Auditor reviews of changing prices disclosures; Auditing research monograph, 6

K. Fred Skousen
W. Steve Albrecht

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AUDITOR REVIEWS OF CHANGING PRICES DISCLOSURES

by K. Fred Skousen and W. Steve Albrecht
Statement of Policy

This Auditing Research Monograph has not been approved, disapproved, or otherwise acted on by the Auditing Standards Board, the membership, or the governing body of the American Institute of Certified Public Accountants. Therefore, the contents of the study, including the recommendations, are not official pronouncements of the Institute.

Auditing Research Monographs are published by the Auditing Standards Division of the American Institute of Certified Public Accountants. The monographs are intended to provide background material and informed discussion that should help in reaching decisions on significant auditing problems.

Individuals and groups are invited to express their views with supporting reasons on the matters in this monograph. Comments, which should be sent to the Institute's director of auditing research, will be treated as public information unless a writer requests that his comments be kept confidential.
AUDITING RESEARCH MONOGRAPH

6

AUDITOR REVIEWS OF CHANGING PRICES DISCLOSURES

by K. Fred Skousen, CPA, Ph.D.
Brigham Young University

and

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Foreword

This is the sixth publication in the Auditing Research Monograph series. The series, published by the Auditing Standards Division of the American Institute of Certified Public Accountants, was undertaken in the belief that research is helpful in defining and solving significant practice problems related to the assurance function. The other studies in the series have been *The Auditor's Reporting Obligation* (1972), *Behavior of Major Statistical Estimators in Sampling Accounting Populations* (1975), *Internal Accounting Control Evaluation and Auditor Judgment* (1981), *The Market for Compilation, Review, and Audit Services* (1981) and *Audit Problems Encountered in Small Business Engagements* (1982).

Numerous practitioners provided comments and assistance at various stages of the project. The study was sponsored jointly by the American Institute of Certified Public Accountants and the Financial Accounting Standards Board.

The study, in my opinion, is a valuable contribution to auditing research.

*New York, N.Y.*

*November, 1984*  

*Vice President, Auditing*
Preface

Statement of Financial Accounting Standards No. 33, *Financial Reporting and Changing Prices*, requires most large companies to provide supplementary financial data on the effects of changing prices. Statement on Auditing Standards No. 27, *Supplementary Information Required by the Financial Accounting Standards Board*, and Statement on Auditing Standards No. 28, *Supplementary Information on the Effects of Changing Prices*, require auditors to apply certain procedures to the companies' supplementary financial data. This study was undertaken to determine the nature, extent, and costs of the procedures used by auditors in complying with these standards. Special emphasis was given to problems encountered by auditors and their perceptions about the usefulness and auditability of the supplementary disclosures. We hope the results will assist auditors and accounting policymakers as they continue to deal with the problems of changing prices.

We would like to express our appreciation to the Financial Accounting Standards Board and the AICPA for financial support and assistance in this project. Robert Freeman of the FASB, Dan Guy of the AICPA, and Robert Berliner of Arthur Young & Company were especially helpful in making contacts with CPA firms, reviewing various drafts, and providing excellent feedback. James Stice, a Brigham Young University graduate student, also provided significant contributions as a research assistant. We would like to thank the research participants for their time and consideration in completing the questionnaires and in providing valuable suggestions.
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Jointly sponsored by the FASB and the American Institute of Certified Public Accountants (AICPA), the auditing research project on which this monograph is based was undertaken to determine the nature and extent of procedures currently used by auditors in reviewing SFAS No. 33 disclosures. Other project objectives were (1) to identify the costs and special problems related to the reviews, and (2) to learn how auditors perceived the usefulness and auditability of SFAS No. 33 data.

The data that provide the basis for the study’s conclusions are from questionnaire responses and in-depth interviews. The questionnaire itself was developed after examining CPA firm guidance materials and discussions with firm representatives. The overall response rate to the questionnaire was 73 percent: There were 119 usable replies from engagement partners and managers—individuals directly involved in reviewing changing prices data for their clients.

The responses generally indicate concern by practicing CPAs about SFAS No. 33 disclosures. The following summary presents the project’s major conclusions.

1. The term *review* is used in this report in a lay sense, not in the technical context of, for example, "compilation and review," as defined in Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (New York: AICPA, 1978).
Auditors perceived that changing prices disclosures are not being used by internal management; rather, these disclosures are provided only to meet the minimum FASB disclosure requirements.

The average review of changing prices disclosures took less than 2 percent of total engagement time and resulted in minor adjustments to the disclosures. No one reported that uncorrected departures from SFAS No. 33 guidelines had resulted in modified audit reports.

Although few of the auditors used formal work programs for reviewing changing prices disclosures, the following procedures were employed in fulfilling their responsibilities: (1) inquiring of management; (2) checking mathematical accuracy; (3) obtaining representation letters; (4) performing reasonableness tests; (5) comparing SFAS No. 33 disclosures with audited financial statements; (6) reviewing narrative explanations; and (7) test checking data to source documents.

Procedures 1, 5, and 6 are specifically required by Statement on Auditing Standards (SAS) No. 27 Supplementary Information Required by the Financial Accounting Standards Board and SAS No. 28 Supplementary Information on the Effects of Changing Prices.

Auditors identified several problems associated with reviewing changing prices disclosures. The most frequently mentioned difficulty was that SAS No. 27 and SAS No. 28 standards and SFAS No. 33 requirements are too general.

Auditors indicated that the present reporting guidelines, which require disclosures based on both constant dollars and current costs, are confusing and too subjective. Many CPAs considered current cost disclosures to be more meaningful than constant dollar disclosures, but also indicated their opinion that requiring changing prices data to be audited would not necessarily increase the information's utility to financial statement users.
Research Purpose and Methodology

In September 1979, the FASB issued Statement of Financial Accounting Standard No. 33, *Financial Reporting and Changing Prices*, an experimental standard on accounting for the effects of changing prices.\(^2\) The statement requires selected public companies to report changing prices disclosures as supplementary information to financial statements. Although the supplementary information is unaudited, auditing standards require auditors to consider it and, in certain circumstances, to report on it.\(^3\)

Because of the experimental nature of SFAS No. 33, the FASB has encouraged research to assess the costs and benefits of changing prices disclosure requirements. The American Institute of CPAs, through

\(^2\) Statement of Financial Accounting Standards No. 33, *Financial Reporting and Changing Prices* (Stamford, Conn.: FASB, 1979). SFAS No. 33 requires most large companies to provide supplementary financial data on the effects of price changes. Two methods are used to disclose this information. The first, historical cost/constant dollar (hereafter, constant dollar), discloses effects of changes in the general price level for all commodities and services. The second, current cost/constant dollar (hereafter, current cost) discloses effects of both changes in the general price level and changes in prices of particular items.

\(^3\) Statement on Auditing Standards No. 27, *Supplementary Information Required by the Financial Accounting Standards Board*, (New York: AICPA, 1979) and Statement on Auditing Standards No. 28, *Supplementary Information on the Effects of Changing Prices*, (New York: AICPA, 1980). SAS No. 27 require auditors to apply certain procedures to require supplementary information required by the FASB. Those procedures include: inquiring of management regarding methods of preparing information; comparing the information for consistency with audited statements and management’s response to inquiries; and applying additional procedures specifically required by other auditing standards. SAS No. 28 requires that the procedures in SAS No. 27 be specifically applied to a company’s changing prices disclosures.
its Auditing Standards Division, also has encouraged research directed toward improving standards and procedures for auditors who must deal with changing prices disclosures. Of fifteen research studies being monitored by the FASB, this project is the only one that focuses on audit issues and provides for auditor input.

To assess the SFAS No. 33 experiment, the views of all interested groups—users, preparers, and auditors—must be recognized. This study gives information and insight from the auditor's perspective; it therefore should be considered in light of related research concerning the usefulness of changing prices disclosures.

**Research Objectives**

SAS No. 27 and SAS No. 28 supply general standards for auditors in meeting their responsibilities with respect to a client's changing prices disclosures, but no detailed procedures for review are specified, nor are special problems that may arise during the review process addressed. Because SFAS No. 33 requirements are new and different from generally accepted accounting principles (GAAP), and because SAS No. 27 and SAS No. 28 provide only general guidance, little is known about the actual review techniques used by CPAs.

The overall objective of the research project was to examine the actual experience of CPAs in conducting such reviews. Thus, this is a descriptive study, focusing on auditors' perceptions, responsibilities, and experiences in reviewing SFAS No. 33 disclosures.

More specifically, the research was designed to accomplish five objectives:

1. Determine the extent and impact of auditor association with SFAS No. 33 changing prices disclosures
2. Identify the costs involved in the review process
3. Identify the techniques and procedures currently used by CPAs in conducting reviews
4. Analyze special problems encountered in conducting reviews
5. Identify auditor perceptions concerning the usefulness and auditability of SFAS No. 33 disclosures

This study may assist the FASB in developing reporting requirements with more useful information that will simplify auditor reviews, thereby lowering the costs of disclosure. In addition, this research may provide useful data for the Auditing Standards Division in considering amendments to, or interpretations of, SAS No. 27 and SAS No. 28.
Methodology

The first step in conducting the research was an examination of guidance materials developed by seven CPA firms for SAS No. 27 and SAS No. 28 reviews. Also studied were FASB Statements, Statements on Auditing Standards, articles, position papers, annual reports, and other publications dealing with financial reporting and changing prices.

The second step was a series of in-depth interviews with national office partners and the personnel of three major CPA firms who had been heavily involved with changing prices disclosures. Project researchers had prepared detailed interview questions based primarily on the CPA firm guidance materials. The interviews proved extremely helpful in clarifying key issues and in identifying additional questions, which were then used in questionnaire development.

The third step in the research process was to design a comprehensive questionnaire, one that would elicit responses from a representative sample of audit practitioners with clients currently disclosing SFAS No. 33 data. The completed questionnaire was sent to each of the partners interviewed, to representatives of the FASB and AICPA, and to academic colleagues for review.

The fourth step was to pilot test the questionnaire. Again, interviews were conducted with key personnel of two different CPA firms. Based on the pilot tests, minor modifications were made in the questionnaire.

Questionnaires were distributed to 172 potential respondents; of these, 73 percent responded.4 (Because of missing pages, seven questionnaires were not usable.) The data and comments received, along with information obtained during interviews, provided the basis for the conclusions of this report.

---

4. A representative sample of companies reporting under SFAS No. 33 was drawn from the FASB data base, and the CPA firms that audit these companies were identified. A cover letter and several questionnaires were sent to a partner in the national office of each of the nine major CPA firms, who, in turn, forwarded the questionnaires to engagement partners or managers directly involved with the particular client companies in the sample.
Results of Research

The results of the research are grouped into five categories: (1) perceived client interest and involvement with SFAS No. 33 disclosures; (2) nature, extent, and impact of CPA involvement with changing prices disclosures; (3) specific techniques used by CPA firms in performing SAS No. 27 and SAS No. 28 reviews; (4) special problems encountered by auditors; and (5) auditor perceptions of the usefulness and auditability of changing prices data.

Perceived Client Interest and Involvement With SFAS No. 33 Disclosures

Ninety-eight percent of the audit clients in the research sample met the SFAS No. 33 size criterion and disclosed changing prices data in all four years (1979 through 1982) covered by the study. However, the auditors perceived that their clients have little interest in SFAS No. 33 disclosures: Only six clients reported changing prices data on a comprehensive basis; others essentially provided the minimum required disclosures specified by SFAS No. 33. Of the 118 responding to the question concerning client interest, auditors considered 104 clients to have complied only because of the disclosure requirement, 12 to have had moderate interest in the changing prices disclosures, and only 2 to have showed sufficient interest to frequently base managerial decisions on SFAS No. 33 data.

Most companies used easily applied measurement methods, which have a low relative cost. For example, indexing is the most common
method for computing the current cost of property, plant, and equipment (PPE). In computing the current cost of PPE, 59 percent of the companies used specific price indexes, 3 percent used direct price quotes, 12 percent used general indexes such as the U.S. Consumer Price Index-Urban, 11 percent used annual appraisals, 7 percent used appraisals in the first year with indexes in subsequent years, and 4 percent used internally developed indexes (see chart 1). The principal specific price indexes used were the U.S. Producer Price Index, and the Handy-Whitman Index.

Chart 1
Methods used in computing current cost of PPE

- Direct price quotes: 3%
- Appraisals in first year: 7%
- Internally developed indexes: 4%
- Annual appraisals of current costs: 11%
- General index (e.g. CPI-U): 12%
- Specific price indexes: 59%
- Other: 4%

5. The Consumer Price Index-Urban suggests a national price level by calculating the average price of a "market basket" of many commodities commonly purchased by urban and suburban households.
6. The U.S. Producer Price Index measures price changes on approximately 2,800 goods sold in large quantities by primary producers to wholesalers and distributors. The Handy-Whitman Index is a property valuation index used in the public-utility industry to estimate construction costs.
With respect to inventory, current costs were most often estimated by using Fifo inventory costing (53 percent); standard costs were used in 17 percent of the companies; and published indexes were employed by another 11 percent of the companies (see chart 2).

Chart 2

Methods used in computing current cost of inventory

- Fifo 53%
- Published indexes 11%
- Standard costs 17%
- Appraisals of current costs 7%
- Catalog prices 5%
- Other 7%

Clearly, large companies do comply with SFAS No. 33, but most are perceived by their auditors as having little interest in the data, reporting the information only because of the FASB requirement. In general, companies do not appear to use the changing prices data specified by SFAS No. 33 for internal managerial purposes. Rather, they provide only the minimum required disclosures; and they use simplified methods to estimate current costs of PPE and inventory (that is, indexes for PPE and Fifo for inventory).
Extent and Costs of CPA Involvement With Changing Prices Disclosures

SAS No. 27 and SAS No. 28 require that auditors be involved with their clients' changing prices disclosures. This research project gathered information on the extent of CPA involvement, the costs incurred, and the impact of auditors' efforts.

The auditors who responded were involved extensively in assisting clients in preparing the changing prices disclosures in the first year of compliance; in subsequent years, auditor involvement generally was limited to reviewing the data. The percentage of auditors who assisted clients in preparing changing prices disclosures decreased from 54 percent in 1979 to 23 percent in 1982. This reduced involvement was a major factor in lowering the average number of chargeable hours for helping prepare changing prices disclosures and for conducting SAS

Chart 3

Chargeable hours associated with changing prices disclosures

- Senior staff: 43%
- Supervisor/manager: 27%
- Client partner: 6%
- Junior staff: 23%
- Review partner: 1%
No. 27 and SAS No. 28 reviews from 104 hours in 1979 to 68 hours in 1982. For 90 percent of the reviews, the procedures represented less than 2 percent of "total audit time."

As shown in chart 3, senior staff accounted for 43 percent of the hours charged to the reviews of changing prices disclosures, supervisors/managers 27 percent, and junior staff 23 percent. Partners accounted for only 7 percent. Using the average chargeable hours mentioned above and constant billing rates of 45 dollars per hour for junior staff, 65 dollars for senior staff, 100 dollars for supervisor/manager, and 150 dollars for partners, the average cost to clients of auditor involvement with the changing prices data was $7,883 in 1979, $6,367 in 1980, $5,381 in 1981, and $5,154 in 1982.

Impact of CPA Involvement With Changing Prices Disclosures

Estimating the impact of auditor association with changing prices disclosures was a more difficult task than measuring costs. Impact, or "effectiveness," can be measured only if the quality, extent of disclosures, and degree of compliance can be assessed both with—and without—auditor involvement. Because involvement is required, it was decided to use a surrogate indicator to aid in measurement—that is, whether or not auditors initiated adjustments to the companies' changing prices disclosures or modified their own reports because of material departures from SFAS No. 33 guidelines.

With respect to adjustments, the performance of SAS Nos. 27 and 28 procedures resulted in modified disclosures for 55 percent of the clients for one or more years. Most of these adjustments involved correcting clerical errors or translation problems with data from foreign subsidiaries. The following describes the results of the adjustments:

- One or more reported current cost numbers were changed for 34 percent of the clients.
- One or more constant dollar numbers were changed for 21 percent of the clients.
- The narrative disclosure was changed for 14 percent of the clients.
- A reported change in the specific prices of inventory and property, plant, and equipment was changed for 15 percent of the clients.

7. The 2 percent reported by auditors represents incremental time. As part of the audit, the auditor spends time obtaining information about the company's industry, business, accounting system, controls, and so forth, which reduces the amount of time he would otherwise have to spend in reviewing the SFAS No. 33 information.
• A reported purchasing power gain or loss was changed for 12 percent of the clients.
• The reported income from continuing operations was changed for 9 percent of the clients.
• A reported "lower recoverable amount" was changed for 4 percent of the clients.\(^8\)

No auditor reports were modified (that is, by the addition of a third paragraph) to call attention to omissions, material departures from SFAS No. 33 guidelines, or an inability to perform SAS Nos. 27 and 28 procedures. Because of the general nature of the standards and the subjectiveness of the changing prices data, most auditors agreed that departures, errors, or omissions would have to be extremely significant before a modification of the audit report would be considered. Auditors suggested that the materiality guidelines for changing prices data are not nearly as strict as those for the data in the primary financial statements.

Apparently, the cost of auditor involvement with changing prices disclosures is comparatively low, representing only a small percentage of total "audit" cost. Involvement does result in some general adjustments—although mostly clerical—to the supplementary disclosures. In no case were uncorrected omissions or departures from SFAS No. 33 guidelines considered material enough to justify modification of the auditor's report.

Specific Techniques Used by CPAs in Performing SAS No. 27 and SAS No. 28 Reviews

As indicated earlier, SAS No. 27 and SAS No. 28 offer only general guidelines for meeting auditor responsibilities for client changing prices disclosures. A major purpose of this research project was to determine what \textit{specific} procedures are being used, and whether or not those procedures are consistent across CPA firms.

To determine existing procedures, participating CPA firms were asked for copies of programs used in meeting SAS Nos. 27 and 28 responsibilities. Seven of the nine CPA firms with twelve or more SFAS No. 33 clients complied. (One firm replied that it did not have a specific program, and one did not respond.) After these programs were analyzed and compared for consistency, it became clear that most programs were general in nature, merely rephrasing the overview procedures outlined

\(^8\) SFAS No. 33 states: "If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollar or current cost, the recoverable amount shall be used as a measure of the assets. . . ." (¶62)
Nevertheless, between these documents and interviews with audit partners, it was possible to determine that auditors frequently use the following seven procedures in meeting their responsibilities:

1. Inquiring of management and other client personnel
2. Checking mathematical accuracy of the current cost and constant dollar computations
3. Obtaining written representations from management
4. Performing reasonableness tests
5. Comparing SFAS No. 33 disclosures with those in the audited financial statements

**Chart 4**

Percentage of time auditors spend on specific procedures in complying with SAS No. 27 and SAS No. 28

- Inquiring of management: 23%
- Checking mathematical accuracy: 21%
- Performing reasonableness tests: 19%
- Comparing disclosures with statements: 16%
- Reviewing narrative explanations: 11%
- Checking data to source documents: 9%
- Other: 1% (Includes obtaining representation letters)
6. Reading narrative explanations

7. Cross-checking data to source documents

Of those procedures, 1, 5, and 6 are specifically required by SAS No. 27 and SAS No. 28. Inquiries of management and other client personnel are emphasized in the auditing standards—and that procedure was considered by auditors to be the most important of the seven. On average, 23 percent of total chargeable hours spent reviewing SFAS No. 33 disclosures were occupied in this activity (see chart 4). Most inquiries were made of the client’s senior accounting staff and controllers; there was little interaction with nonaccounting personnel. Fewer than 5 percent of the respondents ever questioned engineers or appraisers, while over 64 percent made inquiries of senior accounting staff and controllers.

The programs of most CPA firms did not specify the types of inquiries made, but one program did enumerate specific areas for inquiry. Based on that program and on initial interviews, the researchers identified several potential topics that were covered in discussions with client personnel. Respondents ranked specific inquiries as follows in figure 1.

<table>
<thead>
<tr>
<th>Nature of Inquiry</th>
<th>Average Score</th>
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<tbody>
<tr>
<td>1. Are changing prices disclosures consistent from year to year?</td>
<td>4.262</td>
</tr>
<tr>
<td>2. Do current cost and constant dollar computations comply with SFAS No. 33 guidelines?</td>
<td>4.227</td>
</tr>
<tr>
<td>3. Are preparer(s) and reviewer(s) knowledgeable about changing prices disclosures?</td>
<td>4.050</td>
</tr>
<tr>
<td>4. What significant assumptions are made by clients in preparing changing prices disclosures?</td>
<td>3.983</td>
</tr>
<tr>
<td>5. Are assumptions made by the company in preparing the data consistent with the nature of the business?</td>
<td>3.806</td>
</tr>
<tr>
<td>6. Are client's computations internally reviewed and rechecked?</td>
<td>3.704</td>
</tr>
<tr>
<td>7. Are the sources of the current cost data appropriate?</td>
<td>3.655</td>
</tr>
<tr>
<td>8. What methods are used in computing current cost amounts?</td>
<td>3.649</td>
</tr>
<tr>
<td>9. What methods are used in providing constant dollar amounts?</td>
<td>3.550</td>
</tr>
</tbody>
</table>
11. Who prepares the disclosures? 3.413
12. How are monetary assets and liabilities classified? 3.303
13. What assumptions are made about inventory turnover? 3.056
14. What shortcut techniques, if any, are used in computing changing prices disclosures? 3.047
15. How are the "lower recoverable amounts" of assets calculated? 2.947
16. What considerations are given to the homogeneity of assets? 2.857

Checking the mathematical accuracy of client's computations was the second most time-consuming procedure used by auditors. Over 97 percent of the respondents indicated that they test checked mathematical accuracy and, on average, this activity accounted for 21 percent of the chargeable hours relating to reviews by SFAS No. 33 data. Most checking involved recalculating adjustments made through use of the Consumer Price Index-Urban (CPI-U) and specific indexes.

Obtaining written representations from management did not take much of the auditors' time. Therefore, while 83.1 percent of all respondents indicated that they routinely obtained such representations, this procedure is not separately identified in figure 4 or chart 4. The letters served primarily to obtain client representations that the changing prices disclosures were in conformity with SFAS No. 33.

Eighty-seven percent of all respondents indicated that they performed reasonableness tests in complying with SAS No. 27 and SAS No. 28. On average, reasonableness tests consumed 19 percent of total chargeable hours. Specific reasonableness tests that were mentioned included the following:

- Comparing the disclosed purchasing power gain or loss with the net monetary position times the average rate of inflation.
- Comparing constant dollar depreciation with the percentage increase in restatement of fixed assets times historical cost depreciation.
- Comparing the percentage change from historical costs to current cost for fixed assets with the average yearly rate of increase in the value of fixed assets times the assets' lives.
- Comparing the percentage changes in the constant dollar and current cost amounts with the general inflation rate.
• Comparing the relationship between historical cost, constant dollar, and current cost amounts in prior years to that of the current year.

• Performing analytical review procedures to determine fluctuations.

Most responding auditors indicated that they performed one or more of the above tests, but all indicated that they placed less emphasis on these tests than on other procedures.

Although the average percentage of total chargeable hours spent comparing SFAS No. 33 disclosures to audited financial statements for consistency was only 16 percent, all respondents stated that this was a procedure they always performed. (The procedure is required by SAS No. 28, and that might account for the frequent performance.)

The specific comparisons made, with their respective scores, are shown in figure 2.

<table>
<thead>
<tr>
<th>Nature of Comparison</th>
<th>Average Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Examining the consistency between the basic data in the primary financial statements with that used in the changing prices disclosures.</td>
<td>4.274</td>
</tr>
<tr>
<td>2. Examining the consistency of the service lives of property, plant, and equipment with those assumed in the changing prices disclosures.</td>
<td>3.404</td>
</tr>
<tr>
<td>3. Examining the consistency of the inventory turnover assumptions used in changing prices disclosures with those in the primary financial statements.</td>
<td>3.229</td>
</tr>
<tr>
<td>4. Examining the consistency between the use of &quot;lower of cost or market&quot; in the primary financial statements and adjustments to &quot;lower recoverable amounts&quot; in the changing prices disclosures.</td>
<td>3.045</td>
</tr>
</tbody>
</table>

An additional comparison was made of the consistency of methods, indexes, and assumptions used from year to year (average score of 4.188). This procedure is related to the other comparisons made by auditors in checking the consistency of SFAS No. 33 disclosures with the audited financial statements, but it tests consistency over time, as opposed to the consistency of the data disclosed within a single year.
The total time spent on all comparisons is reported in figure 4 under one heading—Comparing SFAS No. 33 disclosures with audited financial statements.

Another procedure used by auditors was the reading of narrative explanations, which, on average, consumed 11 percent of the total chargeable hours resulting from SFAS No. 33 data reviews. Auditors were asked to note the degree of emphasis placed on the completeness of various aspects of the disclosures. Average emphasis scores are in figure 3 for topics they evaluated in management's narrative explanations.

<table>
<thead>
<tr>
<th>Nature of Reading</th>
<th>Average Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Misstatements of fact</td>
<td>4.483</td>
</tr>
<tr>
<td>2. Omissions</td>
<td>4.235</td>
</tr>
<tr>
<td>3. Inconsistencies between changing prices disclosure and data presented in the audited financial statements, or elsewhere in the annual report</td>
<td>4.139</td>
</tr>
<tr>
<td>4. Making sure explanations were logical</td>
<td>4.000</td>
</tr>
<tr>
<td>5. Explanations of all significant and unusual relationships</td>
<td>3.586</td>
</tr>
<tr>
<td>6. Description of all major assumptions</td>
<td>3.456</td>
</tr>
</tbody>
</table>

Reading narrative explanations is not very time consuming, and apparently it is an extremely important step that must be completed. The average scores, ranging from 3.456 to 4.483, are as high as the scores for any other procedure.

Test checking of data to source documents was deemed to be the least important. Yet, 75 percent of the respondents answered that they performed test checks; on average, the tests consumed only 9 percent of their total chargeable hours. Neither SAS No. 27 nor SAS No. 28 suggests examining source documents, and many accountants would consider this to be an "audit" procedure rather than a review technique.

To summarize, the auditors used seven specific procedures in complying with the requirements of SAS No. 27 and SAS No. 28. Those procedures and their relative costs follow in figure 4.

9. An example of such test checking would be the examination of the invoices underlying the property schedules that are used to support the fixed-asset amounts.
Figure 4

<table>
<thead>
<tr>
<th>Percentage of Review Time</th>
<th>Approximate Costs*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inquiring of management and other client personnel</td>
<td>23</td>
</tr>
<tr>
<td>2. Checking mathematical accuracy of computations</td>
<td>21</td>
</tr>
<tr>
<td>3. Performing reasonableness tests</td>
<td>19</td>
</tr>
<tr>
<td>4. Comparing SFAS No. 33 disclosures with audited financial statements</td>
<td>16</td>
</tr>
<tr>
<td>5. Reviewing narrative explanations</td>
<td>11</td>
</tr>
<tr>
<td>6. Test checking data to source documents</td>
<td>9</td>
</tr>
<tr>
<td>7. Other (including obtaining representation letters)</td>
<td>1</td>
</tr>
<tr>
<td>Totals</td>
<td>100</td>
</tr>
</tbody>
</table>

* These costs are estimated using the average 1982 costs as specified on page 11. The costs assume a homogeneity of tasks that probably will not exist because junior staff will spend more time on test checking procedures while managers most likely will make the inquiries.

Special Problems Encountered in Performing SAS No. 27 and SAS No. 28 Reviews

A major objective of the research project was to assist the development of auditing standards by identifying SAS No. 27 and SAS No. 28 implementation problems. Essentially, auditors identified three major difficulties in complying with SAS No. 27 and SAS No. 28. The most common problem cited was that SAS No. 27 and SAS No. 28 are too general to provide much guidance, making it difficult to know when data have been analyzed sufficiently. The comments that follow are typical.

- It is difficult to know when to stop reviewing and yet be comfortable that no embarrassment will result to the client or my CPA firm from amounts disclosed.
- It is difficult to determine the extent of 'review' procedures and to ascertain the propriety and reasonableness of indexes used.

Auditors noted a second problem—the subjectivity of changing prices data. No matter what procedures are performed, auditors claimed they can never feel secure with the data. Typical comments follow.
• Determination of current cost of property and inventory are difficult to become comfortable with.

• Objectively reviewing the assumptions and judgments is difficult, considering the broad nature of assumptions and their limitations on companies with worldwide operations.

A final major problem was the low priority that clients assigned to changing prices data. As a result, the information usually is not available early enough for meaningful evaluation. These responses were typical.

• The client has relatively little interest in the information and prepares it only to comply with GAAP. As a result, there is not a great deal of attention paid to the preparation of the information or the significance of the assumptions used.

• Information necessary to generate data for SFAS No. 33 disclosures generally is not available early enough to allow for adequate time to generate meaningful data and allow adequate time to evaluate reasonableness.

Auditor Perceptions of the Usefulness and Auditability of Changing Prices Data

Final objectives of the research were (1) to assess whether or not auditors perceive changing prices data to be useful to investors and creditors and (2) to determine whether or not disclosures should be audited. In general, the auditors did not perceive the data to be useful. Typical of the responses are the following.

• Changing prices information should not be required. They presume that inflation has an impact of similar latitude in each company's financial statements. Business decisions are never based on these amounts to any great extent. Investors would have a very difficult time using this information to reliably predict earnings trends.

• The confusion brought about by SFAS No. 33 is enough to warrant elimination of the disclosures.

• SFAS No. 33 disclosures should be discontinued due to lack of tangible usefulness to investors and to other interested parties. It is an oversimplified means of presenting the implications of a very complex set of economic variables and events. As a result, it does not represent cost-beneficial information. The basic framework is not readily understandable.

Auditors of public utilities were particularly strong in their criticism of the disclosure requirements. Nearly all commented that, for public utilities,
at least, the requirements are a waste of time. Several respondents explained their objection, pointing out that public utilities are limited to recovering only historical costs through the rate-making process, so the "lower recoverable amount" requirement causes PPE and inventory to be written up to current value and then written back down to historical cost.

However, most respondents stated that, if changing prices disclosures are mandated, the accounting requirements should be more specific to enhance comparability among companies. Generally, the auditors believed SFAS No. 33 allows too many alternatives, which results in inconsistent disclosures. This inconsistency significantly reduces the usefulness of the information. Typical comments supporting this position are these.

- SFAS No. 33 guidelines should have been specific in nature in order to allow for comparability of financial statements.
- The FASB should reduce the number of acceptable accounting methods to avoid confusion and provide better consistency of the information.

Although responding auditors were usually not supportive of any changing prices data, they did favor current cost disclosures over constant dollar disclosures. When asked which method they believed preferable for reporting to investors and creditors, nearly 75 percent of the auditors chose current cost disclosures. Some respondents expressed their views with the following comments.

- The dual approach (constant dollar and current cost) should be eliminated in favor of current cost. A dual approach is confusing and current cost is more appropriate.
- The FASB should drop constant dollar reporting or allow companies to compute data based on indexes representative of their business commitments.
- The assumption of applying constant dollar indexes to complex multinational companies is so illogical that no one should base any judgments on the information.

The final group of survey questions asked about the "auditability" of current cost and constant dollar disclosures, and also whether auditing the disclosures would make them more reliable for external use. Auditors generally stated that data could be audited, but that the auditing would take considerably more time without making the data any more reliable to external users.
Assuming the same SFAS No. 33 requirements, 78 percent of the auditors stated that, by conducting additional verifications and reviews of the indexes, as well as by checking more source documents and mathematical calculations, they could audit and render an opinion on financial statements that included constant dollar disclosures as a footnote. On average, auditors indicated that it would take at least twice as many chargeable hours as it takes to review all SFAS No. 33 data to obtain the sufficient competent evidential matter necessary to audit constant dollar data. Even though audits could be conducted, most respondents concluded that audited constant dollar disclosures would not be much more reliable to external users than the present unaudited supplementary disclosures. Those respondents who were of the opinion that the constant dollar disclosures could not be audited cited these reasons: (1) the lack of specific GAAP; (2) the complications of international operations; (3) the use of too many assumptions and estimates; and (4) the subjectivity of the data.

Only 44 percent of the respondents stated that, given the same requirements as SFAS No. 33, it would be possible to audit and render an opinion on financial statements that included current cost disclosures as a footnote. Those auditors estimated that such procedures would take at least three times as long as current procedures to review all SFAS No. 33 data because they would require more detailed reviews of indexes, more tracing to source documents, more checking of mathematical calculations, more analytical reviews, and more detailed testing of computer programs used to generate the data. Those respondents who were of the opinion that current cost numbers could not be audited cited these reasons: (1) the use of too many assumptions and estimates; and (2) the subjectivity of the data.

Both those who stated that the data could be audited and those who claimed it would be impossible agreed that audited data would not be much more useful to external users than unaudited disclosures. In fact, some auditors indicated that auditing might make the data even more confusing by leading financial statement users to believe the information is more accurate than it really is.

In summary, most auditors responded that the present constant dollar and current cost disclosures are confusing, subjective, and not very useful. Although the CPAs stated that current cost disclosures are more meaningful than constant dollar disclosures, they do not want to see standards expanded, such as by a requirement that inflation data be audited.
Conclusions

Based on an analysis of the accumulated data, the researchers made the following conclusions.

• There is little perceived client interest in changing prices disclosures. Auditors did not perceive that such disclosures are used by internal management; rather, the supplementary information is provided only to meet minimum FASB disclosure requirements.

  Of those auditors surveyed, 87 percent indicated that their clients have little interest in changing prices disclosures. Many commented that changing prices data are not considered by clients when making decisions because of confusion about the meaning of the data.

  Seventy-three percent of the auditors indicated that their clients provided the disclosures only to meet the requirements set forth in SFAS No. 33. In meeting these minimum disclosures requirements, most companies employed the easiest method available for calculating the current cost of property, plant and equipment, and inventories: Of the audited companies, 59 percent used published indexes in valuing PPE, while 53 percent based the current cost of inventories on FIFO.

• The average review of changing prices disclosures required a small percentage of engagement time and resulted only in minor adjustments to the disclosures. Uncorrected departures from SFAS No. 33 guidelines were not ordinarily material enough to justify modifying auditor reports.

  In 90 percent of the cases, the auditors' review of changing prices disclosures consumed less than 2 percent of total engagement time,
amounting to less than $5,200 per client (based on assumed costs in 1982). Senior staff members were most often involved, while partners had relatively little involvement in reviewing the disclosures.

As a result of these reviews, several minor adjustments—usually corrections of clerical errors—were made to the changing prices disclosures. No audit reports were modified because of material omissions or material departures from SFAS No. 33 guidelines.

- Although few formal audit-type programs exist for reviewing changing prices disclosures, CPAs used the following seven procedures to fulfill their responsibilities: (1) inquiring of management; (2) checking mathematical accuracy; (3) obtaining signed representations; (4) performing reasonableness tests; (5) comparing SFAS No. 33 disclosures with audited financial statements; (6) reviewing narrative explanations; and (7) test checking data to source documents.

Inquiring of management was considered the most important step, consuming almost one-quarter of all chargeable hours related to reviews of SFAS No. 33 disclosures. The senior accounting staff and the controllers were the individuals in client management most often contacted by auditors.

Almost all auditors performed mathematical checks of computations and spent 21 percent of chargeable hours on this activity. Obtaining representation letters was not time consuming, and 83 percent of all respondents treated this as a routine review procedure.

Various reasonableness tests relating to changing prices data have been developed by CPA firms. Those tests were applied by 87 percent of auditors for almost one-fifth of the hours chargeable to SAS No. 27 and SAS No. 28 reviews.

Another regular procedure accounted for 16 percent of chargeable audit hours—comparing changing prices disclosures with audited financial statements.

Although reviewing narrative explanations does not consume as much time as other procedures, most auditors considered it to be one of the most important. Management's narrative explanations are reviewed mainly for material misstatements, omissions, and inconsistencies.

The least important procedure performed by the auditors was test checking data to source documents.

- Several problems associated with reviewing changing prices disclosures were identified by auditors. Mentioned most often were these: SAS No. 27 and SAS No. 28 standards are too general; changing prices data are too subjective; and client companies assign low priority to complying with the requirements.

The procedures suggested in SAS No. 27 and SAS No. 28 provide
few specific details for auditors to follow in conducting reviews; therefore, the auditors were uncomfortable with the review process.

The second problem—the subjectivity of changing prices data—results from the flexible guidelines of SFAS No. 33. The statement allows changing prices data to be computed by means of a variety of methods and assumptions. If changing prices disclosures are to be effective, many auditors believe that more specific reporting guidelines must be provided.

- Auditors responded that the present reporting guidelines, which require disclosures to be based on both constant dollars and current costs, are confusing, subjective, and not very useful.

  The respondents commented that requiring changing prices data to be audited would not necessarily result in more useful information for external users. Many suggested that the requiring of information based on constant dollars and current costs actually results in compromising the usefulness of both sets of data. Because each method includes different assumptions, the disclosures are confusing when reported with primary financial statements, which use still a different set of assumptions. Auditors indicated that the current cost basis results in more relevant information for financial statement users, although they did not support an audit requirement for either method.
Appendixes
APPENDIX A

Questionnaire for Analysis of Auditor Reviews of Changing Prices Disclosures

FASB Statement No. 33 (Financial Reporting and Changing Prices) requires certain public companies to report changing price disclosures as supplemental information to their financial statements. Although this information is unaudited, auditors have a reporting responsibility in connection with these disclosures as specified in SAS 27 (Supplementary Information Required by the Financial Accounting Standards Board) and SAS 28 (Supplementary Information on the Effects of Changing Prices). These auditing standards provide general guidelines for meeting this responsibility but do not indicate the detailed procedures to be used in reviewing the client's changing price disclosures. Because of the experimental state of SFAS 33 and the general nature of SAS 27 and 28, little is known about the actual review techniques used by CPA firms. This research is designed to determine the extent of CPA involvement, the procedures being used, costs incurred, and the special problems encountered. The research is cosponsored by the FASB and the AICPA. It is part of a joint research effort to be used by the FASB as it reexamines SFAS 33. Your firm's national office has agreed to support this project and has forwarded this questionnaire to you as a participant. In designing this questionnaire, we have reviewed firm guidance materials, interviewed engagement partners of major CPA firms, received input from the FASB and the AICPA, and performed field tests. The questionnaire is addressed to engagement partners of SFAS 33 clients with the expectation that managers or others will assist in providing the data. We realize that questionnaires are bothersome and have made every effort to reduce the time required to complete this one. Thank you for participating in this study.

I. BASIC INFORMATION

You were the engagement partner responsible for the SAS 27 and 28 procedures for ________________ Company for the latest year for which audited statements are available. Please respond to Parts I and II of this questionnaire with reference to that client.

1. Was this client audited by your firm in the following years? (Check one for each year.)
   1979  _____Yes  _____No  1981  _____Yes  _____No
   1980  _____Yes  _____No  1982  _____Yes  _____No

2. Indicate which years this client provided supplemental changing price data (check one for each year).
   1979  _____Yes  _____No  1981  _____Yes  _____No
   1980  _____Yes  _____No  1982  _____Yes  _____No

*The term review is used in this questionnaire in the context of the lay English and not in the technical sense of "compilation and reviews."
3. Did your firm help the client prepare the changing price disclosures? (Check one for each year.)

- **1979**: Yes  No
- **1980**: Yes  No
- **1981**: Yes  No
- **1982**: Yes  No

4. Indicate approximate chargeable hours involved in helping the client prepare changing prices data and conducting SAS 27 and 28 procedures? (Check one for each year.)

- **1979**: 0-50  50-100  100-200  200-400  400-600  600+  
- **1980**: 0-50  50-100  100-200  200-400  400-600  600+  
- **1981**: 0-50  50-100  100-200  200-400  400-600  600+  
- **1982**: 0-50  50-100  100-200  200-400  400-600  600+

5. During your most recent audit of this client, approximately what percentage of "total audit time" did performing SAS 27 and 28 procedures constitute? (Check one.)

- less than 2 percent
- 2-5 percent
- 6-10 percent
- more than 10 percent

6. During your most recent audit of this client, approximately what percentage of the chargeable hours reported in question 4 were performed by: (identify percentages for each level)

- junior staff
- senior staff
- supervisor/manager
- client partner
- review partner(s)

7. How much interest does your client have in using changing prices data? (Check one.)

- Little interest (Complies only because it is a requirement)
- Moderate interest (Uses selected changing prices data occasionally for managerial decisions)
- High interest (Frequently bases managerial decisions on inflation-adjusted data)

8. In complying with SFAS 33, does the client company report:

- A. On a comprehensive basis?
- B. Only the minimum required disclosures?
- C. More than the minimum but not on a comprehensive basis?

9. In general, how does the client company compute the current cost of its property, plant, and equipment? (Check one)

- Specific Published Price Indexes
- Direct Price Quotes
- General Index (CPI)
- Appraisals or Other Estimates of Current Cost
10. In general, how does the client company compute the current cost of its inventory? (Check one.)

- [ ] FIFO
- [ ] Catalog Prices
- [ ] Specific Published Price Indexes
- [ ] Appraisals or Other Estimates of Current Cost
- [ ] Standard Costs Determined on a Current or NIFO Basis
- [ ] Other (Please explain)

11. What are the principal types of specific price indexes your client uses in determining current costs? (Please specify.) Examples include U.S. Producer Prices, Trade Publications, and LIFO indexes.

- Property, Plant & Equipment
- [ ]
- Inventory
- [ ]

12. Did you determine whether or not the client had written all assets down to their "lower recoverable amounts" in compliance with SFAS 33? (Check one.)

- [ ] Yes
- [ ] No

13. If you answered yes to question 12, please explain how you made the determination.

- [ ]

14. As a result of your SAS 27 and 28 procedures, were any adjustments made to the client's changing price disclosures? (Check one.)

- [ ] Yes
- [ ] No

15. If you answered yes to question 14, did (check all applicable and briefly explain the reason for change):

- [ ] The constant dollar numbers change?
- [ ] The current cost numbers change?
- [ ] The narrative disclosure change?
- [ ] "Lower Recoverable Amounts" change?
II. SPECIFIC PROCEDURES

Procedures that may be used in complying with SAS 27 and 28 include (1) inquiries of management and other client personnel, (2) comparisons of SFAS 33 disclosures with audited financial statements, (3) written representations from management, (4) reasonableness tests, (5) checking mathematical accuracy of computations, (6) checking data to source documents, and (7) reading narrative explanations.

1. Identify the client's personnel with whom you made inquiry. (Check all appropriate positions.)

- Junior Accounting Staff
- Senior Accounting Staff
- Controller
- Other Accounting Personnel (please specify)
- Other Nonfinancial Personnel (please specify)

2. In inquiring of client personnel, how much emphasis was placed on questions relating to: (circle the appropriate response)

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<th></th>
<th>No Emphasis</th>
<th>Little Emphasis</th>
<th>Moderate Emphasis</th>
<th>Strong Emphasis</th>
<th>Very Strong Emphasis</th>
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<tr>
<td>G.</td>
<td>The significant assumptions underlying the changing price disclosures.</td>
<td>1</td>
<td>2</td>
<td>3</td>
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<td>5</td>
</tr>
<tr>
<td>H.</td>
<td>The sources and appropriateness of the current cost data.</td>
<td>1</td>
<td>2</td>
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<tr>
<td>I.</td>
<td>The identification of monetary assets and liabilities.</td>
<td>1</td>
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<tr>
<td>J.</td>
<td>What assumptions were made about inventory turnover.</td>
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<td>2</td>
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<tr>
<td>K.</td>
<td>What considerations were given to the homogeneity of assets.</td>
<td>1</td>
<td>2</td>
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<tr>
<td>L.</td>
<td>How the client treated disposals of business segments.</td>
<td>1</td>
<td>2</td>
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<tr>
<td>M.</td>
<td>Whether the assumptions made by the company in preparing the data were consistent with the nature of the business</td>
<td>1</td>
<td>2</td>
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<td>N.</td>
<td>Which shortcut techniques were used in providing changing price disclosures.</td>
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<td>O.</td>
<td>Whether computations comply with SFAS 33 guidelines.</td>
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<td>P.</td>
<td>The writedown of assets to lower recoverable amounts</td>
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<td>Q.</td>
<td>Other inquiries you made or believe are important. (Please list.)</td>
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3. With respect to SAS 27 and 28 procedures, did you compare the consistency of the assumptions between the client’s changing price disclosures and the reported data in the audited financial statement data. (Check one.)

______Yes  _______No

If yes, please answer question 4. If no, skip to question 5.

4. In making comparisons, how much emphasis was placed on the following? (Circle the appropriate level of response.)
A. Examining the consistency of the inventory turnover assumptions used in changing price disclosures with those in the primary financial statements.  

B. Examining the consistency of the service lives of property, plant, and equipment with those assumed in the changing price disclosures.  

C. Examining the consistency between the use of "lower of cost or market" in the primary financial statements and adjustments to "lower recoverable amounts" in the changing price disclosures.  

D. Examining the consistency of methods, indexes, and/or assumptions used from year to year.  

E. Examining the consistency between the basic data in the primary financial statements with that used in the changing price disclosures.  

F. Other comparisons you made or feel are important. (Please specify.)  

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5. In complying with SAS 27 and 28, were written representations obtained to confirm that the changing price disclosures made were in conformity with SFAS 33? (Check one.)  

6. With respect to SAS 27 and 28 procedures, did you perform reasonableness or analytical tests? (Check one)  

7. Did your reasonableness tests include the following?  

A. Comparisons of the disclosed monetary gain or loss with the average net monetary position times the average rate of inflation.
B. Comparison of constant dollar depreciation with the percentage increase in re-statement of fixed assets times historical cost depreciation.

C. Comparison of percentage change from historical cost to current cost for fixed assets with the average yearly rate of increase in the value of fixed assets times the assets' lives.

D. Other reasonableness tests you performed or believe are important. (Please list and briefly explain.)

8. Did your SAS 27 and 28 procedures include checking the client's mathematical computations?

Yes No

9. Did your SAS 27 and 28 procedures include test checking of data to source documents?

Yes No

10. In conducting your last SAS 28 review, did you analyze the changing price narrative disclosures? (Check one.)

Yes No

If yes, answer question 10. If no, skip to question 11.

11. In reading management's SFAS 33 narrations, how much emphasis was placed on the following? (Circle the appropriate level of response.)

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<th>A. Making sure there were no material misstatements.</th>
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<th>Moderate Emphasis</th>
<th>Strong Emphasis</th>
<th>Very Strong Emphasis</th>
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<tr>
<th>C. Making sure there were no material inconsistencies between changing price disclosures and other information presented in the annual report.</th>
<th>No Emphasis</th>
<th>Little Emphasis</th>
<th>Moderate Emphasis</th>
<th>Strong Emphasis</th>
<th>Very Strong Emphasis</th>
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<td>4</td>
<td>5</td>
<td>N/A</td>
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<th>D. Making sure explanations were logical.</th>
<th>No Emphasis</th>
<th>Little Emphasis</th>
<th>Moderate Emphasis</th>
<th>Strong Emphasis</th>
<th>Very Strong Emphasis</th>
<th>Not Applicable</th>
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<td>N/A</td>
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</table>
E. Making sure all significant and unusual relationships were explained.
   - Strong Emphasis
   - Moderate Emphasis
   - Little Emphasis
   - Very Strong Emphasis
   - Very Strong Emphasis
   - Not Applicable

F. Making sure that the assumptions used were fully described.
   - Strong Emphasis
   - Moderate Emphasis
   - Little Emphasis
   - Very Strong Emphasis
   - Very Strong Emphasis
   - Not Applicable

G. Other items you looked for as you read management's narrations. (Please specify.)
   1. __________________________
   2. __________________________
   3. __________________________

12. In complying with SAS 27 and 28, approximately what percentage of time did your firm spend on each of the following?

- Inquiring of management and other client personnel
- Comparing SFAS 33 disclosures with audited financial statements
- Performing reasonableness tests
- Checking mathematical accuracy of computations
- Test checking data to source documents
- Reviewing narrative explanations
- Other (Please specify)

III. GENERAL INFORMATION AND OPINIONS

1. For how many clients have you performed SAS 27 and SAS 28 procedures?
   - 1
   - 2
   - 3
   - More than 3

2. Have you ever had to add a third paragraph as specified in SAS 27 and 28 in order to call attention to:

   - The omission of changing price disclosures?
   - Material departures from SFAS 33 guidelines
   - The inability to complete required SAS 27 and 28 procedures?

   If yes, please explain _________________________________
3. Assuming essentially the same requirements as SFAS 33, do you believe it would be possible to audit and render an opinion on financial statements that included constant dollar disclosures as a footnote? (Check one.)

_____Yes  _____No

4. If you answered yes to question 3, how much additional time do you think it would take to obtain sufficient competent evidential matter to audit the data? (Check one.)

_____Not much more time than we presently spend
_____Two times as much as we presently spend
_____Four times as much as we presently spend
_____More than four times as much as we presently spend

Other (Please specify)________________________________________

Briefly describe the additional procedures that would be required, if any.

____________________________________________________________________
____________________________________________________________________

5. If you answered no to question 3, what are the major problems prohibiting the auditing of constant dollar disclosures included as footnotes?

____________________________________________________________________
____________________________________________________________________

6. Assuming essentially the same requirements as SFAS 33, do you believe it would be possible to audit and render an opinion on financial statements that included current cost disclosures as a footnote? (Check one.)

_____Yes  _____No

7. If you answered yes to question 6, how much additional time do you think it would take to obtain sufficient competent evidential matter to audit the data? (Check one.)

_____Not much more time than we presently spend
_____Two times as much as we presently spend
_____Four times as much as we presently spend
_____More than four times as much as we presently spend

Other (Please specify)________________________________________

Briefly describe the additional procedures that would be required, if any.

____________________________________________________________________
____________________________________________________________________

8. If you answered no to question 6, what are the major problems prohibiting the auditing of current cost disclosures included as footnotes?

____________________________________________________________________
____________________________________________________________________
9. How much more reliable to external users do you believe the constant dollar disclosures would be if they were audited rather than included as unaudited supplemental disclosures? (Check one.)
   ____Not much better  ____Somewhat better  ____Significantly better

10. How much more reliable to external users do you believe the current cost disclosures would be if they were audited rather than included as unaudited disclosures? (Check one.)
    ____Not much better  ____Somewhat better  ____Significantly better

11. Based on your experience with changing price disclosures, which method do you believe is preferable for reporting to investors and creditors? (Check one and briefly explain.)
    ____Constant Dollar
    ____Current Value
    ____Neither

12. The purpose of this research is to help the standard setting process. We would therefore appreciate any additional comments you might have about how standards for changing price disclosures could be improved. Specifically, we would appreciate your comments about:

   A. Specific problems you have encountered in complying with SAS 27 and 28.

   B. Suggestions you have concerning either SFAS 33 or SAS 28.

   C. Other input you would like to have considered in future standard setting in this area.

As noted in the introduction to this questionnaire, we have reviewed your firm's guidance materials on this subject. However, if you use a more formal written program (similar to an audit program) in complying with SAS 27 and 28, we would appreciate receiving a copy.

Thank you very much for taking the time to complete this questionnaire.
This appendix excerpts the introduction, standards of financial accounting and reporting, and illustrations of disclosures from SFAS No. 33 as they were originally published. The statement subsequently has been amended and interpreted, and readers are urged to refer to these amendments and interpretations.

This reprint does not include Appendixes B through F of the statement. These appendixes are an integral part of the document.

The FASB is using the research results from this monograph, other projects, and the responses to an Invitation to Comment, *Supplementary Disclosures About the Effects of Changing Prices*, to evaluate the SFAS No. 33 experiment. The board has tentatively decided to eliminate historical cost/constant dollar requirements for those companies reporting current cost information and is considering further reductions and modifications in the requirements. An exposure draft is scheduled for fourth-quarter 1984; a final statement probably will become effective in 1985. SFAS No. 33 remains in effect until a revised standard is issued.
INTRODUCTION

1. This Statement establishes standards for reporting certain effects of price changes on business enterprises. It deals with both general inflation and changes in the prices of certain specific types of assets. It requires no changes in the basic financial statements; the required information is to be presented in supplementary statements, schedules, or supplementary notes in financial reports. This Statement applies only to certain large, publicly held enterprises.

The Objectives of This Statement

2. This Statement is based on the objectives set out in FASB Concepts Statement No. 1, Objectives of Financial Reporting by Business Enterprises. That Statement concludes that financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the enterprise (paragraph 37). It also calls for the provision of information about the economic resources of an enterprise in a manner that provides direct and indirect evidence of cash flow potential (paragraphs 40 and 41) and it concludes that management is accountable to the owners for “protecting them to the extent possible from unfavorable economic impacts of factors in the economy such as inflation or deflation” (paragraph 50).

3. The users of financial reports need to have an understanding of the effects of changing prices on a business enterprise to help their decisions on investment, lending, and other matters. This Statement is intended to help users in the following specific ways:

a. Assessment of future cash flows. Present financial statements include measurements of expenses and assets at historical
prices. When prices are changing, measurements that reflect current prices are likely to provide useful information for the assessment of future cash flows.

b. Assessment of enterprise performance. The worth of an enterprise can be increased as a result of prudent timing of asset purchases when prices are changing. That increase is one aspect of performance even though it may be distinguished from operating performance. Measurements that reflect current prices can provide a basis for assessing the extent to which past decisions on the acquisition of assets have created opportunities for earning future cash flows.

c. Assessment of the erosion of operating capability. An enterprise typically must hold minimum quantities of inventory, property, plant, and equipment and other assets to maintain its ability to provide goods and services. When the prices of those assets are increasing, larger amounts of money investment are needed to maintain the previous levels of output. Information on the current prices of resources that are used to generate revenues can help users to assess the extent to which and the manner in which operating capability has been maintained.

d. Assessment of the erosion of general purchasing power. When general price levels are increasing, larger amounts of money are required to maintain a fixed amount of purchasing power. Investors typically are concerned with assessing whether an enterprise has maintained the purchasing power of its capital. Financial information that reflects changes in general purchasing power can help with that assessment.

4. The needs described in paragraph 3 are important to investors, creditors, and also to other users. If information about the effects of changing prices is not available, the cost of capital may be excessive for enterprises that can use capital most effectively. Resources may be allocated inefficiently and all members of society may suffer. Furthermore, people in government who participate in decisions on economic policy may not obtain the most relevant information on which to base their decisions.

5. Many people recognize that the effects of changing prices should be taken into account in the interpretation of information in the financial reports of business enterprises. However, there
are several reasons for believing that those effects cannot be understood adequately until they are measured and disclosed in financial reports:

a. The effects depend on the transactions and circumstances of an enterprise and users do not have detailed information about those factors;

b. Effective financial decisions can take place only in an environment in which there is an understanding by the general public of the problems caused by changing prices; that understanding is unlikely to develop until business performance is discussed in terms of measures that allow for the impact of changing prices;

c. Statements by business managers about the problems caused by changing prices will not have credibility until specific quantitative information is published about those problems.

The Usefulness of Present Financial Statements

6. Most people believe that the primary financial statements should continue to incorporate measurements based mainly on historical prices. Those financial statements rely to a great extent on prices in transactions to which the enterprise was a party. Among the most common and important transactions are sales in which the historical selling prices are used to measure receivables and purchases in which the historical buying prices are used to measure the inventories and property, plant, and equipment acquired. In present financial statements, those historical prices are measured in terms of the number of units of money agreed upon by the buyer and seller at the time of the transaction.

7. There are at least four important reasons for supporting the dominant focus of present financial statements on historical prices. First, it is fitting that the financial statements depend on actual transactions of the enterprise because those transactions determine the changes in owners' equity in the long run. Business enterprises invest cash in assets in order to earn more cash. Historical prices provide the elementary measures of both the amounts invested and the amounts received in return. Second, because historical prices generally are the result of arms-length bargaining,
they provide a basis for reliable measures of the results of transactions. Accordingly, financial statements prepared on the basis of historical prices tend to be capable of independent verification and can be prepared and used with confidence that the information presented is reliable. Third, users' understanding of the effect of changing prices may be enhanced if they are able to compare the measurements in the primary financial statements with measurements that reflect changing prices. Fourth, users are accustomed to the present financial statements.

The Need for Supplementary Information

8. The term "general inflation" means a rise in the general level of prices or a decline in the general purchasing power of the monetary unit. It is widely perceived to be an unfortunate but persistent current feature of the economies of most countries, including the United States. However, measurements in conventional statements are made in nominal dollars, with no direct allowance for the variability of their purchasing power. Many people believe that the users of financial reports need information about measurements that are made in units having the same (i.e., constant) general purchasing power. This Statement requires disclosure of certain supplementary information measured in units having the same general purchasing power. The method used to compute that information is known as constant dollar accounting.

9. Changes in the relative prices of specific goods and services are an integral feature of all modern economies. Many people believe that financial statements based on historical cost fail to provide sufficient information for users because those statements normally do not identify separately changes in prices of assets while they are held by an enterprise. This Statement requires disclosure of certain supplementary information based on measurement of the current cost of inventories and property, plant, and equipment. The method used to compute that information is known as current cost accounting.

10. The Board has concluded that there is an urgent need for enterprises to provide information about the effects on their activities of general inflation and other price changes. It believes
that users' understanding of the past performance of an enterprise and their ability to assess future cash flows will be severely limited until such information is included in financial reports.

The Need for Experimentation

11. Both constant dollar accounting and current cost accounting have been subjects of intensive study for many years. Various methodologies similar to constant dollar accounting have been employed to some extent in several countries. In the United States, 101 enterprises participated in the Financial Accounting Standards Board field test experiment with constant dollar accounting by preparing experimental financial statements for one or more of the years 1972–1974. A few U.S. companies have published constant dollar financial statements for several years; others say that they have prepared similar statements for internal use.

12. Preparers and users of financial reports have had wide experience with measurements similar to current cost. The last-in, first-out inventory method typically produces cost of goods sold (but not inventory) measurements that are similar to those obtained from the use of current cost. Starting with 1976, reports filed by certain companies with the Securities and Exchange Commission (SEC) have included measurements of cost of goods sold, depreciation, inventory and property, plant, and equipment on the basis of replacement cost, an attribute that frequently is similar to current cost. Income statements and supplementary schedules based on current cost accounting recently have been presented by several enterprises in the United Kingdom, Canada, and Australia.

13. Preparers and users of financial reports have not yet reached a consensus on the general, practical usefulness of constant dollar information and current cost information. It seems unlikely that a consensus can be reached until further experience has been gained with the use of both types of information in systematic practical applications. This Statement therefore requires certain enterprises to present information both on a constant dollar basis and on a current cost basis.
14. The measurement and use of information on changing prices will require a substantial learning process on the part of all concerned. The Board makes no pretense of having solved all of the implementation problems. Rather, it encourages experimentation within the guidelines of this Statement and the development of new techniques that fit the particular circumstances of the enterprise. This Statement has been written to provide more flexibility than is customary in Board Statements in the belief that those involved will help to develop techniques that further the understanding of the effects of price changes on the enterprise. In view of the importance of clear explanations of the significance of information on the effects of changing prices, to assist users' understanding of the information, the Board is organizing an advisory group to develop illustrative disclosures that might be appropriate for particular industries.

15. The requirement to present information on both a constant dollar basis and a current cost basis provides a basis for studying the usefulness of the two types of information. The Board intends to study the extent to which the information is used, the types of people to whom it is useful, and the purpose for which it is used. The requirements of this Statement will be reviewed on an ongoing basis and the Board will amend or withdraw requirements whenever that course is justified by the evidence. This Statement will be reviewed comprehensively after a period of not more than five years.

Accounting Series Release No. 190

16. As noted in paragraph 12, the Securities and Exchange Commission has required the filing of information having some similarities to the current cost accounting information called for in this Statement. That requirement is included in Accounting Series Release No. 190, Notice of Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data. However, it is important that the differences between the two sets of information be recognized. This Statement requires presentation of a computation of income from continuing operations using current cost information. ASR 190, however, calls for information that is not suitable for integration into a computation of income. It requires the disclosure of cost of goods sold
at current replacement cost and of depreciation on the basis of the current cost of replacing productive capacity; and the current cost of replacing productive capacity may not be commensurate with labor costs and other operating costs reflected in the income statement. Consequently, ASR 190 emphasizes information that would assist in understanding the "current economics of the business" and it specifically states that the SEC "determined not to require the disclosure of the effect on net income" and that it "did not believe that users should be encouraged to convert the data into a single revised net income figure" (page 7). Some users have nevertheless made that conversion.

17. This Statement emphasizes measurement of the assets owned by the enterprise, whereas ASR 190 focuses attention on the assets that would replace those owned if replacement were to occur currently. Furthermore, this Statement provides for use of current cost or lower recoverable amount as the measure of the asset and of its consumption, rather than requiring use of only one measure—replacement cost—with separate disclosure of net realizable value when it is lower. This Statement calls for disclosure of increases or decreases in the current cost amounts of inventory and property, plant, and equipment as well as calling for measurement of expenses and assets at current cost; and unlike ASR 190, it also requires specific disclosures of the effects of changes in the general price level.

18. The Board is aware of and agrees with the belief that the continuation of requirements to measure both replacement cost data as required by ASR 190 and current cost data as required by this Statement will involve excessive costs for business enterprises. If the Securities and Exchange Commission does not rescind ASR 190 when this Statement becomes effective, the Board will take that factor into account in its decisions about the timing of its review of this Statement and the nature of any revisions to this Statement.

Special Industry Problems

19. Special problems arise in the application of the provisions of this Statement to several particular industries. Special industry task groups have assisted the Board in its study of those problems.
In the case of financial institutions such as commercial banks, thrift institutions, and insurance companies, the Board has concluded that the general provisions of this Statement are useful and applicable. In other cases, such as forest products, mining, oil and gas, and real estate, the Board has concluded that further studies are required to provide a basis for decisions on the applicability to certain types of assets and expenses, of the requirement to present information on a current cost basis. The Board intends to undertake those studies with the help of its advisory task groups, and it aims to publish one or more Exposure Drafts followed in 1980 by Statements dealing with the assets concerned. In the meantime, enterprises are not required to disclose information about the current costs of unprocessed natural resources and income-producing real estate properties. There are no special exemptions from requirements to disclose information on a historical cost/constant dollar basis.

Organization of This Statement

20. Paragraph 22 defines certain terms used in this Statement. Paragraphs 23–28 specify the applicability and scope of this Statement; and paragraphs 29–38 summarize the requirements for the disclosure of supplementary information. Paragraphs 39–50 contain provisions for the measurement of historical cost/constant dollar information in annual reports for fiscal years ended on or after December 25, 1979. Paragraphs 51–60 contain provisions for the measurement of current cost information by those enterprises. The current cost information is required for fiscal years ended on or after December 25, 1979 but first disclosure of the information may be postponed to annual reports for fiscal years ended on or after December 25, 1980. Paragraphs 61–64 contain provisions applicable to both historical cost/constant dollar measurements and current cost measurements. Paragraphs 65 and 66 contain provisions for the presentation of a five-year summary of selected data; and paragraphs 67–69 state the transitional provisions and effective dates of this Statement.

21. Illustrations of schedules that display the information required by this Statement are presented in Appendix A. Appendix B provides background information. The bases for the Board's
conclusions are set out in Appendix C. Illustrative materials are presented in Appendix D and Appendix E. Appendix F provides information about the Consumer Price Index for All Urban Consumers.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Definitions

22. For purposes of this Statement, certain terms are defined as follows:

a. **Constant dollar accounting.** A method of reporting financial statement elements in dollars each of which has the same (i.e., constant) general purchasing power. This method of accounting is often described as accounting in units of general purchasing power or as accounting in units of current purchasing power.

b. **Current cost accounting.** A method of measuring and reporting assets and expenses associated with the use or sale of assets, at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale.

c. **Current cost/constant dollar accounting.** A method of accounting based on measures of current cost or lower recoverable amount in terms of dollars, each of which has the same general purchasing power.

d. **Current cost/nominal dollar accounting.** A method of accounting based on measures of current cost or lower recoverable amount without restatement into units, each of which has the same general purchasing power.

e. **Historical cost/constant dollar accounting.** A method of accounting based on measures of historical prices in dollars, each of which has the same general purchasing power.

f. **Historical cost/nominal dollar accounting.** The generally accepted method of accounting, used in the primary financial statements, based on measures of historical prices in dollars without restatement into units, each of which has the same general purchasing power.

g. **Income from continuing operations.** Income after applicable income taxes but excluding the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes.
h. Public enterprise. A business enterprise (a) whose debt or equity securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally) or (b) that is required to file financial statements with the Securities and Exchange Commission. An enterprise is considered to be a public enterprise as soon as its financial statements are issued in preparation for the sale of any class of securities in a domestic market.

Applicability and Scope

23. The requirements of this Statement apply to public enterprises that prepare their primary financial statements in U.S. dollars and in accordance with U.S. generally accepted accounting principles and that have, at the beginning of the fiscal year for which financial statements are being presented either:

a. Inventories and property, plant, and equipment\(^1\) (before deducting accumulated depreciation, depletion, and amortization) amounting in aggregate to more than $125 million; or

b. Total assets amounting to more than $1 billion (after deducting accumulated depreciation).

Both amounts shall be measured in accordance with generally accepted accounting principles as reported in the primary financial statements (consolidated if applicable) of the enterprise.

24. The requirements of this Statement do not apply, during the year of a business combination accounted for as a pooling of interests, to an enterprise created by the pooling of two or more enterprises, none of which individually satisfies the size test described in paragraph 23.

25. The Board encourages nonpublic enterprises and enterprises that do not meet the size test in paragraph 23 to present the information called for by this Statement.

\(^1\) For the purposes of this Statement, except where otherwise provided, inventory and property, plant, and equipment shall include land and other natural resources and capitalized leasehold interests but not goodwill or other intangible assets.
26. This Statement does not change the standards of financial accounting and reporting used for the preparation of the primary financial statements of the enterprise.

27. The information required by this Statement shall be presented as supplementary information in any published annual report that contains the primary financial statements of the enterprise except that the information need not be presented in an interim financial report. The information required by this Statement need not be presented for segments of a business enterprise although such presentations are encouraged.

28. An enterprise that presents consolidated financial statements shall present the information required by this Statement on the same consolidated basis. The information required by this Statement need not be presented separately for a parent company, an investee company, or other enterprise in any financial report that includes the results for that enterprise in consolidated financial statements.

Requirement for Supplementary Information

29. An enterprise is required to disclose:

a. Information on income from continuing operations for the current fiscal year on a historical cost/constant dollar basis (paragraphs 39–46)

b. The purchasing power gain or loss on net monetary items for the current fiscal year (paragraphs 47–50).

The purchasing power gain or loss on net monetary items shall not be included in income from continuing operations.

30. An enterprise is required to disclose:

a. Information on income from continuing operations for the current fiscal year on a current cost basis (paragraphs 51–64)

b. The current cost amounts of inventory and property, plant, and equipment at the end of the current fiscal year (paragraph 51)
c. Increases or decreases for the current fiscal year in the current cost amounts of inventory and property, plant, and equipment, net of inflation (paragraphs 55 and 56).

The increases or decreases in current cost amounts shall not be included in income from continuing operations.

31. In some circumstances, there may be no material difference between the amount of income from continuing operations on a historical cost/constant dollar basis and the amount of income from continuing operations on a current cost basis. In those circumstances, the current cost information listed in paragraph 30 need not be disclosed for the fiscal year concerned, but the enterprise is required to state, in a note to the supplementary disclosures, the reason for the omission of the information.

32. Information on income from continuing operations (on a historical cost/constant dollar basis or on a current cost basis) may be presented either in a "statement format" (disclosing revenues, expenses, gains, and losses) or in a "reconciliation format" (disclosing adjustments to the income from continuing operations that is shown in the primary income statement). Whichever format is used, such information should disclose, unless they are immaterial, the amounts of or adjustments to cost of goods sold, depreciation, depletion, and amortization expense and (in the case of historical cost/constant dollar income from continuing operations) reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts as required by paragraph 44. Formats for the presentation of the supplementary information are illustrated in Appendix A.

33. If depreciation expense has been allocated among various expense categories in the supplementary computations of income from continuing operations (for example, among cost of goods sold and other functional expenses), the aggregate amount of depreciation expense, on both a historical cost/constant dollar basis and a current cost basis, shall be disclosed in a note to the supplementary information.

34. An enterprise shall disclose, in notes to the supplementary information:
a. The principal types of information used to calculate the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense (paragraph 60)

b. Any differences between (1) the depreciation methods, estimates of useful lives, and salvage values of assets used for calculations of historical cost/constant dollar depreciation and current cost depreciation and (2) the methods and estimates used for calculations of depreciation in the primary financial statements (paragraph 61)

c. The exclusion from the computations of supplementary information of any adjustments to or allocations of the amount of income tax expense in the primary financial statements (paragraph 54).

35. An enterprise is required to disclose the following information for each of its five most recent fiscal years (paragraphs 65 and 66):

a. *Net Sales and Other Operating Revenues*

b. *Historical Cost/Constant Dollar Information*
   1. Income from continuing operations
   2. Income per common share from continuing operations
   3. Net assets at fiscal year-end

c. *Current Cost Information* (except for individual years in which the information was excluded from the current year disclosures in accordance with paragraph 31)
   1. Income from continuing operations
   2. Income per common share from continuing operations
   3. Net assets at fiscal year-end
   4. Increases or decreases in the current cost amounts of inventory and property, plant, and equipment, net of inflation

d. *Other Information*
   1. Purchasing power gain or loss on net monetary items
   2. Cash dividends declared per common share
   3. Market price per common share at fiscal year-end.

All enterprises shall report, in a note to the five-year summary, the average level or the end-of-year level (whichever is used for the measurement of income from continuing operations) of the Consumer Price Index for each year included in the summary (paragraphs 40 and 41).
36. If an enterprise chooses to state net assets, in the five-year summary, at amounts computed from comprehensive financial statements prepared on a historical cost/constant dollar basis or on a current cost/constant dollar basis, that fact shall be disclosed in a note to the five-year summary (paragraph 66).

37. Enterprises shall provide, in their financial reports, explanations of the information disclosed in accordance with this Statement and discussions of its significance in the circumstances of the enterprise.

38. The disclosures summarized in paragraphs 29–37 are required by this Statement. Enterprises are encouraged to provide additional information to help users of financial reports understand the effects of changing prices on the activities of the enterprise.

Historical Cost/Constant Dollar Measurements

39. The index used to compute information on a constant dollar basis shall be the Consumer Price Index for All Urban Consumers, published by the Bureau of Labor Statistics of the U.S. Department of Labor.²

40. An enterprise that presents the minimum historical cost/constant dollar information required by this Statement shall restate inventory, property, plant, and equipment, cost of goods sold, depreciation, depletion, and amortization expense and any reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts (paragraph 44) in constant dollars represented by the average level over the fiscal year of the Consumer Price Index for All Urban Consumers. Other financial statement elements need not be restated. An enterprise that chooses to present comprehensive financial statements on a historical cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars.

² The index is published in Monthly Labor Review. Those desiring prompt and direct information may subscribe to the Consumer Price Index (CPI) press release mailing list of the Department of Labor.
41. If the level of the Consumer Price Index at the end of the year and the data required to compute the average level of the index over the year have not been published in time for preparation of the annual report, they may be estimated by referring to published forecasts based on economic statistics or by extrapolation based on recently reported changes in the index.

42. Inventory and property, plant, and equipment (for computation of the amount of net assets at the end of the current fiscal year for inclusion in the five-year summary of selected financial data paragraph 35(b)(3)), cost of goods sold and depreciation, depletion, and amortization expense shall be measured at their historical cost/constant dollar amounts or lower recoverable amounts. Inventories may need to be reclassified as monetary assets at the date of the use on or commitment to a contract (Appendix D).

43. Measurements of historical cost/constant dollar amounts shall be computed by multiplying the components of the historical cost/nominal dollar measurements by the average level of the Consumer Price Index for the current fiscal year (or the level of the index at the end of the year if comprehensive financial statements are presented) and dividing by the level of the index at the date on which the measurement of the associated asset was established (i.e., the date of acquisition or the date of any measurement not based on historical cost). Those measurements may be restated in base-year dollars for inclusion in the five-year summary (paragraph 65).

44. If it is necessary to reduce the measurements of inventory and property, plant, and equipment, during the current fiscal year from historical cost/constant dollar amounts to lower recoverable amounts, the reduction shall be deducted in the computation of income from continuing operations.

45. Except as provided in paragraphs 42-44 and paragraph 61, the accounting principles used in computing historical cost/constant dollar income shall be the same as those used in computing historical cost/nominal dollar income. Only the measuring unit is changed.

46. Inventory, property, plant, and equipment, and related cost of goods sold and depreciation, depletion, and amortization expense
that are originally measured in units of a foreign currency shall first be translated into U.S. dollars in accordance with generally accepted accounting principles and then restated in constant dollars in accordance with the provisions of paragraph 43.

Purchasing Power Gain or Loss on Net Monetary Items

47. A monetary asset is money or a claim to receive a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. A monetary liability is an obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. The economic significance of monetary assets and liabilities (monetary items) depends heavily on the general purchasing power of money, although other factors, such as the credit worthiness of debtors, may affect their significance.

48. All assets and liabilities that are not monetary are non-monetary. The economic significance of nonmonetary items depends heavily on the value of specific goods and services. Nonmonetary assets include (a) goods held primarily for resale or assets held primarily for direct use in providing services for the business of the enterprise, (b) claims to cash in amounts dependent on future prices of specific goods or services, and (c) residual rights such as goodwill or equity interests. Nonmonetary liabilities include (a) obligations to furnish goods or services in quantities that are fixed or determinable without reference to changes in prices or (b) obligations to pay cash in amounts dependent on future prices of specific goods or services.

49. Guidance on the classification of balance sheet items as monetary or nonmonetary is set forth in Appendix D to this Statement.

50. The purchasing power gain or loss on net monetary items shall be equal to the net gain or loss found by restating in constant dollars the opening and closing balances of, and transactions in, monetary assets and liabilities. An enterprise that presents comprehensive supplementary financial statements on a historical cost/constant dollar basis may measure the purchasing power
gain or loss in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure the purchasing power gain or loss in average-for-the-year dollars. An acceptable approximate method of calculating the purchasing power gain or loss on net monetary items is illustrated in Appendix E.

**Current Cost Measurements**

51. The current cost amounts of inventory and property, plant, and equipment shall be measured as follows:

a. Inventories at current cost or lower recoverable amount (paragraphs 57–64) at the measurement date. (This provision is qualified by paragraph 53 in respect of any depletion expense included in the measurement of inventories.)

b. Property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) at the current cost or lower recoverable amount (paragraphs 57–64) of the assets' remaining service potential at the measurement date.

c. Resources used on partly completed contracts shall be measured at current cost or lower recoverable amount at the date of use on or commitment to the contracts.

52. An enterprise that presents the minimum information required by this Statement on current cost income from continuing operations shall measure the amounts of cost of goods sold and depreciation and amortization expense as follows:

a. Cost of goods sold shall be measured at current cost or lower recoverable amount (paragraphs 57–64) at the date of sale or at the date on which resources are used on or committed to a specific contract. (This provision is qualified by paragraph 53 in respect of any depletion expense included in cost of goods sold.)

b. Depreciation and amortization expense of property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) shall be measured on the basis of the average current cost or lower recoverable amount.
(paragraphs 57–64) of the assets’ service potential during the period of use.

Other revenues, expenses, gains, and losses may be measured by such an enterprise at the amounts included in the primary income statement. An enterprise that chooses to present comprehensive financial statements on a current cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars. (This paragraph is qualified by paragraph 64 for enterprises that are subject to rate regulation or other form of price control.)

53. This Statement does not contain provisions for the measurement, on a current cost basis, of income-producing real estate properties, unprocessed natural resources, and related depreciation, depletion, and amortization expense (paragraph 19). If an enterprise presents information on a current cost basis in an annual report for a fiscal year ended before December 25, 1980, it may measure the assets and the related expenses, described in this paragraph, at their historical cost/constant dollar amounts or by reference to an appropriate index of specific price changes.

54. The amount of income tax expense in computations of current cost income from continuing operations shall be the same as the amount of income tax expense charged against income from continuing operations in the primary financial statements. No adjustments shall be made to income tax expense for any timing differences that might be deemed to arise as a result of the use of current cost accounting methods. Income tax expense shall not be allocated between income from continuing operations and the increases or decreases in current cost amounts of inventory and property, plant, and equipment.

**Increases or Decreases in the Current Cost Amounts of Inventory and Property, Plant, and Equipment**

55. The increases or decreases in the current cost amounts of inventory and property, plant, and equipment represent the differences between the measures of the assets at their “entry dates” for the year and the measures of the assets at their “exit
dates” for the year. “Entry dates” means the beginning of the year or the dates of acquisition, whichever is applicable; “exit dates” means the end of the year or the dates of use, sale, or commitment to a specific contract whichever is applicable. For the purposes of this paragraph, assets are measured in accordance with the provisions of paragraph 51.

56. The increases or decreases in current cost amounts of inventory and property, plant, and equipment shall be reported both before and after eliminating the effects of general inflation. An enterprise that presents comprehensive supplementary statements on a current cost/constant dollar basis may measure increases or decreases in current cost amounts in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure those increases or decreases in average-for-the-year constant dollars. An acceptable approximate method of calculating the increases or decreases in current cost amounts and the inflation adjustment is illustrated in Appendix E.

Information about Current Costs

57. The current cost of inventory owned by an enterprise is the current cost of purchasing the goods concerned or the current cost of the resources required to produce the goods concerned (including an allowance for the current overhead costs according to the allocation bases used under generally accepted accounting principles), whichever would be applicable in the circumstances of the enterprise.

58. The current cost of property, plant, and equipment owned by an enterprise is the current cost of acquiring the same service potential (indicated by operating costs and physical output capacity) as embodied by the asset owned; the sources of information used to measure current cost should reflect whatever method of acquisition would currently be appropriate in the circumstances of the enterprise. The current cost of a used asset may be measured:

a. By measuring the current cost of a new asset that has the same service potential as the used asset had when it was new
(the current cost of the asset as if it were new) and deducting an allowance for depreciation;
b. By measuring the current cost of a used asset of the same age and in the same condition as the asset owned;
c. By measuring the current cost of a new asset with a different service potential and adjusting that cost for the value of the differences in service potential due to differences in life, output capacity, nature of service, and operating costs.

Current cost may be measured by direct reference to current prices of comparable assets or methods such as functional pricing or unit pricing under which the current cost of a unit of service embodied in the asset owned is measured and the current cost per unit is multiplied by the appropriate number of service units.

59. If current cost is measured in a foreign currency, the amount shall be translated into dollars at the current exchange rate, that is, the rate at the date of use, sale, or commitment to a specific contract (in the cases of depreciation expense and cost of goods sold) or the rate at the balance sheet date (in the cases of inventory and property, plant, and equipment).

60. Enterprises may use various types of information to determine the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense. The information may be gathered and applied internally or externally and may be applied to single items or broad categories, as appropriate in the circumstances. The following types of information are listed as examples of the information that may be used, but they are not listed in any order of preferability. Enterprises are expected to select types of information appropriate to their particular circumstances, giving due consideration to their availability, reliability, and cost:

a. Indexation
   (1) Externally generated price indexes for the class of goods or services being measured

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3 Cost of goods sold measured on a LIFO basis may provide an acceptable approximation of cost of goods sold, measured at current cost, provided that the effect of any decreases in inventory layers is excluded.
(2) Internally generated price indexes for the class of goods or services being measured

b. Direct pricing
   (1) Current invoice prices
   (2) Vendors’ price lists or other quotations or estimates
   (3) Standard manufacturing costs that reflect current costs.

**Depreciation Expense**

61. There is a presumption that depreciation methods, estimates of useful lives, and salvage values of assets should be the same for purposes of current cost, historical cost/constant dollar, and historical cost/nominal dollar depreciation calculations. However, if the methods and estimates used for calculations in the primary financial statements have been chosen partly to allow for expected price changes, different methods and estimates may be used for purposes of current cost and historical cost/constant dollar calculations.

**Recoverable Amounts**

62. The term “recoverable amount” means the current worth of the net amount of cash expected to be recoverable from the use or sale of an asset. If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollars or current cost, the recoverable amount shall be used as a measure of the assets and of the expense associated with the use or sale of the assets. Decisions on the measurement of assets at their recoverable amounts need not be made by considering assets individually unless they are used independently of other assets.

63. Recoverable amounts may be measured by considering the net realizable values or the values in use of the assets concerned:

   a. Net realizable value is the amount of cash, or its equivalent, expected to be derived from sale of an asset net of costs required to be incurred as a result of the sale. It shall be considered as a measurement of an asset only when the asset concerned is about to be sold.
b. Value in use is the net present value of future cash flows (including the ultimate proceeds of disposal) expected to be derived from the use of an asset by the enterprise. It shall be considered as a measurement of an asset only when immediate sale of the asset concerned is not intended. Value in use shall be estimated by discounting expected future cash flows at an appropriate discount rate that allows for the risk of the activities concerned.

64. An enterprise that is subject to rate regulation or other form of price control may be limited to a maximum recovery through its selling prices, based on the nominal dollar amount of the historical cost of its assets. In that situation, nominal dollar/historical costs may represent an appropriate basis for the measurement of the recoverable amounts associated with the assets at the end of the fiscal year. Recoverable amounts may also be lower than historical costs. However, cost of goods sold and depreciation, depletion, and amortization expense shall be measured at historical cost/constant dollar amounts (in measurements of historical cost/constant dollar income from continuing operations) or at current cost (in measurements of current cost income from continuing operations) provided that replacement of the service potential provided by the related assets would be undertaken, if necessary, in current economic conditions; if replacement would not be undertaken, expenses shall be measured at recoverable amounts.

Five-Year Summary of Selected Financial Data

65. The information presented in the five-year summary shall be stated either:

a. In average-for-the-year constant dollars or end-of-year constant dollars (whichever is used for the measurement of income from continuing operations) as measured by the Consumer Price Index for All Urban Consumers for the current fiscal year; or

b. In dollars having a purchasing power equal to that of dollars of the base period used by the Bureau of Labor Statistics in calculating the Consumer Price Index (currently 1967).
66. If an enterprise presents the minimum information required by this Statement, it shall measure net assets (i.e., shareholders' equity) for the purposes of the five-year summary:

a. On a historical cost/constant dollar basis at the amount reported in its primary financial statements adjusted for the difference between the historical cost/nominal dollar amounts and the historical cost/constant dollar amounts or lower recoverable amounts of inventory and property, plant, and equipment

b. On a current cost basis at the amount reported in its primary financial statements, adjusted for the difference between the historical cost/nominal dollar amounts and the current cost or lower recoverable amounts of inventory and property, plant, and equipment and restated in constant dollars in accordance with paragraph 65.

If an enterprise elects to present comprehensive supplementary financial statements on a current cost/constant dollar basis, or on a historical cost/constant dollar basis, it may report the amount of net assets in the five-year summary in accordance with the comprehensive statements.

**Effective Date and Transition**

67. The provisions of this Statement shall be effective for fiscal years ended on or after December 25, 1979. However, information on a current cost basis for fiscal years ended before December 25, 1980 may be presented in the first annual report for a fiscal year ended on or after December 25, 1980.

68. An enterprise is required to state, in the five-year summary of selected financial data, only the following amounts for fiscal years ended before December 25, 1979: net sales and other operating revenues, cash dividends declared per common share, and market price per common share at fiscal year-end (paragraph 35(a), (d)(2), and (d)(3)). Disclosure of the other items listed in paragraph 35, for fiscal years ended before December 25, 1979 is encouraged. Disclosure of current cost information in the five-year summary (paragraph 35(c)) for fiscal years ending
before December 25, 1980 may be postponed to the first annual report for a fiscal year ending on or after December 25, 1980.

69. An enterprise that first applies the requirements of this Statement for a fiscal year ended on or after December 25, 1980 is required to state for earlier years, in its five-year summary, only the following items listed in paragraph 35: net sales and other operating revenues (item (a)), cash dividends declared per common share (item (d)(2)), and market price per common share at fiscal year-end (item (d)(3)). Disclosure of the other items listed in paragraph 35 for earlier years is encouraged.

The provisions of this Statement need not be applied to immaterial items.
This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Mosso and Walters dissented.

Mr. Mosso dissents because he believes that the Statement does not bring the basic problem it addresses—measuring the effect of inflation on business operations—into focus. Because of that he doubts that it will effectively communicate the erosive impact of inflation on profits and capital and the significance of that erosion on all who have an investment stake in business enterprises. The Statement seems to him to fail the cost-benefit test because potential benefits are diminished by diffusion and some costs are unnecessary regardless of benefits.

The lack of focus stems from the dual reporting requirements imposed by this Statement, reporting on both historical cost/constant dollar and current cost bases, and is compounded by the ambivalence of the income concepts in both approaches. The Statement offers at least four income numbers—historical cost/constant dollar or current cost, each with or without adjustments for purchasing power gains or losses on monetary items. Other income combinations are invited in the current cost approach because of the juxtaposition of the increase or decrease in current cost amounts of assets. This array of income numbers is a good reflection of the range of views existing among the Board's respondents; but a good mirror does not make a good standard.

Mr. Mosso does not share the widely-held view that the historical cost/constant dollar and current cost models have different objectives. The objective is the same: To measure the effect of inflation on a business enterprise. But there are two types of inflation effect. The Board's historical cost/constant dollar model captures one type, the effect of inflation on the purchasing power of money invested in a particular business. The Board's current cost model captures both types. It incorporates some features of the constant dollar model and also the effect on the prices of goods and services that a particular business deals in. Inflation affects different specific prices in different ways. Consequently, information about changes in an index of general inflation does not provide sufficient information about the effect of inflation on a specific business enterprise. The current cost model is a more comprehensive inflation measurement approach and it makes a free standing historical cost/constant dollar model superfluous.
The constant dollar approach has two uses that he would support: One, as a method of computing simple one-line adjustments of net income and owners’ equity in the primary historical cost financial statements, in conjunction with current cost supplemental statements (a proposal that deserves more support than it has received so far); or two, as an integral part of a supplemental current cost model, essentially as in the current cost approach required by this Statement. As a complete model, however, the historical cost/constant dollar approach has little to recommend it except seniority.

A major criterion that the Board has established for choosing among alternative disclosures is usefulness of the information for predicting earnings and cash flows. The evidence presented to the Board on usefulness in this sense was sketchy, but virtually all of it favored the current cost approach. In fact, usefulness for predicting earnings and cash flows was rarely associated with the historical cost/constant dollar approach, even by its supporters.

Beyond the investor-oriented usefulness criterion, the current cost model bears directly on an urgent national economic policy issue, that of capital formation and its corollary, productivity. The current cost model is built around the notion of maintaining operating capacity, and the distributable income concept that goes with it is designed to trigger attention at the point where reduction of capacity sets in. The whole system pivots on the point where capital investment begins to rise or fall. In the historical cost/constant dollar model, reduction of operating capacity can occur without showing up in the financial statements. This is not to suggest that it is a function of the Board to design accounting standards to promote economic policy objectives. But it is a function of the Board to design standards that measure business income and investment and to be aware, in doing so, of the broader economic consequences of standards. The current cost model has the potential for measuring and communicating many effects of inflation in ways that will be useful both to investors, to policy makers, and to the business community.

Much of the resistance to current cost accounting derives from two interrelated misconceptions: First that it is a major step toward current value accounting and second that its measurements are subjective and open to income manipulation. These are valid concerns. They should not be dismissed or lulled. But neither is an inherent concomitant of current cost accounting.
The essence of current value accounting is revenue recognition on some prerealization basis. The increases in current cost amounts of assets (so-called “holding gains”) arising in a current cost model can be viewed as income equivalents, but that view is not necessary. The model can classify those items as capital maintenance adjustments—necessary to keep the business on a level output trendline.

Subjectivity of measurement is also associated with the current cost model because in theory it breaks the link to historical transaction prices. In practice, this need not be a problem. Indexing can maintain a linkage to historical prices and preserve objectivity and reliability. Many other current costing techniques compare favorably, in terms of objectivity, with historical cost allocation techniques.

In Mr. Mosso’s view, conventional accounting measurements fail to capture the erosion of business profits and invested capital caused by inflation. The urgent need is to focus attention on that basic problem. To do that effectively, it is essential to settle on a single inflation-adjusted bottom line within a framework that captures the price experience of individual firms. The door should be closed quickly and firmly on the dual approach with multiple income numbers.

Mr. Walters dissents because he believes that the dual approach in this Statement unfortunately attempts to deal with two very important but fundamentally different issues in combination. The result is most confusing.

The first issue is the need to measure and report the impact on the enterprise of the change in the exchange value of money. This need is urgent. Paton said: “A summation of unlike monetary units, even of the same name, is a misrepresentation.” The integrity of the historical cost/nominal dollar system relies on a stable monetary system. We have experienced several decades of continuing debasement of the currency. It is essential to the credibility of financial reporting to recognize that the recovery of the real cost of investment is not earnings—that there can be no earnings unless and until the purchasing power of capital is maintained. The constant dollar information required by this Statement, provided one takes the monetary adjustment into consideration, will generally accomplish this within a reasonable order of magnitude. It is not experimental. It is ready to go.
The second issue is the need to introduce current costs or values into the financial reporting model. The record built in the Board's due process indicates that the Securities and Exchange Commission, some educators, and some financial analysts perceive such a need. Issuers of financial statements and auditors, in the main, either do not perceive a need at this time, or believe the proposed model needs further development and testing or that the costs exceed the benefits.

The current cost information introduced in this Statement has significant limitations. It is neither a comprehensive current cost nor a value system. It identifies as income from continuing operations an amount that is sometimes referred to as "distributable income." This amount may have use in funds flow analysis, but it is neither distributable nor income. In most cases, it is a result of subtracting the estimated cost of the next purchase from the revenue from the last sale. It is neither transaction-based income nor real economic income. It has no "bottom line." It is best an intermediate step, easily misinterpreted.

To reduce complexity, the Board elected to defer action or deal inconclusively with such significant matters as backlog depreciation, holding gains, tax allocation, gearing adjustments, and liability measurement. The sacrifice of completeness for understandability leaves us with a model that falls short of the mark on both counts.

This Statement reflects diverse views on the best way to report the effects of changing prices. The resulting product has something for everybody, but by requiring a number of supplemental income amounts which can be used in various combinations, it does not focus on a concept of real income. It offers a smorgasbord of data that fail to meet the tests of simplicity, understandability, and therefore cost-effectiveness.

The weight of evidence suggests that the Board is promulgating a current cost model that is not ready, for a constituency that is not ready for it. Experimentation with current cost and value information is sorely needed to establish their feasibility, reliability, cost, and usefulness. Mr. Walters believes that this experimentation should be conducted with volunteer companies working through professional organizations of business executives, accountants, and financial analysts. Regulators mandate experiments in financial reports; standard setters should not.
Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters
ILLUSTRATIONS OF DISCLOSURES

70. This appendix gives illustrations of formats that may be used to disclose the information required by this Statement. The illustrations relate to a manufacturing enterprise. The Board has formed an advisory group to develop additional illustrations of formats for presenting the information required by this Statement. It intends to publish those illustrations as soon as possible. The illustrations will cover various types of manufacturing and other enterprises. The Board recognizes that clear presentations and explanations are important if information on the effects of changing prices is to be as useful as possible. It encourages enterprises to experiment with the use of different forms of presentation.
SCHEDULE A

STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES

For the Year Ended December 31, 1980

(In (000s) of Average 1980 Dollars)

Income from continuing operations, as reported in the income statement $ 9,000

Adjustments to restate costs for the effect of general inflation

Cost of goods sold (7,384)
Depreciation and amortization expense (4,130) (11,514)

Loss from continuing operations adjusted for general inflation ( 2,514)

Adjustments to reflect the difference between general inflation and changes in specific prices (current costs)

Cost of goods sold (1,024)
Depreciation and amortization expense (5,370) ( 6,394)

Loss from continuing operations adjusted for changes in specific prices $( 8,908)

Gain from decline in purchasing power of net amounts owed $ 7,729

Increase in specific prices (current cost) of inventories and property, plant, and equipment held during the year* $ 24,608

Effect of increase in general price level 18,959

Excess of increase in specific prices over increase in the general price level $ 5,649

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* At December 31, 1980 current cost of inventory was $65,700 and current cost of property, plant, and equipment, net of accumulated depreciation was $85,100.
SCHEDULE B
STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES
For the Year Ended December 31, 1980
(In 000s of Dollars)

<table>
<thead>
<tr>
<th>Item</th>
<th>As Reported in the Primary Statements</th>
<th>Adjusted for General Inflation</th>
<th>Adjusted for Changes in Specific Prices (Current Costs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales and other operating revenues</td>
<td>$253,000</td>
<td>$253,000</td>
<td>$253,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>197,000</td>
<td>204,384</td>
<td>205,408</td>
</tr>
<tr>
<td>Depreciation and amortization expense</td>
<td>10,000</td>
<td>14,130</td>
<td>19,500</td>
</tr>
<tr>
<td>Other operating expense</td>
<td>20,835</td>
<td>20,835</td>
<td>20,835</td>
</tr>
<tr>
<td>Interest expense</td>
<td>7,165</td>
<td>7,165</td>
<td>7,165</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>9,000</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td></td>
<td>244,000</td>
<td>255,514</td>
<td>261,908</td>
</tr>
<tr>
<td>Income (loss) from continuing operations</td>
<td>$9,000</td>
<td>$(2,514)</td>
<td>$(8,908)</td>
</tr>
<tr>
<td>Gain from decline in purchasing power of net amounts owed</td>
<td></td>
<td>$7,729</td>
<td>$7,729</td>
</tr>
<tr>
<td>Increase in specific prices (current cost) of inventories and plant,</td>
<td></td>
<td></td>
<td>$24,608</td>
</tr>
<tr>
<td>and equipment held during the year*</td>
<td></td>
<td></td>
<td>18,959</td>
</tr>
<tr>
<td>Effect of increase in general price level</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess of increase in specific prices over increase in the general</td>
<td></td>
<td></td>
<td>$5,649</td>
</tr>
<tr>
<td>price level</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* At December 31, 1980 current cost of inventory was $65,700 and current cost of property, plant, and equipment, net of accumulated depreciation was $85,100.
## SCHEDULE C

**FIVE-YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES**

(In 000s of Average 1980 Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales and other operating revenues</td>
<td>265,000</td>
<td>235,000</td>
<td>240,000</td>
<td>237,063</td>
<td>253,000</td>
</tr>
<tr>
<td><strong>Historical cost information</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>adjusted for general inflation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations</td>
<td>(2,761)</td>
<td>(2,514)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations per common share</td>
<td>$ (1.91)</td>
<td>$ (1.68)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets at year-end</td>
<td>55,518</td>
<td>57,733</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current cost information</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations</td>
<td>(4,125)</td>
<td>(8,908)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations per common share</td>
<td>$ (2.75)</td>
<td>$ (5.94)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess of increase in specific prices over increase in the general price level</td>
<td>2,292</td>
<td>5,649</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets at year-end</td>
<td>79,996</td>
<td>81,466</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gain from decline in purchasing power of net amounts owed</td>
<td>7,027</td>
<td>7,729</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash dividends declared per common share</td>
<td>$ 2.59</td>
<td>$ 2.43</td>
<td>$ 2.26</td>
<td>$ 2.16</td>
<td>$ 2.00</td>
</tr>
<tr>
<td>Market price per common share at year-end</td>
<td>$ 32</td>
<td>$ 31</td>
<td>$ 43</td>
<td>$ 39</td>
<td>$ 35</td>
</tr>
<tr>
<td>Average consumer price index</td>
<td>170.5</td>
<td>181.5</td>
<td>195.4</td>
<td>205.0</td>
<td>220.9</td>
</tr>
</tbody>
</table>
1. The Financial Accounting Standards Board (FASB) develops standards for financial reporting, including standards for financial statements and for certain other information supplementary to financial statements. This Statement provides the independent auditor with guidance on the nature of procedures to be applied to supplementary information required by the FASB, and it describes the circumstances that would require the auditor to report concerning such information.

Applicability

2. This Statement is applicable in an examination in accordance with generally accepted auditing standards of financial statements.

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1In recognition of the FASB’s role of setting standards for financial reporting, the AICPA Council has approved the following resolution:

That the Auditing Standards Board shall establish under Statements on Auditing Standards the responsibilities of members with respect to standards for disclosure of financial information outside of financial statements in published financial reports containing financial statements. For this purpose, the Council designates the FASB as the body under rule 204 of the Rules of Conduct to establish standards for the disclosure of such information.
included in a document that should contain supplementary information required by the FASB. However, this Statement is not applicable if the auditor has been engaged to audit such supplementary information.

3. Some entities may voluntarily include in documents containing audited financial statements certain supplementary information that the FASB requires of other entities. When an entity voluntarily includes such information, the provisions of this Statement are applicable unless either the entity indicates that the auditor has not applied the procedures described in this Statement or the auditor expands his report on the audited financial statements to include a disclaimer on the information. When the auditor does not apply the procedures described in this Statement to a voluntary presentation of supplementary information, the provisions of SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, apply.

**Involvement with Information Outside Financial Statements**

4. The objective of an examination of financial statements in accordance with generally accepted auditing standards is the expression of an opinion on such statements. The auditor has no responsibility to examine information outside the basic financial statements in accordance with generally accepted auditing standards. However, the auditor does have certain responsibilities with respect to information outside the financial statements. The nature of the auditor's responsibility varies with the nature of both the information and the document containing the statements.

5. The auditor's responsibility for other information not required by the FASB but included in certain annual reports—which are client-prepared documents— is specified in SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*. The auditor's responsibility for information outside the basic financial statements

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2Client-prepared documents include financial reports prepared by the client but reproduced by the auditor on the client's behalf.
in documents that the auditor submits to the client or to others is specified in SAS No. 1, section 610, "Long-Form Reports." The auditor's responsibility for supplementary information required by the FASB is discussed in the paragraphs that follow.

Involvement with Supplementary Information Required by the FASB

6. Supplementary information required by the FASB differs from other types of information outside the basic financial statements because the FASB considers the information an essential part of the financial reporting of certain entities and because the FASB establishes guidelines for the measurement and presentation of the information. Accordingly, the auditor should apply certain limited procedures to supplementary information required by the FASB and should report deficiencies in, or the omission of, such information.

Procedures

7. The auditor should consider whether supplementary information is required by the FASB in the circumstances. If supplementary information is required, the auditor should ordinarily apply the following procedures to the information.  

a. Inquire of management regarding the methods of preparing the information, including (1) whether it is measured and presented within guidelines prescribed by the FASB, (2) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and (3) any significant assumptions or interpretations underlying the measurement or presentation.

b. Compare the information for consistency with (1) management's responses to the foregoing inquiries, (2) audited financial statements, and (3) other knowledge obtained during the examination of the financial statements.

These procedures are also appropriate when the auditor is involved with voluntary presentations of such information (see paragraph 3).
c. Consider whether representations on supplementary information required by the FASB should be included in specific written representations obtained from management (see SAS No. 19, *Client Representations*).

d. Apply additional procedures, if any, that other Statements prescribe for specific types of supplementary information required by the FASB.

e. Make additional inquiries if application of the foregoing procedures causes the auditor to believe that the information may not be measured or presented within applicable guidelines.

**Circumstances Requiring Reporting on Supplementary Information Required by the FASB**

8. Since the supplementary information is not audited and is not a required part of the basic financial statements, the auditor need not expand his report on the audited financial statements to refer to the supplementary information or to his limited procedures except in the following circumstances. The auditor’s report should be expanded if (a) the supplementary information that the FASB requires to be presented in the circumstances is omitted, (b) the auditor has concluded that the measurement or presentation of the supplementary information departs materially from guidelines prescribed by the FASB, or (c) the auditor is unable to complete the prescribed procedures. Since the supplementary information required by the FASB does not change the standards of financial accounting and reporting used for the preparation of the entity’s basic financial statements, the circumstances described above do not affect the auditor's opinion on the fairness of presentation of such financial statements in conformity with generally accepted accounting principles. Furthermore, the auditor need not present the supplementary information if it is omitted by the entity. The following are examples of additional paragraphs an auditor might use in these circumstances.

**Omission of Supplementary Information Required by the FASB**

The Company has not presented (describe the supplementary infor-
Supplementary information required by the FASB in the circumstances) that the Financial Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Material Departures from FASB Guidelines

The (specifically identify the supplementary information) on page xx is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the (specifically identify the supplementary information) is not in conformity with guidelines established by the Financial Accounting Standards Board because (describe the material departure(s) from the FASB guidelines).

Prescribed Procedures Not Completed

The (specifically identify the supplementary information) on page xx is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because (state the reasons).

Even though he is unable to complete the prescribed procedures, if, on the basis of facts known to him, the auditor concludes that the supplementary information has not been measured or presented within FASB guidelines, he should suggest appropriate revision; failing that, he should describe the nature of any material departure(s) in his report.

9. If the entity includes with the supplementary information an indication that the auditor performed any procedures regarding the information without also indicating that the auditor does not express an opinion on the information presented, the auditor’s report on the audited financial statements should be expanded to include a disclaimer on the information.

10. Ordinarily, the supplementary information required by the FASB should be distinct from the audited financial statements and separately identifiable from other information outside the financial statements that is not required by the FASB. However, management
may choose not to place the required supplementary information outside of the basic financial statements. In such circumstances, the information should be clearly marked as unaudited. If the information is not clearly marked as unaudited, the auditor's report on the audited financial statements should be expanded to include a disclaimer on the supplementary information.

11. This Statement provides for exception reporting; that is, the auditor should expand his standard report only to call attention to the omission of supplementary information required by the FASB to be presented in the circumstances, material departures from FASB guidelines on the measurement or presentation of such information, or the inability to complete the procedures prescribed by this Statement, but not otherwise report on such information. The Auditing Standards Board has under consideration the issue of whether the auditor should report explicitly on such information, that is, whether the auditor should issue a report, based on the limited procedures prescribed by this Statement, that states he is not aware of any material modifications that should be made to the information for it to conform with guidelines established by the FASB. This issue has not been resolved because of uncertainties concerning (a) the implications that the location of the information (outside or inside the basic financial statements) may have on explicit versus exception reporting, (b) whether Section 11(a) of the Securities Act of 1933 would apply to an auditor's explicit report on supplementary information included in a securities act filing, and (c) the nature of information that may become required supplementary information. The board intends to decide whether explicit reporting is appropriate when sufficient knowledge is obtained to clarify these matters.

**Effective Date**

12. This Statement is effective for examinations of financial statements for periods ended on or after December 25, 1979.
The Statement entitled "Supplementary Information Required by the Financial Accounting Standards Board" was adopted by the assenting votes of thirteen members of the board. Messrs. Bedford and Berliner dissented.

Mr. Bedford dissents to the issuance of this Statement because it provides for exception reporting rather than explicit reporting on supplementary information required to be disclosed by the FASB. He believes exception reporting does not adequately communicate to users of financial reports the degree of assurance the auditor provides.

Mr. Berliner dissents to the issuance of this Statement because he believes it would unnecessarily impose an open-ended commitment for auditor involvement with all supplementary information prescribed in the future by the FASB. Since no one can reliably predict what information the FASB might decide to require in the future, he believes the profession should not agree in advance to be involved with such supplementary information, which could involve matters outside the auditor's professional expertise, but rather should respond on a case-by-case basis.

Auditing Standards Board (1979-1980)

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MARTIN J. ROSENBLATT
Practice Fellow, Auditing Standards

PAUL J. SANCHEZ
Manager, Auditing Standards

Note: Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepted auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards and requires that members be prepared to justify departures from such Statements.
1. FASB Statement No. 33, *Financial Reporting and Changing Prices*, requires certain public entities to present information on the effects of changing prices.\(^1\) It requires no changes in the basic financial statements; the required information is to be presented as supplementary information in any published annual report that contains

\(^1\)The requirements of FASB Statement No. 33 apply to “public enterprises” that have either (a) inventories and property, plant, and equipment (before deducting accumulated depreciation) of more than $125 million or (b) total assets of more than $1 billion (after deducting accumulated depreciation). *Public enterprise* is defined in FASB Statement No. 33 as “a business enterprise (a) whose debt or equity securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally) or (b) that is required to file financial statements with the Securities and Exchange Commission. An enterprise is considered to be a public enterprise as soon as its financial statements are issued in preparation for the sale of any class of securities in a domestic market.” This definition differs from the definition of public entity in SAS No. 26, *Association With Financial Statements*. 

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the primary financial statements of the entity. The FASB encourages nonpublic entities and entities that do not meet the size test to present the information called for by the statement.

2. Information on the effects of changing prices ordinarily is developed by management, using assumptions and techniques that have not yet been standardized and, thus, that may differ from company to company and from year to year. The FASB is encouraging experimentation within the FASB Statement No. 33 guidelines and development of new techniques that fit the particular circumstances of the entity. Accordingly, FASB Statement No. 33 provides more flexibility than is customary in FASB statements.

3. In applying the procedures specified in SAS No. 27, the auditor's inquiries of management should be directed to, among other things, the judgments made concerning measurement and presentation and, accordingly, should include

a. The sources of information presented for the latest fiscal year and for the five most recent fiscal years, the factors considered in the selection of such sources, and the appropriateness of their application in the circumstances.

b. The assumptions and judgments made in calculating constant dollar and current cost amounts (such as the methods and timing of acquisition and retirement of assets and the classification of assets and liabilities as either monetary or nonmonetary).

c. The need to reduce the measurements of inventory and of property, plant, and equipment from (1) historical cost/constant dollar amounts or (2) current cost amounts to lower recoverable amounts and, if reduction is necessary, the reason for selecting the method used to estimate the recoverable amount and the appropriateness of the application of that method.

4. FASB Statement No. 33 also requires entities to provide, in their financial reports, explanations of the information disclosed in accord-

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2FASB Statement No. 33 is effective for fiscal years ending on or after December 25, 1979. However, initial presentation of current cost information may be postponed to the first annual report for a year ending on or after December 25, 1980. The FASB has issued an exposure draft of a proposed statement titled Financial Reporting and Changing Prices: Specialized Assets, a supplement to FASB Statement No. 33. The AICPA Auditing Standards Board will consider whether additional guidance may be needed with respect to the information contemplated by the exposure draft.
Supplementary Information on the Effects of Changing Prices

inance with that statement and discussions of its significance in the circumstances of the entity. It also encourages entities to provide additional information to help users of financial reports understand the effects of changing prices on the activities of the entity. The auditor should read such narrative explanations and discussions and compare them with the audited financial statements and the related required supplementary information on the effects of changing prices. If the auditor concludes, after discussing the matter with the client, that the narrative (a) is materially inconsistent with either the audited financial statements or the other supplementary information or (b) contains a material misstatement of fact, he should expand his report on the audited financial statements to describe the nature of the inconsistency or misstatement.

The Statement entitled Supplementary Information on the Effects of Changing Prices was adopted unanimously by the fifteen members of the board.

Auditing Standards Board (1979-1980)

James J. Leisenring, Chairman
Robert W. Berliner
J. Frank Betts
John F. Burke
Herman O. Coleman
Philip E. Fess
Jerry M. Gotlieb
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Albert L. Schaps
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L. Edward Tuffly, Jr.
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Wayne Williamson

D. R. Carmichael
Vice President, Auditing
Martin J. Rosenblatt
Practice Fellow, Auditing Standards

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