Accounting Historians Journal

Volume 10
Issue 1 *Spring 1983*

Article 1

1983

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The Accounting Historians Journal
Vol. 10, No. 1
Spring 1983

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ASSET REVALUATION AND COST BASIS: CAPITAL REVALUATION IN CORPORATE FINANCIAL REPORTS

Abstract: The paper is a historical study of the asset revaluation movement and the subsequent establishment of the cost basis in the United States. A survey of the corporate report leads to a generalization that the asset revaluations were fundamentally the adjustments of equity capital triggered by corporate financial policies. The concept of quasi-reorganization then was developed to ensure that the capital revaluation was undertaken for the right reasons. This newly developed concept made the revaluation of equity and assets less useful from the standpoint of corporate financial management. Asset revaluation was thus replaced by the cost principle.

Introduction

The historical development of accounting principles needs to be studied on the basis of the interrelationship among the following three basic factors:

1. Accounting practices of individual corporations
2. Accounting regulations that constrain those practices
3. Environmental conditions, i.e., general economic and social circumstances and business conditions.

The traditional approach of accounting historians seems to have been like Figure 1. That is, corporate accounting practices obey, or are forced to obey, accounting regulations (arrow a), which may change in response to changing environmental conditions (arrow b). Accounting practices, however, do not always obey the regulations. In fact, they frequently disobey regulations, and such repeated infractions may lead to changes in the regulations. In addition, business and other environmental conditions often have direct and vital effects on corporate accounting practices.

The author is indebted to Professors Alfred D. Chandler, Jr. and William W. Cooper for their valuable suggestions. He has also benefited greatly from comments and suggestions by Professors Robert N. Anthony, Paul Frishkoff, Yuji Ijiri, Thomas K. McCraw, Gary J. Previts, Arthur L. Thomas and Stephen A. Zeff. Financial support by the American Council of Learned Societies is gratefully acknowledged.

Figure 2 is a revision of Figure 1, indicating the dynamic relationship among accounting practices, regulations, and environmental conditions. As illustrated in this new Figure, individual companies are constantly seeking, from among alternative accounting rules in relation to the existing regulations or norms, those that are compatible with their particular economic, social, and business conditions (arrows a and c). When these environmental conditions result in practices that repeatedly disobey a particular rule of the regulations, the rule, after seeking all of the possible ways to suppress the infractions, may be adjusted to the actual situation or replaced by another rule.[1] This adjustment or alteration of a particular rule may be accompanied by other derived changes of related rules, thereby bringing a transformation, as it were, to the entire system of accounting regulations (arrow a′).

Consequently, in light of conflicts between practices and regulations, the system of accounting rules needs to be studied in terms of its changes—rather than its static order. Before presenting a theoretical framework for the changes in an accounting system, however, this approach should be tested for its usefulness and enriched with empirical data through a fact-finding study of some critical turning points in the history of accounting. This paper, pursuing a primary historical study of the accounting practices reported by the large U. S. corporations in their annual financial statements, is devoted to a part of that preliminary work.[2]

Traditional Concepts of Asset Revaluation and Cost Basis

Among the critical turning points in the history of accounting, the so-called asset revaluation movement in the 1920s and 1930s and

Figure 1

Traditional Approach to Developing Accounting Principles

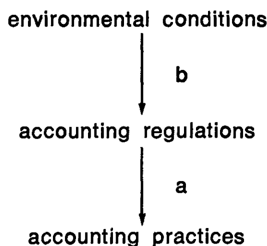
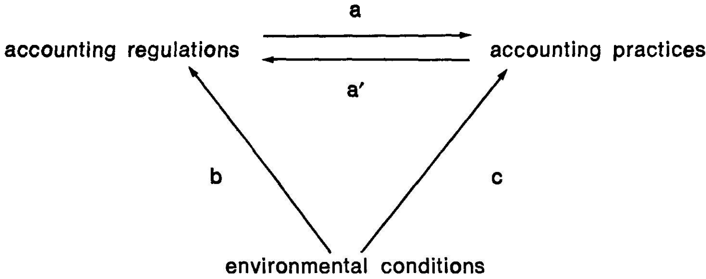


Figure 2

Proposed Approach to Developing Accounting Principles



the subsequent firm establishment of the cost basis may provide a good basis for testing and enriching the proposed approach to studying the history of accounting.[3] The remainder of this paper is a study of how the period of revaluation of fixed assets (tangible and intangible) led to the establishment of cost-based valuation. This study does not address the revaluation of current assets (e.g., inventories) or investments (e.g., securities).

It is sometimes argued that the asset revaluation movement constituted a major departure from the historical cost basis, which was already a generally accepted rule of accounting.[4] To the contrary, some argue that this practice of revaluation simply characterized the common notion of asset valuation that was prevailing among American accountants before the cost principle was established in the 1930s.[5] Whichever view is taken, it is clear that the cost basis did not become established firmly as a practical working rule—i.e., as a rule or a standard which was generally accepted and actually honored in the practice—until the asset revaluation movement came to an end in the 1930s.[6]

According to some leading accounting historians, the asset revaluation movement in the 1920s and 1930s was based on the accretion concept of income, which is said to have been prevailing in those years.[7] The fact that corporate accounts were primarily used as a basis for the granting of credit resulted in the emphasis on balance sheet accounts and the prevalence of the accretion concept of income.[8] The asset revaluation movement was simply an adjustment of the book values of assets according to their current market prices. Because the use of accounts as information for investors

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did not become popular until the stock exchange boom in the 1920s and the collapse of security prices in the early 1930s, it is logically assumed that the accrual concept of income associated with the cost-allocation method could not have been prevailing until then.[9] This view, while perhaps reflecting the traditional way of thinking, is oversimplified.[10]

A series of official statements made by the American Institute of Accountants (AIA), dating from the *Uniform Accounting* of 1917 have been frequently presented as a proof to support this view.[11] Sponsored and published by the Federal Reserve Board in collaboration with the AIA, *Uniform Accounting* has been regarded as an historical document that marked the beginning of generally accepted accounting principles in the United States.[12] It emphasized the so-called balance sheet audit, which was associated implicitly with the accretion method of income determination based primarily on the standpoint of the credit grantor.[13] The basic philosophy of this document was maintained in the AIA's official pronouncement of accounting principles published in 1929, *Verification of Financial Statements.* Not until 1932 did the AIA officially advocate the investor's point of view, instead of creditor's, thereby emphasizing the importance of income accounting based on cost figures, instead of balance sheet figures based on the liquidating values of a going concern.[14] This view was made public by the AIA in its 1934 publication, *Audit of Corporate Accounts*.

While the *Uniform Accounting* of 1917 clearly emphasizes the balance sheet audit, reference to the accretion concept of income, implicit or explicit, is not made. Rather, the accrual concept of income associated with the cost allocation method can be clearly noticed even in this early version of accounting principles. In other words, historical cost valuation was not a product of the 1930s. In fact, cost-based valuation was normally practiced by the majority of large U. S. corporations, regardless of the year for which the annual reports were prepared. This certainly was true for the annual reports of *Fortune 500* corporations during the 1920s and 1930s. Revaluation of assets was more of an exception.[15] However, the exceptions were too critical in terms of their frequency and reported monetary amount to claim that cost valuation was a well-established practice before the 1930s.

Preliminary Survey of Asset Revaluation Movement

A general view of the asset revaluation movement may be obtained from the work of S. Fabricant. He studied the annual reports

of more than 200 large industrial concerns randomly selected from the file of the reports of the New York Stock Exchange for the years 1925 through 1934. Several of Fabricant's findings are particularly relevant to this discussion.

First, he found that, contrary to its characterization as a period of only write-ups,[16] the 1920s saw both write-ups and write-downs of tangible fixed assets. In the 1930s, his study indicated that both the number and monetary amount of write-downs exceeded that of write-ups.

Second, in no year during his period of study, did he find that there was a net write-up of intangible assets for the whole economy. This occurred in spite of the fact that corporations reported a large amount of revaluation for intangible assets every year from 1925 through 1934. In other words, most revaluations, in terms of dollars, of intangibles were downward. This finding led Fabricant to conclude that:

> . . . intangibles are written down when business is good, to indicate caution, as frequently as they are written down when times are bad and values appear to be tottering or to have crashed.[17]

Another important part of Fabricant's study was devoted to an analysis of the actual causes that made asset revaluation so popular among such a large number of corporations. In the corporate annual reports he studied, Fabricant found that discrepancy between book value and some sort of current value was mentioned as the basis of practically all revaluations.[18] However, Fabricant does caution that:

> Even an independent appraisal is still subject to the superior will and responsibility of the officers and directors of a corporation. Occasionally, appraisal does not lead to immediate or ultimate revaluation, or the appraisal may be modified by decision of the directors.[19]

For this and other reasons:

> Appraisals . . . are not reasons for revaluations but only methods of getting at the amount by which to revalue. They can tell us nothing in themselves of these reasons except to suggest that the fundamental factors were sufficiently strong to be sensed by the officials ordering the appraisals.[20]

According to Fabricant, more fundamental factors leading to revaluation include such environmental conditions as changes in general price levels, discovered obsolescence, and errors in earlier estimates of depreciation and depletion. Among them, obsolescence is "probably a major factor accounting for downward revaluations" although it is mentioned in only a few annual reports.[21] In periods of economic depression, the existence of idle properties resulting from obsolescence is the immediate cause of write-downs of tangible assets. Obsolescence is also revealed to some extent in times of prosperity, where most capacity is in full use. This, therefore, gives an explanation of the basic factors contributing to downward revaluations of tangible assets.[22]

These factors Fabricant points out, however, are not sufficient to explain completely the asset revaluation movement (i.e., both write-ups and write-downs). For example, changes in general price levels may fail to give a convincing explanation of the fact that both upward and downward revaluations were made of tangible fixed assets in the 1920s. Furthermore, while obsolescence is an obviously important factor accounting for downward revaluations, it does not necessarily account for upward revaluations, thereby failing to give a general picture of the asset revaluation movement. To gain a better insight into the factors leading to asset revaluations, a complete survey of all adjustments of fixed asset values reported by *Fortune 500* corporations which were in existence during the entire period of asset revaluation movement (i.e., from the early 1920s to the mid-1930s) was undertaken and is presented in the remainder of this paper.[23]

Asset Revaluations: Write-Ups of Fixed Assets

An investigation of what was actually underlying the asset revaluation movement requires identification and analysis of factors contributing to write-ups, as well as those contributing to write-downs. For the sake of convenience, write-ups and write-downs will be discussed separately. This is not meant to imply that the revaluation movement occurred in two separate stages—i.e., write-ups in the 1920s and write-downs in the 1930s. As was discussed previously, both write-ups and write-downs occurred throughout the whole period of asset revaluation.

In investigating upward revaluations, it may be of help to know how the depreciation on the appreciation increase was accounted for in corporate financial reports relative to the resulting appraisal credit. During the 1920s and 1930s, at least three different methods

of accounting for this were used.[24] These methods are categorized as follows:

1. To charge depreciation on the basis of original cost against income, and to charge the depreciation on appreciation increase against appraisal credit.
2. To charge depreciation on the appreciated basis against income and, at the same time, to increase the earned surplus by the amount of the depreciation on appreciation increase—i.e., the realized appreciation—through a charge against appraisal credit.
3. To charge depreciation on the appreciated basis against income, and to make no further surplus adjustment.

The first two methods mentioned above decrease the appraisal credit as it realizes and transfer it to the earned surplus account or to the allowance for depreciation account. In these two instances, therefore, the appraisal credit is regarded as a kind of earned surplus. In the third method, on the other hand, the appraisal credit is dealt with as a kind of capital surplus and remains unchanged until disposed of by special action, sometimes even after the appraised units are retired. Most accountants favored the first two methods, especially the first.[25] The third method, while sometimes advocated, was by no means a prevailing practice.[26] In the first method, the appreciation increase in asset values had no effect on depreciation charges, income, and earned surplus. Even when the second method was used, it never affected the balance of earned surplus.

What was, then, the practical benefit of asset revaluation? The actual cases of upward adjustment may be generally categorized as one of the following two major types (see Table 1 in Appendix for a list of actual cases):

1. Asset accounts are written up and the appraisal credit thus created is transferred to the capital account through the stock dividends.
2. Asset accounts are written up and the appraisal credit thus created is used to relieve the earned surplus of its burden—e.g., to write down the intangibles and/or other doubtful items or to restore the deficit of earned surplus.

The large majority of the upward revaluation cases are of the second type described above. A reasonable generalization, therefore, is that, in the majority of cases, upward adjustments of tangible

fixed assets typically occurred to compensate for the downward adjustments of intangible assets or other doubtful accounts.[27] In these cases, it was the book value of *net assets*—rather than individual fixed assets—that was undergoing a revaluation. In other words, the book value of net assets was allowed to remain unchanged despite the intangibles or doubtful accounts that were written down, or, at the very least, it was not written down as much as the latter items were. An increase in goodwill values, therefore, was recognized to set up a surplus against which write-downs of doubtful accounts were to be charged off.

This practice was complicated since, in many cases, it was the downward adjustment of the goodwill *account* that actually called for a compensating mark-up of goodwill *values* to be reported on the corporate balance sheet. In those cases, the goodwill account on the balance sheet had to be diminished although the actual goodwill values remain unchanged.[28] Moreover, the goodwill account in a going entity was rarely adjusted upward except for the capitalization of actual expenditures according to the standard practice of accounting.[29] In order to be recognized, therefore, goodwill values had to be allocated to individual tangible assets as the increase in their appraisal value, thereby creating a surplus to absorb the amount of doubtful or burdensome accounts to be written off. In summary, what was occurring in these cases was an upward adjustment of *intangible* goodwill values based on a revaluation of net assets (equity capital). In the book entries, however, this practice was accounted for as upward adjustments of individual *tangible* assets.

This same general explanation also applies to the other major type of write-ups mentioned above, i.e., the capitalization via stock dividends of appraisal credit resulting from the upward adjustments of tangible assets. Recognized increase in goodwill values based on a revaluation of net assets (equity capital) was allocated to the individual tangible assets as the increase in their appraisal values, and the earned surplus thus created was transferred to the capital account through the stock dividends.

Underlying what happened in the upward adjustments of fixed asset values, therefore, was a contradiction between the *economic reality* and the *accounting formality* of asset revaluation—i.e., a contradiction between the substantial nature of asset revaluation as a revaluation of equity capital and the way in which it was reported in the corporate accounts. It is likely that this contradiction resulted in a critical difficulty concerning the distinction between capital and

income (capital surplus and earned surplus). Because it was an adjustment of goodwill values associated with the revaluation of equity capital that was actually underlying the upward adjustments of individual assets, the resulting appraisal credit should have been regarded as capital surplus, not earned surplus. As capital surplus, the resulting appraisal credit could not have been used to write down the goodwill account or any other asset accounts until the remaining balance of earned surplus was exhausted.

As a matter of accounting formality, however, the adjustment of goodwill values did appear in the corporate accounts as the appraisal increases in individual tangible assets—i.e., as unrealized profits. The resulting surplus, therefore, was allowed to be dealt with as income (earned surplus) and could be immediately appropriated to any type of write-downs without having already appropriated the remaining balance of earned surplus. This particular way in which the revaluation of equity capital appeared in the corporate accounts was evidently favored by the majority of corporations from the standpoint of their financial policies.[30] As discussed in the next section, it was in the case of write-downs where the contradiction between the economic reality and the accounting formality of asset revaluation became actualized in the corporate reports so that it could no longer be overlooked.

Asset Revaluations: Write-Downs of Fixed Assets

As can be seen from the cases, the downward revaluation of intangible assets (e.g., goodwill, patents, royalty contract) was the most common type of write-down (see Table 2 in Appendix). The effect of such downward revaluations on the net value of equity capital may or may not have been canceled or eased by the compensating upward adjustments of tangible fixed assets. Cases in which write-downs were accompanied by compensating write-ups can be determined by comparing the above instances of write-downs (Table 2) with the list of appraisals that were designed to relieve the earned surplus of its burden (Table 1). Regardless of whether there were compensating upward revaluations, the reduction of intangible assets formed a part of goodwill adjustment based on the revaluation of net assets (equity capital).

Tangible fixed assets were also written down frequently. Some of these write-downs were reported along with a simultaneous reduction of intangible assets to nominal values (see Table 3 in Appendix). These reductions of intangible assets may have been triggered by the downward adjustments of intangible items. Write-downs of

intangible items had to be supplemented by a reduction of tangible assets in order to achieve a reduction in the net value of equity capital items. In essence, the downward adjustment of tangible assets formed a part of the adjustment of intangible goodwill values based on the revaluation of owners' equity. Once the intangible goodwill accounts had been reduced to nominal values, leaving practically no more remaining balance to be written down, declining goodwill values had to be allocated to tangible assets as a decrease in their individual value.

In many cases, on the other hand, tangible fixed assets were written down with no attendant adjustment of intangible assets in the same period. Such write-downs typically occurred when the corporation had little balance of goodwill account to be exhausted (see Table 4 in Appendix). Gold Dust, for example, wrote down the book values of its plant a year after it reduced its intangible assets to $1.00 in 1927. Hammermill Paper adjusted its plant property values in 1932, when it no longer carried intangible values on its balance sheets (they were eliminated in 1928).

There are also many cases where tangible fixed assets were written down with no previous history of a reduction of intangible assets as well as no current balance of intangible accounts available for a reduction of net assets. Among the latter, the U. S. Steel Corporation is a typical case.[31] Write-downs made in 1928 and 1929 by U. S. Steel are summarized in its 1929 annual report as follows:

Earnings heretofore reserved and applied in retirement of U. S. Steel Corporation Bonds through Sinking Funds specifically written off to Property Investment Account		$182,092,834.00
Earnings and Surplus appropriated to cover capital expenditures for additions, betterment and improvements, and which appropriations have been formally applied in reduction of the Property Investment Account, thus substituting tangible property values in lieu of this amount of above excess cost		$207,708,569.68
Surplus specifically applied:		
Appropriated to close of 1928:	$30,205,076.23	
And in year 1929:	88,296,020.09	$118,501,096.32
Total of Income and Surplus applied as above to December 31, 1929		$508,302,500.00

The first two items are the totals of two series of charges made against income and earned surplus for the period from 1901 to 1928. The third item is the direct charges made against earned surplus in 1928 and 1929. According to the corporation's annual report, the total amount of these write-offs was equal to "the par value of the common stock originally issued," which basically corresponded to the goodwill values recognized by the organization of the corporation.[32]

Some exceptional cases where tangible fixed assets were written down with the balance of goodwill account left unaltered are: Addressograph-Multigraph (1932), American Cyanamid (1930), Borden (1931), General Electric (1893), Hart Schaffner & Marx (1933), May Department Stores (1932), and Ward Baking (1932). In the May Department Stores case, the adjustment made was to reduce the unamortized portion of the established value of leases (in essence, an intangible item), and the unadjusted goodwill account that was carried forward was eliminated in the next year. General Electric adjusted its tangible assets in the same year that the entire amount of goodwill values on its balance sheet was acquired. In the Hart Schaffner & Marx case of 1933, the write-down of tangible assets corresponded to specific capital assets written off by subsidiary companies liquidated during the year. The Borden case of 1931 was simply a cancellation of previous appraisals. In the American Cyanamid case, it adjusted its capital assets when it acquired a large amount of goodwill in the same year. True exceptions, therefore, may be relatively small in number. In summary, the write-downs of tangible fixed assets with a balance of the goodwill account left unadjusted to be available for further reduction can be regarded as minor and exceptional cases in terms of both frequency and reported monetary values.

A reasonable generalization, based on these case studies, is that the majority of write-downs of tangible asset values were, in effect, adjustment of intangible goodwill values. A decrease in goodwill values was recognized as an elimination of intangible accounts (e.g., goodwill account) or, where there was no balance of intangible accounts, this decrease was allocated to the individual tangible assets as a decrease in their current values. In some cases, the recognition of decreasing goodwill values may have been motivated by the need to eliminate the deficit of earned surplus. Underlying the write-downs of fixed asset values, therefore, is a revaluation of intangible goodwill values based on the revaluation of equity capital

(net assets), as was the case with the write-ups of tangible assets discussed previously.[33]

Revaluation as a goodwill adjustment must have contradicted the accounting book entries, as it was often entered as a set of downward adjustments of individual tangible assets. The downward revaluation of equity capital may call for a reduction of capital or capital surplus; its accounting form of "asset" revaluation, however, enables the resulting adjustment of net assets to be charged against income or earned surplus as unrealized losses.

This contradiction between the economic reality and the accounting formality of asset revaluation and the resulting difficulty in distinguishing between capital and income apply to both upward and downward revaluations. In case of write-downs, however, this contradiction could not be ignored in the corporate accounts. Two contradicting rules for charging the reduction of asset values against owners' equity were coexisting. The reduction of asset values was charged against either earned surplus or capital surplus, and both rules were widely accepted (see Table 5 in Appendix).[34]

The coexistence of these mutually exclusive rules or norms was an eminent feature of the write-downs in contrast to the write-ups, where the resulting appraisal credit was generally dealt with as a type of earned surplus. In the case of write-downs, a charge against earned surplus was justified on the ground that it was a kind of extraordinary loss resulting from the deterioration of tangible assets which had been held during the period. Accordingly, earned surplus had to be exhausted before a charge could be made against capital surplus. On the other hand, a charge against capital surplus with the remaining balance of earned surplus left unimpaired was justified on the ground that it was simply a restatement of equity capital coming from the outside capital market, which should never be confused with the result of business operations (i.e., earned surplus).

Which approach was preferred was dependent upon whether a particular firm happened to have a significant balance of earned surplus at the point in time when the revaluation was undertaken. Write-downs were charged against earned surplus when its balance was sufficient; otherwise write-downs were charged against capital surplus before any charge was made against earned surplus. This conclusion is supported because there were relatively few cases where a charge against capital surplus was preceded by the exhaustion of earned surplus when writing down fixed asset values.[35] In most cases where capital surplus was used to reduce the asset

values, the remaining balance of earned surplus was kept unimpaired and preserved for current or future dividend payments.

Quasi-Reorganization and Historical Cost Basis

The coexistence of the above-mentioned contradicting rules by which the reduction of asset values was charged against owners' equity (net assets) must have resulted in much confusion. As a consequence, one of these two rules had to be established as a generally accepted standard practice.

A charge against capital surplus, leaving the balance of earned surplus unimpaired, failed to achieve general acceptance because the underlying concept justifying this rule (i.e., capital adjustment in a going entity) was difficult to implement. Downward adjustment of capital accounts is only permissible where a going entity is being discontinued or reorganized—a situation that requires the entire balance of earned surplus to be exhausted prior to any reduction of capital surplus. Quasi-reorganization is an accounting device that can achieve the same effect while avoiding the formalities of actual reorganization. Accounting rules developed in the 1930s and 1940s by the professional accountants (AIA) and the pertinent regulatory body (SEC) confined the revaluation of equity capital to the case of quasi-reorganization, thereby diminishing the discretion of individual corporations to charge the reduction of asset values against capital surplus before exhausting the balance of earned surplus.[36]

Enforcement of this newly developed rule in effect eliminated the possibility to satisfy the common motive for asset revaluations—i.e., to reduce burdensome assets without impairing the source of dividend payments. Consequently, write-downs of asset values became less frequent, and the so-called historical cost basis, which had been theoretically advocated and actually observed with a large number of exceptions, became established as a practical working rule in corporate financial reporting. As a natural result, write-ups of fixed asset values also became less frequent. The asset revaluation movement was coming to an end, and the cost basis for asset "valuation" was firmly established, both in terms of theory and practice.

Summary and Conclusions

In this paper, a study has been made of the establishment of the cost basis through the asset revaluation movement in terms of the dynamic interrelationship among environmental conditions, account-

ing practices, and accounting rules or norms. The historical cost standard is not a product of the regulated era after the 1930s. For many years before then, it had been advocated by the authoritative and professional bodies and had been regularly observed by the majority of large U. S. corporations. As significant exceptions in terms of frequency and monetary amount, however, were the cases of adjusting asset values, which can be referred to as the asset revaluation movement of the 1920s and the 1930s. The cost basis did not become a firmly established practical working rule until this movement came to an end in the late 1930s.

These revaluations were not only made to adjust the book values of individual assets for their current prices, they were also made to adjust the book value of owners' equity (net assets) for its real value assessed by the capital market. In so far as it was primarily the equity value adjustment, the revaluation increase or decrease in the net assets should have been allocated to the intangible goodwill account, instead of to the individual tangible asset accounts. What triggered this revaluation, however, was the corporations' need to diminish the doubtful items or accumulated losses on their balance sheets without impairing the source of dividend payments (i.e., earned surplus). As intangible accounts were generally regarded as doubtful, in case of write-ups, the appraisal increase had to be allocated to tangible assets, instead of to the goodwill account. In case of write-downs, on the other hand, the total value to be written down often exceeded the balance of goodwill or other intangible accounts available for a reduction of net assets. That excess was allocated to tangible fixed assets as the downward adjustments of their book values.

Evidently, the revaluation of individual assets was a departure from the cost principle. Nonetheless, while revaluation of owners' equity could result in the adjustment of individual assets, it was not this practice for which the cost basis was expected to provide a standard. This may offer a partial explanation of why capital revaluation resulting in the revaluation of individual assets was able to be undertaken so widely as to be considered a "movement." The concept of quasi-reorganization was developed primarily to cope with this situation and to ensure that capital revaluation was undertaken for the right reasons.

Quasi-reorganization, however, no longer satisfied the practical need that originally triggered the revaluations of equity and assets—i.e., to diminish doubtful items without impairing the source of dividend payments. As a consequence, the revaluation practice be-

came less useful from the standpoint of corporate financial management and was subsequently replaced by the cost principle. It was neither the increasing intensity of rule enforcement nor the stability or instability of asset prices that was underlying the asset revaluation movement and the subsequent establishment of the cost principle; rather, it was the revaluation of equity capital triggered by corporate financial policies.

Appendix: Tables

Table 1

Upward Revaluation of Fixed Assets

(1) Asset accounts are written up and the appraisal credit thus created is transferred to the capital account through the stock dividends:
Brunswick-Balke-Collender (1920)
Continental Can (1928*)
Hammermill Paper (1928*)
Pittsburgh Steel (1924)
Standard Oil of New York (1922)

(2) Asset accounts are written up and the appraisal credit thus created is used to relieve the earned surplus of its burden—e.g., to write down the intangibles and/or other doubtful items or to restore the deficit of earned surplus:
Borden (1925)
Brunswick-Balke-Collender (1929, 1930)
Continental Can (1923, 1928*)
Goodyear Tire & Rubber (1920)
Hammermill Paper (1928*)
International Shoe (1925)
Mathieson Alkali Works (1922, 1923)
Simmons (1923)

* is a combination of both types.

Upward adjustment of intangibles reported by Flintkote (1921) was associated with an appropriation of surplus for the purpose of the redemption of preferred stock. Goodyear Tire & Rubber (1934) is an important exception where the appraisal credit was dealt with as an increase in capital surplus. There were, of course, some cases that seemed to have no particular intention of surplus adjustment, such as the appreciation undertaken by American Rolling Mill (1922), Cerro de Pasco Copper (1926), E. I. du Pont (1923), and Standard Oil of New York (1916). E. I. du Pont, for example, added 5,805 thousand dollars of appraisal credit to the Depreciation Reserve.

Table 2

Downward Revaluation of Fixed Assets: Write-down of Intangible Assets Only

American Can (1937)
American Cyanamid (1923, 1929)
American Chain (1932)
Babcock & Wilcox (1922, 1923)
Borden (1925, 1926)
Chrysler (1932)
General Electric (1898, 1899, 1905, 1906)
Goodyear Tire & Rubber (1909, 1928)
Hammermill Paper (1928)
Hart Schaffner & Marx (1920, 1935)
International Shoe (1925)
L. C. Smith & Corona Typewriters (1936, 1937)
Ligget & Myers Tobacco (1929)
National Cash Register (1928, 1929)
Mathieson Alkali Works (1922, 1923)
Pet Milk (1938)
Proctor & Gamble (1929)
Radio Corporation of America (1925, 1927)
R. J. Reynolds Tobacco (1927)
Sears, Roebuck (1926-1929, 1934)
S. S. Kresge (1924)
Spicer Manufacturing (1928)
Union Carbide & Carbon (1925)
Universal Leaf Tobacco (1926)
Westinghouse Electric & Manufacturing (1927)
F. W. Woolworth (1922-1925)

Table 3

Downward Revaluation of Fixed Assets: Write-down of Tangible Fixed Assets Along with a Reduction of Intangible Assets to Nominal Values

American Cyanamid (1931)
Babcock & Wilcox (1934)
Beatrice Creamy (1933)
Flintkote (1932)
Gold Dust (1927)
Jewel Tea (1928)
National Tea (1932)
Pet Milk (1936)
Raynols Spring (1930)
Radio Corporation of America (1927)
St. Regis Paper (1936)
Simmons (1932)
Spicer Manufacturing (1932)
Standard Oil of New York (1934)
Standard Oil of Ohio (1931)
U. S. Rubber (1938)

Table 4

Downward Revaluation of Fixed Assets: Write-down of Tangible Assets Only—in Case of Little Balance of Intangible Asset Accounts

Brunswick-Balke-Collender (1922, 1931, 1932)
Certain-teed Products (1930)
Continental Can (1932)
Gold Dust (1928)
Hammermill Paper (1932)
J. C. Penney (1932)
Marland Oil (1930-1932)
National Tea (1935)
Oscar Mayer (1932)
Philips Dodge (1921, 1934)
Phillips Petroleum (1932)
Pittsburgh Steel (1937)
Pullman (1932)
Republic Iron & Steel (1928)
Spicer Manufacturing (1939)
Standard Oil of Ohio (1927)
Union Carbide & Carbon (1929, 1931)
United Fruit (1932)
U. S. Gypsum (1932)
U. S. Steel (1928, 1929)

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Table 5

Charging the Reduction of Asset Values against Surplus

(1) Charged against earned surplus:
American Can (1937)
General Electric (1898, 1899, 1905, 1906)
Ligget & Myers Tobacco (1929)
Mathieson Alkali (1922, 1923)
May Department Stores (1932)
National Tea (1932*, 1935)
National Cash Register (1928, 1929)
Oscar Mayer (1932)
J. C. Penney (1932)
Pet Milk (1936, 1938)
Philips Dodge (1921, 1934)
Phillips Petroleum (1932)
Proctor & Gamble (1929)
Pullman (1932)
Radio Corporation of America (1925-1928)
Republic Iron & Steel (1928)
R. J. Reynolds Tobacco (1927)
Sears, Roebuck (1926-1929, 1934)
Standard Oil of Ohio (1927)
Union Carbide & Carbon (1925, 1929, 1931)
United Fruit (1932)
U. S. Gypsum (1932)
U. S. Rubber (1938**)
U. S. Steel (1928, 1929)
Ward Baking (1932)
Westinghouse Electric Manufacturing (1927)
F. W. Woolworth (1922-1925)

(2) Charged against capital surplus:
Addressograph-Multigraph (1932, 1933, 1934***)
American Cyanamid (1929, 1930, 1931)
American Chain (1932)
Babcock & Wilcox (1934)
Beatrice Creamy (1933)
Borden (1935)
Brunswick-Balke-Collender (1931, 1932)
Chrysler (1932)
Continental Can (1932)
Goodyear Tire & Rubber (1932, 1934)
Hart Schaffner & Marx (1935)
Jewel Tea (1925)
L. C. Smith & Corona Typewriters (1936, 1937)
Marland Oil (1930, 1931, 1932)
May Department Stores (1933)
National Tea (1932*)
Ohio Oil (1935)

Table 5 (Continued)

Charging the Reduction of Asset Values against Surplus

Pittsburgh Steel (1937)
Raynols Spring (1930)
Spicer Manufacturing (1932)
Standard Oil of New York (1934)
Standard Oil of Ohio (1931)
Universal Leaf Tobacco (1926)
U. S. Rubber (1938**)

* National Tea (1932) charged the reduction of assets against both capital surplus and earned surplus.

** U. S. Rubber (1938) charged the reduction of tangible fixed assets against earned surplus and the reduction of intangible assets against capital surplus.

*** Addressograph-Multigraph (1934) charged the reduction against the capital surplus, which was transferred from the earned surplus.

FOOTNOTES

[1]See Watts and Zimmerman for analysis of this aspect.

[2]See Vangermeersh for historical study of accounting practices. See also Zeff (1972), and Previts and Merino to get a general view of the history of accounting in the U.S.

[3]See Zeff (1976), and Marple to get a broader picture of asset revaluation.

[4]Schindler, Chap. II.

[5]May, pp. 28, 90ff. Dickinson, p. 80ff.

[6]Some may argue that a valid comparison cannot be made between accounting rules (i.e., norms) existing during nonregulated years and those occurring after the Securities and Exchange Commission was formed. What is important for the immediate discussion, however, is that, even in the nonregulated era, norms did exist, which exercised control over corporate accounting practices, even though such control was not legally enforced. What constitutes a norm might be an agreement among a large number of accountants, a prevailing custom expected to be honored by a fairly large number of corporations, or a kind of regulations backed up by a particular law. The function of the norm in this sense can be analyzed at least with respect to their relation to actual practices.

[7]May, pp. 28, 90ff. American Institute of Accountants (1952), p. 23ff.

[8]May, pp. 9, 24-25. Littleton (1953), p. 107ff. Littleton and Zimmerman (1962), p. 111ff. See, however, Previts and Merino, Chap. 5 for an opposing view which seems more realistic.

[9]May, Chap. IV. Littleton (1953), pp. 90-91.

[10]See Hawkins to avoid misunderstanding that may result from these oversimplified statements.

[11]May, p. 41ff. Blough.

[12]Carey, p. 132ff. Moonitz, pp. 145-146.

[13]May, pp. 43-44.

[14]May, pp. 43-44.

[15]A survey of the annual reports of *Fortune 500* corporations supports the conclusion that the cost-based valuation of fixed assets was normally practiced by the majority of large U. S. corporations in those days. Exceptional cases are classified in Appendix of this paper although a summary of data is omitted for want of space.

[16]Schindler, p. 11.

[17]Fabricant, p. 5.

[18]Fabricant, p. 6.

[19]Fabricant, p. 6. The amount itself by which the asset values are adjusted should not be taken seriously. There were cases where even tangible assets were written off to the nominal value of $1.00 while they were still useful. For example, Gold Dust (1928); May Department Stores (1932).

[20]Fabricant, p. 7.

[21]Fabricant, p. 7.

[22]Fabricant, p. 9.

[23]Selected are all the U. S. industrial concerns whose financial statements are available in the microfilm edition of the annual reports of *Fortune 500* corporations for the period from the early 1920s to the mid-1930s (from Baker Library, Graduate School of Business Administration, Harvard University). Railroads, public utilities, and financial institutions are excluded from the present survey. Companies coming into existence after the mid-1920s—i.e., those in existence only part of the

period of the asset revaluation movement—are also excluded for the sake of convenience.

[24]Schindler, p. 27. Hull. See also "A Symposium on Appreciation" and "Writing Down Fixed Assets and Stated Capital" for further discussions.

[25]Schindler, p. 27. Pinkerton, p. 46. Moss, p. 174ff.

[26]Kohler, p. 214ff.

[27]See the cases of Monongahela West Penn Public Services Co. (1929-1935) and Northern States Power Co. (1924-1925) cited in Healy as well as Titus, *et. al.* v. Piggly Wiggly Corp., 2 Tenn. App. 184 (1925) cited in "Case Studies in Business: The Accounting Disposition of an Increase in Assets Caused by Revaluation," *Harvard Business Review*, Vol. 7, No. 4, 1929. See also Dewing, Book IV, Chap. 7; Jones, Chap. IX.

[28]As to the preference for writing off the goodwill account, see Hatfield, p. 172; Montogomery (1933), p. 740; Kester, pp. 362-363; Conyngton, Bennett and Pinkerton, pp. 876-877; Ripley, pp. 192-194. See also See v. Heppenheimer *et. al.*, 69 N.J. Eq. 36; 61 Atl. 843, 850.

[29]Hatfield, Chap. IV. Couchman, p. 137.

[30]The result of the questionnaire of May 9, 1928, issued by the Committee on the Definition of Earned Surplus of the AIA may be indicative of the general attitude of accountants toward this problem. In response to Question No. 20, "Would it be sound accounting procedure for a corporation to write off goodwill or other intangible assets by charging them off against a surplus arising from the appraisal of the company's fixed properties?,"
(a) Practically all the larger firms of accountants answered in the affirmative
(b) A bare majority (52%) of the AIA members answered in the negative
(c) A large majority (76%) of the American Association of University Instructors in Accounting (subsequently reorganized into American Accounting Association) members answered in the negative.

See Kohler, p. 214ff.

[31]Trumbull, p. 599ff. Jones, Chap. IX. U. S. Steel's accounting practice may have been related to the attempted reorganization of the company, which went on for almost 10 years after the mid-1920s (see Chandler, p. 361).

[32]As to the relation between the goodwill value and the value of common stock issued at the organization of the corporation, see Montogomery (1925), p. 549.

[33]See also the case of American Locomotive Co. (1931) cited in Hosmer, and the case of Associate Gas & Electric Co. submitted to the SEC decision (11 SEC 975, 1942).

[34]See also Carter, p. 10; National Association of Cost Accountants, p. 1039; Montogomery (1934), p. 415.

[35]Among these limited number of cases are: Brunswick-Balke-Collender (1931, 1932); Continental Oil (1930, 1931, 1932); Simmons (1932); St. Regis Paper (1936). In the Simmons case of 1932 and the St. Regis case of 1936, the earned surplus account had a deficit before the asset values were reduced.

[36]American Institute of Accountants (1939). Securities and Exchange Commission. Schindler.

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