

Accounting TERMINOLOGY BULLETINS

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Prepared by
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Book Value

1. The term *book value* is one of several widely used expressions in which the word *value* appears with a particular qualifying adjective to denote a particular concept of value. *Book value* is to be distinguished from such terms as fair or market value or liquidating value, in that it refers to amounts reflected on accounting records and in financial statements.

2. The term *book value* is seldom if ever used in the body of financial statements, either as an indication of the basis of stating an item therein or in connection with owners' equities. To do so would involve a pointless truism and such use is therefore not recommended.

INDIVIDUAL ITEMS

3. In Accounting Terminology Bulletin No. 1, the term *value* is defined as follows:

Value as used in accounts signifies the amount at which an item is stated, in accordance with the accounting principles related to that item. Using the word *value* in this sense, it may be said that balance-sheet values generally represent cost to the accounting unit or some modification thereof; but sometimes they are determined in other ways, as for instance on the basis of market values or cost of replacement, in which cases the basis should be indicated in financial statements.

4. This use of the word value does not involve the concept of current worth, but rather refers to a particular method of quantitative determination.

5. The following slight rephrasing of the first sentence of the definition quoted in paragraph 3 above gives the clue to the meaning which some have adopted for book value as applied to individual items in books of account or in financial statements:

Book value signifies the amount at which an item is stated in accordance with the accounting principles related to the item.

6. Thus one might refer to the "book value" or "net book value" of fixed assets, or the "book value of investments." More specific terms, however, can be used in describing the kind of value at which individual items are stated; as, for example, *cost less depreciation*, *lower of cost or current replacement cost*, or *lower of cost or selling price*. Similarly the term *ledger balance* or a term such as *the amount shown in published financial statements* would more clearly and accurately convey an exact meaning. The committee believes that any reference to a quantitative determination of a specific item can be more clearly and specifically described by terms other than the general and relatively vague term *book value*.

7. **Recommendation:** The committee recommends that the use of the term *book value* in referring to amounts at which individual items are stated in books of account or in financial statements, be avoided, and that, instead, the basis of amounts intended to apply to individual items be described specifically and precisely.

OWNERS' EQUITY

8. The committee recognizes that the term *book value* is also used in various business arrangements such as partnership agreements, contracts for sale of a business interest, and wills and trusts. For example, partnership agreements sometimes contain a provision

that a deceased partner's interest may be acquired by surviving partners for an amount which is based at least in part on the "book value" of the interest. Contracts for the sale of going business concerns sometimes specify a price based on the "book value" of either the capital stock or the net assets. When used in such documents, the meaning to be ascribed to the term is a question of legal interpretation of the document and appears to depend primarily on the intent of the contracting or other parties rather than on any accounting definition of such term. While such uses of the term are common, they have given rise to misunderstandings and can easily develop into controversies when the intention of the parties is not clear. One typical difficulty arises when there is a change in circumstances between the time when an agreement regarding "book value" was reached and the time when that agreement must be interpreted. For example, a change from the *Fifo* to *Lifo* inventory basis between those two dates would affect the equities involved. Similar situations would arise with respect to any changes in accounting policies or from business combinations, divisive reorganizations, and other comparable events. Even in the absence of such changes, questions arise as to whether "book value" was intended to mean literally amounts shown on ledger accounts or amounts so shown after correction for (a) errors, (b) departures from consistently maintained practices of the enterprise, (c) departures from established practices of the type of organization, or (d) departures from generally accepted accounting principles, or any combination of such corrections.

9. When the intent of the parties is not clear as to the use of the term *book value* in reference to owners' equity, the committee suggests the following definition:

Book value is the amount shown on accounting records or related financial statements at or as of the date when the determination is made, after adjustments necessary to reflect (1) corrections of errors, and (2) the application of accounting practices which have been consistently followed.

10. **Recommendation:** In view of the fact that the intent of the parties to arrangements involving sale or transfer of business interests should govern, and the foregoing definition may not reflect such intent, the committee recommends that the term *book value* be avoided. Instead of this term it is recommended that any agreement involving the general concept of book value should contain a clearly defined understanding in specific and detailed terms, particularly as to such matters as are referred to in paragraph 8 of this bulletin.

COMMITTEE ON TERMINOLOGY (1955-1956)

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