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Reviews

Writings in Accounting

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"AND NOW: THE 'GUTSY' ANNUAL REPORT," Arlene Hershman, DUN'S REVIEW, Vol. 105, No. 3, March 1975.

This article by Arlene Hershman deals predominantly with recent reporting requirements enacted by the Securities & Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB), and the effects of these requirements on both annual reports and investor confidence. Under guidelines issued by the SEC in December of 1974, financial reports of publicly held companies are required to include a "management analysis" of company operations. Companies are also required to include additional information pertaining to such things as stock prices, operational highlights, and contract revenue disputes with the government. These new requirements, coupled with recent FASB rulings on research and development expenditures, are calculated to provide the investing public with more information than ever before. It is pointed out, however, that despite the additional availability of information, the investor must still calculate risks and forecast results of future operations. The usefulness of such information is therefore still dependent upon the capabilities of the individual investor or investing entity.

In addition to requirements set forth by the SEC and the FASB, the author draws attention to the problems of reporting on investment portfolios which have been depressed far below cost, and the current liquidity difficulties which are being experienced by many firms. The author points out that Arthur Andersen announced in January of this year that it would give only "qualified" opinions to companies that reported their investments above market value. Additionally, auditors are apparently less willing to give clean opinions to companies that are experiencing extreme liquidity crises which could eventually threaten their very existence. Both situations are viewed as additional indications of the independent public accountants' reluctance to further strain their already weakened credibility.

In closing, the author questions two aspects of the new trends in financial disclosure. She notes that despite the new requirements there is no way to insure that management's disclosures will be straightforward and candid. Additionally, there is some question as to whether or not investors will make use of the newly required information. One must concede the validity of both points. It is important for one to remember, however, that while these changes are not perfect or all encompassing, they are steps in the right direction and, regardless of whether investors use all, part, or none of the new information, it is important that they at least have such information available.

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"ADJUST YOUR ACCOUNTING FOR INFLATION," Frank T. Weston, HARVARD BUSINESS REVIEW, Vol. 53, No. 1, January-February 1975.

"The urgent need to measure and disclose the impact of inflation or deflation on individual business entities should take priority over all other accounting changes." Such is the contention of Frank T. Weston, partner of Arthur Young and Company, visiting professor at the Harvard Business School and former Accounting Principles Board member. Weston notes that the accounting profession has been slow to respond to continuing complaints from users of financial statements that, because of the effects of inflation, historical costs do not give a true picture of present economic reality. It is his belief, however, that financial accounting and reporting methods can be modified to give both managers and investors the information they need about the impact of inflation. Looking into the immediate future, he foresees at least some limited progress in meeting this challenge.

Weston concentrates in his discussion upon the two modifications of accounting methods presently receiving the most attention as possible solutions to the problem of reporting the effects of inflation: price-level adjusted financial statements and current value statements. He predicts a continuing growth of interest in and use of both. Careful to emphasize the basic differences between the two, Weston reviews the concepts underlying each approach and the benefits to be derived from each by users of financial statements.

Although he agrees that price-level adjusted statements which restate assets on the balance sheet in current dollars are useful, Weston recommends restatement of the beginning-of-the-year balance sheet in end-of-the-year dollars with resulting adjustments of the income statement including a general price-level gain (or loss). He finds the information produced by this approach more useful to both managers and investors. The manager can look to this kind of statement for aid in making lease-buy decisions or in determining the most advantageous time for selling-price increases. The investor

can look at price-level adjusted statements and better judge how well the company is minimizing the effects of inflation. Observing that the AICPA has looked with some favor on price-level adjusted statements for several decades, Weston advocates requiring supplementary price-level adjusted data in financial statements beginning January 1, 1975.

He is more reluctant, however, to advocate current value statements which, he explains, present current values of all assets and liabilities, abandoning the cost principle entirely. Noting the growing interest in and experimentation with current value statements, he concentrates in his discussion on some of the unanswered questions which hamper implementation of this modification: how should current values be determined? how much reeducation of users will be required if current value statements are to come into widespread use? Despite this contrast in attitude toward two potential solutions to the problem of reporting the effects of inflation Weston concludes that both approaches are "steps in the right direction."

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"THE COMPANY SOCIAL AUDIT," David F. Fetyko, MANAGEMENT ACCOUNTING, April 1975.

The growing awareness in the past decade of what has come to be called "the social responsibility of business" has led to the development of a new phenomenon presently receiving considerable attention in business and industry — the company social audit. Pressure groups in the 1960's (environmentalists and consumer advocates among others) demanded that business recognize and accept this social responsibility. The response of business has evolved from early reports which often simply advertised the company's good deeds (in hopes of staving off outside interference with management policies) to the present interest in the issuance of an actual social audit report. Such a report can, the author contends, provide information useful to both the public and management. The public, including the various pressure groups, can look to the social audit report for information needed to judge a company's "social performance." Management can make use of the audit results to evaluate past performance and set future goals and objectives.

Despite the present interest in the company social audit, the idea is still in the developmental stage. Some experimentation has been done and some social audits have been conducted, but many questions remain unanswered. The term social audit is as yet only vaguely defined, and much refinement of techniques and methods will be required. Among the basic questions still to be decided is who would bear the cost of the audit. At this time the government, public interest groups, and research organizations as well as the company itself have been suggested as possible sources of funding. Who should make up the audit team? It has been suggested that accountants might be joined by lawyers, economists, sociologists, business executives, and psychologists in conducting the audit. How can social responsibility be measured? This question appears to. be the most difficult to answer.

There does seem to be some agreement, however, that one of the first audit steps should be the preparation of an inventory of socially relevant activities. This in itself will be a difficult task. Disagreement is likely among the various members of the audit team with their varying viewpoints as well as among the audit team, top management, the government, and the public interest groups. Once the inventory is complete, the team will probably find information difficult to capture. When such obstacles have been overcome, what form will the report take? Several alternatives have been suggested, each with some inherent weaknesses or stumbling blocks. The author recognizes that little precedent has yet been set on how to conduct a social audit and report its results; however, he believes that experience, experimentation, and trial and error will eventually provide the answers.

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"TOWARDS GREATER COMPARABILITY IN ACCOUNTING REPORTS," Lawrence Revsine, FINANCIAL ANALYSTS JOURNAL, Vol. 31, No. 1, January-February 1975.

Certified public accountants have had a dilemma for several years: they have persistently permitted different corporations to choose among various alternative accounting methods in presenting their financial statements. However, one of the major objectives of financial reporting is to provide financial data for meaningful inter-firm comparisons.

Dr. Revsine believes that two factors contribute most to the problem of noncomparability between financial reports of different companies. First, historical cost figures for assets differ because of the timing differences in the original purchases. Secondly, discretionary allocations of costs and revenues must be made when preparing income statements and balance sheets. These two factors create artificial differences in the financial position and operating performance of different firms.

Dr. Revsine believes that although perfect comparability between firms is not possible, attempts to improve comparability are well worth the effort. Accounting can provide information users with sufficient comparable data to form their own estimates of enterprise value. This enterprise value is composed of (1) the value of a firm's tangible assets and (2) the discounted present value of the firm's expected future extraordinary profitability. In order to arrive at meaningful assessments of these two values, the underlying data for the determination of each value must be comparable across firms.

Whenever a firm makes discretionary choices among competing acceptable accounting alternatives, APB Opinion No. 20 requires that the alternative chosen must be disclosed. However, that same Opinion does not require firms to isolate the differences in dollar amounts of profit or financial position arising from the choice of the one over other alternative accounting methods.

Dr. Revsine believes that this situation is very unfortunate since evidence indicates that the market and financial analysts will use such information, if available, in determining security prices. Users of accounting information can and will overcome the non-comparability resulting from discretionary allocations if they are provided with the necessary data to effect a reconciliation.

In a similar manner, the author believes that information users would be receptive to market values for tangible assets if this information is provided to them. He contends that market values should be provided to information users, as such values have the potential to eliminate artificial disparities caused by timing differences of asset purchases. Market values would also eliminate the need for artificial differences in the determination of profit caused by discretionary cost allocations.

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