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Correspondence: German Inflation Accounting

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GERMAN INFLATION ACCOUNTING

Editor, The Journal of Accountancy,

SIR: I have read with much interest Mr. Sweeney's article on *German Inflation Accounting* in the February, 1928, JOURNAL.

Obviously, the method suggested is an advance upon the one it supersedes; but have not accounting principles been sacrificed to simplicity? For instance, profit-and-loss account is credited with a money-value gain on bonds payable. Suppose, however, that in the succeeding year, the value of the book mark rises to eight to one gold mark. If the gold-mark value of the liability for bonds payable is to be stated, the credit in the account must be increased to 25,000 gold marks, requiring an offsetting debit, presumably to profit and loss, of 5,000 gold marks. Therefore, crediting profit and loss in the first year with a supposed money-value gain would be at the expense of the second year. In other words an unrealized gain, subject to fluctuation, has been taken up as profit in the first year. It may be answered that there has also been taken up an unrealized loss on a capital asset such as machinery; but do accounting principles require that market or book losses, due to fluctuations in the value of capital assets intended for use in a business, must be written off to the annual profit-and-loss account?

By all means reduce the balance-sheet to a gold basis, but I suggest that the so-called money-value gains or losses should be credited or debited instead to a currency-adjustment account, the balance of which, if a credit, should be held as a reserve against subsequent fluctuations, or, if a debit, should be offset by an equivalent appropriation from surplus. By so doing we should adhere to accounting principles, which require that provision be made for all possible losses and that no unrealized gains be taken up as profits.

If the money-value differences are carried to an account such as the one suggested, then it will be necessary to charge the depreciation in paper marks, so that the profit and loss does not contain both gold and paper marks. In stating the gold equivalent of the reserve-for-depreciation account, the so-called money-value gain would be carried to the currency-adjustment account.

Yours truly,

J. H. ALLEN.

Orange, N. J., March 3, 1928.

Editor, The Journal of Accountancy,

SIR: Mr. Allen's letter calls attention to a very interesting point, one that might well have been included in the article to which he refers.

The fact that prominent German writers on this subject (e. g., Mahlberg and Schmalenbach) did not treat so-called profits and losses from price changes in the manner suggested by Mr. Allen was due perhaps to a combination of the following reasons:

1. Profits and losses arising from changes in price levels can not be identified, measured and segregated with practical success from profits and losses resulting from conduct of the business operations. As the article stated, gains and

losses from fluctuating price levels may be so intermingled with profits and losses resulting from the continuous flow of business operations as to prevent easy identification as such.

In the example given in the article, a gross loss on sales was shown. Goods were sold below cost—a consequence, presumably to some extent in such a period, of lack of suitable conformity of sales prices to the changing merchandise level of prices, although an apparent profit was realized. The changing price level was thus largely responsible for the actual loss on merchandise operations. But the extent of such responsibility can not be accurately gauged at the close of a period when the individual merchandise transactions have been consummated.

Difficulties of classification and measurement are not in themselves good reasons for not attempting to obtain results that will be as nearly accurate as practically possible. In conjunction with the following reasons, however, this first reason probably was stronger than it would have been alone.

2. In many cases the final losses would have seemed unbearable if all price-variation profits and losses resulting from application of balance-sheet stabilization had been excluded. The example given in the article showed a final net loss of GM 25,000. If the price-variation-reserve method had been used, a conglomerate mark loss of 780,000 would have appeared, together with a similar type of mark reserve for price variations amounting to 755,000. (In some cases, however, use of the method described in the article might have increased the final net loss.)

3. As the closing years of the inflation arrived and people began to lose confidence in the mark, there seemed perhaps less need to reserve any net profits resulting from treating price changes as described in the article—prices seemed unlikely to decrease enough even partly to offset any net profits resulting from a preceding price rise.

Mr. Allen's suggestion seems quite sound, however, with regard to present orthodox accounting theory, and would have to be considered very carefully if any adaptation of German methods were to be attempted in this country.

Yours truly,

HENRY W. SWEENEY.

New York, March 14, 1928.