

siderably longer. Practicable yardsticks or criteria should be established in order that consistent distinctions may be made between fixed assets, operating expenses and maintenance. Ordinarily, this should be accomplished by creating a catalogue of property units to be included in fixed assets, any lesser items to be charged to current expense. Items no longer in service should be removed by charge to depreciation reserve or expense in order that fixed assets will represent the cost of properties in service.

Principle C-3. Appropriate provision or allowances should be made in order to charge operations with the investment in depreciable assets over the estimated life thereof. The accumulated allowances, less property retirements, should be shown as a deduction from fixed assets.

Principle C-4. Long-term investments in securities ordinarily should be carried at cost. When market quotations are available, the aggregate quoted amounts should be disclosed. Investments in affiliates should be segregated from other investments.

Principle C-5. The costs of intangible items, such as debt discount and expense, patents, copyrights, research and development (if deferred) and goodwill should be shown separately. Limited-term items should be amortized against earnings over their estimated lives. The policy in regard to amortization of unlimited-term intangibles should be disclosed.

Principle C-6. The nature and extent of hypothecated or pledged assets should be shown.

Objective D. Account for all known liabilities in a meaningful manner in order that their summarization, considered together with the statement of assets and equity invested by stockholders, will fairly present the financial position of the enterprise at the beginning and end of the period.

Principle D-1. All known liabilities should be recorded regardless of whether the definite amount is determinable. If the amounts cannot be reasonably approximated, the nature

of the items should be disclosed on the face of the summary of liabilities or by footnote.

Principle D-2. Current liabilities should include items payable within one year or at the end of the operating business cycle used in the classification of current assets. Accounts should be shown separately for notes payable to banks, notes payable to others, accounts payable (may include payrolls), Federal income taxes accrued, other accrued taxes, accounts or notes payable to officers, and accounts or notes payable to affiliates.

Principle D-3. Long-term liabilities should be described and due dates and rates of interest shown.

Principle D-4. The nature and extent to which specific liabilities are a preferred lien on assets should be shown.

Principle D-5. Deferred income should be separately classified and described.

Principle D-6. Contingent liabilities of importance should be disclosed.

Objective E. Financial statements should comply with the applicable reporting standards included in generally accepted auditing standards. Reporting to investors should be performed on an entity basis.

Principle E-1. Generally accepted reporting standards applicable to financial statements are set forth in Chapters 7, 8, 9 and 11 of Statements on Auditing Procedure No. 33, which are incorporated in this Inventory.

Principles E-2. Where there is a parent company and one or more subsidiaries, there is a presumption that consolidated statements are more meaningful than separate statements.

Principle E-3. The accounts of consolidated subsidiaries or divisions operating in foreign countries should be translated into dollars at the appropriate rates of exchange.

Principle E-4. Where two or more previously independent entities merge or otherwise combine in such a manner as to constitute a pooling of interests, the new entity inherits the bases of accountability of the constituent entities.

APPENDIX D

"ALTERNATIVE METHODS OF IMPLEMENTING GENERALLY ACCEPTED ACCOUNTING PRINCIPLES"

The following comprehensive list of alternative accounting methods is taken from PAUL GRADY, INVENTORY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR BUSINESS ENTERPRISES 373-79 (AICPA Accounting Research Study No. 7, 1965):

The following list of alternative methods does not purport to be all inclusive. The methods listed are not all of the same nature, some are truly "either-or" choices of management while others are applicable or not applicable depending on the circumstances. The latter illustrate the versatility of accounting to meet different conditions and to prevent financial and accounting abuses.

Revenue is recognized in the sale of products or services at the time of

1. Sale
2. Collection of sales price
3. Completion of product

Revenue is recognized in long-term contracting operations

1. At the time the contract is completed
2. Proportionately over performance

Cash discounts taken by customers on sales affect income

1. At the time of sale
2. At the time of collection

Excise taxes are

1. Included in sales and cost of sales
2. Excluded from the income statement

Pension payments made directly to retired employees are charged to expense

1. When payment is made
2. On an accrual basis over the period of service of the employees. There are several accepted actuarial cost methods which may be used as the basis for the accruals.

Pension payments made indirectly to retired employees through the medium of a fund are charged to expense

1. When payments are made to the fund
2. Normal or current cost on an accrual basis over the period of service of the employees. There are several accepted actuarial cost methods which may be used as the basis for the accruals.
3. So-called past service credits at time of adoption of plan—
 - (a) Not provided for, except as to interest
 - (b) Accrued over period permitted in Income Tax Code, over remaining service life of employees or over longer period such as total average service life of employees. Again, any one of several accepted ac-

tuarial cost methods of computation may be used.

Real and personal property taxes are charged against income of various periods

1. Year in which paid
2. Year ending on assessment (or lien) date
3. Year beginning on assessment (or lien) date
4. Calendar or fiscal year of taxpayer prior to assessment date
5. Calendar or fiscal year of taxpayer including assessment date
6. Calendar or fiscal year of taxpayer prior to payment date
7. Fiscal year of governing body levying the tax
8. Year appearing on tax bill

When items affecting taxable income are reported in financial statements and income tax returns in different periods

1. The tax effect is allocated between periods in the financial statements
2. The tax effect is not allocated between periods
3. The tax effect is allocated for some items but not for others

The investment income tax credit is

1. Spread over lives of the properties
2. Reflected as a reduction in income taxes currently

The following methods of depreciation are used to charge off the cost of depreciable assets over their estimated lives (which also vary considerably from company to company)

1. Straight-line
2. Decreasing charge (declining balance, sum-of-years' digits)
3. Increasing charge (annuity, sinking fund)
4. Production or "use" methods are also used by some companies.

Rates may be composite, group or by individual classes of assets, which introduce further variety in depreciation estimates.

Depletion provisions, designed to amortize the portion of development costs capitalized by extractive enterprises over future production of the developed resources, are determined by

1. A single composite rate
2. Group composite rates for major areas
3. Separate rates for individual tracts or leases

The estimates of the quantities of economically recoverable resources, obviously, are subject to substantial variations and uncertainties.

Extraordinary gains and losses are reported in

1. The income statement
2. The statement of retained earnings

Common stock dividends payable in common shares, the amount chargeable to retained earnings is

1. The fair market value if dividend is less than, say, 20 per cent of stock outstanding
2. Nothing if dividend is at a higher rate. It is then considered a stock split.

When property is distributed as a dividend to stockholders, the amount charged to retained earnings is

1. The book value of the property, or
2. The fair market value of the property

Inventory cost is determined under

1. Fifo
2. Lifo
3. Average cost
4. Base stock, and
5. Various combinations of these methods

In addition to the foregoing cost methods, standard costs are acceptable, if they approximate actual costs, and a zone of tolerance is permitted in undercapitalization of overhead costs; for example, some companies omit depreciation. Cost is reduced to market, where lower, and market means current replacement cost, except that (1) it should not exceed net realizable value, and (2) should not be less than net realizable value reduced by a normal profit margin. Market may be applied on an over-all basis or by individual items. Some companies in metal mining and meat packing carry inventories at market rather than cost.

Investments in unconsolidated subsidiaries are carried at

1. Cost
2. Cost, plus equity in undistributed earnings

Unlimited term intangibles, such as goodwill, not necessarily expected to have value over the entire life of the enterprise, are

1. Not amortized, but charged off when there is clearly no remaining value
2. Amortized over an arbitrary period

Research, development, and experimentation costs are

1. Accumulated as deferred charges and then amortized over an arbitrary, but relatively short period
2. Charged to expense as incurred

Unamortized discount and expense on bonds refunded is

1. Written off to income or retained earnings in the year of refunding
2. Amortized over the remaining life of original issue

Liabilities to trade creditors are recorded at

1. Gross invoice price not reduced for anticipated cash discount
2. Gross invoice price reduced for anticipated cash discount

Fixed assets. Properties acquired are recorded at (1) cost, (2) appraisal amounts, (3) original cost to first owner using them for utility purposes, in case of public utilities, (4) book value of previous owner in case of poolings.

Properties constructed are recorded at (1) direct costs only, (2) direct costs plus partial overhead costs, (3) direct costs plus all overhead costs, including interest on all funds used in the construction (funds from equity sources as well as debt).

Property retirement units are subject to selection or definition by each business entity. This establishes the boundary line between items to be capitalized and those to be charged to expense. Items to be capitalized may also be determined or affected by minimum dollar amounts. A company choosing larger retirement units, as compared with one choosing smaller units, over a period of years would have a larger part of its fixed assets reflected at older vintage dollar costs, and would therefore have relatively smaller depreciation charges and larger maintenance costs.

The "replacement and betterment" method used by railroads for roadway items (ties, rails and ballast) is closely related to selection of retirement units. The new costs of replacements equivalent in character to the old are charged to expense; betterments, such as heavier rail, etc., are capitalized only to the extent of the betterment, and the carrying amounts of the roadway items are not depreciated. The method is also used by other utilities and industrials where parts

of existing units are replaced with parts having greater capacity or versatility.

Property conversion and abandonment losses are

1. Charged to expense or retained earnings, if substantial, by industrial entities
2. Often deferred and amortized over future periods by utilities, if permitted by the regulatory commissions

Containers are

1. Capitalized and depreciated over estimated life
2. Capitalized to extent of customer deposits and excess of cost over deposit charged immediately to expense

Spare parts of machinery are

1. Carried in fixed assets
2. Included, by some companies, in inventories

Patterns, jigs and small tools are

1. Capitalized and depreciated over estimated lives
2. Carried at estimated depreciated values as determined by inspection from time to time
3. Charged to expense as purchased

Development costs of extractive industries are

1. Capitalized and allocated to future production through depletion charges
2. Capitalized but not charged to future income statements through depletion (certain mining enterprises)

3. Capitalized in part and the remaining part charged to expense currently; the portion capitalized is allocated to future production through depletion charges

Material leases of properties in the accounts of the lessee are

1. Capitalized and depreciated if they are, in substance, installment purchases
2. Other lease rentals are charged to expense with suitable disclosure of lease commitments

Repair and renewal costs are

1. Charged to expense when incurred
2. Periodically accrued in advance of expenditures to "normalize" charges between periods

Fire losses, when the enterprise carries no fire insurance, are

1. Charged as a loss when incurred
2. Periodically accrued in advance of actual losses

Business combinations are treated as

1. Poolings, in which book values of assets of constituent companies are carried forward
2. Purchases, thereby establishing a new cost or fair market value for the assets acquired by the dominant and continuing corporation

