ACCOUNTING REPORTS AND STATEMENTS

by

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B. Com., Nizam College, Osmania University, 1961

A REPORT

submitted in partial fulfillment of the

requirements for the degree

MASTER OF SCIENCE

School of Commerce

KANSAS STATE UNIVERSITY
Manhattan, Kansas

1963

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INTRODUCTION

Due to the growth and complexity of modern business, detailed study of the reporting function has become essential. The reporting should be organized on a systematic basis so as to make it useful for management purposes. Facts and figures should be gathered in a proper manner and after being arrayed systematically, should be presented to the proper person. Executives should not be burdened with unnecessary and too much information; it should be just enough for their needs. Reports are detailed at lower levels of management hierarchy but get comprehensive and condensed at the upper levels.

The purpose of this report is to study reporting systems in business organizations. Consequently, various accounting reports and their characteristics and forms are discussed to show how a good reporting system can improve communication, which is essential for the successful operation of a business enterprise.

The first step towards a systematic organization is classifying the reports according to the function they perform. A concise, yet not too detailed classification would be to divide the reports into four major groups: reports for the use of management, stockholders, employees and for credit purposes. The most important of these are stockholders' reports, which include the balance sheet and the income statement. These two statements are important both from the standpoint of management and the general public. The balance sheet gives a bird's-eye view of the financial strength of a company, whereas the income statement discloses the firm's earning power. Also, these two statements play a major role in the guidance and evaluation of a company. A few of the other major statements are consolidated statements, statement of retained earnings and statement of sources and applications of funds. A recent trend in reporting is to portray the information graphically. Such presentation makes the reports clear, simple and effective, particularly for people who lack technical knowledge. Also, certain characteristics and forms of reports help in improving communication. which is the basic object of reports.

What Is a Report

A report as defined by Webster is an "official statement of facts." This definition is rather general, embracing all written communications. For accounting purposes, a report will be defined as a record in which some definite information is presented for the use of different parties, usually to help solve a problem. It is a written statement of results, events, qualities, conditions, progress or interpretation of records. A good report..."records the past, reflects and forecasts the future."[1] The past is recorded in daily, weekly or yearly reports incident to the conduct of the business. The present is reflected in the same reports, after digesting the present conditions. The future is forecast through inferences and recommendations based upon the fundamental data brought to light. But Alex G. Rankin sounds a slightly different note when he observes thus: "There are three fundamental kinds of reporting: historical reporting, reporting for management

1. Chester R. Saunders and Alta G. Anderson, Business Reports, page 1.

control, and reporting as a basis for future planning. All three are closely interwoven."[2] In smaller businesses and in less comprehensive reports, it is desirable that the past, present and the future be reflected. But in large undertakings where detailed and comprehensive reports are used, it is better that each phase of the business activity is reflected separately. The field of reports and statements is so complex that there is bound to be overlapping. Reports should be tailor-made for the different kinds of businesses. A good report is an objective, impartial and a simple presentation of the facts.

Importance of Reports

> The primary function of reporting is to accumulate and communicate information essential to an understanding of the activities of an enterprise, whether large or small, corporate or non-corporate, profit or non-profit, public or private.[3]

Information is a basic requirement of business operations. The regular flow of information up, down and across within a business is essential to sound planning and coordinated activity. The main purpose of the reports is to provide this information. Due to the steady growth of business activity, enterprises are becoming more and more complex, and there is an ever increasing need for developing adequate methods and means by which to keep management well informed as to the past accomplishments and the present status of its enterprise.

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2. Alex G. Rankin, "Making Reports Truly Current," The Controller, June 1960, page 270.

3. Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements, American Accounting Association, page 1.

The need for uniformity and certain minimum standards of disclosure in the area of financial reporting is universally recognized in all countries where financial reporting plays an important role in business life. In Germany, the Corporation Act of 1937 regulates, with great detail, the presentation of financial reports. Every corporation must exercise great care in order to meet the minimum requirements of this act. In the United States, professional accountants through their organizations try to maintain and improve the standards of financial reporting.

At this point we need a slight clarification of the terms "report" and "statement." A statement in the strict sense means a tabulation of figures, accompanied by the necessary footnotes, while a report is a single statement without comment, a group of statements with explanatory notes or any comment on business activity, not necessarily accompanied by statements. There is no definite line dividing these two and there is considerable overlapping. In this paper the terms will be used interchangeably.

CLASSIFICATION OF REPORTS

There are several ways of classifying accounting reports. The most useful and practical basis of classification is according to the function or purpose of the reports. The basic functions of reports can be broken down into four categories and each different type will be discussed separately.

Reports for the Use of Management

The reports intended for the guidance of management in its conduct of the business offers the accountant his greatest opportunity for constructive service. These reports are known as long-form reports, as they include comments in suitable detail on accounts, policies and procedures; recommendations which point to the need for change in office procedures, credit and financial policies; or present suggestions for protection of financial policies and properties or for discontinuance of unprofitable operations. Quite frequently the reports may disclose errors or irregularities in the accounts which will lead to changes in personnel. They may discuss sales and profit trends which merit analysis and study.

The internal managerial reports generally fall into three major groups: (1) control reports, (2) information reports and (3) analytical reports. Control reports are intended to assist in the control of the business by indicating those areas which need corrective action. Information and analytical reports are intended to interpret and present facts for management to use in planning and policy determination.

Control Reports

1. Current Control Reports: These reports which are issued hourly, daily, or weekly, point out deviations from planned or standard performance. Their objective is to induce prompt corrective action before huge losses are incurred. Examples of current control reports are:

(a) daily or weekly reports on scrap or excess material usage, or

(b) weekly reports on cash balances, compared to expected needs.

2. Summary Control Reports: These reports summarize past performance and thus help management by informing them of the effectiveness of their performance and by acting as a check against current control reports. Summary control reports for example could include a statement of income and expense by products, summary cost reports and so on.

Information Reports

These reports compare the results of an activity over a period of time, usually a month or a year, to point out changes in growth or composition. Such reports are usually expressed in terms of ratios or in units, and cover large areas and may relate to income or cost items, assets or liabilities or may present trends in costs and profits.

Analytical Reports

Analytical reports present analyses of certain operations in certain aspects of business activity, such as an analysis of changes in gross profit, analyses of changes in financial condition, analyses of sales by customers or territories, and many other analytical presentations.

Reports to Stockholders

Many companies throughout the world are required either by the state or other regulating bodies to furnish the stockholders with annual financial statements, properly drawn up. In the United States certain companies are under the rules and regulations of the Securities and Exchange Commission which requires the firms to follow certain methods and meet the standards of disclosure. The comparies under regulation have to present to the stockholders at least a balance sheet and an income statement. These two statements are discussed in detail later.

Private owners and other companies which are not under the control of the Securities and Exchange Commission also want to meet the accepted standards of disclosure, for this increases the prestige of the company. Reports should arouse the interest of the stockholders and permit them a quick review of operations. Many details which are useful to the management have no value nor are they of any interest to the stockholders; and if included, obscure the picture for them. Hence reports to stockholders call for a proper elimination of minute details. "The condensation is usually a condensation of items in the statement, not an abridgement of explanatory matter."[4] Such a condensation is known as a summary of the highlights, an example of which is presented in Figure 1. Comparative balance sheets and income statements are of great value to the stockholders. Statements not only for two years, but summaries for five, ten, twenty-five and even fifty years are of interest to stockholders and are of tremendous value to the company in acquainting the public with its progress.

Reports to stockholders should not be complicated and technical in nature. People who read these reports need not necessarily be accountants. Short sentences and brief conversational style have been found most effective.

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4. Jennie M. Palen, Report Writing for Accountants, page 36.

.... COMPANY, INC.

19XX Annual Report

HIGHLIGHTS	19X1	19X0
NET SALES	$ XXX	$ XXX
DEPRECIATION AND AMORTIZATION	$ XXX	XXX
FEDERAL INCOME TAXES	$ XXX	XXX
NET INCOME	$ XXX	XXX
WORKING CAPITAL	$ XXX	XXX
STOCKHOLDERS' EQUITY - COMMON	$ XXX	XXX
EARNINGS PER COMMON SHARE	$ XXX	XXX
DIVIDENDS PER COMMON SHARE	$ XXX	XXX
BOOK VALUE PER COMMON SHARE	$ XXX	XXX
NUMBER OF STORES - END OF YEAR	XXX	XXX

Figure 1. Highlights.

Reports to Employees

The general tendency among the employees is that they greatly overestimate the rate of profit their company makes and some even tend to believe that the reports published by the companies are intentionally misleading. For these reasons many companies attempt to give employees financial information about the company by preparing special reports for their use.

Encouragement of the employees to demand or recognize competent management is essential for the success of a business. It is also recognized that the wage-earners have a right to know the company and are entitled to information about the company's operations. To meet these requirements and to foster good relations with labor, the company management should convey adequate and proper information about the company to the employees. Income statements which show costs by percentages of sales or in terms of parts of the sales dollar are especially useful. Some other useful reports would include those which show the average amount of fixed assets per employee or the amount which is invested to provide each employee with working equipment. Tabulations showing the company's contribution to employee benefits and wage trends are also useful.

Reports for Credit Purposes

Credit, in present times, is the crux of business activity. In order to carry on business, it is often necessary either to borrow money from outside sources or buy goods on credit, until collections come in from customers. Hence to establish a line of credit, bankers, trade creditors, bondholders and other credit grantors require the borrowers to furnish enough information about their financial condition so that their repayment ability and financial strength can be judged.

The data needed for extension of credit can be classified into three categories:

a) financial information

b) antecedent information

c) investigational facts

Financial information concerns all financial facts. These are usually detailed financial statements with supporting data. Oral statements by salesmen, creditors, or lawyers also serve the purpose quite often.

Antecedent information relates to the people who own or manage the business. People granting credit are concerned with the personal histories of the persons actually involved with the business. The credit grantors need to know their experience and ability, record of success or failure, previous employment and position, whether married or single and other details. The object of such close scrutiny is to shed light upon the character of the men comprising the management.

Investigational information is intended for appraising the financial information, like payment habits, i.e., whether prompt or slow, size of bank balance, borrowings and nature of collateral.

It can thus be seen that the data presented in such financial statements help the creditors in analyzing and judging the soundness of a credit risk.

THE BALANCE SHEET

Definition

A balance sheet, otherwise known as a position statement, has been defined in a number of ways. Three common definitions are: (1) "a systematic exhibit based upon the general ledger account balance at the end of the accounting period after adjustment and closing,"[5] (2) a summary of the assets and liabilities of a business and of the interest of the owners in the net assets, and (3) a statement showing the financial position of an enterprise. All the three definitions convey basically the same meaning but emphasize different aspects. The first definition stresses the fact that a balance sheet is comprised of ledger balances which were recorded in accordance with accepted accounting principles which include estimates and approximations. The second definition is quite nontechnical in nature and describes what a balance sheet obviously discloses. The third definition relates to the presentation of the financial position of a company in accordance with generally accepted accounting principles--i.e., reflecting the resources or assets of the business enterprise and the claims or rights attaching to these same assets.

Each of the above definitions contributes to our understand-

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5. Rufus Wixon, Accountants' Handbook (Fourth Edition), page 211.

ing of a balance sheet. But the most common and lucid definition is the one given by Paton and Paton Jr.

> The position statement, or "balance sheet," is the basic financial presentation in that it displays the underlying types of accounting data, the assets, liabilities and stock equity of the enterprise. Arrayed as two balanced dimensions, assets on the one hand and all equities on the other, the position statement may be viewed as the backbone of the double entry system, the master account of the general ledger.[6]

Uses and Limitations

The balance sheet, being a statement of financial position or status, is static in nature. But still it is of first-rate practical importance to stockholders, creditors, management, regulatory bodies and other related parties. The volume of details and style of presentation will differ according to the use to which the balance sheet will be put. A comparison of several years coupled with an analysis of working capital will contribute significantly in showing the course of the enterprise and the trend of the fundamental financial elements.

Investors and creditors are greatly interested in the balance sheet, as it shows the financial position of a firm and also the status of the equity in an enterprise. Such information, which throws light on the solvency of the firm and the related position of the parties as to security, is vital to the parties who have invested and also those contemplating commitment of their funds. In the case of short-term creditors, they need to know the cash posi-

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6. William A. Paton and William A. Paton Jr., Corporation Accounts and Statements, page 395.

tion of their debtor and also the position of his liquid assets and current liabilities.

A fairly detailed balance sheet is of immense help to the management. The management must know the working capital position to schedule expenditures for operating purposes, interest and taxes. A bird's-eye view of the balance sheet is essential to decide upon details like expansion, long-term borrowing and the type of security to be issued.

Even though the balance sheet is of such great importance, it is not without certain limitations. First of all, accountants are faced with technical difficulties. The determination and pricing of inventories and making other numerous adjustments and analyses at the close of the period are very time consuming and complicated. In some of the larger companies, the preparation of a single balance sheet might take several weeks. Another serious problem is that of value attached to certain assets. Such values are usually established upon conventional procedures and assumptions. Some of the assets included in the statement should not be interpreted as having immediate realizable value. Funds invested in machines and equipment for special purposes are committed to future operations and such assets do not possess any independent realizable values. The change in the value of the dollar has caused another problem, which is again felt mostly in the area of assets. Assets are recorded at their apparent value, without being adjusted to the real value of the present dollar. Hence comparisons may give misleading impressions. The value of the current dollar has been cut nearly in half since 1940, and when statements were recorded in varying dollars, false impressions about the value are bound to arise. Further, dollars and cents are not the only criteria used to judge the condition and value of a business. Character, integrity, loyalty and efficiency of the firm and the outlook and possibilities of its expansion should be taken into consideration before any judgment is passed upon the real worth of a business.

Form

The account form continues to be a popular presentation of the balance sheet with "balance sheet" as the heading. In this form of presentation, the balance sheet is divided into two distinct sections opposite each other, usually on facing pages. The left-hand side is captioned "assets" or in some cases "resources." The right-hand side represents liabilities. The most common designation for this side is "liabilities." This term is inadequate and also inappropriate due to the inclusion of the stockholders' equity; hence additional captions like "stockholders' equity" and "capital" are also gaining prominence, and the right-hand side is divided into two sections, "liabilies" and "capital." A variation is found, however, with the three sections set forth in a downward sequence of assets, liabilities and capital. In either variation, the total of assets equals the total of the equities plus the total of the stockholders' equity (Figure 2).

In recent years the "sequence" or "financial position" form is being increasingly used. The main reason for this trend is to make reports more intelligible and clear to the people who lack knowledge of double-entry bookkeeping. The American Institute of

CONSOLIDATED BALANCE SHEET ...... COMPANY

December 31, 19XX

ASSETS

CURRENT ASSETS		
Cash	$	XXX
Marketable Securities - cost		XXX
Accounts receivable		XXX
Inventories - at lower of cost or market ..		
Raw materials and supplies		XXX
Finished product and work in process .		XXX
TOTAL CURRENT ASSETS		XXX
PROPERTY, PLANT AND EQUIPMENT		
Building and equipment at cost		XXX
Less depreciation		XXX
		XXX
Land at cost		XXX
TOTAL PROPERTY, PLANT, AND EQUIPMENT ..		XXX
OTHER ASSETS		
Prepaid expenses and sundry assets		XXX
Investments		XXX
Patents and other intangibles, less amortization		XXX
TOTAL OTHER ASSETS		XXX
		XXX

LIABILITIES

CURRENT LIABILITIES		
Notes payable to bank	$	XXX
Notes payable by subsidiaries		XXX
Accounts payable		XXX
Accrued accounts		XXX
Accrued taxes on income		XXX
Advances from customers		XXX
TOTAL CURRENT LIABILITIES		XXX
LONG-TERM LIABILITIES		XXX

STOCKHOLDERS' EQUITY

CAPITAL STOCK	
Common, no par, --- shares authorized, --- shares outstanding	XXX
EARNINGS RETAINED IN THE BUSINESS	XXX
TOTAL STOCKHOLDERS' EQUITY ...	XXX
	XXX

Figure 2. Account Form of Balance Sheet

Certified Public Accountants[7] recently conducted a survey of stockholders' opinions, which showed they preferred the sequence form which avoided technical terms and formal accounting framework.

Unlike the account form, which presents the financial position in two balancing forms, the sequence form is in a running order, with the presentation of total assets less total liabilities equals stockholders' equity. A slight variation of this is current assets less current liabilities, plus other assets, less other liabilities, equal stockholders' equity. (Figure 3 is an example of "financial position" form.)

Title and Date

A balance sheet is always stated as of a date, and never "for the year ended." In case a business becomes dormant, then the latter term would be suitable. But as a business enterprise is looked upon from a going concern point of view, the balance sheet should always be stated "as of," to show the position of the enterprise on that particular date. Thus we say "Balance Sheet, December 31, 19__," where it is assumed that such a presentation is always at the end of the business period, unless otherwise stated. When a balance sheet is intended for the opening of a business period, then the title used is "Balance Sheet as of the Opening of the Business...."

Some of the common titles are "Statement of Assets and Liabilities" or "Statement of Assets, Liabilities and Stockholders'

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7. Accounting Trends and Techniques (Fourteenth Edition), American Institute of Certified Public Accountants, page 7.

...... COMPANY AND CONSOLIDATED SUBSIDIARIES

December 31, 19XX.

FINANCIAL POSITION

CURRENT ASSETS	
Cash	$ XXX
Marketable Securities at cost	XXX
Accounts receivable, less allowances for doubtful accounts	XXX
Inventories of raw materials, finishing supplies, goods in process and finished goods - valued at the lower of cost or market	XXX
Operating supplies, prepaid advertising and other expenses	XXX
Total current assets	XXX
CURRENT LIABILITIES	
Accounts payable, trade	XXX
Other payables and accrued expenses	XXX
United States and other income taxes	XXX
Total current liabilities	XXX
Working Capital	XXX
INVESTMENTS AND DEPOSITS - at cost or less	XXX
LAND - at cost	XXX
BUILDING, MACHINERY, FURNITURE AND FIXTURES, at cost, less accumulated depreciation	XXX
GOODWILL, FORMULAE, TRADEMARKS, ETC.	XXX
	XXX
SUBORDINATED 5% DEBENTURES	XXX
MORTGAGE PAYABLE	XXX
	XXX
Net assets represented by stockholders equity	XXX
STOCKHOLDER'S EQUITY	
$4.50 Cumulative preferred stock Par value--- Authorized and issued ---	$ XXX
Common stock, par value--- Authorized--- issued---	XXX
Capital in excess of par value of stock	XXX
Retained earnings	XXX
Total stockholders equity	$ XXX

Figure 3. Sequence form of Balance Sheet

Equity" or "Statement of Assets, Liabilities and Capital." Some of the other common headings used are "Balance Sheet," "Statement of Financial Position" or "Position Statement."

BALANCE SHEET ITEMS AND THEIR SEQUENCE

Assets

"Assets should be classified in such a manner as will facilitate the accounting for their utilization and the preparation and interpretation of financial statements."[8] Thus for accounting purposes the current-noncurrent basis of classification is now unanimously adopted. For administrative and financial purposes this type of classification is much more useful than personality-reality or tangible-intangible groupings. Assets are listed in order of their liquidity. The most liquid or current assets are listed first, followed by the fixed or noncurrent assets.

In some industries, particularly utilities and mines, the order of liquidity is reversed and the fixed assets are shown first.

There is considerable discussion going on as to the basis of division of the current asset group from the noncurrent. There is no definite line dividing these two and there is considerable overlapping. William Paton and Paton Jr. suggest five principles on which the demarcation can be made.

1. Degree of liquidity.
2. Normal term or length of life.

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8. Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements. American Accounting Association, page 17.

3. Rate of transfer to expense or loss.

4. Technical character or method of use.

5. Nature of business and intent of management.[9]

Current Assets. Current assets are defined by the American Institute of Accountants as:

> For accounting purposes, the term "current assets" is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.[10]

The most highly liquid assets are listed first, followed by the least liquid. Current assets can be divided into five broad groups: cash, temporary investments or marketable securities, receivables, inventories and prepayments. These will be discussed in order of their liquidity.

Cash is listed as the first item. Usually it is subdivided again as "cash on hand" and "cash in bank." Sometimes both the balances are combined into one item and shown as "cash on hand and in bank." But there is an exception to this rule. Cash must be excluded from the current classification if it is

> ...restricted as to withdrawal or use for other than current operations, or designated for expenditure in the acquisition or construction of noncurrent assets, or segregated for the liquidation of long-term debts.[11]

If an overdraft should appear on the books, then it should be shown as a liability, and not as an offset to cash.

Temporary investments are highly liquid assets, which can be

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9. William A. Paton and William A. Paton Jr., Corporation Accounts and Statements, page 402.
10. Accounting Research Bulletin No. 43, American Institute of Accountants, page 20.
11. Ibid., page 21.

readily realized and converted into cash within an operating cycle, such as marketable securities. Further division of this group is not recommended and all the temporary investments can be consolidated into one group. Any interest on such securities must be included and disclosed by an appropriate caption or footnote. The basis of valuation should also be disclosed. It is preferred that the realizable market value basis of valuation be used.

Under receivables only claims maturing within the business cycle should be included in the current grouping. Accounting Research Bulletin No. 43 excludes from the current classification

> ...receivables arising from unusual transactions (such as the sale of capital assets, or loans or advances to affiliates, officers or employees) which are not expected to be collected within twelve months.[12]

The receivables should be subdivided into notes receivables, accounts receivables and other receivables. Expected uncollectibles, discount and expected collection expense must be deducted from the principal amounts and the net amount should be shown in the outer column. Receivables should be shown at their cash realizable value.

> The term inventory embraces goods awaiting sale (merchandise of a trading concern and the finished goods of a manufacturer), goods in course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies).[13]

Thus inventories, preferably, should be shown under four different subsections: raw materials, work in process, finished goods

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12. <u>Ibid</u>., page 21.
13. <u>Ibid</u>., page 27.

and factory supplies. A little variation is always found in the sequence and minor subheads. The basis of inventory pricing should be clearly indicated. The recent practice of indicating the basis of pricing as "cost or market, whichever is lower" or "lower of cost or market" is inadequate and usually leaves the reader in the dark. Each term, "cost" and "market" must be clearly stated and explained in a supplementary statement, if not on the face of the statement. The American Institute of Accountants defines "cost" as applied to inventories as "the sum of the applicable expenditures and charges directly or indirectly incurred in bringing the article to its existing condition and location." The term "market" is defined as the current replacement cost, except that:

> 1) Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and
>
> 2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.[14]

Prepaid operating expenses, such as for rent, insurance, interest, and taxes should be shown under one head; further subdivision of the prepayments group is not necessary. Frequently we come across the term "deferred charges," which is not an appropriate term. The unexpired cost of most of the prepayments can be recovered. Hence the elimination of the term "deferred charges" is preferred.

Fixed or Noncurrent Assets. By fixed assets it is meant

14. Ibid., page 31.

those which have long-term property elements and those nonliquid in nature. They can be viewed as representing the "fixed capital," a relatively slow-moving investment. For the purposes of clarity, the fixed assets are again subdivided into four, five, or even six groups, depending on the type of industry. The most common subdivisions are investments, property, plant and equipment, intangibles and organization costs, in that order.

Long-term investments and funds committed for long-term purposes are classified under this group. The usual items listed under this group are noncurrent deposits, special deposits, sinking funds, life insurance, shares of other companies, bonds, mortgages and land contracts, both real and personal. The various items should be separately listed and the basis upon which stated should be clearly disclosed.

Plant, property and equipment constitute a major portion of the assets. Sometimes land and other properties are lumped together under one head. But this practice is unsuitable from an accounting point of view. It is better to separate the depreciable assets from the nondepreciable, and also those subject to depletion. Hence a most suitable subdivision will be land, natural resources, buildings and machinery. Depreciation and depletion to date must be properly disclosed and shown as a deduction from the respective assets.

According to Accounting Research Bulletin No. 43,[15] intangibles are of two types: (A) those of limited existence, regulated by law, such as patents, copyrights, liens and franchises, and

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15. Ibid., page 37.

(B) the intangible of unlimited life, such as good will. These should be listed separately on the balance sheet. The class A intangible should be shown at cost less amortization to date, with the amount of amortization disclosed. The class B intangibles should be shown at cost.

Organization costs should be classified separately as the last item. These costs do not have any value in liquidation, so they are usually omitted from the balance sheet. But this practice is objected to by Paton and Paton Jr., who think

> ...costs of organizing the company and of raising permanent capital represent assets of indefinite life; they sustain their potency as long as the corporation maintains its vitality and scope of activity.[16]

Quite frequently it is found that the cost of this intangible is carried at $1, on the basis of conservatism, which is not in accord with sound accounting. However, this practice is prevalent and while the American Institute of Accountants discourages such practice, it does not prohibit it.

Liabilities

The classification of the liabilities should be on the same basis as that of assets, i.e., on the length of time preceding payment. Some of the other criteria employed are: (1) object for which the funds obtained are being employed, (2) method of payment and (3) legal ranking. For our purpose the current and long-term basis will be employed.

Current Liabilities. The American Institute of Accountants

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16. William A. Paton and William A. Paton Jr., Corporation Accounts and Statements, page 409.

defines current liabilities as follows:

> The term "current liabilities" is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities.[17]

Current liabilities consequently should be divided into two main classes, payables and deferred revenues.

The two types of payables, notes payable and accounts payable, are often shown separately, but must be combined and shown as a final figure in the outer column. Any discount on notes payable should be shown as an offset to the notes. It is desirable that the accrued expenses be segregated.

Deferred income includes advances from customers and clients before the delivery of goods and other items such as advance receipt of rentals. This is a definite liability and should be shown separately, immediately after the payables.

Long-term Liabilities. All other liabilities that do not fall under the current group are classified as long-term liabilities. Some companies present all of their long-term liabilities in one figure and the details are revealed by footnotes. Others list long-term notes, bonds, mortgages, etc., separately, the details as to coupon rates, dates of maturity and general character of the debt being disclosed by footnotes. The latter type of presentation is useful, as it gives an idea about the different obligations to which the company has committed itself. The disclosure of the details about each obligation leaves this statement

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17. Accounting Research Bulletin No. 43, American Institute of Accountants, page 21.

clear, and confusion is eliminated.

Recently the term "reserve" has been practically eliminated from published financial statements. The American Institute of Accountants and the American Accounting Association both condemn its use. According to Accounting Terminology Bulletin No. 1,

> 1. The term reserve should be used only to designate appropriations of retained earnings.
>
> 2. Terms such as "accrued depreciation," "estimated uncollectibles," and "estimated liabilities" should be used in lieu of the word "reserve" in other sections of the balance sheet.[18]

The abandoning of the term "reserve" gives clarity to the financial statements. Especially nonaccountants will find it easier to understand some definite and well-defined captions rather than just the term reserve. Also, the term does not have any definite meaning for the professional accountants, and much ambiguity can be eliminated along with the term "reserve."

Stockholders' Equity

This is the last section on the liabilities side. Where there is only one kind of stock equity, two subdivisions are found: (1) the amount paid in by the stockholders and (2) retained earnings. If the amount paid in by the stockholders exceeds the par value of the stock, then the amount of excess should be shown separately and then totaled with par value of the stock to arrive at the net figure. Similarly, the amount of discount, if any, should

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18. Accounting Terminology Bulletin No. 1, American Institute of Accountants. Reference cited from Accountants' Handbook, Rufus Wixon, Editor (Fourth Edition), page 22.12.

be shown as a contra to the formal value. Subdivision of the retained income is not necessary on the face of the statement, although details as to restriction or source may be shown by footnotes. In case any deficit arises, the amount of deficit should be shown as a deduction from the total of the contributed capital.

If the stockholders' equity is of more than one type, then each class of issue should be shown separately. The one most frequently encountered is preferred stock. The presentation of this stock should precede that of the common stock. Pertinent data regarding the stock and dividend arrearages should be separately disclosed either parenthetically or by footnote.

Options, warrants and rights attaching to the stock issue should be shown separately, following the stock equity.

Treasury stock should be shown as a separate item, as a deduction from the total of the stockholders' equity.

INCOME STATEMENT

Definition and Use

The income statement, frequently referred to as "profit and loss statement," is a presentation of the results of operating the business during the period which is being reported on. "The income statement...may be defined as any systematic array of the revenues, expenses and other deductions, and net income of a business enterprise for a stated period."[19] Thus in the simplest

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19. William A. Paton and William A. Paton Jr., <u>Corporation Accounts and Statements</u>, page 362.

form it is a presentation of the revenues for the period, applicable expenses and the net income or loss resulting therefrom.

Unlike the balance sheet, the income statement is of a dynamic nature. It is an activity report, based on the performance of a business enterprise.

The main criterion of judging an enterprise is by its earning power and an income statement, being a record of operations and the final determination of earnings, serves as an essential complement of the balance sheet which is a static presentation of assets and liabilities. For investment purposes, the first thing people look for is the earnings of a company, and consequently its earning power. Earnings are also good indicators of divident payments.

Forms of Presentation

There are two forms of presentation of the income statement: single-step form and the multiple-step form. The single-step form is currently gaining much popularity mainly due to its simplicity. It has no intermediate balances; all the revenues are listed first and then the total of costs and expenses is deducted from the total revenue to derive the net income. A major objection to this kind of statement is the bringing together of the taxes with other deductions. As taxes comprise a major part of the expenses and as they are coerced payments, Paton and Paton Jr.[20] contend that they should be shown separately, after the net income, derived by the deduction of the business expenses. But others seem to think that

20. Ibid., page 367.

taxes or any other expenses are all alike and profit does not arise until these are taken into consideration. Due to the ease in construction and its simplicity, the single-step income statement has gained much prominence and is being used more than the multiple-step form. (Figure 4 illustrates the single-step form.) This type of income statement is based on the functional classification of the items contained therein.

The multiple-step type of statement still remains popular but is steadily losing in favor to the single-step form. (Figure 5 illustrates a multiple-step statement.) Those who propose this form are of the opinion that intermediate balances such as "gross profit," "profit from operations," "income before taxes" and "net income for the year" are of great assistance to management, stockholders and other interested parties. It can be admitted that this type of statement is more useful to management in planning and forecasting different phases of business activity. But for the stockholders and the outside public, a multiple-step statement might add to confusion and misunderstanding due to the presence of the many balances. Statements to the outside public must be as clear as possible, at the same time giving them relevant information in which they are primarily interested, the net profit.

Recently a new type of statement has been developed, which is an effort to reconcile the two forms of statements just discussed. The classification of this type of statement is based on "management efficiency."

A compromise would be to present the object classification on the income statement with a functional classification attached as a supplementary schedule.

.... CORPORATION

STATEMENT OF CONSOLIDATED INCOME

FOR THE YEARS ENDED DECEMBER 31, 19X2 and 19X1

	19X2	19X1
REVENUES:		
Sales less discounts, allowances, etc..	$ XXX	$ XXX
Other Revenues	XXX	XXX
Total	XXX	XXX
COSTS AND EXPENSES:		
Employment costs:		
Wages and Salaries	XXX	XXX
Social Security Taxes	XXX	XXX
Pension and Group Insurance	XXX	XXX
Total	XXX	XXX
Materials and Services purchased.......	XXX	XXX
Provision for Depreciation	XXX	XXX
Losses on Assets Retired	XXX	XXX
Interest and Expenses on Long-Term Debt	XXX	XXX
State, Local and Miscellaneous Taxes ..	XXX	XXX
Provision for Federal Income Taxes	XXX	XXX
Provision for Federal Excess Profits Taxes	XXX	XXX
Total	XXX	XXX
INCOME FOR THE YEAR	XXX	XXX
CASH DIVIDENDS:		
Preferred	-	XXX
Common	XXX	XXX
Total	XXX	XXX
INCOME RETAINED IN THE BUSINESS	XXX	XXX

Figure 4. Single-Step Income Statement.

...... COMPANY AND SUBSIDIARY COMPANIES

STATEMENT OF EARNINGS FOR THE YEAR ENDED

DECEMBER 27, 19X2.

	19X2	19X1
Net Sales	$ XXX	$ XXX
Sales to foreign subsidiary companies	XXX	XXX
Total	XXX	XXX
Cost of goods sold	XXX	XXX
Selling and administrative expenses	XXX	XXX
Depreciation and amortization	XXX	XXX
Total	XXX	XXX
Earnings from operations	XXX	XXX
Interest income	XXX	XXX
Dividends received from foreign subsidiaries	XXX	XXX
Other income	XXX	XXX
Earnings before income and excess-profits taxes	XXX	XXX
Provision for United States, state, and foreign income and excess-profits taxes.	XXX	XXX
Net earnings for the year	XXX	XXX
Cash dividends on capital stock:		
Preferred at six percent	XXX	XXX
Common at $XX per share	XXX	XXX
Total	XXX	XXX
Balance of earnings retained and used in the business	XXX	XXX

Figure 5. Multiple-Step Income Statement.

In the following, costs are classified according to immediate type of expenditure:

COSTS

Employment costs of the firm
Taxes
Produce purchases
Depreciation of plant...[21]

All-inclusive versus Current Operating Performance Concepts

There are two schools which are divided in their opinions as to the presentation of the net income. There are some who argue that extraordinary and nonrecurring gains and losses like fire losses and corrections of prior years net income etc., should be included in the reporting of the income. They contend that business is carried on in such an atmosphere that the occurrence of unusual items may very well be expected. Hence they propose the all-inclusive income statement which presents a complete picture, without any omissions. The extraordinary items are:

> ...generally the ones requiring the greatest amount of judgement in the determination and reporting of income. But by the same token they are the charges and credits which are particularly susceptible of various interpretations and, on occasion, of opportunistic treatment.[22]

For these reasons, the author stresses the sensibility of using an all-inclusive statement. The other school of thought is of the opinion that the statement should stress periodic performance from an operating management standpoint. The primary objec-

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21. Ronald J. Thacker, "Income Statement Form and Classification," The Accounting Review, January 1962, page 52.
22. Wendell P. Trumbull, "The All-Inclusive Standard," The Accounting Review, January 1952, page 3.

tive is to portray the normal course of operations, and the impact of unusual items being avoided, as they do not have a bearing on the results of the particular period. Hence they emphasize the current operating performance concepts. The American Institute of Accountants in Accounting Research Bulletin No. 43 favors the current operating performance concept, whereas the American Accounting Association prefers the all-inclusive, in the following words:

> The income of an accounting period should be reported in a statement providing an exhibit of all revenue and expense (including losses) given accounting recognition during that period. This practice assures that the income statements for a period of years will disclose completely the entire income history of that period.[23]

The best way is to adopt an in-between path. "For most situations the problem can be served by adopting the all-inclusive statement coupled with the requirement that all exceptional items be segregated and clearly described."[24] Consequently Paton and Paton Jr. suggest some exceptional items which can be considered unusual.

1. Tax refunds and additional assessments.
2. Destruction of property by casualty.
3. Disposition of property by sale or retirement.
4. Seizure of property by governmental units (domestic or foreign).
5. Misappropriation or embezzlement.

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23. Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements, American Accounting Association, page 17.

24. William A. Paton and William A. Paton Jr., Corporation Accounts and Statements, page 366.

6. Write-downs of securities, intangibles, or other property.
7. Settlement of interest or dividend arrearages.
8. Payment of bonds or other senior securities at more or less than book value.

Presentation of Revenue

Revenues may be broken down into those resulting from the major operations of the business and those resulting from side-line or minor activities. Major revenues, usually proceeds from delivered products, constitute the larger amount and should be listed first, following by the minor amounts which comprise rents, royalties, minor revenues from investments and so on.

As to the subdivision of the net sales figure, everything depends upon the type of industry. In a company with only a few products, division by products may be feasible. But where companies engage in selling a large number of products, division by major classes is more appropriate, rather than a complete break-down, which might lead to confusion and may be unnecessary.

Sales returns and discounts should always be shown as offsets to the gross amounts. In no circumstances should they be shown as expenses.

Presentation of Deductions

Revenue deductions, to be useful to management as well as stockholders and investors, should be divided into three major groups: expenses, losses and taxes, in that order. Too much subdivision of the charges is unnecessary. Five to seven expense headings usually are enough for most companies. Some companies use a separate heading, "miscellaneous." This practice should be discouraged, as it leaves the reader in a state of blankness. Such expenses should be properly classified and captioned.

Expenses most closely related to technical operations should be presented first. The more indirect expenses should be presented later.

OTHER STATEMENTS AND GRAPHIC PRESENTATION

Statement of Retained Earnings

Another popular name for this statement is "earned surplus statement." Its function is to show the changes in retained income during the period, including additions to it through net income, appropriations of earnings which are not a reduction of net income and dividend declarations. Extraordinary profits or losses of nonrecurring nature and large prior year adjustments not applicable to the net income for the period are recorded in this statement.

A recent tendency is to combine the income and retained earnings statement. Surveys by the American Institute of Accountants showed that out of 600 companies, 261 used the combined statements. The American Institute of Accountants favors the combined statement. In Accounting Research Bulletin No. 43, they approve it thus:

> The combining of these two statements, where possible, will often be found to be convenient and

> desirable. Where this presentation is contemplated, however, certain considerations should be borne in mind if undesirable consequences are to be avoided.[25]

Both forms have their advantages and disadvantages. A combined statement of income and earned surplus shows the earnings of a particular period, as well as long-run adjustments. This helps the reader in evaluating the past performance of a company and its future prospects. He is not so likely to base his judgment entirely on the net income figure. Further, a combined statement calls attention to both income and surplus items.

The appearance of the net income figure somewhere in the middle is clearly a disadvantage. The first thing the reader will look for is the net income, and the figure should be manifest. Great care is often required in presenting combined statements, and the accuracy and application of sound accounting principles should be maintained, especially in distinguishing charges and credits to surplus. A usual tendency is to overlook such vital detail in a combined statement. (Figure 6 illustrates a statement of retained income.)

Consolidated Statements

There is considerable difference between a subsidiary and a branch. The latter is a part of the main organization, while the former is a separate legal entity. The assets of the subsidiary are not owned by the parent nor is the parent obligated to any of the debts of the subsidiary, except in certain circumstances.

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25. Accounting Research Bulletin No. 43, American Institute of Accountants, page 17.

.... COMPANY

STATEMENT OF CONSOLIDATED EARNINGS RETAINED IN THE BUSINESS

Years ended December 31, 19X1 and 19X0

		19X1		19X0
Beginning of Year	$	XXX	$	XXX
Net earnings and (in 19X1) special item...		XXX		XXX
TOTAL		XXX		XXX
Cash dividends on common stock, $ XX per share		XXX		XXX
End of Year		XXX		XXX

Figure 6. Statement of Retained Earnings.

However, subsidiaries constitute a part of the whole enterprise, and the portrayal of the over-all picture of the operating performance and financial position for the group as a whole becomes imperative. For this reason consolidated statements are preferred and are essential from the point of view of the stockholders and the management, particularly of the parent or the dominating company.

The fundamental basis for consolidation is the amount of voting stock held by the parent. When the parent holds 100 percent of the stock of its one or more subsidiaries, then consolidation is a necessity. But as the percentage declines, so does the necessity for consolidated reporting. Most authorities allow as low a percentage as 50+ percent.

It is always advisable to appraise the particular circumstances rather than sticking to hard and fast rules, in deciding upon consolidation. Sometimes a company might be holding a minority interest of only 20 percent of the stock, but consolidation is desirable if the other 80 percent is held by a large number of individuals with small holdings. In the case of foreign subsidiaries consolidation poses a major problem because of the different currencies and restrictions placed upon the removal of funds.

Consolidated statements no doubt have their inadequacies. Stockholders of the parent or the minority company are primarily interested in the earnings of the companies whose stock they hold. The shares held of the subsidiary, or of the parent by the subsidiary, do not interest them to any great extent. Under some circumstances consolidated figures may mislead. It may happen that one subsidiary produces most of the income and yet, because of a heavily invested position, is unable to declare dividends. Thus its poor current position may be offset by a good current position in another subsidiary with small net earnings. Consequently the ratios derived will not portray the true position of any one firm.

Statement of Sources and Application of Funds

Also popularly known as a "funds statement," this statement is used to report the changes in the working capital for an accounting period--"the ebb and flow of funds." It shows all the sources of funds and their utilization. This statement is prepared on the basis of the opening and closing balance sheets and the income statement for the period.

The main items to be taken into consideration are:

A. Transactions which increase working capital.

1. Sale of product.
2. Sale of property.
3. Sales or other realizations of investments not classed as current.
4. Long-term borrowings.
5. Sale of capital stock.

B. Transactions which decrease working capital.

1. Cost of goods sold.
2. Expenses.
3. Additions and betterment to property.
4. Purchase of assets.
5. Debt payment and retirement of capital stock.
6. Capital dividends.

The fund statement is presented in a variety of ways. Some of the common methods are showing funds provided, then funds applied and the difference as increase or decrease in working capital. Or starting with cash balance at the beginning of the year, showing funds provided, funds applied, and the cash balance at the end of the year. Or showing equal totals for "working capital provided" and for "working capital applied," this equally arrived at by including the net change in working capital under "working capital provided" or "working capital applied." The most common type is illustrated in Figure 7.

Graphic Reporting

Graphic presentation of financial data has become very popular in recent years. It has long been recognized as an effective means of disclosing and interpreting financial data, especially for those who lack technical knowledge in this field.

> They make possible the presentation of quantitative data in a simple, clear and effective manner and facilitate comparison of values, trends and relationships. Moreover, charts and graphs possess certain qualities and values lacking in textual and tabular forms of presentation.[26]

Charts and graphs create interest and appeal, and bring out hidden facts and stimulate analytical thinking and investigation.

A variety of graphic forms of presentation have been developed, depending upon the nature of the data, medium of presentation, purpose and audience. The presentation should be simple and

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26. C. F. Schmid, Handbook of Graphic Presentation. 1954. Rufus Wixon (Editor), Accountants' Handbook (Fourth Edition), page 29.12.

STATEMENT OF SOURCES AND DISPOSITION OF FUNDS

Years ended December 31, 19X1 and 19X0

.... COMPANY

SOURCES OF FUNDS	19X1	19X0
Net earnings and special item	$ XXX	$ XXX
Depreciation and amortization	XXX	XXX
Sale of common stock to employees	XXX	XXX
Long-term liabilities of subsidiaries .	XXX	XXX
Other items - net	XXX	XXX
TOTAL	XXX	XXX
DISPOSITION OF FUNDS		
Expenditures for property, plant and equipment	XXX	XXX
Dividends paid on common stock	XXX	XXX
Repayment of notes payable to bank	XXX	XXX
Retirement of XX% sinking fund debentures due 19XX	XXX	XXX
Increase in other assets...............	XXX	XXX
Increase in working capital	XXX	XXX
TOTAL	XXX	XXX
DECREASE IN CASH AND MARKETABLE SECURITIES ..	XXX	XXX
CASH AND MARKETABLE SECURITIES		
Beginning of year	XXX	XXX
End of year	XXX	XXX

Figure 7. Statement of Sources and Application of Funds.

easy to comprehend, and care should be taken to avoid complexity. They should be carefully prepared to attract attention and should afford visualizing at a glance. Some of the common types of presentation used in modern corporate statements are line charts, bar charts, strata charts and pie charts.

<u>Line Charts</u>. Such a chart is used to show the change in a single factor over a number of years and usually two or more series of data are displayed in a single chart. These charts consist of one or more continuous lines joining various plotted points representing dollar amounts or percentages. The trends of revenues and expenses, taxes and earnings, earnings and dividends, etc., are portrayed through line charts. Figure 8 illustrates a line chart.

<u>Bar Charts</u>. This graph is a convenient way of comparison of absolute sizes of quantities. Each bar represents certain amounts of a product, determined by the height and length of the graph.

> The bar means actually to be, or at least to stand in place of, the entity...it represents. The chart legend tells what that is. The measurement of the length of the bar then tells "how much" and completes the information with the least excursion into abstraction.[27]

Due to their ease of comparison and presentation, bar graphs have now become the most popular method of presentation. Figure 9 illustrates a bar chart.

<u>Strata Charts</u>. Also known as band charts, "are useful in portraying, in a time series, the relation of several elements

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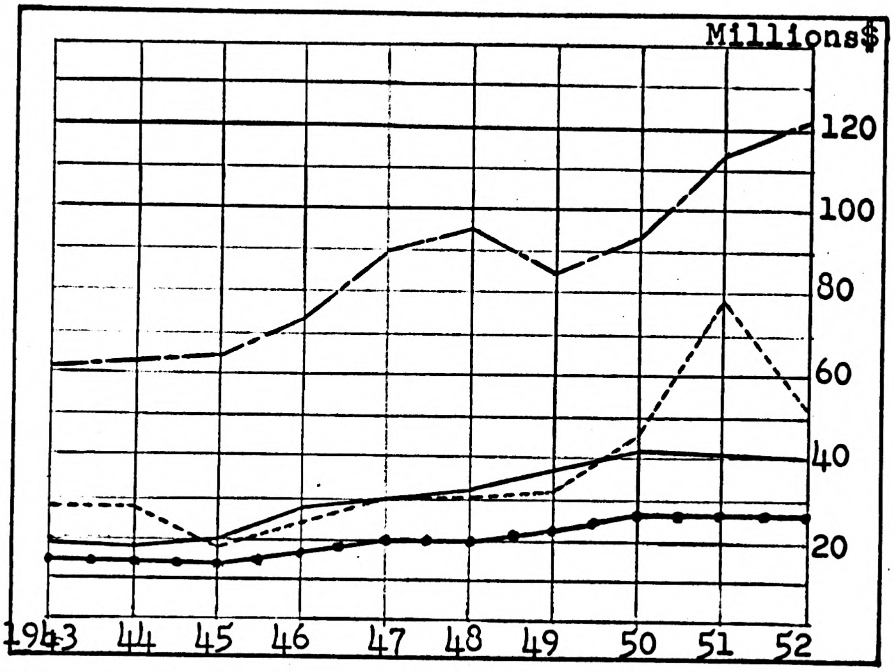
27. "Use of Graphs in Internal Reporting," <u>NAA Bulletin</u> (Section 3), October 1961.

WAGES AND SALARIES,

TAXES, NET INCOME

AND DIVIDENDS PAID



—— Net Income

— — — Wages and Salaries

•—•—• Dividends Paid

------ Taxes

Figure 8. Line Chart

SHIPMENTS OF STEEL PRODUCTS

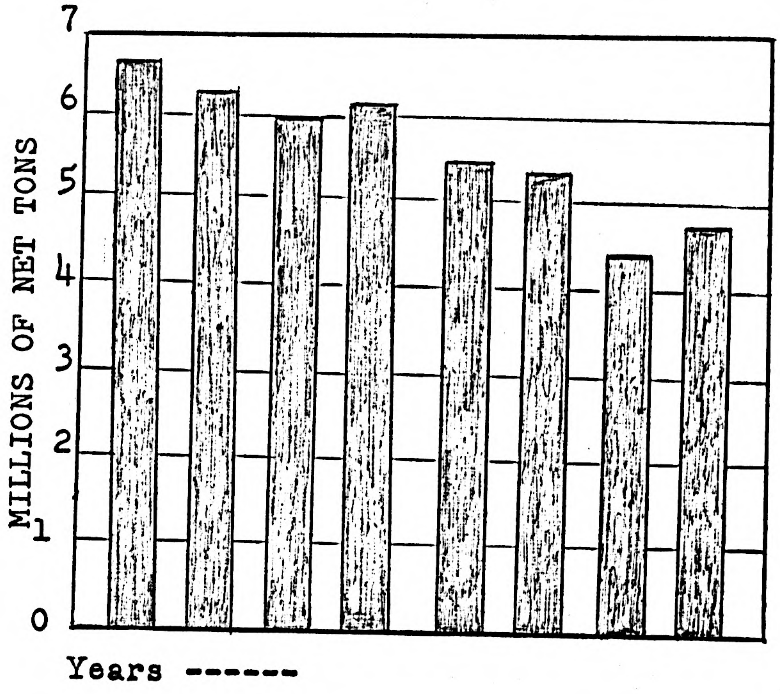


Figure 9. Example of a Bar Graph

making up a total."[28] Plotted lines separate the areas which represent different factors. The strata charts can be useful if there are five or six components and if the width of the bands is broad. They are likely to get ambiguous if too many components are used or if the spread of the bands is too narrow. Figure 10 illustrates a strata chart.

Pie Charts. This is a popular form of presenting the major element of an income statement. It usually represents a whole dollar, comprising the total revenue. It is then sliced into sections representing major expenses like taxes, interest, dividends, and earnings retained in the business. Dollar amounts, percentages or both are given, with the result a complete income statement in graphic form is obtained. Figure 11 illustrates a pie chart.

CONCLUSION

"The difference between an informed and an uninformed management is often the difference between profit and loss."[29] Industry today is a dynamic thing, moving progressively onward at a phenomenal rate. This fast-moving industry demands dynamic, capable and optimistic management. Such a management can be obtained only if they are provided factual data, on time and in an easily understood form. Thus the reporting function of the accountant today is a challenge to him.

Accountants play an important role in all the phases of man-

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28. Rufus Wixon (Editor), Accountants' Handbook (Fourth Edition), page 29.14.

29. J. E. Trainer, "How Accountants Can Help Management Manage," NAA Bulletin (Section 1), February 1959, page 82.

X COMPANY

ANALYSIS OF COST OF GOODS

MANUFACTURED

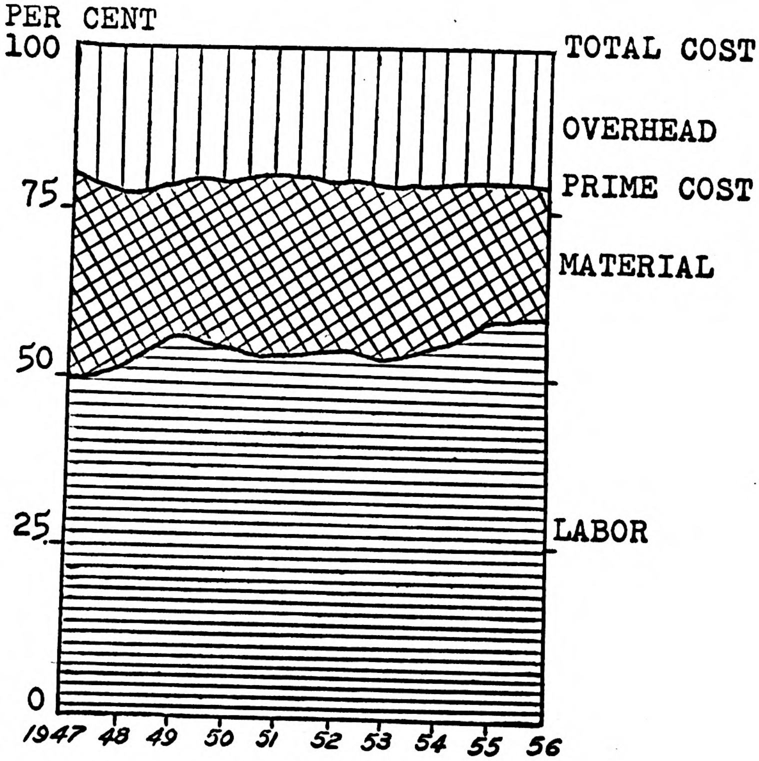

Figure 10. Example of a Strata Chart

DISTRIBUTION OF SALES DOLLAR

OF Y COMPANY

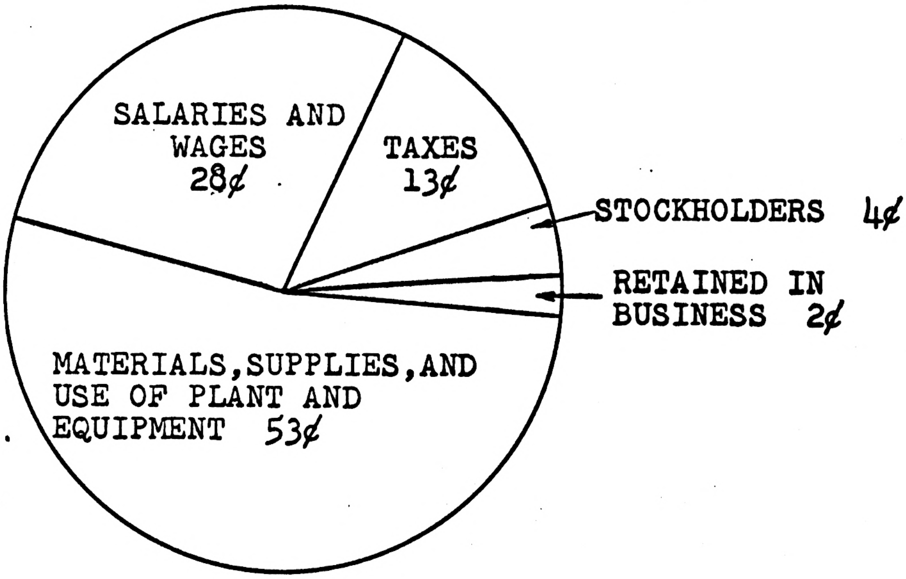

Figure 11. Example of a Circle Chart

agement, i.e., planning, organizing, motivating and controlling. Management has to consult accountants in planning as to future actions and their financial consequences. In organizing, accountants assist in forecasting and budgeting. Motivation requires the concerned people to be well informed as to the plans of action. Controlling is checking the actual results against the standard and the deviations, if any, therefrom. Thus the whole business activity embodies a closer relationship of people who plan in an organized manner and motivate and control each other.

> Thus, the accountant, in his participation in the business process, is not grinding out data in a vacuum but is providing information to be used by individuals in the performance of their business responsibilities. The accountant's role may be described as that of supplying the right information at the right time in an understandable form.[30]

Characteristics of Reports

The basic need of management, and consequently the duty of the accountant, is to supply relevant information and the accounting reports should be so constructed that they not only highlight the relevant data, but possess the relevant characteristics for effective communication. Thus to make reports most useful, certain basic characteristics and rules have to be kept in mind. These are discussed below.

Timeliness. Promptness in reporting is very essential for decision-making. The value of reports is considerably diminished

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30. Richard A. Warne, "Reporting--The Accountants Share in Scientific Management," NAA Bulletin (Section 1), October 1958, page 82.

if they are not on time. Daily reports should be delivered the following day and periodic reports should be ready within a short time after the expiration of the related period. To achieve timeliness, careful planning and organizing are necessary beforehand. Worksheets should be set up in advance and full use must be made of electronic equipment.

Accuracy and Conciseness. Accuracy in reports is stressed a great deal. Reports which are not accurate will be misleading to management. But accuracy need not be carried to the last tiny detail; some estimates may be injected, and so far as possible the report should be concise and to the point.

Simplicity. The more simple a report is, the easier it is to comprehend. Management must not be burdened with a maze of figures and voluminous data. Only the key figures should be presented, and such data which the management cannot use should be eliminated. Simple summaries of facts should be given so that management can get an over-all picture.

Suitability to Recipient. A report should be tailor-made for the individual for whom it is prepared. It will not serve its purpose if the recipient does not understand it. A report should be prepared by taking into consideration the organization's structure and the people involved at different levels of management.

Forms of Reports

To facilitate accountants to achieve their desired objective, i.e., communication, reports are divided into different categories. Kerekes and Winfrey[31] have presented five different forms,

31. Frank Kerekes and Robley Winfrey, Report Preparation, page 7.

which are discussed below.

<u>Form Reports</u>. Form reports are used to record any original data or information, like the details about a manufacturing process or data collected through surveys and tests.

<u>Memorandum Reports</u>. These reports are used for recording matters discussed in meetings. Accountants usually have to submit accounting data in conferences and meetings where memorandum reports are made use of.

<u>Letter Reports</u>. Accountants are sometimes required to furnish accounting details about certain aspects of business activity. In such circumstances, reports in letter form are presented with supporting schedules and exhibits.

<u>Formal Reports</u>. Formal reports are quite lengthy and cover many topics, and contain more items than a letter report. These reports are often accompanied by supporting schedules and letters of transmittal.

<u>Oral Reports</u>. On many occasions an oral presentation of facts carries more effect than a written report. Boards of directors, management personnel and other concerned groups frequently require information which is best presented orally by the accountant. In making oral reports, the accountant must express himself clearly and should have the capability to think on his feet.

The Problem of Communication

After discussing the different kinds of reports and statements, it is now proper to comment on the basic purpose of reports, that is, communication. The classification of reports and the presentation of their characteristics and different forms and the overall discussion was an endeavor towards establishing a sound system of communication within an organization. "Efficient management means informed management--and the accountant is certainly an important man when it comes to the problem of keeping management informed."[32]

Merely supplying the information by presenting the facts is not enough. The facts must be communicated to the readers. Visual scrutiny does not answer questions as to a person's knowledge, ideas and skills. As soon as communication by spoken or written words takes place, opinions begin to form, based not on what was said, but on how it was said. To realize the importance of communications, we can assume three basic objectives, if not more. The first is to convey useful facts, knowledge and ideas. If a report presents data which is not usable, then the report may be considered useless. The second objective should be to convince the recipient of the usefulness, reliability and the value of the subject matter presented. Facts and ideas say very little if not accompanied by interpretation and convincing presentation. Thirdly, to demonstrate the skill and knowledge of the communicator in the matter presented. If the communicator should be hazy or doubtful about his own presentation, then the communication loses its effectiveness.

Accounting reports thus are the basic tools in the realm of communication, which is an essential ingredient in the management

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32. J. E. Trainer, "How Accountants Can Help Management Manage," NAA Bulletin (Section 1), February 1959, page 72.

function.

> "Accounting is primarily a tool for the men who operate the enterprise. The job of accounting is to gather information throughout the company, work it into coordinated and helpful shape and transmit it to others while the memories are still fresh.[33]

Industrial accounting is thus essentially a problem of communication. The language of words and figures must be used with care and should not be mechanical.

We must have a clear conception of the purposes, possibilities and limitations of the many different types of statements and reports and also understand the problems and viewpoints of the operating executives and make sure that they, in turn, understand the true meaning and the limitations of the reports prepared for them. Communication thus is a two-way street. Not only must our thoughts and knowledge be transferred to others but we should have the ability to listen and associate knowledge and thoughts conveyed to us by others. The primary objective of management is to motivate; an informative report, with lucidity enough for successful communication, will help management "to motivate the right people to take the right action at the right time. Good reporting will help provide motivation at all levels of management from foreman to president."[34]

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33. Gordon Moore, "The Reporting Responsibility of Accountants," NAA Bulletin (Section 1, January 1963, page 56.

34. Alex G. Rankin, "Making Reports Truly Current," The Controller, June 1960, page 272.

ACKNOWLEDGMENT

The author wishes to express his sincere appreciation to Professor Merle E. Gugler, Major Professor, for his continued assistance and guidance in writing this report, and to Dean C. Clyde Jones and Dr. Valentine F. Ridgway for their advice and interest.

Special thanks are extended to Professor William J. Clark for his kind and valuable advice and guidance throughout the author's stay at this institution.

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ACCOUNTING REPORTS AND STATEMENTS

by

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B. Com., Nizam College, Osmania University, 1961

AN ABSTRACT OF A REPORT

submitted in partial fulfillment of the

requirements for the degree

MASTER OF SCIENCE

School of Commerce

KANSAS STATE UNIVERSITY
Manhattan, Kansas

1963

Approved by:

____
Major Professor

A business unit is a unified effort of different individuals seeking a common goal, usually profit. The success of such an effort generally depends, to a great extent, upon how well these individuals communicate with and understand each other. Accounting reports and statements play the vital role of communication between different people and help them form opinions and make decisions. The main purpose of this study is to see how communication can be improved through the use of different reports and statements.

Reporting should be organized on a systematic basis so as to make it useful for management purposes. The first step towards a systematic organization is classifying the reports according to the function they perform. A concise, yet not too detailed classification would be to divide the reports into four major groups: reports for the use of management, stockholders, employees and credit grantors. The most important of these are stockholders' reports, which include the balance sheet and the income statement. These two statements are important both from the standpoint of management and the general public. The balance sheet gives a bird's-eye view of the financial strength of a company, whereas the income statement discloses the firm's earning power. Also these two statements play a major role in the guidance and evalu- of a company.

The balance sheet is presented in two types of forms: the account form and the sequence form. The account form of balance sheet is divided into two sections, opposite each other. Assets are listed on the left and liabilities and the stockholders' equity on the right. In the sequence form, assets are listed first, followed by the liabilities, which are deducted from the former to derive the stockholders' equity figure.

The income statement is presented in two forms, single-step and multiple-step. The single-step statement is devoid of intermediate balances. Revenues are listed first, followed by the expenses. The expense total is deducted from the revenue total to derive net income. The multiple-step income statement has three or four balances like "gross profit," "profit from operations," "income before taxes," etc., and finally the net income figure. An income statement may be all-inclusive or may just emphasize current operating performance. The former type takes into account unusual items like losses from natural calamities, etc., whereas the latter portrays only the current operating performance, omitting all the unusual items.

A recent trend in reporting is to portray the information graphically. Such presentation makes the reports clear, simple and effective, particularly for people who lack technical knowledge.

There are certain characteristics that should be kept in mind before the preparation of reports. Reports should be timely, accurate, simple and suitable to the recipient. Also different forms of reports for different people and purposes help to improve communication, which is the basic object of reports.