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WILLARD J. GRAHAM: THE LEADING PRICE-LEVEL ACCOUNTING ADVOCATE

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Willard J. Graham had diverse interests that extend beyond the boundaries of this paper [Porter and Langenderfer, Spring 1985]. This paper will focus on his thinking and his contributions in the area of price-level accounting.

While Graham was deeply interested in all aspects of accounting [Porter and Langenderfer, Spring 1985], his first and lasting professional "love" was price-level accounting. We are unsure whether his interest in price-level accounting preceded or followed the research he performed for his doctoral dissertation on *Public Utility Valuation* [Graham, 1934] which was completed in 1934, but we think a possible genesis of his interest in the inflation issue may be found in this story that Graham often told to audiences:

> Back in 1919 I was in the shoe business, that is, I was working Saturdays, at $1.25 a day, in a shoe store in a little town in Colorado while going to school. One snowy day I sold a pair of shoes; the box said the cost was $5.00 and the selling price was $7.00; and I sold them at $7.00. It was the next-to-last pair of that particular item, so I put it in the "want book," which we had hanging on the wall.
>
> That night I helped the owner make out the orders for new stock. When we came to this particular item, we found that the wholesale price was $7.50. Prices were going up fast in 1919, as most of you cannot remember—but some of us can. So, the owner said to me, "Did you make a profit on that deal?"
>
> I said, "Sure. They cost $5.00 and I sold them for $7.00; that's two dollars."
>
> "But," he said, "it costs $7.50 to replace them."
>
> "Well, " I said, "you can price the new pair at $10.00 and make your profit on them too."
>
> "But," he said, "suppose you had been ill today and couldn't have come to work. We couldn't have waited on all our customers. Your customer might have gone away without his pair of shoes. Wouldn't we have saved fifty cents?"
>
> And you know, I never forgot that. [Graham, 1949b].

Although this story emphasizes the replacement cost concept, Graham surely recognized that in many cases the replacement cost was more often a reflection of the impact of inflation than a reflection of a change in real value [Graham, 1959a]. In any case, we do know that Graham was perhaps "the strongest advocate (of price-level accounting) in the United States" [Edwards and Bell, 1965, p. 26] from 1934 until his death in 1966.

Recommendations Regarding Price-Level Accounting

Graham's advocacy of price-level accounting was contained in numerous lectures, speeches, and manuscripts. In addition, his testimony regarding the topic was incorporated into many governmental documents including the 1959 *Tax Revision Compendium* [Graham, 1959b]. While the condensation of his opinions, proposals, suggestions, and conclusions regarding price-level accounting is a monumental task, we will try to communicate the essence of his views on price-level accounting through the excerption of the following questions and answers from a very excellent statement of the problem and one approach to its solution promulgated in 1951 while Graham was Chairman of the American Accounting Association's Committee on Accounting Concepts and Standards:

Question I:
Is modification of the conventional accounting approach to net income determination to give explicit recognition to changes in the value of the of the dollar a desirable development?

Answer to Question I:
(1) In periodic reports to stockholders, the primary financial statements, prepared by management and verified by an independent accountant, should, at the present stage of accounting development, continue to reflect historical dollar costs.
(2) There is reason for believing that knowledge of the effects of the changing value of the dollar upon financial position and operating results may be useful information, if a practical and substantially uniform method of measurement and disclosure can be developed.
(3) The accounting effects of the changing value of the dollar should be made the subject of intensive research and experimentation; the specific significance of the basic problem should be determined with as much accuracy as possible; the means of its solution, if its significance warrants, should be thoroughly investigated.

Question II:
If so, what methods are most appropriate for measuring variations in the value of the dollar and for giving effect to such variations in financial reports?

Answer to Question II:
(1) The effects of price fluctuations upon financial reports should be measured in terms of the over-all purchasing power of the dollar—that is, changes in the general price level as measured by a *general* price index. For this purpose, adjustments should not be based on either the current value or the replacement costs of specific types of capital consumed.
(2) The measurement of price level changes should be all-inclusive; all statement items affected should be adjusted in a consistent manner.

Question III:
If such modification is desirable, how is disclosure best to be accomplished?

Answer to Question III:
(1) Management may properly include in periodic reports to stockholders comprehensive supplementary statements which present the effects of the fluctuation in the value of the dollar upon net income and upon financial position.
   (a) Such supplementary statements should be internally consistent; the income statement and the balance sheet should both be adjusted by the same procedures, so that the figures in such complementary statements are coordinate and have the same relative significance.
   (b) Such supplementary statements should be reconciled in detail with the primary statement reflecting unadjusted original dollar costs, and should be regarded as an extension or elaboration of the primary statements rather than as a departure therefrom.
   (c) Such supplementary statements should be accompanied by comments and explanations clearly setting forth the implications, uses, and limitations of the adjusted data [Graham, 1951].

The preceding recommendations could have been incorporated into financial statements several decades ago. The interest in price-level accounting waxes and wanes, however, depending upon whether the inflation rates are high or low. A fews years ago, when domestic inflation rates were high, the Financial Accounting Standards Board (FASB), through SFAS-33, required that certain corporations report inflation-adjusted financial information in their annual reports [FASB, 1979]. Today, however, "interest in inflation accounting has generally declined because of the low domestic inflation rates" [Bisgay, July 1985]. Perhaps for this, or other reasons, the FASB recently by a four-to-three vote, through SFAS-89, made "voluntary the supplementary disclosure of current cost/constant purchasing power information" [FASB, 1986].

In a report on a recent questionnaire survey, Rosensweig [April 1985] indicated that not as many firms were using constant purchasing power information generated for external financial reports as required by SFAS-33 as he had expected. We speculate that Graham would not have been surprised at this finding primarily because the profession elected to present only selected data rather than comprehensive statements on a current cost/constant dollar basis. After all, when an analyst wants to delve into the financial affairs of a business, s/he wants to do a comprehensive in-depth analysis, not a skimpy overview. Yet at the present time comparable statements on both a historical cost-constant dollar basis are not available.

These evidences of a decline in interest regarding the effect of inflation on financial statements have been counterbalanced perhaps by a recently released research monograph on *Inflation and Managerial Decision Making* by the National Association of Accountants which contains four major recommendations that generally correspond with Graham's earlier thinking regarding the price-level issue:

> First, companies should launch a major educational program for managers about the nature of inflation and its effects on business firms.
>
> Second, inflation-adjusted data ought to be a part of strategic planning, capital budgeting, pricing, cost budgeting, inventory management, and an analytical review of business performance.
>
> Third, particularly for those companies most vulnerable to inflation, managers' performance should be judged on the basis of inflation-adjusted measures.
>
> Fourth, the Financial Accounting Standards Board should continue to require the disclosure of inflation's effect on a firm [Conners, March 1985].

The fact that three of the seven FASB members dissented regarding the adoption of SFAS-89 documents the fact that there are still advocates of price-level accounting alive today. One dissenting FASB member, David Mosso ". . . believes that accounting for the interrelated effects of general and specific price changes is the most critical set of issues that the Board will face in this century. It is too important either to be dealt with inconclusively as in the original Statement 33 or to be written off as a lost cause as in this Statement" [FASB, 1986]. FASB members Raymond Lauver and Robert Swieringa shared the views expressed by their fellow dissenting colleague.

Conclusion

Whether of the "galloping" or "creeping" variety, "Inflation is a dangerous threat to our economy" [Graham, 1959b, p. 1179]. In this regard, Graham was quick to point out that one of the "fathers" of communism once remarked, "the way to destroy capitalism (America) is by the debauchment of the currency, which is the essence of inflation" [Graham, 1959a]. As Graham testified before the congressional Committee on Ways and Means in Washington in 1959, "If it (inflation) cannot be controlled, resulting inequities can be reduced by a principle of taxing economic gain rather than dollar gain" [Graham, 1959b, p. 1179].

Today, after more than 25 years, these important recommendations regarding price-level accounting have not been adequately incorporated into the FASB standards and SEC regulations underlying the preparation of financial statements. Neither, have they been made an integral part of the Internal Revenue Code.

In a debate that included Willard Graham, Maurice Stans, and Leonard Spacek regarding price-level accounting before the Institute of Internal Auditors in Chicago in 1949, Stans complimented Graham by stating that he was "twenty years ahead of his time and of his contemporaries" [Graham, Stans and Spacek, 1949]. Unfortunately, it appears that he may have been much further ahead of his accounting contemporaries than predicted by Stans.

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