Reviews - Writings in Accounting

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"GET READY FOR PRICE-LEVEL-ADJUSTED ACCOUNTING," Richard F. Vancil and James N. Kelly, HARVARD BUSINESS REVIEW, Vol. 53, No. 2, March-April 1975.

Last January the Financial Accounting Standards Board issued an exposure draft on a new standard that would require the effects of price-level changes to be shown in financial statements.

It is the opinion of Vancil and Kelly that price-level adjusted (PLA) accounting will probably be adopted by the FASB effective January 1, 1976, and the stated purpose of their article is "to help corporations learn to handle reporting of PLA financial data before it becomes mandatory."

The authors point out that PLA procedures are theoretically complex and will involve recalculation and restatement of all existing accounts; however, predicting the implications of PLA accounting is not impossible. Vancil and Kelly have constructed an inflation simulation model that generates pro forma statements in both conventional and PLA formats for a five-year period. The model showed that while sales grew 70% over the five years using conventional statements, the growth rate under the PLA format was only 3%. Similarly profits grew at a compound rate of 18.9% per year using conventional statements and only 3% using the PLA format, approximating the growth in sales.

Vancil and Kelly feel that PLA financial statements should be mandatory if they provide a truer measure of the effectiveness of management actions and suggest that corporate executives should attempt to evaluate the proposed standard in terms of measuring the effectiveness of their own actions over the next several months.

One very interesting observation is made concerning the switch from FIFO to LIFO. Companies that expect inflation to continue should and are switching from FIFO to LIFO causing a reduction in earnings. Many others are hesitant to change because of the problems of educating stockholders and the fact that executive bonus programs are often tied to profits. However, in the simulation model, profits were higher under the LIFO method when statements used the PLA format, growing at an annual rate of 7.7% as compared with 3% using FIFO.

The authors conclude by confessing to be undecided on the merits of PLA accounting solely on the basis of the simulation model and suggest that managers should conduct their own tests using a variety of possible actions.

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"A CHANGE IN THE CONTENT OF ANNUAL REPORTS," James J. Benjamin and Robert H. Strawser, MANAGERIAL PLANNING, March/April 1975.

The article begins by acknowledging that the accounting profession is under pressure to include forecasted information in published financial reports. The Trueblood Committee took a favorable position on the presentation of forecasted data and the Securities and Exchange Commission has become increasingly interested in the possibility of including forecasts in the published financial statements.

The authors polled two hundred and fifty controllers of the 500 largest U.S. industrial firms and two hundred members of the National Association of Accountants to determine their opinions on (1) the need for including forecasted information in financial statements, (2) the form of such presentations and (3) the need to extend the attest function to projections of financial data. A creditable 34.9% usable responses were received.

The majority of those responding agree that there is a need for presentation of forecasted data. The primary reason given is that such data will improve the user's insight into management's plans and expectations. Others felt it will stimulate management to improve its budgeting and planning activities and tend to reduce the number of items which are anticipated by management, but are surprises to outsiders. The main problems foreseen in such presentations are the user's ability to understand their implications and possible investor dissatisfaction when actual performance is worse than that forecasted.

Most of those surveyed agree that forecasted data can be quantified and summarized in financial statements. It is generally agreed that the projections should include information pertaining to general financial goals, but should not include such specific data as forecasted earnings per share. The income statement is most favored as the proper place for forecast presentation.

While many respondents believe that auditors will eventually be required to attest to financial forecasts, a clear majority are against such attestation. Most indicate that the lack of standards, the doubtfulness of professional capability, the increased exposure to legal liability and the incompatibility of the external auditor's role are major obstacles to be resolved before the auditor can be required to attest to forecasted statements.

The authors provide a pragmatic view of many of the problems associated with the presentation of forecasted financial statements.

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