

American Institute of Accountants

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THE NATIONAL ORGANIZATION OF CERTIFIED PUBLIC ACCOUNTANTS

13 EAST 41ST STREET, NEW YORK 17, N. Y.

TO THE MEMBERS OF THE
AMERICAN INSTITUTE OF ACCOUNTANTS:

September 25, 1947

Gentlemen:

The committee on accounting procedure held its quarterly meeting in New York on September 23 and 24, 1947. Among the problems considered were depreciation on replacement values and charges to income for excessive construction and replacement costs. After extended discussion the committee concluded that an immediate statement of its views might be helpful to the profession when called upon to deal with these two problems in the preparation and examination of year-end financial statements. Accordingly, without waiting to take the time necessary to prepare a formal bulletin on the subject, such a statement was prepared for immediate release to newspapers and distribution to the membership.

The statement of the committee is as follows:

"The American Institute of Accountants committee on accounting procedure has given extensive consideration to the problem of making adequate provision for the replacement of plant facilities in view of recent sharp increases in the price level. The problem requires consideration of charges against current income for depreciation of facilities acquired at lower price levels.

"The committee recognizes that business management has the responsibility of providing for replacement of plant and machinery. It also recognizes that, in reporting profits today, the cost of material and labor is reflected in terms of 'inflated' dollars while the cost of productive facilities in which capital was invested at a lower price level is reflected in terms of dollars whose purchasing power was much greater. There is no doubt that in considering depreciation in connection with product costs, prices, and business policies, management must take into consideration the probability that plant and machinery will have to be replaced at costs much greater than those of the facilities now in use.

"When there are gross discrepancies between the cost and current values of productive facilities, the committee believes that it is entirely proper for management to make annual appropriations of net income or surplus in contemplation of replacement of such facilities at higher price levels.

"It has been suggested in some quarters that the problem be met by increasing depreciation charges against current income. The committee does not believe that this is a satisfactory solution at this time. It believes that accounting and financial reporting for general use will best serve their purposes by adhering to the generally accepted concept of depreciation on cost, at least until the dollar is stabilized at some level. An attempt to recognize current prices in providing depreciation, to be consistent, would require the serious step of formally recording

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appraised current values for all properties, and continuous and consistent depreciation charges based on the new values. Without such formal steps, there would be no objective standard by which to judge the propriety of the amounts of depreciation charges against current income, and the significance of recorded amounts of profit might be seriously impaired.

"It would not increase the usefulness of reported corporate income figures if some companies charged depreciation on appraised values while others adhered to cost. The committee believes, therefore, that consideration of radical changes in accepted accounting procedure should not be undertaken, at least until a stable price level would make it practicable for business as a whole to make the change at the same time.

"The committee disapproves immediate write-downs of plant cost by charges against current income in amounts believed to represent excessive or abnormal costs occasioned by current price levels. However, the committee calls attention to the fact that plants expected to have less than normal useful life can properly be depreciated on a systematic basis related to economic usefulness."

Very truly yours,

CARMAN G. BLOUGH,
Director of Research