# STATEMENT AT THE PUBLIC HEARINGS ON MEASUREMENT-CHANGING PRICES BEFORE THE FINANCIAL ACCOUNTING STANDARDS BOARD

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Please allow me to take a few minutes to summarize my comments on the Financial Accounting Standards Board's Exposure Draft for those who have not read my written comments.

I have two main objections to the proposal. First, while professing its adherence to the concept of financial capital, the FASB has adopted the concept of physical capital by proposing to require measurement and disclosure of what it calls "income from continuing operations on current cost basis." Since Theodore Limperg proposed this concept under the label under the label "consumable income" over half a century ago, it has repeatedly "consumable income" over half a century ago, it has repeatedly appeared in the accounting literature under various labels, such as distributable income, sustainable income, current operating profit, etc., and now the FASB has give it yet another label. Besides a common concept that underlies them, all these terms have had one more property in common--nobody has yet been able to show, by example, by theoretical argument, or by empirical evidence, that this concept of income is of any practical usefulness to anybody. I would have thought that useless concepts inflict only limited harm as long as they remained confined to the books on accounting theory. But now that the Board seems to have decided to require hundreds of business firms to put this concept into practice, it is perhaps fair to ask, "What is the purpose of this exercise?

The Board justifies its proposal on the basis of an assertion without evidence that, somehow, it will help to assess the future cash flows and enable various parties who use the financial information to make better decisions. The language of such justification is vague, almose opaque, and full of "maybes" and "likelies" (see, for example, paragraph 73). Not an iota of evidence has been cited to suggest that at least some of these uncertainties will be resolved in favor of the position taken by the Board. Much reliance seems to have been placed on the label selected by the Board, "current cost income from continuing operations," which assumes that this income is expected to continue while other elements of income, such as holding gains, are not. Yet continued inflation, the very basis of the present proposal, implies that the holding gains too will continue to accrue. There is no evidence that the so-called "current cost income from continuing operations" has a greater tendency to "continue" than the holding gains. In a sense, the holding of assets, too, is a continuing operation of firms and its consequences should therefore be included in the income from continuing operations. On the other hand, if the Board means to say "current cost continuing income from operations," it must point to at least some evidence that this component of income is indeed more likely to continue than other components. We do not have time enough this afternoon to discuss the theoretical arguments or evidence in detail;[1] but I would like to at least urge, if not challenge, the Board, its staff of economists and accountants, and those who support the FASB proposal to come up with at least one comprehensive example of how the proposed measurement of holding gains separately from the "current cost income from continuing operations" will help make better decisions and to defend

[1]See P. Prakash and S. Sunder, "The Case against Separation of Current Operating Profit and Holding Gains," The Accounting Review (January 1979), pp. 1-21.

such an example as the basis of installing a new financial reporting requirements for <u>all</u> large firms. Until at least one such illustration can be produced, I would request the Board to consider suspending the part of the proposal which requires separation of holding gains from the so-called "current cost income from continuing operations."

My second objection is to the assumption made in the proposal that the rate of price changes will continue at the present high level. Considering the amount of effort it takes to arrive at agreed-upon changes in the accounting system, it is perhaps desirable now to consider the possibility that the rates of price change may not always stay at such high levels and that it is conceivable that if they decline in the future to a level closer to four or five percent, the benefits obtained from implementing the accounting for changing prices may not be worth the cost of carrying out annual revaluations of all assets of all firms. When the rate of price changes is sufficiently small, there is little difference between the historical-cost accounting and current cost data and little useful purpose is served by continuing to impose the requirements of the present proposal. For this reason, I would suggest that the present statement be modified in such a way as to adjust automatically to the changing rates of inflation in order to avoid locking ourselves into an inflation accounting system. My paper, coauthored with Professor Prakash[2] contains one modest proposal on these lines that the Board may

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[2] P. Prakash and S. Sunder, "Revaluation Threshold: A Solution for Accounting under Changing Prices," Working Paper, University of Chicago, 1976.

like to consider. We have suggested that the measurement of the current cost of plant, property and equipment, and, possibly, inventory be required whenever an appropriately selected price index has changed by a predetermined amount, such as ten or twenty percent, since the time of the last such measurement. Such a scheme will automatically adjust the frequency of current cost measurements to the magnitude of inflation. When the rate of price changes is high, the system may require annual measurements of current cost; when it goes down, less frequent measurements will be necessary.