

SEP 24 1974

Mr. Newton N. Minow  
Sidley & Austin  
1730 Pennsylvania Ave., N.W.  
Washington, D.C. 20006

Dear Mr. Minow:

Thank you for your letter of September 23 and for sending me a copy of your letter to President Ford in which you advocate prompt action to deal with the effects of inflation on financial statements.

While I certainly concur that inflation reduces the significance of financial statements based on historical dollar cost, it is not clear to me that such accounting practices are actually fueling inflation as you suggest. In any event, it is essential that adequate information be provided to investors and other economic decision makers so that they can be informed of the impact of inflation on business entities. To this end, we issued last January a release calling attention to the problems inherent in the traditional accounting approach under conditions of rapidly increasing prices, and we urged companies to make disclosure of inventory profits. In addition, we have outstanding a proposed rule which would require disclosure of the impact on income of using current replacement cost to compute cost of goods sold. This proposal is in the process of being revised and will soon be re-exposed for comment. We believe that these are productive steps.

In your letter, you suggest that standards should be adopted without delay to require the presentation of price-level adjusted financial data, and you indicate that procedures to prepare such data have already been developed. It is true that techniques for mechanical adjustment of financial statements by the use of general price indices are well known to accountants, but it is by no means apparent that such mechanical adjustments are the most meaningful approach to providing useful data regarding the impact of inflation on the financial position and operating results of individual business firms. It would be a great mistake to uncritically embrace a mechanical technique simply because it is readily available without careful consideration of its costs and benefits and a review of alternative approaches that might be more promising. You may be interested in the enclosed paper prepared by the Commission's Chief Accountant on this subject.

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You can rest assured that both the Commission and the Financial Accounting Standards Board are deeply concerned with this subject and that we will be working together to arrive at answers which will ensure improved financial reporting under conditions of rapidly changing prices.

Sincerely,

Ray Garrett, Jr.  
Chairman

Enclosures

Accounting Series Release No. 151  
Paper on "Financial Reporting in an  
Age of Inflation"

cc: Marshall S. Armstrong, Chairman  
Financial Accounting Standards Board