

An Empirical Study of Net Assets Disclosure: Inflation Accounting Revisited

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ABSTRACT

This paper analyzes the differences in methods of calculating and disclosing net assets between Statement of Financial Accounting Standards #33 (FAS33) and other existing current cost and constant dollar methods. Furthermore, this paper provides empirical evidence on the methods employed by a sample of 78 companies that calculate net assets for FAS33 reporting. We found there are many methods being applied to determine net assets. The lack of uniformity reduces the effectiveness of net assets disclosure required by FAS33. This study demonstrates that the Financial Accounting Standards Board should issue statements that are more well-defined and less ambiguous about preferred net asset disclosure methods.

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I. INTRODUCTION

The primary objective of net assets reporting is to provide useful information about net assets to those who are interested in it. More specific objectives can be found in FASB Statement of Financial Accounting Concepts No. 1:

"Financial reporting should provide information about an enterprise's economic resources, obligations, and owner's equity. That information helps investors, creditors, and others identify the enterprise's financial strengths and weakness and assess its liquidity and solvency. – also provides a basis for investors, creditors, and others to evaluate information about the enterprise's performance during a period. – provides direct indications of the cash flow potentials of some resources and of the cash needed to satisfy many, if not most, obligations" (para. 41, underlining added)

To make net assets disclosure useful, comparability of accounting information is essential.

Comparability is one of the characteristics of information addressed in FASB Statement of Financial Concepts No. 2 that make it useful, and is one of the qualities considered when accounting choices are made. Comparability of accounting information enables users to identify and to explain the differences or similarities between two or more sets of economic facts. Differences and similarities in economic facts can be obscured by the use of incomparable accounting methods.

In the United States, the first statement issued by FASB that set the standard for reporting the effects of inflation on business enterprises was Statement of Financial Accounting Standards No. 33 (FAS33), Financial Reporting and Changing Prices, in 1979. FAS33 required certain companies to disclose supplementary information on both a current cost basis and on a constant dollar basis. However, it was felt that the guidelines were not sufficiently focused so that the disclosure of supplemental information would have become standard. One of the main areas of concern was the determination of net assets. There appeared to be many interpretations of FAS33 on the measurement of net asset amounts after the effects of changing prices have been taken into account.

In 1986, a time when the U.S. economy was experiencing little inflation, FAS33 was superseded by Statement of Financial Accounting Standard No. 89, Financial Reporting and Changing Prices (FAS89). FAS89 made the supplementary disclosure of current cost and constant dollar information voluntary. However, with crude oil prices surging past an unprecedented \$55 a barrel in the fall of 2004 and oil prices more than 70 percent higher than the previous year, it might be time to re-examine the impact of price changes on net assets disclosure. This study has two purposes, which are: (1) to examine the nature of differences in net asset figures between the current cost and constant dollar methods, and (2) to use FAS33 financial reporting information to study the comparability of net asset disclosures.

Section II will deal with the relationship between price changes and net assets disclosure using the constant dollar and current cost methods. Several sources of differences affecting net assets disclosure will be shown. The sources of these differences will be further explored in Section III. Section IV will study the disclosures of net assets required by

FAS33 and discuss an empirical study using 78 companies on their net assets disclosure. Finally, Section V will provide some concluding remarks in terms of the study's objectives.

II. CHANGING PRICES AND NET ASSETS DISCLOSURE

The following discussion on net assets will focus on those two methods adopted by FAS33: (A) constant dollar method and (B) current cost method. In order to clarify the relationship between changing prices and net assets in these two methods, Chamber's model (1974) will be used and expanded upon. The following symbols will be used:

- M^j =total amount of monetary assets at time j .
- N^j =total amount of nonmonetary assets at time j .
- L^j =total amount of monetary liabilities at time j .
- O^j =total amount of nonmonetary liabilities at time j .
- R^j =total amount of owners' equity at time j .
- P_g =an index of changes in the general price level.
- P_i =rate of specific price change for item i .

A. Constant Dollar Method

At time t_0 :

$$R^0 = M^0 + N^0 - L^0 - O^0 \quad (1)$$

At time t_1 :

$$R^1 = M^0 + N^0(1+P_g) - L^0 - O^0(1+P_g) \quad (2)$$

The restatement of (1) in terms of prices at t_1 is as follows:

$$R^0(1+P_g) = M^0(1+P_g) + N^0(1+P_g) - L^0(1+P_g) - O^0(1+P_g)$$

which is,

$$R^0(1+P_g) = M^0 + N^0(1+P_g) - L^0 - O^0(1+P_g) + (M^0P_g - L^0P_g) \quad (3)$$

It can be assumed that stockholders would be as well off at t_1 as at t_0 in terms of purchasing power, that is, $R^1 = R^0(1+P_g)$. Comparing (2) with (3), R^1 is less than $R^0(1+P_g)$ by the amount of $(M^0P_g - L^0P_g)$; thus $(M^0P_g - L^0P_g)$ represents the purchasing power loss from holding of net monetary assets¹ if M^0 larger than L^0 . $[M^0P_g - L^0P_g]$ would represent a gain if L^0 larger than M^0 .

From equation (2) and equation (3), we know the amount of net assets can obviously be affected by the following sources: (1) the monetary and nonmonetary classifications, $[M, N, L, O]$, (2) unit of measure $[P_g]$, (3) purchasing power gain/loss on net monetary position

$[M^0P_g - L^0P_g]$, and (4) scope of revaluation of assets and liabilities $[M, N, L, O]$.

B. Current Cost Method

At time t_0 :

$$R^0 = M^0 + N^0_i - L^0 - O^0_i \quad (4)$$

where $N^0_i = N^0_1 + N^0_2 + \dots + N^0_k$ and $O^0_i = O^0_1 + O^0_2 + \dots + O^0_s$

At time t_1 :

$$R^1 = M^0 + N^0_i(1+P_i) - L^0 - O^0_i(1+P_i) \quad (5)$$

Comparing (4) with (5), R^1 is more than R^0 by the amount of $N^0_iP_i - O^0_iP_i$, which represents the increase in prices of specific nonmonetary assets and liabilities if $N^0_iP_i$ is larger than $O^0_iP_i$. [$N^0_iP_i - O^0_iP_i$ would represent a decrease if $N^0_iP_i$ is smaller than $O^0_iP_i$.]

From equation (4) and equation (5) we also know that the amount of net assets can be affected by several sources which are (1) the monetary and nonmonetary classifications $[M, N, L, O]$, (2) increase in the prices of specific nonmonetary assets and liabilities position $[N^0_iP_i - O^0_iP_i]$, and (3) scope of revaluation of assets and liabilities $[M, N, L, O]$.

Sources of changes in net assets identified in this section will be discussed with FAS33 in the next section.

III. FAS33 AND NET ASSETS DISCLOSURE

In September 1979, the Financial Accounting Standards Board (FASB) issued FAS33, which mandated two methods: constant dollar method and current cost method. The Statement required companies with total assets larger than \$1 billion or inventories plus gross property, plant and equipment larger than \$125 million to state the amount of their net assets (i.e., shareholders' equity) on both bases,

- "a. On a historical cost/constant dollar basis at the amount reported in its primary financial statements adjusted for the difference between the historical cost/nominal dollar amounts and the historical cost/constant dollar amounts or lower recoverable amounts of inventory and property, plant, and equipment
- b. On a current cost basis at the amount reported in its primary financial statements, adjusted for the difference between the historical cost/nominal dollar amounts and the current cost or lower recoverable amounts of inventory and property, plant, and equipment and restated in constant dollars --- it may report the amount of net assets --- in accordance with the comprehensive statements" (para. 66).

Based on Section II, the following sources of differences in methods of calculating

and disclosing net assets between FAS33 and other existing constant dollar and current cost methods can be identified:

1. The monetary and nonmonetary classification
2. Unit of measurement
3. Purchasing power gain/loss on net monetary assets
4. Increase in the prices of specific nonmonetary assets
5. Scope of revaluation of assets and liabilities
6. Other sources

The first and fifth sources are applicable to both methods. The fourth and sixth sources relate to current cost method. The other two sources are related to constant dollar method only.

A. The Monetary and Nonmonetary Classifications

The distinction between monetary and nonmonetary items is critical. Different classification schemes will result in different net asset amounts. FAS33 provides guidance for the classification of certain assets and liability items as monetary or nonmonetary [see Appendix D of FAS33]. However, writers on this subject are not in the agreement about this classification system. For example, FAS33 classifies claims to foreign currency and claims payable in foreign currency as monetary, but Hendriksen (1982) suggests that these items may be monetary or nonmonetary (p. 212). Additionally, FAS33 classifies deferred policy acquisition costs and unearned property and casualty insurance premiums as nonmonetary, but American General (1981) believes these should be classified as monetary items. Davidson, Stickney and Weil (1976) also demonstrated that land for public utility industry might be monetary or nonmonetary (p. 166). The difficulty in defining monetary and nonmonetary assets and liabilities arises because the distinction between the two classifications was arbitrarily set.

B. Unit of Measure

A central issue in constant dollar method is the unit of measure. The index required by FAS33 to compute monetary amounts on a constant dollar basis was the Consumer Price Index for All Urban Consumers [CPI-U]. Some other widely used indexes of price change that are computed regularly by agencies of the U.S. government are: (1) The GNP Deflator, (2) The CPI-U, (3) The Wholesale Price Index, and (4) The Composite Construction Cost Index. From equation (2), it is obvious that different indexes will produce different net assets figures.

C. Purchasing Power Gain or Loss on Net Monetary Items

According to FAS33, Purchasing Power Gain or Loss on Net Monetary Items shall not be included in income from continuing operations (para. 29). Writers on this subject do not

agree on the correct method of reporting this information in the financial statements. Various presentation methods were suggested:

1. As a component part in the calculation of net income for the period [Norby (1979) and Chambers (1975)]
2. In a Statement of Changes in Owners' Equity
3. In a Statement of Net Profit and Inflation Gain or Loss [see AICPA (1963), pp. 250 - 251]
4. As the last element in or immediately following the calculation of net income [see AICPA (1963), pp. 12 - 13]
5. In the computation of net income but not in income from operations [This is in accordance with the financial capital maintenance concept and was included by the Board in the Exposure Draft (1978)]
6. Other views [see Mason (1977), pp. 23 - 24]

As a consequence, the Board decided that disclosure itself was the most important consideration and did not attempt to classify these items as either income or capital (para. 155) in the hopes of encouraging experimentation. However, Hendriksen (1982) expresses the view that "it is likely that a separate reporting of purchasing power gain or loss does not provide information, because of their interrelationship with all other activities of the firm" (p. 216).

D. Increase in Prices of Specific Nonmonetary Assets

FAS33 also specifies that any increase in the prices of specific nonmonetary assets should not be included in income from continuing operations (para. 30, para. 119). Edwards and Bell (1961) put together a detailed case in favor of this kind of income dichotomy. However, others [see Prakash and Sunder (1979)] favor the opposing view that separation is invalid.

E. Scope of Revaluation of Assets and Liabilities

FAS33 does not require the preparation of comprehensive financial statements on a constant dollar or current cost basis. In the computation of net assets, only inventory (INV) and property, plant and equipment (PPE) need be adjusted for the effects of changing prices (para. 66). The Board considered and rejected a requirement that the amount of net assets should be calculated by a comprehensive application of constant dollar method or of current cost method (para. 202). Furthermore, little guidance is provided by FAS33 for companies that wish to present comprehensive financial statements, except that the minimum disclosures² required for partial restatement must be present if comprehensive restatement occurs. Thus, FAS33's unwillingness to provide further guidance allowed companies to use a variety of methods to calculate their net assets.

F. Other Sources

Another area that adds to the incomparability among companies' financial statements is the different methods of estimating current cost. In a survey conducted by Arthur Young (1981), the following methods were noted:

1. Direct Pricing - by current invoice prices or quotations
2. Unit Pricing - cost per unit from published sources
3. Functional Pricing - estimate plant production costs per unit of output
4. Indexing - apply cost indexes to the original cost

Arthur Young & Company's survey (1981) indicated that preparers' calculation of current cost of PPE amounts were based on their interpretations of the FASB's definition (p. 17). However, most companies adopted a reproduction cost approach, as opposed to a replacement cost approach, in determining the current cost of PPE. Additionally, a variety of other approaches being used to measure the current cost of inventory and cost of sales were also found. Obviously different approaches used will produce different net asset figures.

Due to the wide variety of approaches found in the last two sources, we expect that application of FAS33 will have the effect of making net asset figures (on constant dollar or current cost basis) incomparable among companies. This expectation will be confirmed in the next section.

IV. DISCLOSURES OF NET ASSETS REQUIRED BY FAS33

A. Previous studies

Research results using FAS33 data are mixed. For example, Murdoch (1986) shows that constant dollar, current cost, and net holding returns do not exhibit information content incremental to historical cost returns in explaining security price changes. However, purchasing power returns on equity do show incremental information content. Bandyopadhyay and Warfield (1998) find that current cost asset book values are associated with equity values for firms with relatively long operating cycles, low levels of unrecorded assets, and for firms in the utility industry.

A review of the 1979 and 1980 annual reports for 1039 companies indicates that inflation-adjusted measures of net assets were much higher than those reported in the primary financial statements [see Vasarhelyi and Phillips (1982)]. Most companies disclosed only the amount of net assets. Only a few companies provided more detailed information about the make-up of net asset amounts by presenting this information in a condensed Balance Sheet or Statement of Shareholders' Equity, or by including explanations and comments [see FASB (1980), Goodman et al. (1981)]. Goodman et al. states: "an analysis of this information indicates that there are substantial inconsistencies among companies in the method of computing the net asset amounts" (p. 27). They found that some companies have classified some or all of their preferred stock as monetary liabilities; while other companies have included other items in the calculation. At least three calculation methods were found by Vasarhelyi et al (1985). The major calculation methods noted were: (a) restatement of inventories and property, plant and equipment only in net assets calculation, (b) restatement

of inventories, PPE, and monetary items in the net assets calculation, and (c) comprehensive restatement of the balance sheet. The overall effect was to make the net asset figure uncomparable among companies. Arthur Young's Survey (1981) also points out that "the differing interpretations of the current cost of property, plant, and equipment ... can have a significant impact on the restated amounts and on the comparability of FASB Statement 33 data among companies". In addition to the differing interpretations of certain items, the less-than-comprehensive nature of FAS33 would also lead to the expectation of measurement error due to the omission of the revaluation of certain assets and liabilities.

B. Empirical study

In this study, 78 companies were randomly selected and surveyed on the method used to calculate the net assets figure for FAS33 reporting. The sample contained 53 non-utilities and 25 utilities firms.

For the non-utilities, methods were categorized into five different types and one miscellaneous. Table 1 provides a list of the methods and number in each category. For the utilities, there were four method types and also a miscellaneous category. Table 2 provides a list of the methods and number of companies in each category.

Table 1

NON-UTILITIES	NUMBER OF FIRMS IN CATEGORY
Reconciliation Method	19
Gross Adjustment Method	12
Net Change Method	6
Statement of Changes Method	12
Complex Method I	2
Miscellaneous	2
Total	53

Table 2

UTILITIES	NUMBER OF FIRMS IN CATEGORY
Reconciliation Method	8
Equity Adjustment Method	3
Selective Disclosure Method I and II	4
Complex Statement Method I and II	4
Miscellaneous	6
Total	25

As the above lists shows, there are many different methods being used by companies to calculate net assets [Please see Appendix A for examples of these methods]. Means of net asset figures disclosed by these 78 companies are presented in the Appendix B. On average non-utility company's net asset figures are higher than utility company's. Current

cost figures of net assets are higher than historical cost or constant dollar figures. Thus, comparability among companies is lacking with this additional net assets information.

As was shown by the different methods, this lack of comparability between companies increases the risk that the information may be misunderstood or misused by investors, analysts, shareholders, and others. This is one of the possible reasons that Beaver (1982) found that "taken at face value, the value of stockholders' equity implied by current cost and constant dollar accounting is considerably different from that implied by the market value of common equity ..., this disparity deserves further consideration" (p. 38). FASB should review those areas of FAS33 that are being interpreted differently by preparers and determine whether or not preparers should have such wide-latitude with respect to these choices.

V. CONCLUSION

The inclusion of the effects of changing prices on a business enterprise is valuable and should be presented for users of financial statements. However, FAS33 does not fully address the issue of setting a standard to determine and present this type of information so that will be useful. In this study we found there are many methods being applied to determine net assets. In order for the information to be useful, the users must be able to understand what is being presented and also must be able to compare this information among companies. Comparability is very useful in determining which companies are utilizing resources efficiently and which are not.

FAS33 has left too many areas for interpretation and not enough uniformity, thus reducing the effectiveness of the additional information required by it. Comparability among companies is lacking with this additional information. The Financial Accounting Standards Board should consider issuing statements that are more well-defined and less ambiguous. This will reduce the amount of different interpretations that add confusion and contribute to information overload. Standard setters should take into consideration a principle's application and usefulness before accounting rules and regulations are issued.

ENDNOTES

1. These resulting gains and losses have been variously described as "Purchasing Power Gains and Losses," "Inflation Gains and Losses," etc. The FASB in Statement No. 33 calls them "Purchasing Power Gain or Loss on Net Monetary Items" which will be used hereafter.
2. Because accounting for changing prices is a complex issue, the Board simplifies the analysis in a number of ways. First, restatement is necessary only for inventory, property, plant, and equipment, cost of goods sold, and depreciation and depletion expense; sales and other revenues, and other expenses do not have to be adjusted (para. 40, 52, 104, 216). In addition, investments in subsidiaries, intangibles, and deferred charges and credits do not have to be restated. Yet the effect of not restating items such

as equity investments can make a significant difference to restated income from continuing operations and net assets. Second, no distinction is made between realized and unrealized holding gains and losses.

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APPENDIX A**RECONCILIATION METHOD**

Reconciliation of December 31, 1980 Historical Cost Shareholders' Equity to December 31, 1980 Net Assets Calculated on the Constant Dollar and Current Cost Basis
(Average 1980 Dollars - In Thousands)

	<u>Current Cost</u>	<u>Constant Cost</u>
Historical cost shareholders' equity		
December 31, 1980	\$849,131	\$849,131
Valuation adjustments for:		
Inventory	(715)	866
Property and equipment, net	475,661	370,691
Net monetary liabilities	<u>30,849</u>	<u>30,849</u>
Net Assets 12/31/80	<u>\$1,354,926</u>	<u>\$1,251,537</u>

GROSS ADJUSTMENT METHOD

(Constant Dollar)

Reconciliation of Stockholders' Equity (In Millions)

	<u>December 31, 1980</u>	<u>December 31, 1979</u>
HISTORICAL COST:		
Common Stockholders' equity	\$959,400	\$876,600
Less: Inventories	(538,700)	(569,000)
Plant, Property & Equipments	<u>(884,500)</u>	<u>(799,000)</u>
	(463,800)	(494,400)
CONSTANT DOLLARS:		
Add: Inventories	630,600	634,800
Plant, Property & Equipments	1,141,800	1,013,800
Adjustment to realizable value		<u>(30,00)</u>
Net Assets	<u>\$1,308,600</u>	<u>\$1,124,200</u>

NOTE: Excludes Redeemable Preferred Stock

GROSS ADJUSTMENT METHOD (Current Cost)
Reconciliation of Stockholders' Equity (In Millions)

	December 31, 1980	December 31, 1979
HISTORICAL COST:		
Common Stockholders' equity	\$959,400	\$873,600
Less: Inventories	(538,700)	(569,000)
Plant, Property & Equipments	(884,500)	(799,000)
	(463,800)	(494,400)
CURRENT COSTS:		
Add: Inventories	620,400	662,100
Plant, Property & Equipments	1,344,600	1,162,700
	1,501,200	1,330,400
X 246.8 Avg. 1980 CPI		
217.4 Avg. 1979 CPI	-	1.1352
Net Assets	\$1,501,200	\$1,510,270

NOTE: Excludes Redeemable Preferred Stock

NET CHANGE METHOD
DECEMBER 31, 1980 (In Millions)

CONSTANT DOLLAR		\$ 280.39
Net Assets - Historical Basis		
Plus - Increase in Inventory and		
Property, Plant, and Equipments		
Inventory – Constant Dollar	\$ 75.80	
PPE – Constant Dollar	105.15	180.95
Inventory – Historical Dollar	\$ 74.45	
PPE – Historical Dollar	80.51	(154.96)
Net Assets - Year End Constant Dollar		306.38
Convert to Average 1980 Dollars		245.5/258.5
Net Assets -Average 1980 Constant Dollars		\$ 290.97
CURRENT DOLLAR		
Net Assets - Historical Basis		\$ 280.39
Plus - Increase in Inventory and		
Property, Plant, and Equipments		
Inventory – Current Cost	\$ 78.98	
PPE – Current Cost	152.17	\$ 231.15
Inventory – Current Cost	\$ 74.45	
PPE – Current Cost	80.51	(154.96)
Net Assets - Year End Current Cost		356.58
Convert to Average 1980 Dollars		245.5/258.5
Net Assets -Average 1980 Current Cost		\$ 338.64

CPI - 245.5 Avg. for 1980; 258.5 Estimate for 1980 Y/E (actual was 258.4)

STATEMENT OF CHANGES METHOD**Reconciliation of Shareholders' Equity as of December 31, 1980**

(Millions)	Nominal \$	Average 1980\$	
	Historical Cost	Current Cost	Specific Cost
1/1/80 – Inventories	5,481	8,611	13,056
– PPE (net)	26,293	40,637	51,560
– Other nonmonetary/ assets/ (liabilities) – net	252	252	252
– Net monetary items	(9,474)	(10,171)	(10,171)
– Shareholders' equity	22,552	39,329	54,697
Net income from continuing operations	5,650	3,930	3,135
Dividends paid	(2,348)	(2,348)	(2,348)
Cost of shares reacquired net of proceeds from shares sold*	(441)	(441)	(441)
Purchasing power gain on net monetary items	–	1,160	1,160
Holding gain/(loss) on inventories	–	(306)	–
Increase in specific cost of inventories & PPE (inflation)	–	–	3,014
Shareholders' Equity 12/31/80	25,413	41,324	59,217
12/31 – Inventories	6,550	9,333	15,188
– PPE (net)	30,311	42,947	54,985
– Other nonmonetary/ assets/ (liabilities) – net	(483)	(483)	(483)
– Net monetary items	(10,965)	(10,473)	(10,473)
Shareholders' Equity 12/31/80	25,413	41,324	59,217

* Change in capital account.

EQUITY ADJUSTMENT METHOD

XYZ Gas Light Company

Reconciliation of the Historical Cost Shareholders' Equity to the Net Assets Calculated on the Constant Dollar and the Current Cost Basis (In Thousands)

	December 31, 1980	December 31, 1979
Historical Cost/Nominal Dollar		
Shareholders' Equity		
Common Stock Equity	\$ 144,527	\$140,093
Preferred Stock	42,069	42,704
Total Shareholders' equity	186,596	182,797
Less: Preferred Stock ¹	42,069	42,704
Common Stock Equity	144,527	140,093
Restatement Factor (Average CPI-U for the Year/Year- end CPI-U)	246.9/259.2	217.4/229.4
Net Assets Calculated on the Constant Dollar and the Current Cost Basis	\$ 137,669	\$132,765

¹ Excluded from historical cost shareholders' equity in computation of net assets at year-end because the regulatory

commissions having jurisdiction over the Company's retail rates treat preferred stock similarly to debt, thus the Company treats preferred stock as a monetary item in the computation of gain/loss on net monetary items.

SELECTIVE DISCLOSURE I

For The Year Ended December 31, 1980 (In Thousands)

	As Reported Historical Cost	Adjusted to Average 1980 Constant \$	Adjusted to Average 1980 Constant Costs
Operating Revenues	\$278.679	\$278.679	\$278.679
Operating Expenses:			
Fuel for generation	\$ 58.434	58.434	58.434
Power purchased and interchanged, net	(11.308)	(11.308)	(11.308)
Gas purchased for resale	86.693	86.693	86.693
Other operating expenses	30.701	30.701	30.701
Maintenance	10.695	10.695	10.695
Depreciation	23.068	40.919	43.374
Taxes	35.318	35.318	35.318
	\$233.601	\$251.452	\$253.907
Utility Operating Income	\$ 45.078	\$ 27.227	\$ 24.772
Other Income	\$ 9.122	\$ 6.218	\$ 5.987
Interest Charges	22.817	22.817	22.817
Net Income	\$ 31.383	\$ 10.628	\$ 7.942
Increase in Specific Prices (current costs) of net plant assets held during the year			\$117.555
Effect of increase in general price level			(142.007)
Net change during the year			\$(24.452)
Reduction to Net Recoverable Cost		\$(56.744)	(29.606)
Reduction of Purchasing Power Loss in Net Amounts Owed		<u>44 619</u>	<u>44 619</u>
Net		\$(12.125)	\$ (9.439)

SELECTIVE DISCLOSURE I

Net Asset Calculation and Analysis

Since XYZ Power and Light Company cannot recover any increment in restated plant through depreciation the entire amount is reversed. Thus for XYZ Power, Net Assets equal Common Stockholders' Equity. The slight variation between these amounts on the ABC Resources, Inc. Statement is caused by the assumed 100% recovery on the subsidiaries other than Power. Within the following calculation is the effect of certain accounts which are not classified as Plant, Property, or Equipment for XYZ Power and Light Co., but are for ABC Resources, Inc.

<u>Power non-recoverable</u>	
Net assets at year ended 12-31-80 in average 1980 dollars:	(000)
Net assets 12-31-80 original cost	\$ 219,273
Net subsidiary assets	<u>(13,005)</u>
	206,368
Convert IP and other sub to average 1980 Dollars X 246.9/258.8 =	196,879
Net other subs ended to date, i.e. average 1980 dollars without reduction for non-recoverable amounts	<u>150,002</u>
<u>Total XYZ Resources, Inc. adj. for inflation at average 1980 Dollars</u>	<u>\$ 211,881</u>

COMPLEX METHOD I

(\$Millions)	1980		1979	
	Constant Dollar	Current Cost	Constant Dollar	Current Cost
HISTORICAL COST - NET ASSETS	636.05	636.05	549.16	549.16
Adjustments: - Increase/(Decrease)				
<u>Assets</u>				
Cash	\$(.91)	\$(.91)	\$(2.23)	\$(2.23)
Certificates of Deposit	(1.20)	(1.20)	(1.36)	(1.36)
Accounts Receivable	(18.22)	(18.22)	(18.52)	(18.52)
Inventories	189.98	181.92	142.54	161.27
Future Income Tax Benefits	(2.21)	(2.21)	(2.42)	(2.42)
Other Current Assets	(2.99)	(2.99)	(0.91)	(0.91)
Total Current Assets	\$164.45	\$156.39	\$117.10	\$135.83
Net Facilities	\$182.19	\$252.43	\$142.69	\$239.42
Investment In Associated Companies	5.72	5.72	3.30	3.30
Excess of Cost over Net Assets of Business Purch.	44.85	44.85	35.52	35.52
Other	(1.56)	(1.56)	(0.69)	(0.69)
Total Assets	\$395.67	\$457.83	\$297.92	\$413.38
<u>Liabilities</u>				
Loans Payable to Banks	\$ 0.76	\$ 0.76	\$ 1.82	\$ 1.82
Commercial Paper	—	—	1.14	1.14
Current Maturities of Long-Term Debt	0.61	0.61	10.70	10.70
Accounts Payable	8.53	8.53	5.28	5.28
Accrued Payrolls	5.20	5.20	5.58	5.58
Other Accrued Liabilities	5.85	5.85	4.54	4.54
Taxes on Income	2.60	2.60	0.79	0.79
Total Current Liabilities	\$ 23.55	\$ 23.55	\$ 29.85	\$ 29.85
Long Term Debt	\$ 12.57	\$ 12.57	\$ 10.28	\$ 10.28
Reserve for Foreign Pensions and Termination Indemnities	3.56	3.56	4.22	4.22
Deferred Taxes on Income	2.34	2.34	1.73	1.73
Minority Interests	0.28	0.28	0.33	0.33
Total Liabilities	\$ 42.30	\$ 42.30	\$ 46.41	\$ 46.41
Adjusted Net Assets	\$1074.00	\$1136.18	\$893.49	\$1008.95

COMPLEX METHOD II

XYZ Power Company
Reconciliation of Stockholder's Equity
(Net Assets in thousands)

	Constant Dollar Average 1980	Current Cost Average 1980
<u>Equity at January 1, 1980</u>		
Property Plant and Equipment	C\$ 4,095,588	C\$ 4,095,588
Investment Tax Credit	(47,099)	(47,099)
Net Monetary items	(2,954,379)	(2,954,379)
Net Assets at January 1, 1980 at net recoverable cost	1,094,110	1,094,110
<u>Changes in stockholder's equity during 1980</u>		
Income (Loss) from continuing operations	23,381	(3,986)
Dividends and other adjustment to Equity*	59,180	59,180
Gain from Decline in Purchasing Power of net monetary liabilities	305,460	305,460
Excess of increase in general prices over specific price changes		(109,282)
Reduction to net recoverable cost	(319,117)	(182,468)
Net Assets at December 31, 1980 at net recoverable cost	C\$ 1,162,960	C\$ 1,162,960
<u>Equity at December 31, 1980</u>		
Property, Plant and Equipment	C\$ 3,394,964	3,394,964
Investment Tax Credit	(50,909)	(50,909)
Net Monetary Items	(2,961,095)	(2,961,095)
Net Assets at December 31, 1980 at net recoverable cost	C\$ 1,162,960	C\$ 1,162,960

COMPLEX METHOD II

XYZ Power Company
Reconciliation of Stockholder's Equity
(Net Assets in thousands)

*Dividends and other changes in Stockholders Equity

	1979	1980	Change
Other paid-in capital	692,145	866,145	\$ 174,000
Premium on preferred stock	461	941	480
Cash Dividends on common stock			(115,300)
			\$ 59,180

COMPLEX METHOD II

Determination of the Erosion of Equity and the Reduction of Purchasing Power Loss

	Balance at 12/31/79	Net Change	Balance at 12/31/80	Effect
PLANT ASSETS				
Historical Cost	\$3,827,652	\$ 240,019	\$4,067,671	
C \$ (Avg 1980)*	4,095,588	240,019	3,904,964	\$(430,643)
MONETARY ASSETS				
Historical Cost	465,084	85,188	550,272	
C \$ (Avg 1980)*	497,640	85,188	528,261	(54,567)
Historical Cost	\$4,292,736	\$ 325,207	\$4,617,943	
C \$ (Avg 1980)*	\$4,593,228	\$ 325,207	\$4,433,225	\$(485,210)
COMMON EQUITY (NET ASSETS)				
Historical Cost	\$1,022,533	\$ 188,884	\$1,211,417	
C \$ (Avg 1980)*	1,094,110	188,884	1,162,960	\$(120,034)
L.T.C.				
Historical Cost	44,017	9,013	53,030	
C \$ (Avg 1980)*	47,099	9,013	50,909	(5,203)
MONETARY LIABILITIES				
Historical Cost	3,226,186	127,310	3,353,496	
C \$ (Avg 1980)*	3,452,019	127,310	3,219,356	(359,973)
Historical	\$4,292,736	\$ 325,207	\$4,617,943	
C \$ (Avg 1980)*	\$4,593,228	\$ 325,207	\$4,433,225	\$(485,210)
*CONVERSION FACTORS: 12/31/79 Avg. 1980 CPI-U INDEX 246.8 = 1.07				
Dec. 1979 CPI-U INDEX 229.9				
12/31/80 Avg. 1980 CPI-U INDEX 246.8 = 0.96				
Dec. 1980 CPI-U INDEX 258.4				

NOTES:

- Preferred stock has been classified as monetary item since it is treated as the same as debt for rate-making purposes. Therefore, dividends on preferred stock have been deducted from income from continuing operations and net assets represents only common stock equity.
- We object to the disclosure of the reduction to net recoverable cost without also reflecting the offsetting effect of debt financing. In any event, the caption should explain that reduction to recoverable cost is reflected and constant dollar and current cost amounts should be on the same basis. Income (loss) from continuing operations including the reduction to net recoverable cost should be as follows:

	1980	1979
Constant dollar	(295.74) A	(378.93) C
Current cost	(186.45) A	(120.04) C
- Nuclear fuel inventories reflected in utility plant section of the balance sheet are classified as monetary assets due to fuel cost recovery mechanisms, which limit recovery to cost.

APPENDIX B

NET ASSETS DISCLOSURES

<u>Non-Utilities</u>	<u># of firms</u>	<u>Mean (in millions)</u>	<u>1979</u>	<u>1980</u>
Reconciliations Method	19	Historical Cost	1362	1730
		Current Cost	2357	2751
		Constant Dollar	1563	2373
Gross Adjustment Method	6	Historical Cost	761	837
		Current Cost	1443	1509
		Constant Dollar	1151	1295
Net Change Method		Historical Cost	428	474
		Current Cost	835	841
		Constant Dollar	636	766
Statement of Changes Method	12	Historical Cost	2867	3226
		Current Cost	6020	7061
		Constant Dollar	4312	5102
Complex Method I	2	Historical Cost	1234	1355
		Current Cost	1919	2159
		Constant Dollar	1635	1885
Miscellaneous	2	Historical Cost	127	144
		Current Cost	190	197
		Constant Dollar	170	181
Total	53	Historical Cost	1410	1651
		Current Cost	2709	3110
		Constant Dollar	1937	2464
<u>Utilities</u>				
Equity Adjustment Method	8	Historical Cost	971	1059
		Current Cost	1015	1007
		Constant Dollar	977	1007
Reconciliation Method	3	Historical Cost	637	518
		Current Cost	706	937
		Constant Dollar	518	639
Selective Disclosure Method I & II	4	Historical Cost	205	207
		Current Cost	293	307
		Constant Dollar	293	314
Complex Statement Method I & II	4	Historical Cost	567	665
		Current Cost	666	809
		Constant Dollar	605	728
Miscellaneous	6	Historical Cost	586	652
		Current Cost	674	693
		Constant Dollar	600	656
Total	25	Historical Cost	652	697
		Current Cost	725	780
		Constant Dollar	662	723