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George E. Smith: Let Ethics Guide Your Decisions
By Kathy Williams
Integrity, ethics, communication skills—these are the essential assets all management accountants should possess, contends this former chairman and CEO of J.M. Tull Industries. Now retired from the business front lines, George Smith reads financial statements as a hobby, teaches at a nearby university, and delights in telling students about the real world of business and how they can succeed in it.

Are Ethics Dangerous to Your Job?
By Robert G. Morgan, Jalaleddin Soroosh, and Charles J. Woelfel
How valid are NAA’s new Standards of Ethical Conduct for Management Accountants in resolving the ethical conflicts management accountants face daily? This critique of the Statement and results of a survey of CMAs and controllers regarding the necessity and validity of NAA’s code of ethics may surprise you.

The Controller Who Said ‘No’
By Anne J. Rich
What do you do if the president of your division is recklessly padding his expense account, paying his wife to stuff envelopes, and charging his company for the cost of his all-night poker games at a local hotel? This controller blew the whistle and here’s what happened.

Donating Inventory Can Improve Profitability
By James D. Kimes
Don’t scrap perfectly good but obsolete inventory items. Give them to your favorite charity, and you will not only help those in need, but under certain circumstances you can get a healthy deduction of one half the gross profit—plus the base cost of the inventory items.

Surviving the IRS Tax Accrual Decision
By Gary A. Growe and Philip G. Kaplan
Now that the Arthur Young case has once and for all settled whatever lingering doubt there was concerning IRS access to tax accrual work papers, business and the accounting profession will have to view these papers realistically and prepare them with the expectation that they will not survive the classification for “eyes only.”

Using Sales Equivalency as a Cost Saving Tool
By Robert L. Enrick
Increase sales or reduce manufacturing costs? That’s the dilemma for many companies, particularly those faced with constraints on energy and raw materials. One way to analyze your options is to convert your gains from manufacturing costs or a sales volume increase to a common denominator, as illustrated here.

Accounting for Computer Software: the FASB Approach
By Gregory A. Ray and Anne D. McCallion
Computer software: To expense or capitalize? The lack of accounting guidelines has frustrated this high-tech sector almost since its inception. This year, however, the Financial Accounting Standards Board in all probability will issue a statement on this complex topic. If the Board’s exposure draft is any guide, the statement will have a profound impact on the industry. Here is an illustration of how it would be implemented.
Direct Labor Cost Not Always Relevant at H-P
By Rick Hunt, Linda Garrett, and C. Mike Merz

The typical line manager did not understand and did not use many of this high-tech company's cost reports so the management accounting staff threw out the textbooks and adapted the accounting system to the new, high-tech environment.

Taxes, Will the Administration's proposals—particularly the Treasury Dept.'s tax reform and simplification plan—hurt or help businesses? In a special feature in the March issue, we focus on probable winners and losers in the eyes of tax specialists from the Big 8, corporations, and other organizations. Look for a wide-ranging interview with Charles A. Bowsher, Comptroller General of the U.S., in the April issue.


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Leadership by Objectives

"Having lost sight of our objectives, we redoubled our efforts." Of course that old saw is the classic syndrome describing what happens to some organizations whose leadership is muddled.

Organizations that lose sight of their objectives tend to wander off course, reacting to every short-term stimulus. Such leadership—or nonleadership—leaves organization members frustrated and unmotivated; it leaves the organization in imminent peril of failure.

Daily we witness illustrations of this classic management trap. A company soars for a number of years, realizing record profits and sales. Then something happens: leadership at the top forgets what its true objectives are—and things start to unwind. Sales drop, productivity declines, and profits take a nosedive. A frantic management scurries around desperately looking for the quick fix: cutting here, delaying shipments, trying to buy time.

The problem often rests with the leadership itself. The chief executive officer has lost sight of his organization's objectives and, as a result, the organization stalls.

Every organization, no matter how large or how small, is following its own objectives, whether explicit or stated. President Reagan, for example, has four major objectives: to maintain a strong defense, reduce the deficit, keep the lid on inflation, and foster a strong economy. Every NAA chapter president also has certain objectives in mind for his or her chapter. Some have modest goals—just to finish in the top twenty-five, perhaps.

Whatever the aims are, they must be published and every member of the organization made aware of what these objectives are. Effective leaders, like NAA's winning chapter presidents, spell out their organization's objectives at the beginning of each fiscal year. They make sure everyone in the organization understands them, they adopt policies to achieve them, and they review progress toward those objectives at regular intervals. Each subunit and member of the organization has a part to play in achieving these aims and should be held accountable for carrying out the program as planned.

The key element, of course, is the leader himself, who must keep the "big picture" in mind even when everyone else has forgotten it. That is what leadership is all about—keeping the organization on target and focused toward the plan. The chapter presidents who practice this philosophy usually collect the trophies at the end of the year.

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Opinion

Robert L. Shultis, Executive Director

In Search of Excellence, the Marketplace, and Millard Fillmore

On a recent long flight, I managed to catch up on some reading that had been piling up in the briefcase. Top on the list was the paperback edition of *In Search of Excellence* by Thomas J. Peters and Robert H. Waterman, Jr. While it was published a couple of years ago and even though a prominent business magazine has called attention to the not wholly favorable track records of some of the "excellent" companies described in the book, its insights and its felicitous language make the book a worthwhile evening's reading.

There was one statement describing the leadership of these "excellent" companies with which we NAAers might take exception, however. It said: "The star performers [the "excellent companies"] are seldom led by accountants or lawyers." MANAGEMENT ACCOUNTING's interview series of management accountants who have become CEOs of successful companies belies the 100% accuracy of this statement. Certainly the dramatic turnaround in General Motors' fortunes under Roger Smith, or the continued success of CSX Corporation with Hays Watkins, or the steady, solid growth of CPC International guided by Jim McKee—to name just a few—assures us that accountants can and do make successful CEOs.

What I think the authors are telling us is that to supply successful leadership, the CEO must be attuned to the marketplace and must encourage innovation, change, and positive, optimistic thinking even at the risk of an occasional miscue or mistake. It's true that many accountants and lawyers don't have the risk-taking, gut-feel sense of management that would allow them to succeed as CEOs or entrepreneurs in this dynamic, ever-changing society we live in. But many of them do. Certainly Ed Hennessy of Allied Corp. does. He has turned his company from a rather stodgy basic chemical supplier to a fast-moving, high-tech conglomerate. (MANAGEMENT ACCOUNTING, Jan. '85.)

Let me quote a couple more sentences from Peters' and Waterman's book:

"It appears that evolution is continuously at work in the marketplace; that adaptation is crucial; and that few big businesses pull it off. Many of our excellent companies most probably will not stay buoyant forever."

"The excellent companies are learning organizations. They don't wait around for the marketplace eventually to do them in; they create their own internal marketplace."

"Intriguingly, the top companies have developed a whole host of devices and management routines to stave off calcification. They experiment more, encourage more tries, and permit small failures; they interact with customers—especially sophisticated customers—more."

"The role in linking the populations of companies to the needs of the environment has always been recognized by economists; if companies do not stay fit and relevant, they do not survive." (Italics mine.)

There's certainly a lesson here for NAA. All we have to do is substitute the word "association" for "companies" and we have our charge loud and clear. Neither we, nor any other organization, can continue to serve our membership today the way we might have 20 or 25 years ago. People change; philosophies change; needs change.

This came out all too clearly in the in-depth survey of membership attitudes that our consultants conducted for NAA last spring. While there continues to be considerable value placed on the formal and informal get-togethers, such as our chapter meetings, and probably always will be, there is a rising desire for greater interchange and news within specialized segments of the accounting profession, without specific time commitments on the part of the participants.

Following the aegis of Peters and Waterman, to be responsive to the marketplace, then, NAA is setting up what we call Member Interest Groups (MIGs). Probably by this time you have received a brochure describing the new program, but the uniqueness of the project may not have been entirely clear. Another newsletter and another accounting journal isn't necessarily what the world is waiting for. But what makes NAA's Member Interest Groups unique is twofold:

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Management Information Systems

M.C. Gallagher and J.E. Gauntt

Computer Literacy Is a Professional Responsibility

“What” and “how much” does the management accountant need to know about computing? While it may not be necessary for every accountant to be able to write sophisticated computer programs, the accountant who is not comfortable with computer-based technology is handicapped, and this disadvantage will increase in the future.

Computer literacy can be defined as the knowledge necessary to use computers to solve business problems and can be classified into six levels. These levels are characterized by two dimensions. First, each level implies a knowledge of certain types of information. Second, each level implies an ability to incorporate that information into a disciplined thought process. The levels of literacy presented here are arranged in a hierarchy of understanding and include examples of expected performance at each level.

Level One: Knowledge. This level represents the lowest level of learning and involves recall, specific facts, terms, and definitions. A knowledge of common computer terms, methods, procedures, principles and very basic computing concepts would be involved with level one literacy. To the observer this represents the most general knowledge of the way a computer functions; to the user this represents the ability to respond, relatively mechanically, to the preparation of special forms, or to the direct entry of data into a pre-written program which prompts the user for specific data. The simple ability to use an electronic keyboard, respond to a series of pre-programmed interactive instructions, or work through a computer-aided-instruction program would be examples of level-one literacy. The accountant preparing inputs for computerized financial statements should possess at least level-one literacy.

Level Two: Comprehension. This level goes beyond remembering and includes a low level ability to understand and interpret. Understanding simple computer principles and the ability to justify methods and procedures would be involved with level-two literacy. To the observer this represents a “black box” level of understanding of a system (the system accepts certain inputs, does unknown operations to them, and creates certain outputs); to the user this could include the ability to interpret computer commands, translate formulas to be understandable by the computer, and predict output forms. The ability to convert verbal material into a mathematical formula that is entered into the computer, to store and retrieve word processing files, or to access auxiliary print devices serve as examples of level-two literacy. The company using a central record-keeping system should employ at least one accountant with level-two literacy who has an appreciation of the computer services provided by the system, and understands the limitations of such a system.

Level Three: Application. This level refers to the ability to use learned rules, methods, concepts, and principles in new situations. Applying such concepts and principles to manipulate data and produce results obviously requires a higher level of understanding than those mastered at the comprehension level. To the observer this would be the ability to infer from the known inputs and outputs of a system to some of the underlying processes; to the user this could include the ability to construct a screen format or relational matrix and perform a series of operations using them. The ability to use a database management software package to produce a sales analysis and reports or to build a break-even model of a business situation using an electronic spreadsheet would be examples of this level of literacy. The management accountant participating in the development of new internal systems would probably require level-three literacy. An accountant without this level of literacy would be in danger of making what would be at best an uninformed decision, and could settle for a system that would not be capable of expansion or flexible enough to handle future needs. Level-three literacy not only includes an understanding of the methods and concepts used to satisfy current business needs, but also involves the management accountant’s ability to transfer these principles to emerging, more sophisticated information requirements.

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Taxes

Israel Blumenfrucht
and Jerold M. Weiss, Editors

Tax Benefits Relating to Corporate Distributions Substantially Limited

The Deficit Reduction Act of 1984 includes provisions that restrict and limit tax benefits relating to corporate distributions. Destined to have an impact on corporate tax planning are the Act’s new provisions affecting the distribution of appreciated property, and the restrictions on the dividends—received deduction.

Appreciated Property Distribution Rules Revised

The Deficit Reduction Act of 1984 substantially revises the tax rules relating to nonliquidating corporate distributions of appreciated property. The new rules could affect both the corporation distributing the property as well as the recipient shareholder.

Under prior law, a corporation generally recognized no gain or loss on the distribution of property to its shareholders. However, there were certain specific instances when gain, but not loss, was recognized. Examples include distributions of property subject to depreciation recapture, appreciated LIFO inventory, and property subject to a liability when the liability transferred exceeds the adjusted basis of the property.

The 1984 Tax Act amends the general rule relating to nonrecognition of gain by providing that a corporation distributing appreciated property to its shareholders on or after June 14, 1984, must now generally recognize gain for the amount of the difference between the fair market value of the property and its adjusted tax basis. The effect of this rule is to treat the distribution as a sale of the property for its fair market value at the time of distribution.

This new rule could significantly alter a corporation’s decision to distribute appreciated property. While under prior law, a corporation strapped for cash could distribute property to its shareholders without incurring any additional tax liability which could further deplete its cash resources, such a corporation may be unable to make any distribution because it would be unable to pay the additional tax liability it would incur as a result of the distribution. For example under the prior law, if a corporation owned property with a tax basis of $20,000 and a fair market of $60,000, it could distribute the property to a shareholder without paying tax on the $40,000 appreciation. Under the new law, however, the corporation will be required to recognize the $40,000 gain on the distribution and, therefore, may be unable or unwilling to distribute appreciated property because of the increased tax liability it will incur as a result of the distribution.

Furthermore, corporations can no longer use the nonrecognition of gain provision as a device for avoiding double taxation on appreciated property. Under the old law, instead of selling appreciated property and being taxed both on the corporate level for the recognized gain and on the shareholder level when distributing the cash as a dividend, corporations would distribute the property directly to the shareholders and thereby avoid entirely the tax at the corporate level.

As with all tax rules, Congress included an important exception to the new law. The exception applies to distributions to noncorporate shareholders only. A corporation generally will not be required to recognize gain on the distribution of appreciated property if the following conditions are satisfied:

1. The distribution is considered a dividend for tax purposes;
2. The shareholder owns 10% or more of the corporation’s outstanding stock for a five-year period ending on the date of the distribution; and
3. The property was used by the corporation in the active conduct of its trade or business other than inventory and accounts and notes receivable.

Careful analysis of this exception indicates that Congress intended to exempt closely held corporations, whose stock is held by noncorporate shareholders, from the harsh effects imposed by the new law. However, there are limits as to the kind of appreciated property which may be distributed. Inventory, accounts and notes receivable, and property held for investment purposes by the corporation are not subject to the exception. Thus, the exception essentially applies only to machinery and buildings used in the trade or business. Moreover, the benefits accorded by this exception are further limited by the fact that the exceptions to the nonrecognition of gain which existed under the old law, such as the recognition of...
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Management Accounting Practices

Louis Bisgay, Editor

MAP Sponsors Second Roundtable

On November 19, about a dozen financial executives from companies located in the counties of Westchester (N.Y.) and Fairfield (Conn.) sat around a table and discussed current issues of concern to them and to their corporations. This, the second meeting of the NAA Westchester/Fairfield Accounting Roundtable, was hosted by MAP Committee Chairman Bernard R. Doyle at General Electric Co. in Fairfield. The first meeting was held last June at an IBM facility and was chaired by then MAP Chairman John F. Chironna.

The Roundtable was established to provide a forum for controllers, directors of accounting, etc., to talk about accounting and other matters that are of common interest. No attempt is made to determine a group's position on an issue. Rather, the forum provides an opportunity for the exploration of a subject and the interchange of ideas. Also, the MAP Committee obtains additional views from industry about significant topics.

MAP Committee on Software

The Management Accounting Practices (MAP) Committee expressed its support for the threshold position taken by the Financial Accounting Standards Board in its exposure draft, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." The Board's position is that costs of producing product masters, other than research and development costs, incurred subsequent to establishing recoverability should be capitalized (MAP Nov. '84).

While the MAP Committee's letter suggested various modifications to the exposure draft, the principal difference of opinion concerns costs of detail program design. The FASB considers detail program design costs to be costs of research and development, and therefore chargeable to expense, whereas the MAP Committee believes that phase of software production to be a part of the programming process and hence subject to capitalization.

MAP Comments on Other Issues

Proposed FASB Technical Bulletin 84-d clarifies that collateralized mortgage obligations (CMOs), a relatively new type of secondary mortgage market instrument, should be presumed to be borrowing and reflected as liabilities on the issuer's balance sheet, unless certain conditions specified in the Bulletin are met. The MAP Committee's letter endorsed issuance of this technical bulletin, observing that the approach taken is consistent with the provisions of FAS 76 and 77. It was noted, however, that those statements addressed problems substantively similar to the issue under review, and that the Board should strive to address issues broad enough to obviate the necessity of developing three sets of similar guidelines.

The MAP Committee commented to the International Accounting Standards Committee on its preliminary exposure draft, "Accounting by Retirement Benefit Plans," and to the International Federation of Accountants on Exposure Draft 22, "Representations by Management." Both sets of comments encouraged the organizations to proceed to the next step.

MAP Committee Chairman Bernard R. Doyle and FASB Chairman Donald J. Kirk exchanged letters concerning accounting by nonbusiness organizations. Mr. Doyle's letter highlighted inconsistent accounting practices among different types of nonbusiness organizations. Although recognizing that resolution of some issues may depend upon proposed amendments to the FASB Concepts Statement No. 3, he urged that the Board give a higher priority to those issues not affected by the amendments. Mr. Kirk's response gave assurance that the Board remains committed to resolving reporting inconsistencies by nonbusiness organizations. He cited the proposed technical bulletin dealing with reporting joint costs of multipurpose mailings having both program and fund-raising components as an example of the Board's sensitivity to the need for standards.

For copies of NAA comment letters, contact Ms. Harriet Wink at the NAA office in Montvale.

FASB Statements Are Issued

The FASB has issued FAS 81, "Disclosure of Postretirement Health Care and Life Insurance Benefits," and No. 82, "Financial Reporting..."
Cost of Capital: a Logic Trap

Having taught Financial Management at Michigan State University, I am familiar with the pitfalls of and the subtleties of logic in the cost of capital (Nov. '84 issue) arguments. Initially I feared that Map [Committee on Management Accounting Practices] might succumb to one of those logic traps. Much to my delight, however, MAP’s discussion is thorough and accurate; a truly excellent job.

Due to the expanse of the subject and MAP’s desire for brevity, all the important issues of cost of capital could not be addressed. However, I believe that one common misconception about the cost of capital should have been discussed so that management accountants could be saved from this potentially costly mistake. Upon initial exposure to the cost of capital topic, it might seem reasonable that since debt is cheaper than equity, increasing the proportion of debt in a firm’s capital structure would decrease its weighted average cost of capital. What this argument fails to realize is that as the amount of debt increases, the risk to the stockholders increases and, consequently, the cost of equity increases. Depending on several factors, including the firm’s debt-equity ratio, the impact of this increased cost of equity on the weighted average cost of capital could be greater than, equal to, or less than the impact of the relatively cheap debt. Thus, the addition of new debt to the firm’s existing capital structure in some instances could actually raise the firm’s overall cost of capital.

The point is that the cost of capital is a mixture of funds and must be considered as an inseparable package. Otherwise, when the cost of funds is used to generate a hurdle rate in a capital budgeting decision, the decision maker could arrive at the erroneous conclusion that a project should be accepted if it is financed with debt but rejected if it is financed with equity.

Again, I would like to congratulate MAP on the quality of their cost of capital statement. However, I feel the above discussion should have been included in the statement to address and repudiate this common misconception.

Leon A. Hoshower
Assistant Professor of Accounting
The Pennsylvania State University
Central Pennsylvania Chapter

Scope of Management Accounting

Daniel L. Kovlak’s article, “Understanding Your Town’s Financial Report” (Dec. '84), offers an excellent example of management accounting’s broad scope. Management accounting is often considered in the limited context of manufacturing operations, but such a
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Digital Rainbow Computer and RealWorld Software

NAA recently acquired a Digital Rainbow Model 100B to perform a variety of accounting-related functions. The Rainbow comes with 128K RAM memory and is expandable to more than 580K, making it possible to run Lotus 1-2-3, Symphony, and other sophisticated software packages. A hard disk can be added for data storage. The Rainbow has a CP/M-86/80 operating system with an INTEL 8086(16-bit) chip, making it one of the faster machines on the market. Because it has a CP/M operating system, the Rainbow is able to use a large variety of software with little or no modification.

NAA also received, for test purposes, four of the seven RealWorld software packages that are available for small business accounting systems. Each RealWorld software package is essentially complete and needs little or no modification, although customization is possible. The RealWorld software is menu driven, making it easy for a novice to quickly learn how to use the system. One drawback of the packages is that the order entry and accounts receivable software do not interface directly, which makes it necessary to enter certain customer data twice. This drawback can be overcome with a small amount of custom programming.

The manuals that accompany each software package are easy to follow and very explicit, a feature that makes RealWorld software more attractive than a number of other comparable systems. If questions arise, customer support personnel are available. This service is usually provided for an extra fee, although a certain amount of free support service also may be obtained, depending on which contract terms are selected. NAA’s experience has been that the support people are very knowledgeable, helpful, and patient. They are willing to work through a problem with the caller step-by-step until it is resolved. If a newer release is ever issued, the software can be upgraded for a modest fee. An automatic installation procedure is being developed. The computer itself will prompt the user on each step.

The accounts receivable software package is designed for use by small businesses and has been refined numerous times over the past nine years. The easily maintainable system control file allows the user to define various parameters which control many of the characteristics of the system. A master file of all sales representatives can be maintained, too. The customer file contains last payment and account balance information, sales volume and gross profit history information, as well as several codes that allow the user to tailor the handling of each customer appropriately. The accounts receivable open item file contains a record for each sale, credit, and debit memo, finance charge, cash receipt, and balance forward transaction.

The software handles cash receipts, editing, and posting on an interactive basis. An accounts receivable aging report may be printed for all or selected customers. Finance charges may be automatically calculated, edited, and posted. Sales representatives’ commissions can be computed and printed. Sales analyses by customer, customer type, responsible salesperson, state, and customer sales volume also can be made.

The software package for inventory control can be used standalone or in conjunction with the order entry/billing system. Several auxiliary files can be created. In addition to the standard features, the item file has the capability of listing three prices, discount and commission calculation codes, two costs, and various stock control and sales history figures. Item costing may be done on a weighted average, standard, LIFO, or FIFO basis. The system supports the optional use of multiple warehousing inventory control. A wide variety of reports may be printed.

The order entry/billing package works only in conjunction with the accounts receivable and inventory control packages and uses the accounts receivable customer file and the inventory control item file. The order entry/billing package is both powerful and flexible, and it allows the entry of orders either for immediate billing or for partial or whole billing at a later time. Orders may be entered optionally by sales profit center for general ledger purposes. Customer information from accounts receivable may be retrieved during order entry either by customer number or name. An optional sepa-
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Pausing at the end of a long, satisfying career as chairman and CEO of J.M. Tull Industries, this part-time educator, board director, and foundation and civic leader offers management accountants advice on succeeding in their companies.

By Kathy Williams

Management accountants should be the conscience of their companies, contends George E. Smith, former chairman and chief executive officer of J.M. Tull Industries. "They help choose the policies of their companies, and they must do it right. They have to keep everybody's best interests foremost and balance those interests for the best results.

"In private companies," he explains, "it might be trying to hold taxes down or preserve company money to keep it in the company. If a company's public, it has its stockholders to worry about, how its private policies are going to affect the stock or the quality of stockholders' earnings. These are all accounting functions. Particularly if the CEO of that company does not have an accounting background, then the accountant definitely becomes the conscience."

He insists that an accountant's most important asset is ethics. "Management accountants have to be dedicated to their jobs—going that second mile to get the job done—but what I can't stress too much is integrity. They must have integrity and
ethics—and let people know where they stand and try not to deviate from it. I had to fire a man once for deliberately giving me false information. When a person is intellectually dishonest, you just can't go with him. I can go with a crook because I know where he stands. But one time I wanted a decision, and this person gave me all the facts. I thought. Maybe I was derelict or maybe I didn’t get the rest of the facts—maybe I didn’t do all my homework—but I relied on him for the information. And I made a decision, but it wasn’t a good decision. The next time I saw him I said, ‘You know, your information didn’t work. You lied to me. You knew something I didn’t know, and you told me just enough to get the decision. If you do that again, I am going to fire you.’ In about three years it happened again, and I had to fire him. I told him, ‘You’ve done it again.’ Maybe there might have been another way for me to get the information I needed, but CEOs have to depend on their financial people for correct information, especially if the CEOs aren’t accounting oriented.” Then he smiles: “But that is the good part about a CEO having been in finance and accounting—he knows how to get more information than somebody else would.”

In a recent interview with MANAGEMENT ACCOUNTING, he reiterated the point. “You’ve got to have credibility and integrity in what you do, and I would go so far as to say if you are working for somebody that won’t let you have that, you’d better go somewhere else.”

George Smith was fortunate. His company firmly believed in employee integrity, so he stayed 46 years. After graduating from high school in 1934, he took a job in a warehouse for a year because he didn’t have enough money to go to college. Then in 1935 he joined J.M. Tull and started attending classes at Georgia Evening College (now Georgia State University) in Atlanta. He earned a B.S. degree in commerce in 1939. He chose accounting as his career because “numbers just came naturally to me, and it was an area in which I felt there was a need and that I could do something with. Also, the company knew I was taking accounting, so I was able to use it as my vehicle—I guess you’d say—to move along.”

In 1936, while still attending college, he was named accounting manager and performed those duties until World War II interrupted his career. He joined the U.S. Army Air Force in 1943 and returned to J.M. Tull in 1946. Three months later he was named treasurer, then vice president of finance in 1962, executive vice president in 1965, president and chief executive officer in 1967, and chairman of the board and CEO in 1978.

A Career in ‘the Dead Overhead’

He credits his company success to his accounting background although when he began his career, accountants there weren’t regarded highly. “Accounting was just something you had to do.” Mr. Smith chuckles, “Mr. Tull, who was one of the greatest salesmen I ever met, called it the dead overhead.”

J.M. Tull was a metals processing, manufacturing, and distribution company that had started as an industrial supply house in 1914, and sales were paramount, not finance. A local organization, it didn’t branch out of Atlanta until around 1955 when it purchased a company in Florida. When it continued to expand, it only went as far west as Louisiana and Texas and as far north as Virginia. Its products include carbon steel items such as wire, rods, bars, and tubes; stainless steel; brass; copper; aluminum; bronze; and nickel that are sold to the government and a wide range of industries. It also performs the unusual service of cutting the metals to size and shaping them to customers’ specifications.

Fortunately, Mr. Smith recognized that accounting would become more important and play a more vital role as the company grew, so he decided to take an interest in the whole business, not just the financial area. “I think if you are a good accountant, you have to be a student of the whole business. I made myself have contacts with our mills, which were very important to us, and to try to learn what their problems were as related to ours. I used to love to get out occasionally and travel with the salesmen and see the customers, which slowed the salesmen down because the customer always wanted to show us his plant, but he was proud of it and I think it helped with customer relations.
"In addition, in a company such as ours, which is medium-sized, you wear a lot of hats. You have to learn fast if you are really going to make a contribution. So, I tried to be a little bit more than the bean counter or the numbers crunched."

Becoming a Generalist

He succeeded fairly quickly, using his financial background as a basis for larger decision making. "While I was president, accounting helped me when I had to negotiate big contracts or decide on markets because metals distribution and processing is really a hands-on business. Inventory and accounts receivable are the two biggest things on that balance sheet you receive. Inventories can run $30 million, and it is like a department store almost—very low profit, but you've got to turn it over to get your return on investment," he explains.

He kept daily track of sales via computer. "We ran that computer 24 hours a day, and every morning when I got to work, I had a report on my desk of the sales by branches and sales by major products, and the gross profit, and we had finally worked out formulas so that every day, within 10%, I knew what our net profit was that month up to that day. If something looked bad, we could take some action after comparing it against our budgeted figures. . . . I didn't get into warehousing or manufacturing except if it looked as though our backlog were building and we weren't giving any service. Service was the name of the game.

"It could have been too much hands-on," he muses, "but I had to look at the big picture and not lose it. I tell you this because I think accountants need to learn the entire business. I tried to learn the business as I went along because sales and marketing were our lifeblood. I tried to be a generalist as much as I could."

Although he refuses to take credit for any major contributions to J.M. Tull Industries, saying instead that the company just evolved naturally, he does admit that he influenced costing decisions. "I always felt that if a company got into trouble, it didn't know what the cost was. So everybody was very cost conscious at Tull. Everything we did had to be cost justified. Every month people reported if they added on another piece of equipment or they were going to do this or that, and we said 'Okay, what are you going to get out of it? Cost it out.' We justified everything we did."

That's one reason the company set up a highly successful computer system tying all headquarters and branch activities together, even though Mr. Smith wasn't sure initially about the outcome. "I thought we would never be able to justify the system—to be on line, which we are now, with computers here and at every branch. Now I don't see how we could have run without the system. For example, Miami can go into that computer and find out what is in stock in every branch in the system. If they don't have an item, they can put an order through in Tampa. We run shuttle trucks so we can keep the inventory turning. We couldn't possibly stock 30,000 or 40,000 items in inventory; dollars would run out the roof. All controls are in Atlanta, but a branch can order via computer. It can find out the status of an account, the history of the account, how the company is paying, and other information."

The computer also is the company's communications system. "We dropped all our teletype costs by using the computer for messages—it just clears right through the lines when it wants to. We can send a message to Richmond through the computer in Atlanta."

Mr. Smith says he was happy to be a part of the changeover from manual to computer operations, but, again, he declines credit except for "staying in the middle of the conversion and meeting with the right people until the system was functioning as it should."

Looking Beyond the Ledgers

Through his hard work, conscientiousness, and total business outlook, George E. Smith quietly rose to the top of his profession. Now he wants to make sure that other management accountants are recognized and become leaders in their companies. He is concerned, however, that unless they become more extroverted, better communicators, and less interested in only the numbers, they won't succeed. Therefore, at every opportunity, he talks with young people and tries to describe the
real-life operations of the business world.

He stresses the need for management accountants to look beyond the ledgers and learn company operations, a trait that he says probably helped him achieve the J.M. Tull chairmanship. "I guess I just showed more interest and worked harder than most of the people around there. I had learned the entire business and just moved along with it..."

After he became CEO, he applied his philosophy in dealing with employees he recognized as "comers." One man in particular, he recalls, "worked in accounting and had so much drive and promise that I brought him over as my assistant for a while. He still needed some experience, so I sent him to New Orleans; they needed a manager down there. And it just about killed him. He just couldn't believe I was going to throw him to the wolves. I said, 'well, if you are going to move in this company, you are going to have to learn more about it.' So I sent him there, and he responded to the challenge. Today he's the No. 2 man at Tull," he smiles.

Because he has been involved in audit committees as a board director and has served as an officer in every organization to which he has belonged, he knows it's vital for accountants to be adept at communicating beyond figures. "I have seen in many companies and organizations and when I have attended various meetings with other financial people that many accountants, especially the younger ones, don't have anything to talk about other than numbers. If you ask them about their activities or their companies, they can't answer you. That's unfortunate because so many of them have much to offer, but they can't break out of their shells. Many of them would be disappointed, I think, if they didn't move up into other jobs, but they probably won't unless they develop their communication skills," he sighs.

They need to initiate improvements in company operations also, he says. "The people who offer a different point of view or suggestions on cutting costs or solving a problem are the ones a company or CEO looks to for the future. We've had a couple of people at Tull who were fine accountants. You would give them a problem and say 'let's work this out,' and you would always get the right answer, but they would never come to you and suggest 'why don't we look at this idea as a different solution.' Management promotes employees who approach first and offer suggestions in areas that maybe the CEO hasn't thought about because he was too busy. That's what helps people—and especially management accountants—get ahead.

"Management accountants can be so vital to their employers," he reiterates. "Many of the people whose companies got into trouble in the last two or three years—in the age of deflation—were not accountants, so they didn't know what was happening to them. They could do pretty well in inflation; they were buying inventory that was going up all the time. But the people who had never been through deflation didn't know how to manage. Yet some people who were running companies and had an accounting background saw pretty quickly what was happening. While they were suffering in the downturn, they came through in a lot better shape."

Learning to Communicate

How can management accountants learn to communicate their specialized knowledge to top management? Mr. Smith suggests college or continuing education courses, for one, especially courses offered in business school that specifically teach financial people how to write reports, present ideas to management, give oral presentations, and the like. In addition, management accountants should join professional associations, such as NAA, to interact with their peers and trade ideas. When he was treasurer at J.M. Tull, he joined the Atlanta Chapter, retaining his membership until he became company president and was forced to resign because of time and business meeting commitments.

He was reluctant to quit, but "I never liked to belong to any groups unless I could be active in them," he explains. "While I was a member, NAA was helpful, especially the contacts. In your business if you ran into something that wasn't in the books, you could call or go see somebody. We all traded information, and that was quite helpful." He also found the meeting topics and publications useful. To round out his experiences, he

One of the greatest salesmen I ever met called accounting the 'dead overhead.'
joined and became active in trade associations related specifically to his line of business—the Steel Center Institute and Georgia Freight Bureau, Inc., for example.

'I Never Learned How to Play'

Mr. Smith retired from J.M. Tull in 1981 and became secretary-treasurer of the J.M. Tull Foundation, where he “looks after the records and the dealings with the banks and occasionally will see somebody,” he smiles modestly. The Foundation had been established in the early 1960s by philanthropic company owner J.M. Tull who wanted to encourage young people to pursue their education. Mr. Tull’s wife had died and he had no children so “we have tried to perpetuate his name to a certain extent,” says Mr. Smith.

“For instance, over at the University of Georgia, we’ve donated enough money to have a chair in the accounting school, and the University named the accounting school the J.M. Tull School of Accounting. Now it is one of the top 10 schools in the country,” he says proudly. Mr. Smith, who is an adjunct professor at the University of Georgia, thoroughly enjoys teaching. The Foundation also has donated money to other colleges and universities, mainly for buildings and scholarships.

Reminiscing about his career, he muses: “I guess I was a workaholic who never learned how to play, and it sounds strange, but one of my hobbies is reading financial statements—I love to read them. I tell my students to read those statements, but the place to go is the footnotes. That’s where you’re going to find out what the problems are and what the opportunities are, and there have been plenty in the last three or four years.”

When he is not perusing annual reports, he spends his days with two foundations—J.M. Tull and another one—serves on several corporate boards of directors, and participates actively in numerous civic and trade organizations. Much of his time is taken up by the Trust Company of Georgia, where he is a director. He credits his accounting background with giving him the opportunity to serve in numerous financial capacities, especially on audit committees of various company boards. Take the bank, for example. “When I retired, the bank felt, well, old Smith doesn’t have anything to do, so it put me on every committee it has. The executive committee, for instance, looks at the big loans. Here again, I don’t think I could really serve as I should on that committee if I hadn’t had a background in accounting.”

Making Every Day Count

Management accountants always should continue their education in accounting and related matters, Mr. Smith believes, and he practices this philosophy. An inveterate reader, he laughs: “My wife says if I bring any more books into the house, it’s going to sink.” At present he’s concentrating on the Unraveling of America, what happened to the United States in the 1960s and 1970s, and various business books discussing economic trends and management techniques. A few years ago, he even spent two weeks at the famed Aspen Institute, attending a lecture series.

Why all this emphasis on learning by a retired executive? “I had an old fellow tell me years ago, ‘Son, count that day lost you don’t learn something.’ That’s pretty good advice. I’ve just tried my best over the years and hope I will continue to be challenged until I’m laid under. I never did want to get caught on an accounting situation or other topic with my peers or anyone else... a continuing interest and study are necessary if you really want to be successful.”
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Are Ethics Dangerous to Your Job?

By Robert G. Morgan, Jalaleddin Soroosh, and Charles J. Woelfel

Each day management accountants face issues testing their ethical responsibilities. A management accountant "is basically an interpreter for management and, as such, has an obligation to interpret correctly and accurately. What happens when management does not accept interpretations of business affairs as presented by the accountant? How should he react when told that the business wants to show a certain profit and it is his job to juggle the books so that such a profit figure can be recorded? What is his duty in this situation?
Is there a point beyond which he should not go or allow himself to be used as a technical tool to achieve an end with which he is not in agreement?" 

Questions such as these have been debated and discussed for many years without resolution. New disclosures of corporations accused of overcharging consumers, polluting the environment, bribing foreign officials, or withholding unfavorable information from stockholders arise almost daily. Although few corporate officials are guilty of deceptive practices, the NAA has become concerned about the reputation and image of management accountants.

As part of an effort to enhance the image of management accounting as a profession, NAA has produced and published *Statement on Management Accounting No. 1C: Standards of Ethical Conduct for Management Accountants.* We would like to critique the Statement and report the results of a survey of certified management accountants (CMAs) and corporate controllers concerning their opinions of the requirements of the code of ethics.

**Is Management Accounting a Profession?**

Medicine and law are the old, traditional "learned professions," and their members have long enjoyed high esteem. Within the past century, the certified public accountant (CPA) also has been recognized as a member of a profession. Now management accountants are attempting to enter this distinguished circle. For a professional association to qualify as a "learned profession," it must meet these six objective criteria:

1. Each renders an essential service to society.
2. Each depends upon a body of specialized knowledge acquired through formal education.
3. Each has developed a language of its own which, in its more sophisticated forms, is understandable only to the initiated.
4. Each has requirements for admission to the profession which are regulated by law.
5. Each is governed by ethical principles which emphasize the virtues of self-subordination, honesty, probity, and devotion to the welfare of those served.
6. Each has procedures for disciplining those whose conduct violates ethical standards.

The management accounting profession shares the first three criteria with other professions. Management accountants render a service to society that is analogous to the service performed by a doctor. While treating a patient, a doctor is protecting society from potentially contagious diseases. Similarly, the management accountant works for a single employer, and society reaps the benefits from quality reports, analyses, and statements. Without the information prepared by management accountants, effective and efficient operation of a company would be difficult.

Management accountants also have a specialized body of knowledge and a language learned through a formal educational process at institutions of higher learning. This body of knowledge is dynamic, not static. Because the rate of growth and change of accounting knowledge continues to accelerate, extensive continuing education is required to maintain one's accounting skills.

Through the CMA program the NAA conducts a certification procedure that includes preparatory educational requirements, an examination, and a practical experience requirement—just as the CPA does. However, the similarity ceases here. Members of the three "learned professions" are licensed by the state in which the individual practices; the CMA is not licensed by any governmental organization. The designation CMA is not formally recognized and does not convey an exclusive right to practice. Thus, management accountants only partially meet criterion four.

Let's discuss criteria five and six. The NAA has recognized the need for a formal code of ethics and has issued its Standards of Ethical Conduct to guide management accountants in dealings with superiors, subordinates, and outside parties. How effective is this Statement?

**A Critique of Statement No. 1C**

The Statement provides guidelines for actions and in that sense can be classified as a statement of moral philosophy. The standards, however, primarily are descriptive. Rationale for the rules or procedures is neither clearly specified nor self-evident. As moral principles, the standards do not adequately establish a foundation upon which...
professional conduct can be termed permissible or impermissible.

The standards of ethical conduct for management accountants promulgated in the Statement are philosophical statements that offer a systematic but limited view of management accounting. The Statement identifies major elements of professional conduct (competence, confidentiality, integrity, and objectivity) that apparently are intended to constitute the ethical environment of management accounting.

Competence, confidentiality, integrity, and objectivity are not defined nor interrelated, nor is their interdependency specified in the Statement. Instead, a list of responsibilities is provided for each criterion. The document does not mention whether the listed responsibilities are meant to be all-inclusive. If they are not meant to be all-inclusive, it should be clearly indicated. Moreover, the rationale for the placement of various responsibilities in specific criteria can be questioned. For example, the responsibility to "communicate unfavorable as well as favorable information and professional judgments or opinions" relates more closely to "objectivity" than to "integrity."

The standards in the Statement are listed alphabetically. Was this placement intentional? An interrelationship among the terms could have been demonstrated. For example, two of the standards, competence and integrity, relate to personal characteristics of management accountants. The other two standards, objectivity and confidentiality, relate to attitudes involving acceptable organizational behavior. The Statement could have been structured to produce a more insightful view of professional conduct for management accountants by including: quality of character (personal characteristics), functions performed, and attitudes or states of mind.

The distinction between what is ethical, legal, and professional is not maintained in the Statement, yet these terms are not identical in meaning because an action can be both ethical and legal, neither ethical nor legal, ethical but not legal, and legal but not ethical. Also, professional conduct may not be identical with ethical or legal conduct. For example, one's manner of dress may involve professional conduct but may not have ethical or legal implications. These distinctions should have been established and maintained. To cite an example from the Statement, one of the responsibilities listed under confidentiality reads: "Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so." Situations can arise when one might not be obligated legally to refrain from disclosing confidential information but might be obligated ethically or professionally to do so. Similar difficulties arise in several other instances in the document.

The section titled "Resolution of Ethical Conflict" refers to a procedure for achieving agreement or consensus among persons with initially conflicting attitudes or interests. The recommendation that conflict be referred to a superior suggests that agreement or compliance with a common understanding is all that needs to be sought in the way of conflict resolution. However, one does not resolve an ethical conflict by simply reaching an agreement if what is agreed to is ethically wrong. A conspiracy to look the other way should be clearly unacceptable, but it would seem to comply with the letter of this portion of the document, if not the intent. The Statement could have been drafted so that the procedures it prescribes could not be supported without questionable practices being brought to light and corrected.

When the Statement was issued, no sanctions were provided for violations of the standards described. Apparently it was deemed unnecessary, impractical, or unenforceable to apply sanctions. The force of the standards evidently relies on moral suasion or on their eventual acceptance by the management accounting profession. Now the NAA is in the process of establishing a method of disciplining violators. For example, new members must sign an agreement to abide by the Statement. Also, the Institute of Management Accounting has adopted the Statement for CMAs and has established procedures to review or investigate violations of the code. Possible punishments for a CMA violating the Statement include censure, suspension, or expulsion.

What CMAs and Controllers Think About the Statement

How do CMAs and controllers view the code of

An action can be ethical but not legal, or legal but not ethical, or neither ethical nor legal.
ethics' requirements? We studied the attitudes of controllers and CMAs relative to specific responsibilities delineated in the Statement. The respondents expressed opinions on the importance of and the degree to which management accountants are currently abiding by the responsibilities cited in the Statement. Participants were instructed:

Several requirements of the management accountant's code of ethics are listed in part I of this questionnaire.

a. How much of the requirement is now practiced by management accountants?

b. How much of the requirements do you think...
should be practiced by management accountants?
c. How important is this requirement to you?

For each item respondents were instructed to circle a number on the rating scale that corresponded to their beliefs. The numbers on the rating scale ranged from one to seven, with lower numbers representing lesser amounts and higher numbers representing greater amounts.

A perceived practice deficiency was calculated for each of the 15 code standards by subtracting part a of an item from part b of the same item. For example, a respondent might have completed a question as follows:

Management accountants have a responsibility to refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.

a. How much is there now? 1 2 3 4 5 6 7
b. How much should there be? 1 2 3 4 5 6 7

If 2 were circled in response to part a and 7 in response to part b, the respondent believes there is a practice deficiency of 5. The assumption is made that when part a is subtracted from part b, a large difference indicates a high degree of deficiency while a smaller difference indicates a smaller degree of deficiency.

The results from part c of each question—"How important is this requirement to you?"—also were tabulated for each group. A higher result means an individual places more importance on a responsibility, while a lower result indicates that an individual places less importance on a responsibility. Individual scores for CMAs and controllers were tabulated separately for each standard so that group comparisons could be made for each item.

The questionnaire was mailed to 400 CMAs and 400 corporate controllers. The CMAs were randomly selected from the 1981 Roster of Certificates in Management Accounting published by the Institute of Management Accounting. The controllers were randomly selected from the 1982 Standard and Poor's Industry Survey published by Standard and Poor's. Responses were received from 134 CMAs and 126 controllers, for a response rate of 33.5% and 31.5%, respectively.

This level of response suggests significant interest in the Statement.

How Well Are Ethics Practiced?

Table 1 contains each group's practice deficiency score by question. The data in this table are based on the difference between part b, how much there should be, and part a, how much there is now. The four categories of standards—competence, confidentiality, integrity, and objectivity—are shown separately. When statistical tests were applied to the responses of both CMAs and controllers, no significant differences were found (see Table 1). This result indicates that the two groups agree on the quality of practice exhibited by management accountants. In general, they believe it is high. This high quality may be explained by an informal code of ethics that management accountants already may be following. Management accountants may feel, collectively, that their practice is aligned closely with the practice of their fellow professionals, CPAs. This belief may stem from their common preparatory training, which usually is directed toward accounting as a profession and the responsibilities of a professional. Two CMAs expressed this view:

"The code of ethics should be the natural response of a professional person..." and "In my current position I follow these guidelines/standards on an ongoing basis. These standards are the cornerstone of the profession."

A second explanation for the perceived high quality of practice and the lack of difference could be attributed to the existence of corporate codes of ethics. Many respondents called the NAA Statement unnecessary and duplicative because most corporations have their own codes of ethics. The NAA Statement merely restated those. One controller(summarized this position:

"We do not believe a Code of Professional Ethics is necessary as all managers and executives are governed by their individual and/ or company code of ethics."

Another controller was more positive:
Table 2
Average Importance of Requirement Score

<table>
<thead>
<tr>
<th>Part I. Competence</th>
<th>Controllers</th>
<th>CMAs</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management accountants (MAs) have a responsibility to:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.</td>
<td>6.469</td>
<td>6.278</td>
<td>NS</td>
</tr>
<tr>
<td>2. Perform their professional duties in accordance with relevant laws, regulations, and technical standards.</td>
<td>6.704</td>
<td>6.539</td>
<td>.01</td>
</tr>
<tr>
<td>3. Prepare complete and clear reports and recommendations after appropriate analysis of relevant and reliable information.</td>
<td>6.616</td>
<td>6.417</td>
<td>.05</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part II. Confidentiality</th>
<th>Controllers</th>
<th>CMAs</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management accountants have responsibility to:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so.</td>
<td>6.747</td>
<td>6.569</td>
<td>.01</td>
</tr>
<tr>
<td>5. Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.</td>
<td>6.649</td>
<td>6.293</td>
<td>.01</td>
</tr>
<tr>
<td>6. Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.</td>
<td>6.827</td>
<td>6.730</td>
<td>NS</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part III. Integrity</th>
<th>Controllers</th>
<th>CMAs</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management accountants have a responsibility to:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict.</td>
<td>6.667</td>
<td>6.276</td>
<td>.01</td>
</tr>
<tr>
<td>8. Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.</td>
<td>6.707</td>
<td>6.287</td>
<td>.01</td>
</tr>
<tr>
<td>9. Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.</td>
<td>6.510</td>
<td>5.897</td>
<td>.01</td>
</tr>
<tr>
<td>10. Refrain from either actively or passively subverting the attainment of the organization’s legitimate and ethical objectives.</td>
<td>6.724</td>
<td>6.278</td>
<td>.01</td>
</tr>
<tr>
<td>11. Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.</td>
<td>6.302</td>
<td>6.026</td>
<td>.05</td>
</tr>
<tr>
<td>12. Communicate unfavorable as well as favorable information and professional judgments or opinions.</td>
<td>6.526</td>
<td>6.336</td>
<td>NS</td>
</tr>
<tr>
<td>13. Refrain from engaging in or supporting any activity that would discredit the profession.</td>
<td>6.418</td>
<td>6.212</td>
<td>NS</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part IV. Objectivity</th>
<th>Controllers</th>
<th>CMAs</th>
<th>Level of significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management accountants have a responsibility to:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. Communicate information fairly and objectively.</td>
<td>6.677</td>
<td>6.470</td>
<td>.01</td>
</tr>
<tr>
<td>15. Disclose fully all relevant information that could reasonably be expected to influence an intended user’s understanding of the reports, comments, and recommendations presented.</td>
<td>6.495</td>
<td>6.407</td>
<td>NS</td>
</tr>
</tbody>
</table>

The Mann-Whitney V test for nonparametrics uses median values not mean values. Mean values are reported for comparisons. Only levels of significance of .05 or below are shown. The notation "NS" indicates that the differences in importance were not significant at the .05 level of confidence.

“We, at . . . , are in complete agreement with the principles of establishing a code of professional ethics for all management accountants. As stated in your questionnaire, the adherence to the standards of the code improves the value and status of management accountants. As you can infer by our responses to your questionnaire... the management of . . . has firmly incorporated the principles of the code into its corporate philosophy.”

CMAs, on the other hand, expressed less enthusiastic support for the code of ethics. One CMA
made the following comment:

"I consider a code of ethics important, but without a ruling body to enforce it (such as the AICPA enforces its code) I see it having little impact. Individuals will continue to follow their personal code of ethics as in the past. I do think it might help to educate young accountants as to what is expected in the way of ethics."

A second CMA responded:

"Much of the code is similar to my corporation's Standards of Conduct for officers."

In summary, although CMAs and controllers agree that the Statement has value, they indicate that corporate codes of ethics already exist and that the NAA's Statement for management accountants reinforces currently existing codes. By reinforcing current codes of ethics, the Statement provides a useful service and a measure of consistency among companies.

Are Ethics Important?

The results of part c of the responses—"How important is this requirement to me?"—are presented in Table 2. The responses to part c are more revealing than the deficiency portion of the questionnaire. The statistical tests used indicated that controllers' and CMAs' responses are significantly different in nine of the 15 responsibilities. The mean score for controllers was higher than the scores for CMAs, which indicates that controllers place a greater value on the responsibilities than do CMAs.

Why do CMAs and controllers differ? One possible reason is that controllers view management accountants as a large group of professionals who perform a necessary and valuable service for their companies. This view was expressed by a controller who wrote:

"Management accounting rarely seems viewed as a true profession. Efforts to more strongly stress the professional nature of the activity would benefit both company management and outsiders who use corporate financial data."

CMAs view themselves as employees who have little chance for professional judgment. For example, one CMA stated:

"CMAs are not CPAs. CPAs have an independent relationship with their clients due to the nature of the work they perform. The CMA's client is his boss. Therefore, more times than not, what is provided is what the boss wants. A professional code will not change this relationship."

A second CMA expressed his concerns about the Statement:

"I feel a management accountant's first responsibility is to his employer as long as he is not required to perform illegal or unethical acts... It should be kept in mind that the management accountant is always under control as an employee, and real pressure can be applied not associated with public accountants. In many companies a manage-

One does not resolve an ethical conflict by simply reaching an agreement.

Another concern expressed by CMAs was that a code of professional ethics caused an adversary relationship between management and the accountant. One CMA told us:

"Outside agencies have an existing army of auditors helping them already—management does not need internal spies questioning their judgment and going behind their backs..."

A third reason for CMAs to be less enthusiastic than controllers about the Statement seems to be the matter of enforcement. CPAs have both professional and legal support for their code of ethics, while CMAs have no legal means of enforcement. As one CMA said:

"I hold both the CPA and CMA. I worked in public for five years and in industry for 15. The Code of Ethics is fine, but since management accountants do not belong to
one organization, there is no enforcement club/stick to make it work (i.e., no penalty for violating it). I still think the code is a good idea and something everyone who calls himself a management accountant should strive for."

The responses to the questionnaire and the comments made by the participants indicate that both CMAs and controllers believe a code of ethics is a good idea. CMAs, however, are less supportive than controllers. The CMAs' lack of enthusiasm can be explained by their fear of the impact the Statement might have on their jobs. CMAs fear confrontation with their employers rather than viewing the Statement as a guide for improving their practices.

Controllers view the Statement as enhancing and justifying their confidence in the high quality of practice that currently exists. Controllers know that when management accountants follow the code, reports will be of the highest quality, and corporate secrets will be safe.

Not a Final Solution

It appears that what the NAA has produced is a code of professional conduct rather than standards of ethical conduct. The Statement undoubtedly is a step in the right direction in that it recog-

nizes a problem and a need. The document provides a degree of objectivity to the process of determining what is a correct professional (but not necessarily moral) action in management accounting and removes some of the subjectivity from the process.

Most definitions of a profession include or imply the understanding that its members adhere to a code of professional conduct. The Statement provides management accounting with a supporting justification for its claim to professionalism. For this it can be applauded.

Our overall conclusion is that the Statement will serve a useful purpose for both CMAs and controllers. Its standards will assist the profession in self-regulation and should improve professional competence. It also should convince management accountants that professional standards are desirable. The Statement is a good beginning that should lead to a good end. It is a solution, but it is not a final solution, for professional conduct is an issue that will be with us as long as accountants are held accountable.
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The Controller Who Said 'No'

He faced the classic professional dilemma: Should he report the wrongdoing and risk being fired or keep silent and compromise his integrity?

By Anne J. Rich

"A set of do's and don'ts is important but not enough. If the company, from the top executives on down, embraces a stated standard of ethical and moral conduct, it can create an environment that supports consistent ethical conduct and leads to greater cohesiveness within a corporate structure."

Donald V. Siebert, retired chairman of the board, JC Penney Company December 25, 1983, N.Y. Times

It's the beginning of another September work day and G.G. Peterson is trying to decide whether to accept the president's latest expense report. Many conflicting thoughts are bouncing about in Peterson's mind. He is concerned about legal liability, he has just read the newly issued Standards of Ethical Conduct for Management Accountants, and he remembers his own life-time commitment to honesty. He decides to make a telephone call.

What circumstances led up to that telephone call? How did Peterson's own moral code as well as his respect for the National Association of Accountants' standards affect the outcome? Is honesty rewarded in business? G.G. Peterson's personal professional battle is a true story that may provide some insight into these questions.

G.G. Peterson had been controller of the American subsidiary of a European-based conglomerate for a year and a half. During this time, his only contact, as was true of the entire American staff, had been with the subsidiary's president. Even the vice president of marketing had been denied direct access to the two European partners.

The division's president, Roger Green, had been promoted rapidly. In five years he had moved from a starting salary of $1,000 to one in excess of $50,000. He readily boasted about his managerial ability and liked to tell his staff he was a respected turn-around manager. Four people reported to him: the production and inventory control manager; the V.P., manufacturing; the V.P., research and development; and G.G. Peterson, controller. All were very competent individuals.

During Peterson's first year many expenses...
seemed high, particularly entertainment. President Green repeatedly told Peterson that the lavish entertainment reimbursements were part of an approved compensation package. Following the president's directions, Peterson approved the disbursements. In the second year, expenses increased. But now, instead of true entertainment vouchers, Peterson began to see invoices for luggage, expensive clothing, household furnishings and other nonbusiness, personal items. Occasionally he would question the appropriateness of the expense. The president again insisted that the European partners had agreed to treat such items as fringe benefits. The controller was directed to pay. Although budgets were prepared for the American subsidiary, the European office paid little attention to individual line items. Because the bottom line was acceptable, no one questioned the large travel and entertainment expenditures.

By the middle of year two, Green had put his wife on the payroll. He said she wrote correspondence and stuffed envelopes at home. Peterson knew there was adequate secretarial support in the office. Moreover, Green, who felt that he had built the company and "it owed him," began to charge his all-night card parties at a local hotel. He justified the room as a cost incurred in interviewing potential employees. By now, it was clear to Peterson that the situation had gone from possible improprieties to potential illegalities. Whatever else, it was definitely unethical.

How Much Padding Is Acceptable?

Lately, numerous articles have appeared in professional journals, from the Harvard Business Review to the Connecticut CPA, on the subject of ethics in the work environment. It appears that many individuals feel the principles and values that were so respected in the past have eroded. Peterson's thoughts turned to a speaker at a recent chapter meeting. A question was addressed to the audience concerning honesty on the job. Does using the firm's telephone for personal calls make a person a thief? What about taking pencils and stationery home for personal use? How much padding of the expense account is acceptable? To this controller's surprise, the tolerance for these kinds of acts was extremely high. Many of Peterson's colleagues could not understand why he was at all concerned about a few thousand dollars of corporate funds being diverted. After all, the European company was a multimillion dollar conglomerate. Few of his peers would even consider risking their jobs for this insignificant sum.

Peterson, however, was upset. At last, he sought the advice of a good friend who was a CPA and he talked to his fellow NAA members. "I was troubled a great deal," he remembers. "I thought about leaving my position. I had been in similar circumstances twice before. Both times I was fired as a result of trying to maintain my own high moral standards. Now I have a family to support." There was another concern. Green had come from a criminal background. He often boasted of his own wartime record as well as his father's use of physical force. Green himself appeared capable of physical violence. Although a combat veteran, Peterson feared for his own and his family's safety.

After agonizing over his situation, Peterson came to a decision. He would "avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict." He would "refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives." He would "communicate unfavorable as well as favorable information and professional judgments or opinions." And he would "refrain from engaging in or supporting any activity that would discredit the profession." Because his immediate superior was involved, Peterson telephoned the company's corporate attorney and asked to see him.

"I went to the attorney's office with photocopies of clearly misrepresented travel and entertainment vouchers. I knew the lawyer was also on the company's European board and would reflect the values of the parent company. I also knew one of the European partners was in the United States and could be reached quickly if the attorney desired. I didn't know how the attorney would react."

After reviewing the evidence, the attorney felt there was a good chance something was wrong. The company's Big 8 auditors were in the same building and the partner in charge and the manag-
er were called in. After talking the situation over, the men agreed the European partner should be informed. Peterson was understandably frightened. If it became known that he was the one who exposed the fraudulent expense vouchers, he might expect retribution from Green. The attorney and the auditors were understanding. Several days later, Peterson was informed that the European owner asked to meet with him. They met that night.

The plan that emerged from their meeting was for the partner to make a routine visit to the American subsidiary. Peterson would direct his attention to the irregularities. The partner assured Peterson his involvement would be kept secret. Peterson sensed the partner appreciated his honesty.

The Tightening Web and Denouement

The plan was executed perfectly. The partner arrived at the office and went through invoices and records. The file incriminating the president was complete. The next step was clearly up to the partner. Knowing that the second owner was expected in the U.S. shortly, Peterson felt nothing would happen immediately. He was wrong. The European partner called Mr. Green in to discuss his findings. Skillfully, the partner went over each invoice with Green. At first, Green suspected nothing. But, as the conference went on, he felt a web tightening around him. Finally, he admitted wrongdoing and begged for another chance.

The following day, the second partner arrived and was informed of the situation. That night, Peterson met with both partners. "I advised them to fire the president. Everyone in the shop was aware of his activities; no one respected him." It is commonplace in the U.S. to fire employees caught stealing. Peterson knew it wouldn't be productive to keep Green. But the European owners felt Green should repay the company for the full amount of his debt. He was demoted to vice president and took a cut in pay.

The task of determining exactly how much Green owed fell to the auditors and Peterson. After they had examined all invoices, Green was charged over $20,000. Many of the personal items, bought recently, were returned, among them an air conditioner, numerous tools, and supplies. He was credited with roughly $9,000. He agreed to pay back the difference over the next three months.

There was also the matter of a personal, interest-free loan of $13,000. Initially, Green expected Peterson to deduct the loan payments from his salary and report the lower amount to the IRS as salary, an illegal action. Instead, Peterson recorded the wages at the proper amount and the debt was to be paid back in after-tax dollars.

What happened to Peterson? He was promoted to vice president of finance and given a raise in salary. If the company does well, Peterson will probably continue to be well treated. Green still works for the company as a vice president but does little except complain and demoralize other employees. At a time in history when magazine articles contain stories about white collar crime, and the breakdown of the ethics of the business community, G.G. Peterson's story might be considered unusual. After all, there is a perception that most whistle blowers—like the proverbial bearer of bad news—are punished.

Will the NAA Standards of Ethical Conduct for Management Accountants provide the necessary motivation and guidelines for others to counter what often seems to be widespread acceptance of questionable acts? For Peterson, his laminated plaque of the Standards is strategically placed in his office as a reminder of his integrity, professionalism and, most important, his self-esteem. 🕒

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Donating Inventory Can Improve Profitability

Here's how your company can give unwanted goods to a worthy cause—and at the same time reduce its tax bill.

By James D. Kimes

Companies can donate obsolete and slow-moving items to charity and at the same time strengthen their bottom line. There is a little known tax law that makes donating inventory financially appealing because it allows more than the base cost of the inventory as a deduction. Companies may deduct one half the gross profit plus the base cost—provided the donee qualifies as a specific kind of charity.

The options an inventory controller has are very few when it comes to making a decision about what to do with inventory items that may be moving too slowly to warrant the carrying cost. The items can be scrapped for a total loss, sold at distressed prices, returned to the vendor at a substantial restocking charge, or given away as charitable contributions.

The objective, of course, is to choose the option that produces the highest net profit. Scrapping inventory for a complete loss is the most costly, because lower taxes is the only relief. The only positive feature of disposing of inventory outright is that it’s quick. For inventory management to be maximally effective, it must be decisive. Often the attempt to sell slow-moving merchandise at a distress sale can result in costly foot-dragging. On the other hand, there is very little related cost associated with scrapping inventory as compared to selling it at distressed prices. For instance, trying to sell slow-moving merchandise requires someone’s effort and expertise. An organization may not have such a person or may not deem it profitable to devote time to a fruitless endeavor. There is both tangible cost and opportunity cost associated with trying to motivate the sales force to participate conscientiously in a close-out exercise. Such effort subtracts from the amount of time that can be devoted to products that are more profitable. Usually the attitude prevails that, if the merchandise didn’t sell the first time, why should it move as a close-out?

The best of all worlds is an environment in which a company would be more motivated to donate inventory than to scrap it. Fortunately, there is such an arrangement that makes a donation of unwanted goods more profitable than taking a total loss.

Prior Law Discouraged Donations

Under prior tax law (sec. 170(e)(3)(A)), a taxpayer who made a charitable contribution of property was required to reduce the amount of the deduction (from fair market value) by the amount of ordinary gain he would have realized had the property been sold instead of donated to charity. (Under certain circumstances, a taxpayer also was required to reduce the amount of his charitable contribution by a portion of the capital gain he
would have received if the property had been sold. Thus, the donor of appreciated ordinary income property (property the sale of which would not give rise to long-term capital gain) could deduct only his basis in the property rather than its full fair market value.

When this rule was added to the Code in 1969, it was intended, in part, to prevent abuse by taxpayers in high marginal tax brackets and corporations which could donate substantially appreciated ordinary income property to charity and actually be better off, after tax, than if they had sold the properties and retained all the after-tax proceeds of the sales.

The rule that the donor of appreciated ordinary income property could deduct only his basis in the property effectively eliminated the abuses which led to its enactment; however, at the same time, it resulted in reduced contributions of certain types of property to charitable institutions. In particular, those charitable organizations that distribute food, clothing, medical equipment, and supplies to the needy, and victims of disaster received fewer contributions.

 Favorable Treatment Introduced

Congress decided a few years ago that it was desirable to change the law and provide a greater tax incentive for contributions of certain types of ordinary income property, but it did not want the donor to be in a better after-tax situation if he decides to donate property rather than sell it.

The Tax Reform Act of 1976 allows a corporation (other than a subchapter S corporation) a deduction for up to half of the appreciation on certain types of ordinary income property contributed to a public charity (other than a governmental unit) or a private operating foundation.

In order to qualify for this treatment, the following conditions must be satisfied:

1. The donee must use the property in a use related to its exempt purpose and solely for the care of the ill, the needy, or infants;
2. The donee must not transfer the property in exchange for money, other property, or services;
3. The donor must receive a statement from the donee representing that its use and disposition of the property will comply with requirements 1. and 2. above; and
4. The property must satisfy the relevant requirements of the Federal Food, Drug, and Cosmetic Act in effect on the date of transfer and for 180 days prior to such transfer.

If all these conditions are complied with, the charitable deduction is generally for the sum of the taxpayer's basis in the property and one-half of the unrealized appreciation. In no event, however, is a deduction to be allowed for an amount that exceeds twice the basis of the property. Furthermore, no deduction is to be allowed for any part of the unrealized appreciation that would have been ordinary income (if the property had been sold), because of the application of the recapture provisions relating to depreciation, certain mining exploration expenditures, certain excess farm losses, certain soil and water conservation expenditures, and certain land-clearing expenditures.

By virtue of the requirement that donations must be made to donees who use the property "solely for the care of the ill, the needy, or infants," the range of products that will qualify is limited, but the number of products that probably would not be useful (such as most basic raw materials), are few in comparison to the many consumer and commercial products that can be used in maintenance operations of charitable institutions.

The Timid Tax Manager

Code Section 170(e) has proven to be a very intelligent piece of legislation, especially because so many of the federally funded social programs have been discontinued. There is a definite need for business concerns to donate more inventory to charity. Obsolescence due to style, fashion, and the fickle tastes of the American consumer has always presented a problem for inventory management. Although legislation has enabled more businesses to purge their inventory often enough to keep it sufficiently lean and balanced, I have found in discussing this problem with various controllers and tax managers that one or more of three things is standing in the way of greater charitable activity involving inventory: they simply are not aware of the legislative provision; there is inordinate concern about IRS's acceptance of fair market value; and inventory management is not being adequately coordinated.

Of the executives I've talked to, those who profess to know about the tax law have never seriously considered investigating its benefits. Often they aren't sure how the formula reads (deduction is equal to cost plus one-half of gross profit, but not to exceed two times cost). Unfortunately, it is true that very little has been written about the tax.

'It can be more profitable to donate inventory than to take a total loss.'
benefits of charitable donations. Even the wording in the tax manuals is scant and somewhat hard to follow.

One institution I support needed flooring for a new building it was constructing. An official of the institution called me for help and I in turn called a friend of mine who was in the flooring business. Neither my friend nor his accountant were aware of the tax provision relating to inventory donations. To make a long story short, the institution got its flooring, my friend got a larger than expected tax deduction, and I had my suspicions confirmed that many accountants are unaware of the favorable treatment feature of donating inventory.

Another stumbling block is the timid tax manager. He is afraid some question may be raised regarding the price used in computing the gross profit portion of the deduction equation. I believe the IRS will not be too pesky if a solid argument can be made on behalf of a reasonable price. Even though a product has been discounted at one time or another, this does not mean the discounted price has to be used in computing the deduction. Trade discounts based on volume are common.

Neither does it mean that just because an item is moving slowly that the price must be lowered in computing the deduction. It is management’s decision to retain merchandise as long as it wants even though few items are selling at list price. On the other hand, it would be unfair to use full price after the merchandise has been marked down due to obsolescence and slow movement. What is required, then, from a technical standpoint is to use a price that reflects fair market value, even though it may be a discounted price.

The general rule to determine fair market value is provided in Regs. 1.170 A-1(c) (2). The rule states that if the property is of a type that the taxpayer sells in the course of his business the fair market value is the price the taxpayer would have received had he sold the property in the “usual market in which he customarily sells at the time and place of the contribution, and in the case of goods in quantity, in the quantity contributed.” However, if a donor makes a contribution of property such as stock in trade at a time when he could not have been reasonably expected to realize its usual selling price, the value of the gift is reduced to the amount for which the property would have been sold at the time of the contribution (Regs. 1.170 A-1(c) (3)).

Because the tax deduction cannot exceed two times cost, another guideline to use is that gross profit margin cannot exceed 67%. Once gross margin exceeds 67%, cost plus one-half of gross profit will exceed two times cost. For those companies whose products carry high selling and distribution costs, and therefore justify a high gross margin, the fair market value could represent a heavily discounted price but would still make the donation worthwhile. Donors of inventory should be careful not to overstate the value of the property. The Tax Reform Act of 1984 states explicitly that the penalty for an overstatement infraction is an additional 30% of the tax underpayment attributable to the valuation overstatement. (Ref. Act Sec. 155(C)(1), amending code Sec. 6659).

There’s a management maxim that says if your staff never works any overtime, you could be overstaffed. There may be some truth to that. It is also possible that if you never heard from IRS, it could be that your stance on deductions, which are not always cut and dried, could be too conservative.

This brings us to the final stumbling block—a lack of coordination of inventory management. A well-organized operation is important because the IRS requires donations to be made at specific times in order not to violate the fair market guidelines. A team to coordinate this effort should be created and consist of the product manager, the purchasing agent, the production scheduler, and the tax manager, with the controller as chairman.

**Determining the Most Profitable Option**

A company considering an inventory donation must decide what merchandise to donate and what should be sold. To facilitate the decision, a break-even equation can be used by satisfying four variables: tax rate; list price; cost; and the expense involved in selling the merchandise, such as commissions, distribution costs, and accounts receivable carrying costs.

The break-even equation actually addresses the “least cost” approach, and sets each option equal to the other. A price is then found that, when reached, will yield the same net profit. It is then up to the committee to determine whether to sell the merchandise or give it away. Some of the factors influencing this decision are:

- How much time is left before fiscal year-end;
- How much has been donated to charity already (the limit now for charitable deductions for a corporation is 10% of taxable income for taxable years beginning with 1983);
- Is there a charity that qualifies and can use the product in question; and
- Are inventory levels too high?
The equation derived below solves for the indifferent price, at which point the merchandise can be donated to charity and yet not affect net profit:

\[ (Y - XY - C)(1 - t) = -C(1 - t) - (L - C)(.5)(t) \]  

Where \( Y \) = breakeven price
\( X \) = selling expenses as a percent of \( Y \)
\( C \) = Cost
\( t \) = tax rate
\( L \) = list price or price for calculating gross profit qualifying for special treatment

This equation can be simplified to make it easier to solve for \( Y \), the breakeven price:

\[ Y - XY = -C(1 - t) + (L - C)(.5)(t) + C \]  
\[ Y(1 - X) = -C(1 - t) + (L - C)(.5)(t) + (1 - t)(C) \]

Let's take an example:

Cost (C) = $6.00
List Price (L) = $10.00
Tax Rate (t) = .48
Selling Expense (X) = .15 (15% of \( Y \))

Inserting these values into equation (4), we get a breakeven price of $2.17. In other words, if we don't think we can sell the item in question at a marked-down price of $2.17, or 36% of cost, then we should donate it to a qualifying charity.

This equation can be modified for any model more suitable to a specific situation. For instance, it might be wise to assign some fixed costs to selling expense. It may not be realistic to view selling expense as being purely variable and a function of the selling price. Assigning a fixed expense would tend to make the break-even price higher.

Making the Effort

With looming budget deficits, the government is looking for every dime of revenue it can get. However, the small amount of revenue lost due to the increased use of the favorable treatment of Code 170(e) is minor compared to the benefits received. In addition to helping the needy, business profits by being able to write off slow-moving inventory more quickly.

It was estimated in 1976 that if companies took advantage of such favorable treatment, the amount of lost tax revenues would have been $5 million for fiscal year 1977, $8 million for 1978, and $33 million for 1981. These amounts are insignificant when compared to the multiplier effect of inventory value being donated versus the value that is written off at base cost and scrapped simply because there is no advantage or benefit to the corporate taxpayer.

Fortunately, legislation has made it more profitable under certain circumstances to donate inventory rather than take a total loss. This gives business the incentive to donate more, to go that extra mile in locating charities that can use a particular product; and, as a result, government, individual taxpayers, business, and our nation's needy all benefit.

Other legislation that provides similar tax incentives include the Computer Contribution Act of 1983 (H.R. 701), and the special rule instituted by the Economic Tax Act of 1981 that allows favorable treatment for contributions for scientific research. Information on donating computers to primary and secondary schools can be obtained by writing to the Committee on Ways and Means, U.S. House of Representatives, Washington, D.C. 20515. The technical requirements for scientific research contributions are found in ERTA Section 222(a), Code Section 170 (e)(4)(B)(i)-(vii).

I recommend that every business concern regardless of size should have one individual who has a working knowledge of these tax laws, responsible for administering inventory donations. By paying special attention to this provision, companies can demonstrate a concern for social needs while strengthening the bottom line.
Surviving the IRS Tax Accrual Decision

If potential disclosure of work papers presents an unacceptable risk to business, then accountants perhaps should adopt an alternative method of auditing the reserve for contingent tax liabilities.

By Gary A. Growe and Philip G. Kaplan

On March 21, 1984, the Supreme Court of the United States unanimously decided the case of U.S. v. Arthur Young and Co., in favor of the Internal Revenue Service and in so doing granted the Service broad powers in subpoenaing what the accounting profession claimed were sensitive and private documents. Two major positions of the accounting profession were rejected. First, the Court overruled the establishment of a limited accountant-client work product privilege and, second, adopted a very broad definition of the word "relevance" as contained in §7602 of the Internal Revenue Code.

Tax accrual work papers have been labelled the definitive road to the soft spots on a corporate tax return. These sensitive documents are prepared in connection with an accounting firm's review of a company's annual disclosure filings with the Securities & Exchange Commission. The securities laws require all publicly traded companies annually to file independently audited financial statements with the SEC. With a tax audit, the independent firm must give an opinion as to the adequacy of the company's reserve for contingencies. One of the contingencies addressed is the possibility that through the audit, additional tax liability may be imposed. The amount of money reserved for potential tax liability is referred to as the tax accrual. Tax accrual work papers represent the auditor's background material prepared in the review of the contingency reserve and normally will contain memoranda concerning the reasonableness of the client's tax position, the likelihood of IRS challenge, the probable outcome of litigation and the possibility of settlement. A thorough and frank review by the independent accounting firm will bring together most of the corporation's potential tax vulnerabilities and highlight for an examining agent exactly where the taxpayer expects a challenge. Companies concerned about their tax accrual file can take steps to preserve its confidentiality. To understand what can be done, a review of the Arthur Young case and the Supreme Court's decision is necessary.

A 'Special Disbursement Account'

When performing a routine audit to determine the income tax liability of Amerada Hess Corporation, IRS auditors discovered that the corporation had made questionable payments from a "special disbursement account." A criminal investigation of the corporation's tax returns ensued and, in the course of that investigation, the IRS, pursuant to §7602 of the Internal Revenue Code, subpoenaed Amerada Hess's independent public accounting firm, Arthur Young and Co.
This Code Section authorizes the Secretary of the Treasury to summon and examine any books, papers, records, or other data that may be relevant or material for a particular tax inquiry. Early cases decided under this section, United States v. Powell and United States v. Davis, instructed that the requirements for judicial enforcement of subpoenas issued under this section were minimal. Broad scope always has been given to the Internal Revenue Service in exercising its §7602 summons power.

What prompted the controversy in Arthur Young was that the subpoena requested that the firm’s tax accrual work papers prepared during its audit of Amerada Hess be turned over to the IRS. Arthur Young refused to comply with the subpoena, arguing that the documents were not relevant to the investigation and were otherwise privileged under an asserted accountant-client privilege. The trial court rejected both positions and ordered the tax accrual work papers produced.

On appeal, the United States Court of Appeals, Second Circuit, reversed, holding that tax accrual work papers were confidential and created, by judicial declaration, an accountant-client work product privilege. The Appeals Court attempted to balance a conflict in our society. On the one hand, the Court was concerned with the public interest in ensuring the maintenance of fair and honest markets in securities transactions and, on the other, with revenue collection. The possibility that corporate clients would withhold information from their auditors because of the fear that their tax accrual analysis may be subject to subpoena persuaded the Court that tax accrual work papers should be deemed the privileged work product of auditors.

The Supreme Court overruled this far reaching Appellate Court opinion and rejected the notion that a privilege exists for the protection of auditors’ tax accrual work papers. This aspect of the decision has received, by far, most of the public discussion and debate. However, the more important aspect of the Court’s decision was its adoption of a very broad working definition of relevance under Section 7602 of the Code. Courts had, in the past, placed restrictions on the IRS summons power under §7602. Several courts had adopted what was known as the “realistic expectation test.” The Tenth Circuit, in United States v. Coopers and Lybrand specifically refused enforcement of a Section 7602 subpoena which sought production of tax accrual work papers on the basis that they were not relevant to the correctness of a tax return. Focusing on the fact that the tax accrual work papers were not used in the preparation of the corporate tax return, the Court held that the documents were not relevant within the meaning of §7602.

Contrary to the decision in Coopers and Lybrand, other courts have adopted a more liberal standard and defined relevance as “whether the information might throw light upon the correctness of the return.” The Supreme Court in Arthur Young accepted this broad definition of relevance. The Court stated the test differently when it emphasized that “records that illuminate any aspect of the return are therefore highly relevant to legitimate IRS inquiry.” The Court justified this result by noting that use of the words “may be” in §7602 reflected a Congressional intent to allow the IRS to obtain items of even potential relevance to an ongoing investigation.

**Work Product Privilege Rejected**

The second part of the Arthur Young case is the Supreme Court’s rejection of the existence of an auditor work product privilege. In discussing the Court’s holding on this question, it is important that we view the result in proper perspective. The Supreme Court was correct in its denial of the privilege. The attempt to create an auditor’s work product privilege through judicial fiat was unsupported by prior precedent. The Second Circuit Court of Appeals had cited a famous Supreme Court case, Hickman v. Taylor, which established the existence of a lawyer’s work product privilege as support for a similar work product privilege for the accounting profession. However, the work product doctrine as developed under Hickman v. Taylor protects from disclosure information that counsel obtains in anticipation of litigation through sources other than his or her client. In addition, the work product privilege may be overcome by an adversary’s assertion and demonstration of need. In rejecting the auditor’s work product privilege, the Supreme Court drew a sharp distinction between the role of private counsel and the role of an independent certified public accountant:

The Hickman work-product doctrine was founded upon the private attorney’s role as the client’s confidential adviser and advocate, a loyal representative whose duty it is to present the client’s case in the most favorable possible light. An independent certified public accountant performs a different role.
By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. To insulate from disclosure, a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.

Clearly, the auditor while serving as a certified public accountant in reviewing the public company's financial statements and tax returns does not serve as an advocate. Generally accepted accounting principles require accountants to examine the records in order to ensure that a proper reserve is established for contingent tax liabilities. The proper role of the certified public accountant is closer to that of an adversary than an advocate of his or her client.

**Tax accrual work papers have been labelled the definitive road map to the soft spots on a tax return.**

Finally, although the Court never discussed the point, it is clear that the work product privilege was never applicable to the accountant-client relationship. The work product doctrine only protects written material prepared by counsel in anticipation of litigation as it was intended to assist counsel in his or her role as an advocate. In the context of tax accrual work papers, the independent certified accountant is not and cannot be an advocate for the company. Tax accrual work papers are clearly not prepared in anticipation of litigation, although some portion of a tax accrual memorandum may attempt to predict the outcome of litigation with the IRS.

**Following a Policy of Self-Restraint**

After *Arthur Young* is there any reason to resist subpoenas and refuse to turn over tax accrual work papers on the basis that they are irrelevant under §7602 and represent nothing more than a fishing expedition? The answer to that question may very well lie with the policy of the government. A close reading of the Court's opinion reveals that in adopting a broad definition of "relevance" and in rejecting the concept of an accountant's work product privilege, the Supreme Court relied on the government's expressed declaration of self-restraint in subpoenaing accountants tax accrual work papers. The Court stated (on page 1504):

> Recognizing the intrusiveness of demands for the production of tax accrual work papers, the IRS has demonstrated administrative sensitivity to the concerns expressed by the accounting profession by tightening its internal requirements for the issuance of such summonses. Although these IRS guidelines were not applicable during the years at issue in this case, their promulgation further refutes respondent's fairness argument and reflects an administrative flexibility that reinforces our decision not to reduce irrevocably the §7602 summons power.

The Court was referring to the 1981 Revision of the Internal Revenue Manual, which addresses the issue of the accrual work papers. The manual is clear that the papers will be requested only in unusual circumstances. In addition, a specific issue or issues must have been identified previously by the IRS auditor. It is required that the auditor have already sought from the taxpayer all facts known to the taxpayer relating to the issues and that the taxpayer's records are the primary source of data to support the return. Requests for tax accrual work papers are not part of the IRS standard examining procedure and in summoning work papers, it must look to the corporation before the independent auditors. In order to issue a subpoena calling for the production of tax accrual work papers, the IRS examiner must have written approval.11

Shortly after the case was decided, the Commissioner did, in a bulletin, reaffirm the Service's adherence to the manual and a policy of self-restraint with respect to the subpoenas for tax accrual work papers.12 However, the IRS manual is not binding upon the Service or a Court. A future change of administrations brings with it the possibility of change in the Service's policy. It is therefore important to monitor the issuance of subpoenas for tax accrual work papers in the future. To the extent that it become commonplace for a §7602 subpoena to include requests for tax accrual work papers, then the door would be open to attack the relevancy of a particular subpoena on a case-by-case basis.
What Can Be Done

The stark reality now facing management accountants and their company’s independent public accounting firms is that when the IRS determines that it needs or requires access to tax accrual work papers in order to conduct an audit, these documents will be subject to subpoena. However, steps may be taken to blunt the impact of the Arthur Young decision:

- If management is concerned about disclosure of working papers, it should instruct its certified public accounting firm to strip the papers down to the bare minimum.
- The accounting profession should consider changing the generally accepted accounting standards pertaining to tax accrual work papers. Preparation of those work papers is not required by any regulation or statute, but they are prepared in order to comply with generally accepted accounting standards. If potential disclosure of these papers presents an unacceptable risk to business, accountants should adopt an alternative method of auditing the reserve for contingent tax liabilities. One possibility is that a statistical-based estimate of the average tax liability for a corporation with similar characteristics be used.
- Some accountants may attempt to cloak the preparation of these tax accrual work papers with the umbrella protection of the attorney-client privilege. Corporations, theoretically, could retain counsel to prepare the analysis of the sufficiency of the contingency reserve with legal counsel retaining the services of the independent certified public accountant. Although there are no court decisions on whether this device is an acceptable method of preserving the confidentiality of tax accrual work papers, it is our opinion that attempting to use legal counsel as insulation will not work. The procedure would raise the issue of when an attorney is serving as an attorney and when as an accountant. Based upon the Supreme Court’s analytical distinction between lawyers in an adversarial role and accountants, it would appear that retaining counsel just for the purpose of protecting tax accrual work papers almost assuredly will fail.
- Companies should maintain complete files. This policy will allow the argument that because the IRS has direct access to all corporate records it needs tax accrual work papers to conduct an audit, it can subpoena them.
- Some accountants have suggested that once the work papers have been used, they may be destroyed. It is arguable that tax accrual work papers are not primary documents specifically required to be maintained. They would appear to be ancillary, consisting of memoranda and opinions. Before destroying these papers, however, companies should consult legal counsel on the possibility that such destruction might violate both civil and criminal statutes.

In the final analysis, it is difficult to imagine any accounting document that today can be safely classified as confidential. Whether this decision will have a chill effect on communications between a company and its accounting firm remains to be seen. The Supreme Court, however, did rely heavily on the integrity of the accounting profession in the issuance of the Arthur Young opinion and viewed the responsibility of the profession in assuring adequate public disclosure to be paramount. If full communication is lost, then the accounting profession will no doubt resort to the issuance of modified certification, clearly an unsatisfactory procedure.

The stark reality: when the IRS needs tax accrual work papers to conduct an audit it can subpoena them.

1104 S.Ct. 1495 (1984), copy attached as an appendix.
1Federal regulations require that these audits be performed in accordance with generally accepted accounting standards. Regulation 9-X, 17 C.F.R. §210.1-02(d) (1993). The requirement that the opinion must address the adequacy of the corporation’s reserve for contingencies is set forth in FASB Statement No. 5, Accounting for Contingencies, 1 Account Standards. The Internal Revenue Manual discusses the requirement that an accountant evaluate a corporation’s reserve for contingent tax liabilities: “The evaluation is based in part on the accountant’s analysis of corporate records and in part on its assessment of opinions and projections communicated in confidence by the client. In reaching its conclusion, the accountant considers all uncertain tax positions taken by the client and determines the extent of reserves necessary to cover the liability that would result assuming that all such questions were resolved against the client. Int. Rev. Manual—Audit (CCH) §4233, Ch.32024(4), at 7231-22.
2In pertinent part, Section 7602 of the Internal Revenue Code provides as follows: For the purpose of ascertaining the correctness of any return, . . . determining the liability of any person for any internal revenue tax . . . the Secretary is authorized (1) to examine any books, papers, records, or other data which may be relevant or material to such inquiry; (2) to summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody or care of books of account containing entries related to the business of the person liable for tax or required to perform the act, or any other person whose the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; . . .
436 F.2d 1028 (5th Cir. 1961).
5455 F.2d 728, 733 (9th Cir. 1973).
7United States v. Harrington, 388 F.2d 520, 523 (2d Cir. 1968).
8455 F.2d 728, 733 (9th Cir. 1973); United States v. Ryan, 480 F.2d 272, 275 (7th Cir. 1973); United States v. Ryan, 485 F.2d 728, 733 (9th Cir. 1973); United States v. El Paso, 662 F.2d 530 (5th Cir. 1982); United States v. Nosal, 587 F.2d 113 (2d Cir. 1978).
9Arthur Young, supra.
10329 U.S. 495 (1947).
12IR 84-85 (1/29/84).
Using Sales Equivalency as a Cost Saving Tool

This common denominator between marketing and production needs can be used to show management—surprise!—how small percentage gains in manufacturing improvement translate to sizable amounts in sales volume equivalents.

By Norbert L. Enrick

When constraints on energy resources and raw materials occur, many companies dominated by marketing managers will find it essential to move to a more balanced position, giving equal weight to manufacturing considerations. As a result, important savings in energy use; reductions in scrap, rework and waste; and enhancement of productivity can often be gained.

Yet, a balance between marketing and production needs is difficult to achieve because of traditional differences in performance measurement. In particular, marketing tends to emphasize increases in sales volume while production stresses cost reductions. Marketing and manufacturing, however, can place their gains on a common denominator by converting manufacturing cost savings into sales volume equivalencies.

In practice, a firm using this recommended approach is likely to encounter a welcome surprise: seemingly small percentage gains in terms of manufacturing improvement translate to relatively sizable amounts in sales volume equivalents.

Basic Concepts of Sales Equivalency

Conversion of cost savings to sales equivalents is best illustrated with the aid of a case study. A manufacturer earns a variable margin profit of 4% on $10 million volume annually. Scrap, rework, and waste reductions in processing are anticipated to yield a cost saving of 1% based on goods sold. This 1% represents 25% of overall profitability of 4%, which is applied to $10 million sales annually to constitute the equivalent of $2.5 million in additional volume. Going beyond monetary aspects, it must be realized that raw materials that are processed without going to scrap or waste become desirable additional product, available for sale at a time when market conditions contain elements of supply constraints. It is thus particularly in the areas of quality-control and the installation of modern, effective programs where management can achieve major benefits with relatively little expenditure.

Sales equivalencies can be read directly from Table 1. Using our prior example, enter the table at the level "Profit Percent = 4%" and move to "Manufacturing Cost Reduction = 1%," to find entry of 25% under "Equivalent Sales."

Alternatives and Choice

Sales volume equivalencies can be contrasted and compared to help managers choose an alternative course of action when necessary. Consider a firm with a 4% profit rate and vol-
ume of $10 million per year, which has these two alternatives:

1. Cost reduction program with a saving of 1%, which translates to \((1/4)(10,000,000)\) = $2,500,000 additional sales. Amortized installation cost is $100,000.
2. Sales promotion program with anticipated volume increase of 10% or $1 million. Program cost is $100,000.

Because the program costs are relatively small and identical we may, for simplicity, ignore them. It is clear that the cost reduction program is superior because it will gain the equivalent of $2.5 million additional sales, as against only $1 million from the promotion program. Therefore, if financial resources are limited, the cost reduction program should receive preference.

Sales volume equivalency comparisons can be sharpened by introducing the concept of expected value, which takes cognizance of the probability of success of a program. Generally, one can be more assured of success in an internal program (where machinery, equipment, and materials are known) than in an external one (where marketing situations, consumer preferences, and reactions to sales promotions may vary considerably).

Thus, it would not be unusual to have the following pair of probabilities:

1. Probability of success of internal program, 0.85 or 85%.
2. Probability of success of external program, 0.60 or 60%.

Now, an expected value is simply the product of an anticipated value (such as a sales volume as a result of a marketing program) multiplied by its probability of success. We thus have:

1. Expected equivalent sales gain from cost reduction
   \[ \text{Expected equivalent sales gain} = (\text{Anticipated Gain})(\text{Probability of Success}) = 2,500,000(0.85) = 2,125,000 \]
2. Expected anticipated sales gain from marketing campaign
   \[ \text{Expected anticipated sales gain} = (\text{Anticipated Gain})(\text{Probability of Success}) = 1,000,000(0.60) = 600,000 \]

Analysis in terms of expected values, therefore, represents a more refined comparison than simple contrasting of sales equivalencies. In the present example, the expected values point more strongly than before to the advantages of the cost reduction program. Situations can be demonstrated, however, where expected values significantly change the ordering of alternatives of action in the management decision process.

**Additional Benefits**

Expected sales equivalencies are a convenient means for ranking projects and arriving at ultimate management decisions on the allocation of financial and other resources to the most deserving programs. Experience thus far with this technique tends to demonstrate that improvement programs in manufacturing can have hidden, large-scale benefits. These benefits are brought out most strongly when viewed in sales equivalent terms. Moreover, when a cost improvement pro-

### Table 1

<table>
<thead>
<tr>
<th>Profit (%)</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>6</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>12</th>
<th>15</th>
<th>20</th>
<th>25</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>100</td>
<td>200</td>
<td>300</td>
<td>400</td>
<td>600</td>
<td>800</td>
<td>1000</td>
<td>1200</td>
<td>1500</td>
<td>2000</td>
<td>2500</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>50</td>
<td>100</td>
<td>150</td>
<td>200</td>
<td>300</td>
<td>400</td>
<td>500</td>
<td>600</td>
<td>750</td>
<td>1000</td>
<td>1350</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>33</td>
<td>67</td>
<td>100</td>
<td>133</td>
<td>200</td>
<td>267</td>
<td>333</td>
<td>400</td>
<td>500</td>
<td>667</td>
<td>833</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>25</td>
<td>50</td>
<td>75</td>
<td>100</td>
<td>150</td>
<td>200</td>
<td>250</td>
<td>300</td>
<td>375</td>
<td>500</td>
<td>625</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>17</td>
<td>33</td>
<td>50</td>
<td>67</td>
<td>100</td>
<td>133</td>
<td>167</td>
<td>200</td>
<td>250</td>
<td>333</td>
<td>415</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>12</td>
<td>25</td>
<td>38</td>
<td>50</td>
<td>75</td>
<td>100</td>
<td>125</td>
<td>150</td>
<td>180</td>
<td>250</td>
<td>313</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>10</td>
<td>20</td>
<td>30</td>
<td>40</td>
<td>60</td>
<td>80</td>
<td>100</td>
<td>120</td>
<td>150</td>
<td>200</td>
<td>250</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>8</td>
<td>17</td>
<td>25</td>
<td>33</td>
<td>50</td>
<td>67</td>
<td>83</td>
<td>100</td>
<td>125</td>
<td>167</td>
<td>208</td>
<td></td>
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<tr>
<td>9</td>
<td>7</td>
<td>13</td>
<td>20</td>
<td>27</td>
<td>40</td>
<td>53</td>
<td>67</td>
<td>80</td>
<td>100</td>
<td>133</td>
<td>167</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>30</td>
<td>40</td>
<td>50</td>
<td>60</td>
<td>75</td>
<td>100</td>
<td>120</td>
<td></td>
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<tr>
<td>11</td>
<td>4</td>
<td>8</td>
<td>12</td>
<td>16</td>
<td>24</td>
<td>32</td>
<td>40</td>
<td>48</td>
<td>60</td>
<td>80</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

**Example:**

Given a sales volume of $10,000 and a cost saving of $400, and an annual profit based on sales of 3%.

Then, the cost saving is 100($400)/$10,000 or 4% of sales. From the table shown above, 4% cost savings and 3% profit represent a sales equivalent of 133%.

**Result:** The 133% sales equivalent, applied to annual sales of $10,000 represents the additional profit obtainable from \((1.33)(10,000)\) or $13,300 additional sales volume.

**Source:** Calculated from \((\text{cost savings})/(\text{profit})\) in percent.
Table 2
Ceramic's Current Financial Statement

<table>
<thead>
<tr>
<th>Categories</th>
<th>Dollars (000)</th>
<th>% of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Direct labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-kiln</td>
<td>2,000</td>
<td>18.2</td>
</tr>
<tr>
<td>After kiln</td>
<td>1,000</td>
<td>9.1</td>
</tr>
<tr>
<td>b. Indirect labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Final inspection</td>
<td>200</td>
<td>1.8</td>
</tr>
<tr>
<td>Other indirect</td>
<td>300</td>
<td>2.7</td>
</tr>
<tr>
<td>c. Materials</td>
<td>3,000</td>
<td>27.3</td>
</tr>
<tr>
<td>d. Variable overhead (at 10% of direct labor and materials)</td>
<td>600</td>
<td>5.4</td>
</tr>
<tr>
<td>e. Fixed overhead</td>
<td>900</td>
<td>8.2</td>
</tr>
<tr>
<td>f. Transportation and selling (at 10% of sales)</td>
<td>1,100</td>
<td>10.0</td>
</tr>
<tr>
<td>g. General administration</td>
<td>900</td>
<td>8.2</td>
</tr>
<tr>
<td>h. Cost of sales (sum of a to g)</td>
<td>10,000</td>
<td>90.9</td>
</tr>
<tr>
<td>i. Sales</td>
<td>11,000</td>
<td>100.0</td>
</tr>
<tr>
<td>j. Gross profit (i - h)</td>
<td>1,000</td>
<td>9.1</td>
</tr>
<tr>
<td>k. After-tax profit (50% of j)</td>
<td>500</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Table 3
Current Annual Scrap

<table>
<thead>
<tr>
<th>Categories</th>
<th>Dollars (000)</th>
<th>% of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior to kiln</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Labor (= $2,000 at 10% scrap)</td>
<td>200</td>
<td>1.8</td>
</tr>
<tr>
<td>b. Material (= $3,000 at 10% scrap)</td>
<td>300</td>
<td>2.7</td>
</tr>
<tr>
<td>c. Labor plus material (= a + b)</td>
<td>500</td>
<td>4.5</td>
</tr>
<tr>
<td>d. Variable overhead (at 10% of $500)</td>
<td>50</td>
<td>.5</td>
</tr>
<tr>
<td>e. Total pre-kiln scrap (= c + d)</td>
<td>550</td>
<td>5.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>After kiln (through to final inspection)</th>
<th>Dollars (000)</th>
<th>% of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>f. Labor (at 16% scrap rate applied to original $3,000 reduced by $200 pre-kiln scrap)</td>
<td>448</td>
<td>4.1</td>
</tr>
<tr>
<td>g. Material (at 16% scrap rate applied to original $3,000 reduced by $300 pre-kiln scrap)</td>
<td>432</td>
<td>3.9</td>
</tr>
<tr>
<td>h. Labor plus material (= f + g)</td>
<td>880</td>
<td>8.0</td>
</tr>
<tr>
<td>i. Variable overhead (at 10% of $880)</td>
<td>88</td>
<td>0.8</td>
</tr>
<tr>
<td>j. Total after-kiln scrap (h + i)</td>
<td>968</td>
<td>8.8</td>
</tr>
</tbody>
</table>

Overall (pre- plus post-kiln) | 1,518 | 13.8 |

The program aims toward the cutting of scrap, rework, and waste, and the general enhancement of product quality, it is making a direct contribution to marketing beyond the sales-equivalent data. Scrap and other prior losses are now good, salable product; and, beyond that, a quality-controlled product is a more marketable product. Salesmen spend less time on quality complaints and thus are able to spend more effort on constructive selling.

Let's look at a case history that illustrates these points. A ceramic insulators manufacturer, after several years of declining earnings, showed the financial performance presented in Table 2. At this point the firm was acquired by a holding company. The new management hired a quality control manager whose first task was to develop a proposal for and justification of a quality cost improvement program. Recognizing the four principal aspects of quality costs: prevention, appraisal, internal failures, and external failures, the quality control manager proposed a formal system, incorporating inspection at each operation throughout processing. The purposes were to facilitate:

1. Quick discovery and removal of defective product at the point of origin.
2. Corrective action to remove the problem source, whether machinery setting or adjustment, operator procedure or raw materials responsible.

Such a program recognizes the highly interactive nature of planning and control on effective process-to-process production operations. The quality control manager recommended a program with two principal features:

1. Product inspection after all major operations steps to divert defective output from further processing.
2. Process technicians who would check processes and use information on defective output to work with production people in the identification and correction of causes of quality problems.

This program was justified in terms of quality improvements, resulting in enhanced profit, and the sales volume equivalents of this accomplishment. In carrying out the program, the quality control manager:

1. Analyzed current scrap costs (Table 3), based on the aforementioned financial data, which showed current scrap at $1,518,000 or 13.8% of sales.
2. Determined the quality costs under current operations (Table 4), at $1,828,000 or 16.6% of sales.
3. Determined quality costs under the proposed program, of $1,239,000 or 11.26% of sales. While the costs of quality appraisal and defects prevention increase, the reductions in costs of scrap and customer complaints are anticipated to more than make up for these expenditures.
4. Did a value analysis showing anticipated cost
Table 4
Annual Quality Costs

<table>
<thead>
<tr>
<th>Categories</th>
<th>Dollars (000)</th>
<th>% of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prevention</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality control manager's salary at 80%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Appraisal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality control manager, 20% of salary</td>
<td>200</td>
<td>1.8</td>
</tr>
<tr>
<td>Final inspection (from Table 2)</td>
<td>6</td>
<td>0.5</td>
</tr>
<tr>
<td>Inspection and quality control stations at key processing points (at 5% of direct labor costs of $3,000,000)</td>
<td>200</td>
<td>1.62</td>
</tr>
<tr>
<td>Salaries of 3 process technicians</td>
<td>150</td>
<td>1.36</td>
</tr>
<tr>
<td></td>
<td>45</td>
<td>0.41</td>
</tr>
<tr>
<td>Internal failures</td>
<td>1,518</td>
<td>13.8</td>
</tr>
<tr>
<td>Scrap (reduced 50%)</td>
<td>759</td>
<td>6.90</td>
</tr>
<tr>
<td>External failures</td>
<td>110</td>
<td>1.0</td>
</tr>
<tr>
<td>Customer complaints (reduced 50%)</td>
<td>55</td>
<td>0.50</td>
</tr>
<tr>
<td>Total quality costs</td>
<td>1,828</td>
<td>16.6</td>
</tr>
<tr>
<td>Current figures</td>
<td>1,239</td>
<td>11.26</td>
</tr>
<tr>
<td>Proposed figures</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Savings in terms of equivalent sales dollars. First subtract proposed quality costs from current quality costs to arrive at a figure of $589,000. The equivalent sales dollars represent the anticipated profit from increased sales to match the cost savings from the quality control program. In other words, at a profit of 9.1% of sales billed (from Table 2), to earn $589,000 in profit on sales, the additional sales volume generated would have to be $6,473,000. This sum is calculated from: Equivalent sales volume required, $ = 100($589,000)/9.1 = $6,473,000.

One may also say that the cost saving is equivalent to the profit that would be earned on a 58.8% increase in sales volume based on current annual sales of $11 million.

Finally, a new financial statement, reflecting the effects of the proposed program, as in Table 5 (proposed) is generated.

In larger manufacturing plants, these analyses cannot be done by just one person, and cooperation between sales, industrial engineering, quality control, and engineering design is necessary.

Weighing Value and Priorities

Because there are usually numerous program proposals vying for recognition and resources, a comparative study often is necessary. In the case of our case history, such a comparison might look like the example in Table 6.

For these three programs, A, B, and C, the re-

Table 5
Ceramic's Annual Financial Statement

<table>
<thead>
<tr>
<th>Categories</th>
<th>Dollars (000)</th>
<th>% of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prekilin adjusted for 5% scrap reduction</td>
<td>1,900</td>
<td>17.3</td>
</tr>
<tr>
<td>Post-klin, adjusted for 8% scrap reduction</td>
<td>920</td>
<td>8.4</td>
</tr>
<tr>
<td>Indirect labor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inspection, allowing for additional controls</td>
<td>350</td>
<td>3.2</td>
</tr>
<tr>
<td>Other indirect</td>
<td>300</td>
<td>2.7</td>
</tr>
<tr>
<td>Materials</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted for 5 + 8.0 = 13% scrap reduction</td>
<td>2,610</td>
<td>23.7</td>
</tr>
<tr>
<td>Variable overhead</td>
<td>522</td>
<td>4.7</td>
</tr>
<tr>
<td>Fixed overhead</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased to show quality control manager's salary</td>
<td>930</td>
<td>8.5</td>
</tr>
<tr>
<td>Transportation and selling</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted for 0.5% reduction in returns</td>
<td>1,095</td>
<td>10.0</td>
</tr>
<tr>
<td>General administration</td>
<td>900</td>
<td>8.2</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>9,527</td>
<td>86.6</td>
</tr>
<tr>
<td>Sales</td>
<td>11,000</td>
<td>100.0</td>
</tr>
<tr>
<td>Gross profit</td>
<td>1,473</td>
<td>13.4</td>
</tr>
<tr>
<td>After-tax profit (at 50% of)</td>
<td>737</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Notes: 1. In indirect labor, $150,000 is added for inspection and control stations at all key processing stages.
2. Benefits not appearing on financial statement are (1) better scheduling ability as a result of reduced scrap variations, and (2) enhanced customer goodwill created from better quality and reduced returns. These benefits may be expected, however, to have major long-run impacts on profitability.
Table 6
A Comparative Study

<table>
<thead>
<tr>
<th>Annual basis</th>
<th>Project A: quality control program</th>
<th>Project B: new processing equipment</th>
<th>Project C: sales promotion campaign</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cost savings income</td>
<td>$589,000</td>
<td>200,000</td>
<td>900,000</td>
</tr>
<tr>
<td>2. Profit increase as a percent of sales</td>
<td>5.4</td>
<td>1.8</td>
<td>8.1</td>
</tr>
<tr>
<td>3. Sales equivalents</td>
<td>$6,472,527</td>
<td>2,197,802</td>
<td>900,000</td>
</tr>
</tbody>
</table>

Table 7
Effects of Quality Control Program

<table>
<thead>
<tr>
<th>Cost saving from quality control program</th>
<th>Saving or income</th>
<th>Equivalent sales volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>$589,000</td>
<td>$6,473,000</td>
<td></td>
</tr>
</tbody>
</table>

| Income from additional salable merchandise | 814,000 | 814,000 |

Perspective probabilities of success were evaluated by management at 0.2, 0.4 and 0.3, yielding expected equivalent sales of $1,294,505 for A, $879,121 for B, and $270,000 for C. These expected values may require further adjustment in relation to the amount of time and money resources involved in each project. Nevertheless, a comparable set of values for an initial ordering of priorities has been established.

The final decision is based on the resources available, the investment required, the risks incurred, and the equivalent sales volume expected. Nor will that decision be exclusive; that is, all projects may receive recognition in various degrees.

Extending the Analysis

Thus far, the analysis has used constant sales of $11 million as a basis. Conditions occur in industry, however, where shortages of productive capacity create a ready market for "all that the manufacturing plant can produce." In such a situation, cost savings in production deserve to be measured not only in terms of their equivalent sales volume, but also in terms of the additional salable product created.

In our illustrative example, there is a reduction in scrap from $1,518,000 to $759,000, as well as a decline in complaints from $110,000 to $55,000. This reduction represents $814,000 of additional merchandise (formerly scrap and returns) now available for sale as first quality. For a firm running at capacity and experiencing energy and raw materials shortages, there is no other way of achieving this result except through a quality control program, as just shown. Assuming, again, a profit margin of 9.1% based on sales, this scrap reduction represents an additional profit of $70,074.

A comprehensive analysis is seen in Table 7. The total of $7,287,000 represents 66.25% of current sales, thus underscoring production's contribution in sales equivalent terms. Scarcities of both energy and raw materials, as well as inflationary pressures on operating costs, are likely to prevail and even accelerate as production problems in the Eighties. A redoubled search by management for profit potentials in production is therefore mandated. It is useful to present anticipated gains from productivity, quality, and other programs in comparable measures, such as in sales equivalent terms. Competing programs can then be placed in proper perspective, permitting effective ordering of priorities and logical allocation of resources.

An important feature of good analysis is the presentation of all essential data going into cost and value comparisons. Thanks to more complete information, the process of demonstrating the best alternative action or actions available—as well as the task of securing approval and cooperation from all parties and individuals involved in the acceptance and follow-through on ultimate decisions—is greatly facilitated. When information is presented in a comprehensive, essentially complete manner—as illustrated by our case history—the task of investigating and resolving questioned items is again greatly eased.
Accounting for Computer Software: the FASB Approach

Part of new technology, computer software development has outrun the accountants. Not for long, however, because the FASB is about to issue a new statement—and here’s how it may work.

By Gregory A. Ray and Anne D. McCallion

Companies that produce and market computer software, either as a stand-alone product or as part of another product or process, could be affected if the Financial Accounting Standards Board’s (FASB’s) Exposure Draft, “Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed” is issued as a final statement. The Exposure Draft identifies costs incurred in the process of creating a computer software product that is to be sold, leased, or otherwise marketed that may be capitalized and those that must be charged to expense. It also provides guidance as to which costs are research and development and disclosed as such in accordance with FASB Statement No. 2, “Accounting for Research and Development Costs.”

The software industry and its auditors have been concerned about the accounting for computer software costs for some time, claiming that there is little definitive guidance in the area of accounting for the costs of computer software to be sold, leased, or otherwise marketed and that the existing literature has been interpreted inconsistently. The result is a lack of comparability in the financial statements of companies in the industry, and this is compounded by the fact that many software companies have been entering the capital markets for the first time.

A software industry organization, the Association of Data Processing Service Organizations (ADAPSO), initiated a project to develop guidance for its members on accounting for software costs. Soon after, the Accounting Standards Executive Committee of the American Institute of CPAs invited ADAPSO and the National Association of Accountants to join in an effort to address these issues. The task force that resulted consisted of representatives of these associations and of the AICPA, as well as invited observers from organizations including the FASB and SEC.

In August 1983, the SEC issued a moratorium precluding registrants from capitalizing the costs of internally developed computer software that is to be marketed, if they had not previously disclosed their policy of doing so. Shortly thereafter, an issues paper focusing on accounting for computer software costs was completed by the task force and submitted to the FASB by AcSEC, and the FASB formally added a project on this subject to its agenda. The Exposure Draft issued in August 1984 is the most recent step in the Board’s due process of arriving at a solution to this accounting question.

Readers of the Exposure Draft will undoubtedly—
ly have questions on how it would be applied in individual circumstances. We here address some of those questions. A basic starting point is with the software product process.\(^2\)

The Software Product Process

A computer software product passes through various planning and production activities from conception to completion, with key decision points throughout the process. The process involves interdependent technical and business activities and decisions. Basically, the process is the same among computer software producers, but the details and timing of each activity and the terminology may differ. Although the process described below is presented sequentially, activities in different stages may actually occur concurrently, and certain activities may be performed more than once using a variety of approaches. The primary activities that are completed in the creation of a computer software product are planning and design (including product design and detail program design) and production (including coding, testing, and completion of documentation and training materials).

PLANNING AND DESIGN

Planning and design is the initial step in the creation of a computer software product, and it continues until final decisions are made regarding the design and the feasibility of producing and selling the product. The degree of formality in a company's planning function may vary, but it should be sufficiently detailed and documented so that a product's overall feasibility can be determined.

Companies that formally document their planning typically develop a product plan that includes preliminary product specifications and design, a market analysis, and a marketing plan. In addition, they develop a production plan and a financial plan. Those plans normally address:

- The market and competitive environment;
- The product functions, features, and performance requirements to meet market needs;
- The product specifications that direct the implementation of the product functions, features, and performance requirements;
- The production approach or methodology;
- Personnel and computer resources required to produce the product;
- The probability of financial success of the product, including an evaluation of the expected return on investment.

As the plans are prepared, alternatives are narrowed until a single approach is ready for management approval. If the approach is rejected, the process may be discontinued or plans may be revised until management is satisfied that the product is viable. If the plans are approved, work begins on developing a product that meets the technological, marketing, and financial requirements specified in the plans.

Based upon the results of the previous activities, the functions that the product must perform to satisfy the consumer need are defined. The functions are then analyzed in terms of the expectations, operational requirements, and technical environment of the product's anticipated users to determine what features the product must contain.

The technical constraints within which the product must operate are evaluated to determine how it must function to implement the desired features. Specifically, the software's required interaction with the operating hardware, the programming languages, and any required specialized technical capabilities (such as the ability of one software product to share data or interface with another) are considered. Technical performance issues also are addressed including the volume of data to be processed; processing efficiency; on-line response time; compatibility with required systems' software; and ease of implementation, operation, and upgrading. The product's technical functions are defined, and measurements established that will serve as standards to determine whether it has been completed successfully.

PRODUCT DESIGN

When the planning and preliminary design activities have been advanced to the stage that the issues previously discussed have been resolved, the product design activity usually can begin. The product design activity includes:

- Generally defining how the component programs of the software must work together to implement the product functions, features, and performance requirements;
- Evaluating alternative methods of meeting those requirements, considering each alternative's feasibility and relative cost;
- Defining the scope of the software solution relative to hardware and manual functions with which the product must interact;
- Generally defining interfaces to other products;

Some costs of software development can be classified as R&D; others can be capitalized.
in or outside the enterprise's software line.

- Creating a product design in sufficient detail to serve as product specifications.

The product specifications are subsequently used to support production planning and to guide the detail program design activity. Typically, product specifications include:

- General input (on-line screens and batch transactions);
- General output (on-line screens and hard-copy reports);
- Major processes or data transformation definitions;
- Data storage and data structure requirements;
- General data flow and interaction with transforming processes;
- General definitions of software control facilities such as processing activity journals, approval checkpoints, and audit trails.

Enterprises prepare specifications in varying detail at this point and, normally, plans are prepared for completing the documentation and addressing projected customer support requirements.

The results of the planning and product design activities serve as guidelines through the balance of the process. The process becomes less and less iterative as it progresses; however, certain earlier activities and even some planning and design activities may be required to solve problems as they arise. Those activities are generally performed on a smaller scale and focus on the solution to specific problems, not overall product redesign.

DETAIL PROGRAM DESIGN

The product design usually is transformed into a detail program design that serves as the lowest level design for the product. This stage is normally required before coding, testing, and packaging the software product. It takes product function, feature, and technical requirements to their most detailed, logical form before coding begins.

In some enterprises the same individual or team may work on the product from start to finish, that is, from planning through coding, testing, and writing documentation. In other enterprises duties are segregated. For instance, the design function may be separate from the coding function, or the design function may be divided so that the design during product planning is done by one individual or group, and the lower level of design is done by another individual or group.

The detail program design varies from enterprise to enterprise depending on the product, the complexity of the project, and the design technique used. Many design methods exist. Program processes may be represented as step-by-step narratives, illustrated in the form of “data input-computer process-data output,” diagrammed using a specific design technique, or represented in some other way. The result is a detailed, logical picture of all program processes from which it is easy to generate code. In some cases, critical fragments of computer-readable code are written; in others, detailed specifications that are not yet in a form the computer can accept provide the logic framework. Normally, the project team:

- Determines the activities necessary to transform the general product design and specifications into a detail program design,
- Divides the activities into smaller tasks,
- Assigns people to the tasks,
- Determines when each task should be complete,
- Develops test plans and test data to be used during coding and testing.

At this point, a design test or a verification walk-through is usually performed to determine if the design satisfies the requirements specified in the product, production, and financial plans.

PRODUCTION OF PRODUCT MASTERS

The production of product masters generally involves coding and testing, as well as the development of documentation and training materials.

Software companies may face new accounting requirements if the standard is adopted.

Coding of the product generally begins when the detailed specifications are completed. Coding involves preparing detailed instructions in a computer language to carry out the requirements described in the detail program design. Such coding may consist of thousands of instructions; it can be developed by a programmer or, in some cases, it can be machine-generated. During coding and testing, there is normally a continuing effort to document the product’s capabilities. This documentation forms a substantial part of the materials that will eventually go to customers to support the product’s use. Quality control activities in this process generally include design verification walk-throughs of programs and documentation and analysis of results against the detail design specifications.

Unit testing is a quality control activity by which programs are tested individually and in groups before the whole system is tested. System
testing is a product quality assurance step that normally takes place when the programs have been completed and unit-tested. To ensure that their systems are tested impartially, many organizations use quality assurance groups that are not part of the production teams.

A test plan is developed to help determine if the product meets the feature, function, and technical performance requirements that were previously established in the planning and design of the product. The testing also helps to determine if the product works in accordance with the design, documentation, and training materials. After the errors detected during system testing are corrected, a base or master version of all software product components is produced, and the product is ready for packaging.

The documentation and training materials are edited, and some sections may be rewritten to make sure they fully explain the product's capabilities. A master version is produced and used to make copies that accompany the software masters. These activities are crucial because many users will rely on the written material provided with the product to learn how to use the software and how to resolve any operating difficulties.

The FASB Proposal

The Exposure Draft provides guidance in two major areas. It specifies which costs are to be classified as research and development and which costs incurred in the creation of a computer software product are eligible to be capitalized. According to the Exposure Draft, the costs of planning, designing, and establishing technological feasibility of a computer software product would be charged to expense when incurred and disclosed in accordance with FAS 2, Accounting for Research and Development Costs. This includes the costs incurred to develop or modify both the product design and the detail program design.

On the other hand, the costs of producing product masters, including coding and testing, would be capitalized after recoverability for that product has been established. Recoverability is established when technological, market, and financial feasibility and management commitment have been documented. The Exposure Draft defines each of those requirements.

The costs incurred to establish market feasibility, financial feasibility, and management commitment and ability are charged to an expense other than research and development. The costs of establishing technological feasibility and completing the detail program design are charged to expense as research and development regardless of when in the software product development process they are incurred. The costs of coding and testing, as well as preparing documentation and training materials are capitalized, but only after the recoverability criteria have been met.

The amount of costs that are eligible for capitalization will vary depending on the nature of the individual product. Because costs may not be capitalized until the recoverability tests have been met, and because it is not as easy to establish recoverability for a product employing leading-edge technology as it is for a conventional product, capitalization is more likely to begin sooner for the conventional product than for the high-tech one. It is conceivable that for some innovative products, virtually no capitalization will occur because recoverability cannot be established until the product is nearly complete.

ESTABLISHMENT OF RECOVERABILITY

The product design, documentation requirements, customer support requirements, and the production plan can provide the information necessary to determine technological feasibility. In making this determination, management evaluates whether the skills, hardware, and software technology are available to produce the product. Some products may require considerable research, and therefore more detailed planning, before the enterprise can determine recoverability. If the product is an enhancement, management must consider whether the product can be produced using the existing technical foundation. That decision can generally be made quickly by people who know the base product.

Technological feasibility is established when it is probable that the product will meet its design specifications within the technical and business constraints established in the product, production, and financial feasibility plans. Technological feasibility is not necessarily established at the same point in the process for all products and all enterprises. For many products, technological feasibility can be established early in the overall process; for example, when the product does not differ significantly from existing products. For other products, the establishment of technological feasibility may require completion of some or all of the production activities to resolve uncertainties.

In considering market and financial feasibility, management evaluates the market analysis and marketing plans, the production plan, and the fi-
Financial feasibility plan. It then estimates the risks of failure by examining such factors as:

- Experience of the enterprise;
- Reliability of previous planning;
- Capability of the enterprise to finance, build, market, and support the product;
- Size and nature of the market;
- Product life cycle;
- Viability and volatility of the market;
- Risk of technological and market obsolescence;
- Length of development time.

The risks are weighed against the expected return; in some instances management may decide to proceed despite high risks and without the establishment of market or financial feasibility because the return is expected to be high.

Accounting Under the Exposure Draft

To highlight the effects that the proposed standard would have on current accounting practice, we provide an example of a typical application which is compared to the prevalent accounting policy of expensing all software costs as they are incurred. The initial capitalization and expensing of computer software costs are shown, along with the amortization of capitalized costs over the estimated economic life of the product, the ongoing recoverability test, and required disclosures. The example is based on the following assumptions:

1. The software company is creating a relatively conventional product to complement its existing product line.
2. The development and production costs are all incurred in one calendar year, and the recoverability tests are met in the same year.
3. The product is available to be sold, leased, or otherwise marketed on January 1, 19X2.
4. All amounts are for financial reporting and do not consider income tax implications.
5. The company's year ends on December 31.

Company A is developing a product to handle an accounts payable function for a specialized industry. The recoverability of product costs is established and documented by management on February 1, 19X1. The costs incurred are shown in Table 1. Additional data for the product are shown in Table 2. The amounts that would be expensed in 19X1 by applying both the Exposure Draft method and the current prevalent method are shown in Table 3.

Any costs that may be incurred after January 1, 19X2, are either treated as a product enhancement (and are therefore subjected to the recoverability test and other accounting requirements specified in the Exposure Draft for a new product) or are charged to expense as maintenance or customer support.

AMORTIZATION

Under the FASB proposal, capitalized costs would be amortized on a product-by-product basis. Amortization is the greater of the amount computed by the straight-line method over the es-
Table 3

<table>
<thead>
<tr>
<th>Expense as R&amp;D:</th>
<th>Current prevalent method</th>
<th>Exposure draft method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development of product design</td>
<td>$9,000</td>
<td>$9,000</td>
</tr>
<tr>
<td>Work on detail program design necessary to document technological feasibility</td>
<td>7,000</td>
<td>7,000</td>
</tr>
<tr>
<td>Other costs incurred to establish and document technological feasibility</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Completion of detail program design</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Coding</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>Testing</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Preparation of documentation and training materials</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Modification of product design and detail program design</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td>97,000</td>
<td>37,000</td>
</tr>
<tr>
<td>Expense as other than R&amp;D:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Documenting market and financial feasibility</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Documenting management commitment and ability</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Total amount expensed</td>
<td>$112,000</td>
<td>$52,000</td>
</tr>
</tbody>
</table>

Table 4

<table>
<thead>
<tr>
<th>Year</th>
<th>Amortization expense computed by:</th>
<th>Amortization expense for year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Straight-line</td>
<td>Future revenues</td>
</tr>
<tr>
<td>19X2</td>
<td>$12,000 (a)</td>
<td>$8,936 (b)</td>
</tr>
<tr>
<td>19X3</td>
<td>12,000</td>
<td>11,077 (c)</td>
</tr>
<tr>
<td>19X4</td>
<td>12,000</td>
<td>16,875 (d)</td>
</tr>
<tr>
<td>19X5</td>
<td>12,000</td>
<td>12,431 (e)</td>
</tr>
<tr>
<td>19X6</td>
<td>12,000</td>
<td>10,681</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(a) $60,000 \times \frac{1}{5} = $12,000
(b) $60,000 \times \frac{[70,000/(70,000 + 100,000 + 130,000 + 100,000 + 70,000)]}{100,000 + 70,000} = $8,936
(c) $48,000 \times \frac{[90,000/(90,000 + 130,000 + 100,000 + 70,000)]}{100,000 + 70,000} = $11,077
(d) $36,000 \times \frac{[150,000/(150,000 + 100,000 + 70,000)]}{100,000 + 70,000} = $16,875
(e) $18,125 \times \frac{[130,000/(130,000 + 70,000)]}{100,000 + 70,000} = $12,431
(f) Amortize the balance of unamortized cost.

It is fairly common in the software industry to enhance an existing product, thereby creating a new product with a larger market, longer life, or better sales potential. In these cases, all or part of the software of an existing product is modified. To apply the Exposure Draft method in computing amortization, the book value of the original product would be brought forward and increased by the costs incurred for the enhancement. The asset would be amortized over the new estimated life of the enhancement.

PURCHASED SOFTWARE

The cost incurred to purchase a software product also would be subject to the provisions of the proposed standard. If the company purchases computer software that is to be sold, leased, or otherwise marketed, the costs would be capitalized only to the extent that the recoverability test is met. In each reporting period, the recoverability test would be reapplied to any costs that have been capitalized. At first glance, it may appear that the application of an initial recoverability test to purchased software would be redundant because a company would presumably not spend its resources on a product to be resold when it does not expect to recover its cost. However, the recoverability test consists of four interrelated criteria that are not always met nor documented prior to purchasing all or part of a software product to be sold, leased, or otherwise marketed. For example, a company might purchase the makings of a product even though its technical feasibility was in question. Establishing recoverability in this case would not be redundant and is required under the Exposure Draft method prior to capitalizing.

ONGOING RECOVERABILITY TEST

The recoverability of capitalized software costs would be assessed on a product-by-product basis during each reporting period. Costs would be written down as a charge to income to the extent that they are no longer recoverable. After they are written down, costs would not be subsequently reinstated as assets, even if the original amount subsequently appears to become recoverable.

This ongoing recoverability requirement means that for each period being reported on, each product of a company must continue to meet the criteria specified in the proposal for recoverability. In this case, the financial feasibility test compares the book balance of the capitalized costs plus any costs that are to be capitalized in the period with the estimated future revenues reduced by the remaining costs of producing, marketing, and maintaining the product. The amounts shown in Table 5 would be compared for the financial feasibility.

Amortization expense computed by:
- Straight-line method
- Future revenues

Amortization expense for year:
- $12,000
- $11,077
- $16,875
- $12,431

The Exposure Draft method prior to capitalizing.

The cost incurred to purchase a software product also would be subject to the provisions of the proposed standard. If the company purchases computer software that is to be sold, leased, or otherwise marketed, the costs would be capitalized only to the extent that the recoverability test is met. In each reporting period, the recoverability test would be reapplied to any costs that have been capitalized. At first glance, it may appear that the application of an initial recoverability test to purchased software would be redundant because a company would presumably not spend its resources on a product to be resold when it does not expect to recover its cost. However, the recoverability test consists of four interrelated criteria that are not always met nor documented prior to purchasing all or part of a software product to be sold, leased, or otherwise marketed. For example, a company might purchase the makings of a product even though its technical feasibility was in question. Establishing recoverability in this case would not be redundant and is required under the Exposure Draft method prior to capitalizing.

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Table 5
Comparison Amounts for Recoverability Test

<table>
<thead>
<tr>
<th>Year</th>
<th>Book value of product</th>
<th>Additional costs to be capitalized</th>
<th>(1) + (2) subtotal</th>
<th>Estimated future revenues</th>
<th>Remaining cost of producing etc.</th>
<th>(4) - (5) subtotal</th>
</tr>
</thead>
<tbody>
<tr>
<td>19X1</td>
<td>$60,000</td>
<td>$0</td>
<td>$60,000</td>
<td>$480,000</td>
<td>$83,000</td>
<td>$397,000</td>
</tr>
<tr>
<td>19X2</td>
<td>48,000</td>
<td>0</td>
<td>48,000</td>
<td>400,000</td>
<td>43,000</td>
<td>357,000</td>
</tr>
<tr>
<td>19X3</td>
<td>36,000</td>
<td>0</td>
<td>36,000</td>
<td>300,000</td>
<td>23,000</td>
<td>277,000</td>
</tr>
<tr>
<td>19X4</td>
<td>19,125</td>
<td>0</td>
<td>19,125</td>
<td>170,000</td>
<td>8,000</td>
<td>162,000</td>
</tr>
<tr>
<td>19X5</td>
<td>6,694</td>
<td>0</td>
<td>6,694</td>
<td>70,000</td>
<td>3,000</td>
<td>67,000</td>
</tr>
<tr>
<td>19X6</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Here, a write-down of the basis of this product under the recoverability test is not necessary because, for each year, the projected net revenue (col. 6) is greater than the total cost in col. 3.

DISCLOSURE
Under the proposal, the unamortized computer software costs included in each balance sheet presented would be disclosed, as well as the total amount charged to expense in each income statement presented for computer software costs other than research and development. The latter requirement would include the amortization expense for the period and the amount written down, written off, or not capitalized because the recoverability test was not met. The disclosure requirements for research and development costs in Statement 2 apply to the costs of planning, designing, and establishing technological feasibility of a computer software product to be sold, leased, or otherwise marketed. An example of the disclosure for each year is shown in Table 6.

Companies that market computer software may face new accounting and record-keeping requirements if the proposed standard is adopted. Documentation of the technological, market, and financial feasibility of a new software product, as well as management commitment and ability to produce and market the product, would be a prerequisite to capitalization of software production costs. This documentation would most likely be scrutinized by the company's auditors.

The Exposure Draft also requires that the recoverability and amortization provisions be applied separately for each product and that records be maintained, therefore, on a product-by-product basis. This requirement could increase the record keeping for most companies that do not have such information gathering systems in place.

Companies that are able to meet the requirements of the proposed standard would be able to report as an asset those production-type costs that in most cases are currently being expensed. This should help, at least in the short run, to improve the company's financial ratios which might in turn enhance the company's financing ability and earnings outlook.

The Board plans to issue a final standard early this year. Interested and affected parties, whether they agree or disagree with the proposal, are encouraged to participate in the due process of developing this accounting standard by sending written comments to the Board. A copy of the Exposure Draft is available from the FASB Order Department, High Ridge Park, P.O. Box 3821, Stamford, Conn. 06905-0821.

Expression of individual views by members of the FASB and its staff is encouraged. The views expressed in this article are those of the authors. Official positions of the FASB on accounting matters are arrived at only after extensive due process and deliberation.

Table 6
Illustration of Footnote Disclosure

The total amount of unamortized computer software costs included in the balance sheet at December 31, 19XX is $ (a). The total amount charged to expense during 19XX for computer software costs (other than research and development costs, which are disclosed in note xx) is $ (b).

The appropriate amounts for year are:

<table>
<thead>
<tr>
<th>Year</th>
<th>Unamortized software costs</th>
<th>Total amount charged to expense</th>
<th>R&amp;D costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>19X1</td>
<td>$60,000</td>
<td>0</td>
<td>$37,000</td>
</tr>
<tr>
<td>19X2</td>
<td>48,000</td>
<td>12,000</td>
<td>0</td>
</tr>
<tr>
<td>19X3</td>
<td>36,000</td>
<td>12,000</td>
<td>0</td>
</tr>
<tr>
<td>19X4</td>
<td>19,125</td>
<td>16,875</td>
<td>0</td>
</tr>
<tr>
<td>19X5</td>
<td>6,694</td>
<td>12,431</td>
<td>0</td>
</tr>
<tr>
<td>19X6</td>
<td>0</td>
<td>6,694</td>
<td>0</td>
</tr>
</tbody>
</table>

Hereafter referred to as a "software product" or "product."

This section has been adapted from an Issues Paper "Accounting for Costs of Software for Sale or Lease," prepared by the AICPA Accounting Standards Division Task Force on Accounting for the Development and Sale of Computer Software.
Direct Labor Cost Not Always Relevant At H-P

It took considerable courage for the accounting staff at this high-tech company to eliminate direct labor as a separate cost category.

By Rick Hunt, Linda Garrett, and C. Mike Merz

Having dutifully learned in college that they were supposed to provide useful information to help manage the business, a group of management accountants at the Hewlett-Packard Company became somewhat disgruntled to realize that the typical line manager could not understand and did not use many of their cost reports. At about the same time, Hewlett-Packard's management staff began to question the traditional production philosophies practiced in the United States. For some of Hewlett-Packard's high-technology products, production practices made popular by Japanese firms seemed more appropriate.

Accordingly, when a new printed circuit fabrication facility was introduced at the Disc Memory Division in May 1983, the production process incorporated some of the Japanese manufacturing techniques. These techniques encouraged the accounting staff to make fundamental changes in the product cost system. Information flows between the accounting, production, and material functions were radically altered.

For the most part, the accounting systems became much simpler. For example, direct labor was no longer included as a separate product cost; all manufacturing labor became part of overhead. By simplifying the accounting for work-in-process inventories, an estimated 100,000 journal entries per month were eliminated!

High-Tech Environment

Traditional costing methods did not work well for printed circuit board fabrication because the manufacturing environment had changed. Printed circuit boards were manufactured in a new environment, called “Repetitive Manufacturing,” in which a high volume of standardized units are fabricated, machined, assembled, and tested. Job-order costing is not appropriate for repetitive manufacturing because the job order system is not suited for controlling a very high volume of standardized products. Attempted use of a job order costing system at Hewlett-Packard frustrated line managers and production workers because they could not physically differentiate between the products in different orders that were being worked on. In order to keep the process flowing efficiently, workers and materials were frequently traded between orders which confounded the cost accounting system's attempt to track the costs of each order.

Repetitive manufacturing also differs from the environment suited to process costing. Process costing works best for the continuous processing of products consisting of fluids or powders. Repetitive manufacturing deals with discrete physical units rather than fluids or powders and is not an
inherently continuous process.

How repetitive manufacturing differs from the job order and process manufacturing systems is illustrated in Table 1. Two characteristics of repetitive manufacturing permitted simplifying product costing: direct labor cost typically comprises a very small percent of total product cost, and repetitive manufacturing can operate with minimal levels of work-in-process inventory. In many electronic products, direct labor comprises only 3% to 5% of product costs and as little as 1% of inventory costs. Furthermore, variations in the amount of direct labor cost depend primarily upon how well the process functions rather than on worker efficiency or wage rates. Several Hewlett-Packard divisions, therefore, have decided not to explicitly account for direct labor. Rather, all labor is included in manufacturing overhead; aggregate labor variances from budget are reported weekly or monthly with no attempt to trace variances to a particular product lot.

Japanese Techniques: JIT, TQC, KANBAN

The impetus to eliminate inventories came from the apparent success of the Japanese in producing high volumes of quality products. Many observers have pointed out that Japanese firms have become more efficient at repetitive manufacturing than their American competitors. The Japanese can build small cars for $2,000 less than U.S. manufacturers. A Toyota plant can produce nine auto engines per day, per employee, using 454 square feet of plant space, while one of the better U.S. auto engine plants produces only two engines per day, per employee, and requires 777 square feet of plant space.

Japanese success has resulted in part from adoption of the "Just-in-Time" (JIT) philosophy. The goal of JIT is to "Produce and deliver finished goods just in time to be sold, subassemblies just in time to be assembled into finished goods, fabricated parts just in time to go into subassemblies, and purchased materials just in time to be transferred into fabricated parts." One obvious feature of JIT is to control (or eliminate) inventory. Schonberger, however, also views JIT as: a quality and scrap control tool, a streamlined plant configuration that raises process yield, and an employee involvement and motivational mechanism.

From a management accounting standpoint, we are naturally concerned more with the cost implications of JIT than the technical aspects. Note that JIT potentially could put lots of accountants out of business. Accounting systems have traditionally focused on tracing cost flows through various inventory stages; by drastically reducing inventory levels, JIT automatically reduces the volume of accounting detail. One accountant using a microcomputer prepares all of the cost reports for certain products in H-P’s Boise printed circuit fabrication line. On a similar production line operating in the traditional manner, with inventory buffer levels between each step in the process, H-P would need as many as three cost accountants and a fully automated cost system.

The repetitive manufacturing environment also benefits from two other Japanese manufacturing techniques which complement JIT:

1. Under Total Quality Control (TQC) The responsibility for quality control is shifted to production workers. The goal of TQC is to identify and correct errors at the point where they occur in the manufacturing process. Combining JIT and TQC prevents continued production of defective parts. Because JIT uses very small lot sizes (the goal is one), defective units are immediately identified at the next work center and must be rapidly reworked so the process can continue. In extreme cases, a worker can shut down the production line until a process that causes defects is corrected.

Table 1
Characteristics of Manufacturing Process Assumed for Product Costing Systems

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Repetitive manufacturing</th>
<th>Job order</th>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Volume</td>
<td>High</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>2. Nature of product</td>
<td>Standard products in</td>
<td>Each job is different</td>
<td>Uniform product such as fluids or powders produced continuously</td>
</tr>
<tr>
<td></td>
<td>discrete units</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Process time</td>
<td>Short</td>
<td>Long</td>
<td>Long</td>
</tr>
<tr>
<td>4. Direct labor content</td>
<td>Very small</td>
<td>High</td>
<td>Varies; large enough to require accounting for</td>
</tr>
<tr>
<td>5. Work-in-process</td>
<td>Minimal</td>
<td>High</td>
<td>Varies; large enough to require accounting for</td>
</tr>
<tr>
<td>levels</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C. Mike Merz, CMA, is professor of accounting at Boise State University. A member of the Boise Chapter, he has a doctorate in business from the University of Southern California.
2. **KANBAN** is a method of determining material requirements using a “pull” system. Used with JIT, KANBAN signals when materials should be moved between work centers. Materials are “pulled” between work centers in the sense that each work center signals to the preceding work center when it is ready to receive more work. Units are produced to order and are transferred only when the next work center signals that it is ready. A work center must stop producing if it gets ahead of the subsequent work center. KANBAN differs from Material Requirements Planning (MRP) in that KANBAN produces to the order of the next work center, whereas in MRP, each work center produces to satisfy the estimated demand and then “pushes” production through the process.

The many technical aspects of how these so-called Japanese manufacturing techniques improve both the productivity and quality of repetitive manufacturing environments are beyond our scope here; our concern is more with accounting impacts. By partially implementing some of these techniques, at least two of H-P’s divisions were able to make fundamental changes in their accounting systems.

**Simplified Cost Accounting**

In order to adapt to its manufacturing environment and to provide useful management information, some Hewlett-Packard divisions made the following changes in their cost accounting systems:

1. **Eliminate Direct Labor Cost Category.** In a somewhat radical departure from traditional cost accounting methodology, direct labor is no longer accounted for as a separate product cost. Prior to this change, great amounts of worker, manager, and accountant time were consumed in tracking direct labor costs to specific work orders. Because direct labor comprises such a small percent of total product cost—only 3% to 5%—the continual effort to prepare standard labor costs and then variances from these standards had little potential impact upon overall cost control. In addition, if labor variances occurred, these variances resulted...
more from how efficiently the process was working on a particular day rather than worker efficiency. The cost accounting staff had tremendous difficulty correcting labor vouchers because the workers and managers could not always distinguish between work orders. For all of these reasons, both the accounting and production managers agreed to include direct labor within manufacturing overhead.

2. Treat Manufacturing Overhead as an Expense. Implementing the Just-in-Time (JIT) concept drastically lowered inventory levels and reduced the time between the start of production and delivery of finished goods. Virtually all of the manufacturing overhead incurred each month, now including direct labor, flowed through to cost of goods sold in the same month. Tracking overhead through work-in-process and finished goods inventory provided no useful information. Management decided, therefore, to treat manufacturing overhead as an expense charged directly to cost of goods sold. Overhead remaining in work-in-process and finished goods is maintained with end-of-month adjusting entries.

In Figure 1, cost flows through the simplified system are compared with cost flows tracked by a traditional system. Simplifying the accounting for inventories greatly reduced the volume of accounting detail processed each month. The dotted line in Figure 1 that connects material inventory with cost of goods sold represents the ultimate goal. If the use of Just-in-Time principles can reduce the material content in work-in-process and finished goods to insignificant levels, then material costs also could flow directly to cost of goods sold.

3. Reduce Accounting for Scrap and Rework. Maintaining buffer levels of inventory between work centers permits production of large quantities of defective units because an out-of-specification process can continue for a relatively long time period before the next work center discovers the defective units. With JIT and the KANBAN "pull" system, buffer inventories are reduced to minimal levels and work centers are not permitted to get ahead of each other. Defective units are discovered almost immediately and an out-of-specification process is corrected before large numbers of defective units are produced.

In one Hewlett-Packard plant, a flashing red light and siren are turned on when workers first recognize that a process or work center is producing defective units. The entire production line shuts down until engineering corrects the problem. As would naturally be expected, when the red light starts flashing, the siren begins blaring and production stops, management devotes immediate attention to fixing production line problems. As a result, the cost of scrap and rework dropped significantly. Although much less effort is now required to collect the costs of scrap and rework, these costs have taken on a new significance. Because scrap and rework no longer occur with regularity, each scrap and rework item is carefully analyzed to prevent recurrences.

The net result of these changes is that Hewlett-Packard realized significant savings in staff time and costs without any significant changes in costs reported in their financial statements, or costs used in planning and controlling production, or costs analyzed for pricing and make-or-buy decisions. Production line managers can now understand the simpler reports provided by the accounting department and actually use the information in those reports. Accountants can now "focus on solving tomorrow's problems instead of unraveling yesterday's errors," one of the goals of H-P's accounting staff.

Challenge for Management Accountants

Are these changes described here really a "big deal"? Do these changes require a fundamental change in the cost accounting model? Should management accountants change their role in order to help their firms compete in international markets? For several reasons, the answer is yes to all of these questions.

As Robert Kaplan recently observed, for the last 25 years, accounting methodology has accepted a model based upon mass production of a mature product with known characteristics and a stable technology. Although the disciplines of operations research, probability, statistics, and economics have been applied to cost accounting topics, these applications have remained within a static model. Cost accountants are taught to optimize decisions within a stable environment where cost structures and the degree of uncertainty can be specified.

In today's fast-paced product markets, few firms have the luxury of producing mature products with a stable technology. For example, Hewlett-Packard now sells 5,000 different products, and half of current orders are for products developed within the last three years.

Experts believe that managers (including management accountants) should intervene in the pro-
Management accountants can now solve tomorrow's problems instead of unraveling yesterday's errors.

Our experience indicates that the currently available literature—management accounting texts, handbooks prepared for professional accountants and accounting journals—do not prepare accountants to question continued use of traditional cost models. For example, all texts and hundreds of journal articles address the problem of computing and analyzing direct labor variances. Against this background, it took considerable courage for the Hewlett-Packard staff to suggest eliminating direct labor as a separate cost category.

Note also that the examples described here definitely are "material" in the usual accounting sense. The production lines affected employ thousands of people and process many millions of dollars of costs each year. And Hewlett-Packard is, of course, a prominent public corporation which must publish audited financial statements. It is an acclaimed leader in the development of high technology electronic products. As other Hewlett-Packard divisions experiment with new production environments and modified cost accounting systems, some of the changes described here may well have far-reaching effects.

Simplifying the accounting system and reducing the volume of accounting detail permitted H-P's accountants much more time to work with production. Better management information is now provided. The accounting staff is excited about its expanded role in helping management improve productivity.
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- The Impact of Management Accounting on U.S. GAAP
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- Management Accounting—Implementation of New Ideas in a Multiproduct/Multinational Company
- The Future of Management Accounting: An Australia Perspective
- The Management Accountant and the Public Accountant—Working Together
- Management Accounting in a Difficult Situation—The Chrysler Experience
- U.S. GAAP—A View Expressed By The French Stock Exchange
- Developing Internationally Acceptable Accounting Principles—The Elf Aquitaine Experience
- Audit Committees and the Board of Directors' Responsibilities

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International Federation of Accountants

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Managing
Harold Geneen with Alvin Moscow, Doubleday & Co., Inc., Garden City, N.Y., 1984, 281 pp.—The dedication of this very important book states, "To all those who aspire, in whatever endeavor, to rise above the level of mediocrity." Few readers of this magazine need an introduction to Mr. Geneen. He began his financial career as a staff auditor for one of the major public accounting firms, switched to industry, and rose through a succession of ever more important management positions until he became chief executive officer of ITT in 1959. This book is not a history of his tenure at ITT, but a summing up of his philosophy of business management.

In 1977, when Mr. Geneen retired as CEO, ITT was the 11th largest industrial company in the country, although, as is carefully pointed out, six of the larger firms were oil companies. The growth of ITT resulted in large part from Mr. Geneen's approach to management and from his ability to identify profitable merchant activities then integrate them into the ITT way of doing things. Mr. Geneen states in his book that, while the growth of ITT sales revenues from acquisitions was substantial, an analysis of the profitability of the individual components suggests that profits reported to shareholders derived proportionately from existing operations on a continuing basis as much as from new acquisitions. This was not a "paper" increase in earnings—it represented genuine industrial growth.

This book describes how Mr. Geneen managed a firm as diverse as ITT. Basically, the process consisted of week-long meetings each month in Europe and separate week-long meetings each month in the United States at which the general managers of every operating unit came together and had full, frank, and open discussions. Three elements appear to be the touchstones of Mr. Geneen's approach: forecasting operations, controlling to make sure that forecasts were met, and avoiding surprises. Because of his financial background and his emphasis on financial controls over operations, this book is essential reading for any management accountant who aspires to move into general management.

"Management must manage! Management MUST Manage! MANAGEMENT MUST MANAGE! How many times do I have to tell you?" These decrees appear to sum up the Geneen way of doing things, and by management he means control over every aspect of a unit's operations. The time commitment and effort required are the subjects of more than one reference in the book. It is apparent that not every business executive is prepared to devote the time and effort implied by the Geneen method. Twelve- to 16-hour days appear to have been the rule, not the exception. Managing a firm that made 350 acquisitions and operated them as 250 profit centers, with annual sales approaching $20 billion, is indeed an achievement.

One of the most important chapters is titled, quite simply, "The Numbers." In this chapter, Mr. Geneen begins by saying, "The drudgery of the numbers will make you free." At first reading, this statement appears rather harsh, but after Mr. Geneen describes the ITT budget review process and the subsequent control quarter by quarter, month by month, and even week by week, to make sure that budgets are met, the reader becomes a believer. Mr. Geneen's emphasis is always on "getting the facts" and then making sure that the "facts" are indeed "hard" and not just opinions or wishes.

This is one of the most readable business books published recently. Many volumes have been written by consultants who describe what should be or what could be or by historians who describe what others have done. Managing is written by somebody who has been there and who has accomplished what he is writing about. The material makes fascinating reading and can be completed in one sitting in less than three hours. In truth, it deserves far closer perusal from persons truly interested in the success of their own business careers.

Treasurers' and Controllers' New Equipment Leasing Guide
Albert R. McMeen, III, Prentice-Hall, Inc., Englewood Cliffs, N.J., 1984, 242 pp.—Most books on leasing cover (1) financial analysis—how to decide whether leasing or buying is better, (2) the accounting issues—whether a lease should be capitalized or expensed, and (3) the tax issues. This volume is one of the few that concentrate on the fourth and most important aspect of leasing, the business decision. The fact that leasing is a major way to finance the acquisition of assets and appears to be expanding, despite tightening up of tax and accounting regulations, suggests that some good business purposes are served. Lease by lease, transaction by transaction, purchase often appears to provide lower cost financing than leasing. Relatively few controllers, when performing the traditional lease- vs. -buy analysis, find that leasing provides a lower cost form of asset acquisition.

Nonetheless, the growth of leasing suggests that certain business needs are being met, and this book is a good indication of what is involved in the real world of leasing—as opposed to the theory. For example, the author provides a major chapter on the leasing industry, including lessee and lessor motivations, and the impact of leasing on business risks such as bank relations, taxes, and balance sheet position.

The most valuable part of the book is the section that deals with bargaining for a lease proposal, including how to choose a lessor, coming to grips with residual values, and the current intricacies
of tax-oriented leasing. The material on the financial accounting issues is straightforward, easy to read, and understandable, but it does not really break new ground.

The chapters describing how to negotiate the most favorable lease terms and the related legal documents are a masterpiece of business help. For example, a section on early termination and casualty value brings out points regarding tax recapture that a casualty loss might trigger. Even the section on obtaining a timely credit decision and how to put the best foot forward for the credit analysis is written from the point of view of a practitioner rather than someone with only theoretical knowledge.

Perhaps the single major flaw with the book is its physical construction. Rather than being hardbound, it is distributed in a three-ring loose-leaf notebook. The physical construction of the notebook is poor, and the pages tend to fall out as one flips back and forth from section to section. This complaint, however, is minor. The contents of the book make it well worthwhile for anyone interested in finding out how to go about leasing equipment.


Jeff A. Schnepper, Addison-Wesley Publishing Co., Inc., Reading, Mass., 1984, 408 pp.—This practical book would be valuable to any NAA members who do tax work on the side. A professional tax adviser undoubtedly would be familiar with most of the material here, but for persons with substantial income of their own, who do their own tax returns, who try to minimize the amount due, or who advise other individuals and small businesses, this book could be quite helpful, particularly at the $8.95 price. The book, up-to-date through the Tax Reform Act of 1984, can be recommended.

Using Computers to Learn...

About Computers

J. L. Lawrence, Petrocelli Books, Princeton, N.J., 1984, 122 pp. (plus 160 pp. of programs)—The title of this book is somewhat misleading. Actually, the volume is the first in a series to be titled Using Computers to Learn. . . . Thus, this book really is “about computers.” The author discusses computer languages, data structures, graphics, and other numerical applications. Using a number of programs written in Apple III business BASIC, he explains how a computer works. Also, these programs are provided free in an appendix.

While it would take a fair amount of time simply to copy the programs and load them into a computer, much less run them and try to understand them, anyone seriously interested in learning how a computer works could enhance his level of knowledge substantially by performing these exercises. But just as it is not necessary to understand the physics of the internal combustion engine in order to drive a car, one does not have to understand the logic of “data transformations” in order to balance a checkbook. Yet if one wishes it, the author provides a simple checkbook balancing program consisting of some 287 lines of logic.

Perhaps one of the most interesting chapters of the book deals with graphics. The author discusses what is involved in producing graphic representations through a computer onto a video screen. The basic problem is that the amount of data, in terms of dots on the computer screen, color intensity, and resolution, is substantial. “Considering the examples above, it is easy to see why computer graphics pushes the limits of present-day technology. The speed required to display an image at reasonable resolution level is phenomenal. In addition, the computational time required to shade an image and eliminate hidden surfaces is so significant that true animation is possible for only very simple images or by the use of time lapse photography,” (p. 61). This is a book from which the serious student of computers could gain a lot of knowledge. If, on the other hand, one wants to use a computer only for spreadsheets and word processing, then this book is not necessary.

Managerial Accounting and Control Techniques for the Non-Accountant

Mary M.K. Fleming*, Van Nostrand Reinhold Co., 135 West 50th St., New York, N.Y., 10020, 1984, 341 pp.—The author, a CMA, is a professor of accounting and coordinator of the CMA review program at California State University, Fullerton. Her book would be an excellent addition to the library of anyone studying for the CMA exam. The writing is clear, the graphics understandable, the content comprehensive.

The material on fundamental cost concepts, analysis of financial statements, cost accounting, and budgeting could be very helpful for the “nonaccountant” for whom the book supposedly is written. These are the early chapters, however.

When the author starts to delve into the calculation of material and labor variances, linear programming, the time value of money, and economic order quantities for inventory, the typical nonaccountant might find himself over his head.

Had the title simply been, “Managerial Accounting and Control Techniques,” and if the marketing were aimed at management accountants, this book would be a winner. Accountants may assume the book is too elementary, while nonaccountants who buy it may be lost. Members seeking a good review for the CMA exam, however, would be well-advised to get a copy.
T&E Record Keeping Required

Under the 1984 tax law, new record-keeping requirements on all travel and entertainment expenses become effective for tax years beginning after 1984. The new requirements limit the amount of investment tax credit and deductions allowed for business automobiles and draw a sharp distinction between autos used more than 50% for business and autos used 50% or less for business. Those who use automobiles for business purposes must keep accurate records including documentation of miles driven, dates driven, business purpose, driver's name, and amount of expenditures for gas and oil. A detailed vehicle record must be kept unless a business can clearly show that the vehicle is never used for personal activities.

P-W/Deloitte Merger Fails

Because some of the partners vetoed the proposed merger, Price Waterhouse and Deloitte Haskins & Sells have ended talks that were designed to lead to a combination of the two Big 8 firms. Observers suggested that the failure of this proposed merger probably would dampen any plans to pursue mergers by other major public accounting firms. In a joint statement, the partners said: "The absence of agreement in certain important countries made it necessary to terminate discussions despite the high level of partner support overall."

More Top Execs Use Computers

One-third of the respondents in a survey of 100 top corporate executives in Fortune 500 companies personally use computers when making critical business decisions. The survey, conducted by Trinet, Inc., a subsidiary of Control Data Corp., disclosed that computers are used particularly by executives under 50 for financial, budgeting, and marketing decisions. About 35% of the leaders interviewed use computers in their offices and about 23% use them at home, according to the survey. One significant finding: 77% of the respondents who use computers have done so for only two years or less.

President Seiffert Names Two

NAA President Herbert Seiffert has appointed Harold A. Morrissey, Jr., Amarillo Area, as a national director to fill the unexpired one-year term of a director who resigned. He also appointed Past National President Grant U. Meyers as chairman of the Ad Hoc Committee on the Common Body of Knowledge. Mr. Meyers is president, Grandor Corp, Richardson, Texas.

CPA Firms Stint on Benefits

A new survey of CPA firm salaries indicates that while many recommend tax-saving retirement plans to their clients, only 23% have such plans themselves. This phenomenon may be because of the relative youth of most accounting staff employees, who place greater emphasis on current cash and shorter-term benefits. The survey, sponsored by CPA Digest and CPA Administrative Report, shows that salaries for CPA firm partners/owners average $66,400 nationally, and pay for recent accounting graduates averages $19,800.

Business/Accounting Briefs

The Data Processing Management Assn. (DPMA) International has published a newly developed curriculum designed to guide the study of computer systems and their uses for high school students. "The DPMA Secondary Curriculum on Information Technology and Computer Information Systems" outlines and recommends a series of "core" courses that concentrate on applications of computers. Copies of the curriculum are available from DPMA, Attn: Hildegard Klemm, manager of educational services, 505 Busse Hwy., Park Ridge, Ill. 60068. . . Not high grades but personal energy and sociability apparently have stronger links to business success, according to a 20-year study of Stanford MBAs. Successful postgraduates demonstrated a clear dominance in the importance of oral communications over written communications, and an outgoing personality. Those who were self-employed 20 years after graduating "tended to be more impulsive, defiant, and egocentric." . . . Labor rates have outpaced productivity gains to the point where the cost of goods and service consists of 75% "labor cost." What is needed is a "productivity standard" that ties wage rates to productivity gains, says the December issue of Productivity Newsletter.
The Association is going to Mid-America for its 66th Annual International Conference. St. Louis will be the host city for this year's program of talks, panels and discussions of the topics that upscale management accountants need to hear and share. NAA's annual conferences represent a learning experience unique in the profession.

TOPICS
• The Information Transformation: A Study in Survival
• The Latest Generation of Micro Hardware & Software: Where is it Heading?
• Quality Information: Improved Tools for High Technology Management Needs
• Taking Stock: A Woman's Guide to Corporate Success
• Cost Accounting: The Number One Enemy of Productivity
• The Public Oversight Board & Corporate Management
• Cash Management Update
• Executive Wardrobe Engineering
• Data Processing in a Marketing Environment
• How the Board of Directors Views the CFO
• Federal Tax Update

In Addition
Special programs for spouses and the young people (separate events for pre-teens and teens). Family Event (Pops Concert at Powell Hall). Presentations of Trophies, Medals, and other Awards. National Officers' Reception (Sunday's lead-off function). Annual Dinner.

SPEAKERS
Dean O. Morton, President, Hewlett-Packard Company
A. A. Sommer, Chairman, Public Oversight Board
Charles T. Smith, Jr., Chairman of NAA, Managing Partner, Peat, Marwick, Mitchell & Co.
Ralph R. Goldman, Senior Vice President, Shearson/American Express
John P. Imlay, Jr., Chairman & CEO, Management Science America, Inc.
August Bequai, Author & Attorney
Dana R. Richardson, CPA, Partner, Arthur Young & Company
Dr. Sharon Crain, President, Crain & Associates, Inc.
Dr. Eli M. Goldratt, Chairman, Creative Output, Inc.
Charles Starrett, Director, Defense Contracting Administration Agency

Special Guest Speaker
Senator Howard Baker,
Former Majority Leader, U.S. Senate
"Can President Reagan's Goals Toward Deficit Reduction be Achieved? — The Politics that Have to be Considered"

A Word About the Host City
St. Louis is proud of its historic role as Gateway to the West, symbolized by the graceful curves of 630-foot high Gateway Arch. You will like St. Louis — its touch of Midwestern charm blending with a big dose of frontier boldness. You will find all kinds of people there, all eager and happy to welcome the NAA family.

PLAN NOW TO ATTEND! Check These Dates On Your Calendar—June 23-26, 1985
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rate ship-to address file allows frequently used ship-to addresses different from bill-to addresses to be automatically accessed from this file during order entry. Item pricing is controlled primarily through the item file in the inventory control system, but manual overrides may be specified during order entry. The sales analysis software runs in conjunction with the accounts receivable and inventory control packages and includes a master menu from which a variety of reports can be selected. The software is capable of tabulating and printing reports of sales analysis by customer, customer type, customer sales volume, responsible sales representative, state, item, item category, and item sales volume. Password protection also is included. NAA for many years had been manually processing orders, billing, inventory, receivables, and sales analysis for our own publication sales. Starting in September 1984, these functions were transferred to the Rainbow, using the RealWorld software packages. Results have been excellent. Essentially the same or even slightly less time is now spent inputting data, creating new customer files, and printing out results. We are completely current on processing orders, have better control over receivables, and have usable inventory and sales figures. The conversion has been a success.

Contributors: Robert W. McGee and Deborah R. Moore

Letters

view is not valid. Every type and kind of activity, regardless of size, in which monetary value is involved should utilize management accounting concepts and techniques. Nonmanufacturing activities of manufacturing firms, wholesale and retail businesses, banks and other financial enterprises, insurance companies, railroads, airlines, trucking and bus companies, schools, hospitals, governmental units, churches, and welfare organizations—all should employ management accounting in order to operate effectively. It is incumbent on management and on accountants to apply relevant management accounting tools to their fields of endeavor.

NAA properly asserts a leadership role in pursuit of the need for broad applicability by publishing articles such as this one by Mr. Kovlak and by sponsoring research projects such as the recent one, titled "Planning and Control of Municipal Revenues and Expenditures."

Milton F. Usry, Ph.D.
The University of West Florida
Pensacola, Fla.

Anything but Stereotypes

Many thanks for the "opinion" regard-
procedures, and processes. This knowledge will enable the accountant to communicate objectives and to evaluate responses from computer and technical specialists. Management accountants who intend to work directly with computers in the areas of software development, systems design, or technical evaluation will have need for computer literacy beyond level three.

Level Four: Analysis. Level four requires an understanding of both content and structural form. This includes an understanding of the organizational structure and function of the major computer components as well as a recognition of the relationships which exist between them. To the observer, this level requires an understanding of input, processing, storage, and output forms and methods. In addition to this level of understanding, a user would require the ability to diagram computer operations and develop logical operating instructions for the computer. The ability to write an original program that would compute production estimates, perform investment tax-credit analysis, or prepare an amortization schedule would be examples of this level of literacy.

Level Five: Synthesis. This level refers to the ability to formulate new systems or to put the component parts together in such a way as to form a new whole. To the observer this level of literacy would imply the ability to trace an unexpected result back to its causal factor. To the user, this level requires an understanding of storage, retrieval, and processing functions and methods used in computers, plus the ability to create or formulate new integrated systems to solve problems for the user. Examples of this level of literacy would include the development of an integrated order entry/inventory control software system, the design of a telecommunications network for a state government agency, or development of a new operating system for a particular computer system.

Level Six: Evaluation. This level assumes knowledge of all preceding levels plus the ability to make conscious value judgments regarding adequacy, consistency, and value. Level six is the highest in the cognitive hierarchy and, therefore, involves the ability to make valid and informed technical appraisals and comparisons of computer systems.

It is important to recognize that in addition to the six levels of literacy (depth of knowledge), an additional dimension involving breadth of knowledge also exists. It is technically possible, for example, that one could obtain specific understanding of a single microcomputer system such as an IBM PC, Apple or TRS-80 at what could be called level-six literacy. However, knowledge and understanding must increase in both depth and breadth at each successive level in the above hierarchy. Level-five and level-six literacy, in particular, involve the transfer of knowledge across hardware and software systems.

It also is important to recognize that the achievement of any of the above levels of computer literacy is dependent upon acceptable performance at each previous level. The completion of several computer courses or seminars alone provides no guarantee of "computer literacy." It is not the process but the conceptual mastery of the tools necessary to perform at the desired level that determines computer literacy.

We cannot depend on hardware manufacturers and educators to tell us what we should know about computers. As a professional accountant, each individual must develop a personal strategy for achieving and maintaining computer literacy. This can be done by first defining a goal and then proceeding to achieve this level through training and education.

Some sources for computer information and education include:

- Reading. Books and articles provide one of the least expensive and most convenient sources of learning. Accounting periodicals are publishing more articles on this subject, and there are at least 20 prominent specialized journals dedicated to various aspects of computers and data processing such as Personal Computing, Business Computer Systems, Popular Computing, Datamation, Creative Computing, Byte, and Online.
- Professional seminars, short courses and workshops. These programs can
be a good source of new knowledge. Although usually expensive, seminars can be an excellent way to gain "hands-on" experience and/or integrated and comprehensive knowledge quickly. To reduce the risk associated with unsuccessful programs, check seminar objectives, structure, methods, and leaders carefully. Ask what the "hands-on" experience will be and how they will be accomplished. The practitioner attending a seminar should formulate specific goals before the seminar starts, and should raise questions at appropriate times to satisfy those goals. It is also important to use the break periods to pursue those goals with the instructor and with other attendees.

- Formal course work offered by local and regional colleges and universities. These are often the most comprehensive sources of computer knowledge. However, for-credit courses can be very time consuming and frustrating. Many of the learning experiences are designed around projects and homework assignments developed for students with little work experience. An accountant who supplements the course with relevant exercises can use such activity to move to a higher level of literacy.

- Professional society meetings and conferences. National and regional conferences can be expensive and time consuming. Like local chapter meetings, however, they offer an informal and often very productive vehicle for meeting and exchanging information and ideas concerning the application of computer technology within the field of accounting. This type of activity should be viewed as a tool for maintenance of existing literacy, rather than a way of developing new literacy.

- Computer hardware and software vendors. These organizations offer short courses and training seminars on the use of their products. Some vendor seminars are limited to customers only and many require a fee for participants; other programs are offered free of charge.

- Other sources. In-house staff personnel knowledgeable about computers, and computer consultants, hired by the company to perform specialized activities, can be excellent sources of information. Even interns from local universities and colleges may offer a potential source of new information.

- Taking the plunge. Acquiring a personal computer is more of a strategy than a direct source of knowledge. However, many have purchased their own personal microcomputers in order to become computer literate. In the past, "plunging" into the world of computing often meant beginning, with great difficulty, in programming oriented courses designed to achieve level-four objectives. An important advantage of the personal computer is that training materials and instructional software for them have made it possible for an individual to begin at the lowest level of literacy and progress upward to other levels.

Today's management accountant should be concerned not only with the computer's potential to increase the accounting department's ability to generate timely financial reports, but also with the identification of the minimum level of computer literacy necessary to fulfill his/her professional responsibilities. The required level of literacy varies, but most accountants will conclude that the ability to apply computer concepts (level-three literacy) is a practical minimum that must be attained in today's corporate environment.

Michael C. Gallagher is dean of the division of business administration at the University of Houston-Victoria, Tex. James E. Gauntt is an assistant professor of accounting at the University of Arkansas at Little Rock.

**Taxes**

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gain for property subject to depreciation recapture and property subject to a liability where the liability transferred exceeds the adjusted basis, have not been repealed and are still in effect. Accordingly, other than in very specific circumstances, the new law in essence eliminates a corporation's option to distribute appreciated property to its
shareholders without recognizing gain on the distribution.

**Dividends-Received Deduction**

The dividends-received deduction, which generally allows a corporation to deduct 85% of the dividends received from another corporation, has been a staple of corporate tax planning. The 1984 Act restricts the deduction when dividends are received with respect to stock purchased with borrowed funds or for indebtedness related to a corporation’s stock portfolio (e.g., new debt secured by previously acquired stock).

The purpose of the new law is to limit a corporation’s use of the dividends-received deduction as a device for sheltering other corporate earnings. Under prior law, a corporation could borrow funds to buy stock in another corporation which was issuing dividends. The purchasing corporation was then able to claim a double deduction: the interest on the debt to purchase the stock was deductible and the dividends received were subject to the 85% dividends-received deduction.

To neutralize this double tax benefit, instead of the 85% deduction, a corporation receiving dividends from stock acquired with borrowed funds will be allowed to deduct a lesser percentage of dividends, depending on the extent to which the stock was debt-financed. The new law, however, does not apply to all taxpayers. In general, the new law does not apply to taxpayers owning at least 50% of the corporation's outstanding stock as well as to taxpayers owning at least 20% of a corporation’s stock where five or fewer shareholders directly own at least 50% of the stock.

The Conference Report specifically pointed out that this provision is not only applicable to dividends from stock acquired with borrowed funds but also can affect dividends from previously acquired stock. For example, if a firm acquired stock for cash and later obtained funds through a borrowing secured by the stock “in a case in which the purchaser could reasonably have been expected to sell the portfolio stock rather than incur the indebtedness,” the new provision would apply.

The extension of the new provision to this type of situation could result in substantial uncertainty on the part of corporate taxpayers who may now have to engage in a continual rethinking of stock retention and disposition in determining the method it can use to borrow funds. Indeed, in the absence of regulatory guidance, it would appear to be difficult to ascertain whether a firm could reasonably be expected to sell a portfolio rather than incur indebtedness.

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**Letters**

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After the visit to the GASB (Opinion, Dec. ’84). The accounting profession, both private and public, has long needed more authoritative assistance in the area of governmental accounting and auditing. The GASB will provide this.

I particularly liked [the] description of Messrs. Antonio and Ives as being “anything but the stereotypes of legend and lore.” The distinguished part-time members, Messrs. Defliese and Staats, should fit that category also. We accountants tend to become “patterned professionals” and fitted into a narrow mold.

Roger A. Garrett
Hanks, Partin & Garrett
Memphis, Tenn.

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MANAGEMENT ACCOUNTING/FEBRUARY 1985 71
Reading Guide for Students

By Jonathan B. Schiff

Accounting professors and students often have difficulty in relating accounting theory as delineated in textbooks to management accounting practice.

One reason for this problem is a lack of exposure to the manner in which internal operations are carried on, measured, evaluated, and controlled. It is true that books of readings are available, but they tend to focus on theoretical discussions and extensions of the text material. One solution that I have evolved is to provide reports of "real-world" applications of the concepts developed in the textbooks.

MANAGEMENT ACCOUNTING frequently publishes "applications articles" describing in detail actual applications of management accounting concepts. The articles are short, clearly written, and fill the gap by providing background and real-world application of management accounting concepts.

In January 1980, MANAGEMENT ACCOUNTING published a matrix tying articles in the magazine.
to the relevant theory in the leading textbooks. This second management accounting applications matrix updates that article with coverage from January 1978 through June 1984. This matrix lists approximately 170 articles which are cross-indexed to 21 topics keyed to eight leading cost and management accounting textbooks.

It is interesting to note that this second matrix includes more than twice the number of articles than the previous matrix. This is a reflection of MANAGEMENT ACCOUNTING's success in publishing useful, technical articles for practitioners of management accounting. The pattern developed for the earlier article generally has been followed with the following adjustments: The applications reading list is indexed to several additional texts which include those with the widest current collegiate adoption figures. They are presented in two groups: cost accounting texts and management accounting texts. Additionally, several new topics have been included in the matrix. These additions include management information systems, inflation accounting (particularly for internal reporting purposes), productivity, and tax. These topics generally are not covered in the text.
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and Changing Prices: Elimination of Certain Disclosures.”

FAS 81 requires companies that provide health care or life insurance benefits to retirees, their dependents, or survivors to disclose, as a minimum:

- A description of the benefits provided and the employee groups covered,
- A description of the accounting and funding policies,
- The cost of those benefits recognized for the period,
- The effect of significant matters affecting the comparability of the costs recognized for all periods presented.

The Board concluded that because costs of potential future health care and life insurance benefits are likely to be material and because companies often disclose insufficient information about those benefits there is a need for a statement on disclosures. FAS 81 represents an interim step in the project on postretirement benefits other than pensions.

Statement 82 applies to those companies subject to the reporting requirements of FAS 33, “Financial Reporting and Changing Prices.” For years ending on or after December 15, 1984, the amendment eliminates the requirement to provide supplemental disclosures on a historical cost/constant dollar basis for companies that provide supplemental disclosures on a current cost/constant purchasing power basis.

After reviewing (a) responses to an invitation to comment and an exposure draft, (b) the findings of several research studies, and (c) the recommendations from members of an advisory group, the Board decided that reporting the effects of changing prices using two different methods may detract from the usefulness of the information and that historical cost/constant dollar information is less useful than current cost/constant purchasing power information.

Although the Board is working on a statement that will address current cost/constant purchasing power disclosures, it wanted to relieve companies of the costs associated with historical cost/constant dollar disclosures in time for 1984 financial reporting.

FASB Issues Exposure Drafts

Three proposed statements have been released by the Board. Two represent implementation and practice problems:

- “Induced Conversions of Convertible Debt” would stipulate the accounting when a debtor offers a “sweetener” to holders of convertible debt to induce prompt conversion to equity securities.
- “Yield Test for Determining Whether a Convertible Security is a Common Stock Equivalent” proposes that an “effective yield test” replace the “cash yield test” in determining whether a convertible security is a common stock equivalent in computing primary earnings per share.

The other proposal, “Designation of AICPA Guides and Statements of Position on Accounting by Brokers and Dealers in Securities, by Employee Benefit Plans, and By Banks as Preferable for Purposes of Applying APB Opinion 20,” would update FAS 32, which designated the specialized accounting and reporting principles in certain AICPA Guides and SOPs as preferable accounting principles for purposes of applying Opinion 20.

SEC Suggests Discussion

Securities & Exchange Commission Staff Accounting Bulletin 57 expresses views on the accounting for contingent warrants issued by a company.

Footnote 4 of the SAB points out that the authoritative accounting literature cannot specifically address all the novel and complex business transactions into which companies might enter. Therefore companies and their auditors must look to pervasive, fundamental principles or they must attempt to analogize from what appear to be similar situations. The footnote cautions that the SEC staff may not always agree with a registrant so it recommends companies and their auditors discuss with it proposed accounting treatments for transactions and events not specifically covered in the accounting literature.
NAA’s Building Fund Campaign

The NAA Building Fund gives members the opportunity to share in pride of ownership of the Association’s new permanent home. It is every member’s facility.

The chapter/member campaign is being conducted in six regions, each with a Regional chairman:

North-Eastern Region: James W. McLeod, Merrimack Valley.
Mid-Eastern Region: Betty J. Oldham, Cincinnati.
South Eastern Region: James O. Ingle, Atlanta North.
South Central Region: Fred S. Schulte, Austin Area.
North Central Region: Thomas F. Cottelee, Chicago.
Western Region: Charles R. Leone, San Jose.

All contributions go to offset costs related to the new building. All contributions are tax-deductible, and all will be listed in MANAGEMENT ACCOUNTING.

Names of Donors, Supporters, Sponsors and Founders will be permanently recognized in the building. In addition, Donors and Sponsors will receive desk plaques with a picture of the building. Sponsors and Founders will receive wall plaques.

Here is an updated list of those who have pledged and contributed:

Founders — $10,000 or more

Sponsors — $5,000 - $9,999

Supporters — $1,000 - $4,999

Donors — $100 - $999
People in the News

Promotions and New Positions

Joseph J. Cegala, Atlanta Central, has been promoted to manager with the Atlanta office of Ernst & Whinney.

Philip L. Moore, Baltimore, has been promoted to manager—business and finance planning for the Food Service Division of McCormick & Company.

Marie L. Tornaquinifici, Bergen-Rockland, was named to the newly created position of assistant vice president, operations liaison, for Butler Service Groups Contract Technical Services Div.

Bernard Y. Kwan, Connecticut Gateway, has been named vice president—operations, The Paul Revere Investment Management Corp.

Edward H. McCracken, Delaware, past president, has been named senior financial analyst in the corporate controller's department at ICI Americas, Inc. He is a member of the Committee on Marketing and Membership.

Gerald J. Lawrence, Green Mountain (Vt.), recently was named financial controller of Artec, Inc.

Alan J. Treeter, Greenwood (S.C.), past president of the Committee on Materials & Inventory Control at ICI Americas, Inc., has been named national director, Business Management, and Robert B. Alexander to director of materials & inventory control at Flexible Technologies.

James R. Speelman, Kansas City, is now corporate controller for Birdview Satellite Communications.

Richard G. Durante, Lehigh Valley, was named office manager/controller at Canada Dry Bottling Co.

Lyn O'Berry, Member-at-Large, U.S.A., has been named corporate comptroller for Univisco and its subsidiary Cavalier Computer Supplies and Business Forms, and to the board of directors of Univisco.

Stephen R. LePore, Merrimack Valley, was promoted to controller of business centers at Wang Corp.

Richard A. Yanez, Miami, was named controller, Gulfstream Racetrack.

Kenneth D. Anderson, Minneapolis Viking, has been elected vice president of Data Card Corp.

H. Michael Finley, Nashville-Capitol City, has been promoted to vice president—finance of International Clinical Laboratories, Inc.

Francis J. Dignan, Norwich, has been promoted to controller, of Sheffield Tube Corp., in New London, Conn.

Harriet T. Lore, Philadelphia, is the new controller of Center City Chevrolet. ... Greg E. Scott is the accounting manager for Atlantic Clinical Financial.

Joseph M. Donato, Piedmont Winston-Salem, has been promoted to vice president—finance of Paul N. Howard Co.

Bobby S. Ellery, San Antonio, has joined Solo Serve Corp. as assistant controller.

Donald R. Holmes, South Birmingham, is now controller with Tymeshare/McDonnell Douglas.

Emeritus Life Associates (ELA)

J. Charles Baummer, Baltimore.

David W. A. Beach, Pomona Valley-Inland Empire.

James F. Benson, Mohawk Valley.

Edgar T. Bitting, Lancaster.

William G. Brown, Jr., Muskegon, past president.

Henry J. Carley, Elmira Area.

C. Ray Carpenter, Mobile.

Dean S. Cronenwett, North Central Ohio.

Warren G. Day, Massachusetts North Shore.

James A. Dodge, Atlanta North.

Crawford P. Gillette, Georgetown-Myr-
specific fields of interest within the broad business and accounting field—controllership and business planning—so the activities and subject matter will be of immediate and primary interest to those who are, or aspire to be, practicing in these fields.

2. Through the use of questionnaires, interviews, turnaround documents and so on, the information that is disseminated to the groups will be largely generated by the members themselves. The news, as the networks get rolling, should come from the best possible intelligence source—the peer members—and therefore, be uniquely usable by the other members of the group. It won't be a rehash of yesterday's business journals.

Once these two groups are moving forward, the Ad Hoc Committee on Member Interest Groups plans to consider others where the marketplace sees a need. Since the readers of this column are part of the marketplace, we—the committee and staff—would like to hear from you on any aspect of the program.

As Peters and Waterman have said, a big organization—and NAA is a big organization—must continue to adapt and innovate or it will languish and ultimately perish. Our goal is certainly to avoid having NAA become a candidate for the Millard Fillmore Medal of Mediocrity, which is awarded annually by the Millard Fillmore Society in honor of the nation's 13th and "most mediocre" president. (His chief claim to fame seems to be that he was the first president to install a bathtub in the White House.)

Certainly NAA's objective is to continue to "search for excellence" in our service to members. We think we've found one more way in the form of the Member Interest Groups. We hope you will agree.
**New Products/Services**

**Eastman Kodak Co.,** has introduced a complete line of HD600 diskettes for use in most small computers. They come in a variety of standard sizes and formats including high-density products and micro size diskettes. These disks are reportedly seven times denser than the average floppy disk and are applicable to industry and business use. They include the 5 1/4-inch, 96 tracks-per-inch (tpi) configuration, for use with the IBM PC, AT and compatibles. For further information, contact the company at 343 State Street, Rochester, N.Y. at (716) 724-4241.

**Arthur Young** has introduced the Decisionmate Series microcomputer-based software, designed for local governments. Its three systems include fund accounting, utility accounting, and payroll/personnel. This menu-driven system can be purchased individually, or all-together. The fund accounting system maintains all of a government unit's ledgers simultaneously, including the general ledger, the encumbrance ledger, and accounts payable ledger. The system offers 10 screen displays and 34 printed reports. The utility accounting system can replace service bureau contracts for governmental billing and receivables requirements. The payroll/personnel system permits the use of up to 99 voluntary deductions, and supports leave and cost accounting. The Decisionmate series works on the IBM PC, IBM/XT, The Texas Instruments professional computer, and the Sperry PC. For further information, contact Patrice Ingrassia, New York, N.Y., at (212) 407-1724.

**Thoughtware, Inc.** has introduced Trigger—software to help managers focus their attention on the areas of their operations that contribute the most to profitability. Trigger monitors key performance areas, identifies exceptions to performance guidelines, and then issues memos identifying the problem, its probable causes, and the action needed to remedy it. The software consists of three program application disks, a computer-based tutorial in using the disks, and a reference manual that includes case histories. Trigger operates on the IBM PC or compatibles with a minimum of 28 k of memory and dual disk drives. Typical applications include sales quotas and performance of individual sales persons. For further information, contact Thoughtware, Inc., Coconut Grove, Fla. at 1-800-848-9273 or (305) 854-2318.

![TI's Pro-Lite computer.](image)

**Texas Instruments, Inc.** has introduced the Pro-Lite, a briefcase-size personal computer which runs a large selection of software. Data that can increase productivity may take the form of inventory status reports, marketing data, order/shipment status, or customer reports and presentations, depending on the industry application. The Pro-Lite is a convergence of TI's portable terminal and professional computer products. The screen can display either characters or complex graphics. The entry-level configuration includes 256,000 bytes of memory. The modular design allows users to configure a system that meets their needs. The keyboard has 79 keys and includes 12 function keys and an embedded numeric keypad, for use with calculator, spreadsheet, and database management software. For further information, contact Texas Instruments, Dallas, Tex., at 1-800-527-3500.

**Deloitte, Haskins & Sells** is offering a microcomputer tax-planning program, the Expatriate Tax Calculation System, to help U.S. multinational companies calculate the significant sums required to protect or equalize the pay of their executives on foreign assignments. The system calculates current-year costs and the equalization payment that will be needed at the end of the year. Because it uses conventional programming and Lotus 1-2-3, the system can be used on-site overseas, as well as in the home office. For further information, contact Warren K. Wentworth, Pittsburgh, Pa., at (412) 223-6900.

**Dow Jones Information Services,** has announced that the Dow Jones Market Manager PLUS is now available for use on the IBM PC XT. Based on a tax-lot accounting system, the Market Manager PLUS reportedly controls up to 26 different portfolios and maintains up to 500 open tax-lots. The Market Manager PLUS provides automatic valuation of stocks, bonds, treasury issues, options, and mutual funds. It also offers automatic dividend reports sorted by tax exemption codes, year-to-date commission reports, and automatic stock split routines. It is targeted toward individual investors, small business owners, investment counselors, securities brokers, and business educational professionals. For further information, contact JoAnne Kennedy, N.J., at (609) 452-2000.

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by Robert Half