


4-1985

Companies Are Not Using FAS 33 Data

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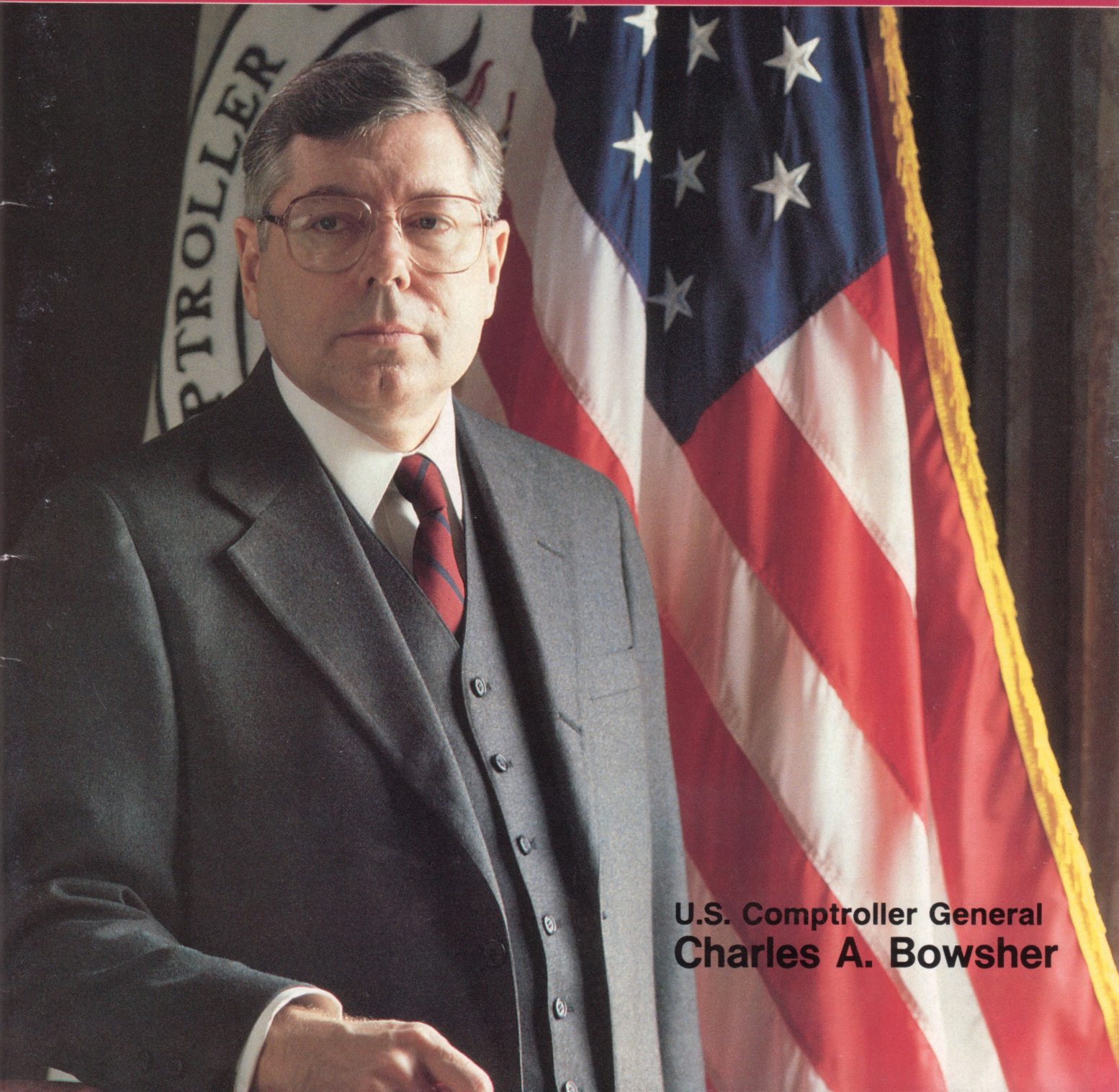
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MANAGEMENT ACCOUNTING

PUBLISHED BY THE NATIONAL ASSOCIATION OF ACCOUNTANTS/APRIL 1985



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Charles A. Bowsher**

MANAGEMENT ACCOUNTING

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Companies Are Not Using FAS 33 Data

The least use of FAS 33 data was reported for 'determining cash dividends,' even though such data were said to be necessary to avoid excessive dividend payouts, which impair capital formation.

By Kenneth Rosenzweig

How is price-adjusted information required by FAS 33, "Financial Reporting and Changing Prices," being used for management decision-making purposes? I mailed a questionnaire survey to the controllers of all companies in the FASB's Statement 33 bank to find out the answers and to examine the company characteristics associated with such use.

The questionnaire was designed to find out the extent of use and reporting of FAS 33 information for internal company purposes such as management decision making, and the factors which might be associated with that use and reporting.

The controllers were asked about the extent of internal use and reporting by their companies of FAS 33 information. The respondents were asked to indicate the extent of their use and reporting on a seven-point scale from 1 or "never" to 7 or "always." In general, very little use or reporting of FAS 33 information was revealed. See Table 1.

It was hypothesized that usage of FAS 33 information might differ among the companies according to the types of decisions for which information was required. Some decisions may be readily adaptable to the use of FAS 33 information while others may not be. However, the questionnaire responses did not reveal much difference in the ex-

tent of usage for various decision types. The decision types included adjustment of insurance coverage, capital investment decisions, product pricing and sales decisions, other purposes, make-or-buy decisions, and determining cash dividends.

It is ironic that the least usage of FAS 33 information among the decision types was reported for "determining cash dividends" because much of the literature on inflation accounting has stressed the paramount importance of inflation adjustments to avoid excessive dividend payouts and thereby impairment of original capital resulting from the use of net income based on inflated historical cost.

Another hypothesis of this study was that companies' use of FAS 33 information would differ by organizational level. It was assumed that because FAS 33 information always would be available on a company-wide basis, the greatest use would be at the headquarters level. The use by company units would be less frequent because of an assumption that the FAS 33 information may not be assembled for those units. The questionnaire responses, however, give little support to this hypothesis.

An important prerequisite for the use of FAS 33 information by managers is the reporting of that information to them. Casey and Sandretto (1981)¹ found that 45% of the Fortune 500 com-



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panies that responded to their survey reported inflation-adjusted accounting data to managers. In contrast, my study—although it focused on FAS 33 information and measured extent of reporting in a different way—revealed very little reporting of that information to managers.

Casey and Sandretto found a materially higher rate of reporting of inflation-adjusted data to top than to operating management while this study indicated no difference in the rate of reporting between company-wide and company units. Furthermore, the results on the reporting questions in the present study have even lower scores generally than the results on the usage questions. This outcome suggests the possibility that top management of many companies may have discouraged the use of FAS 33 information within the compa-


sion. In other words, those companies that use FAS 33 information for one purpose tend to use it for others. If FAS 33 information is used on the company-wide level, it is likely also to be used by company units. If companies reported FAS 33 information company-wide, for company units, or on a special request basis, they were more likely to use that information internally.

As noted, the questionnaire results generally indicated very little use or reporting of FAS 33 information. In order to assess the possible association of other company characteristics with the use of FAS 33 information, I focused on differences in such use. For this purpose, the dependent variable, "Overall Usage of FAS 33 Information," was recoded into two categories: "never" and "to some extent." "Never" included only those com-

Firms that used price indexes were less likely to use FAS 33 data.

Table 1
Overall Usage of FAS 33 Information

	Never 1	2	3	4	5	6	Always 7	Total
Number	301	176	40	10	3	1	1	532
Percent	56.6	33.3	7.5	1.9	.6	.2	.2	100


 Mean
1.6

nies by failing to work that information into the companies' internal reporting systems. Thus, lower-level managers may not have had the opportunity to use the information.

Because the Casey and Sandretto study asked about the internal reporting of all types of inflation-adjusted information including that not induced by FAS 33, the difference between the high reporting responses of that study and the low reporting responses of this study suggests that many companies are reporting to managers inflation-adjusted information other than that required by FAS 33.

Relationships among Measures of Internal Use

Even though the general level of usage and reporting of FAS 33 information was low, perhaps some companies may have reported or used FAS 33 information for one purpose while not reporting or using it for other purposes. To examine this question, Pearson correlations were calculated between the measure, Overall Usage of FAS 33 Information, and measures of internal reporting and more specific use of that information (See Table 2).

The uniformly strong and positive correlations among these measures is striking and suggests that internal reporting and use of FAS 33 information in companies is essentially a single dimen-

panies that answered "never" on the original 7-point usage scale. "To some extent" included answers 2 through 7 on the original 7-point usage scale.

From the 14 variables measuring use and reporting of FAS 33 information, the variable Overall Usage of FAS 33 Information was selected for exclusive use as a dependent variable in this analysis for three reasons. First, the dependent variables had proven to be highly correlated with one another. Second, Overall Usage seems to represent a general aspect of the dependent variables. Third, Overall Usage after recoding divides the population into two roughly equal subgroups as follows:

Frequency Distribution

Overall Usage of FASB 33 Information

Value	Number of firms responding	% of firms responding
Never	301	57
To some extent	231	43
	532	100

Firm Characteristics and FAS 33

To analyze the possible relationship of company characteristics with Overall Usage of FAS 33, I focused on four general dimensions conjectured to be associated with use of FAS 33 information:

1. Commitment of management to producing and using FAS 33 information.
2. Adaptability of management to using FAS 33 information.
3. Prior experience by management with use of price-adjusted information.
4. Industry in which the company operates.

Management Commitment. Two aspects of the commitment of management to producing and using FAS 33 information were measured: the existence of a formal policy that management use the information and the amount of effort companies devoted to developing the information. Thus, the first hypothesis:

H1: Companies whose managements have a formal policy that FAS 33 information be used for internal purposes are likely to make greater use of that information.

It is a natural expectation that a formal policy may influence managers to use FAS 33 information and the research findings support this expectation to some extent. Because only a small proportion of the respondent companies had a formal policy (about 2%), it is difficult to predict what effect the policy would have had on usage of FAS 33 information in other companies. But apparently the formal use policy did affect usage in the companies that had such a policy.

H2: Companies that devote a greater amount of effort to the development of FAS 33 information are more likely to use that information for internal purposes.

Because carefully developed information is likely to be more useful, it is reasonable to expect that companies devoting greater effort to developing FAS 33 information are more likely to use it.

This hypothesis was tested by analyzing two variables: the number of man hours devoted by company personnel to the development of FAS 33 information and the complexity of the method used to adjust for price changes. This analysis indicates that companies using FAS 33 information devoted materially greater man hours to the development of FAS 33 information than companies that did not use the information. The "never" usage subgroup reported 664 average number of man hours, as compared to 960 average number of man hours reported by companies using FAS 33 information "to some extent."

For the second variable, as an index of the overall complexity of adjustment methods used, the companies were asked which of four methods was the predominant one used to develop current costs for property, plant, and equipment. The methods,

discussed in FAS 33, are price indexes, direct pricing, unit pricing, and functional pricing. It was assumed that the use of price indexes required considerably less effort than the use of the other three methods because those methods require a direct evaluation of the value of individual assets while price indexes can be applied to assets of different age groups without a direct evaluation. The research findings show that companies that employed price indexes were much less likely to have used FAS 33 information than companies which employed the other methods. See Table 3.

In summary, the results of the analysis of the two variables for hypothesis two suggest that a difference between companies that used FAS 33 information and those that did not was greater hours spent on development as well as the utiliza-

Table 2

Pearson* Correlations: Overall Use of FAS 33 Information with Measures of Internal Reporting and More Specific Use

For evaluation of unit managers	.45
For adjustment of insurance coverage	.49
For capital investment decisions	.57
For determining cash dividends	.41
For product pricing and sales decisions	.47
For make-or-buy decisions	.43
For other purposes	.46
Company-wide level	.59
By company units (departments, divisions, etc.)	.46
Company-wide reporting of FAS 33 information	.36
Reporting for any company units	.36
Reporting on a special request basis	.49

*Pearson correlations are nominally suitable only for data that is on an interval or ratio scale, both of which assume that the distances between points on the scale are equal. Although the responses to these questions are on only an ordinal scale, it is common in research of this kind to use Pearson correlations because they are easy to calculate and readily understandable. As a check of the appropriateness of the Pearson correlations, Kendall rank-order correlations among these measures were also calculated. There were no material differences between the Kendall and the Pearson correlations.

tion of more complex methods involving the revaluation of individual assets, rather than only the minimally required methods.

Management Adaptability. Five aspects of the adaptability of management to producing and using FAS 33 information were assessed:

1. Perceived use of the information by external parties.
2. Perceived understanding of the information by operating management.
3. Perceived usefulness of the information for internal purposes.
4. Belief that adjustments for changing prices will continue to be required.
5. Decentralized responsibility for developing the information.

How the Study Was Conducted

The questionnaires were mailed to the controllers of all companies on the FAS 33 Data Bank (User's Manual, 1983) as of Summer 1983. A second mailing in December 1983 was made to companies that had not responded to the first mailing. A total of 1,514 surveys were mailed out, and 544 surveys were used in the analysis, a 37% response based on the estimated total of 1,464 presumed subject to FAS 33.

The true response rate is probably somewhat higher than 37% because it is logical to assume that some of the companies that failed to respond were not subject to FAS 33. The response rate is excellent for studies of this kind and lends support to the contention that the research results reported reasonably represent the total population of companies subject to FAS 33.

The extent of use and reporting of FAS 33 information was measured on a 7-point attitudinal scale from 1, or never, to 7, or always, for various aspects of reporting and use. Questions concerned use of FAS 33 information for various purposes and at different company levels. Reporting questions covered regular and special request reporting as well as reporting at different company levels.

Factors that might be associated with use and reporting of FAS 33 information were determined from hypotheses. These hypotheses were developed from intuition and the literature. ☐

H3: Companies whose managements believe they will be evaluated by investors and other external users on the basis of FAS 33 information are likely to make more use of that information.

Because company management often is evaluated by external parties such as stockholders on the basis of financial statement net income, management's objective may be to maximize the reported income number rather than the company's long-run economic well being. To the extent the income number is based on historical cost, historical cost management information may be seen as facilitating decisions which maximize the income number. But if management perceives that external parties are using FAS 33 information, it may be motivated to use it also. This is referred to as the "criterion" factor.

Jablonsky and Dirsmith (1979)² examined this factor and concluded that it may account for the still widespread use of the inferior accounting rate-of-return and payback methods instead of the ostensibly superior net present value and internal rate-of-return methods for capital budgeting decisions, as well as the all too frequent overemphasis on return on investment (ROI) for evaluating division managers.

This hypothesis was tested with two variables: the respondents' opinions about the usefulness of

FAS 33 information for external users and the respondents' opinions about the relative weight that external users will place on historical cost and FAS 33 information in evaluating the company. The results from both variables support the hypothesis that companies who believe they will be evaluated by external users on the basis of FAS 33 information are more likely to use that information.

H4: Companies whose operating managers understand the difference between historical cost and FAS 33 financial information are likely to have more use of FAS 33 information.

If managers do not understand the difference between historical cost and FAS 33 information, they are unlikely to demand or to use the unfamiliar FAS 33 information for their decision making. The research findings provide moderate support for this hypothesis.

H5: Companies whose managements perceive FAS 33 information to be useful for internal uses are likely to have more use of that information.

The credibility of FAS 33 information should be an important determinant of its use. Kaplan (1984)³ points out that the general subservience of internal management accounting to the external reporting function has resulted in the frequent internal use of inadequate methods solely because they were required for external reporting. Thus, the past unacceptability of all nonhistorical cost valuation methods for financial reporting may have inhibited the use of such methods for management decision making because only historical cost information was considered by managers to be legitimate. For some companies, ASR 190 and FAS 33 may have given more credibility to accounting data adjusted for changing prices, thereby encouraging more use of that information.

This hypothesis was tested in both a positive and negative manner. On the positive side, the extent the respondents felt the information was useful for internal users was measured for the two information usage subgroups. On the negative side, the respondents were asked the extent they felt certain factors had inhibited the use of FAS 33 information by management. These factors were: information is inaccurate, information is biased, and information is not understood.

The research findings strongly support the conclusion that companies whose respondents felt FAS 33 information was "useful" are more likely to have used that information.

On the negative side, the research findings do

not support the conclusion that the extent the respondents felt FAS 33 information was inaccurate, biased, or not understood was materially associated with whether the information was used.

It is interesting that a positive belief that FAS 33 information is useful was associated with greater use but beliefs that FAS 33 information was deficient in certain respects were not associated with reduced usage. Perhaps companies that believed FAS 33 information was useful but that it had certain deficiencies, such as inaccuracy, bias, or difficulty in understanding, felt that managers could learn to compensate for these deficiencies. As a consequence, they may not restrict usage of the information by managers. Management accounting information is typically of a lower standard of precision than is financial accounting information because more knowledgeable managers are generally better able than less knowledgeable external parties to distill the essential meaning

companies who participate in the development of FAS 33 information are more likely to understand it and therefore to use it. Another rationale for this hypothesis is that generally only information aggregated by company units is suitable for use by those units. Information assembled by the headquarters unit is likely not aggregated by company units and therefore may not be usable by them.

The hypothesis was tested in two ways: specifically with respect to the development of FAS 33 information and more generally with respect to overall decentralization of the financial function. First, the respondents were asked what organizational level had primary responsibility for developing FAS 33 information: corporate or company headquarters vs. company units. The research findings provide slight support for this hypothesis.

Although most companies in both subgroups developed FAS 33 information at the headquarters level, a slightly higher percentage of the com-

If companies felt FAS 33 data were useful, they were more likely to use such data.

Table 3
Predominant Method of Developing Current Cost for Property, Plant, and Equipment

Usage subgroups	No direct evaluation	Direct evaluation		
	% of 429 companies using price indexes	% of 38 companies using direct pricing	% of 24 companies using unit pricing	% of 14 companies using functional pricing
Never	59	53	46	29
To some extent	41	47	54	71
	100	100	100	100

from unrefined information without being misled by its shortcomings.

H6: Companies whose managements believe that some form of required adjustments for changing prices will continue to be required for external financial statements are likely to exhibit more internal use of FAS 33 information.

If FAS 33 information is perceived as being only a passing phenomenon, then companies may invest little time in learning to use it. But if the requirement to produce FAS 33 information is permanent, then companies may see an advantage to learning how to use it. The research findings provide only slight support for this hypothesis:

H7: Companies in which the primary responsibility for the development of FAS 33 information is decentralized to lower company levels are likely to have more use of such information.

It seems logical that managers of decentralized

panies that used FAS 33 information developed that information by company units.

With respect to the overall decentralization of the financial function, respondents were asked whether the company physically houses its financial records at corporate or company-wide level or at company units. Of that subgroup reporting usage of FAS 33 information, 51% said the company decentralized financial records but only 44% of the companies which did not use FAS 33 information said their financial records were decentralized. The results from both tests of the hypothesis suggest some tendency for more decentralized companies to have used FAS 33 information more. Decentralized companies may be more flexible and, in some cases, may have allowed managers in localized areas the freedom to develop uses for FAS 33 information which was not possible in more centralized companies.

Prior Experience with Price-Adjusted Information. Companies that have a familiarity with price-adjusted information due to prior use are more accustomed to using it and therefore should be more inclined to use FAS 33 information. This hypothesis (H8) was tested with two variables: the extent

that any form of information adjusted for changing prices was used prior to ASR 190 and whether the company was subject to ASR 190.

The research results from the first variable suggest that the extent a company used information adjusted for changing prices prior to ASR 190 is highly associated with whether that company uses FAS 33 information currently. On the second variable, the results suggest a slightly higher tendency for companies that have used FAS 33 information to have been subject to ASR 190 than companies that have not used FAS 33 information.

These results suggest the general conclusion that prior experience with price-adjusted information is an important determinant of the current use of FAS 33 information.

Table 4
Companies in Industrial Categories
Using FAS 33 Information

<u>Companies</u>	<u>Industrial category</u>	<u>% using FAS 33 information</u>
33	Retail trade	58
159	Manufacturing	50
135	Transportation, communication, electric, gas, and sanitary services	43
26	Services	38
77	Finance, insurance, and real estate	27

Industry in which the Company Operates. It seems plausible that companies in different industries would exhibit different levels of usage of FAS 33 information because they would tend to face different conditions with respect to such factors as technological change, competition, exposure to inflation, and so on. To test this hypothesis, the companies were asked in which of the nine general categories of the Standard Industrial Classification (*Standard Industrial Classification Manual*, 1972) most of their activities fell. The research results support this hypothesis (See Table 4).

Industrial categories with fewer than 25 companies were eliminated from the table because their results were likely to be more a function of the nature of the particular companies included rather than their industry. As can be seen, most of the companies were in the two categories: manufacturing; and transportation, communication, electric, gas, and sanitary services. These two categories exhibited moderate amounts of usage although they differed somewhat from one another. The most usage of 58% was reported in the retail trade category which may be due in part to that industry's long experience with price level adjustments used in connection with the retail inventory method. The least usage (27%) was reported in the finance, insurance, and real estate category

which may be due to the predominantly monetary nature of assets and liabilities of companies in that category, thus obviating the need for balance sheet adjustments.

Why FAS 33 Was Not Used

Why have companies not generally used FAS 33 information for internal purposes? The study provides some evidence that top management commonly failed to encourage the use of the information by not working it into the internal reporting system, not adopting a policy that the information be used, and not committing resources (preparation man hours and costly adjustment methods) to developing high quality information suitable for decision making. Furthermore, the study suggests that managers in companies that encouraged use in these ways used the information to a greater extent. The failure of top management to encourage use of FAS 33 information probably accounts for the fact that operating management was found to have little understanding of it.

Another important factor was the perceived lack of use of FAS 33 information by external parties such as stockholders. This may partly account for the perceived lack of usefulness of FAS 33 information for internal users. Company managements may have felt it in their interest to use historical cost (non-FAS 33) information because external parties were perceived to be evaluating them on the basis of that information. Moreover, companies which believed external parties would use FAS 33 information more had more internal use of that information.

A further significant factor is the general lack of credibility of the information itself. It is apparent that management generally did not believe FAS 33 information was useful. This is in sharp contrast to Casey and Sandretto's earlier conclusion that, "resistance to inflation-adjusted accounting appears to be fading." Whether the lack of use is due to the factors stated above, the newness of the information, or its essential uselessness cannot be determined from this study. But, interestingly, the study provides some evidence that specific deficiencies of the information, such as inaccuracy, bias, or lack of understandability, could be compensated for by management in the process of using it.

Companies in different industries were found to display materially different rates of use of FAS 33 information but, surprisingly, many aspects of the complexity of company environment, which might be expected to be associated with industry, were found essentially unrelated to use of FAS 33 information. These included extent of: market competition, technology change, cost increase, company size, multiplicity of industries, and for-

eign operations. Other factors that were found unassociated with use of FAS 33 information were extent of outside assistance employed in developing the information and the difficulty the company experienced in implementing the requirements of FAS Statement 33.

As a test of whether the attitudes and biases of the respondents rather than actual differences between companies may have accounted for the findings of this study, the responses also were analyzed for various respondent characteristics, including respondent position, seniority, formal education, and knowledgeability. No material differences were found for these characteristics.

Those companies that are not generally using FAS 33 information internally must be following one of the following practices:

1. The companies are developing their own customized adjustments for price changes.
2. Company managers are using unadjusted information but are allowing for the effect of price

changes in making decisions and are making implicit mental adjustments of the unadjusted information.

3. Company managers are using unadjusted information and are ignoring the effect of price changes.

This study provides no information with regard to which of the above strategies companies are following but the difference between the high internal inflation reporting responses of the Casey and Sandretto study and the low FAS 33 internal reporting responses of this study suggests that at least some companies are developing their own price-adjusted information. Future research should concentrate on determining which of the above practices companies are following and on remedying whatever factors are inhibiting the use of FAS 33 information. ☐

¹C.J. Casey and M.J. Sandretto, "Internal Uses of Accounting for Inflation," *Harvard Business Review*, Nov.-Dec., 1981.

²S.F. Jablonsky and M.W. Dirsmith, "Is Financial Reporting Influencing Internal Decision Making?" *MANAGEMENT ACCOUNTING*, July 1979.

³R.S. Kaplan, "The Evolution of Management Accounting," *The Accounting Review*, July 1984.

Only about 2% had a formal policy mandating internal use of FAS 33 data.

Accounting for Commodity Futures

47 ◀◀

cost of the grain purchased.

Because of the large number of transactions a processor may make in both the cash and futures market, a one-to-one correlation may be difficult to trace. The statement allows, when volume of transactions make impractical a direct matching, a reasonable allocation of the losses or gains on futures contracts to those assets sold and those remaining in inventory. This allocation, however, must remain consistent.

The statement does not require futures contracts to be exactly the item intended to be hedged. Rather, the statement requires the futures contract acting as a hedge have a high correlation of price changes at the inception and throughout the hedging period, that high correlation is probable, and that a clear economic relationship exists

between the prices.

An ongoing assessment of correlation of price fluctuations between the futures contract and the item intended to be hedged should be performed. The statement does not quantitatively describe what constitutes "high correlation."

Besides items mentioned previously, other company positions could affect the meeting of the hedge criteria. These positions may include other assets, liabilities, commitments and transactions considered in assessment of whether a particular item contributed to exposure.

Enterprises with decentralized risk management activities may meet the hedging requirement if the hedging criteria are met within a business unit even though they are not met when the enterprise is considered as whole. ☐