

12-1966

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Recommended Citation

West, Katherine M. (1966) "Trends of Special Interests To the Accountant in Financial Reports," *Woman C.P.A.*: Vol. 29 : Iss. 1 , Article 1.

Available at: <https://egrove.olemiss.edu/wcpa/vol29/iss1/1>

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Trends of Special Interests To the Accountant in Financial Reports

Katherine M. West, CPA

Today, more than ever before, the informational demands upon accounting are steadily increasing. Accountants, at one time referred to primarily as financial historians, are now involved not only in the preparation of financial statements for fiscal periods, which represent chapters in the financial history of the business enterprise, but also in the presentation of statements, such as budgets, that provide for the estimated results of future transactions.

Though there is a marked increase in the scope and quantity of business information made available to outside parties, more information is being sought. Currently, with the growing emphasis on public relations programs, there are those who note that the contents of the financial statements are not keeping pace with the attractive covers and numerous graphs contained in the reports published. The accounting profession with its third-party responsibility is concerned with the ever-present problem of how much information should be furnished to third parties without harming the best interests of the company.

Accounting information must be useful to a wide range of interested parties acting in various capacities both within and outside of the particular business entity. The external users are a heterogeneous group consisting in the main of present and potential investors, employees, stock exchanges, customers, governmental units, creditors, security analysts, trade associations, credit rating bureaus, officers of trade unions, regulatory bodies, economists, the press, etc. Are financial statements considered adequate accounting information for so diverse a group with such widely varying interests? Certainly some users are interested only in specific information, while others want additional relevant data, some of which may be of a forecast nature and not within the scope of verifiability required for externally reported accounting information. Though the basic problem, communication, is not unique and exists in other professions, the demand for a solution is more pronounced.

The need for publicly-owned corporations to raise large aggregates of capital and the sizable increment in the number of shareholders are factors contributing to the

wider distribution of financial reports. To be useful, these reports, which serve as a means of communication between the corporation and the stockholders, should be understood to the extent required by each user. Such a requirement is desirable but not easily fulfilled. Often the statements are used by parties with opposing interests, for example, buyers and sellers. The stockholder who is unschooled in accounting may not understand the specialized meanings of some of the words and may not be competent to decide what information is needed. On the other hand, the user at a high level of stockholder sophistication understands to some degree why it is difficult to express complex corporate transactions in simple terms. Even with the increased information contained in financial reports, many of the shareholders, often transient investors, need professional investment advice.

The investment analysts generally want more information than the financial statements contain. They are interested in detailed sales breakdowns, profit breakdowns, operating information of individual entities in a consolidation, statistical reviews, cash-flow statements, and supplementary net-realizable-value statements—important, often confidential information requiring management's approval for distribution. Bank loan officers are inclined to deemphasize financial statements in favor of cash budgets and pro forma statements of future condition.

Even though they agree that it is difficult for the financial statements to satisfy fully the needs of so broad-based a group of users, interested people outside of the profession are nevertheless joining the drive for more comparability in the statements. Criticism in numerous cases is ill-founded for the reader refuses to note the explanations of differences clearly cited in the body of the report or in the notes to the statements. That the auditor's involvement extends only to representing the statements as being fairly presented is not understood by even some of the informed members of the financial community. The expressed or implied indictments by those outside of the profession as to improper reporting of financial information coupled with recent lawsuits against auditors carry overtones of

lack of true independence, integrity, and competence. These serious charges, which create considerable journalistic interest, must be met with dedicated effort to examine the growing responsibilities and hazards of the accounting profession in an age of complex international business.

Much of the pressure for improving the communication qualities of the financial statements has been generated within the profession. The specialized meaning of words used in accounting has always presented a problem. In this regard an important contribution has been made by the issuance of the Accounting Terminology Bulletins by the American Institute of Certified Public Accountants. A review of the 1965 edition of Accounting Trends and Techniques¹ revealed increased usage of the suggested terminology, but in some areas conformity has been slow. For example, of the 600 survey companies studied in the compilation of material for the 1965 edition, 122 companies continued to use the designation, "earned surplus," though the case for discontinuance has indeed been strong.

Another step forward in the achievement of improved comparability of financial statements was taken by the action of the Council of the American Institute of Certified Public Accountants which set forth the requirement that, on all financial statements for periods beginning after December 31, 1965, members of the Institute must disclose, either in the notes to the financial statements or in the accompanying auditor's report, any material deviations between the accounting principles used in the financial statements on which they report and those accepted by the Accounting Principles Board. Where practicable, the effect of the departure, as well as the fact of the departure, should be disclosed.

By recommending that listed companies follow opinions of the Accounting Principles Board, the stock exchanges have helped in the drive for improvement in reporting and have influenced industry associations and other organizations to closer and increased collaboration with members of the accounting profession.

Certain provisions of the Internal Revenue Code, in particular those that permit postponement of the recognition of income for tax purposes and increased deductions under accelerated depreciation methods, have had considerable influence on manage-

¹"Accounting Trends and Techniques in Published Annual Reports—1965," American Institute of Certified Public Accountants, 1966.

(Continued on page 9)

STATEMENT OF OWNERSHIP, MANAGEMENT AND CIRCULATION (Act of October 23, 1962; Section 4369, Title 39, United States Code)

1. Date of filing: October 27, 1966
2. Title of publication: THE WOMAN CPA
3. Frequency of issue: Bi-monthly
4. Location of known office of publication: 327 South LaSalle Street, Chicago, Illinois 60604 (Cook County)
5. Location of the headquarters or general business offices of the publishers: 327 South LaSalle Street, Chicago, Illinois 60604.
6. Names and addresses of publisher, editor, and managing editor:

Publisher, American Woman's Society of Certified Public Accountants; American Society of Women Accountants, 327 South LaSalle Street, Chicago, Illinois 60604.

Editor, Mary J. McCann, CPA, 1700 Power & Light Building, Kansas City, Missouri 64105.

Managing editor, Beatrice C. Langley, 327 South LaSalle Street, Chicago, Illinois 60604.

7. Owner (if owned by a corporation, its name and address must be stated and also immediately thereunder the names and addresses of stockholders owning or holding 1 percent or more of total amount of stock. If not owned by a corporation, the names and addresses of the individual owners must be given. If owned by a partnership or other unincorporated firm, its name and address, as well as that of each individual, must be given.)

Name, American Woman's Society of Certified Public Accountants, 327 South LaSalle Street, Chicago, Illinois 60604; American Society of Women Accountants, 327 South LaSalle Street, Chicago, Illinois 60604.

8. Known bondholders, mortgagees, and other security holders owning or holding 1 percent or more of total amount of bonds, mortgages or other securities (If there are none, so state): None.

9. Paragraphs 7 and 8 include, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting, also the statements in the two paragraphs show the affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner. Names and addresses of individuals who are stockholders of a corporation which itself is a stockholder or holder of bonds, mortgages or other securities of the publishing corporation have been included in paragraphs 7 and 8 when the interests of such individuals are equivalent to 1 percent or more of the total amount of the stock or securities of the publishing corporation.

10. This item must be completed for all publications except those which do not carry advertising other than the publisher's own and which are named in Sections 132.231, 132.232, and 132.233, Postal Manual (Sections 4355a, 4355b, and 4356 of Title 39, United States Code).

- A. Total No. copies printed (net press run). Average No. copies each issue during preceding 12 months: 6,441. Single issue nearest to filing date: 6,780.
- B. Paid circulation.
 1. Sales through dealers and carriers, street vendors and counter sales. Average No. copies each issue during preceding 12 months: None. Single issue nearest to filing date: None.
 2. Mail subscriptions. Average No. copies each issue during preceding 12 months: 5,174. Single issue nearest to filing date: 5,253.
- C. Total paid circulation. Average No. copies each issue during preceding 12 months: 5,174. Single issue nearest to filing date: 5,253.
- D. Free distribution (including samples) by mail, carrier, or other means. Average No. copies each issue during preceding 12 months: 915. Single issue nearest to filing date: 930.
- E. Total distribution (Sum of lines C and D). Average No. copies each issue during preceding 12 months: 6,089. Single issue nearest to filing date: 6,183.
- F. Office use, left-over, unaccounted, spoiled after printing. Average No. copies each issue during preceding 12 months: 352. Single issue nearest to filing date: 597.
- G. Total (sum of E and F—should equal net press run shown in A). Average No. of copies each issue during preceding 12 months: 6,441. Single issue nearest to filing date: 6,780.

I certify that the statements made by me above are correct and complete.

Beatrice C. Langley
Business Manager

IN MEMORY OF IDA S. BROO

WHEREAS, the American Society of Women Accountants desires to record its deep sorrow at the death on September 12, 1966, of its beloved founder, Ida S. Broo, of Indianapolis Chapter Number One, who served this Society as its first president and has been a guiding influence in succeeding years,

NOW, THEREFORE, BE IT RESOLVED that the members of this Society give formal expression of their grievous loss in the passing from life of a woman whose foresight, vision, and wisdom was so instrumental in the formulation of this Society, whose dedication to the Society never dimmed, a woman who was esteemed by her associates, loved by her friends, and respected by all members of this Society.

BE IT RESOLVED FURTHER that a copy of this Resolution over the signature of the National President and National Secretary, and under the seal of this Society be tendered to her family and her chapter, Indianapolis Chapter Number One, American Society of Women Accountants, as a humble expression of the Society's heartfelt sympathy in their bereavement.

BE IT FURTHER RESOLVED that this Resolution be spread upon the minutes of the Annual Business Meeting of September 30, 1966, and that it be published in *The Woman CPA* and the *ASWA Coordinator*.

In a memorial resolution presented at its annual business meeting on October 1, 1966, The American Woman's Society of Certified Public Accountants expressed its deep sorrow and inestimable loss in the death of its beloved member, Ida S. Broo, who served as the fifth president of the Society and who expanded its horizons in the founding of the American Society of Women Accountants.

Trends of Special Interest to the Accountant in Financial Reports

(Continued from page 4)

ment's choice of accounting methods, irrespective of the ever-present underlying concern for showing current favorable performance on the financial statements. Accordingly, the problem of comparability has become more involved.

Because a detailed account-by-account comparison has been readily possible in judging the performance of government-regulated companies for which a uniform system of accounts has been prescribed, the financial statements of these companies have been pointed out as fulfilling the requirement of uniformity in financial reporting. If so, have sound, uniform accounting principles been applied to the items going into each account? Still a closer look at the facts reveals that regulated companies must comply with accounting requirements promulgated by various authorities and thus must be able to furnish different sets of figures. In the case of one reporting company, the overlapping jurisdictions were Federal and state commissions, and in an opinion footnote, the auditors stated their belief that since the state had the major jurisdiction over the affairs of the company, the statements based on the state's account-

ing requirements were most useful to the company's stockholders.

Has the Securities and Exchange Commission been involved in the movement toward uniformity in financial reporting? The Securities Exchange Act of 1934 made mandatory the filing of annual reports of listed companies, and these reports were made available to the public. In May 1964, the Commission with its broad authority over prospectuses and annual reports set forth a new requirement that the reports to stockholders be based on accounting practices and principles generally consistent with those required for financial statements filed with the Commission and that any material deviations therefrom be noted in the stockholder reports and any resultant differences reconciled with the Commission report. In answer to a "formal petition" by a public accounting firm, the Commission issued on December 7, 1965 Accounting Series Release No. 102 which requires that, effective for fiscal years ending on or after December 31, 1965, deferred income taxes arising out of installment sales be classified as a current liability if the related installment receivables are classified as current assets and consequently ruled out the practices of show-

(Continued on page 10)

Trends of Special Interest to the Accountant in Financial Reports

(Continued from page 9)

ing the deferred income tax account as a noncurrent liability and the related installment receivables as a current asset.

With the growing emphasis on "cash flow," a term exceedingly popular with security analysts, the statement of source and application of funds has been added as supplementary information in financial reports. Accountants have expressed concern about financial articles that foster the erroneous impression that the "cash flow" figure is to be considered superior and as a substitute for the net income properly determined as a measure of the company's real earning power. The New York Stock Exchange early in 1964 in a letter addressed to presidents of companies listed on the Big Board urged that a statement of source and application of funds be included in future annual reports to stockholders. In Interpretive Opinion No. 3, The Statement of Source and Application of Funds, the Accounting Principles Board of AICPA stated the opinion that "inclusion of such information is not mandatory and it is optional as to whether it should be covered in the report of the independent accountant." Of the 600 survey companies reviewed in the 1965 edition of Accounting Trends and Techniques, 191 companies included funds statements in their annual reports, and the auditors referred to the funds statements in the following areas of the reports: five in the scope paragraph, eighty-two in the opinion paragraph, eighty-six in the scope and the opinion paragraphs, and eighteen in a separate place in the report.

What are the current problems to which accountants are directing their study and effort in the endeavor to provide more meaningful financial information?

Published interim reports become more popular each day and are fast becoming an integral part of the financial communication programs of numerous corporations. Security analysts and stockholders, continuing the drive for putting the investor on notice, want important financial developments reported more often than annually at the end of the fiscal period. They complain that unusually significant events, known almost immediately to insiders, are revealed only in the reports which are distributed sometimes long after the close of the fiscal year. Some of the stock exchanges are requiring the publication of interim earnings statements. Although accountants note that brief reports may be misleading, that the user may erroneously apply a multiple factor to forecast annual results, and that the reports

of corporate-management activities may be overly enthusiastic, the interim report is here to stay and is within the province of the public accountant. Some are suggesting that the audit program include a review of the interim reports issued since the last published annual report, and that the auditor furnish a statement to the effect that the format and contents have been examined and that any abnormalities have been explained in the accompanying footnotes.

The statement, "prices go up and prices go down," seems to have lost some popularity in the last few years. Whenever prices are changing noticeably and in one direction, particularly over an extended period of time, considerable stimulation is given to the measurement problems involved in financial reporting. Do business entities have an accountability for reporting changes in capital resources and the results of operations in terms of price-level changes? At this time, opinions differ.

The advocates of historical cost point to the high degree of verifiability, the lack of personal bias, alleged limitations of price-index numbers, complex adjustment procedures not readily understandable, adequate parenthetical and footnote presentations showing current information, and the possible ultimate abandonment of historical statements. Others believe that certain accounts, such as inventories and fixed assets, should be shown at current costs in the financial statements and that a reconciliation with the conventional-form statement should be set forth in a footnote. Still others define "price-level adjustments" as meaning replacement cost as used in appraisals and would adjust each account accordingly, giving no consideration to overvaluation problems.

A substantial part of the criticism of statements based on historical cost concerns the comparability of these statements. Recent studies, however, point toward some agreement in accounting circles as to the recognition of price-level changes.

The Staff of the Accounting Research Division of the American Institute of Certified Public Accountants in Accounting Research Study No. 6, "Reporting the Financial Effects of Price-Level Changes," recommends that all items on both the balance sheet and the income statement be restated by means of a single index of the general price level and that a net gain or loss on monetary items be shown as a separate item in the statements. The adjusted figures are to be shown as supplemental statements or in extra columns in the primary financial exhibits.

(Continued on page 12)

An alternative solution to the problem of a corporation that is faced with the dilemma of a Section 531 problem is the election of Subchapter S status within the first thirty days of the 1967 year. Here, however, the shareholders are compelled to pick up in their individual returns the entire net income of the corporation whether or not distributed. The election negates the possibility of retention of possible future profits, should it be justified.

D.L.B.

Trends of Special Interest to the Accountant in Financial Reports

(Continued from page 10)

In the booklet recently published by the American Accounting Association, "A Statement of Basic Accounting Theory," it is suggested that both historical cost and current cost be presented in adjacent columns and that current cost be secured by reference to established market price or through application of a price index to acquisition cost.

With the stress on the usefulness of financial reports comes the realization that there is a decided trend toward getting away from using technical terms that do not have precise meaning. Though there is a natural desire to reduce to a minimum the number of words used, there has been increasing growth in the footnote area and in the number of statements that show the explanations of the items directly below each title. Improvements in format, content, and other facets of the published annual report are part of management's continuous effort to maximize communication with stockholders.

In some minds, the earnings-per-share statistic is the figure that is accepted as summarizing all activity. Investment decisions are made accordingly with no consideration given to the possibility that a portion of the earnings-per-share amount may be due to income from unusual transactions and with a complete disregard of all other pertinent data. Thus, as another step in improved reporting, it is suggested that where applicable in the presentation of the earnings-per-share figure, the portion of this figure contributed by net income from operations and the remainder derived from income due to unusual transactions be separately stated. More detailed information will be forthcoming if the SEC concludes, as the result of a current study, that sales and profits for specific lines and services should be shown in detail. Concurrently, some writers of financial articles are stressing the need for presentation of in-

dividual company statements as well as the consolidated statement in cases where the individual statements are more meaningful.

The comparative financial statements that are a popular presentation in today's financial report may someday be replaced by financial statements showing a ten-year span with explanatory commentary by management as to the cause and significance of fluctuations. Increasing international business and investments augment the possibility that the present problems of uniformity and comparability in financial reports will be shifted from the local and national scene to an international setting. The present views in disputed accounting areas are surprisingly divergent, but they pose as a necessary forerunner to more profound research into what is needed. Accountants may differ as to the proper course of action, but there is evident an underlying general agreement that there will be expansion of the accounting discipline to give more information and to move ultimately toward international uniformity of accounting and auditing standards.

Financial Statements for the Transnational Enterprise

(Continued from page 6)

as to currency shown. Where United States corporations hold 51% or more of the stock of a foreign subsidiary, the United States dollar is used in the statements. Companies of two foreign countries consolidating their financial statements frequently use a fictional monetary unit, such as the Eurodollar which is based on the gold standard. Finally, there are corporations whose management believes that a translation of one currency into another is not meaningful.

A Fictional Currency

As brought out above, the transnational enterprise must arrive at some common denominator in the preparation of its financial reports. Since in all likelihood a number of different currencies are involved, it seems logical that the use of a fictional currency might be of great help.

There are several advantages to employing a fictional monetary unit. The use of any one country's currency might meet considerable resistance because it would seem to give this country a special position of importance or superiority over other nationalities' interests in the enterprise. A fictional currency cannot be opposed on the basis of nationalistic feelings. Secondly, a fictional, imaginary monetary unit is not subject to fluctuating exchange rates set by national governments. If its value were related

(Continued on page 14)