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Effective Reporting

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Basically there are two types of reports prepared by accountants which are designed to satisfy two different types of needs. One of these types is reports to management for its use in controlling expenses and evaluating the efficiency of the various operations of the enterprise. The other type is reports to the various segments of the public. These are for the purpose of informing the public about the past, present and future operations of the business.

Reports to management for control purposes must be tailored to meet the specific requirements of management. Their form and content can cover a wide range depending on the size of the enterprise and the type of business that is conducted. For example, the type of reports sent to the top management of a small electric equipment manufacturer with 100 employees would be materially different from the reports sent to the top management of the General Electric Company. In addition, there probably would be a lot more layers of management reports in the General Electric system than in that of a small company.

The form of organization also will have a definite bearing on the form of management reports. For example, if the enterprise is comprised of autonomous divisions, each self-sufficient and charged with making a profit, the reports will be quite different than those of an enterprise which has one area for measuring profits.

Because of this wide divergence in reporting requirements, it would be impracticable to try to say what information management reports should contain and the form they should take. These reports must be tailor-made to conform to the organizational set up of the enterprise and to furnish the information that the various levels of management require to enable them to manage effectively and to make decisions.

In general, they must answer the questions, "What has happened," "What is happening," and "What is going to happen." If reports to management answer these and other basic questions, the accountant has done a worthwhile job. There are, however, two major problems which confront him in preparing these reports. First of all he must determine what information is needed and, secondly, he must find a method of presentation which is concise, meaningful, and which tells the story in an interesting fashion.

The financial and statistical data required at each level of management within each corporate organization will vary. The lower the level of management the more detailed the report will need to be. And conversely, the higher the level of management, the more condensed the report should be. For example, a company using a budget within the framework of a responsibility accounting and reporting system will certainly require reports showing variations from the budget since this is needed for cost control. Top management reports generally show only budget variations either in the over-all company picture or by the responsibility areas at the next lower level of management; whereas, the reports to the bottom level responsibility area will show the budget variations in detail by accounts and functions. The financial reports prepared for directors do not generally contain as much detail as the reports to top management.

Thus, recognizing that he cannot prepare one set of standard reports to serve all levels of management, the accountant must first find out the requirements of management at each organizational level.

The second problem area in regard to management reporting is the method of presentation and the form which the report will take. Reports, like any other means of communication, should be timely, clear and concise. The question of how to obtain these objectives is one that the accountant must answer if he is to efficiently fulfill his function of service to other members of management. One factor which may have a bearing on the method of presentation to top management and, in particular, to directors will be the background that these men have. A director or vice president with an engineering or legal background may not be as familiar with some formal accounting terminology and techniques as the controller or treasurer. Therefore, a clear, concise narrative or a graph may be more meaningful to such directors without accounting backgrounds than a series of financial figures or schedules. Some companies include a series of selected charts each month in their financial reports since they show very quickly and clearly any important deviations from the past.

The accountant should review his reporting system periodically to see if it is still meeting management's objectives and also to see if new ideas, techniques or concepts have been developed which can aid him in effectively communicating his vast accumulation of financial data to management.

In summary, the form and content of management reports must be designed to provide the information required by management in a form that is understandable to management. This form and content will vary greatly between companies because of differences in organization, operations and requirements. Therefore, such reports must be tailored to fit the specific needs of a particular enterprise.

Probably a much more difficult responsibility of the accountant is the preparation of reports for the general public. This is a more difficult responsibility, not because such reports are more important than management reports, but because it is more difficult to find out if the reports are accomplishing their purpose.

Ordinarily, management has rather definite ideas about the information it needs and will pass these ideas on to the accountants. In contrast, the average stockholder probably doesn't fully understand financial statements, doesn't have any definite ideas about the information he would like to receive, and even if he did have definite ideas there is not much opportunity for him to communicate them to the accountants. In addition, if you aren't supplying management with information that it wants and needs, there probably would be little, if any, reluctance on the part of management to tell you about this weakness. On the other hand, the common stockholder is very unlikely to communicate with the company about such lack of information. Instead, if he is dissatisfied with the company he might sell his stock and buy the stock of another company.

There are numerous reports prepared for the public. Many of them are prepared for submission to regulatory bodies such as state public service commissions, federal power commission, Securities and Exchange Commission, various government departments, etc. Most of these reports follow either specified forms or require designated questions to be answered. Therefore, there is not much latitude allowed the accountant in the preparation of these reports.

However, the form and content of reports to investors – stockholders, bondholders, and others—afford the accountant a lot of latitude and plenty of opportunity to exercise his ingenuity. In addition, in my opinion, these are the most important reports published by business enterprises.

Just who are these investors and what do they want to know? Lenders, such as bondholders and noteholders, and the owners of a company's preferred stock have all advanced funds to the corporation at a fixed return over the life of the security. They can receive no more or less than this specified rate regardless of how much profit the enterprise makes. The only way that their investment can appreciate or depreciate is for interest rates in general to fluctuate. Therefore, these investors are primarily interested in the company's earning enough money to be able to pay the annual interest and preferred dividends plus staying in a financially solvent position to enable it to repay the loan upon maturity.

If the loan is secured by a mortgage on the company's property the mortgage holders also will be interested in the amount of insurance that is carried and the amount that is spent for maintaining the mortgaged property. But reports setting forth this type of information are easy to prepare, because they merely present facts which oftentimes are specified by the mortgage instruments.

However, the real ingenuity of the accountant comes to play in preparing annual and periodic reports for the common stockholders. These are the investors who really own the business. They are the ones who receive a return on their investment only after interest has been paid on debt and dividends on preferred stock. After all of these have been paid, the common stockholders get what is left.

Likewise, in case the enterprise fails, the common shareholders in liquidation get anything that is left after all other obligations of the company have been paid and the preferred stockholders are repaid their investment. Thus, the common stockholder takes the most risk, but also has the opportunity of earning the most if the enterprise is successful. If his earnings per share increase, there is a good likelihood of his dividends increasing, which, in turn, will cause the price of the stock to rise. In this way he receives both increased income and appreciation in his original investment.

For this reason, the amount of earnings per common share becomes probably the most important figure in the financial statements. And I'm afraid, it is the only figure in the entire report that some stockholders look at.

Now just who are these stockholders and what do they want to know? A 1962 survey made by the New York Stock Exchange indicated that about 17 million individuals owned shares in United States corporations. Of these, nearly 5½ million were housewives and over one-half were women. And this share ownership by individuals is growing—for example, in the Exchange's 1952 survey, only 1 out of 16 adult Americans was a shareowner. By 1962 this had increased to 1 out of 6. Of course, in addition to shares owned by individuals, a great many are owned by institutions such as banks and insurance companies, pension funds, brokers, dealers, etc.

Shareowners purchase common stock with future growth in earnings and the resultant increase in dividends and appreciation in market value of the stock in mind. The only good that past earnings will do them is to indicate what they might expect in the future. This is an excellent example of the truth in the statement that "the past is prologue."

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that the additional depreciation, especially on fully depreciated assets which had a basis once again, provided an enormous stimulus to economic growth and became one of the major reasons for the German economic recovery since 1948. This is one example of accounting practices influencing economic development.

The Russian Revolution

Since there is almost no private property in Russia, Russian balance sheets do not need such accounts as land, natural resources, goodwill, and owner's equity. Since intercompany receivables and payables are handled through the central bank, these accounts also do not appear on Russian balance sheets.

Under a planned economy, income statements and especially cost accounting are the major concern of Russian accountants. In order to compare the performance of several factories and the adherence of each factory to the government plan, it becomes necessary to set up rigid accounting practices.

In the area of cost accounting, depreciation seems to be the most important trouble spot. Since the statements of all plants in similar industries have to be comparable, it became necessary for the Central Planning Commission to set the depreciation rates.

The major difference in Russian methods of depreciation is in the handling of major repairs which, for reasons of comparability, are provided for in the annual depreciation expense. Since these capital repairs are provided for, there is no incentive to keep machines in good working order and thus reduce major repairs. In fact, there is a reason for letting machinery deteriorate until major repairs are necessary since minor repairs are an expense whereas major repairs show up only on the balance sheet. Soviet planners are aware of this defect; but since comparable cost figures are their major concern, this method is retained.

Another serious flaw in Russian accounting is the practice of entering gains and losses on the disposition of fixed assets in the Russian equivalent of the capital account. In this way income statements are kept comparable, but again there is no incentive for managers to keep losses low since they are primarily judged on their adherence to the given plan as evidenced by the income statement. Since Russian plans seem to suffer from the same defects as some American budgets, namely that they are a combination of wishful thinking and realistic planning, managers face great difficulties in keeping to their assigned plans.

With the knowledge that wages and prices in Russia are set by the Central Planning Commission, one aspect of Russian thinking becomes clear. Since a firm is unable to effect cost reductions through purchases at lower prices, it can only show a favorable picture by using less materials and/or less labor than the plan allows. This must be the reason for the otherwise unexplainable stress on quotas which must be exceeded if the manager is to create a good impression.

Conclusion

The objectives of accounting determine to a certain degree the accounting practices used in a country. In the United States the generally accepted objective seems to be to account for the profitability of an enterprise; in continental Europe it appears to be the control of business and the protection of creditors by the central governments; and in Russia the control of and adherence to the central plan. If it is remembered that economic objectives are determined by a country's past history, it becomes evident that accounting is not something separate from the life and philosophy of a country, but something very much a part of it which is influenced by history, by economics, and by politics.

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Therefore, an income statement covering only one period or a balance sheet showing the financial position as of a certain instant is of little value. What is needed to show trends are comparative statements setting forth at least two comparable periods such as the same two quarters of the latest two years, or two year income statements. In fact, a very good indicator of trends are five or ten year statistics on sales volumes, revenues, net income, and various other significant income statement and balance sheet items.

In addition to presenting statistical data, the report to shareholders should include interpretative data. For example, if something has happened or is expected to happen that materially affects the operations and earnings of the company, this should be disclosed. Similarly, the outlook for the future should be discussed. And a very important point right here is that the bad should be disclosed and discussed along with the good. If this policy is not followed, stockholders will soon lose confidence in the management. Since the common stockholders own the company and therefore elect the directors who in turn select the officers who in turn hire the balance of the employees, loss of a stockholder confidence can have some bad effects on everyone in the company.

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All material should be presented in as simple and understandable a manner as possible. Of course, we must be careful not to throw the baby out with the bath by attempting to oversimplify at any cost. To do so would be to run the risk of providing something like the following deliberately humorous annual report:

"This is the annual report of Children's Press. Children's Press makes books for children. Last year (1962) we made lots of books. We made more books than we did the year before (1961).

"Ted Winter is our president. Ted Winter adds up the number of books we sell each year.

"The year ends on Dec. 31. On Dec. 31, 1962 when Mr. Winter added up the number of books we sold, he found we took in a lot of dollars in exchange for the books. He counted them all up. He says we took in \$3,700,000 last year. In the year before when Mr. Winter counted up the books and the dollars on Dec. 31, 1961, he said we took in \$1,800,000 that year.

"See the difference. We took in more dollars last year than we did the year before. Mr. Winter is a happy man. He says any man in business is happy when he takes in more dollars than in the year before. He says he is happier when he sends out less dollars, too.

"Sometimes Mr. Winter doesn't wait until the end of the year to count the books or the money. Sometimes he does it every three months. We call them quarters. There are four quarters in each year.

"The first quarter this year ended on March 31. Mr. Winter said we sold more books in the first quarter this year than we did in the first quarter last year. He says we took in \$1,125,000 in the first quarter this year. Last year we took in \$403,000 in the first quarter. This makes Mr. Winter wonder.

"Sometimes Mr. Winter counts the orders for books coming into our office and he looks at them and tries to tell in advance what the next quarter will be like. This is not easy. It's hard to tell about the future. Mr. Winter says that after looking at the orders in his office he believes that in the second quarter of this year, which follows the first quarter, there should be even more dollars. He wonders how many.

"Mr. Winter is a happy man. He is our president."

Actually, while this annual report is greatly oversimplified, it does contain quite a bit of pertinent information. It tells the reader that the President is profit minded, that the trend in sales has been sharply upward for both the year and quarter, and that sales in the immediate future will be even better. However, it doesn't say whether or not the enterprise made any more money for its stockholders as a result of the increased sales.

A lot has been written on items that should be included in annual or other reports to stockholders. I'd like to briefly cover some of the recommendations.

1. Sales Breakdown—By products (in natural groupings), and by types of customers or industries served. Include figures and percentages when charts or graphs are used. Avoid giving a false impression as to the importance of a certain project or product.
2. Pertinent Correlations—Give correlation or relationships with specific economic facts and trends. If, for example, sales correlate with freight car loadings, or other factors, so indicate.
3. Outlook For Sales and Profits—Discuss factors and influences that may affect the forecast. Refer to the previous year's prediction and explain what happened.
4. Product Price Trends – Compare price trends with previous year. Give separate price indexes for major groups of products. Discuss price trends and also costs of materials.
5. Foreign Operations—Give capital investment, sales and net earnings, and restrictions on the free flow of funds.
6. Company Policies—Business creed. Code of ethics. Expansion policy. Relations with employees, customers, communities and suppliers.
7. Research and Development – Amounts spent on research, description of research staff, amount of sales represented by products unknown five or ten years ago.
8. Advertising—Amount spent. Explain declines and increases.
9. Plans for Capital Expenditures – Give cost, source of funds, purpose.
10. Non-Recurring Earnings and Expenses—Specify non-recurring items and explain the reason and effects.
11. Management – Describe the director's business or professional affiliations. Describe management in depth.

We hope that investors and potential investors will become familiar with the company by reading the annual and periodic reports prepared for them. However, there is another way that they also learn about the company and decide whether to buy or sell its securities. That is by reading reports and being advised by professional security analysts.

Most brokerage houses, insurance companies, banks, and others who deal in securities have one or a staff of men and women

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EDITOR'S PAGE

Authors in This Issue

Ula K. Motekat, author of "Fundamental Differences between Anglo-American and European Accounting Practices," was born in Germany and came to the United States after graduation from high school. She received the Colorado medal for the highest score in the November 1957 CPA examination. She has studied at the University of Cologne and graduated from the University of Denver magna cum laude in 1964. She has worked as an accountant in Germany and is now employed in the tax department of Ernst & Ernst in Denver. She is a member of Denver Chapter of ASWA. Miss Motekat has furnished a detailed bibliography which will be made available to an interested reader on request.

Miles J. Doan, author of "Effective Reporting," is Vice President and Secretary of The Cincinnati Gas & Electric Company, Cincinnati, Ohio. This manuscript is based on a talk he presented to the Cincinnati Chapter of ASWA.

Editorial Staff and Board Appointments

Lucille R. Preston and Margaret L. Bailey, Presidents of AWSCPA and ASWA respectively, have appointed the editorial staff and board for the new year of THE WOMAN CPA. We are pleased to announce the appointments:

Mary F. Hall, CPA, will serve as Associate Editor and as Editor of "Tips for Busy Readers." Miss Hall was President of AWSCPA for the 1962-1963 year. She served as National Secretary of ASWA for the 1957-1958 year and has been an active member on the chapter level. She conducts her own accounting practice in Cincinnati, Ohio.

Doris L. Bosworth, CPA, will serve as Tax Editor. Miss Bosworth is a manager in the Tax Department of the New York office of Peat, Marwick, Mitchell & Co. She is Second Vice President of the New York Chapter of ASWA and last year was a contributor to "Tips for Busy Readers."

Beatrice C. Langley has been reappointed Business Manager, and Jane Strenciwilk, CPA, will continue to serve as Comments and Idea Exchange Editor.

Mary E. Beniteau, CPA, has been reappointed to the Editorial Board for a regular three-year term. Miss Beniteau had just completed serving the unexpired term of Katherine E. Pfeifer. She is employed by Haskins & Sells in Dallas, Texas. She is the 1965-1966 President of the Dallas Chapter of ASWA.

Our sincere appreciation is extended to Dorothea Watson, CPA, who has completed a two-year term as Tax Editor. Miss Watson has made much valuable tax information available to our readers in well-written language. She is serving on the current AWSCPA Board of Directors and as Editor of AWSCPA NEWS.

Our thanks also go to Patricia A. Perry, who has completed a three-year term on the Editorial Board, for her fine assistance in reviewing and evaluating manuscripts submitted for publication.

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whose sole function is to study the investment merits of securities of various companies. These security analysts make extensive studies and then prepare reports which are distributed to brokerage offices and used by security salesmen, to the investment committees of institutions, and other areas where investment decisions are made. Thus, they have a very important bearing on the popularity or unpopularity of the securities of any company.

Needless to say, these professional security analysts want a lot more detailed and technical information than the average stockholder. To meet this need, our Company, like many companies, each year prepares a Financial and Statistical Review which is a supplement to our Annual Report. This is mailed to our list of approximately 1,500 security analysts who have evidenced an interest in our Company.

But, after all is said and done and all of the reports are made, there are two basic items which make a company popular or unpopular with the investing public.

1. The first is a growing, soundly financed, soundly operated company which earns a profit adequate to afford the investor security for the principal of his investment and reasonable assurance of a fair return on his investment; and secondly
2. A sound, efficient, and progressive management imbued with the profit motive and dedicated to the best interest of the Company's investors, employees and customers.

If a company has these, the word will spread among the investing public and, if the opposite conditions exist, that word also will spread regardless of the amount of effort expended to build a favorable company image in the minds of investors.