of the former committees on accounting procedure and on terminology. During its existence, the committee on accounting procedure issued a series of accounting research bulletins and the committee on terminology issued a series of accounting terminology bulletins. In 1953, the first forty-two of the accounting research bulletins were revised, restated, or withdrawn and appeared as Accounting Research Bulletin No. 43 and Accounting Terminology Bulletin No. 1. Since 1953, other bulletins have been issued, the last accounting research bulletin being No. 51 and the last terminology bulletin being No. 4.

The Accounting Principles Board has the authority, as did the predecessor committees, to review and revise any of these bulletins and it plans to take such action from time to time.

Pending such action and in order to prevent any misunderstanding meanwhile as to the status of the existing accounting research and terminology bulletins, the Accounting Principles Board now makes public announcement that these bulletins should be considered as continuing in force with the same degree of authority as before.

Included in this volume¹ are Accounting Research Bulletin No. 43 (a revision and restatement of previous Bulletins) and Bulletins No. 44 to 51 in the form in which they were originally published. These are all of the bulletins which were in force at September 1, 1959, and up to the date of this publication,² none of them has been revised or revoked by any action of the Accounting Principles Board.

¹Accounting Research and Terminology Bulletins, Final Edition, 1961, American Institute of Certified Public Accountants.

²September 1961.

Accounting Research Bulletin No. 43

Restatement and Revision of Accounting Research Bulletins

STATUS

Issued: June 1953

Effective Date: June 1953 (replaced ARBs issued September 1939–January 1953)

Affects: No other pronouncements

Affected by: Chapter 1A, paragraph 1 amended by FAS 111, paragraph 8(a)
 Chapter 1A, paragraph 4 deleted by FAS 135, paragraph 4(a)
 Chapter 1B; Chapter 5, paragraph 7; Chapter 7B, paragraph 6; Chapter 9C; Chapter 10B;
 Chapter 12, paragraphs 12 and 18; and Chapter 15, paragraph 12 amended by APB 6,
 paragraphs 13, 15, 16, 23, 23, 18, and 19, respectively
 Chapter 1B, paragraph 7 amended by APB 6, paragraph 12; APB 16, paragraph 7; and FAS 135,
 paragraph 4(b)
 Chapter 2A, paragraph 3 amended by APB 20, paragraph 5(a), and FAS 154, paragraph C2
 Chapter 2B and Chapter 8 deleted by APB 9, paragraph 2
 Chapter 3A, paragraph 4(f) amended by FAS 115, paragraph 125
 Chapter 3A, paragraph 6(g) amended by APB 21, paragraph 5, and FAS 111, paragraph 8(a)
 Chapter 3A, paragraph 7 amended by FAS 78, paragraph 5
 Chapter 3A, paragraph 8 amended by FAS 6, paragraph 16
 Chapter 3A, paragraph 9 amended by FAS 135, paragraph 4(a)
 Chapter 3A, paragraph 10 added by APB 6, paragraph 14
 Chapter 3A, footnote 4 deleted by FAS 6, paragraph 16
 Chapter 3B replaced by APB 10, paragraph 7
 Chapter 4, paragraph 5 and footnote 2 amended by FAS 151, paragraph 2
 Chapter 4, paragraph 5A added by FAS 151, paragraph 2
 Chapter 4, paragraph 8 amended by FAS 133, paragraph 526
 Chapter 5, paragraphs 1 through 9 deleted prospectively by APB 17, paragraph 8
 Chapter 5, paragraphs 5, 6, 8, and 9, and footnote 1; Chapter 10B, paragraphs 15 and 17;
 Chapter 12, paragraph 21; and Chapter 15, paragraphs 7 and 17 amended by APB 9,
 paragraph 2
 Chapter 5, paragraphs 8 and 10 amended by FAS 44, paragraphs 3 and 4
 Chapter 5, paragraph 10 deleted prospectively by APB 16, paragraph 7
 Chapter 5 deleted by FAS 142, paragraph D1
 Chapter 6 deleted by FAS 5, paragraph 7
 Chapter 7A, paragraph 10 amended by FAS 111, paragraph 8(a)
 Chapter 7C deleted by ARB 48
 Chapter 9B replaced by APB 6, paragraph 17
 Chapter 9C, paragraph 5 amended by FAS 96, paragraph 205(a), and FAS 109, paragraph 288(a)
 Chapter 9C, paragraphs 11 through 13 amended by APB 11, paragraph 2(a)
 Chapter 9C, paragraphs 11 through 13 replaced by FAS 96, paragraph 205(a), and FAS 109,
 paragraph 288(a)
 Chapter 10A, paragraph 19 amended by APB 9, paragraph 2, and FAS 111, paragraph 8(a)
 Chapter 10B deleted by APB 11, paragraph 1(a), and FAS 109, paragraph 288(a)
 Chapter 11B, paragraph 8 amended by APB 11, paragraph 2(b)
 Chapter 11B, paragraph 8 deleted by FAS 96, paragraph 205(a), and FAS 109, paragraph 288(a)
 Chapter 11B, paragraph 9 amended by APB 9, paragraph 2, and FAS 111, paragraph 8(a)
 Chapter 11B, footnotes 3 and 4 amended by APB 9, paragraph 2

Chapter 11B, footnotes 3 and 4 deleted by FAS 111, paragraph 8(a)
 Chapter 12, paragraph 5 amended by FAS 8, paragraph 4; FAS 52, paragraph 3, footnote 1; and FAS 131, paragraph 129(a)
 Chapter 12, paragraph 6 replaced by FAS 131, paragraph 129(b)
 Chapter 12, paragraphs 7 and 10 through 22 deleted by FAS 8, paragraph 4, and FAS 52, paragraph 3, footnote 1
 Chapter 12, paragraphs 8 and 9 deleted by FAS 94, paragraph 16
 Chapter 13A deleted by APB 8, paragraph 6
 Chapter 13B, paragraph 2 amended by FAS 123, paragraph 381(a)
 Chapter 13B, paragraphs 6 through 13 and footnotes 2 and 3 deleted by APB 25, paragraph 4
 Chapter 13B, paragraph 14 amended by APB 25, paragraph 4
 Chapter 13B, paragraph 15 deleted by FAS 123, paragraph 381(b)
 Chapter 13B deleted by FAS 123(R), paragraph D10
 Chapter 14 deleted by APB 5, paragraph 1
 Chapter 15, paragraph 11 amended by APB 11, paragraph 2(c)
 Chapter 15, paragraph 11 deleted by FAS 96, paragraph 205(a)
 Chapter 15 deleted by APB 26, paragraph 2

Other Interpretive Pronouncements: AIN-ARB 43, Chapter 13B, Interpretation No. 1 (Superseded by APB 25)

FTB 85-1

FTB 85-6

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncements: Chapter 1A—SOP 76-3

SOP 93-6

PB 14

Chapter 1B—SOP 76-3

SOP 93-6

PB 14

Chapter 3A—SOP 90-7

Chapter 4—SOP 85-3

SOP 94-6

PB 2

Chapter 7A—SOP 90-7

Chapter 9C—SOP 85-3

SOP 88-1

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: No EITF Issues

Interpreted by: Chapter 3A, paragraph 7 interpreted by EITF Issues No. 86-5 and 86-30

Related Issues: Chapter 1A—EITF Issues No. 85-1 and 97-14

Chapter 2A—EITF Topic No. D-85

Chapter 3A—EITF Issue No. 95-22

Chapter 4—EITF Issues No. 84-10, 84-24, 86-46, 96-9, 01-9, 04-6, and 04-13

Chapter 7B—EITF Topic No. D-82

Accounting Research Bulletin No. 43**Restatement and Revision of Accounting Research Bulletins****CONTENTS**

	Page
Preface.....	ARB43-4
Introduction.....	ARB43-5
Chapter 1—Prior Opinions	
A. Rules Adopted by Membership	ARB43-6
B. Opinion Issued by Predecessor Committee.....	ARB43-7
Chapter 2—Form of Statements	
A. Comparative Financial Statements	ARB43-8
B. Combined Statement of Income and Earned Surplus [Deleted]	
Chapter 3—Working Capital	
A. Current Assets and Current Liabilities.....	ARB43-8
B. Offsetting Securities Against Taxes Payable.....	ARB43-11
Chapter 4—Inventory Pricing.....	ARB43-11
Chapter 5—Intangible Assets [Deleted]	
Chapter 6—Contingency Reserves [Deleted]	
Chapter 7—Capital Accounts	
A. Quasi-Reorganization or Corporate Readjustment.....	ARB43-16
B. Stock Dividends and Stock Split-ups.....	ARB43-17
C. Business Combinations [Deleted]	
Chapter 8—Income and Earned Surplus [Deleted]	
Chapter 9—Depreciation	
A. Depreciation and High Costs.....	ARB43-20
B. Depreciation on Appreciation	ARB43-22
C. Emergency Facilities; Depreciation, Amortization and Income Taxes	ARB43-22
Chapter 10—Taxes	
A. Real and Personal Property Taxes.....	ARB43-24
B. Income Taxes [Deleted]	
Chapter 11—Government Contracts	
A. Cost-Plus-Fixed-Fee Contracts.....	ARB43-26
B. Renegotiation.....	ARB43-28
C. Terminated War and Defense Contracts.....	ARB43-29
Chapter 12—Foreign Operations and Foreign Exchange.....	ARB43-33
Chapter 13—Compensation	
A. Pension Plans; Annuity Costs Based on Past Service [Deleted]	
B. Compensation Involved in Stock Option and Stock Purchase Plans	ARB43-34
Chapter 14—Disclosure of Long-Term Leases in Financial Statements of Lessees [Deleted]	
Chapter 15—Unamortized Discount, Issue Cost, and Redemption Premium on Bonds Refunded [Deleted]	
Appendix A—List of Accounting Research Bulletins with Cross-References	ARB43-36
Appendix B—Changes of Substance Made in the Course of Restating and Revising the Bulletins.....	ARB43-37
Appendix C—Bulletins Not Included in the Restatement and Revision.....	ARB43-40

PREFACE

Since its organization the American Institute of Accountants, aware of divergences in accounting procedures and of an increasing interest by the public in financial reporting, has given consideration to problems raised by these divergences. Its studies led it, in 1933, to make certain recommendations to the New York Stock Exchange which were adopted by the Institute in 1934. Further consideration developed into a program of research and the publication of opinions, beginning in 1938, in a series of Accounting Research Bulletins.

Forty-two bulletins were issued during the period from 1939 to 1953. Eight of these were reports of the committee on terminology. The other 34 were the result of research by the committee on accounting procedure directed to those segments of accounting practice where problems were most demanding and with which business and the accounting profession were most concerned at the time.

Some of these studies were undertaken to meet new business or economic developments. Some arose out of the war which ended in 1945 and the problems following in its wake. Certain of the bulletins were amended, superseded, or withdrawn as changing conditions affected their usefulness.

The purposes of this restatement are to eliminate what is no longer applicable, to condense and clarify what continues to be of value, to revise where changed views require revision, and to arrange the retained material by subjects rather than in the order of issuance. The terminology bulletins are not included. They are being published separately.

The committee has made some changes of substance, which are summarized in appendix B.

The several chapters and subchapters of this restatement and revision are to be regarded as a cancellation and replacement of Accounting Research Bulletins 1 through 42, excepting the terminology bulletins included in that series, which are being replaced by a separate publication.

Although the committee has approved the objective of finding a better term than the word *surplus* for use in published financial statements, it has used *surplus* herein as being a technical term well understood among accountants, to whom its pronouncements are primarily directed.

Committee on Accounting Procedure
June, 1953

Each section of Accounting Research Bulletin No. 43, entitled Restatement and Revision of Accounting Research Bulletins, was separately adopted by the assenting votes of the twenty members of the committee except to the extent that dissents, or assents with qualification, are noted at the close of each section. Publication of the bulletin as a whole was approved by the assenting votes of all members of the committee, one of whom, Mr. Andrews, assented with qualification.

Mr. Andrews assents to the publication of this bulletin only to the extent that it constitutes, with no changes in meaning other than those set forth in appendix B, a restatement of the bulletins previously issued by the committee and not mentioned in appendix C as having been omitted. He dissents from the statement contained in the preface that this bulletin is to be regarded as a cancellation of the previously issued bulletins; he regards it as beyond the power of the committee to cancel its previous statements, which in his view inescapably remain authoritative expressions as at the date of their utterance.

Committee on Accounting Procedure (1952-1953)

Paul K. Knight,

Chairman

Frederick B. Andrews

Frank S. Calkins

H. A. Finney

Roy Godfrey

Thomas G. Higgins

John A. Lindquist

Perry Mason

Edward F. McCormack

John Peoples

Maurice E. Peloubet

John W. Queenan

Walter L. Schaffer

C. Aubrey Smith

C. Oliver Wellington

William W. Wernitz

Edward B. Wilcox

Raymond D. Willard

Robert W. Williams

Karl R. Zimmermann

Carman G. Blough,

Director of Research

INTRODUCTION

Accounting and the Corporate System

1. Accounting is essential to the effective functioning of any business organization, particularly the corporate form. The test of the corporate system and of the special phase of it represented by corporate accounting ultimately lies in the results which are produced. These results must be judged from the standpoint of society as a whole—not merely from that of any one group of interested persons.

2. The uses to which the corporate system is put and the controls to which it is subject change from time to time, and all parts of the machinery must be adapted to meet changes as they occur. In the past fifty years there has been an increasing use of the corporate system for the purpose of converting into readily transferable form the ownership of large, complex, and more or less permanent business enterprises. This evolution has brought in its train certain uses of the processes of law and accounting which have led to the creation of new controls, revisions of the laws, and reconsideration of accounting procedures.

3. As a result of this development, the problems in the field of accounting have increasingly come to be considered from the standpoint of the buyer or seller of an interest in an enterprise, with consequent increased recognition of the significance of the income statement and a tendency to restrict narrowly charges and credits to surplus. The fairest possible presentation of periodic net income, with neither material overstatement nor understatement, is important, since the results of operations are significant not only to prospective buyers of an interest in the enterprise but also to prospective sellers. With the increasing importance of the income statement there has been a tendency to regard the balance sheet as the connecting link between successive income statements; however this concept should not obscure the fact that the balance sheet has significant uses of its own.

4. This evolution has also led to a demand for a larger degree of uniformity in accounting. *Uniformity* has usually connoted similar treatment of the same item occurring in many cases, in which sense it runs the risk of concealing important differences among cases. Another sense of the word would require that different authorities working independently on the same case should reach the same conclusions. Although uniformity is a worthwhile goal, it should not be pursued to the exclusion of other benefits. Changes of emphasis and objective as well as changes in conditions under which business operates have led, and

doubtless will continue to lead, to the adoption of new accounting procedures. Consequently diversity of practice may continue as new practices are adopted before old ones are completely discarded.

Applicability of Committee Opinions

5. The principal objective of the committee has been to narrow areas of difference and inconsistency in accounting practices, and to further the development and recognition of generally accepted accounting principles, through the issuance of opinions and recommendations that would serve as criteria for determining the suitability of accounting practices reflected in financial statements and representations of commercial and industrial companies. In this endeavor, the committee has considered the interpretation and application of such principles as appeared to it to be pertinent to particular accounting problems. The committee has not directed its attention to accounting problems or procedures of religious, charitable, scientific, educational, and similar non-profit institutions, municipalities, professional firms, and the like. Accordingly, except where there is a specific statement of a different intent by the committee, its opinions and recommendations are directed primarily to business enterprises organized for profit.

Voting Procedure in Adopting Opinions

6. The committee regards the representative character and general acceptability of its opinions as of the highest importance, and to that end has adopted the following procedures:

- a. Any opinion or recommendation before issuance is submitted in final form to all members of the committee either at a meeting or by mail.
- b. No such opinion or recommendation is issued unless it has received the approval of two-thirds of the entire committee.
- c. Any member of the committee dissenting from an opinion or recommendation issued under the preceding rule is entitled to have the fact of his dissent and his reasons therefore recorded in the document in which the opinion or recommendation is presented.

7. Before reaching its conclusions, the committee gives careful consideration to prior opinions, to prevailing practices, and to the views of professional and other bodies concerned with accounting procedures.

Authority of Opinions

8. Except in cases in which formal adoption by the Institute membership has been asked and secured, the

authority of opinions reached by the committee rests upon their general acceptability. The committee recognizes that in extraordinary cases fair presentation and justice to all parties at interest may require exceptional treatment. But the burden of justifying departure from accepted procedures, to the extent that they are evidenced in committee opinions, must be assumed by those who adopt another treatment.

9. The committee contemplates that its opinions will have application only to items material and significant in the relative circumstances. It considers that items of little or no consequence may be dealt with as expediency may suggest. However, freedom to deal expediently with immaterial items should not extend to a group of items whose cumulative effect in any one financial statement may be material and significant.

Opinions Not Retroactive

10. No opinion issued by the committee is intended to have a retroactive effect unless it contains a statement of such intention. Thus an opinion will ordinarily have no application to a transaction arising prior to its publication, nor to transactions in process of completion at the time of publication. But while the committee considers it inequitable to make its statements retroactive, it does not wish to discourage the revision of past accounts in an individual case if it appears to be desirable in the circumstances.

The Company and Its Auditors

11. Underlying all committee opinions is the fact that the accounts of a company are primarily the responsibility of management. The responsibility of the auditor is to express his opinion concerning the financial statements and to state clearly such explanations, amplifications, disagreement, or disapproval as he deems appropriate. While opinions of the committee are addressed particularly to certified public accountants whose problem it is to decide what they may properly report, the committee recommends similar application of the procedures mentioned herein by those who prepare the accounts and financial statements.

Chapter 1

PRIOR OPINIONS

Section A—Rules Adopted by Membership

Below are reprinted the six rules adopted by the membership of the Institute in 1934, the first five of which had been recommended in 1933 to the New York Stock Exchange by the Institute's committee on cooperation with stock exchanges.

1. Unrealized profit should not be credited to income account of the corporation either directly or indirectly, through the medium of charging against such unrealized profits amounts which would ordinarily fall to be charged against income account. Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured. In the absence of the circumstances referred to above or other specific guidance, such as in FASB Statement No. 66, *Accounting for Sales of Real Estate*, the installment method is not acceptable. An exception to the general rule may be made in respect of inventories in industries (such as packing-house industry) in which owing to the impossibility of determining costs it is a trade custom to take inventories at net selling prices, which may exceed cost.

2. Capital surplus, however created, should not be used to relieve the income account of the current or future years of charges which would otherwise fall to be made thereagainst. This rule might be subject to the exception that where, upon reorganization, a reorganized company would be relieved of charges which would require to be made against income if the existing corporation were continued, it might be regarded as permissible to accomplish the same result without reorganization provided the facts were as fully revealed to and the action as formally approved by the shareholders as in reorganization.

3. Earned surplus of a subsidiary company created prior to acquisition does not form a part of the consolidated earned surplus of the parent company and subsidiaries; nor can any dividend declared out of such surplus properly be credited to the income account of the parent company.

4. [This paragraph has been deleted. See Status page.]

5. Notes or accounts receivable due from officers, employees, or affiliated companies must be shown separately and not included under a general heading such as notes receivable or accounts receivable.

6. If capital stock is issued nominally for the acquisition of property and it appears that at about the same time, and pursuant to a previous agreement or understanding, some portion of the stock so issued is donated to the corporation, it is not permissible to treat the par value of the stock nominally issued for the property as the cost of that property. If stock so donated is subsequently sold, it is not permissible to treat the proceeds as a credit to surplus of the corporation.