Woman C.P.A.

Volume 37 | Issue 3 Article 6

7-1975

Financial Statements: The “New Look” in Financial Statements Dr.

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New Look

Annual reports are acquiring a new look faster than are men and women's fashions. The reports now flowing through the mails contain few of the elaborate productions of the past years and have acquired a niggardly approach. The information contained in these reports is also changing in form and content. Some of the new data appear as a result of new SEC requirements. Other data appear because stockholder groups are demanding more information on financial and social issues. Annual meetings face challenges by organized stockholder groups and public interest law firms seeking to force more disclosure of corporate policies. Auditor's opinions often contain three paragraphs: Lewis Gilbert, New York stockholder advocate, warns, "If the certifying statement is longer than the normal two paragraphs, watch out. The third paragraph is likely to be telling you something is wrong."

Fewer Frills

The recession and the SEC have brought a new look to corporate annual reports. 1974 reports contain fewer pages, fewer pictures, are smaller in size, and are no longer the handsome productions of the past years. The covers of the annual reports and the tone of the shareholder's letter often reflect social issues and business moods. For several years prior to 1974 the cover of the Procter and Gamble Company annual report had a colored picture with a dozen or more colored pictures inside. Those reports stressed the environment and consumerism. For example, one of the reports devoted four pages to "Toward a Better Environment" and another contained a five-page section titled "P&G Manages Forests for the Future." In contrast, the 1974 report is an austere document; the black and white cover contains only the P&G trademark. The state of the economy is the central topic of discussion inside.

Economy appears to be the watchword for 1974 reports. Litton Industries, for years the pacesetter of unusual annual reports, may have started the trend with its report for the fiscal year ended July 31, 1974. Remember its "masterpiece" that was more than 200 pages long and contained full color reprints of many great art treasures? Its latest report is a 64 page black and white booklet without a single picture. The financial statements show a $40 million loss and contain a crisply worded review of operations.

General Motors with its 1974 profits down by 61% trimmed its annual report by 46%, from 52 pages to 28, and cut its color pages by 64%, from 31 to 11. First Pennsylvania Corp., a financial holding company that recorded a 19% drop in per-share earnings, packages its annual report in a brown-paper-bag cover imprinted with the shrinking 1974 dollar bill — one quarter the size and value of its 1950 counterpart. Electric company reports are especially spartan. Cincinnati Gas and Electric Co. has only a few black-and-white photos and sketches of its operations. Some utilities have cut out all art work in their reports.

The record for the year's smallest annual report goes to GAF Corp., which has reduced its 36-page booklet to a 4 x 6-inch microfiche card. That's not the way shareholders will receive the report, however. GAF is using the card to demonstrate filmmaker GAF's belief that most newspapers, books and reports will arrive like this someday. (A microfiche that size can hold 98 letter-size pages; an ultrafiche can hold up to 8,000 pages.)

Economy and declining fortunes may not be the only reason for the low-key look. The president of one of major corporate report publishing concerns believes that the companies want to be blue-chip again. He explains that in the go-go years of the stock market, chief executives wanted readers of their annual reports to think that their companies were among the glamorous growth companies. But, in today's uncertain times, "sound and stable are now adjectives that company officers want financial audiences to tack onto their companies."

More Data

Corporations this year are publishing more statistics and more financial details than ever before. The main impetus for this is that the SEC made sweeping changes for annual reports. The SEC now requires:

1. Financial statements certified for two fiscal years instead of one.
2. A five-year summary of financial results, where none was required before.
3. Management assessment of its financial information.
4. A brief description of the company's operations and those of its subsidiaries.
5. Breakdowns of results by lines of business or classes of product.
6. Identification of each high execu-

tive officer and director and their principal occupations.

7. Name of the market where the stock is traded, high and low sales prices quarterly for the last two years and dividend data for two years.

In addition, each report must state that the 10K report is available from the company to any stockholder on request and without charge. *What is the 10K?* The SEC Act of 1934 requires most publicly held companies to file an annual report with the SEC on Form 10K. This report includes financial statements, schedules, and other data which involve activities of the company for the period covered by the report, the due date is 90 days after the close of the period. Incidentally, 8 copies must be filed and there is a filing fee of $250.

What is found in the all-important 10K? Detailed balance sheet and operating data are included. The business "done or intended to be done" must be described each year, not just when there has been a change. If the company engages in several lines of business, each line is broken down by sales and earnings. This allows shareholders to see if any of the lines of the business are losing money, and to determine the most profitable divisions. The annual report of the Cincinnati Equitable Insurance Company discloses that 56% of the reported earnings resulted from its ownership of a subsidiary. The investment in the subsidiary, reported on the equity basis, accounted for only 10% of total assets. The president's letter explained that the tornados that swept through Cincinnati on April 3, 1974, resulted in unusual losses incurred by the casualty insurance division. Thus, he attempted to explain the rate of return on total assets of the parent as compared to the rate of return on its investment in the subsidiary.

The 10K also provides data about the purchase or sale of plant and equipment and the method of depreciation used. In it one can find the state of incorporation and the address and telephone number of the principal executive offices; this information is not always found in annual reports. It also reports the amount of research and development and tooling costs. Detail is provided on any litigation in which the company is engaged. It will tell much about the competitive position of the concern and something of its problems, matters that are sometimes played down in annual reports. For example, the Consolidated Edison Company discusses the deteriorating customer payment patterns in its 10K in explaining why accounts receivable from customers increased by 271% in a four and one-half year period. The report states "the company estimates that a substantial portion of this increase is due to deteriorating customer payment patterns. A measure of this deterioration is the age of the accounts receivable."

Some enterprising managements anticipated the SEC requirement that the 10K must be made available to stockholders and are sending out the 10K in lieu of the annual report. However, this practice is rare and for large companies probably will never become the accepted practice. Many 10Ks are more than 100 pages in length; the printing and mailing expense could be substantial. It is also doubted by many that the average stockholder would read beyond the opening pages. The requests for 10Ks by stockholder's have been negligible. Some companies, such as Weyerhaeuser, the lumber giant, and Browning-Ferris Industries, a Houston-based waste collection firm, included the full 10K with their reports.

If the annual report incorporates the 10K, it may tend to become dull and drab. The Outboard Marine report shows that this can be avoided, since it is both aesthetically pleasing and informative. The report has the usual attractive picture on the cover. Four pages in the front of the statement are devoted to financial highlights and the usual messages from the chief executives. The next 22 pages consist of the 10K and the last four pages cover "The Year in Review," a list of officers, and other statistical data. Naturally, this method of combining the 10K and annual report results in some economies. However, managements must weigh these savings against postage costs and additional printing expenses; most 10Ks are much larger than the 22-page 10K section for Outboard Marine.

More Disclosure

For the first time a more meaningful breakdown of sales figures by classes of products and a discussion of subsidiary operations will be found. Many of the companies acquired in the "merger fever" of the late 60's and early 70's have not met earnings expectations. A major weakness of some annual reports of the past (and of some present reports) has been the absence of information on how former independent companies are doing after the merger. Eli Lilly & Co. doesn't say a word in its letter to stockholders about Elizabeth Arden Co., which it fought to acquire four years ago. Not until 30 pages into the report does one find that Arden's operations "reduced" Lilly's net income in 1974 by $3.9 million. The report says nothing about Arden's losses.

Campbell Soup sets the pace for the right kind of disclosure in its annual report. It states, "Approximately one-third of the total increase in the company's sales for fiscal 1974 represented an increase in volume, with price increases accounting for the remaining two-thirds." However, it says nothing of how well formerly independent companies are now doing under the Campbell banner. These include Pepperidge Farms and Swanson.

Warning: Read between the lines and look hard

Even with the new era of more information, there are guidelines for reading annual reports that may prove useful. Look carefully at the footnotes. Bad news is very often hidden or explained there. Explanations and footnotes may not be written in readable English. Remember that when companies have had a good year they will tell you straight out. When they haven't the language of reporting may become contrived. The key in the letters to shareholders is the phase: "Year of transition." When you see that you can expect lower earnings. If the transition is upward, the reports speak of continued growth instead of "transition." Since the annual reports are intended for the lay person, corporations should seek to eliminate vague and confusing language. The following quotations originated with Alfred Eris, of Alfred Eris Associates, Inc., a New York public relations firm. For example, Topps Chewing Gum finds it hard to say "Our products are selling well." Instead, it declares "Our established products continue to exhibit strong consumer acceptance." Chief executive officers are reluctant to admit that they are bewildered by international developments. Instead they "consider" and "evaluate;" the Masoneilan International report reads "High rates of inflation . . . balance of payment problems . . . shortages of material are being considered and evaluated." Why can't reports be written in simple terms? Why does "We are going to do our best" come out as "We intend to continue to merit the faith our customers have placed in us?"

Beware — A three Paragraph Auditors' certificate

The auditor's report usually consists of two highly stylized paragraphs summarizing what the auditor checked and what was found. But the 1974 annual reports are often going beyond the tradi-

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to *Love's Labor's Won*; however, the binding of the book by hand had required the use of some high quality material which turned out to be a portion of an inventory accounting record of a stationer, Christopher Hunt, "who in August, 1603, was doing business in Exeter and subsequently by 1607 had moved to Paternoster Row in London."

In the inventory, consisting of several manuscript leaves, Mr. Hunt (or his scribe) had a good deal of data relating to other matters, and there are even some pencil notations of a later generation; but the important point is that the inventory clearly reveals that there was in print in 1603 a Shakspere play called *Love's Labor's Won*. Actually, *Love's Labor's Lost* is an older play from the standpoint of proof. All of the plays in the stock of the book seller are listed in Elizabethan English and the quality and price of most of the items are presented. Thus, an accounting document has assisted importantly in quieting much of the speculation on this subject.

The most important historical gap still remaining is whether *Love's Labor's Won*, after being published under that title, was later used by Shakspere in plays after 1603. Mr. Baldwin describes vividly his detective work in trying to settle for all time this remaining questionable point by exercising his large understanding of Shakspere; and by logical analysis, Mr. Baldwin comes to the end of his detective story with the following conclusion: "We have left, therefore, as suspicious characters *Measure for Measure*, and *All's Well that Ends Well*. In character, pattern, etc., *All's Well* is closest of all the plays to *Love's Labor's Lost*, so that I have long considered it to be the most likely candidate. But this mention in 1603, while it eliminates some plays entirely and others probably, yet it does not indicate directly whether *Love's Labor's Won* survives at all, nor if so under what title. Consequently, there would be no point to reviewing here all the suggested identifications of *Love's Labor's Won* with various plays of Shakspere. Simply, we are now assured that in August, 1603, there was in print a play called *Love's Labor's Won*, which Meres attributes directly to Shakspere, as does our stationer by indirection. If a copy of *Love's Labor's Won* is ever discovered, it is not likely to be exactly the folio version of *All's Well*."[5]

Perhaps the moral of all this is that computer tapes of today's inventories of *Oklahoma* and *South Pacific* should be preserved for curious scholars of the Twenty-fifth Century!

Notes

[1]See especially: Johnston, D.L., "Was Shakespeare an Accountant?" *Canadian Chartered Accountant*, Nov., 1954, pp. 276-8. Also printed in *New York Certified Public Accountant*, July, 1956, p. 432-5. Also, see "Shakespeare Was an Accountant." *Accountancy*, May, 1964, pp. 395-6, reprinted in the *Woman CPA*, September 1969, pp. 4 & 10. And, Pritchard, R. T., "Shakespeare and Accounting." *The Accounting Review*, January, 1946, pp. 67-70.

[2]This is the spelling preferred by T.W. Baldwin, a noted scholar, in his attractively decorated thin (42 pages) volume published in 1957 by the Southern Illinois University Press, Carbondale, Illinois. Mr. Baldwin has published at least four other works on Shakspere.

[3]Francis Meres was a divine and minor writer of the period, who wrote in 1598 his *Palladis Tamia*. The reference to *Love's Labor's Won* may refer to *T'e Taming of the Shrew*, per Craig & Bevington, Editors, *The Complete Works of Shakespeare*, revised edition, Glenview, Illinois: Scott Foresman & Company, 1973, p. 1305. See also reference to the "mysterious" *Love's Labor's Won* on page 1307. Another reference on p. 1312 indicates that it is unlikely that *Much Ado About Nothing* is the same play as *Love's Labor's Won*. On page 1316, there is a reference to the "intriguing" *Love's Labor's Won* and they reject the possibility that it is the same as *All's Well that Ends Well* because of the dating and first registration of the latter play.

[4]Meres spells it *Love labours Wonne*.

[5]Quoted by permission from page 15 of Mr. Baldwin's book.

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tional two paragraphs and are presenting "qualified" opinions, signifying serious reservations about the companies' financial statements. No one is keeping a count of this years' qualified opinions, but the increase is widely acknowledged. The management partner of one of the big eight accounting firms is quoted in a recent *Wall Street Journal* article: "Qualified opinions are three times as numerous as they were a year ago. We're writing qualifications on companies that have never had them in their entire existence." Typically, the auditors are using the middle paragraph to highlight uncertainties. Previously these might have been buried in a footnote. The accountants are hesitant to venture hard-and-fast judgments about many of the imperceptibles that companies face. Accountants have always acknowledged that annual reports are filled with uncertainties and rely on estimates and judgment. Accountants are now attempting to impress this practice on the public. They are giving qualified opinions for a whole range of reasons, but the majority deal with uncertainties as to asset realizations. Leading business publications are warning the shareholders to beware of a "Subject to" clause in the auditor's report. When such a phrase appears one should read the report carefully and especially the footnote to which it refers.

Social Reporting

More reports are devoting space to explaining company policies for civic and social betterment. This aspect of annual reports will be covered in a later issue.

Conclusion

Annual reports are changing. The process is more evolutionary than revolutionary. In many cases the changes are being dictated by the SEC. Few accountants or shareholders question whether the additional disclosure is *good;* the real concerns rest on the additional costs necessary to effect the new disclosures.