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## Single-Purpose Statements

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# Single-Purpose Statements

[In the November JOURNAL OF ACCOUNTANCY, Jerome N. Frank, Chairman of the Securities and Exchange Commission, suggested the possibility of single-purpose financial statements, commending to the reader an article on accounting by M. C. Kaplan and D. M. Reaugh, reprinted from the *Yale Law Review* in the September, 1939, issue of the *Accounting Review*. The text of Mr. Frank's interesting suggestion is reprinted below, followed by the opinions of Norman J. Lenhart and Edward B. Wilcox, practising accountants.—*Editor*]

## STATEMENT BY JEROME N. FRANK

"It may very well be—I am suggesting this for your consideration—that the present balance-sheet which attempts on two pages, with some accompanying explanatory notes or tables, to describe a vast business enterprise, cannot at the same time meet all of the varied demands made upon modern accountancy. It is possible that our all-purpose balance-sheet cannot faithfully serve all of its many masters—the divergent and sometimes conflicting interests of creditors, stockholders, management, tax collectors, the regulatory agencies. Would it not be feasible to construct 'single purpose' balance-sheets and possibly income statements which would reflect the enterprise in the terms and categories which would best serve particular purposes and then in a separate column make the necessary reconciliation between the various statements? Or, the all-purpose historical balance-sheet might be made more meaningful to the investor by supplementing it with a special-purpose financial statement designed to serve the particular interests of the investor. For although educated prophecy needs sound history, it needs more than that—it needs history presented and explained in the light of the specific prediction that must be made."

## OPINION OF NORMAN J. LENHART

I found "Accounting for Investors,"<sup>1</sup> by Jerome N. Frank, as well as "Accounting, Reports to Stockholders, and the S.E.C.,"<sup>2</sup> by Maurice C. Kaplan

<sup>1</sup> Reprinted in the Nov., 1939, JOURNAL OF ACCOUNTANCY, pp. 295-304.

<sup>2</sup> *Yale Law Journal*, Apr., 1939, reprinted in abridged form in *The Accounting Review*, Sept., 1939, pp. 203-236.

and Daniel M. Reaugh, most interesting reading. Mr. Frank referred to and highly praised the article by Messrs. Kaplan and Reaugh although he did not express complete approval thereof. Most of what is said in both articles has been the subject of discussion among leaders in the public accounting profession for many years. Most of the criticisms expressed therein appear to be not so much criticisms of what is now considered to be the best accounting practice but rather criticism of failure to follow such best accounting practice.

In any consideration of these two articles (and I believe they should be considered together) the thoughts expressed in the following paragraph from the report of the New York Stock Exchange subcommittee on independent audits and audit procedure of the committee on stock list should be kept in mind:

"The broad improvement which has taken place over the years in American corporation accounting and in reporting to stockholders has been a gradual development marked by the consolidation of each advance, a progression in which abrupt and ill-considered changes have largely been avoided. It is with a certain historical sense and a strong conviction of the soundness of such a well integrated development that your subcommittee prefaces its report with the reminder that accounting and auditing procedures are in their very nature not final but evolutionary, both in themselves and in their adaptation to a continuously evolving business world, and that new developments should be introduced only where their practicability is reasonably established."

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I do not believe there is any substantial difference in the form of financial statements which will best serve stockholders, investors, and credit grantors. It is true that credit grantors, for example, may and generally do wish information in addition to that which may be found in the usual financial statements. However, much of this information is not of a character which could well be presented in financial statements.

Certainly no competent management would be satisfied merely with such financial statements as might be of interest to stockholders, investors, and credit grantors. Supporting statements in considerable detail, comparisons with budget estimates, and many other related statements are required by management.

Examples of single-purpose financial statements which have been prepared for many years whenever the occasion might demand are:

Statements prepared in accordance with forms supplied by credit grantors, credit-rating agencies, and banks.

Statements prepared in accordance with forms supplied by regulatory agencies, such as Interstate Commerce Commission, Securities and Exchange Commission, taxing commissions, etc.

Statements prepared for companies in bankruptcy.

Pro forma or "giving-effect" financial statements.

Combined financial statements as distinguished from consolidated financial statements.

Liquidating statements.

I get the impression that Messrs. Frank, Kaplan, and Reaugh are advocating the preparation of financial statements in more detail and with more explanation than is now the case rather than statements in some form basically different from the best examples of statements now prepared for stockholders, investors, and credit grantors.

I do not believe that stockholders, for example, would be interested in financial statements prepared for some or all of the special purposes listed above, such as for regulatory bodies, taxing commissions, etc., nor do I believe that credit grantors or investors generally would be interested in such statements.

Messrs. Kaplan and Reaugh, in their article, said:

"Most of the classifications in accounting are broad and generic—very loose abstract words and phrases into which we attempt to pack the divergent transactions of business life."

The first sentence of the succeeding paragraph of their article reads:

"A fuller realization by accounting practitioners and teachers of the generic nature and purposive character of accounting categories should lead to a paring off of the broader concepts, the elimination of those which are meaningless or which no longer serve specific needs adequately, an application of existing concepts and the formulation of new ones in terms of specific situations and specific functions, and to a healthy skepticism to counteract the appearance of certitude induced by mathematical symbols."

I wonder how many readers will clearly understand the meaning of that last sentence; I certainly do not.

#### OPINION OF EDWARD B. WILCOX

The demand for various single-purpose financial statements intended for restricted use, instead of so-called all-purpose statements for general use, is being heard with increasing frequency. Chief among the special purposes for which these new kinds of statements may be intended are management control, investment, and credit. Management appears to be primarily interested in a tool which will measure costs and efficiency, and facilitate intelligent decisions. Investors desire a basis for

estimating earning power; and credit men are more concerned with liquidity and ability to pay short-term obligations. It has been suggested that no one set of financial statements will best serve all of these purposes.

The demands for single-purpose statements have come largely from outside the ranks of independent public accountants, and generally have been more critical than constructive. This is as it should be, since it is certainly the task of the accountant to solve the problem when it has been laid before him. Some of the comments made in connection with these proposals are not specifically applicable to them, but are of a more general nature, such as need for uniformity and better general understanding, full disclosure, avoidance of obscurity and manipulation of accounts, etc. It is necessary to differentiate what is relevant to the proposal from what is not. For example, the adoption of natural business years would improve financial statements for use of management, investors, and bankers, as well as for other purposes, but does not appear to be exclusively applicable to any one purpose. I believe that there are three pertinent questions to be considered in connection with single-purpose statements:

1. How shall they be prepared and differentiated from one another?
2. What dangers will arise from their use?
3. Will they greatly increase the cost of accounting services?

How to prepare and differentiate single-purpose statements will call for much study and research, and it is not possible at the outset to foresee the results very clearly. It seems that consideration of the problem should deal with classification of items, subsidiary explanations, and general principles of treatment and presentation. For example, statements of costs and expenses

prepared for management might be classified and allocated according to departmental responsibility, whereas these same items would be more intelligible to investors if they were classified according to their original nature and probable recurrence. Subsidiary information of interest to credit men might deal with seasonal trends and peak financial requirements as indications of ability to pay short-term obligations. It has also been repeatedly stated by bank credit men that they desire to know in detail the nature of current assets and liabilities and the methods and extent of the accountant's verification. Investors, on the other hand, are more interested in the basis of depreciation and other similar charges, and in a complete statement as to equities of various classes of securities, and availability of surplus for distribution. Their estimates of earning power would also be aided by comparative statements of income and by adjusted statements for periods longer than one year.

The most important development would be a set of standards for treatment and presentation of single-purpose financial statements. To measure cost and efficiency for management, wide variance should be permitted, and the truth will often be better expressed by duplicating or omitting certain charges. For investors, statements of income should reflect, not merely the fortuitous results of short periods, but should afford a basis of comparison with other periods and other concerns. It may be that some comparatively rigid rules should be adopted for this purpose. Such a rule might be that current assets and liabilities should always be stated on a valuation basis, and that fixed assets should always be stated on a historical basis. For restricted purposes such rigid pronouncements would be much more acceptable than if they had to be taken as applying to accounting generally. A much more difficult but very important aspect of this field deals

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with adjustments to disclose the effect of inconsistent bases of charges such as depreciation of properties acquired at various price levels, or the result of fluctuations in the value of the dollar.

The danger in undertaking to furnish single-purpose financial statements lies in increasing confusion and misunderstanding, and in the possible misuse of such statements for unintended purposes. Some standard label for them could be adopted, and possibly their preparation should be limited to independent certified public accountants. It is particularly important that the so-called all-purpose statements now in general use be understood and appreciated before they are abandoned. Both

this problem and that of increased cost, can only be judged after some determination has been made as to how single-purpose statements may be prepared and differentiated.

Regardless of how it is to be done, or of whether or not it is to be done at all, the fundamentally important point is that the suggestion be carefully and judiciously considered and that it be neither adopted in a fine flush of liberalism, nor rejected out of stubborn adherence to tradition. Accounting must continue to be a growing and evolving thing, and must not fail to respond adequately to the increasing demands and responsibilities which are constantly being heaped upon it.