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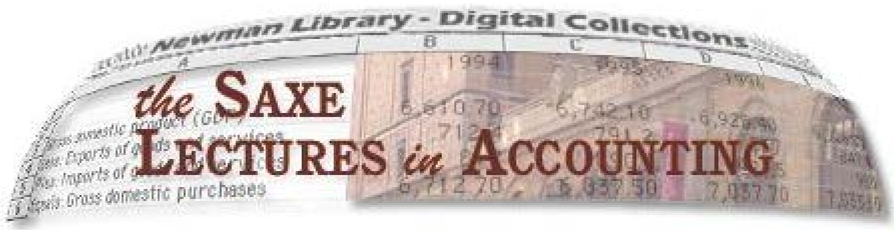

DISCLOSURE BEYOND ACCOUNTING DISCLOSURE : AN UNSATISFIED NEED

by
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[Introductory note: Homer Kripke (A.B. 1931, J.D. 1933, Univ. of Michigan) is Chester Rohrlich Professor of Corporate Law, Finance and Taxation and Director of the Securities Institute at New York University School of Law. He was formerly Assistant Solicitor of the United States Securities and Exchange Commission and Assistant General Counsel of C.I.T. Financial Corporation. He has practiced law in large and small law offices in New York, New Jersey, Illinois and Ohio.

Professor Kripke is a member of the Permanent Editorial Board of the Uniform Commercial Code. He was recently a member of the SEC's Advisory Committee on Corporate Disclosure. He was a Consultant to the American Law Institute's Federal Securities Code Project; a member of the American Bar Association's Committee on Federal Regulation of Securities, Professional Responsibility, Law and Accounting, and Uniform Commercial Code, and the Committee on Securities Regulation of the Association of the Bar of the City of New York. He was one of the Reporters for the Review Committee on Article 9 of the Uniform Commercial Code; a member of the Executive Committee of the National Bankruptcy Conference; a member of the Council of the Section on Corporation, Banking and Business Law of the American Bar Association; a member of the American Bar Foundation's Advisory Committee on the Corporate Debt Financing Project; a member of the Project Advisory Committee for the Goodwill Project of the American Institute of Certified Public Accountants; and a member of the Special Committee on Lawyers' Role in Securities Transactions of the Bar of the City of New York.

Professor Kripke has written widely in the field of securities, legal-accounting problems, Uniform Commercial Code and consumer credit. He is the author of a book on Consumer Credit, of the SEC and Corporate Disclosure, and with Professor Fiflis, of a book on Accounting for Business Lawyers (2d ed., 1977).]

My thesis tonight is going to be that the SEC's disclosure program and its foundation, the current accounting model, need a bolder, more penetrating theoretical structure, and my belief is that this can best come, and will come if from anywhere, from the academic accountants. The SEC's disclosure program has over forty-five years involved a tremendous amount of effort, much boasting by the SEC as to what it has accomplished, a vigorous enforcement program, a demand that everybody -- lawyers and accountants, both inside and outside, and Boards of Directors -- help the SEC in its enforcement program, and vast amounts of commentary from outsiders both favorable and unfavorable. Yet despite all of this there has been very little in the way of analysis as to what disclosure is supposed to accomplish, and how it is supposed to accomplish it.

Professor Alison G. Anderson, in the Hastings Law Journal of January, 1974, (1) pointed out that there have always been two themes and purposes running through the SEC's disclosure system. One is disclosure in order to prevent gross frauds in the sale of securities, and not much more. The other is the use of securities disclosure as an aid in making decisions to buy, sell or hold securities. Although the original intention was a little uncertain, unquestionably the SEC's rhetoric has tended more and more toward claiming the value of disclosure for securities decisions. The SEC undoubtedly had the right and power to steer it that way, because the Congressional mandate prescribed a list of topics of disclosure in a Schedule A to the Securities Act and left the SEC with very considerable flexibility. Yet despite this turn in the direction of disclosure for use in securities decisions, it seems to be literally, the fact that the SEC for most of its history never asked the questions: "How are securities decisions made? What factors enter into the decision to buy, sell, or hold securities?" One would think that the SEC would have tried to learn from persons who had the responsibility for making that kind of decision what their decisional process was. And yet the fact is, as an SEC top official said publicly in 1975.in a program in which I participated, they had never made the inquiry. For instance, they had never asked investors what their decisional process was or what information they called for or how they used the information that was available, and whether their thinking about the relevance and materiality of information coincided with what the SEC's thinking was as evidenced by the disclosures required in its forms. In my view the pinnacle of SEC arrogance and solipsistic thinking occurred in its Rule 146, adopted in about 1974, in which it prescribed the disclosure required to be received by the prospective investors in the case of private placements, even though it also required that the persons permitted to buy securities privately without the benefit of the SEC registration process should be people who were sophisticated, able to "fend for themselves," or if not able to fend for themselves, required to be aided by sophisticated offeree representatives. Even though it limited the potential buyers and offerees to these sophisticated persons, it nevertheless undertook itself to prescribe what the disclosure to them had to be, rather than permit them to decide what they wanted to know.

And yet the SEC's understanding of the decisional process was naive. Its first effort to find out what users wanted to get out of the disclosure process was the appointment early in 1976 of the Advisory Committee on Corporate Disclosure, on which I served. On the verge of that appointment, Ray Garrett, Jr. having just resigned as Chairman of the SEC and speaking with the new program in mind, stated his view of what the SEC's understanding of the disclosure process was; and I quote from Garrett's speech of January 14, 1976:

> "There is an implicit, fundamentalist Faith in the approach contained [in the Securities' Act forms]. Investors make investment decisions primarily by extrapolation from a company's past experience, accurately portrayed. I certainly do not know and I am reasonably confident that the Commission collectively does not know the extent to which this is statistically true."

Phrasing that in my own terms, Ray Garrett said that the Commission assumed that securities analysis consisted in an extrapolation of past earnings records of the company into the future, and on the basis of that, making estimates of securities values. He left unsaid the obvious -- that earnings were based on the accounting model founded on historical cost, and that the SEC was assuming that this accurately modelled the past experience of the issuer. Well, everybody but the SEC knew that that was not the securities decision process.

But the SEC, having assumed that the world resembled the accounting model and that the securities decision process was based squarely on it, depended almost entirely on accounting as the vehicle for corporate disclosure. If you examine an SEC registration statement or other disclosure document, there has been very little there apart from the accounting. There is a description of the business, usually insufficient for a person intending to make a serious study of the company. There is a description of the management, what their experience has been for five years, how old they are, and that sort of thing, insufficient for anyone to make a realistic determination of the quality and depth of management. Everyone knows that the only way you can find that out is by inquiry among the peers of the company and not by disclosure that you can realistically expect to come from the company itself.

Thus, realistically, disclosure depends upon accounting. But at the commencement of the SEC disclosure process in the early 1930's, accounting was like the earth at the Creation, as described in the first chapter of Genesis, "without form and void, and darkness hovered over the face of the waters."

Under those circumstances the SEC's most fundamental task, in my opinion, was to take accounting, the only then available structure of information for securities decisions, and help to shape it to be useful for investors. This, by the way, is not a completely obvious proposition because we have only recently reached a consensus, after the Trueblood Report, that the purpose of financial accounting is to enable investors to make securities decisions. The Institute of Chartered Accountants in England and Wales had long insisted that that was not the purpose of accounting; and many American accountants, including Mr, Murphy, the Chairman of General Motors who had been its Controller, in a program that Sandy Burton reported, continued to argue that the purpose of accounting was as a report on stewardship to existing investors, and not to furnish information for securities decisions.

At any rate, instead of taking leadership in developing accounting for this purpose, as it did for the legal aspects of disclosure, the SEC turned the matter over to the practicing accountants, with an understanding dating from 1937, that is the basis of SEC Accounting Release #4, that if the accountants would just get on with the job of unifying accounting and deciding on accounting principles, the SEC would let them take the lead. I have a great respect for the public accounting profession, but if one segment of the financial community was to get that job, it obviously should have been the users, not the preparers or certifying accountants. But in 1937 our present professionalism in securities selection did not exist, and only recently has its full extent been recognized. The practicing accounting profession is handicapped in the development of principles useful for securities decisions by the fact that the SEC keeps them under constraints by the constant threat of liability. There certainly are inglorious pages in the history of the public accounting profession's performance of its duties under the Securities Acts, and yet there is an area of inadvertent or negligent failure to comply with accounting or auditing standards, that does not deserve the kind of pressure that the SEC exerts.

A then standard accounting text, Gilman, *Accounting Concepts of Profit* (1939), accepted as a fact that accounting represented a series of expedient choices and that the result is net income, and defended it on that basis. In 1940, in their famous book, *Introduction to Corporate Accounting Standards*, Professors Paton and Littleton sought to put a theory underneath the practice of accounting, namely, that the accountant's process is to match costs and revenues. Some critics do not take that as an acceptable formulation of a principle and argue that matching is not a theory, but merely describes a process. It doesn't make accounting *mean* anything more definable than the result of the process as shaped by the realization rules.

But one thing that matching seemingly does is to provide an apparent theoretical justification for another development which was occurring during the same period, the fastening of the concept of historical cost on the accounting process. If one goes back prior to the SEC and into the 1920's, one can find that accounting was not based strictly on historical cost, or on the concept of matching with paramount emphasis on the income account. There were many examples of accounting, in the early decades of this century, in which income appeared as the difference between the net worths shown on successive balance sheets, without a primacy of the income statement, and sometimes even without the publication of such a statement. It was not at all clear how the balance sheets were constructed. In many cases the net worth computation depended on a valuation of the assets, rather than historical cost. But when Paton and Littleton said that accounting is a process of matching costs and revenues, the accountants seized on the word "costs" and said "costs" mean historical costs, and therefore that accounting is the process of matching historical costs to revenues. But one can accept the concept of matching as a description of what accountants do, without necessarily having to accept the theme that "costs" mean "historical costs." If one studies Professor Paton's writings, which range way back to 1920, and when I studied under him in 1929, and way up almost into the 1970's, you find a fluctuation in his concept of "costs" in the matching process. Originally I think he meant value. Then in his book he asserted firmly that costs meant historical costs. Later, after World War II, when he saw the inflation, he redefined his process of matching and said that costs meant current costs or values. It's easy enough to make that change. The American Accounting Association once pointed out that the process of matching can use "costs" to mean opportunity costs, which are of course one attribute of value. Thus the matching process need not nail accounting to historical cost. But it served to do so. It was an expedient argument for doing so, since there were other reasons for wanting to do so in the 1930's and 1940's. The 1920's had been marked by alleged accounting abuses, centering on values written up, and unfounded appraisals as the basis of securities issues. I'm old enough to have read many securities issue files of the 1920's in connection with the reorganization process in the 1930's, when those messes were cleaned up. And then in the 1930s we had the converse: corporations were writing assets down below historical cost, as a form of alleged conservatism but as a means of getting rid of exhaustion charges and thus bolstering their income accounts.

Thus we had several contributing factors -- the abuse of value accounting both in the 1920's and the 1930's; the SEC's anxious desire for objectivity, so its staff would have objective standards by which to examine the filings; and the accountants' anxiety for objectivity so that they too could turn their backs on abusive practices associated with valuations and conform to firm standards and avoid the liability which has been a potential of the securities enforcement process.

All of these circumstances served to carry accounting into the early 1970's with no unifying theory or vision and no penetrating search for one in the practicing profession or the SEC. The AICPA's Committee on Accounting Procedure published the ARB's and its Accounting Principles Board (APB) published its Opinions, but they developed no theory: they merely put out fires. The APB rejected proposals of Professors Moonitz & Sprouse to move toward a theory based on value and away from historical costs. The organization of the academic accountants, the American Accounting Association, published statements of unified theory in 1936 and 1966, and a number of committee reports moving toward a value basis of accounting in 1964 and 1965, but the practicing profession and the SEC paid little or no attention.

So where did we end up? One way to find the answer is to read closely between the lines of APB Statement #4, which was the first official formulation of the principles of accounting that received a large measure of assent. It is written skillfully, and it seems to present a logical picture; but actually, when one reads carefully between the lines, what it says is, that sometimes accountants do this and sometimes they do the opposite. The choices are motivated by expediency and objectivity or other reasons, and when one gets done with this heterogeneous process, the bottom line is called 'net income'. Net income thus has no other meaning than the bottom line of this series of expedient choices. We also ended up with a demand for something better than APB and its products, and that led to the FASB, which began functioning in 1973, vigorously supported by the SEC. To its credit it should be said that the FASB has made a stab at the cost or value issue, the central question of accounting and is working diligently on a Conceptual Framework of accounting. Just by the tasks it poses for itself, the FASB is a substantial step ahead. But let's take a look at FASB's Conceptual Framework and its other positions to date. Fundamentally, I think the FASB shows indication of being very conservative and, above all, cautious. It has avoided taking a position on cost against value and I doubt that many would believe that the present period of experimenting with both forms of inflation adjustment will lead to resolution very soon. Meanwhile, FAS No. 8 on Translation of Foreign Currency and No. 12 on Marketable Securities contain indefensible provisions caused by inflexible adherence to historical costs. There is no justification for this inflexibility, since accounting has long permitted upward departures from original cost in other cases of sure marketability as diverse precious metals and packinghouse products.

Now I'd like to pick up an old controversy by going back to Harvey Kapnick's lecture in this Series about three years ago, when he disapproved the SEC's Accounting Series Release 190, which required replacement cost disclosure, and promoted his own program for value accounting. My very good friend Professor Abraham Briloff responded in a fury and argued that approaches to value accounting were nothing but a devise of the Establishment, the corporations, to obtain bigger depreciation allowances for tax purposes and thus save taxes. Since the government is going to need the same amount of money to run itself, in Briloff's view this would mean that more of the cost of government would be thrown on the individual taxpayers. Professor Briloff moved me greatly with that argument, but the more one thinks about it, the more one relaizes that his objection is not really fundamental. If we move to value accounting and the bottom line of corporate financial reporting and tax returns becomes very different from what it is, the result must be that we will have a complete reconstitution of our income tax structure. Political decisions -- not mathematical decisions, but political decisions -- will be made as to the extent to which different elements of the community bear the impact of taxes. I myself would resist the attempt to use value accounting as an excuse for shifting the overall burden of taxation, but I would not want a fair-minded consideration of "the central question of accounting" to be prejudiced by the fear of a capitalist coup.

It seems apparent that the FASB is not going to use its conceptual framework for consideration of fundamentals. So far, the framework is occupied with definitions and qualitative characteristics. Many people have questioned, and I certainly question, whether FASB is going to get anywhere struggling with the definitions and hoping that principles will now from the definitions. There's a beautiful article by Dopuch and Sunder in the *Accounting Review* of January, 1980,(2) analyzing whether the FASB's statements on the objectives and elements of accounting show any promise of enabling people to make selections of accounting principles from all of this structural theory. And their conclusion is that the definitional structure shows very little promise of being helpful in reaching decisions. Beyond this, the conservative approach is shown by recent decisions of the FASB. They have limited their treatment of value to supplementary information, even though they recognize that in this inflationary period, we must have some approach to value accounting. They have refused to be venturesome in recognizing a cost of equity, while producing in FAS 34 astonishing complexities for mandatory interest during construction, frequently with counter-intuitive results.

To summarize, it seems to me that the FASB is starting down a path which may be largely sterile, and the SEC does not have the will to force basic change. The only persons with a more realistic approach to what the accounting process could be are the academic accountants.

As early as 1961, Professor David Solomons made a "guess" that "the next twenty-five years may subsequently be seen to have been the twilight of income measurement." The stubborn truth that value is the present worth of expected future net *cash flow* demands careful study of the entire structure of accrual accounting. The FASB passes over the point, on the basis that accrual accounting records events that have or will have cash flow consequences, and is a better predictor of future cash flow than would be a straight cash flow presentation. This formulation raises large questions as to the function, in accrual accounting supposedly useful for securities decisions, of depreciation charges and amortization of intangibles. Dr. John C. Burton, when he was the SEC's accounting spokesman, said that accrual accounting is an averaging process showing the cash generating ability of the enterprise. But this formulation highlights the grievous insufficiency of present day accrual accounting in the recognition of the time value of money. In today's world when we have had 20% interest rates, the time value of money is pretty important, as we have all discovered. And yet these averaging processes deliberately obscure the time periods in which cash consequences are going to occur. Accounting was very late in recognizing the time value of money, and perhaps the first occasion in which it consciously did so was APB Opinion, #21 on the valuation of receivables and payables, only a few years ago. Much of the gain in that opinion, I think, was largely lost with FAS #15 on Troubled Debt Restructurings, which in effect says that if you succeed in collecting your principal, even 50 years from now, you haven't suffered a loss although you will have had no earnings or little earning on your investment tied up during that period.

It's hard to see that that gives any recognition to the time value of money. Accounting still does not in actual practice give any effect to time value considerations in the depreciation process. We have straight line and accelerated depreciation methods. We have very few depreciation methods in use on sinking fund or annuity methods which recognize the time value of money. The interesting thing about it all to me, as a lawyer, is that in another branch of accounting, in management accounting, (capital budgeting) accounting does recognize very firmly the time value of money and almost ignores the whole structure of accrual accounting in trying to determine the potential profitability of an investment opportunity by ignoring accrual thinking and looking solely to the extent and timing of cash flows.

There is a need here for some fundamental thinking. It is not coming and will not come from FASB, SEC, AICPA, the Financial Executives, or their several constituencies. Their interlocking pressures for conservative adherence to conventional thinking need not apply to academic accountants, and I hope that the academics will turn to these questions.

Academic accountants have already played a leading role in empirical research on the use of accounting numbers in securities decisions, and the effect of change in accounting methods on securities prices. There is still need for a broader understanding of the securities selection process. How does the analyst go from the SEC document to the securities decision? You can find a great deal of discussion in the *Financial Analysts Journal* and the *Journal of Portfolio Management*, and elsewhere, about the analysis' analytic processes. But you'd find it surprisingly difficult, as I did when I used to run an interdisciplinary forum at New York University Law School, to set up a program with some leading securities analysts to talk about their processes of going from historical cost accounting statements to the securities decision. I found no one willing to talk about his process. I don't know whether they were afraid to show that the process was ultimately intuitive, I think the process is a subtle one based on an unarticulated process of considerable complexity.

That brings us to a question how far uniform, inflexible requirements for disclosure by the SEC can contribute to this subtle process of determining the worth of a security.

In the first place, the SEC disclosure process as a practical matter can call for disclosure only about the company itself. It would be unreasonable to require the company to make disclosure and projections about the future of the economy as a whole, or even of its own industry, because the company itself has no unique knowledge or ability to understand the world better than anyone else. I don't suggest at all that the company should make projections about the macroeconomic setting of the company's future operations. Yet it is impossible to extrapolate from the company's own history into the future without taking into account the macroeconomic setting. Is there some connection between the company and the macroeconomic setting that could be usefully put into disclosure documents? The first thing we know is that every security price is geared to market price performance. There are measurements; of the history of that relationship for each security, known as the beta coefficient, and there is a tremendous economic literature on it in which the academic accountants have fully participated. There are articles pointing out how the betas are affected by changes within the company. It seems to me that some disclosure showing the gearing of the particular security market price to an index of the general market might usefully be made where the security has a public history, with the beta defined as the market risk. This same economics has found, in general, a linear relationship between this risk and expected return on the security. The greater the beta or expected market risk, the greater the return. One need not fully accept this mathematical analysis to accept the fundamental insight that the return of every security will be geared to the market. The economists specializing in this study have been so busy playing with their numbers that they have not approached the problem from the point of view of useful disclosure for securities investors. The SEC's Advisory Committee on Corporate Disclosure avoided the question, and we have yet to work through that problem.

The next point is that it is now generally recognized that intelligent security selection is done not on an individual basis but on a portfolio basis, to achieve a diversification which minimizes the risk of the individual security and picks related levels of market risk and expected returns. The consequences of that have yet to be thought out in terms of SEC disclosure. Moreover, portfolio needs differ among individual investors because the existing status of their portfolios affects their decisions as to what securities are attractive to them. Every individual has portfolio needs based on a personal time horizon. A security that might be attractive to a young executive, thirty years old, with a comfortable income and an ability to look forty years down the future, might not be attractive to me as I approach retirement. On a cost/benefit basis, the potential increment of wealth or income from risk-taking might be very different for some persons from that of others, depending upon what their present respective status of income and wealth is. The marginal utility values are different depending upon what stage of the utility curve you are on. So, the possibility of adapting security disclosure to the needs of the individual investor has not begun to be explored by the SEC, certainly not by the high pressure, mathematical economists.

The best article that I have seen in this field, and I do not claim to have read all of the, vast outpouring of the literature, is one by an academic accountant, Professor Hakanssohn of California, printed in the *Duke University Second Accounting Symposium* of December 1976, which I commend to you as an analysis of what the problem of securities disclosure for investment purposes really is. Hakanssohn suggests that to analyze the security disclosure problem we need to have a better model of the market, a better model of the individual investor, a better model of the firm and a consideration of their interaction of their interaction. It is a big order, but there is a need to try for it. And the people most likely to command all of the disciplines that enter into the effort are again the academic accountants. The lawyers who have controlled disclosure all these years cannot do it because the lawyers simply do not have the mathematical or the economic equipment. The practicing accountants are not going to do it. Sandy Burton's remarks in the *New York Times* a week ago Sunday are very applicable. He asked, "Where are the angry young accountants?" Paraphrasing that, one could ask, "Where are practicing accountants who are looking beyond the need for doing this week's job and filling the long term needs of the whole accounting and disclosure process?" Despite their vast organizations, I do not see it coming in the AICPA or the FASB, nor in the SEC which relies on them.

The final question is a very big question, how far a mandated disclosure process administered by the government, and necessarily rigid, can serve the need of investors? Can we expect the government to find a way not to treat all investors as uniform, to find some way to recognize their respective time horizons and their individual needs or complementing their existing portfolios? I have elsewhere applauded the recent proposals of the SEC for changing the 10-K form, and related changes, (3) but these do not deal with the fundamental question I am raising.

Professor William H. Beaver, an academic accountant, as a member of the SEC Advisory Committee on Corporate Disclosure, asked what is perhaps the same question in the chapter which he wrote for that Committee's Report. He first asserted (p.621)

> "There is an implicit reliance on the functioning of the professional investment community in order to qualify the current system as an effective mechanism for disclosure. More-over, this community often relies on investment information that is more comprehensive and in some cases more timely than that contained in the mandated filings."

and then he asked:

> "Under these conditions, the question arises concerning the role of the SEC and its mandated disclosure system in the entire framework. Why is it desirable to have a portion of that disclosure system contain a mandated set of disclosures?"

It turns out to be the same question from different vantage points, because each aspect presents the challenge whether the goals and the potential accomplishments of our disclosure system provide sufficient benefit to the public to warrant the mandated requirements. Above all, we need to have a better knowledge of how accounting relates to securities decisions and probably a substantially more daring accounting model to model the business world more effectively. On both of these, I have high hopes that the academic accounting profession can lead the way.

(1) 25 *Hastings L. Rev.* 311

(2) 55 *Accounting Review* 1.

(3) American Bar Ass'n. Section of Corporate, Banking and Business Law. Symposium on Corporate Disclosure, Williamsburg. Va., March 15, 1980, forthcoming in *The Business Lawyer*.

QUESTIONS AND ANSWERS

Question:
I am not very well versed in Accounting, so I may sound a little naive at several points. However, investors as risk takers are constantly concerned with the future and in the prediction of what will happen to their money. All information is digested by the market and supposedly is impounded in the market price, yet it's obvious that stock price movements are not necessarily related to that information. Take for example the recent jagged movement of oil stocks where there was no way for anyone to justify the movement of those stocks upon strictly analyzing financial statements. Do you feel that even if the numbers are changed, it will really make a difference in how people are going to invest their money -- whether they will be able to make more intelligent decisions?

Dr. Mellman:
He is asking essentially if accounting numbers are improved by altering the principles or the basis of accounting or improving the disclosures, whether that will create a climate or improve decision making for investment purposes?

Answer:
Certainly that is everyone's hope. While it is perfectly clear that the matrix for investment decision is considerably broader than the results or the future of the individual company, nevertheless the company's past results and its future are an integral part of the decision. If we have an accounting that comes closer to picturing the company results and possibilities, we might very well have better investment decisions. There is an interesting contrast between my recent book and my general attitude, on the one hand, and that of Martin Whitman on the other. Marty Whitman is an analyst in New York who published a book just a few months before mine came out called T*he Aggressive Passive Investor,* in which his thesis is that there are many aspects of value for a company that a sophisticated investor can recognize but are simply not shown by modern accounting, e.g., potential borrowing power, the use of the company's stock as a means of acquisition if the company has a good price earnings ratio and is not too heavily burdened with debt, and the like. Also, values which are hidden by the deferred tax account showing as debt although it will never become payable. Other types of distortions of what he calls economic reality present in current accounting. Now to the extent that accounting can be changed to bring out those potential values, the opportunities in that field will not be limited to specialists like Marty Whitman, but will be more freely available to other investors, and price, presumably, will reflect it.

Question - Leopold Bernstein:
I am interested in your ideas about the efficiency of the market and you said many investors obtain a free gift from the market judgment. Of course, in the free market declines that we recently had, I am sure you would be very happy to do without that gift. But if you have such faith in workings of the market in terms of impounding all the information, why do you not extend this faith to the marketplace for accounting information? Accounting has evolved over many years with the aid of the illustrious scholars that you have cited here. Bankers, for example, have a very vital interest in financial statements and what they present and they have created their own demands over the many years. Isn't it possible that today's accounting statements are pretty close to what the market wants? What is the force that prevents the financial statements today from delivering what sophisticated analysts on an equity basis or a loan basis really want?

Answer:
You remember, Leo, in my book, I faced that question and recognized that there is very little support in many decision makers for the ideas of switching accounting from historical cost toward any kind of a value approach. I have to recognize that, and I conceded in the book the potential force of your argument. But we have had this historical cost accounting now since the early 1930's and there are very few people old enough to remember that there was another time, and very few people who can conceive

operating under a different system. That is particularly true of the decision makers in the insurance companies whom George Benston questioned and whose votes on the subject I discussed in my book. We have had no free market in accounting ideas because the SEC and the Accounting Establishment have mandated the present system, so we don't know what would be the outcome in a truly free market, whether the present system would be accepted if rival systems could have been offered and tried over the last many years and their operations seen by others. We will get something like that beginning this year as the supplemental information on value accounting comes to be used. We will be seeing what its impact is on securities prices and what the discussions are as to where reality is, the historical cost result or the inflation accounting results. After we have had some experience in that, I will buy your argument that the free market will determine which is the better.