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60 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602

September 20, 1974

The Honorable Gerald R. Ford
The White House
Washington, D.C. 20025

Dear Mr. President:

The entire nation is pleased that you have called together a group of business and labor leaders, economists and representatives of other disciplines and professions to help decide what to do about inflation -- the most important public problem facing our country today. In our view, it is imperative that in analyzing the problem and weighing possible solutions, you must have available economic and financial information that reflects current economic reality.

As members of the Public Review Board recently established by the accounting firm of Arthur-Andersen & Co., we have been asked by that firm to give serious consideration to matters involving accounting and financial reporting from the standpoint of the public interest. Each of us brings to this responsibility a diverse background of public service and private activity. We write to you in our own independent capacity, and do not speak for Arthur Andersen & Co. Based on our review of the situation and after consultation with leading partners of that firm, we have come to the unanimous conclusion that changes in price levels are rendering the financial statements of many companies of questionable accuracy in determining their real results of operations and financial position -- just as changes in the dollar wages received by the working man today do not reflect changes in his true wages. As a result, present accounting and reporting practices are actually fueling inflation.

Accurate reporting of economic reality by business enterprises cannot itself cure inflation, but it can provide a common starting point in assessing the character and magnitude of the problems we face. We do not have such financial reporting today. Traditional financial statements purporting to show financial condition and earnings are based on historical costs which assume that the purchasing power of a dollar remains constant; accordingly, these statements reflect a confusing mixture of dollars of

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varying purchasing power spent or invested over the years. This leads to a distortion in perception and analysis caused by unacknowledged changes in the monetary yardstick. This distortion impedes the government in the conduct of responsible fiscal and monetary policy, handicaps business in pricing its products and in financing expanded productive capacity and affording employment opportunities, adversely affects labor in seeking fair and realistic wage settlements, and confuses investors in allocating their capital resources.

Although the direction and magnitude of the resulting departures from economic facts vary greatly from company to company, historical cost financial statements generally overstate real earnings during periods of inflation. Such overstatement occurs because companies match the old historical dollar costs of plant and equipment and, frequently, goods in inventory against sales stated in current dollars, thereby giving rise to fictitious profits. Based on current trends, the overstatement of pretax earnings of American business attributable to "inventory profits" and understated depreciation amounts to many billions of dollars annually. Reporting such profits without an adjustment for inflation not only undermines the usefulness of financial statements as a basis for reaching informed decisions, but also erodes vitally needed capital. This in turn slows business modernization and expansion, with a consequent loss of productive capacity and jobs.

For these reasons, we strongly believe that you and your advisors should recognize these deficiencies in past and present financial reporting as you seek answers to the problem of inflation. With respect to future financial reporting of business enterprises, we are communicating, by copies of this letter, our deep and urgent concern to the Financial Accounting Standards Board and the Securities and Exchange Commission, the two responsible bodies with authority over the establishment of accounting and reporting standards, with our recommendation to adopt without delay standards which require that changes in price levels be reflected as supplemental data in future published financial statements. There is no need for delay since the procedures to prepare price-level adjusted financial data have already been developed. Failure to make these changes, we are

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convinced, would aggravate inflation, frustrate efforts to deal with it, and contribute substantially to the risk of far more serious economic dislocations in the future.

Very truly yours,

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William L. Cary
James Don Edwards
George Romney
Randolph William Thrower
Newton K. Minow

By Newton K. Minow

Copies to:

The Honorable Ray Garrett, Jr.
Chairman
Securities and Exchange Commission

The Honorable Marshall S. Armstrong
Chairman
Financial Accounting Standards Board

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