What is price?

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Biographical notes: Michael Grayson solved the allocation problem (said in an American Accounting Association monograph to be 'inherently insoluble') using a mathematical proof. By solving the problem, it became clear that using market values and taking holding gains and losses into income (which is what FASB 157 requires) would be economically harmful. One week after the 2008 US presidential election, the vice chairman of the International Accounting Standards Board and a former chairman of the US Securities and Exchange Commission appeared on the cable television channel CNBC, both saying that this fair value accounting was harmful.

Economists talk about a concept called price.
This concept is really very nice.
It can be used for either supply or demand,
For an answer which may be either customised or canned.

Price is the valuation at which a transaction occurs
Where a buyer and a seller of a good – let's say, furs –
Agree to exchange between themselves.
Pay the money for the furs? Okay, take them down from the shelves.

The price is what the buyer pays
To the seller, so cost is what the buyer says.
The seller shows the price as his revenue,
But still must cover his outlays, too.

If both buyer and seller are not under any compunction
To enter a transaction, then we can get up the gumption
To call the price where they meet a market price.
This is much better than just rolling the dice

To come up with a value of what each gives to the other.
Try to guess in the absence of a price? Oh, brother!
If the market is open to all, then anyone may buy or sell
At whatever price will make the market work well.

That typically is where all sellers who want to sell
Have sold as much as they want. Do tell!
Furthermore, all buyers have bought as much as they want and can afford,
So that price is one which strikes a chord.

The price where buyers and sellers meet and clear the market
Is what we call the market price. One way of announcing is to just bark it.
Today, we have more advanced electronic means
Which get the news out to all those human beans.

There are much more sophisticated and lengthy explanations of this idea,
But we are not going to spend the time, so have no fear
That you will have to earn a doctorate before you understand
That price leads to utility maximisation in this land.

'Why does this matter to accountants?' you ask.
It matters because FASB 157 sets us the task
Of reporting market price even when none exists
Instead of historical cost. It makes accountants anarchists.

Do those financial statements faithfully represent what they purport?
No, they do not, as Grayson (2009) showed with an example short.
A company might be selling below its cost, and yet a profit report
As required by FASB 157, even though there is little or no support

For some of the valuations included in the statements,
But FASB 157 says that is okay, these are not misstatements
Because you are just doing what we told you to do,
And now you earned a profit, so big bonuses are due to you.

This is economically harmful, as Grayson (2004) showed.
Massive liabilities can be reported at far less than actually owed.
Assets can be shown at prices nobody would pay,
Simply because that is what the output of a model does say.

We have tried this before, with general price level accounting,
But accounting historians get no respect, so there is nobody to do the recounting
Of what happened when this was tried under a different name.
What should we expect? Probably results the very same.

References

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