5-27-1950

An Analysis and Comparison of Conflicting Theories of Modern Accounting

Josefina Abeyta Velasquez

Velasquez — Conflicting Theories of Modern Accounting

AN ANALYSIS AND COMPARISON
OF CONFLICTING THEORIES
OF MODERN ACCOUNTING

By
Josefina Abeyta Velasquez

A Thesis
Presented in Partial Fulfillment of the
Requirements for the Degree of
Master of Arts in Business Administration

University of New Mexico
1950

This thesis, directed and approved by the candidate's committee, has been accepted by the Graduate Committee of the University of New Mexico in partial fulfillment of the requirements for the degree of

MASTER OF ARTS

E F Castetter
DEAN

May 27, 1950
DATE

AN ANALYSIS AND COMPARISON OF CONFLICTING THEORIES OF MODERN ACCOUNTING

By

Josefina Abeyta Velasquez

Thesis committee

~~Vernon G.~~ John L Dunbar
CHAIRMAN

Vernon G. Sorrell

W J Harmeyer

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

Accounting, as we know it today, has evolved from double entry bookkeeping as it was developed in Italy sometime during the thirteenth or fourteenth century.[1] Since its origin to about 1930, accounting had been undergoing a gradual change. The recent widespread use of the corporate type of business has caused the development of accounting to accelerate. This rapid change that accounting has undergone has caused it to be considered a new science. It is new in that it has many new problems to embrace and many new vistas to portray. The many rules that have developed since the origin of accounting are now tearing at the seams with the burden placed on them by the many changes that have occurred in business activity. At present, not just a small number of people are interested in the picture of a business organization as shown by the records of the organization's activities, but literally thousands are vitally interested. The owners of a business organization are often miles and miles from the center of

---

[1] Edward Peragallo, Origin and Evolution of Double Entry Bookkeeping (New York: American Institute Publishing Company, 1938), Preface.

CHAPTER I

INTRODUCTION

Accounting, as we know it today, has evolved from double entry bookkeeping as it was developed in Italy sometime during the thirteenth or fourteenth century.[1] Since its origin to about 1920, accounting had been undergoing a gradual change. The recent widespread use of the corporate type of business has caused the development of accounting to accelerate. This rapid change that accounting has undergone has caused it to be considered a new science. It is new in that it has more new problems to solve and many new vistas to portray. The many rules that have developed since the origin of accounting are now weathering at the seams with the burden placed on them by the many changes that have occurred in business activity. At present, not just a small number of people are interested in the picture of a business organization as shown by the records of the organization's activities, but literally thousands are vitally interested. The owners of a business organization are often miles and miles from the center of

---

[1] Edward Peragallo, *Origin and Evolution of Double Entry Bookkeeping* (New York: American Institute Publishing Company, 1938), Preface.

operations. They know no more about the business than what is shown in records mailed to them at regular intervals. These records must, therefore, be very comprehensive, very accurate, very revealing, and easy to understand. Many of these owners have not had enough experience with business records to understand or analyze short composite reports. Such reports must of necessity be detailed enough to be self explanatory.

Management needs reports that will help it to make intelligent decisions for the business. It is upon the facts revealed by these reports that management bases long-range planning or minute decisions. These reports are the most important tool that management has at its disposal. In fact, reporting to management is the primary function of accounting. Reports to management must have a true story to tell. It must not be a colored story, but it must be an illustrative and revealing story. It should stand comparing and analysing. It should be a simple yet complete story. It must not have any hidden nooks and corners that might cause management to get lost or confused. When management finishes reading this story, it should have a complete

understanding of every phase of the business as it was when the reports were made. Worthwhile planning and sound decisions can then be made.

Reports must also be made to governmental agencies. Often records made to such agencies must differ radically from those made to stockholders and other interested persons, for governmental agencies are seeking different information from that needed by others. Accounting rules and theories must be stretched in such a way that the records made by following them reveal the truth to all interested persons no matter how many different views of the multiple business activities these people may require.

Accounting has grown academically too. It is now an important subject in the curriculum of most colleges. Many students are not satisfied with a course in bookkeeping or in elementary accounting. They want to study all phases of the subject. As a result, much literature is now being published which deals with the concepts, theories, or principles of accounting.

This rapid growth of accounting from both the academic and practical point of view has resulted in much conflict as to the interpretation of the theories understanding of every person of the business as it was when the reports were made. Accurate, logical and sound decisions can then be made.

Reports must also be able to serve special agencies. Often reports made to such agencies must differ radically from those made to stockholders and other interested persons, for governmental agencies are seeking different information from that wanted by others. Accounting rules and theories must be stretched in such a way that the reports made by following them reveal the truth to all interested persons no matter how many different views of the multiple business activities these people may require.

Accounting has grown academically too. It is now an important subject in the curriculum of most colleges. Many students are not satisfied with a course in bookkeeping or in elementary accounting. They want to study all phases of the subject. As a result, much literature is now being published which deals with the concepts, theories, and principles of accounting.

This rapid growth of accounting from both the academic and practical point of view has resulted in much conflict as to the interpretation of the theories or principles of accounting as they apply to current business problems. For example, some authorities believe that the theories or principles of accounting should be flexible. Others believe that such theories or principles should be standardized and stated very precisely. Exact quotations from some authorities are hereby given. They clearly illustrate how keenly these authorities feel toward these conflicts.

Robert H. Montgomery states in the forword to Edward Peragallo's book:

> The principal value of the study which Mr. Peragallo has made is that it establishes beyond dispute two things: first, that by its very nature accounting adapts itself to business procedure, not business to accounting procedure;
>
> . . . .
>
> Accounting methods which have endured are those which have met the test of the pragmatists----how well do they serve the given purpose? Accounting has but one purpose, to set forth the results of business operations accurately and truthfully. It draws upon the resources of many sciences, but remains an art, varying in effectiveness with the knowledge and skill of the practitioner----this is the lesson of history.[2]

In general, practitioners are against standardization. Laurence L. Vance quotes Colonel Robert H. Montgomery as stating,

---

[2] _Ibid_., Forword.

> I do not ask for standardization of accounting practice or procedure. That would mean the substitution of fixed rules for opinion and discretion. In fifty years we have learned much. If we had been standardized or unionized at any time during those fifty years, I am sure we would have lost one of our choicest possessions--independence to express our convictions in each particular case submitted to us, and most cases differ from every other case.[3]

The following quotation is still another statement against standardization.

> The nature of accounting--the meaning and significance of many accounting reports--is fashioned by the demands of businessmen. A proprietor may wish to determine his liability for income tax. He will demand records and summaries that will conform to the requirements of statutes and regulations. At the same time he may wish to ascertain that his expectations of an enterprise income were or were not fulfilled. The records, summaries, and interpretations necessary to satisfy the later demand may or may not correspond with good tax accounting. What is more, the procedures of good managerial accounting frequently depart from the conventions of proprietorship accounting.
>
> Methods and procedures are flexible, and can be bent to a variety of uses. They are not fixed and rigid--a straight and narrow path to an immutable goal. The form and content of accounting statements will vary according to the purposes for which they are prepared, and in relation to considerations of speed, accuracy, and expense. Standardization and rigidity are greatly to be

---

[3] Robert H. Montgomery, "What Have We Dome and How", Fiftieth Anniversary Celebration (New York: American Institute of Accountants, 1937), p. 89, cited by Laurence L. Vance, "Current Problems and Accounting Theory," The Accounting Review, 19:231, July 1944.

I do not ask for standardization of accounting practice or procedure. That would mean the substitution of fixed rules for [illegible]. In fifty years we have learned that [illegible] been standardized [illegible] those fifty years, I [illegible] one of our [illegible] to express our convictions in each particular case submitted to us, [illegible] from every other case.[3]

The following [illegible]

against standardization.

The nature of [illegible] significance of [illegible] accounting [illegible] enhanced by the demands of [illegible]. The proprietor may wish to [illegible] income tax. [illegible] that will conform to the federal [illegible] and regulations. At the same time [illegible] ascertain that [illegible] income [illegible]. [illegible] reports, summaries, and [illegible] satisfy the latter [illegible] with good tax accounting. [illegible] procedures of good [illegible] accounting [illegible] depart from the [illegible] accounting.

Methods and procedures [illegible] can be bent to a variety of uses. [illegible] and rigid—a straight and narrow [illegible] mutable goal. The form and content of accounting statements will vary according to the purposes for which they are prepared, [illegible] considerations of [illegible], accuracy, [illegible]. Standardization and [illegible]

---

[3] Robert H. Montgomery, "What Have We Done, and How", Fiftieth Anniversary Celebration (New York: American Institute of Accountants, 1937), p. 57, cited by Laurence L. [illegible] Theory," The Accounting Review, [illegible]

desired, if for no other reason than to facilitate understanding; yet accounting reports are narratives and, like the story-teller, the accountant must frequently adapt his presentation to his audience and adjust the content of his tale to emphasize his point.

. . . .

Judgement rather than custom must play the major roll for a number of reasons. In the first place, business practices change in time, and satisfactory experience for one generation may be cutmoded in another.[4]

There are arguments in favor of standardization too. Their attitudes can best be expressed by the following quotations:

A consistent framework of standards is needed to serve as a basis for judgement in construction and interpreting financial statements.

Accounting standards should be systematic and coherent, impartial and impersonal, and in harmony with observable objective conditions.[5]

Howard S. Greer states in his forword to the above cited book:

. . . Accountants have been coming gradually to a recognition of the need for more precise and more widely accepted standards to guide them in the performance of their duties. They have been faced with difficult problems--that of reconciling the diverse treatments of business facts which have been customery in past periods,

---

[4] Edward G. Nelson, "A Brief Study of Balance Sheets," The Accounting Review, 22:342, October, 1947.

[5] W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards (Chicago: American Accounting Association, 1940) p. 1.

and that of influencing the managers of business enterprise toward the adoption of more uniform and consistent accounting procedures.

. . . .

Diverse methods of treatment of like situations in the accounts of business enterprises had given rise to serious misconceptions, not only in the mind of the public, but also in the attitudes of business and financial leaders themselves. If accountants could not agree on the principles according to which the amount of a profit or the extent of an equity were to be measured, what purpose was served by impressively certified statements of corporation finances? It seemed plain that the time had come for those interested in theories and principles to cease raising questions and to begin furnishing answers.[6]

Both sides of the problem are ably and amply defended in current accounting literature. It is the belief of the author that some standardization is necessary. Reports and statements would be more easily understood. Much of the current criticisms concerning vague statements and vague reports would be eliminated. Of course, careful study of the more common problems should be made and recommendations suggested. THE AMERICAN INSTITUTE OF ACCOUNTANTS have been taking a step in the right direction. Problems are carefully studied by able men and recommendations are made by means of the Accounting Research Bulletins. It is very apparent that these recommendations do not satisfy all accountants.

---

6 *Ibid.*, Forword.

There are many articles in current accounting journals frankly discussing these recommendations. These articles serve as incentives for further study so they are of great value.

Standardization should be flexible enough to make room for new or unusual problems that may arise. Standardization may not even prove practical for the profession as a whole but there should at least be standardization within like industries.

I. THE PROBLEM

__Statement of the problem.__ It is the purpose of this study to present the point of view of different accounting authorities on theories of accounting upon which these authorities are not fully agreed, with the purpose of giving those interested in current accounting trends a chance to view these theories from different angles. It is hoped that such a presentation will be an incentive that will lead to more extensive reading of current accounting literature for only through such reading can any one person reach more intelligent interpretation of present conflicting theories of accounting.

__Delimitation of the problem.__ Since the scope of current accounting literature dealing with conflicting theories of accounting is so extensive and varied, it has been necessary to limit this study to those theories of accounting concerning currently widely discussed balance sheet and profit and loss presentation. Such topics as fixed asset valuations, inventory pricing, reserves, and terminology are considered in this study but only as they affect balance sheet and profit and loss presentation.

<u>Importance of the problem</u>. The statements quoted in the introduction illustrate that the rapid development of accounting has caused authorities on the subject to have conflicting opinions as to what is the best procedure to follow in any one case. An understanding of these conflicts is necessary in order to best evaluate any or all accounting literature that is being published today. It will also cause an accountant to use better judgment in solving present business problems for he will be able to view the problem from many more angles.

Students of modern accounting are often confused to find that accounting authorities do not agree on vitally important topics of accounting. They do not know who to believe. It would be best to introduce them to the different conflicting views, to help them to compare and analyze these views, and to help them to make up their mind as to what view is best to follow in any one situation. Unless this is done, present accounting students would be traveling along a very narrow road into the world of accounting knowledge. Any little turning away from this narrow road that they may attempt would lead them into a forest of utter confusion. It would be best to let them realize that there is no complete agreement among

well known accounting authorities, that there usually is good ground for such disagreement, and that a study of the disagreements would lead to a broader view into the world of accounting knowledge. It is with this in mind that an analysis and comparison of the conflicting theories of accounting is presented.

II. SOURCES OF DATA

Current literature on accounting and current accounting texts have been carefully studied with the intention of presenting the different points of view pertaining to concepts of accounting which are not fully agreed upon. Much has been said on the different topics and many authors have discussed the same topics. Though each had something very significant to say, it would be impossible to quote them all. It is hoped that the readers of this thesis are induced to delve into all the interesting and important accounting literature that is being published currently.

CHAPTER II

DEFINITION OF ACCOUNTING

Accounting is such a broad subject and it can be made to serve so many purposes that a definition is almost impossible. Many authorities shied from committing themselves to such a definition. In this connection, Paton makes the following statement, "It is doubtless often better to permit the entire exposition to build what definition it may in the reader's mind than to attempt to formulate the essence of the matter in a few words."[1] In place of a definition he gives a detailed discussion of the different phases of accounting. He makes it clear that the functions of accounting are different when considered from the point of view of the business enterprise, the owners or proprietors, the student or teacher, the managerial, and the industrial community as a whole.[2]

---

[1] William Andrew Paton, Accounting Theory (New York: The Ronald Press Company, 1922), p. 3.

[2] William Andrew Paton, Accounting (New York: The Macmillan Company, 1926), pp. 18-19.

In one of his early works Finney defines accounting thus:

> Accounting comprises a body of legal, industrial, commercial, and financial principles which must be taken into consideration in determining how,and to what extent, the transactions of a business affect the value of its assets and the amount of its liabilities, profits, and capital.[3]

In one of his later works Finney gives the following description of accounting: "Accounting is the language of commerce--the language in which the history of a business is recorded, its operations are summarized, its financial condition is stated, and its budget forcasts are expressed."[4]

After careful and detailed explanation of each different phase of accounting, Johnson makes this statement:

> In summary, accounting may be defined as the collection, compilation, and systematic recording of business transactions; the preparation of financial reports; the analysis and interpretation of these reports; and the use of these reports as tools of management.[5]

---

[3] H. A. Finney, Principles of Accounting (New York: Prentice-Hall, Inc., 1933), v. 1, p. 1.

[4] H. A. Finney, General Accounting (New York: Prentice-Hall, Inc., 1941), Preface.

[5] Arnold W. Johnson, Principles of Accounting (New York: Farrar & Rinehart, Inc., 1937), p. 1.

Foster states:

> Accounting is a scheme for recording the financial facts of business transactions and a method for assembling and presenting these data in the forms best adapted to the needs of those having financial or managerial interests in administering the available forces of an enterprise. It may be thought of as performing three functions: supplying a record of financial events, protecting the interests of those furnishing the enterprise capital, and providing a tool to assist the management in operating the enterprise with the greatest possible efficiency. These three functions are not mutually exclusive; as a matter of fact, they are interdependent; a decision affecting one of the functions has an influence on the others.[6]

The definition given by the American Institute of Accountants in their Research Bulletin Number 9 is as follows:

> Accounting is the art of recording, classifying and summarizing in significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.[7]

Kennedy, Esterly and von Minden effectively state, "Accounting can be called the eyes of business." People often say, "Nothing could be worse than losing your eyesight." Managers of business enterprises, large or small, would be just as badly handicapped without accounting, for accounting enables them to

---

[6] Louis O. Foster, Introduction to Accounting (Chicago: Richard D. Erwin, Inc.,), p. 12.

[7] Accounting Research Bulletins Issued by Committee on Accounting Procedure. American Institute of Accountants (New York: May, 1941, No. 9), p. 67.

see the progress or failure of the business enterprise and to analyze the causes involved.[8]

It is for this reason that the author believes that accounting is a revealing picture of the financial condition of a business concern. Anything that magnifies or crystallizes this picture so that it is more clearly viewed, more easily understood, better analyzed, and more readily compared is an important part of accounting. Records and statements are means by which the picture is presented to management or other interested parties.

A significant point revealed by a study of the different definitions of accounting is that the definitions are not conflicting. They are merely an attempt to describe in a few words a field that is very far-reaching. Accounting is too broad and it serves too many purposes. A definition is almost impossible. To say it all in a few words is truly a tremendous task.

---

[8] Donald D. Kennedy, George R. Esterly, William J. von Minden, Introductory Accounting (New York: The Ronald Press Company), p. 3.

CHAPTER III

SUMMARY REPORTS

Most parties interested in the affairs of a business get their information from the summary reports; namely, the balance sheet and the income statement. (Another name for the income statement is the profit and loss statement. However, "income statement" is much more commonly used in current accounting literature.). These two reports are of great significance and importance as they are the media by which the accountant presents valuable information concerning the business to management, investors, stockholders, and the public.

In recent years these statements have received a great deal of criticism. Some of the reasons for this criticism are:

1. The form and terminology are confusing to those trying to interpret them.

2. Methods of valuing assets, such as inventory, are not clearly stated nor are they comparable, as different methods are used in different years within the same company or in the same year between different companies in any one industry.

3. The excessive use of reserves leads to confusion and mistrust.

4. It is not clear whether present costs are being matched against current revenues.

5. Attempts to equalize income between years is viewed with mistrust.

6. Footnotes and other explanatory remarks concerning statement items are often poorly stated so that they become confusing rather than explanatory. An excessive use of such remarks is to be discouraged.

As a result, the public and especially members of labor unions misinterpret and mistrust statements.

> An exhaustive survey made by the Controllership Foundation reveals wide mistrust of financial statements, erroneous ideas of profits, and confusion over the language in which business reports facts to the public.[1]

It may seem as though it does not matter whether labor and the public understand business reports. Some claim that so long as management and the more important stockholders can interpret and make use of these statements, labor and the public can be forgotten. However, accounting has a social obligation to perform. Information revealed in the summary reports can be used to tell what the economic standing of the nation is. Important nation-wide planning can be the result of the interpretation of many business reports.

---

[1] Staff of The Journal of Accountancy "What the Public Thinks About Financial Statements" Journal of Accountancy, 83:487, June, 1947.

Also, business men are trying to show the public and labor why they can not pay higher wages or why they can not produce more. Large business organizations suffer when their laborers strike and when the public misinterpret their motives. Labor and the public think business is making large profits which are not being divided equitably with the men who help realize them. If the public and labor could be made to understand the problems of business, there would be greater cooperation between the two. All would profit. Business men understand this; therefore, they are trying to communicate with labor and the public but they are trying to communicate at their own language level. About half of the American adults have had less than eight and one-half years of schooling. If the public is to understand financial statements, these statements must be written in the language of the people not in the language of the professional student. There is an understandable word that can be used to mean the same as any difficult word.[2]

This is some of the information labor leaders would like to have in order to be fair in their demands.

---

[2] James M. Lambie, Jr. "Financial Reports Can Be Written So People Can Understand Them" Journal of Accountancy, 84:41, July, 1947.

In a general sense, we are interested in the same facts regarding the operations of a business as are stockholders and others, with a few more breakdowns needed to give more detail on certain items more closely related to the workers part in the business. For instance, we need a breakdown of the item "cost of goods sold" in the income statement, which is not usually given. Such a breakdown should show direct labor costs, material and other costs. A further breakdown of "labor costs" is necessary to separate the compensation of wage earners from that of the supervisory force.

Compensation of wage earners will then be available for comparison with other items in the report, such as total net income from sales, and profits before and after taxes. This would also enable us to determine fairly accurately what the total cost to the company of a proposed wage increase would be. It would also then be possible to estimate the productivity of labor in terms of value created in the particular industry per dollar expended for labor--an estimate fully as important as productivity in terms of volume, as a determining factor as regards wages.

Dividend payments, total compensation of management, and income transferred to surplus are also important items in giving workers' representatives a balanced view of the distribution of the company's income.

In the balance-sheet, we are naturally interested in finding out the working capital position of the company, and the net worth, in order to estimate the rate of return on investment. These facts can, of course, be readily determined from most reports as they are now prepared.

The presentation of explanatory data on the company's various reserves, and their purpose, would help clear up any possible misunderstanding that might arise on that account--as would an explanatory statement regarding the procedure followed in inventory valuation.

Information which can be obtained from financial reports is not the only type of data that union representatives need, in order to eliminate guesswork in contract negotiations. Actual rates being paid for various classifi-

In a general way, we are interested in the same facts regarding the financial position as are stockholders and others, but we feel a breakdown of a few more of the income items more closely related to wages would help in the business. For instance, we need a breakdown of the item "cost of goods sold" in the income statement, which is not given. Such a breakdown should show labor costs, material and other costs. A further breakdown of "labor costs" is needed to separate the compensation of wage earners from that of the supervisory force.

Compensation of management should be available for comparison with other items in the report, such as total net income, total sales and profits before and after taxes. This would also enable us to determine fairly accurately what the total cost to the company of a proposed wage increase would be. It would then be possible to estimate the productivity of labor in terms of value created in the particular industry per dollar expended for labor--an estimate fully as important as productivity in terms of volume, as a determining factor in setting wages.

Dividend payments, total compensation of management, and income transferred to surplus are also important items in giving union representatives a balanced view of the distribution of the company's income.

In the balance-sheet, we are naturally interested in finding out the working capital position of the company, and its net worth, in order to estimate the rate of return on investment. These facts can, of course, be readily determined from most reports as they are now prepared.

The presentation of supplementary data on the company's various reserves, and their purposes, would help clear up any possible misunderstanding that might arise on that score--as would an explanatory statement regarding the procedures followed in inventory valuation.

Information which can be obtained from financial reports is not the only type of data that union representatives need. In order to eliminate guesswork as to how actual rates being paid for various kinds of cations of work, variations of rates within job classifications, actual annual earnings, and the cost of such items as paid sick leave, and overtime work, would be extremely useful in both developing a spirit of mutual confidence and in ascertaining where particular adjustments are needed."[3]

As has already been mentioned in Chapter I, financial reports are indispensable to management. Without them, management would not be able to do any planning as it is through them that management gets all of its inside views of the business. These reports portray the results of all business activities.

Government, too, is greatly interested in the income made by business. It, too, is seeking information so as to know what share of the income should be taken up as taxes. Income tax laws and tax experts make it easy for government people to find out what they wish to know about a business.

The stockholders want to know why more income is not being divided among them. These people are greatly interested in the surplus statement. This statement may be a separate report or it may be combined with the income statement. Some authors

---

[3] Lane Kirkland, "Preparation of Financial Information Should Be Influenced By Labors' Needs", Quotations from an address before an accounting conference at the University of Georgia, Journal of Accountancy, 87:272-73, May, 1949.

recommend that this statement should include a summary of nonrecurring items. Others advocate that nonrecurring items may be a part of the income statement.

> When nonrecurring items are so reported, the statement of profit and loss offers information concerning normal as well as extraordinary items that are of significance for a full evaluation of the events of the past fiscal period as these affected proprietorship.[4]

Nonrecurring items are defined as follows:

> Nonrecurring items include gains and losses from sale of investments and property and equipment; losses from fire, inventory price declines, retirement of bonded debt, and war reconversions; income tax adjustments; and corrections in profits of prior periods."[5]

Some accountants who are in favor of showing nonrecurring items in the income statement and who are against showing such items in a separate surplus statement are advocates of the "clean surplus" theory. They believe that "all elements of income, profits, expenses, and losses (except profits and losses on transactions in the company's own capital stock) should be absorbed against the income of the same period." Other accountants who are against a separate surplus statement wish to protect readers by combining the income and surplus statement. They fear that

---

[4] W. E. Karrenbrock and Harry Simons, Intermediate Accounting (Cincinnati: South-Western Publishing Company, 1949), p. 15.

[5] *Ibid.*, p. 15.

some readers "are not aware of the significance of matters disclosed in the surplus statement."[6]

The present trend is to consider the income statement of greater importance than the balance sheet. As has been stated previously, it is even recommended that the surplus statement be combined with the income statement for greater convenience to readers. Another important reason for the significance given to the income statement is the great importance being given to accounting for income. The tendency is to use self-explanatory terminology for divisions of the income statement. There are objections to the use of expressions such as "net profit on sales" or "net profits on operations." The contention is that there is no "net profit" until all costs have been deducted from revenues.[7]

There has been much said as to what costs should be used. "But the basic, the significant income amount is that based on current costs.[8]

---

[6] H. A. Finney, Principles of Accounting (Intermediate; New York: Prentice-Hall, Inc., 1946) pp. 46-7.

[7] Ibid., p. 44.

[8] Willard J. Graham, "The Effect of Changing Price Levels Upon the Determination, Reporting, and Interpretation of Income," The Accounting Review, 24:26, January, 1949.

some readers "are not aware of the significance of matters disclosed in the surplus statement."[6]

The present trend is to consider the income statement of greater importance than the balance sheet. As has been stated previously, it is often recommended that the surplus statement be combined with the income statement for greater convenience to readers. Another important reason for the significance shown to the income statement is the great importance being given to accounting for income. The tendency is to use self-explanatory terminology for divisions of the income statement. There are objections to the use of expressions such as "net profit on sales" or "net profits on operations." The contention is that there is no "net profit" until all costs have been deducted from revenues.[7]

There has been much said as to what costs should be used. "But the basic, the significant income amount is that based on current costs."[8]

---

6 H. A. Finney, Principles of Accounting (Intermediate; New York: Prentice-Hall, Inc., [illegible]) p. [illegible].

7 Ibid., p. 44.

8 Willard J. Graham, "The Effect of Changing Price Levels upon the Determination, Reporting, and Interpretation of Income," The Accounting Review, [illegible], January, [illegible].

The proper matching of costs with revenues is imperative.[9] Improper matching causes confusion and make income statements of different years of the same company or of the same year but of different companies within the same industry impossible to compare and analyse. In order to be of real value, financial statements must be prepared in such a way as to be easily compared and analysed.

The use of current costs in the income statement does not necessitate the showing of fixed asset costs in the balance sheet as current costs too. This would mean that book values would be constantly changed. This would not be advisable. As Graham says,

> I would recommend, therefore, that the fixed assets and the regular reserves for depreciation be shown at their original costs, with parenthetical statements of current cost for detailed analysis.[10]

Also, footnotes that explain items in the body of statements are recommended, but these footnotes and parenthetical statements must be well worded and they must be used sparingly. Excessive use of them may result in greater confusion.

---

[9] John G. Blocker, "Mismatching of Costs and Revenues," The Accounting Review, 24:33, January, 1949.

[10] Graham, op. cit., p. 26.

The proper matching of costs with revenues is imperative.[9] Improper matching causes confusion and make income statements of different years of the same company or of the same year but of different companies within the same industry impossible to compare and analyse. In order to be of real value, financial statements must be prepared in such a way as to be easily compared and analysed.

The use of current costs in the income statement does not necessitate the showing of fixed asset costs in the balance sheet as current costs too. This would mean that book values would be constantly changed. This would not be advisable. Mr Graham says,

> I would recommend, therefore, that the fixed assets and the regular reserves for depreciation be shown at their original costs, with parenthetical statements of current cost for detailed analysis.[10]

Also, footnotes that explain items in the body of statements are recommended, but these footnotes and parenthetical statements must be well worded and they must be used sparingly. Excessive use of them may result in greater confusion.

---

[9] John G. Blocker, "Mismatching of Costs and Revenues," The Accounting Review, [illegible], 33, January, 1949.

[10] Graham, op. cit., p. [illegible]

It must be remembered that no statements can be made to fit all purposes or to serve all needs. Nevertheless, an effort should be made to prepare statements that reveal all of the facts, that are easy to understand, compare, and analyse. The remainder of this thesis will discuss those items that seem to cause the most confusion in a study of financial statements. They are:

1. Fixed asset valuations and depreciation,
2. Inventory pricings,
3. Reserves,
4. Terminology.

CHAPTER IV

FIXED ASSETS AND DEPRECIATION

How to carry fixed assets on the books and how to report their value on statements is a subject frequently discussed in current accounting literature. The problem arises because of the effect that rising prices and reduced purchasing power have on replacement costs and on net income. Current expenses are stated in present dollar values while depreciation is stated in past dollar values. If depreciation is a major expense and if fixed assets were bought far enough in the past so that their cost value is out of line with current prices, the understatement of depreciation calculated on cost would overstate net income.[1] Some authorities believe that fixed assets should be reported at cost, others believe replacement cost should be the figure used. Still others believe that current prices should be used. The problem is further complicated by the inability to predict how long price levels will be high or how suddenly they may decline.[2] Also, replacement

---

[1] W. A. Paton, "Depreciation and the Price Level," The Accounting Review, 23:119, April, 1948.

[2] Maurice Moonitz, "Adaptations to Price Level Changes," The Accounting Review, 23:137, April, 1948.

CHAPTER IV

FIXED ASSETS AND DEPRECIATION

How to carry fixed assets at cost and how to report their value on statements are subjects frequently discussed in current accounting literature. The problem arises because of the effect that rising prices and reduced purchasing power have on replacement costs and on net income. Current expenses are stated in present dollar values while depreciation is stated in past dollar values. If depreciation is a major expense and if fixed assets were bought long enough in the past so that their cost value is out of line with current prices, the understatement of depreciation calculated on cost would overstate net income.[1] Some authorities believe that fixed assets should be reported at cost, others believe replacement cost should be the figure used. Still others believe that current prices should be used. The problem is further complicated by the inability to predict how long price levels will be high or how suddenly they may decline.[2] Also, replacement

---

[1] W. A. Paton, "Depreciation and the Price Level," *The Accounting Review*, 23:119, April, 1948.

[2] Maurice Moonitz, "Adaptations to Price-Level Changes," *The Accounting Review*, 23:137, April, 1948.

costs are hard to state because fixed assets are usually not replaced in exact kind. Some improvements have been made in the newer asset that makes it substantially different from the asset it is replacing.[3]

Furthermore, replacement cost does not distinguish between those higher replacement costs due to price changes and those due to other causes.[4] Another suggestion (made by Dohr) is "that fixed assets be restated periodically in terms of current prices and that depreciation be calculated on the new or restated basis." Such a practice is practical only if appropriate safeguards are used, if it is used as a "fresh start" in a quasi-reorganization, it is used at "relatively wide intervals of time."[5]

Dohr further states:

> The best chance of a workable solution of the problem seems to be in a process of adjustments for changes in price level by means of carefully constructed indices of price changes in the areas in which an economic position, in terms of things, is to be maintained. By the application of these indices the cost of utilization of long-term

---

[3] Ibid., p. 143.

[4] James L. Dohr, "Depreciation and the Price Level" The Accounting Review, 23:118, April, 1948.

[5] Ibid., p. 118.

> facilities can be placed on a current basis and can be made reasonably comparable to the remaining charges in the income statement. Presumably the method will be applied both ways--to eliminate illusionary losses as well as illusionary gains although the latter, in an economy in which the long-term trend of prices is upward, are the more important consideration. It goes without saying that the success of the method will depend upon its general application throughout the business world.[6]

The argument most frequently used in favor of replacement costs is that depreciation based on cost, if the cost occured in the nineteen thirties or even in the early nineteen forties, will not provide for the replacement of such assets. Paton believes this argument is an erroneous statement of the function of depreciation. Depreciation does not provide a fund. Depreciation systematically charges the cost of such assets to revenues in an attempt to measure income more accurately.[7]

To arrive at replacement costs in the asset accounts would mean to recognize appreciated asset values. A. B. Carson is against appreciation. His reasons are expertly stated in the following quotation.

> Recording appreciation violates the principle of conservatism (in the balance sheet, at least)

---

[6] _Ibid_., p. 118.

[7] Paton, _op_. _cit_., p. 120.

> as well as the doctrine of realization. Accountants are loath to inject any more subjectivity into their record keeping than was absolutely required by the necessity of trying to match cost and revenue. There is a widespread feeling that financial records would become a mere collection of various opinions if the door were fully opened to subjective considerations.[8]

Maurice E. Peloubet believes that calculation of depreciation on replacement values is possible as the information can be found in the books of the company, except the information required to convert cost to a present value. This could be either an appraisal figure arrived at by appraisal methods or an index number for the class or group of assets being valued.[9]

Other solutions to the problem of reflecting higher prices on the accounts or on statements are suggested by W. A. Paton:

1. To state in periodic reports statements showing the limitation of net income in view of present conditions and the need for retaining earnings in order to maintain financial strength.

2. To introduce supplementary accounts into the regular system of accounts which show plant accounting and depreciation on an-overall replacement-cost basis. The recorded cost dollars are retained. The difference between

---

8 A. B. Carson, "A Source and Application of Funds--Philosophy of Financial Accounting." The Accounting Review, 24:163, April, 1949.

9 Maurice E. Peloubet, "Depreciation and the Price Level," The Accounting Review, 23:126, April, 1948.

as well as the doctrine of realization, accountants are loath to inject any more subjectivity into their record keeping than was [illegible] required by the necessity of trying to match costs and revenue. There is a widespread feeling that financial records would become a mere collection of various opinions if they were fully exposed to subjective considerations.[8]

Maurice E. Peloubet believed that calculation of depreciation on replacement values is possible as the information can be found in the books of the company, except the information required to convert cost to a present value. This could be either an appraisal figure arrived at by appraisal methods or an index number for the class or group of assets being valued.[9]

Other solutions to the problem of reflecting higher prices on the accounts or on statements are suggested by W. A. Paton:

1. To state in periodic reports to stockholders the limitation of net income in view of present conditions and the need for retaining earnings in order to maintain financial strength.

2. To introduce supplementary accounts into the regular system of accounts which show plant accounting and depreciation on an over-all replacement-cost basis. The recorded cost dollars are retained. The difference between

---

[8] A. P. Carson, "A Source and Application of Funds—Philosophy of Financial Accounting," The Accounting Review, 24:[illegible], April, 1949.

[9] Maurice E. Peloubet, "Depreciation and the Price Level," The Accounting Review, 23:[illegible], April, 1948.

the two accounts is shown "as a final adjustment of net nearnings in the income statement."

3. Another plan is to "resort to quasi-reorganization."

4. There could be no objection to presenting different costs to management which would help them in the administration of the business.[10]

One of the important objectives of accounting recording or reporting is to help management in the solution of its problems. "The historic cost figure of an asset often bears little relation to its current value and hence is of limited use to management."[11]

The executive committee of the American Accounting Association made this statement:

> There should be no departure from the cost basis to reflect the assets of an enterprise at amounts higher than unassigned costs. Continuous replacements of assets, frequently of a type different from those replaced, and the practical difficulty of measuring replacement values emphasize the need for a historical record in terms of the consistent, objective basis of cost.[12]

Paul J. Graber in a report he made for the Committee on Revision of the Statement of Principles

---

[10] Paton, *op. cit.*, pp. 122-123.

[11] R. W. Coleman, "The Role of Accounting in Management," *The Accounting Review*, 24:182, April, 1949.

[12] Executive Committee, "Concepts and Standards Underlying Corporate Statements," *The Accounting Review*, 23:340, October, 1948.

of the American Accounting Association gave this summary:

> The establishment of an accounting cost at acquisition measured by a cash outlay or by a fair market value depending upon the nature of the transaction:
> The periodic assignment of accounting cost to expense to reflect asset expirations. The unassigned amounts applicable to future periods will be reported in the balance sheet.
> Suppression of accounting costs or upward revaluations of assets are departures from the recognized basis of asset accounting.[13]

The American Institute of Accountants have considered the question of the proper accounting for depreciation on appreciation. The committee has made a definite recommendation with respect to the charge to be made against income in such a case. The recommendation is as follows:

> This bulletin is concerned with appreciation primarily due to (1) increases in the relevent price levels, or (2) demonstration that the property has greater usefulness than is reflected in the amount at which it is carried in the books, . . .
>
> 4. The committee is of the opinion that when such appreciation has been entered in the books, income should be charged with depreciation computed on the new and higher values. This proposition is the most important part of the present statement and for it there seems to be general support. A corporation should not at the same time claim larger property values in its statement of assets, and provide for the amortization of only smaller property sums in its statement of income.
>
> 5. It is recognized that in the past the contrary view has been held in the pro-

---

[13] Paul J. Graber, "Assets" <u>The Accounting Review</u>, 23:14, January, 1948.

> fession and in other authoritative quarters, and in some cases it may be unreasonable to require a corporation to change a treatment adopted in good faith in the past. The committee believes, however, that a change to conform to the views now expressed is very desirable, and that members of the Institute should exercise their influence to the utmost to bring about such changes.[14]

It is evident that the conflict as expressed by accounting authorities on the question of fixed asset and depreciation accounting procedure is whether assets should be recorded on the original cost basis or on some appraised method and whether depreciation should be computed on the original cost of the asset or on the appraised value. Those that advocate the use of cost as the best method for recording asset valuation have good reasons to support their belief. Those who believe that some appraised method such as replacement values should be used have equally convincing reasons for their belief.

It seems proper that at this point, the stand taken by the American Institute of Accountants should be carefully considered. The recommendation previously quoted in this chapter (footnote 14) gives the impression that the Institute favors appreciation or the use of some appraised method. That recom-

---

[14] Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants, (New York: April, 1940, No. 5), pp. 37-38.

mendation is for cases where appreciation has already been entered in the books. This statement is found in the same bulletin:

> 2. Accounting for fixed assets should normally be based on cost, and any attempt to make property accounts in general reflect current values is both impracticable and inexpedient. Appreciation normally should not be reflected on the books of account of corporations . . .[15]

It seems to the author that the Institute's stand that accounting for fixed assets should be based on cost is very sensible. All the complications encountered with the attempt to compute a fair and just appraised value are eliminated. The problems that arise when appreciation is recorded in the books are also eliminated. Since an appraised value is just an estimate, any computation based on such an estimate is at best a good guess. Therefore, asset accounts, depreciation accounts, and even surplus account have an element of guesswork in them when computations are based on some appraised method. No matter how scientific may be the method of appraisal, it is not as true a figure as the true cost figure. Another matter to consider is the matter of price changes. Unless appraisals are made often, the recorded value need not be the present value.

---

[15] Ibid., p. 37.

CHAPTER V

INVENTORY PRICING

In a thorough study of financial statements, much thought and attention should be given to inventory pricing. It is through the sale of inventory that most business concerns acquire their income. In order to compare or analyse business reports, it is necessary to know what method was used in pricing inventory. Was the same method used in all reports under analysis? What costs were matched against what revenues? If a change is made, full disclosure of the change and the effect the change had on income should be made.[1]

DEFINITIONS OF INVENTORY

> The term "inventory" embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process) and goods to be consumed directly or indirectly in the production (raw materials and supplies).[2]
>
> The term _inventories_ is used to designate the stock on hand that is held for sale in the normal course of business, as well as those goods that

---

[1] _Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants_, (New York: July, 1947, No. 29), p. 241.

[2] Ibid., p. 235.

> are being used or will be used in producing goods to be made available for sale.[3]

The significant point is that the controversies arising out of inventory pricing is not in the definition of inventory. Most authors seem to agree on that. They agree as to what should be included and what should be excluded. Finney says, "The general rule is that inventory should include all goods for which the company holds title, whether the goods are in its possession or elsewhere."[4] The controversies arise in defense of the different methods of pricing inventories.

COST OR MARKET, WHICHEVER IS LOWER

Before beginning the discussion of Cost or Market, Whichever is Lower, definitions of "cost" and "market" will be given.

Newlove, Smith, and White describe "cost" thus:

> What is cost? Cost is the entire outlay made in order to secure the asset and place it ready for use. Thus it means something more

---

[3] Wilbert E. Karrenbrock and Harry Simons, <u>Intermediate Accounting</u> (New York: South-Western Publishing Co., 1949), p. 141.

[4] H. A. Finney, <u>Principles of Accounting</u>--Intermediate (New York: Prentice-Hall, Inc., 1946), p. 250.

than the purchase price; it includes all supplementary and incidental costs necessary for the particular concern to obtain the services of the asset. There is no such thing as obsolute cost; cost is an individual matter. Identical assets will have different costs to different concerns. The cost of merchandise may vary with the quantity purchased.[5]

Many factors determine what market value is.

The Treasury Department defines "market" thus:

Under ordinary circumstances and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer . . . .[6]

The Committee On Accounting Procedure defines "market" thus:

As used in the phrase "lower of cost or market" the term "market" means current replacement cost (by purchase or by reproduction, as the case may be) except that:

(1) Market <u>should not exceed</u> the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonable predictable costs of completion and disposal) and

(2) Market <u>should not be less</u> than net realizable value reduced by an allowance for an approximately normal profit margin.[7]

---

5 George Hillis Newlove, C. Aubrey Smith, and John Arch White, <u>Intermediate Accounting</u>, (New York: D. C. Heath and Company, 1939), p. 118.

6 <u>Federal Regulations on Income Tax and Withholding on Wages</u>, (New York: Prentice-Hall Inc., 1948), p. 8044, Sec. 29.22(c)-4.

7 <u>Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants</u>, (New York: July, 1947, No. 29), p. 239.

When the balance sheet was considered of greater value than the income statement, cost or market, whichever is lower, was used generally. It was considered conservative to provide for all losses but to anticipate no profits. The use of this method provided a conservative method for pricing inventory in the balance sheet. With the emphasis being placed on the income statement, it is the current belief that the use of this method distorts the profits of successive periods. This tends to make a series of income statements misleading. So there is a tendency to believe that inventory cost should not be decreased unless selling prices are decreased before the inventory is sold.[8] The use of cost or market, whichever is lower "results in the reduction of profits of one period but the inflation of the profits of the next period in a corresponding amount. Mismatching of cost and revenues cannot be avoided and the profit or loss of each accounting period is incorrectly stated".[9]

---

[8] Finney, Op. Cit., pp. 253-257.

[9] John G. Blocker, "Mismatching of Costs and Revenues", The Accounting Review, 24:35, January, 1949.

When the balance sheet was considered of greater value than the income statement, cost or market, whichever is lower, was used generally. It was considered conservative to provide for all losses but to anticipate no profits. The use of this method provided a conservative value for inventories shown in the balance sheet. With more emphasis being placed on the income statement, it is the current belief that the use of this method distorts the profits of successive periods. This tends to make a series of income statements misleading. So there is a tendency to believe that inventory cost should not be decreased unless selling prices are decreased before the inventory is sold.[8] The use of cost or market, whichever is lower "results in the understatement of profits of one period but the inflation of the profits of the next period in a corresponding amount. The matching of costs and revenues cannot be avoided and the profit or loss of each accounting period is incorrectly stated."[9]

---

[8] Finney, Op. Cit., [illegible]

[9] John G. Blocker, "A Matching of Costs and Revenues", The Accounting Review, [illegible] (September, 19[illegible]),

Paton makes these remarks concerning cost or market, whichever is lower:

> This plan of valuation, it must be insisted, is at best nothing more than a counsel of conservatism and is not to be recommended. It is unreasonable in that it may mean the use of two bases of valuation in the determination of a single inventory figure, and in view of the fact that price movements are commonly quite general in their effect it virtually brings about, from period to period, a shifting from one basis of valuation to another--the acme of bad practice. Further, the work of pricing, under this scheme, is very much extended.[10]

COST

It seems as though stating that inventories should be priced at cost would not arouse so much controversy, yet there is not a single article on inventories that does not air different views as to what constitutes cost or how to determine cost. Identical articles are bought at different prices at different times. These articles lose their identity as far as original cost is concerned as different ones are taken out of inventory and sold or used in the manufacturing process. Also, other costs alter the original invoice price. For example, Blocker states:

---

[10] W. A. Paton, <u>Accounting</u> (New York: The Macmillan Company, 1926), pp. 374-375.

> It is generally agreed that inventory costs should include all costs up to the point where goods are placed in the storeroom or are in a salable state. The invoice price at the vendor's shipping point, less all trade and cash discounts offered, plus transportation costs, cartage costs, insurance, receiving, testing, temporary storage, and purchasing costs, represent a correct cost of inventories which should remain in asset status until matched against the revenues identified with their sale.[11]

There is a tendency now to consider cost as "net cost." This means that discounts are not considered in the nature of a profit in the income statement. Instead, they are deducted from the invoice price thereby considering "cost" as the actual amount of money paid.[12] Now comes the question as to how to determine cost when numerous purchases have been made at different prices. The most exact method would be to identify each article with its own cost. This method is not often used because it may be impossible, or too expensive to use. So substitute methods are used.

SIMPLE AVERAGE METHOD

When this method is used all purchases large or small are added together and divided by the number of purchases.

---

[11] Blocker, *op. cit.*, p. 35.

[12] Henry Rand Hatfield, *Accounting* (New York: D. Appleton and Company, 1931), pp. 104-105.

WEIGHTED AVERAGE METHOD

The beginning inventory and all the purchases are added together and divided by the total number of units. It is assumed that "all sales are made proportionately from all acquisitions, and that inventories will forever contain some goods of the earliest acquisitions."

Finney also states that on "a rising market, the weighted average costs will be less than current costs, and, on a falling market, the weighted average costs will be in excess of the current costs."

When perpetual inventories are kept it is possible to compute a new unit average after each acquisition. This method is known as the moving average method.[13]

FIRST IN, FIRST OUT AND LAST IN, FIRST OUT

The methods that have caused the most discussion in current accounting literature are the first in, first out method and the last in, first out method.

When the first in, first out method is used, the assumption is made that the older goods are used first and that the goods most recently purchased make up the inventory. It seems logical for most goods to

---

[13] Finney, _op_. _cit_., p. 263.

move in this order. Also, the inventory valuations follow the most recent market trends as the inventory is priced at the most recent costs.

When the last in, first out method is used, it is assumed that the most recent purchases are used first and that the older purchases are still in stock. Since this is such a controversial issue, significant statements made by different authors will, therefore, be quoted.

> Inventory valuations on the last-in first-out basis thus tends to smooth off the peaks and fill in the troughs of the business cycle. This has been a major factor in its wide acceptance in recent years.[14]

Paton has this to say concerning the first-in, first-out method:

> For most situations the first-in, first-out procedure is to be preferred to all other methods of estimating invoice cost of inventory. The main advantages are:
>
> 1. The inventory is drawn from the actual records in a systematic manner.
>
> 2. The result is clearly a cost value, with no recognition of unrealized profit or loss, but is nevertheless a reasonable measure, in most cases, of the current market valuation.

---

[14] Wilbert E. Karrenbrock and Harry Simons, Intermediate Accounting (New York: South-Western Publishing Company, 1949), p. 152.

move in this order. Also, the inventory valuations follow the most recent market trends as the inventory is priced at the most recent costs.

When the last-in, first-out method is used, it is assumed that the most recent purchases are used first and that the older purchases are still in stock. Since this is such a controversial issue, significant statements made by different authors will, therefore, be quoted.

> Inventory valuations on the last-in first-out basis thus tends to smooth off the peaks and fill in the troughs of the business cycle. This has been a major factor in its wide acceptance in recent years.[14]

Paton has this to say concerning the last-in first-out method:

> For most situations the last-in first-out procedure is to be preferred to other methods of estimating invoice cost of inventory. The main advantages are:
>
> 1. The inventory is drawn from the actual records in a systematic manner.
>
> 2. The result is closely related to value, with no recognition of unrealized profit or loss, but is nevertheless a reasonable measure; in most cases, of the current market valuation.

---

[14] Wilbert E. Karrenbrock and Harry Simons, *Intermediate Accounting* (New York: South-Western Publishing Company, 1949), p. [illegible].

3. The assumed movement of goods--a continious, orderly stream--represents a condition to which the management should adhere as closely as possible, particularly in the case of goods subject to deterioration and style changes.[15]

The first-in, first-out method shows market fluctuations while the last-in, first-out method levels off or stabilizes profits. Paton states concerning this characteristic of the last-in, first-out method:

> The peculiar merit of this scheme, it is contended, is the resulting stabilization of operating net--the minimizing of the effect of price movements in the periodic reports. . . . .
> This statement of the so-called advantage of the method reveals its essential weakness: it tends to bring about, artificially, an appearance of stability in a fluctuating business. This is the very antithesis of sound accounting. The purpose of the particular income report, is to show the results of business operations as brought about by the impinging conditions of the particular period--and not the results of an average or "normal" year.[16]

Finney states:

> The argument between _lifo_ and _fifo_ seems to boil down to a question of whether current costs should be shown in the balance sheet as an asset (_fifo_ method) or be matched against current revenue in the income statement (_lifo_ method). The _lifo_ method places the emphasis on the income statement, but its effect on the balance sheet (and particularly on the elements of working capital shown therein) should not be overlooked. In a rising

---

[15] W. A. Paton, _Essentials of Accounting_ (New York: The MacMillan Company, 1938), p. 484.

[16] _Ibid._, p. 484.

3. The earned [illegible] [illegible]
that [illegible] year--represents a
condition [illegible] management and
adhere [illegible]
larly in the [illegible] of [illegible]
deteriorate [illegible]

The first-in, first-out method [illegible]
fluctuations while the last-in, first-out [illegible]
off or stabilizes profits. [illegible]
this characteristic of the last-in, first-out [illegible]

> The peculiar merit of this method [illegible] con-
> tended, is the resulting stability [illegible] the
> net--the [illegible] of the [illegible] move-
> ments in the periodic reports. . . .
> This statement of the [illegible]
> method reveals its essential weakness. [illegible]
> to bring about, artificially, an appearance of
> stability in a fluctuating business. [illegible]
> very antithesis of sound accounting. [illegible]
> of the particular [illegible] report, [illegible]
> results of business operations as [illegible]
> by the fluctuating [illegible] of the particular
> period--and not the results of an average or
> "normal" year.[16]

Finney states:

> The argument between lifo and fifo [illegible]
> down to a question of whether current costs should
> be shown in the balance sheet as an asset (fifo
> method) or be matched against current revenue in
> the income statement (lifo method). The lifo
> method places the emphasis on the income statement,
> but its effect on the balance sheet (and particu-
> larly on the elements of working capital shown
> therein) should not be overlooked. [illegible]

---

15 W. A. Paton, Essentials of Accounting (New York: The MacMillan Company, [illegible]), p. [illegible].

16 Ibid., p. [illegible].

> market, the inventory of a company using the _lifo_ method would be given a lower valuation than that given to an identical inventory of another company using the _fifo_ method, and the _lifo_ company's working capital would be unfavorably stated in comparison with that of the _fifo_ company. In a falling market, the _lifo_ company would obtain an advantage.[17]

For Federal Income Tax purposes, consistency is recommended. If the inventory contains non-identifiable goods purchased at different prices, the "first-in-first-out" method is recommended.[18] However, any taxpayer who is required to take inventory can use the elective method which enables him to use the "last-in-first-out" method.[19]

Much has been said concerning these two methods in current accounting literature but the above quoted statements bring out the major points discussed. The main idea is that financial reports or statements that are to be compared should be carefully studied before a definite conclusion is reached. The method used for inventory pricing should be known by the person or persons studying the reports. Changes in the method of inventory pricing or valuation should be made known before analytical studies are made.

---

[17] Finney, _op. cit._, p. 268.

[18] _Federal Regulations on Income Tax and Withholding on Wages_, (New York: Prentice-Hall Inc., 1948) p. 8042, Sec. 29.22(c)-2.

[19] _Ibid._, pp. 8046-8048B Sic. 22(d); 29.22(d)-1; 29.22(d)-3.

CHAPTER VI

RESERVES

The use of reserves has increased in the last few years. They have been used as cushions for the uncertainties that have arisen after the war.[1] The use of so many reserves confuses those who try to interpret financial statements for the meaning of the word "reserve" as used by accountants usually does not mean the actual setting aside of an asset or cash as the word seems to denote. When the inexperienced person sees the word "reserve" used in a statement he visualizes a pile of cash that equals the amount of the reserve. The more times he sees the word "reserve" the more piles of cash he pictures in his mind. He feels that some of that cash should come to him either as an increase in wages, as larger dividends, or as lower prices for the goods he buys in the market. To the accountant, such reserves are merely entries subdividing valuation accounts, liability accounts, or surplus accounts.

---

[1] Maurice H. Stans, "Modernizing the Income Statement," The Accounting Review, 24:8-9, January, 1949.

CHAPTER VI

Reserves

The use of reserves has increased in the last few years. They have been used to provide for the uncertainties that have arisen from the war. The use of so many reserves [illegible] those who try to interpret financial statements for the meaning of the word "reserve" as used by accountants mainly does not mean the actual setting aside of an asset or cash as the word seems to denote. When the inexperienced person sees the word "reserves" used in a statement he visualizes a pile of cash that equals the amount of the reserve. The more often he sees the word "reserve" the more piles of cash he pictures in his mind. He feels that some of that cash should come to him either as an increase in wages, or larger dividends, or as lower prices for the goods he buys in the market. To the accountant, such reserves are merely entries in valuation accounts, liability accounts, or as future expenses.[1]

---

1 [illegible] "[illegible] the Income Statement." The Accounting Review, [illegible]

VALUATION ACCOUNTS

It is desirable to show the original cost of fixed assets and the amount of the cost that has already been charged to operations. The amount that has been charged to operations is called "Reserve for Depreciation". Another valuation reserve is called "Reserve for Bad Debts". Operations are charged with an estimated loss and accounts receivable are reduced by the same amount. When the amount of receivables lost becomes known the reserve account is charged with that amount.[2] Another valuation reserve is "Reserve for Depletion".

The above valuation reserves represent an estimated deduction in the value of the related asset. Some reserves represent deductions which can be measured. Finney states: "The cost of the leasehold improvements should be written off in equal periodical installments between the date of the expenditure and the date of expiration of the lease." Another "exactly measurable decrease in the value of an asset" is a "reserve for the decrease in the

---

[2] W. E. Karrenbrock and Harry Simons, Intermediate Accounting (Cincinnati, Ohio: South-Western Publishing Company, 1949), p. 31.

It is desirable to show the original cost of fixed assets and the amount of the cost that has already been charged to operations. The amount that has been charged to operations is called "Reserve for Depreciation". Another valuation reserve is called "Reserve for Bad Debts". Operations are charged with an estimated loss and accounts receivable are reduced by the same amount. When the amount of receivables lost becomes known the reserve account is charged with that amount.[2] Another valuation reserve is "Reserve for Depletion".

The above valuation reserves represent an estimated deduction in the value of the related asset. Some reserves represent deductions which can be measured. Finney states: "The cost of the leasehold improvements should be written off in equal periodical installments between the date of the expenditure and the date of expiration of the lease." Another "exactly measurable decrease in the value of an asset" is a "reserve for the decrease in the

---

[2] W. E. Karrenbrock and Harry Simons, *Intermediate Accounting* (Cincinnati, Ohio: South-Western Publishing Company, 1949), p. 31.

market value of securities owned".[3]

The use of the word "reserve" in connection with "an exhaustion of cost to be recognized as an expense" rather than as "withholding of profits" is the wrong use of the word. "Allowance for Depreciation" or "Provision for Depreciation" are suggested by some authors instead of "Reserve for Depreciation".[4]

Paton states:

> The most appropriate use of the term "reserve" in accounting, and the use to which the term might well be restricted, is to indicate a subdivision of the earned surplus account.[5]

These valuation reserves should never be set apart in a separate section of the balance sheet. They should be shown as a deduction from the related asset. Seeing them apart would cause confusion.[6]

The following statements give the stand the Committee on Accounting Procedure has taken on the matter of "reserves".

> 5. The committee is therefore of the opinion that inventory reserves, such as those created:

---

[3] H. A. Finney, Principles of Accounting--Intermediate (New York: Prentice-Hall, Inc., 1946), p. 473.

[4] Ibid., p. 474.

[5] W. A. Paton, Accountants Handbook (New York: The Ronald Press Company, 1947), p. 1033.

[6] Finney, op. cit., p. 474.

market value of securities [illegible].

The use of the word "reserve" [illegible] with "an exhaustion of costs to be [illegible] expense" rather than as "withholding of profits" is the wrong use of the word. "Allowance for Depreciation" or "Provision for Depreciation" are suggested by some authors instead of "Reserve for Depreciation".[4]

Paton states:

> The most appropriate use of the term "reserve" in accounting, and the use to which the term might well be restricted, is to indicate a subdivision of the earned surplus account.[5]

These valuation reserves should never be set apart in a separate section of the balance sheet. They should be shown as a deduction from the related asset. Seeing them apart would cause confusion.[6]

The following statements give the stand the Committee on Accounting Procedure has taken on the matter of "reserves".

> 5. The committee is therefore of the opinion that inventory reserves, such as those created [illegible]

---

[3] H. A. Finney, Principles of Accounting, Intermediate (New York: Prentice-Hall, Inc., 19[illegible]), p. [illegible].

[4] Ibid., p. 47[illegible].

[5] W. A. Paton, Accountants' Handbook (New York: The Ronald Press Company, 19[illegible]), p. [illegible].

[6] Finney, op. cit., p. [illegible].

(a) for possible future inventory losses on inventories not on hand or contracted for, or

(b) without regard to any specific loss reasonably related to the operations of the current poriod, or

(c) for the purpose of reducing inventories other than to a basis which is in accordance with generally accepted accounting principles.

are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income and that they should not be used to relieve the income account of any year.

6. The committee is also of the opinion that if a reserve of the type described in paragraph 5 is set up: (1) it should be created preferably by a segregation or appropriation of surplus, (2) no costs or losses should be charged to it and no part of it should be transferred to income or in any way used to affect the determination of net income for any year, and (3) the reserve should be restored to surplus when it is no longer considered necessary. The committee recognizes as proper, though less desirable, the alternative procedure of (a) setting up such a reserve by an appropriation of net income so reported in the income statement that the final figure would clearly indicate that it is not the entire net income, and (b) of showing the subsequent return of such a reserve at the foot of the income statement after the determination of net income for the period in such a way as to clearly indicate that it is not income.[7]

---

[7] Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants, (New York: October, 1947, No. 31), pp. 256-257.

(a) for possible future inventory losses on inventories not on hand or contracted for, or

(b) without regard to any specific loss reasonably related to the operations of the current period, or

(c) for the purpose of reducing inventories other than to a basis which is in accordance with generally accepted accounting principles,

are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income and that they should not be used to relieve the income account of any year.

6. The committee is also of the opinion that if a reserve of the type described in paragraph 7 is set up: (1) it should be created only by a segregation or appropriation of surplus, (2) no costs or losses should be charged to it and no part of it should be transferred to income or in any way used to affect the determination of net income for any year and (3) the reserve should be restored to surplus when it is no longer considered necessary. The committee recognizes as proper, though less desirable, the alternative procedure of (a) setting up such a reserve by an appropriation of net income to be reported in the income statement [illegible] the final figure must clearly indicate that it is not the entire net income, and (b) of showing the subsequent return of such a reserve at the foot of the income statement after the determination of net income for the period in such a way as to clearly indicate that it is not income.[7]

---

[7] Accounting Research Bulletins Adopted by Committee on Accounting Procedure, American Institute of Accountants, (New York: October, 1947, [illegible]) pp. 256-257.

LIABILITY ACCOUNTS

Finney states that liabilities which can be exactly measured such as interest and wages should be called "Accrued Interest" and "Accrued Wages" rather than "Reserve for Interest" or "Reserve for Wages." Estimated liabilities such as taxes are properly called "Reserve for Taxes." These accounts should be shown in the balance sheet "under a liability caption" and not under a separate "reserve" section.[8]

RESERVES FOR CONTINGENCIES

Usually reserves for contingencies are a surplus reserve. Sometimes, such reserves may be "part surplus and part liability", or "part surplus and part valuation." A contingency reserve that is hard to interpret may be shown in the balance sheet under a section for reserves between the liabilities and the new worth sections.[9]

Most of the current criticisms on the use of reserves arises from the improper use of contingency

---

[8] Finney, op. cit., p. 474.

[9] Arnold W. Johnson, Intermediate Accounting (New York: Rinehart and Company, 1947), pp. 448.

reserves. They are sometimes used to equalize income in different years. This practice makes the use of financial statements misleading and their value becomes doubtful.

The following quotation signifies the stand the Committee On Accounting Procedure has taken concerning "General Purpose Contingency Reserves."

> . . . The Committee is therefore of the opinion that general contingency reserves, such as those created:
>
> (a) for general undetermined contingencies, or
>
> (b) for a wide variety of indefinite possible future losses, or
>
> (c) without any specific purpose reasonably related to the operations for the current period, or
>
> (d) in amounts not determined on the basis of any reasonable estimates of costs or losses,
>
> are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income.
>
> RECOMMENDED PROCEDURES
>
> Accordingly it is the recommendation of the committee that, as to general contingency reserves described in paragraph 3:
>
> (a) Provisions for such reserves should not be included as charges in determining net income.
>
> (b) When such a reserve is set up it should be created preferably by a segregation or appropriation of surplus; it may be created by an appropriation of net income but this is less desirable.

reserves. They are sometimes used to equalize income in different years. This practice makes the financial statements misleading, and their value becomes doubtful.

The following quotation discloses the stand the Committee on Accounting Procedure has taken concerning "General Purpose Contingency Reserves."

> . . . The Committee is therefore of the opinion that general contingency reserves, such as those created:
>
> (a) for general undetermined contingencies, or
>
> (b) for a wide variety of indefinite possible future losses, or
>
> (c) without any specific purpose reasonably related to the operations for the current period, or
>
> (d) in amounts not determined on the basis of any reasonable estimates of costs or losses,
>
> are of such a nature that charges or credits relating to such reserves should not enter into the determination of net income.

RECOMMENDED PRACTICE

> Accordingly it is the recommendation of the committee that, as to general contingency reserves described in paragraph 3:
>
> (a) Provisions for such reserves should not be included as charges in determining net income.
>
> (b) When such a reserve is set up, it should be created preferably by a segregation or appropriation of surplus; it may be created by an appropriation of net income, but this is less desirable.

(c) If such a reserve is created by an appropriation of net income, the net income should first be determined and so designated, after which the reserve provision should be deducted and clearly captioned as an appropriation of net income and the final figure should be so captioned as to clearly indicate that it is not the entire net income.

(d) Costs or losses should not be treated as charges to such reserves and no part of such a reserve should be transferred to income or in any way used to affect the determination of net income for any year.

(e) When such a reserve or any part thereof is no longer considered necessary it should be restored to surplus, either directly (the preferable treatment) or after the determination of net income, in the income statement, in such a way as to indicate clearly that it is not income.

The following notation is given in the bulletin concerning paragraphs (d) and (e): "This paragraph also applies to general contingency reserves set up in prior years".[10]

---

[10] Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants (New York: July, 1947, No. 28), pp. 232-33.

SURPLUS ACCOUNTS

Surplus reserves are withheld profits. The title of such reserves should be descriptive enough so that the reason for the withholding of such profits is clearly understood by any interested person.[11] The proper use of the term "reserve" is for the withholding of profits. Therefore, subdivisions of the surplus account for withholding purposes are properly called reserves. The danger here is that too many reserves may be created, thereby, causing an improper amount of the profits to be divided among stockholders as dividends. Most of the literature on "reserves" emphasizes the conservative use of reserves.

---

[11] Paton, op. cit., p. 1034.

CHAPTER VII

TERMINOLOGY

In recent years, accountants have been forced to use words carefully. Much has been written on words that may have one meaning when used by the layman and another when used in a technical sense by the accountant. It is this change in meaning that causes so much confusion. The meaning that accountants give these words is not explained in dictionaries. Anyone, except the professional student of accounting, would be unable to tell what the word, as used in an accounting sense, means. Therefore, the conflict in the meaning of these words does not exist within the accounting profession as much as it exists in the use to which the general public gives to these common words and the technical meaning that accountants give to them.

Accountants are conscious of the misunderstanding that may be caused by the use of such words. As a result, the American Institute of Accountants has a committee working on the problem. Several Accounting Research Bulletins (Numbers 7, 9, 12, 16, 20, and 22) have been issued in which the problem is discussed.

In Bulletin Number 7, the committee defined its task as follows:

> The first task of the committee might therefore well be to prepare a discussion of the specialized usage in accounting of common terms, that would be more extensive than mere definitions, and might perhaps include suggestions for modifications of present practice, with the object of minimizing misunderstandings. Such a discussion might not only be circulated in the profession, but brought to the attention of publishers of general dictionaries with a view to recognition of the special usages in the new editions of such works.[1]

It is of extreme importance that the public should understand the meaning of these words as they are used by accountants as the public is very much interested in the affairs of business organizations.

The public forms opinions and makes decisions on the basis of their understanding of business statements and reports. In order to insure that just opinions are formed and just decisions made, a clear understanding of all terminology used in such reports is essential.

Some of the words discussed in the Accounting Research Bulletins and other current literature as

---

[1] Accounting Research Bulletins Issued by Committee On Accounting Procedure, American Institute of Accountants (New York: November, 1940, No. 3) p. 52.

being words frequently misunderstood are assets, liabilities, depreciation, value, income, surplus, and reserve. The rest of this chapter is devoted to a discussion of these terms.

Noble defines assets and liabilities as follows:

> The property owned by a business and used in the operation of that business is called assets . . . . The rights of the creditors in the assets of a business are known as the liabilities of the business.[2]

The American Institute of Accountants has the following to say concerning assets and liabilities:

> . . . in a realistic view one must recognize that the words "assets" and "liabilities" are in accounting usage often no more than substitutes for Dr. and Cr. as the headings for the two sides of a balance sheet, and further that not all the items carried under those heads are assets or liabilities in the ordinary sense of those words, and not all the items that are assets or liabilities in the ordinary sense are commonly included under these heads. Thus in one case goodwill, which may be the most valuable of assets, may not appear, but in another discount on common stock may appear under the head of assets.[3]

The reasons why the word "depreciation" can be misunderstood are ably stated by the Committee on Accounting Procedure of the American Institute of

---

[2] Howard S. Noble, Accounting Principles--Fourth Edition (New York: The South-Western Publishing Company, 1945), p. 2.

[3] Accounting Research Bulletin No. 7, op. cit., p. 53.

Accountants in the following statement:

> It must be admitted that the use of the term in accounting is unsatisfactory, since it is applied in its normal sense to some assets, such as marketable securities, and in a specialized sense to others, such as fixed-capital assets. Moreover, the specialized sense differs not only from the colloquial sense but also from the sense in which the term is used in engineering, and is far removed from the root-meaning of the word itself. Therefore, if reluctance to accept temporary inconvenience in order to achieve permanent clarification stands in the way of the substitution of a more descriptive term, it may be said that the profession at least owes it to the public to define with reasonable precision and clarity the meaning of the word, when used as a term of art in accounting.[4]

The committee defines the word in a later bulletin thus:

> Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.[5]

The word "value" in accounting means the figure at which an asset or liability is stated.

---

[4] Accounting Research Bulletins Issued by Committee On Accounting Procedure, American Institute of Accountants (New York: October, 1942, No. 16) p. 135.

[5] Accounting Research Bulletins Issued by Committee On Accounting Procedure, American Institute of Accountants (New York: May, 1944, No. 22) p. 179.

To the average person the word means "worth." In accounting, the word should not be used without a qualifying adjective. Some terms used are "replacement value", "book value", and "market value".[6]

"Income" is another frequently discussed word. Johnson defines "income" thus:

> In free and independent transactions, the considerations received for the sale or use of assets and services constitute gross income. From the accounting point of view, the considerations received must be in terms of money. Often, the word "revenue" is used synonymously with gross income.[7]

There is a trend toward the emphasis of income in modern accounting. "Accounting for Income" and "Income Statement" are phrases commonly used. The emphasis is on the earning power of a business. As a result, the word "income" may be over-taxed. It may be used to embrace too much and its use may become confusing.

The word "surplus" has received its share of criticism especially if called "earned surplus". The word means "undistributed income" or undistributed profits". The word "earned surplus" should not

---

[6] Accounting Research Bulletin No. 7, op. cit., p. 53.

[7] Arnold W. Johnson, Intermediate Accounting (New York: Rinehart & Company, Inc., 1947), p. 487.

be used to distinguish undistributed profits from capital surplus.[8]

The most misleading word as used in accounting is the word "reserve". Reserves have been discussed in Chapter VI of this thesis; therefore, the word will not be discussed here.

The amount of literature being written about terminology seems to denote that an attempt is being made to prepare statements that are easy to understand. At present, there is a consciousness among men for better wording of such statements. No final decision has been reached as to what is the best word to use in a given situation, but the meaning of simple yet confusing words is being crystallized through discussion. Most writers are finding it difficult to say in so many words what each of these common words means when used in a technical accounting sense, but clearer and better definitions will be the result of the present discussions. Undoubtedly, this word consciousness will result in better, more understandable reports.

---

[8] Committee on Accounting Procedure, American Institute of Accountants, "Report of Committee on Terminology" (New York: May, 1941, No. 9), pp. 74-75.

CHAPTER VIII

SUMMARY

The brief summary of the historical background of modern accounting shows that accounting underwent a gradual change which accelerated with the widespread use of the corporate type of business. This acceleration in its growth has brought many new functions for accounting to perform. Accounting records and reports must summarize the financial standing of a large and complicated business concern in such a way that management can get a clear picture of the business. These reports must help management to reach decisions that will carry the business to greater success.

Many others are interested in the affairs of a business concern. The government wants to get its due share of the profits in the form of taxes, stockholders want to get their share of the profits, labor wants to get a just wage rate, and the public wants greater production and lower prices on commodities. Each wants to be fair in its demands. An understanding of the affairs of the business is essential to form a just decision by these interested parties. They must depend on the financial statements of the business

concern to get the information they need. It is very easy to see what an important purpose these statements serve. They must be easy to understand, easy to analyse, and easy to compare. They must portray a true picture of the financial standing of the business.

This thesis endeavors to portray the importance of financial statements by placing emphasis on the conflicting views of the different authors of accounting literature. The science of accounting is in the prime of its growth. As a result, many problems that have arisen are in the process of being solved by eminent accountants. It is through a study of their points of view that one can get a better perspective of these problems. Of necessity, these views are still on a conflicting stage, but are gradually being pulled towards a solution. The fact that they are conflicting does not detract from their importance. In fact, it is the many conflicting ideas that make one realize how broad these problems are and how one-sided a dogmatic decision can be. This also makes one realize how important it is for any one accountant to be well versed in modern accounting literature. A broad knowledge of modern accounting literature is necessary

to form intelligent decisions.

Therefore, this thesis presents the different views concerning some of the more controversial parts of financial statements. Fixed asset valuation and depreciation, inventory pricings, reserves, and terminology are discussed as these topics are prominent in modern accounting literature.

Two main views have been presented concerning fixed asset valuations. There are those who believe that fixed assets should be shown in the books at their cost value and that depreciation should be based on this value. The American Institute of Accountants upholds this view. Others believe that replacement value or some appraised value should be used. This valuation would conform with rising prices and with the high price at which the assets would be replaced.

Inventory pricings have also been discussed. Various methods of pricing inventory have been discussed. The controversial issues, however, center on the last in, first out method and on the first in, first out method. It is brought out that the last in, first out method tends to smooth out the business cycle by smoothing off the high spots and filling to form intelligent [illegible].

Therefore, this thesis presents the different views concerning some of the more controversial areas of financial reporting. Fixed asset valuation and depreciation, inventory pricing, reserves, and terminology are discussed. All these topics are important in modern accounting literature.

Two main views have been presented concerning fixed asset valuation. There are those who believe that fixed assets should be shown in the books at their cost value and that depreciation should be based on this value. The American Institute of Accountants upholds this view. Others believe that replacement value or some appraised value should be used. This valuation would conform with rising prices and with the high price at which the assets would be replaced.

Inventory pricing has also been discussed. Various methods of pricing inventory have been discussed. The controversial issues, however, center on the last in, first out method and the first in, first out method. It is thought that the last in, first out method tends to smooth out the [illegible] cycle by smoothing off the high spots and [illegible].

in the low spots. This factor has caused its wide usage. The first in, first out method is a cost value method since it does not recognize unrealized profits or losses. The inventory is drawn from the records in a systematic manner.

The danger in the use of too many reserves under non-descriptive titles is emphasized. Such a use of reserves may be confusing to those attempting to study financial statements as the word "reserve" does not mean the same to the layman and to the accountant. Those attempting to study statements wander if the extensive use of reserves is warranted. When a reserve is used, its title should be explicit enough so that no confusion and doubt arises.

Accounting terminology is frequently discussed in current accounting literature. Common words used in a technical sense by the accountant causes confusion to those not acquainted with the technical meaning of the word. In order to avoid such confusion, Accountants have been trying to define such words more clearly and to bring the problem before authors of dictionaries so that the technical meaning shall be included in future revisions of such works.

Accountants have become word conscious because they realize that reports made by them are studied by many interested persons. They want for these persons to clearly understand what these reports or statements are trying to portray.

RECOMMENDATIONS

When students of accounting are limited in any one course to the works of one author, they are, of necessity, being presented with limited and even biased knowledge of the subject. It would be impractical to cover the works of several authors when the student is mastering the fundamentals of the subject, but an attempt should be made, in a separate course, to introduce those students that will pursue the subject further, to an analysis and comparison of current accounting literature. A course called "A Survey of Current Accounting Literature" would not only introduce the student to the wealth of valuable material being written on the subject, but would also help the student to form more intelligent decisions in the use of accounting theory. It must not be forgotten that accounting is undergoing an accelerated form of growth and that brilliant minds are constantly working to crystalize this growth into words that the rest of us less brilliant can put into practice by bettering the forms of accounting, recording and reporting.

Today's students of accounting will be doing

outmoded work unless they keep their minds up to date by constantly reading and studying current accounting literature. A survey of such literature would give the students an appreciation of the work being done by authorities in the accounting field. Such a course would also serve as an incentive for further reading. A realization of the constant changes that are going on in the accounting field would cause the student to study such literature long after he is out of school. The open mindedness with which these students would use in their accounting work would go a long way in a better solution of today's conflicting theories of accounting.

No texts on the subject are at present on the market. If such texts were written, they would soon have to be revised. Probably a better plan would be to study the current issues of the Journal of Accountancy and The Accounting Review plus new texts that may come into the market. Libraries should have all of this material at hand so that it would be available to students who are taking such a course.

This material should also be made available

by practicing accountants, for year by year the new changes being made as a result of conflicting theories being molded into satisfactory solutions causes the accountant who goes on practicing the theories he learned when he was a student to become hopelessly outmoded. It might even seem logical that a refresher course be offered to all practicing accountants at regular intervals and that practicing accountants should be required to take such a course. Such a procedure is at present being followed successfully in other professions. It keeps those in the profession from getting in a rut. It helps their minds to grow with the times, as accounting is certainly growing. Those practicing it and those studying it should certainly not be allowed to fall behind. They must be helped to keep time with this accelerated accounting growth.

It is certainly hoped that this presentation of the conflicting theories of accounting did not leave the reader with the idea that accountants are divided in their accounting believes. Conflicting theories appear merely because accountants have recognized problems that the profession must solve.

In order to come to a just and sane solution, all views of the problems must be considered. This is all conflicting theories of accounting are: different views of problems the profession is working hard to solve.

BIBLIOGRAPHY

Accounting Research Bulletins Issued by Committee on Accounting Procedure, American Institute of Accountants. New York: Numbers 5, 7, 9, 12, 16, 20, 22, 28, 29, and 30.

Blocker, John G., "Mismatching of Costs and Revenues," The Accounting Review, 24:35, January, 1949.

Carson, A. B., "A Source and Application of Funds--Philosophy of Financial Accounting," The Accounting Review, 24:163, April, 1949.

Coleman, R. W., "The Role of Accounting in Management," The Accounting Review, 24:182, April, 1949.

Committee on Accounting Procedure, American Institute of Accountants, "Report of Committee on Terminology," Accounting Research Bulletins, No. 9, May, 1941. 75 pp.

Dohr, James L., "Depreciation and the Price Level," The Accounting Review, 23:118, April, 1948.

Executive Committee, "Concepts and Standards Underlying Corporate Statements," The Accounting Review, 23:340, October, 1948.

Federal Regulations on Income Tax and Withholding on Wages. New York: Prentice-Hall, Inc., 1948. 8450 pp.

Finney, H. A., General Accounting. New York: Prentice-Hall, Inc., 1941. 604 pp.

Finney, H. A., Principles of Accounting. New York Prentice-Hall, Inc., 1933. 600 pp.

Finney, H. A., Principles of Accounting. Intermediate, New York: Prentice-Hall, Inc., 1946. 873 pp.

Foster, Louis O., Introduction to Accounting. Chicago: Richard D. Erwin, Inc., 1941. 742 pp.

Graber, Paul J., "Assets," The Accounting Review, 23:14, January, 1948.

Graham, Willard J., "The Effect of Changing Price Levels Upon Determination, Reporting, and Interpretation of Income", The Accounting Review, 24:26, January, 1949.

Hatfield, Henry Rand, Accounting. New York: D. Appleton and Company, 1931. 548 pp.

Johnson, Arnold W., Intermediate Accounting. New York: Rinehart and Company, 1947. 670 pp.

Johnson, Arnold W., Principles of Accounting. New York: Farrar & Rinehart, Inc., 1937. 690 pp.

Karrenbrock, Wilbert E., and Henry Simons, Intermediate Accounting. Cincinnati: South-Western Publishing Company, 1949. 459 pp.

Kennedy, Donald D., George R. Esterly, William vonMinden, Introductory Accounting. New York: The Ronald Press Company, 1941. 702 pp.

Kirkland, Lane, "Preparation of Financial Information Should Be Influenced By Labor's Needs," Quotation from an address before an accounting conference at the University of Georgia, Journal of Accountancy, 87:272-273, May, 1949.

Lambie, James M., Jr., "Financial Reports Can Be Written So People Can Understand Them," Journal of Accountancy, 84:41, July, 1947.

Moonitz, Maurice, "Adaptations to Price Level Changes," The Accounting Review, 23:137, April, 1948.

Nelson, Edward G., "A Brief Study of Balance Sheets," The Accounting Review, 22:342, October, 1947.

Newlove, George Hillis, Aubrey C. Smith, John Arch White, Intermediate Accounting. New York: D. C. Heath and Company, 1939. 838 pp.

Noble, Howard S., Accounting Principles. Fourth edition; New York: The South-Western Publishing Company, 1945. 768 pp.

Paton, W. A., Accountants Handbook. New York: The Ronald Press Company, 1947. 1505 pp.

Paton, W. A., Accounting. New York: The Macmillan Company, 1926. 849 pp.

Paton, W. A., Accounting Theory. New York: The Ronald Press Company, 1922. 508 pp.

Paton, W. A., "Depreciation and the Price Level", The Accounting Review, 23:119, April, 1948.

Paton, W. A., Essentials of Accounting. New York: The Macmillan Company, 1938. 830 pp.

Paton, W. A. and A. C. Littleton, An Introduction to Corporate Accounting Standards. Chicago: American Accounting Association, 1940. 100 pp.

Peloubet, Maurice E., "Depreciation and the Price Level," The Accounting Review, 23:126, April 1948.

Peragallo, Edward, Origin and Evolution of Double Entry Bookkeeping. New York: American Institute Publishing Company, 1938. 156 pp.

Staff of the Journal of Accountancy, "What The Public Thinks About Financial Statements, "Journal of Accountancy, 83:487, June, 1947.

Stans, Maurice H., "Modernizing the Income Statement," The Accounting Review, 24:8-9, January, 1949.

Vance, Laurence L., Current Problems and Accounting Theory," The Accounting Review, 19:231, July, 1944.

D.T.