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REPORTING FINANCIAL DATA TO PRESENT AND PROSPECTIVE INVESTORS

Address of

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"Too Many Annual Reports Still Are Guessing Games." That is the headline of a short article in a fairly recent issue of a well known financial weekly. The author's principal complaint is that "... all too many companies still feel satisfied merely to present a statement of one year's results and leave it to the stockholders' memory or research to discover the changes from the preceding year." In support of this assertion the American Institute of Accountants' study of annual reports of 525 companies for fiscal years ending July 1946 to June 1947 is cited as showing that 297, or 57%, of the companies provided no comparative reports. The author seems to feel that while this may be only an irritating inconvenience for investors having access to statistical services and financial publications it is a serious matter for the small stockholder removed from financial centers unless he is the rare person who saves reports from year to year. While hopeful that subsequent years will show an improvement, the writer of the article finds it difficult to understand why the movement should be so slow. Corresponding information which has been supplied for another year shows that 18 more companies used comparative statements in 1947 than in 1946.

A sampling of the current crop of 1948 reports to stockholders furnished to the Securities and Exchange Commission with proxy statements indicates a continuance, but slowly, of the trend to comparative statements. Six out of 34 companies supplied no comparative figures and five others supplied comparisons only in condensed summaries. Of another group of 58 published reports, 16 reports omitted comparative figures entirely and 11 others included prior years' figures only in

condensed tables. One of this group of 58 companies published only a consolidated balance sheet and a balance sheet of an unconsolidated foreign subsidiary. The amounts of the net earnings and depreciation for the year were disclosed in the president's report.

But let me go back into history a little before considering other aspects of the annual reports currently being produced.

Mr. Robert H. Montgomery, who, among other appointments, was formerly a lecturer on auditing at New York University, in the first edition of his Auditing Theory and Practice published in 1912 discussed the major advantages of an audit. The sixth in his list was protection of stockholders and the public with respect to which he said:

> "The interests of the real proprietors of a business (the stockholders in the case of a corporation) should be protected in every feasible and reasonable manner. One way in which such an end might be served would be to conform to the English method. There stockholders elect at the annual meeting a professional accountant as the auditor of the company for the ensuing year, and his report is made to the stockholders and not to the officers and directors.
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> "A corporation which has nothing to hide cheerfully sends its balance sheet out to its stockholders, and if the latter exhibit enough interest in the matter to request that the certificate of a professional auditor be attached, such request will probably be complied with. Therefore, in every possible and dignified way the auditor should impress upon stockholders the many advantages to themselves of such procedure.
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> "The value of the publicity of audited accounts cannot be overestimated. In a general way all corporations are believed to be making unreasonable profits, particularly all corporations which in any way attempt to serve the public.
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> "For instance, in New York City, the taxicab companies have been attacked in the newspapers and one ordinance after another has been passed regulating fares, all, of course, reducing them. During the last four or five years at least two millions of dollars have been lost by three or four of these companies. During this time they

have not made periodical statements to their stockholders nor to the public, setting forth these losses and the reason therefor. For some mysterious reason publicity has been shunned.

"It is about as certain as anything can be that if certified statements of operations had been secured and sent to the newspapers annually, commencing, say, four years ago, a far different state of public opinion would have resulted.

"Corporations which are secretive about their accounts or which issue statements not certified to, have only themselves to blame if they are made the victims of hostile legislation."

The late John R. Wildman, Professor of Accounting in New York University under whom some of you may have worked on the Warburton Desk Company engagement, had something to say for the general guidance of auditors. In his Principles of Auditing copyrighted in 1916 he said:

"Ideals are excellent, but they should not be allowed to prevail over common sense. They should be tempered with judgment. Procedure which might be quite proper in general would perhaps need to be changed in a case, for instance, where the stock of a certain corporation is all owned by one man, the report goes to one man, affects no one in the organization but himself and is used for no outside purpose. Certain opinions of such a man may not coincide precisely with those of the accountant. He may wish his books kept in a certain way. The accountant need feel no offense because this is so. He may have the opinion that the ideas of the proprietor are wrong and that his way of doing things are not the most approved, but there is no reason why he should drop the engagement because of this fact. The position of the proprietor may not be a variation of principle but represent rather a difference of opinion. If such a man wishes the accountant to certify to the effect that the accounts are right and properly kept and the accountant feels that they are not all right, it is a different matter entirely. Ethics and honor are two things to be zealously guarded."

Ten years after this was written Professor William Z. Ripley of Harvard noted that the Liberty Loan compaigns of the first world war led to a great increase in popular investment in business and other corporations. He also observed "the surprising development of employer ownership of corporate securities and the spread of customer ownership among the electrical public utilities" and the tendency after the

depression in 1920 "toward the transformation of hitherto purely personal businesses, closely owned, into very widely held and loosely governed public enterprises." The chapters which follow this introduction to Main Street and Wall Street were written in 1926 and 1927 and brought together in the book in 1932--all rather significant dates and the title may seem somewhat prophetic to some people today. As most of you may remember, Ripley was very critical of financial reporting practices of the twenties and earlier but where praise was due he gave it as in his citing of United States Steel and General Motors. His conclusion was that the "stockholders are entitled to adequate information, and the state and the general public have a right to the same privilege." Two essentials of an adequate statement he held to be a balance sheet and income account. The time had long passed, he said, when the latter may be refused to shareholders. Yet the American Institute's study in 1948 turned up the practice in one per cent of its samples. I shall return to Ripley later to show how some of his "horrible" examples have improved in twenty years.

Any reference to the historical development of corporate reporting would be incomplete without proper acknowledgment of the work of the New York Stock Exchange. It appears that listing applications of that exchange used as early as 1900 included agreements to publish detailed statements of income and expenditures and a balance sheet giving a detailed and accurate statement of condition of the company at the close of the fiscal year. Today twelve national stock exchanges have rules requiring that corporations whose securities are listed shall submit annual reports to stockholders.

A landmark in the development of corporate accounting and reporting was the address of Mr. J. M. B. Hoxsey, the New York Stock Exchange's executive assistant to the Committee on Stock List, before the American Institute of Accountants in 1930 following which the Institute appointed a committee to cooperate with the Stock Exchange in the consideration of problems of common interest to investors, exchanges and accountants. This committee's correspondence with the Stock Exchange initiated in September 1932 and published in January 1934 disclosed the intention of the Exchange to require audited financial statements in connection with listing applications made after July 1, 1933. The correspondence also disclosed the three-way agreement among the Exchange, the American Institute of Accountants and the Controllers Institute of America with respect to the form of the auditors' certificate and certain accounting principles.

Concurrent with this activity of the accountants and the Stock Exchange the Securities Act became law in May 1933. The Commission organized in July 1934 under the Securities Exchange Act took over administration of the former Act in September 1934. Prominent accountants assisted the Commission in preparing its forms and regulations under both Acts and regular practice since that time has been to seek the views of accountants, registrants, and others in connection with the drafting of our accounting regulations. This practice was followed in the preparation of Regulation S-X, our principal accounting regulation, in 1940 and in subsequent additions and amendments. With the passage of the Administrative Procedure Act in 1946 this program became mandatory. I mention this to emphasize the fact that practicing public accountants

and representatives of registrants have had ample opportunity to present, and have presented, their views with respect to our accounting requirements, which reflect our efforts to eliminate questionable reporting practices and to adopt the best practices as promptly as they can be determined to have general acceptance.

Except for amendments to cope with certain war time conditions, the addition of articles applicable to investment trusts and the incorporation in the regulation of special accounting requirements for companies in the promotional and exploratory stage previously found in the appropriate forms, Regulation S-X has not undergone significant revision since its adoption. However, we are now engaged in gathering comments and suggestions from various sources with a view to incorporating in Regulation S-X any new developments that appear to be beneficial and to eliminating or correcting obsolete or presently inapplicable material. In this connection we have been interested in gleaning any ideas we can from published reports to stockholders. These reports, while filed with us with proxy statements, have not generally been subjected to our critical review.

The reading of current published reports and their comparison with various studies that have been made in the past have been a fascinating and I hope ultimately a fruitful expenditure of time and effort. Despite the fact that there is still ample opportunity for criticism in the small sampling of reports I have examined for the purposes of this paper, I think even Professor Ripley would have to admit that a substantial improvement has been made since his book was published. There still appear to be a few managements who seem to apply

the rule advocated for prisoners of war--give only your name, rank and serial number.

I have observed a number of commendable changes in 1948 over 1947, particularly in the form of the profit and loss statement and in the handling of appropriations of income or surplus for various purposes. As an example of the latter, one company, whose reports to stockholders (at least from 1935) have been presented in commendable detail and arrangement but which in 1947 and earlier years deducted provisions for general contingencies in the statement of income before arriving at "Net Income for year, as adjusted," in 1948 reported an addition to the contingency reserve as a direct charge to earned surplus. Comment of the president of the company on this change was: "Following a suggestion made by the New York Stock Exchange to all corporations whose securities are listed on that Exchange, the Income Statement is presented without deduction for additions made during the year to the General Reserve for Contingencies."

Another very large corporation in 1946 closed its "Statement of Earnings" in three lines:

"Earnings Before Provision for Contingencies	$------
Provision for Contingencies	------
Net Earnings after Provision for Contingencies	------"

Dividends were then deducted and the opening balance of earned surplus was added to arrive at earned surplus at the end of the year. In 1947 and 1948 this company's statements of earnings closed with the unequivocable caption "Net Earnings," after which dividends on preferred and common stocks were deducted successively. "Earnings Retained in the

Business at Beginning of Year" was then added to the uncaptioned balance of earnings. Deductions, including "Appropriation for Contingencies," resulted in "Earnings Retained in the Business at End of Year." The related statement of financial position at December 31, 1947 and 1948 was presented in the new form advocated by some accountants. In this statement the Reserve for Contingencies is grouped with capital stock and retained earnings to support the "Excess of Assets over Liabilities," one of three highlighted captions on the statement, the others being "Current Assets" and "Working Capital." To complete this reference one of the notes must be quoted:

> "In the years 1941 to 1947, the Board of Directors set aside amounts aggregating $10,000,000 as an addition to the reserve for contingencies, having in mind the losses which might result from an abrupt decline in inventory prices and other unpredictable contingencies. In view of the continued high level of commodity prices during 1948, the Board made an addition of $1,500,000 to this reserve. The Reserve for Contingencies represents an appropriation of earnings retained in the business but will not be used to relieve future income of charges properly applicable thereto."

This language first appeared in the 1947 report. The American Institute of Accountants' Research Bulletin No. 28 relating to contingency reserves appeared in July 1947, and Bulletin No. 31 relating to inventory reserves was dated October 1947. Similar election by other companies of this method of reporting additions to reserves of the type in these two examples, it seems to me, would have avoided much confusion in financial reporting to investors in company reports, press releases and discussion in financial periodicals, and probably would have avoided the necessity for the publication by the Institute of Bulletin No. 35 in October 1948. This bulletin makes a sound recommendation which should be followed by all companies reporting for the benefit of public investors, i.e.,

"that the net income for the period be shown henceforth without deductions or additions of items which are properly [underlining supplied] excluded from the determination of net income." The items referred to relate to general purpose contingency reserves and inventory reserves previously mentioned, and excessive costs of fixed assets and annual appropriations in contemplation of replacement of productive facilities at higher price levels discussed in the Institute's Research Bulletin No. 33, all items which I think properly should be excluded from the determination of income. Bulletin 35, however, also would exclude as deductions from or additions to income certain so-called extraordinary charges and credits referred to in the Institute's Research Bulletin No. 32, an exclusion to which we have objected, and so advised the Institute when the bulletin was issued, on the grounds that misleading financial statements might result.

Before leaving the second of my examples it may be noted that the "Statement of Earnings" substantially meets the income statement requirements of Regulation S-X and in addition, by means of a printing device, appropriately highlights four items, "Earnings from Operations," "Net Earnings," "Earnings Applicable to Common Stock" and "Net Earnings a Share of Common Stock."

Twenty years ago Professor Ripley, in commenting upon the annual reports of the largest corporation in an important industry stated:

> "For concerns like the ["X"] Company such newfangled gewgaws as income accounts or depreciation simply do not exist...Diminutive, dainty, tied up with fancy string, perhaps, these reports are tenderly reminiscent of the parties of our youth"; "The secretive tactics of the ["X"] Company, later to be commented upon, are quite commonly ascribed to a desire to entrench itself beyond all possible competition as a low-cost

producer before divulging the profitableness of its business to possible rivals"; "and," after referring to another company's questionable use of reserves to juggle profits, "/"X"/, whether dominated by the same group in management or not, are alike notorious for obfuscation in this regard...The /"X"/ Company, with 15,657 shareholders in 1925, the largest manufacturer of its kind in the world, has likewise roughly handled its accounts, always on behalf of those 'in the know'. Net earnings after the war, as reported, long failed to reflect the full measure of profits, through resort to all sorts of fancy charge-offs to depreciation. History does not relate whether this concealment of profits was to discourage industrial competition for the time being, or was, as rumored, on account of the heavy war taxes on corporate income. Anyhow, all of a sudden came an abrupt abandonment of this ultraconservative depreciation policy in 1922. The number of shares was multiplied sevenfold, accompanied by an increase four times over in the amount of dividends paid. This fulguration through the long overdue disclosure of earnings was, of course, at once reflected in bounding quotations for the stock."

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"And now for the income accounts! The niggardly /"X"/ Company, in its three-by-four inch balance sheet, stingy even of prepositions, gives us this and nothing more: 'Earnings, Year 1925.' Such a policy, mysterious or macabre, invites the comment that the record is either too good or too poor to be frank about either way. Once again, maintenance and depreciation items would be elucidating."

The earliest report to stockholders of this company appearing in our proxy files is for 1942. This one measures 7-3/8 inches by 8-1/2 inches, or four times the area of the 1925 report, and no fancy ribbons tied to it! Gross Sales for the current and prior year are disclosed in the president's letter, and depreciation for the year appears in the income statement but the fixed assets are covered by a single caption in the balance sheet, "Plants, Real Estate, Machinery, Intangibles, etc. (at Cost in cash or Capital Stock, Less Allowances for Depreciation.)" The first filing on Form 10 and subsequent annual reports on Form 10-K filed with the Commission disclose that prior to 1944, when extensive plant studies were completed, no analysis of the company's property account was available and depreciation was credited

to the asset account. An analysis for subsidiaries was shown in a schedule. The amount of accumulated depreciation was first published for 1944, the year in which intangibles were written off to capital and earned surplus. The next significant change in this company's published reports was for 1945 when the income statement was improved to show "Net Sales" and "Cost of Sales" and otherwise was substantially in the form prescribed by our Regulation S-X. A four page glossy insert presented pictures of the company's products. The company elected a new president during that year. In 1946 the four page glossy insert carried photos of typical operations in the company's plants--no other significant changes appeared. In 1948 the company recognized its fiftieth anniversary by putting a gold paper cover on its report for 1947. More significant changes for the reader, however, were the addition of a page devoted to a summary of operations of the "we received--we expended" type with the principal items also stated in cents per dollar of income. Two pages are devoted to simple bar charts showing ten-year comparisons of net sales, employees, payroll, stockholders and dividends. These charts show that in 1947 the company had approximately 30,000 employees and 65,000 stockholders, all of whom were potential if not active customers of the company. For 1948 the company's report--now grown to 8-1/2 by 11 inches--appeared in a glossy cover with a night view of the plant on the front and a highly attractive picture of the product just inside. As a whole the report is a strong competitor of reports of other companies which have established a reputation for excellence. The ten-year charts are cleverly presented, the text is

readable and illuminating on such subjects as depreciation, reserves for high-cost plant additions and inventory (appropriated from earned surplus), employee relations, expansion plans, and so on. Composition of the fixed asset total in the balance sheet is disclosed in a footnote. But the company disregards the Institute's recommendation with respect to income and surplus by deducting substantial appropriations to reserves for high-cost plant additions from "Net Income for the Year" before adding the first-of-the-year balance of "Unappropriated Earned Surplus." This latter title suggests another look at the balance sheet presented in comparative form, as were the combined income and surplus statement and supporting balance sheet notes. The following presentation warrants consideration in our search for improved forms:

"Earned Surplus (Retained for use in the business):
Appropriated:
Insurance and Contingent Reserve..........
Reserve for High-cost Plant Additions......
Inventory Reserve.........................
Unappropriated................................"

I have devoted considerable time to this one example for I think it may be considered fairly typical of the metamorphosis of financial reporting in the last twenty-five years.

In June 1946 the Commission made a report to Congress entitled "A Proposal to Safeguard Investors in Unregistered Securities." This report contained a study of reports to stockholders of companies not required to file reports with the Commission but having 300 or more stockholders and $3,000,000 or more of total assets. This study attracted quite a little attention, particularly among accountants.

The study included reports of 119 companies while 39 other companies whose reports were solicited through a nongovernmental channel either did not reply or refused to furnish their reports.

A current check of our files reveals that of these 119 companies 18 have since filed registration statements with the Commission and one company which did not reply to the request for a report has registered and now files annual reports with us. Five additional companies included financial statements in applications for exemption from the registration provisions of the Securities Act of 1933, two of these being from companies which did not submit reports in connection with the study; the other three companies' reports show improvements in some respects but not on all points criticized. One company included in the study (on which work was completed in May 1945), listed its stock on the New York Curb Exchange and filed a registration statement in November 1945. The first annual report filed with us thereafter was for 1945 and included a printed report to stockholders identified as in partial answer to the item of the form requiring a brief description of material changes during the year in the general character of the business done by the registrant and its subsidiaries. The 1944 report of the company, which was not certified by independent public accountants, had been criticized in our study for failure to total current assets and current liabilities, to show the amount of reserve for doubtful accounts, to classify inventories and to give adequate details with respect to capital stock. No such criticisms were necessary with respect to the certified financial statements contained in the 1945, 1946 and 1947 annual reports.

Published reports of four other companies criticized in the study were found in the proxy files--the earliest for 1945 indicating abandonment of non-registered status before the study was published. Two of these with little to correct had improved somewhat, and one was substantially improved. But the most serious case of this group charged with six breaches of good practice, including failure to show the amount of sales, was no better in 1948 than it had been in 1944. This company's "Summary of Income and Expense" ends with the caption, "Surplus Net Profit" suggesting perhaps somewhat the same idea as the Helen E. Hokinson cartoon in the Girard Trust Company report, "How much would the tax be if I leave it ALL to the Government?" Our files suggest the possibility that while the certifying accountant in this case appears to have been in practice for many years, he may not have had much experience with clients with securities listed on stock exchanges. Nevertheless, none of the faults charged against the published financial statements appeared in those contained in a registration statement filed by this company with the Commission in July 1946. Of interest in this connection is an analysis made last year which showed that while the certification of the financial statements of 2,265 registrants for 1946 with aggregate assets of 100 billion dollars, was participated in by 416 independent accountants or accounting firms, 279 accountants or firms each certified to financial statements for only one registrant and 58 firms certified to only two each.

Returning to our 1946 study, we found that the principal failures in presentation were nondisclosure of sales and cost of sales, combining of cost of sales with other operating expenses, failure to classify

inventories and indicate basis of valuation, failure to classify fixed assets and to disclose the amount of the accumulated depreciation, and failure to adequately describe capital stock issues. The American Institute of Accountants' survey of 525 corporate reports for 1946-1947, which includes both registered and non-registered corporations, revealed substantially the same deficiencies, among others, with the non-registered companies showing the higher proportion of failures. The Institute's report covering the same companies for the succeeding year and additional companies not included in the tables reveals a little improvement in most categories. A shift by some 30 companies from the multiple step form to the single step form of income statement seems to correlate with an increase in nondisclosure of cost of sales and gross profit. These two items disappear entirely when the single step form presents employment costs and material costs separately--a form of presentation deplored by some financial analysts and not accepted as compliance with the provisions of Regulation S- X with respect to profit and loss or income statements. This approach, it seems to me, is more appropriately presented in more informal fashion in the text of the report or in a supplementary statement than in the formal certified financial statements, a procedure followed by a number of leading corporations, including Du Pont and General Motors. In a group of 92 reports scrutinized in the course of preparing this paper I found 32 with some form of single step income statement (including 12 which deducted income taxes or extraordinary items separately--ten of these being certified by the same firm of certified public accountants). Only seven of the statements presented employment costs and material costs separately--four

being certified by the same firm of accountants and the other three divided between two firms.

A short time ago, on another occasion, I discussed some of the recent developments in the presentation of financial data. These included the recommendations from several sources for accountants to abandon or clarify their use of the term reserve and to use new terminology in place of surplus. I think it is clear that these recommendations are being considered favorably. Of the 92 reports just referred to, those for 25 companies show "Earnings Retained in the Business," or similar language, in lieu of earned surplus, and eight others show the term as a parenthetical alternative, as in the General Motors balance sheet. In these 33 cases, 17 involved balance sheets certified by one firm of accountants while three were in a group of 19 statements certified by another firm. In 33 of the 92 cases the term "reserve" was not used in the balance sheet in connection with doubtful accounts and depreciation.

I was interested also in noting the extent to which prepaid expenses were included in current assets. This procedure, you will recall, was recommended unanimously by the 21 members of the Institute's Accounting Procedure Committee and published in their Research Bulletin No. 30 in August 1947. Twenty-four of the 92 reports (including 18 certified by one firm) followed the practice; all 19 reports certified by another firm did not. (Since I have indicated a rather heavy concentration of reports certified by two accounting firms, I should state that altogether there were 23 firms represented, some with only one report.)

Consideration is being given to the specific inclusion in Regulation S-X of the substance of these Institute pronouncements with respect to surplus, reserves and prepaid expenses. At present this regulation does not prohibit their being complied with, for Rule 3-01 provides that statements may be filed in such form and order, and may use such generally accepted terminology as will best indicate their significance, and prepaid expenses may be shown as current assets or deferred charges.

A recent inquiry raised a question, not specifically answered in Regulation S-X, which may trouble those who do not have an extensive SEC practice. The question related to the rule which permits the expression of money amounts in thousands of dollars in statements and schedules, provided an indication to that effect is inserted beneath the caption of the statement or schedule, or at the top of each money column. The rule further provides that zeros need not be substituted for the omitted figures. (Incidentally I can recall only one company which takes advantage of this rule and in doing so it gets highly involved in the use of asterisks to identify figures not expressed in thousands. Statisticians of the Commission tell me that perhaps one per cent of the annual reports apply the rule.) The specific question was whether all of the provisions of this rule applied also to financial statements and schedules expressed in dollars only, with cents omitted. My answer, of course, was that it was not necessary to indicate beneath captions, or at the top of money columns, or to substitute zeros when the figures for cents were omitted. Of the 92

published reports referred to previously, 45 omitted cents and 47 balanced to the last cent. There is no discernible pattern (size, age, certifying accountant, line of business, etc.) influencing the choice. Ripley, in the twenties, ridiculed the publication of large amounts carried out to the last penny, as conveying an assurance of exactness that could not be. I should think the obvious economies in composition and neatness of presentation would cause more companies to drop the cents. Perhaps those who retain the cents feel that the psychological factors favor greater confidence in the figures when cents are shown. I am inclined to doubt it.

In addition to the foregoing I gained a few general impressions: an occasional substantial item of treasury stock shown as an asset; cost of sales and gross profit all too frequently concealed by including selling, general and administrative expenses with cost of sales; depreciation for the year not disclosed in a few cases--apparently included with costs and expenses but not mentioned; depreciation shown separately among expenses with no reference in cost of sales to its exclusion from that figure; and several cases in which depreciation is treated as an other deduction from income along with interest, far down the page, from "Net Profit from Operations."

There is one other feature of financial reporting to which I wish to call attention and to invite comments as to form, general usefulness and whether it should be incorporated in SEC requirements-- the Statement of Application of Funds. This form of statement was considered during the formative stages of Regulation S-X but considerable difficulty was encountered in designing a form, acceptable to all of the

collaborators, that was felt could be prepared by all companies with a reasonable expenditure of effort commensurate with the benefits anticipated.

Of the 92 reports I have been using as raw material for this paper, 11 contained a statement of application of funds in the generally recognized sense of analyzing the change in working capital by adjusting net income for non-cash charges and accounting for non-operating sources and uses of funds, and 19 presented a simplified operating statement accounting for the disposition of total sales revenue or the sales dollar. One company is counted in both groups and two of the latter group also presented a hybrid form of source and disposition of funds chart.

From a critical professional point of view nearly all of these statements suffer to some extent from a lack of precision in the use of terms, due, it appears, to experimentation in developing the form to appeal to the lay reader. For example, one two-year comparative form is called an "Informal Funds Statement" and labels the two parts "'Source of Cash'" and "'Use of Cash.'" The use of quotes on the titles appears to indicate a technical reservation, and properly so, I think, for I am somewhat doubtful that "Reserved for depreciation" is a source of cash or that the balancing item "Added to working capital" is entirely comprised of cash. This example merely demonstrates the difficulty in reconciling technically correct use of terms with a simplified presentation.

Simplified operating statements run into similar difficulties. The following is one of several well presented summaries:

"HOW THE COMPANY USED ITS 1948
GROSS INCOME OF $493,724,000

$276,053,000	SPENT FOR PRODUCTS, MATERIALS, SERVICES AND ALL EXPENSES EXCEPT WAGES, COMMISSIONS, AND EMPLOYEE BENEFITS,	55.9%
46,307,000	PROPERTY USED UP IN PRODUCING INCOME (depreciation, depletion and retirements),	9.4%
32,368,000	DIRECT TAXES (other than those collected on the sale of products).	6.6%
$ 66,365,000	LEFT FOR WAGES, COMMISSIONS, AND EMPLOYEE BENEFITS,	13.4%
18,137,000	DIVIDENDS TO STOCKHOLDERS,	3.7%
54,494,000	USE IN THE BUSINESS	11.0%
$493,724,000		100.0% "

Here again I think it is clear that "Spent for" is an incorrect term to apply to "Property Used Up in Producing Income." The company Ripley so roundly criticized in my earlier references presented a similar statement with the added feature of setting out separately "Officers' salaries for management of the business."

One innovation turned up in the lot, as follows:

"Source of Funds:		
Net Profit.................................		$11,491,691
Capital Stock Sold		
Preferred Shares........................	$1,737,214	
Common Shares...........................	2,847,760	4,584,974
Serial Notes Issued.......................		1,175,652
		$17,252,317
Disposition:		
Excess of Capital Expenditures over Provision for Depreciation and Sales of Property..	$3,935,161	
Increase in Deferred Charges, etc.........	770,430	
Mortgages Paid............................	230,167	
Dividends		
Preferred Shares........................	407,542	
Common Shares...........................	3,496,146	8,839,446
Increase in Net Current Assets..............		$8,412,871"

Note that this solution avoids the confusing theory that depreciation is a source of funds--an idea that has been under fire in current discussions of these statements.

I have no carefully worked out solution to this problem and I do not want my comments here to be construed as discouraging the use of either of the forms of analysis in common use until a technically sound and at the same time useful solution is found. A proposal that the proper approach is to begin with sales or gross revenue suggests the possibility of combining certain features of the simplified income statement and the source and disposition of funds statements resulting in a conversion of accrual accounting results into a modified statement of cash receipts and disbursements.

One old company which reported complete conversion to a modern product in 1948 also came up with a much improved annual report which contained one idea I have never seen before. In the center of the asset side of the balance sheet appears a box as follows:

"Working Capital:
1948 - $________
1947 - $________"

The figures are quickly checked by a glance at total current assets and total current liabilities. The working capital figure is given prominence by this device without doing violence to the old principle that assets and liabilities should not be netted in the balance sheet.

In conclusion, although I think as did the financial writer to whom I referred in my opening remarks, that "Too Many Annual Reports Still Are Guessing Games," I am convinced that the amount of guessing required of investors is being reduced.

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