The legislature intended to authorize the transfer of jurisdiction. It is not legally possible to transfer the jurisdiction in the way specified. However, the remainder of the act is not dependent on the recording of an instrument. Therefore, the proper construction is that the requirement of a recordable instrument is severable.

The director of mental health, who is appointed pursuant to section 3 of Act 271, Public Acts of 1945, as last amended by Act 236, Public Acts of 1963,[4] can initiate the transfer by a letter addressed to the department of conservation in which he offers to make the transfer. Written acceptance of the land in question should be made by the conservation commission on behalf of the department of conservation. That letter should be sent to the controller for his approval and signature as chief executive of the department of administration. The controller, who is also the secretary of the state administrative board, should be requested to have the transfer placed on the administrative board agenda for consideration and approval. If the administrative board approves the transfer, such action should be made part of the formal minutes of the proceedings of the administrative board. Then, the controller as secretary of the administrative board should attach a copy of the minutes approving the transfer to the letter of transfer and return it to the director of mental health for forwarding to the department of conservation.

If advice is desired in drafting the letter of transfer, I would be happy to assign one of my assistant attorneys general to help in this regard.

FRANK J. KELLEY,
Attorney General

631118.4

TAXATION: Corporate Annual Privilege Fee Act.
CORPORATION & SECURITIES COMMISSION: Definition of "earned surplus."
LEGISLATURE: Constitutionality of Senate Bill 1046 and House Bill 54, 1963 Ex. Sess.

Senate Bill 1046 and House Bill 54, 1963 Extra Session, Michigan 72nd Legislature, which would amend § 4 of Act 85, P.A. 1921 as amended, to define "earned surpus" taxable therein to mean the retained earnings of a corporation as reflected on its balance sheet, so long as they are determined in accordance with generally accepted principles of accounting, are unconstitutional in that they would delegate to private parties the power to include or exclude items in determining "retained earnings" for the balance sheet statement without legislative definitional standards.

No. 4242 November 18, 1963.

Hon. Lenton G. Sculthorp
Commissioner
Corporation & Securities Commission
Lansing, Michigan

You request the opinion of the Attorney General on the following question:

[4] M.S.A. Cur. Mat. § 14.861(3), p. 800-801.

"Are Senate Bill 1046 and House Bill 54, now before the extra session of the 1963 Legislature, constitutional; that is to say, in conformity with the existing Michigan Constitution and the new Michigan Constitution which becomes effective January 1, 1964?"

In explanation of your request, you state:

"The above bills, which are identical except in one respect, both seek to amend Act 85, P.A. 1921, as amended (Corporate Annual Privilege Fee Act), so that the tax will not be on all surplus but instead will only be on paid-in surplus and earned surplus. Earned surplus is then defined as meaning the retained earnings of the company as reflected on its balance sheet to stockholders, and such retained earnings shall be determined in accordance with generally accepted principles of accounting.

"Senate Bill 1046 contains the further provision that the burden of proof that generally accepted accounting principles were used shall be on the corporation, and the Michigan Corporation and Securities Commission may at any time challenge the company to prove that generally accepted principles of accounting were used.

"The purpose of this legislation is to reduce the tax of those corporations who have a Reserve for Deferred Federal Income Tax or Reserve for Investment Credit which have heretofore been considered by this Commission as a part of taxable surplus pursuant to the present wording in Section 4 of the above act.

"Section 1 of Article V of the present Constitution and Section 1 of Article IV of the new Constitution effective January 1, 1964, both state that the legislative power of the State of Michigan is vested in a Senate and a House of Representatives. It is believed that these bills may, in effect, be delegating the legislative power to levy taxes to the accounting profession since they would be the arbiters who would determine whether or not 'generally accepted principles of accounting' were applied in any given instance. I believe there is disagreement within the accounting profession as to what constitutes 'generally accepted principles of accounting' in many areas."

Senate Bill No. 1046 would amend § 4 of Act 85, P.A. 1921, as amended, as follows:

1. It would change the definition of the tax base from "paid-up capital and surplus" to "Paid-up capital, PAID-IN surplus and EARNED SURPLUS."

2. It would eliminate the existing definition of "surplus" and would prescribe the following definition of "EARNED surplus":

"* * * the retained earnings of the corporation as reflected in the fiscal year-end balance sheet statement of the corporation which is communicated or distributed to stockholders pursuant to section 45 of Act No. 327 of the Public Acts of 1931, being section 450.45 of

the Compiled Laws of 1948, or pursuant to the laws of any other state or voluntarily. Such retained earnings shall be determined in accordance with generally accepted principles of accounting; * * *."

3. It provides that the corporation has the burden of proof to establish that generally accepted principles of accounting are reflected in its balance sheet.

House Bill No. 54 is identical, except it does not contain the additional language referring to the burden of proof.[1]

To answer your question it is necessary to determine whether the prescribed corporate franchise tax base conforms to the constitutional requirements that require the legislature to exercise, without delegation, its legislative powers and to impose a uniform tax on taxable classes. Section 1 of Article IV of the Constitution of 1963 and the first clause of Section 1 of Article V of the Constitution of 1908 vest the legislative power of the State of Michigan in a Senate and House of Representatives; and Article IX, Section 3, of the Constitution of 1963 provides that every tax other than the general ad valorem property tax shall be uniform upon the class upon which it operates, as does Section 4 of Article X of the Michigan Constitution of 1908.[2]

The effect of these and comparable constitutional requirements is to require the legislature to exercise the taxing power of the State of Michigan by specifically prescribing the tax base and providing for uniform taxation of any persons or property within a class.

Banner Laundering Co. v. *State Board of Tax Administration,* 297 Mich. 419, 432-433

C. F. Smith Co. v. *Fitzgerald,* 270 Mich. 659

Union Steam Pump Sales Co. v. *State,* 216 Mich. 261

Bells Gap Railroad Co. v. *Pennsylvania,* 134 U.S. 232

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[1] It is also identical to House Bill 436, Michigan 72nd Legislature, Regular Session of 1963. Senate Bill 1150, Michigan 71st Legislature, Regular Session of 1961, was intended to accomplish a comparable result in reference to corporations subject to regulations under the Michigan Public Service Commission, except the accounting reference there was to the uniform system of accounts prescribed by the Michigan Public Service Commission which, it is presumed, is also one of the accounting standards referred to in the bills in question. Senate Bill 1230, Michigan 70th Legislature, Regular Session 1960, is comparable to Senate Bill 1150 of 1961, neither of which substituted "PAID-IN surplus AND EARNED SURPLUS" for the term "surplus."

[2] Section 32 of Article IV, Michigan Constitution of 1963, reads:

"Every law which imposes, continues or revives a tax shall distinctly state the tax."

(as did Section 6, Article X, of the Michigan Constitution of 1908). Section 2 of Article IX of the new Constitution reads:

"The power of taxation shall never be surrendered, suspended or contracted away."

(The 1908 Constitutional counterpart is Section 9, Article X.)

11 *Am. Jur.*, Constitutional Law, Section 219

Colony Town Club v. *Unemployment Comp. Com.*, 301 Mich. 107

Minor Walton Bean Co. v. *Unemployment Comp. Com.*, 308 Mich. 636

Lievense v. *Unemployment Comp. Com.*, 335 Mich. 339

Coffman v. *State Board of Examiners*, 331 Mich. 582

King v. *Concordia Fire-Insurance Co.*, 140 Mich. 258 (1905)

In re Brewster St. Housing Site, 291 Mich. 313

Tribbett v. *Village of Marcellus*, 294 Mich. 607

These cases make it self-evident that the lack of any definite standard or treatment of "earned surplus" by the accounting profession would make completely unworkable any tax base which is dependent upon accounting treatment, and would render any such tax base unconstitutional under the uniformity provisions of the Michigan Constitution and the due process and equal protection clauses of both the Michigan and the United States Constitutions. It would also constitute an unlawful delegation of legislative power.

The Michigan delegation rule was first considered in *King* v. *Concordia Fire-Insurance Co.*, 140 Mich. 258 (1905), *supra.* It is expressed in this language in *In re Brewster St. Housing Site, supra,* 291 Mich. 313, 340:

> "*King v. Concordia Fire-Insurance Co.*, 140 Mich. 258 (6 Ann. Cas. 87), may be regarded as establishing the law in this State upon this subject. Quoting Locke's Appeal, 72 Pa. 498 (13 Am. Rep. 716), it was said:
>
> " 'The legislature cannot delegate its power to make a law; but it can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make, its own action depend.'
>
> "The court cited *Georgia Railroad v. Smith,* 70 Ga. 694, and also quoted the following with approval:
>
> " 'The true distinction [said Ranney, J., in *Cincinnati, W. & Z. R. Co. v. Com'rs of Clinton County,* 1 Ohio St. 77, 88] is between the delegation of power to make the law, which necessarily involves a discretion as to what it shall be, and conferring authority or discretion as to its execution, to be exercised under and in pursuance of the law. The first cannot be done; to the latter no valid objection can be made.' "

Following this rule, the Michigan Supreme Court, in *Colony Town Club v. Mich. Unemployment Comp. Comm., supra,* 301 Mich. 107, held that the Michigan legislature could not define a term to exclude that which was excluded by the Federal social security act. It was held that this was an unconstitutional delegation of legislative power to the Commissioner of Internal Revenue. In reference to this question, the Court stated, at pp. 113-114:

> "This amendment, if given the construction claimed for it by appellant, is unconstitutional in that it attempts to delegate to a

> Federal agency the final decision regarding the interpretation and construction to be placed upon a State statute. It would make the decision of the commissioner of internal revenue as to who is entitled to exemption from paying the Michigan tax conclusive and binding upon the Michigan unemployment compensation commission, the appeal board, and the State courts. Such authority cannot be delegated by the legislature. (Cases cited)"

In *Tribbett v. Village of Marcellus, supra,* 294 Mich. 607, 615, the Michigan Supreme Court indicated that an absolute discretion, such as that involved here, would be unconstitutional.

The Court applied this delegation rule in *Milk Marketing Board v. Johnson,* 295 Mich. 644, and there determined that the delegation of the power to establish and enforce standards of milk marketing by a board composed of a majority of members directly involved in the production and marketing of milk was unconstitutional. In reference to this question, the Court stated as follows:

> "'* * * This is legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be, and often are, adverse to the interests of others in the same business. * * * The delegation is so clearly arbitrary, and so clearly a denial of rights safeguarded by the due process clause of the Fifth Amendment, that it is unnecessary to do more than refer to decisions of this court which foreclose the question. * * *'" quoted from *Carter v. Carter Coal Co.,* 298 U.S. 238, 310, 56 S Ct. 855.

It is of course contrary to both due process and uniformity provisions to classify taxpayers in a manner not reasonably related to the privilege sought to be taxed. In the instant case, the privilege is the right to carry on business in this State in a corporate capacity. This privilege does not vary nor does it have any relationship to accounting procedures adopted by or controlling various corporations. The privilege here granted cannot possibly vary with the balance sheet designation of "earned surplus". Thus, any classification based upon any such irrelevant considerations is unconstitutional under Article X, Section 4, of the Michigan Constitution of 1908.[3] Cf. *C. F. Smith Co. v. Fitzgerald, supra,* 270 Mich. 659, 673.

Due process also requires that the classification adopted bear a reasonable relationship to the privilege enjoyed. In *Louis K. Liggett Co. v. Lee,* 288 U.S. 517, a Florida chain store tax was declared unconstitutional. The amount of the tax increased with the number of stores and the number of counties in which such stores were located. The Court said at page 533:

> "We are unable to discover any reasonable basis for this classification. * * *"

We turn, then, to an examination of the statutory language here involved

[3] The same substantive provision is found in Article IX, Section 3, of the 1963 Constitution.

to determine whether the legislature has provided a definite standard to determine what constitutes "earned surplus" by reference to the generally accepted accounting principles of the accounting profession as reflected on balance sheets of corporations.

The proposed corporate franchise tax base, as above indicated, consists of paid-up capital, paid-in surplus and earned surplus. "Earned surplus" is defined as the retained earnings reflected in the balance sheet of the corporation which is communicated or distributed to stockholders, with the further proviso that such retained earnings shall be determined in accordance with generally accepted principles of accounting. "Earned surplus" is not otherwise defined in the statute under the proposed amendment.

In order to determine the tax base, then, it would be necessary first to ascertain what are the retained earnings of a corporation as reflected on the year-end balance sheet statement communicated or distributed to stockholders and then determine whether the retained earnings as so reflected are determined in accordance with generally accepted principles of accounting. Senate Bill 1046 requires the corporation to prove, when challenged, that the retained earnings were in accordance with generally accepted principles of accounting, and House Bill 54 fails to mention the burden of proof.

The definition of the term "earned surplus" is based upon the following assumptions: (1) That all corporations prepare balance sheets for their stockholders; (2) that all balance sheet statements of corporations will contain the caption "retained earnings"; (3) that all balance sheet statements employing the caption "retained earnings" establish a proper standard for the uniform imposition of the corporate privilege tax in accordance with "generally accepted principles of accounting"; (4) that accounting is an exact science based on formulae and definitional principles applicable and binding in the preparation of corporate balance sheet statements; and (5) that the legislature can incorporate by reference the "generally accepted principles of accounting" for "retained earnings" to define the corporate privilege tax base.

It is common knowledge that many corporations do not prepare balance sheets for stockholders and that many balance sheets communicated or distributed to stockholders do not contain the caption "retained earnings". Many small, closely held corporations in fact do not prepare any formal balance sheet statements, and a substantial percentage of many other corporations prepare consolidated balance sheets for stockholders. As to these corporations, there appears to be no prescribed statutory definition of "earned surplus".

In reference to the corporations that do communicate or distribute to stockholders a balance sheet statement that sufficiently identifies "retained earnings", the question remains: What are retained earnings in accordance with generally accepted principles of accounting? An examination of the authorities on this question indicates that this is a matter of accounting opinion, which does not lend itself to a definite or fixed ascertainment. This is illustrated by the differing accounting treatment of the reserve for deferred federal income taxes item, to which you refer in your request, by

various regulatory agencies and by the American Institute of Certified Public Accountants.[4]

The lack of a fixed standard is inherent in the function of accounting. As stated in *Accountants' Handbook*,[5] at page 1.1:

> " 'Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.' " (formulated by the American Institute of Ac-

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[4] "Accounting Bulletin No. 43" by the American Institute of Certified Public Accountants, dated June 1953, concerns the treatment of tax savings resulting from the use of amortization depreciation for Federal income tax purposes. "Bulletins Nos. 44", dated October 1954, and "44 (Revised)", dated July 1958, involve the accounting treatment of tax savings resulting from the use of section 168 I.R.C. 1954 accelerated depreciation for Federal income tax purposes. Neither accounting bulletin characterizes the item for "surplus" purposes.

"Accounting Bulletin No. 44" states that

> "* * * in the ordinary situation, deferred income taxes need not be recognized in the accounts unless it is reasonably certain that the reduction in taxes during the earlier years of use of the declining-balance method for tax purposes is merely a deferment of income taxes until a relatively few years later, and then only if the amounts are clearly material."

"Bulletin No. 44 (Revised)" requires deferred Federal income taxes to be recognized even though the tax savings are indefinitely deferred. By letter of April 15, 1959, by an "interpretation" of "Bulletin No. 44 (Revised)", the Institute would exclude the tax savings from "surplus."

The Michigan Public Service Commission, by Order No. D-668-55.1, dated Sept. 12, 1955, treated the item as a part of "surplus under its system of accounts prescribed for the Indiana & Michigan Electric Company. By Orders D-1282-A, dated Aug. 8, 1951, and D-1282-A-54.2, dated Nov. 5, 1954, the Commission required it to be treated as a miscellaneous reserve of The Detroit Edison Company in accounts prescribed for that company and, therefore, without the purview of "surplus" as defined in the uniform system of accounts.

The Ohio Public Utilities Commission treats the item as a part of surplus for its accounting and regulatory purposes [Public Utilities Commission of Ohio's Order "In the Matter of the Application of the Cincinnati Gas and Electric Company, etc., No. 27.749"].

On the Federal level, the Interstate Commerce Commission does not recognize the creation of this reserve and therefore the amount it represents is automatically a part of surplus or retained earnings, by accounting for it in what is referred to as the "flow through" method [Interstate Commerce Commission's Order of Feb. 9, 1959; 24 F.R. 1401].

On the other hand, the Securities and Exchange Commission requires the item to be treated under a nonequity caption, such as a deferred tax credit, on the balance sheet [United States Securities and Exchange Commission's release issued as Securities Exchange Act Release No. 5844; Federal Register of March 5, 1960, Vol. 25, No. 45, pp. 1940 et seq.].

For the difference in the accounting treatment of this item, see, generally, Stone & Webster Service Corporation, "Rate and Accounting Treatment of Liberalized Depreciation and Accelerated Amortization," May 1963.

[5] Wixon, Rufus, Ph.D. (Editor), *Accountants' Handbook*, 4th ed., The Ronald Press Company, New York, 1957 (Library of Congress Catalog Card Number: 56-10173).

counting [AIA] Committee on Terminology [Accounting Terminology Bull. No. 1])

The authors go on to state:

"Accounting is an *art,* not a science. As Smith and Ashburne (Financial and Administrative Accounting) point out, 'accounting is not formulated with reference to nor does it stand on general truths or the operation of natural or general laws.' They add that 'accounting qualifies as an art when an art is defined as the skillful adaptation of means for the attainment of some useful and beneficial result.' "

In defining "accounting principles", the authors state at pages 1.9-1.10:

"* * * Considerable controversy and some confusion have existed as to the nature of an accounting principle. There are those who feel that the term 'principle' is too rigid to be applied to accounting since it connotes a 'fundamental belief' or a 'general truth.' To others the significance of the term 'principle' in accounting is that of a 'rule of action or conduct' and as such accounting principles are subject to change. To avoid this conflict of terminology, Paton and Littleton (An Introduction to Corporate Accounting Standards) used the term 'standards.' They state:

" 'The term "standards" is used advisedly. "Principles" would generally suggest a universality and degree of permanence which cannot exist in a human-service institution such as accounting.'

"Both 'principles' and 'standards' are used by accountants to represent their rules of action. Blough (in CPA Handbook) comments as follows:

" 'In the opinion of accountants generally, accounting principles are not principles of nature but rules of human behavior. They are not inherent in nature to be discovered by man but are developed by man. They are, therefore, not immutable and they need to be changed to meet changing needs. They are designed for the greatest usefulness of those who need to rely upon accounting.' "

The authors make reference to how accounting standards are developed and point to the primary influences of accounting societies and government regulatory agencies. In reference to the development of definite accounting principles (or standards), the authors quote, at page 1.10, a statement by the AIA Committee on Accounting Procedure, as follows:

" 'It is important that all accountants understand that the committee does not have, and has never sought to assume, the authority to prescribe accounting standards or principles. Such standards emerge from many sources. They may emerge from a variety of practices in financial reporting, with the committee attempting to narrow the area of differences through its opinions. Other standards may be developed in the committee opinions and become generally accepted by adoption in practice by industry and the profession. The American Accounting Association and other organizations have contributed materially to the development of generally accepted practices. Other accounting standards emerge in practice or in the accounting literature without official

recognition or sanction by the committee, such as the adoption of the "financial position" form of balance sheet, and its variations, in which net assets are shown as being equal to stockholders' equity.' "

George S. Hills, writing for the *Iowa Law Review*,[6] in an article entitled "Statement of Legal Concepts of Accounting," states, at pages 213-214:

> "Accounting principles recognize convention, custom, and judgment. The existence of a body of generally accepted accounting principles does not mean that there is only one proper accounting treatment for every situation with which the accountant must deal. For many situations there are available a number of treatments which are in accord with generally accepted principles. * * *"[7]

In a book entitled *Financial Accounting*,[8] George O. May (formerly senior partner of Price, Waterhouse & Company, Certified Public Accountants), on page 1 of Chapter 1, quotes the definition formulated by the AIA Committee on Terminology, as quoted above from *Accountants' Handbook*, and notes that accounting includes the purely recording function (bookkeeping) and its analytical and interpretive functions (which involve the presentation of financial statements).

In an American Law Institute Publication entitled *Basic Accounting for Lawyers*,[9] by Barton E. Ferst, the following is stated, at page 3, in reference to accounting principles:

> "* * * the principle is not a rule that admits of no variation and is impossible of conflict with other rules. For the purposes of use here, it might be well to paraphrase the language of Accounting Research Bulletin, No. 9, and define accounting principles as such postulates derived from experience and reason as have proved useful and have become generally acceptable."

The author then notes, on page 5, that there are several sources of accounting authority and, therefore,

> "* * * it is possible that there will be, in a given matter, respectable differences in opinion. In such cases it may be impossible to categorically state that one approach is correct and the other erroneous. * * *"

George S. Hills, in a comprehensive article in the *Columbia Law Review*,[10] deals with what he refers to as "The Law of Accounting". He there notes, at page 2:

> "The primary function of accounting is to display the facts as they exist in a particular situation and for a particular purpose. While interpretation of the facts is also within the purview of the accountant,

[6] Vol. 36, No. 2, Winter 1951, Iowa City, Iowa, U.S.A.

[7] The author further indicates that accounting involves a determination of questions of fact, as distinguished from questions of law, in a legal proceeding and are never legal determinations. He further indicates that a determination of accounting treatment is primarily a legislative, as distinguished from a juidicial, function.

[8] New York, The Macmillan Company, 1943.

[9] Copyright 1950 By the American Law Institute.

[10] Vol. 54, pages 1 and 1049 (January and November, 1954).

as his expression of opinion, acceptance of his interpretation can rest only on its reasonableness in the light of the facts."

However, accounting cannot shield the facts from being ascertained in discharge of the judicial function.

Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 643; *American Telephone & Telegraph Co. v. United States,* 299 U.S. 232.

The fact that references to accounting principles are inadequate to determine a tax base is further illustrated by this quotation from Chapter 11, page 78, of *Lawyer's Guide to Accounting.*[11]

"As Mr. George O. May, a distinguished accountant, expressed it,

" '. . . I should warn you that the terminology of accounting is somewhat loose and vague. . . . When you hear a reference made to an accounting "principle," you may find that in reality it is nothing more exalted than a convention or rule of convenience.' [*The Journal of Accountancy,* Vol. LXIII, p. 334.]

* * *

"* * * there is no comprehensive, *authoritative* compilation or code of accounting principles. Principles cannot be established in accounting, as they are in the realm of natural sciences, by experimentation; nor have they been determined, as in the law, by authoritative pronouncement, although the accounting procedures of railroads, utilities, and certain other lines of business have been standardized by governmental regulation."

From what has thus far been said, it is clear that the phrase "generally accepted principles of accounting", as used in Senate Bill 1046 and House Bill 54, prescribes an uncertain tax base, the determination of which is delegated to those persons that will prescribe the accounting for a particular financial statement within the vague framework of "generally accepted principles of accounting". As a practical matter, this would mean that corporations could determine, within the broad framework of "generally accepted principles of accounting", "retained earnings" for corporate privilege tax purposes. This has the effect of prescribing nonuniform standards.

This is vividly demonstrated by a paper presented to the Michigan College Accounting Educators' Conference on May 11, 1963, entitled "The Need for Uniform Accounting Standards," by William D. Hall, CPA[12] [reported in *The Michigan C.P.A.,* Vol. XIV, No. 10, June, 1963, pages 19-25]. Mr. Hall there states the purport of his paper to be:

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[11] Harry A. Finney, Ph.B., LL.D., C.P.A., and Richard S. Oldberg, B.S., J.D., *Lawyer's Guide to Accounting,* Prentice-Hall, Inc., Englewood Cliffs, N.J., 1955. Library of Congress Catalog Card No.: 55-10590.

[12] William D. Hall is a partner in the firm of Arthur Anderson & Co. in Chicago. He is a permanent member of the firm's Committee on Accounting Principles and Auditing Procedures. Before moving to Chicago, Mr. Hall was a partner in the Detroit office of the firm and served as Chairman of the Accounting and Auditing Procedures Committee of the Michigan Association.

"My discussion will deal with, and I hope demonstrate, two conclusions: 1) We do not have uniform accounting standards today, and 2) adoption of such uniform standards is essential to the progress, and possibly even to the survival, of our profession." (page 19)

In reference to the lack of uniformity, he states, in part:

"* * * Many diverse, and even contradictory, alternative practices crowd together under the umbrella of our so-called generally accepted accounting principles. We know this; we live with it every day. Some accountants deplore this; some accept it as inevitable, even though perhaps undesirable; and some even encourage it." (page 19)

In reference to the general knowledge of this condition, he states:

"As evidence of the fact that even the informed reader of financial statements may not be aware of the extent and impact of alternative accounting practices, I might call attention to an article appearing in *Barron's National Business and Financial Weekly*, December 24, 1962, issue entitled 'Pitfalls for the Unwary—Corporate Accounting, Investors Have Learned the Hard Way, Is Full of Them.'* * *

"With respect to the article itself, despite its rather sensational title, it was factually and fairly written. * * * I would commend it to your attention, and particularly one portion which stated:

" 'Accounting is a very fluid practice. Accounting varies from industry to industry. In fact, even among companies in the same field, practices are so diverse as to make comparisons of earnings less than meaningful.

" 'To be sure, few companies make it a habit to juggle their books. Nonetheless, there are many acknowledged alternatives by which earnings can legally be exaggerated or minimized. Inventories, for example, can be accounted for in a half-dozen ways, each with a different consequence for profits. In like fashion, assets can be written up or down, acquisitions treated as purchases or as pooling of interests, research costs expended or deferred, and depreciation accelerated or not.' " (pages 19-20)

After considering what he refers to as the background of and the progress concerning uniform standards, he states:

"* * * Whatever it may stem from, we have a substantial lack of uniformity in recording and reporting financial transactions. Someone may say that this does not result from alternative principles—that the principles are uniform but that the practices, or procedures, followed under these principles vary. Frankly, at this point I am not interested in the semantics of whether we are talking about principles, practices, procedures, postulates, concepts, conventions, doctrine methods, techniques, axioms, assumptions, rules, canons, or what have you, any or all of which terms are variously applied to different levels of the standards under which we operate. Semantics cannot obscure the lack of uniformity." (page 22)

The author defines the uniform standards sought thusly:

> "* * * By this I mean that we should arrive at a point where, if two or more accountants using their professional judgment reach the same conclusion on a set of facts, the resulting financial statements would be comparable." (page 23)

As otherwise expressed, he urges that the accounting "measuring devices"

> "* * * should be such that they would give the same result *if* situations were alike. * * *" (page 24)

In terms of the formal certification by certified public accountants that a balance sheet is prepared in accordance with generally accepted principles of accounting, an article entitled "Financial Reporting In a Changing Society," by Marquis G. Eaton,[13] appearing in *The Journal of Accountancy*, August 1957, pages 25-31, contains the following language pertinent to the constitutional problem posed by your inquiry:

> "In our formal, conventionalized opinions on financial statements, we certified public accountants say that we have examined the accounts and believe that the financial statements fairly present the financial position of an enterprise and the results of its operations 'in conformity with generally accepted accounting principles.'
>
> "There is some reason to believe that this phrase—'generally accepted accounting principles'—suggests to the ordinary reader the existence of some authoritative code of accounting, which when applied consistently will produce precise and comparable results. The appearance of precision is strengthened by the reporting of net income in exact dollars and cents, instead of rounded approximations.
>
> "Now, we accountants know that 'generally accepted accounting principles' are far from being a clearly defined, comprehensive set of rules which will ensure the identical accounting treatment of the same kind of transaction in every case in which it occurs. We know that 'generally accepted accounting principles' are broad concepts, evolving from the actual practices of business enterprises, and reflected in the literature of the accounting profession. To be sure, many of these principles have been formally defined or clarified in the accounting research bulletins of the American Institute. But we all know that in some areas there are equally acceptable alternative principles or procedures for the accounting treatment of identical items, one of which might result in an amount of net income reported in any one year widely different from the amount an alternative procedure might produce." (page 26)
>
> "Yet, I suspect it would come as something of a shock to some people to realize that two otherwise identical corporations might re-

[13] Marquis G. Eaton, C.P.A., was president of the American Institute of Certified Public Accountants at the time he wrote this article. He is past president of the Texas Society of C.P.As. and of the Southern States Conference of C.P.As. He has served as the chairman of several Institute committees, and is a frequent contributor to *The Journal of Accountancy*. Mr. Eaton is senior partner of Eaton & Huddle in San Antonio, Texas.

port net income differing by millions of dollars simply because they followed different accounting methods—and that the financial statements of both companies might still carry a certified public accountant's opinion stating that the reports fairly presented the results in accordance with 'generally accepted accounting principles.'

"The clause in our opinions that these principles have been 'applied on a basis consistent with that of the preceding year' provides assurance that the statements of a single company for a series of years may be compared without fear that the rules of the game have been changed from one year to the next.

"It cannot be assumed, however, that all companies, even in the same industry, are following the same rules, and this makes it harder to compare results among companies or among industries." (pages 26-27)

"Oswald W. Knauth, business executive, economist and author, put his finger on this problem in an article in *The Journal of Accountancy* ('An Executive Looks at Accountancy, Jan. 57, pp. 29-32). He said:

" 'The accountant can generally conform the reports of any one company to a single system, so that they are comparable from year to year unless conditions change radically. But he cannot make the reports of two or three companies comparable to each other. Nor can he add up a number of reports to find a general total. Yet that is just what is being done. * * *'

"Mr. Knauth went on to say that comparisons between financial reports of two companies, and particularly between two companies in different industries, or between entire industries, are so arbitrary as to be not only worthless but dangerous." (page 27)

The Supreme Court of Michigan rejected the argument that balance sheet treatment should control for corporate privilege tax purposes as follows:

"Undiscriminating adherence to some of the figures on a balance sheet cannot reasonably be made the measure of the tax. Because of the various reports and taxes required from corporations and the development of accounting and auditing along mysterious lines, the books and the balance sheet may have strange items and need interpreting. * * * " [Emphasis supplied] *In re Appeal of Hoskins Manufacturing Co.,* 270 Mich. 592, 598.

Such "undiscriminating adherence" involves an unconstitutional delegation of legislative power to private individuals and/or those prescribing "generally accepted principles of accounting". It violates the uniformity, equal protection and due process requirements of the Michigan and Federal Constitutions.

Therefore, be advised that Senate Bill 1046 and House Bill 54, 1963 Extra Session, Michigan 72nd Legislature, which would amend § 4 of Act 85, P.A. 1921, as amended, to define "earned surplus" taxable therein to mean the retained earnings of a corporation as reflected on its balance sheet, so long as they are determined in accordance with generally accepted

principles of accounting, are unconstitutional in that they would delegate to private parties the power to include or exclude items in determining "retained earnings" for the balance sheet statement without legislative definitional standards.

FRANK J. KELLEY,
Attorney General.

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JUSTICES OF THE PEACE: Fees.

A justice of the peace going out of office is entitled to fees for taking the complaint and issuing a warrant in cases pending before him which have not been completed because the defendant cannot be located. Said justice of the peace, not having entered the complete case on the docket while in office and not having made and filed a report to the prosecutor or certified the case to other magistrates or courts, is not entitled to fees therefor.

No. 4200 November 20, 1963.

Mr. John L. Schwendener
Prosecuting Attorney
Kalamazoo, Michigan

Your recent letter advises that a justice of the peace in your jurisdiction has gone out of office and that a question has arisen as to the fees which should be allowed the justice of the peace in a number of pending criminal cases handled by the justice of the peace. In these cases a complaint was sworn to and a warrant issued, but the warrant has not been served because the defendant cannot be located. You specifically ask whether the justice of the peace is entitled to fees for:

(1) taking a complaint by oath,
(2) a warrant,
(3) entering the cause on the docket,
(4) for making and filing a report to the prosecuting attorney,
(5) certifying the case to other magistrates or courts.

You advise that it is your opinion that the justice of the peace should be allowed only the fees for the complaint and warrant.

Section 2, Chapter XV, Act 175, P.A. 1927,[1] as amended, the Code of Criminal Procedure, sets out the services for which a justice of the peace shall be allowed fees. This section provides in part as follows:

> "A justice of the peace shall be allowed for taking a complaint on oath, 60 cents; a warrant, 60 cents; for entering any cause upon the docket, 60 cents; a bond or recognizance, 60 cents; for approving the same, 25 cents; issuing a subpoena (not exceeding 10 in any 1 case), 25 cents; for certifying cause to other magistrates or court, 40 cents * * * for making and filing report in a criminal case to the prosecuting

[1] As amended by P.A. 1960, No. 49; M.S.A. 1961 Cum. Supp. § 28.1239.