Statement of Financial Accounting Standards No. 33

Note: This Statement has been completely superseded

FAS33 Status Page
FAS33 Summary

Financial Reporting and Changing Prices

September 1979

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Standards No. 33

Financial Reporting and Changing Prices

September 1979

CONTENTS

FAS 33: Financial Reporting and Changing Prices

FAS 33 Summary

This Statement applies to public enterprises that have either (1) inventories and property, plant, and equipment (before deducting accumulated depreciation) amounting to more than $125 million or (2) total assets amounting to more than $1 billion (after deducting accumulated depreciation).

No changes are to be made in the primary financial statements; the information required by the Statement is to be presented as supplementary information in published annual reports.

For fiscal years ended on or after December 25, 1979, enterprises are required to report:

a. Income from continuing operations adjusted for the effects of general inflation
b. The purchasing power gain or loss on net monetary items.

For fiscal years ended on or after December 25, 1979, enterprises are also required to report:

a. Income from continuing operations on a current cost basis
b. The current cost amounts of inventory and property, plant, and equipment at the end of the fiscal year
c. Increases or decreases in current cost amounts of inventory and property, plant, and equipment, net of inflation.

However, information on a current cost basis for fiscal years ended before December 25, 1980 may be presented in the first annual report for a fiscal year ended on or after December 25, 1980.

Enterprises are required to present a five-year summary of selected financial data, including information on income, sales and other operating revenues, net assets, dividends per common share, and market price per share. In the computation of net assets, only inventory and property, plant, and equipment need be adjusted for the effects of changing prices.

Illustrative formats for disclosure of the required information are included in this Summary as Schedules A, B, and C.

To present the supplementary information required by this Statement, an enterprise needs to measure the effects of changing prices on inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense. No adjustments are required

to other revenues, expenses, gains, and losses.

In computations of current cost income, expenses are to be measured at current cost or lower recoverable amount. Current cost measures relate to the assets owned and used by the enterprise and not to other assets that might be acquired to replace the assets owned. This Statement allows considerable flexibility in choice of sources of information about current costs: An enterprise may use specific price indexes or other evidence of a more direct nature. This Statement also encourages simplifications in computations and other aspects of implementation: In particular "recoverable amounts" need be measured only if they are judged to be significantly and permanently lower than current cost; that situation is unlikely to occur very often.

The Board believes that this Statement meets an urgent need for information about the effects of changing prices. If that information is not provided: Resources may be allocated inefficiently; investors' and creditors' understanding of the past performance of an enterprise and their ability to assess future cash flows may be severely limited; and people in government who participate in decisions on economic policy may lack important information about the implications of their decisions. The requirements of the Statement are expected to promote a better understanding by the general public of the problems caused by inflation: Statements by business managers about those problems are unlikely to have sufficient credibility until financial reports provide quantitative information about the effects of inflation.

Special problems arise in the application of the current cost requirements of this Statement to certain types of assets, notably natural resources and income-producing real estate property. The Board will consider those problems further and address them in an Exposure Draft with a view to publishing a Statement in 1980. This Statement gives guidance on the treatment of those assets and related expenses for enterprises that present current cost information for fiscal years ending before December 25, 1980.

This Statement calls for two supplementary income computations, one dealing with the effects of general inflation, the other dealing with the effects of changes in the prices of resources used by the enterprise. The Board believes that both types of information are likely to be useful. Comment letters on the Exposure Draft revealed differences of opinion on the relative usefulness of the two approaches. Many preparers and public accounting firms emphasized the need to deal with the effects of general inflation; users generally preferred information dealing with the effects of specific price changes. The Board believes that further experimentation is required on the usefulness of the two types of information and that experimentation is possible only if both are provided by large public enterprises. The Board intends to assess the usefulness of the information called for by this Statement. That assessment will provide a basis for ongoing decisions on whether or not provision of both types of information should be continued and on whether other requirements in this Statement should be reviewed. The Board will undertake a comprehensive review of this Statement no later than five years after its publication.

The measurement and use of information on changing prices will require a substantial learning process on the part of all concerned. In view of the importance of clear explanations to users of financial reports of the significance of the information, the Board is organizing an advisory group to develop and publish illustrative disclosures that might be appropriate as a guide to preparers in particular industries.

INTRODUCTION

1. This Statement establishes standards for reporting certain effects of price changes on business enterprises. It deals with both general inflation and changes in the prices of certain specific types of assets. It requires no changes in the basic financial statements; the required information is to be presented in supplementary statements, schedules, or supplementary notes in financial reports. This Statement applies only to certain large, publicly held enterprises.

The Objectives of This Statement

2. This Statement is based on the objectives set out in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises.* That Statement concludes that financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the enterprise (paragraph 37). It also calls for the provision of information about the economic resources of an enterprise in a manner that provides direct and indirect evidence of cash flow potential (paragraphs 40 and 41) and it concludes that management is accountable to the owners for "protecting them to the extent possible from unfavorable economic impacts of factors in the economy such as inflation or deflation" (paragraph 50).

3. The users of financial reports need to have an understanding of the effects of changing prices on a business enterprise to help their decisions on investment, lending, and other matters. This Statement is intended to help users in the following specific ways:

a. Assessment of future cash flows. Present financial statements include measurements of expenses and assets at historical prices. When prices are changing, measurements that reflect current prices are likely to provide useful information for the assessment of future cash flows.
b. Assessment of enterprise performance. The worth of an enterprise can be increased as a result of prudent timing of asset purchases when prices are changing. That increase is one aspect of performance even though it may be distinguished from operating performance. Measurements that reflect current prices can provide a basis for assessing the extent to which past decisions on the acquisition of assets have created opportunities for earning future cash flows.
c. Assessment of the erosion of operating capability. An enterprise typically must hold minimum quantities of inventory, property, plant, and equipment and other assets to maintain its ability to provide goods and services. When the prices of those assets are increasing, larger amounts of money investment are needed to maintain the previous levels of output. Information on the current prices of resources that are used to generate revenues can help users to assess the extent to which and the manner in which operating capability

has been maintained.

d. Assessment of the erosion of general purchasing power. When general price levels are increasing, larger amounts of money are required to maintain a fixed amount of purchasing power. Investors typically are concerned with assessing whether an enterprise has maintained the purchasing power of its capital. Financial information that reflects changes in general purchasing power can help with that assessment.

4. The needs described in paragraph 3 are important to investors, creditors, and also to other users. If information about the effects of changing prices is not available, the cost of capital may be excessive for enterprises that can use capital most effectively. Resources may be allocated inefficiently and all members of society may suffer. Furthermore, people in government who participate in decisions on economic policy may not obtain the most relevant information on which to base their decisions.

5. Many people recognize that the effects of changing prices should be taken into account in the interpretation of information in the financial reports of business enterprises. However, there are several reasons for believing that those effects cannot be understood adequately until they are measured and disclosed in financial reports:

a. The effects depend on the transactions and circumstances of an enterprise and users do not have detailed information about those factors;
b. Effective financial decisions can take place only in an environment in which there is an understanding by the general public of the problems caused by changing prices; that understanding is unlikely to develop until business performance is discussed in terms of measures that allow for the impact of changing prices;
c. Statements by business managers about the problems caused by changing prices will not have credibility until specific quantitative information is published about those problems.

The Usefulness of Present Financial Statements

6. Most people believe that the primary financial statements should continue to incorporate measurements based mainly on historical prices. Those financial statements rely to a great extent on prices in transactions to which the enterprise was a party. Among the most common and important transactions are sales in which the historical selling prices are used to measure receivables and purchases in which the historical buying prices are used to measure the inventories and property, plant, and equipment acquired. In present financial statements, those historical prices are measured in terms of the number of units of money agreed upon by the buyer and seller at the time of the transaction.

7. There are at least four important reasons for supporting the dominant focus of present financial statements on historical prices. First, it is fitting that the financial statements depend on actual transactions of the enterprise because those transactions determine the changes in owners' equity in the long run. Business enterprises invest cash in assets in order to earn more cash.

Historical prices provide the elementary measures of both the amounts invested and the amounts received in return. Second, because historical prices generally are the result of arms-length bargaining, they provide a basis for reliable measures of the results of transactions. Accordingly, financial statements prepared on the basis of historical prices tend to be capable of independent verification and can be prepared and used with confidence that the information presented is reliable. Third, users' understanding of the effect of changing prices may be enhanced if they are able to compare the measurements in the primary financial statements with measurements that reflect changing prices. Fourth, users are accustomed to the present financial statements.

The Need for Supplementary Information

8. The term "general inflation" means a rise in the general level of prices or a decline in the general purchasing power of the monetary unit. It is widely perceived to be an unfortunate but persistent current feature of the economies of most countries, including the United States. However, measurements in conventional statements are made in nominal dollars, with no direct allowance for the variability of their purchasing power. Many people believe that the users of financial reports need information about measurements that are made in units having the same (i.e., constant) general purchasing power. This Statement requires disclosure of certain supplementary information measured in units having the same general purchasing power. The method used to compute that information is known as constant dollar accounting.

9. Changes in the relative prices of specific goods and services are an integral feature of all modern economies. Many people believe that financial statements based on historical cost fail to provide sufficient information for users because those statements normally do not identify separately changes in prices of assets while they are held by an enterprise. This Statement requires disclosure of certain supplementary information based on measurement of the current cost of inventories and property, plant, and equipment. The method used to compute that information is known as current cost accounting.

10. The Board has concluded that there is an urgent need for enterprises to provide information about the effects on their activities of general inflation and other price changes. It believes that users' understanding of the past performance of an enterprise and their ability to assess future cash flows will be severely limited until such information is included in financial reports.

The Need for Experimentation

11. Both constant dollar accounting and current cost accounting have been subjects of intensive study for many years. Various methodologies similar to constant dollar accounting have been employed to some extent in several countries. In the United States, 101 enterprises participated in the Financial Accounting Standards Board field test experiment with constant dollar accounting by preparing experimental financial statements for one or more of the years 1972-1974. A few U.S. companies have published constant dollar financial statements for

several years; others say that they have prepared similar statements for internal use.

12. Preparers and users of financial reports have had wide experience with measurements similar to current cost. The last-in, first-out inventory method typically produces cost of goods sold (but not inventory) measurements that are similar to those obtained from the use of current cost. Starting with 1976, reports filed by certain companies with the Securities and Exchange Commission (SEC) have included measurements of cost of goods sold, depreciation, inventory and property, plant, and equipment on the basis of replacement cost, an attribute that frequently is similar to current cost. Income statements and supplementary schedules based on current cost accounting recently have been presented by several enterprises in the United Kingdom, Canada, and Australia.

13. Preparers and users of financial reports have not yet reached a consensus on the general, practical usefulness of constant dollar information and current cost information. It seems unlikely that a consensus can be reached until further experience has been gained with the use of both types of information in systematic practical applications. This Statement therefore requires certain enterprises to present information both on a constant dollar basis and on a current cost basis.

14. The measurement and use of information on changing prices will require a substantial learning process on the part of all concerned. The Board makes no pretense of having solved all of the implementation problems. Rather, it encourages experimentation within the guidelines of this Statement and the development of new techniques that fit the particular circumstances of the enterprise. This Statement has been written to provide more flexibility than is customary in Board Statements in the belief that those involved will help to develop techniques that further the understanding of the effects of price changes on the enterprise. In view of the importance of clear explanations of the significance of information on the effects of changing prices, to assist users' understanding of the information, the Board is organizing an advisory group to develop illustrative disclosures that might be appropriate for particular industries.

15. The requirement to present information on both a constant dollar basis and a current cost basis provides a basis for studying the usefulness of the two types of information. The Board intends to study the extent to which the information is used, the types of people to whom it is useful, and the purpose for which it is used. The requirements of this Statement will be reviewed on an ongoing basis and the Board will amend or withdraw requirements whenever that course is justified by the evidence. This Statement will be reviewed comprehensively after a period of not more than five years.

Accounting Series Release No. 190

16. As noted in paragraph 12, the Securities and Exchange Commission has required the filing of information having some similarities to the current cost accounting information called for in this Statement. That requirement is included in Accounting Series Release No. 190, *Notice of*

Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data. However, it is important that the differences between the two sets of information be recognized. This Statement requires presentation of a computation of income from continuing operations using current cost information. ASR 190, however, calls for information that is not suitable for integration into a computation of income. It requires the disclosure of cost of goods sold at current replacement cost and of depreciation on the basis of the current cost of replacing productive capacity; and the current cost of replacing productive capacity may not be commensurate with labor costs and other operating costs reflected in the income statement. Consequently, ASR 190 emphasizes information that would assist in understanding the "current economics of the business" and it specifically states that the SEC "determined not to require the disclosure of the effect on net income" and that it "did not believe that users should be encouraged to convert the data into a single revised net income figure" (page 7). Some users have nevertheless made that conversion.

17. This Statement emphasizes measurement of the assets owned by the enterprise, whereas ASR 190 focuses attention on the assets that would replace those owned if replacement were to occur currently. Furthermore, this Statement provides for use of current cost or lower recoverable amount as the measure of the asset and of its consumption, rather than requiring use of only one measure — replacement cost — with separate disclosure of net realizable value when it is lower. This Statement calls for disclosure of increases or decreases in the current cost amounts of inventory and property, plant, and equipment as well as calling for measurement of expenses and assets at current cost; and unlike ASR 190, it also requires specific disclosures of the effects of changes in the general price level.

18. The Board is aware of and agrees with the belief that the continuation of requirements to measure both replacement cost data as required by ASR 190 and current cost data as required by this Statement will involve excessive costs for business enterprises. If the Securities and Exchange Commission does not rescind ASR 190 when this Statement becomes effective, the Board will take that factor into account in its decisions about the timing of its review of this Statement and the nature of any revisions to this Statement.

Special Industry Problems

19. Special problems arise in the application of the provisions of this Statement to several particular industries. Special industry task groups have assisted the Board in its study of those problems. In the case of financial institutions such as commercial banks, thrift institutions, and insurance companies, the Board has concluded that the general provisions of this Statement are useful and applicable. In other cases, such as forest products, mining, oil and gas, and real estate, the Board has concluded that further studies are required to provide a basis for decisions on the applicability to certain types of assets and expenses, of the requirement to present information on a current cost basis. The Board intends to undertake those studies with the help of its advisory task groups, and it aims to publish one or more Exposure Drafts followed in 1980 by Statements dealing with the assets concerned. In the meantime, enterprises are not required

to disclose information about the current costs of unprocessed natural resources and income-producing real estate properties. There are no special exemptions from requirements to disclose information on a historical cost/constant dollar basis.

Organization of This Statement

20. Paragraph 22 defines certain terms used in this Statement. Paragraphs 23-28 specify the applicability and scope of this Statement; and paragraphs 29-38 summarize the requirements for the disclosure of supplementary information. Paragraphs 39-50 contain provisions for the measurement of historical cost/constant dollar information in annual reports for fiscal years ended on or after December 25, 1979. Paragraphs 51-60 contain provisions for the measurement of current cost information by those enterprises. The current cost information is required for fiscal years ended on or after December 25, 1979 but first disclosure of the information may be postponed to annual reports for fiscal years ended on or after December 25, 1980. Paragraphs 61-64 contain provisions applicable to both historical cost/constant dollar measurements and current cost measurements. Paragraphs 65 and 66 contain provisions for the presentation of a five-year summary of selected data; and paragraphs 67-69 state the transitional provisions and effective dates of this Statement.

21. Illustrations of schedules that display the information required by this Statement are presented in Appendix A. Appendix B provides background information. The bases for the Board's conclusions are set out in Appendix C. Illustrative materials are presented in Appendix D and Appendix E. Appendix F provides information about the Consumer Price Index for All Urban Consumers.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Definitions

22. For purposes of this Statement, certain terms are defined as follows:

a. *Constant dollar accounting.* A method of reporting financial statement elements in dollars each of which has the same (i.e., constant) general purchasing power. This method of accounting is often described as accounting in units of general purchasing power or as accounting in units of current purchasing power.
b. *Current cost accounting.* A method of measuring and reporting assets and expenses associated with the use or sale of assets, at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale.
c. *Current cost/constant dollar accounting.* A method of accounting based on measures of current cost or lower recoverable amount in terms of dollars, each of which has the same

general purchasing power.

d. *Current cost/nominal dollar accounting.* A method of accounting based on measures of current cost or lower recoverable amount without restatement into units, each of which has the same general purchasing power.
e. *Historical cost/constant dollar accounting.* A method of accounting based on measures of historical prices in dollars, each of which has the same general purchasing power.
f. *Historical cost/nominal dollar accounting.* The generally accepted method of accounting, used in the primary financial statements, based on measures of historical prices in dollars without restatement into units, each of which has the same general purchasing power.
g. *Income from continuing operations.* Income after applicable income taxes but excluding the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes.
h. *Public enterprise.* A business enterprise (a) whose debt or equity securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally) or (b) that is required to file financial statements with the Securities and Exchange Commission. An enterprise is considered to be a public enterprise as soon as its financial statements are issued in preparation for the sale of any class of securities in a domestic market.

Applicability and Scope

23. The requirements of this Statement apply to public enterprises that prepare their primary financial statements in U.S. dollars and in accordance with U.S. generally accepted accounting principles and that have, at the beginning of the fiscal year for which financial statements are being presented either:

a. Inventories and property, plant, and equipment [1] (before deducting accumulated depreciation, depletion, and amortization) amounting in aggregate to more than $125 million; or
b. Total assets amounting to more than $1 billion (after deducting accumulated depreciation).

Both amounts shall be measured in accordance with generally accepted accounting principles as reported in the primary financial statements (consolidated if applicable) of the enterprise.

24. The requirements of this Statement do not apply, during the year of a business combination accounted for as a pooling of interests, to an enterprise created by the pooling of two or more enterprises, none of which individually satisfies the size test described in paragraph 23.

25. The Board encourages nonpublic enterprises and enterprises that do not meet the size test in paragraph 23 to present the information called for by this Statement.

26. This Statement does not change the standards of financial accounting and reporting used

for the preparation of the primary financial statements of the enterprise.

27. The information required by this Statement shall be presented as supplementary information in any published annual report that contains the primary financial statements of the enterprise except that the information need not be presented in an interim financial report. The information required by this Statement need not be presented for segments of a business enterprise although such presentations are encouraged.

28. An enterprise that presents consolidated financial statements shall present the information required by this Statement on the same consolidated basis. The information required by this Statement need not be presented separately for a parent company, an investee company, or other enterprise in any financial report that includes the results for that enterprise in consolidated financial statements.

Requirement for Supplementary Information

29. An enterprise is required to disclose:

a. Information on income from continuing operations for the current fiscal year on a historical cost/constant dollar basis (paragraphs 39-46)
b. The purchasing power gain or loss on net monetary items for the current fiscal year (paragraphs 47-50).

The purchasing power gain or loss on net monetary items shall *not* be included in income from continuing operations.

30. An enterprise is required to disclose:

a. Information on income from continuing operations for the current fiscal year on a current cost basis (paragraphs 51-64)
b. The current cost amounts of inventory and property, plant, and equipment at the end of the current fiscal year (paragraph 51)
c. Increases or decreases for the current fiscal year in the current cost amounts of inventory and property, plant, and equipment, net of inflation (paragraphs 55 and 56).

The increases or decreases in current cost amounts shall *not* be included in income from continuing operations.

31. In some circumstances, there may be no material difference between the amount of income from continuing operations on a historical cost/constant dollar basis and the amount of income from continuing operations on a current cost basis. In those circumstances, the current cost information listed in paragraph 30 need not be disclosed for the fiscal year concerned, but the enterprise is required to state, in a note to the supplementary disclosures, the reason for the

omission of the information.

32. Information on income from continuing operations (on a historical cost/constant dollar basis or on a current cost basis) may be presented either in a "statement format" (disclosing revenues, expenses, gains, and losses) or in a "reconciliation format" (disclosing adjustments to the income from continuing operations that is shown in the primary income statement). Whichever format is used, such information should disclose, unless they are immaterial, the amounts of or adjustments to cost of goods sold, depreciation, depletion, and amortization expense and (in the case of historical cost/constant dollar income from continuing operations) reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts as required by paragraph 44. Formats for the presentation of the supplementary information are illustrated in Appendix A.

33. If depreciation expense has been allocated among various expense categories in the supplementary computations of income from continuing operations (for example, among cost of goods sold and other functional expenses), the aggregate amount of depreciation expense, on both a historical cost/constant dollar basis and a current cost basis, shall be disclosed in a note to the supplementary information.

34. An enterprise shall disclose, in notes to the supplementary information:

a. The principal types of information used to calculate the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense (paragraph 60)
b. Any differences between (1) the depreciation methods, estimates of useful lives, and salvage values of assets used for calculations of historical cost/constant dollar depreciation and current cost depreciation and (2) the methods and estimates used for calculations of depreciation in the primary financial statements (paragraph 61)
c. The exclusion from the computations of supplementary information of any adjustments to or allocations of the amount of income tax expense in the primary financial statements (paragraph 54).

35. An enterprise is required to disclose the following information for each of its five most recent fiscal years (paragraphs 65 and 66):

a. *Net Sales and Other Operating Revenues*
b. *Historical Cost/Constant Dollar Information*
    (1) Income from continuing operations
    (2) Income per common share from continuing operations
    (3) Net assets at fiscal year-end
c. *Current Cost Information* (except for individual years in which the information was excluded from the current year disclosures in accordance with paragraph 31)
    (1) Income from continuing operations

(2) Income per common share from continuing operations
(3) Net assets at fiscal year-end
(4) Increases or decreases in the current cost amounts of inventory and property, plant, and equipment, net of inflation

d. *Other Information*
(1) Purchasing power gain or loss on net monetary items
(2) Cash dividends declared per common share
(3) Market price per common share at fiscal year-end.

All enterprises shall report, in a note to the five-year summary, the average level or the end-of-year level (whichever is used for the measurement of income from continuing operations) of the Consumer Price Index for each year included in the summary (paragraphs 40 and 41).

36. If an enterprise chooses to state net assets, in the five-year summary, at amounts computed from comprehensive financial statements prepared on a historical cost/constant dollar basis or on a current cost/constant dollar basis, that fact shall be disclosed in a note to the five-year summary (paragraph 66).

37. Enterprises shall provide, in their financial reports, explanations of the information disclosed in accordance with this Statement and discussions of its significance in the circumstances of the enterprise.

38. The disclosures summarized in paragraphs 29-37 are required by this Statement. Enterprises are encouraged to provide additional information to help users of financial reports understand the effects of changing prices on the activities of the enterprise.

Historical Cost/Constant Dollar Measurements

39. The index used to compute information on a constant dollar basis shall be the Consumer Price Index for All Urban Consumers, published by the Bureau of Labor Statistics of the U.S. Department of Labor.[2]

40. An enterprise that presents the minimum historical cost/constant dollar information required by this Statement shall restate inventory, property, plant, and equipment, cost of goods sold, depreciation, depletion, and amortization expense and any reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts (paragraph 44) in constant dollars represented by the average level over the fiscal year of the Consumer Price Index for All Urban Consumers. Other financial statement elements need not be restated. An enterprise that chooses to present comprehensive financial statements on a historical cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars.

41. If the level of the Consumer Price Index at the end of the year and the data required to

compute the average level of the index over the year have not been published in time for preparation of the annual report, they may be estimated by referring to published forecasts based on economic statistics or by extrapolation based on recently reported changes in the index.

42. Inventory and property, plant, and equipment (for computation of the amount of net assets at the end of the current fiscal year for inclusion in the five-year summary of selected financial data paragraph 35(b)(3)), cost of goods sold and depreciation, depletion, and amortization expense shall be measured at their historical cost/constant dollar amounts or lower recoverable amounts. Inventories may need to be reclassified as monetary assets at the date of the use on or commitment to a contract (Appendix D).

43. Measurements of historical cost/constant dollar amounts shall be computed by multiplying the components of the historical cost/nominal dollar measurements by the average level of the Consumer Price Index for the current fiscal year (or the level of the index at the end of the year if comprehensive financial statements are presented) and dividing by the level of the index at the date on which the measurement of the associated asset was established (i.e., the date of acquisition or the date of any measurement not based on historical cost). Those measurements may be restated in base-year dollars for inclusion in the five-year summary (paragraph 65).

44. If it is necessary to reduce the measurements of inventory and property, plant, and equipment, during the current fiscal year from historical cost/constant dollar amounts to lower recoverable amounts, the reduction shall be deducted in the computation of income from continuing operations.

45. Except as provided in paragraphs 42-44 and paragraph 61, the accounting principles used in computing historical cost/constant dollar income shall be the same as those used in computing historical cost/nominal dollar income. Only the measuring unit is changed.

46. Inventory, property, plant, and equipment, and related cost of goods sold and depreciation, depletion, and amortization expense that are originally measured in units of a foreign currency shall first be translated into U.S. dollars in accordance with generally accepted accounting principles and then restated in constant dollars in accordance with the provisions of paragraph 43.

Purchasing Power Gain or Loss on Net Monetary Items

47. A monetary asset is money or a claim to receive a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. A monetary liability is an obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. The economic significance of monetary assets and liabilities (monetary items) depends heavily on the general purchasing power of money, although other factors, such as the credit worthiness of debtors, may affect their significance.

48. All assets and liabilities that are not monetary are nonmonetary. The economic significance of nonmonetary items depends heavily on the value of specific goods and services. Nonmonetary assets include (a) goods held primarily for resale or assets held primarily for direct use in providing services for the business of the enterprise, (b) claims to cash in amounts dependent on future prices of specific goods or services, and (c) residual rights such as goodwill or equity interests. Nonmonetary liabilities include (a) obligations to furnish goods or services in quantities that are fixed or determinable without reference to changes in prices or (b) obligations to pay cash in amounts dependent on future prices of specific goods or services.

49. Guidance on the classification of balance sheet items as monetary or nonmonetary is set forth in Appendix D to this Statement.

50. The purchasing power gain or loss on net monetary items shall be equal to the net gain or loss found by restating in constant dollars the opening and closing balances of, and transactions in, monetary assets and liabilities. An enterprise that presents comprehensive supplementary financial statements on a historical cost/constant dollar basis may measure the purchasing power gain or loss in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure the purchasing power gain or loss in average-for-the-year dollars. An acceptable approximate method of calculating the purchasing power gain or loss on net monetary items is illustrated in Appendix E.

Current Cost Measurements

51. The current cost amounts of inventory and property, plant, and equipment shall be measured as follows:

a. Inventories at current cost or lower recoverable amount (paragraphs 57-64) at the measurement date. (This provision is qualified by paragraph 53 in respect of any depletion expense included in the measurement of inventories.)
b. Property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) at the current cost or lower recoverable amount (paragraphs 57-64) of the assets' remaining service potential at the measurement date.
c. Resources used on partly completed contracts shall be measured at current cost or lower recoverable amount at the date of use on or commitment to the contracts.

52. An enterprise that presents the minimum information required by this Statement on current cost income from continuing operations shall measure the amounts of cost of goods sold and depreciation and amortization expense as follows:

a. Cost of goods sold shall be measured at current cost or lower recoverable amount (paragraphs 57-64) at the date of sale or at the date on which resources are used on or committed to a specific contract. (This provision is qualified by paragraph 53 in respect of

any depletion expense included in cost of goods sold.)

b. Depreciation and amortization expense of property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) shall be measured on the basis of the average current cost or lower recoverable amount (paragraphs 57-64) of the assets' service potential during the period of use.

Other revenues, expenses, gains, and losses may be measured by such an enterprise at the amounts included in the primary income statement. An enterprise that chooses to present comprehensive financial statements on a current cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars. (This paragraph is qualified by paragraph 64 for enterprises that are subject to rate regulation or other form of price control.)

53. This Statement does not contain provisions for the measurement, on a current cost basis, of income-producing real estate properties, unprocessed natural resources, and related depreciation, depletion, and amortization expense (paragraph 19). If an enterprise presents information on a current cost basis in an annual report for a fiscal year ended before December 25, 1980, it may measure the assets and the related expenses, described in this paragraph, at their historical cost/constant dollar amounts or by reference to an appropriate index of specific price changes.

54. The amount of income tax expense in computations of current cost income from continuing operations shall be the same as the amount of income tax expense charged against income from continuing operations in the primary financial statements. No adjustments shall be made to income tax expense for any timing differences that might be deemed to arise as a result of the use of current cost accounting methods. Income tax expense shall not be allocated between income from continuing operations and the increases or decreases in current cost amounts of inventory and property, plant, and equipment.

Increases or Decreases in the Current Cost Amounts of Inventory and Property, Plant, and Equipment

55. The increases or decreases in the current cost amounts of inventory and property, plant, and equipment represent the differences between the measures of the assets at their "entry dates" for the year and the measures of the assets at their "exit dates" for the year. "Entry dates" means the beginning of the year or the dates of acquisition, whichever is applicable; "exit dates" means the end of the year or the dates of use, sale, or commitment to a specific contract whichever is applicable. For the purposes of this paragraph, assets are measured in accordance with the provisions of paragraph 51.

56. The increases or decreases in current cost amounts of inventory and property, plant, and equipment shall be reported both before and after eliminating the effects of general inflation. An enterprise that presents comprehensive supplementary statements on a current cost/constant

dollar basis may measure increases or decreases in current cost amounts in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure those increases or decreases in average-for-the-year constant dollars. An acceptable approximate method of calculating the increases or decreases in current cost amounts and the inflation adjustment is illustrated in Appendix E.

Information about Current Costs

57. The current cost of inventory owned by an enterprise is the current cost of purchasing the goods concerned or the current cost of the resources required to produce the goods concerned (including an allowance for the current overhead costs according to the allocation bases used under generally accepted accounting principles), whichever would be applicable in the circumstances of the enterprise.

58. The current cost of property, plant, and equipment owned by an enterprise is the current cost of acquiring the same service potential (indicated by operating costs and physical output capacity) as embodied by the asset owned; the sources of information used to measure current cost should reflect whatever method of acquisition would currently be appropriate in the circumstances of the enterprise. The current cost of a used asset may be measured:

a. By measuring the current cost of a new asset that has the same service potential as the used asset had when it was new (the current cost of the asset as if it were new) and deducting an allowance for depreciation;
b. By measuring the current cost of a used asset of the same age and in the same condition as the asset owned;
c. By measuring the current cost of a new asset with a different service potential and adjusting that cost for the value of the differences in service potential due to differences in life, output capacity, nature of service, and operating costs.

Current cost may be measured by direct reference to current prices of comparable assets or methods such as functional pricing or unit pricing under which the current cost of a unit of service embodied in the asset owned is measured and the current cost per unit is multiplied by the appropriate number of service units.

59. If current cost is measured in a foreign currency, the amount shall be translated into dollars at the current exchange rate, that is, the rate at the date of use, sale, or commitment to a specific contract (in the cases of depreciation expense and cost of goods sold) or the rate at the balance sheet date (in the cases of inventory and property, plant, and equipment).

60. Enterprises may use various types of information to determine the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense.[3] The information may be gathered and applied internally or externally and may be applied to single items or broad categories, as appropriate in the circumstances. The

following types of information are listed as examples of the information that may be used, but they are *not* listed in any order of preferability. Enterprises are expected to select types of information appropriate to their particular circumstances, giving due consideration to their availability, reliability, and cost:

a. Indexation
   (1) Externally generated price indexes for the class of goods or services being measured
   (2) Internally generated price indexes for the class of goods or services being measured
b. Direct pricing
   (1) Current invoice prices
   (2) Vendors' price lists or other quotations or estimates
   (3) Standard manufacturing costs that reflect current costs.

Depreciation Expense

61. There is a presumption that depreciation methods, estimates of useful lives, and salvage values of assets should be the same for purposes of current cost, historical cost/constant dollar, and historical cost/nominal dollar depreciation calculations. However, if the methods and estimates used for calculations in the primary financial statements have been chosen partly to allow for expected price changes, different methods and estimates may be used for purposes of current cost and historical cost/constant dollar calculations.

Recoverable Amounts

62. The term "recoverable amount" means the current worth of the net amount of cash expected to be recoverable from the use or sale of an asset. If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollars or current cost, the recoverable amount shall be used as a measure of the assets and of the expense associated with the use or sale of the assets. Decisions on the measurement of assets at their recoverable amounts need not be made by considering assets individually unless they are used independently of other assets.

63. Recoverable amounts may be measured by considering the net realizable values or the values in use of the assets concerned:

a. Net realizable value is the amount of cash, or its equivalent, expected to be derived from sale of an asset net of costs required to be incurred as a result of the sale. It shall be considered as a measurement of an asset only when the asset concerned is about to be sold.
b. Value in use is the net present value of future cash flows (including the ultimate proceeds of disposal) expected to be derived from the use of an asset by the enterprise. It shall be considered as a measurement of an asset only when immediate sale of the asset concerned is not intended. Value in use shall be estimated by discounting expected future cash flows at an appropriate discount rate that allows for the risk of the activities concerned.

64. An enterprise that is subject to rate regulation or other form of price control may be limited to a maximum recovery through its selling prices, based on the nominal dollar amount of the historical cost of its assets. In that situation, nominal dollar/historical costs may represent an appropriate basis for the measurement of the recoverable amounts associated with the assets at the end of the fiscal year. Recoverable amounts may also be lower than historical costs. However, cost of goods sold and depreciation, depletion, and amortization expense shall be measured at historical cost/constant dollar amounts (in measurements of historical cost/constant dollar income from continuing operations) or at current cost (in measurements of current cost income from continuing operations) provided that replacement of the service potential provided by the related assets would be undertaken, if necessary, in current economic conditions; if replacement would not be undertaken, expenses shall be measured at recoverable amounts.

Five-Year Summary of Selected Financial Data

65. The information presented in the five-year summary shall be stated either:

a. In average-for-the-year constant dollars or end-of-year constant dollars (whichever is used for the measurement of income from continuing operations) as measured by the Consumer Price Index for All Urban Consumers for the current fiscal year; or
b. In dollars having a purchasing power equal to that of dollars of the base period used by the Bureau of Labor Statistics in calculating the Consumer Price Index (currently 1967).

66. If an enterprise presents the minimum information required by this Statement, it shall measure net assets (i.e., shareholders' equity) for the purposes of the five-year summary:

a. On a historical cost/constant dollar basis at the amount reported in its primary financial statements adjusted for the difference between the historical cost/nominal dollar amounts and the historical cost/constant dollar amounts or lower recoverable amounts of inventory and property, plant, and equipment
b. On a current cost basis at the amount reported in its primary financial statements, adjusted for the difference between the historical cost/nominal dollar amounts and the current cost or lower recoverable amounts of inventory and property, plant, and equipment and restated in constant dollars in accordance with paragraph 65.

If an enterprise elects to present comprehensive supplementary financial statements on a current cost/constant dollar basis, or on a historical cost/constant dollar basis, it may report the amount of net assets in the five-year summary in accordance with the comprehensive statements.

Effective Date and Transition

67. The provisions of this Statement shall be effective for fiscal years ended on or after December 25, 1979. However, information on a current cost basis for fiscal years ended before

December 25, 1980 may be presented in the first annual report for a fiscal year ended on or after December 25, 1980.

68. An enterprise is required to state, in the five-year summary of selected financial data, only the following amounts for fiscal years ended before December 25, 1979: net sales and other operating revenues, cash dividends declared per common share, and market price per common share at fiscal year-end (paragraph 35(a), (d)(2), and (d)(3)). Disclosure of the other items listed in paragraph 35, for fiscal years ended before December 25, 1979 is encouraged. Disclosure of current cost information in the five-year summary (paragraph 35(c)) for fiscal years ending before December 25, 1980 may be postponed to the first annual report for a fiscal year ending on or after December 25, 1980.

69. An enterprise that first applies the requirements of this Statement for a fiscal year ended on or after December 25, 1980 is required to state for earlier years, in its five-year summary, only the following items listed in paragraph 35: net sales and other operating revenues (item (a)), cash dividends declared per common share (item (d)(2)), and market price per common share at fiscal year-end (item (d)(3)). Disclosure of the other items listed in paragraph 35 for earlier years is encouraged.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Mosso and Walters dissented.

Mr. Mosso dissents because he believes that the Statement does not bring the basic problem it addresses — measuring the effect of inflation on business operations — into focus. Because of that he doubts that it will effectively communicate the erosive impact of inflation on profits and capital and the significance of that erosion on all who have an investment stake in business enterprises. The Statement seems to him to fail the cost-benefit test because potential benefits are diminished by diffusion and some costs are unnecessary regardless of benefits.

The lack of focus stems from the dual reporting requirements imposed by this Statement, reporting on both historical cost/constant dollar and current cost bases, and is compounded by the ambivalence of the income concepts in both approaches. The Statement offers at least four income numbers — historical cost/constant dollar or current cost, each with or without adjustments for purchasing power gains or losses on monetary items. Other income combinations are invited in the current cost approach because of the juxtaposition of the increase or decrease in current cost amounts of assets. This array of income numbers is a good reflection of the range of views existing among the Board's respondents; but a good mirror does not make a good standard.

Mr. Mosso does not share the widely-held view that the historical cost/constant dollar and current cost models have different objectives. The objective is the same: To measure the

effect of inflation on a business enterprise. But there are two types of inflation effect. The Board's historical cost/constant dollar model captures one type, the effect of inflation on the purchasing power of money invested in a particular business. The Board's current cost model captures both types. It incorporates some features of the constant dollar model and also the effect on the prices of goods and services that a particular business deals in. Inflation affects different specific prices in different ways. Consequently, information about changes in an index of general inflation does not provide sufficient information about the effect of inflation on a specific business enterprise. The current cost model is a more comprehensive inflation measurement approach and it makes a free standing historical cost/constant dollar model superfluous.

The constant dollar approach has two uses that he would support: One, as a method of computing simple one-line adjustments of net income and owners' equity in the primary historical cost financial statements, in conjunction with current cost supplemental statements (a proposal that deserves more support than it has received so far); or two, as an integral part of a supplemental current cost model, essentially as in the current cost approach required by this Statement. As a complete model, however, the historical cost/constant dollar approach has little to recommend it except seniority.

A major criterion that the Board has established for choosing among alternative disclosure is usefulness of the information for predicting earnings and cash flows. The evidence presented to the Board on usefulness in this sense was sketchy, but virtually all of it favored the current cost approach. In fact, usefulness for predicting earnings and cash flows was rarely associated with the historical cost/constant dollar approach, even by its supporters.

Beyond the investor-oriented usefulness criterion, the current cost model bears directly on an urgent national economic policy issue, that of capital formation and its corollary, productivity. The current cost model is built around the notion of maintaining operating capacity, and the distributable income concept that goes with it is designed to trigger attention at the point where reduction of capacity sets in. The whole system pivots on the point where capital investment begins to rise or fall. In the historical cost/constant dollar model, reduction of operating capacity can occur without showing up in the financial statements. This is not to suggest that it is a function of the Board to design accounting standards to promote economic policy objectives. But it is a function of the Board to design standards that measure business income and investment and to be aware, in doing so, of the broader economic consequences of standards. The current cost model has the potential for measuring and communicating many effects of inflation in ways that will be useful both to investors, to policy makers, and to the business community.

Much of the resistance to current cost accounting derives from two interrelated misconceptions: First that it is a major step toward current value accounting and second that its measurements are subjective and open to income manipulation. These are valid concerns. They should not be dismissed or lulled. But neither is an inherent concomitant of current cost accounting.

The essence of current value accounting is revenue recognition on some prerealization basis. The increases in current cost amounts of assets (so-called "holding gains") arising in a current cost model can be viewed as income equivalents, but that view is not necessary. The

model can classify those items as capital maintenance adjustments — necessary to keep the business on a level output trendline.

Subjectivity of measurement is also associated with the current cost model because in theory it breaks the link to historical transaction prices. In practice, this need not be a problem. Indexing can maintain a linkage to historical prices and preserve objectivity and reliability. Many other current costing techniques compare favorably, in terms of objectivity, with historical cost allocation techniques.

In Mr. Mosso's view, conventional accounting measurements fail to capture the erosion of business profits and invested capital caused by inflation. The urgent need is to focus attention on that basic problem. To do that effectively, it is essential to settle on a single inflation-adjusted bottom line within a frame-work that captures the price experience of individual firms. The door should be closed quickly and firmly on the dual approach with multiple income numbers.

Mr. Walters dissents because he believes that the dual approach in this Statement unfortunately attempts to deal with two very important but fundamentally different issues in combination. The result is most confusing.

The first issue is the need to measure and report the impact on the enterprise of the change in the exchange value of money. This need is urgent. Paton said: "A summation of unlike monetary units, even of the same name, is a misrepresentation." The integrity of the historical cost/nominal dollar system relies on a stable monetary system. We have experienced several decades of continuing debasement of the currency. It is essential to the credibility of financial reporting to recognize that the recovery of the real cost of investment is not earnings — that there can be no earnings unless and until the purchasing power of capital is maintained. The constant dollar information required by this Statement, provided one takes the monetary adjustment into consideration, will generally accomplish this within a reasonable order of magnitude. It is not experimental. It is ready to go.

The second issue is the need to introduce current costs or values into the financial reporting model. The record built in the Board's due process indicates that the Securities and Exchange Commission, some educators, and some financial analysts perceive such a need. Issuers of financial statements and auditors, in the main, either do not perceive a need at this time, or believe the proposed model needs further development and testing or that the costs exceed the benefits.

The current cost information introduced in this Statement has significant limitations. It is neither a comprehensive current cost nor a value system. It identifies as income from continuing operations an amount that is sometimes referred to as distributable income." This amount may have use in funds flow analysis, but it is neither distributable nor income. In most cases, it is a result of subtracting the estimated cost of the next purchase from the revenue from the last sale. It is neither transaction-based income nor real economic income. It has no "bottom line." It is best an intermediate step, easily misinterpreted.

To reduce complexity, the Board elected to defer action or deal inconclusively with such significant matters as backlog depreciation, holding gains, tax allocation, gearing adjustments, and liability measurement. The sacrifice of completeness for understandability leaves us with a model that falls short of the mark on both counts.

This Statement reflects diverse views on the best way to report the effects of changing prices. The resulting product has something for everybody, but by requiring a number of supplemental income amounts which can be used in various combinations, it does not focus on a concept of real income. It offers a smorgasbord of data that fail to meet the tests of simplicity, understandability, and therefore cost-effectiveness.

The weight of evidence suggests that the Board is promulgating a current cost model that is not ready, for a constituency that is not ready for it. Experimentation with current cost and value information is sorely needed to establish their feasibility, reliability, cost, and usefulness. Mr. Walters believes that this experimentation should be conducted with volunteer companies working through professional organizations of business executives, accountants, and financial analysts. Regulators mandate experiments in financial reports; standard setters should not.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: ILLUSTRATIONS OF DISCLOSURES

70. This appendix gives illustrations of formats that may be used to disclose the information required by this Statement. The illustrations relate to a manufacturing enterprise. The Board has formed an advisory group to develop additional illustrations of formats for presenting the information required by this Statement. It intends to publish those illustrations as soon as possible. The illustrations will cover various types of manufacturing and other enterprises. The Board recognizes that clear presentations and explanations are important if information on the effects of changing prices is to be as useful as possible. It encourages enterprises to experiment with the use of different forms of presentation.

Schedule A

STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES

For the Year Ended December 31, 1980
(In (000s) of Average 1980 Dollars)

Income from continuing operations, as reported in the income statement		$ 9,000
Adjustments to restate costs for the effect of general inflation		
Cost of goods sold	(7,384)	
Depreciation and amortization expense	(4,130)	(11,514)
Loss from continuing operations adjusted for general inflation		(2,514)
Adjustments to reflect the difference between general inflation and changes in specific prices (current costs)		
Cost of goods sold	(1,024)	
Depreciation and amortization expense	(5,370)	(6,394)
Loss from continuing operations adjusted for changes in specific prices		$ (8,908)
Gain from decline in purchasing power of net amounts owed		$ 7,729
Increase in specific prices (current cost) of inventories and property, plant, and equipment held during the year *		$ 24,608
Effect of increase in general price level		18,959
Excess of increase in specific prices over increase in the general price level		$ 5,649

Schedule B

STATEMENT OF INCOME FROM CONTINUING OPERATIONS ADJUSTED FOR CHANGING PRICES

For the Year Ended December 31, 1980
(In (000s) of Dollars)

	As Reported in the Primary Statements	Adjusted for General Inflation	Adjusted for Changes in Specific Prices (Current Costs)
Net sales and other operating revenues	$253,000	$253,000	$253,000
Cost of goods sold	197,000	204,384	205,408
Depreciation and amortization expense	10,000	14,130	19,500
Other operating expense	20,835	20,835	20,835
Interest expense	7,165	7,165	7,165
Provision for income taxes	9,000	9,000	9,000
	244,000	255,514	261,908
Income (loss) from continuing operations	$ 9,000	$(2,514)	$(8,908)
Gain from decline in purchasing power of net amounts owed		$ 7,729	$ 7,729
Increase in specific prices (current cost) of inventories and property, plant, and equipment held during the year *			$ 24,608
Effect of increase in general price level			18,959
Excess of increase in specific prices over increase in the general price level			$ 5,649

Schedule C

FIVE-YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES

(In (000s) of Average 1980 Dollars)

	Years Ended December 31,				
	1976	**1977**	**1978**	**1979**	**1980**
Net sales and other operating revenues	265,000	235,000	240,000	237,063	253,000
Historical cost information adjusted for general inflation					
Income (loss) from continuing operations				(2,761)	(2,514)
Income (loss) from continuing operations per common share				$ (1.91)	$ (1.68)
Net assets at year-end				55,518	57,733
Current cost information				(4,125)	(8,908)
Income (loss) from continuing operations					
Income (loss) from continuing operations per common share				$ (2.75)	$ (5.94)
Excess of increase in specific prices over increase in the general price level				2,292	5,649
Net assets at year-end				79,996	81,466
Gain from decline in purchasing power of net amounts owed				7,027	7,729
Cash dividends declared per common share	$ 2.59	$ 2.43	$ 2.26	$ 2.16	$ 2.00
Market price per common share at year-end	$ 32	$ 31	$ 43	$ 39	$ 35
Average consumer price index	170.5	181.5	195.4	205.0	220.9

Appendix B: BACKGROUND

71. Accounting literature has long recognized that price changes cause difficulties in measuring and comparing financial statement elements. As Professor William Paton noted in 1922, "the value of the dollar — its general purchasing power — is subject to serious change over a period of years... Accountants... deal with an unstable, variable unit; and comparisons of unadjusted accounting statements prepared at intervals are accordingly always more or less unsatisfactory and are often positively misleading." [4] The subject of changes in general prices has been discussed widely in accounting literature and was extensively studied by the Accounting Principles Board (APB) of the American Institute of Certified Public Accountants (AICPA) and its predecessor, the Committee on Accounting Procedure. In 1947,[5] 1948,[6] and 1953 [7] the Committee, and in 1965 the APB (in APB Opinion No. 6, Status of Accounting Research Bulletins), considered accounting problems related to sharp increases in the general level of prices. Several of these pronouncements were particularly concerned with the amount of depreciation to be charged against current income for facilities acquired at lower prices. The Committee concluded that depreciation charges should be based on historical cost, but gave full support to the use of supplementary financial schedules, explanations, or footnotes by which company management might explain the need for retention of earnings because of the effects of inflation.

72. The AICPA published ARS No. 6, *Reporting the Financial Effects of Price-Level Changes,* in 1963; and in June 1969, the APB issued APB Statement No. 3, *Financial Statements Restated for General Price-Level Changes*. The Statement recommended that "historical-dollar" financial statements be supplemented by general price-level information. But the APB stopped short of requiring general price-level information for fair presentation of financial position and results of operations in conformity with generally accepted accounting principles. Very few companies have followed the APB's recommendation.

73. The FASB added the subject of reporting the effects of general price-level changes in financial statements to its agenda in January 1974, issued an FASB Discussion Memorandum, *Reporting the Effects of General Priced-Level Changes in Financial Statements,* on February 15, 1974, held a public hearing in April 1974, and on December 31, 1974 issued an FASB Exposure Draft, *Financial Reporting in Units of General Purchasing Power.* That Exposure Draft proposed to require supplementary disclosure of specified financial information, stated in units of general purchasing power, in addition to financial statements presented in units of money. The Board received 476 letters of comment on the Exposure Draft. In November 1975, the Board announced that a final Statement on general purchasing power accounting would not be issued that year, pending additional analysis of the results of a field test of the Exposure Draft provisions conducted by a large number of companies

74. In March 1976, the Securities and Exchange Commission issued ASR 190 requiring certain publicly held companies to disclose replacement cost information about inventories, cost of sales, productive capacity, and depreciation. The Commission announced at that time that its requirements were not competitive with the Board's proposal for general price-level accounting information, and did not prejudge the Board's conceptual framework studies.

75. In June 1976, the Board deferred action on its Exposure Draft on general purchasing power accounting pending further progress on its project on a conceptual framework for accounting and reporting. The Board concluded that general purchasing power information was not sufficiently understood by preparers and users, and the need for it was not sufficiently demonstrated to justify imposing the cost of implementation upon all preparers of financial statements at that time. Another consideration was the effort required at that time of many of the largest corporations in providing the current replacement cost data required by the SEC.

76. On December 2, 1976, the Board published, as part of its conceptual framework project, an FASB Discussion Memorandum, *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement.* Public hearings were conducted on the measurement issues in that Discussion Memorandum in January 1978. The Board received 270 letters of comment on measurement issues in response to the Discussion Memorandum and 27 presentations were made at the public hearing.

77. In May 1977, the Board published an FASB Research Report, *Field Tests of Financial Reporting in Units of General Purchasing Power.* The Report summarized the results of field tests by 101 companies of the restatement techniques proposed in the December 1974 Exposure Draft.

78. On December 28, 1978, the Board issued an FASB Exposure Draft, *Financial Reporting and Changing Prices,* and on March 2, 1979, published an Exposure Draft, Supplement to the 1974 proposed Statement on general purchasing power adjustments. That Exposure Draft was entitled *Constant Dollar Accounting.*

79. Those Exposure Drafts were general in nature and did not address possible problems of measurement or disclosure that might be faced by different industries or for specialized assets. The Board recognized that those problems needed further attention and therefore appointed six special industry task groups for banking and thrift institutions, forest products, insurance, mining, oil and gas, and real estate. Those task groups were composed of industry executives, public accountants, financial analysts, and academicians. Their objectives were to identify the problems of measurement related to specialized assets and industries and to propose solutions that were consistent with the objectives and conceptual conclusions in the Exposure Drafts on changing prices and constant dollar accounting. An additional objective of the Oil and Gas Task Group was to maintain a close, direct liaison with the SEC and its staff as the Commission considered its proposed Reserve Recognition Accounting (RRA). To help assure this close contact, three of the members of the SEC's Advisory Committee on RRA also served on the

Board's Oil and Gas Task Group.

80. The six industry task groups each held open meetings in January through May 1979, issued Preliminary Reports in April 1979, and held public hearings in May 1979 at which 30 organizations and individuals commented on the Preliminary Reports.

81. The Board received letters of comment on the Exposure Drafts and on the task groups' Preliminary Reports from 450 respondents. Copies of the letters commenting on the Preliminary Reports were sent to all members of the related task groups.

82. The Board sponsored a Conference on Financial Reporting and Changing Prices in New York City on May 31, 1979 to call attention to the urgent need for better disclosure of the effects of inflation on business operations. More than 400 financial executives, analysts, accountants, professors, and public sector policymakers heard the comments of 14 speakers representing all segments of the Board's constituency. At the Conference, and subsequently in written Interim Reports issued after considering comments on their Preliminary Reports, the six industry task groups presented their recommendations to the Board. The Board received comments from 50 individuals and organizations in response to the task groups' Interim Reports.

83. In June 1979, the Board conducted a public hearing on the Exposure Drafts. Thirty-one organizations and individuals presented their views at the three-day hearing.

84. After issuance of the Exposure Drafts, the Board and its staff maintained close contact with representatives of the SEC to keep them fully informed of the Board's and task groups' activities, particularly as they affected the SEC's reconsideration of its ASR 190 replacement cost disclosure requirements and its development of RRA for oil and gas producing activities. Members of the SEC's staff attended the meeting of the Board's Oil and Gas Task Group, and representatives of the Board attended all of the meetings of the SEC's RRA Advisory Committee.

85. In March 1978, the Board reorganized its Conceptual Framework Task Force and appointed 23 members to advise the Board and its staff on certain issues related to preparing the Exposure Drafts and this Statement. Members of the task force came from various industries, public accounting, the securities industry, and academe. The task force met four times in 1978 and 1979 and were consulted on several specific measurement and disclosure issues that are addressed in this Statement. Drafts of various sections of this Statement were sent to the task force members for comment.

86. The worldwide nature of the problem of disclosing effects of changing prices has led to active development of general price level and "current value accounting" proposals in other countries. Some of these proposals have been tested and have been withdrawn temporarily for further development before being implemented. Some of the countries in which proposals have been developed are Argentina, Australia, Brazil, Canada, France, Ireland, Japan, Mexico, Netherlands, New Zealand, South Africa, the United Kingdom, and West Germany. The

European Economic Community (EEC) has issued a directive allowing member states to permit valuation methods that reflect inflation, and the International Accounting Standards Committee (IASC) is expected to issue an Exposure Draft of a proposed standard on changing prices in 1980.

Appendix C

BASIS FOR CONCLUSIONS

CONTENTS

Appendix C: BASIS FOR CONCLUSIONS

Introduction

87. This appendix reviews considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement; it includes reasons for accepting certain views and rejecting others. Each consideration that was important to an individual Board member is discussed in this appendix. However the Board members who assented to this Statement did so on the basis of overall considerations and they do not attach equal weight to each consideration discussed.

88. This appendix first reviews the objectives of this Statement (paragraphs 92-96). In broad terms, the objectives are to provide information on the most significant effects on business enterprises of changing prices. This Statement calls for supplementary information about those effects in financial reports of large public enterprises. Alternative bases for the preparation of supplementary information are described in paragraphs 97-101. Paragraphs 102-115 explain two fundamental conclusions, on which all the other conclusions depend: (a) historical cost/nominal dollar accounting should continue to be used in the primary financial statements and (b) all enterprises affected by this Statement should present two types of supplementary information — historical cost/constant dollar information and current cost information. During the next several years, the Board intends to examine additional evidence on the usefulness of the supplementary information. There are strong reasons for expecting that the information will be useful; however, the evidence will provide a basis for future decisions on the continuation or modification of the requirements of this Statement and possibly on extending them to a larger group of enterprises.

89. Paragraphs 116-155 explain the reasons for believing that each of the requirements of this Statement will be useful in providing information that is relevant to the objectives of this Statement.

90. The preparation of information on the effects of changing prices may present special difficulty in certain industries because of the nature of the resources that they use or because of other aspects of their operations. Some of those special difficulties are discussed in paragraphs 156-178.

91. The remainder of this appendix gives the bases for the Board's conclusions at a more detailed level. Issues that arise in current cost accounting are discussed in paragraphs 179-186; issues that arise in constant dollar accounting are discussed in paragraphs 187-192; issues that arise under both methods are discussed in paragraphs 193-198. Decisions on the applicability of this Statement and on the display of information are explained in paragraphs 199-207.

Objectives of This Statement

92. Changing prices have significant effects on business enterprises. If those effects are not recognized, poor decisions may be made in all sectors of society. Investors may lack important information for decisions on how much to invest, in which enterprises to invest, and on what terms; creditors may have a weak basis for decisions on the granting and pricing of credit. Consequently, the cost of capital may be too high or too low for individual enterprises: resources may be allocated inefficiently. Furthermore, people in government who participate in decisions on economic policy may not obtain the most relevant information on which to base their decisions.

93. Many people have a general understanding of the need to take account of changing prices in the interpretation of financial statements. However, there are several reasons for believing that the effects of changing prices cannot be understood adequately until they are directly reflected in financial reports:

a. The effects of changing prices depend partially on the transactions and circumstances of an enterprise and users do not have detailed information about those factors.
b. Alleviation of the problems caused by changing prices depends on a widespread understanding of those problems; a widespread understanding is unlikely to develop until business performance is discussed in terms of measures that explicitly allow for the effects of changing prices.
c. Statements by managers about the problems caused by changing prices will have greater credibility when enterprises publish financial information that addresses those problems.

94. This Statement calls for information that will be useful for users' assessments of the effects of changing prices in the following ways:

a. *Assessment of future cash flows.* In present financial statements, assets and expenses are generally measured on the basis of historical costs; changes in the prices of assets during the period between their acquisition and use or sale often are not reported. Supplementary information about those price changes will provide an up-to-date basis for users' assessments of future cash flows.
b. *Assessment of erosion of operating capability.* In assessing the future prospects of an enterprise, the users of financial reports are typically interested in whether or not an enterprise has maintained its operating capability. The maintenance of operating capability (the ability to supply a fixed quantity of goods and services) requires the holding of minimum quantities of inventory and property, plant, and equipment (and perhaps other assets). When the prices of those assets are increasing, larger amounts of money investment are needed to maintain the previous levels of output. For example, an enterprise may buy an item of inventory for $100 and sell it for $140. The transactions would contribute $40 to income determined on a historical cost/nominal dollar basis (i.e., under generally accepted accounting principles). However, the enterprise may need to replace the inventory at a cost of $115. The sale produces only $25 ($140 less $115), available for distribution without impairment of operating capability. A larger distribution, in payment of taxes or dividends, could result in an erosion of the capital required to maintain operating capability. Information on the current prices of resources that are used to generate revenues can help users to assess the extent to which and the manner in which operating capability has been maintained.
c. *Assessment of financial performance.* An enterprise may become better off as a result of holding

assets while their prices increase. For example, an enterprise may decide to increase its inventory beyond the minimum required level in order to avoid expected future increases in prices. If the price increases do take place, the decision will have increased the worth of resources. Moreover, if contribution margins (selling prices less buying prices) increase with buying prices, an enterprise may be able to sustain a given level of net cash inflows with a smaller physical investment: increases in buying prices may leave the enterprise better off in the sense of being able to earn higher nominal cash inflows. Disclosure of the effects of price changes may provide an improved basis for assessing the worth of the resources of an enterprise and hence for assessing its financial performance.

d. *Assessment of the erosion of general purchasing power.* Cash distributions by an enterprise to investors are used partly for consumption, that is for expenditures that will determine investors' standard of living. For most people, the ultimate objective of investing is to maintain or improve their standard of living or to increase their estate. When prices in general are increasing, larger sums of money are needed to maintain a fixed standard of living. If rates of return are (approximately) fixed, larger cash distributions may be obtained only as a result of increases in the amount of money invested: The amount of additional investment required depends on the rate of inflation and the extent to which it is compensated by changes in rates of return. For example, the investment of $1,000 at 10 percent will yield $100 per year. If the general price level increases by 15 percent, $115 will be needed to maintain the purchasing power of the yield. If the rate of return remains equal to 10 percent, the investment would need to be increased to $1,150 to maintain purchasing power. Financial information that reflects changes in general purchasing power can provide an improved basis for assessing whether an enterprise has maintained the purchasing power of its capital.

95. The objectives described in paragraph 94 are derived from the objectives of financial reporting set out in Concepts Statement 1. In particular that Statement calls for:

a. Information to help present and potential investors, creditors, and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise (paragraph 37).
b. Information about the economic resources of an enterprise, claims to those resources, and transactions, events, and circumstances that change its resources and claims to those resources (paragraph 40).
c. Information about an enterprise's performance provided by measures of earnings and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information (paragraph 43).

96. In fulfilling the objectives summarized in paragraph 94, this Statement requires information only about the effects of changes in the specific prices of resources used by an enterprise and the effects of changes in the general purchasing power of money. It is beyond the scope of this Statement

to consider other matters that are relevant to the assessment of future cash flows. The Board believes that problems associated with changing prices are urgent and require immediate attention.

Alternative Accounting Systems

97. The alternatives considered by the Board may be grouped under three headings:

a. Measurements of inventory and property, plant, and equipment
   (1) Historical cost
   (2) Current reproduction cost
   (3) Current replacement cost
   (4) Net realizable value
   (5) Net present value of expected future cash flows (value in use)
   (6) Recoverable amount
   (7) Current cost
   (8) Value to the business (current cost or lower recoverable amount)
b. Concepts of capital maintenance
   (1) Financial capital maintenance
   (2) Physical capital maintenance (the maintenance of operating capability)
c. Measuring units
   (1) Measurements in nominal dollars
   (2) Measurements in constant dollars.

It is possible to combine any method of asset measurement with either concept of capital maintenance and with either measuring unit even though some combinations have greater coherence than others.

98. Paragraph 97 identifies alternatives for the measurement of certain nonmonetary assets but makes no reference to alternatives for the measurement of nonmonetary liabilities. Various alternatives are available for the measurement of liabilities. However, the Board decided to focus on alternatives available for asset measurement because it believes that those alternatives have the greatest immediate importance for the urgent needs described in paragraph 94.

99. The asset measurements listed in paragraph 97 may be described as follows:

a. *Historical cost.* Assets are measured initially at the amount of cash (or its equivalent) paid to acquire them. Subsequently, the historical cost may be adjusted for depreciation or amortization.
b. *Current reproduction cost.* The amount of cash (or its equivalent) that would have to be paid to acquire an identical asset currently. If the reproduction cost of a used asset is measured by referring to the cost of a new asset it may need to be adjusted for depreciation or amortization.
c. *Current replacement cost.* The amount of cash (or its equivalent) that would have to be paid to acquire currently the best asset available to undertake the function of the asset owned (less depreciation or amortization if appropriate). This concept of replacement cost should be distinguished from the cost of replacing the service potential of the asset owned, called "current cost" in this Statement.

d. *Net realizable value.* Assets are measured at the amount of cash (or its equivalent) expected to be derived from sale of an asset, net of costs required to be incurred as a result of the sale.

e. *Net present value of expected future cash flows.* Assets are measured at the present value of expected future cash inflows into which the asset is expected to be converted in due course of business less the present value of expected future cash outflows necessary to obtain those inflows. This measurement of an asset is often described as value in use.

f. *Current cost.* Current cost is equal to the current replacement cost of the asset owned, adjusted for the value of any operating advantages or disadvantages of the asset owned. Current cost differs from current replacement cost in that current cost measurement focuses on the cost of the service potential embodied in the asset owned by the enterprise whereas current replacement cost may be a measurement of a different asset, available for use in place of the asset owned. Current cost will be less than current replacement cost if the service potential of the asset owned is less than the service potential of the asset that would replace it. That may be the case, for example, when the asset owned has a higher operating cost or produces an output of lower quality. Similarly, current cost may be less than current reproduction cost if identical used assets are not available for purchase and if acquisition of a new, but otherwise identical, asset would not be worthwhile because that asset is obsolete for the purposes of the enterprise concerned.

g. *Recoverable amount.* The net realizable value of an asset that is about to be sold or the net present value of expected cash flows (value in use) of an asset that is not about to be sold.

h. *Value to the business.* Value to the business may be defined as the lower of (1) current cost and (2) recoverable amount, where recoverable amount is measured at the higher of net realizable value and net present value of future cash flows. The rationale for measurement at value to the business is that the measurement of an asset should depend on the circumstances of the enterprise. Current cost is the appropriate measure if purchase of the asset would be worthwhile in current circumstances, i.e., if the value of the earning power of the asset is at least equal to current cost. In some cases, however, current purchase of the asset would not be worthwhile and current cost would then overstate the worth of the asset. If the asset is about to be sold, its worth to the business is limited to net realizable value. If the asset is not about to be sold (but would not be replaced), value in use would be an appropriate measure of the asset. Value to the business is often called "deprival value" because it can be assessed by assuming that the enterprise has been deprived of the use of an asset and asking how much the enterprise would need to be paid to compensate it for the loss. Current cost sets the upper limit for measurement of the asset. The maximum loss incurred by the enterprise, following deprival, would be limited to the current cost of the asset as long as replacement was possible. The assumption of deprival should not be interpreted literally; it is no more than a helpful analytical device. (As the above discussion indicates, the terms "value to the business," "deprival value," and "current cost or lower recoverable amount" all have the same meaning.)

100. Capital is maintained when revenues are at least equal to all costs and expenses. The appropriate measurement of costs and expenses depends on the concept of capital maintenance adopted. The capital maintenance concepts listed in paragraph 97 may be described as follows:

a. Financial capital maintenance. If capital is regarded as a quantity of financial resources, costs and

expenses should be measured in terms of the financial resources (usually historical costs) used up in earning the revenues. Suppose, for example, that an enterprise is established with a capital of $1,000 in cash; that sum is used immediately to purchase inventory; the inventory is sold a year later for $1,500. Cost of goods sold would be measured at $1,000, the amount required to maintain the original money amount of capital invested in the inventory, and income would be measured at $500. Suppose, as an alternative, that the inventory is held and measured at its current cost ($1,200) at the end of the year. Those who believe in financial capital maintenance would recognize the increase in current cost ($200) as part of income: $1,000 is deducted from the current cost of $1,200 at the end of the year to maintain the amount of financial capital invested.

b. Physical capital maintenance (the maintenance of physical operating capability). According to this view, costs and expenses are measured at an amount sufficient to preserve the capacity of the enterprise to maintain previous levels of output of goods and services. Consider again the numerical example given in subparagraph (a) above. If the inventory is sold for $1,500, and if the current cost of the inventory is $1,200 at the date of sale, income would be measured at $300 ($1,500 less $1,200); $1,200 must be retained to maintain the physical operating capability of the enterprise. Similarly, if the inventory is held and measured at $1,200 at the end of the year, no income would be recognized.

101. The units of measurement listed in paragraph 97 may be described as follows:

a. Nominal dollars. All events, transactions, and other circumstances affecting the financial statements are measured and reported in actual money amounts without adjustment for the fact that one dollar represents a different amount of purchasing power at different times. Measurements are expressed in nominal dollars in the primary financial statements under generally accepted accounting principles.

b. Constant dollars (units of general purchasing power). All events, transactions, and other circumstances affecting the enterprise are measured in units of constant general purchasing power represented by the dollar at some specified base date. Advocates of this method of measurement often regard its main advantage as the use of homogeneous units whereas the nominal dollar method involves units having a variable worth. Consider again the simplified numerical example given in paragraph 100 and suppose that the general price level increases by 10 percent during the year under consideration. Suppose, also, that the purchasing power of the dollar at the end of the year is used as the unit of measure. The amount of capital to be maintained under the financial capital maintenance concept will be $1,100 because that amount in end-of-period dollars has the same purchasing power as $1,000 at the start of the period. If the inventory was sold at the end of the period for $1,500, income would be measured at $400 ($1,500 less $1,100). If the inventory was held and measured at a current cost of $1,200 at the end of the period, and the financial capital maintenance concept was again used, income would be measured at only $100 ($1,200 less $1,100). Constant dollars may be used as a measuring unit regardless of which attribute of assets is measured and regardless of whether the financial capital maintenance concept or the physical capital maintenance concept is used.

Selection of Supplementary Disclosures

102. In choosing among the alternatives described in paragraphs 97-101, the Board considered the benefits of each system in terms of usefulness in meeting the needs listed in paragraph 94 and it weighed those benefits against the costs of implementing the systems. Usefulness was assessed in terms of the relevance of the measurements to the objectives and in terms of the reliability of the measurements as indicated by representational faithfulness and verifiability. The Board recognized the desirability of limiting the costs of preparing information about the effects of changing prices by allowing an enterprise the flexibility to choose any one of several alternative sources of information to obtain the required measurements and by encouraging approximate methods of computation.

103. No accounting computation can represent perfectly all the complex considerations that are relevant to the assessment of future cash flows to an enterprise or to the evaluation of enterprise performance. It will always be necessary for users of financial reports to exercise independent judgment, taking account of their knowledge of the general economic environment and the structure of the industry in which an enterprise operates. Decisions on the desirability of new accounting requirements should be based on answers to questions such as: Would the new information provide an improved basis for users' judgment? Does the new information represent an improvement over existing information, an improvement that is sufficient to justify the extra costs?

104The Board concluded that information in the primary financial statements should continue to be measured on a historical cost/nominal dollar basis and that enterprises should present certain supplementary information according to two main bases:

a. Historical cost/constant dollar accounting. Inventory and property, plant, and equipment, cost of goods sold, and depreciation expense would be measured at historical cost/constant dollar amounts or lower recoverable amounts. Constant dollar adjustments need not be applied comprehensively to the remaining nonmonetary items in the financial statements but would be applied to computation of the purchasing power gain or loss on net monetary items.
b. Current cost accounting. Inventory and property, plant, and equipment, cost of goods sold, and depreciation expense would be measured at current cost or lower recoverable amounts. Current cost adjustments would not be applied to other items in the financial statements. Constant dollar adjustments would not be applied comprehensively to the current cost information but would be applied to computations of the increase or decrease in current cost amounts of inventory, property, plant, and equipment and to the purchasing power gain or loss on net monetary items.

In the Exposure Draft, the Board expressed its conclusion that the financial capital maintenance concept is more useful than the physical capital maintenance concept. It has subsequently concluded that it should express no preference for either concept at this time and that enterprises should present information that would enable users to assess the amount of income under both concepts.

105. The Board believes that further experimentation is required on the usefulness of the two types of supplementary information described in paragraph 104. The basis for that belief is set out in paragraphs 109-115. However, the Board has concluded that there are strong reasons to expect that

both types of supplementary information will be useful. Those reasons are reviewed in paragraphs 116-155 in terms of the objectives described in paragraph 94. Special considerations are applicable to certain types of enterprises and those considerations are discussed in paragraphs 156-178.

Continued Reliance on Historical Cost/Nominal Dollar Accounting

106. Most financial statements prepared in the United States measure nonmonetary assets at historical costs. For example, under present practice, inventory and property, plant, and equipment are normally measured at historical cost or depreciated historical cost in the balance sheet; when an asset is wholly or partly used in revenue-producing activities, the related expense is also measured at historical cost. The measuring unit in financial statements is the nominal dollar; changes in the purchasing power of the dollar are ignored.

107. Historical cost/nominal dollar accounting is widely believed to provide useful information. Historical cost is accepted as a satisfactory measure of asset value at the date of acquisition. It can be measured with acceptable reliability in the vast majority of cases. The tradition of measuring profit on the sale of an asset as the excess of selling price over historical cost is simple to understand, as is the meaning of acquisition cost as the measure of an asset.

The Advantages of Requirements of Supplementary Information

108. Many observers concerned with financial reports have had little experience with the preparation and use of financial reports based on systems other than historical cost/nominal dollar accounting. A change in the measures of assets and expenses in the primary financial statements would be confusing to some. An approach based on supplementary information has several advantages over requirements for changes in the primary financial statements: Familiar types of information would continue to be available to users and would provide a basis for evaluation of the supplementary information; experience with supplementary information on the effects of changing prices would permit better assessment of the usefulness of alternative methods; possible disruption of the procedures involved in accounting, auditing, and financial analysis would be minimized; and the exemption of small and closely held enterprises from the requirements of a Statement on supplementary disclosure would be preferable to exemptions from requirements related to the primary financial statements. Moreover, the retention of historical cost as the basic measure for most enterprises makes it possible to justify the allowance of more flexibility in the preparation of information on the impact of changing prices. Experience with supplementary information based on different measurement concepts may or may not eventually lead to changes in measurements in the primary financial statements. The Board concluded that no change should be made to the primary financial statements at this time. That decision was widely supported by those who commented on the Exposure Draft.

The Need for Experimentation

109. The Exposure Draft proposed that enterprises should be permitted to choose between the

provision of supplementary information on a historical cost/constant dollar basis and on a current cost basis. Guidelines were provided for the choice. The Board had tentatively concluded that a choice should be permitted because it believed that both methods would provide useful information but it had insufficient evidence to select one and reject the other. Moreover, the Board concluded that both methods could be implemented with acceptable reliability. Extensive field tests of historical cost/constant dollar accounting had been carried out by the Board in 1975 and enterprises had obtained extensive experience, in complying with the SEC's replacement cost requirements in ASR 190, with the measurement of data having many similarities to current cost data.

110. Constant dollar accounting and current cost accounting may be regarded as methods for dealing with two different problems. In times of general inflation, the nominal dollar has a variable purchasing power. Nominal dollar accounting therefore involves the aggregation of measures expressed in a variable unit. Constant dollar accounting overcomes that problem. However, historical cost/constant dollar accounting simply restates the primary financial statements in units of constant purchasing power. Current cost accounting deals with changes in the specific prices of resources used by the enterprise. Many comment letters on the Exposure Draft argued that the differences of purpose made it inappropriate to allow a choice between the two methods.

111. Many people have also argued that the provision of choice would make it difficult to gather valid evidence on the usefulness of the two methods. If similar enterprises chose different methods, the information in their reports would not be comparable. Moreover, choices might be biased in favor of one method with the result that insufficient evidence would be available for a comparative evaluation of the two methods. The Board accepted the arguments against the provision of choice between current cost information and historical cost/constant dollar information.

112. The comment letters and public hearings indicated sharp divisions of opinion on the relative usefulness of historical cost/constant dollar accounting and current cost accounting. Comments from the users of financial reports strongly supported a system that measured assets at current cost. Those comments appear to reflect the belief that current cost measures are more relevant than historical cost measures for the assessment of future cash flows. Many preparers of financial reports and public accounting firms favored historical cost/constant dollar accounting. Their comments typically emphasized the lower cost and the higher verifiability and representational faithfulness of historical cost/constant dollar accounting.

113. The arguments against permitting choice and the absence of a clear preference for one method suggest the need to call for supplementary information according to both methods. The Board considered whether such a requirement could be met within acceptable cost limits. It concluded that the incremental costs of implementation would not be excessive if it provided for simplifications in the methods of measurement and computation. Moreover, the incremental cost would be further limited if, as expected, the SEC rescinds its requirement for the disclosure of replacement cost data under ASR 190. The Board further noted that some of the preparatory work would be common to both methods. For example, if an enterprise determined current cost by using indexes of specific price, the same "aging" of assets would be required for both historical cost/constant dollar measurements and current

cost measurements. Moreover, most of the enterprises covered by this Statement would already have undertaken that "aging" in preparing data on replacement costs to comply with ASR 190.

114. Some people believe that the presentation of supplementary information about two different measures of income will be confusing to some users. The Board believes that confusion can be substantially avoided if enterprises include sufficient explanatory material in the financial reports to help users understand the supplementary information; this Statement requires presentation of that explanatory material. The Board also believes that the presentation of alternative measurements may be desirable in itself. A single measure may be insufficient to convey all the effects of changing prices on a business enterprise.

115. The Board intends to assess the usefulness of the information called for by this Statement. It proposes to carry out research to answer questions such as the following: Which supplementary information is used? By whom is it used? How is it used? The Board will review the requirements of the Statement comprehensively when it has obtained sufficient evidence on usefulness. It anticipates that a period of up to five years may be required to gather satisfactory evidence. However, the Board will also reassess the costs and benefits of providing the information required by this Statement on an ongoing basis and will amend or withdraw requirements whenever that course is justified by the evidence.

The Usefulness of Supplementary Information on Changing Prices

The Assessment of Future Cash Flows

116. Concepts Statement 1 expresses the Board's conclusion that financial reports should provide information to help users assess the amounts, timing, and uncertainty of future cash flows. That conclusion provides the primary basis for believing that the information required by this Statement will be useful.

117. Current cost income reflects current cost margins—sales revenues less the current cost of inputs. Information on current cost margins may be useful for assessing future cash flows particularly if the selling price of a product is closely related to its current cost at the date of sale. However, the Board recognizes that selling prices are not determined by costs alone and that assessments of future cash flows must take account of changes in economic conditions as they affect the industry in which the enterprise operates.

118. The increase or decrease in current cost amounts of assets held by the enterprise may also provide a useful basis for the assessment of future cash flows. The results of holding activities and continuing operations will be affected differently by economic forces and the two measures may therefore be useful in different ways for the assessment of future cash flows. It is easier to take account of the various forces shaping the time patterns of operating income and changes in current cost amounts if the two items are separated as they are in the current cost information provided for by this

Statement.

119. Some people have pointed out that the holding of assets is normally necessary to the continuation of business activities. They have argued that the results of holding and the income from continuing operations are joint effects, and they take the view that separation is therefore invalid. However, the Board believes that this argument is outweighed by the counterarguments: separation may well improve the basis for assessments of future cash flows. Moreover, the holding period is not absolutely fixed. It may be varied to take advantage of favorable buying opportunities that may not recur, and it is useful to disclose separately the results of such opportunities.

120. The measurement of the current costs or lower recoverable amounts of assets may be regarded as partial recognition of the net present values of future cash flows from the use of the assets. Current cost represents a conservative measure of the net present value of future cash flows because net present value represents the maximum price at which purchase of an asset would be worthwhile. Competitive market forces normally cause current costs to have a closer and more stable relationship than historical costs to net present values. Moreover, recoverable amounts will be approximately equal to the net present values of future cash flow. Consequently, current costs or lower recoverable amounts may be regarded as providing a useful supplement to historical cost information for the purposes of assessing future cash flows.

121. The measurement of income from continuing operations on a current cost basis may be regarded as a guide to assessments of whether an enterprise has maintained its operating capability, i.e., its capacity to supply a fixed quantity of goods and services. Current cost income from continuing operations does not measure the maintenance of operating capability exactly because it rests on certain simplifying assumptions. For example, an enterprise may need to increase its net monetary working capital to maintain operating capability and that factor is ignored in the measurement of current cost income. Moreover, an enterprise may be able to obtain some of the capital required to maintain operating capability by borrowing or by raising new equity capital from external sources: That possibility also is ignored in the measurement of current cost income. Subject to those factors, however, the difference between dividends paid by an enterprise and current cost income from continuing operations provides an indication of changes in operating capability: An excess of dividends over current cost income indicates that operating capability has decreased; an excess of current cost income over dividends indicates that operating capability has increased. An enterprise will not normally wish to maintain its operating capability at a constant level over time. Decisions on the desired level of operating capability depend on rates of increase in the costs of resources used by the enterprise, the strength of demand for its products, the opportunities for commencing new lines of business and other factors. However, users who wish to assess future cash flows may find it helpful to have information from which they can assess whether operating capability has changed during a fiscal year. The relationship between current cost income and operating capability is discussed more fully in paragraphs 124-130.

122. In paragraphs 118 and 119, it was noted that separation of current cost income and increases or decreases in current cost amounts of assets held may be useful for assessments of future cash flows

because the two measures have different patterns over time. The usefulness of information on changes in current cost amounts may be explained in a different way. An increase in current costs of assets held by an enterprise represents an increase in its financial investment. Presumably, an enterprise can expect to earn a rate of return on that additional investment. Hence, information on changes in current cost amounts represents a basis for assessing changes in future cash flows and related returns on investment. That use of current cost information is discussed further in paragraphs 131-136.

123. The measurement of current cost amounts may be useful for the assessment of future cash flows in another, more general, manner. When users wish to assess future cash flows, they will often examine the components of financial statements in detail rather than focusing on summary measures such as income from continuing operations. Cost of goods sold at current cost, depreciation expense at current cost, and the current cost amounts of inventory and property, plant, and equipment will incorporate more up-to-date information about the prices of resources used by an enterprise than the corresponding historical cost amounts. Information based on current prices may provide a more useful basis than historical cost amounts for assessing future prices of the resources concerned and hence for assessing future cash flows.

Information on the Erosion of Physical Capital

124. Some members of the Board attach particular importance to the use of information on current cost income from continuing operations for assessments of whether an enterprise has maintained its operating capability. Erosion of physical capital (or erosion of operating capability) may be regarded as the failure to retain sufficient financial resources to acquire the assets needed to maintain the capacity of the enterprise to provide a constant supply of goods and services. The concept of physical capital erosion may be linked to a concept of distributable income where distributable income is defined as the amount of cash that may be distributed without reducing the operating capability of an enterprise. The information on current cost income from continuing operations required by this Statement provides a basis for users' assessments of distributable income.

125. In computations of current cost income from continuing operations, cost of goods sold, and depreciation expense are measured at current cost or lower recoverable amounts. The relevance of those measures to the assessment of the operating capability of an enterprise may be demonstrated by considering various circumstances in which the measurements may need to be made. First, suppose that current cost is equal to replacement cost (there have been no changes in technology or fashion since the asset owned was purchased) and that recoverable amounts exceed current cost: replacement of the asset is worthwhile. In that situation, costs must be measured at current cost in order to provide for the maintenance of operating capability. Assume, for example, that inventory is purchased for $1,000 and sold for $1,500 at a time when current cost is $1,200. Although historical cost/nominal dollar income is $500 ($1,500 less $1,000), distributions may be limited to $300 ($1,500 less $1,200) to maintain operating capability. Costs are measured at $1,200 in order to provide for the replacement of the inventory out of revenues. An increase of $200 ($1,200 less $1,000) in current costs would be recognized but would not be regarded as part of income under concepts that address the maintenance of physical operating capability.

126. In other circumstances, current cost may be less than replacement cost for various reasons. The service potential of the asset owned may be less than the service potential of new assets that are available. That situation would be important if purchase of a new asset would be worthwhile. Alternatively, the replacement of the asset owned may not be worthwhile because the type of inventory or output of the asset is no longer marketable at a satisfactory price; in other words, the recoverable amounts are lower than current cost. In those circumstances, measurement of costs may reflect (1) replacement costs or (2) current costs or lower recoverable amounts. The nature of the alternatives may be illustrated by a simplified example. Suppose that inventory was purchased for $1,000 but that the item goes out of fashion and is sold for $900 when replacement cost is $1,200. The results of the transaction may be measured in the following two ways:

	Replacement Cost	Measurement at Current Cost or Lower Recoverable Amount
Sales revenues	$ 900	$ 900
Cost of goods sold	1,200	900
Loss from continuing operations	$ (300)	$ 0
Cost at date of sale	$1,200	$ 900
Cost at date of acquisition	1,000	1,000
Increase (decrease) in current cost amounts	$ 200	$ (100)

Measurement at current cost or lower recoverable amount produces an income from continuing operations of zero. That concept may be justified by the argument that $100 has been lost while the asset was held and should be reported as a "decrease in current cost amounts"; operating capability can be maintained at the date of sale if revenues are at least equal to costs measured at $900. The alternative approach is to measure cost of goods sold at replacement cost, so that income would be measured at negative $300 and an increase in current cost amounts of $200 would be reported. That approach reflects the view that in order to continue with similar operations, an enterprise should maintain net assets at $1,200. The enterprise may not wish to replace the inventory but it would be assumed to wish to have capital of $1,200 available for purchase of other assets. The Board concluded that expenses should be measured at current cost or lower recoverable amount in the measurement of income on a current cost basis. It believes that replacement cost is not relevant to the measurement of income from continuing operations when replacement would not be worthwhile.

127. The discussion in paragraphs 125 and 126, illustrated by reference to the holding of inventory and the measurement of cost of goods sold, is applicable also to the measurement of depreciation expense. However, the concept is more complicated in the case of depreciation expense because the replacement of property, plant, and equipment may take place several years after the measurement date. Suppose, for example, that an enterprise buys a fixed asset for $1,000 and that the asset has a life of only two years. If the current cost of the asset increases by 10 percent per year, depreciation

expense measured at the midpoint of each year would be $525 in year 1 and $577 in year 2, a total of $1,102 and less than the current cost of $1,210 at the replacement date. The gap between the total depreciation expense during the life of the asset and its current cost at the end of its life is often referred to as "backlog depreciation." However, the omission of backlog depreciation from expense does not prevent the maintenance of operating capability when assets are acquired at regular intervals. Suppose, for example, that an enterprise has 10 similar assets, each having a maximum life of 10 years, and present ages range evenly from 1 to 10 years. The aggregate depreciation expense on the 10 assets, at current cost, would represent the current cost of the one asset that needs to be purchased currently. If the pattern of asset acquisition is uneven to a significant extent, backlog depreciation may need to be considered in users' assessment of the maintenance of physical capital.

128. The discussion in paragraphs 125-127 has ignored two other influences on distributable income: The effect of changing prices on monetary working capital and the opportunity to increase the amount of debt in times of rising prices. The adjustments to cost of goods sold and depreciation expense, discussed above, recognize increases in costs that need to be recovered to provide for increases in capital invested in inventory and property, plant, and equipment. However, they do not provide for the increase in monetary working capital (for example, cash plus receivables less payables) that is commonly required as a result of increasing prices. It is also possible that the borrowing capacity of an enterprise may be related to the current costs of its assets so that part of the increase in assets required to maintain operating capability may be provided by increasing the amount of debt rather than by retention of earnings. Some people have argued that it would be desirable to include approximate adjustments for these factors in a supplementary measure of income.

129. The Board has concluded that no adjustments should be required at this time for the factors described in paragraph 128 because: (a) the adjustments would significantly increase the complexity of the requirements and (b) the amount of debt that is actually raised will depend on discretionary decisions of the enterprise. Moreover, the Board has a separate project on funds flows and liquidity and it believes that special aspects of the effects of changing prices on funds flows should be studied as part of that project. The Board believes that, pending completion of the project on funds flows and liquidity, assessments of changes in monetary working capital and of changes in borrowing capacity should be based on other information in the financial reports. It encourages enterprises to comment on these factors in explanations of the supplementary financial information. Some Board members regard the purchasing power gain or loss on net monetary items (paragraphs 150-155) as mitigating the need for adjustments of monetary working capital and for changes in borrowing capacity. That view is based on the observation that increases in the general price level produce a purchasing power loss on monetary assets, such as receivables (the loss may be seen as a provision for extra monetary working capital requirements) and a purchasing power gain on debt and payables (the gain may be regarded as a recognition of an increase in distributable income resulting from the use of additional debt or payables to provide financial resources for some of the additional investment required to maintain operating capability). However, those Board members recognize the deficiency of the purchasing power gain or loss for these purposes, resulting from the fact that it reflects changes in general price levels rather than changes in specific prices that affect the enterprise.

130. On the basis of the arguments set forth in paragraphs 125-129, some Board members believe that distributable income can represent a useful basis for certain aspects of users' assessments of future cash flows. The actual distribution made by an enterprise will normally differ from current cost income from continuing operations for various reasons. However, investors who wish to assess future cash flows are likely to find it useful to have some basis for assessing whether increases or reductions in operating capacity have taken place; and creditors and other users of financial reports may wish to assess whether an enterprise has been able to maintain operating capability without raising additional capital from external sources. Other Board members believe that consideration of the concept of distributable income and the related concerns with the needs for additional monetary working capital and changes in borrowing capacity is not appropriate in this Statement dealing as it does with measurements of earnings. In their view, those matters relate to dividend policy and other aspects of financing policies and are more properly considered in the Board's project on funds flows and liquidity. Those Board members agree, however, that for the additional reasons discussed in paragraphs 131-136, information about income from continuing operations measured on a current cost basis is likely to be helpful to users in their assessments of future cash flows.

The Comprehensive Measurement of Enterprise Performance

131. Some Board members believe that an important use of current cost accounting is in providing an improved basis for the comprehensive assessment of enterprise performance; that basis is represented by the sum of current cost income from continuing operations and the increase or decrease in the current cost amounts of assets (referred to in the Exposure Draft as holding gains and losses). Those Board members believe that investors and creditors are primarily concerned with the performance of an enterprise in terms of its ability to generate cash flows and returns on financial investment rather than with its physical operating capability. Although potential cash flows are not independent of operating capability, an enterprise may be able to increase its cash flows and returns on investment without increasing its operating capability. According to this view, an enterprise invests financial resources with the expectation that the investment will generate acceptable levels of cash inflow. Recovery of the amount of financial resources invested is a return *of* capital; cash flows in excess of the amount invested are returns *on* invested capital. From that point of view, increased investments of financial resources to maintain physical operating capability are indistinguishable from increased investments of financial resources to expand physical operating capability. Both kinds of investments will be made only if expected cash flows provide an acceptable return on the investment.

132. The ideal measure of the worth of the resources of an enterprise might be obtained by measuring assets at the net present value of future cash flows. An asset is valuable to the extent that it can generate future cash flows and only to that extent. Moreover, if net present values would be ideal measures of worth, changes in net present value over a period would be ideal measures of enterprise performance. However, the Board has concluded that the general use of net present values is not practicable and it does not expect their use to become practicable. The use of net present value calculations required by this Statement is limited to some special situations in which they may be needed for measurements of recoverable amounts. There are at least two overriding objections to the general use of net present values. The measurements cannot be made with acceptable reliability.

Furthermore, the jointness of cash flows to the enterprise means that net present values for individual assets cannot be obtained without using arbitrary allocations that lack economic significance. In general, net present values are better suited to measurement of the value of the whole enterprise than to measurements of individual assets. However, assessment of the value of the whole enterprise is the essence of the process of financial analysis; it is not properly a part of the information that should be provided directly in financial reports.

133. Having rejected the general use of net present values, the Board considered whether another system of measurement would provide a useful basis for users' assessment of the worth of the enterprise. Historical cost (less depreciation, if appropriate) may provide a useful basis for such assessments when prices are stable. However, when prices are increasing, historical cost measures tend to lose their significance as bases for assessment of the worth of an asset. Some Board members concluded that the measurement of assets at current cost or lower recoverable amount could provide a useful basis for assessing future cash flows to the enterprise because those measurements can be regarded as surrogates for the net present value of cash flows expected to be earned from the use of assets. Current costs may presumably be expected to have some relationship to net present values (and hence future cash flows) because estimated net present value will represent the maximum sum that an enterprise would be willing to pay for an asset. The exact nature of the relationship will depend on conditions in the markets in which the assets are bought and sold. Measurements of assets at their recoverable amounts represent direct estimates of the net present values of future cash flows (in the case of values in use) or approximations to net present values (in the case of net realizable values).

134. If measurements of assets at current cost or lower recoverable amounts are regarded as surrogates for measurements of the net present value of future cash flows, it follows that a basis for assessments of enterprise performance during a period may be provided by an income measure that reflects changes in current costs or lower recoverable amounts. Income from continuing operations on a current cost basis does not fully reflect those changes. It omits the difference between the measure of the asset at its acquisition date (i.e., acquisition cost) and the measure of the asset at the date of use or sale.

135. The increases or decreases in current cost or lower recoverable amounts are often known as holding gains or losses and they were so described in the Exposure Draft. However, several comment letters argued that the terms "gain" and "loss" should not be applied to these items because they are not part of the income that is available for distribution without impairing the operating capability of the enterprise. That view reflects the physical capital maintenance concept described in paragraphs 124-130. However, those who favor the financial capital maintenance concept believe that capital is maintained when revenues are sufficient to recover the financial reserves invested; under that concept, holding gains or losses are regarded as part of income. After considering those alternative points of view, the Board concluded that it is preferable to use the neutral description "increase or decrease in current cost amounts" to describe differences between acquisition cost and current costs or lower recoverable amounts at the date of use or sale.

136. The Board concluded that enterprises should be required to report the increase or decrease in

current cost amounts separately from income from continuing operations. Users may find it useful to add the two numbers together to obtain a basis for assessing the overall performance of an enterprise during the fiscal year. However, separate reporting of the two amounts may be helpful for the assessment of future cash flows for the reasons discussed in paragraph 118. It is easier to take account of the various forces shaping the time patterns of operating income and changes in current cost amounts if the two items are separated as they are in the current cost information provided for by this Statement. In assessing overall performance, users should take into account changes in market conditions governing the prices of assets held by the enterprise since those changes may affect the extent to which changes in current cost are associated with changes in expected future cash flows. Current cost measurements do not reflect all the factors that influence the value of an enterprise.

Maintenance of Purchasing Power

137. Paragraphs 138-144 explain the reasons for believing that current cost/constant dollar accounting can provide a useful basis for users' assessments of whether an enterprise has maintained the purchasing power of their investments. The focus is on two measures derived from current cost accounting: (a) income from continuing operations on a current cost basis and (b) the increase or decrease in current cost amounts, net of inflation.

138. The main purpose of investment by shareholders and others is to earn a return that is available, sooner or later, in cash to meet personal expenditures. Investors will hope to receive cash (in the form of dividends, interest payments and so on) in amounts that have a convenient pattern over time, particularly if they rely on the cash to meet fixed commitments. Investors are also concerned with the purchasing power of the cash that they receive. If they receive a fixed amount of money each year, in times of inflation, their purchasing power will decline year by year. In that situation, investors may wish to save money in order to provide a fund that can be used as needed to compensate for the decline in purchasing power. They may be interested in an estimate of the maximum amount they can spend in a given year without expecting a decline in future purchasing power, even if they decide, for personal reasons, to spend a different amount.

139Investors' need for information about the purchasing power associated with their investments can be met by the use of a "constant dollar" measuring unit. The potential usefulness of such a system can be illustrated by a simplified numerical example. Suppose that an investor holds a fixed interest security having a very long life. Suppose also, to simplify the calculations, that effective interest rates for such securities have been 14 percent per year for several years; and that the rate of general inflation has been 10 percent per year for several years. In those circumstances, it may be reasonable to assume that the market value of the security will be constant over time. It is assumed that the market value of the security is $1,000, interest receipts are $140 per year and that all economic conditions are expected to remain constant for several years. If the investor spends $140 each year, purchasing power will steadily decline. In the second year, the interest receipt will provide enough to purchase only $140/1.1, i.e., $127 worth of goods and services measured in terms of the purchasing power of the dollar in year one. If the investor wishes to enjoy a constant amount of purchasing power in each year, the purchasing power of his investment must be maintained. That means that expenditures must be

restricted in each year to produce savings equal to the rate of inflation multiplied by the value of the investments at the start of the year; the saving would have to be invested in securities that were similar to the original holding. The transactions would then run as follows:

	Value of Investments at Start of Year	Interest Receipts	Saving Reinvested	Personal Expenditure	Value of Investments at End of Year
Year 1	$1,000	$140	$100	$40	$1,100
Year 2	$1,100	$154	$110	$44	$1,210
Year 3	$1,210	$169	$121	$48	$1,331

Personal expenditures increase by 10 percent each year, in step with inflation.

140. If the methods of constant dollar accounting are applied to the illustration in paragraph 139, and the unit of measurement is the purchasing power of the dollar at the end of the year concerned, income will be measured at the amounts shown above as personal expenditure. Thus, constant dollar accounting may help to answer the question: How much can be spent this year if the investor wishes to maintain the purchasing power of expenditures from year to year? The computations, would run as follows in year one:

Interest Income		$140
Change in value of security:		
Value at end of year	$1,000	
Value at beginning of year, restated in end-of-year dollars ($1,000 X 110/100)	1,100	(100)
Net income		$ 40

The computations involve, in effect, deducting a capital maintenance adjustment equal to the rate of inflation multiplied by the amount of net assets at the beginning of the year. Furthermore, if the computations for each year are restated in constant dollars of a fixed base year, each row in the table in paragraph 139 would contain the same numbers. For example, if all measurements were made in constant dollars as of the end of year one, income would be measured at $40 in each year, thus providing another way of illustrating that the investor can enjoy a fixed amount of purchasing power from year to year. The above illustration has been highly simplified particularly in its assumption that interest rates and rates of inflation are constant. In practice, an assessment of the future purchasing power available as a result of past activities would have to take account of possible changes in rates of return and in rates of inflation. However, constant dollar accounting may provide a useful basis for users' assessments of such factors.

141. The illustration in paragraph 140 of the usefulness of constant dollar accounting dealt with transactions undertaken by an investor. Some people believe that computations of performance in

constant dollars should be regarded as useful for investors but that they should not be applied directly to information in the financial reports of an enterprise. Others believe that it can be useful to have information about the performance of an enterprise, measured in constant dollars. The reasons for that belief are examined next.

142. In paragraphs 131-136, it was argued that a useful indication of overall enterprise performance could be obtained by considering income from continuing operations on a current cost basis together with a computation of the increase or decrease in the current cost amounts of assets held by the enterprise. Users' assessments based on that information will need to take account of various external factors, including the extent to which assets held by the enterprise are traded in competitive markets and the implications for the extent to which current cost measures indicate potential future cash flows. The application of constant dollar accounting to information prepared on a current cost basis can be regarded as an adjustment for changes in the general purchasing power represented by the worth of the enterprise insofar as that worth is recognized under current cost accounting.

143. Income from continuing operations on a current cost basis may be regarded as a number measured, approximately, in constant dollars having the average purchasing power of dollars during the year concerned. Revenues are measured in average dollars if they are spread evenly over the year and expenses are measured at current costs at the dates of use or sale. The increase or decrease in current cost amounts over the year reflects the differences between measures of assets in end-of-year dollars and in beginning-of-year dollars. Those differences must be adjusted for the general inflation component to obtain a measure of changes in current costs in constant dollars (the adjustment is analogous to the adjustment of the changes in the value of the security, illustrated in paragraph 140).

144. On the basis of the discussion in paragraphs 138-143, the Board concluded that information disclosed by an enterprise on the increase or decrease in current cost amounts of assets should be reported net of inflation.

The Usefulness of Historical Cost/Constant Dollar Accounting

145. One way of expressing the arguments for using a system of constant dollar accounting is to say that the measuring unit should serve as a common denominator for the adding, subtracting, and comparing of revenues and expenses, assets and liabilities, owners' equity, and earnings. Some observers question whether a nominal monetary unit such as the nominal dollar can serve that function. Conversion of nominal dollars to constant dollars is recommended by them as a means of obtaining the benefits of a common denominator. That process is considered analogous to the process under which measurements made in one currency are translated into another currency for comparative purposes. Constant dollar measurements may be added, subtracted, compared, and used without the need to make subjective allowances for inflation in a manner that would otherwise be necessary for valid comparisons. That, according to its advocates, is a pervasive advantage of using constant dollar information as a supplement to nominal dollar information.

146. The rate of return on investment is commonly used as a measure of investment performance. Investors who are concerned with purchasing power may want to compute their rate of return by

dividing constant dollar income by constant dollar investment. A computation of a constant dollar return on investment may be useful for an individual who invests in securities, one who invests in his own business, or one who joins with others in a partnership or corporation. A shareholder cannot expect to obtain a net increase in purchasing power in the long run if the corporation does not increase the purchasing power equivalent of its net assets. If shareholders take an interest in the corporation's constant dollar return on investment, it follows that managers may be evaluated partly on that basis and may concern themselves with that measure of performance. Top managers may also appraise and compare divisional management and divisional activities on the same basis. Regulatory authorities and other governmental agencies may also be concerned with the preservation of the equity interest in the enterprise. Finally, the widely recognized desire of investors to compare the performance of different enterprises suggests the need for uniform computations of constant dollar returns on investment.

147. Constant dollar accounting and current cost accounting have been developed as solutions to fundamentally different problems: Constant dollar accounting deals with general inflation by adopting an appropriate measuring unit; current cost accounting deals with specific price changes by measuring an appropriate attribute of resources held and used by an enterprise.

148. However, some people believe that it is useful to regard measurements of assets and expenses at their historical cost/constant dollar amounts as rough approximations to the measurements obtained under current cost accounting. If the constant dollar selected as the measuring unit is the average purchasing power of the dollar over the fiscal year, certain revenues and expenses that are spread evenly over the year will be measured at approximately the same amount in the primary financial statements and under historical cost/constant dollar accounting and current cost accounting. This Statement provides that those items may be reported at the same amounts in the supplementary information and in the primary financial statements. The principal differences between income in the primary financial statements and income under current cost accounting and historical cost/constant dollar accounting will be in the measurements of cost of goods sold and depreciation expense. In both cases, the numbers represent original cost of the related asset adjusted for changes in price levels between the date of acquisition and the date of use or sale. In the case of historical cost/constant dollar accounting, the adjustment is based on an index of general prices; in the case of current cost accounting, the adjustment reflects specific price changes. Similar differences characterize the balance sheet measurements of inventory and property, plant, and equipment under the two systems. It follows that historical cost/constant dollar measurements will approximate current cost measurements only to the extent that general price changes are approximately the same as changes in the specific prices of resources used by the enterprise.

149. The view that historical cost/constant dollar measurements represent an approximation to current cost measurements may be helpful because it focuses attention on differences in the relevance and reliability on information produced under the two systems. The measurement of current cost may be a matter of practical difficulty. If the measurement is based on a specific price index, it will be necessary to choose an appropriate index and accept that the index may fail to reflect the effect of changing technology and the mix of assets used by the enterprise. If the measurement is based on a

direct pricing method, it may be difficult to obtain evidence that is unambiguously relevant to the circumstances of the enterprise. Those problems of judgment are avoided in historical cost/constant dollar accounting. Even opponents of historical cost/constant dollar accounting agree that it is verifiable and represents accurately what it purports to represent. Many believe that current cost measurements have greater relevance to the assessment of future cash flows but historical cost/constant dollar measurements have greater reliability. The Board concluded that it should call for the disclosure of income from continuing operations under both historical cost/constant dollar accounting and current cost accounting partly in order to obtain evidence of users' trade-off between relevance and reliability.

The Purchasing Power Gain or Loss on Net Monetary Items

150. An enterprise often needs to hold cash and the effect of doing so may be analyzed according to the concepts of constant dollar accounting. The value of cash is fixed in nominal dollars. If an enterprise holds $100 in cash, it will still have $100 at any later time. Holding cash does not in itself produce a nominal dollar profit or loss; however, during a period of inflation there is a loss of purchasing power. For example, the holding of $100 for one year, when the inflation rate is 8 percent, involves a loss of $8 of purchasing power (measured in end-of-year dollars): one would need 108 end-of-year dollars to have the purchasing power equivalent of 100 beginning-of-year dollars.

151. The loss of purchasing power from holding cash is one component of the purchasing power gain or loss on net monetary items. Furthermore, if cash loses value, so does a claim to cash (a receivable)—and a payable is associated with a gain of purchasing power: Losses on monetary assets such as receivables, and gains on monetary liabilities such as payables, must be counted in the same way as the loss on holding cash. The reporting of purchasing power gains or losses on net monetary items may provide an improved understanding of some of the implications, in periods of inflation, of the monetary components of working capital and of the amount of debt included in the capital structure of the enterprise.

152The foregoing discussion has explained the reasons for believing that constant dollar accounting provides a useful basis for assessment of the performance of an enterprise in maintaining the purchasing power of investors. The purchasing power gain or loss on net monetary items is another part of the information that may be useful for that assessment. Suppose, for example, that an enterprise is established with capital of $2,000. It invests $1,500 in inventory and holds $500 in cash. Inventory is sold for $1,950 at the end of the year; general inflation is 10 percent during the year. Cash (and total assets) at the end of the year amount to $2,450 ($1,950 plus $500) and the nominal dollar increase in owners' equity is $450 ($2,450 less $2,000). The adjustment for changes in the purchasing power of owners' equity is $200 ($2,000 times 0.1) and the increase in the purchasing power of the investment in the enterprise is $250 ($450 less $200), measured in "end-of-year dollars." The enterprise will report income from continuing operations, on a historical cost/constant dollar basis, of $300 (sales $1,950 less cost of sales measured at $1,500 times 110/100). However, income overstates the increase in purchasing power because it excludes the loss of purchasing power resulting from the holding of cash. The purchasing power loss on net monetary items will be $50 (cash at the end of the year, $500, less cash at the beginning of the year, in end-of-year dollars, $500 times 110/100). Total

increase in purchasing power ($250) is equal to income from continuing operations ($300) less the loss of purchasing power on net monetary assets ($50). Similar results would be obtained under current cost accounting except that historical cost/constant dollar income from continuing operations would be divided between current cost income from continuing operations and the increase or decrease in current cost amounts, net of inflation. Generalization of this kind of reasoning indicates that the total increase or decrease in purchasing power resulting from the activities of an enterprise may be assessed on the basis of the sum of current cost income from continuing operations, the change in current cost amounts of assets net of inflation and the purchasing power gain or loss on net monetary items.

153. Several commentators on the Exposure Draft argued that it was inappropriate to describe the purchasing power adjustment as a gain or loss. They were particularly critical of the implicit suggestion that an enterprise could gain by borrowing. The Board believes that a gain in purchasing power associated with a prudent amount of debt may be a sign of successful management when the funds have been invested in assets that maintain their purchasing power or lose purchasing power less rapidly than monetary items. The full significance of gains or losses of purchasing power on monetary items can be understood only in the context of a study of all components of income.

154. Suppose that Enterprise A has $1,000 of equity capital; Enterprise B borrows $1,000 at 15 percent per year. Both enterprises buy inventory at a cost of $1,000 and sell it a year later for $1,500; general inflation is 10 percent per year. Computations of income from continuing operations on a historical cost/constant dollar basis and of the purchasing power gain on debt, in end-of-year dollars, would run as follows:

	Enterprise A	**Enterprise B**
Sales	$ 1,500	$ 1,500
Cost of goods sold ($1,000 times 110/100)	(1,100)	(1,100)
Gross margin	400	400
Interest expense	—	(150)
Income from continuing operations	$ 400	$ 250
Purchasing power gain on debt	$ 0	$ 100

A comparison of the performance of the two enterprises should take into account the purchasing power gain on debt. Both enterprises need to measure cost of goods sold at $1,100 in order to reflect the amount of general purchasing power invested in the inventory. Both enterprises obtain a gross margin of $400, measured in end-of-year dollars. Enterprise B must pay $150 in interest. However, Enterprise B's income from continuing operations, $250, understates the increase in purchasing power earned for equity investors. Enterprise B has earned a real cash surplus of $350 because it has received $1,500 and needs only $1,150 to repay the borrowing with interest. Another way of looking at the effect of the purchasing power gain on debt would be to regard it as a reduction in the interest expense incorporated in the computation of income. Similar arguments would be applicable when current cost accounting methods are used.

155. The arguments in paragraphs 150-154 suggest that there is a case for including the purchasing power gain or loss on net monetary items in the computation of income from continuing operations. That treatment would have the advantage that the purchasing power gain on debt could be set against the associated interest expense to produce a measure of interest expense, net of inflation, consistently with the general principles of constant dollar accounting. However, in view of some comments on the Exposure Draft, expressing doubt about the usefulness of the item, the Board concluded that it would be preferable for it to be displayed separately, pending further experience with its use in practice.

Special Industry Problems

156. Special considerations arise in the choice of a system for measuring the effects of changing prices on enterprises that own particular categories of assets. Discussions about which attribute of an asset should be measured involve weighing the relevance and reliability of various alternatives, taking account of the costs of preparing the information. Consideration of those factors may suggest the desirability of measuring different attributes of different assets. The Board has concluded that current cost is a useful measurement for inventory and property, plant, and equipment. However, measurements of the current costs of some assets may have relatively low relevance and reliability while other measures, for example net present value of future cash flows, may have more relevance and an acceptable level of reliability. In such cases, it may be desirable to call for measurement of a different attribute from the one that is required for other assets, provided that information about the measurements can be presented in a format that enables users to understand its significance.

157. Many different categories of assets could be regarded as suitable subjects for special study and the identification of categories that merit special treatment involves subjective judgment. Various types of natural resources, assets committed to long-term contracts, works of art (books, paintings, film libraries, and so on), and other assets all may merit special consideration. The Board selected six industries, in which special types of assets were judged to be particularly important and formed task groups to advise it on the applicability of the proposals in the Exposure Draft to the industries concerned. Those task groups dealt with banking and thrift institutions, forest products, insurance, mining, oil and gas, and real estate. The Board's conclusions for assets held in those industries and for certain other special classes of assets are summarized in paragraphs 158-178. The Board will monitor the experience of all enterprises in preparing the information required by this Statement and attempt to identify any other categories of assets that require special consideration.

Natural Resources

158. Natural resources, given special consideration by the Board, comprise mainly oil and gas reserves and resources held by mining enterprises (nonrenewable resources) and timberlands, including growing timber (renewable over a long time period). Those resources have a number of special characteristics that are relevant for this Statement. The primary special characteristic of natural resources may be described as a limitation on replacement. The supply of oil and gas reserves and mineral ore bodies, for example, is limited. An individual enterprise may expand its holdings of

nonrenewable resources by exploration to discover previously unknown supplies. However, the process will be subject to a high level of uncertainty and is likely to involve operations needing progressively higher levels of expenditure. The worthwhileness of further exploration at increasing levels of expenditure will depend on economic conditions in the industry concerned. The time may come, or may have come already in some cases, when increasing expenditures cause an enterprise to abandon the attempt to obtain additional supplies of existing types of resources.

159. The "replacement problem" described in paragraph 158 is important because it indicates unusual difficulties in measuring the current costs of nonrenewable resources. The measurement of current costs could be undertaken in at least three ways:

a. A restatement, in terms of current prices, of the actual historical costs incurred to obtain the resources; the result would be a measurement of the cost that would be incurred today to carry out the past process of exploration and development.
b. An estimate of the current cost of finding and developing an equivalent source of supply; the result would normally be a higher cost than that obtained under (a) because new sources of supply would normally be less accessible than previous sources and because costs may be affected by changes in other factors such as environmental and safety requirements.
c. An estimate of the current buying price of resources already found by another enterprise; the result would presumably reflect the net present value of future cash flows.

Method (b) would be most relevant in providing a basis for users' assessment of whether or not an enterprise had maintained its operating capability. Enterprises normally intend to seek new supplies by exploration and development; and current finding cost would represent an estimate of the cost of that process. However, any estimate of current finding cost would be subject to considerable uncertainty and, in some cases, might even be inapplicable because new supplies do not exist. Consequently, it may be necessary to consider methods (a) and (c) as surrogates for the measurement of current finding cost.

160. There are some special difficulties in measuring the actual historical cost of acquiring natural resource assets. In general, the balance sheet value of natural resources will reflect only some of the actual costs of acquisition. Many of the costs are commonly treated as expenses when they are incurred. The difficulty is noteworthy in the case of growing timber but it also applies to the assets of enterprises in the oil and gas industry and the mining industry. This factor may limit the relevance of the measurements obtained from method (a) in paragraph 159.

161. It may be desirable to consider the possibility of measuring certain natural resources on a net present value basis. The measurement of net present value depends on estimates of levels of demand, future selling prices, future operating costs, and discount rates. For most assets, such measurements cannot be made with a high standard of reliability at the present time (paragraph 132). Consequently, their use must be limited to special situations, where current cost measures are likely to be lacking in relevance and reliability.

162. Several problems of implementation remain to be considered before requirements can be introduced for the measurement and reporting of net present values for most natural resources. However, the quantity of some natural resources owned by an enterprise can be measured with sufficient reliability to provide useful information. For example, acceptable measurements can be made of the quantity of proved oil and gas reserves, of the quantity of mineral ore bodies, and the quantity of growing timber. A degree of objectivity can also be obtained by assuming the continuance of price levels prevailing at the date of the measurement. Such measurements of net present values may not be free from bias: They may tend to underestimate net present values if procedures for estimating quantities count only resources that are reasonably certain. Moreover, price fluctuations may cause difficulties in certain industries. However, the measurements can be regarded as partial recognition of the worth created by the enterprises in acquiring natural resources; and the information content of the measurements may be high because the worth of the enterprises depends heavily on their holdings of natural resources. Such measurements may be useful as a basis for the assessment of future cash flows and of enterprise performance during a period.

163. The Board concluded that it should consider further the usefulness of alternative measurements of natural resource assets and the problems of implementing those measurements before finalizing requirements for their treatment under current cost accounting. It plans to publish an Exposure Draft dealing with natural resource assets and to publish a final Statement in 1980. Enterprises are not required to disclose information on a current cost basis in annual reports for fiscal years ending before December 25, 1980. The Statement on the measurement of natural resources is expected to be published in time to provide a basis for the preparation of annual reports for fiscal years ending on or after December 25, 1980. If an enterprise publishes consolidated information on income from continuing operations on a current cost basis, in annual reports for years ended before December 25, 1980, it may use historical cost/constant dollar measures or current cost measures based on appropriate special indexes of natural resources used and held.

164. The problems of implementation of current cost measures of natural resources do not apply to the measurement of historical cost/constant dollar income. Therefore the Board concluded that it should not exempt natural resources from the requirements to disclose information on income on a historical cost/constant dollar basis (or from the related requirement to report purchasing power gains and losses on net monetary items); the information would be important in the context of the Board's wish to obtain experimental evidence of usefulness and would provide a basis for the comparison of enterprises in all industries.

The Real Estate Industry

165. Income-producing property is an important asset of many real estate enterprises. It would be possible to measure such assets and the related depreciation expense on a current cost basis. However, the Real Estate Task Group recommended that income-producing properties should be measured either at net present value of future cash flows or at net realizable value in due course of business. The Task Group argued that those measurements would be most relevant in helping users to assess the worth of an enterprise and that they could be measured with acceptable reliability because the properties were

typically leased under long-term contracts. The Task Group further argued that changes in the worth of income-producing property should be reflected directly in the income of real estate enterprises, thus obviating the need for a separate measurement of depreciation expense.

166. Many real estate enterprises have other important business activities, in particular, the development of real estate. The Board considered the desirability of establishing separate requirements for those activities. However, it concluded that it should deal with all the main activities of real estate enterprises at one time because of the interdependencies between the different activities. Such interdependencies arise, for example, when an enterprise develops a property that it subsequently holds to produce income.

167. The Board concluded that the arguments of the Real Estate Task Group established the need for further consideration of the special features of real estate enterprises. The Board believes that there may be net benefits in the disclosure of measurements of net present value of income-producing properties but that further study is required of the implementation problems before a decision is made on that issue. The Board plans to publish in 1980 a Statement dealing with the special characteristics of the real estate industry. It concluded that real estate enterprises should disclose information on a historical cost/constant dollar basis in the meantime.

The Banking Industry

168. A task group was established to advise the Board on the application of this Statement to commercial banks and thrift institutions. The Banking Task Group pointed out that the effects of inflation on banks are, in some respects, highly specialized. A critical factor is the impact of inflation on interest income and interest expense; information on a bank's asset-liability posture provides a basis for assessing the extent to which a bank is exposed to risk with respect to changing interest rates. This Statement does not call for any information that directly addresses those factors. However, many banks do provide supplementary information on rates of interest income and expense in relation to an analysis of assets and liabilities. The Board believes that such information is useful.

169. The Banking Task Group believes that property, plant, and equipment, and the associated depreciation expense are generally immaterial in the banking industry. Accordingly, it suggested that information on the current costs and on historical costs in constant dollars of those items would not be useful. It recommended that the requirements to present information on a current cost basis should not apply to banks and that banks should be permitted to treat all assets as monetary assets for the purposes of historical cost/constant dollar computations.

170. The Board accepted the assertion that current cost adjustments and constant dollar adjustments to depreciation expense might be immaterial for many banks. However, it concluded that no special exemptions or provisions were needed to deal with that situation. This Statement provides that current cost information need be presented only if current cost income from continuing operations is materially different from historical cost/constant dollar income from continuing operations; and the requirements of this Statement are qualified by the more general provision that they need not be applied to immaterial items. Those provisions appear to be adequate to meet the points raised by the

task group. However, the Board believes that the adjustments discussed in paragraph 169 may be material for some banks and that there are no arguments of principle to justify exemptions in those cases.

The Insurance Industry

171. A task group was established to advise the Board on the application of this Statement to the insurance industry. In some respects, the special characteristics of insurance enterprises are similar to those of banking enterprises. In particular, inventories and property, plant, and equipment are often small in relation to other balance sheet items. The Insurance Task Group recommended that insurance enterprises should be exempt from the requirement to present information on a current cost basis and that they should be permitted to treat all assets and liabilities as monetary for the purposes of constant dollar measurements. The Board agreed that current cost adjustments would often be immaterial for insurance enterprises. However, it concluded that no special provisions or exemptions were needed to deal with that situation. This Statement provides that current cost information need be presented only if current cost income from continuing operations is materially different from historical cost/constant dollar income from continuing operations.

172. The Insurance Task Group pointed out difficulties in classifying certain assets and liabilities as monetary or nonmonetary—for example, loss reserves for claims, deferred policy acquisition costs and unearned premium reserves. The task group was particularly concerned that this Statement should not call for a costly analysis of particular balance sheet categories (for example, an analysis of loss reserves between monetary and nonmonetary items) and that related assets and liabilities should be treated consistently (for example, deferred policy acquisition costs should be treated in the same manner as unearned premium reserves). The Board concluded that the general definitions of monetary and nonmonetary items should be applicable to insurance enterprises. It believes that those definitions meet the main concerns of the task group (Appendix D).

Regulated Businesses

173. The Board did not establish a task group to advise on the application of this Statement to utilities and other regulated businesses. However, meetings were arranged with representatives of the industry and several comment letters were received from utilities. The main problem arising in the application of this Statement to utilities concerns the measurement of assets and related expenses. Some people argue that inventory, property, plant, and equipment, and the associated expenses of a rate regulated enterprise should not be measured at an amount in excess of the historical cost/nominal dollar amount in the computations of income from continuing operations and related disclosures. That argument is based on the observation that utilities may not be permitted to recover more than historical cost/nominal dollar amounts in their selling prices; the provision that assets should be measured at cost or lower recoverable amount leads to measurement on a historical cost/nominal dollar basis. Other arguments point to a different conclusion. Utilities have the same problem as other enterprises in maintaining their operating capability and in avoiding erosion of general purchasing power. Historical cost/constant dollar measures and current cost measures may provide a useful basis for assessments of those factors. Furthermore, the presentation of information on a historical cost/constant dollar basis

and on a current cost basis may be important to a general public understanding of the operations of utilities.

174. The Board believes that it is important to distinguish the measurement of expenses in the computation of income from continuing operations from the measurement of assets held at the end of the fiscal year. Choice of a measurement for assets (inventory and property, plant, and equipment) requires consideration of the worth to the business of the service potential provided by the assets. The Board concluded that assets should be measured at cost (historical cost in constant dollars or current cost) or lower recoverable amount. It believes that the special characteristics of utilities provide no justification for departure from the general requirement: Failure to consider recoverable amounts (which may be measured by historical cost in nominal dollars or by lower amounts) could give a misleading impression of the worth of resources owned by the enterprise.

175. Choice of a measurement for expenses involves different considerations. The Board focused on two main alternatives:

a. Measure expenses at cost (historical cost in constant dollars or current cost) or lower recoverable amount in all situations.
b. Measure expenses at cost or lower recoverable amount unless replacement of the related asset would be undertaken under current economic conditions, in which case measure expenses at cost and ignore lower recoverable amount.

The effect of the choice can be illustrated by a simplified numerical example. An enterprise has property, plant, and equipment measured at $10,000 at historical cost in nominal dollars at the beginning of the year (and no other assets and no liabilities). It is permitted to set its prices at a level that will result in income, on a historical cost/nominal dollar basis, equal to 15 percent of net assets, i.e. $1,500. Assets were purchased at various past dates and have varying lives. Depreciation for the year and asset values at the beginning and end of the year are as follows:

	Depreciation	**Assets at Beginning of Year**	**Assets at End of Year**
Historical cost in nominal dollars	$2,000	$10,000	$ 8,000
Historical cost in constant dollars	2,800	13,000	11,500
Current cost	4,000	18,000	16,700
Recoverable amount	3,500	10,000	8,000

It is assumed that recoverable amounts of assets are equal to historical costs in nominal dollars although that equality does not always hold because, for example, the allowed rate of return may be higher or lower than the appropriate discount rate. It is also assumed for simplicity that all sales are made and expenses incurred at the end of the year. The rate of inflation is 10 percent per year. Computations of income from continuing operations based on the alternative measures of expenses and

of related changes in current cost amounts of assets would run as follows, in end-of-year dollars:

	Alternative (a) (cost or lower recoverable amount)			Alternative (b) cost)	
	Historical Cost in Nominal Dollars	Historical Cost in Constant Dollars	Current Cost	Historical Cost in Constant Dollars	Current Cost
Sales revenues less expenses	$ 3,500	$ 3,500	$ 3,500	$ 3,500	$ 3,500
Depreciation expense	(2,000)	(2,800)	(3,500)	(2,800)	(4,000)
Reduction of historical cost to lower recoverable amount		(200)		(200)	
Income from continuing operations	$ 1,500	$ 500	$ 0	$ 500	$ (500)
Increase in current cost amounts, net of inflation			$ 500		$ 1,000

The increase in shareholders' equity, measured in constant dollars, is $500 (assets at the end of the year $11,500 = cash $3,500 plus plant $8,000—less assets at the beginning of the year $10,000 X 110/100). The current cost computations divide this amount between income from continuing operations and the increase in current cost amounts of assets. Current cost income is lower under method (b) (a loss of $500) than under method (a) because of the restriction of depreciation expense under method (a) to the recoverable amount. That restriction does not apply to the historical cost/constant dollar depreciation expense in this illustration.

176. Alternative (b) has the advantage that it provides a basis for the assessment of the extent to which income from continuing operations provides for maintenance of operating capability; current cost measures are relevant for that assessment. It can also be argued that the sacrifice involved in using up the service potential of assets is represented by current cost when that service potential would be replaced. An enterprise that is affected by rate regulation differs from other enterprises in that it is likely to wish to replace its assets even when the recoverable amount is lower than current cost. Recoverable amounts will normally be lower than current cost only because of the effect of rate regulation; replacement will be worthwhile provided that the enterprise expects to be able to recover an appropriate return on the expenditure involved in replacement when it is incurred. Similar arguments apply to historical cost/constant dollar computations. Consequently, the Board concluded that method (b) was preferable for rate regulated enterprises.

Sale under Contracts

177. The Board considered whether special procedures were required for measuring the costs (either historical costs in constant dollars or current costs) of goods and services used to carry out contracts. Two bases for measurement were considered:

a. Measure expenses at the date of use or commitment to the contract and measure assets (partly completed contracts) at the dates when the resources were used on or committed to the contract
b. Measure expenses at the date of use on or commitment to the contract and measure assets (partly completed contracts) at the balance sheet date.

178. The choice between option (a) and option (b) rests essentially on a decision as to whether changes in current cost amounts should be recognized after resources have been used on or committed to a contract. (In many cases, the date of use on a contract will be the same as the date of commitment; however, reference is made to the date of commitment to allow for the possibility that materials are ordered specially or earmarked for a contract and held for some time before they are used.) The Board believes that there would be little significance in measures of changes in the cost of resources after their use on or commitment to a contract; their worth then cannot be measured independently of the revenues earned from the contract as a whole. Use of a resource on a contract may be regarded as similar to conversion to a receivable. Having regard also to the desirability of simplification, the Board concluded that option (a) was preferable.

Current Cost Measurement Issues

The Measurement of Current Cost

179. Paragraph 60 lists various sources of information to which reference may be made for the measurement of current costs. Those sources of information may be divided into two categories: direct pricing methods and methods based on the use of indexes. The Exposure Draft expressed a preference for direct pricing methods while recognizing the need to give due consideration to availability, reliability, and cost. Several comment letters on the Exposure Draft argued that the expression of preference for direct pricing methods would increase considerably the cost and complexity of the requirements. They stated that the use of indexes would be the only practicable method for measuring current cost in many cases. The Board recognizes that the choice of the best source of information about current cost, taking account of relevance, reliability, and cost, will vary according to the circumstances of the enterprise. It also recognizes the desirability of simplifications in the computations required by this Statement. Consequently, the Board concluded that it should *not* express a preference as between the use of direct pricing methods and methods based on the use of indexes.

Used Assets

180. In measurements of the current cost of property, plant, and equipment, the focus normally will be on used assets rather than new assets. The current cost of used assets may be estimated by three alternative methods:

a. A direct estimate of the buying price of an asset of the same age and in the same condition as the asset owned.
b. An estimate of the buying price of a similar new asset less an allowance for depreciation calculated according to an acceptable accounting method.
c. An estimate of the buying price of a new improved asset less an allowance for the operating disadvantages of the asset owned (higher operating costs or lower output potential) and an allowance for depreciation calculated according to an acceptable accounting method. This approach yields what may be described as a measurement of the current cost of the service potential of the asset owned.

Alternative (a) provides the more direct measurement of the current cost of a used asset than alternatives (b) and (c); however, alternative (a) will produce reliable results only if there is an active market in used assets. The choice between alternatives (b) and (c) should reflect the method of acquisition that would be appropriate in the circumstances of the case. If the enterprise would purchase a similar new asset, because the asset owned is not functionally obsolescent, alternative (b) would be appropriate. If the enterprise would purchase an improved asset, alternative (c) would be appropriate. The Board concluded that the choice of method should be made according to the circumstances of the case, taking account of the availability and reliability of the evidence.

Assets outside the United States

181. Many enterprises will need to measure the current cost of inventory and property, plant, and equipment located outside of the United States. The Board recognizes that such cases may present particular difficulty depending upon the availability of economic information in the country concerned. Experimentation in methods of measurement will be particularly necessary in such cases and approximate methods are acceptable in cases of difficulty. The concepts underlying current cost indicate that measurements should be based on production or purchase of the asset in whatever location or market would minimize total cost including transportation cost. In some cases, the purchase would be made in the United States and current cost would be estimated directly in dollars. In other cases, current cost would have to be estimated first in an external market, and that cost would have to be translated into dollars at the current exchange rate in order to obtain the current cost of the asset in dollars.

Income Tax Expense

182. A number of questions arise in relation to the calculation of income tax expense in measuring current cost income from continuing operations. Over the lifetime of an item of property, plant, and equipment, current cost depreciation expense will be higher than historical cost depreciation expense (provided that current costs are increasing.) The difference will be exactly equal in the aggregate to changes in current cost amounts (before elimination of the inflation component). However, the equality between "excess depreciation expense" and changes in current cost amounts applies only to aggregates over the lifetime of an asset; it does not normally hold for a single year in isolation. Consequently, current cost methods may be seen as causing timing differences that should be

recognized in the provision for deferred taxes.

183. An additional argument for adjusting the provision for deferred taxes would apply to supplementary information on income from continuing operations both on a historical cost/constant dollar basis and a current cost basis. It would be relevant if depreciation in the supplementary disclosures and depreciation in the primary financial statements were based on different estimates of length of asset life, amount of salvage value, or on the use of a different depreciation method: Such circumstances would indicate additional timing differences not recognized in the primary financial statements. The Board recognizes that all these circumstances give rise to arguments in favor of adjustments to deferred taxes. However, the Board believes that there are strong arguments for restricting the complexity of the requirements of this Statement at a time when users are inexperienced in the analysis of supplementary disclosures and in order to limit the costs of preparing supplementary information. The Board has concluded therefore that no adjustments to the amount of the provision for income taxes in the primary financial statements should be made for the purposes of calculating supplementary information on income from continuing operations.

184. This Statement requires that changes in current cost amounts of assets should be disclosed separately from current cost income from continuing operations. Income tax expense will include tax attributable to those changes in current cost amounts that are realized during the year, and the question arises as to whether income tax expense should be divided into two parts: one to be deducted in computing income from continuing operations, the other to be deducted from changes in current cost amounts. The Exposure Draft called for such a division of income tax expense.

185. The Board has reviewed the treatment of income taxes proposed in the Exposure Draft, partly as a result of comments that the requirement obscured the effective burden of taxation. Those comments seem to be based partly on the view that current cost income from continuing operations should represent a basis for assessment of the extent to which provision has been made to maintain operating capability. Users who wish to assess the overall performance of the enterprise may wish to consider both current cost income from continuing operations and changes in the current cost amounts of assets. In that context, it may be preferable to assess income tax expense as a separate item rather than focusing on summary indicators obtained by allocating the expense. Allocations of income taxes between current cost income and changes in current cost amounts may also obscure the relationship between specific price changes and general inflation, reflected in changes in current cost amounts, net of inflation—an important factor in assessments of the effect of changing prices on the enterprise.

186. Some people believe that strong arguments exist in favor of the allocation of income tax expense between current cost income from continuing operations and changes in current cost amounts. In their view, taxes should be attributed to the gain to which they relate. They point out that income taxes would be less if changes in current cost had not occurred (and current cost income from continuing operations was as reported). They also point out that the principle of tax allocation is described in APB Opinion No. 11, *Accounting for Income Taxes* (paragraph 52) and is generally applied, for example, to the reporting of extraordinary items in the basic financial statements. After considering the alternative points of view, and having regard to the desirability of restricting the

complexity of the requirements of the Statement, the Board concluded that no such allocations of income tax expense should be made for the purposes of the supplementary disclosures required by this Statement.

Constant Dollar Measurements

187. The Board considered various bases for the measuring unit used in the computation of information required to be presented in constant dollars:

a. Dollars having a purchasing power equal to that of dollars of the base period used by the Bureau of Labor Statistics in calculating the Consumer Price Index for All Urban Consumers
b. Dollars having a purchasing power equal to that represented by the average level over the current fiscal year of the Consumer Price Index
c. Dollars having a purchasing power equal to that represented by the level of the Consumer Price Index at the end of the current fiscal year.

188. Computations in "average-for-the-year dollars" may be made either directly or by using computations in "end-of-year dollars" as an intermediate step. Suppose, for example, that an enterprise holds a cash balance of $1,100 throughout its fiscal year. The Consumer Price Index stands at 100 at the start of the year and at 110 at the end of the year; the average level over the year is 106. The purchasing power loss on holding cash may be computed directly in average-for-the-year dollars by expressing beginning and ending balances in average dollars: $1,100 x 106/100 less $1,100 x 106/110 = $106. The computation in end-of-year dollars would run: $1,100 x 110/100 less $1,100 = $110 and that sum may be converted to average dollars: $110 x 106/110 = $106.

189. The Board concluded that option (b)—use of average-for-the-year dollars—should normally be used for computations relating to the current year. It has significant computational advantages in that context: Several revenues and expenses that are spread evenly throughout the period may be assumed to be the same in historical cost/nominal dollars and historical cost/constant dollars. Current cost measures of cost of goods sold and depreciation expense also approximate measures in average-for-the-year constant dollars without further adjustment. Comparisons of amounts in the primary financial statements with components of historical cost/constant dollar income and current cost income may be less confusing to users if many of the components are measured similarly. However, enterprises are encouraged to present comprehensive supplementary financial statements on a constant dollar basis. Use of the average-for-the-year dollar in comprehensive statements may be confusing to users because it results in balance sheet amounts that differ from the historical cost/nominal dollar equivalents for monetary assets and liabilities. Consequently, the Board concluded that enterprises that present comprehensive constant dollar statements should be permitted to use the end-of-year dollar as a measuring unit.

190. Somewhat different considerations apply to the presentation of the five-year summary. If information is presented in current dollars (options (b) or (c)), the information relating to previous years must be restated. If information is presented in "base-period" dollars (option (a)), information on

income for the current year will be measured in different units in the supplementary income statement and in the five-year summary. Either possibility may be confusing to some users. The importance of the five-year summary is in presenting information about trends over time and each option seems equally useful for that purpose. The Board consequently concluded that enterprises should be permitted to present the five-year summary either in current dollars (average-for-the-year or end-of-year dollars whichever is used in the measurement of income for the current year) or in base period dollars.

191. The Board considered whether it would be appropriate to permit the use of different accounting principles in the computation of historical cost/constant dollar income from those used in the computation of historical cost/nominal dollar income. It concluded that the same accounting principles should be used under both measurement systems (except as provided in the special circumstances described in paragraphs 193-198). Thus, for example, the same principles should be used to determine the costs attributed to assets in the supplementary information as in the primary statements. The main advantage of historical cost/constant dollar accounting is that it provides a basis for comparing the measurements and estimates in the basic financial statements with measurements that reflect changes in general prices. That comparability would be lost if different accounting principles were generally to be used.

192. The Board considered whether transactions in foreign currency should be:

a. First translated into U.S. currency and then restated for U.S. inflation; or
b. First restated for local inflation and then translated into U.S. currency.

It concluded that option (a) was preferable because the usefulness of constant dollar measurements is partly to provide information about the erosion of investors' purchasing power and the relevant measure of purchasing power for most investors in U.S. enterprises is the purchasing power of the U.S. dollar. That conclusion is consistent with the requirements of FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements.* However, further consideration may need to be given to this issue as a result of the current review of that Statement.

Methods for Current Cost Measurements and Constant Dollar Measurements

Recoverable Amount

193. The value to the business of an asset cannot exceed the maximum sum that an enterprise would be willing to pay to acquire the asset. In some circumstances, the amount of cash recoverable from the use of an asset may be so small that the enterprise would not wish to buy the asset at its current cost if the asset were not already owned. The maximum sum that an enterprise would be willing to pay for the asset is given by net realizable value or by the net present value of cash flows expected to be

derived from its use, i.e., value in use. Accordingly, the Exposure Draft provided that an asset should be measured at its value in use if that amount is lower than current cost and immediate sale is not intended.

194. Several comment letters expressed concern about the need to measure value in use. They argued that the Exposure Draft implied the need to measure value in use for all assets to determine whether value in use is lower than current cost—a very expensive procedure. They emphasized the low reliability of measurements of value in use. They indicated that it is often difficult to determine value in use for individual assets because cash flows may be jointly attributable to several assets. They also suggested that the results of applying measurements of value in use might be confusing in cases of volatile prices, because the appropriate measurement might change from value in use to current cost and vice versa from year to year.

195. The Board concluded that the concept of limiting asset measurements to recoverable amounts should be retained. It also concluded that the limitation should be applied to historical cost/constant dollar measurements of assets as well as to current cost measurements. It believes that such a limitation is needed to avoid significant overstatements of the worth of assets. However, the Board also believes that it is desirable to avoid excessive complexity in applications of the provisions of this Statement and that the need to measure value in use should arise relatively rarely. Consequently, it concluded that value in use need be considered as a measurement of an asset only when it is judged to be materially and permanently lower than historical cost in constant dollars or current cost.

Depreciation Expense

196. Calculations of depreciation must be based on various estimates and assumptions, and if enterprises with similar circumstances make different estimates or select different assumptions, the comparability of their calculations of income from continuing operations will be impaired. Moreover, the usefulness of the supplementary disclosures might be impaired if an enterprise were to adopt different assumptions and estimates for calculations of depreciation in the primary financial statements on the one hand, and for calculations of depreciation in the supplementary information on the other hand. The estimates and assumptions in question are length of asset life, salvage value of the asset, and depreciation method (straight-line, declining-balance, sum-of-the-years-digits, and so on).

197. The Board considered the following possible requirements in relation to the measurement of depreciation:

a. A requirement that all enterprises should use the same assumptions and estimates in calculations of depreciation in both supplementary information and in the primary financial statements,
b. A requirement that all enterprises should use a particular specified depreciation method in calculations of depreciation for presentations of supplementary information, and
c. Recognition that an enterprise should be permitted to select different assumptions and estimates for calculations of depreciation in supplementary information from those used in the primary financial statements.

A disadvantage of alternative (a) is that some enterprises may have selected an accelerated method of depreciation for use in the primary financial statements in order to make some allowance for the impact of inflation: Accelerated methods of depreciation have the effect of increasing aggregate depreciation charges during periods in which the amount of property, plant, and equipment in use is growing. Similarly, an enterprise may have made conservative estimates of asset lives and salvage values for financial statement purposes in order to accelerate depreciation charges and thereby make some allowance for inflation. If the same methods and estimates were to be used for calculations of supplementary information, the effect might be to build in a double allowance for inflation and make an excessive depreciation charge. Alternative (b) has the disadvantage that it ignores the possible existence of valid reasons for differences in depreciation methods associated with the existence of various patterns of maintenance costs, usage, or output capacity over the asset life.

198. The Board concluded that, in the calculation of depreciation for presentations of supplementary information, an enterprise should be permitted to use different estimates and methods from those used in the primary financial statements, provided that allowance for inflation was a factor in choices made for the financial statements. However, it would be undesirable for an enterprise to adopt different estimates and methods in order to avoid disclosure of the full impact of changing prices, and there normally should be a presumption that estimated asset lives and salvage values will be the same for purposes of the primary financial statements and the supplementary disclosures. The Board believes that it will be a sufficient safeguard to require footnote disclosure of any differences in depreciation methods and estimates. The Exposure Draft provided that changes in estimates and methods used in calculations of depreciation should be permitted only in the case of measurements of current cost information. However, the Board has subsequently concluded that the arguments are equally applicable to measurements on a historical cost/constant dollar basis.

The Foreign Exchange Gain or Loss

199. The Exposure Draft called for separate disclosure of the foreign exchange gain or loss. Several comment letters argued against that requirement, partly because of uncertainties regarding the outcome of the Board's review of Statement 8. Having regard to the desirability of simplifying the requirements of this Statement, the Board concluded that separate disclosure of the foreign exchange gain or loss should not be required as part of the supplementary information.

Scope of Supplementary Disclosure

200. In considering which enterprises should be required to comply with this Statement, the Board put considerable weight on the need to avoid the imposition of excessive costs on the preparers of financial reports. It believes that there are potential net benefits to users to be derived from the disclosure of current cost information and historical cost/constant dollar information by all enterprises. The Board concluded that all enterprises should be encouraged to comply with this Statement, but that compliance should be required initially only for large, publicly held corporations. Financial reporting by such corporations may be presumed to be of importance to a relatively large group of users and those corporations may benefit from economies of scale in preparing the information, partly because

they have established sophisticated accounting systems. Moreover, many of them are already providing information similar to that required by this Statement in complying with ASR 190 of the Securities and Exchange Commission. The size test in paragraph 23 has been expressed partly in terms of amounts of inventories and property, plant, and equipment, rather than some alternative such as sales and other operating revenues, or stockholders' equity, because the differences between historical cost/nominal dollar income from continuing operations on the one hand and historical cost/constant dollar or current cost income from continuing operations on the other hand, are likely to be most affected by the amounts of those assets.

201. The Board considered the implications of the scope of this Statement in relation to enterprises that have merged during the year and are using the pooling of interests method for preparing basic financial statements. Two situations are particularly important:

a. Two or more enterprises merge during the year; none of them meets the size test individually at the start of the year although the combined assets of the enterprises would meet the size test. The Board concluded that this Statement should *not* apply to the enterprises during the year of the merger. Hence, no special provision is required for this situation.
b. Two or more enterprises merge during the year and one of them does meet the size test at the start of the year. The Board concluded that this Statement should apply during the year of the merger to the whole of the new enterprise created by the merger. It recognized that there might be some difficulties in developing the required data for the enterprises to which this Statement had not previously applied. However, the Board believes that it will be feasible for such enterprises to meet the requirements, given the permitted level of flexibility in the measurements; and it believes that the application of the requirements to the enterprise as a whole is preferable to the alternative of exempting part of the enterprise.

Partial Reporting

202. This Statement does not require an enterprise to present a statement of financial position and a complete statement of earnings on a historical cost/constant dollar basis or on a current cost basis. Required supplementary disclosures are limited to a five-year summary of important data, supplementary information on income from continuing operations, and certain other supplementary data. The Board considered and rejected a requirement that the amount of net assets presented in the five-year summary of selected financial data should be calculated by a comprehensive application of historical cost/constant dollar methods or of current cost methods. The Board hopes that enterprises will experiment with the preparation of more than the minimum required amount of supplementary information. However, it believes that experience should be gained in the preparation and use of partial information before consideration is given to the requirement of more comprehensive information. The disclosures required under this Statement have been chosen on the grounds that they are believed to be particularly important to users—they include items for which differences between historical cost/nominal dollar amounts and historical cost/constant dollar or current cost amounts are likely to be particularly great.

Choice of Format

203. The Board considered whether it should call for supplementary disclosures to be presented in a fixed format. It has decided that it is appropriate to allow flexibility in the choice of format so that enterprises may experiment to find methods of presentation which they believe to be most effective in their particular circumstances. Some illustrations of possible formats are given in Appendix A. Similarly, some flexibility is thought to be desirable in the choice of line items to be disclosed in the supplementary statement of income from continuing operations. It is presumed that it will normally be appropriate to disclose the same line items in the supplementary statement as are disclosed in the basic financial statements. However, only cost of goods sold, depreciation, depletion, and amortization expense, and any reductions from historical cost/constant dollar amounts to lower recoverable amounts are specifically required to be disclosed separately because only those items would normally be material to an understanding of the supplementary information on income from continuing operations.

The Five-Year Summary of Selected Data

204. The use of constant dollar accounting may be particularly helpful in the comparison of a series of measurements relating to sequential periods. It has long been thought that such a comparison may be facilitated by restating the measurements in terms of a common price level. For example, many policymakers emphasize the importance of "real growth" in the economy as measured by gross national product data restated in dollars of a specified base year. That same practice is viewed by some as helpful in comparing data relating to several periods in the life of one enterprise. Sales revenues, net assets, stockholders' equity, earnings, and dividends are obvious candidates for that treatment. Some observers think that "unsophisticated investors" may be misled if a company whose sales and earnings in nominal dollars have doubled in the last 10 years is described as a growth company. During that period, the general price level in the United States has roughly doubled. Restatement of the nominal dollar measurements of such a company would show that current sales and earnings represent approximately the same purchasing power as those of 10 years earlier.

205. The Board has selected certain data to be displayed in a five-year tabulation. The data required to be included in the tabulation were selected because of their importance to users; users may be directly interested in the trend of the series or they may be interested in using the data for the calculation of ratios.

206. Users are likely to be interested in the constant dollar trend of sales as a basis for assessing the success of the sales effort of the enterprise in the face of changing economic conditions and competitive pressures. The constant dollar series of income from continuing operations, purchasing power gain or loss on net monetary items, and increase or decrease in the current cost amounts of assets are all important in providing bases for the assessment of various aspects of future cash flows. Income from continuing operations in conjunction with net assets may be used to estimate rates of return earned by the enterprise. Earnings per common share, dividends per common share, and market price per common share are all directly important to investors. Their inclusion also permits users to

compute "constant dollar price-earnings ratios" and "constant dollar market rates of return" (taking account of dividends and changes in stock prices). However, calculation of income from continuing operations, purchasing power gain or loss on net monetary items, increases or decreases in current cost amounts of assets, net assets, and earnings per common share all require a significant computational effort. Consequently, an enterprise is not required to report these data for years prior to the effective date of this Statement or prior to the year in which this Statement first applies to the enterprise, if later, although such reporting is encouraged.

Effective Date

207. The Exposure Draft provided that this Statement should apply to fiscal years ending on or after December 25, 1979. The feasibility of that provision has been generally acceptable to preparers in so far as the historical cost/constant dollar requirements are concerned. However, several comment letters as well as the special industry task groups have emphasized the difficulty in preparing information on a current cost basis for publication in 1979 annual reports. The Board recognizes that difficulty although it believes that there is an urgent need for information on a current cost basis and that the difficulty will be limited by experience gained in meeting the requirements of ASR 190. The Board considered the possibility of permitting late publication of the data for 1979, possibly in an interim report in 1980. However, that possibility would have the disadvantage of disrupting the normal pattern of reporting. The Board concluded that the requirements of this Statement should apply for fiscal years ended on or after December 25, 1979, but that enterprises should be permitted to delay first disclosure of information on a current cost basis to the annual report for the first year ending on or after December 25, 1980.

Appendix D: MONETARY AND NONMONETARY ITEMS

208. This appendix provides guidance on the interpretation of paragraphs 40 and 48 for the classification of certain asset and liability items as monetary or nonmonetary. The following table is not intended to provide answers that should be followed regardless of the circumstances of the case. Rather, the intent is to illustrate the application of the definitions to common cases under typical circumstances. In other circumstances the classification should be resolved by reference to the definitions.

	Monetary	Nonmonetary
ASSETS		
Cash on hand and demand bank deposits (U.S. dollars)	X	
Time deposits (U.S. dollars)	X	
Foreign currency on hand and claims to foreign currency†	X	
Securities:		

Common stocks (not accounted for on the equity method)		X
Common stocks represent residual interests in the underlying net assets and earnings of the issuer.		
Preferred stock (convertible or participating)		
Circumstances may indicate that such stock is either monetary or nonmonetary. See convertible bonds.	(see discussion)	
Preferred stock (nonconvertible, non-participating)		
Future cash receipts are likely to be substantially unaffected by changes in specific prices.	X	
Convertible bonds.		
If the market values the security primarily as a bond, it is monetary; if it values the security primarily as a stock, it is nonmonetary.	(see discussion)	
Bonds (other than convertibles)	X	
Accounts and notes receivable	X	
Allowance for doubtful accounts and notes receivable	X	
Variable rate mortgage loans	X	
The terms of such loans do not link them directly to the rate of inflation. Also, there are practical reasons for classifying all loans as monetary.		
Inventories used on contracts		
They are, in substance, rights to receive sums of money if the future cash receipts on the contracts will not vary due to future changes in specific prices. (Goods used on contracts to be priced at market upon delivery are nonmonetary.)	(see discussion)	
Inventories (other than inventories used on contracts)		X
Loans to employees	X	
Prepaid insurance, advertising, rent, and other prepayments.		
Claims to future services are nonmonetary.		
Prepayments that are deposits, advance payments or receivables are monetary because the prepayment does not obtain a given quantity of future services, but rather is a fixed money offset.	(see discussion)	
Long-term receivables	X	
Refundable deposits	X	
Advances to unconsolidated subsidiaries	X	
Equity investment in unconsolidated subsidiaries or other investees *		X
Pension, sinking, and other funds under an enterprise's control		
The specific assets in the fund should be classified as monetary or non-monetary. (See listings under securities above.)	(see discussion)	
Property, plant, and equipment		X

Accumulated depreciation of property, plant, and equipment		X
Cash surrender value of life insurance	X	
Purchase commitments—portion paid on fixed price contracts		X
An advance on a fixed price contract is the portion of the purchaser's claim to nonmonetary goods or services that is recognized in the accounts; it is not a right to receive money.		
Advances to supplier—not on a fixed price contract	X	
A right to receive credit for a sum of money; not a claim to a specified quantity of goods or services.		
Deferred income tax charges †	X	
Offsets to prospective monetary liabilities.		
Patents, trademarks, licenses and formulas		X
Goodwill		X
Deferred life insurance policy acquisition costs †	X	
The portion of future cash receipts for premiums that is recognized in the accounts. Alternatively, viewed as an offset to the policy reserve.		
Deferred property and casualty insurance policy acquisition costs		X
Related to unearned premiums.		
Other intangible assets and deferred charges		X

	Monetary	**Nonmonetary**
LIABILITIES		
Accounts and notes payable	X	
Accrued expenses payable (wages, etc.)	X	
Accrued vacation pay.		
Nonmonetary if it is paid at the wage rates as of the vacation dates and if those rates may vary.	(see discussion)	
Cash dividends payable	X	
Obligations payable in foreign currency	X	
Sales commitments—portion collected on fixed price contracts		X
An advance received on a fixed price contract is the portion of the seller's obligation to deliver goods or services that is recognized in the accounts; it is not an obligation to pay money.		
Advance from customers—not on a fixed price contract.	X	
Equivalent of a loan from the customer; not an obligation to furnish a specified quantity of goods or services.		
Accrued losses on firm purchase commitments.	X	
In essence, these are accounts payable.		

Deferred revenue		
Nonmonetary if an obligation to furnish goods or services is involved. Certain "deferred income" items of savings and loan associations are monetary.	(see discussion)	
Refundable deposits	X	
Bonds payable and other long-term debt	X	
Unamortized premium or discount and prepaid interest on bonds or notes payable	X	
Inseparable from the debt to which it relates—a monetary item.		
Convertible bonds payable	X	
Until converted these are obligations to pay sums of money.		
Accrued pension obligations		
Fixed amounts payable to a fund are monetary; all other amounts are nonmonetary.	(see discussion)	
Obligations under warranties		X
These are nonmonetary because they oblige the enterprise to furnish goods or services or their future price.		
Deferred income tax credits †	X	
Cash requirements will not vary materially due to changes in specific prices.		
Deferred investment tax credits †	X	
Not to be settled by payment of cash; associated with nonmonetary assets.		
Life insurance policy reserves	X	
Portions of policies face values that are now deemed liabilities		
Property and casualty insurance loss reserves	X	
Unearned property and casualty insurance premiums		X
These are nonmonetary because they are principally obligations to furnish insurance coverage. The dollar amount of payments to be made under that coverage might vary materially due to changes in specific prices.		
Deposit liabilities of financial institutions	X	

Appendix E: ILLUSTRATIVE CALCULATIONS TO COMPUTE HISTORICAL COST/CONSTANT DOLLAR INFORMATION AND CURRENT COST INFORMATION

INTRODUCTION

209. This appendix gives an example of the methodology that might be used in calculating the disclosures illustrated in Appendix A (Schedules A and B).

210. Computation of historical cost/constant dollar information and of current cost information could be based on a detailed analysis of all transactions and an updating of all revenues, expenses, gains and losses to reflect changes in purchasing power. However, the Board believes that the costs of preparing the information can be reduced with little loss of usefulness by simplifying the methods of calculation. The Board has therefore concluded that revenues, expenses, gains and losses except cost of sales and depreciation expense need not be adjusted from the amounts shown in the primary income statement and that approximate methods of computation are acceptable for adjusting cost of sales and depreciation expense (and the related asset measurements). The *measurement* of current cost is not illustrated in this appendix. However, enterprises may find it convenient to follow the methods of measurement illustrated for historical cost/constant dollar measurements, using specific price indexes in place of general price indexes.

211. The objective in making these calculations is to obtain a *reasonable degree* of accuracy—complete precision is not required. Preparers are encouraged to devise short-cut methods of calculation, appropriate to their individual circumstances. Some useful simplifications are described in the FASB Research Report, *Field Tests of Financial Reporting in Units of General Purchasing Power,* published in May 1977.

212. Where inventories and cost of sales are accounted for under the LIFO method in the primary financial statements the only adjustment normally required in computing income from continuing operations would be to eliminate the effect of changing prices on any prior period LIFO layer liquidation.

213. The following sample calculations illustrate the minimum required calculations (in paragraphs 223-237). A method of checking the arithmetic accuracy of the calculations is included in paragraphs 238 and 239.

214. Throughout this illustration $ indicates nominal dollars and C$ indicates average 1980 constant dollars.

215. The results of these calculations, summarized in paragraph 248, are reflected in the illustrative disclosures in Appendix A.

STEPS TO RESTATE FINANCIAL INFORMATION

216. Seven basic steps to restate nominal dollar information (either on a historical cost basis or a current cost basis) into constant dollars are illustrated in this appendix:

1 .Analyze inventory (at the beginning and end of the year) and cost of goods sold to determine when the costs were incurred.
2. Restate inventory and cost of goods sold into constant dollars and current cost.
3. Analyze property, plant, and equipment, and related depreciation, depletion, and amortization expense to determine when the related assets were acquired.
4. Restate property, plant, and equipment and depreciation, depletion, and amortization expense into constant dollars and current cost.
5. Identify amount of net monetary items at the beginning and end of the period and changes during the period (Appendix D).
6. Compute the purchasing power gain or loss on net monetary items.
7. Compute change in current cost of inventory and property, plant, and equipment and the related effect of the increase in the general price level.

217.

Historical Cost/Nominal Dollar Financial Statements and Other Background Information

Balance Sheets as at December 31, 1980 and 1979
(000s)

	1980	1979		1980	1979
Current assets:			Current liabilities:		
Cash	$ 1,000	$ 2,000	Bank indebtedness	$ 35,000	$ 22,000
Accounts receivable	36,000	30,000	Accounts payable and accrued expenses	12,000	10,000
Inventories, at FIFO cost	63,000	56,000	Income taxes payable	6,000	6,000
			Current portion of long-term debt	5,000	5,000
Total current assets	100,000	88,000			
Property, plant, and equipment, at cost	100,000	85,000	Total current liabilities	58,000	43,000
Less accumulated depreciation	56,000	46,000	Deferred income taxes	6,000	5,000
	44,000	39,000	Long-term debt	34,000	39,000
			Total liabilities	98,000	87,000
			Shareholders' equity	46,000	40,000
	$144,000	$127,000		$144,000	$127,000

Statement of Earnings and Shareholders' Equity
For The Years Ended December 31, 1980 and 1979
(000s)

	1980	1979
Sales	$253,000	$220,000
Cost of goods sold, exclusive of depreciation	197,000	170,600
Selling, general, and administrative expenses	20,835	25,500
Depreciation	10,000	8,500
Interest	7,165	3,400
	235,000	208,000
Earnings before taxes	18,000	12,000
Income taxes	9,000	6,000
Net income	9,000	6,000
Shareholders' equity at beginning of the year	40,000	37,000
	49,000	43,000
Dividends	3,000	3,000
Shareholders' equity at end of the year	$ 46,000	$ 40,000
Net income per share	$ 6.00	$ 4.00

218. Inventory and Production

a. Inventory is accounted for on a FIFO basis and turns over four times per year. There is no significant amount of work in progress or raw material.
b. At December 31, 1980 and 1979 inventory consisted of 900,000 units and 1,000,000 units respectively—representing production of the immediately preceding quarter. Management has measured the current cost of inventory at $73 per unit at December 31, 1980 ($65,700,000) and $58 per unit at December 31, 1979 ($58,000,000).
c. Costs were incurred and goods produced as follows:

	1979	1980				
	4th	1st	2nd	3rd	4th	Total
Historical Costs (000s)	$56,000	$39,560	$59,400	$42,040	$63,000	$204,000
Units produced (000s)	1,000	618	900	618	900	3,036
Units sold (000s)		1,000	618	900	618	3,136

d. At December 31, 1980 the selling price per unit was $85.

219. Property, Plant, and Equipment

a. Details of fixed assets at December 31, 1980 are as follows:

Date Acquired	Percent Depreciated	Historical Cost (000s)	Accumulated Depreciation (000s)
1973	80	$ 50,000	$40,000
1974	70	5,000	3,500
1975	60	5,000	3,000
1976	50	5,000	2,500
1977	40	5,000	2,000
1978	30	5,000	1,500
1979	20	10,000	2,000
1980	10	15,000	1,500
		$100,000	$56,000

b. Depreciation is calculated at 10% per annum, straight line. A full year's depreciation is charged in the year of acquisition.

c. There were no disposals.

d. Management has measured the current cost of property, plant, and equipment at December 31, 1980 and 1979 as follows:

	(000s)			
	December 31, 1980		December 31, 1979	
Date Acquired	Current Cost	Accumulated Depreciation	Current Cost	Accumulated Depreciation
1973	$120,000	$ 96,000	$110,000	$77,000
1974	10,000	7,000	6,000	3,600
1975	15,000	9,000	7,000	3,500
1976	18,000	9,000	12,000	4,800
1977	12,000	4,800	10,000	3,000
1978	17,000	5,100	15,000	3,000
1979	12,000	2,400	10,000	1,000
1980	16,000	1,600	—	—
	220,000	$134,900	170,000	$95,900
Accumulated depreciation	134,900		95,900	
Net current cost	$ 85,100		$ 74,100	

e. The "net recoverable amount" has been determined by management to be in excess of net current cost.

220. Dividends

Dividends were paid at the rate of $750,000 per quarter.

221. Consumer Price Index (All Urban Consumers)

Average	1973	133.1	Average 4th Qtr.	1979†	210.0
"	1974	147.7	Average 4th Qtr.	1980†	237.8
"	1975	161.2	December	1979	212.9 *
"	1976	170.5	December	1980	243.5 *
"	1977	181.5			
"	1978	195.4			
"	1979	205.0*			
"	1980	220.9‡			

OBJECTIVE

222. The objective is to express the supplementary information in average 1980 dollars. As indicated in paragraph 210, nominal dollar measurements are to be used for all elements other than inventory, property, plant, and equipment, cost of sales, depreciation, and increases in current cost amounts of inventory and property, plant, and equipment.

Inventory and Cost of Goods Sold

Step 1: Analyze inventory and cost of goods sold.

223. Inventory is assumed to turn over four times per year (paragraph 218). Therefore inventory with an historical cost of $63,000 at December 31, 1980 is assumed to have been acquired during the fourth quarter of 1980 and inventory with an historical cost of $56,000 at December 31, 1979 is assumed to have been acquired in the fourth quarter of 1979.

Step 2:Restate historical cost of inventory and cost of goods sold into average 1980 dollars and at current cost.

224. Inventory:

	(000s)	
	Historical Cost Constant Dollars	**Current Cost**
$63,000 † × 220.9 (average 1980) / 237.8 (4th qtr. 1980)	C$ 58,523	$65,700 ‡

225. Cost of goods sold, historical cost/constant dollar:

	Nominal Dollars	(000s) Conversion Factor	Average 1980 Dollars
Balance, January 1, 1980	$ 56,000	× 220.9 (avg. 1980) / 210.0 (4th qtr. 1979)	C$ 58,907
Production during 1980 (paragraph 218c)	204,000	*	204,000
Balance, December 31, 1980	(63,000)	× 220.9 (avg. 1980) / 237.8 (4th qtr. 1980)	(58,523)
Cost of goods sold	$197,000		C$204,384

226. Cost of goods sold, current cost:

Current cost at the beginning of the year	$ 58/unit
Current cost at the end of the year	$ 73/unit
	$ 131/unit
Average current cost ($131 X 1/2)	$65.5/unit
Units sold during the year (000s)	3,136
Average current cost of goods sold (000s)	$205,408

227. In applying the standard the historical cost/constant dollar and current cost amounts should be compared to the "recoverable amount." This is illustrated below:

Market price/unit at year end (from paragraph 218d):	$85
Restated to average 1980 dollars:	
$85 × 220.9 (average 1980) / 243.5 (Dec. 1980)	C$ 77.11
Historical cost/constant dollar:	(000s)
Market value of inventory on hand at end of the year (77.11 × 900,000)	C$ 69,399
Restated historical cost (paragraph 225)	58,523
Excess—no write down required	C$ 10,876
Current cost:	
Market value per unit at end of year	$85
Current cost per unit of inventory on hand at end of year (paragraph 218b)	73
Excess—no write down required	$12

Property, Plant, and Equipment and Depreciation, Depletion, and Amortization Expense

Step 3: Analyze property, plant, and equipment and depreciation, depletion, and amortization.

228. An analysis of property, plant, and equipment was given in paragraph 219. It normally will not be necessary to restate the cost and accumulated depreciation for each asset individually in order to obtain an acceptable level of accuracy. Satisfactory results can normally be obtained by using annual totals of acquisitions and dispositions and the average index for the year of acquisition and disposal. Moreover, assets acquired many years before the balance sheet date might be combined into convenient groups where there is some doubt about the specific years of acquisition or where changes in the index for several years can be considered on an average basis. For example, the cost of all assets acquired between 1945 and 1950 could be measured by reference to an index representing an average of those years.

Step 4: Restate property, plant, and equipment and depreciation, depletion, and amortization expense into constant dollars and current cost.

229. Historical cost of property, plant, and equipment in average 1980 dollars:

Date of Acquisition	(1) Historical Cost/ Nominal Dollars (000s)		(2) Conversion Factor		(3) (1) × (2) Historical Cost/ Constant Dollars (000s)	(4) Percent Depreciated	(5) (3) × (4) Accumulated Depreciated (000s)	(6) (3) – (5) Net
1973	$ 50,000	×	220.9(Avg. 1980) / 133.1(Avg. 1973)	=	C$ 82,983	80	C$ 66,386	
1974	5,000	×	220.9(Avg. 1980) / 147.7(Avg. 1974)	=	7,478	70	5,235	
1975	5,000	×	220.9(Avg. 1980) / 161.2(Avg. 1975)	=	6,852	60	4,111	
1976	5,000	×	220.9(Avg. 1980) / 170.5(Avg. 1976)	=	6,478	50	3,239	
1977	5,000	×	220.9(Avg. 1980) / 181.5(Avg. 1977)	=	6,085	40	2,434	
1978	5,000	×	220.9(Avg. 1980) / 195.4(Avg. 1978)	=	5,652	30	1,696	
1979	10,000	×	220.9(Avg. 1980) / 205.0(Avg. 1979)	=	10,776	20	2,155	
1980	15,000	×	220.9(Avg. 1980) / 220.9(Avg. 1980)	=	15,000	10	1,500	
	$100,000				C$141,304		C$86,756	C$54,548

Historical cost/constant dollar depreciation expense for 1980 is calculated as follows:

C$ 141,304 (column 3) X 10% straight line =C$ 14,130

Property, Plant, and Equipment at Current Cost

230. It will usually be appropriate to calculate current cost depreciation, depletion, and amortization expense by reference to average current cost of the related assets (current cost of assets at beginning of year and current cost of assets at end of year / 2).

	Current Cost (000s)
Current cost, Dec. 31, 1979 (paragraph 219d)	$170,000
Current cost, Dec. 31, 1980 (paragraph 219d)	220,000
	$390,000
	÷2
Average current cost	$195,000
Current cost depreciation:	
10% straight line	$ 19,500

In this example, management has determined that the "recoverable amount" is greater than net current cost of property, plant, and equipment and there is no write down required.
Purchasing Power Gain on Net Monetary Items

Step 5: Identify monetary items at the beginning and end of the period and change during the period.

231. Monetary items:

	(000s) Balance*	
	Dec. 1980	Dec. 1979
Cash	$ 1,000	$ 2,000
Accounts receivable	36,000	30,000
Bank indebtedness	(35,000)	(22,000)
Accounts payable and accrued expenses	(12,000)	(10,000)
Income taxes payable	(6,000)	(6,000)
Current portion of long-term debt	(5,000)	(5,000)
Deferred income taxes	(6,000)	(5,000)
Long-term debt	(34,000)	(39,000)
Net monetary liabilities	($61,000)	($55,000)

Step 6: Compute the purchasing power gain or loss on net monetary items.

232. The amount of net monetary items at the beginning of the year, changes in the net

monetary items and the amount at the end of the year are restated into average 1980 dollars. The purchasing power gain or loss on net monetary items is then the balancing item as illustrated below:

	(000s)		
	Nominal Dollars	**Conversion Factor**	**Average 1980 Dollars**
Balance, January 1, 1980	$55,000	× 220.9 (avg. 1980) / 212.9 (Dec. 1979)	C$57,067
Increase in net monetary liabilities during the year	6,000	*	6,000
			63,067
Balance, December 31, 1980	61,000	× 220.9 (avg. 1980) / 243.5 (Dec. 1980)	55,338
Purchasing power gain on net monetary items			C$ 7,729

lncrease in current cost of inventories and property, plant, and equipment

Step 7: Compute change in current cost of inventory and property, plant, and equipment and effect of the increase in the general price level.

233. Increase in current cost of inventories

	(000s)		
	Current Cost/ Nominal Dollars	**Conversion Factor**	**Current Cost/ Average 1980 Dollars**
Balance, January 1, 1980 (paragraph 218b)	$ 58,000	× 220.9 (avg. 1980) / 212.9 (Dec. 1979)	C$ 60,179
Production (paragraph 218c)	204,000	*	204,000
Cost of goods sold (paragraph 226)	(205,408)	*	(205,408)
Balance, December 31, 1980 (paragraph 218b)	(65,700)	× 220.9 (avg. 1980) / 243.5 (Dec. 1980)	(59,602)
Increase/(decrease) current cost of inventories	$ 9,108		C$ 831

234. The "inflation component" of the increase in current cost amount is the difference between the nominal dollar and constant dollar measures. Using the numbers from paragraph 233:

	(000s)
Increase in current cost (nominal dollars)	$9,108
Increase in current cost (constant dollars)	C$ 831
Inflation component	8,277

235. Increase in current cost of property, plant, and equipment

	(000s)		
	Current Cost/ Nominal Dollars	**Conversion Factor**	**Current Cost/ Average 1980 Dollars**
Balance, January 1, 1980 (paragraph 219d)	$ 74,100	× 220.9 (avg. 1980) / 212.9 (Dec. 1979)	C$ 76,884
Additions (paragraph 219d)	15,000	*	15,000
Depreciation expense (paragraph 230)	(19,500)	*	(19,500)
Balance, December 31, 1980 (paragraph 219d)	(85,100)	× 220.9 (avg. 1980) / 243.5 (Dec. 1980)	(77,202)
Increase in current cost of property, plant, and equipment	$ 15,500		C$ 4,818

236. The "inflation component" of the increase in current cost amount is the difference between the nominal dollar and constant dollars measures. Using the numbers from paragraph 235:

	(000s)
Increase in current cost (nominal dollars)	$15,500
Increase in current cost (constant dollars)	C$ 4,818
Inflation component	10,682

Summary of increase in current cost amounts

237. Summarizing paragraphs 234 and 236 above:

	Increase in Current Cost	(000s) Inflation Component	Increase Net of Inflation
Inventory	$ 9,108	8,277	C$ 831
Property, plant, and equipment	15,500	10,682	4,818
Totals	$24,608	18,959	C$5,649

Check of Calculations

238. A reconciliation of shareholders' equity, with changes in the amounts of net assets on a historical cost/constant dollar basis, and current cost/constant dollar basis although not required by this Statement, acts as a check on the arithmetical accuracy of the calculations.

Changes in shareholders' equity during 1980 in average 1980 dollars.

	Source Paragraph	(000s) Historical Cost/ Average 1980 Dollars	Source Paragraph	Current Cost/ Average 1980 Dollars
Equity at Jan. 1, 1980				
Inventory	(225)	C$ 58,907	(233)	C$ 60,179
Property, plant, and equipment—net	(239)	53,678	(235)	76,884
Net monetary items	(232)	(57,067)	(232)	(57,067)
		55,518		79,996
Loss from continuing operations	(App.A)	(2,514)	(App.A)	(8,908)
Dividends	(220)	(3,000)	(220)	(3,000)
Gain from decline in purchasing power of net monetary liabilities	(232)	7,729	(232)	7,729
Excess of increase in specific prices over increase in the general price level			(237)	5,649

		C$ 57,733		C$ 81,466
Equity at Dec. 31, 1980				
Inventory	(224)	C$ 58,523	(233)	C$ 59,602
Property, plant, and equipment—net	(229)	54,548	(235)	77,202
Net monetary items	(232)	(55,338)	(232)	(55,338)
		C$ 57,733		C$ 81,466

239. Historical cost/constant dollar property, plant, and equipment at December 31, 1979 in average 1980 dollars.

	(000s)		
Date of Acquisition	**Historical Cost/ Constant Dollars** *	**Percent Depreciated**	**Accumulated Depreciation**
1973	C$ 82,983	70	C$58,088
1974	7,478	60	4,487
1975	6,852	50	3,426
1976	6,478	40	2,591
1977	6,085	30	1,826
1978	5,652	20	1,130
1979	10,776	10	1,078
Totals	C$126,304		C$72,626
Accumulated depreciation	72,626		
Net property, plant, and equipment at Dec. 31, 1979, carried to paragraph 238	C$ 53,678		

240. Restated amounts

Summary of Amounts Restated in Average 1980 Dollars
(000s)

	Source Paragraph	Historical Cost/ Constant Dollars	Source Paragraph	Cost/Current Information
Cost of goods sold	(225)	C$204,384	(226)	C$205,408

Depreciation expense	(229)	C$ 14,130	(230)	C$ 19,500
Purchasing power gain on net monetary items	(232)	C$ 7,729	(232)	C$ 7,729
Increase in current cost of inventories			(234)	C$ 831
Increase in current cost amount of property, plant, and equipment			(236)	C$ 4,818
Inventory	(224)	C$ 58,523	(233)	C$ 59,602
Property, plant, and equipment—net	(229)	C$ 54,548	(235)	C$ 77,202

Appendix F: THE CONSUMER PRICE INDEX

241. The table included in this appendix is the official Department of Labor Consumer Price Index—CPI (U), U.S. City Average, All Items (1967 = 100). This table includes monthly indexes and the average index for the year from 1913.

Monthly updates to the table are published in the United States Department of Labor, Bureau of Labor Statistics, "News."

U.S. Department of Labor
Room 1539
Bureau of Labor Statistics
Washington, D.C. 20212
Consumer Price Index
All Urban Consumers—(CPI-U)U.S. City Average All Items (1967 = 100)

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Avg.
1913	29.4	29.3	29.3	29.4	29.2	29.3	29.6	29.8	29.9	30.1	30.2	30.1	29.7
1914	30.1	29.8	29.7	29.4	29.6	29.8	30.1	30.5	30.6	30.4	30.5	30.4	30.1
1915	30.3	30.1	29.8	30.1	30.2	30.3	30.3	30.3	30.4	30.7	30.9	31.0	30.4
1916	31.3	31.3	31.6	31.9	32.0	32.4	32.4	32.8	33.4	33.8	34.4	34.6	32.7
1917	35.0	35.8	36.0	37.6	38.4	38.8	38.4	39.0	39.7	40.4	40.5	41.0	38.4
1918	41.8	42.2	42.0	42.5	43.3	44.1	45.2	46.0	47.1	47.9	48.7	49.4	45.1
1919	49.5	48.4	49.0	49.9	50.6	50.7	52.1	53.0	53.3	54.2	55.5	56.7	51.8
1920	57.8	58.5	59.1	60.8	61.8	62.7	62.3	60.7	60.0	59.7	59.3	58.0	60.0
1921	57.0	55.2	54.8	54.1	53.1	52.8	52.9	53.1	52.5	52.4	52.1	51.8	53.6
1922	50.7	50.6	50.0	50.0	50.0	50.1	50.2	49.7	49.8	50.1	50.3	50.5	50.2
1923	50.3	50.2	50.4	50.6	50.7	51.0	51.5	51.3	51.6	51.7	51.8	51.8	51.1
1924	51.7	51.5	51.2	51.0	51.0	51.0	51.5	51.0	51.2	51.4	51.6	51.7	51.2
1925	51.8	51.6	51.7	51.6	51.8	52.4	53.1	53.1	52.9	53.1	54.0	53.7	52.5

1926	53.7	53.5	53.2	53.7	53.4	53.0	52.5	52.2	52.2	52.7	52.9	52.9	53.0
1927	52.5	52.1	51.8	51.8	52.2	52.7	51.7	51.4	51.7	52.0	51.9	51.8	52.0
1928	51.7	51.2	51.2	51.3	51.6	51.2	51.2	51.3	51.7	51.6	51.5	51.3	51.3
1929	51.2	51.1	50.9	50.7	51.0	51.2	51.7	51.9	51.8	51.8	51.7	51.4	51.3
1930	51.2	51.0	50.7	51.0	50.7	50.4	49.7	49.4	49.7	49.4	49.0	48.3	50.0
1931	47.6	46.9	46.6	46.3	45.8	45.3	42.2	45.1	44.9	44.6	44.1	43.7	45.6
1932	42.8	42.2	42.0	41.7	41.1	40.8	40.8	40.3	40.1	39.8	39.6	39.2	40.9
1933	38.6	38.0	37.7	37.6	37.7	38.1	39.2	39.6	39.6	39.6	39.6	39.4	38.8
1934	39.6	39.9	39.9	39.8	39.9	40.0	40.0	40.1	40.7	40.4	40.3	40.2	40.1
1935	40.8	41.1	41.0	41.4	41.2	41.1	40.9	40.9	41.1	41.1	41.3	41.4	41.1
1936	41.4	41.2	41.0	41.0	41.0	41.4	41.6	41.9	42.0	41.9	41.9	41.9	41.5
1937	42.2	42.3	42.6	42.8	43.0	43.1	43.3	43.4	43.8	43.6	43.3	43.2	43.0
1938	42.6	42.2	42.2	42.4	42.2	42.2	42.3	42.2	42.2	42.0	41.9	42.0	42.2
1939	41.8	41.6	41.5	41.4	41.4	41.4	41.4	41.4	42.2	42.0	42.0	41.8	41.6
1940	41.7	42.0	41.9	41.9	42.0	42.1	42.0	41.9	42.0	42.0	42.0	42.2	42.0
1941	42.2	42.2	42.4	42.8	43.1	43.9	44.1	44.5	45.3	45.8	46.2	46.3	44.1
1942	46.9	47.3	47.9	48.2	48.7	48.8	49.0	49.3	49.4	49.9	50.2	50.6	48.8
1943	50.6	50.7	51.5	52.1	52.5	52.4	52.0	51.8	52.0	52.2	52.1	52.2	51.8
1944	52.1	52.0	52.0	52.3	52.5	52.6	52.9	53.1	53.1	53.1	53.1	53.3	52.7
1945	53.3	53.2	53.2	53.3	53.7	54.2	54.3	54.3	54.1	54.1	54.3	54.5	53.9
1946	54.5	54.3	54.7	55.0	55.3	55.9	59.2	60.5	61.2	62.4	63.9	64.4	58.5
1947	64.4	64.3	65.7	65.7	65.5	66.0	66.6	67.3	68.9	68.9	69.3	70.2	66.9
1948	71.0	70.4	70.2	71.2	71.7	72.2	73.1	73.4	73.4	73.1	72.6	72.1	72.1
1949	72.0	71.2	71.4	71.5	71.4	71.5	71.0	71.2	71.5	71.1	71.2	70.8	71.4
1950	70.5	70.3	70.6	70.7	71.0	71.4	72.1	72.7	73.2	73.6	73.9	74.9	72.1
1951	76.1	77.0	77.3	77.4	77.7	77.6	77.7	77.7	78.2	78.6	79.0	79.3	77.8
1952	79.3	78.8	78.8	79.1	79.2	79.4	80.0	80.1	80.0	80.1	80.1	80.0	79.5
1953	79.8	79.4	79.6	79.7	79.9	80.2	80.4	80.6	80.7	80.9	80.6	80.5	80.1
1954	80.7	80.6	80.5	80.3	80.6	80.7	80.7	80.6	80.4	80.2	80.3	80.1	80.5
1955	80.1	80.1	80.1	80.1	80.1	80.1	80.4	80.2	80.5	80.5	80.6	80.4	80.2

1956	80.3	80.3	80.4	80.5	80.9	81.4	82.0	81.9	82.0	82.5	82.5	82.7	81.4
1957	82.8	83.1	83.3	83.6	83.8	84.3	84.7	84.8	84.9	84.9	85.2	85.2	84.3
1958	85.7	85.8	86.4	86.6	86.6	86.7	86.8	86.7	86.7	86.7	86.8	86.7	86.6
1959	86.8	86.7	86.7	86.8	86.9	87.3	87.5	87.4	87.7	88.0	88.0	88.0	87.3
1960	87.9	88.0	88.0	88.5	88.5	88.7	88.7	88.7	88.8	89.2	89.3	89.3	88.7
1961	89.3	89.3	89.3	89.3	89.3	89.4	89.8	89.7	89.9	89.9	89.9	89.9	89.6
1962	89.9	90.1	90.3	90.5	90.5	90.5	90.7	90.7	91.2	91.1	91.1	91.0	90.6
1963	91.1	91.2	91.3	91.3	91.3	91.7	92.1	92.1	92.1	92.2	92.3	92.5	91.7
1964	92.6	92.5	92.6	92.7	92.7	92.9	93.1	93.0	93.2	93.3	93.5	93.6	92.9
1965	93.6	93.6	93.7	94.0	94.2	94.7	94.8	94.6	94.8	94.9	95.1	95.4	94.5
1966	95.4	96.0	96.3	96.7	96.8	97.1	97.4	97.9	98.1	98.5	98.5	98.6	97.2
1967	98.6	98.7	98.9	99.1	99.4	99.7	100.2	100.5	100.7	101.0	101.3	101.6	100.0
1968	102.0	102.3	102.8	103.1	103.4	104.0	104.5	104.8	105.1	105.7	106.1	106.4	104.2
1969	106.7	107.1	108.0	108.7	109.0	109.7	110.2	110.7	111.2	111.6	112.2	112.9	109.8
1970	113.3	113.9	114.5	115.2	115.7	116.3	116.7	116.9	117.5	118.1	118.5	119.1	116.3
1971	119.2	119.4	119.8	120.2	120.8	121.5	121.8	122.1	122.2	122.4	122.6	123.1	121.3
1972	123.2	123.8	124.0	124.3	124.7	125.0	125.5	125.7	126.2	126.6	126.9	127.3	125.3
1973	127.7	128.6	129.8	130.7	131.5	132.4	132.7	135.1	135.5	136.6	137.6	138.5	133.1
1974	139.7	141.5	143.1	143.9	145.5	146.9	148.0	149.9	151.7	153.0	154.3	155.4	147.7
1975	156.1	157.2	157.8	158.6	159.3	160.6	162.3	162.8	163.6	164.6	165.6	166.3	161.2
1976	166.7	167.1	167.5	168.2	169.2	170.1	171.1	171.9	172.6	173.3	173.8	174.3	170.5
1977	175.3	177.1	178.2	179.6	180.6	181.8	182.6	183.3	184.0	184.5	185.4	186.1	181.5
1978	187.2	188.4	189.8	191.5	193.3	195.3	196.7	197.8	199.3	200.9	202.0	202.9	195.4
1979	204.7	207.1	209.1	211.5	214.1	216.6	218.9	221.1					

Footnotes

FAS33, Footnote 1--For the purposes of this Statement, except where otherwise provided, inventory and property, plant, and equipment shall include land and other natural resources and capitalized leasehold interests but *not* goodwill or other intangible assets.

FAS33, Footnote 2--The index is published in *Monthly Labor Review.* Those desiring prompt and direct information may subscribed to the Consumer Price Index (CPI) press release mailing list of the Department of Labor.

FAS33, Footnote 3--Cost of goods sold measured on a LIFO basis may provide an acceptable approximation of cost of goods sold, measured at current cost, provided that the effect of any decreases in inventory layers is excluded.

FAS33, Appendix A, Par. 70 Schedule A Footnote *--At December 31, 1980 current cost of inventory was $65,700 and current cost of property, plant, and equipment, net of accumulated depreciation was $85,100.

FAS33, Appendix A, Footnote *--At December 31, 1980 current cost of inventory was $65,700 and current cost of property, plant, and equipment, net of accumulated depreciation was $85,100

FAS33, Appendix B, Footnote 4--William A. Paton, *Accounting Theory* (Houston, TX: Reprinted by Scholars Book Co., 1973), p. 427.

FAS33, Appendix B, Footnote 5--American Institute of Certified Public Accountants, Committee on Accounting Procedure, ARB No. 33, *Depreciation and High Costs* (New York: AICPA, December 1947).

FAS33, Appendix B, Footnote 6--Committee on Accounting Procedure, letter to AICPA members reaffirming the recommendations of ARB No. 33, October 1948.

FAS33, Appendix B, Footnote 7--Committee on Accounting Procedure, ARB No. 43, *Restatement and Revision of Accounting Research Bulletins,* Chap. 9, Section A, "Depreciation and High Costs" (New York: AICPA, June 1953).

FAS33 Footnote †--Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of constant dollar accounting.

FAS33, Appendix D, Footnote*--If an investment is accounted for on the equity method, and if the investor is preparing comprehensive constant dollar financial statements, the financial statements of the investee theoretically should be restated in constant dollars and the equity method should then be applied. However, if restated financial statements cannot be obtained

from the investee, the investor may be able to prepare such statements using nominal dollar information that is available, such as nominal dollar financial statements for a series of years. As a simpler alternative, an investor that prepares comprehensive constant dollar statements merely could restate the entries in the investment account as recorded in accordance with the equity method.

FAS33 Footnote†--Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of constant dollar accounting.

FAS33 Appendix D Footnote†--Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of constant dollar accounting.

FAS33 Appendix D Footnote†--Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of constant dollar accounting.

FAS33 Appendix D Footnote†--Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of constant dollar accounting.

FAS33, Appendix E, Footnote †--Calculated by averaging the estimated monthly indexes for each quarter.

FAS33, Appendix E, Footnote †--Calculated by averaging the estimated monthly indexes for each quarter.

FAS33, Appendix E, Par. 221, Footnote *--Estimated for illustrative purposes.

FAS33, Appendix E, Par. 221, Footnote *--Estimated for illustrative purposes.

FAS33, Appendix E, Footnote *--Estimated for illustrative purposes.

FAS33, Appendix E, Par. 221 Footnote ‡--Calculated by averaging the estimated monthly indexes for 1980. The index for the last month of the year may not be available at the time of preparing the supplemental disclosures and may be estimated by extrapolating the rate of change for the previous month.

FAS33, Appendix E, Footnote †--From paragraph 218c.

Footnote ‡--From paragraph 218b.

FAS33, Appendix E, Par. 225, Footnote *--Assumed to be in average 1980 dollars.

FAS33, Appendix E, Par. 231, Footnote *--Paragraph 217

FAS33, Appendix E, Par. 232, Footnote *--Assumed to be in average 1980 dollars.

FAS33, Appendix E, Par. 233, Footnote *-- Assumed to be in average 1980 dollars

FAS33, Appendix E, Par. 235, Footnote *--Assumed to be in average 1980 dollars.

FAS33, Appendix E, Par. 239, Footnote *--Paragraph 229