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Asset valuation: An historical perspective

Thomas A. Racliffe

Paul Munter

Thomas A. Ratcliffe
and
Paul Munter
TEXAS TECH UNIVERSITY

ASSET VALUATION: AN HISTORICAL PERSPECTIVE

Abstract: Asset valuation has been discussed in the accounting and economic literature for most of the twentieth century. In the literature, discussions ranged from advocating only historical costing to the use of current value accounting exclusively. This paper traces the development of theoretical and pragmatic discussions on the topic of asset valuation.

Inflationary pressures in the developing environment of accounting have forced accountants to begin analyzing means of reflecting the impacts of inflation on financial statements. The notion of accounting for the effects of inflation on financial reporting is not new. During the early years of this century, the idea of current cost accounting was being deliberated. For example, Hatfield discussed current cost accounting as far back as 1909. Further, in discussing the differences between accounting income and economic income, Canning indicated a preference for current costs as a valuation mechanism. And in 1939, MacNeal went as far as to suggest that "truth in accounting" can only be attained when financial statements display the current value of assets and the profits and losses resulting from changes in these asset values.

This paper represents an attempt to trace the development of theoretic and authoritative thought concerning asset valuation issues. Two tables are presented to summarize this developmental process. Table I outlines the basic asset valuation conclusions of some classic theoretical works in accounting and business. While this annotated listing is not all-inclusive, it is representative of the related substantive works of this century. Table II summarizes the asset valuation conclusions in studies performed under the auspices of authoritative organizations within accountancy.

An analysis of the development of asset valuation thought reveals the reactive nature of accounting as a discipline. Seemingly without regard to the theoretical works on asset valuation, authoritative bodies in the accounting profession had not, by the 1930s, made

TABLE I

ANNOTATED BIBLIOGRAPHY OF THEORETICAL VALUATION STUDIES

Author	*Year*	*General Conclusions*
Hatfield	1909	Historical cost is the appropriate valuation method for most circumstances, however current cost may be better at times.
Canning	1929	Assets should be valued based upon the future cash flows to be generated if such a measure is directly available. If not, an indirect measure (such as exit prices) may be used as a surrogate.
Bonbright	1937	Value to the Owner Concept — an asset's value to the enterprise is what the enterprise would lose if it was deprived of the asset.
MacNeal	1939	"Truth in Accounting" only exists when assets are valued at their current value, which is best measured by replacement cost.
Hicks	1946	Income is a change in wealth, e.g. the amount which can be consumed in a time period to leave ending wealth equal to beginning wealth.
Edwards and Bell	1961	For information to be useful in managerial decision making, replacement cost is the most appropriate valuation method.
Staubus	1961	Investors are interested in cash flows, hence assets should be valued at the present value of the future cash flows to be generated to the enterprise.
Chambers	1966	Assets should be individually valued at their current cash equivalent (exit price) and then summed to determine the aggregate value of the assets.
Sterling	1970	Assets should be valued at the price for which the assets could be sold (exit price) as one basket of goods. This is an aggregate valuation as opposed to Chambers' individual asset valuation.
Revsine	1973	The long-term investor is interested in cash flows. Current replacement cost provides the closest approximation to the present value of future cash flows generated by the assets and therefore should be used in valuing assets.

any attempts to effectively operationalize the positions of current value advocates. In fact, the trend was to adhere more closely to historical cost as an approximation of value. However, over the past few decades, several influential accounting organizations have moved toward advocating some form of inflation accounting although many of these approaches continue to adhere to the principle of historical costing.

Current trends in authoritative thought seem to indicate that authoritative rule-making bodies in accounting are moving toward recognizing the necessity for some form of inflation accounting. Witness for example the recent Financial Accounting Standards Board statement on constant dollar and current cost accounting. If it is in fact true that current values are more indicative of accounting truths than historical costs, apparently the accounting profession soon will be providing financial information that reflects "truth in accounting."

TABLE II

AUTHORITATIVE BODIES' VALUATION STUDIES

Authoritative Body	*Year*	*Study*	*General Conclusions*
American Accounting Association	1936	A Tentative Statement of Accounting Principles Underlying Corporate Financial Statements	Historical Cost is only proper valuation base
	1941	Accounting Principles Underlying Corporate Financial Statements	Historical cost is only proper valuation base
	1948	Accounting Concepts and Standards Underlying Corporate Financial Statements	Historical cost is proper valuation base but parenthetical disclosure of current value may be needed if materially greater than historical cost
	1951	Price Level Changes and Financial Statements — Supplement No. 2 to the 1948 Statement	Historical cost is appropriate valuation base for primary financial statements. General price-level adjusted statements appropriate for supplemental disclosures
	1957	Accounting and Reporting Standards for Corporate Financial Statements	Does not specify an appropriate valuation base
	1964	Accounting for Land, Building, and Equipment — Supplement No. 1 to the 1957 Statement	Current cost and holding gains and losses should be reported in the *primary* financial statements

Authoritative Body	*Year*	*Study*	*General Conclusions*
	1966	A Statement of Basic Accounting Theory	Dual presentation of historical cost and replacement cost in the *primary* financial statements
Accounting Research Division of the American Institute of Certified Public Accountants (AICPA)	1961	ARS #1 — The Basic Postulates of Accounting ARS #3 — A Tentative Set of Broad Accounting Principles for Business Enterprises	Current costs should be incorporated into *primary* financial statements
Accounting Principles Board	1962	Statement No. 1	Rejects ARS #1 and #3
AICPA	1965	ARS #7 — Inventory of Generally Accepted Accounting Principles	Discusses state-of-the-art of accounting principles thus relies on historical costs
	1969	Statement No. 3 — Financial Statements Restated for General Price-Level Changes	Optional use of supplemental disclosure of general price-level statements
AICPA Study Group on the Objectives of Financial Statements (Trueblood Committee)	1973	Objectives of Financial Statements	Use current values if they differ significantly from historical cost
Financial Accounting Standards Board (FASB)	1974	Financial Reporting in Units of General Purchasing Power — Exposure Draft	Mandatory use of supplementary general price-level adjusted statements
Securities and Exchange Commission	1976	ASR #190	Supplemental disclosure of replacement cost of plant assets and inventories with related expenses
	1978	Reserve Recognition Accounting	Present value of future cash flows used as valuation base in *primary* financial statements
FASB	1978	Financial Reporting and Changing Prices — Exposure Draft	Mandatory use of supplementary current cost information
FASB	1979	Financial Reporting and Changing Prices — SFAS #33	Requires reporting of constant dollar and current cost information for disclosure in annual reports to shareholders

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