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Attack On The Dollar Concept

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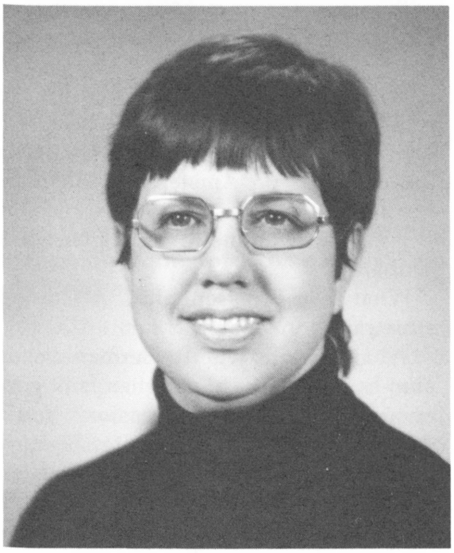
The author explains the shortcomings of the traditional dollar comcept and suggests a new, expanded concept in its place.



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Lists of accounting concepts (or principles) usually include a reference to the dollar concept, the idea that accounting records are kept in the form of dollars. Sometimes the concept is referred to as the money concept, sometimes as the unit of measurement assumption and sometimes the stable dollar convention. Various other terms are also used.

The dollar concept, while continuing to be listed with basic concepts such as continuity, realization, and matching, is under attack from many sources. It is evident that accounting concepts or principles are not the same type of immutable principles found in the physical sciences, nor are they comparable to the axioms or postulates of mathematics. In a social science, such as accounting, principles may change from time to time, particularly when tested by the realities of the business world. The dollar concept may, of necessity, fall by the wayside as the times warrant. It is overwhelming to think that a complex modern business can be reduced to a model stated in dollar terms and contained in three or four pages of financial statements. As accountants face increasingly complicated business systems, the dollar concept must be expanded to include other forms of measurement.

The attack on the dollar concept is currently appearing in three forms: (1) the price level problem, (2) the need to measure human values which are not easily quantified, and (3) the disclosure crisis. The purpose of this article is to examine each of these areas and to propose a broader, expanded version of the dollar concept to encompass the changes needed in today's world.

The Price Level Problem.

This particular attack on the dollar concept is well known, and its inclusion in a discussion of this nature will be no surprise. Most textbook authors who include a reference to the dollar concept also point out that the purchasing power of the dollar is constantly changing. For example, Niswonger and Fess say:

> The dollar is far inferior, as a unit of measurement, to such quantitative standards as the pound, gallon, or yard, which have remained unchanged for centuries. The instability of the purchasing power of the dollar is well known. The disruptive effects of inflation on accounting reports during the past few decades are acknowledged by accountants, but to date recognition has not been given in the accounts and in the conventional financial statements to the declining value of the unit of measurement.[1]

The price level problem is really a dual problem because there are not only changes in the general price level but also changes in specific asset price levels which may move with, or even counter to, the changes in the general price level. Thus, there are changes in the measuring stick (the dollar) reflected in the change in the general price level and also changes in replacement values of particular assets measured by the changes in specific price levels.

Accounting Research Study No. 6 discussed in detail the price level problem as have many other studies. To date, however, price-level adjusted data are merely recommended supplementary material rather than material incorporated into audited financial statements. Adjustments to statements for changes in the general price level appear to have more chance of gaining acceptance by the profession than adjustments for changes in specific price levels. Although the computations may be laborious, the use of a widely-accepted price index provides an objective measure of the change and no radical departure from historical cost. Adjustments for changes in specific price levels involve use of less reliable specific price indexes or appraisals. In this case the departure from historical cost may be significant.

A problem somewhat similar to the price level dilemma is encountered by companies with foreign branches or subsidiaries. The financial records of the foreign segment are usually expressed in terms of the monetary unit of the country in which the branch or subsidiary is located. To prepare financial statements for the company as a whole, it is necessary to translate the account balances to dollars. Depending on the nature of the account, the exchange rate used for the translation may be an historical exchange rate, a current exchange rate, or an average exchange rate for the period. Exchange adjustment gains and losses may result from the translation process. Devaluations during the period of either the domestic or foreign currency present special problems. The dollars of the resulting combined financial statements by no means represent common size or stable monetary units.

The price level problem, as well as the difficulties arising from international operations, have been dealt with at length by other authors, and only a brief discussion is included here. The other two attacks on the dollar concept are perhaps not quite as familiar and will be discussed in greater detail.

Need to Measure Human Values

Accounting has long been thought of as pertaining only to business or at least only to financial data. Today it is becoming recognized that the skills of accountants in dealing with quantifiable variables can be applied to social areas as well as financial areas. Recent issues of accounting periodicals have contained many articles on "social accounting" or "socioeconomic accounting," i.e., the application of accounting techniques to the social sciences. It is easy to see from the current literature that accounting has expanded out of the dollar measurement realm into a broader realm of social measurement. The measurement tools vary from project to project, but it is clear that the tools used do involve more than monetary measures.

One example of accounting's involvement in social measurement was a project undertaken some time ago by Touche Ross & Co. The accounting firm's assignment was to develop an information and management system for the city's various War on Poverty programs. The basic objectives of the assignment were to develop a system for keeping track of individual clients and services rendered and, as a long-range goal, the development of a total management system.

The accounting firm tackled the problem of quantifying characteristics relating to the program by placing the characteristics on a numerical scale. For example, health was placed on a seven-point scale from "excellent" to "failing health to continuous hospitalization." The clients' need was measured by the difference between their current ratings and an acceptable level.[2]

In addition to numerical scales, another tool that has been used to measure human or social values is the cost-benefit ratio. Cost-benefit analysis involves choosing from among alternatives on the basis of costs and their effectiveness in the attainment of specified objectives. Costs are stated in dollar terms, but benefits may be measured in a number of different units. The crucial measure is the ratio of cost to benefits. Variations of the cost-benefit idea include cost-effectiveness analysis, cost-utility analysis, and input-output analysis. Systems analysis and planning, programming, and budgeting systems (PPBS) also use this basic idea.

Utilizing the cost-benefit concept, David Linowes gives an example of a program designed to keep high school students from "dropping out." The cost is dollars used in maintaining a school and faculty, and the benefit is the number of students who stay in school until graduation.[3]

Cost-benefit analysis was also used by Price Waterhouse when it assisted the Philadelphia school district in setting up a program budget. Rather than the old-line approach of making the budget a departmental responsibility, the budget is expressed in terms of inputs and outputs. In an elementary school, inputs are numbers of teaching aids or dollars of cost. Outputs are boosted reading or arithmetic skills.[4]

Two tools used to measure human or social values are numerical scales and ratios of costs and benefits. Accountants are increasingly being employed to measure such values. In measuring such values, they are departing from the dollar concept.

The Disclosure Crisis

Another attack on the dollar concept is caused by the need to disclose information to the readers of financial statements which cannot be expressed in dollar terms. Financial statements of larger companies today usually contain two or three pages of footnotes in fine print. Some information contained in footnotes is more important than that which appears in the body of the reports. As time goes on, even more information may have to be attached to the financial statements to make them meaningful.

It is almost impossible to compile an exhaustive list of items which cannot be disclosed by the dollar amounts in financial statements and must be disclosed parenthetically or by footnote. The following items are examples of commonly disclosed items:

1. Essential provisions of employee pension or retirement plans.
2. Stock option plan information.
3. Description of leases and accounting methods used for leasing activities.
4. Past balance sheet events which have a material effect on the financial statements.
5. Contingent events which may have a material effect on the financial statements.
6. Effect of changes in accounting principles, reporting entries, estimates that affect future periods, or correction of material errors.

In addition to items such as those appearing on the above list, it is necessary to disclose departures from Opinions of the Accounting Principles Board even though substantial authoritative support exists for the method used.

The disclosure principle has been stated as "Accounting reports should disclose that which is necessary to make them not misleading."[5] It is easy to see that this is a catch-all provision and many items that occur in special situations may be disclosed at the discretion of the accountant. In fact, many accountants have applied the rule "when in doubt, disclose" which multiplies the amount of fine print in an annual report.

There seems to be every reason to believe that accountants will disclose more nonmonetary material concerning the financial statements, rather than less, as time goes on. In the Continental Vending decision in 1969, Judge Friendly wrote in his opinion that accountants must do more than merely comply with generally accepted accounting principles; they must make whatever disclosures are necessary for fair presentation of the data.[6] Other lawsuits have also questioned the accounting methods and disclosure practices of accounting firms. Almost every Big Eight firm has had to defend itself in at least one suit of this kind. Thus, accountants seem to be faced with more thorough disclosures even though they themselves may not desire such a move.

The disclosure problem is recognized by the business community. Some time ago *Business Week* published an article entitled "Accounting: A Crisis Over Fuller Disclosure." In this article, the writer commented:

> The problem is complicated by the enormous complexity of modern business. Companies can operate in a dozen different countries and two dozen different industries. To reduce such complex operations to a simple balance sheet and consolidated income statement — even with supporting tables and pages of detailed footnotes — call for sweeping simplification . . . the fair disclosure doctrine has thrown the accounting profession into a state of confusion, confrontation, and crisis. Accounting is not a precise body of rules covering every case that comes up . . . Inevitably it contains a large component of personal judgment.[7]

The need to disclose nonmonetary information presents an attack on the dollar concept. Not all essential data, even in financial reports, can be expressed in dollar terms. Disclosures attached to current statements in footnote or parenthetical form are usually lengthy. The need to disclose even more data demanded by the courts and the business community will cause such additional information to continue to be lengthy and probably to increase in the future.

Towards a Better Concept

The dollar concept is outdated in terms of what accountants are doing today. The attack has come in three different forms: the effects of the unstable purchasing power of the dollar, the need to measure human values, and the need to disclose information that is not stated in dollar terms. A broader statement on measurement in accounting is needed.

Although the dollar concept is clearly too narrow a concept for what accounting attempts to do, accounting still remains a quantitative skill. Perhaps a better statement of the measurement idea would be: "Quantification: Accounting quantifies financial and other information." Such a statement makes clear the idea that accounting does quantify data but does not limit the unit of measurement to dollars, ratios, units of production, number of shares of stock, or whatever. The statement emphasizes that financial information is the primary type of data with which accounts deal (although this may change at some future date) but does not exclude other types of information, such as social values.

It may be argued that such a statement is too broad and could apply to many of the quantitative sciences such as mathematics or statistics. It is not necessary that an accounting concept or principle be a limiting assumption. A concept or principle does not try to define accounting or state its limits, it merely lists one of the things that accounting tries to do. Disclosure or continuity are concepts that could easily be applied to areas other than accounting.

It could also be argued that such a quantification statement is too narrow, that — particularly in the disclosure area — accounting is not even attempting to quantify some variables. This argument appears to have some validity. Perhaps one way to correct such an omission is to tackle the problem from the standpoint of restating the disclosure concept, although such a restatement is outside the realm of this article. Another way to approach the problem is to explain the basic concept, "Quantification: Accounting quantifies financial and other information," by adding something like "however, descriptive material may appear in nonquantitative terms." It would seem that the basic statement is sufficient as it stands but some additional clarification could be made, if desired. It has always been recognized that accounting contains descriptive information concerning dollar amounts. Dollar amounts are meaningful only when explained by account titles, balance sheet and income statement classification, etc. Any type of quantitative data can be expected to have some descriptive titles and information.

Summary

An accepted concept in accounting is the dollar concept, the idea that the unit of measurement in accounting is the dollar. In today's world the dollar concept has become outmoded. Fluctuating price levels cause the dollar to be an unstable measuring stick. Moreover, accounting is becoming increasingly involved in measuring human values which cannot be expressed in dollar terms. Even financial information is difficult to present in strictly dollar amounts because the courts and the accounting profession demand more and more thorough disclosure of pertinent data.

What is needed is a restatement of the dollar concept. A suggested restatement is: "Quantification: Accounting quantifies financial and other information." Broadening the dollar idea to a general quantification concept allows the concept to encompass the changes in the scope of accounting that have occurred.

Footnotes

[1]C. Rollin Niswonger and Philip E. Fess, *Accounting Principles*, 10th ed. (South-Western Publishing Co., 1969) p. 349.

[2]Robert Beyer, "The Modern Management Approach to a Program of Social Improvement," *Journal of Accountancy*, CXXVII, No. 3, (March 1969), pp. 37-45.

[3]David F. Linowes, "Socio-Economic Accounting," *Journal of Accountancy*, CXXVI, No. 5, (November, 1968), p. 40.

[4]Donald Rappaport, "New Approaches in Public Education," *Journal of Accountancy*, CXXVI, No. 1 (July 1968), p. 36.

[5]Maurice Moonitz, "The Basic Postulates of Accounting," *Accounting Research Study No. 1*, AICPA (New York 1961), p. 50.

[6]*U.S. v. Carl J. Simon, et al.*, 425 F 2d 796 (1969).

[7]"Accounting: A Crisis Over Fuller Disclosure," *Business Week*, No. 2225, (April 22, 1972), p. 55.