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paragraphs 15 and 17; Chapter 12, paragraph 21; and Chapter 15, paragraphs 7 and 17 amended by
APB 9

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Chapter 5, paragraph 10 superseded prospectively by APB 16

Chapter 6 superseded by FAS 5

Chapter 7A, paragraph 10 amended by FAS 111

Chapter 7C superseded by ARB 48

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Chapter 9C, paragraphs 11 through 13 superseded by FAS 96 and FAS 109

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Chapter 10B superseded by APB 11, FAS 96, and FAS 109

Chapter 11B, paragraph 8 superseded by APB 11, FAS 96, and FAS 109

Chapter 11B, paragraph 9 and footnotes 3 and 4 amended by APB 9

Chapter 11B, paragraph 9 amended by FAS 111

Chapter 11B, footnotes 3 and 4 superseded by FAS 111

Chapter 12, paragraph 5 amended by FAS 8 and FAS 52

Chapter 12, paragraphs 7 and 10 through 22 superseded by FAS 8 and FAS 52

Chapter 12, paragraphs 8 and 9 superseded by FAS 94

Chapter 13A superseded by APB 8

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Chapter 14 superseded by APB 5

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

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PREFACE

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

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

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 Certain of the bulletins were amended, superseded, or withdrawn as changing conditions affected their usefulness.

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

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

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

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

Committee on Accounting Procedure

June, 1953

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

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

Committee on Accounting Procedure (1952-1953)

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INTRODUCTION

Accounting and the Corporate System

1. Accounting is essential to the effective functioning of any business organization, particularly the corporate form. The test of the corporate system and of the special phase of it represented by corporate accounting ultimately lies in the results which are produced. These results must be judged from the standpoint of society as a whole—not merely from that of any one group of interested persons.
2. The uses to which the corporate system is put and the controls to which it is subject change from time to time, and all parts of the machinery must be adapted to meet changes as they occur. In the past fifty years there has been an increasing use of the corporate system for the purpose of converting into readily transferable form the ownership of large, complex, and more or less permanent business enterprises.
3. As a result of this development, the problems in the field of accounting have increasingly come to be considered from the standpoint of the buyer or seller of an interest in an enterprise, with consequent increased recognition of the significance of the income statement and a tendency to restrict narrowly charges and credits to surplus. The fairest possible presentation of periodic net income, with neither material overstatement nor understatement, is important, since the results of operations are significant not only to prospective buyers of an interest in the enterprise but also to prospective sellers. With the increasing importance of the income statement there has been a tendency to regard the balance sheet as the connecting link between successive income statements; however this concept should not obscure the fact that the balance sheet has significant uses of its own.
4. This evolution has also led to a demand for a larger degree of uniformity in accounting. *Uniformity* has usually connoted similar treatment of the same item occurring in many cases, in which sense it runs the risk of concealing important differences among cases. Another sense of the word would require that different authorities working independently on the same case should reach the same conclusions. Although uniformity is a worthwhile goal, it should not be pursued to the exclusion of other benefits. Changes of emphasis and objective as well as changes in conditions under which business operates have led, and doubtless will continue to lead, to the adoption of new accounting procedures. Consequently diversity of practice may continue as new practices are adopted before old ones are completely discarded.

Applicability of Committee Opinions

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

Voting Procedure in Adopting Opinions

6. The committee regards the representative character and general acceptability of its opinions as of the highest importance, and to that end has adopted the following procedures:
 - a. Any opinion or recommendation before issuance is submitted in final form to all members of the committee either at a meeting or by mail.

- b. No such opinion or recommendation is issued unless it has received the approval of two-thirds or the entire committee.
 - c. Any member of the committee dissenting from an opinion or recommendation issued under the preceding rule is entitled to have the fact of this dissent and his reasons therefor recorded in the document in which the opinion or recommendation is presented.
7. Before reaching its conclusions, the committee gives careful consideration to prior opinions, to prevailing practices, and to the views of professional and other bodies concerned with accounting procedures.

Authority of Opinions

8. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of opinions reached by the committee rests upon their general acceptability. The committee recognizes that in extraordinary cases fair presentation and justice to all parties at interest may require exceptional treatment. But the burden of justifying departure from accepted procedures, to the extent that they are evidenced in committee opinions, must be assumed by those who adopt another treatment.
9. The committee contemplates that its opinions will have application only to items material and significant in the relative circumstances. It considers that items of little or no consequence may be dealt with as expediency may suggest. However, freedom to deal expediently with immaterial items should not extend to a group of items whose cumulative effect in any one financial statement may be material and significant.

Opinions Not Retroactive

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

The Company and Its Auditors

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

Chapter 1

PRIOR OPINIONS

Section A—Rules Adopted by Membership

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

1. Unrealized profit should not be credited to income account of the corporation either directly or indirectly, through the medium of charging against such unrealized profits amounts which would ordinarily fail to be charged against income account. Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured. An exception to the general

rule may be made in respect of inventories in industries (such as packing-house industry) in which owing to the impossibility of determining costs it is a trade custom to take inventories at net selling prices, which may exceed cost.

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

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

4. While it is perhaps in some circumstances permissible to show stock of a corporation held in its own treasury as an asset, if adequately disclosed, the dividends on stock so held should not be treated as a credit to the income account of the company.

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

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

Section B—Opinion Issued by Predecessor Committee

1. Following an inquiry made by the New York Stock Exchange, a predecessor committee on accounting procedure in 1938 issued the following report:

“Profits or Losses on Treasury Stock”

2. “The executive committee of the American Institute of Accountants has directed that the following report of the committee on accounting procedure, which it received at a meeting on April 8, 1938, be published, without approval or disapproval of the committee, for the information of members of the Institute:

To the Executive Committee,
American Institute of Accountants:

3. “This committee has had under consideration the question regarding treatment of purchase and sale by a corporation of its own stock, which was raised during 1937 by the New York Stock Exchange with the Institute’s special committee on cooperation with stock exchanges.

4. “As a result of discussions which then took place, the special committee on cooperation with stock exchanges made a report which was approved by the committee on accounting procedure and the executive committee, and a copy of which was furnished to the committee on stock list of the New York Stock Exchange. The question raised was stated in the following form:

5. “Should the difference between the purchase and resale prices of a corporation’s own common stock be reflected in earned surplus (either directly or through inclusion in the income account) or should such difference be reflected in capital surplus?”

6. "The opinion of the special committee on cooperation with stock exchanges reads in part as follows:
7. "Apparently there is general agreement that the difference between the purchase price and the stated value of a corporation's common stock purchased and retired should be reflected in capital surplus. Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits or losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common stock.'
8. "This committee is in agreement with the views thus expressed; it is aware that such transactions have been held to give rise to taxable income, but it does not feel that such decisions constitute any bar to the application of correct accounting procedure as above outlines.
9. "The special committee on cooperation with stock exchanges continued and concluded its report with the following statement:
10. "Accordingly, although your committee recognizes that there may be cases where the transactions involved are so inconsequential as to be immaterial, it does not believe that, as a broad general principle, such transactions should be reflected in earned surplus (either directly or through inclusion in the income account).'
11. "This committee agrees with the special committee on cooperation with stock exchanges, but thinks it desirable to point out that the qualification should not be applied to any transaction which, although in itself inconsiderable in amount, is a part of a series of transactions which in the aggregate are of substantial importance.
12. "This committee recommends that the views expressed be circulated for the information of members of the Institute."

Chapter 2

FORM OF STATEMENTS

Section A--Comparative Financial Statements

1. The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an installment of what is essentially a continuous history.
2. In any one year it is ordinarily desirable that the balance sheet, the income statement, and the surplus statement be given for one or more preceding years as well as for the current year. Footnotes, explanations, and accountants' qualifications which appeared on the statements for the preceding years should be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. If, because of reclassifications or for other reasons, changes have occurred in the manner of or basis for presenting corresponding items for two or more periods, information should be furnished which will explain the change. This procedure is in conformity with the well recognized principle that any change in practice which affects comparability should be disclosed.
3. It is necessary that prior-year figures shown for comparative purposes be in fact comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out.
4. Circumstances vary so greatly that it is not practicable to deal here specifically with all situations. The independent accountant should, however, make very clear what statements are included within the scope of his report.

Section B--Combined Statement of Income and Earned Surplus

1. Attention has already been called in the introduction to the increased significance attributed to the income statement by users of financial statements and to the general tendency to regard the balance sheet as the connecting link between successive income statements. It therefore becomes important to consider the problems presented by the practice of combining the annual income statement with the statement of earned surplus.
2. The combining of these two statements, where possible, will often be found to be convenient and desirable. Where this presentation is contemplated, however, certain considerations should be borne in mind if undesirable consequences are to be avoided.

Advantages of Combined Statements

3. Over the years it is plainly desirable that all costs, expenses, and losses, and all profits of a business, other than decreases or increases arising directly from its capital-stock transactions, be included in the determination of income. If this principle could in practice be carried out perfectly, there would be no charges or credits to earned surplus except those relating to distributions and appropriations of final net income. This is an ideal upon which all may agree, but because of conditions impossible to foresee it often fails of attainment. From time to time charges and credits are made to surplus which clearly affect the cumulative total of income for a series of years, although their exclusion from the income statement of a single year is justifiable. There is danger that unless the two statements are closely connected such items will be overlooked, or at any rate not given full weight, in any attempt on the part of the reader to compute a company's long-run income or its income-earning capacity.
4. There is a marked tendency to exaggerate the significance of the net income for a single year, particularly the degree to which the net income can be identified exclusively with that year. In so far as the combined form calls attention to the character of the income statement as a tentative installment in the long-time financial results it serves a useful purpose.
5. To summarize, the combined income and earned surplus statement serves the purpose of showing in one statement both the earnings applicable to the particular period and modifications of earned surplus on a long-run basis. It distinguishes current charges and credits related to a company's more usual or typical business operations from material extraordinary charges and credits¹ which may have arisen during the period by placing them in different sections of a continuous statement.

Disadvantages and Limitations

6. In the combined statement, net income for the year appears somewhere within the statement and not at the end. Such wording and arrangement should be used as will make this item unmistakably clear and leave the reader in no doubt as to the point at which the net income has been determined.
7. While it is true that the net income amount, when expressed as earnings per share, is often given undue prominence and its significance exaggerated, there nevertheless remain the responsibility for determination of net income by sound methods and the duty to show it clearly. The adoption of the combined statement provides no excuse for less care in distinguishing charges and credits to income from charges and credits to surplus than would be required if separate statements of income and surplus were presented. Failure to exercise care in the use of this form of statement would immediately discredit it.

Chapter 3

WORKING CAPITAL

¹ See chapter 8, paragraphs 11, 12, and 13.

Section A--Current Assets and Current Liabilities

1. The working capital of a borrower has always been of prime interest to grantors of credit; and bond indentures, credit agreements, and preferred stock agreements commonly contain provisions restricting corporate actions which would effect a reduction or impairment of working capital. Many such contracts forego precise or uniform definitions and merely provide that current assets and current liabilities shall be determined in accordance with generally accepted accounting principles. Considerable variation and inconsistency exist, however with respect to their classification and display in financial statements. In this section the committee discussed the nature of current assets and current liabilities with a view toward a more useful presentation thereof in financial statements.
2. The committee believes that, in the past, definitions of current assets have tended to be overly concerned with whether the assets may be immediately realizable. The discussion which follows takes cognizance of the tendency for creditors to rely more upon the ability of debtors to pay their obligations out of the proceeds of current operations and less upon the debtor's ability to pay in case of liquidation. It should be emphasized that financial statements of a going concern are prepared on the assumption that the company will continue in business. Accordingly, the views expressed in this section represent a departure from any narrow definition or strict *one year* interpretation of either current assets or current liabilities; the objective is to relate the criteria developed to the operating cycle of a business.
3. Financial position, as it is reflected by the records and accounts from which the statement is prepared, is revealed in a presentation of the assets and liabilities of the enterprise. In the statements of manufacturing, trading, and service enterprises these assets and liabilities are generally classified and segregated; if they are classified logically, summations or totals of the *current* or *circulation* or *working* assets, hereinafter referred to as *current assets*, and of obligations currently payable, designated as *current liabilities*, will permit the ready determination of working capital. *Working capital*, sometimes called *net working capital*, is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital which constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business. If the conventions of accounting relative to the identification and presentation of current assets and current liabilities are made logical and consistent, the amounts, bases of valuations, and composition of such assets and liabilities and their relation to the total assets or capital employed will provide valuable data for credit and management purposes and afford a sound basis for comparisons from year to year. It is recognized that there may be exceptions, in special cases, to certain of the inclusions and exclusions as set forth in this section when such exceptions occur they should be accorded the treatment merited in the particular circumstances under the general principles outlined herein.
4. For accounting purposes, the term *current assets* is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. Thus the term comprehends in general such resources as (a) cash available for current operations and items which are the equivalent of cash; (b) inventories of merchandise, raw materials, goods in process, finished goods, operating supplies, and ordinary maintenance material and parts; (c) trade accounts, notes, and acceptances receivable; (d) receivables from officers, employees, affiliates, and others, if collectible in the ordinary course of business within a year; (e) installment or deferred accounts and notes receivable if they conform generally to normal trade practices and terms within the business; (f) marketable securities representing the investment of cash available for current operations and (g) **prepaid expenses, such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received, and operating supplies. Prepaid expenses are not current assets in the sense that they will be converted into cash but in the sense that, if not paid in advance, they would require the use of current assets during the operating cycle.**
5. The ordinary operations of a business involve a circulation of capital within the current asset group. Cash is expended for materials, finished parts, operating supplies, labor, and other factory services, and such expenditures are accumulated as inventory cost. Inventory costs, upon sale of the product to which such costs attach, are converted into trade receivables and ultimately into cash again. The average time intervening between the acquisition of materials or services entering this process and the final cash realization constitutes an *operating cycle*. A one-year time period is to be used as a basis for the segregation of current assets in cases where there are

several operating cycles occurring within a year. However, where the period of the operating cycle is more than twelve months, as in, for instance, the tobacco, distillery, and lumber businesses, the longer period should be used. Where a particular business has no clearly defined operating cycle, the one-year rule should govern.

6. This concept of the nature of current assets contemplates the exclusion from that classification of such resources as: (a) cash and claims to cash which are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated¹ for liquidation of long-term debts; (b) investments in securities (whether marketable or not) or advances which have been made for the purposes of control, affiliation, or other continuing business advantage; (c) receivables arising from unusual transactions (such as the sale of capital assets, or loans or advances to affiliates, officers, or employees) which are not expected to be collected within twelve months; **(d) cash surrender value of life insurance policies**; (e) land and other natural resources; (f) depreciable assets; and (g) long-term prepayments which are fairly chargeable to the operations of several years, or deferred charges such as unamortized debt discount and expense, bonus payments under a long-term lease costs of rearrangement of factory layout or removal to a new location, and certain types of research and development costs.

7. The term *current liabilities* is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance-sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the production of goods or in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services²; and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually twelve months, are also intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.³

8. This concept of current liabilities would include estimated or accrued amounts which are expected to be required to cover expenditures within the year for known obligations (a) the amount of which can be determined only approximately (as in the case of provisions for accruing bonus payments) or (b) where the specific person or persons to whom payment will be made cannot as yet be designated (as in the case of estimated costs to be incurred in connection with guaranteed servicing or repair of products already sold). The current liability classification, however, is not intended to include a contractual obligation falling due at an early date which is expected to be

¹ Even though not actually set aside in special accounts, funds that are clearly to be used in the near future for the liquidation of long-term debts, payments to sinking funds, or for similar purposes should also, under this concept, be excluded from current assets. However, where such funds are considered to offset maturing debt which has properly been set up as a current liability, they may be included within the current asset classification.

² Examples of such current liabilities are obligations resulting from advance collections on ticket sales, which will normally be liquidated in the ordinary course of business by the delivery of services. On the contrary, obligations representing long-term deferments of the delivery of goods or services would not be shown as current liabilities. Examples of the latter are the issuance of a long-term warranty or the advance receipt by a lessor of rental for the final period of a ten-year lease as a condition to execution of the lease agreement.

³ Loans accompanied by pledge of life insurance policies would be classified as current liabilities when, by their terms or by intent, they are to be repaid within twelve months. The pledging of life insurance policies does not affect the classification of the asset any more than does the pledging of receivables, inventories, real estate, or other assets as collateral for a short-term loan. However, when a loan on a life insurance policy is obtained from the insurance company with the intent that it will not be paid but will be liquidated by deduction from the proceeds of the policy upon maturity or cancellation, the obligation should be excluded from current liabilities.

refunded,⁴ or debts to be liquidated by funds which have been accumulated in accounts of a type not properly classified as current assets, or long-term obligations incurred to provide increased amounts of working capital for long periods. When the amounts of the periodic payments of an obligation are, by contract, measured by current transactions, as for example by rents or revenues received in the case of equipment trust certificates or by the depletion of natural resources in the case of property obligations, the portion of the total obligation to be included as a current liability should be that representing the amount accrued at the balance-sheet date.

9. The amounts at which various current assets are carried do not always represent their present realizable cash values. Accounts receivable net of allowances for uncollectible accounts, and for unearned discounts where unearned discounts are considered, are effectively stated at the amount of cash estimated as realizable. However, practice varies with respect to the carrying basis for current assets such as marketable securities and inventories. In the case of marketable securities where market value is less than cost by a substantial amount and it is evident that the decline in market value is not due to a mere temporary condition, the amount to be included as a current asset should not exceed the market value. The basis for carrying inventories is stated in chapter 4. It is important that the amounts at which current assets are stated be supplemented by information which reveals, for temporary investments, their market value at the balance-sheet date, and for the various classifications of inventory items, the basis upon which their amounts are stated and, where practicable, indication of the method of determining the cost—e.g., *average cost, first-in first-out, last-in first-out*, etc.

One member of the committee, Mr. Mason, assented with qualification to adoption of section A of chapter 3.

Mr. Mason does not accept the view implied in paragraph 6 that unamortized debt discount is an asset. Also, referring to paragraph 9, he believes that the market value is the most significant figure in connection with marketable securities held as temporary investments of cash, and would prefer to show such securities in the accounts at their market value, whether greater or less than cost. He would accept as an alternative the use of cost in the accounts with market value shown parenthetically in the balance sheet.

Section B--Application of United States Government Securities against Liabilities for Federal Taxes on Income

1. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of set-off exists. An example of such exception was the showing of United States Treasury Tax Notes, Tax Series A-1943 and B-1943, as a deduction from the liability for federal taxes on income, which the committee approved in 1942.

2. In view of the special nature of the terms of the 1943 tax notes, the intention of the purchaser to use them to pay federal income taxes could be assumed, since he received no interest or other advantage unless they were so used. Some purchasers doubtless viewed their purchase of the notes as being, to all intents and purposes, an advance payment of the taxes.

3. In the absence of evidence of a contrary intent, it was considered acceptable, and in accordance with good accounting practice, to show the notes in the current liability section of the balance sheet as a deduction from federal taxes on income in an amount not to exceed the accrued liability for such taxes. The full amount of the accrued liability was to be shown with a deduction for the tax payment value of the notes at the date of the balance sheet.

4. It also was recognized as clearly proper to show the notes in the current asset section of the balance sheet as any other temporary investments are shown. If at the balance-sheet date or at the date of the independent auditor's report there was evidence that the original intent was changed, the notes were to be shown in the current asset section of the balance sheet.

⁴ There should, however, be full disclosure that such obligation has been omitted from the current liabilities and a statement of the reason for such omission should be given. Cf note 1.

5. Government securities having restrictive terms similar to those contained in the 1943 tax series notes are no longer issued, although certain other types of government securities have since been issued which are acceptable in payment of liabilities for federal taxes on income. However, because of the effect on the current position of large tax accruals and the related accumulations of liquid assets to meet such liabilities, many companies have adopted the practice of acquiring and holding government securities of various issues in amounts related to the estimated tax liability. In their financial statements these companies have often expressed this relationship by showing such securities as a deduction from the tax liability, even though the particular securities were not by their terms acceptable in payment of taxes. If the government securities involved may, by their terms, be surrendered in payment of taxes, the above practice clearly falls within the principle of the permissive exception described in paragraph 1. The committee further believes that the extension of the practice to include the offset of other types of United States government securities, although a deviation from the general rule against offsets, is not so significant a deviation as to call for an exception in an accountant's report on the financial statements.

6. Suggestions have been received that similar considerations may be advanced in favor of the offset of cash or other assets against the income and excess profits tax liability or against other amounts owing to the federal government. In the opinion of the committee, however, any such extension or application of the exception, recognized as to United States government securities and liabilities for federal taxes on income, is not to be regarded as acceptable practice.

One member of the committee, Mr. Calkins, assented with qualification to adoption of section B of chapter 3.

Mr. Calkins does not approve the concluding sentence of paragraph 5, which states that the offset of other types of United States Government securities, although a deviation from the general rule against offsets, is not so significant a deviation as to call for an exception in an accountant's report. He believes that the significance of such a deviation is a matter for judgment based on the facts of a particular case; that the broader language of the statement constitutes a condonation of the practice of offsetting against tax liabilities United States Government obligations which are not by their terms acceptable in payment of federal taxes; and that the condonation of such a practice is inconsistent with the opinion of the committee expressed in paragraph 6, with which he agrees, that cash and other assets should not be offset against liabilities for federal taxes.