Woman C.P.A.

Volume 13 | Issue 1 Article 7

12-1950

What's New in Reading

Ruth C. Ford

WHAT'S NEW IN READING

RUTH C. FORD, CPA, Columbus, Ohio

FIVE MONOGRAPHS ON BUSINESS INCOME by Sidney S. Alexander, Martin Bronfenbrenner, Solomon Fabricant and Clark Warburton (economists), discussion by the Study Group on Business Income and a paper by George O. May, published by the Study Group on Business Income of the American Institute of Accountants.

Sidney S. Alexander, presently on the economic staff of the International Monetary Fund, analyzes the income concept from a theoretical point of view and compares the result of that analysis with the concept of income as conventionally measured by accountants with the conclusion that if price levels did not change there would be no difference between the two concepts.

The discussion points out that when prices fluctuate, the accountant's practice of basing depreciation on historical cost rather than replacement value and of absorbing inventories into operations at cost rather than replacement value produces a mixed income, pure economic income, or sales profit, and price gains on items charged to cost of goods sold. The inclusion of the latter type of gains in income will not maintain capital intact. The discussion of the practical application of these theories to present business problems leads Mr. Alexander to the conclusion that while accountants' procedures do accord separate treatment of capital gains on assets sold out of the normal course of business, they do not recognize capital gains on inventories and on other assets which are eventually charged to cost and are confounded with normal income.

Martin Bronfenbrenner, presently with General MacArthur's Staff in Japan, on loan from the University of Wisconsin, views "Business Income in the Light of Monetary Theory." The long-term upward price trend which is being forecast represents a resumption of the movement which can be traced back to antiquity. Mr. Bronfenbrenner describes its effect on the economy of the various nations of the world in the past and particularly on the present economy of the United States. He discusses the effect of the policy of the present Administration of guaranteeing full employment and production; the effect of collective bargaining of labor unions; unemployment inflation, stagnation and underconsumption.

Mr. Bronfenbrenner discusses the Measurement of Business Income Under Rising Prices, emphasizing the controversy between matching sales by transfers of inventory at prices representing replacement value of inventories sold (LIFO) or on the basis of earliest cost (FIFO) and the related problem of stating depreciation on the basis of replacement cost or on historic cost. He proposes a practical means of dealing with the situation which may eventually meet with the approval of business, tax authorities, the leaders of labor and the consuming public, all hinging on the acceptance by the professional accountant. The concept of income presently maintained by the accounting profession results in a lack of provision for the increased cost of replacing inventories and capital instruments. A continuing business concept provides for the maintenance of capital intact. It is estimated that corporate profits were overstated twenty-five per cent over the three-year period 1946 to 1948, on the basis of eliminating the capital impairment which was included as income.

Solomon Fabricant, Professor of Economics at New York University and a member of the Study Group views Business Costs and Business Income Under Changing Price Levels, from the standpoint of translating business income into real income. To compare the profits of years of various price levels the economist developed first the price index which is in common use. When the inventory has increased during the year, the economist considers the increase in capital to be the increase in units and does not consider that the increase in value of the number of units owned at the beginning of the year represents a real accretion in wealth. The economist method of adjustment insures that no inventory revaluation will be left in the income account to over or understate business income. With the objective to relate costs to revenues the economist does not stop with materials that come out of inventory but carries on to depreciation and depletion which are adjusted in the same way, absorbing capital assets into cost of production on the basis of current prices rather than original cost.

Mr. Fabricant also looks at The Varied Impact of Inflation on the Calculation of

Business Income. He reminds accountants that although they do not allow ordinary revaluation of assets to get into the income accounts, that they are really doing the same thing by the indirect process of turnover of assets during inflation. As a result the ordinary business accounts provide an exaggerated notion of business profits when prices are going up. In 1947 the upward inventory revaluation accounted for five billion dollars of the eighteen billion of corporate profits after tax according to the Department of Commerce.

Clark Warburton, an economist with the Federal Deposit Insurance Corporation and a member of the group, in viewing Monetary Theory and the Price Level Trend in the Future disagrees with Mr. Bronfenbrenner that a long-term trend of rising prices is inevitable and believes that there is enough knowledge and power to push the price level, as a matter of deliberate national policy, in either direction or to maintain a reasonable degree of stability. He outlines a different concept of the scope and character of monetary theory on the economic history of the world. He traces the causes of booms and depressions and expresses the belief that with the present knowledge of monetary controls there need not be extreme depressions.

Mr. Warburton advocates the construction of a more comprehensive index of prices of the final products of the economy, after which industry should make approximations of the difference between the costs and the replacements of its properties, equipment and inventories and the accounts be adjusted for the differences. He believes once this is accomplished that the Bureau of Internal Revenue will agree to the adjustments for tax purposes.

The final chapter by George O. May presents The Case Against Change in Present Methods of Accounting for Exhaustion of Business Property. He believes that accounting procedures should not be revised so as to bring the cost of property exhaustion into account at approximately the same price levels as the revenues and that the situation should be met by supplementary information, assuming social usefulness to be the objective.

In view of the many vital problems facing the accounting profession today it is argued that this problem which is diminishing in importance as the postwar years increase, can be set aside especially because economic profits of the past three years have been high enough to insure that no serious economic or financial harm has resulted from continuance of old accounting methods up to now.

Mr. May submits that the evidence indicates that the option to use the LIFO method has not resulted in treatments best adapted to the business and that a similar option in accounting for property exhaustion would have a similar result. Evidence is found also to support the argument that there have always been fluctuations in the value of money and that business men have traditionally acted upon the assumption that the value of the monetary unit was stable, although they knew this to be contrary to fact. He supports his argument by quotations from well known authorities.

This book is distributed to members of the Institute, any of whom will be glad to loan it to you if copies are not available from the American Institute of Accountants.

STATEMENT OF THE OWNERSHIP, MANAGEMENT, AND CIRCULATION REQUIRED BY THE ACT OF CONGRESS OF AUGUST 24, 1912, AS AMENDED BY THE ACTS OF MARCH 3, 1933, AND JULY 2, 1946

Of THE WOMAN C.P.A., published bi-monthly at New York, N. Y., for October 1, 1950.

1. The names and addresses of the publisher, editor, managing editor, and business managers are:
Publisher, American Woman's Society of Certified Public Accountants and American Society of Women Accountants, 342 Madison Avenue, New York 17, N. Y.
Editor, Helen F. McGillicuddy, 656 Aldine Avenue, Chicago 13, Illinois.
Managing editor, None.
Business manager, Helen Lord, 342 Madison Avenue, New York 17, N. Y.

2. The owner is:
American Woman's Society of Certified Public Accountants (a non-stock corporation), Pres., Edith Moore; Vice-Pres., Jean D. Colavecchio, 342 Madison Avenue, New York 17, N. Y.
American Society of Women Accountants (a non-stock organization), Pres., Grace A. Dimmer; Vice-Pres., Vera J. Bobsene, 342 Madison Avenue, New York 17, N. Y.

3. The known bondholders, mortgagees, and other security holders owning or holding 1 percent or more of total amount of bonds, mortgages, or other securities are: None.

4. Paragraphs 2 and 3 include, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting; also the statements in the two paragraphs show the affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner.

HELEN LORD, Business Manager

Sworn to and subscribed before me this 29th day of September, 1950. Elisabeth J. Rubino
[SEAL] (My commission expires March 30, 1951)