

ACCOUNTING UNIFORMITY IN THE REGULATED INDUSTRIES

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I

INTRODUCTION

In the search for an answer to the dilemma of uniformity or comparability versus flexibility in financial accounting, the experience of the regulated industries is often cited by those on either side of the question. The regulated companies require large amounts of capital and therefore are the subject of extensive investor interest. Regulated-company financial reporting to the public is, for the most part, based upon prescribed classifications of accounts, leading to the presumption that their reports are uniform not only as to cost classifications but also as to accounting principles or standards used. Yet, on the other hand, much of the criticism of present-day reporting to investors is directed at these same regulated industries.

Does, then, experience in the regulated industries, which are subject to various regulatory accounting rules, support the desirability and possibility of achieving greater uniformity (in the sense of comparability) in financial reporting by regulated companies and by other industrial and commercial corporations? We will examine this question here. To do so, it will be helpful to the uninitiated to review the industries that are regulated; the institutional form of regulation; the history and purposes behind the various uniform systems of accounts; the uses made of such classifications of accounts both in regulation and in financial reporting to the public; differences between those accounting principles embodied in the uniform systems and the so-called "generally accepted accounting principles"; differences among the various uniform systems; and the underlying causes of these differences. Finally, conclusions will be drawn as to whether the experience with prescribed systems of accounts indicates the desirability and feasibility of seeking greater comparability in financial reporting generally.

A. The Historical Argument Over Uniformity

The uniformity dilemma in the regulated industries almost predates accounting as a profession. In 1886, the report of the Cullom Committee of the Senate¹ in-

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¹ Senate Select Comm. on Interstate Commerce, *The Regulation of Interstate Commerce by Congress*, S. REP. No. 46, 49th Cong., 1st Sess. pt. 2 (1886). The Committee on Interstate Commerce held

cluded comments by a number of parties in response to a circular sent out by the committee. Question twelve in the circular read, "Should corporations engaged in interstate commerce be required to adopt a uniform system of accounts?"² The following favorable responses could just as well have been written today as almost a century ago:

1. [T]he advantage of the uniformity and simplicity thereby secured is indispensable to a proper comparison of the results of operation.³
2. Unless such uniform system of accounts was kept, it would be impossible for the commissioners or their clerk to know what the actual net earnings of the company were.⁴

And those who oppose increased comparability in financial statements today do so in terms almost the same as those used eighty years ago:

1. [I]t would be very difficult, if not impossible, for all transportation companies to adopt a uniform system of accounts. Many things incident to the accounts of one company do not appear or belong in those of another. . . . I do not think a uniform system of accounts could be adopted by all corporations engaged in interstate commerce, nor do I regard it as important they should.⁵
2. From one point of view, a uniform system [of accounts] would serve many advantages under all circumstances, but upon general principles I am so much opposed to limiting the scope and actions of individuals that I think we could forego many obvious advantages for the indirect benefit that results from every citizen being allowed to use his intellect in his own way and compete with all others for better results. *It encourages originality and develops ingenuity.*⁶

B. The Function of Financial Reports

Because the area under discussion is uniformity and comparability in financial reporting to the public, it is necessary, as a starting point, to assess briefly the objectives and uses of financial statements. The basic function of accounting and financial reporting in the public area is to provide information, through the medium of financial statements, that investors in their individual circumstances can use to make informed decisions with respect to buying and selling their interests and that creditors can use for their purposes. Other segments of the public, such as customers, employees, and government, also have an interest in the financial affairs of a business.

hearings on the regulation of interstate commerce (principally railroads) and proposed certain legislation, which eventually resulted in the Interstate Commerce Act of 1887, 24 Stat. 379 (codified in scattered sections of 49 U.S.C.).

² Senate Select Comm. on Interstate Commerce, *supra* note 1, at app. 2.

³ *Id.* at 45 (joint statement by William McPherson, Jr., Commissioner of Railroads, and Wyllys C. Ransom, Deputy Commissioner, State of Michigan).

⁴ *Id.* at 52 (statement of W. L. Bragg, President of the Alabama Railroad Commission).

⁵ *Id.* at 91 (statement by General George B. Wright, former Railroad Commissioner of Ohio).

⁶ *Id.* at 155 (statement of W. G. Raoul, President of the Central Railroad and Banking Company). (Emphasis added.)

The decisions of investors involve the process of choice—choosing to buy or not to buy, or to sell or not to sell, an interest in any one business enterprise. The investment decision must be made by reference not to the one enterprise but to all others that are available. Thus, the financial information about itself that a business discloses will be substantially useful only if that information provides a basis for comparing that business with others. Thus there is now a widely recognized need in the investing community not only for publication of financial information about businesses but also for the publication of reports that disclose essential factual differences and are therefore “comparable” in some degree. Debate continues over the form of disclosure of particular financial facts and the degree of comparability that can and should reasonably be required.

II

THE REGULATED AND THE REGULATORS

For the purposes of this discussion, “regulated industries” are those regulated as to rates. These include service utilities (electric, gas, telephone, water, and so forth) and transportation utilities (railroads, airlines, trucking, pipelines, and so forth). There are other industries that are subject to some degree of regulation by state or federal agencies, notably insurance and banking institutions, that are not discussed here. Although there is an element of price control over these other industries and some authority is exercised over their accounting, it would appear that the conclusions to be drawn from their experiences would not affect the conclusions reached here.

Initially, most regulation was performed at the state or local level, but, with the increasing complexities of commerce, federal regulation was instituted to cover matters that could not be reached by state and local regulation. Today almost all states have some form of regulatory commission, the vast majority of which have rate and service control over at least some public utilities operating within the state. The federal agencies that exercise the greatest degree of control over regulated industries are the “consumer protectors,” the Federal Power Commission (FPC), the Federal Communications Commission (FCC), the Civil Aeronautics Board (CAB), and the Interstate Commerce Commission (ICC), and the “investor protector,” the Securities and Exchange Commission (SEC).

The Federal Power Act⁷ gives the FPC regulatory jurisdiction over companies engaged in the sale of electric energy at wholesale in interstate commerce. Similar authority over companies engaged in the interstate transmission of natural gas sold for resale is conferred on the FPC by the Natural Gas Act.⁸ Under the authority of

⁷ 49 Stat. 847 (1935), as amended, 16 U.S.C. §§ 791(a), 824-24h, 825-25r (1964).

⁸ 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-17(w) (1964).

statutes that it administers,⁹ the FPC has issued uniform systems of accounts for electric companies and natural gas companies.¹⁰ In addition, its chief accountant has recently adopted the practice of issuing accounting releases setting forth interpretations of its uniform systems of accounts.¹¹

The FCC has jurisdiction over interstate telephone and telegraph rates¹² and has prescribed uniform systems of accounts.¹³ The CAB regulates the routes and rates of air carriers¹⁴ and has prescribed uniform systems of accounts for such companies.¹⁵ The ICC regulates the interstate transportation by common carriers of passengers or property by railroads, motor carriers (truck and bus lines), inland water carriers, and pipelines (except those transporting natural gas or water). The Interstate Commerce Act authorizes the ICC to prescribe uniform systems of accounts for railroads, pipelines, motor carriers, carriers by water, freight forwarders,¹⁶ and the Commission has promulgated a system for each such industry.¹⁷

The Public Utility Holding Company Act of 1935 invested the SEC with extensive control over the accounting followed by a limited number of public utility holding company systems having electric or gas utilities as subsidiaries,¹⁸ and the Commission has prescribed a uniform accounting system for such holding companies.¹⁹ Since securities of utilities are usually publicly held, the registration, reporting, and proxy-solicitation provisions of the Securities Act of 1933²⁰ and the Securities Exchange Act of 1934²¹ would ordinarily apply to, and therefore be of more significance to, most regulated companies. However, the Securities Act exempts from the provisions thereof carrier securities the issuance of which is subject to regulation by the ICC,²² and prohibits the SEC from prescribing accounting requirements inconsistent with those prescribed by the ICC in the case of other carriers.²³ Under the Securities Exchange Act, the SEC is prohibited from prescribing accounting requirements for any company that are inconsistent with those prescribed for that company by any other federal agency.²⁴

⁹ Federal Power Act § 302, 49 Stat. 855 (1935), 16 U.S.C. § 825a(a) (1964); Natural Gas Act § 8, 52 Stat. 825 (1938), 15 U.S.C. § 717g(a) (1964).

¹⁰ 18 C.F.R. pts. 101, 104, 105, 204, 205 (1961 and Supp. 1965).

¹¹ See J. Accountancy, Feb. 1965, p. 14.

¹² Communications Act of 1934, § 220(a), 48 Stat. 1078, 47 U.S.C. § 220(a) (1964).

¹³ 47 C.F.R. pts. 31, 33, 34, 35 (1965).

¹⁴ Federal Aviation Act of 1958, § 407(e), 72 Stat. 766, 49 U.S.C. § 1377(e) (1964).

¹⁵ 14 C.F.R. pt. 241 (1964).

¹⁶ § 20(5), 54 Stat. 917 (1940), as amended, 49 U.S.C. § 20(5) (1964).

¹⁷ 49 C.F.R. pts. 10, 14, 18, 20, 24 (1963 and Supp. 1965); pts. 181, 182, 184, 323, 324, 440 (1964 and Supp. 1965).

¹⁸ § 15(a), 49 Stat. 828 (1935), 15 U.S.C. § 790(a) (1964).

¹⁹ 17 C.F.R. pts. 256, 257 (1964).

²⁰ 48 Stat. 74, as amended, 15 U.S.C. §§ 77a-aa (1964).

²¹ 48 Stat. 881, as amended, 15 U.S.C. §§ 78a-hh (1964).

²² § 3(a)(6), 52 Stat. 1240 (1938), 15 U.S.C. § 77c(a)(6) (1964).

²³ § 19(a), 48 Stat. 85, as amended, 15 U.S.C. § 77s(a) (1964).

²⁴ § 13(b), 48 Stat. 894, 15 U.S.C. § 78m(b) (1964).

III

REGULATORY AUTHORITY OVER FINANCIAL REPORTING

The legislative background of the federal regulatory statutes is crammed with evidence that Congress was of the opinion that uniform accounting and reporting were necessary *within the respective industries* if the agencies were to carry out their responsibilities. Although Congress has granted the FPC, FCC, CAB, and ICC the authority to specify the reports they wished to be filed with them, we can find no evidence that Congress ever expressly stated that these agencies were granted authority over financial reports to investors and the general public. However, as indicated below, the courts have found such congressional intent in the Federal Power Act.

Each of the four agencies has taken a somewhat different position on the question of conforming reports to stockholders and the public with the agency's uniform system of accounts. The FPC has recently taken the position that reports to stockholders must conform to the accounting requirements set forth in its uniform systems of accounts. That the Commission's jurisdiction extends into this area was established in 1964 when its newly taken position was upheld by a federal court of appeals in the *Appalachian Power Company* case.²⁵ Arthur L. Litke, who became Chief Accountant of the FPC subsequent to the time its position in the *Appalachian* case was established, commented as follows on that decision in a recent address:

The Appeals Court held that the Federal Power Commission's systems of accounts are to be regarded as the basic accounts in cases where there may be conflict with those prescribed by state commissions. In addition, the Appeals Court affirmed the Commission's authority to insist that utility stockholder reports conform to Federal Power Commission accounting procedures. The decision is another in a series of cases in which the Commission has been sustained on fundamental questions concerning the force and effect of its prescribed systems of accounts. By refusing to review the case, the Supreme Court has left, in effect, the suggestion of the Appeals Court that the Federal Power Commission take full advantage of the authority given to it by the Federal Power Act. Obviously, the decision and how the Commission will now proceed is vitally important. Looking beyond the statutory command, there is an obvious challenge to the Commission to impose accounting standards which are balanced with the general needs and interests of government, management, and investors.

The *Appalachian* decision affirms the Commission's responsibility to review the financial statements of jurisdictional companies in their reports to stockholders and to the public. As yet, however, the Commission has not formulated any definite procedures for carrying out this responsibility. The accounting profession is of great influence in improving financial statements to the end that accounting nonconformities are eliminated or reduced in number. In this respect cooperation of the profession will assuredly be sought by the Commission.²⁶

²⁵ *Appalachian Power Co. v. FPC*, 328 F.2d 237 (4th Cir.), *cert. denied*, 379 U.S. 829 (1964).

²⁶ Address before the Federal Government Accountants Association Symposium, June 17, 1965. See J. Accountancy, Aug. 1965, pp. 10-14.

The general direction in which the FPC now intends to move may be indicated by the series of letters sent by the Commission in early 1965 to a number of electric companies commenting upon the companies' 1963 reports to stockholders. While for the most part these comments related to minor matters that would not affect the usefulness of such reports to the investing public, they do indicate that the Commission intends to exercise actively its newly established power.

The FCC has not extended its authority to financial statements furnished to stockholders or other parties; relatively few telephone companies are subject to the Commission's jurisdiction, most being subject only to state regulation. Neither has the CAB attempted to exercise authority over or to prescribe the form and content of published financial reports. The prescribed annual report to the CAB includes a schedule for reconciling such report with the statements on which the independent public accountants have given their opinion, clearly indicating that this agency recognizes a distinction between its reporting requirements and those of the investing public.

In 1960, the ICC issued a proposed rule that would have prohibited carriers subject to its accounting regulation from including in their published reports financial statements that were inconsistent with the corporate books maintained in conformity with the applicable uniform system of accounts. This proposed rule was issued in response to a petition filed by Arthur Andersen & Co. requesting a rule or decision as to whether the uniform systems of accounts for railroads and other carriers applied to the financial statements included in published reports or whether carriers were free to publish statements prepared in accordance with generally accepted accounting principles. Many organizations, including Arthur Andersen & Co., responded in opposition to the proposed rule making, and on January 25, 1962, the ICC reversed its course by issuing an order stating that

Carriers desiring to do so may prepare and publish financial statements in reports to stockholders and others, except in reports to this Commission, based on generally accepted accounting principles for which there is authoritative support, provided that any variance from this Commission's prescribed accounting rules contained in such statements is clearly disclosed in footnotes to the statements.²⁷

A few railroads and a number of other carriers subject to the Commission's jurisdiction have adopted the practice permitted by this rule, primarily in regard to the reporting of deferred income taxes. However, the majority of railroads continue to report to their stockholders in accordance with the accounting requirements of the ICC.²⁸

The SEC possesses, in addition to its extensive but largely unexercised statutory authority over accounting methods employed by securities issuers registering with it,²⁹

²⁷ ICC Order No. 33581, 49 C.F.R. § 25.1 (1964).

²⁸ See notes 16-17 *supra* and accompanying text.

²⁹ The SEC's powers to prescribe accounting rules for companies registering with it are specific and

broad accounting powers under the Public Utility Holding Company Act.³⁰ Regulations under this act provide that "no registered holding company or subsidiary company thereof shall distribute to its security holders or publish financial statements which are inconsistent with the book accounts of such company or financial statements filed with" the Commission.³¹ To require each company or subsidiary company to publish only financial statements consistent with its own book accounts does not necessarily produce uniformity or comparability unless the books and records of each company are required to be kept under the same accounting rules and principles. In fact, neither uniformity nor comparability has resulted from this rule.

Generally, state regulatory commissions have not formally required that reports to stockholders conform to their uniform systems of accounts. However, because utilities are ordinarily corporate citizens of the states in which they do business and must have their financings approved, there is some obligation to observe the accounting prescribed by the state authority.

IV

HISTORY OF THE DEVELOPMENT OF UNIFORM SYSTEMS OF ACCOUNTS

A. Massachusetts' Early System

Some control of accounting and reporting has been granted by statute to regulatory agencies almost from their inception in order to assist them in carrying out their functions. Reflecting the widespread belief that accounting control is an

sweeping. Securities Act of 1933, § 19(a), 48 Stat. 85, as amended, 15 U.S.C. § 77s(a) (1964). However, the Commission has, for the most part, chosen to abstain from the use of this broad authority and has instead relied for investor protection on the customary practices of business and the alternatives considered acceptable by the accounting profession. The present Chairman, Manuel F. Cohen, has stated the policy this way:

"No one can dispute the assertion that the Commission has the power to decree 'acceptable' accounting principles and practices. I think it is common knowledge that we have, at various times, been urged to do just that. However, from its inception, the Commission has preferred cooperation with the profession to governmental action, and has actively encouraged accountants to take the initiative in regulating their practices and in setting standards of conduct. In response, the profession, although not the recipient of delegated power (as are the NASD and the stock exchanges), has performed an important service as a self-regulatory institution."

Cohen, *Current Developments at the SEC*, 40 ACCOUNTING REV. 1, 5-6 (1965).

While the SEC's policy has been restrained to a considerable degree, it has not been entirely passive. Through meetings, correspondence, and speeches, members of the SEC staff and individual commissioners have encouraged improvement in specific areas. In addition, its 102 Accounting Series Releases have dealt with significant accounting principles and practices.

On occasion, the Commission's pronouncements have fostered noncomparability in reporting, such as the one that allowed immediate "flow-through" of the investment tax credit as an alternative to the theoretically preferable "service-life" method, because of the "substantial diversity of opinion which exists among responsible persons." SEC Accounting Ser. Release No. 96, Jan. 10, 1963. On the other hand, the Commission's recent pronouncement on the balance-sheet classification of deferred income taxes arising from installment sales (SEC Accounting Ser. Release No. 102, Dec. 7, 1965) is a significant contribution in the direction of comparability in reporting. See generally Pines, *The Securities and Exchange Commission and Accounting Principles*, *supra*, pp. 727-51, at 729-41.

³⁰ § 15(a), 49 Stat. 828, 15 U.S.C. § 790(a) (1964).

³¹ 17 C.F.R. § 250.28 (1964).

essential part of the regulatory process, the Montana Public Service Commission recently stated: "A prescribed system of accounts is a prerequisite to effective control of utilities by a regulatory body."³² As stated in the same decision, in connection with a discussion of the history of uniform system of accounts,

The first step toward uniform public utility accounting was taken in 1876 by Massachusetts, which directed its board of railroad commissioners to "Prescribe a system in which the books and accounts of corporations, operating railroads or street railways should be kept in a uniform manner."³³

The Massachusetts Board had been established in 1869, and required an annual report for each railroad. By 1875 the Board was moved to state the following:

For several years past the Commissioners have in each of their annual reports, freely criticised the methods of book-keeping in use by the various railroad corporations of the State, and the character of the returns [reports] made from them. The railroad returns are, and must continue to be, essentially unreliable, if not even deceptive, until a radical reform in the methods of railroad book-keeping is effected. . . . [A]s long ago as the year 1846, only eleven years after the first three roads were opened in Massachusetts, the corporations were called upon by a general law for annual statements of their doings and condition, which since then have been published as part of the records of the State. . . . Neither has provision ever been made in Massachusetts, or elsewhere, to secure any uniformity in the books and the methods of keeping them, which lie behind the returns. A system might indeed be prescribed by law, and in some cases has been, but the carrying out of the system is left practically in the discretion of the several corporations. . . .

. . . In the popular mind it is naturally supposed that, as the results are uniform, the methods through which they are arrived at are likewise uniform, and it requires very considerable familiarity with railroad accounts to see that this is not the case.³⁴

After citing a number of examples of alternative methods (such as charging either property or income when replacing iron rails with steel rails), the Railroad Commissioners' Report stated, "There is but one remedy for such a condition of affairs; that, however, is a very obvious one. It will be found in an increased publicity and more perfect uniformity."³⁵

B. The Interstate Commerce Commission

The initial attempts at railroad regulation were made through state agencies, but their attempts were considered ineffective. The laws were crudely drawn, and conflicts arose between the states because nearly three-fourths of all railroad traffic was interstate. In 1886, the Supreme Court, in the *Wabash* case,³⁶ spelled the end of any successful state control, pointing up the fact that federal action would be neces-

³² Montana Power Co., 42 P.U.R.3d 241, 253 (Mont. Pub. Serv. Comm'n 1962).

³³ *Id.* at 252.

³⁴ MASSACHUSETTS BOARD OF RAILROAD COMM'RS, SEVENTH ANN. REP. 25-26 (1876).

³⁵ *Id.* at 34.

³⁶ *Wabash, St. L., & P. Ry. v. Illinois*, 118 U.S. 557 (1886).

sary to provide railroad regulation. Even before the *Wabash* decision, Congress had investigated railroad regulation with the appointment in 1872 of the Windom Committee of the Senate. A recommendation of this committee was the establishment of a "Bureau of Commerce," which would

be clothed with authority of law, under regulations to be prescribed by the head of such Department, to require each and every railway and other transportation company engaged in inter-state transportation to make a report, under oath, of the proper officer of such company, at least once each year, which report should embrace, among other facts, the following, namely: . . . A full and detailed statement of receipts and expenditures, including the compensation paid to officers, agents, and employees of the company.³⁷

The "Act to Regulate Commerce" was finally passed and signed by President Cleveland on February 4, 1887.³⁸ The Cullom Committee Report, upon which the act was largely based, recommended that the Commission

should be empowered to prescribe the manner in which such corporations shall keep their accounts, and to require of them uniform reports at such times as they may designate and upon such subjects as they may deem of public interest.³⁹

Although authorized by the 1887 Act to "prescribe (if in the opinion of the Commission it is practicable to prescribe such uniformity and methods of keeping accounts) . . . a uniform system of accounts,"⁴⁰ the Commission made no effective use of its authority. However, in 1905 it apparently was believed by Congress that a uniform system would facilitate the work of the Commission:

It was . . . a recognition of the difficulty which even an expert accountant would experience in undertaking the investigation of a strange system of accounts, that led to the proposal that the Commission be authorized to prescribe the form and method of accounting for the carriers.⁴¹

In 1906, the Hepburn Act⁴² amended section 20 of the Interstate Commerce Act in order to clothe the Commission with investigative and enforcement authority over railroad accounting. The amended section 20 no longer included the parenthetical phrase conditioning accounting regulation on the Commission's opinion of its practicability, and its deletion may have indicated that Congress no longer had any doubts on this score.⁴³ In 1907, the ICC prescribed a uniform system of accounts for railroads.

³⁷ Senate Select Comm. on Interstate Commerce, *Transportation Routes to the Seaboard*, S. REP. NO. 307, 43d Cong., 1st Sess. 241-42 (1874).

³⁸ 24 Stat. 379 (1887) (codified in scattered sections of 49 U.S.C.)

³⁹ Senate Select Comm. on Interstate Commerce, *The Regulation of Interstate Commerce by Congress*, S. REP. NO. 46, 49th Cong., 1st Sess. 214-15 (1886).

⁴⁰ Interstate Commerce Act § 20, ch. 104, 24 Stat. 386 (1887).

⁴¹ Senate Select Comm. on Interstate Commerce, *Digest of Hearings on Railway Rates*, S. Doc. No. 244, 59th Cong., 1st Sess. 97 (1905).

⁴² § 7, ch. 3591, 34 Stat. 593 (1906).

⁴³ See Senate Select Comm. on Interstate Commerce, *Regulation of Railroad Rates*, S. Doc. No. 292, 59th Cong., 1st Sess. 35 (1906).

Delegation by Congress to the Commission of authority to prescribe a uniform system of accounts was upheld by the Supreme Court. In overruling a railroad that had sought to enjoin enforcement of ICC accounting regulations as "unreasonable," the Supreme Court in 1913 made a short and simple statement of the case for a uniform system of accounts:

Congress, in authorizing the Commission to prescribe a uniform system of accounts, recognized that accounting systems were not then uniform; and in reiterating this authorization in 1906, and adding a prohibition against the keeping of other accounts than those prescribed, manifested a purpose to standardize and render uniform the accounts of the different carriers with respect to matters that entered into property and the improvements thereof, on the one hand, and the current operations of the company, on the other. . . . Plainly, the law-making body recognized the essential distinctions between property accounts and operating accounts, between capital and earnings; it recognized that the practice of different carriers varied in respect to these matters; and that *no system of supervision and regulation would be complete without requiring the accounts of all the carriers to speak a common language*.⁴⁴

In 1913, the Interstate Commerce Commission established uniform accounting procedures for interstate telephone companies over which it then had jurisdiction.

C. Developments in State Regulatory Commissions

State commission accounting regulation appeared to spring from alleged abuses of the time. In New York, an investigating committee appointed by the state legislature reported a gross abuse due to overcapitalization and manipulation of securities for the purpose of unifying control and eliminating competition.⁴⁵ The committee also found that millions had been invested in securities that were earning no dividends and that were intrinsically worthless. As a result of the committee's investigation, a state commission was established in 1906 to supervise gas and electric utilities. In 1907 a public service commission was formed, and control of public utilities was transferred from the municipalities to this agency of the state government.

In 1905, Wisconsin enacted a comprehensive railroad regulation law that established the principle of regulation by an appointive commission as well as much of the regulatory procedure. In 1907, Wisconsin extended the provisions of the 1905 law to street railways and telephone companies and brought heat, light, water, power, and telephone companies under the Commission's jurisdiction. In 1909, the New York and Wisconsin commissions both prescribed uniform systems of accounts for gas and electric utilities. By the end of 1915, twenty-three states had adopted uniform systems of accounts. As would be expected, there were many variations among the various state systems.

⁴⁴ *Kansas City So. Ry. v. United States*, 231 U.S. 423, 442-43 (1913). (Emphasis added.)

⁴⁵ See WILLIAM E. MOSHER & FINLA G. CRAWFORD, *PUBLIC UTILITY REGULATION* (1933).

In 1919, the National Association of Railway and Utilities Commissioners (NARUC), recognizing the desirability of uniformity among states with respect to gas and electric companies, stated that it planned to present a "report on uniformity of classifications of accounts and report forms for gas and electric companies with the purpose in mind of attempting to bring closer together the classifications and forms prescribed by the various state commissions."⁴⁶ The NARUC supported uniformity as a basis of arriving at useful comparative figures, as a means of eliminating wasteful duplication of records by utilities operating in more than one state, and as a method of training and developing competent professional staff accountants and statisticians. However, the NARUC Committee on statistics and accounts stated that "different laws and different policies, to say nothing of different local conditions, will make necessary, to some extent, different accounting requirements in different states."⁴⁷ By 1922 the NARUC had agreed upon electric and gas systems of accounts. Although these systems provided uniformity in some matters, there continued to be substantial variations among states; some states, for example, required or permitted depreciation accounting, while others accepted retirement accounting.

D. Federal Action Deemed Necessary to Correct Abuses of the 1920s

The 1920s were a period of expansion and consolidation by public utilities and saw the rise of public utility holding companies. The financial abuses that occurred during this period are documented in the historical reports issued by the Federal Trade Commission covering its investigation from 1928 to 1935. According to these reports, these abuses included the following:

(2) Loading the fixed capital account of public utilities with arbitrary or imaginary amounts in order to establish a base for excessive rates.

(3) Writing up the fixed assets without regard to the cost thereof, with the result of watering the stock or creating a fictitious surplus.

....

(7) Manipulating the security markets to deceive stockholders, bondholders, or potential purchasers of its securities.

....

(10) Misstatement of earned surplus, or failure to distinguish earned from capital surplus, and making payment of dividends from the latter.

....

(13) Deceptive or unsound methods of accounting for assets and liabilities, costs, operating results and earnings, including write-ups unrealized or fictitious profits, stock dividends, etc.⁴⁸

⁴⁶ NARUC, PROCEEDINGS OF THE 31ST ANNUAL CONVENTION 100 (1919) (quoting from letter from U. G. Powell to Charles E. Elmquist).

⁴⁷ NARUC, PROCEEDINGS OF THE 32D ANNUAL CONVENTION 283 (1920).

⁴⁸ FTC, *Summary Report on Utility Corporations*, S. Doc. No. 92, pt. 73-A, 70th Cong., 1st Sess. 62 (1935).

One of the reasons declared by Congress for establishing control of public utility holding companies was that

investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers [holding companies and their subsidiaries], because of the absence of uniform standard accounts.⁴⁹

This emphasis here on the interest of investors in uniform accounting is particularly to be noted.

The Federal Trade Commission reports concluded that federal regulation of electric companies was necessary to fill the gap that state regulation could not reach. The FTC favored legislation that would "require proper accounting with respect to the values of assets, whether in plant or in security investments, and also with respect to actual income and net profit . . ."⁵⁰ Among the specific recommendations of the FTC was one that "the appropriate agency should also be granted power to make and enforce regulations as to uniform accounting, providing for proper allowances for reserves, depreciation, etc."⁵¹ Adoption by Congress of the Federal Power Act, in the light of the Federal Trade Commission's citation of inadequate depreciation reserves and other abuses, constituted a directive to the FPC, the agency ultimately designated to carry out many of the reforms in the 1935 legislation, to *require* adequate reserves.

The Senate committee report recommending enactment of the Public Utility Holding Company Act stated that its accounting provisions took "a long step in the direction of the uniform accounting which is so essential in the electric industry."⁵² Representative Lea in debate in the House stated, "One of the main difficulties in regulatory control from which we have suffered in the last few years has been lack of an accounting system that was faithful to the facts."⁵³

E. Courts Uphold Regulatory Control

Control over accounting matters by federal regulatory agencies has been firmly established by the Supreme Court in several decisions involving the different federal agencies.⁵⁴ For example, in 1934 the jurisdiction over interstate telephone and telegraph companies was transferred from the ICC to the FCC, and the FCC prescribed a uniform system of accounts to be effective January 1, 1936. American Telephone & Telegraph Company objected to certain provisions of the new system,

⁴⁹ Public Utility Holding Company Act of 1935, § 1(b)(1), 49 Stat. 803, 15 U.S.C. § 79a(b)(1) (1964).

⁵⁰ FTC, *supra* note 48, at 65.

⁵¹ *Id.* at 74.

⁵² Senate Select Comm. on Interstate Commerce, *Public Utility Act of 1935*, S. REP. No. 621, 74th Cong., 1st Sess. 53 (1935).

⁵³ 79 CONG. REC. 10574 (1935).

⁵⁴ Already discussed in connection with ICC accounting regulation was *Kansas City So. Ry. v. United States*, 231 U.S. 423 (1913). See note 44 *supra* and accompanying text.

including the requirement for "original cost." The Supreme Court, in upholding the FCC, stated that a reviewing court

is not at liberty to substitute its own discretion for that of administrative officers who have kept within the bounds of their administrative powers. To show that these have been exceeded in the field of action here involved, it is not enough that the prescribed system of accounts shall appear to be unwise or burdensome or inferior to another. Error or unwisdom is not equivalent to abuse. What has been ordered must appear to be "so entirely at odds with fundamental principles of correct accounting" . . . as to be the expression of a whim rather than an exercise of judgment.⁵⁵

F. Historical Reasons for Accounting Control and Uniform Systems of Accounts

The historical development of the uniform systems of accounts, covered only briefly here, leads to these conclusions:

1. Regulatory commissions were usually created to cure either specific abuses or deficiencies or to offset the effect of decreased competition. The abuses and deficiencies included, among others, misleading or inadequate financial reporting, inadequate service, and excessive or discriminatory rates. Stemming from this background, administrative action, including promulgation of accounting regulations, has tended toward the prevention of specific abuses rather than toward the promotion of objective, sound accounting.⁵⁶

2. Periodic reporting of financial information, rates, statistical data, and so forth, by the regulated to the regulators has been considered an essential part of regulation from the beginning. Legislators and regulators soon concluded that a uniform system of accounts for reporting to regulators was advisable. However, as is demonstrated more fully below, the adoption of separate and different uniform systems of accounts by the various regulatory agencies has not achieved comparability in financial reporting among companies that are regulated by different agencies. Similarly, comparability with nonregulated companies has not been achieved.

V

REGULATORY USE AND MISUSE OF A UNIFORM SYSTEM OF ACCOUNTS

Having been empowered by legislation to prescribe uniform systems of accounts, and having done so, what uses have regulatory agencies made of the various uniform systems?

One of the primary uses of the uniform systems of accounts has been to accumulate statistical data of a particular industry that is ostensibly comparable.⁵⁷ Federal

⁵⁵ *American Tel. & Tel. Co. v. United States*, 299 U.S. 232, 236-37 (1936).

⁵⁶ We may now be entering a period in which many regulatory agencies may be adopting an aggressive rather than a preventive approach to regulation, since there have been few dragons to slay in the last 25 years.

⁵⁷ In its 1964 annual report, the FPC named as one of its functions that it "gathers, analyzes, maintains, and publishes information concerning the electric power industry generally." FPC ANN. REP. 15 (1964).

regulatory agencies and many state agencies prepare statistical summaries⁵⁸ from the annual reports submitted to them by each regulated utility.⁵⁹ The summaries usually include financial data prepared on the basis of the accounts as prescribed in the uniform system, as well as technical data such as equipment capability and performance. To the extent that each reporting utility interprets the reporting requirements in the same manner, the uniform or standardized reporting regulations unquestionably produce data that is consistent enough for some reasonable uses. For example, electric production statistics summarizing fuel costs, cost per installed kilowatt, and so forth, are considered to be reasonably comparable. These data are used extensively by industry groups in developing long-range forecasts and plans. The FPC's *National Power Survey*⁶⁰ issued in 1964 illustrates a use of this data by regulatory authorities.

These annual reports are also used by regulators as the starting point in evaluating the reasonableness of the rates. From such reports, an agency can make roughly comparable calculations as to the return on the net original cost of plant investment or capitalization being earned by each utility under the reporting requirements prescribed by the agency.

Reporting data in accordance with a uniform system of accounts does not, of course, mean that the facts being reported upon are necessarily uniform. In fact, the very reason that investors and others make comparisons between utility companies is because the conditions under which each utility operates do vary, and it is only through the application of uniform principles and standards in connection with accounting for and reporting upon the facts surrounding each utility's operations that these variations can be compared in a meaningful manner. However, regulatory agencies have on occasion utilized data reported pursuant to a uniform system of accounts as a means of putting a group of utilities on a "uniform" basis when, in fact, such utilities are not uniform. Several examples can be cited to illustrate that the misuse of data in this manner destroys rather than achieves comparability.

The FPC periodically summarizes, from the annual reports submitted to it, the depreciation rates used by electric and natural gas companies.⁶¹ The composite rate by functional property class and in total is shown for each utility, and, in the most recent compilation of electric company depreciation rates, these vary from under two per cent to well over three per cent, with a composite average of about 2.7 per cent. It would be an obvious misapplication of "uniformity" to require or sug-

⁵⁸ Examples of accumulations of statistical or financial data include the FPC's annual reports on Statistics of Electric Utilities in the United States, Statistics for Interstate Natural Gas Pipeline Companies, and Typical Electric Bills, as well as the FCC's Statistics of Communications Common Carriers.

⁵⁹ FPC Annual Report Forms Nos. 1 and 2 for electric utilities and licenses and natural gas companies; ICC Railroad Annual Report Form A.

⁶⁰ FPC, NATIONAL POWER SURVEY, 1964.

⁶¹ E.g., FPC, ELECTRIC UTILITY DEPRECIATION PRACTICES, 1961 (FPC S-161, 1964); FPC, DEPRECIATION PRACTICES OF NATURAL GAS COMPANIES, 1961 (FPC S-159, 1963).

gest that a company use a rate of 2.7 per cent unless 2.7 per cent were appropriate for the individual utility. Operating conditions, potential obsolescence, and the "mix" of property between steam and hydraulic production equipment are merely a few of the important factors that must be considered in determining a proper composite depreciation rate for any one company. Nevertheless, there are instances in which a regulatory agency has tested the "adequacy" of a given utility's accumulated depreciation provision by using such reported "averages." This is much like obtaining an average of all sizes of shoes worn and then requiring individuals to wear the average size—if the wearer avoids foot trouble, it is purely happenstance.

The 1963 statistical report on privately owned utilities prepared by the FPC⁶² includes a tabulation of computed "rates of return" for Class A electric companies. The Commission adjusted the reported figures of those companies that provided reserves for deferred taxes, increasing 1963 "return" (profits) for such amounts. This was done even though, under the Commission's own rules and practices, as well as those of the state authorities, amounts added to the reserves are not available as earnings or surplus for distribution to security holders. In most instances, the applicable state regulatory body had permitted these companies to include a deferred tax provision in determining the rates charged to customers and required that the reserves accumulated by means of such provisions be set aside and passed on to appropriate future customers. The inclusion of such restricted reserves in "return" produced an erroneous and misleading result, as might be expected from an attempt to impute "uniformity" where it does not exist.

There have been rare instances where regulatory agencies have utilized financial information reported pursuant to uniform systems of accounts to set arbitrary cost allowances for rate purposes. To illustrate, there have been cases in which a utility's officers' salaries were allowed as a cost for rate-making purposes only to the extent such salaries were in line with an "average" of those paid by other selected utilities. Employing a similar rationale, regulators in another recent case established maintenance expense for rate purposes at a level considerably below actual cost, using a standard experience average of several other utilities operating under entirely different conditions.

Thus, a uniform system of accounts does facilitate statistical summarizations, providing some statistical comparability of limited usefulness—certainly far less than that visualized at the time regulatory powers over accounting were granted. Uniform systems of accounts are used in some programs of continuing rate surveillance, and, on occasion, they have been misapplied in futile attempts to obtain uniformity from disuniform facts.

It is possible to have comparability without a uniform classification of accounts. If sound, uniform accounting principles and standards are applied to each business

⁶² FPC, STATISTICS OF ELECTRIC UTILITIES IN THE UNITED STATES, 1963, CLASSES A AND B, PRIVATELY OWNED COMPANIES (FPC S-168, 1965).

transaction, the financial statements should be reasonably comparable as to financial position and results of operations even though minor differences may exist between balance sheet or income statement captions. But merely reporting pursuant to a detailed classification of accounts does not, in itself, automatically provide comparability.

Several groups of utilities exchange information as to costs by classified account. Members of such groups report that they find comparisons by classified account only of limited use and that extensive further investigation of differences is usually required before any benefits are obtained. Such differences must be analyzed to determine the effects of unique factors affecting each company's costs, such as differences in operating characteristics, extensive variations in the interpretations of the costs to be included in each prescribed account, location, techniques of allocating indirect costs, and so forth. The answer to comparability of costs appears not to be a detailed account-by-account comparison but the application of sound uniform accounting principles to the items going into each account.

VI

DISUNIFORMITY AMONG UNIFORM SYSTEMS OF ACCOUNTS

How "uniform" are the various uniform systems of accounts as compared to each other? Are the uniform systems appropriate for use in financial reporting to stockholders and others? When the uniform systems are so used, are financial statements comparable to those of other regulated companies and of nonregulated companies? In examining these questions, we shall compare the various uniform systems of accounts with each other and with the accounting principles considered by the accounting profession to be generally acceptable. Possibly the most significant of the differences to be found relate to the prescribed accounting for (1) income tax expense, (2) plant and related depreciation costs, and (3) items to be charged or credited to income or surplus.

A. Lack of Uniformity in Accounting for Federal Income Taxes

Some of the most significant opinion differences in accounting revolve around the question of whether accounting should relate business transactions to their tax effect or whether income taxes should be treated as an expense of the current period regardless of the accounting treatment of the related transactions. "Generally accepted accounting principles" are quite flexible on this matter, and regulatory authorities have exhibited wide differences in their treatment of the accounting for tax consequences of various transactions.

Nonregulated companies have been guided in this matter by a number of pronouncements from the American Institute of Certified Public Accountants. In Ac-

counting Research Bulletin No. 43,⁶³ the AICPA adopted the general proposition that the tax effects resulting from transactions should follow the accounting accorded the basic transaction, whether it is a profit resulting in additional taxes or a loss producing a tax reduction (tax benefit or negative taxes). This "tax allocation" theory is stated as follows:

Financial statements are based on allocations of receipts, payments, accruals, and various other items. Many of the allocations are necessarily based on assumptions, but no one suggests that allocations based on imperfect criteria should be abandoned in respect of expenses other than income taxes, or even that the method of allocation should always be indicated. Income taxes are an expense that should be allocated, when necessary and practicable, to income and other accounts, as other expenses are allocated. What the income statement should reflect under this head, as under any other head, is the expense properly allocable to the income included in the income statement for the year.⁶⁴

The AICPA also followed the principle of matching revenues and expenses in its Bulletin No. 44,⁶⁵ regarding the use of liberalized depreciation for tax purposes, and similarly followed this same thought when the Accounting Principles Board issued its Opinion No. 1, regarding use of the Treasury Department's "depreciation guidelines."⁶⁶

Accounting prescribed by the regulatory authorities for the economic effects of the tax laws frequently is not consistent with "generally accepted accounting principles," and there are important conflicts in the requirements of regulatory agencies. The differing positions of certain regulatory bodies are set forth below.

1. *Federal Power Commission*

The FPC uniform systems of accounts prescribe a combination of theories for handling income tax allocations. The instructions for income taxes require that the amounts recorded as an operating expense in the income statement reflect the "actual taxes payable which are chargeable to utility operations" after the taxes applicable to nonutility operations or to credits to surplus have been allocated to those accounts. Prepayments of taxes are to be recorded as such. The tax reduction resulting from losses or nonutility or nonjurisdictional operations or from losses charged to surplus cannot be allocated to those accounts. These tax reductions must be used to increase reported income from jurisdictional operations by reducing the taxes charged thereto.

The FPC's present uniform system of accounts permits the deferral of tax reduc-

⁶³ COMMITTEE ON ACCOUNTING PROCEDURE, AICPA, RESTATEMENT AND REVISION OF ACCOUNTING RESEARCH BULLETINS 88 (Accounting Research Bull. No. 43, 1953).

⁶⁴ *Ibid.*

⁶⁵ COMMITTEE ON ACCOUNTING PROCEDURE, AICPA, DECLINING-BALANCE DEPRECIATION (Accounting Research Bull. No. 44 (Revised), 1958).

⁶⁶ ACCOUNTING PRINCIPLES BOARD, AICPA, NEW DEPRECIATION GUIDELINES AND RULES (Opinion No. 1, 1962).

tions arising from the use of liberalized depreciation and accelerated amortization under sections 167 and 168 of the Internal Revenue Code of 1954. However, the FPC currently has under consideration a proposed rule that would bar the future use of deferred tax accounting for section 167 benefits unless a subject company is both able and willing to prove that it will have little or no future growth.⁶⁷ As to the use of straight-line (as opposed to "liberalized") depreciation rates for tax purposes in excess of those used for book purposes—such as frequently results when the "guideline" tax rates are used—the FPC's prescribed accounts do not provide for a matching of the depreciation costs and their directly related income tax effects.

2. *Interstate Commerce Commission*

Under the ICC uniform system of accounts, railroads use income tax reductions resulting from depreciation and amortization for tax purposes in excess of book amounts to reduce tax provisions and thereby increase net income reported to the Commission. The ICC permits these figures to be adjusted so that reports to the public can be made in accordance with "generally accepted accounting principles."⁶⁸ However, the ICC does require that both additional taxes and tax reductions resulting from credits or charges to surplus be allocated to surplus, in contrast to the FPC's proviso for tax allocation solely on taxable gains credited to earned surplus. The ICC does not specifically provide for tax allocation for other items treated differently for tax and book purposes except that they may be submitted to the ICC for consideration and decision as to the accounting for the tax consequences.

3. *Civil Aeronautics Board*

The CAB uniform system of accounts for air carriers requires that income tax increases or reductions be related to the income or deduction transaction that caused the tax effect. It provides for a proper allocation between operating and non-operating accounts and deferral of tax benefits for items deferred for book purposes. Thus, its position conforms to the practice of industrial and commercial companies but differs from that of the FPC and ICC.

4. *National Association of Railroad and Utilities Commissioners*

The tax accounting outlined in the NARUC's suggested uniform systems of accounts is similar to that prescribed by the FPC with one significant exception. The NARUC accounts neither prescribe nor prohibit accounting for the deferred taxes resulting from the use of liberalized depreciation and accelerated amortization. This system of accounts is followed by many state commissions with variations for specific matters, particularly those related to tax allocation. The NARUC position can be stated to provide additional areas of noncomparability with the FPC, ICC,

⁶⁷ *Notice of Proposed Rule Making*, 29 Fed. Reg. 9723 (1964).

⁶⁸ See text accompanying note 27 *supra*.

and CAB, but it usually does provide a high level of uniformity among utilities within one industry within individual states.

5. *Federal Communications Commission*

The FCC uniform system of accounts for telephone companies prescribes a strict "taxes paid" theory. It does not provide for any deferred tax accounting or tax allocation in any form. This system of accounts appears to be out of step with the rest of the accounting world in so far as income taxes are concerned, but practices within the industries regulated by this Commission have not made this policy important.

6. *NARUC-FCC Telephone Separations Manual*

While neither the NARUC nor the FCC provides for tax allocation in its uniform system of accounts, the Separations Manual published by the joint NARUC-FCC Special Cooperative Committee on Communications Problems provides for tax allocation (positive and negative) between operating and nonoperating items, thus following the widespread practices of industrial and commercial companies. Positive and negative tax allocations are utilized in the Separations Manual to avoid the unfairness that would result from the subsidizing of customers in one state by those in another, the manual being used almost universally throughout the country to establish telephone rates.

B. Differences in Accounting for Property and Depreciation

Except for certain expenditures by railroad companies following the ICC prescribed system of accounts, both regulated and nonregulated companies follow the same principle of recording investments in productive facilities at cost. Nonregulated companies recover their investment (except for the effect of changes in price levels) in productive facilities by charges against income over the useful life of the asset (depreciation accounting).

Almost all regulatory agencies have now adopted the principle of depreciation accounting. However, when used property is acquired by a utility, most regulatory agencies now require that a distinction be made between the cost of acquisition and "original cost," *i.e.*, the cost to the person who first devoted it to public service. Differences between cost and "original cost" are generally required to be recorded as "plant acquisition adjustments" to be disposed of as the regulatory agency approves or directs. Usually these amounts are either charged directly to surplus or amortized as a nonoperating or operating expense. In direct contrast with this practice, nonregulated companies in effect depreciate "plant acquisition adjustments" as an operating expense to the extent such amounts apply to tangible property.

The CAB uniform system of accounts does not use the term "original cost" and prescribes the use of a "property acquisition adjustment" only in cases where property is acquired from associated companies or through a consolidation, merger, or reorganization.

The accounting with respect to property prescribed by the ICC in the railroad industry is a combination of regular depreciation accounting and replacement accounting. The usual type of depreciation accounting is followed for such assets as freight and passenger-train cars, locomotives, bridges and trestles, office buildings, communication systems, and shop machinery. Replacement accounting—sometimes referred to as "betterment" accounting—is followed for grading, ties, rails, other track material, ballast, and track-laying and surfacing costs. These procedures provide that costs be charged to property accounts at the time of initial construction. When and to the extent they are replaced in kind, the cost of the replacement is charged to expense, and no entries are made to the property accounts, which retain the amounts capitalized at the time of original construction. When replaced with heavier or improved material, the cost in excess of the cost of replacing in kind is also capitalized. The so-called "betterment" capitalized is limited to the "betterment" in material; labor is charged to operating expense, both when materials are replaced in kind and when replaced with improved or heavier material.

C. Surplus vs. Income

Controversies over whether a particular item should be charged against, or credited to, surplus or current income have probably stimulated as much polemic discussion as any other subject in the history of accounting. A wide divergency in views continues, leading to another area of disuniformity and noncomparability.

The AICPA has discussed these problems extensively in its publications. Its Bulletin No. 43, states that

there should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption relates to items which in the aggregate are material in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operation of the period.⁶⁹

The Bulletin lists certain items of an extraordinary nature that should be excluded from the determination of net income "when their inclusion would impair the significance of net income so that misleading inferences might be drawn therefrom."⁷⁰ Other bulletins and pronouncements of the AICPA deal with specific items.

In general, the SEC requires that nonregulated companies include special credits

⁶⁹ COMMITTEE ON ACCOUNTING PROCEDURE, AICPA, RESTATEMENT AND REVISION OF ACCOUNTING RESEARCH BULLETINS 63 (Accounting Research Bull. No. 43, 1953).

⁷⁰ *Ibid.*

or charges in the income statement, which may be shown as special items after net income. On the other hand, it follows the dictates of the regulatory agencies for utility companies in this matter in most instances.

The uniform systems prescribed by the regulatory agencies vary considerably in their instructions regarding items to be charged or credited to surplus. Airlines operating under jurisdiction of the CAB must include all items, except dividends, in income. The uniform systems prescribed by the FPC, FCC, ICC, and NARUC all include detailed instructions regarding items that are to be disposed of through surplus. Thus, there is a considerable divergence of views as to the treatment of these items. These variations in accounting treatment produce substantial differences in reported periodic income.

D. Other Differences in Accounting

As any accountant or financial analyst can confirm, there are many other areas of accounting noncomparability. Some of the more common differences are discussed below:

1. *Current assets and current liabilities.* There is a considerable difference between the well-established concepts of current assets and current liabilities used by industrial and commercial corporations and those prescribed by some of the regulatory agencies. To illustrate, several systems of accounts do not permit the inclusion of maturities of long-term debt due within one year as a current liability, contrary to widespread practice. The FCC system of accounts does not include accrued taxes, interest, dividends, or rents as a current liability unless they are past due. Many instructions require that customer deposits be included as a current liability although historically most of the deposits are retained for several years.

2. *Capitalization of construction overheads.* As a general rule, regulated companies capitalize as a part of construction cost substantially all overheads related thereto, including a factor for return on common equity capital as a part of "interest during construction." Industrial and commercial corporations usually capitalize only directly assigned overheads and never a factor for return on equity used to finance construction.

3. *Charitable contributions.* Many regulatory agencies require that charitable contributions and donations be recorded as nonoperating expenses. Industrial and commercial companies record such outlays as an operating expense.

4. *Contributions in aid of construction.* The FCC uniform system requires contributions in aid of construction to be credited to plant while many other uniform systems require that these contributions be recorded as a credit, deferred to infinity.

5. *Capital stock expense.* Most nonregulated companies consider capital stock expense to be a reduction of the proceeds from the sale of the stock, reducing the capital received therefrom, whereas most uniform systems do not permit such

accounting and require that it be amortized against income or charged to earned surplus.

VII

EFFECT ON FINANCIAL REPORTING OF DISUNIFORMITY AMONG UNIFORM SYSTEMS

The extent of the variances in financial reporting as a result of the differences among the various uniform systems of accounts is clearly demonstrated by the results of a review of 248 public utility annual reports for the year 1964. Table one sets forth the manner in which the annual reports reflected the effect of claiming liberalized depreciation for tax purposes while utilizing straight-line, or other less rapid methods, for book purposes. It should be borne in mind that in most instances the amounts of the differences are quite substantial in relation to earnings for the year and the accumulated amounts are material in relation to common stock equity.

TABLE 1
METHODS USED BY REGULATED COMPANIES IN ACCOUNTING FOR
LIBERALIZED DEPRECIATION DEDUCTIONS

Method	Total	Electric and/or Gas Distribution	Gas Pipeline (or Inte- grated)	Telephone	Railroad	Airline
Flow-through.....	86	59	2	3	22	—
Deferred taxes recorded.....	124	78	17	3	6	20
Liberalized depreciation not utilized.....	44	23	4	6	5	6
Less—Utilities included as both flow-through and deferral because of operat- ing in two or more states with conflicting require- ments.....	(6)	(4)	(1)	(1)	—	—
	248	156	22	11	33	26

A similar diversity was noted in these annual reports with respect to the method followed in accounting for the investment tax credit. The review of the reports disclosed that 131 companies used a service-life method, ninety-two companies used an initial year flow-through method, and the remaining twenty-five companies either could not utilize the credit or did not disclose the accounting followed. This diversity in financial reporting grows out of the diversity in the regulatory directives as to the treatment of the investment tax credit. These directives may be summarized as in table two, although it should be remembered that the federal agencies were under congressional directives that they could not use an immediate flow-through method for rate purposes,⁷¹ and ostensibly therefore for accounting purposes, without the agreement of the regulated company.

⁷¹ Revenue Act of 1964, § 203(e), 78 Stat. 35 (1964).

TABLE 2
REGULATORY REQUIREMENTS AS TO ACCOUNTING FOR THE INVESTMENT CREDIT

	Regulatory Agencies		
	Federal	District of Columbia	States
Service life.....	4(1)	1	33(1)
Initial year flow-through.....	1	—	10
No known position taken.....	—	—	7
	5	1	50

(1) Federal agencies and several state agencies also permit flow-through.

The above data with respect to deferred taxes and the investment credit demonstrate that the differences among the uniform accounting requirements of regulatory agencies have a significant effect on the reporting of financial data to the public. Electric and gas distribution companies are in substantial part regulated at the state level, and the split in the position of state regulators on the question of accounting for deferred taxes and the investment credit is clearly illustrated by the alternative reporting procedures. On the other hand, while not shown above, there is a high level of uniformity and comparability within most individual state jurisdictions. Indeed, it can be said that significant differences frequently arise between jurisdictions but not within them.

Many analysts and financial advisors adjust reported earnings of flow-through companies to a deferral basis (and vice versa) to produce data that they believe is more usable for investment purposes. It is important, therefore, to consider the extent of the disclosure in the annual reports of the fifty-nine electric and gas companies that employ the flow-through technique for deferred taxes. Of the fifty-nine, thirteen did not disclose the amount of flow-through, thus preventing even the so-called sophisticated investor from making the adjustment. Of the remaining forty-six, twenty-three disclosed the current and accumulated effect of "flow-through" accounting, and twenty-three disclosed the current year's amount only. In describing the effect, nine reports stated net income had been increased, while thirty-nine stated income tax expense had been reduced, leaving readers with the question, "What's the difference?" Nine made other comments, and two said nothing.

Of the 248 annual reports surveyed, 242 included opinions of independent public accountants. Nineteen of these opinions included exceptions disclosing deviations from "generally accepted accounting principles." Eighteen of these nineteen opinions related to the financial statements of railroad companies. It thus appears that, while the ICC permits railroads to utilize generally accepted accounting principles in reporting to the public, at least eighteen of the thirty-three railroads surveyed chose

not to do so. As to the other regulated companies whose reports were surveyed, it is clear that the differences arising from the adoption of alternative accounting and reporting standards in obedience to uniform systems of accounts are not being disclosed in accountants' opinions. Investors and others apparently must look elsewhere for this information. Accountants do not feel called upon to provide it.

VIII

WHY AGENCIES HAVE NOT ACHIEVED UNIFORMITY AMONG THEMSELVES

In considering why uniform accounting standards have not been adopted by regulatory agencies, thus failing to produce uniformity except on an agency-by-agency or jurisdiction-by-jurisdiction basis, two reasons stand out: (1) The purposes of regulation have not included the achievement of uniformity except in so far as effective regulation of rates and service requires it, and (2) the accounting profession has not provided guidelines, consisting of sound accounting principles and standards, upon which conscientious regulators could base a uniform system of accounts.

A. Regulatory Purposes

While the history of utility regulation reveals that the protection of investors was often stated as a reason for the creation of regulatory machinery, other reasons, such as the assurance of reasonable rates and adequate service, were usually accorded much greater weight by legislators and certainly by the regulators themselves. Consequently, each agency's viewpoint on accounting matters is frequently influenced by an inherent bias in line with the legislative intent of its governing statutes, judicial interpretations, and the political climate in which it operates. Moreover, uniform systems of accounts were never designed for the purpose of reporting to stockholders and the public, and until recently no federal regulatory agency had even attempted to require their use for such purpose.⁷² Instead, these systems were designed as a means of correcting or controlling the abuses, real or alleged, that gave rise to the creation of the agency. Comparability to firms in other jurisdictions and in non-regulated industries was rarely sought as a basic purpose of the regulatory scheme, although uniformity within the jurisdiction was considered to be essential to effective regulation.

Under these circumstances, it is understandable that many regulators give significant consideration, intentionally or unintentionally, to the rate implications of their accounting regulations. As a result, accounting often becomes a vehicle for achieving a predetermined end result rather than being a means by which comparable, and therefore usable, financial information can be communicated to investors. Further, there is no effective way in which investors can appeal questionable accounting decisions of regulatory agencies.

⁷² See text accompanying notes 25-26, *supra*.

B. The Failure of the Accounting Profession to Provide Leadership

If the accounting profession had reached a consensus as to the proper handling of particular transactions, regulatory bodies might have been reluctant to prescribe contrary practices in their uniform systems of accounts. Because of the profession's inability to eliminate "acceptable" alternatives with respect to most major issues, the regulators have felt no necessity to conform their accounting regulations to any standard other than their own convenience. The accounting profession's abdication of leadership in the development of accounting concepts has thus contributed materially to the unsatisfactory state of financial reporting in the regulated industries.

The accounting profession has maintained that generally accepted accounting principles pertain to all business enterprises, including public utilities.⁷³ But the same source also asserts that "differences may arise in the application of generally accepted accounting principles as between regulated and nonregulated businesses."⁷⁴ Paul Grady's recent *Inventory of Generally Accepted Accounting Principles for Business Enterprises* states that an accounting practice becomes a "generally accepted accounting principle" when there is "authoritative support" for it, and lists as one of several sources of such authoritative support the various uniform systems of accounts.⁷⁵ This would appear to amount to a delegation of professional judgment to determine what is sound accounting, with the result that the AICPA would be bound by the decisions of regulatory agencies on accounting matters. With such circularity of reasoning, the Institute would have little claim to standing before any agency, and the agencies could hardly be expected to look to the profession for meaningful guidance in the determination of sound, objective accounting principles.

IX

CONCLUSIONS

Multipurpose uniform systems of accounts have generally produced a high level of comparability of financial statements of companies subject to regulation within a single jurisdiction. But for reasons just outlined, interjurisdictional comparability has not reached as high a level. Serious differences exist in matters being reported in financial statements, although the level of comparability does compare favorably with that achieved by nonregulated companies. Dual jurisdiction, such as that exercised by the FPC and any of the state commissions, has not contributed to comparability of financial statements among jurisdictions. With a few areas of exception, detailed cost and revenue classification uniformity has not proved feasible, and

⁷³ ACCOUNTING PRINCIPLES BOARD, AICPA, ACCOUNTING FOR THE "INVESTMENT CREDIT" 9-10 (Opinion No. 2, 1963) (Addendum, "Accounting Principles for Regulated Industries").

⁷⁴ *Id.* at 10.

⁷⁵ PAUL GRADY, *INVENTORY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR BUSINESS ENTERPRISES* 52-53 (AICPA Accounting Research Study No. 7, 1965).

even where this type of uniformity has been achieved the agencies have sometimes misunderstood the proper use of, and have misapplied, the accounting data.

The over-all experience of the regulated industries would indicate that comparability in financial reporting could readily be obtained on major matters of principle if an organizational form could be developed to arbitrate disputes concerning principles that should be employed in all public financial reporting. The AICPA could contribute greatly to this, but an accommodation to the lawful powers of the agencies must first be resolved. All regulatory bodies could, of course, require reports for their purposes that differ as to accounting principles from those used to report to the general public, a practice already followed by the ICC.

The ultimate objective must be comparability in financial reporting both among companies within a single industry and among companies in different industries, so that substantial factual matters are not hidden from the public view by accounting flexibility. These goals should and can be reached without incurring a costly burden of detailed or straitjacket uniformity. Existing regulatory commissions have a built-in bias springing from their historic statutory goals that may disqualify them as objective prescribers of sound accounting principles that are fair to all segments of the population. Unfortunately, the AICPA seems also to have disqualified itself from achieving this objective by knowingly acquiescing in multiple standards of accounting both through a lack of independence from outside pressures and through an unwillingness to seek, through professional action, required accounting principles that produce comparable financial statements in the many obvious instances where this is possible.

What then is the answer to this dilemma? It is becoming increasingly clear that the goal of greater comparability in financial reporting, so essential to investors, creditors, consumers, labor, management, and to the public at large, can be achieved only through a reconstituted professional accounting organization that is, in fact, independent and is willing to take a stand on sound accounting principles. If this cannot be achieved, the solution may be in the establishment of an independent court which would hear evidence on the various viewpoints, arbitrate questions on the basis of established criteria, and render decisions that would be binding on those concerned.