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Some Simpler Methods of Accounting for the Effects of Changing Prices

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Some Simpler Methods of Accounting for the Effects of Changing Prices

SURENDRA P. AGRAWAL and KENNETH ROSENZWEIG*

The complexities of accounting for the effects of changing prices on financial statements could be lessened with the use of simpler accounting methods. Because of existing complexities, even the industrialized countries require only their larger business entities to provide inflation-adjusted information. Such information is prepared by making numerous adjustments to the traditional, historical cost-based data. For example, in the United Kingdom, inflation-adjusted income is calculated in two stages: operating profit and profit attributable to shareholders. These calculations are based on the concept of value to the business and require complicated adjustments with respect to cost of goods sold, depreciation, monetary working capital, and financial leverage.¹ In the United States, requirements are even more extensive; selected items must be reported under two different methods: current cost and restatement of historical cost in constant dollars.²

Absence of sophisticated accounting systems to produce the inflation-adjusted information and fear of excessive costs to develop new accounting systems are the main reasons smaller corporations in industrialized nations and business entities in most developing countries are

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¹ For details, see Accounting Standards Committee, "Current Cost Accounting," *Statement of Standard Accounting Practice No. 16* (1980).

² For details, see Financial Accounting Standards Board, "Financial Reporting and Changing Prices," *Statement of Financial Standards No. 33* (henceforth referred to as SFAS No. 33) (Stamford, Conn.: FASB, 1979).

not being asked to report inflation-related information.³ Furthermore, it is often observed that when inflation rates are rather low, the interest in inflation accounting declines to a low level. The distorting effect of inflation, whether high or low, on the financial statements of all kinds of businesses, large or small, in all countries, creates the necessity for financial statement users to assess the impact of inflation. It is essential, therefore, that business entities in developing nations, as well as in industrialized countries, possess techniques which allow the reporting of the effects of changing prices on their financial statements to be both feasible and accurate, regardless of the extent of such changes. In the accounting literature, several simple methods based on one-line adjustments of net income and owner's equity have been proposed. Although such methods are claimed to be quite effective, they have received little exposure or attention. In his dissent to Statement of Financial Accounting Standards (SFAS) No. 33, David Mosso refers to one such method as deserving more support than it has thus far received. Similarly, in his dissent to Statement of Financial Accounting Concepts (SFAC) No. 5, John March suggests that "income must first deduct a provision for maintenance of capital in real terms," and further states that "complex implementation should not be necessary to provide for the erosion of capital caused by the effects of inflation. . . ."⁴ This paper explores and evaluates one-line adjustments as a possible alternative to the more complex methods used previously. The primary purpose of inflation accounting is discussed first, followed by an attempt to develop criteria for the evaluation of inflation accounting methods. Three one-line adjustment methods are then explained, and each is evaluated in terms of these criteria.

PURPOSE OF INFLATION ACCOUNTING

A principal reason for the diversity of views as to an appropriate method of accounting for the effects of changing prices is the lack of a clear understanding of the primary purpose of such an exercise. Even the Financial Accounting Standards Board (FASB) failed to address the question adequately with the resulting indecisiveness inevitably reflected in the weaknesses mentioned earlier.

Several approaches may be taken. Because of the instability of the dollar as a unit of measurement, many people believe that financial

³ For example, see paragraph 200 of SFAS No. 33.

⁴ Financial Accounting Standards Board, *Statement of Financial Accounting Concepts No. 5*, "Recognition and Measurement in Financial Statements of Business Enterprises" (Stamford, Conn.: FASB, 1984), pp. 32-33.

statements should be prepared in units of general purchasing power (GPP) or constant dollars. This represents only a change in a technique, however, not a change in any of the principles of accounting.⁵ Therefore, the question concerning the primary purpose of inflation accounting still remains unanswered. Moreover, in many countries outside the United States, accounting in GPP units has been rejected because such units were seen to be imaginary with no physical existence or usage, and because the technique does not account for the effects of changes in the particular prices relevant for a given business entity.⁶

A case has also been made for using valuation bases other than historical cost, such as current replacement cost, exit value, or economic value. But it is generally recognized that these bases represent different attributes of the same financial statement item.⁷ Such values usually differ from each other and from historical cost even in the absence of changing prices. Therefore, adoption of a particular valuation system cannot be regarded as the primary purpose of inflation accounting. Values of two or more attributes of various items might be found useful, however, in many decision situations,⁸ but their disclosure need not depend upon the use of any particular method of inflation accounting.

The concept of capital maintenance provides the theoretical basis for determination of income, as well as invested capital on the balance sheet. Analogous to the recovery of cost, it is the point that divides return *of* capital from return *on* capital: returns in excess of the amount necessary to maintain capital capacity are earnings; returns below that point cause net losses.⁹ Several alternative capital maintenance concepts have been advocated, including the following:

1. Financial capital measured in nominal monetary units;
2. Financial capital measured in constant dollars; and
3. Physical capital that represents operating capability.

While a traditional, historical cost system helps achieve 1, its failure

⁵ Financial Accounting Standards Board, "Financial Reporting in Units of General Purchasing Power," *Exposure Draft* (Stamford, Conn.: FASB, 1974), par. 34.

⁶ For example, see the report of the Inflation Accounting Committee (Sandilands Committee), *Inflation Accounting* (London: Her Majesty's Stationery Office, 1975).

⁷ For example, see Eldon S. Hendriksen, *Accounting Theory* (Homewood, Ill.: Irwin, 1977), p. 264.

⁸ Ibid.

⁹ Financial Accounting Standards Board, "An Analysis of Issues Related to Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement," *Discussion Memorandum* (Stamford, Conn.: FASB, 1976), par. 264.

to compensate for inflation is well documented in the accounting literature. A considerable difference of opinion exists as to which of the other two is an appropriate objective of inflation accounting. However, the differences among the three alternatives are caused mainly by inflation or changing prices, and in their absence the three concepts will produce identical results.

The achievement of a particular capital maintenance concept should be considered the primary purpose of inflation accounting since it provides an appropriate criterion for the determination of income under inflationary conditions. This is consistent with the fundamental objectives of financial statements as set out in the FASB's Statement of Financial Accounting Concepts No. 1.¹⁰ Disclosure of the particular capital maintenance concept that an entity is trying to achieve would provide financial statement users with information helpful in assessing the amount, timing, and uncertainty of prospective cash flows, such as those from dividends, and for making rational decisions. A clear distinction between return *on* capital and return *of* capital would also result in a more appropriate evaluation of the performance of an entity's management.

One aspect of capital maintenance deserves further examination. Capital maintenance is primarily a long-term objective, that is, the effectiveness of a method of accounting in terms of the achievement of a concept of capital maintenance can be judged only by considering the long-term effect on income calculated under that method. For example, over the life of an asset, an accounting method attempts to reduce distributable income sufficiently so that the cash not distributed to owners due to the reduction would be adequate at the end of the asset's life for its replacement in terms of the adopted concept. But the capital maintenance concept does not define the amount of the reduction in income that is assignable to the different years of the asset's life. For example, it might be possible, in an extreme case, to account for the impact of lifetime inflation in a single year and still maintain adequate capital. To preclude such a possibility, the relationship of the year-to-year effect on income with the degree of inflation may be considered a criterion for evaluating the annual income adjustments. Since there would be no reduction in income if the inflation rate were zero, it seems reasonable that the amount of the reduction should be positively associated with the degree of inflation. For this purpose, the re-

¹⁰ Financial Accounting Standards Board, "Objectives of Financial Reporting by Business Enterprises," *Statement of Financial Accounting Concepts No. 1* (Stamford, Conn.: FASB, 1978).

duction in income is the difference between the amount of net income as calculated under traditional accounting and that under the method of inflation accounting. Furthermore, the degree of inflation is measured by the relative change in the general price level or the specific prices faced by a particular company, depending on the concept of capital maintenance employed.

In summary, two criteria have been developed to evaluate the appropriateness of methods of inflation accounting: (1) achievement of the capital maintenance concept employed, and (2) association of the year-to-year effects on income with the degree of inflation.

In this section, the purpose of inflation accounting was discussed, and these two criteria were developed. The next section describes and illustrates three one-line inflation adjustment methods which are evaluated with respect to the two criteria in the concluding section of the paper.

ONE-LINE ADJUSTMENT METHODS

The principal feature of these methods is that they provide a one-line adjustment in the income statement that encompasses the total impact of inflation for the period and reduces the income computed under historical-cost principles to an inflation-adjusted amount. The corresponding credits are accumulated in an account that is reported as one part of the invested capital of the entity. The amount of adjustment depends on two factors: (1) the capital maintenance concept adopted, either financial capital in constant dollars or physical capital; and (2) the method of computation, either a direct calculation based on owners' equity or an indirect calculation linked with a comprehensive revision of the financial statements. A permutation of these factors may lead to a number of methods since there could be many ways to prepare comprehensive revisions of financial statements to account for the effects of changing prices. Not all such permutations have been discussed in the literature, however, and this paper will discuss only the three that have been suggested. The important features of these methods will be described and illustrated here with a numerical example. The transaction data on which the example is based, the financial statements prepared under conventional historical-cost principles, and those in historical cost/constant dollars are given in the appendix. The data are for the complete three-year life cycle of the business from initial investment to liquidation. The simple example highlights the essential differences among the methods.

The Price Waterhouse Method

Price Waterhouse & Co. proposed a one-line inflation accounting method to the FASB while it was in the early stages of developing Statement No. 33.¹¹ This method reports all revenues and expenses on the income statement at historical cost, while a single line item, "provision for current impact of inflation," reduces net income to an amount equal to that on a comprehensively restated historical cost/constant dollar income statement. The amount of this provision is accumulated from year to year in an account called "provision for cumulative impact of inflation" in the stockholders' equity section of the balance sheet. In essence, the cumulative provision may be viewed as an appropriation of the historical cost-based retained earnings which is not available for distribution as dividends. It is therefore part of the invested capital of the enterprise.

Exhibit 1 shows the financial statements prepared under the Price Waterhouse method from the data given in the appendix. The provision for the current impact of inflation each year incorporates all the differences between the historical cost revenues and expenses and the comprehensively restated revenues and expenses. For example, the provision in Year One of the illustration could be explained as follows:

Increased sales	\$ 1,905
Increased cost of goods sold	(1,429)
Loss from holding cash	(7,619)
Gain from holding debt	6,000
	<u>\$(1,143)</u>

The amount of the cumulative provision in the balance sheet is a simple accumulation of the provision made in all the periods to date. For example, the cumulative provision in Year Two, \$3,548, is equal to the Year-One provision of \$1,143 plus the Year-Two provision of \$2,405.¹²

The Price Waterhouse method has the following significant features:

1. The various items in the financial statements are reported at their historical costs.
2. The historical-cost income is reduced by recognizing as a deduction

¹¹ Price Waterhouse & Co., "Financial Reporting and Changing Prices," a position paper submitted to the FASB in response to the latter's exposure draft dated December 28, 1978. The method was explained further by Joseph Connor (Chairman, Price Waterhouse & Co.) in "Inflation's Impact on Earnings, and a Formula for Full Disclosure," *Finance Magazine* (September/October 1978).

¹² The Price Waterhouse position paper referred to in footnote 11 did not completely define the treatment of the "cumulative provision." This was clarified by one of the authors of the position paper, Robert Hampton III, in two letters dated July 3 and October 6, 1980.

**Exhibit 1. Single-Line Linkage to Constant Dollar Financial Statements
(Price Waterhouse Method)**

Income Statement			
	Year		
	1	2	3
Sales	\$40,000	\$66,000	\$96,000
Cost of goods sold	(30,000)	(46,500)	(64,500)
Interest expense	(6,000)	(4,000)	(2,000)
	4,000	15,500	29,500
Provision for current impact of inflation	1,143	2,405	9,605
Net income	<u>\$ 2,857</u>	<u>\$13,095</u>	<u>\$19,895</u>

Balance Sheet			
Assets	December 31, year		
	1	2	3
Cash	\$24,000	\$33,000	\$89,000
Inventory	60,000	46,500	-0-
Total assets	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>
Equities			
Loan payable	\$40,000	\$20,000	\$ -0-
Stockholders' equity			
Contributed capital	40,000	40,000	40,000
Cumulative provision	1,143	3,548	13,153
Retained earnings	2,857	15,952	35,847
Total stockholders' equity	44,000	59,500	89,000
Total equities	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>

the current impact of inflation. Although the impact appears as a single-line adjustment, its computation incorporates the total effect of general inflation on the various items.

3. As a result of 2, the amount of retained earnings available for distribution as dividends is reduced.

4. The invested capital of the entity increases, thus preserving the amount contributed by the owners in terms of its general purchasing power or more.

5. The prior preparation of a comprehensive set of financial statements in constant dollars before the amount of the current impact of inflation can be computed is necessary.

The Grady Method

Paul Grady has proposed a method that does not require the prior preparation of comprehensively restated constant dollar financial

statements.¹³ This method involves calculation of the adjustment to net income, called the "loss from general inflation," based on the decline in the purchasing power of the beginning-of-year owners' equity.¹⁴ The loss is accumulated, year by year, in an account in the stockholders' equity section called "inflation adjustment" which is treated as a part of the invested capital of the entity.

Exhibit 2 contains the financial statements prepared under this method. Here, the first-year loss from general inflation is equal to the initial capital of \$40,000 times the relative change in the general price level, $(110 - 100)/100$ during the year. In subsequent years, the loss from inflation is computed with reference to the beginning-of-year owners' equity, that is, \$44,000 in Year Two, and the relative change in the general price level, that is, $(124 - 110)/110$ in Year Two.

Like the Price Waterhouse method, the Grady method involves reporting the various financial statement items at historical cost. The loss from general inflation is based, however, on the beginning balance of the owners' equity and thus does not require comprehensively restated statements. This leads to differences between the two methods in the amounts of income and retained earnings. Furthermore, the amount of invested capital may also differ although, in both cases, the amount contributed by owners is preserved in terms of its general purchasing power or more.

The Agrawal Method

Agrawal's proposed method is similar to the Grady method but substitutes a unique company price index for the general price index.¹⁵ The company index is a weighted average of the specific price changes of the various expenditures which are required for the company's operations.

Exhibit 3 illustrates the use of this method. Since the company in the illustration purchases only inventory, the company index is computed

¹³ Paul Grady, "Purchasing Power Accounting," *Price Waterhouse Review*, vol. 20, no. 3 (1975): 2-5. A method similar to this has been used by Chambers, but in conjunction with exit values rather than historical costs; see Raymond J. Chambers, "NOD, COG, and PuPU: See How Inflation Teases," *Journal of Accountancy* (September 1975): 63-73, and other works.

¹⁴ This method has been described in more detail in Surendra P. Agrawal, "Accounting for Inflation," *Commonwealth Conference of Accountants* (Proceedings) (The Institute of Chartered Accountants of India, 1975), pp. 20-27. An earlier exposition of a similar method may also be found in S. P. Agrawal and A. S. Raj, "Accounting for Inflation," *Chartered Accountant* (March 1968): 479-84.

¹⁵ Surendra P. Agrawal, "Accounting for the Impact of Inflation on a Business Enterprise," *Accounting Review* (October 1977): 789-809.

**Exhibit 2. Single-Line Common Dollar Direct Capital
Adjustment Financial Statements
(Grady Method)**

Income Statement			
	Year		
	1	2	3
Sales	\$40,000	\$66,000	\$96,000
Cost of goods sold	(30,000)	(46,500)	(64,500)
Interest expense	(6,000)	(4,000)	(2,000)
	<u>4,000</u>	<u>15,500</u>	<u>29,500</u>
Loss from inflation	4,000 ^a	5,600 ^b	2,879 ^c
Net income	<u>\$ -0-</u>	<u>\$ 9,900</u>	<u>\$26,621</u>

Balance Sheet			
	December 31, year		
	1	2	3
Assets			
Cash	\$24,000	\$33,000	\$89,000
Inventory	60,000	46,500	-0-
Total assets	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>
Equities			
Loan payable	\$40,000	\$20,000	\$ -0-
Stockholders' equity			
Contributed capital	40,000	40,000	40,000
Inflation adjustment	4,000	9,600	12,479
Retained earnings	-0-	9,900	36,521
Total stockholders' equity	<u>\$44,000</u>	<u>\$59,500</u>	<u>\$89,000</u>
Total equities	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>

^a $40,000 \times 110 - 100/100$

^b $44,000 \times 124 - 110/110$

^c $59,500 \times 130 - 124/124$

on the basis of the prices of inventory only, which are assumed to be as follows:

	Year		
	1	2	3
January 1	100.0	112.5	121.5
December 31	112.5	121.5	134.9

The first-year loss from inflation is equal to the initial capital of \$40,000 times the relative change in the company price index, $(112.5 - 100.0)/112.5$ over the year. In subsequent years, the loss from inflation is computed with reference to the beginning-of-year owners' equity, \$44,000 in Year Two, times the relative change in the company price index, $(121.5 - 112.5)/112.5$ in Year Two.

**Exhibit 3. Single-Line Current Cost Direct Capital
Adjustment Financial Statements
(Agrawal Method)**

Income Statement			
	Year		
	1	2	3
Sales	\$40,000	\$66,000	\$96,000
Cost of goods sold	(30,000)	(46,500)	(64,500)
Interest expense	(6,000)	(4,000)	(2,000)
	4,000	15,500	29,500
Loss from inflation	5,000 ^a	3,250 ^b	6,562 ^c
Net income	<u>(\$ 1,000)</u>	<u>\$11,980</u>	<u>\$22,938</u>

Balance Sheet			
	December 31, year		
	1	2	3
Assets			
Cash	\$24,000	\$33,000	\$89,000
Inventory	60,000	46,500	-0-
Total assets	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>
Equities			
Loan payable	\$40,000	\$20,000	\$ -0-
Stockholders' equity			
Contributed capital	40,000	40,000	40,000
Inflation adjustment	5,000	8,520	15,082
Retained earnings	(1,000)	10,980	33,918
Total stockholders' equity	<u>44,000</u>	<u>59,500</u>	<u>89,000</u>
Total equities	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>

^a $40,000 \times 110 - 112.5/100$

^b $44,000 \times 121.5 - 112.5/112.5$

^c $59,500 \times 134.9 - 121.5/121.5$

Because of the use of the company-specific price index rather than a general price index, this method results in the reduction in the amounts of net income and retained earnings by different amounts from those under the Grady method. The capital is preserved in terms of the capability of the company to acquire similar assets (that is, physical capital) or more.

AN EVALUATION OF THE THREE METHODS

The major advantage of these methods seems to be their simplicity and understandability. The basis of valuation of the various items in the financial statements continues to be historical cost with which a vast majority of users are quite familiar. Moreover, since the one-line items

added to the statements accumulate the overall impact of inflation rather than reporting it in several categories, they are perhaps easier to explain and understand. Furthermore, because of the use of historical cost as the basis of valuation, the statements prepared under these methods may be perceived as more objective than comprehensively revised statements (particularly those utilizing current costs).

It may be useful to explore further the economic substance behind the one-line adjustments made to income. Whether such adjustments are actually "losses" (that is, reductions in net assets) is debatable. In the Price Waterhouse method, the one-line adjustment to income, called provision for current impact of inflation, represents a summary of the modifications to various revenues and expenses and the gain or loss from holding monetary assets and liabilities, as is illustrated on page 162. Although some have argued that the gains or losses from holding monetary items are real declines in the purchasing power of the company's net assets, the modifications of revenues and expenses are merely differences between the historical cost and constant dollar amounts and do not seem to represent such declines. Furthermore, the loss from inflation under the Grady or Agrawal methods cannot be interpreted as a loss, in the sense of a reduction in net assets; it can only be understood as an additional recovery of cost required to maintain the capital of the company in accordance with the particular capital maintenance concept utilized and to leave the company as well off at the end of a period as it was at the beginning. Consequently, it seems desirable to view the one-line adjustments under all three methods as items necessary to restate income to an inflation-adjusted amount, rather than as losses.

The three methods are now analyzed and evaluated in terms of the criteria developed earlier.

Capital Maintenance

Both the Price Waterhouse and Grady methods preserve the amount contributed by the owners in terms of its general purchasing power or more. Thus both methods attempt to maintain financial capital in constant dollars. The actual maintenance, however, may be somewhat more than the required amount as is illustrated here for the earlier example:

Invested capital at the end of year 3

Price Waterhouse method

$$\$40,000 + \$13,153 = \$53,153$$

Grady method

$$\$40,000 + \$12,479 = \$52,479$$

Amount of initial capital in constant

dollars

$$\$40,000 \times 130/100 = \$52,000$$

The excess over the constant dollar figure is caused by the existence of retained earnings. If the entire income as computed under the two methods had been distributed as dividends at the end of each year, the invested capital at the end of Year Three under both methods would have amounted to \$52,000, thereby maintaining capital in terms of general purchasing power. The comprehensive historical cost/constant dollar financial statements do preserve this amount exactly since invested capital is \$52,000 at the end of Year Three, as is shown in the appendix. The Price Waterhouse and Grady methods are, however, more conservative than constant-dollar accounting when an entity re-invests retained earnings in its operations in that they lead to the maintenance of a larger amount of capital.

The Agrawal method attempts to achieve the physical capital maintenance concept. Exhibit 3 shows that under this method, the invested capital at the end of the third year is \$55,082, while the amount directly computed under the concept is $\$40,000 \times 134.0/110 = \$53,960$. Again, the excess is due to the existence of retained earnings, and, in their absence, the invested capital under this method would equal the calculated figure.

The three methods may be modified so that they maintain only the original invested capital in terms of its general purchasing power or operating capability. These modifications may be achieved as follows:

1. Under the Price Waterhouse method, the amount of retained earnings may be forced to equal the amount of the retained earnings appearing in the comprehensive general price-level balance sheet. This would require a transfer from the provision for cumulative impact of inflation to retained earnings each year.
2. Under the Grady and Agrawal methods, the calculation of the loss from inflation might be based on the total of the original capital and inflation adjustment rather than total owners' equity.

Periodic Earnings

Exhibit 4 shows the association between the rate of inflation, as measured by the percentage change in the respective price index, and the reduction in income under the three methods. The table indicates that the reduction in income under the Price Waterhouse method is strongly but negatively related to the percentage change in the general price index. In the third year, when the rate of inflation is lowest, the reduction in income is highest, while in the second year when the inflation rate is highest, the reduction in income is lowest. Thus, this method does not seem to meet the second criterion developed earlier.

**Exhibit 4. Association of Percentage Change in Price Indexes
with Reduction in Income for Three
Single-Line Inflation Methods**

Year	Percentage change in general price index	Reduction in income		Percentage change in company price index	Reduction in income — Agrawal method
		Price Waterhouse method	Grady method		
1	10	\$1,143	\$4,000	12.5	\$5,000
2	13	2,405	5,600	8.0	3,250
3	5	9,605	2,879	11.0	6,562

Exhibit 4 also indicates that the associations are positive for both the Grady and Agrawal methods. In the third year, when the percentage change in the general price index is lowest, the Grady method's reduction in income is also lowest, while in the second year when the inflation rate is highest, the reduction in income is also highest. Although the association between the percentage change in the company price index and the reduction in income under the Agrawal method is positive, it is not so strong as that under the Grady method. In the second year, when the inflation rate is lowest, the reduction in income is also lowest, while in the first year when the inflation rate is highest, the reduction in income is high but not the highest. Thus, both methods appear to meet this criterion to a large extent.

This evaluation underscores the basic differences among the three methods. But before firm, generalized conclusions can be reached, this subject needs to be studied further in at least three areas:

1. The particular capital maintenance concept that should be strived for under inflationary conditions, namely, financial capital in constant dollars or physical capital.
2. The appropriateness of the criteria used for evaluation.
3. Whether the positive and negative associations found in exhibit 4 are replicated with other examples and in other situations.

In view of their simplicity and effectiveness, these methods deserve serious consideration, particularly in those countries and for those business entities for which highly complex inflation adjustment methods may not be feasible or desirable. Furthermore, in periods of low-level, creeping inflation, a simplified method would be less costly to implement and therefore more attractive to company management.

APPENDIX. TRANSACTION DATA

	Year		
	1	2	3
Equity investment — Jan. 1	\$40,000		
Borrow (10% interest) Jan. 1	60,000		
Purchase inventory, June 30 of respective year	3,000 @ \$30 = \$90,000	1,000 @ \$33 = \$33,000	500 @ \$36 = \$18,000
Sell inventory, June 30 of respective year	1,000 @ \$40 = \$40,000	1,500 @ \$44 = \$66,000	2,000 @ \$48 = \$96,000
Repay loan — Dec. 31 of respective year	20,000	20,000	20,000
General price indexes			
January 1	100	110	124
June 30	105	117	127
December 31	110	124	130

Weighted average inventory method used.

Historical Cost Financial Statements

Income Statement

	Year		
	1	2	3
Sales	\$40,000	\$66,000	\$96,000
Cost of goods sold	(30,000)	(46,500)	(64,500)
Interest expense	(6,000)	(4,000)	(2,000)
Net income	<u>\$ 4,000</u>	<u>\$15,500</u>	<u>\$29,500</u>

Balance Sheet

	December 31, year		
	1	2	3
Assets			
Cash	\$24,000	\$33,000	\$89,000
Inventory	60,000	46,500	-0-
Total assets	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>
Equities			
Loan payable	\$40,000	\$20,000	\$ -0-
Stockholders' equity			
Contributed capital	40,000	40,000	40,000
Retained earnings	4,000	19,500	49,000
Total stockholders' equity	<u>44,000</u>	<u>59,500</u>	<u>89,000</u>
Total equities	<u>\$84,000</u>	<u>\$79,500</u>	<u>\$89,000</u>

Historical Cost/Constant Dollar Financial Statements
(Stated in Constant Dollars as of Respective Year-end)

Income Statement

	Year		
	1	2	3
Sales	\$41,905	\$69,949	\$98,268
Cost of goods sold	(31,429)	(52,916)	(73,902)
Interest expense	(6,000)	(4,000)	(2,000)
	<u>4,476</u>	<u>13,033</u>	<u>22,366</u>
Loss from holding cash	(7,619)	(5,029)	(3,439)
Gain from holding debt	<u>6,000</u>	<u>5,091</u>	<u>968</u>
Net income	<u><u>\$ 2,857</u></u>	<u><u>\$13,095</u></u>	<u><u>\$19,895</u></u>

Balance Sheet

	December 31, year		
	1	2	3
Assets			
Cash	\$24,000	\$33,000	\$89,000
Inventory	<u>62,857</u>	<u>52,916</u>	<u>-0-</u>
Total assets	<u><u>\$86,857</u></u>	<u><u>\$85,916</u></u>	<u><u>\$89,000</u></u>
Equities			
Loan payable	<u>\$40,000</u>	<u>\$20,000</u>	<u>\$ -0-</u>
Stockholders' equity			
Contributed capital	44,000	49,600	52,000
Retained earnings	<u>2,857</u>	<u>16,316</u>	<u>37,000</u>
Total stockholders' equity	<u><u>46,857</u></u>	<u><u>65,916</u></u>	<u><u>89,000</u></u>
Total equities	<u><u>\$86,857</u></u>	<u><u>\$85,916</u></u>	<u><u>\$89,000</u></u>

INSTRUCTIONS TO AUTHORS

All manuscripts submitted for consideration should be typed on 8½ x 11" paper and should be double-spaced throughout, including synopsis, footnotes, and bibliography. At least two copies should be submitted for review. Margins should be appropriately wide to facilitate editing. The title of the paper, the author's name, rank, and affiliation, and any acknowledgments should appear on the first page of the body of the manuscript. All pages, as well as bibliography, exhibits, and appendices, should be serially numbered. The beginning of each paragraph should be indented. Footnotes may be placed either at the bottom of the appropriate page, or on a separate page. Each manuscript should be accompanied by a brief synopsis of the article explaining its international significance.

HEADINGS

All major headings within the manuscript should be in capital letters. They should not be numbered. Subheadings should be in capital and lower case letters on a separate line beginning at the left margin. If third-level headings are used, they should begin at the left margin and should end with a period. The text will follow on the same line immediately.

EXHIBITS

Each exhibit should be titled and numbered. A textual reference should be made to each exhibit. It would be helpful if the author would indicate by marginal notation where each exhibit should be placed. These instructions will be followed as printing practices allow.

FOOTNOTES

Footnotes should be numbered consecutively throughout the manuscript with superscript arabic numerals. Citations should not be made in brackets in the text. Mathematical symbols should not have footnote numbers attached. Entries for books should include author's name, title of the work underlined, and, in parentheses, place of publication, name of publisher, and date of publication. For journals, author's name, title of article within quotation marks, title of journal underlined, date of issue in parentheses, and page numbers should be included. Please see the following examples.

¹ William A. Dymsha, Multinational Business Strategy (New York: McGraw-Hill, 1972), pp. 49-53.

² Geoffrey Holmes, "Replacement Value Accounting," Accountancy (March 1972): 4-8.

BIBLIOGRAPHY

Manuscripts may include a bibliography at the end of the paper. If so, such references are not to be limited to those references cited in the text. Each entry should contain all data necessary for identification. Citations should be arranged in alphabetical order necessary for identification. Multiple works by

the same author should be listed according to chronological order of publication. Examples are listed below.

Robert L. Aliber and Clyde P. Stickney. "Accounting Measures of Foreign Exchange Exposure—The Long and Short of It." Accounting Review, January 1975, pp. 44-57.

American Institute of Certified Public Accountants. Accounting Research Bulletin No. 43. New York: AICPA, 1953.

———. "Financial Statements Restated for General Price Level Changes." Statement of the Accounting Principles Board No. 3. New York: AICPA, 1969.

Leonard Lorensen and Paul Rosenfield. "Management Information and Foreign Inflation." Journal of Accountancy, December 1974, pp. 98-102.

Lawrence Revsine. Replacement Cost Accounting. Englewood Cliffs, N.J.: Prentice-Hall. 1973.

MATHEMATICAL NOTATION

Mathematical notation should be stated as simply as possible so as to simplify typesetting. Alignment should clearly indicate superscripts and subscripts. Equations which are numbered should have the numbers in parentheses flush with the left-hand margin.