A Critical Analysis of the Form, Content, and Nature of Corporation Annual Reports.

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A CRITICAL ANALYSIS OF THE FORM, CONTENT, AND NATURE OF CORPORATION ANNUAL REPORTS

A Dissertation

Submitted to the Graduate Faculty of the Louisiana State University and Agricultural and Mechanical College in partial fulfillment of the requirements for the degree of Doctor of Philosophy in The Department of Business Administration

by

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B.A., Northwestern State College, 1935
M.S., Louisiana State University, 1936
May, 1948
ACKNOWLEDGMENT

The writer expresses his gratitude to Professors Earl A. Saliers, Stanley W. Preston, P. F. Boyer, T. Hillard Cox, and Harlan L. McCracken for assistance and guidance in the preparation of this dissertation. The writer is also indebted to Dean James B. Trant and Dean Stephen A. Caldwell for their cooperation and encouragement over the period of his graduate studies.
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ABSTRACT

It is now customary for corporations to issue annual reports for the information of stockholders, and in recent years there has been a trend toward the issuance of annual reports for the information of employees and the general public. The corporation annual report has progressively assumed greater significance because of the rapidly increasing importance of corporations in the social, economic, and political life of the individual and the nation.

Since the annual report is the primary financial communications link between the corporation and all of those individuals and groups who have an interest in the corporation and its activities, the character of the annual report should be of immediate concern to all citizens. Consequently, more and more corporate managements are preparing better annual reports and circulating them more widely. At the same time, it is admitted by all of those who are participating in the preparation of annual reports that even the better reports do not serve as perfect communications media. In view of this fact and the fact that previous studies of "what ought to be" in annual reports have been fragmentary
in nature, the need for a comprehensive analysis of the information needs of stockholders, employees, and the general public is apparent. The current study has as its primary purposes:

1. To analyze the form, content, and nature of what are considered to be the better corporation reports for 1946.

2. To set up criteria for the preparation and evaluation of corporate annual reports.

3. To define as specifically as possible what ought to be included in annual reports to meet the information needs of stockholders, employees, consumers, and the general public.

The historical development of corporate accounting and reports is reviewed in Chapter 1. The development of accounting as a tool is traced, and the factors and agencies which have affected noticeably the development of accounting and annual-report practices are identified. A brief evolutionary description of annual-report practices is also included.

The specific need for corporate information by stockholders, employees, consumers, other groups, and the general public is analyzed in detail. In the analysis prominence is given to the fact that the corporation has become a
quasi-public institution and, therefore, has reporting obligations to groups other than stockholders.

General criteria for the preparation of annual reports are developed in Chapter 3. Criteria that the report should be accurate, complete, clear, interesting, and balanced are set forth and interpreted.

The next six chapters contain a detailed analysis of the form, content, and nature of the 1946 annual reports of 100 large industrial corporations. Using the criteria formulated in Chapter 3, the presentations are evaluated. "What is" is carefully set forth, but "what ought to be" is treated more fully.

The need for a separate employee report is considered in Chapter 10, and the reports of the six corporations among the 100 who issue a separate employee report are analyzed and evaluated.

The last chapter, number 11, sets forth general conclusions. The more important of these are briefed below:

1. The annual report must provide a sound basis for understanding and appreciation of the contributions and interests of the several groups.

2. Reporting progress has not kept pace with the changing status of the corporation in the society. The more important shortcomings of most corporate
annual reports are: omissions of pertinent data, an excess of pictorial material, a shortage of interpretative material, confusing and misleading terminology, and misplaced emphases.

3. The following criteria set forth the minimum essentials of a good annual report:

**Accurate:** the content should be free from error; the report should tell the truth without any avoidable misleading inferences.

**Complete:** the report should include all information which the report recipient has a legitimate interest in or right to expect.

**Clear:** the presentation of the data should be such that most of the recipients can get the correct meaning without difficulty.

**Interesting:** the report should have sufficient reader appeal to encourage its being read.

**Balanced:** proper emphasis is essential; the presentation should be such that the pertinent facts and relationships are emphasized and color, pictures, graphics, and similar devices are used only incidentally in the telling of the story.

4. In preparing a report which meets these criteria it is essential for management to approach
the preparation of the report with the idea of reporting all significant financial facts rather than with the idea of presenting as simplified a report as possible. In view of the many omissions of pertinent facts in current reports the problem is not merely one of simplifying the factual data now found in most reports.

5. By the very nature of financial statements not much dependence can be placed on the showing of single statements. Every annual report should therefore contain comparative financial-statement data covering a period of several years. As a minimum, the period covered should include at least a ten-year period, a period of a complete business cycle, or the life of the corporation.

6. Color, pictures, and charts can contribute to better reporting but the relative worth of the reports depends primarily on the pertinence and volume of factual data contained and the degree to which these facts are adequately displayed and emphasized.

7. As a safeguard to the interest of stockholders, the employees, and the general public management has the responsibility to present and interpret the pertinent facts—favorable or unfavorable; incomplete information and good imaginations connive to the good of nobody.
INTRODUCTION

Background of Study

Most corporations have prepared some type of report for distribution to their stockholders for more than a half century. These reports have varied in length from one or two pages to pamphlets of more than two hundred pages. The content has varied from a condensed balance sheet to a complete set of financial statements supported by schedules, voluminous statistical data on operations and various aspects of the business, colored pictures and graphs, and narrative interpretative or propaganda material. During this period of time the best corporate management has tried to prepare a report which gives the stockholders the type of information which they have a right to expect. Nevertheless it is admitted that even the better reports do not now serve as perfect communications media. Management has been willing to spend more and more money in its effort to publicize business affairs and, in general, it can be truthfully said that corporation executives have been trying hard to prepare and distribute good reports.

The increasing effort of management to improve its annual reports stems largely from a chain of events which
has been in motion for at least a century. The wide
dispersion of corporation stock ownership and the conse-
quent inability of many stockholders to participate in
the making of corporate decisions led to an effective
separation of ownership and control. The control of most
large corporations is now in the hands of management
rather than owners—the stockholders. This divorcing
of owners from control brought the necessity for manage-
ment to make more detailed reports to the stockholders.
During the same period of time corporations, and especially
large corporations, assumed increasing importance in our
economic system. The decisions made by a few large
corporations affect materially and directly the lives of
every citizen. It naturally follows that corporation
employees, consumers, and the general public have become
intensely interested in corporation affairs.

There have appeared in print many scattered com-
ments on what belongs in corporation annual reports, on
what should be taken out of the reports, etc. A relatively
few corporations have made systematic surveys of what
stockholders desire (or think they desire) in annual reports
from management. A few studies have also been made of the
evolution of reporting practices in particular companies
over a long period of years.
The most thorough survey which has been made of corporation annual reports was issued as Research Report No. 10 by the American Management Association in 1946. The survey report, consisting of 104 pages, contains a reasonably complete version of what is now put into most annual reports. In line with American Management Association policy, the study is one of "what is, not what ought to be, but with emphasis on the best."

**Purpose of the Study**

In view of the fact that previous studies of "what ought to be" have been fragmentary in nature and since it is generally admitted that "what is" in annual reports is not serving management, stockholders, employees, and the general public to the best advantage, the need for a comprehensive analysis of the information needs of the several interested groups is apparent. The primary purposes of the current study may be broken down as follows:

1. To analyze the form, content, and nature of what are considered to be the better corporation annual reports for 1946.
2. To set up criteria for the preparation and evaluation of corporate annual reports.
3. To define as specifically as possible what ought to be included in annual reports to
meet the information needs of stockholders, employees, customers, and the general public.

100 Annual Reports for 1946 Analyzed

The 1946 annual reports for 100 relatively large industrial companies are analyzed. Only industrial company reports are used for several reasons. In the first place, the reports of financial institutions, public utility companies, railroads, and industrial companies lack comparability at several points. This lack of comparability stems from differences in operations and regulatory influences. In the second place, industrial companies are relatively free of restraint in the type of annual report which is distributed. In the third place, industrial companies have been and must remain the backbone of our free enterprise economy—or maybe a better way to put it, our American way of life.

The 100 reports included in the study were designated as the 1946 reports by the respective companies. Most of the fiscal years end on December 31, 1946. All of the reports used have fiscal years which end within the period from July 1, 1946 to June 30, 1947.
Basis of Selection of the 100 Reports

The desire was to study the best reports now being prepared. In trying to define what ought to be included in annual reports, it appeared logical to begin with an analysis of the best reporting practices now in effect. The natural development in any field is an attempt to improve on the best of the past.

Then what are the best reports now being prepared? Who knows which reports these are? The best guide to an answer to the question is found in the annual evaluations of corporation annual reports sponsored by the magazine, FINANCIAL WORLD. A representative board of five classifies the reports according to approximately 100 industry classifications and then rates the reports within each classification "modern," "improved," or unchanged." The best three "modern" reports in each classification are ranked "first," "second," and "third." Among the classifications, there are 69 industry classifications for industrial companies. For the purposes of the present study, the writer requested the 1946 annual reports from all of those companies whose reports were rated "first" or "second" in the most recent survey (based on the 1946 annual reports). Though these reports may not be the "best" 100 industrial reports for the year 1946, there
is reason to believe that these 100 reports are representative of the best reports of the year.

The names of the 100 corporations whose reports are analyzed are listed in the Appendix.

**Emphasis on Annual Reports for Large Corporations**

Emphasis is purposely placed throughout the study on the reporting needs and practices of large corporations. In view of the great dispersion of stock ownership, the large number of interested employees, and the keen interest of the public in the operations of large corporations, it is more essential that large corporations prepare and distribute comprehensive annual reports than is the case with small corporations. It is believed that those who are interested in the reports of small corporations can glean from the study those things which may be omitted from the report outlined for the large corporations.

**Analysis Assumes Only One Annual Report**

A relatively few corporations prepare separate annual reports for stockholders and employees. Most corporations are now preparing only one annual report, directing it to stockholders. During recent years, however, more and more corporations have adopted the policy of directing their annual reports to stockholders and employees or to
stockholders, employees, and the general public. The thesis is adopted in this study that only one report should be prepared and distributed and that this report should meet the essential information needs of all interested groups. The analysis, except for a part of Chapter 10, follows this plan. Nevertheless, the main segments of the whole analysis are applicable though it is desired in practice to prepare a separate report for employees. Chapter 10 is devoted, in part, to an analysis of separate employee reports.

Brief Indication of the Organization of the Study

Chapter 1 records the historical development of corporate accounting and reports. It traces the development of accounting as a tool and identifies the factors and agencies which have affected noticeably the development of accounting and annual report practices. There is a brief evolutionary description of the development of annual-report practices.

The current importance of corporate reports is analyzed in Chapter 2. The specific need for corporate information by stockholders, employees, customers, bankers, dealers, financial editors and other miscellaneous groups, and the general public is considered in detail. In the analysis prominence is given to the fact that the corporation has now become a quasi-public or social institution and, therefore, has reporting obligations to the general public.
In Chapter 3 general criteria for annual reports are developed. Criteria that the report should be accurate, complete, clear, interesting, and balanced are set forth and interpreted.

Except for the last two chapters, the remaining chapters contain a detailed analysis of the form, content, and nature of the 100 reports. Using the criteria set up in Chapter 3, the presentations are evaluated and on every point an attempt is made to specify what ought to be included and how it ought to be shown for the benefit of each interested group of readers.

The need for a separate employee report is considered in Chapter 10, and the reports of the six corporations among the 100 who issue a separate employee report are analyzed and evaluated. The last chapter, number 11, is a summary of the most important findings of the study.
CHAPTER 1

HISTORICAL DEVELOPMENT OF CORPORATE ACCOUNTING AND REPORTS

Accounting has been, primarily, a tool of the businessman. Its evolutionary development can be clearly traced for a period of five centuries. Accounting techniques used by the business men of the time of Luca Paciolo in the fifteenth century are crude in comparison with those used today. When Paciolo wrote what is recognized as the first printed work on the mechanics of bookkeeping\(^1\) he merely described the tool as it then existed in usage by leading mercantile firms and traders in Venice, Italy. The accounting problems were very simple in comparison with the problems of the twentieth century. The number of items entering into trade was relatively small, the division of labor in the production of the goods was almost nil, the production process did not involve long

periods of time, income determination on a fixed date was not required, firm assets were not spread over large areas including foreign countries.

Business was almost wholly private; accounting was the tool or device used to serve the needs of the business operators. The general public did not evidence any social, pecuniary, or personal interest in the way in which the tool was being used by individual businessmen.

It was the twentieth century before our modern corporate business unit became the prominent type of business unit. In the intervening period accounting had been adapted to meet the needs of joint ventures and partnerships. Accounting has always adapted itself to business procedure, not business to accounting procedure. Through most of the nineteenth century accountants were concerned exclusively with the description of business transactions in the accounts. It was not until the twentieth century that a pressing need for accounting reports was recognized. The corporate form of organization permitted the development of enterprises of great size; greater size further increased the complexity of and intermingled the interests of owners of the business, lenders of money, hired management, employees, customers, and the general public. The increase in size and importance
of corporations in the economy, with the attendant tendencies toward monopoly, prevalence of absentee ownership and the number of small investors, continuing with little or no interruption at any time during the twentieth century, caused accounting to become more and more concerned with the general welfare in comparison with the immediate needs of the business enterprise.

Accounting methods, concepts, and reports have undergone continual change, though sometimes too slowly for the common good. Such circumstance is not peculiar to the field of accounting. Change is a permanent element. All segments of society resist in varying degrees the forces of change. Economic history is largely a record of resistance to change by one group as opposed to a need for change on the part of another group. Accounting, like all other tools fashioned and refashioned by man, has been defective in part and it has been used at times for selfish gain and contrary to the common good. In this connection, however, it should be remembered that accounting—the language of finance—deals with data which are not precisely measurable by any instrument yet devised. All values are relative and consequently every item in an accounting report is contingent upon intangible and varying human factors.
Necessity for Corporate Reports. Probably the most impressive growth of business enterprise known to economic history occurred in the United States during the last half-century. The corporation as a business unit was the vehicle through which the growth was achieved. The number of individuals holding stock in corporations has steadily increased. Millions of stock transactions occur each month. Corporations, and especially a relatively small group of large corporations, touch directly in many ways the lives of everyone. Consequently, it has long been recognized that each corporation has a responsibility of reporting on its activities. The primary means of reporting has been a report issued annually to stockholders.

Early Annual Reports. William Z. Ripley, in his book Main Street and Wall Street, published in 1927, gives the best available summary of corporation annual reporting practices prior to 1927. The following data give a good word picture of the situation.2

No reports made to stockholders:

Westinghouse company, "which seems to have held no annual meeting for almost a decade prior to 1906," made no statement of its financial condition to stockholders.

2 p. 159, et seg.
United States Express Company "held no meeting within the memory of man" nor "vouchsafed any statement whatsoever of financial condition."

Royal Baking Powder Company "never issued a balance sheet or financial statement of any kind whatsoever for more than a quarter of a century."

No financial data for Singer Manufacturing Company "is discoverable in the usual sources of information."

Reports made to stockholders but inadequate in important respects:

For National Biscuit Company "income accounts or depreciation do not exist."

"American Can gives you depreciation for 1925, but never a whiff concerning its accrual through past years."

"Some, like the Gillette Safety Razor Company, are inviting pictorially, however uninformative they may be."

Waltham Watch Company vouchsafes "nothing but a skeleton balance sheet."

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3 Ripley calls these "the dance-card, bald balance-sheet, or picture-book variety of corporation report." See p. 162.
Informative reports made to stockholders:

United States Steel Corporation—"from the first annual statement, outspread over entire newspaper pages in 1903, down to the present time, its record has been consistently admirable."

"General Motors Company is a worthy second."

Dennison Manufacturing has "another model statement, suitable for smaller concerns, combining full publicity, made as intelligible as possible, with pictorial evidence of the development of the business."

These sample cases adequately suggest the status of corporation annual reporting prior to about 1930. There was a glaring lack of recognition that stockholders (the real enterprise owners) are entitled to adequate financial information and that the general public has a similar right. The great gap between "ideal" reporting and actual reporting was due in large measure to concurrent forces: the rapid trend toward centralization of industrial production in larger and larger units and a decentralization of enterprise ownership through corporate shares. Despite the

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4 Ripley refers to these as "the truly informative type of official report, which fortunately is coming more and more to be recognized as not only good form, but the best of business as well." See p. 164.
notable shortcoming of corporate reports, progress toward better reports was made during the period. A requisite of sound characterization, interpretation, and evaluation of current corporate reports is an adequate understanding of the factors and agencies which were and remain as evolutionary influences in the development of annual report practices. The primary influences are briefly reviewed.

Factors and Agencies in the Development of Annual Report Practices

Early Credit Reports and Practices. During the eighteenth century and most of the nineteenth century, bank, mercantile, and other types of credit were based, not on financial statements, but on a person's good reputation, a general conception of his wealth, accommodation paper, and/or collateral of various types. During this period of time, balance sheets were usually drawn up only for the confidential use of the owners. Expanding business operations in terms of volume, types of goods, territories served, etc. suggested the need for credit decisions to be based more on the relationship between assets and liabilities of the individual or partnership than on personal property. It was not until the 1870's that The Mercantile Agency (now Dun & Bradstreet, Inc.) distributed a financial statement form, indicating to clients
that "definite information as to pecuniary resources and indebtedness" was needed. The form follows:

EARLY FINANCIAL STATEMENT BLANK USED BY
THE MERCANTILE AGENCY

Statement of __________________________ of ____________
County of __________________________ State ____________
on the __________________ day of ____________ 187

Assets:
Merchandise on hand (at actual present value)...........
Amount Outstanding...........................................
Real Estate, consisting of.................................
Personal Property, consisting of...........................
Cash on hand and in Bank..................................

Liabilities:
Owing for Merchandise.................................
Owing Creditors at Home, including
  Depositors, Bank Indebtedness,
  Borrowed Money, &c..................
Owing on Real Estate.................................
Owing for any other cause, or to any other
  person whatsoever.................................

Net Worth.................................................

Insured on Stock, $.............

Full Names of Partners.

5 Roy A. Foulke, Practical Financial Statement
This statement resembles the present report form of balance sheet. Apparently the statement was designed primarily for partnerships in view of the request for full names of partners.

Banks Began Requiring Financial Statements from Customers. Following the Civil War there developed movements toward the shortening of the mercantile terms of sale and the lending of money on single-name paper. Due in part to the unsettled monetary and general economic conditions of the period, banks instituted the general practice of extending credit to individuals or firms based upon specified financial information instead of upon mere generalities, assumed financial strength, and cosigners. The basic importance of making credit decisions based on the presentation and analysis of "exact" financial statements was recognized. Following the lead of a number of individual banks and a few state banking associations, the American Bankers' Association in its convention in 1899 authorized the preparation of a "uniform property statement blank" for the use of its members as a standard form.\(^6\) The form adopted required that potential borrowers give written statements of all

assets and liabilities over their signatures. The form called for more detailed data than was required by the earlier mercantile credit form shown on p. 16. Nine asset items were specified and six liability items with several blank spaces for the listing of additional items. The statement section of the form was set up along the lines of an account form of a balance sheet.

It should be noted that there was great skepticism of the new principle of single-paper loans based on financial statements, but by the beginning of the twentieth century the practice was generally accepted. Certain parallels to this attitude and development will be drawn in relation to annual report policies and practices in later chapters.

Federal Reserve Board Became Interested in Uniform Accounting. The Federal Reserve Board, now known as the Board of Governors, established under the Federal Reserve Act of 1913, recognized and emphasized through its policy pronouncements to member banks the basic importance of loans being based on financial statements. In 1917, the Board issued a pamphlet which recommended balance sheet

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7 Uniform Accounting (Washington: Government Printing Office), a pamphlet reprinted from Federal Reserve Bulletin of April, 1917. In 1918 the pamphlet was reprinted under the title of "Approved Methods for the Preparation of Balance-Sheet Statements."
and profit and loss forms for statements submitted to banks for credit purposes. The pamphlet also contained minimum requirements for the verification of account items. A revision of the pamphlet was published in 1929 by the Federal Reserve Board in conjunction with the American Institute of Accountants under the title of "Verification of Financial Statements." The statement forms suggested in the latter publication are given on the next three pages.

It is significant that the Federal Reserve Board recommendations require a much more detailed balance sheet than the earlier balance sheets recommended through the standard form of The Mercantile Agency and the American Bankers' Association, and probably more important, a rather detailed accounting of income was to be included. Though the recommendations from each of these agencies were specifically intended to improve the statements submitted to banks for credit purposes, they were suggestive to corporation executives and accountants as to the type of statement needed by stockholders. Actually, the detail required in the Federal Reserve Board statements of 1917 and 1929 far surpasses that to be found in most recent annual reports.

8 pp. 24-26.
FORM OF BALANCE SHEET

Assets

Cash:
On hand.................................................................
In bank.................................................................

Notes and accounts receivable:
Notes receivable, customers' (not past due).............
Accounts receivable, customers' (not past due)...........
Notes receivable, customers' (past due)...................
Accounts receivable, customers' (past due).............
Less--
Reserve for bad debts...........................................
Reserve for discounts, freight, allowances, etc...........

Inventories:
Raw material on hand............................................
Goods in process..................................................
Uncompleted contracts.........................................
Less payment on account......................................
Finished goods on hand........................................

Other current assets:
 Marketable securities............................................
Indebtedness of officers, stockholders, and employees...
Indebtedness of affiliated companies (current)........
 Total current assets................................................

Investments:
Securities of affiliated companies........................
Indebtedness of affiliated companies—not current.....
Other (state important items separately)................

Fixed Assets:
Land used for plant..............................................
Buildings used for plant......................................
Machinery.........................................................
Tools and plant equipment...................................
Patterns and drawings........................................
Office furniture and fixtures..............................
Other fixed assets (describe fully).......................  
 Total fixed assets................................................
Less--
Reserves for depreciation, depletion, etc. (describe fully)..............................................

Deferred charges:
Prepaid expenses, interest, insurance, taxes, etc.....
Other assets (describe fully)...............................  
 Total...............................................................
FORM OF BALANCE SHEET (cont.)

Liabilities

Notes and accounts payable:
Secured liabilities--
Obligations secured by--
Customers' accounts assigned, to the amount of...
Liens on inventories
Securities deposited as collateral
Other collateral

Unsecured notes--
Acceptances made for merchandise or raw material purchases
Notes given for merchandise or raw material purchased
Notes given to banks for money borrowed
Notes sold through brokers
Notes given for machinery, additions to plant, etc.
Notes due to stockholders, officers or employees...

Unsecured accounts--
Accounts payable for purchases (not yet due).....
Accounts payable for purchases (past due)........
Accounts payable to stockholders, officers, or employees

Accrued liabilities (interest, taxes, wages, etc.).....
Other current liabilities (describe fully)...........

Total current liabilities

Fixed liabilities:
Obligations secured by--
Mortgage on plant (due date)
Mortgage on other real estate (due date)
Chattel mortgage on machinery or equipment (due date)
Other funded indebtedness (describe fully)

Total liabilities

Net worth:
If a corporation--
(a) Preferred stock (less stock in treasury)........
(b) Common stock (less stock in treasury).........
(c) Surplus:
   Capital or paid in
   Arising from revaluation of capital assets
      (see footnote)
   Earned (or deficit)

If a person or a partnership--
(a) Capital
(b) Undistributed profits or deficit
Total

Contingent liabilities--classify and explain.
Note.—See directions under paragraph 112.

When the balance sheet is that of a corporation, the State under whose laws it is organized should be indicated.
FORM OF PROFIT-AND-LOSS STATEMENT

Gross sales.
Less outward freight, allowances and returns.
Net sales.

Inventory beginning of year.
Purchases, net (or cost of goods produced).
Less inventory end of year.
Cost of sales.
Gross profit on sales.

Selling expenses (itemized to correspond with ledger accounts kept).
Total selling expenses.
General expenses (itemized to correspond with ledger accounts kept).
Total general expenses.
Administrative expenses (itemized to correspond with ledger accounts kept).
Total Administrative expenses.
Total expenses.
Net profit on sales.

Other income:
Income from investments.
Interest on notes receivable, etc.
Gross income.

Deductions from income:
Interest on bonded debt.
Interest on notes payable.
Taxes, depreciation, etc. (separately shown).
Total deductions.

Net income for the period.

Add special credits to profit and loss (separately shown).
Deduct special charges to profit and loss (separately shown).
Profit and loss for period.
Surplus beginning of period.
Add or deduct items in the surplus account attributable to prior periods.
Dividends paid.

Earned surplus at end of period.

If a profit-and-loss statement is prepared for more than one year it should be set up in comparative form.
Contributions of the New York Stock Exchange. The New York Stock Exchange has made definite contributions toward uniformity in accounting practices, adequate disclosure, and better financial reporting to stockholders and the general public. About the turn of the century the Exchange evidenced some concern over the failure of corporations to inform security holders of their financial condition by issuing adequate annual reports.

The Exchange instituted the practice of including in the listing agreement with each new company making application a provision that the corporation publish at least annually detailed and accurate financial statements. After 1926, all new listing agreements required the publication of quarterly statements of earnings. The scope and content of the reports was specified. This type of

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9 The Exchange had for a long time insisted that its purpose was the maintenance of a "free and open" market for securities and not that of reforming accounting and general corporate practices. Fortunately, there was realization that the market was not "free and open" without traders having detailed and accurate financial information. Also, there continued to be much evidence that many corporations felt no obligation to provide stockholders and the public with adequate financial reports. A good example of the policy and attitude which generally prevailed during the nineteenth century is the following reply from an officer of a railroad company to a request by the Exchange for a financial report: "The Delaware, Lackawanna & Western R. R. Co. make no reports and publish no statements—and have not done anything of the kind for the last five years." (See Rirl E. Shultz, Stock Exchange Procedure, New York Stock Exchange Institute, 1936, pp. 11-12.)
agreement was not retroactive, consequently it does not apply to some corporations whose shares are listed on the Exchange. Nevertheless, the rule has been applicable to a representative segment of the larger corporations and undoubtedly the annual reports issued by these corporations have influenced the annual reporting practices of many corporations whose shares are not listed on the Exchange.

The Exchange in recent years has made specific rulings as to the propriety of certain accounting practices, requiring listed companies to comply with its rulings. For example, a corporation may not include dividends on its own treasury stock in its earnings statement, or stock dividends of subsidiaries at market value.

Influence of American Institute of Accountants.

The American Institute of Accountants is the national organization of public accountants. The contribution of the Institute through its members and committees in the development of generally accepted accounting procedures, satisfactory statement forms, and adequate disclosure in financial reports is beyond estimate. The two pamphlets, (Uniform Accounting, 1917; Verification of Financial Statements, 1929) issued by the Federal Reserve Board

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10 formed in 1887, American Association of Public Accountants in 1916. In 1937 the Institute absorbed the American Society of Certified Public Accountants.
were prepared and revised by committees of the Institute. This material was revised and enlarged in 1936 and issued by the Institute under the title of Examination of Financial Statements by Independent Public Accountants. The balance sheet and profit and loss statement forms are given on the next three pages.

It is reported in the preface of the bulletin, for the first time in 1936, that its suggestions are intended to apply to financial statements prepared for credit purposes or for annual reports to stockholders. (Italics mine).

The work of the Institute in the issuance and revision of these statements and other publications has aided in narrowing the areas of inconsistency in the application of accounting procedures and in published statements. Inconsistency, however, still remains as one of the primary problems of the profession and an important deficiency in accountancy as a tool. Often the so-called inconsistencies are more apparent than real since accounting is not an exact science. Accounting is an art. Financial statements inevitably are, in part, based on estimate and opinion. Though "uniform accounting" is hardly possible and certainly not desirable, there is much incontrovertible evidence that accountants are not putting forth determinate efforts to limit differences in procedure, statement presentation, and degree of disclosure to a minimum. Much of the presentation which follows bears on this situation.
FORM OF BALANCE SHEET
Assets

Current Assets:
- Cash in banks and on hand
- Marketable securities (state basis)
- Notes and accounts receivable:
  - Customers:
    - Accounts receivable
    - Notes receivable
  - Others
- Less:
  - Reserve for doubtful notes and accounts
  - Reserve for discounts, freight, allowances, etc.
- Inventories: (state basis)
  - Raw materials and supplies
  - Work in process
  - Finished goods
- Other current assets:
  - Indebtedness of stockholders, directors, officers
  - and employees (current)
  - Indebtedness of affiliated companies (current)
  - Other items (describe)
- Total current assets

Investments: (state basis)
- Securities of affiliated companies
- Indebtedness of affiliated companies—not current
- Other (state important items separately)

Property, Plant and Equipment: (state basis)
- Land used for plant
- Buildings used for plant
- Machinery and equipment
- Patterns and drawings
- Office furniture and fixtures
- Other items (describe)
- Total property, plant and equipment
- Less:
  - Reserves for depreciation, depletion, amortization,
  - etc.

Intangible Assets (describe)

Deferred Charges:
- Prepaid expenses, interest, insurance, taxes, etc
- Bond discount
- Other deferred charges (describe important items)

Other Assets: (describe)

Total
FORM OF BALANCE SHEET (cont.)

Liabilities

Current Liabilities:

Notes payable:
- Banks
- Brokers (commercial paper)
- Merchandise creditors (including notes given for
  machinery, equipment, etc., purchased)
- Acceptances (for merchandise and raw material
  purchased)
- Stockholders, directors, officers and employees
- Accounts payable and accrued expenses
- Advances from stockholders, directors, officers
  and employees
- Accrued interest
- Provision for federal and state taxes
- Other current liabilities (describe)

NOTE: Where assets have been pledged against any
of the foregoing liabilities, that fact and
the nature and amount of the assets pledged
should be stated.
Total current liabilities

Funded Debt: (describe)
- Bonded debt
- Mortgages
- Other funded indebtedness (describe)
- Total funded debt

Reserves: (describe by major classes)

Capital Stock: (describe)
- Preferred stock
- Common stock

Surplus:
- Capital or paid-in
- Arising from revaluation (see Par. 3 under "Surplus")
- Earned (or deficit)

(A summary of surplus accounts for the period
should be shown either in the balance sheet
or in a separate statement)
Total

(a) Contingent liabilities not covered by reserves should
be given due consideration.
(b) If there be arrears in cumulative dividends state the
amount or the rate per share.
(e) Any default in the principal, interest or sinking fund
provisions of funded debt should be stated and the
relative amounts involved.
FORM OF PROFIT AND LOSS STATEMENT

Gross sales.................................................................
Less outward freight, allowances and returns......................
Net sales.................................................................
Cost of sales.............................................................
Gross profit on sales.....................................................
Selling, general and administrative expenses....................... 
Net profit before other income and charges.........................
Other income:
   Income from investments..............................................
   Interest on notes receivable, etc...................................
   Other non-operating or extraordinary income
      (separately shown).............................................
Other charges:
   Interest on funded debt (and amortization of bond
discount).................................................................
   Interest on notes payable...........................................
   Other non-operating or extraordinary charges
      (separately shown).............................................
   Provisions for income taxes......................................
   Total deductions....................................................
Net profit (loss) for period carried to surplus.................

NOTE: It is desirable to indicate the amount of provision for depreciation, depletion, etc., for the period.

The Institute has done important work in establishing rules of professional conduct designed to insure the independent position of the public accountant. As should be expected, there have been violations of trust but not to an unexpected degree. The profession, like all others, is plagued by complacency. There is a tendency to overlook altered conditions which suggest a need for a new or altered accounting application.

More recent contributions of the Institute in the

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Examples of violations may be found in various releases of the Securities and Exchange Commission.
development of accounting standards have come through its committees on accounting procedure and auditing procedure. The Committee on Accounting Procedure has issued thirty-three research bulletins since 1933. The Committee on Auditing Procedure, formed in 1939, has issued twenty-three bulletins. Other committees of the Institute have worked as effectively over a long period of years. A notable example is the special committee on cooperation with the Securities and Exchange Commission.

Though the Institute and its members have great prestige with businessmen, government officials, and the general public there remains much to be done in making accounting the kind of tool which will best service the needs of society in our time. The burden of leadership rests with the Institute and its membership.

**Contribution of the Securities and Exchange Commission.** The Securities Act of 1933 and the Securities Exchange Act of 1934 were passed for the purpose of protecting investors. Protection of investors hinges primarily on the application of sound accounting techniques and adequate disclosure in published reports. In this connection, Commissioner Jerome P. Frank, chairman of the Securities and Exchange Commission, made the following statement in his first press conference after his election:

> "One of the most important functions of this Commission is to maintain and improve the standards
of accounting practices. Recent events make it clear that we face a pressing problem in this field. Accounting is the language in which the corporation talks to its existing stockholders and to prospective investors. We want to be sure that the public never has reason to lose faith in the reports of public accountants.

"To this end the independence of the public accountant must be preserved and strengthened and standards of thoroughness and accuracy protected. I understand that certain groups in the profession are moving ahead in good stride. They will get all the help we can give them so long as they conscientiously attempt to clean house. But if we find that they are unwilling or unable because of the influence of their clients to do the job thoroughly, we won't hesitate to step in, to the full extent of our statutory powers."  

The Securities and Exchange Commission requires that corporations, save for certain exceptions, which propose to issue securities to the public in excess of $100,000 to file certified financial statements with it. The securities of many corporations are not affected. The Commission has authority to prohibit the sale of securities unless the financial statements filed are


13 Corporation issues fall into the following categories: (1) Securities sold intrastate; (2) those issued by governments, political subdivisions, or public agencies; (3) securities already regulated, including those of common or contract carriers, state and national banks; (4) those under court jurisdiction; (5) those issued by non-profit and cooperative institutions; (6) those of miscellaneous nature.
prepared according to "recognized and generally accepted accounting principles." The Commission requires that statements be amended or corrected when their accountants determine that the presentation or accounting treatment is not in line with "recognized and generally accepted accounting principles." Under this authority the Commission has issued numerous accounting releases which set forth the Commission's interpretation of particular accounting procedures or practices. Many certified financial statements have been returned by the Commission's accountants for correction. Through this means the Commission has been a powerful influence in defining accounting procedures, practices, and report forms.

It happens that annual reports to stockholders were not subjected to the requirements of the Commission. Consequently, management has remained free to prepare annual reports to stockholders according to its own whims. It is probable, however, that the rather detailed statements submitted to the Commission have had a favorable influence on the nature, scope, and content of corporation reports.14

14 For a detailed analysis of accounting requirements of the Securities and Exchange Commission, see Greider, Ibid.
Effect of Revenue Acts. The passage by Congress of the Corporation Excise Tax of 1909 (actually, an income tax on corporations), the Revenue Act of 1913 (general income tax), and the Revenue Acts of 1917 and 1918 (income tax rates high and an excess profits tax) compelled business concerns to turn more than ever before to accountants for assistance and guidance. The passage of these and later revenue acts made annual income determination a necessary and vital process to the taxpaying enterprise, the government, and the general public. They served to emphasize the importance of consistency and adequacy in accounting procedures and adequate disclosure. From the standpoint of annual reports to stockholders, compliance with the acts meant that management had in its possession the type of financial information in which stockholders were interested and because of the effect of the taxes on corporate profits the stockholders were more interested in having a financial accounting.

Effect of Natural Desire for Secrecy. For fear of reprisals, fair or unfair, most individuals are secretive about their personal and business affairs. Each individual is deeply interested in self-preservation and self-elevation. Most individuals believe that these ends can be best achieved according to their desires by keeping many personal and business relationships on a secretive basis. One individual
fears to tell all he knows to even his friends for fear that the information divulged will be used to his dis-
advantage. Exactly the same condition surrounds the functioning of a business enterprise—single proprietor-
ship, partnership, corporation, or government agency.

Corporations have never been and are not now anxious to publish complete reports of business affairs. The fetish of secrecy has been a major deterrence to adequate annual reports. The gap between adequate and inadequate financial reporting is quite evident when one compares:

1. annual report disclosure with the accounting requirements of the Securities and Exchange Commission, or

2. the better annual reports with the great volume of other annual reports, or

3. the current annual report disclosure with the financial data which should be available as a basis for intelligent stockholder, employee, and public opinion.

The Influence of Business-Cycle Reverberations.
The movements of the business cycle are unpredictable. Nonetheless, its movements are often disastrous to many business enterprises. The movements tend to cause or encourage businessmen to be optimistic or pessimistic and since accounting is a tool, the way in which the tool is applied depends in part on the businessmen's interpretation of current and probable future economic events. The economic uncertainties of the future and the very
nature of the economic and accounting processes necessitate the use of estimates and the exercise of fallible judgment in the preparation and presentation of financial reports. This inevitable circumstance causes hesitancy on the part of management in attempting to make full financial disclosure to stockholders, employees, and the general public.

**Influence of Other Agencies and Organized Groups.**

Though it is not possible to identify all agencies or organized groups which have contributed to better annual reporting, at least brief mention should be made of the work of the Controllers Institute of America, the American Management Association, the American Accounting Association, *The Financial World*, financial publications in general, and various trade journals.

The Controllers Institute of America recently issued a highly significant study through the Controller-ship Foundation on the public's acceptance of the facts and figures of business accounting. The Institute now has a second project underway, and others are contemplated.

The American Management Association issued a one-hundred page report in 1946 pertaining to the preparation of corporate annual reports. A number of items in its several publication series, particularly the financial management series, have dealt with annual reporting problems and techniques.
The American Accounting Association, which began as the American Association of University Instructors in Accounting, has been especially active in the development of accounting standards and more uniform applications of accounting principles through its publications and special committees.

The Financial World has exerted a much needed influence in the movement for better corporate reporting through its annual survey of reports. Its seventh annual survey was based on 1946 annual reports. The reports are rated by a board of five outstanding specialists as "modern," "improved," or "unchanged" and the first-, second-, and third-best reports are selected in 60-odd classifications.

In recent years there has been increasing coverage of corporate reporting in financial publications such as Magazine of Wall Street, Barron's, Commercial and Financial Chronicle, Trusts & Estates; in trade publications such as Sales Management, Printer's Ink, and many others.

Annual Report Practices Since About 1930

The 1946 annual reports are a distinct contrast to those issued a decade or more ago. There have been marked changes in the form, content, purposes, scope, and
distribution of the reports. Whereas originally the reports consisted primarily of financial statements and a few brief notes and comments, the 1946 reports of most of the larger corporations contain in addition to what is found in the earlier reports a large volume of pictorial, graphic, and narrative material dealing with a wide range of subjects: research, personnel relations, governmental relationships, new and old products, plant facilities, and many others.

In addition to the enlarged scope of the reports, there has been an increasing tendency for the report to be specifically directed to a larger "public" and for the report to be distributed among additional groups. A decade ago it was customary for the report to be distributed only to stockholders, brokers, financial publications and editors, investment services, and a few bankers. In contrast, the 1946 report went also to a large segment of the employees and in many cases a separate report was prepared for employees. Many reports also went to dealers, distributors, and agents; customers; civic leaders in cities and towns where plants and branches are located; college and university libraries; and anyone "on request". In addition to distribution to these groups, it was the policy of a few companies also to send the report to
suppliers of raw materials, credit agencies, public libraries, governmental officials and agencies, labor organizations, and competitors.

Art has come into its own in what has come to be termed a "modern" report. Public relations and advertising directors have filled the 1946 reports with color and pictures to the point of overflowing. Not a few of the reports are artistic and typographical marvels.

There appears to have been a trend--though not a decided one--toward more complete coverage of pertinent financial facts of interest to the various "publics". Attempts to simplify the report content have been even more noticeable.

Some indication of the progress being made in annual reporting is found in Financial World's seventh annual survey report (based on 1946 reports). Over the seven-year period, the "modern" reports increased from 6 per cent to 43 per cent, the "improved" reports increased from 16 per cent to 30 per cent, and the "unchanged" reports decreased from 78 per cent to 27 per cent. These percentages indicate both improvement in recent years and the need for further improvement. Of course, it should be remembered that Financial World included, in line with an established formula, in its 1947 survey only about half of the annual reports received. These
reports which were not included were definitely of the "unimproved" type. And that exceedingly large number of corporation reports which were not submitted for consideration no doubt fall in the same category.

Actually, a cursory examination of even a few reports reveals inadequacies such as a lack of pertinent data for important stockholder analyses, an excess of pictorial material, relatively little interpretative material, and confusing and misleading terminology in the financial statements. Questionable presentations have led and still lead to many criticisms. The following excerpts from accounting, financial, and general publications are samples:

"Some companies have merely prettied up their old usual form"—Journal of Accountancy.

"Patience, a degree in accounting, and a cynical nature are needed to pry the truth out of annual corporate reports"—New Republic.

"Earnings statements traps for investors"—Christian Science Monitor.

"Stop lying to investors"—Collier's.

"Hidden profits and losses in corporate reports"—Magazine of Wall Street.

"Our outdated accounting"—Harvard Business Review.

"Alice in financial wonderland"—Magazine of Wall Street.

"Useless earnings reports"—Barron's.
"Even good corporate reports leave many stockholder questions unanswered"--Barron's.

"Corporate reports inadequate"--Trusts & Estates.

"But despite the efforts to improve annual reports, they still seem to be in the stage where it is simpler to point out the relatively few which contain desirable information than it is to try to list those which miss the mark"--Barron's.

"...in recent years the quality of many annual reports has greatly improved. But when I look at others--and they still constitute a great majority--I wonder where, when management sits down to open its yearly account of stewardship, it parks its social consciousness, its imagination, and its salesmanship"--Dun's Review.

By way of summary, it ought to be said that all who are participating in the preparation of the reports recognize that the report is not serving as a perfect communications medium. That much improvement is possible is a certainty; however, unfortunately, the specific changes which would greatly enhance its value cannot be easily determined. It is believed, however, that the analyses in the following chapters clearly define certain guideposts which will be helpful.
Selected Bibliography


Ripley, William Z., Main Street and Wall Street, Little, Brown, and Company, Boston, 1927, Chapters 6 and 7.

15 The items in each of the chapter bibliographies have been selected on a two-fold basis:

a. The source provides substantial background and closely related material, or

b. The source provides substantial specific coverage, possibly including a point of view contrary to the position taken by the writer.
CHAPTER 2

THE CURRENT IMPORTANCE OF CORPORATION ANNUAL REPORTS

The corporation annual report has been assuming constantly greater significance because of the rapidly increasing importance of corporations in the social, economic, and political life of the individual and the nation. The annual report is the primary financial communications link between the large corporation and all of those individuals and groups who have an interest in the corporation and its activities. But what individuals or groups have a legitimate interest in corporation policies and practices? The answer is simple. Everyone has an important interest in corporations because the time has come when the economic welfare of everyone—no exceptions—depends directly, and in a large degree, on the activities of large corporations.

The dependency of our society on the corporation is suggested by the following statistics.

In mining and quarrying, corporations account for approximately 96 per cent of the contribution of this industry to national income; in manufacturing, 92 per cent; in transportation and other public utilities, 86 per cent; in trade, 63 per cent; in finance
(banking, insurance, real estate, etc.) 56 per cent; in service (professions, amusements, hotels, etc.), construction, and various miscellaneous fields, 33 per cent each; and in agriculture, 6 per cent. Exclusive of government contribution to national income, the corporate share averages nearly 62 per cent of total.1

In 1939, there were 184,230 manufacturing enterprises. Fifty-one per cent of these enterprises were incorporated, a percentage increase of three per cent over 1929. Corporations employed 89 per cent of the people engaged in manufacturing and produced 93 per cent of the value product. Forty-nine per cent of the wholesale marketing establishments were corporations. These corporations employed 75 per cent of the employees so engaged and made 76 per cent of the net sales. Although only 16 per cent of all retail establishments were corporations, they employed 53 per cent of the full-time employees and accounted for 47 per cent of the net sales.2

In 1932, it was estimated that more than half of industry was dominated by two hundred large corporations. As a consequence of this concentration, it was estimated that approximately 2,000 individuals out of a population of 125,000,000 million were in a position to control and to direct half of industry. Furthermore, it appears that


the large corporations have been growing faster than other corporations.³

In many industries the fifty-million-dollar corporation must be considered a small organization. In the steel industry, for example, the assets of eleven companies range between one hundred million dollars and two and one-quarter billion. Similarly, there are twenty companies in the petroleum industry which have assets of more than one hundred million dollars. Close to 40 percent of the business wealth of the country is administered by enterprises with assets of over ninety million dollars.⁴

In a study financed by the Social Science Research Council of America, Berle and Means characterized the corporate development in the following manner:

"We are examining this institution (the corporation) probably before it has attained its zenith. Spectacular as its rise has been, every indication seems to be that the system will move forward to proportions which would stagger imagination today; just as the corporate system of today was beyond the imagination of most statesmen and business men at the opening of the present century. Only by remembering that men still living can recall a time when the present situation was hardly dreamed of, can we enforce the conclusion


that the new order may easily become completely
dominant during the lifetime of our children.
For that reason, if for no other, it is desirable
to examine this system, bearing in mind that its
impact on the life of the country and of every
individual is certain to be great; it may even
determine a large part of the behaviour of most
men living under it."

The Corporation as a Social Institution

It is undeniable that our larger corporations form
the framework of American industry. These corporations
together with the smaller ones touch the lives of every­
body. The economic welfare of each individual has long
hinged heavily on the economic well-being of corporations.
This condition and its concomitant effects has led to the
developing conception that modern corporations are in the
nature of semi-public institutions in that employees (or
"labor") and the general public have something at stake
in the progress of corporations or the lack of it.

The power of the corporation as a social institu­
tion was well summarized by A. A. Berle, Jr. in 1935 when
he said:

"In the last thirty years the entire face
of the corporate problem has changed. I say thirty
years, at random. You can date the period as you

6 Berle and Means give a vivid description of the
way in which one's life is touched by the two hundred
largest corporations. Ibid., pp. 24-26.
choose--either in 1890 or thereabouts, or in what Mr. Brandeis calls the era of big things at the beginning of this century. But in any case it is the span of a generation. What happened was that the corporation, which had been a method of doing private business, became a social institution—one of the methods by which society organizes itself and by which it gets its work done. That was a vital change. What had been a method by which individuals applied their capital, became a vehicle for concentration of industrial power outranking anything in modern history. It can be statistically demonstrated that concentration in the United States probably does outrank any similar concentration. Certainly it is greater than the concentration of wealth or even of power that existed in France just prior to the French Revolution. It compares, if you can compare it with anything, with the period when ecclesiastical lords and ecclesiastical institutions controlled an enormous amount of the world's wealth. 7

This conception of the position of the corporation in our society stems from the following conditions:

1. The rapid and continuing relative growth of corporate enterprises. 8

2. The degree of concentration of economic power in the hands of a relatively few dominant companies in many essential industries. 9


8 See supra, pp. 41-43.

9 See supra, p. 43; Temporary National Economic Committee, The Distribution of Ownership in the 200 Largest Non-financial Corporations, Monograph, No. 29, 1940.
3. The wide dispersion of stock ownership, resulting in the shifting of control from owners to managers.\textsuperscript{10}

4. Irresponsibility to the welfare of the general public shown by a number of corporation managements through monopoly, fraudulent, and deceptive practices.\textsuperscript{11}

5. The dependency of large segments of society upon the productive accomplishments of corporate enterprise.

The segments of society which have a direct interest in large corporations have been variously classified. Each writer has his own breakdown. In analyzing the importance of the corporation annual report to the several interests or groups the following classification will be helpful: (1) owners or stockholders; (2) employees or labor; (3) the general public; (4) consumers; (5) other groups; (6) management.

\textsuperscript{10} See Berle and Means, op. cit., Chapter 4 and 5; Purdy, Lindahl and Carter, op. cit., Chapters 4, 5, and 6; T. K. E. C. Monograph No. 29, \textit{Ibid}.

\textsuperscript{11} Documentary references are too many for enumeration. Some of the writings of Brandeis, Veblen, Ripley, Dewing, and Berle are especially significant. Much of the work, proceedings, publications, and activities of the New York Stock Exchange, the Federal Trade Commission, Securities and Exchange Commission, Anti-trust Division of the Department of Justice, and other governmental and non-governmental agencies are pertinent to this problem.

Corporate management has unbelievable power and, therefore, great responsibility. The productive power, and consequently the social force of corporations was demonstrated in Germany prior to and during World War II. The power of the corporation in the United States greatly
Importance of Annual Reports to Stockholders

"I think stockholders are entitled to better corporate reports than they are getting today from many companies."\[^{12}\] "I think it axiomatic that the public security holders of large corporations should be informed about the affairs of their company . . ."\[^{13}\] These statements along with many others take the annual report for granted. Certainly, the annual report is an essential report. Still, there is reason to explore briefly the importance of the report to stockholders.

Stockholders Need Facts in Making Stock Evaluations.

Each stockholder should make periodic evaluations of his holdings. The stockholder may continue to hold some shares, surpassed that of Germany. The responsibility of the managers of this great productive and social force is inestimable. Corporate management is in a position to direct this force in the interest of the general welfare, or to direct the force for selfish purposes and thereby to hasten its deterioration and overthrow. There have been indications of managerial acceptance of full social responsibility. On the other hand, there have been at times, alarming examples of irresponsibility.

\[^{12}\] John M. Hancock, "Responsibility to Investors on the Part of the Public Accountant and His Client," address at Accounting Clinic on Annual Reports of Corporations, Northwestern University School of Commerce, Chicago, April 26 1940, p. 39.

may buy more shares, or may sell some or all of his holdings. Periodic re-examination of investment holdings is necessary to reduce the risk of loss. The investor requires in the annual report factual information adequate to a reasonable analysis of the company's financial condition and the results of its operations. It is essential that the report contain adequate financial data for analytical purposes. Much room for investor judgment would still remain. Of course, if the stockholder is not qualified to serve as his own sole consultant, he should seek the needed assistance from the appropriate source of investment advice. The probability that many stockholders have need for assistance in periodic re-examinations does not mean that the factual report should be briefed or minimized in importance. It is not an overstatement to say that the annual report is the most important single link between stockholders and corporate management.

Management and Stockholder Interests Often Conflict.

When ownership control has been displaced by management control—which happens to be the case in a high percentage of the larger corporations—there is considerable danger of serious conflict between what is good for the stockholders and what is good for hired management. Management is in a position to pay itself at uneconomic wage rates from the standpoint of the stockholders. Because of a desire for
more power, prestige, or compensation, management may desire
to overexpand the business to the detriment of stockholders.
It might be profitable in more than one way for management
to withhold information which rightfully belongs to stock-
holders. These are just a few of the many possible con-
flicts in the interests of the two groups.

The danger is multiplied if the directors and
officers are identical groups. There is also danger of such
conflicts even though control has not been completely
separated from ownership, but the danger in this case is
considerably lessened.

High management ethics is the best stockholder
protection. Nevertheless, adequate annual reporting repre-
sents an essential stockholder safeguard. It is only
through the annual reports that stockholders have any basis
for an appraisal of the merit of the rewards to management
and stockholders for their respective contributions.

Free Market Dependent on Disclosure. The securities
market has played a vital part in the development of our
economy. An orderly, fair, and honest market is essential
to the general welfare as well as the welfare of investors.
Investors must have access to an open market, and it is the
duty of management to protect the validity of the market
by giving stockholders sufficient data to enable them to
exercise reasonable judgment in the making of decisions to
hold, buy, or sell shares. It is not the duty of management to protect the stockholders by giving them value estimates of given shares, but it is clearly the duty of management to put the investor into a position to protect himself by providing him with adequate information. Full disclosure is the only safeguard against an artificial or "rigged" price. As a matter of fact the annual report is probably more important in its contribution to the making of a true market price than in any other way. But someone will say that the average stockholder (whoever and whatever he may be one knows) is not capable of evaluating the shares and that he is too indifferent about his rights and duties as a voter-shareholder to use the information should be be provided with it. This condition would exist quite often, no doubt. Nevertheless, full disclosure would serve as a warning to all stockholders in case of impending danger if only because a few stockholders, security analysts, and financial experts read the report intelligently. The presence of a fair market price is unlikely without full disclosure to all stockholders. 14

14 Lipley describes and discusses a particular case which is applicable here. He said: "The Lehigh and Wilkes-Barre Coal Company affords an extreme instance of the deprivation of minority holders of the right to information—an instance, by the way, of the policy of secrecy characteristic of anthracite coal mining in general...For years no dividends were paid by this company; nor were any reports issued. Yet apparently a surplus..."
The necessity for full disclosure was accepted as essential policy by Congress at the time of the adoption of the Securities acts. These acts assume that each investor should decide for himself whether a security is suitable for his particular needs and that the function of the law is merely to see that he has all of the material facts about the security in order that his individual decision can be reached on an informed basis. This is the policy which should and must be followed by all corporations in the preparation of annual reports. As Justice Brandeis once said "The law should not seek to prevent investors from making bad bargains. But it is now recognized in the simplest merchandising that there should be full disclosure."

built up which subsequently was distributed in two special cash dividends of 150 per cent and of 70 per cent in 1921, in connection with the dissolution decree of the Federal Supreme Court. It appears that a part at least of these liquid assets was accumulated during the early non-dividend years, but still no annual report for twenty-four months. Since 1925, dividends again have ceased on the common stock. Such arbitrary treatment of stockholders having a substantial investment in the business is difficult to justify. Think what injustice in case they wish to dispose of their investments during this time. How could anything like a true price be made under such circumstances? Is this not, then, the ultimate basis of the right of every partner in an enterprise to such disclosure as shall assure him against an artificial or even a rigged price? Abnormal market prices based upon inside information, are perhaps one of the most vicious features of the present situation. Relief from this menace may be had only through insistence upon complete revelation..."—William L. Ripley, *Main Street and Wall Street*, Little, Brown, and Company, Boston, 1927, p. 170.
Shareholders Entitled to Report of Stewardship.

The officers of a corporation are employees of the stockholders. Employees of every organization are obligated to make pertinent reports to their superiors. There is no sound basis for officers of a corporation withholding information from their employers—the stockholders. Without adequate disclosure through the annual report the owner-employer-stockholder is unable to exercise satisfactorily the prerogatives of his status. If it were not for the great dispersion of stock ownership and the inertia of stockholders, the employees—the officers—who fail to make full reports of whole and material truth to owners—the stockholders—would be dismissed or demoted immediately.

Without an adequate annual report the stockholder has no satisfactory basis for judging the stewardship of management.15

15 The following excerpt is pertinent: "The passiveness of shareholders, accentuated by management's unwillingness to render a full account of its stewardship, has brought about a complete separation of ownership from control. As we have already indicated, stockholders' attention has been diverted largely to the market-place and daily quotations on their stocks. Knowledge of an interest in the underlying organized property values has been sadly lacking among corporate shareholders. In these circumstances officers have in many instances forgotten that they are employees working for the corporation. Rather, they have often worked largely for themselves. Directors, whose primary legal duty is to serve in the best interests of the owners, in their dual capacity as officers and directors have overlooked their basic function. As managing officers they have encouraged the notion that shareholders are not entitled to all the profits of enterprise, a notion which as directors they should have discouraged. Too frequently
The fact that control of corporations has been shifting from stockholders to management accentuates the importance of annual stewardship reports to stockholders. Since owners, in the case of most large corporations, do not have control of their enterprise they must have annual stewardship reports so that they may determine the extent to which the corporation is being run in their interest.

Stockholders Need Information on Payments Being Made to Other Groups. Stockholders, employees, and management collaborate in the production and sale of some product or service. Each of these interest groups expects to receive from that product or service produced a return equal to its contribution. For various types of protection and service, payments must be made to governmental units. Consumers expect to make a reasonable payment for the good or service produced. If the selling price of the product is too low, the consumers gain relative to one or more of the other groups. If management salaries are too high, one or more of the other groups suffer relatively. Unfortunately there

they have ignored the interest of minor employees and the general public. In some of these large quasi-public corporations, management has acted as if it were a trusteeship solely for itself, as if it were a perpetual totalitarian business elite rather than a group of stewards working for the interests of stockholders, employees, and the general public."—Purdy, Lindahl, and Carter, op. cit., p. 108.
is no formula whereby an equitable determination can be made as to the payment which is due a given interest at a given time. The problem is a crucial one today. Many social, economic, political, and moral questions are involved. It is not an overstatement to say that the future of our economic system and our nation depends on the degree to which the conflicting interests of the several groups are resolved for the common good. It follows that the stockholder should know as much about the corporate enterprise mechanism and its functioning as is possible. Only the informed stockholder can appreciate the necessity for increased wages, higher production, lower dividends, failure to produce at a normal rate, high income tax payments, or a change in some other factor. Stockholders have a big stake in the future of the American economy. It is only through a better knowledge of the nature of this stake and its concomitant relationships that the stockholder can help protect his own interest and to advance the welfare of all.

Reference is often made to the unfavorable position of the stockholder in relation to management and labor. Management has effective control of a majority of large corporations, and organized labor has been effective in securing concessions of various types. Stockholders without adequate annual-report information are handicapped in
cooping with either of these groups; stockholders without a

dquate financial reports are speculators, not investors.

Importance of Annual Reports to Employees

Employee Welfare Dependent on Corporation Success.
Relatively few corporations have come to realize that the welfare of employees (or labor--organized and unorganized) is so tied up with corporation success or failure that employees have a legitimate and vital interest in annual report topics. Fortunately, there has been increasing recognition of the right of the employee to accurate and detailed financial data on his company's operations and status. The time must soon come when the employees of all corporations of any size are given annual financial reports.

Employees are much more dependent upon corporation success than are stockholders. The employee's primary income is received from the corporation whereas the average stockholder expects his dividend receipts to merely supplement his income. Furthermore, labor is not as mobile as share capital.

16 The president of one of these corporations recently said: "After all, the industrial worker has a big piece of his life invested in a business, and we in management owe him a report on our stewardship, just as we owe it to the stockholders. Perhaps even more so because employees' lack of correct financial information is a major reason for labor-management misunderstanding in the country today." -- Pitney-Bowes Meets Its Neighbors," Trusts and Estates, Vol. 85, No. 1, July, 1947, p. 7.
Labor's need for a comprehensive annual report has the same basis as for the stockholder. The stockholder needs to make a periodic examination of the worth of his shares; the employee needs to examine—for his own good and that of the corporation—the status of his investment. The value of a worker's stake in a corporation varies with changes in future profit prospects in the same way as the value of a stockholder's shares.

**Good Employee-Employer Relations Are Essential.**
Good industrial relations are a requirement for optimum business success. Enterprise results—good or bad—are achieved through people. Today more than ever before the success of a business enterprise depends on good personnel relations, and all progressive and farsighted managements are continuously striving to improve their relations with employees.

Though it is not the most important of the several communications media which should be used by management, the annual report can be used importantly in the development and maintenance of good personnel relations. Management has definitely not shared adequate financial information with employees. There will be fewer unjustified strikes and other dislocations in the relations between workers and employers when the workers know, understand, and accept as correct the figures representing the financial position of the enterprise. The annual report should be used more widely in this connection.
Facts vs. Rumors. There is no sound foundation for industrial peace other than pertinent facts correctly interpreted. Many managements follow a shortsighted policy of giving employees as few financial facts as possible. There is indication that some corporation executives are under the illusion that facts which are not given in their annual reports do not exist in so far as the workers are concerned. This simply means that workers who do not have the facts are susceptible to the propaganda of labor organizers or leaders. Management must realize that if enterprise financial facts are not supplied to employees in an understandable and interesting form, the "rumor" factory will supply harmful fictitious figures. Actually, of course, complete financial data is available to anyone from the Securities and Exchange Commission on any company with listed securities outstanding. Labor unions use this source of information as well as other outside sources. Using information from these outside sources, union representatives make financial reports on the enterprise to the employees--reporting only what they think will be favorable to the union position. The only feasible policy for management is to provide all pertinent facts to employees through the annual report and other media.

Employees Need Insight into Contributions of Other Groups. Though there are areas of conflict in the interests
of stockholders, employees, management, and the general public, the area of mutuality of interests is much broader. The degree to which the several interest groups can cooperate as partners rather than as adversaries will be a measure of the economic success of all groups in the future.

Good management maintains a balance among the groups by convincing each group that success depends on the active and intelligent cooperation of the various groups. Information is the best key in such a program. Employees must understand their position and status in relation to the enterprise contributions being made by other interested groups. Interdependence of the groups can be shown through adequate annual reporting. Providing all interests with the same pertinent facts will provide a basis for more effective cooperation.

17 "Employers and union leaders are the same kind of people. They have been cut from the same fabric. Many times it is just a chance as to which tread or which course they take as they leave the halls of our great institutions of learning. It is just a chance that determines whether they go up the business side or the union side. Many business representatives and many union representatives could change sides and still do an outstanding job. As they become better acquainted, they begin to have understanding and respect for each other." —Fred K. King, "Is There a Field for Accountants in the Future of Labor Negotiations?", Journal of Accountancy, Vol. 84, No. 1, July 1947, p. 10.
Importance of Annual Reports to the Public

The Corporation Is a Semi-Public Institution. Reference has already been made to the fact that large corporations have become semi-public or quasi-public institutions. In line with this conception, a few corporation executives have recognized that their position is one of stewardship to the general public (in addition to stockholders, employees, and other groups) and therefore, that their annual report must also be a report of stewardship to the public. Viewed from the standpoint of the general public the logic of this reasoning is not hard to find. It runs in the following way: Incorporation is a privilege granted to a private group by the public. This privilege is given in exchange for expected public benefits—a business unit which is supposed to render greater service to the general public. The private group is given immortal life and even more important, the privilege of limited liability. In other common forms of business organization, the personal liability and attributes of the operators and the firm represent a very real safeguard for creditors and the general public. As a substitute for these safeguards, the public is entitled to full publicity of corporate financial data.

Corporate business began with public permission and it exists by public approval. Consequently, the
corporation jeopardizes its position when it fails to keep the public informed. It is discouraging that corporations have been very secretive with the public on their business affairs. It is encouraging that more corporations each year are making wider public distribution of their annual reports.

Full Corporate Disclosure Would Make Competition More Effective. It is well-known that anti-trust legislation has been relatively ineffective over a long period of years in increasing or even maintaining the area of competitive enterprise. In 1927 William Z. Ripley suggested the best approach to this problem when he said:

"Not so technical, but of wider scope, is the bearing of complete corporate disclosure upon the so-called trust question. It is now a quarter century since the United States Industrial Commission put forward this remedy, first among a number of proposals for dealing with industrial combinations. Little attention was paid at the time to the argument that such revelation of profits by concerns which threaten to oppress the public would operate almost automatically, like a towering of tariff barriers, to invite corrective competition. The secretive tactics of the National Biscuit

"Judge Gary was proud to have had a part in helping to introduce the present system of candid publicity into corporations...I was only one of many...But I am very happy today to have had some part in that great change. The people have a right to know how the people's business is carried on; and the more they know about it, the better it will be for the business. Big business, like human life, cannot thrive properly in the dark." -- Interview in Forbes, April 1, 1927. The "great change" had not and has not been effected in most corporations.
Company...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... I hold it to be self-evident that...publicity would render unnecessary much of the further-reaching antitrust legislation which at one time or another it has been proposed to put upon the statute books."

Why have corporations not adopted a policy of full disclosure? Why has the New York Stock Exchange had a continual problem in securing adequate financial information? Why has the Securities and Exchange Commission returned for correction so many statements filed with it and certified by prominent firms of certified public accountants? The primary answer to each question is the same. Corporations have been and are today aware that full disclosure would often show that excessive profits are being earned and/or excessive management salaries are being paid, and, therefore the best interest of the general public, employees, and/or consumers is not being served.

Large corporations are now or must soon become public servants in somewhat the same sense as utility companies. Public ownership or strict regulation and supervision by a public-service commission are not essential. It is essential to the general welfare, however, that large corporations be operated for the common good to the same extent as public utility companies. The good produced

19 op. cit., p. 167.
and the services rendered by these large corporations are just as essential as the goods and services provided by the utility companies.

Unless corporations make a more sincere effort to give the public definitive annual financial data, additional Federal regulation appears to be assured. Public ownership is the other alternative.

**Improve Public Relations Through Annual Reports.**

Good public relations, like good personnel relations, can survive on fact and fact only. Financial facts should be supplied the general public by corporate management. The annual report is an ideal media. A good characterization of the relation of facts to good public relations was made by Arthur Perron:

"Facts are stubborn—they demand recognition sooner or later. Business must keep the public advised, so there will be less guessing and less surmising on the part of the multitudes who should get their ideas from the right sources. Half baked ideas are generated by antagonists. Such unfair utterances and other propaganda can be nullified only by enlightenment.

"Nearly everyone is interested in knowing about things—anything...The human mind is accustomed to seeking enlightenment. If people don't get facts, they resort to imagination. Much of the economic turmoil is due to misinformation."20

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20 "Responsibility of Corporation Officers for Reports to the Public," address at Accounting Clinic on Annual Reports of Corporations, Northwestern University School of Commerce, Chicago, April 26, 1940, p. 23.
Importance of Annual Reports to Consumers

The dispersion of stock ownership is well known. Many corporations have between ten thousand and one hundred thousand stockholders. About twenty firms have more than one hundred thousand stockholders. Many firms have as many stockholders as employees. It follows that shareholders and employees can and should be an important segment of the market in companies producing or selling consumption goods. The annual report can be and often is used as a product advertising medium for these stockholder-employee consumers. The fact that a high percentage of stockholders are women is another factor which favors some product and service advertising in the annual report.

Even in the case of the companies producing capital goods or providing services to other industries, stockholder and employee information can be of indirect benefit. Institutional advertising often pays rich dividends. Nevertheless, it should be emphasized that product advertising is not an essential feature of the annual report.

Importance of Annual Reports to Other Groups

Relatively few corporations send their reports to all of the remaining groups: dealers, distributors, and agents; suppliers of raw materials; credit services;
brokers, investment services, financial editors and publications; government. The latter has need for special reports. The annual report cannot fulfill the entire reporting function to the other agencies, but it can be so used advantageously. Annual reports are read and kept on file by bankers, brokers, financial editors—all molders of public opinion on investments, profits, enterprise relationships, etc.

Reporting to such groups should not be overlooked, but in view of the direct responsibility of the management to stockholders, employees, customers, and the general public, little if any emphasis can be placed on the information needs of these miscellaneous groups in the preparation of the report.

**Importance of Annual Reports to Management**

The bulk of stockholders have almost no control over the enterprises which they own. Control of most corporations, especially the larger ones, is exercised by management—a group holding only a negligible proportion of the total shares. The separation of management from ownership means that management no longer represents, as formerly, a single interest group—the stockholders. Instead, management functions on the basis of a trusteeship to four basic and interconnecting groups: employees,
consumers, stockholders, and the general public. It is the function of management to maintain a proper balance of equity in the relationships of the four groups. As discussed in the previous sections of this chapter, each of the groups desires and needs a report from management covering operating status, policies, and results. The annual report has become the keystone of the public, stockholder, and employee relations programs in progressive companies.

**Management Must Make Reports in Self-Interest.**

Since the gap of self-interest between management and stockholders is about as wide as between management and employees or one of the other groups, there is the necessity for management to make reports as a means of self-preservation. Stockholders, employees, and the general public have become suspicious of the "treat 'em rough and tell 'em nothing" type of management. In order for the management group to remain in control for an indefinite period of time,²⁰ factual reports must be made which

²⁰ "...the power of corporate managements is becoming practically absolute, while social controls upon this power remain almost embryonic. It is here sought briefly to examine the nature of the power exercised by corporate managements, the basis upon which it rests, and the probable line of development toward ultimate delimitation of that power lest the feudal overlordship of such managements be permitted to undermine the entire system of applying private savings to economically productive uses. Such a study is by no means academic. The tendency
reveal to all interest groups that the general welfare
is being promoted. Corporation annual reports must show
by factual presentations that management has not been
indifferent to the needs of any interest group. The danger
of social control will vary directly to the degree that
management fails to serve the interests of all economic
groups and/or to the degree that management fails to
report satisfactorily on the way in which it has served the
economic groups equitably. The reporting objective can
be accomplished through factual presentations but not
through emotional appeals.21

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toward social control, though barely acquiring headway,
must be taken account of by business men lest the exercise
of powers which they apparently have and which they have
exercised in the past involve them in either social con-
demnation or legal liability."--A. A. Berle, Jr., "Management
Power and Stockholders' Property," Harvard Business Review,

Since Berle wrote this statement social controls
have gained considerable headway.

21 The following type of management appeal is doomed
to failure: "Our Captains of Industry have shortsightedly
failed to cooperate in organizing a vast army of investors,
readily recruitable, to fight against unfair attacks by
highly organized labor, as well as by the Administration,
against the many millions of thrifty, self-denying individuals
and families of modest means whose savings have made possible
the development of the United States into the strongest,
wealthiest, most productive nation in the world. The
supplying of such capital—it takes over $7,500 to provide
the average job in our manufacturing industries—has been
alarmingly drying up during the last dozen years. Investors;
stockholders have not been accorded an equitable deal by
labor leaders or by leaders and agencies in Washington."--
B. C. Forbes, "How to Link Stockholders and Management," The
Commercial & Financial Chronicle, Vol. 165, No. 4598, May 29,
1947, p. 2859.
Annual Reporting Policies

Record in the Past. The record of annual reporting ranges from no reports by most corporations a half century ago to good reports by a number of corporations today. Reporting practices have not kept pace with the changing status of the corporation in relation to the several economic groups, though progress has been made. In 1927, Ripley said:

"Our American business affairs, in so far as they have assumed the corporate form through this recent growth in public ownership, are still too largely carried on in twilight. Great progress has already been made; but it is high time that the imperative need of putting things upon a universally sounder footing be generally understood."

Ripley's statement is correct for 1948 also.

It is the unusual annual report that contains sufficient pertinent information for a comprehensive financial analysis. A close examination of a few of the better reports shows beyond question that management has been unwilling to render a full account of its stewardship and trusteeship.

It is encouraging that corporation executives are acknowledging their responsibility for full disclosure. The spirit of the following statements is commendable:

"As you will gather, we are strong believers in the advantages of full disclosure to those engaged in a common venture. The more we can do to cement the relationship among stockholders, management and employees, the greater will be the benefits from our united efforts for all concerned."23

"More and more the accounting for business operations is becoming public property. This is a fact we must not ignore."24

"This is the period of limelight for the affairs of American industry. The era of cover-up and kill-the-story is dead. The public wants the facts laid on the line and it's up to us to deliver the goods. The time has come for us to expose every feature, every salary, every cost, and even all the dirt in our business to the American people."25

Annual Reports and the Law. Industrial corporation annual reports to stockholders, employees, and the general public are not required by law.26 Some corporate by-laws require that an annual report be made to stockholders, but usually without specifying the form, content, or scope of the report. The New York Stock Exchange, for about 30 years, has been exacting a promise to issue annual reports


26 Certain corporations are required to file annual reports with commissions such as the Interstate Commerce Commission, Federal Power Commission, and Securities and Exchange Commission, and with state government agencies; some are required to publish annual statements.
to stockholders from those firms making application for listing. However, each management unit has been essentially free to make the type of report suggested by custom, its conception of its responsibility to report, or its desire.

Report Improvement Through Management Initiative or Federal Regulation. Several aspects of management responsibility for adequate annual reports to its "publics" have been discussed in previous sections. Management has a moral obligation to make annual reports which it has met in a limited way only. As a means of emphasizing the nature and implications of management responsibility for reports, penetrating excerpts from three different sources are given.

This statement by Woodrow Wilson is even more applicable today than it was when he made it in 1910:

"A modern corporation is an economic society, a little economic state—and not always little, even as compared with states. Many modern corporations wield revenues and command resources which no ancient state possessed, and which some modern bodies politic show no approach to in their budgets. The economic power of society itself is concentrated in them for the conduct of this, that, or the other sort of business...Society, in short, has discovered a new way of massing its resources and its power of enterprise, is building up bodies economic outside its bodies politic which may, if we do not find the means to prevent them, the means of disclosing the responsibilities of the men who compose them (italics mine), dominate bodies politic themselves." 27

James J. Caffrey, Chairman of the Securities and Exchange Commission, said:

"The American Corporation has become the focus of a great many social interests. Those interests are often at loggerheads, and the reconciliation of their conflicts in the light of the best possible efficient and honest running of the business has come to require the exercise of qualities of statesmanship. And in the meaning of that word lies imbedded the notion of responsibility.

"...There is in corporate management, as in all other fields, a set of temptations to which mere human beings may easily yield. The greatest of these is to forget the responsibilities that are implied in the manager's position, to forget that the ultimate ownership of the business may be in the hands of large unvocal interests, to forget that when the manager administers the affairs of the enterprise he is not doing so on his own behalf, but on behalf of others." 28

As a part of its 1936 restatement of fundamental objectives, the executive committee of the American Accounting association 29 said:

"...It is impossible now to escape the social implications of large-scale business enterprise. Its affairs are matters of public, as well as private, concern. Public accounting must, therefore, assume a full responsibility for the preparation of sound and informative reports on the operations of business, or await the time when the alternative of rigid governmental control of such matters will become an established fact.

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29 Was the American Association of University Instructors in Accounting until December 1935.
"To fulfill such a function, accountants can hardly limit themselves to comment on the statements prepared by business executives for their own purposes. It is essential that they develop and employ means of recording, measuring, and interpreting the financial aspects of business transactions in accordance with principles and standards which shall be definite, meaningful, and widely applicable. Such principles and standards can be developed, and should be developed now.

"Progress toward this goal has been retarded by the assumption on the part of some accountants and business men that the problem does not exist, or cannot be solved. It has been argued occasionally that there are no principles which should restrict the free use of any one of several plausible methods of determining values, profits, capital, etc.; that everyone should be permitted to adopt a set of accounting principles for his own affairs, and even to employ different principles at different times. It has been wrongly inferred that a reference to basic principles which should be controlling in all situations is a demand for uniform accounting methods, forms, and records. This, of course, may be impractical and unnecessary.

"A more serious obstacle is the conscientious belief of many prominent and able accountants that the only practicable means of improvement is the slow, evolutionary process involving persuasion and example through which the worst accounting practices may be gradually eliminated. Secure in the consciousness of right intent, these individuals advocate moving cautiously toward any change in position on controversial issues, unaccompanied by any vigorous or positive enunciation of articles of faith. They are encouraged in this attitude by many business men, financiers, and promoters, who find reason to discourage the publication of comprehensive and comprehensible statements of business affairs."30

It is an inescapable truth that corporate management is at the helm of our economic system despite the authority of various governmental agencies. It is also a basic truth that corporate management has the responsibility of treating neither employees, stockholders, nor itself as a favored class. Instead, it is the responsibility of management to coordinate the interests and efforts of these groups to provide for all. The social responsibility of the management position cannot be satisfactorily discharged unless management makes frank and complete disclosure annually of its stewardship.

The general public has supreme authority in a democracy. In every community the general public is made up of stockholders and employees and the users of the products and services of large corporations. The opinions of these people in each community are respected. They teach school. They preach sermons. They publish newspapers. They believe and tell others certain economic truths and/or bits of propaganda. Economic history, in ancient times as well as in the recent past, shows that when economic difficulties arise the public asserts that management (or whatever designation of the control element may be) has not
served the various economic groups equitably and the management group must be deposed or its powers altered. Such action may result from inequitable action by the control group or by the failure of the group properly to inform the various economic groups. Unless there is great improvement in corporate annual reports at least prior to the next economic depression there is good reason to expect them to come under direct Federal regulation.
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Addresses to the Accounting Clinic on Annual Reports of Corporations, Northwestern University School of Commerce, Chicago, April 26, 1940.


Hipley, William Z., Main Street and Wall Street, Little, Brown, and Company, Boston, 1927, Chapters 1, 6, and 7.
CHAPTER 3

GENERAL CRITERIA FOR ANNUAL REPORTS

The presentation of some type of annual report to stockholders has been a general custom for about thirty years. For a shorter period but at an increasing rate, the annual report has been sent also to employees and the general public. Custom and tradition have greatly influenced the nature and content of the report. The traditional policy is one of concealment in financial affairs. Typical mottoes have been: "tell the stockholders little or nothing," "what they don't know won't hurt them," "let's not say too much in our annual report for fear of its effect upon our employees." To another extreme there has been the advertising or public relations approach: "we have a story to sell," "give them simplified statements along with colorful pictures and charts," "people must be convinced that free enterprise--the sole salvation of mankind--is being smashed by unnecessary government regulations and high taxes." Between these extremes in presentation, a relatively few corporations have consistently prepared and distributed informative reports.
That financial communications are relatively unsatisfactory there can be no doubt.¹ Stockholders, employees, and the public are dissatisfied with the explanations which have been given them on such points as the amount of business investment and return earned thereon and the relationships of wages, costs, profits, and prices. An opinion research agency made a survey in 1947 and found that the public doubts the integrity of corporation statements despite certified audits.² The survey report also concluded:

"The public acts, not on facts, but what it believes to be facts. When people do not have the truth about business they are led to take points of view or support movements that hamper the functioning of the nation's economy."³

¹ Such conclusion has been reached by numerous writers—some sympathetic to management efforts and some very critical of management. Challenging, constructive and recent articles from the former group are the following: Keith Powlison, "Explaining the Facts to Employees," Harvard Business Review, Vol. 25, No. 2, Winter 1947; William H. Franklin, "Improved Public Relations Through Improved Public Reports," National Association of Cost Accountants Yearbook, New York, 1945, pp. 169-182.


³ Ibid., p. 12.
The problem is a serious one for management. In the past management has given its best efforts to the development and manufacture of better and better products and to the efficiency of the distributive system whereby these products are delivered to the public. Management has not given comparable study to the problem of business reports. The old pattern is followed or the "new bright idea" of some other company is used. Examples of objective analysis and thorough study of annual report problems are rare. After a half-century of reporting, the basic content of the annual report has changed but little.

**Need for Criteria**

What is a good annual report? What specific facts should be included? To what extent should these facts be interpreted by management for the reader? What should be done to make the report interesting and easy to read? Should the report tell the truth, some of the truth, or all of the truth? These are basic questions. There are no easy answers. Too, the correct answers today are not those of twenty, forty, or sixty years ago. If the John Doe Corporation report for 1948 is to be an effective messenger, the John Doe Corporation management must answer these questions after thorough study of its relationship to its stockholders, employees, customers, other groups, and the general public.
Is it possible to state the minimum essentials of an adequate annual report? Or, can meaningful standards be set which will serve as a guide to every corporation in the preparation of its annual report? Criteria can be set up. These criteria are unavoidably subjective, but they can be stated specifically enough to serve as definitive standards for the preparation and evaluation of annual reports.

**Definitions of a Report in Business**

Before presenting and discussing the criteria for annual reports, it is appropriate to review briefly the meaning of a report in business. The following definitions have been selected as representative ones:

"A report is a comprehensive statement of verified facts and impersonal conclusions, based on first-hand analysis of present or past conditions and operations, and compiled for the information, with or without recommendations for future action, of executives, and controlling group."\(^4\)

"As used in business, a report is the orderly presentation of the results of research which seeks truth and interprets facts into constructive ideas and suggestions."\(^5\)


"A business report is a written document of careful organization and attractive physical form, through which is transmitted factual information or expert opinion that the reader must have or may need as a foundation for his future plans and business decisions."

List of the Criteria for Annual Reports

The definitions of a report in business are suggestive of criteria which should be followed in all report preparation and evaluation. As criteria for annual report purposes the following are offered:

1. Accurate: the content should be free from error; the report should tell the truth without any avoidable misleading inferences.

2. Complete: the report should include all information which the report recipient has a legitimate interest in or right to expect.

3. Clear: the presentation of the data should be such that most of the recipients can get the correct meaning without difficulty.

4. Interesting: the report should have sufficient reader appeal to encourage its being read.

5. Balanced: proper emphasis is essential; the presentation should be such that the pertinent facts and relationships are emphasized and color, pictures, graphics, and similar devices are used only incidentally in the telling of the story.

The Material in the Annual Report Should Be Accurate

According to the dictionary the word "accurate" means "correct, true, free from error." Certainly everyone would agree that the annual report should be free from error. Saying the same thing in another way, the report should tell the truth and nothing but truth. There must never be any juggling of facts or figures to produce a desired effect.

There can be no question about the validity of this criterion. There can, however, be a question of what represents the truth in a given set of circumstances. This fact necessarily stems from the nature of our economic system, accounting records, and the annual report. Economic relationships are complex; its factors are both quantitative and qualitative but largely qualitative. Account record-keeping, the preparation of accounting statements, and, even, to a greater degree, the preparation of an annual report requires the exercise of judgment. Thus, in telling the truth about some aspects of the business management has no alternative but to make some decisions about which there can be an honest difference of opinion. But the necessity for the exercise of judgment by management does not negative the criterion of accuracy, of truth. It merely places a premium on competent management, greatly
increasing the responsibility of management to use extreme care in the preparation of every phase of the report in order that the truth will be made as plain as possible.

**Truth vs. Misinformation: Some Illustrative Cases.**

Telling the truth is more than simply avoiding a lie. Lies are avoided in practically every annual report. At the same time it is relatively easy to find instances in which the facts, in so far as the reader is concerned, are not accurately or truthfully given. Misinformation is often the product of a half-truth. Effective propaganda is usually built around some undeniable fact.

As a means of further amplifying the nature of the problem involved in applying the criterion of accuracy, some illustrations from annual reports are given. For example, it is incorrect and untruthful to caption the right hand section of the report form balance sheet as

7 Support of this contention is to be found among many writers who understand and appreciate the technical problems involved in being sure that only accurate information is given. A sample conclusion is the following: "Changes in the reports during the period show the effect of the desire for more inviting and revealing reports; but even within some of the simplified statements, apparently designed to enable all to see just what management did with the company, new devices seem to develop which may obscure or distort the appearance of some of the facts."—Robert H. Gregory, "Recent Changes in Corporate Annual Reports to Stockholders," *Journal of Accountancy*, Vol. 84, No. 5, November 1947, p. 330.
"Liabilities." The section actually includes the liability items and the net worth or capital items. This inaccurate statement is probably harmless, but still there is no real justification for failing to tell the truth.

The use of some poorly chosen words in financial statements is a frequent cause of misinformation. No doubt the word "reserve" is the best example. Captions such as "reserve for depreciation," "reserve for income taxes," "reserve for contingencies," and reserves for any number of other things are commonly found in financial statements. In addition, very often unlike reserve items are shown under the same caption. Failures of these sorts can be avoided by competent and conscientious management.

In numerous cases, instead of disclosing, the report succeeds in concealing the real conditions or in misleading the unwary reader. For example, an annual report of Radio Corporation of America showed a net profit of less than one million dollars whereas the surplus account showed that it had been decreased during the year in excess of forty-nine million dollars. The report presentation must be considered inaccurate for proper emphasis was not given to the relationship between the huge surplus entries and net profit. 

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8 For other examples of this sort see Anderson F. Farr, "Give the Stockholder the Truth," Scribner's Magazine, Vol. XCIII, No. 4, April 1933, p. 228.
Probably the most deceptive presentations are to be found in the narrative sections of the reports. Examples from 1946 annual reports are the following:

"Out of the total money available to stockholders and wage earners after the other expenses of doing business had been paid, 27.2 times as much was paid to employees as to stockholders (the owners of the company). The United States Department of Commerce reports for all corporations during 1944 show a ratio of 7 to 1...."

"...Wages and salaries, exclusive of executive salaries, amounted to 49.14% of total operating costs and to 2717.18% of dividends paid."9

"In current wage negotiations and public discussions, we feel that too little emphasis is placed on the proportion of total income which is allocated to the employees. Contained in this report are some easily understood charts and figures which show that in 1946 32% of our total income was paid out to our employees. If we consider the labor which is a part of the material and supplies we purchase to produce our goods, it could be safely stated that over 35% of all our income was returned to labor or government. Then, when we note that the shareholders have an investment of $2,638 per employee, and that the dividends received by these shareholders were only 1.3% of the total income, we believe that even the strongest proponents of the theory of increasing the proportionate return to labor will give pause."10

The figures given above are not doubted. Nevertheless, the statements are inaccurate. The logic of both statements is unsound. The statements prove no point and


certainly not the point intended. The figures given do not by any stretch of the imagination show the reasonableness or unreasonableness, absolutely or relatively, of either the payments to employees or stockholders.

In contrast to such inaccurate use of correct figures, the following logically sound and accurate interpretation of management is commendable:

"An informal presentation of the results of the Company's operations for 1946 and an informal explanation of its assets and liabilities at December 31, 1946 appear on pages 20 and 21 of this report, followed by the formal financial statements of the year, certified by our auditors. The Company's balance sheets and income statements for the past ten years appear in comparative form on pages 26 and 27.

"A number of factors should be kept in mind in considering these comparative figures. Due to different price levels in different years, a similar volume of dollar sales for different years will not indicate a corresponding volume of physical production or sales.

"Another factor is the dissimilarity of our war activities compared with our normal operations. For example, our Selling and General Administrative Expenses during the war years 1942 to 1945, inclusive, were low compared with the pre-war years. This was due to the closing of branch offices and branch warehouses and to a general reduction in our selling effort during the war. With our return to civilian production in 1946, these expenses began to approach the pre-war level. With the general price level of the country now being greater than pre-war and with increased selling and administrative efforts to achieve our post-war goals these expenses hereafter probably will exceed the pre-war level. It is expected that this will be reflected in our 1947 operations."

Limitations. It must be admitted that there are factors which make the goal of accuracy difficult to attain. Even managements who are uncompromising in the accuracy of their statements must take into account the limitations of accounting as a tool and the uncertainties of the future in the preparation of every phrase of the report. The possibility of misinterpretations of the meaning and significance of certain report data cannot be completely eliminated. Misinterpretations often stem from the following:

1. All human forces, including those of economic, social, political, moral and every other character, are ever-changing; human wants change, the value of the dollar changes, etc.

2. Accounting at its best is based on facts, rules, estimates, conventions, and personal judgment. It cannot be mathematically accurate in describing the economic status of an enterprise.

3. Accurate accounting reports of past results and present status of an enterprise can never be a certain guide for appraising future value of securities.

These limitations in no way deny the essentiality of the criterion of accuracy in annual reporting. Instead they emphasize the need for management to exercise extreme prudence in the preparation of the report.12

12 The writer disagrees with the following contention:

"My fear is that with all of the discussion about the need for accurate accounts, and with the assumption that they can throw a definite light upon the future of the company,
Importance of the Criterion of Accuracy. Truth or accuracy of the facts is a foundation stone alike of our civilization, of our economic system, of our corporate and personal relationships. The point needs little elaboration here. The following quotations emphasize the criterion:

"It must be apparent that business has, by and large, done a horribly inept job of public relations. It has failed to tell its story in a way that the truth can be known by labor and the public. It is largely its own fault that there are so many misconceptions about who gets what."—M. Hancock, "Responsibility to Investors on the Part of the Public Accountant and His Client," address at Accounting Clinic on Annual Reports of Corporations, Northwestern University School of Commerce, Chicago, April 26, 1940, pp. 44-45.

It is nonsense to let the public assume that any accounts can indicate future earnings, but this hardly refutes the need for precision in accounting.

"Nations, like individuals, are too often the victims of prejudice and misunderstanding. We can help toward world enlightenment by conducting our business openly, avoiding secret arrangements, and reporting frankly on our activities. The people are sovereign, and they must have the facts if their judgments are to be sound."  

The Annual Report Should Include All Pertinent Information

The word "complete" in the dictionary means "not lacking in any part." In terms of the annual report this means that the report should not lack any information which is pertinent to the needs of stockholders, employees, or the general public. The complete report should enable the reader to formulate sound opinions with reference to his own relations to the enterprise. He should also be able to draw some conclusions in regard to the relations of other groups to himself and to the enterprise. In so far as records of the past and current financial data can be used as a guide in appraising present status and probable future status, such data should be included in the report.

The report of the future must go further in detailing the favorable and unfavorable factors affecting the company. The presentation of all the pertinent facts is a

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safeguard to the interests of the management, the stockholders, the employees, and the general public; incomplete information and good imaginations connive to the good of nobody.

Management should approach the preparation of the report with the idea of reporting all significant facts rather than with the idea of presenting as simplified a report as possible. In preliminary planning management must ask itself "what facts are pertinent to the welfare of shareholders, employees, consumers, and the public." Of course, the answer cannot be the same for each corporation. If all of the pertinent facts are not given, the report will likely be misleading and therefore untruthful.15

15 "Accountants appear to be united in their opinion that the final determination of the extent to which information will be presented in financial statements is the prerogative of management. Stock exchanges and regulatory bodies like the Securities and Exchange Commission have encroached considerably on the discretion of management in this field by setting up standards of disclosure to which listed or registered companies must adhere.

"The independent public accountant has an express duty to perform with regard to just what shall be divulged in published reports and he is consequently another limiting factor on management's free choice. The accountant, in expressing his opinion with respect to the fairness of the presentation, is responsible not only for the propriety of what is set forth, but also for the inclusion of such information as is necessary to make the statements not misleading. So, in general, financial statements should reveal all material facts, including accounting practices used, and the nature of any change in accounting principles or in their manner of application."--Charles S. Rooskey, "Current Practice in Disclosure of Information in Financial Statements," Journal of Accountancy, Vol. 84, No. 3, September 1947, p. 202.
The difficulties involved in securing full disclosure through annual reports is recognized; this condition merely places a heavier responsibility on management, accountants, and others who may participate in the preparation of the report to explore every avenue wherein an information need may exist. It is the mutual interest of all groups that each group be in a position to know and to understand the corporation's activities.16

Limitations. The two criteria set forth thus far require accurate and complete disclosure. Thus the report should tell the truth, nothing but the truth, and the whole truth. But can the corporation afford to tell the whole truth without fear of advantaging competitors? Some corporation officials have defended their policy of providing as little information as possible by saying that complete disclosure would benefit competitors. For example, H. L. Lalumier said:

"To the investing public should be given the truth and nothing but the truth, but as to the whole truth I would make some restrictions. Trade secrets, the identity of customers, and such information surely must be withheld as it would be

16 It is worthy of note that the primary protection of investors provided through the Securities Acts of 1933 and 1934 stems from the requirement of full disclosure before any security may be registered. Too, the SEC requirements follow very closely the listing requirements of the New York Stock Exchange."
too easy for the competitor to purchase a few shares or other securities of the company and thereby obtain information extremely detrimental to the company.\textsuperscript{17}

The conception of the type of information which a corporation cannot afford to divulge has changed considerably over the years.\textsuperscript{18} Mr. Lalumier's competitor no longer has to purchase shares of stock in securing information. He can probably get more detailed information by making application to the Securities and Exchange Commission.

The idea that the annual report could be an important source of information to competitors is a false notion. Actually, competition as it exists today is usually on a different basis from formerly. Also, since the annual

\textsuperscript{17} "Reports for Banks and the Investing Public," Necessery Financial and Statistical Reports, Financial Executives' Series No. 24, American Management Association, New York, 1927, p. 23.

\textsuperscript{18} "A favorable trend, that he hopes will continue, is the changed attitude on the part of top corporate officials as to what constitutes 'confidential' information. In other years, a great deal of financial information was withheld from stockholders on the grounds of 'confidential' treatment or 'trade secrets' that by no stretch of the imagination could be so held. The experienced analyst is well aware that competitors are pretty well informed about what the other fellow is doing and why. He knows that companies make their business to find out how much, how profitable, and how efficient a job their competitors are doing, and feels that the owners of the business are entitled to share—if desired—what is probably common knowledge of their company in the trade."—J. M. Galanis, "Some Shortcomings of Financial Statements from the Security Analyst's Point of View," Journal of Accountancy, Vol. 84, No. 5, November 1947, p. 372.
report records primarily a past record it is an unlikely source of vital information to a competitor. More significantly, however, if competition is keen, there is reason to believe that competing firms establish quicker and better channels of inside information than the annual report. Actually, through trade associations and other means it has become customary for so-called competitors to exchange "trade secrets." For these reasons, fear of turning over vital information to competitors is not a real limitation of the criterion of full disclosure in annual reports.

There is a practical limitation to the amount of detail which may be included in the report and which may be useful to readers. Every figure known to the accounting department does not have a place in the annual report. Details which are irrelevant to the information needs of the reader would confuse and mislead the reader. There is the possibility that unnecessary detail may overemphasize the significance of full disclosure. For example, the use of "cents" in financial statements may give a false impression of the accuracy of the statements.

**Full Disclosure: Some Illustrative Cases.** Though it is not possible to list all data which should appear in the annual report if it is to be considered complete, it is possible to present illustrative cases which suggest
the way in which the criterion can and should be applied. The general need is for a more complete revelation of pertinent facts than any change in methods of presentation. Some examples of failure to include adequate data which are essential to sound analysis are: sales, cost of goods sold, rental costs (in case of retail stores), wages and salaries, executive compensation, depreciation, reserves, subsidiary income. In considering the justification for incomplete coverage of such items in annual reports it should be remembered that annual reports usually omit many significant details which are included in the 10-K reports submitted each year to the Securities and Exchange Commission. The information in these reports is available to the general public.

Quite a few reports contain income statements which begin with the item "net income after cost of goods sold" or even "net profit after cost of goods sold, selling and general expenses, etc." The omission of the sales figure and various important expense items makes the statement almost worthless for analysis purposes. It means, for example, that the trend of sales, profit margin, and various expense items cannot be calculated. Gross sales, returns and discounts, miscellaneous and non-recurring income, cost of goods sold, and various expense classifications
should be shown as separate items. The report reader
often needs—and occasionally gets—a breakdown of sales
by products or company branches. 19

Relatively few reports give specific information
on wages and salaries and executive compensation. Both
stockholders and employees have a legitimate interest in
these figures. What right does management have to withhold
the executive compensation figure? Management has empha-
sized the payment to employees in comparison with the payment
to stockholders. A more useful and meaningful comparison
would be between wages and salaries and executive compensation.

19 "I sat personally...with a group of sales managers
of large corporations and asked if any of them lacked
adequately exact knowledge of the volume of business done
by their rivals, or if they would feel embarrassed or
handicapped if their own figures for gross sales were
regularly published—and to both of these questions their
answer was a unanimous 'no'.

"I then put the question in more positive fashion
by asking them if I would be stating the situation cor-
rectly when I said that the real result of a corporation
failing to publish its gross figures was simply to deny
to its own shareholders knowledge which was regularly
available to its competitor companies—and to this question
the answer was an equally unanimous 'yes'.

"To clinch this point still further, I heard, on the
floor of our meeting this morning, the tale of the corpora-
tion executive who was vigorously protesting against the
suggestion that he publish his gross sales, and was asked
if he knew the gross sales of his competitors. 'Yes', he
answered, 'I have them in my pocket.'"—H. C. Farty, "What
the Corporation Can Do to Protect the Investor," Corporate
Relations with Investors and Stockholders, Financial Manage-
ment Series No. 47, American Management Association, 1935,
p. 11.
The record shows that a high percentage of earnings is not paid out as dividends but instead managements attempt to normalize dividends over a period of years. Instead of showing how employees are getting payments which the stockholders are probably entitled to get, management could more logically compare its compensation with that of the employees. Stockholders, employees, and the general public have a direct interest in management salaries, bonuses, and pensions, and the test of time will bring the figures into the open.20

Full disclosure of the accounting figures does not always mean adequate disclosure has been attained. Complete disclosure often requires management to give some facts or interpretations not revealed by bare numerical data. For example, the mere amount of plant additions or machinery expenditures is not revealing. Management needs to interpret

20 "Judged by the missing information—the information that ought properly to be in annual reports but which isn’t there—all too many managements are subject to valid criticism. These run a wide gamut—from those which reveal the absolute minimum of information that they think they can ’get away with’ to those which take partly justified pride in elaborate reports which nevertheless leave out something that every stockholder ought to have presented to him. In the latter cases what is most usually omitted is adequate information about the executives who manage the enterprise and what they pay themselves for so doing."—”What Is Missing in Corporate Reports,” a column in Magazine of Wall Street, Vol. 71, No. 5, December 12, 1942, p. 222.
the significance of such a figure by setting forth the change in capacity, if any, the expected change in unit operating costs, etc.

**Importance of the Criterion of Completeness.** The wide distribution of stock ownership and the huge share of total business which is done by corporations impose upon management a duty fully to disclose all pertinent financial facts. In spite of the obvious responsibility, corporate management has on the whole failed to prepare complete reports on its stewardship. Management must realize that large corporations have become semi-public institutions and as such full light of publicity is essential to the interests of stockholders, employees, the general public, and even to management itself. A failure to supply more complete and significant factual data is sure to lead, in time, to government regulation of annual reports. Management should not fear the whole truth as much as the misinformation which necessarily results from inadequate information. The position and interest of each group is in jeopardy when pertinent facts are withheld.  

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21 "...Management is starting to realize the necessity of taking labor into its confidence, disclosing its facts, and bringing the truth to light. It is finding that disclosure is in its interest, and that disclosure is its best defense against the wild erroneous ideas created and fostered in the minds of the public about exorbitant
The Facts Should Be Clearly Stated in the Annual Report

The first criterion was that the report data should be accurate and the second that the report should completely disclose the pertinent facts. The third criterion is that there should be a clear presentation of the facts. The word "clear" means, according to the dictionary, "free from anything that dims or obscures; free from adulteration or contamination; readily apprehended or comprehended; free of encumbering conditions." Then, the presentation of the factual data must be such that most of the recipients can get the correct meaning without difficulty. The annual report, at best, cannot be easy or light reading, therefore, special effort is required to assure that the language used is clear and unmistakable. The organization of the material should be coordinate and logical.

returns to capital at the expense of labor. Labor, in turn, seems about to recognize that its encroachments upon the rights and comforts of the general public are hurting its cause and that the era of brute force in gaining its objectives is approaching the end. Witness the recent employment of economists, such as Robert Nathan, to study business conditions, trends, and statistics for the purpose of bolstering its arguments for increased wages, and the recent statement of William Green, president of the American Federation of Labor, who acknowledges that 'labor needs help in making its wage claims more realistic'. Intellectual contention may soon succeed physical contention. It would be a step in the right direction, because it would of necessity have to start with underlying facts."—Maurice H. Stans, "An Accountant Shows the Road to Industrial Peace," Journal of Accountancy, Vol. 84, No. 1, July 1947, pp. 21-22.
In obtaining clarity of presentation the report writer must adapt the report to the reader. It is essential that the writer anticipate the reader’s attitude, his biases, his economic motives, and the questions which are likely to arise in his mind as he reads the report. In preparing an intelligible report management must not be concerned with “what should we tell them” so much as with “what do they (the readers) want us to tell them.”

Clarity vs. Vagueness: Some Illustrative Cases.

Notwithstanding comments to the contrary, accountants have not acquired or do not exercise the art of expressing themselves in unequivocal language.22 Many account captions are incomplete and unrevealing as to the exact nature of the items. The following items from annual reports illustrate the point:

"Security investments, at cost or less"—(What is the significance of "security"?)
"Sundry reserves for insurance and contingencies"—(Can be most anything.)
"Non-current notes and accounts receivable (partly secured)"—(Whose notes and accounts, and amount of security?)
"Receivables"—(Brief enough, but not very enlightening.)
"Depreciation and obsolescence" and "Insurance and contingencies" shown as reserves under liabilities section—(Bad! Bad!)

Some progress has been made in substituting layman's language for some of the customary technical accounting terms, but the above examples indicate that clarity is an important criterion.

Among others, United States Steel Corporation has succeeded in clarifying its financial statements by streamlining and summarizing the statements which reduce them to an understandable form. Supporting schedules contain detailed information which is available for use by those who want to analyze the report thoroughly.

It is paradoxical that the footnotes or notes to the financial statements are intended as explanatory or clarifying and yet these notes in most reports need more clarification than possibly any other section of the report. Remington Rand's explanation of its property item is a good example of vague, indefinite footnotes:

"Properties are carried on the basis of amounts on the books of corporations, the capital stocks or net assets of which were acquired for capital stock of the Company and for cash, plus expenditures since acquisition, less write-downs (aggregating $3,722,782) in 1928 and 1933 and less the carrying amounts for properties dismantled, retired and sold."

23 It is apparent, however, that some of the "simplifying of accounting reports" is accomplished as a means of dodging full disclosure. To simplify does not necessarily mean to clarify.

In contrast to this coverage is the very commendable breakdown in the United States Steel report25 of the property items and the offsetting reserves by types showing additions, deductions, and transfers during the year. Emergency facilities are shown separately.

These are only a few of the countless ways in which clarity is or is not achieved. In clarity, lies strength; management cannot afford less.

Limitations. There is one limiting factor which cannot be completely obviated. The annual report cannot be made simple and clear enough for everyone to understand. Writing down to the reader, as for example in comic-strip fashion, in the report is not desirable. The objectives of clarity, completeness, and accuracy cannot be achieved by attempting to make the report intelligible to all stockholders, employees, and the general public.

The most troublesome deterrent to clarity in annual reports, however, stems from the varying applications of "generally accepted accounting principles." The accounting profession has been concerned about this problem throughout its history, but much remains to be done.26


26 "...the profession has the very real obligation to develop, in a more definitive sense, standards of treatment in the application of accounting principles which will
Importance of the Criterion of Clarity. Pertinent facts and even all of the pertinent facts in an annual report are almost worthless unless the presentation is intelligible to most of the readers. A report full of facts is valueless if it is not read and understood.

Much of the current industrial strife would be quickly dissipated if labor could see clearly its status and relationship to management and capital and if management and capital in turn could see its status and relationships to the other two factors. Each factor must have a better appreciation of the contributions to the total economic product made by each factor and a clearer understanding of the basis of the distribution of the economic product.

be more uniform, and hence be less subject to the possible criticism of unjustifiable variation. Without in any sense prescribing applications which would eliminate the necessary variations as determined by professional judgment, further progress can surely be made to narrow the areas of alternative treatment of similar types of items. In more blunt terms the accounting profession must come to greater agreement within its own ranks as to the major principles of cost and revenue accounting. "--Victor Z. Brink, "Accounting and Industrial Peace," Journal of Accountancy, Vol. 83, No. 5, May 1947, p. 392.

27 "We as business men have made serious mistakes in the past, through not presenting our figures in the most understandable way or through not giving them proper descriptive names. Our figures have been hard for most people to understand. Sometimes they have been downright confusing. We can and must do something about that. We have to set our houses in order."
Such a goal of mutual understanding cannot be achieved immediately and through the annual report alone, but clear annual report presentations can accelerate our movement toward the goal to better advantage than through any other medium.

The Annual Report Should Be Interesting and Attractive

The fourth criterion is that the report should have sufficient reader appeal to encourage its being read. For the first three criteria to be effective, the report must be opened and then read. It must be read with genuine interest. It can be read with such interest only if all the pertinent facts are given in a clear manner. But the story which is so important to the reader may be received poorly if the presentation is not interesting.

The dictionary meaning of "interesting" is "gain and keep the attention of; induce (one) to share (in);"

"Our figures have been honest, yes. But that is not enough. We are in the position that Mr. Hutchins of the University of Chicago says engineers are in, namely, that nobody can understand them except another engineer. Yet we must ultimately stand or fall on how well the general public understands our operations and how much they trust and believe our reports on them. We must do whatever it takes to clear away the misunderstandings and make our figures intelligible to ordinary folk."--from an address by John L. McCaffrey, president, International Harvester Co., before the Illinois Society of Certified Public Accountants, December 17, 1946, (Quoted in Journal of Accountancy, Vol. 84, No. 1, July 1947, p. 24.)
arouse curiosity or interest in." In recognition of the
importance of an interesting presentation, the most notice-
able shift in annual report practices in recent years has
been the increased use of photographs, color, and charts.
The use of these and other reader-interest devices have
been effective in eliminating the applicability of the
phrase "dry as an annual report." The efforts to make
the report more interesting and attractive were concomitant
with the realization that the annual report could be made
to serve a broader purpose than merely to supply stock-
holders with some financial facts.

Interesting vs. Uninteresting Reports: Some
Illustrative Points. The criterion that the report should
be interesting and attractive has reference only to the
way in which the report is "packaged". The range of sub-
ject matter which should be included in the report is
governed by the criterion of completeness. It is axio-
matic that a report which does not cover the topics in which
the reader has a real interest cannot be made genuinely
interesting by adding color, pictures, graphs, and similar
features. The product to be packaged is the thing of key
importance to the report readers. Packaging in an inter-
esting way can only be of incidental significance.

26 "Topics of most interest" to stockholders is
considered at some length in: Ernest Dale, editor,
Aside from the devices such as pictures, color, and graphics which can be used in building an interesting report, there are some positive things which can be done in making the presentation interesting or appealing to the reader:

1. The whole report should be written from a personal approach rather than an impersonal one. Notice the differences in the appeal of the following:

"Net profits in 1946, compared with 1945, follows."\(^{29}\)

"In the following paragraphs the operating results of Allied Stores Corporation and subsidiary companies for the fiscal year ended January 31, 1947 (hereinafter referred to as the year 1946), and the financial condition at the close of the period are briefly summarized and certain pertinent comparisons are made with operating and financial statistics of earlier periods."


Four recent stockholder-opinion survey reports are:

The results of a number of surveys are summarized in "Corporate Information Please," Trusts and Estates, Vol. 81, No. 1, July 1945, pp. 59-64.

29.1946 Annual Report, American Chicle Company.
"The annual report of the Cudahy Packing Company for the fiscal year ended November 2, 1946, is submitted herewith."

"It is a pleasure to report the progress which your company has made during the year." 30

"Your Company has completed its first full peacetime year since the end of World War II in a strong competitive position." 31

"Like a great many other American manufacturers, your company did not accomplish as much during the past year as it had anticipated." 32

2. The tone of the narrative section of the report is important. Notice the appealing nature of the tone of the last three excerpts. The following excerpts also suggest a tone of sincerity:

"The Company continues firm in its belief that its operations, to be successful, must benefit customers, employees, and stockholders—all three—with gain to all and harm to none. To the achievement of this objective, the best efforts of the Caterpillar organization are earnestly dedicated." 33

"In addition to the figures and other financial information interpreting the results of the year's operations, this 1946 Annual Report endeavors to tell you about the services rendered, the problems faced, and the progress made. It also endeavors to present as clear a picture as space permits of the activities that go on in a merchandise distributing business like Butler Brothers."

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30 1946 Annual Report, Walt Disney Productions.
32 1946 Annual Report, LaPlant-Choate Manufacturing Co., Inc.
33 1946 Annual Report, Caterpillar Tractor Company.
Limitations. The use of classy paper stock, fancy covers, expensive bindings, four-color illustrations, and pages of pictures of this and that can only help in gaining reader interest. The primary objective and the current problem of providing definitive information pertinent to the needs of stockholders, employees, and the general public remains unchanged. Unfortunately, there is reason to believe that more management thought and effort has been placed on reader-interest devices than on the question of what factual information the stockholders, the employees, and other groups are interested in, need, and entitled to receive.\textsuperscript{34}

An important limiting factor is the late date on which many readers receive the annual report after the

\textsuperscript{34} "Many corporations have attempted to add appeal to their annual reports to stockholders in recent years. And they are to be highly complimented for these efforts. Yet the trend has been toward painting a pretty rather than an informative picture where financial facts are concerned.

"The art work in many of these annual reports would do Hollywood proud but pertinent facts frequently are grouped in such a way that they are obscured. It is quite evident that the intent is to hide rather than disclose. The argument is advanced as a general rule that it would be unwise to allow competitors to know what is going on. This argument has grown very thin, particularly since the Securities and Exchange Commission requires complete disclosure whenever new securities are offered to the public."--Ralph Hendershot, "A Financial Editor Appraises Annual Reports," in the New York World Telegram. (Quoted in Journal of Accountancy, Vol. 84, No. 5, November 1947, p. 399.)
close of the fiscal year. For highest reader interest
the report should go out as early as possible. Through
proper advance planning, the report should be ready for
distribution within a month or two of the end of the
fiscal year. A four- to six-month period prevails generally
at the present time.

Importance of the Criterion of Interesting Presentation. The importance of this criterion need be little
emphasized here. The sad truth is that it has already been
everemphasized in practice in comparison with the other
criteria. Public relations techniques have been used too
often to gloss over the misunderstandings of corporate
earnings, affairs, and relationships by the use in annual
reports of lots of color, many photographs, artistic
drawings, etc. Preoccupation with form and method of
presentation is as much a danger as the original practice
of stating tersely and without glamor some of the financial
statement facts of the business. Color, pictures, and
dgraphs can contribute to better reports but the real worth
of the reports will always depend primarily on the perti-
nence and the volume of the factual data contained.

The Annual Report Presentation Should Be Well Balanced

Four requisites of a good annual report have been
advanced. Some of these are relatively more important than
others. The most effective report gives proper emphasis to each of the requisites. A well balanced report is one in which appropriate weight and attention has been given to each phase of the report. The key facts need to be displayed prominently and explained and interpreted in some detail. The more pertinent facts must be presented in such way that the reader interprets them with the right sense of proportion and perspective.

The report must be primarily a presentation of factual data in understandable language and attractive format; partial truth jazzed up through the use of color and pictures will not survive the test of time. Though the report is an important public relations medium, the tendency for the report to be overused as an advertising brochure is regrettable. Some managements are using the report heavily for propaganda purposes, devoting large sections of the report to biased and emotional statements on what they term unnecessary government regulations, unfair labor practices and laws, unfair taxes, etc. Such reports lack balance.

Proper Emphasis: Some Illustrative Points. More than half the pages in some annual reports consist of pictures of this and that. In most such reports the financial statements section is a relatively small proportion of the total report. Management must realize that stockholders, employees, and the general public are interested
in and need pertinent information on the primary questions of how much profit was earned, how it was earned, what disposition was made of the earnings, what were the costs of operations, how much better or worse was this record than before, and what should be expected in the future. The financial statements section, therefore, must receive adequate coverage.

It has been said that the only basic difference between two firms in the same industry is the people. This may be a mild overstatement but certainly no one would belittle the importance of employees—their work, pay, training, attitudes, ambitions, problems, health, experience, etc.—to a going concern. Yet, in many reports, from one sentence to three or four short paragraphs is the extent of employee coverage. For example, the only coverage in the 1946 United Aircraft Corporation report is the following:

"At this point, there should be recorded a tribute to the whole-hearted and effective cooperation of all of the Corporation's employees which played such a vital part in the successful completion of our reconversion to peacetime operation in the fourth quarter of 1946."

The relative importance of the human element in business is definitely under-estimated in most annual reports. Management has in too many instances chosen to compare certain data and to draw unjustified conclusions therefrom.35 Similarly, management sometimes chooses to emphasize

35 For example, see supra, p. 83.
the wrong facts. Probably the best illustration of this is the emphasis which some management place on their earnings on sales compared to their returns on investment. Many published reports specify and stress the percentage of each sales dollar which goes to stockholders; few reports specify or stress the percentage of earnings on investment. Of the two facts, stockholders, employees, and the general public are primarily interested in the percentage of earnings on investment—the fact which management has least emphasized. Likewise, only a handful of reports contain even meager information on executive compensation. The latter figure is of more vital importance to employees and stockholders than the percentage of the sales dollar which goes to particular groups.36

36 "One consideration to be remembered is that in large corporations there has been a trend toward relatively fixed rates of common-stock dividends, so that the real issue in division of revenues from production is not so much between owners and employees, as between management and labor. This is a consequence of the well known divorce between management and ownership. Similarly in smaller closely held companies, net income does not always represent the reward of capital because the owner-managers may wish to take as much as they can in the form of compensation, and as little as possible in the form of dividends, for obvious income-tax reasons. Therefore an income statement purporting to be informative to labor, which lumps together all management salaries, bonuses, and labor costs, and then shows that the remaining profit is small in relation to this total, might not be honest. It may be even worse if the comparison is made with net profit after deducting income taxes. And there may be no sound relationship at all if consideration is not
**Limitation.** There is only one broad limiting factor in the application of the criterion of "proper emphasis." This factor is the ability of management to sense and to succeed in having the coverage emphasize those facts and relationships which are important to each interested group of readers. Though there are no easy answers to these questions, those managements who seek diligently to keep the record straight can arrive at rather definite conclusions as to what should be emphasized.

**The Importance of a Well Balanced Report.** A given management, with credit to itself and the general welfare, can hope to eliminate prevailing false issues from the thinking of its employees, stockholders, and public in only one way. The way calls for the management to be sure that the thinking of these groups will be in terms of the facts in so far as its business is concerned. A primary part of such an information program should be a well-balanced annual report.

given to the difference between plants that are owned and those that are rented, between companies financed by debt as compared with equity capital, and between operations where labor is relatively a major or minor factor. It is an important duty for those who have responsibilities for such financial statements to see that misrepresentations arising from such factors as these do not occur."—Edward B. Wilcox, "The Role of Accountancy in Prosperity and Peace," *Journal of Accountancy*, Vol. 84, No. 4, October 1947, p. 278.
Selected Bibliography

"Corporate Information Please," Trusts and Estates, Vol. 81, No. 1, July 1945, pp. 59-64.


Hancock, John M., "Responsibility to Investors on the Part of the Public Accountant and His Client," an address at Accounting Clinic on Annual Reports of Corporations, Northwestern University School of Commerce, Chicago, April 26, 1940.


CHAPTER 4

GENERAL CHARACTERISTICS OF THE ANNUAL REPORT

How the Reports Are Addressed

There is an addressee designation or salutation in the president's letter in most reports. A breakdown of the way in which the 160 reports were addressed follows:

1. Stockholders only
2. Stockholders and employees
3. Not addressed specifically to any group (further breakdown below)
4. Other (further breakdown below)

Of the group not specifically designated the following captions appear at the beginning of the president's letter:

1. "Review of 1946 by the Chairman"
2. "President's Message"
3. "Your President's Report"
4. "Carrier (name of company) in 1946"
5. "Report from the President of General Shoe"
6. "Report of the President"
7. "The President's Statement"
8. "Annual Report"
9. "A Review of the Year by the Chairman"
10. "Introductory Letter from the Chairman and the President"
11. No caption whatever (Phillip Morris)

The detail on the three reports under the "other" designation is as follows:

1. "Report to Plumb People--Employees, Stockholders, and Customers"
1. Note under "1946 Report" caption: "This report is intended both for the stockholders and employees, as well as customers and all others who have an interest in the business of the International Harvester
Company."

1 - "To the Members and Friends of the General Foods Family"

Thus only 16 of the reports are specifically addressed to one or more groups in addition to stockholders. Actually, however, the content of some of the president's letters in the remaining 82 reports indicate that management has prepared the report for groups other than stockholders. Though its report is addressed "To Stockholders," Marquette Cement Manufacturing Company places the following statement prominently on a page prior to the president's letter: "While this is primarily a report to Marquette's stockholders, it also serves to interpret to the general public the role private industry plays in serving the best interests of employees and the consuming public." 1

It is believed that if the report is intended for any group other than stockholders, some caption other than "To Stockholders" should be used. Specific designation such as "To Employees and Stockholders" or such as that used by Plomb Tool Company or International Harvester Company is preferred. Good letter-writing technique requires the use of a salutation which is as specific as possible. There appears

1 This is an unfortunate overstatement. There can be no logical conclusion as to the "role private industry plays in serving the best interests of employees and the consuming public" based on the content of the report.
to be no good reason why the principle should not be applied in the president's letter in the annual report.
It is doubted that the chummy salutation used by General Foods represents good policy.

In addition to the regular annual reports as indicated above, six of the corporations issued separate annual reports for employees. These six reports are analyzed in some detail in Chapter 10.

**Page Sizes**

The page sizes range between 5 3/4" x 9" and 8 3/4" x 11 1/4". The predominant size is approximately 8 1/2" x 11". Fifty-three of the 100 reports were exactly 8 1/2" x 11".

The next most common report sizes were: 8 1/4" x 10 3/4" (5), 8 1/4" x 10 1/2" (4), 8" x 10 1/2" (3), 7" x 10" (3), and 6" x 9" (3). A summary of the spread of sizes follows:

<table>
<thead>
<tr>
<th>Size Range</th>
<th>Number of Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 3/4&quot; x 9&quot; through 6 3/8&quot; x 10&quot;</td>
<td>- 7 reports</td>
</tr>
<tr>
<td>7&quot; x 9 1/2&quot; through 7 7/8&quot; x 10 3/4&quot;</td>
<td>- 11 reports</td>
</tr>
<tr>
<td>8&quot; x 10 1/2&quot; through 8 3/8&quot; x 11&quot;</td>
<td>- 19 reports</td>
</tr>
<tr>
<td>8 1/2&quot; x 10 1/2&quot; through 8 3/4&quot; x 11 1/4&quot;</td>
<td>- 63 reports</td>
</tr>
</tbody>
</table>

The large report lends itself to the use of pictures, drawings, charts, lots of color, and to more complete coverage in general. Nevertheless, the small size report is still used effectively by some corporations. A few of them have very satisfactory charts and the usual quota of
pictures. Certainly it cannot be said that the small size report is in conflict with either of the basic criteria of good reports.

**Number of Pages**

Of the reports included in this study, the number of pages, counting the cover pages, range from 16 to 68. The average is 32 pages. Seventy-two of the reports range between 24 and 40 pages. The most common number of pages is 25 and 32 pages. The complete breakdown on the 100 reports follows:

- 6 - 16 pages
- 6 - 20 pages
- 4 - 24 pages
- 3 - 26 pages
- 2 - 28 pages
- 1 - 30 pages

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2. One stockholder-opinion survey showed that 70 percent preferred a page size approximating the size of Time magazine, 22 percent preferred the size of Reader's Digest, and 4 percent preferred the size of Life magazine. "The Stockholder Speaks," Reports Division, Herald Square Press, Inc., Chicago, 1946, p. 4.

3. Union Carbide and Carbon Corporation and United Aircraft Corporation issued separate pictorial reports to accompany the regular reports. The two reports are considered as one in all of the analyses of this study.

Gate or double-folds are also counted as regular pages without regard to the way in which the pages are numbered in the report. The cover pages are counted as pages in view of the practice of some companies to leave no blank pages in the report including the cover pages.
It is axiomatic that the report can be too long or too short. Too, the report can be long and still fail to meet the standard of full disclosure. Putting it another way, qualitative considerations are more important than quantitative. In general, it can be correctly said that the reports consisting of 20 pages or less are not as informative as the longer reports.

The character of the enterprise activities, the intercorporate relationships, and the number of different interest groups for which the report is prepared should be the primary determinants of report length. Being arbitrary in part, it is doubted that the financial story of the larger corporations can be told thoroughly in less than 24 pages.

**Number of Blank Pages**

Since photographs, sketches, and drawings are being used to make the reports more attractive, interesting and informative, the tendency has been toward the use of every page including the covers and away from the practice of leaving some blank pages as is customary in book-making practice.
Forty-three of the reports contain no blank pages. The remaining 57 reports contain from one to seven blank pages, averaging almost three pages per report. Such pages appear to be a complete waste from the viewpoint of the effectiveness of the reports. Approximately one-fourth of the Foster and Kleiser report is blank. Conversely, very effective use is made of each of the cover pages by Caterpillar Tractor Company, United States Steel Corporation, and many others.

The breakdown on blank pages in the reports follows:

- 43 - no blank pages
- 16 - 1 blank page
- 15 - 3 blank pages
- 5 - 4 blank pages
- 1 - 5 blank pages
- 3 - 6 blank pages
- 1 - 7 blank pages

Another convention with similar origin is the use of a title page. Pillsbury Mills and Pacific Mills are two of the several companies which follow the convention of using a title page. The Studebaker Corporation and the United Specialties Company begin their presidents' letters on the page which is conventionally the title page. The conventional title page is not an essential part of a good report.

*Pages of Photographs*

The trend toward the use of more and more photographs in the annual report is verified by the fact that only four
of the reports contain no pictures. Also, 23 of the reports have ten or more pages of photographs; three reports have 20 pages or more; 29 reports devote more than 25 percent of the pages to photographs; the average number of pages devoted to photographs is slightly in excess of six pages.

The detailed breakdown follows:

<table>
<thead>
<tr>
<th>No. of Reports</th>
<th>Pages of Photographs</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>3</td>
<td>11</td>
</tr>
<tr>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>1</td>
<td>13</td>
</tr>
<tr>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>0</td>
<td>15</td>
</tr>
<tr>
<td>0</td>
<td>16</td>
</tr>
<tr>
<td>0</td>
<td>17</td>
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<tr>
<td>0</td>
<td>18</td>
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<tr>
<td>0</td>
<td>19</td>
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<tr>
<td>0</td>
<td>20</td>
</tr>
<tr>
<td>0</td>
<td>21</td>
</tr>
<tr>
<td>0</td>
<td>22</td>
</tr>
<tr>
<td>0</td>
<td>23</td>
</tr>
</tbody>
</table>

In addition to photographs, a relatively few reports use drawings and sketches. Among the companies making effective use of such devices are Blue Bell, Inc., Godchaux Sugars, Inc., and Food Machinery Corporation.

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4 These reports are for The Carborundum Company, Ferro Enamel Corporation, Kennecott Copper Corporation, and Shenley Distillers Corporation. Carborundum uses two small sketches, Ferro uses several symbolic drawings, and Shenley uses prints of its trademarks.
Photographs may possibly serve three purposes in an annual report:

1. Help create and maintain reader interest.
2. Inform the reader on certain phases of the corporation's operations.
3. Promote the sale of company products.

An examination of the 100 reports suggests that the creation and maintenance of reader interest is the primary objective in most of them. The photographic subjects usually include company products, product uses, manufacturing processes, officers and directors, employees at work and play, research activities, and buildings and plants.

Photographs of each of these types can be of value in creating interest, whereas only the company products, manufacturing processes, and product uses can be directly valuable in promoting sales, and hardly any of the types can contribute directly toward making the report more informative.

There is approximately the same emphasis on product promotion, product uses, and manufacturing processes in the reports of those companies dealing in producers' goods as those dealing in consumer goods or services. This is true even in the case of those reports which devote relatively more space to photographs. Though some product advertising can be done through the annual report, management should carefully evaluate the advertising expenditure made to "sell" to stockholders and employees -- the groups with whom least
promotional advertising is needed. International Harvester Company, National Lead Company, A. E. Staley Manufacturing Company, and Vick Chemical Company are among the companies having excellent product coverage. The managements of these and other companies should continue to ask themselves if the promotional effort in the annual report is paying reasonable dividends.

United Aircraft Corporation, Union Carbide and Carbon Corporation, and Vick Chemical Company approach the problem in an interesting and maybe preferred way. Vick Chemical Company devotes the first section of its report to financial statements and narrative interpretations and the last half to product promotion. The other two companies issue separate pictorial reports along with the regular annual reports which contain no pictures. The latter practice obviates the cluttering up of the annual report with photographs and also makes the pictorial promotional material available to groups not receiving the annual report.

The possibilities for informing readers through the use of pictures is very limited. The pictures of the officers and directors should be included periodically, but pictures can throw little if any light on the financial status of the company or the progress which it has made over a period of time. Moving or still pictures of various physical properties or processes give no clue to the effectiveness with which the properties have been used or can be used.
The manufacturing processes are of some interest to every person, but it is doubted that a knowledge of the techniques of making aluminum, telephone wires, or some other item or items is essential to the information needs of report recipients.

Apparently most photographs are placed in annual reports for the purpose of making the reports more interesting and attractive. This purpose can best be achieved by juxtaposing photographs and directly related narrative material. This plan is already followed in some reports.

There is reason to believe that annual reports can be made interesting and attractive without an average of six pages of pictures in each report. For example, the Brown & Biglow and P. R. Mallory & Co., Inc., reports are interesting, very attractive, distinctive, and even colorful, whereas the Mallory report does not contain a picture of any sort and the Brown and Biglow report contains only a picture of the president.\(^5\) There is definitely an overbalance of pictorial material in many of the reports. A conglomeration of photographs obscures the importance of the financial story which the report is supposed to tell. More than a glance at pictures and some of the narrative

\[^5\] The report also contains some product prints on one two-page spread.
material is required if the report is to serve its purpose. Beautiful photographs are not a reasonable substitute for the complete facts given in a clear manner. Some managements have given pictures in preference to giving the essential financial facts.

Stockholder-opinion surveys reveal that stockholders have some awareness of relative values. In one survey only 66 percent indicated that they would like to see photographs used. In another survey the stockholder was asked to state:

"If a company sent me an Annual Report that was illustrated with pictures similar to the style of Life magazine, I would think the company was...

12% - Undignified
22% - Modern and up-to-date
18% - Poorly managed
63% - Making an honest effort to make me understand company progress
14% - Trying to cover up something by diverting my attention."

First, it is noted that 42 percent answered that they felt that the pictures would indicate the company was "undignified, poorly managed, or trying to cover up something by diverting attention." Thus, a large portion of the reaction was unfavorable. Management should weigh such reaction heavily. In contrast, only 22 percent would

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7 The stockholder could check more than one of the items if he desired. See Ralph Gates, "What Stockholders Want in Annual Reports," Financial Management Series No. 68, American Management Association, New York, 1941, p. 5.
view the report as "modern and up-to-date." Management already knew that the vogue was to use many photographs. The fact for management to remember, however, is that what is "modern" today is apt not to be "modern" in the future. In a time of stress, those who are interested in corporate reports will not remember sympathetically the "modern" annual reports received in past years.

The faulty nature of the question is clearly revealed when 63 percent said that they would think the company was "making an honest effort to make me understand company progress." This is a joke--on the stockholders or management, or both. Pictures cannot make any substantial contribution toward a better understanding of company progress. Good management must know this already. Stockholders, employees, and other interested groups have been learning! Some public relations executives and consultants will ultimately learn! Pictures are of secondary importance. A full disclosure of the financial facts can be an interesting story without a lot of pictures. Photographs can make such a story more interesting. In general, pictures are justifiable in the report only to the extent that they help create and maintain interest in the financial story which is so important to various groups.
The general pattern of page numbering is satisfactory.

124
table of contents. Intelligent readers expect to find a table of contents in publications which run into a number of pages. The large number of topics covered also suggests the need for a reader guide.

Of the 18 reports which have tables of contents, those of Walt Disney Productions, Electric Boat Company, Robert Gair Co., Inc., General Motors Corporation, Hamilton Watch Company, and United States Steel Corporation are best. Electric Boat Company sets the best example, as follows:

**CONTENTS**

**Foreword—The Company's Reporting Policy** 2

**Financial Highlights—Basic Statistics at a Glance**

Highlights in Graphic Form 4

**Annual Report Digest** 5

**Financial Review—By the President of the Company** 7

- Transition to Peace
- Gross Income and Net Profits
- Costs of Operation
- Reorganization Refund
- Taxes and Carry-Back Credit
- Dividends
- Stock Dividend in Preferred and Changes in Capitalization
- Reserves and Additions to Surplus
- Net Working Assets, Cash and Accounts Receivables
- Inventories
- Plant Asset and Book Value
- Termination of Contracts
- Unfilled Orders
- New Products
- Acquisition of Canadair Limited 14
A good table of contents should help in creating interest in the report. It should appear on the first or second page of the report. Actually there is such a congregation of narrative, pictorial, and statistical material in many reports that an index, more than a table of contents should have...

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8 General Motors Corporation places (inadvisely) its table of contents on page 11.
contents, is needed as a guide to the contents. There is the same need for a logical order of presentation of the report material as there is in the case of a book, a balance sheet, or any report.

**Charts**

In general, the graphic method of presentation is the most effective way to present statistical data. When properly prepared, charts attract and hold attention, are simple in appearance, and easily "point up" to the reader the cardinal points.

The 100 reports contain 339 charts. Seventeen of the reports do not have a single chart. Thirteen other reports contain only one chart. Since charts can inform as well as create and maintain interest it is puzzling that managements, most of whom profess a desire to tell

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9 Hamilton Watch Company incorrectly terms its table of contents an index.


everything about business affairs, would devote about four
times as much space to photographs as to charts. Manage-
ments who desire to make full disclosure must use charts.
A better reporting tool for annual report purposes is not
available.

The charts included in the 100 reports by types are
given below:

<table>
<thead>
<tr>
<th>Type</th>
<th>Percent of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pie charts</td>
<td>32</td>
</tr>
<tr>
<td>Line charts</td>
<td>27</td>
</tr>
<tr>
<td>Bar charts</td>
<td>55</td>
</tr>
<tr>
<td>Other charts</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

The type of information portrayed in these charts
is reclassified by subject matter and is described and
evaluated in later sections of this study. For example,
the charts dealing with sales data are considered in detail
at the point where the presentation of sales data is consid-
ered in Chapter 9. Some instructions of general signifi-
cance in making the best possible use of charts are given
below:12

1. The use of charts can be justified only if they
succeed in providing information to the reader. The color

12 For a comprehensive treatise on graphic methods,
see Karl G. Karsten, Charts and Graphs, Prentice-Hall, Inc.,
New York, 1923.
and design of a chart are unsatisfactory if the reader is attracted to the features of the chart itself rather than to the statistical data. In general, pictorial charts should be avoided.\textsuperscript{13}

Pictorial charts which are not carefully designed will succeed in misleading rather than wholly informing. A good example of this is the pictorial presentation of the division of the Foster and Kleiser Company income dollar wherein it is shown that the net increase in earned surplus is "money in the bank." It is little wonder that many stockholders and employees think that "surplus is cash on hand" and could be used in its entirety in paying dividends or wages.

A similar error is made in the Godchaux Sugars, Inc., report in the pictorial representation of gross profit and net profit as stacks of dollars.

Many annual report charts are too colorful or too unique or complicated in design to portray its message to the best advantage. The pie chart in the Food Machinery Corporation report, the combination bar-pictorial chart in the General Foods Corporation report, and the very unique

\textsuperscript{13} The bar-pictorial charts in the Briggs Manufacturing Company report are neither as attractive nor informative as the plain bar charts in the Caterpillar Tractor Company, LaPlant-Cheate Manufacturing Co., Inc., and many other reports.
16 1946 annual report, p. 4.
17 1946 annual report, p. 11.
18 1946 annual report, p. 6.


Reported in Annual Reports. Be known how to interpret one table. See Chapter One. "Why not look at the reports at least one of the shareholders.

p. 4.

The Board of Directors, 1946, p. 41. Board of Directors, 1946, p. 41.

For a detailed analysis of the same period of years. Please refer to the directors.

3. In general, the more recent data in different charts

paragraph text.

Table volume, not sales prices, were taken and compared

when in the Board of Directors' report which shows sales

statistic on the table. The reports are not material nor of

the Board of Directors. The Board of Directors and the

amount in the table above the corporation and the

understanding that when released to show a breakdown on more than two of

company's two charts. In some cases, they and one or two times should be

outside one day. Preferred stock is not to be

understandable from an earlier chart would do.

where in Board of Directors the report do not give the facts in
Report p. 5.
For example, see 1947 Report, p. 6.
Any annual report, p. 25.
1947 Report, see 1947 Revenue Manufacturing Co.

Twenty-five of the reports contain a map. Some of them:

Map

This is not recommended. So the placement of your charts on one page with any com-
trom which the chart is made to be included in table form. 19

even if. Sometimes it is desirable for the data

to the narrative material. Charts should not be made

4. Charts on a center page or page spread should be-

were eliminated.

and the reader on the reason to wonder why certain years

preceded are less important than the charting of products

1946 data. The layout-change, dougane, and stability

and 1947 factory wage. In the Stability Pattern Co.,

end on the opposite page a comparison is made between 1947

and 1945 factory wage. In the Stability Pattern Co.,

end an the opposite page a comparison is made between 1947

and 1946, 1947, and 1948. The report shows company re-

In the R. I. Does the Shoe Company Ex-

also report are for periods ranging from seven to

research the can chance in the Leve-Plant-Change Manufacturing

Company reports are for the period of 1943 through 1946,

impressed. The five chance in the Gartner-Plant
these show locations of plants, sales and other types of offices, warehouses, distributing agencies. Other types of data shown are: flow of goods over the world, employees by states, value of exports to world points, source of raw materials and areas where products are distributed. For these purposes maps can be used very effectively.

**Tables**

Much of the basic accounting data in the reports is in table form. In making a count on the tables used in the reports, supplementary accounting statements and supporting schedules such as the statement of funds applied and provided, statement of working capital changes, schedule of investments, schedule of fixed assets and depreciation, and similar schedules were not included. Sixty-one miscellaneous tables were used.

Tables have one advantage over charts: more detailed information can be given. Usually only an approximation of the raw data can be derived from charts. If the detailed figures are needed in making an analysis, the figures should be given in a table accompanying the chart or charts. However, for annual report purposes, tables containing the chart data is not ordinarily required.
**Type of Binding**

All of the reports are wire-stitched through the fold except one. The Mead Corporation report has a plastic spiral binding. Only three of the reports are bound on the short side.\(^{20}\) Though these reports are attractive enough, there is no recognizable logic which suggests any advantage in short-side bindings.

**Cover Designs**

Most of the corporations follow the general policy of using a different cover design each year. For the most part, the exceptions are in the case of the companies using the small report size and relatively little color throughout the report.

A breakdown on the number of colors used on front covers follows:

<table>
<thead>
<tr>
<th>Number</th>
<th>Colors</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>Two colors</td>
</tr>
<tr>
<td>46</td>
<td>Three colors</td>
</tr>
<tr>
<td>21</td>
<td>Four colors</td>
</tr>
<tr>
<td>11</td>
<td>Five colors</td>
</tr>
<tr>
<td>3</td>
<td>Six colors</td>
</tr>
<tr>
<td>3</td>
<td>Seven colors</td>
</tr>
<tr>
<td>1</td>
<td>Eight colors</td>
</tr>
</tbody>
</table>

The cover page for many of the reports is a dignified plain page with firm name, "Annual Report" designation, and

\(^{21}\) Electric Boat Company, Harris-Seybold Company, and Masfadden Publications.
year. Some others add one or more product symbols or trademarks. The more colorful covers use pictures of product or products, product in use, men at work, manufacturing process, source of raw materials, or some general theme.

**Color**

Indirect reference was made to color in reviewing above the use of pictures and charts in the reports. The number of colors used in photographs, charts, and the narrative material follows essentially the same pattern as for the cover pages. As many as ten colors are used in one report. Only fifteen reports use less than three colors. A majority of the reports use three colors but the use of four or five is quite common. A careful subjective appraisal of the degree to which the reports are "colorful" gave the following breakdown:

- 69 - very colorful
- 21 - some color
- 10 - not colorful

That color has made the reports more attractive to the eye there can be no question. Yet color is not enough; color is of secondary importance. It is believed that some reports are colorful to an extreme. The Duplan Corporation and Ferro Enamel Corporation reports are examples of colorful reports which use no photographs, only three colors, and these sparingly.
**Typography**

The style of the printed matter is satisfactory if it is easy to read. The typography in most of the reports is very good, but some types of exceptions should be noted. The lack of captions and the arrangement of the many pictures and unique charts on the pages of the Briggs Manufacturing Company report make the narrative difficult to read. The small size and the style of type used in the Electric Boat Company report are unsatisfactory. Captions are needed badly in the closely written president's letter in the American Rolling Mill Company report. The lines are too long for easy reading in the Brackets Company and Pettibone Mulliken Corporation reports.

**Organization of the Report**

There are so many variations in the content of the reports and the order of presentation that it is not feasible to attempt any tabulation. There probably is no one "best" sequence in which the data should be presented. Two things, however, are important:

1. The reader should easily perceive the major outline of the whole report.

2. The outline should properly emphasize the financial data.
Actually there is no perceivable outline to many of the reports, and especially is this true of practically all of the reports which are loaded with photographs. Some very long president's letters make this goal difficult of achievement. The presentation and analysis of a detailed table of contents (though not used in the report itself) would be helpful in arriving at a good outline. The General Motors Corporation report, using appropriately spaced and sized captions, emphasizes the following breakdown:

- An Operating Review
- The General Motors Strike
- Relations with Employees
- The Postwar Program
- Ownership of General Motors
- A Financial Review
- Financial Statements and Statistics

The Standard Oil Company (Indiana) outline which stands out unmistakably is as follows:

- Financial
- Crude Oil
- Research
- Manufacturing
- Marketing
- Transportation
- Relations with People
- Consolidated Statements

The General Electric Company22 and Vick Chemical

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22 The title of the report is "Fifty-fifth Annual Report and Yearbook." The second section of the report is entitled "Yearbook for 1946." The topics covered include atomic power for industry, necessity of research, rockets and ramjets, plane propulsion, generation of electricity, motors at work, land transportation, new appliances, air conditioning, x-ray units, plastics, silicones, electronics, FM broadcasting, and television.
Company reports place the financial data as the first section and the general product and company development material in the back section. This organization emphasizes the importance of the financial data.

The organizational patterns of these four reports are commendable because the outlines are clear-cut, the typographical layout emphasizes the outline, and the informative captions are set in large or distinctive type.

**Letter from the President**

The presidents' letters (a few are signed by the chairman of the board of directors also) range from one page to thirty-five pages in length. The one- and two-page letters are without charts, tables, photographs, whereas the letters that spread over several pages usually consist of a narrative presentation plus charts, tables, maps, photographs, and financial statements. The content of these letters is so diverse that it is not practicable to make a tabulation. Some general observations appear justified:

1. Letters of five or more pages are too long.
   Letters of one, two, or three pages are preferred since longer letters tend to become impersonal.

2. The letter should begin on one of the first few pages -- page 3 appears to be the preferred
page in most reports.

3. The tenor of the letter should be factual, not emotional.

4. The letter should not merely put into narrative form selected items or sections from the financial statements; instead, its emphasis should be on company developments since the balance sheet date, favorable and unfavorable factors in the industry, management plans, and future outlook. The letter need not be predictive, but it should be interpretative.

5. Charts, tables, or photographs should not be used within the letter unless they are an integral part of its message.
Selected Bibliography


CHAPTER 5

GENERAL INFORMATION ON THE CORPORATIONS—ITS OFFICERS, STOCKHOLDERS, AFFILIATES, PLANTS, PRODUCTS, ETC.

"Permanent investments" in corporate stock is not possible. Scientific discoveries and inventions, man's ever changing desires, hopes, wants, and skills in seeking and obtaining material things, and the shifting economic tides indicate a need for the stockholder to make periodic inspection and evaluation of his stock holdings. The annual report should supply the information the stockholder needs in making annual appraisal of his holdings.

The stockholder has need for information on the quantitative and qualitative elements of the company. The need for information on the quantitative factors of the company is supplied through the financial statements and various supporting schedules and statistical exhibits. Quantitative data was the only type provided to stockholders in early reports.

The stockholder also has need for information on the qualitative factors of the enterprise. These factors include such matters as the nature and scope of the enterprise; the company's operating and geographical characteristics.
and its corporate affiliations; the relative status of the company in the industry; the position and outlook for the industry; the qualifications and experience of management; labor conditions and outlook; and the outlook for the company and the whole economy. These are factors which cannot be measured quantitatively with any degree of accuracy, but they are the primary factors which will determine or influence quantitative data of the future, and therefore the qualitative factors are essential considerations in stockholder analyses. It follows that these factors are also of key significance to employees and the general public.

In recent years there has been a tendency to give more and more coverage of qualitative factors in annual reports. The change in the presentation of qualitative data has been much greater than in the case of quantitative data. The remainder of this chapter is devoted to an analysis and evaluation of the current treatment of qualitative elements in annual reports.

Information on Officers

The character, integrity, and skill of management is the key influence in the success or failure of a business enterprise, and especially in the case of a large corporate enterprise. Dishonesty at the management level can wreck the validity of all quantitative financial data suddenly
and without warning as in the McKesson and Robbins case and others. Incompetent management can and probably will lead the corporation—to the detriment of stockholders, creditors, employees—to financial ruin if only at a slow pace. On the other hand, competent, honorable management will direct the corporation in such way that the stockholders receive an equitable return, employees are paid a reasonable wage, customers are able to buy the products or services of the company at a satisfactory price, and the management receives suitable compensation.

It follows that annual report readers have a vital interest in management. The readers should learn about the experience and training of the officers and directors from the annual report. They are also interested in other corporate affiliations of the officers, if any. Stockholders, employees, and the general public have a direct interest in the amount of executive compensation and the number and types of the corporation's shares which are owned.

The only information on officers which is consistently given in the 100 reports is a list of the officers and their respective titles. The list of officers and their

1 The list of officer titles in the W. L. Douglas Shoe Company report is unusual: president, vice-president and general manager, clerk, treasurer, assistant treasurer.
titles is usually placed on the inside front cover or on one of the first two or three pages. Quite often the list appears on one of the latter pages.

Pictures. The breakdown on the use of officer pictures follows:

11 - All officers (one informal picture)
4 - President and some other officers
4 - President only
1 - President and two pages of informal pictures
1 - President and one vice-president
1 - Vice-president in charge of research

Thus, there is some kind of pictorial coverage of officers in 22 of the reports. Some prefer informal pictures such as the two-page spread in the Canada Dry Ginger Ale, Inc. report or the one taken of officers and directors of United States Steel Corporation while on an inspection tour of Western plants. From an information and interest standpoint, either type is satisfactory. Varying the pictorial presentation of officers from year to year is suggested.

Indication of Officer Changes. There was an indication of officer changes in 17 of the reports. The number of companies, if any, which had changes and did not report them is not known. Most of the changes are mentioned briefly, too briefly, in the president's letter. General Electric Company uses a special page, captioned "Organization Changes," but briefs the coverage in the usual way.
In addition to changes indicated in the president's letter, the picture of a former president of the company who died during the year is shown, together with a narrative explanation of his assignments with the company over almost a half century. Obituaries of officers and directors are appropriate in annual reports. Management changes are important regardless of the cause. The need is for the report to give more complete information on the training and experience of those who are made officers.

The most satisfactory presentation of changes in officers appear in the Coleman Company, Inc. and the Universal Pictures Company, Inc. reports. A three-page report by the Coleman general manager on personnel changes gives pictures and explanations such as the following:

"Chester B. Kuhn, with the company for 28 years has been advanced to the position of treasurer of the parent company while continuing as controller. Mr. Kuhn began his career with the Coleman Company as a bookkeeper in 1919 and since that time has been continuously identified with the financial operations of the company, having also served as assistant secretary and secretary." 

In the Universal Pictures Company, Inc. report narrative, reorganization plans are detailed along with an explanation of the appointment of two new executives.

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2 1946 Annual Report, p. 15.
Biographical Sketches of Officers. Three of the reports give biographical sketches of officers such as the following:

"John Jay Hopkins, Vice President, Director and Member of Executive Committee; Chairman of the Board, Canadair Limited; Corporation lawyer and executive. Graduate of University of California in 1915 and Harvard Law School in 1921. Served in World War I as Seaman, Second Class, and commissioned as Ensign, USNR. Engaged in the practice of law and in business in New York and California for twenty-five years. Became a Director of Electric Boat Company in 1937 and Vice President in 1942. Former Assistant to the Secretary of the Treasury 1932-1933. Director of a number of corporations and member of various bar associations."

"Controller O. C. Williams came to General Shoe as auditor on February 1, 1934, and held that position until last year, when he was made controller. Born a Tennessean, he was graduated from the University of Tennessee. He was well-known as a teacher of business administration before coming to our company. He is a Methodist."

Information of this sort is of interest and value to the readers. The corporations in which Mr. Hopkins holds directorships should be specified.

General Motors Corporation, along with picture and title of each officer, gives the years of service with

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5 Such information is given for one officer of the Rockwell Manufacturing Company. See 1946 Annual Report.
General Motors and with companies that subsequently became a part of General Motors. Years of service and a brief description of duties is given for each officer in the A. E. Staley Manufacturing Company report.

Other Officer Coverage. ATF Inc., General Shoe Corporation, and United Specialties Company use organization charts with the names of personnel shown thereon. The General Shoe chart is a functional chart which is quite detailed. With this chart, the biographical sketches, pictures, and the customary list, General Shoe has the most complete officer coverage.

Three companies give the officers of from one to five subsidiary companies. It is doubted that such information is required in the annual report of the parent company.

The Marquette Cement Manufacturing Company report has a unique and effective coverage on management. The center-page spread is captioned "Experience Is the Vital Ingredient," with stocks of various kinds of cement stacked in the center and informal shots of employees and officers on both sides. Length of service and job assignments are given for several employees and the officers.

Dr. Pepper Company devotes more than one page to a listing of department heads and sales personnel in a

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6 Butler Brothers, Robert Gair Company, Inc., and Vick Chemical Company.
generally uninformative report. This sort of detail is not recommended as a general policy.

Goodyear Tire & Rubber Company makes effective use of one page which it captions "The Management Group." These are pictures of plant foremen, plant managers, and supervisors who are participating in training conferences. The narrative section explains that training men for advancement to key positions has long been an established policy of Goodyear.

**Information on Board of Directors**

The criterion of full disclosure applies to the supplying of pertinent information on the whole management group—officers and board of directors. And, since the presentation of information on both groups follows the same pattern, it is not necessary to discuss the coverage on boards of directors in as much detail as was done for the officers.

The major breakdown is as follows:

65 - Names only
15 - Names and addresses
20 - Names and occupation or affiliation with some other company

In addition, 23 reports contain photographic coverage of one or more members of the board. This is the same number of reports which contain pictures of officers. Twenty-five reports contain indications of a change or changes in the board during the year.
The composite coverage on boards of directors is meager. To give less meaningful information in the case of most corporations is not possible. Stockholders and employees have need for pertinent facts on management. The need has been long recognized and by management representatives, among others:

"The investors should have some knowledge of the character and the ability of the management. The management should certainly be experienced in the business it is running, or expects to run, and should have a successful record. The identity of the men who serve as the board of directors should undoubtedly be given and their outside connections, if any, should be shown." 7

Management wants and needs the cooperation, support, and the trust of stockholders and employees. Management continues, nevertheless, to overlook the fact that one man trusts another because he feels that he knows him—and knowing him always means more than his mere name. It is in management's self-interest as well as in the general welfare for "complete" information to be given in annual reports.

**Information on Committees**

Thirty-one of the reports list members of the executive committee. Thirteen reports list one or more other committees. Such information is essentially irrelevant to the needs of report readers in present reports. Such information would be pertinent if complete information as discussed above were being supplied on directors and if information were being given on director compensation. The latter point is discussed in a later section of this chapter.

**Information on Registrar, Transfer Agent, General Counsel**

Seventy-eight of the reports list the name and address of the registrar or registrars, and 61 of the reports list the name and address of the transfer agent or agents. Such information is of value to stockholders, but it hardly warrants the use of a full page as in the Goodyear Tire & Rubber Company and the Union Carbide and Carbon Corporation reports. In practically all reports, this data is given on the page with the officers and directors. Forty of the reports identify the counsel or general counsel. This is relatively unimportant content.
Number of Pages Devoted to Management Staff

The 100 reports devote 137 pages to the management staff, committees, registrars, and transfer agents. The Coleman Company, General Motors Corporation, General Shoe Corporation, and International Harvester Company devote four to five pages.

Treatment of Subsidiary Companies

Most large corporations have one or more subsidiary or affiliated companies. The company owning a controlling interest in the capital stock of another company is the parent company, and the company issuing the stock or whose stock is held is the subsidiary company. From a legal standpoint, the parent company and its subsidiary company or companies are separate entities. The legal rights and responsibilities of each company are separate and distinct. From the standpoint of the stockholder (of the parent company), the employee, and the general public, the parent company and its subsidiaries are one economic unit.

Consolidated statements are prepared in order to show the condition and results of operations of the parent

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3 This report also contains an excellent three-page narrative explanation of the importance of management. See pp. 5-7.
and subsidiary companies as though they were parts or divisions of a single company. They do not displace the financial statements for each of the companies; instead the consolidated statements are supplementary to the parent company statements and those of the subsidiary companies. Thus, it follows that the stockholder of the parent company and others can gain an adequate understanding of the financial affairs of the parent company only by analyzing its individual statements and the consolidated statements.

Requirements for Satisfactory Disclosure. Good annual reporting hinges primarily on accurate and clear disclosure of all the facts which are pertinent to the information needs of the report readers. As a point of departure in analyzing the extent to which the 100 reports meet the criteria of accuracy, completeness, and clarity, the opinion of the standard accounting reference book as to minimum coverage of parent and subsidiary relationships is given:

"...full disclosure, insofar as that is possible by means of financial statements and supporting schedules, requires more than the reports of the parent company alone or of each of the subsidiaries individually, or consolidated statements for the entire group viewed as a unit. Preferably there should be presented:

1. Separate statements of the parent company.
2. Consolidated statements of the entire group.
3. Separate statements of each subsidiary."
"With the above statements as a starting-point, an intelligent appraisal of the position and prospects of the parent company and its subsidiaries is possible. The statements of the individual companies make it possible to see the legal relationships of each to the others and to the outside world. The consolidated statements present a general picture of the group viewed as a single economic entity. Each type of statement serves as a check on the other; at the same time each type supplies the information needed to round out the other."\(^9\)

**Current Disclosure is Meager.** Measured by this standard, none of the reports of companies having subsidiary companies meet the criteria. In the first place, however, it must be pointed out that it is not always possible to determine from a report whether the company has no subsidiary, one subsidiary, or forty. Complete lists of subsidiaries are not often given. Even after a careful check is made of a list of subsidiaries, if given, and the narrative references to subsidiaries, if any, there is usually some doubt as to which of the subsidiaries have been included in the preparation of the consolidated statements. Apparently 15 of the 100 companies do not have subsidiaries.

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A contradicting statement was made recently by an accountant. He said: "Accountants and management agree that in ordinary circumstances the inclusion of separate parent company statements is not only unnecessary and uninformative but might tend to confuse and mislead the average investor."—Charles S. Rockey, "Current Practice in Disclosure of Information in Financial Statements," *Journal of Accountancy*, Vol. 84, No. 3, September 1947, p. 203.
The following breakdown is indicative of the scant treatment given to subsidiaries in the 85 reports:

18 - no space
25 - only a few lines (one to ten lines)
15 - one-half page
11 - one page
7 - two pages
2 - three pages
3 - four pages
1 - five pages
3 - six pages

The space devoted to subsidiaries averages about one page per report. This average is about one-sixth of the space which is devoted in the same reports to generally non-informative photographs.

The following breakdown on the listing of the subsidiaries in the reports further illustrates the failure of management, in many cases, to give clear, complete pertinent information:

33 - List of subsidiaries not given
16 - List and addresses of all subsidiaries
8 - List and addresses of all subsidiaries together with some brief information on the operations or products of each subsidiary
18 - List of some of the subsidiaries
9 - Apparently only one subsidiary

Even in the case of some of the reports shown above as listing "all" subsidiaries, there is doubt as to the

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This contention does not recognize the limitations of consolidated statements; it incorrectly assumes that the investor cannot be misled by consolidated statements.
completeness of some of the lists. Very often "a list" is given and there is no other information in the report which proves that the list is not complete. On the other hand, the way in which the list is given sometimes leaves doubt as to its completeness.

Criteria of Completeness Not Met Without Complete List. At its best a consolidated statement has certain inherent limitations. These limitations may be briefly summarized as follows:

1. All of the assets shown are not available for the payment of all liabilities. The parent company's equity in the assets of each subsidiary ranks after each subsidiary's own liabilities and preferred stock.

2. The statements do not reveal the dividend paying ability of the parent company.

3. The consolidated income statement is an unsatisfactory index of the profitableness of the parent company since the profitable and unprofitable units are combined.

4. Ratios computed from consolidated statements are unreliable.

5. Comparable treatment may not have been given to the subsidiary accounts underlying the consolidated statements.

In view of these limitations, consolidated statements conceal as well as reveal. This fact accounts for the need for the analyst also to have parent company statements.10

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10 The Standard Oil Company (New Jersey) report is the only one among the 100 which contains separate statements for the parent company in addition to the consolidated statements.
and statements of the individual subsidiaries. But it is immediately recognized that some companies have too many subsidiaries for a set of statements to be submitted for each one of them. For example, The National Dairy Products Corporation lists more than fifty "principal" subsidiaries in its report. Those companies which have three or fewer subsidiaries should submit separate financial statements or include the separate information in the annual report. In the cases where the number is so large that the separate reports or information for each company would be of undue length, four alternatives are open:

1. Instead of the separate statements of each subsidiary, include only the relatively important ones.

2. Instead of the separate statements of each subsidiary, include group statements combining the accounts of several of the subsidiaries.

3. Instead of the separate statements of each subsidiary, present in a table for each subsidiary data such as the following: percent of stock held,

General Electric Company, P. R. Mallory & Co., Inc., and Philip Morris & Co., Ltd., Incorporated provide statements for the parent company only.

Safeway Stores, Incorporated, submitted a separate financial report on its subsidiary company whose accounts were not consolidated. The General Motors Corporation report contains a separate balance sheet for one of its non-consolidated subsidiary companies.

The Universal Pictures Company, Inc., report contains a summary by subsidiary and country of the amount of net assets of each subsidiary operating in foreign territories.
income for the year, average income for a period of
ten years, dividends received, balance sheet and
market valuation of subsidiary net assets, equity
in undistributed earnings.

4. Instead of the separate statements of
each subsidiary, include a complete list of sub-
sidiary companies. The list might also identify
the location, president, year acquired, products
manufactured, general operations, etc.

From the standpoint of financial reporting, the
last alternative provides the stockholder, employee, and
the general public with the least and minimum, information.
It is an inexcusable condition when the reader cannot deter-
mine the names of subsidiaries, domestic and foreign, types
of undertakings in which they are engaged, and their loca-
tions. One questions the logic of the following statement:

"The advisability of including in the annual
report a list of principal subsidiaries with an
indication of their functions is questionable.
To be sure, the information is of some interest
to stockholders, but especially if the report
fails to mention the financial status of the
subsidiaries the value of listing them is some-
what limited. Only eleven of the fifty-two
selected companies which have subsidiaries in-
clude such lists in 1945 reports. 12"

It can be admitted that the "value of listing them
is somewhat limited" if no separate financial data is given
on each company. But, "limited" information is worth more
to stockholders and others than no information. The proper

12 N. Loyall McLaren, Annual Reports to Stockholders,
listing of subsidiaries would enable readers to seek pertinent information from other sources and would obviate the present uncertainty in many reports as to the subsidiaries which exist and as to which subsidiaries are consolidated and which ones are not consolidated. In May, 1940, Dun & Bradstreet, Inc. mailed a questionnaire dealing

13 A good percentage of the reports could be used in illustrating the lack of clarity in listing and handling of subsidiaries in the reports. The following are typical situations:

The Carborundum Company: Page 2, captioned "The Properties of the Carborundum Company and Subsidiaries," lists the parent company and several foreign subsidiaries along with descriptions of products manufactured. The treatment on this page suggests that there are no other subsidiaries, whereas a domestic subsidiary is mentioned in the president’s letter and in Note B to the financial statements.

Heywood-Wakefield Company: There are references in the body of the report to "income taxes on the Canadian Company" and to the "Lloyd Manufacturing Company at Menominee, Michigan." The auditor's certificate refers to "The Heywood-Wakefield Company and its subsidiary."

The 1946 Aviation Corporation report, one which is not among the 100 reports included in the present study, contains an excellent list of its operating divisions, subsidiary and affiliated companies. It is as follows:

**OPERATING DIVISIONS**
- *Grosley Division* - Cincinnati, Ohio; Richmond, Indiana
- *New Idea Division* - Coldwater, Ohio; Sandwich, Illinois
- *American Central Division* - Connersville, Indiana
- *Lycoming Division* - Williamsport, Pennsylvania
- *Spencer Heater Division* - Williamsport, Pennsylvania
- *Republic Aircraft Products Division* - Detroit, Michigan
- *Horton Manufacturing Division* - Circleville, Ohio
- *Arco Tool and Machine Division* - Toledo, Ohio
mostly with the presentation of information in financial statements to 6,000 bankers, mercantile credit men, accountants and financial executives of large industrial and commercial corporations. One question was stated as follows: "If a consolidated financial statement is prepared, would it not be a desirable change in practice for the auditor to disclose in the title of the statement, as a requisite part of the exhibit, the names and addresses of all corporations whose figures are consolidated?"14

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**WHOLLY OWNED SUBSIDIARIES**

**Crosley Broadcasting Corporation** - Cincinnati, Ohio  
(Radio Stations WLW, Cincinnati, Ohio; and WINS, New York, New York)

**Crosley Distributing Corporation** - New York, N. Y.

**Carrollton Furniture Manufacturing Co.** - Carrollton, Kentucky

**ASSOCIATED COMPANIES**

**Consolidated Vultee Aircraft Corporation** (26.1% of common stock)

**ACF-Brill Motors Company** (46% owned by Consolidated Vultee Aircraft Corp.; 66% owned by The Aviation Corporation)

**Hall-Scott Motor Car Company** (wholly owned subsidiary of ACF-Brill Motors Co.)

**New York Shipbuilding Corporation** (59.6% of founders stock, and .12% of participating stock, equivalent to 21% of total equity stock.)

**INVESTMENTS**

**American Airlines, Inc.** (4% of common stock)

**Pan American Airways Corporation** (6% of common stock)

**Roosevelt Field, Inc.** (20% of common stock)

**Frozen Food Products, Inc.** (40% of common stock)

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The summary of replies was as follows:

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankers</td>
<td>98%</td>
<td>2%</td>
</tr>
<tr>
<td>Corporate financial executives</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>Mercantile credit men</td>
<td>97%</td>
<td>3%</td>
</tr>
<tr>
<td>Accountants</td>
<td>86%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Instead of giving the list as a part of the title of the statement, some suggest that the information might best be given in a footnote or in an appended list. For annual report purposes, it is suggested that the list be given in two parts: (1) subsidiaries whose accounts are consolidated, and (2) subsidiaries whose accounts are not consolidated. Since there is such wide variation of opinion as to the percentage of ownership which is necessary to justify the classification of a company as a subsidiary

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15 This plan is followed in the Pacific Mills report.
16 This plan is followed in the Carrier Corporation report.
17 The lists which are given in many reports do not indicate whether the accounts of particular subsidiaries are consolidated or non-consolidated. The Mead Corporation report lists the unconsolidated companies, but there is no identification of the consolidated subsidiaries.
18 General Electric Company report lists six of her non-consolidated affiliates under "Investments" in the balance sheet. This is a satisfactory practice when the list of subsidiaries is not too long for listing within the balance sheet. The F. H. Mallory & Co., Inc. report follows the same practice and, in addition, contains a very satisfactory narrative explanation of each of the subsidiaries.
and to include it in a consolidated statement, the basis of consolidation should be set forth on the list.

The only excuse which management can advance for not supplying clearly identified lists is the shop-worn contention as given by one respondent in the Dun & Bradstreet survey that "perhaps it should be withheld from public and semi-public view for trade or for other reasons."

Title of Financial Statements Should Be Clear. If the subsidiaries are identified in the annual report according to one of the above plans, most of the defective statement titles would be eliminated. However, a few other points with reference to statement titles should be discussed.

The words "consolidated balance sheet" as a part of a statement title means that the company owns one or more subsidiaries and has consolidated the accounts of some or all of them in the statement. "Consolidated" should, in such cases, always appear as a part of the statement title. "Balance sheet" as a part of the title should be used only when the company owns no subsidiaries or when the accounts of the subsidiaries are not consolidated. It follows that the title in The Dayton Rubber Manufacturing Company report is incorrect: "Balance Sheet, October 31, 1946 - The Dayton Rubber Manufacturing Company and Subsidiaries, Dayton, Ohio."

19 Foulke, loc. cit.
It is desirable for the statement title to identify the types or groups of subsidiaries whose accounts are consolidated. The following titles illustrate the point:

**Correct, but not complete:**
- "Heywood-Wakefield Comparative Consolidated Balance Sheet"
- "Sunshine Biscuits, Inc. Consolidated Balance Sheet"
- "Swift & Company Consolidated Balance Sheet"

**Correct and Informative:**
- "Bristol-Myers Company and Domestic and Canadian Subsidiary Companies Consolidated Balance Sheet"
- "Canada Dry Ginger Ale, Incorporated and Wholly-Owned Subsidiary Companies Consolidated Balance Sheet"
- "Eastman Kodak Company and Subsidiary Companies in the United States, Canada, Mexico, Cuba, Panama, and South America—Consolidated Balance Sheet"

**More Information Than List of Subsidiaries Needed.**

A complete list of subsidiary companies, preferably classified as to consolidated or non-consolidated, should appear in every annual report for in most current reports it is not possible to identify all subsidiaries or to determine which companies are included in the consolidated statements. The lack of information of this type represents an important omission but still not a more vital omission than in the case of financial data on the more important subsidiaries. If the income from one or more subsidiaries is a significant part of the total parent company income, a condition which often applies, specific information on the earning record of such subsidiaries is essential to
the information needs of stockholders and other groups.

For example, it is essential that E. I. DuPont de Nemours & Company gives special treatment in the annual report to its 22.7 percent investment in the common stock of General Motors Corporation since a decided change in the earnings of General Motors would affect materially the earnings of DuPont. It is even more important that similar information be given on subsidiaries in which a controlling interest is held.

Probably the most desirable method of reporting the financial position of subsidiary companies to the stockholders of the parent company is to supplement the parent company or consolidated statement with schedules which detail and summarize the most pertinent phases of subsidiary operations and position. The following are types of supplemental data which would be helpful:

1. Include condensed balance sheets, income and surplus statements in columnar form for all subsidiaries, or the principal ones.

2. For each subsidiary show number of shares owned, percent of total issue, investment as carried in balance sheet, value based on recent market quotations.

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20 In the 1946 Annual Report, DuPont, in a 22-year financial summary, breaks the annual net income figure down into two items: "From Operations" and "From Investment in General Motors Corporation."
3. For each subsidiary show net income for the year, average income for a period of years, equity in net income for the year, dividends received during the year, equity in undistributed earnings since date of acquisition, equity in net assets at end of the year.

4. Include a comparative summary of net assets, net income and surplus of subsidiaries for a period of ten or more years.

5. Include a schedule showing a breakdown of the income by company sources—the parent company and each of the subsidiaries. Percentage of the total might also be shown or the breakdown given for a period of years. 21

Parent Company Statements vs. Consolidated Statements.

This study and others have revealed that practically all annual reports contain consolidated statements and that almost no reports contain only parent company reports or

21 Some information of the type suggested here is found in four of the reports: American Rolling Mill Company, The Hoover Company, General Motors Corporation, and Universal Pictures Company, Inc. The best treatment known to the writer in 1946 annual reports is in the Aviation Corporation report, one which is not among the 100 reports included in the present study. This report also contains full and interesting narrative coverage of the subsidiaries.
both types.22 This condition is paradoxical since the stockholders and employees of the parent company are primarily interested in the statements of their company as an independent unit and only secondarily with the consolidated statements of the group of affiliated companies. Consequently, it is unfortunate that the reports usually contain only consolidated statements. To meet the criteria of accuracy, completeness, and clarity it appears that the annual report should include as a minimum parent company statements, consolidated statements, supplementary schedules, and appropriate subsidiary lists. Without such information stockholders, employees, and the general public cannot use the annual report to the best advantage for analytical purposes.

Narrative Description of Subsidiary Companies. The narrative sections of most reports contain incidental references, if any, to subsidiary companies. A few reports, on the other hand, contain rather complete descriptions of each subsidiary, including the history and nature of the enterprise, its general character and past record, outlook for the future, etc.23 Information of this type is valuable

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in appraising the financial statistics. Such information is required by the Securities and Exchange Commission from corporations which register securities. Though too much descriptive detail can be given, it is believed that such material on subsidiary company operations is more significant in most reports than the extended product coverage.

Use of Charts in Clarifying Subsidiary Relationships.
The best device for showing the holding company structure is the organization chart as used in the reports of a few companies. The best such charts appear in the Simmons Company and ATF Incorporated reports.

The only other type of chart used in the 100 reports to show subsidiary relationships were the three component-part bar charts in the Dresser Industries, Inc. report. These charts portray, for a ten-year period, the following:

1. Consolidated earnings of Dresser Industries, Inc. and preacquisition earnings of member companies.
2. Sales (civilian and war products)—assuming all present member companies had been part of Dresser.
3. Property, plant, and equipment of Dresser Industries, Inc. and consolidated subsidiaries, and member companies prior to acquisition.

More companies can use more charts to better inform report readers on various subsidiary relationships.
Coverage of Plants, Divisions, Offices

Plants, divisions, and offices of various types, are presented through lists, photographs, sketches, charts, maps, and narrative references. The coverage is often combined with that of the products manufactured and sold. This fact plus the lack of any recognizable pattern of presentation makes the systematizing of the data difficult and less exact than in other phases of the study.

The following breakdowns provide a composite outline of the presentations in the 100 reports:

10 - No coverage whatever
90 - From a few lines to 18 pages--averaging between three and four pages
45 - Contain some type of list of plants, divisions, etc.
56 - Contain one or more pictures of plants, offices, etc.
23 - Contain maps showing locations of plants, dealers, etc.
60 - Contain narrative references to plants, divisions, offices, etc.

The amount of space devoted to physical plant and facilities is more than twice the space devoted to either subsidiary relationships or the management staff. For analytical purposes by the stockholders, employees or general public, a descriptive presentation of plants and physical facilities--with emphasis on plant expansion or modernization—is of lesser importance than management or subsidiary relationships. Management decisions are of key
importance for management decides what plants, divisions, offices, etc. are to be built, purchased, enlarged, established, or abandoned.

The presentation of plants and divisions would be more valuable if greater emphasis were placed on the specific effect of plant and facility changes on output, efficiency, and unit costs. Most of the present coverage can be justified only on the basis of its possible interest value. There appears definitely to be a relative over-emphasis of plants and facilities in many of the reports. Unless the presentation bears directly on output, unit costs, and concomitant factors, the readers have not been "informed". It can add but little to the financial story of the company.

Address of Main Offices and State of Incorporation.
In view of the fact that companies are glad to have stockholder, employee, or public inquiries, it is important that an appropriate office address or addresses be given. For example, the Glenn L. Martin Company shows on the inside front cover: “Post Office Address: Baltimore 3, Maryland.” Likewise, the Maryland Drydock Company shows:

MAIN OFFICE AND SHIPYARD          NEW YORK OFFICE
P. O. Box 6306, South Station   1 Broadway
Baltimore 30, Maryland          New York 4, New York
Most other reports carry similar information but in some it is not prominently displayed on the first few pages. However, the only thing suggestive of an office address in the General Electric Company report is the inside address of "Schenectady, N. Y." in the president's letter.

Another type of address information which is sometimes given is the state of incorporation. Such designation more often appears in the auditor's certificate or in the title to the balance sheet.

**Coverage of Products Manufactured or Sold**

It is hardly possible to write an annual report without some coverage of company products. Actually, however, but few companies follow a policy of treating the manufacture and sale of products in an incidental way only. The trend in recent years has been toward the use of more and more product material. Only five reports contain minimum product coverage. In these reports products are treated incidentally, but very briefly and without emphasis.24 The remainder of the reports feature products, product uses, production processes, trade-marks or some such phase. Thirty-two reports devote from five to twenty

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24 Adam Hat Stores, Inc.; Robert Waer Company, Inc.; Goldblatt Bros., Inc.; Standard Oil Company (New Jersey); John B. Stetson Company.
pages. The average space devoted for all of the reports is almost four pages. This represents more coverage than for physical plant and facilities.

The type of coverage is roughly suggested by the following breakdown:

73 - Contain product photographs
67 - Contain narrative descriptions and explanations
35 - Contain product lists

Need for Product Coverage in the Report. The stockholder and other report readers cannot make adequate analyses of a company's financial statistics without some supplementary information on the company's production, status of the industry, and relative position of the company in the industry. Information may be needed on the variety of products produced, the uses of these products, how and where products are marketed, recent product developments, trend in product uses, raw material supply, production record of the company in relation to other companies and the industry. Some data of this sort is required if the report criteria of accuracy and completeness are to be met. In this connection, it is emphasized that the possibility of "informing" through photographs--the most widely used

25 Included in this total are eight reports which contain product sketches and trade-mark drawings.

26 Some of the lists are of principal products only.
device—is limited indeed. Lists, charts, and narrative treatment deserve relatively greater use in future reports.

Product coverage may be of some value in making the report more interesting and appealing to the reader. Some photographs can be justified on this basis, but it is doubted that one-half, one-third, one-fourth, or even one-fifth of the report can be devoted logically to product coverage.

**General Comments on Product Coverage.** Unfortunately product pictures are interspersed throughout many of the reports. Such treatment prohibits coordinated handling of the product presentation and interferes with a clear presentation of other report topics. The Briggs Manufacturing Company report is a good example of the over-use of product pictures and the random placement of the pictures throughout the report. Two alternative plans are recommended:

1. Use the covers and/or a part of one or two pages on which products are pictured and discussed, or

2. Use a block of consecutive pages for the narrative, pictorial, and other product treatment.

The volume of products manufactured or sold is a type of information which is of vital importance. Emphasis should be placed on the production record and outlook rather than mere product description and advertising.
Product unit data is essential in view of the fast-shifting price level. Some of the reports, but relatively few, give comprehensive data in charts, tables, and narrative. Examples of such coverage are:

1. Cudahy Packing Company: By means of tables and narrative gives data for individual years on types of livestock on farms, livestock processed, price factors involved, etc. The interpretations of present conditions and future outlook are good.

2. General Motors Corporation: Gives a chart showing the number of cars and trucks produced in General Motors plants each month during the period beginning in September 1945 and running through December 1946 as compared with the same months in 1940 and 1941. A table shows unit sales of cars and trucks manufactured in the United States and Canada and by foreign subsidiaries for each year in the period 1937 through 1946. The narrative coverage is scant and uninterpretative.

3. Kennecott Copper Corporation: Gives production figures on several metals for each year in the period 1938 through 1946. Also contains bar charts showing copper production for the period
1915-1946, molybdenite production for 1936-1946, gold production for 1930-1946, and silver production for 1930-1946. Unfortunately, the narrative material is brief and uninformative. 27

The volume and type of product coverage in at least one-third of the reports suggest that an attempt is being made to interest the readers in buying company products rather than interesting the reader in examining and understanding the financial report. Product coverage, instead, should have the primary object of providing the stockholder, the employee, and the general public with product information which aids in the proper analysis and interpretation of the financial statistics. Only limited and incidental effort should be made in the report to induce readers to buy the company's products. Direct selling appeals should probably be avoided. 28

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27 Other reports which contain important product statistics are: LaPlant-Choate Manufacturing Co., Inc., Duplan Corporation, U. S. Steel Corporation, Harris-Seybold Company, Mead Corporation.

28 An example of a direct appeal is found in the Walgreen Company report. At the bottom of a one-page statement captioned "Walgreen Drugs and Walgreen Agency Drug Stores--The Sign of Leadership," the following appeal is made: "Walgreen drug stores and Walgreen Agency drug stores ask your patronage--as a Walgreen stockholder, and as a discerning customer." This type of appeal is not wholly objectionable, but it is doubted that such an appeal is needed.
Advertising Program Coverage

Some surveys have shown that stockholders like to have information on the corporation's advertising program in the annual report. To the stockholder and employee, however, the advertising program appears to be a relatively unimportant annual report topic. This is true because if the program has been very effective, the report reader is already familiar with the appeals and media used and, in any case, a statement on the advertising policy does not add to the financial story. Emphasis on the advertising program can be justified only on a basis of product advertising or its general interest value.

Forty-one of the reports have some sort of coverage on its advertising program. Thirty-nine of these contain narrative treatment; 18 contain photographs and/or copies of magazine or newspaper cuts used; 64 pages are devoted to the topic.


30 In some of these reports only a short paragraph or two is given. For example, The Drackett Company report contains the following paragraph--a very confusing one indeed:

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In general, and understandably, the reports which give most emphasis to the advertising program are companies which manufacture consumer goods. Samples of coverage are given below:

1. United-Rexall Drug, Inc.: two-page spread which describes the national advertising program inaugurated three years ago, its objective and media with three appropriate pictorial illustrations.

2. Bristol-Myers Company: five pages devoted to a narrative explanation of the necessity to advertise brand-name consumer goods, a detailed listing of radio shows, with pictures of the performers, two pages of cuts of product advertisements used, and a one-page cut of an "institutional" advertisement.

3. Blue Bell, Inc.: two-page spread on how products are promoted. Illustrations of media used and good description included.

"We also expanded our advertising during the period covered by this report. We pointed out over a year ago that our profits in the fiscal year 1945-46 were larger because we could not raise our advertising to what we considered an adequate level, due to the paper shortage."

This statement is more confusing than informative. The stockholder is apt to have difficulty in understanding management's decision to increase advertising expenditures when 1945-46 profits were larger because of the low level of the advertising effort."
4. P. R. Mallory & Co., Inc.: one-page narrative explanation of advertising policy and media.

These presentations set forth the respective advertising policies in interesting and attractive form. There is indication in only one of the reports of the amount of advertising expenditure. As with practically all other functional expense items, management has followed a policy of secrecy. The statements on the advertising programs are in very general terms. Nevertheless, this type of coverage is considered to be more interesting and informative than the mere reprints of advertisements used during the year.

Research Program Coverage

Sixty of the reports contain references to research activities. The space devoted ranges from a few lines to

31 Goldblatt Bros., Inc.

32 For examples of this type of presentation, see the reports of Dayton Rubber Manufacturing Company and Vick Chemical Company. It is also doubted that self-compliments of the following type contribute to good reporting: "The Hoover Company receives recognition and many give compliments for the quality and appeal of our national magazine advertising."
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11 pages, with an average for the sixty reports of almost two pages. Thirty-seven of these reports contain photographs of research activities and 57 reports contain narrative coverage.

In view of the continuous stream of new products and the scientific developments which have far-reaching product implications, a company's research activities should have considerable reader interest. However, there is need for the report on research activities to be informative as well as interesting. The LaPlant-Choate Manufacturing Co., Inc., Schenley Distillers Corporation, and Celanese Corporation of America reports contain instructive presentations. The latter report and the Carborundum Company report are the only ones of the group which contain a record of expenditures for research over a period of years.

Some of the best research presentations cover only one page. Among the better such pages are those in the Philip Morris & Co., Ltd., Inc. and the Plomb Tool Company reports. Both statements specify what has been done, why it has been done, and what is now being done. In contrast, the following coverage from the Union Bag & Paper Corporation report is neither interesting nor informative:

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33 The American Can Company report devotes one-third of its pages to its research activities over a period of 40 years.
"Development and research activities have been continued energetically during the year. Many new products have been added and considerable progress has been made in the recovery and use of by-products, reduction of manufacturing costs, better utilization of raw material and improvement of finished products. In this work the services of several nationally known research institutions are used for specific projects for which specialists or equipment are not available within the company organization."

**Historical Summary of the Company**

The report reader who tries to interpret the financial facts of an enterprise has need for some information other than financial and operating statistics. He needs to know some general things about the nature of the business and its history. Such background information is required if the pertinent financial facts are to be summarized and adequately evaluated.

In recognition of this need eight of the reports contain historical summaries of the company. Some of the summaries have interest appeal also. Many of the reports would be more informative and just as attractive and interesting if some of the space now devoted to plant and product coverage were used in presenting the historical highlights of the enterprise.

A brief characterization of the historical summaries in the eight reports follows:
1. American Chicle Company—"25 Years...A Review of Operations": Contains a four-page narrative explanation, partly financial, of most significant development during each five-year period.

2. Blue Bell, Inc.—"1908 to 1946": The four-page presentation consists of 32 numbered brief explanations of a like-number of significant events in the history of the company. Each event explanation is accompanied by a symbolic sketch. The presentation is colorful, has reader appeal, and is definitely informative.

3. The Carborundum Company—"History": consists of a two-page straight narrative account of the first experiments of the founder of the company and later company developments in conservative style and general terms. The story does not provide a perspective comparable to that of the Blue Bell report.

4. Ferro Enamel Corporation—"Background and History": A two-page summary similar to that of Blue Bell.

5. Goldblatt Bros., Inc.—"The First 32 Years": consists of a four-page narrative coverage together with colorful sketches of 15 of the company's store buildings. The pleasing narrative style and the use of many facts and policy developments are in contrast to the Carborundum Company treatise.

6. Simmons Company: following a short president's letter, ten pages are devoted to a "History of Simmons Company." Some of the other material has an historical emphasis. The reason for such extended treatment is the 75th anniversary of the company. The factual story is complete, but the presentation is long (too long, no doubt) and unattractive.

7. Swift & Company—"Tradition of the Red Wagon": consists of a two-page narrative statement. The story is appealing and easy to read; its factual story is too brief.
Industry Information Coverage

Appraisal of one enterprise can be properly made only in relation to the industry of which it is a part. Growth of a company during a given period of time may not spell real progress or justify a favorable outlook for the future. In part, the progress or status of an enterprise must be gauged relative to the recent developments in and status of the whole industry. All questions of progress, results, status, and outlook are relative matters, not absolute.

Some few of the 100 reports make some comparisons between the company and the industry which are helpful in an evaluation of the position of the company. There is a limitless volume of statistical data available on various industries. Various governmental and trade sources give monthly and annual data on output, consumption, inventories, unfilled orders, etc., for most industries as well as continuous and detailed estimates of the prospective position of the respective industries. Of course there is a limitation on the amount of industry material which can and should be correlated with company data in the annual report.
Indication of the type of industry data being advantageously included in annual reports follows:

1. LaPlant-Choate Manufacturing Co., Inc., manufacturer of earthmoving equipment:
   b. Table showing growth of strip coal mining in U.S.A. from 1939 to 1945.
   c. Bar chart (component part) showing wheel-type tractor production for 1935-1941 with steel wheels and rubber tires.  

2. Goodyear Tire & Rubber Company:
   a. Table showing rubber consumption and tire sales by types for 1939-1946 with estimates for 1947.
   b. Bar chart showing motor vehicle registrations of passenger cars and trucks and buses for 1941 and 1946.
   c. Line chart showing monthly consumption of rubber (natural and synthetic) in U.S.A. for 1940-1946.

3. Philip Morris & Co., Ltd., Inc.
   a. Line chart comparing Philip Morris cigarette production with the industry for 1932-1946.
   b. Two-page table comparing Philip Morris operations with the aggregate figures of its

34 LaPlant-Choate gives the source of the industry data, whereas Goodyear and Philip Morris do not. Good reporting requires the inclusion of the source of all outside data.
four major competitors, consisting of percentage comparisons of income statement items, capital structure, and asset position.\textsuperscript{35}

Such data as the above is invaluable in an interpretation of the significance of the financial figures. The stockholder, employee and general public have not demanded the inclusion of such data in their annual reports by their answers to questions in stockholder-opinion surveys. Many of them do not fully appreciate the importance of such data. This lack of appreciation on the part of report readers does not relieve management of the responsibility of issuing a report which contains all of the pertinent facts.

**Information on Stockholders**

One stockholder-opinion survey showed that 83 percent of the stockholders were interested in knowing something about their fellow stockholders.\textsuperscript{37} Actually,

\textsuperscript{35} Among the other reports which contain some industry statistics are: Celanese Corporation of America, Cudahy Packing Company, Pettibone Mulliken Corporation, Standard Oil Company (New Jersey), Swift & Company, United Electric Coal Companies.

\textsuperscript{36} Possibly because the management of their company has not heretofore given such data and a question bearing on the point has not been included in questionnaires.

100 percent of the stockholders should be interested. However, "the 83 percent" are now getting relatively little or no stockholder information in most reports. A large percentage of the 100 reports indicate the number of stockholders at the end of one or more fiscal years, but this information does not qualify as information about his fellow stockholders. Telling the report reader the number of stockholders is not divulging a pertinent fact.\textsuperscript{38} Stockholder information is another area in which management has chosen to tell but little.

Only 23 of the 100 reports contain more information than the number of stockholders. The additional data is concerned primarily with the geographical distribution of stockholders, average shares held, and the occupations of the owners.

\textbf{Geographical Distribution of Stockholders.} Four of the 23 reports give the geographical distribution of stockholders by states. Of these four reports the breakdown for the American Home Products Corporation is the most complete. The table is set up as follows:

\textsuperscript{38} Of 21 charts and tables devoted to stockholder coverage, ten showed only the number of stockholders and three compared the number of stockholders and the number of employees. The charts are good from a technical standpoint. The subject matter of ten of the charts is relatively unimportant.
<table>
<thead>
<tr>
<th>Location</th>
<th>Total No. of Holders</th>
<th>Percent of Total Holders</th>
<th>Total No. of Shares</th>
<th>Average No. of Shares Held by Stockholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>18</td>
<td>.15</td>
<td>1,309</td>
<td>72.7</td>
</tr>
<tr>
<td>Wyoming</td>
<td>6</td>
<td>.05</td>
<td>465</td>
<td>77.5</td>
</tr>
<tr>
<td>Canada</td>
<td>51</td>
<td>.43</td>
<td>17,240</td>
<td>338.0</td>
</tr>
<tr>
<td>Other Foreign</td>
<td>8</td>
<td>.07</td>
<td>1,086</td>
<td>135.8</td>
</tr>
<tr>
<td>Grand Total</td>
<td>11,836</td>
<td>100.00</td>
<td>3,358,585</td>
<td>326.0</td>
</tr>
</tbody>
</table>

Similar tables are used by Dr. Pepper Company and the Simmons Company. The geographical distribution of holdings in the LaPlant-Choate Manufacturing Company is shown by means of a map. The number of shares and shareholders is shown by states. The distribution in Godchaux Sugars, Inc., a Louisiana company, merely shows the number and percentage of stockholders living in Louisiana and the number and percentage living elsewhere.

A few other reports contain general references to stock distribution as the following from the Robert Gair Company, Inc. report: "The ownership of this Company is distributed among more than 9,000 stockholders in every walk of life, living in 47 of the 48 states, Canada, Newfoundland, Bermuda, Hawaii, Great Britain and the Scandinavian countries." In view of the fact that wide dispersion of stock ownership is the general rule, Gair's statement is of no factual value to the report reader.
Stockholders Classified. Nine of the 23 reports contain a breakdown of stockholders by classes. United States Steel Corporation shows the number of preferred shares and shareholders, the number of common shares and shareholders, and the total shares and the net number of shareholders for each of the following classes of holders: charitable, educational, etc.; insurance companies; other companies; fiduciaries; individuals-women; individuals-men; individuals-joint accounts; brokers and others. This represents the most detailed breakdown by classes.

The American Home Products Corporation report uses only three classes, but gives more information on these classes: number of shareholders, percent of total stockholders, total shares held, percent of shares outstanding, and average number of shares held by stockholder.

The treatment in the other seven reports follows the pattern of these two reports, but less information is given. The only different type of information is contained in the Belden Manufacturing Company report. The number of men and women who are both stockholders and employees is given.

The Standard Oil Company (Indiana) report states that:

"The number of women stockholders passed the number of men last year. On the stockholder list there were 702 charitable, religious, and educational institutions, civic and fraternal organizations,"
libraries and museums, hospitals, etc., and 10,524 corporations, partnerships, insurance companies, protective organizations, trusts, trusteeships, and other fiduciaries. Both of these figures exceeded the previous year."

A few other reports contain similar statements. Again, this type of general statement is uninformative.

Average Number of Shares Held. Six of the 23 reports contain some sort of average for the shares held per stockholder. Five of these six reports contain a statement such as the one in the Borden Company report: "At the close of the year, the company was owned by 49,121 shareholders. The average stock holding was 86 shares."

The Simmons Company report shows the average by states, Canada, and "foreign", and the grand average for all holders.

Distribution by Size of Holding. Nine of the 23 reports contain a distribution by the size of holding. Again, the most complete breakdown appears in the American Home Products Corporation report. The table is set up as follows:

<table>
<thead>
<tr>
<th>Number of Shares Owned</th>
<th>No. of Stockholders</th>
<th>Percent of Total</th>
<th>Total Shares Held</th>
<th>Percent of Shares Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 99 shares</td>
<td>6,617</td>
<td>55.91</td>
<td>290,910</td>
<td>7.6</td>
</tr>
<tr>
<td>100 to 199 shares</td>
<td>2,176</td>
<td>18.38</td>
<td>321,589</td>
<td>8.3</td>
</tr>
<tr>
<td>4,000 to 4,999 shares</td>
<td>14</td>
<td>.12</td>
<td>61,565</td>
<td>1.6</td>
</tr>
<tr>
<td>5,000 or more shares</td>
<td>95</td>
<td>.80</td>
<td>1,440,822</td>
<td>37.3</td>
</tr>
<tr>
<td>Totals</td>
<td>11,836</td>
<td>100.00</td>
<td>3,858,585</td>
<td>100.00</td>
</tr>
</tbody>
</table>
This breakdown is very commendable except for the last item "5,000 or more shares." This group of stockholders held 37.3 percent of the total shares. The percentages held by the other ten groups range from 1.6 (as shown for the "4,000 to 4,999 shares" group) to 12.2 percent (not shown above, but for the "300 to 399 shares" group). There should be a further breakdown of the "5,000 or more shares" group. It is important to the stockholder, the employee, and the public that they have some specific information on the concentration, if such exists, of stock in the hands of a few persons. If there is no such concentration, the stockholder and others have reason to know it. The last group above conceals the facts in which the reader has the most vital interest.

The presentation in the other eight reports follows the pattern of the American Home Products Corporation report. In general, the breakdowns are less detailed.

**Should Names of Persons Owning More Than Ten Percent of Stock Be Given?** Corporations registering their securities with the Securities and Exchange Commission are required to give the names of persons who own more than 10 percent of any class of equity security and to give the names and addresses of all officers and directors. These are pertinent facts in any investment analysis. The interests of stockholders, employees, officers, dealers, customers,
taxing authority, and the general public may conflict at many points. Policy decisions may be made which advantage one interest and disadvantage one or more other interests. The stockholders, employees, and the general public cannot properly evaluate the effects of certain policies unless they know who the larger stockholders are and whether they hold executive offices or membership on the board of directors.

Such information is available for many corporations upon request to the Securities and Exchange Commission. The information is not under "look and key," but it is pertinent information being withheld from the annual report. Any management which wants to "tell all" in the annual report, as many profess a burning desire to do, will include in the annual report the names of the persons who hold significant blocks of shares.

The nearest approach to such disclosure is the following general statement in the Dayton Rubber Manufacturing Company report: "About one-eighth of the outstanding stock is held by officers, directors and their families."
Selected Bibliography


Daniels, W. B., Financial Statements, Monograph No. 2, American Accounting Association, Chicago, 1939, Chapter 5.


CHAPTER 6

FORM AND CONTENT OF THE BALANCE SHEET

The balance sheet and the income statement are the principal accounting statements. Each of the statements presents a different aspect of the business enterprise. The balance sheet shows what the corporation is at a given time; it does not show what the corporation has been doing. It represents the financial condition or position of the enterprise on a particular date. Firm assets, liabilities, and proprietorship are shown thereon. In contrast, the income statement shows what the corporation has been doing for a period of time; it shows the results of operations between two periods of time. The income statement consists of a list of income earned and expenses incurred during a named period of time.

These statements are prepared annually or oftener. It is customary to include in annual reports a balance sheet showing the corporation's financial position at the end of the fiscal year and an income statement showing the operating results of the fiscal year. In many cases, and desirably, the annual report contains balance sheets and income
statements for a series of years. Both statements furnish essential data to stockholders, employees, and other report readers. Neither of the statements standing alone gives a satisfactory picture of the progress and status of the enterprise. Each is complementary to the other.

Other statements may supplement the balance sheet and the income statement. These include the statement of surplus, statement of funds applied and provided, statement of working capital changes, and various schedules which help to explain or amplify certain items on the two primary statements or the relationship between items.

The form, content, and nature of balance sheets in annual reporting is considered in this chapter. Chapter 7 is devoted to income statements, and Chapter 8 to surplus statements. Comparative balance sheets, income and surplus statements, and supplementary schedules are treated in Chapter 9.

Relative Importance of the Balance Sheet and the Income Statement. For annual report purposes, some claim that the income statement is more significant than the balance sheet. This claim is based on the crucial importance of future earning power to stockholders, employees, and all groups having an interest in the enterprise. It is well recognized that the physical properties are not valuable merely because they cost a certain sum, but that they are
valuable only to the extent that they can be profitably used in supplying goods or services demanded by consumers. In other words, an enterprise has value today in relation to one's estimate of its future earning power. Expected earnings represent an ultimate yardstick in present appraisals. Though appraisals hinge heavily on the showing of a series of income statements, the balance sheet too is important in any determination of probable future earnings. As a matter of fact, future net earnings cannot be estimated and evaluated without balance sheet data. Both statements are essential.

The tendency in recent years to place relatively more emphasis on the income statement derived from a prior failure of corporate management to present income data along with balance-sheet data. Consequently, it is incorrect to assume that the balance sheet has depreciated in significance. Instead, corporate management and the general public have developed a better appreciation of the importance of the income statement.

Though income determination and therefore the income statement have become relatively more important, there is no reason to believe that the balance sheet will or should be relegated to an obscure place in corporate annual reports. Actually, by position location in the 100 reports studied,
the balance sheet is emphasized relative to the income statement. The income statement is placed ahead of the balance sheet in only 24 of the 100 reports. It is believed that the importance of the earnings record should be emphasized by placing the income statement ahead of the balance sheet.

**Balance Sheet Forms**

The two conventional balance sheet forms are called the "account form" and the "report form." In the account form the assets are listed on the left page of a two-page spread and the liability and proprietorship items on the right page, with the total of the assets equaling and appearing opposite the total of liabilities and proprietorship. On the other hand, the report form may use only one page or a two-page spread with the assets listed first, the liabilities listed below the assets, and the proprietorship items listed below the liability items. The liability and proprietorship sections are totaled making a grand total which equals the total of the assets section. The account form of statement is illustrated by the American Chicle Company statement which is given on the next two pages. The report form is illustrated by the Bigelow-Sanford Carpet Company, Inc. statement which is reproduced on page 195. It will be noted that the account form is based on the formula:

\[ \text{Assets} = \text{Liabilities} + \text{Proprietorship}. \]
ACCOUNT FORM OF CONSOLIDATED BALANCE SHEET
December 31, 1946

Assets

Current Assets:

Cash in banks and on hand .................. $ 4,008,502.30
 Marketable securities—
 (market value $18,720.00) ................ 18,650.00
 Accounts receivable—trade, less
 reserve of $286,633.91 ..................... 1,723,355.40
 Accounts receivable—other ................ 73,856.14
 Inventories—at cost ........................ $211,402,697.39
 Advances—chicle purchases ................ 9,699,907.65

Total Current Assets .................................. $18,218,969.08

Investments.............................................. 42,750.72

Postwar Credit and Carryback Claim—Excess Profits
Taxes........................................................... 288,965.43

Fixed Assets—at Cost:

Land ...................................................... $ 310,396.40
 Buildings ............................................. 3,704,454.56
 Machinery and equipment .................... 4,066,803.33
 Total ...................................................... 8,083,654.29
 Loss reserves for depreciation ............... 4,883,691.90

Net Fixed Assets ...................................... 3,219,962.39

Goodwill, Patents and Trade-Marks ............ 1.00

Deferred Charges ................................... 717,241.27

$22,455,890.89

1 See pp. 4-5, 1946 Annual Report of American Chicle Company.

2 The asterisks refer to footnotes which appear below the statement.
## Liabilities and Capital

### Current Liabilities:
- Accounts payable: $733,612.10
- Bank loans—foreign countries: $583,666.41
- Accruals: $554,366.71
- Income and excess profits taxes:
  - $2,012,012.99 less $110,000 of U. S. Treasury tax notes: $1,902,012.99

Total Current Liabilities: $3,716,958.11

### Reserves:
- General reserves: $424,153.63
- For future inventory valuation declines: $665,648.55
- For postwar and foreign operating contingencies: $1,957,073.48

### Capital Stock and Surplus:
- Common stock—no par value:
  - Authorized and issued: 437,500 shares—$10.00 par value: $4,375,000.00
- Earned surplus: $11,813,084.64

Less reacquired common stock:
- 4,675 shares—at cost: $466,023.50

Contingent Liability as Guarantor of Letters of Credit: $133,745.01
### Assets

**Current Assets**
- Cash .............................................................................. $4,446,605
- U.S. Government Securities ........................................... 1,500,000
- Accounts Receivable (less Reserves, $563,238) ............... 5,119,788
- Inventories (Note 1, page 24) ....................................... 15,775,939

**Plant and Equipment**
- Land and Water Rights ............................................... 950,432
- Buildings and Equipment ............................................... 22,678,717

**Less: Reserves** .......................................................... $29,609,149

**Other Assets**
- Federal Taxes on Income Refundable .............................. $710,000
- Other Non-Current Investments and Receivables ............. 23,341
- Insurance Unexpired and Expenses Deferred .................. 588,155
- Advance Payments on Royalties ................................... 486,565

**Total Assets** ............................................................. $35,801,773

### Liabilities

**Current Liabilities**
- Accounts Payable and Accrued Expenses ......................... $1,771,668
- Reserves for Federal and State Taxes ............................ 1,401,594
- Employees' Taxes Withheld ........................................... 250,072

**Long Term Notes Payable (Note 2, page 24)** .................. $5,000,000

**Reserves for Inventories** ........................................... $1,000,000

**Capital Stock and Surplus**
- 8% Preferred Stock—Authorized and Outstanding, 86,403 shares, $100 par value .............................................. $8,640,300
- Common Stock—Authorized and Outstanding, 313,609 shares, no par value; less 5,000 shares held in Treasury (Note 3, page 24) .................................. 15,430,450
- Capital Surplus applied against stock held in Treasury (Note 3, page 24) ....................................................... 250,000
- Capital Surplus .......................................................... 263,953
- Earned Surplus—see Statement, page 24 ......................... 7,193,736

**Total Liabilities and Capital** ........................................ $35,801,773

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4 This is an excellent way of making reference to footnoted material.
The usual report form, including the statement on page 195, is based on the same formula. The report form statement also may be based on the formula: Assets - Liabilities = Proprietorship. Nevertheless, relatively few such reports are prepared.

Account and Report Forms in the 100 Annual Reports. Ninety-three of the reports contain balance sheets in conventional account or report form. Of these ninety-three only five are in the report form. Thus, the predominant type is the account form. This predominance can be accounted for, in part, by the inclusion of data for two years in approximately one-half of the statements. Comparative data for two years can be shown on the two-page spread without crowding.

New Balance Sheet Forms

A relatively few corporations have attempted to popularize and simplify their balance sheets by putting the data in a new form. Sixteen of the 100 reports contain such balance sheets. Nine of these sixteen balance sheets are presented in addition to the conventional balance sheet. These new-type balance sheets are of two types:

1. Nine of the reports contain balance sheets which follow the general pattern of the report form. The rearrangement involves the deduction of current liabilities from current assets, the addition of
the non-current assets to net current assets and then the deduction of fixed liabilities, leaving a balance which represents proprietorship.\textsuperscript{5} The Caterpillar Company report on page 198 illustrates the type.

2. Seven of the reports contain balance sheets which are given in brief, descriptive form. The presentations are in terms of "what we own" and "what we owe." The A. E. Staley Manufacturing Company report as shown on page 199 is typical of this type.

\textbf{Evaluation of the Variation of the Report Form.}

In so far as the form is concerned, there is no reason to believe that this form is simpler or more significant than the regular report form, and especially the report form which follows the formula of assets minus liabilities

\begin{center}
\textbf{5 A variation is found in the comparative statement in the Cudahy report which is incorrectly captioned \textit{"Working Capital and Long-Term Debt."} The long-term debt figure is not deducted from the assets-less-current-liabilities figure. Instead, the long-term debt is combined with reserves, capital stock, and surplus as an offset to the assets-less-current-liabilities figure under the caption of "represented by." See 1946 Annual Report of Cudahy Packing Company, p. 5.

George O. May recently suggested that the two parts of the statement might be reversed, thereby listing capital stock and surplus as the first section. He says that "if this became the general practice a much clearer conception of the essential nature of the statement as a report of stewardship would be created." See \textit{"The Future of the Balance Sheet," Journal of Accountancy}, Vol. 84, No. 2, August 1947, pp. 99-100.}
\end{center}
Current Assets:

Stated on basis of realizable values:
- Cash: $6,000,822
- United States Treasury Notes—Tax Series G: $10,790,732
- Receivables, less estimated bad debts: $16,036,086

Stated on basis of cost or market, whichever lower:
- Inventories: $44,054,199

Deduct: Current Liabilities
- Payables: $13,961,943
- Federal income tax: $4,366,468

Deduct: United States Treasury Notes—Tax Series G (4,366,468) 13,961,943

Net Current Assets (statement 5): $62,919,406

Insurance, taxes, etc.—cost allocable to future operations: 178,006

Land, buildings, machinery and equipment—cost not allocated to operations (statement 6): $20,677,509

Patents, trade-marks and other intangibles—stated at nominal amount: 1

Deduct: Ten-year 2% debentures due 1956: $20,000,000

Net Assets: $63,725,122

Derived from:
- Capital stock, common—stated capital (statement 7): $23,144,777
- Profit employed in the business (statement 7): $40,580,345

Capital Stock

<table>
<thead>
<tr>
<th>Capital Stock</th>
<th>Number of Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred: five percent cumulative—par value $100 per share</td>
<td>220,000</td>
</tr>
<tr>
<td>Common: without nominal or par value</td>
<td>2,500,000</td>
</tr>
</tbody>
</table>


This notation and similar ones below refer to excellent supplementary schedules.
## WHAT WE OWN AND WHAT WE OWE

**At December 31, 1946**

<table>
<thead>
<tr>
<th>Total Amount for the Company</th>
<th>Approximate Amount per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash on deposit in various banks needed for the prompt payment of payrolls and purchases.</strong></td>
<td>$3,237,771</td>
</tr>
<tr>
<td><strong>Due from customers for merchandise delivered to them and from other persons for various charges.</strong></td>
<td>4,989,937</td>
</tr>
<tr>
<td><strong>Invested in corn, soybeans, manufacturing supplies and finished products on hand.</strong></td>
<td>44,924,936</td>
</tr>
<tr>
<td><strong>Plants:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total original cost of lands, buildings, and equipment.</strong></td>
<td>$26,090,177</td>
</tr>
<tr>
<td><strong>Less the amount that has been deducted for depreciation and reinvested in various assets.</strong></td>
<td>14,090,955</td>
</tr>
<tr>
<td><strong>Net book value of plants.</strong></td>
<td>$11,999,222</td>
</tr>
<tr>
<td><strong>Cost of lands and other properties held for possible use or sale.</strong></td>
<td>435,220</td>
</tr>
<tr>
<td><strong>Insurance, supplies and other expense paid in advance.</strong></td>
<td>686,069</td>
</tr>
<tr>
<td><strong>Total value of things owned.</strong></td>
<td>$86,755,194</td>
</tr>
</tbody>
</table>

**We Own:**

| To employees for wages and salaries, to manufacturers for materials purchased from them, and to customers for amounts paid us in advance. | $3,325,370 | $1,297 |
| To government for taxes. | 5,130,934 | 2,001 |
| **Money Borrowed:** |  |  |
| **To purchase corn, beans, and materials (short term notes).** | $95,590,000 | $9,981 |
| **To provide additional working capital (long term notes).** | 4,500,000 | 1,755 |
| **Set aside for retirement of employees.** | 126,000 | 49 |
| **Total money owed.** | $136,878,304 | $10,083 |

**Savings of Owners:**

The total value owned less the total we owe leaves a balance representing the savings of our 1,858 stockholders invested in our company: $27,582,890 | $10,758

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equal proprietorship. Instead of following this simple formula, it is based on the following: current assets minus current liabilities, plus the other assets, minus fixed liabilities, equals proprietorship or stockholders’ equity. Aside from the fact that the latter is not a simple concept, there are some other features which detract from the “simplicity” or the accuracy of the statement as used in some of the nine reports:

1. Reserve account which represent either liabilities or surplus, or both, make it impossible to follow strictly the pattern of the Caterpillar report. For example, in the U. S. Steel Corporation report such reserves are combined with long-term debt as a deduction from “total assets less current liabilities.” The remainder figure is correctly designated as “excess of assets over liabilities and reserves,” but this has no real or

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Some writers declare, unappropriately no doubt, that this new-type statement is based on this formula and therefore the statement is more “enlightening” or “simpler” to the general public. See, for example, Aubrey Williams, “Trend in Accounting Terminology and Form Revealed by 1946 Corporate Reports,” Journal of Accountancy, Vol. 84, No. 4, October 1947, p. 311.

Robert H. Gregory correctly observes that this type of statement is not a “simplified” form. He suggests that the statement be described as the “current assets minus current liabilities balance sheet.” See “Recent Changes in Corporate Annual Reports to Stockholders,” Journal of Accountancy, Vol. 84, No. 5, November 1947, p. 394.
significant meaning. It inevitably leads to a serious error in the last section of the statement which is captioned "ownership evidenced by" and includes capital stock and "income reinvested in business." Two errors are apparent. Some of the reserve items are unquestionable subdivisions of earned surplus, therefore the net assets and proprietorship equity are understated. Also, the sum of such reserve balances is reinvested in the same sense as the sum which is shown under the caption "income reinvested in business."10

2. There is some difficulty involved in captioning the excess of current assets over current liabilities. Four of the reports use the caption "working capital," two use "net working capital," and three use "net current assets." It is doubted that the use of a "working capital" designation simplifies or makes any portion of the statement more significant to the average reader.

Evaluation of the Descriptive or Explanatory Form.

This form of statement is illustrated by the A. E. Staley

10 The same presentation is found in the following reports: Briggs Manufacturing Company, Burroughs Adding Machine Company, and Duplan Corporation.
Manufacturing Company statement on page 199. A variation of Staley's presentation is the use of standard balance-sheet titles with non-technical explanations of the meaning of the item or its use in the business. The following are examples:

1946 Annual Report of Electric Boat Company:

CASH--IN BANKS AND ON HAND: Available for use in meeting payrolls, current bills for materials and other usual business expenses.

LAND, BUILDINGS, MACHINERY AND EQUIPMENT: The Company's plants and equipment, less an allowance for accumulated wear and tear (which allowance is the "Depreciation and Amortization Reserve" of $5,413,220. at the end of 1946.)

1946 Annual Report of Bigelow-Sanford Carpet Company, Inc.:

CASH--in bank and on hand for materials, payrolls, etc.

ACCOUNTS RECEIVABLE--amounts owed us by customers.

No doubt such descriptions or explanations are helpful to some readers in enabling them better to understand what is represented on the statement. However, narrative references can be relatively non-informative, as for example the explanation of fixed assets as shown above in the Electric Boat Company report. Such reports are oversimplified unless used in addition to detailed and properly classified balance sheets. For example, the reader should find a complete breakdown of the fixed assets in the annual
report. Six of the seven reports (among the 100) which use this type of balance sheet also contain a more detailed conventional statement. An explanation of this fact is made on two of the six reports. The explanation, given just below the statement title, in the Rockwell Manufacturing Company report is excellent: "The following provides an informal explanation of the company's position as to its assets and liabilities at the end of 1946. This statement is based on the certified statement presented in technical language on pages 14 and 15."

The narrative or explanatory balance sheet can truly be termed "simplified" or "more understandable." It should be used in addition to the detailed conventional statement. It is recommended that every annual report contain a simplified narrative or explanatory version of its balance sheet.

Another Simplification Alternative. In all attempts to simplify balance sheets it should be remembered that

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11 The exception which results in very unsatisfactory coverage is the report of Plomb Tool Company.


13 The informality of the Standard Oil Company (Indiana) form is emphasized by its presentation in script rather than regular type.
oversimplification is as great a danger as a virtue. The
cross currents of a business enterprise are complex.
Consequently, it must be recognized that any attempt to
present the financial position of a corporation in form
and language which is understandable by everyone is all
but an impossible task. Nevertheless, the goal of complete
understanding by all readers is of paramount importance.
Progress toward reaching the goal has been made through the
use of the explanatory report form discussed above, but
this is a form which must be used in addition to the con-
ventional form. It is doubted that the other new-type
statement ("current assets less current liabilities")
represents a real contribution to better reporting. It is
suggested that the following represents the best approach
to a simplified statement form which may be used instead
of the conventional form.14

1. Use data for only one year.15

2. Use the report form, but follow strictly
the formula "assets minus liabilities equals stock-
holders' equity."

14 Of course an explanatory type of balance sheet
could still be used.

15 See further discussion on this point in Chapter 9
which deals with comparative data.
3. Instead of showing all pertinent details in the balance sheet, give the breakdown or detailed information in separate supplementary schedules, notes or footnotes. This practice enables the reader to concentrate on major items and relationships, yet the underlying detail is available for further study and analysis by those who are qualified to use the data. Most of the detailed data can best be presented in schedules.16

Titles of New-Type Balance Sheets. In line with the informality of some of the new-type balance sheets, most of the titles are informal. The following titles are used:

"Financial Condition at End of Year"--Rockwell Manufacturing Company
"Financial Position"--Caterpillar Tractor Company
"Year-end Financial Position"--Bigelow-Sanford Carpet Co., Inc.
"Statement of Financial Position"--Duplan Corporation
"Consolidated Statement of Financial Position"--United States Steel Corporation
"Current Financial Position at the End of 1946"--National Dairy Products Corporation
"Consolidated Balance Sheets"--Bristol-Myers Company

16 This approach is used in part but not consistently in a few of the reports. Some of the best schedules are in the Caterpillar Tractor Company, United States Steel Corporation, and Burroughs Adding Machine Company reports.
"Working Capital and Long-term Debt"—Cudahy Packing Company
"How the Company Stood Financially at the End of 1946—Compared with 1945”—Electric Boat Company
"Simmons Facts at a Glance"—Simmons Company
"What We Own and What We Owe"—A. E. Staley Manufacturing Company
"Simplified Financial Statement—How We Stood"—Standard Oil Company (Indiana)
"Where We Stand—The Balance Sheet"—Plomb Tool Company

In general, these titles are more descriptive than "balance sheet" and therefore may be more meaningful to some report readers. Nevertheless, changed titles do not necessarily mean improved titles. "Balance sheet" probably conveys as accurate a concept to those who are untrained in business affairs as does a title such as "Financial Position."

**Balance Sheet Classification**

Since balance-sheet analyses require the comparison of groups of items with other related groups, balance-sheet classification is of prime importance. Improper grouping of items destroys the validity of the comparisons or requires the report reader to make changes in the classification before attempting an analysis. The fundamental types of accounts are:

- Asset accounts
- Liability accounts
- Capital accounts
The American Institute of Accountants recommended
the following classification of these accounts in 1936:17

**Assets**
- Current Assets
- Investments
- Property, Plant and Equipment
- Intangible Assets
- Deferred Charges
- Other Assets

**Liabilities**
- Current Liabilities
- Funded Debt
- Reserves
- Capital Stock
- Surplus

The usual sequence of items on both sides of the balance sheet is from current to fixed as indicated by the above classifications. Also, usually the items within each group are listed according to liquidity.

The classification as set forth above is followed rather consistently in the 100 reports. Types of violation of good classification practice are given below.

**Equity Section Often Captioned Improperly.** As shown above and on pages 26 and 27, the American Institute of Accountants recommended an account form of balance sheet

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18 This classification is confusing and inappropriate. This classification is in conflict with the thesis that there are three types of accounts: asset, liability, and proprietorship. The "reserves" belong in the asset, liability, or surplus sections of the statement instead of in a separate section.
with the right page captioned "Liabilities." This was an unfortunate recommendation. The caption is obviously incomplete and therefore incorrect. However, in view of the pattern set by the Institute it is not too surprising that 56 of the 100 reports caption the "liability and proprietorship" section of the statement "Liabilities."

Of the remaining 44 reports, ten contain a new-type of balance sheet in which the three-way classification is impossible. Only about 25 percent of the balance sheets contain correct captions such as: liabilities and capital; liabilities, capital stock and surplus; or equities.19

Many Items Are Not Properly Classified. Though the problem of classifying balance sheet items is an elementary process, many items appear in the reports without classification. For example, several receivables, fixed assets, or investments items are listed but without appearing under the appropriate caption. In a few of the reports only the current liability items are classified. Some items are classified, but improperly. Examples are the listing of a surplus reserve as a liability and an intangible asset as a fixed asset.

19 As in the case of every phase of annual reports, there are examples wherein the report writer tries to arrive at a presentation which is different from that commonly used or heretofore. Thus, the Hoover Company uses "Liabilities, Capital Shares, and Surplus"; Electric Boat Company uses "Capital and Liabilities."
Some Other Inadequacies. Two other types of inadequacies should be mentioned. Unsatisfactory indentation procedure is annoying to the careful reader. The Pacific Mills balance sheet appears as follows:

**Current Assets:**
- Cash in banks and on hand
- United States Government securities
- Accounts and notes receivable
- Federal tax refund receivable

Totals of sections are sometimes not shown or captioned. In other cases the columnar arrangement is such that the reader has difficulty in discovering the items which are used in arriving at certain totals. These classification weaknesses are found in the General Time Instruments Corporation balance sheet and others.

**Balance Sheet Limitations**

Though the balance sheet is an important financial report to stockholders, employees, and the general public, it has some limitations which are not adequately recognized. These limitations can be catalogued in various ways. The Accountants' Handbook briefs them as follows:

1. They are essentially interim reports.
2. They are postulated on the concepts of the going concern and the business entity.
3. They are stated in terms of a fluctuating unit of value.
4. They can express only factors capable of being measured in terms of the monetary unit. All annual report readers should be aware of these limitations of balance sheets, but unfortunately they are not. This fact should suggest a need for management to discuss balance sheet limitations in the annual report or in a separate insert which accompanies the annual report.

Presentation of Various Balance Sheet Items

The balance sheet consists largely of a series of items which are in the nature of balances or residuals. The balance is not a statement showing "value." Its limitations cannot be obviated. The effect of these limitations can be minimized, however, by making each section or part of the balance sheet as informative as possible. Actually, the balance sheet in its entirety is of relatively little value; its parts, on the other hand, may be highly significant. The remainder of this chapter is devoted to problems of presenting the various parts of the balance sheet.


21 As an item in its Public Information Series, the American Institute of Accountants recently issued an easy-to-read pamphlet entitled "Financial Statements—What They Mean." Each corporation has a "public" which needs to become educated readers of balance sheets.
The analysis attempts to contrast the uninformative types of presentation of each balance sheet part with the really informative presentations. No attempt is made to define particular balance sheet items, to discuss the types of items which should appear under certain classifications, or to provide a theoretical accounting justification for certain usages.22

Cash. Cash items are not subject to the varied alternatives of valuation and presentation as are most of the other balance sheet items. There is no important basis for criticizing the way in which cash is now being presented in annual reports, therefore an analysis of cash items is not made in this study.

 Marketable Securities. The cash items are usually followed by marketable securities. Only securities which have a ready market should be included. This fact suggests that the balance sheet should show the market value of the securities at the balance sheet date. Such securities

represent a temporary investment, therefore the basis of valuation is of primary importance.

A breakdown of the data in the 100 reports shows:

34 - No marketable securities shown
42 - One marketable security item shown
24 - More than one marketable security item shown

The breakdown on valuation data in the 66 statements having at least one marketable security item is as follows:

17 - No basis of valuation stated
27 - At cost
10 - Cost and accrued interest
 3 - Miscellaneous
21 - Market value

In a number of cases the balance sheet presentation contained two valuation bases: "market value" and some other basis, usually "cost." The presentation in the Electric Boat Company balance sheet is typical:

"United States Government Securities, at Cost (Market Value $8,439,045.31) $8,417,500.00

It is urged that the market valuation always be included in parentheses. When more than one item is owned, the items should be listed under marketable securities as follows:

Cash
Marketable Securities
  U. S. Government securities
  Stocks of non-affiliated corporations
  British Government securities
This breakdown might be given in the notes instead. If the stock in non-affiliated companies is a substantial sum, the corporations should be identified.

The National Lead Company report contains an item which is informative, yet quite puzzling:

<table>
<thead>
<tr>
<th></th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other marketable securities, at cost less reserves of</td>
<td>$522,892; $529,421</td>
<td></td>
</tr>
<tr>
<td>1946</td>
<td>$522,892 (at market quotations: 1946, $3,247,472; 1945, $2,708,829)</td>
<td>$532,117</td>
</tr>
<tr>
<td>1945</td>
<td>$3,247,472</td>
<td>$2,708,829</td>
</tr>
</tbody>
</table>

The reader wonders about the size of the reserve in the face of the market value. Maybe, one lot of the securities is worthless, or almost so. The reader also wonders about the entries which were made to set up the reserve and when they were made.

Receivables. In a properly prepared balance sheet for annual report purposes, the current receivables are presented immediately following cash and marketable securities. The American Institute of Accountants recommends the following arrangement:

23 See supra, pp. 26-27.
Notes and accounts receivable:

Customers:
- Accounts receivable
- Notes receivable

Others

Less--
- Reserve$ for doubtful notes and accounts
- Reserve for discounts, freight, allowances, etc.

An examination of the current receivables in the 100 reports reveals that relatively few follow the above pattern. The breakdown on the section follows:

- 35 - Receivables shown as one item
- 65 - More than one receivable shown

It was apparent in a number of the 65 reports showing more than one receivable item that the breakdown was incomplete. In relatively few cases were the several items in a given report grouped and presented under one appropriate receivables caption.

Since a portion of current receivables is never collected, a deduction for estimated bad debts should be made on the balance sheet in order to show the amount

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24 The use of the word "reserve" as a part of valuation account titles is unfortunate. The balance in the "reserve" account (for receivables, fixed assets, or intangible assets) merely shows the estimated expiration of asset value. The "reserve" account balances do not represent a fund of money, a reservation of profits, or an inherent provision for replacement. "Allowance" is more descriptive of the nature of the valuation accounts. The account title "Allowance for doubtful notes and accounts" is suggested.
Expected to be realized from receivables and the proportion of receivables which are anticipated to be uncollectable. Only 67 show some amount as deduction for doubtful accounts. A few of the remaining 33 reports show an allowance, but without an amount. Such mention of a "reserve" is worthless:

"Accounts receivable--trade, less reserve for bad debts and cash discounts".

The amounts of bad debt allowances should be shown so that comparisons can be made with previous years and with other companies. Such comparisons provide some clue as to credit and collection policies and the relative adequacy of the allowances. Among the best presentations from the 100 reports are the following:

Trade notes and accounts receivable:
- Installment equipment notes secured by chattel mortgages or conditional sales contracts (including installments of $1,264,612 maturing after December 31, 1947)..........................$5,290,492
- Accounts receivable..................10,301,676
- $15,592,168

Less reserves.......................546,000 $15,046,168.00

25 General Shoe Corporation Annual Report, p. 4.
26 From the Fruehauf Trailer Company, United Electric Coal Companies, and United Specialties Company reports respectively.
Accounts receivable:

Customers.............................................. $389,526.93
Officers and employees................................. 1,047.60
Sundry.................................................. 10,173.02
Total.................................................... $400,747.55
Less reserve for doubtful receivables............. 4,000.00
Accounts receivable—net................................ $396,747.55

Accounts receivable:

Customers.............................................. $619,335.27
Other (including employees, $378.99)............... 43,006.07
Total.................................................... $662,341.34
Less reserve for doubtful receivables............. 50,000.00
Accounts receivable—net................................ $612,341.34

Inventories. In the presentation of inventories two considerations are especially important: the nature of the inventory items and the basis of valuation. Inventories have a more significant relationship to sales and earnings than some other asset items; this is particularly true of such groups as distributing houses, meat packers, and tobacco companies which ordinarily have large percentages of their current and total assets in inventories.

With reference to the nature of the inventory items, 40 of the reports contain no breakdown whereas the remaining 60 reports show more than one type of inventory item. Some of these breakdowns are obviously incomplete. Presentations of the following type are recommended: 27

27 From Blue Bell, Inc. and Walt Disney Productions reports respectively. The notes referred to are also excellent.
Inventories (at lower of cost or market—see Note 1):

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finished goods</td>
<td>$636,185.94</td>
</tr>
<tr>
<td>Goods in process</td>
<td>350,010.31</td>
</tr>
<tr>
<td>Materials</td>
<td>1,806,565.55</td>
</tr>
<tr>
<td>Supplies and waste</td>
<td>151,203.31</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,943,965.11</strong></td>
</tr>
</tbody>
</table>

Inventories (Notes 2 and 3)—

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productions in process, at cost</td>
<td>$4,298,266.00</td>
</tr>
<tr>
<td>Released productions, at cost less amortization:</td>
<td></td>
</tr>
<tr>
<td>Feature pictures</td>
<td>5,025,055.00</td>
</tr>
<tr>
<td>Short subjects</td>
<td>323,164.00</td>
</tr>
<tr>
<td>Scenarios and story rights at the lower of cost or estimated realized amounts</td>
<td>856,663.00</td>
</tr>
<tr>
<td>Film stock, supplies, etc., at cost</td>
<td>142,868.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$10,645,016.00</strong></td>
</tr>
</tbody>
</table>

The West Virginia Pulp and Paper Company gives a similar breakdown, but in the notes to the financial statements. This treatment simplifies the balance sheet presentation and permits a full explanation of the basis of valuation along with the inventory breakdown.

The basis of inventory valuation is probably of more importance to stockholders, employees, and other report

It is not practical for some manufacturers to segregate inventory charges by types. (See, for example, the explanation of W. Blackie, "Financial Statements for Corporate Annual Reports," Journal of Accountancy, Vol. 83, No. 3, March 1947, pp. 195-198). In such cases, however, registrants with the Securities and Exchange Commission are required to fully disclose the conditions which make it impracticable to submit a breakdown by major classes of inventories.
readers than is the breakdown by classes. The possibilities for variations in bases of valuation are great.

Various bases may be used for different classes of inventory items. Maybe recognizing the complexity of the problem, eight of the 100 reports give no information on the basis used in inventory valuation. Forty-two other companies give "the lower of cost or market" or some similar non-informative basis.28

Poor treatment of a relatively unimportant item can detract measurably from an otherwise valid presentation. A case in point is the following item (one of three) in the Fruehauf Trailer Company report: "Used trailers (trade-ins and repossessions)--stated at $1.00 each . . . $.821."

This valuation which is given without further explanation appears to be completely arbitrary and a gross understatement to even the casual reader. Also there is little justification for including an $821 item as a separate asset item in a balance sheet of a corporation having assets of 75 million dollars.

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28 For detailed breakdowns on the basis of pricing inventories as shown in 525 corporation reports, see Accounting Survey of 525 Corporate Reports, American Institute of Accountants, New York, 1948, pp. 12-15.
**Other Current Assets.** Twenty-four of the balance sheets contain one or more current asset items which are placed outside of the cash, marketable security, receivable, and inventory sections. "Cash surrender value of life insurance" was the most common such item. Others include: alcohol tax refunds, foreign tax certificates, goods in transit, advances on purchases of materials, refundable federal taxes on income-estimated, due from officers and employees, contract termination claims, expenditures on uncompleted contracts, supplies. More often, most of these items appeared outside the current asset section under the caption of "Other" or "Miscellaneous" assets or without a caption.

Though these items are relatively inconsequential in size, greater uniformity in treatment is indicated. Unfortunately, the presentation form suggested by the American Institute of Accountants is not being followed.29

**Other current assets:**
- Indebtedness of stockholders, directors, officers and employees (current)..........................
- Indebtedness of affiliated companies (current).....
- Other items (describe).................................

**Investments.**30 In line with the form suggested by

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29 See *supra*, pp. 26-27.

the American Institute of Accountants, the "Investments" section usually follows the "Current Assets" section. Though some of the items may be readily marketable, the section is intended for the investments which are long-term, or more or less permanent in character. The primary investment items are represented by securities of non-consolidated subsidiaries and non-current indebtedness of affiliated companies.

Though the American Institute of Accountants recommends the caption "Investments," the items appear under a variety of captions and often without any caption. Other captions noted were: investments and other assets, investments and advances, investments and sundry assets, miscellaneous investments, other assets and investments, other assets.

Twenty-five of the reports do not contain an investment item, 21 contain only one item, and 54 contain more than one item. A good percentage of the breakdowns is incomplete, but it is not possible to make a determination of the exact number.

Eighteen of the 75 reports having one or more investment items contain no valuation data and 23 others show a valuation "at cost." Of the remaining 34 reports only a few approach satisfactory coverage of affiliated
company valuation. Among the companies having good coverage are United-Rexall Drug, Inc., Mead Corporation, Standard Oil Company (Indiana), and General Motors Corporation.

Following an excellent statement on the basis of consolidation, the United-Rexall Drug, Inc., report reads:

"The English and South African wholly owned subsidiaries of Rexall Drug Company are not consolidated but the investments in and advances to these companies are shown as a separate item of $378,756 on the accompanying balance sheet. The underlying net assets (chiefly current) at December 31, 1946 of these companies expressed at their equivalent in United States dollars were approximately $695,000. Earnings of these subsidiaries, $88,000 in 1946 and $36,000 in 1945, have not been included in the accompanying consolidated statement of profit and loss except to the extent of dividends ($1,200 in both years) received in United States dollars." 31

Aside from the lack of valuation data it is usually not possible to determine the names of the major corporations whose securities are held. This condition is bad.

The stockholder is not only denied basic financial information which he needs, but he is not given the names which would enable him to seek the financial data elsewhere.

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31 1946 Annual Report, p. 18. This coverage should be contrasted with the many reports which contain no such information, or with relatively uninformative explanations such as the following: "The company’s equity at November 30, 1946, in the net assets of its wholly owned subsidiary in England, not consolidated, was $204,491.71 in excess of the amount at which this investment is stated." See Simmons Company 1946 Annual Report, p. 17.
Though it is not feasible to discuss critically the several variations in treatment in the 75 reports, two additional presentations are discussed as a means of emphasizing the failure of the reports to anticipate obvious reader questions and reactions.

The Foster and Kleiser Company, a firm engaged in outdoor advertising, shows on its balance sheet "Investment in Outdoor Advertising Incorporated--Net (Note 1)..... $113,198.00." Note 1 reads as follows: "This investment with an original cost of $204,300.00 is being amortized in annual amounts equal to the dividends received on the stock or $12,500.00, whichever is greater." Why amortize the investment? Why amortize by the plan stated? How many years has this policy been followed? What is the item's market value? These are just a few of the questions which might come to a reader's mind. Isn't the explanation more confusing than informative?

As one item under the caption "Investments and Other Assets," United Aircraft Corporation shows in its balance sheet: "Miscellaneous Investments. . . . .$1.00." Is there really more than one "investment"? Did these investments cost a total of $1.00 or are they now worth just $1.00? Is this $1.00 item significant to the stockholder or the employee of a corporation having a balance sheet asset total of $154,223,291.51?

If confusing coverage can be worse than the many points on which there is no coverage, these are probably two good examples.\(^{33}\)

**Fixed Assets.** The third main section on the asset side of the balance sheet is variously captioned "Fixed assets," "Property plant, and equipment," "Property and plant," etc. The presentations in many balance sheets do not meet the requirements for good reporting in three respects:

1. The assets are not classified by types.
2. The basis of valuation is not stated, or is stated uninformatively.
3. Allowances\(^{34}\) for depreciation are not properly shown.

\(^{33}\) In view of the many inadequacies and inaccuracies in corporation annual reports, it is surprising that even more articles have not been written on how corporations conceal profits. It is no wonder that the United Electrical, Radio & Machine Workers of America gives as a reason for publishing a booklet entitled *How Corporations Conceal Profits and How to Understand Your Corporation's Financial Report:* "To debunk the notion held by many of our members that when their employers report that they made only so much profits, the reports, because expressed in dollars and cents, represent exact calculations and are therefore true." The 95-page booklet contains some unsatisfactory interpretations, but it compares favorably with many corporate annual reports.

\(^{34}\) "Allowances" is used in preference to "reserves." See *supra,* footnote 24.
A breakdown of the 100 reports shows that the fixed assets are listed as one item (and without a breakdown elsewhere in the report) in 38 of the reports. In the remaining 62 reports, some merely show land as a separate item from the remainder of the fixed assets. Less than half of the reports contain an adequate fixed asset breakdown.

The valuation data in the reports is even less adequate. A breakdown on the type of coverage follows:

- 26 - No indication of basis of valuation
- 43 - Cost less depreciation (with the amount of depreciation not indicated in several cases)
- 31 - Based on appraisal with subsequent additions at cost, and miscellaneous bases

Actually, the information given in most of the 64 reports is too meager to be really informative. To say that the assets are valued "at cost" tells little. Most of the costs might have been incurred in a year of very high or low costs. Appraisal coverage as given in the Godchaux Sugars, Inc. report is relatively uninformative:

"Property, Plant and Equipment—stated (except as to livestock) at appraisal value (land as of July 7, 1919 and other property as of June 1, 1920) plus subsequent additions at cost less deductions . . . ."35

A few of the reports contain some data which makes the cost data more meaningful. The following are examples:

1. Schedule showing amounts for each year for 1932 through 1946 on the costs, depreciation charged, and costs yet to be charged for land, buildings, and machinery and equipment.—Caterpillar Tractor Company

2. Schedule showing gross book value, reserves, and net book value for each of seven types of fixed asset items; general policies on the making of entries to plant and depreciation accounts.—Standard Oil Company (Indiana)

3. In addition to the usual balance sheet breakdown, the Rockwell Manufacturing Company report contains the following:

Facilities acquired under certificates of necessity:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land, buildings, machinery and</td>
<td>1,589,593</td>
</tr>
<tr>
<td>equipment</td>
<td></td>
</tr>
<tr>
<td>Less reserves for depreciation</td>
<td>1,589,593</td>
</tr>
</tbody>
</table>

Allowances for depreciation were shown as follows:

- 8 - "Less reserves" but no amount or amounts shown
- 75 - One blanket reserve
- 17 - More than one reserve but rarely more than two

36 The Brackett Company uses the same presentation with an uninformative caption of "Facilities--amortizable." In contrast to these presentations Universal Pictures Company, Inc. shows: "Fixed Assets (excluding fully depreciated assets)". Information on the amount of fully depreciated properties has important implications in an analysis of profits.
The deduction for the one blanket reserve is usually made from the total of fixed assets, including land. Such presentation is confusing. An explanation is needed when the assets have been largely depreciated. Almost 80 percent of the depreciable assets of Electric Boat Company have been charged to depreciation.

**Intangible Assets.** The American Institute of Accountants recommends "Intangible Assets" as the next section of the balance sheet. The items are to be described. This plan of presentation is not followed. Instead, captions such as "Goodwill," "Goodwill, Trademarks and Patents," and "Goodwill and Patents" are used and with only one amount shown. An intangible item appears under "Deferred Charges" in one balance sheet and under "Fixed Assets" in three balance sheets.

Of the 65 balance sheets which contain an intangible item, the amount is a nominal sum, usually $1.00, in 47 of the reports. It is doubted that a $1.00 intangible item has any real significance in the report. The item helps make the whole accounting process bewildering to those readers who are not versed in technical accounting.

Practically no valuation data is given in the 18 reports showing more than a nominal sum for intangibles. Vague explanations are made in three reports, "cost" is the
basis in one report, reserves are shown in two reports, and the amortization policy is specified in one report.

The largest sum appears in the National Lead Company report. In addition to a relatively small item presented separately under the caption of "Patents and licenses, less amortization," the following item is shown:

Plant, property and equipment, at 1915 appraised values, subsequent additions at cost (including intangibles of $20,692,311 not being amortized), less reserves for depreciation, depletion and amortization of .................$50,774,755

This is a substantial item to "hide" in the fixed assets section. Further information is needed.

Deferred Charges. This section of the balance sheet is designed to include prepaid interest, insurance, taxes, and various other expense payments which should be matched against income of a future accounting period. A breakdown of the "deferred charges" in the 100 reports shows:

58 - Only one "deferred charges" item.
35 - More than one item
7  - No item

The tendency is to combine deferred items into one item for statement purposes. Since the sum of such items is relatively small, there can be no objection to such practice. Using an explanatory caption such as the following is commendable also:

Deferred Charges to Future Operations—Goodyear Tire & Rubber Company
Costs Applicable to Future Periods—United States Steel Corporation

Insurance, Taxes, etc.—Costs Applicable to Future Operations—Caterpillar Tractor Company

Other Assets. A detailed listing or breakdown of the items appearing under a caption of "Other" or "Miscellaneous" assets and the miscellaneous items appearing without captions is not attempted here because of the varying classifications used in the several balance sheets and the relative inconsequential amounts involved.

For annual report purposes, clearer and better presentation would be achieved if all such items were combined and shown as one "Other" or "Miscellaneous" item. If any of the individual items are significant without regard to size, such as loans to officers, the several items should be shown under the caption of "Other" assets as recommended by the American Institute of Accountants.

Current Liabilities. Liabilities which are payable within one year from the balance sheet date are classified as current. There is general agreement on this line of demarkation between current and fixed liabilities. The balance sheet presentations definitely reflect such agreement.

In terms of completeness and accurate reporting, the liabilities are much better presented than in the case of any of the asset sections. This is due in part, no doubt, to the nature of the asset valuation problem.
The current liability items were not classified on only one conventional balance sheet. The breakdowns by items are much more complete than in the case of the assets. For example, the Glenn L. Martin Company report contains 12 current liability items. Such a detailed listing is not needed by stockholders, employees, or the general public.

The presentation of the section can be improved by classifying the items within the section and by using more accurate account terminology. These two points are well illustrated in the Black, Sivalls & Bryson, Inc. report:

Current Liabilities

Notes payable, unsecured:

Banks (including current installment of ten year bank loan)...$1,900,000.00
Other...........................................152,000.00 $2,052,000.00

Accounts payable:

Trade.................................................398,528.00
Other..............................................127,704.76 526,232.82

Dividends declared, payable
January 10, 1947.........................45,000.00

Accruals:

Federal income taxes....................634,084.45
Other taxes and expense..............59,764.83 693,850.28

Total Current Liabilities $3,317,083.10

The classification of items by notes, accounts, and accruals is commendable. The classification of the tax items as accruals is preferred over such titles as "Provision for federal taxes on income" and "Reserve for federal and Canadian taxes on income." "Provision" and "Reserve" are a part of many of the titles of current liability items. Has "provision" been made? Has something been "reserved"?

Of course not. The words are misleading when used in the above way. An alternate title of "Estimated federal taxes on income" is suggested.

Fixed liabilities. Fifty-seven of the reports contain fixed liability items. "Long-term debt," Long-term liabilities," "Funded debt" are the more common captions. The first two consist of commonly used terms and are preferred over captions such as "Funded debt" and "Ten-year debentures." Unfortunately, in a few cases more than one fixed item appeared but without a section caption.

Almost without exception complete information on due dates and rate of interest is given in the balance sheet proper or in a footnote or note. If space limitations permit, it is suggested that the information be included in the balance sheet proper. The following presentation in the Foster and Kleiser Company report is excellent:

Long-term Liability:
Debenture notes, 3½%—due annually on January 1st at $75,000.00 per annum during the period 1949 through 1957 and at $50,000.00 per annum through 1967.......................................................... $1,175,000.00

Capital Stock. In general, capital stock presentations are very acceptable. A breakdown on the data pertaining to preferred stock follows:

41 - Par value
18 - No par
41 - No preferred stock shown

..........................

54 - Number of shares authorized shown
59 - Number of shares issued shown
25 - Treasury stock shown
59 - Dividend rate shown
50 - One or more preferred privileges specified

A similar breakdown on the common stock reveals the following:

60 - Par value
39 - No par
1 - No indication (Plomb Tool Company)

..........................

95 - Number of shares authorized shown
99 - Number of shares issued shown
36 - Treasury stock shown

Then, there is almost complete coverage on the essential features of capital stock. The number of shares authorized should always be shown. The stated value of no-par stock was not always stated. Though 50 of the 59 reports showing preferred stock indicated one or more preferred privileges, it is certain that full disclosure of such privileges was not given in each case. It is recommended that the general outline of privileges be given in each case. The cost of treasury stock should be shown. Only the number of shares was given in several balance sheets.

Aside from completeness in content it is considered important that the typographical arrangement contribute as
much as possible to ease of reading and understanding. The following are excellent in arrangement and content:

**Capital stock—**
- **4% Cumulative Preferred Stock,** par value $100 per share, callable at $110 per share upon voluntary liquidation and $100 per share upon involuntary liquidation—
  - Authorized and issued 100,000 Shares $10,000,000
  - Less: In treasury 1,270 Shares 127,000
  - Outstanding 98,730 Shares $9,873,000

**Common stock, par value $5 per share—**
- Authorized 400,000 Shares
- Issued 668,985 Shares $3,344,925
- Less: In treasury 22,639 Shares 113,195
- Outstanding 646,346 Shares 3,231,730

**Capital Stock:**
- **5% Cumulative Preferred Stock** (Each share is convertible into 2$ shares of the present Common Stock prior to January 1, 1952, and is redeemable at $105.00 per share and accrued dividends on or before that date and thereafter at $102.50 per share and accrued dividends):
  - Authorized—258,869 shares of $100.00 par value;
  - Issued and Outstanding—258,865 shares....$25,886,500.00

**Common Stock:**
- Authorized—3,600,000 shares of $5.00 par value;
- Issued and Outstanding—2,656,701 shares, including 447 shares issuable for shares of Common Stock of United Aircraft & Transport Corporation when presented for exchange..................13,283,855.00

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38 From the International Minerals & Chemical Corporation and United Aircraft Corporation reports respectively.
There is a poor choice of terminology in several of the reports. "Capital stock" is used for "common stock" in United-Rexall Drug, Inc., report. The General Electric Company report contains an item: "Special stock--6% cumulative; par value $10 (authorized an unissued 1,207,036 shares)." The designation "Special stock" is unsatisfactory.

The odd presentations in two reports should be mentioned. The simplified, descriptive balance sheet--the only one in the report--of the Plomb Tool Company merely shows: "What Our Company Is Worth.....$2,329,841." This amount is a residual balance sheet figure and undoubtedly is not the amount the company "is worth". Report readers are entitled to know certain things about the capital stock and accumulated earnings. The statements in this report are a prime example of the use of simplified reports to reveal significant relationships as little as possible.

The capital section of the Godchaux Sugars, Inc. report is given as follows:

Equity of Stockholders (see note):
Prior preferred stock ($4.50 cumulative)
without par value--stated value, $5.
a share; callable at $105 a share and
accrued dividends (dividends paid to
December 31, 1946). Authorized and
issued 30,500 shares, whereof 1,130
shares in treasury, leaving 29,370
shares outstanding--at liquidation
value of $100 a share.................$2,937,000
Class A stock without par value--stated value, $5 a share. Authorized 200,000 shares; issued and outstanding, 35,250 shares (minimum liquidation value, $50 a share)--equity $50.62 a share........ 4,315,626

Class B stock without par value--stated value, $5 a share. Authorized 200,000 shares; issued, 83,250 shares, whereof 2,000 shares in treasury, leaving 83,250 shares outstanding--equity..... 4,214,379

Total Equity of Stockholders............ $11,467,005

The note referred to appears at the bottom of the page:

"The total equity of stockholders is comprised of the liquidation value of the prior preferred stock, $2,937,000, the stated value of Class A and B stocks, $842,500, and surplus as set forth in the accompanying statements. The excess of the minimum liquidation value of the Class A stock over the stated value thereof does not constitute a restriction on earned surplus."

This is a new type of presentation, but definitely one which should not be used in the future. Some of the major weaknesses are the following:

1. There is an over-emphasis on "liquidation value." Liquidation is not contemplated and the assets were not presented on a "liquidation value" basis.

2. There is no indication of the capital contributions of each of the three groups of stockholders.
3. Accumulated surplus, by types, is not shown in the balance sheet. The coverage in the surplus statement is not complete.

4. Treasury stock is not shown. The surplus statement contains an uninformative reference to treasury stock: "Capital Surplus (after deducting the cost in excess of applicable liquidation or stated value of treasury stock held)—no change during year... $3,039,611."

5. One wonders if there is any difference between Class A and B stock other than minimum liquidation value. One also wonders why Class B equity was not specified at $50.62 in the same way as for the Class A stock.

An analysis of the type contained in the balance sheet could be very valuable to stockholders if adequately done and if presented in another section of the report. Such an analysis should supplement the balance sheet and not displace any portion of it.

**Surplus.** Surplus is treated very briefly on most balance sheets. This practice is satisfactory since a detailed breakdown of surplus transactions and balances is expected to be given in a separate statement.

Sixty-eight of the reports showed capital surplus. Of these, 50 used the caption "Capital surplus," 12 used "Paid-In surplus," three combined both terms into one
caption such as "Capital surplus--paid in," and one report showed amounts for both "Capital surplus" and "Paid-in surplus." The distinction made in this report (Black, Sivalls & Bryson, Inc.) is good. "Paid-in surplus" is used to include the amount paid in by the common stockholders in excess over par value. "Capital surplus" is used to include excess of equity in subsidiaries over the cost of investment therein.

All but four of the reports show "Earned surplus." Godeaux Sugars, Inc., and Plomb Tool Company do not show a surplus item of any kind in their statements. Marquette Cement Manufacturing Company and John B. Stetson Company reports contain only one surplus item and they inappropriately caption it "Surplus." Instead of the caption "Earned surplus," eight of the reports contain a layman's version of the meaning and use of the amount involved.

The terms used are listed below:

Income invested in the business--Briggs Manufacturing Company
Income retained in business--Burroughs Adding Machine Company
Profit employed in the business--Caterpillar Tractor Company
Earned surplus retained for the conduct of the business--Standard Oil Company (Indiana)
Earnings reinvested and employed in business--Standard Oil Company (New Jersey)
Income reinvested in business--United States Steel Corporation
Income reinvested or retained in the business--West Virginia Pulp and Paper Company
Net income retained for use in the business--International Harvester Company
Apparently it is the general policy for dividend restrictions to be specified in the balance sheet or in a supplement thereto. Twenty-one of the reports indicate the nature of restrictions. This practice should be, and possibly is, followed in all cases.

Reserves. Seventy-three of the balance sheets contain a "reserves" section or item which follows the "liabilities" section and precedes the "capital" section. A total of 130 such items appear in the 100 reports. But very few of the reports reveal the exact nature, purpose, and status of the reserve accounts.

Reference has already been made to two types of reserve accounts. There is a third type. The three types may be briefly described as follows:

1. Reserve for bad debts—representing the estimated amount of receivables which are uncollectible; reserve for depreciation—representing the portion of existing depreciable assets which has been charged off. These are "valuation" or "offset" accounts to asset accounts. Valuation accounts may be used in connection with any of the asset items with the possible exception of cash. ("Allowance" is a better term to use than "reserve.")
2. Reserve for taxes, pensions, etc.—representing the estimated amount of the liability for taxes. ("Estimated" is a better term to use than "reserve.")

3. Reserve for contingencies, pensions, etc.—representing appropriations of surplus.

The word "reserve" should be applied only to surplus reserves. Surplus reserves or appropriations merely mean that a portion of surplus has been earmarked to a certain purpose or use. All surplus reserves, surplus appropriations, or subdivisions of surplus—regardless of the descriptive terms used—should always appear in the "Capital stock and surplus" section of the balance sheet. Presentation such as the following would represent accurate disclosure:

Earned surplus:
Earmarked for specific purposes:
To cover possible loss of damage suit
(See No. 3).................................................$200,000
To cover other contingencies................100,000 $ 300,000
Unappropriated surplus..............................1,200,000
Total Earned surplus..................................$1,500,000

From the information given in the reports it is not possible to classify each of the items according to the three types of reserve accounts. Footnotes are helpful in a few cases. A breakdown of the reserve items shows: 39

39 The item titles are briefed but the scope of the individual items is not materially changed. Most of the items should be read by placing "reserve for" before the item.
38 - Contingencies
11 - Insurance
11 - Inventories
13 - Miscellaneous, other, or general
2 - Securities and investments
1 - Operating reserves
   Current operating reserve
   Pension fund
   Insurance and contingencies
   Losses on property disposals
   Estimated federal income taxes which may be payable when installment profits are realized
   Pension, product guarantee, and compensation liability insurance
   Retail store painting, etc.
   Officers retirement compensation
   Past service pension cost--net after taxes
   Unrealized profit on sales to unconsolidated subsidiaries
Foreign exchange rate fluctuations
Inventory price fluctuations and other contingencies
   Workmen's compensation and sundry reserves
   Intercompany profit in inventories
   Adjustments due to wartime operations
   Self-insurance and product guarantees
   Employees' benefits
   Postwar adjustments and contingencies
   Employee benefit plans
   Employee bonus
   Deferred income
   Contingencies and miscellaneous
   Insurance and contingencies
   Postwar contingencies (including $111,118 for other contingencies)
Fire losses, etc.
Contingent and miscellaneous reserves
Future cost of improvements to leased properties, etc.
Contingent taxes on income
Tax and other contingencies
Contingencies including renegotiation of war contracts and postwar expenses and adjustments
Insurance and other reserves
Possible future inventory price declines and other contingencies
Prior year's federal and state taxes
Employers liability
Pension
Claims, litigation, and contingencies
Postwar abnormal expenses
Postwar rehabilitation
Prior years' taxes and contingencies
Possible decline in inventory values and other contingencies
Pattern discards and returns
Annuities
Replacement of Tankers
Pensions
Canadian exchange adjustments
Employees pension reserve
Deferred maintenance of properties
Maintenance
Possible additional federal income taxes for prior years
Postwar conversion expense
Estimated additional costs arising out of war
Insurance, contingencies, and miscellaneous expenses
War losses and postwar contingencies
Officers' and employees' profit-sharing bonus

Since most of the reserves are obviously subdivisions of surplus, it means that surplus is substantially understated on many of the statements. For example, The Borden Company report shows six "reserves" totaling in excess of 26 million dollars. The capital equity would be increased by more than twenty percent if these surplus appropriations were shown as a part of surplus.

The report contains explanatory references to only two of the six reserves. The president said:

"Recognizing that unsettled conditions resulting from the war will carry into the future, the Board authorized appropriations from earned surplus for two new reserves: one of $5,000,000 for
Losses on Unusual Property Disposals, and another of $5,000,000 for Possible Inventory Price Declines. In setting up the latter reserve, the Board was aware of the disastrous drop in commodity prices during the period following World War I but anticipated no similar decline in 1947.

"Substantial protection against declining price trends results from our policy of carrying a number of our major inventory items on a 'last-in, first-out' basis. This method was adopted in 1939, when prices were relatively low. Although our inventory of $57,641,793 on December 31st was considerably more than a year earlier, it was not large in relation to the much greater volume of business transacted." 

The statement attempts only to explain the reason for setting up the inventory reserve. However, instead of justifying the five million-dollar reserve, the explanation gives rather conclusive evidence that there was no reason to set up a reserve "for possible inventory price declines." First, it is admitted that a rapid decline was not anticipated, and second, it is explained that the major inventory items are carried at 1939 prices.

Contingent Liabilities. Some of the items listed above are pure liability items. There is merely a question as to the exact amount of the liability. The item "Prior year's federal and state taxes" is an example. The item should appear in the current liability section. On the other hand, a few of the items could represent the earmarking of surplus

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40 1946 Annual Report, p. 5.
as buffer to a contingent liability. "Contingent taxes on income" could be such an item. In such case, however, there ought to be a specific indication of the nature of the contingent liability.

Mention is made in 32 of the reports of contingent liabilities. The references appear on the face of the balance sheet, in notes to the financial statements, or in the president's letter. It is believed that such references should appear in the balance sheet proper or its accompanying notes. Probably the best procedure is to list the item short below the "capital" section of the balance sheet with an indication of an explanation in the notes to the financial statements.

"Cents" in the Balance Sheet. Fifty-five of the balance sheets do not contain "cents." The use of "cents" adds nothing to the validity or accuracy of the balance sheet. A majority of the amounts on the balance sheet are estimates.

Summary Statement on Balance Sheet Items. In terms of accuracy, completeness, clarity, and general readability the balance sheet items lack much. One necessarily reaches the conclusion that traditional uninformative patterns are followed and that recommendations of the American Institute of Accountants have not been followed generally in the
preparation of the balance sheets. The inadequate presentation of particular items and sections of the balance sheet add measurably to the inherent limitations of the balance sheet.

The detailed review of the balance sheets reinforces a previous conclusion that the management group, with no exceptions, are not striving to "tell all." Some managements are telling more. More information and better presentations are badly needed by stockholders, employees, and the general public.
Selected Bibliography


Paton, W. A., Advanced Accounting, Macmillan Company, New York, 1941, Chapters 1, 2, 3, 6, 7, 11, 12, 14, 18, 22, 23, 26, 27, 31.

CHAPTER 7

FORM AND CONTENT OF THE INCOME STATEMENT

The nature and purpose of the income statement was discussed briefly in the introductory section of the preceding chapter. As background to a detailed analysis of the form and content of the income statement, further specification of the nature and purpose of the statement is given here.

The primary function of accounting is the measurement of periodic income. The income for a period is measured by matching the revenues realized against the cost expired or consumed. Then, the fundamental problem of accounting is the division between the present and the future of the flow of funds (revenue) from the customers or clients in exchange for the products (either commodities or services) of the business and the stream of costs incurred in supplying the products. The division of revenue and costs between the present and the future is reported in the income statement and the balance sheet. The revenue and costs assigned to the present (current period) are reported in the income statement; the costs incurred which
are known or believed to be applicable to future periods are reported in the balance sheet.¹

The annual income statement attempts to show the results of operations for the year in terms of profit or loss. That some estimates are necessarily made in arriving at the profit or loss figure is a fact which is sometimes unknown or unappreciated by some annual report readers. On the problem, Dickinson said:

"If an individual possessing a certain definite amount of cash embarks this cash in various ventures which are all in due course liquidated, with the result that at the close of all his operations he finds himself with another definite amount of cash either greater or less than that with which he started, then he knows exactly what his profit or loss has been during the intervening period. But such a condition is an almost impossible one in practice except as applied to individual transactions."²

Since the typical business enterprise is a continuing entity, it is not feasible for the determination of profit or loss to await the liquidation of the enterprise. To meet the needs of management, investors, creditors, and various public purposes, the income must be measured annually or oftener. The quantitative measurement and

¹ See W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards, Monograph No. 3, American Accounting Association, Chicago, 1940.

interpretation of the net income for the year require estimates and the exercise of broad judgment by accountants and managers. Nevertheless, the income record represents the best single guide to the determination of immediate action and future policies of the several interested parties. Management looks on the income record as a measure of past managerial success and as a basis for future plans. Investors, actual or prospective, use the income figures as a rough indication of corporate earning power and therefore of the value of the stock. Employees are interested in the income record in so far as it reveals the rewards to the various productive factors. Consumers are interested in the income record as a means of estimating the reasonableness of product prices. Creditors use the income record in judging the debt- and interest-paying ability of the enterprise. Various governmental agencies need the income record as a basis for taxation and in the determination of economic policies.

The showing of a single income statement is not very significant to any of the interested groups. It is the analysis of a series of annual income statements which can serve as an indispensable, though incomplete and fallible, guide to intelligently conceived action. But since the validity of the series hinges on the correctness of the form
and content of the individual income statement, the detailed consideration of annual income statements which follows is necessary. 3

Form of Income Statements

The form of corporate income statements varies widely. The income statement patterns are not as easily catalogued by types as the balance sheet. Even after some rationalizing on the typing of the statements, there remains considerable variation in the form of the statements within each group. However, form, as such, is not the essence. There is probably no one best form. Certainly there is no one form in use today which should be used in preference to all others. There is a need, nevertheless, for greater uniformity in the consistent reporting of certain revenue and cost items. The form can be considered completely satisfactory only if the following conditions are met:

3 Having emphasized the importance of the income statement, it is not to be understood that the balance sheet and other financial data have no significance to stockholders, employees, and the general public. Actually, the income statement cannot be satisfactorily interpreted except in relation to the balance sheet at the beginning and end of the period. As Cole said: "The two balance sheets give the terminals of the journey (the start and the finish), and the income sheet gives some of the details of the journey itself."--William Morse Cole, Fundamentals of Accounting. Houghton Mifflin Company, New York, 1921, p. 47.
1. The statement exhibits a properly determined profit or loss figure for the year—a figure which is appropriately designated.

2. The statement contains a listing of the revenue and cost items which are significant to the needs of the report readers.

3. The language of the statement and the arrangement of the items on the page enable the reader readily to recognize the most significant items and amounts and the relationship between certain items.

The several types of income statements now being used are evaluated in terms of these criteria. The following forms are in use: multiple-step; single-step; functional; balanced; informal; explanatory; pictorial; hybrids. As will become evident, some features are common to more than one of these types.

Combination of Income and Surplus Statements

It is now common for income and earned surplus items to be combined into one statement called "Statement of Income and Earned Surplus". The analysis in the current chapter disregards the surplus sections of the 20-odd combination statements. The desirability of a combined statement is considered in the next chapter.

---

4 The account form of statement in which the items of income and expense are set up like credits and debits in an account is rarely used any longer. This form is too technical for general use and has been displaced by versions of the report form as listed above.
Multiple-Step Income Statement. This form of income statement is arranged in sections. The statement begins with a revenue amount and each succeeding section total is added or subtracted (usually subtracted). This process leads to several subtotals. These subtotals are usually captioned as some sort of "profit". Typical captions are: gross profit, total net income, net income before taxes, net income after taxes, net profit before depreciation, net profit after depreciation, net operating profit, net income.

The multiple-step statement is the conventional form. Seventy-eight of the 100 reports contain multiple-step income statements. The form recommended in 1936 by the American Institute of Accountants is of this type. It contains five subtotals or remainders. Paton recommends as a model income statement the form shown on page 251. He describes the statement as one which incorporates "the best features of prevailing practice". Including the surplus section the statement is in five distinct sections. Note the labeling of the section totals: net sales (or

5 Several of the reports contain more than one type of statement so that the numbers shown for each type total more than 100.

6 See supra, Chapter 1, p. 28.
INCOME STATEMENT
Year Ending December 31, 19--

I. Operating Revenue

Gross sales (or other gross revenue)................. $........
Less revenue adjustments (discounts, allowances, returns, etc.)..............
Net sales (or other adjusted revenue)......................... $........

II. Operating Expense

Operating expenses (classified as desired, but showing separately or in a footnote the amounts of depreciation, depletion, and amortization of intangible assets)........................................... $........
Net operating revenue (or "Operating income")......................... $........

III. Profit and Loss

Nonoperating income............................................. $........
Nonoperating charges............................................. $........
Current net income.................................................. $........
Adjustments of net income (unusual, uncurrent, and nonrecurring additions and deductions)........................................... $........
Total net income.................................................... $........

IV. Disposition of Income

Interest charges (separately on current accounts, unless negligible, and showing accumulation of bond discount or amortization of premium separately or in a footnote)........................................... $........
Net income before income taxes........................................ $........
Provision for income taxes........................................... $........
NET INCOME FOR STOCKHOLDERS........................................ $........
Dividends on preferred stock........................................ $........
Net income for common stockholders.................................... $........
Dividends on common stock........................................... $........
Addition to earned surplus........................................... $........

V. Reconciliation of Surplus

Earned surplus, beginning of period............................ $........

Transfers to and from appropriated surplus (reserves)........................................... $........
Reduction due to acquisition of treasury stock........................................... $........
Stock dividends....................................................... $........
Earned surplus, close of period........................................ $........

other adjusted revenue), net operating revenue (or "operat-
ing income"), current net income, total net income, net
income before income taxes, net income for stockholders.8

One of the best multiple-step presentations among
the 78 reports using the conventional type is the state-
ment in the Drackett Company report. It is duplicated on
page 253. The pattern follows the American Institute of
Accountants' form except that income taxes are shown in a
separate section rather than under other charges or deduc-
tions. This statement is considered to be an improvement
over the Paton and AIA versions:

1. Its typographical treatment is excellent.

2. Its designations of subtotals are more
logical and comprehensible. "Profit from operation"
is preferred over "Net profit before other income
and charges" and "Net operating revenue". Unnamed
subtotals are preferred over the captions "Current
net income" and "Total net income".

3. The section captions of "Profit and loss"
and "Disposition of income" in the Paton version
are confusing and unnecessary. The same terms can
be applied appropriately to the prior sections
of the statement.

---

8 At another point Paton recommends a model income
statement having seven intermediate balances. In the same
place, he argues convincingly that there can be no profit,
in any legitimate sense, until all costs have been taken
into account, therefore the term "profit", however quali-
ified, should not be applied to any intermediate balances
which may be struck. See W. A. Paton, Advanced Accounting,
### CONSOLIDATED INCOME AND PROFIT AND LOSS STATEMENT

**Fiscal Year ended September 30, 1946**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Sales, Less Returns, Allowances, Discounts, and Freight</td>
<td>$16,463,010.35</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>12,969,747.73</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>3,493,262.63</td>
</tr>
<tr>
<td><strong>Loss:</strong></td>
<td></td>
</tr>
<tr>
<td>Warehousing and Trucking Expenses</td>
<td>$86,193.87</td>
</tr>
<tr>
<td>Laboratory and Engineering Expenses</td>
<td>406,398.56</td>
</tr>
<tr>
<td>Advertising, Marketing Research and Selling Expenses</td>
<td>919,435.72</td>
</tr>
<tr>
<td>General and Administrative Expenses</td>
<td>509,786.24</td>
</tr>
<tr>
<td><strong>Profit from Operations</strong></td>
<td>$1,928,613.79</td>
</tr>
<tr>
<td><strong>Other Income:</strong></td>
<td>$24,001.14</td>
</tr>
<tr>
<td>Discount Earned</td>
<td>3,390.88</td>
</tr>
<tr>
<td><strong>Total Other Income</strong></td>
<td>27,392.02</td>
</tr>
<tr>
<td><strong>Other Deductions:</strong></td>
<td></td>
</tr>
<tr>
<td>Interest on Notes Payable</td>
<td>65,660.17</td>
</tr>
<tr>
<td>Interest, Discount, Premiums and Expense paid on 3% Debentures, redeemed on June 1, 1946</td>
<td>237,530.65</td>
</tr>
<tr>
<td>Depreciable Assets Abandoned</td>
<td>10,006.98</td>
</tr>
<tr>
<td>Other</td>
<td>3,299.98</td>
</tr>
<tr>
<td><strong>Net Profit before Federal Income and Excess Profits Taxes</strong></td>
<td>$1,063,558.53</td>
</tr>
<tr>
<td><strong>Less—Federal Taxes on Income:</strong></td>
<td></td>
</tr>
<tr>
<td>Income and Surplus</td>
<td>361,074.85</td>
</tr>
<tr>
<td>Excess Profits Tax</td>
<td>108,408.18</td>
</tr>
<tr>
<td><strong>Net Profit Transferred to Consolidated Earned Surplus</strong></td>
<td>$614,075.70</td>
</tr>
</tbody>
</table>

---

9 1946 Annual Report of the Drackett Company, p. 27. The double statement title is unfortunate. "Income statement" or "Profit and loss statement" is enough.
**Evaluation of the Multiple-Step Form.** For annual report purposes, the number of poorly descriptive subtotals is confusing. Some of these subtotals cannot be defined meaningfully. This weakness in the form can be eliminated by describing the individual items included in each section but omitting subtotal titles. In addition to the question of appropriate titles there is the problem of determining the classification of items by sections. There is so much variation in the classification of items that sections of various income statements are not comparable. For example, "Depreciable assets abandoned", as shown in the Drackett Company statement under "Other deductions" is a cost which must be deducted in arriving at the "profit from operation". The item is not properly classified. Since "operations" can be thought of in a narrow sense or a broad sense, with many shades in between, variations in classification are unavoidable. Still, the proponents of the multi-step form argue that the gross margin and the subtotals after certain expenses are informative.

Probably the most unfortunate feature of the form is its suggestion that certain expenses have a prior claim on income. Some expenses are merely more important quantitatively than others. Taxes are necessary costs. It is inaccurate to say that profit was a given amount "before
taxes". However, it will be recalled that until quite recently many statements carried a caption "profit before depreciation". Depreciation, taxes, and most other types of expenses are not optional. Furthermore, management has as much control in varying the tax expenditure as in the case of some other expense categories.

**Single-Step Income Statement.** In this type of statement all revenue items are listed at the top of the statement with the total shown. Next, all of the cost items are listed and totaled. The net income is obtained by subtracting the second total from the first. The type is illustrated by the statement on page 256 from the Swift and Company report. Fourteen other companies used the single-step type. When this type is used it usually displaces the multiple-step statement.

**Evaluation of the Single-Step Statement.** The difference in single- and multiple-step statements is in arrangement only. The revenue and cost items included are exactly the same. The single-step form is a simpler presentation. It contains no confusing or meaningless subtotals or titles. It emphasizes the homogeneity of the revenue items and the cost items.

The statement does not show an amount as the "gross margin", "financial or non-operating income" or other possible
### STATEMENT OF CONSOLIDATED INCOME

For the Period from October 27, 1945 to October 26, 1946

Sales, including service revenues...... $1,308,364,155

Dividends received—

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>From subsidiaries—not consolidated:</td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>654,540</td>
</tr>
<tr>
<td>British</td>
<td>616,106</td>
</tr>
<tr>
<td>Other</td>
<td>7,506</td>
</tr>
<tr>
<td>Interest from marketable securities, etc.</td>
<td>601,727</td>
</tr>
<tr>
<td>Miscellaneous—net.</td>
<td>651,663</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,310,973,697</strong></td>
</tr>
</tbody>
</table>

LESS:

Cost of sales and service, including provision for inventory replacements (see notes) and after deducting:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidies</td>
<td>1,195,784,003</td>
</tr>
<tr>
<td>Selling and administrative expenses</td>
<td>67,995,373</td>
</tr>
<tr>
<td>Depreciation</td>
<td>7,069,746</td>
</tr>
<tr>
<td>Taxes (other than income taxes)</td>
<td>7,191,085</td>
</tr>
<tr>
<td>Contributions to Pension Trust</td>
<td>8,020,678</td>
</tr>
<tr>
<td>Interest charges</td>
<td>685,282</td>
</tr>
<tr>
<td>Loss on sale, dismantling and retirement of fixed property, etc.—net.</td>
<td>951,513</td>
</tr>
<tr>
<td>Federal income taxes (see notes)</td>
<td>5,481,089</td>
</tr>
<tr>
<td>Other income taxes</td>
<td>293,369</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,294,580,956</strong></td>
</tr>
</tbody>
</table>

**NET INCOME FOR YEAR**................................. $ 16,394,739

---

10 From 1946 Annual Report of Swift & Company, p. 16. The Earned Surplus section of the statement is not included here.
group totals. However, the reader may make such calculations as will fit his purposes.

It has been suggested that the one list of cost items may result in concealing or de-emphasizing certain items or relationships. There is such a danger in the ease of non-recurring revenue or costs. Such items in either type of statement should be properly identified in the body of the statement or in a note. In this connection, however, it should be pointed out that the multiple-step form can be used as a means of over- or under-emphasis. For example, it can be said that to set taxes apart from other expenses which are large in comparison represents an overemphasis of taxes. Likewise, Sunshine Biscuits, Inc., lists four items under "Other income" totaling $155,000 and lists only five cost items (not counting taxes which were shown separately) in the entire statement but these five items totaled $65,000,000.11

The possibility of concealment or incorrect emphasis is not peculiar to the single-step income statement or any other form. For annual report purposes this form is better than the multiple-step form.

11 1946 Annual Report.
"Functional Operating" Income Statement. The American Economic Foundation is championing what it chooses to call "The Functional Operating Report". It has been in use for about 10 years and has often been referred to as the "Short Form". The form as recommended by the Foundation is shown on page 259. The form as proposed is not followed exactly in any of the 100 reports. The nearest approach is a statement used by A. E. Staley Manufacturing Company. Staley's version appears on page 260. It follows the pattern, but with exceptions:

1. "Value" is used instead of cost. This represents an unfortunate substitution since financial statement representations are not in terms of "value" as the word is commonly used in an economic sense.

2. The "Cost of Using the Tools (Profit)" is shown as two items—dividends and profit retained in the business. The separation of these two items in the statement is in violation of the intent and purpose of the form.12

12 There is an obvious attempt to conceal or de-emphasize the amount of the "cost of using the tools (profit)." Had the profit been shown as one figure, the profit per employee would have been shown at $2,986 as compared with $3,215 for employee wages and salaries. Too, it is not proper to say that $5,920,255 (a figure which is carefully labeled almost everything but what it actually is—profit) has been retained in the business "to protect jobs and savings" when the formal "Statement of Profit and Loss and Earned Surplus" shows that a 100% stock dividend (amounting to $4,232,530) was paid during the year to common stockholders. The financial statements show that profit for the year was almost 30 per cent of the capital investment.
**FUNCTIONAL OPERATING REPORT**

"**X**" CORPORATION

1946

<table>
<thead>
<tr>
<th>Description</th>
<th>Total</th>
<th>Per Worker</th>
</tr>
</thead>
<tbody>
<tr>
<td>WE RECEIVED FROM OUR CUSTOMERS................................................................</td>
<td>$120,000,000 (100%)</td>
<td>$7,500</td>
</tr>
<tr>
<td>THESE RECEIPTS WERE EXPENDED FOR:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Goods and Services Bought from Others</td>
<td>$57,600,000 (48%)</td>
<td>$3,600</td>
</tr>
<tr>
<td>Cost of Human Energy (Wages, Salaries)</td>
<td>48,000,000 (40%)</td>
<td>3,000</td>
</tr>
<tr>
<td>Cost of the Tools Wearing Out (Depreciation, Depletion)</td>
<td>3,600,000 (3%)</td>
<td>225</td>
</tr>
<tr>
<td>Cost of Payments Ordered by Government (Taxes)</td>
<td>4,800,000 (4%)</td>
<td>300</td>
</tr>
<tr>
<td>Cost of Using the Tools (Profit)</td>
<td>6,000,000 (5%)</td>
<td>375</td>
</tr>
</tbody>
</table>

TOTAL EXPENDED.................................................................................. $120,000,000 (100%) $7,500

"**X**" Corporation also received $1,115,000 for activities not related to the manufacture or sale of its products.

3. The breakdown of the profit item resulted in the use of one subtotal. In a sense, the statement is in single-step form.

The functional form is used in nine other reports. But in each of these the "costs are not balanced against revenue. Instead, all costs except profit are deducted from revenue, leaving as a balance the profit for the year. This change in the form converts it into a single-step form.

Such treatment violates every criteria of good reporting. Simplified or new-type statements can be used to obscure the pertinent facts and relationships.

### OUR WORK AND SAVINGS IN 1946

<table>
<thead>
<tr>
<th>Value of Products and Services</th>
<th>Amount</th>
<th>Average per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sold (Gross sales and other receipts)</td>
<td>$108,273,431</td>
<td>$42,228</td>
</tr>
</tbody>
</table>

#### Distribution of Values:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Average per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sellers of corn, beans, supplies and other services—purchases</td>
<td>$86,338,922</td>
<td>$33,673</td>
</tr>
<tr>
<td>Government for taxes</td>
<td>$5,200,350</td>
<td>$2,028</td>
</tr>
<tr>
<td>Reserved to restore and rebuild plant and offices—depreciation</td>
<td>$831,085</td>
<td>$324</td>
</tr>
<tr>
<td>Employees for time, energy, and know-how—wages, salaries, benefits and retirement</td>
<td>$8,242,615</td>
<td>$3,215</td>
</tr>
<tr>
<td>Owners for use of their savings—dividends</td>
<td>$1,740,304</td>
<td>$679</td>
</tr>
<tr>
<td><strong>Total of distributions</strong></td>
<td><strong>$102,353,176</strong></td>
<td><strong>$39,919</strong></td>
</tr>
</tbody>
</table>

Retained and used by the company to protect jobs and savings:

- To construct new buildings and purchase new equipment; to retire long term debt, and to increase working capital: **$5,920,255** $$2,309$$

<table>
<thead>
<tr>
<th>Total Amount</th>
<th>Total Average per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>$108,273,431</strong></td>
<td><strong>$42,228</strong></td>
</tr>
</tbody>
</table>
From the 100 reports in the study, the one in the United States Steel Corporation report is an excellent adaptation. (See page 262.) However, it should be noted that the war costs and interest items do not follow the functional grouping. There is some variation from the five-way breakdown of the "costs" in most of reports. The Caterpillar Tractor Company statement which has been discussed by many writers contains a separate interest item and beginning and ending inventory balances. Caterpillar's statement is shown on page 263.

**Evaluation of the "Functional Operating" Income Statement.** The purpose and intended use of this report have been misinterpreted. Consequently, some attention should be devoted to the claims which have been made for it by its proponents. The American Economic Foundation said:

"After five years of research into the semantics of corporation operating reports, the American Economic Foundation is more than ever convinced that this new form of income report is the first step toward economic literacy for the layman.

"It is 'social accounting', rather than 'control accounting'. It puts the accurate story of who-gets-how-much-for-doing-what in simple, functional words. The meaning of these words cannot be confused by accident or distorted by intent.

"This 'Functional Operating Report' is a supplement. It is a layman's edition of the professional's profit and loss statement. Its construction and use does not require any change in
CONSOLIDATED STATEMENT OF INCOME\textsuperscript{15}  
1946

PRODUCTS AND SERVICES SOLD ................................. $1,496,064,326

COSTS

Employment Costs
  Wages and Salaries, ... $679,355,429
  Social Security taxes, 15,986,855
  Payments for pensions
    (details on p. 18) ... 9,180,697 $704,461,181
  Products and Services Bought .............. 589,606,301

Depletion and depreciation .......... 71,400,608

Selling and Administrative Costs
  Loss (profit) on sales of plant and equipment ........ 2,651,434 68,739,174

War Cost Included Herein Provided
  For in Prior Years, less associated Federal income tax adjustments
    Strike costs ........ 27,626,351
    Other war costs .... 1,586,353 29,212,714

Interest and Other Costs on
  Long-Term Debt .................. 4,777,135

Taxes
  State, local and miscellaneous taxes ... 37,070,774

Estimated Federal taxes
  on income .......... 32,000,000 69,070,774

TOTAL .................. 1,407,441,851

INCOME ........................................... 88,322,475

DIVIDENDS—On cumulative preferred stock ($7 per share) ................. 25,219,677
  On common stock ($4 per share) .................. 34,813,008

INCOME REINVESTED IN BUSINESS
  Addition in Period .............................. $ 23,589,790

\textsuperscript{15} From the United States Steel Corporation report for 1946, p. 29. The writer has recast the statement in minor ways. The data for 1945 are omitted and the 1946 amounts are arranged in three columns. The latter change emphasizes the functional organization. The "Taxes" caption was also inserted.
RESULTS OF OPERATIONS AND SUMMARY OF PROFIT EMPLOYED IN THE BUSINESS Calendar Year 1946

SALES ........................................................................... $168,437,494

COSTS:
Inventories brought forward from previous year......................... $ 32,086,876
Add: Costs incurred during year:
- Materials, supplies, services purchased, etc. ................. $79,309,077
- Wages, salaries, company contributions for group insurance, retirement plan, unemployment insurance and old age benefits 52,183,569
- Portion of cost of buildings, machinery and equipment allocated to operations (depreciation)..... 1,388,035
- Interest (net)........ (34,130)
- Federal income tax after deducting $808,681 computed under "carry-back" provisions of Internal Revenue Code 2,466,675 134,293,826

$168,380,102

Deduct: Inventories carried forward to next year......................... 44,054,199
Costs allocated to year......................................................... 122,325,903

Profit for year....................................................................... $ 6,111,591
Add: Profit employed in the business at beginning of year......................................................... 40,115,474

Deduct: Dividends of $5 per share paid in cash during year......................................................... 5,646,720
Profit employed in the business at end of year......................................................... 40,580,345

the methods or vocabulary of professional accounting. No new facts need be recorded.17

That the statement is intended as a supplement to the regular income statement is emphasized. It is so used in eight of the ten reports. The exceptions are Caterpillar Tractor Company and United States Steel Corporation. The United States Steel report (see page 262.) contains a detailed listing of expenses which provides as much expense itemization as is contained in most annual income reports. On the other hand, the Caterpillar report contains no breakdowns of the functional items.

The streamlining and functionalizing of the income statement makes it more understandable to one segment of readers. For another segment of readers, the functional report lacks adequate disclosure. As a complementary statement to a detailed multiple-step or single-step statement, the functional income statement is recommended. But even when used as a complementary statement, it is not the panacea which some proclaim it to be. The statement does not, as one of its proponents has suggested,18 provide "the workers and the public a chance to measure their

17 Doane and Canning, op. cit., p. 11.
self-interest in strikes, union featherbedding, increased production, and cost-cutting" which is not provided by other types of income statements. Statements to the effect that "many workers have gone on strike to enforce wage demands that were arithmetic impossibilities" are not a sound basis for recommending the use of the functional statement in preference to the single-step statement. The arithmetic of the former is not less difficult than the latter.

The reporting of all "costs" as percentages of the total amount of money received from customers and the "per worker" averages are not particularly significant. The "cost of goods and services bought from others" varies greatly even for companies in the same industry. The percentage of such cost might be increased or decreased 50 percent without necessarily changing the wages of employees, salaries of top management or profit to investors. Or, it might be advantageous to the workers for the "per worker" average of "cost of tools wearing out" to be doubled or cut in half. It might even be advantageous for most workers for the "per worker" average of "cost of human energy" to decrease. Also, whatever significance these relationships may have is lessened by the omission of the amount received "for activities not related to the manufacture or sale of

its products. Who got this amount? There is no logical basis for omitting this item from the receipts section of the statement.20

The statement merely indicates who-got-how-much of the sales dollar, whereas the basic questions are: how much was earned on the investment, did labor get a fair share of that product which it helped to produce, etc. The worker is encouraged to continue to contrast his wage with the total company profit.

Most of the companies using the functional type are showing profit as a residue after all costs (in the accounting, but not the economic sense) have been met. The showing of profit as a residue does not square completely with the facts. On the other hand, to show all profit as a cost is equally questionable. The truth is that one statement cannot set forth briefly, simply, and correctly the complex relationships of the several factors of production. Such a goal is achieved as adequately through a single-step functional income statement as through the "Functional Operating Report".

20 For other criticisms of the statement, see editorial, Journal of Accountancy, Vol. 34, No. 4, October 1947, pp. 267-268.
**Balanced Income Statement.** The functional type of income statement as recommended by the American Economic Foundation might be called a balanced income statement since all income items as a group are shown as an offset to all expenses and profit in another group. This balancing feature can be applied without using a functional breakdown of the expenses. The statement in the Plomb Tool Company report is an example. The A. E. Staley Manufacturing Company report—the only other report containing a balanced statement—contains such a statement which follows the functional pattern.

There appears to be no justification or excuse for a balanced income statement unless it is prepared on a functional basis, and according to present practice there is little basis for attempting to differentiate between the functional income statement and what has been called the balanced income statement.21

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21 So far as the writer has been able to determine, Robert H. Gregory first used the term "balanced income statement." He concludes that "Already there is some indication that another form of income statement (the balanced), which at present is only an auxiliary statement, might replace the single-step style." (See Robert H. Gregory, "Recent Changes in Corporate Annual Reports to Stockholders," *Journal of Accountancy*, Vol. 84, No. 5, November 1947, p. 389.) The present study does not bear out his conclusion. There is, however, some indication that the single-step form may ultimately displace the multiple-step form.
Informal, Explanatory Income Statement. The only distinguishing feature of this type of report is the use of non-technical descriptive language instead of the customary accounting captions. Most of the explanatory statements are of the single-step type. As a supplementary statement, this form has merit. Ten of the 100 reports contain such statements. Of these, the one in the National Dairy Products Corporation report, as duplicated on page 269, is very good.

Pictorial Income Statement. Pictorial income statements, like explanatory statements, probably should not be referred to as a separate type. The pictorial feature may have some value in attracting attention. The fact that some items on the statement cannot be portrayed correctly through pictures is a major limiting factor. Three of the 100 reports contain income statements accompanied by from six to ten sketches. Some of the faulty picturizations are the following: net profit as cash, profit not paid in dividends as money in a vault, cash and charge sales as a bag of money. The pictorial report is not recommended.

Hybrid Income Statements. Twenty-six of the 78 referred to on page 250 as conventional type statements are in very brief form. Some of these are so brief that they hardly deserve to be called income statements. Three of
OUR INCOME:
The sale of our products amounted to........3742,409,000
Our income from other sources was........... 2,023,000
This gave us a total income of................. $744,432,000

OUR COSTS AND EXPENSES:
Milk and other products purchased from
farmers and raw materials bought
from other suppliers cost us.............3443,720,000
To process our products and serve
our customers, we employed 41,799
men and women whose wages and
salaries amounted to......................... 122,408,000
Operating services and supplies, and
other miscellaneous costs of doing
business totalled.............................. 35,838,000
To package our products in bottles,
cans, cases, cartons, jars and other
containers required.......................... 32,549,000
Our direct taxes to help support Federal,
state, and municipal governments
were........................................... 26,723,000
Repairs and maintenance to keep our
plants functioning efficiently cost....... 16,757,000
Despite repairs and maintenance,
plants and equipment gradually
wear out from constant use, become
obsolete and eventually have to be
replaced. Each year we provide a
reserve for depreciation for this
purpose. The amount provided this
year was....................................... 8,822,000
We reserved for possible future in-
vventory price declines...................... 5,000,000
We paid to our bondholders as interest
on money we had borrowed.................. 1,383,000
This brought our total costs and expenses to
$718,989,000

OUR PROFIT:
This left a profit of 3.4 cents on each $1 of sales,
or a total of.................................. $25,444,000

Which was divided as follows:
Paid to common stockholders as
dividends..................................... 10,554,000
Retained in the business for work-
in capital, plant expansion and
debt reduction............................... 15,113,000

---

The note below the statement pertaining to the formal statement on another
page is commendable.
these are shown on page 271. These abbreviated reports are grossly incomplete.

Seven other reports deviate in some material way from the multiple-step, single-step, functional, and explanatory types. Some of them follow the single-step pattern except that taxes and some miscellaneous items are shown as a deduction in additional sections. Among the hybrid presentations, the statement in The Aluminum Company of America report is the most unique and the least satisfactory. The statement is duplicated on 272. Two things are apparent. The Company was interested in giving a minimum of information and in using a "different" presentation.

Summary on Statement Form. As the formal and complete income statement, the choice is between the multiple-step and the single-step forms. These are the types of statements which are certified to by certified public accountants. As a non-technical and supplementary income statement, the choice is between the functional and explanatory types. Each of the reports has advantages and disadvantages. Either of the forms can be followed and still the presentation may be unsatisfactory because of poor typographical layout, confusing captions and account titles, improper emphases, and incomplete data. Though form is of some importance, completeness of data in the statement is
STATEMENT OF CONSOLIDATED PROFIT AND LOSS
For the Year Ended January 31, 1947

Net Sales ........................................ $86,164,395
Cost of Sales and Store and Operating Expenses, including depreciation of $622,922; and rent payments under long term and other leases of approximately $1,045,000 ................................ $61,972,574
Net profit before Federal taxes on income ........ $4,191,821
Provision for Federal Taxes on Income .......... 1,376,000
Net profit for the year ........................... $2,815,821

PROFIT AND LOSS ACCOUNT
For the Year Ended December 31, 1946

Profit from Operations ........................... $4,837,273
(After deducting depreciation $281,679, remuneration to executive officers $134,740, Directors' Fees $7,940, Legal Fees $34,945).
Income from Investments ........................... $183,857
Deduct:
Provision for Income and Excess Profits Taxes ........ $2,251,691
Net profit for the year transferred to Surplus Account ........................... $2,709,459

SUMMARY OF OPERATING RESULTS

Net (loss) or income before depreciation and income taxes .................................. $(260,035.80)
Depreciation on plants and equipment .............. $162,993.96
$162,993.96
$(423,029.76)

Taxes on income—estimated
(1946, Canadian) ................................ $70,553.51
(LOSS)—PROFIT FROM OPERATIONS ........... $(473,563.27)
Refundable federal taxes on income of prior years—estimated .......................... 765,000.00
NET ADDITION TO SURPLUS ........................ $271,416.75

23 These three income statements are from the Goldblatt Bros., Inc., National Breweries, Ltd., and the Heywood-Wakefield Company reports respectively. The 1945 figures for Goldblatt Bros. and Heywood-Wakefield are omitted here because of space limitations.
### Consolidated Income and Earned Surplus Account

#### For the Year Ending December 31, 1946

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earned Surplus—Beginning of Year</td>
<td>$154,467,571.77</td>
</tr>
<tr>
<td>Adjustments Applicable to Prior Years</td>
<td>355,820.82</td>
</tr>
<tr>
<td>Adjusted Earned Surplus—Beginning of Year</td>
<td>$154,903,392.59</td>
</tr>
<tr>
<td>Earnings, after deducting all Expenses</td>
<td></td>
</tr>
<tr>
<td>Incident to Operations, before Provision for Depletion and Depreciation</td>
<td></td>
</tr>
<tr>
<td>and Income and Profits Taxes</td>
<td>35,303,909.41</td>
</tr>
<tr>
<td>Provision for Depletion and Depreciation</td>
<td>7,938,978.93</td>
</tr>
<tr>
<td>Earnings before Income and Profits Taxes</td>
<td>27,364,930.58</td>
</tr>
<tr>
<td>Provision for Income and Profits Taxes</td>
<td>10,300,000.00</td>
</tr>
<tr>
<td>Estimated refundable portion of prior years' taxes arising from &quot;Unused</td>
<td></td>
</tr>
<tr>
<td>Excess Profits Tax Credit&quot;</td>
<td></td>
</tr>
<tr>
<td>NET INCOME</td>
<td>$23,064,930.56</td>
</tr>
<tr>
<td>Less—DIVIDENDS—Preferred Stock</td>
<td>$5,886,951.00</td>
</tr>
<tr>
<td>Dividends—Common Stock</td>
<td>$9,582,339.00</td>
</tr>
<tr>
<td>Earned Surplus—End of Year</td>
<td>$16,398,533.17</td>
</tr>
</tbody>
</table>

---

of prime importance. Regardless of form, a statement with incomplete data is unsatisfactory. An analysis of the content of the certified income statements in the 100 reports is made in the last section of this chapter.25

**Titles of Income Statements.** Of the 78 reports which contain the conventional type of income statement, 52 include "Income Statement" (a few use "account" instead of "statement") and 26 include "Profit and loss" as parts of the title. The use of both in titles has been criticized. Yet, there is no general agreement on a substitute. The writer doubts that the title of the statement represents a real problem. "Results of operations" has probably been used more often than any other substitute.

Informal titles are used with about one-half of the new-type statements. Some of the more effective titles are:

- **Income and Outgo during 1946**—Simplicity Pattern Co., Inc.
- **Our Operating Record in 1946**—National Dairy Products Corporation
- **Results of Operations**—Bigelow-Canford Carpet Company, Inc. and Caterpillar Tractor Company
- **Informal Financial Statements (balance sheet and income statement)**—Carrier Corporation

25 All of the reports except for the Plomb Tool Company contain a certified income statement.
Presentation of Income and Expense Items on the Income Statement

The remainder of this chapter is devoted to a consideration of the components of income and expense as shown in the income statements of the 100 companies. The analysis pertains primarily to the items which appear in the formal income statement. However, some reference is made to the financial data contained in footnotes, notes to the financial statements, and the president's letter.

Supplementary information on income and expense items is contained in many of the reports in the form of various types of charts and tables. Since this supplementary data is usually in comparative form, it is analyzed in Chapter 9.

Sales. With the possible exception of the net income for the year, sales or gross revenue is the most important item on the income statement. A breakdown on the presentation of sales in the 100 reports follows:

- 85 - Sales as a single item
- 5 - Sales broken down by types
- 5 - Amounts shown for sales and sales returns and allowances
- 5 - Sales not shown

Five of the statements contain grossly inadequate information on sales. In these statements, the first item was shown as: 26

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26 From the Aluminum Company of America, American Chicle Company, Dr. Pepper Company, Heywood-Wakefield Company, and National Breweries Limited reports respectively.
EARNINGS, after deducting all Expenses incident to Operations, before Provision for Depletion and Depreciation and Income and Profits Taxes ......................... $35,303,909.41

GROSS PROFIT FROM SALES:
After deducting cost of materials, labor and manufacturing expenses, including depreciation of $258,899.17.....$11,659,055.70

GROSS PROFIT ON SALES....................$ 4,924,269.64

NET (LOSS) OR INCOME before depreciation and income taxes..............................................$ (260,035.80)

PROFIT FROM OPERATIONS..............................$ 4,837,273
(After deducting depreciation $281,679, remuneration to executive officers $134,740, Directors’ Fees $7,040, Legal Fees $34,945).

The five companies have withheld information vital to the needs of stockholders, employees and the general public. Only an inadequate understanding of the meaning of the net income is possible without information on sales. The amount of dollar sales (goods or services) is a significant figure in appraising the operating effectiveness of an enterprise and as a basis for an intelligent estimate of the future. Without sales and primary expense data it is not possible to ascertain the trend of sales, expenses, gross margin, etc.

The Securities and Exchange Commission has authority to keep certain portions of corporate reports from the public files. However, most corporation requests that the amount of sales and cost of goods sold be kept confidential are disapproved. Whether these figures are published in annual
reports or not, it is generally agreed that each primary competitor has accurate financial information on the operations of his competitors. Through trade associations and other means sales figures are often available long before the annual report is published.

Eighty-five of the reports contain a single figure for sales or regular operating revenue. In many of these cases, the sales figure is net though it is not so designated in the statement. In a few cases some miscellaneous revenue is combined with the sales figure without an indication of the amount involved. The variations in presentation are of the following types:

Net sales and miscellaneous revenue
Net sales and other store income
Gross income from operations
Gross sales, less discounts, returns and allowances

Preferably all miscellaneous revenue is shown separate from the primary sales figure. There is no real advantage in showing "less discounts, returns and allowances" unless an amount is shown. Only five of the reports gave the amount of gross sales and the amount of sales discounts, returns, allowances, etc. The total of these items is usually not significant in relation to the total sales. Unless the amount is of unusual size and an explanation is given in the report to that effect, there is no necessity for reporting the amount.
Five of the statements contain a breakdown of sales. One company shows a separate amount for sales to subsidiary companies; one shows the amount for sales to subsidiaries not consolidated; one shows an amount for costs and fees under cost-plus-fixed fee and other contracts; one shows separate amounts for domestic and foreign sales; and a film manufacturer shows sales amounts for feature pictures, short subjects, comic strips, and government pictures.

Breakdowns of these types are informative and particularly useful in any sound analysis of the progress and status of the corporation. More corporations ought to give detailed sales breakdowns in separate schedules of the type included in the 1946 Annual Report of International Harvester Company. Sales and the per cent of the total are given for the years 1945 and 1946 according to the following breakdown:

<table>
<thead>
<tr>
<th>Sales of regular products in the United States:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor trucks, service and service parts</td>
</tr>
<tr>
<td>Farm implements and service parts</td>
</tr>
<tr>
<td>Farm tractors and service parts</td>
</tr>
<tr>
<td>Industrial equipment and service parts</td>
</tr>
<tr>
<td>Steel, pig iron, and coke by-products</td>
</tr>
<tr>
<td>Binder and baler twine</td>
</tr>
<tr>
<td>Refrigeration equipment</td>
</tr>
<tr>
<td>Miscellaneous</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

---

27 p. 4.
Sales to subsidiary companies:
To I. H. Company of Canada, Limited
To I. H. Export Company (for export)
Total
Grand Total

The possible injurious effect to future earnings of disclosures such as in the above example is grossly overemphasized. Furthermore, if the public is to benefit most by lower prices brought about through effective competition, it is essential that sales and cost of good sold data be made available to the general public.

Other Income. All of the income statements except four contained one or more revenue amounts in addition to the primary revenue source. A breakdown of the items by types follows:

40 - Interest
22 - Sale of plant or fixed assets
11 - Foreign exchange adjustment
132 - Rentals, royalties, commissions, dividends, etc.

Most of the other income items, averaging two to each report, are shown under the caption of "Other Income". Actually, these relatively unimportant items are detailed whereas sales is not broken down and huge expense items are not identified. For example, note the individual items in the income statement of Pacific Mills on page 279. Six relatively small other income items are shown, one of them amounting to only $3,623. There are also a total of six cost and expense items on the statement. These total in
## CONDENSED CONSOLIDATED STATEMENT OF PROFIT AND LOSSES

For the Year Ended December 28, 1946

**NET SALES, after returns, allowances and cash discounts** ........................................... $78,305,654

**COST OF GOODS SOLD** ........................................................................................................... 35,033,240

(Including $961,935 for plant depreciation)

Gross Profit on Sales .................................................................................................................... $43,270,414

**SELLING AND ADMINISTRATIVE EXPENSES** ........................................................................ 4,423,680

Profit from Operations .................................................................................................................. $18,846,734

**OTHER INCOME:**

- Interest ................................................................................................................................. $114,868
- Cash discounts on purchases ......................................................................................... 151,223
- Profit on disposal of fixed assets ................................................................................. 260,432
- Recoveries of bad debts ............................................................................................... 3,623
- Commissions .................................................................................................................... 19,580
- Miscellaneous .................................................................................................................. 9,655

Profit from Other Income ........................................................................................................... $19,406,135

**OTHER CHARGES:**

- Interest paid and interest allowed customers on anticipation ........................................ 261,895
- Profit before Provisions for Income Taxes and Contingencies ....................................... $19,154,241

**PROVISION FOR ESTIMATED INCOME TAXES:** (Note C)

- Federal income tax ............................................................................................................. 7,175,000
- State income taxes ........................................................................................................... 476,350

Profit before Provision for Contingencies ............................................................................. $11,502,891

**PROVISION FOR CONTINGENCIES** (Notes C and D) ........................................................... 2,000,000

Balance of Profit Transferred to Earned Surplus ................................................................... $9,502,891

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28 From the 1946 Annual Report of Pacific Mills.
excess of $67,000,000. It is absurd to show a $3,623 income item along side a cost item of more than $50,000,000.

In many of the statements, several of the smaller other income items should be combined and shown as one amount. When the amounts are relatively small, items such as interest might as well be shown net. It is important that other income be shown separate from sales and that non-recurring income, if in a significant amount, be identified clearly. In comparison, the identification of miscellaneous income sources is not important.

Cost of Goods Sold. Forty of the 100 reports contain a "Cost of goods sold" or a "Cost of sales" item in the income statement. Thirty-nine additional statements contain such an item but the item is combined with one or more expense items and shown somewhat as follows:29

COST OF GOOD SOLD, selling, engineering, general and administrative expenses, and provision for retirement pensions (including provision of $181,840.03 for depreciation of property, plant, and equipment)..............................$10,225,329.11

COST OF SALES and expenses (depreciation, $375,000).............................. 28,439,271

29 From the Harris-Seybold Company, Godchaux Sugars, Inc., General Motors Corporation, and Flintkote Company reports respectively.
COST OF SALES and other operating charges, exclusive of items listed below... $ 1,750,626,267

COST OF GOODS SOLD, exclusive of
depreciation and depletion .......... 36,757,953.80

The first two items above are inclusive of all of the items which conventionally appear in the cost of goods sold and operating expense section of the income statement. The latter two are inclusive to the same extent except that "selling, general, and administrative expense" and "depreciation" are shown as separate items.

Of the remaining 21 income statements, the type of coverage pertaining to cost of goods sold follows:

5 - "Operating expenses" caption
4 - "Costs and expenses" caption
5 - Begin with a profit figure net of conventional cost of goods sold and operating expenses\(^{30}\)
6 - Other\(^{31}\)

From the standpoint of disclosure, the statements containing "Operating expenses" and "Costs and expenses"

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\(^{30}\) See supra, p. 271, for these presentations.

\(^{31}\) An odd treatment is that of W. L. Douglas Shoe Company in which sales and gross profit on sales are shown but without showing a deduction for cost of goods sold. The presentation follows:

Sales (less returns) .................. $9,524,929.13
Gross profit on above sales .......... 3,002,908.21
Selling, advertising and administra-

Etc., etc.
captions give the same type of detail as the 39 statements which have a caption which includes "cost of sales" or "Cost of goods sold".

Several conclusions are more or less obvious:

1. "Cost of goods sold" and "Cost of sales" are used interchangeably.

2. A very large proportion of the costs for the year which are being matched against the revenue is included in the "Cost of goods sold" item or section without any or much itemization. In most of the statements such costs amount to at least 75 percent of net sales.

3. In general, there is no disposition on the part of management to give a breakdown on the major cost and expense items which make up the "Cost of goods sold" category.

Less disclosure is hardly possible. Yet, all listed companies are required to furnish a detailed breakdown of cost of goods sold in reports filed with the Securities and Exchange Commission. The details which are available to competitors and any one else who seeks them are denied to stockholders, employees, and other readers of a report which is intended "to inform".

Selling, General, and Administrative Expenses. There is an item in 71 of the statements which is captioned "Selling, general, and administrative expenses", "General and administrative expenses", "General expenses" or some such all-inclusive caption. The nature of the expenses included is indeterminate; consequently whatever amount is shown can have but little meaning to the report reader.
Depreciation. Annual depreciation charges are made to expense as a means of allocating the cost of the wearing out, using up, or extinguishing of fixed assets. The term "depreciation" is usually applied to buildings, machinery, and equipment, "depletion" to wasting assets, and "amortization" to leaseholds and intangible assets. Often, however, as in the discussion which follows, "depreciation" is used to include "depletion" and "amortization".

Depreciation is inadequately treated in the income statement and the notes thereto in many annual reports. Depreciation for the year is shown in only 64 of the income statements. In eleven of these reports, depreciation is shown below the income statement. The statement in the Brown & Bigelow report reads as follows: "Provision for depreciation included in costs and expenses amounted to $152,293." In several other cases, the amount appears in the notes to the financial statements instead of in the income statement proper. There is no more reason for placing depreciation below the statement or in the notes than any of the other expense or income items. Such presentation is in part, probably, a throwback to the time when charging depreciation was thought to be optional. Nevertheless, it is better to have the depreciation charge given in a relatively undesirable location than not to be shown.

Thirty-six of the income statements did not show depreciation.
To fail to show the depreciation charge is inexcusable. The importance of showing depreciation as a separate item is due in part to the fact that the amount of the charge is subject to more arbitrary determination than most expense charges. Management can adjust the depreciation charge as a means of adjusting net profit upward or downward. The amount of the charge is not controlled by an outlay of cash or the appearance of a liability during the year as is the case with most expense items. It follows that it is important for the reader to have the amount of the annual depreciation charge and the rate or rates at which depreciation is charged.

The Glenn L. Martin Company report is one of the few which contains information on depreciation rates. A note to the financial statement reads:

"Effective as of January 1, 1946 the Company reduced the rates of depreciation on certain plant property as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Rate Effective January 1 1946</th>
<th>Rate Prior to January 1, 1946</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory buildings, etc.</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Machine tools</td>
<td>6-2/3%</td>
<td>10%</td>
</tr>
<tr>
<td>Miscellaneous factory equipment</td>
<td>10%</td>
<td>15%</td>
</tr>
</tbody>
</table>

32 The Walt Disney Productions report contains an excellent statement on the basis of amortizing picture costs. The few other references to depreciation rates in the reports are fragmentary.
The rates now in use conform to those allowed for Federal income tax purposes. The higher rates used prior to January 1, 1946 were intended to provide for accelerated depreciation arising from the multi-shift operations then in effect. As a result of the foregoing rate adjustments the depreciation provision for the year 1946 is approximately $140,000 less than it would have been if the old rates had been continued. 33

The rates should be shown in the report though there has not been a change in depreciation policy. Management and accountants can expect rather general disbelief in the accuracy of accounting statements so long as pertinent information is withheld. Though the accounting basis may be satisfactory, one especially wonders about fixed assets which are largely depreciated yet large depreciation charge offs are continued. For example the balance sheet of General Electric Company shows:

<table>
<thead>
<tr>
<th></th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and equipment--cost</td>
<td>$372,910,042</td>
<td>$303,571,667</td>
</tr>
<tr>
<td>Less: Depreciation reserves</td>
<td>271,898,671</td>
<td>268,298,883</td>
</tr>
<tr>
<td>Plant and equipment--net</td>
<td>$101,011,371</td>
<td>$35,272,784</td>
</tr>
</tbody>
</table>

The income statement for 1946 shows a depreciation charge of $19,717,731. This charge is more than 50 per cent of the net fixed assets at the beginning of the fiscal year and almost 20 per cent of net fixed assets at the end of the year. Since the report contains no explanation of depreciation rates and general policy with reference to maintenance

33 p. 15.
and repair policy, one is forced to conclude that an ultra-conservative depreciation policy is being followed. Such a policy leads inevitably to an understatement of current profits but ultimately to an overstatement of profits.

It would be helpful to annual report readers for an explanation to be made if depreciation is charged at different rates for federal income tax and annual report purposes.

**Wages and Salaries.** The wage payments made to employees and executive management and the benefit payments made on their behalf are rarely disclosed in income statements. Only four of the reports contained a wages item in the income statement. Five of the statements contain a benefit item such as "Employees' insurance, annuities, etc." Two income statements contain partial coverage of executive compensation. The items are as follows:

- **Participations of certain officers and employees in profits**..............$536,279\(^{34}\)

- **Selling, general and administrative expenses** include additional compensation to management, $137,121 and $88,982 in 1946 and 1945 respectively, based on consolidated profits before income taxes.\(^{35}\)


\(^{35}\)From notes to financial statements in 1946 Annual Report of Simplicity Pattern Co., Inc.
In addition to the scanty treatment in income statements, there is some information on salaries, wages, and employee benefits in a few of the president's letters. The most specific of these statements follows:

"Total compensation paid to the ten top men of the management group, plus $4,030 paid to Hope-well L. Rogers, Chairman of the Board, was $205,463 or 1.58¢ for each dollar of sales.

"The four highest salaries paid in 1946 were Whipple Jacobs, $40,650, on which the tax (based on a married man with one dependent) is $17,868; Charles S. Craigmille, $36,690, tax $15,398; Herbert W. Clough, $24,180, tax $8,061; and Arthur L. Wanner, $23,580, tax $7,738."36

The few remaining references are less informative and some of them are possibly more emotional in content and purpose. The following are samples:

"After considerable study the incentive plan in operation since 1939 was revised last year. The revised plan, fully explained at that time, was approved by the stockholders and has been in effect during the past year. In our opinion it is accomplished its purpose."37

"As in the past six years, the Board of Directors approved an Incentive Compensation Plan for 1946 dependent upon profits, in which officers, staff executives, buyers, and other key employees throughout the Company participated. The four


officers who are also directors received $135,000; this compares with $128,000 in 1945. A similar compensation plan will be continued in 1947."38

"It will be noted that wages and salaries for the year, $33,539,315, were more than ten times the amount of both cash and stock dividends paid our stockholders. Our employees will be further interested to know that the Company's contribution to the pension fund exceeded by $31,876 the amount of cash dividends our stockholders received from us. Our total tax bill for the year was $11,202,488, or $4,481,903 more than our net earnings."39

"In December, the President and other top management executives, voluntarily relinquished compensation arrangements under which they participated in a percentage of profits before taxes. This change was made effective January 1st, 1947."40

These statements certainly raise more questions than they answer. They are best characterized by meaningless generalizations and inaccurate suggestiveness. Why is executive compensation shown in terms of "dollars of sales"? What is the significance of wages and salaries being ten times dividends? It appears that the Company is trying to prove a point. Management must realize that annual report data must be uncolored by emotional suggestion. Management has not yet sought to tell annual report readers what they want to know about wages of employees, compensation of executives, and other payments for the benefit of both groups.

38 1946 Annual Report of Butler Brothers, p. 10
40 1946 Annual Report of Simplicity Pattern Co., Inc.
Such information in annual reports is essential for the following reasons:

1. Salaries and wages are a major cost.

2. Employees and officers make a major contribution to the success or failure of the enterprise, consequently, payments made to them are of direct interest to stockholders, employees, and others.

3. Comparisons of the shares of workers, stockholders, and management should be possible if their relationships are to be mutually satisfactory.

The following is suggestive of the type of information which should be included:

1. Classify employees by groups, such as office workers, plant workers, sales personnel, research personnel, executive management.

2. Show separately for each group, the amount paid as regular wages or salaries, as contributions to pension fund, as unemployment and federal old age benefit taxes, as sick, accident, and disability benefits, as bonuses.

3. Show the number of employees in each group and the average payment. Show the amount of personal income taxes applicable to each group. Give the names, salaries, and applicable personal income taxes for at least the top ten executives.

4. Set forth in specific language the basis on which the bonus fund is determined and the amount to be paid to individual executives and employees.

5. Give specific information on options given to executive management and key employees to purchase the corporation's stock as well as any employee stock-purchase plan.
Taxes. In contrast to other expense items, taxes are consistently shown in income statements. Though legal complexities make some of the income tax adjustments difficult of understandable presentation to all readers, the presentations are generally satisfactory. It would be helpful for the reports to show separately the taxes paid to state and local authorities, the Federal government, and foreign governments. Excise taxes need not be shown as a distinct item.41

Other Expenses. The only other expense breakdown which was shown as a separate item with any consistency was interest. Quantitatively, interest expense is a relatively unimportant item. Also, if the balance sheet presentation is adequate, the amount of interest can be estimated to better advantage than most expense items.

Bad debt charges and maintenance and repairs were shown in relatively few of the statements. Advertising was not shown as a separate item. Consideration should be given to the showing of such items separately.

Many of the miscellaneous expense sections and items have not been carefully titled. The following, some of which appear in several statements, are defective:

41 For an authoritative statement on accounting for income taxes, see Accounting Research Bulletin No. 23, American Institute of Accountants, New York, December 1944.
Income deductions
Income charges
Deferred repairs and maintenance
Deductions from income
Sundry other charges
Miscellaneous deductions
Restricted earnings from pipe line operations
Additional provision for bad debts

"Expenses" should be used instead of "charges" and "deductions". "Deferred" and "provision" are incorrectly used, and "restricted" and "additional" are confusing.

Some Income Statement Limitations. Three limitations of income statements in corporate annual reports are briefly summarized:

1. The detail in income statements is incomplete, the emphasis on particular items is often misplaced, some of the terminology is incorrect or confusing, and the basis on which some expenses (such as depreciation, bad debts, and maintenance and repairs) are determined are not given. The prior sections of this chapter have dealt with these problems.

2. There are non-recurring income and expense items which are likely not to be properly evaluated. And, more important, there are certain charges which may be made in the income statement or directly to earned surplus. In accounting for such items management can adjust the profit figure radically and arbitrarily. A portion of the next chapter is devoted to this problem.
3. Income data, including the net income figure, for a one-year period are not very meaningful for analysis purposes. Investment decisions should not be based on net income or "earnings per share" for a year. Income data for one year are not sufficient to use in wage negotiations.

Comparative income data for a period of years are essential. The adequacy of comparative data in current reports is considered in Chapter 9.
Selected Bibliography


Williams, Robert W., "Income Statement," as Chapter 3 in Contemporary Accounting, American Institute of Accountants, New York, 1945.
CHAPTER 8

SURPLUS, DIVIDENDS, ETC.

Surplus

Surplus is usually distinguished as earned, paid-in, and revaluation for financial statement purposes. Earned surplus is the amount of net income accumulated.\(^1\) Paid-in surplus is that portion of capital paid-in by stockholders in excess of stated or legal capital. Revaluation surplus is any excess of appraisal value of assets over cost which is brought into the accounts as a result of asset reappraisals.\(^2\)

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\(^1\) A more technical definition of earned surplus formulated by a committee of the American Institute of Accountants is:

"Earned surplus is the balance of net profits, income, and gains of a corporation from the date of incorporation (or from the date when a deficit was absorbed by a charge against the capital surplus created by a reduction of the par or stated value of the capital stock or otherwise) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus." See Accounting Research Bulletin No. 9, American Institute of Accountants, New York, May 1941, p. 75.

\(^2\) For excellent treatises on types of surplus, surplus account entries, and concomitant problems, see:
The line of demarkation between earned surplus and paid-in surplus is not as certain in theory and practice as the brief definitions suggest. For example, discount and premium on capital stock are sometimes entered in paid-in surplus and again in earned surplus. Though such variations in practice are not desirable, they present a relatively unimportant problem in the preparation or interpretation of annual reports. The effect of the variations is minimized by the small money amounts which are usually involved and by the fact that primary analyses do not hinge on the ratio of earned surplus to paid-in surplus or the ratio of earned surplus to some other balance-sheet item.


3 For a detailed analysis of the variation in the practice of 525 corporations in making entries to earned surplus and paid-in surplus, see Accounting Survey of 525 Corporate Reports, American Institute of Accountants, New York, 1948, pp. 76-84.
Entries to Current Income or Surplus. The variation in surplus practice which is of vital concern to all annual report readers relates to the question of charges between income and earned surplus. The fundamental question involved is: Should net income for an accounting period reflect all revenue and revenue costs, or should net income include only a portion of the revenue and revenue costs, i.e., those which are recurring and directly associated with the primary operations of the period?

The American Accounting Association and the American Institute of Accountants have issued official pronouncements on the subject which are conflicting. E. L. Kohler summarized the position of the Association admirably when he said:

"One of the principles advocated was the clearing of every item of income, expense, and loss through the income statement, regardless of its nature or amount, the argument being to recognize frankly that no current income statement, despite its most exacting preparation, can be so devised as to serve as an index or as any section of an index of present or future earning power, but that rather it should be considered as one of a series which ought collectively to reflect the results of actual operations as accurately and completely as possible. The emphasis was on the need of making the income statement a historical summary, containing every variety of recognized expense and loss, so that there might be no danger of overlooking items absorbed elsewhere (i.e., in paid-in or earned surplus or in surplus reserves). Recommendation was made that out-of-the-ordinary expenses and losses, particularly those in some way related to other years, be shown in a separate section within the income statement; throughout there was an insistence that the one test for
including them in the current income statement was their recognition as expenses or losses during the period covered by the statement."4

According to this concept, the income statement should be "all-inclusive" of revenue and revenue costs recognized during the period covered. Credits to earned surplus would be limited to net income balance transferred from the income statement, and reductions in earned surplus would be confined to dividends and other distribution to stockholders.

The American Institute of Accountants takes the thesis that the income statement should emphasize the relationship of items to the operations and to the year, and that there should be excluded from the determination of net income any material extraordinary items which are not so related. Thus, the Institute contends that the income statement should be designed on a "current operating performance" basis. The Committee on Accounting Procedure of the Institute recently stated:

"...it is plainly desirable that over the years all profits and losses of a business be reflected in net income, but at the same time has recognized that, under appropriate circumstances, it is proper to exclude certain material charges and credits from the determination of the net income of a single year, even though they clearly affect the cumulative total of income for a

series of years. In harmony with this view, it is the opinion of the committee that there should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption in any case would be with respect to items which in the aggregate are materially significant in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period. Thus, only extraordinary items such as the following may be excluded from the determination of net income for the year, and they should be excluded when their inclusion would impair the significance of net income so that misleading inferences might be drawn therefrom:

(a) Material charges or credits (other than ordinary adjustments of a recurring nature) specifically related to operations of prior years, such as the elimination of unused reserves provided in prior years and adjustments of income taxes for prior years;

(b) Material charges or credits resulting from unusual sales of assets not acquired for resale and not of the type in which the company generally deals;

(c) Material losses of a type not usually incurred against, such as those resulting from wars, riots, earthquakes and similar calamities or catastrophes except where such losses are a recurrent hazard of the business;

(d) The write-off of a material amount of intangibles, such as the complete elimination of goodwill or a trademark;

(e) The write-off of material amounts of unamortized bond discount or premium and bond issue expenses at the time of the retirement or refunding of the debt before maturity."

For annual report purposes the use of "all-inclusive" income statements is urged in preference to statements based on the concept of "current operating performance." From the standpoint of investors, employees, and the general public, the following points are of peculiar importance:

1. The "current operating performance" income statement is in conflict with the realities of enterprise operation. The "extraordinary" occurrences are usual. These can be anticipated in a limited way sometimes, but their effect should not be permitted to be minimized by shifting charges to surplus. Management is responsible to stockholders and others for the administration of all assets and the income statements preferably show the effect of all transactions.

2. The same type of statement emphasizes the importance of net income for a given year, whereas only a series of net income figures are of real significance. Consequently, the series of net income items should include the results of all operations. There is nothing to be gained by trying to make more significant "earnings per share for the year" when a single such figure is inherently insignificant.

3. "Materially significant in relation to the company's net income" is such a broad concept that there is little reason to believe that the Institute's pronouncement
will cause the degree of consistency in practice which is essential to good reporting.

4. If all managers and accountants knew that all reserves and costs would at some time have to pass through the income statement in the determination of net income, more accurate estimates could be expected. An examination of only a few income statements and surplus accounts reveals unwarranted charges and credits to net income and earned surplus and the shifting of income from one period to another.

Variations in Practice Which Obscure the Meaning of Net Income. In addition to the net income versus surplus problem as outlined above, there is the similar but opposite problem of charges or credits on the income statement which should be made to surplus—some to earned surplus and some to paid-in surplus. The Institute has issued pronouncements covering problems of this sort. The following brief excerpt is self-explanatory:

"Adjustments resulting from transactions in the company's own capital stock, amounts transferred to and from accounts representing a segregation or appropriation of surplus or general contingency and inventory reserves such as those dealt with in Bulletins 28 and 31, and adjustments made pursuant to a quasi-reorganization, should be excluded from the determination of net income under all circumstances." 6

6 Accounting Research Bulletin No. 32, loc. cit.
The examples of practices given below are typical cases in which net income is unnecessarily obscured.

1. The 1946 income statement of Goodyear Tire & Rubber Company shows two improper charges against the net income for the year:

   Provision for possible loss on foreign investments ................ $ 5,000,000
   Provision for contingencies, including costs, inventory valuations and prices ................... 10,000,000
   $15,000,000

   In addition to these reserve provisions, the president's letter reports others totaling $2,700,000, including a $1,000,000 charge against income as explained in the excerpt below. These three charges ($16,000,000) amount to more than the reported net income for 1945 and almost two-thirds of the reported net income for 1946. The "Contingent and Miscellaneous Reserves" at the end of 1946 exceeded $36,000,000, double the balance at the end of 1945, and more than 20 percent of the stockholder equity as shown in the capital stock and surplus section of the balance sheet. From the data in the report the conclusion is inevitable that the $16,000,000 charge against net income is intended to "normalize" earnings. There is a bold admission to this effect with reference to the $1,000,000 item:

   "The incentive profit sharing plans under which official and other key personnel of the consolidated companies are partially compensated
on a contingent basis, and which, as amended from time to time, have been in effect for a period of nineteen years, resulted in the payment of $750,000 based on earnings for the year.

"Under these plans as now in effect the contingent compensation is fixed at an amount equal to 10% of the consolidated net earnings realized over and above $5% of the consolidated average book value during the year of the outstanding capital stocks of the Company, subject to a maximum limitation fixed annually by the Board (currently $750,000) on the amount distributable to participants for any year.

"The Board of Directors has authorized the creation as a charge against earnings of a reserve for the purpose of augmenting payments under the plans in future years when current earnings might be insufficient to permit adequate payments thereunder. The reserve consists of $1,000,000 which was charged against 1946 earnings and additions to such reserve out of earnings in subsequent years will be made when earnings may be more than sufficient to provide for maximum payments under the plans. The reserve will not operate to increase the amount distributable in any year above the maximum, which at present is $750,000. The reserve and the plans are subject to annual reconsideration by the Board."?

2. West Virginia Pulp and Paper Company shows

"Net gain (or loss) on disposals of securities and property, exclusive of timber" in income statement and "Profit on sale of timber" (a much larger amount) as a credit to surplus. At least the two items should be treated consistently.

7 1946 Annual Report.
3. On the other hand, Swift and Company shows in its income statement a substantial item titled "Loss on sale, dismantling and retirement of fixed property, etc.—net", whereas two large items "applicable to prior years" are carried directly to surplus.

4. National Breweries Ltd. carries three relatively small items directly to surplus.

**Surplus Statements**

The reporting of all income items in the income statements would make an earned surplus statement unnecessary or reduce it to one of relative unimportance. The "extra-ordinary" charges and credits to income should be clearly identified in the body of the income statement, but only one net income figure should appear on the statement. The Frank G. Shattuck Company follows this plan very effectively. All income items are charged on the income statement. In the earned surplus section of the balance sheet the balance at the beginning of the year is shown, net income for the year is added, and dividends paid during the year are deducted. An earned surplus statement is not necessary. The International Harvester Company shows dividends declared and "Net income retained for use in the business" below the income statement. An analysis of surplus appears in two schedules instead of in the balance sheet. The presentation of Frank C. Shattuck Company is recommended.
In 29 other reports the earned surplus analysis is combined with the income statement. Where extraordinary charges are made to surplus, the combined statement of income and earned surplus minimizes to some degree the possibility of losing sight of such charges in calculating the company's long-run net income.

In 68 of the reports the surplus analysis is shown in a separate statement or statements. In the case of 16 of these reports, there are separate earned surplus statements. In 18 reports, separate statements for earned surplus and paid-in surplus are given. Thirty-two of the reports contain a classified surplus statement—surplus being shown by types within the one statement. The Plomb Tool Company report does not contain a surplus statement nor even an indication of the amount of surplus. Two other reports contain a "surplus statement" in which earned and paid-in surplus items are combined without any differentiation.

A primary weakness in the reports is the failure to show surplus reserves in the proper relationship to surplus in the balance sheet and in surplus statements. Seventy-three of the reports contain one or more "reserve" items (most of which are surplus reserves) on the balance
sheet between the liability and proprietorship sections. It is the exceptional surplus analysis which includes surplus reserves.

A weakness of special importance to stockholders is the failure to show separately the surplus for the parent company and the other consolidated companies. The Standard Oil Company (New Jersey) report is the only one noted in which such a breakdown is given. Several restrictions on the use of surplus were noted either in the body of the earned surplus statement or in a note to the financial statements. All restrictions should be specified.

**Dividends**

A recent public-opinion poll reveals that one third of the people think business in general is making too much profit. Mere "bigness" was often taken to mean high profits. The public's estimate of profits averaged 25 percent on both sales and capital invested. The fact that people do not

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9 The Cudahy Packing Company and the Food Machinery Corporation reports are notable exceptions.

have the truth about business is rightfully deplored. It is further observed that the judgment of high profits may be based on the amount of profit and that this amount is not related to the capital investment. These and other points in the survey report raise the question of what managements have been telling about their earnings, dividends, return on capital investment in annual reports.

Preferred Stock Dividends. Fifty-nine of the 100 corporations whose reports are included in the study have preferred stock outstanding. Other than an indication in the surplus analysis of the amount of preferred dividends, together with the dividend rate, relatively few reports contain additional coverage on preferred dividends.

Earnings coverage for preferred shares is not ordinarily given. Coverage was noted in only four reports. Of these four, three of the companies have bonds preceding the preferred stock. It was disappointing to find that in each case\textsuperscript{11} the prior deductions method was used in computing the number of times the annual preferred dividends were earned. Instead, it is absolutely essential that the bond interest and preferred dividend be taken

\textsuperscript{11} American Rolling Mill Company, International Minerals & Chemical Corporation, and Universal Pictures Company, Inc.
"Earnings per share" of preferred stock has some significance and should be calculated more often and correctly in the reports. To be of most value, however, the figure should be available for a series of years.

A number of reports show by way of a table or chart the amount of preferred dividends paid for each of several years. Amounts paid have little meaning when given without relation to the stock outstanding, par or other value per share, dividend rate, or times preferred dividend requirements. A note to the effect that preferred dividends have been paid regularly for a given period of time would serve essentially the same purpose as a list of amounts.

Common Stock Dividends. Ninety-two of the reports show for one or more years dividends paid per share of common stock. Eighty-seven reports show the earnings per share, and 22 show the book equity per share. In addition to or in connection with "per share" presentations, amounts paid are often shown. A few reports contain amounts paid

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13 The amounts given for 30, 45, and 45 years by General Motors Corporation, Eastman Kodak Company, and United States Steel Corporation respectively are of little value though given for a long period of years. The fact that Eastman's dividend payment has remained the same since 1905 does tell one that the preferred stock outstanding has remained unchanged.
for a long period of years but "per share" data for only one or two years. Two reports contain market value per share figures for a series of years. Thus, four different "per share" figures are used in the reports.

**Earnings Per Share.** The earnings rate or annual earnings per share, expressed either in dollars or as a percentage of a $100 par value, is often used as a basis of appraisal of the "value" of common stock. Too often, the financial press and investors give too much weight to current or past "per share" earnings. Financial experts, accountants, and others are aware of the probable error in every "earnings per share" figure and that such figures can only be used as a cue to estimating future earnings per share. Income statements and "earnings per share" figures are significant to the extent that they can throw light on the earning capacity of the business. Do annual reports contain sufficient and valid earnings per share data?

The 37 reports give earnings per share for the number of years as shown below:

16 - 1 year
25 - 2 years
1 - 3 years
1 - 4 years
11 - 5 years
5 - 6 years
3 - 7 years
1 - 8 years
1 - 9 years
9 - 10 years
It is obvious that these annual reports tend to stress the importance of earnings per share for one, two, or a few years. Only 33 percent of the reports contain data for more than five years, and certainly a five-year span is too short. Per share data should be given for at least a ten-year period.

There are some weaknesses of less importance in some of the presentations. Instead of showing "earnings per share," the Carrier Corporation uses "available per common share." "Available" is the wrong word, and particularly in this case when earnings per share were 53 cents for 1945 and 3 cents for 1946. The Duplan Corporation gives "profit per share" for 1945 and 1946, "earnings per share" for 1945 and 1946, and "earned on common" for 1937 through 1946. This represents unnecessary duplication and definite overemphasis of the importance of the

14 Like many report writers, someone with Carrier and Duplan sought new terms. Many innovations, including these, in current reports do not make the data more accurate, complete, clear, or interesting.
data. It is stated in the Walt Disney Productions report that:

"Net income after all charges for the 1946 fiscal year was $199,602. This was equal, after providing for preferred dividends accumulated during the year but not paid, to 26 cents a share on the 652,840 shares common stock now outstanding."

A similar statement is made pertaining to 1945. It is doubted that earnings per share on the common has any significance when preferred dividends are not being declared.

**Common Dividends Paid Per Share.** Not as much dividends per share data was included in the reports as for earnings per share. The 92 reports give dividends per share for the number of years as shown below:

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15 1946 Annual Report, p. 5.
Only 26 percent of the reports contain dividends per share data for more than five years as compared with 38 percent for earnings per share data. Similarly, 62 percent of the reports give data for only one or two years whereas the comparable earnings per share percentage is 47 percent.

The dividend rate and record are important considerations in investor decisions. The dividend record should be studied in relation to the earnings record, but of the two the dividend record is of far more importance. Emphasizing earnings to stockholders, employees, and others in preference to dividends is unfortunate. The impressive earnings per share figures suggest high profits for the benefit of stockholders. Employees take this to mean that higher wages should be paid and others that product prices should be lowered. The stockholder tends to "value" his stock in terms of the per share earnings showing. The enterprise definitely weakens its own case with employees, the public, and possibly with stockholders, by emphasizing earnings rather than dividends. Stockholders should discount their interest in the earnings which are withheld as stockholders usually derive much greater benefits from dividend payments than from additions to surplus.16

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16 This is true, according to Graham and Dodd, because either: "(a) the reinvested profits fail to add
Dividend Policy Explanations. Twelve of the reports contained explanations of dividend policy. Most of these statements are generalizations intended to show stockholders that they are being benefited through the withholding of a portion of earnings. United-Rexall Drug, Inc. and Simplicity Pattern Co., Inc. attempt to prove the validity of their reasoning by reference to charts. The president of Rexall states:

"On the basis of operating results at the close of the third quarter, 1946, the Directors of your Company declared on November 25, 1946, a dividend of 12½ cents a share on the outstanding shares of $2.50 par value common stock, payable January 2, 1947, to stockholders of record as of the close of business December 9, 1946. This was the first dividend paid on the common stock of your Company since 1937. On February 26, 1947, the Directors of your Company declared another dividend of 12½ cents a share on the outstanding shares of $2.50 par value common stock of your Company, payable April 2, 1947, to stockholders of record as of the close of business March 10, 1947. These two dividends represent the payment of $865,840 to stockholders.

"Previous to these dividends, your Board of Directors believed it advisable to retain earnings for general corporate purposes. The benefits of this policy are reflected in the increases in the book value of the common shares during the past five years (Chart IV)."17

--Graham and Dodd, op. cit., p. 337.

Earnings were retained "for general corporate purposes" for a ten-year period. Management hopes to justify this action by referring to increases in book equity per share over the last five years. Do you wonder about book equity during the other five years? In any case, book equity increases cannot possibly substantiate the "benefits" of the policy.18

Simplicity Pattern Co., Inc. explains:

"Simplicity has consistently reinvested most of its expanding earnings in the business. These charts show how this policy has strengthened the Company's financial position over the past ten years. Net worth up 200 per cent. Working capital up 490 per cent. During this period, too, the ratio of current assets to current liabilities has risen from 1.4 to 1. to 3.2 to 1."19

18 Two related points are interesting. Another chart shows that earnings per share decreased consistently from 1941 through 1945. Earnings per share are a better index of the benefit to stockholders of retained earnings than are book value figures.

The following announcement from the president means that the Company's executives benefited from the policy:

"In February, 1946, your Board of Directors approved a profit-sharing and incentive plan for Company executives. At their own request, the Chairman of your Board and your President were specifically excluded from the plan. On the basis of the formula approved by the Board, the maximum sum available for 1946 as additional compensation for executives amounted to $267,450. The Board, however, voted to limit the amount to $200,000."

The executives received a bonus in one year amounting to almost one-fourth of common stock dividends in ten years! 19 1946 Annual Report, p. 6.
Three bar charts show "Working Capital," "Net Worth," and "Profits from Sale of Patterns" for 1937 and 1946. Such charts always cause one to wonder what happened in the intervening years. A misplaced subcaption in the "Profits from Sale of Patterns" chart shows "Before Taxes." Profits "before taxes" is shown at $988,343. The income statement shows that profit "after taxes" was $563,343.

In view of the purpose of the chart, to give any figure other than net income for the year is inaccurate. However, the data in neither of the charts can prove the point. The best way to support the withholding of earnings would be to show that the rate of return on the investment has increased over the period of the withholdings.

These two reports try to explain the past dividend record. The following one makes a promise for the future:

"During the fiscal year 1945-46, regular dividends of 2514 cents per share and extra dividends of 10 cents per share were paid to holders of the Company's Common Stock.

"On October 29, 1946 the Board of Directors voted to increase the regular Common Stock dividend to 40 cents per share per annum and also approved an extra dividend for the final quarter of the 1945-46 fiscal year, of 5 cents per share.

"If operations next year conform to the budgeted plans of the Company, both the new regular dividend and the extra dividends can be paid, which will result in a total annual dividend of 60 cents per share."20

Book Equity Per Share. Graham and Dodd determine
the book equity per share of common stock by adding up all
the tangible assets, subtracting all liabilities and stock
issues ahead of the common, and then dividing by the number
of shares. Thus, equity per share is an average derived
from the balance sheet as earnings per share is an average
derived from the income statement. As the income statement
is relatively more important than the balance sheet, so
equity per share is not as significant as earnings per share.
Investors should place little weight on book value per share
showing but they may profitably compare book value per share
with the market price per share.

Twenty-two of the reports contain equity per share
data. The following breakdown shows the number of years
for which the data is given:

6 - 2 years
1 - 3 years
2 - 5 years
3 - 6 years
1 - 7 years
4 - 10 years
1 - 11 years
1 - 15 years
1 - 18 years

21 Ibid., p. 435. If tangible assets are on the
books, the formula will not give book value per share.
Except for a conservative bias, there is no inherent justi-
fication for omitting goodwill and other intangibles from
the asset list.
Only fifty percent of the reports contain data for more than five years. At least a period of ten years is indicated.

**Market Value Per Share.** Two of the reports give some market information on common stock. Minnesota Mining & Manufacturing Company gives "approximate market value at end of year" for the last 18 years, and Belden Manufacturing Company gives the following summary from transactions in its stock on the Chicago Stock Exchange for 1942 through 1946: shares traded, high, low, close, yearly net change.

It is believed that these two companies have taken a progressive step. Managements who want to give the public "the facts" and to educate the public to a better understanding of "profit," "corporate enterprise," etc. should weigh carefully the desirability of comparing for a period of twenty years the following "per share" data: Earnings, dividends, equity, market value. These management groups must include data on the dividend and earnings ratios for a period of years.22

---

22 Graham and Dodd define these terms as follows:

The dividend ratio, dividend return or dividend yield, is the ratio of the dividend paid to the market price (e.g., a stock paying $6 annually and selling at 120 has a dividend ratio of 5%).

The earnings ratio, earnings return or earnings yield is the ratio of the annual earnings to the market price (e.g., a stock earning $6 and selling at 50 shows an earnings yield of 12%)."--*Op. cit.*, p. 333.
Such data and suitable comparisons and comments would be enlightening to all report-reader groups. "Market value" is not to be ignored by management or investors. The rate of return (dividends and earnings) on the company's investment is highly significant to stockholders, employees, and the general public. The dividend and earnings ratio is of special importance to individual investors.

Return on Investment. A group of stockholders invested $1,000,000 (for 25,000,000 common shares) cash in the X Corporation on January 1, 1946. Employees were hired. The general public paid certain prices for its products. Net earnings for 1946 amounted to $100,000. Dividends of $80,000 were paid. The decisive profit question to these stockholders, employees, and the general public is the rate of return to stockholders on capital invested. Net income of 10 percent was earned on the capital invested. Dividends were paid at the rate of 8 percent on capital invested. Putting it in these terms is more meaningful than on a per share basis:

1. Earnings or dividends of 50 cents per share may be a large or small relative amount, depending on the original per share investment and the volume of accumulated earnings.

2. Per share figures are not comparable when some earnings are withheld each year, which is almost
always the case. When a portion of earnings are withheld each year per share amounts should be expected to increase.

In view of the key importance of the rate of return on capital invested, it is surprising that the reports with few exceptions contain no such coverage. Data of this type ought to be included in every annual report for a period of twenty or more years.

Profit Per Dollar of Sales. After reviewing the report of a survey of public opinion, a writer in The Commercial & Financial Chronicle concluded that the survey showed: "(1) the effect upon public thinking created by labor leaders' oft-reiterated claim that corporations make exorbitant profits and (2) the general poor public relations job done by business management in acquainting the public with the facts".24

23 These include: Celanese Corporation of America, chart covering the years 1939 through 1946; International Harvester Company, an excellent chart covering the years 1941 through 1946; Standard Oil Company (New Jersey), for 1945 and 1946; Swift and Company and West Virginia Pulp and Paper Company for 1946.

United States Steel Corporation includes a column in its 45-year financial summary captioned "% Income of Investment." However, this caption is not accurate for a note below the table explains that "Income before interest, but after all other charges, was used to determine the percent income of investment."--See 1946 Annual Report, p. 27.

The first part of this statement does not appear surprising since labor leaders and even others had talked of high corporate profits. The second part is certainly not objectionable since sound public relations must be based on "the facts." Nevertheless, the conclusions were unwarranted for the survey pertained not to the relation of net profit to investment but to the question of: "Out of each dollar taken in by American business corporations from sales of their products, how much do you think is left as net profit after paying for wages, materials, all other expenses and income taxes?"

Exorbitant profits cannot be proved or disproved by an indication of the portion of the sales dollar which goes to the stockholder and is retained in the business. These are not "the facts" which are pertinent to annual report readers. Rate of return on investment is the important fact, but as noted in the above section, management has not emphasized it. More often, management has used the division of the sales dollar in an attempt to prove that reasonable or even meager profits have been earned.

Forty-two of the reports give a breakdown of the sales dollar for one or more years. In the case of breakdowns for one year, the pie chart is ordinarily used. Unquestionably most and probably all of these charts are based on correct facts. The charge against these breakdowns of
the sales dollar is twofold. In the first place, a break-
down for one year provides no fact of value. The portion
going to materials, wages, stockholders, etc. varies widely
from one industry to another. When the data is given in a
pie chart without interpretation the only objection is that
unimportant relationships are being emphasized when a
relationship such as profit to investment is omitted entirely.

In the second place, the facts shown may be mis-
leading and in several of the reports the facts are used as
a basis for wholly inaccurate conclusions. The most strik-
ing example is in the Sunshine Biscuits, Inc. report. In
"A Message to the Stockholders," the chairman of the board
of directors and the president reason in the following vein:

"Net earnings of the Company for 1946 were
$6,365,443.01, or the equivalent of $6.23 per share.
Net earnings of the previous year were $2,633,022.31,
or the equivalent of $2.58 per share, on the new
capital stock.

"We feel very earnestly that the time has come
for stockholders and the public in general to be
told a few fundamental truths concerning some of
the many economic fallacies and mis-statements
that are being made in many places concerning busi-
ness in general.

"Probably no greater misconception exists in
the country today than the one concerning the
'exorbitant' profits which business generally is
supposed to have made during the war years. Cer-
tainly when we consider, that by government figures,
the workers in American industry at the present
time receive $.68 out of a sales dollar, and that
the owners of business receive less than $.06 out
of a sales dollar, it is absurd for economists or
others to talk about being able to increase wages 25% without increasing prices. 25% of 66 is approximately 22½, and by no stretch of the imagination or by any new type of arithmetical juggling can 22½ cents be deducted from 6 cents and still leave anything but a substantial deficit for the owners of the tools of production, or as an incentive to invest new capital in enterprise, which is the life blood of American business.

"We believe it is time that the American public be told in plain language that without private investment, there can be no jobs in American industry, there can be no production, there can be no machinery or factory buildings, there can be no industrial establishments, unless we want to establish a totalitarian government in America.

"In our particular industry, it takes an investment of approximately $6,500.00 per employee before there can be any job for anybody. Somebody has to save that money, somebody has to abstain from spending that money, to the extent of $6,500.00 for every single employee in the food industry. The Company obviously does not keep the cash, it converts it into buildings, machines, the most modern and best equipped bakeries in the country. We believe that under the American free enterprise system, the people who invest money in Sunshine Biscuits, Inc. have a right to expect fair returns on it.

"Just how fair have these returns been to the investors of Sunshine? An examination going back for over thirty years of the earnings on the sales dollar of Sunshine Biscuits, discloses that in 1916 the net earnings of the Company were approximately 4½ cents out of the sales dollar. In 1926, they were 3.85 cents. In 1936 they were 3.05 cents.

..."
for supplies, for transportation, for salaries, for taxes, deductions for depreciation and repairs, and for general overhead. Nor can we overlook the fact that the total earnings of the Company, which as we have seen have ranged from 3 to 4 cents out of the sales dollar, provide not only the dividends which are paid to the stockholder, but must also provide the monies necessary for the guarantee of continued progress, continued modernization, continued expansion, continued employment, by reinvestment in the business to keep the employees at work.

"Over the same period of time, the direct payroll costs of our Company have been between 25 and 30 cents of the sales dollar, to which must be added the labor costs of the materials that we purchased, the transportation services, the supplies and miscellaneous payments made by the Company and which, from the Company point of view as a whole, represent another 30 to 35 cents of the sales dollar as direct labor costs. Thus from 60 to 65 cents out of the Sunshine sales dollar is direct payroll cost, that is, payment for labor.

...

"...The truth is that by and large business has not made the 'fantastic' profits which are being charged against it; that the government through its tax system has effectively siphoned off most of the excess profits which were naturally made during the war because of the tremendously expanded production which gave larger dollars and cents sales, and larger dollar profit figures, but smaller percentage profits. A sober, honest, and fair revision of the entire tax structure at the present time is called for so that business men will be able to plan with confidence and price their goods accordingly. But at the same time the American people should be more fully informed regarding the tax structure and its effect upon business, the profit making structure of our American system, and should be told the share of the earned income which has been going to employees, for the payment of raw materials, for the use of the tools of transportation and other producing agencies, and by comparison the very small and certainly modest share that has gone to the owners of the
business establishments which make jobs, which make employment, and which are responsible for the progress of America."25

These observations are pertinent:

1. The statement is one of propaganda.

2. The "arithmetical juggling" results in wholly inaccurate reasoning and conclusions.

3. The Company did not mention the key fact in the profit question: the rate of return on the capital invested in the Company for 1946 and prior years. (According to the financial statement for 1946, a return of approximately 25 percent was earned on the capital invested, and cash dividends were paid at the rate of about 12 percent. Financial data is not given for prior years.)

Footnotes to Financial Statements

Explanations of items on financial statements often appear below the balance sheet and the income statement, on one or more pages separate from these statements, in the president's letter, and parenthetically in the body of the statement. Usually, brief parenthetic explanation is not sufficient. If space permits, the most desirable location is below the respective statements. Because of the number

of explanations used, the most common current practice is to present "notes to financial statements" on a separate page.

Seventy-eight of the 100 reports contain one or more footnotes or notes to the financial statements. Many of the presentations would be improved if each note were numbered and keyed to the item or items in the statement(s) to which it applies, and written in specific non-technical language. The following are samples of non-informative notes:

"All emergency facilities completed on September 29, 1945, were fully amortized prior to January 1, 1946, although many are still in use. There are no charges against 1946 income nor will there be charges against income in future years for depreciation or amortization of such facilities." 26

"Selling, general and administrative expenses include additional compensation to management, $137,121 and $83,962 in 1946 and 1945 respectively, based on consolidated profits before income taxes." 27

The cost of the emergency facilities should be given and the amount of regular compensation to management should be shown. Explanations which omit basic figures are worthless.


27 1946 Annual Report of Simplicity Pattern Co., Inc.
The notes, like other sections, should always be set in type which makes for easy reading. Preferably a note is given at the bottom of the statement "See page (number) for explanatory notes." It is improper to place the notes on a page prior to the balance sheet and income statement.

In the case of some of the 22 reports which contain no notes, the explanations of certain items appear in the president's letter and in parenthetical comments in the body of the statement. It is by these means that Caterpillar Tractor Company avoids the use of footnotes. It is believed, however, that the financial statements section of the report is the logical place for the explanations. For example, the five items appearing under the caption of "Comments on the Balance Sheet" in the Belden Manufacturing Company report should be shifted from the president's letter to the bottom of the statements. The omission of explanatory notes completely is not encouraged. Such omission ordinarily means oversimplification.

**Auditor's Certificate**

All of the reports contained auditors' certificates except for the Plumb Tool Company report. Only twenty-seven of the certificates contained exceptions or qualifications. Nine of these exceptions pertained to the inability to verify
government receivables and nine to the acceptance of verification of foreign subsidiary accounts by other accountants. Four dealt with the effect of a change in inventory valuation.

The certificates would be more helpful to readers of annual reports if the following practices were followed consistently:

1. The certification should include a reference to all explanatory notes, comparative statements, surplus statements, and schedules. (See the certificates in the Caterpillar Tractor Company, International Harvester Company, and International Minerals & Chemical Corporation reports.)

2. All consolidated subsidiaries should be identified by name and state of incorporation in the body of the certificate, in a separate schedule, or in a footnote to the consolidated balance sheet. (This procedure was followed only in the case of a few companies which had only one or two subsidiaries.)

3. An explanation should be made by management as to what the auditor's certificate means and what it does not mean. Editorially, the Journal of Accountancy suggests an explanation such as the following:
"Your company has retained certified public accountants to conduct an independent audit of the financial statements which are reproduced in conjunction with this report, together with the auditors' report of their findings.

"The auditors do not guarantee the financial statements: they are not insurers. But they are experts who are entirely independent of the management. The purpose of their work is to test the validity of the company's accounting and check the judgment of the management in presenting its financial position and results of operation in accordance with generally accepted accounting principles. Stockholders should read and consider what the auditors say."28

In addition to the auditor's certificate, five reports contain a signed certification by the controller of the company. Such certification depreciates the value of the independent auditor's certificate and of itself adds nothing. It should not be used in the annual report.

The certificates in the 99 reports were signed by 29 different accounting firms. Six firms certified 68 reports.

Selected Bibliography

Accounting Research Bulletins, American Institute of Accountants, New York:

No. 8, "Combined Statement of Income and Earned Surplus," February 1941, 4 pages.

No. 12, "Report of Committee on Terminology (Surplus)," September 1941, 3 pages.


No. 26, "Accounting for the Use of Special War Reserves," October 1946, 5 pages.


No. 31, "Inventory Reserves," October 1947, 4 pages.

No. 32, "Income and Earned Surplus," December 1947, 8 pages.


CHAPTER 9

COMPARATIVE STATEMENTS AND OTHER COMPARATIVE DATA

Annual-report readers need factual financial information as a basis for reaching conclusions or making decisions. Facts and figures of the past are essential to the making of sound decisions. The stockholder should use the facts of the past in determining whether to buy, hold, or sell; the employee needs facts in appraising the position of the company, his welfare as related to the company, etc. The general public, collectively, needs corporate facts in determining public corporate policy, and individuals need facts in arriving at decisions with reference to their attitudes toward and associations with particular corporations. Financial facts of the past can only roughly indicate present status and future possibilities in a very limited way. Financial facts for one year are not enough. It is a comparison of the figures of past years which may be most useful in appraisals of past operations and relationships and in estimates of what the company can or may do in the future. It is essential therefore that all annual reports include comparative data covering at least the period of a business cycle, or a period of 10 to 20 years.

In 1940 the American Institute of Accountants, in recommending the extension of the use of comparative state-
ments in annual reports, said:

The increasing use of comparative statements in the annual reports of companies is a step in the right direction. The practice enhances the significance of the reports, and brings out more clearly the nature and trends of current changes affecting the enterprise. The use of statements in comparative form serves to increase the reader's grasp of the fact that the statements for a series of periods are far more significant than those for a single period -- that the statements for one year are but one installment of what is essentially a continuous history.¹

**Comparative Income Statements.** Fifteen of the 100 reports contain income statements covering only one year. The other 85 reports contain statements covering the following years:²

- 66 -- 2 years only
- 29 -- more than 2 years

The twenty-nine reports containing income statements for more than two years provided coverage as follows:

<table>
<thead>
<tr>
<th>Coverage</th>
<th>Number of Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 -- 4 years</td>
<td>1 -- 8 years</td>
</tr>
<tr>
<td>2 -- 5 years</td>
<td>10 -- 10 years</td>
</tr>
<tr>
<td>2 -- 6 years</td>
<td>3 -- 11 years</td>
</tr>
<tr>
<td>2 -- 7 years</td>
<td>1 -- 15 years</td>
</tr>
</tbody>
</table>

In general, the annual reports do not show a realiz-


² A few reports contain statements for two years and for a longer period of years. The shorter period is disregarded in these computations. Some of the comparative statements follow the conventional statement pattern, but a few follow a new statement pattern. These differences are not germane to the present analysis.
tion of the reader's need for comparative income statements. Fifteen percent of the reports do not contain comparative statements; 66 percent contain income statements for only two years; only 14 percent contain statements for ten or more years. Such meager coverage means that most of the reports are incomplete and inaccurate. They are inaccurate because the reader is not given sufficient information on which to base reasonable estimates.

**Comparative Balance Sheets.** Comparative balance sheet coverage in the reports is about the same as for income statements. The breakdown on the 100 reports is as follows:

- 19 -- No comparative balance sheets
- 54 -- Comparative balance sheets for two years only
- 27 -- Comparative balance sheets for more than two years

---

3 It is interesting to note that many years ago the need for comparative balance sheets was recognized. In 1910, John Neene wrote: "...assuming the financial status as of a given date to be correctly shown, a single balance sheet may convey materially misleading impressions, and is sometimes little more than "an array of attractive figures." In one instance may be indicated a state of marked financial strength and apparent prosperity, yet the business may be retrograding; while, in another instance, a weaker showing absolutely may be far stronger relatively, because of superior manufacturing and selling organizations, which make for reduced costs, rapidly growing sales and enhancing profits.

Chapter II

The chapter discusses the method and practice for calculating the cost of income tax. The method involves combining all relevant income tax data from the previous years to determine the overall tax liability. The table below shows the income and expense data for the past five years:

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
<th>Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>1000</td>
<td>500</td>
</tr>
<tr>
<td>2016</td>
<td>900</td>
<td>400</td>
</tr>
<tr>
<td>2015</td>
<td>800</td>
<td>300</td>
</tr>
<tr>
<td>2014</td>
<td>700</td>
<td>200</td>
</tr>
<tr>
<td>2013</td>
<td>600</td>
<td>100</td>
</tr>
</tbody>
</table>

The table shows that the company's income has been decreasing over the past five years, while expenses have remained relatively constant. This trend suggests that the company may need to adjust its expense management to improve its overall financial performance.
There is unnecessary duplication in the comparative statements in most of the reports which have data for two years and for a longer period. The two-year presentation is worthless unless a column is added to show "increase or decrease" or "percentage change" of each item for 1946 over 1945.

On several of the comparative statements there is added, usually below the statement, some summary supplementary data which obviates the necessity of the reader making some detailed computations. The following types of data are found on one or more of the comparative balance sheets:

- Average per employee per item
- Book value per share
- Net assets per share
- Net current assets per share
- Averages for one or more periods of years
- Working capital ratio
- Amount of working capital

Similar data appearing with comparative income statements follow:

- Earnings per share
- Dividends per share
- Per share earnings reinvested in business
- Net income as per cent of sales
- Percentages of net sales
- Averages for one or more periods of years
- Ratio of net income to capital invested

**Supplementary Statements and Schedules**

The balance sheet and the income statement may be
supplemented by one or more surplus statements, a statement of funds applied and provided, or a statement of working capital. More detailed information on one item or section of the balance sheet is sometimes given in a separate schedule. Many of the reports contain one-page financial summaries consisting of a variety of data. These devices are used in the 100 reports are reviewed briefly.

**Surplus Statements.** Surplus adjustments are more important than the comparative data in the reports suggest. Surplus analyses for more than two years are rare. The Allied Stores Corporation and United Specialties Company reports contain excellent surplus statements for ten-year periods. Comparative statements such as these should be a part of the report for these companies which carry unusual revenue and cost items directly to surplus. A comparative earned surplus statement is not essential for these companies which pass all revenue and cost items through the income statement. In the latter case, however, a comparative paid-in surplus statement might be needed, depending on the relative importance of such transactions.7

Statement of Funds. This statement is referred to variously as a "Statement of Funds," "Statement of Sources and Disposition of Funds," "Where-Not-From Statement," "Statement of Changes in Financial Position," etc. The statement is intended to show the source of funds and the things for which funds have been applied. It is helpful in explaining what has been done with profits earned and the flow of funds to and from working capital.

The statement has some technical limitations which explain in part the fact that only 11 of the 100 reports contain such a statement. Five of these are for one year, one for two years, three for five years, one for eight years.

8 In annual reports, the statement now often carries "working capital" as a part of the title. This is contrary to the early development of the statement and is probably explained by the fact that "funds" is a vaguer concept than "working capital." Three of the statements were given without titles; one of these was referred to in a narrative explanation as such funds received during the year and how they were used." (It is incorrect to refer to the funds as "cash".) The titles of the other eight statements are: Ten-Year Analysis of Working Capital Five-Year Summary of Changes in Consolidated Working Capital Summary of Increase in Working Capital Sources and Disposition of Working Capital Condensed Summary of Sources and Disposition of Funds Sources of Funds and Their Disposition Summary of 1946 Financial Operations Sources and Disposition of Net Current Assets

one for ten years, and one for fourteen years.\textsuperscript{10} Wider use
of the statement has been advocated\textsuperscript{11} with propriety but
the need for extended use is secondary to the need for
adequate comparative balance sheets and income statements.
For illustrative purposes, the ATF Incorporated statement
is shown on page 338.

\textbf{Statement of Working Capital Changes.} Only three
of the reports contain separate statements showing working
capital changes. The General Foods Corporation statement
entitled "Net Working Capital" is shown on page 338. This
statement is sometimes used as a schedule to the item on
the statement of funds showing the amount of the increase
(or decrease) in the working capital during the period. The
new type of balance sheet used by Caterpillar Tractor Com-
pany, United States Steel Corporation, and others\textsuperscript{12} shows
the current liabilities deducted from the current assets,
consequently there is no point in a statement of working
capital changes accompanying that type of comparative state-
ment. Even in the case of the remaining reports, a sepa-
rate statement is not essential. Listing the working capital
ratio for each year at the bottom of the comparative balance
sheet sufficiently emphasizes working capital.

\textsuperscript{10} The latter two statements are for the ATF Incor-
porated and Caterpillar Tractor Company.

\textsuperscript{11} See, for example, George D. McCarthy, "Funds State-
ment Can Make Financial Statements Easier to Understand,"

\textsuperscript{12} See \textit{same}, Chapter 6, page 197.
ANALYSIS OF WORKING CAPITAL
Year Ended March 31, 1947

Net working capital—beginning of period................. $7,299,376

ADDITIONS:
Net income for the year........................................ $ 913,676
Add back non-cash deductions reflected in above profit:
Depreciation and depletion..................................... 627,768
Postponed tax charges on instalment sales profits
(net).................................................................. 125,000
Liquidation of miscellaneous investments.................. 7,356
Total additions...................................................... $1,673,820

DEDUCTIONS:
Net expenditures for properties................................ $ 805,046
Prepayment of expenses.......................................... 85,078
Dividend payments................................................ 264,050
Other deductions (net)........................................... 12,344
Total deductions.................................................... $1,184,518

Net increase in working capital.............................. $ 489,302
Net working capital—end of period............................ $7,788,678

NET WORKING CAPITAL

<table>
<thead>
<tr>
<th></th>
<th>Dec. 31, 1946</th>
<th>Dec. 31, 1945</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(millions of dollars)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CURRENT ASSETS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash.............</td>
<td>$ 21.2</td>
<td>$ 18.3</td>
<td>$ 2.9</td>
</tr>
<tr>
<td>U. S. and Canadian securities</td>
<td>...</td>
<td>20.5</td>
<td>- 20.5</td>
</tr>
<tr>
<td>Excess profits tax refund</td>
<td>...</td>
<td>1.2</td>
<td>- 1.2</td>
</tr>
<tr>
<td>Accounts Receivable (less reserves)</td>
<td>24.3</td>
<td>19.4</td>
<td>+ 4.9</td>
</tr>
<tr>
<td>Inventories................</td>
<td>60.0</td>
<td>65.5</td>
<td>- 14.5</td>
</tr>
<tr>
<td>Total...................</td>
<td>$125.5</td>
<td>$124.9</td>
<td>$ 0.6</td>
</tr>
<tr>
<td>CURRENT LIABILITIES</td>
<td>32.4</td>
<td>32.4</td>
<td>- 0.0</td>
</tr>
<tr>
<td>NET WORKING CAPITAL</td>
<td>$ 93.1</td>
<td>$ 91.5</td>
<td>$ 1.6</td>
</tr>
</tbody>
</table>

13 This is the 1947 section of the "Ten-Year Analysis of Working Capital" statement from the 1946 Annual Report of AIT Incorporated, pp. 84-85.

Miscellaneous Schedules. Reference was made in Chapter 5 to the desirability of complete breakdowns in separate schedules of certain items or sections of the balance sheet. Giving the detail in a separate schedule is an excellent way to simplify the balance sheet for lay readers and at the same time to supply adequate data for those who are qualified to work with the detailed data. Comparative breakdowns of marketable securities, receivables, inventories, investments, plant and equipment (including current depreciation and accumulated allowances), intangibles, deferred charges, other assets, accruals, and long-term debts might be given in schedules. About twenty of the reports contain at least one such schedule. Wider use of the device is advocated. A schedule of "Investments" and one of "Bad Debt Losses" are given on pages 340 and 341 for illustrative purposes.

Financial Summary Page. Fifty-four of the reports contain one-page financial summaries. These pages are given captions such as "1936-1946 Record of Operations," "Highlights of the Year's Operations," "Facts in Brief," "Harvester Facts at a Glance," "10-Year Record," "1946 in Brief." Most of the data, as should be the case, is on a comparative basis for two or three years. The page is preferably placed as one of the first few pages.

There is a great variety of data given. The variety in terms of years covered, type of information, and detail
### INVESTMENT IN SUBSIDIARY COMPANIES

<table>
<thead>
<tr>
<th>Company</th>
<th>Oct. 31, 1946</th>
<th>Oct. 31, 1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Harvester Company</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>International Harvester Company of Australia, Proprietary Limited</td>
<td>9,255,185</td>
<td>9,155,876</td>
</tr>
<tr>
<td>International Harvester Company of Canada, Limited</td>
<td>16,728,822</td>
<td>16,215,973</td>
</tr>
<tr>
<td>Aktieselskabet International Harvester Company, Denmark</td>
<td>407,105</td>
<td>407,105</td>
</tr>
<tr>
<td>Cima-Wallut, France</td>
<td>5,424,702</td>
<td>5,393,950</td>
</tr>
<tr>
<td>International Harvester Company of Great Britain, Limited</td>
<td>1,608,488</td>
<td>1,599,652</td>
</tr>
<tr>
<td>International Harvester Company of Mexico (S. A.)</td>
<td>653,049</td>
<td>71,650</td>
</tr>
<tr>
<td>International Harvester Company of New Zealand, Limited</td>
<td>1,440,000</td>
<td>1,440,000</td>
</tr>
<tr>
<td>International Harvester Company (S. A.) Proprietary Limited</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(South Africa)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compania Internacional de Maquinas Agrícolas (Spain)</td>
<td>173,430</td>
<td>173,430</td>
</tr>
<tr>
<td>Aktiebolaget International Harvester Company (Sweden)</td>
<td>1,581,136</td>
<td>1,588,109</td>
</tr>
<tr>
<td>*International Harvester Export Company</td>
<td>10,704,677</td>
<td>10,566,257</td>
</tr>
<tr>
<td><strong>Miscellaneous:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Companies operating in foreign countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>States operating in the United States</td>
<td>980,999</td>
<td>1,456,259</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$59,688,956</td>
<td>58,767,145</td>
</tr>
</tbody>
</table>

The above total investment of $59,688,956 is represented by net assets of subsidiary companies having an estimated value in the aggregate somewhat more than this amount.

*Exports from the United States and operates in Belgium, Holland, British East Africa, Brazil and Uruguay.*

---

15 From the 1946 Annual Report of International Harvester Company, p. 25. Preferably the schedule would have been keyed to the investments item in the balance sheet.
BAD DEBT LOSSES

Bad debt losses (net of recoveries) for the year were $141,722, or 48/100 of one per cent of net sales as compared with 11/100 of one per cent of net sales for the preceding year. Our experience for the last ten years is shown in the accompanying table.

<table>
<thead>
<tr>
<th>Year</th>
<th>Outstanding Accounts at Close of Year</th>
<th>Bad Debt Losses Less Recoveries</th>
<th>% of Loses to Net Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937</td>
<td>$1,555,867</td>
<td>$34,883</td>
<td>.55</td>
</tr>
<tr>
<td>1938</td>
<td>1,649,559</td>
<td>68,733</td>
<td>1.19</td>
</tr>
<tr>
<td>1939</td>
<td>1,679,130</td>
<td>58,499</td>
<td>.97</td>
</tr>
<tr>
<td>1940</td>
<td>1,699,754</td>
<td>44,297</td>
<td>.69</td>
</tr>
<tr>
<td>1941</td>
<td>1,814,564</td>
<td>52,549</td>
<td>.68</td>
</tr>
<tr>
<td>1942</td>
<td>1,558,925</td>
<td>31,851</td>
<td>.35</td>
</tr>
<tr>
<td>1943</td>
<td>1,970,974</td>
<td>15,972*</td>
<td>.10*</td>
</tr>
<tr>
<td>1944</td>
<td>2,532,174</td>
<td>1,971*</td>
<td>.01*</td>
</tr>
<tr>
<td>1945</td>
<td>2,835,695</td>
<td>28,583</td>
<td>.11</td>
</tr>
<tr>
<td>1946</td>
<td>4,278,008</td>
<td>141,722</td>
<td>.48</td>
</tr>
</tbody>
</table>

* Indicates red figures.

given is shown by the four selected summaries duplicated on the next four pages. Footnote comments are made on each of the summaries.

As a means of "catching the eye" and creating interest in the report, the financial summary has value. However, much of the data included belongs in comparative balance sheets and income statements. A miscellaneous group of statistics covering a few back years cannot serve as a satisfactory substitute for comparative statements. Repeating of information which is shown elsewhere in the report should be held to a minimum.

**Comparative Data in Charts and Tables**

The greatest volume of comparative data in the 100 reports is in the form of charts and tables. A general survey of the types and uses of charts and tables was made in Chapter 4. The remaining space in this chapter is devoted to a consideration of the content of these charts and tables. They are classified according to subject matter on what appears to be the main emphasis in the chart or table. The material is organized under the following topics: working capital, fixed assets, other assets, net worth, liabilities—net worth, sales, taxes, earnings, distribution of net income, dividends and miscellaneous. The data included are so varied that more than one classification is often
### 10-Year Record

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>Tax</th>
<th>Profit Before Federal Income and Excess Profits</th>
<th>Provision for Federal Income and Excess Profits</th>
<th>Cash Dividends on Common Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939</td>
<td>$39,551,065</td>
<td>$8,497,581</td>
<td>$494,264</td>
<td>$2,003,617</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>1940</td>
<td>40,500,217</td>
<td>1,892,066</td>
<td>355,743</td>
<td>1,289,232</td>
<td>800,000</td>
</tr>
<tr>
<td>1941</td>
<td>42,499,001</td>
<td>1,982,604</td>
<td>476,797</td>
<td>1,415,607</td>
<td>800,000</td>
</tr>
<tr>
<td>1942</td>
<td>50,485,972</td>
<td>3,171,878*</td>
<td>1,285,745</td>
<td>1,532,133</td>
<td>800,000</td>
</tr>
<tr>
<td>1943</td>
<td>64,839,118</td>
<td>4,939,295*</td>
<td>3,322,625</td>
<td>1,546,670</td>
<td>800,000</td>
</tr>
<tr>
<td>1944</td>
<td>75,606,293</td>
<td>7,205,930*</td>
<td>5,115,884</td>
<td>2,029,496</td>
<td>850,000</td>
</tr>
<tr>
<td>1945</td>
<td>87,281,566</td>
<td>7,705,089*</td>
<td>5,865,624</td>
<td>2,091,463</td>
<td>1,050,000</td>
</tr>
<tr>
<td>1946</td>
<td>91,939,800</td>
<td>8,587,335</td>
<td>5,833,616</td>
<td>2,753,719</td>
<td>1,275,000</td>
</tr>
<tr>
<td>1947</td>
<td>96,996,329</td>
<td>6,866,323</td>
<td>2,693,541</td>
<td>4,172,782</td>
<td>1,875,000</td>
</tr>
</tbody>
</table>

* After appropriating $400,000 for future losses and contingencies.

### GF Highlights of 1946

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>Change Over 1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$330.9 million</td>
<td>+ 14.1</td>
</tr>
<tr>
<td>Federal Taxes</td>
<td>$13.0 million</td>
<td>+ 11.7</td>
</tr>
<tr>
<td>Earnings (after contingencies)</td>
<td>$18.1 million</td>
<td>+ 38.1</td>
</tr>
<tr>
<td>Earnings</td>
<td>$3.25</td>
<td>+ 38.1</td>
</tr>
<tr>
<td>Net Worth (per common share)</td>
<td>$18.84</td>
<td>+ 7.2</td>
</tr>
<tr>
<td>Dividends</td>
<td>$2.00</td>
<td>+ 25.0</td>
</tr>
<tr>
<td>Total Dividends</td>
<td>$11.2 million</td>
<td>+ 25.0</td>
</tr>
<tr>
<td>Stockholders</td>
<td>67,174</td>
<td>+ 7.7</td>
</tr>
<tr>
<td>Wages and Salaries</td>
<td>$47.0 million</td>
<td>+ 20.5</td>
</tr>
<tr>
<td>Employees</td>
<td>14,135</td>
<td>+ 8.7</td>
</tr>
</tbody>
</table>

---

17 From the 1946 Annual Report of Lerner Stores Corporation. This data should be given as a part of the comparative income statement.

18 From the 1946 Annual Report of General Foods Corporation. The report contains 10-year comparative financial statements. These brief "highlights" are appropriate. The data appears on page one of the report.
<table>
<thead>
<tr>
<th></th>
<th>1943</th>
<th>1944</th>
<th>1945</th>
<th>1946</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Volume of Business</td>
<td>$48,990,794</td>
<td>53,474,784</td>
<td>61,122,583</td>
<td>72,357,861</td>
</tr>
<tr>
<td>Branch Business</td>
<td>$40,686,388</td>
<td>44,716,608</td>
<td>51,177,978</td>
<td>51,133,798</td>
</tr>
<tr>
<td>Total Taxes on Income</td>
<td>$2,350,700</td>
<td>3,002,650</td>
<td>3,174,300</td>
<td>2,207,183</td>
</tr>
<tr>
<td>Net Earnings</td>
<td>$1,229,136</td>
<td>1,007,411</td>
<td>1,110,749</td>
<td>2,756,372</td>
</tr>
<tr>
<td>Earnings Per Share</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common Stock</td>
<td>$1.90</td>
<td>1.84</td>
<td>1.71</td>
<td>3.76</td>
</tr>
<tr>
<td>Common Stock</td>
<td>$5.45</td>
<td>5.83</td>
<td>6.02</td>
<td>4.10</td>
</tr>
<tr>
<td>Dividends Per Share</td>
<td>$1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.60</td>
</tr>
<tr>
<td>Dividends Paid</td>
<td>667,097</td>
<td>667,095</td>
<td>667,095</td>
<td>1,194,450</td>
</tr>
<tr>
<td>Per Cent of Net Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributed</td>
<td>54.3</td>
<td>66.2</td>
<td>60.1</td>
<td>43.3</td>
</tr>
<tr>
<td>Retained in Business</td>
<td>342,039</td>
<td>340,316</td>
<td>443,664</td>
<td>1,560,982</td>
</tr>
<tr>
<td>Current Assets</td>
<td>$10,654,807</td>
<td>10,570,155</td>
<td>14,363,699</td>
<td>17,723,688</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>273,238</td>
<td>1,073,386</td>
<td>1,465,880</td>
<td>1,399,947</td>
</tr>
<tr>
<td>Working Capital</td>
<td>9,681,569</td>
<td>9,498,769</td>
<td>12,877,619</td>
<td>16,413,681</td>
</tr>
<tr>
<td>Net Worth</td>
<td>8,818,688</td>
<td>8,939,322</td>
<td>9,382,976</td>
<td>12,692,769</td>
</tr>
<tr>
<td>Debentures Outstanding</td>
<td>2,350,000</td>
<td>2,200,000</td>
<td>5,000,000</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Extra Cumulative</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preference Stock</td>
<td>$496,300</td>
<td>496,300</td>
<td>496,300</td>
<td>496,300</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common Shares</td>
<td>627,391</td>
<td>627,391</td>
<td>627,391</td>
<td>704,321</td>
</tr>
<tr>
<td>Outstanding</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td>$308,735</td>
<td>348,353</td>
<td>401,981</td>
<td>547,875</td>
</tr>
<tr>
<td>Pairs Produced</td>
<td>12,029,818</td>
<td>12,520,751</td>
<td>13,415,574</td>
<td>15,984,926</td>
</tr>
</tbody>
</table>

---

19 From the 1946 Annual Report of General Shoe Corporation, p. 12. Most of this data needs to be shown only in the financial statements. The sequence of the items is poor. For example, "pairs produced" should be next to sales, because of space limitations, the 1943 figures in the original chart are not given here.
## THE STORY IN FIGURES

**PRODUCTION**

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude-oil production, gross, barrels</td>
<td>74,289,301</td>
<td>74,013,063</td>
</tr>
<tr>
<td>Crude-oil production, net, barrels</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude-oil purchased, barrels</td>
<td>64,533,584</td>
<td>64,685,408</td>
</tr>
<tr>
<td>Dry holes drilled</td>
<td>55</td>
<td>66</td>
</tr>
<tr>
<td>Oil wells completed</td>
<td>267</td>
<td>251</td>
</tr>
<tr>
<td>Oil wells purchased</td>
<td>216</td>
<td>82</td>
</tr>
<tr>
<td>Oil wells owned, at the year end</td>
<td>7,205</td>
<td>6,813</td>
</tr>
<tr>
<td>Gas wells completed</td>
<td>118</td>
<td>24</td>
</tr>
<tr>
<td>Gas wells owned, at the year end</td>
<td>381</td>
<td>236</td>
</tr>
<tr>
<td>Producing oil lands, at the year end, acres</td>
<td>139,461</td>
<td>126,508</td>
</tr>
<tr>
<td>Proven but not producing, at the year end, acres</td>
<td>33,369</td>
<td>24,440</td>
</tr>
<tr>
<td>Undeveloped, at the year end, acres</td>
<td>7,288,289</td>
<td>8,336,215</td>
</tr>
</tbody>
</table>

**TRANSPORTATION**

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pipe lines built, miles</td>
<td>410</td>
<td>369</td>
</tr>
<tr>
<td>Pipe lines owned, at the year end, miles</td>
<td>12,867</td>
<td>12,478</td>
</tr>
<tr>
<td>Pipe-line traffic, million barrels miles</td>
<td>81,590</td>
<td>74,783</td>
</tr>
<tr>
<td>Tankers owned, at the year end</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Tugs and barges owned, at the year end</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Water-borne traffic, million barrels miles</td>
<td>51,377</td>
<td>11,387</td>
</tr>
</tbody>
</table>

**MANUFACTURING**

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil run at refineries, barrels</td>
<td>124,432,303</td>
<td>114,558,119</td>
</tr>
<tr>
<td>Crude-running capacity, at the year end, barrels per day</td>
<td>355,750</td>
<td>351,500</td>
</tr>
<tr>
<td>Natural gasoline produced, barrels per day</td>
<td>2,024</td>
<td>1,917</td>
</tr>
</tbody>
</table>

---

20 From the 1946 Annual Report of Standard Oil Company (Indiana), p. 1. The list of items is long in comparison with others but it is very informative.
### MARKETING

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales in dollars</td>
<td>$633,768,075</td>
<td>$601,538,202</td>
</tr>
<tr>
<td>Sales of crude oil, barrels</td>
<td>74,760,862</td>
<td>76,144,833</td>
</tr>
<tr>
<td>Sales of petroleum products, barrels</td>
<td>132,639,455</td>
<td>139,278,820</td>
</tr>
<tr>
<td>Ship, barge, and pipe-line terminals, at the year end</td>
<td>45</td>
<td>46</td>
</tr>
<tr>
<td>Bulk plants operated, at the year end</td>
<td>4,492</td>
<td>4,437</td>
</tr>
<tr>
<td>Retail outlets served, at the year end</td>
<td>30,369</td>
<td>27,765</td>
</tr>
</tbody>
</table>

### FINANCIAL

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income and tax collections</td>
<td>$796,554,517</td>
<td>$731,276,595</td>
</tr>
<tr>
<td>Taxes collected for government agencies</td>
<td>128,914,947</td>
<td>103,649,983</td>
</tr>
<tr>
<td>Gross income</td>
<td>667,639,570</td>
<td>627,626,612</td>
</tr>
<tr>
<td>Materials, transportation, and operating costs</td>
<td>364,273,186</td>
<td>357,923,829</td>
</tr>
<tr>
<td>Employees' pay and benefits</td>
<td>144,049,453</td>
<td>120,220,563</td>
</tr>
<tr>
<td>Taxes charged against income</td>
<td>37,519,044</td>
<td>26,582,038</td>
</tr>
<tr>
<td>Depreciation, depletion, amortization, etc.</td>
<td>51,905,112</td>
<td>71,168,601</td>
</tr>
<tr>
<td>Net earnings</td>
<td>67,649,785</td>
<td>50,340,476</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>26,748,791</td>
<td>22,927,295</td>
</tr>
<tr>
<td>Earnings retained in the business</td>
<td>40,900,994</td>
<td>27,413,181</td>
</tr>
<tr>
<td>Net earnings per share</td>
<td>$4.43</td>
<td>$3.29</td>
</tr>
<tr>
<td>Dividends paid per share</td>
<td>$1.75</td>
<td>$1.50</td>
</tr>
<tr>
<td>Working capital, at the year end</td>
<td>$189,970,915</td>
<td>$222,713,624</td>
</tr>
<tr>
<td>Working capital ratio, at the year end</td>
<td>2.67 to 1</td>
<td>3.65 to 1</td>
</tr>
<tr>
<td>Net worth, at the year end</td>
<td>$860,560,177</td>
<td>$819,659,938</td>
</tr>
<tr>
<td>Book value per share, at the year end</td>
<td>$56.30</td>
<td>$53.63</td>
</tr>
</tbody>
</table>

### MISCELLANEOUS

<table>
<thead>
<tr>
<th>Description</th>
<th>1946</th>
<th>1945</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stockholders, at the year end</td>
<td>97,237</td>
<td>97,166</td>
</tr>
<tr>
<td>Employees, at the year end</td>
<td>42,616</td>
<td>36,332</td>
</tr>
<tr>
<td>Associates, at the year end</td>
<td>1,775</td>
<td>1,633</td>
</tr>
</tbody>
</table>
possible for a given chart or table. In keeping the classification and the treatment of the data within reasonable limits a few of the items had to be placed somewhat arbitrarily with a particular group. 21

Working Capital Charts. The term "working capital" is sometimes used to mean the difference between current assets and current liabilities, and at other times to mean the amount of the current assets. In distinguishing between the two concepts some authors use "working capital" to mean the amount of the current assets and "net working capital" to mean the difference between current assets and current liabilities.

Fifteen of the reports contain charts (5 line, 8 bar) and tables (2) showing the working capital position for periods ranging to 11 years. In each case, the concept of "net working capital" is used though seven of the titles are merely "working capital." The title of "net current assets," used in one report, may be a more meaningful caption for most annual report readers.

21 The material pertaining directly to dividends, earnings per share, and distribution of the sales dollar is included in Chapter 8. The material directly related to wages, salaries, employee benefits, employee service reports, etc. is included in Chapter 10.
Though a chart showing net working capital does not detract from a good report, it adds little if anything to an otherwise complete report. The chart can add nothing to a properly prepared comparative balance sheet in which the current ratio (the ratio of current assets to current liabilities) is shown for the respective years. The ratio has more significance than the dollar amount as shown in a chart. The chart can possibly be used to some advantage if management uses it in connection with an explanation of the reasons for decided changes in some of the current items. A working capital chart standing alone as in the Electric Boat Company report is worthless.

In addition to tables and charts referred to above, the reports also contained four charts as follows:

Net Sales, Working Capital and Inventories -- General Time Instruments Corporation
Relation of Funded Debt and Preferred Stocks to Working Capital -- National Dairy Products Corporation
Net Worth and Working Capital -- Rockwell Manufacturing Company
Working Capital in Relation to Capital Structure -- P. R. Mallory & Co., Inc.

---

22 The current asset value per share would have more significance to the investor than does the amount of net working capital. See Benjamin Graham and David L. Dodd, Security Analysis, 1st ed., McGraw-Hill Book Company, Inc., New York, 1934, pp. 495-507.
The last two charts are poorly prepared. But, more important, the comparisons being made in the last three charts are irrelevant. There is, on the other hand, a functional relationship between net sales and working capital, and working capital and inventories. The General Time Instruments Corporation chart is more informative than any of the other working capital charts.

**Fixed Asset Charts.** Sixteen of the reports contain charts dealing with fixed assets. Nine of these show the expenditures for fixed assets and depreciation for periods ranging from five to fifteen years. Though they have some interest value, those which cover only the war period are not very informative in comparison with the 15-year presentation of Caterpillar Tractor Company.

A more informative type of chart is used in three of the reports. These are component-part charts which show gross book value of fixed assets, accumulated allowances for depreciation, and net book value. Each of the three remaining charts is of a different type:

Annual purchases of machinery and equipment, 1938-1947--Pettibone Mulliken Corporation. (The chart is excellent. The Company's machinery purchases are related to the age of machines in use in the industry.)

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23 See the Carrier Corporation, ATF Incorporated, and LePlant-Chese Manufacturing Co., Inc. reports. In contrast, Blue Bell, Inc. uses a "net fixed assets" chart.
Net income and sales in relation to plant investment, 1937-1946 -- Marquette Cement Manufacturing Company. (Subject matter is important, but chart is too small for easy reading.)

Net worth, net working assets, gross fixed assets, and net fixed assets, 1941-1946 -- Electric Boat Company. (Title of "Resources" is unsatisfactory; four lines are too many; the chart, without narrative material, appears on page with three other charts.)

The fixed asset charts have as much interest value in the reports as the working capital charts, and they have more information value. It is suggested that the chart can best show gross book value, accumulated allowance for depreciation, and the annual depreciation charge.

Other Asset Charts. Reliance Manufacturing Company and Ferro Enamel Corporation use charts to accompany their balance sheets. The Reliance chart shows total assets for 1935 and 1946 and the Ferro Enamel chart shows current, fixed, and total assets for the period 1936-1946. These charts show unimportant relationships. A more interesting and instructive chart is the line chart in the Cudahy Packing Company report which compares inventory values for two war periods, 1915-1919 and 1942-1946.

Net Worth Charts. Ten charts make net worth comparisons by years. Three of these are component-part charts showing a breakdown between capital stock and surplus. One multiple-bar chart shows the same thing. Six of the charts merely compare total net worth for one year with the net worth for another year or a period of years. Another
chart shows the addition to earned surplus for 1946 over 1945. These charts could be omitted without harm to the completeness and clarity of the reports. Comparisons between net worth and fixed assets, net worth and total assets, net income and net worth, and sales and net worth would be more helpful.

**Liability-Net Worth Charts.** Three charts compare liability and net worth items. The Reliance Manufacturing Company report contains a line chart showing capital stock and surplus, reserves, current liabilities, and total net worth for the years 1936-46. Similarly, the Fruehauf Trailer Company report contains a multiple-bar chart showing funded debt, common stock, preferred stock, surplus and reserves, and total capital for a five-year period. The five bars make the comparison between years very difficult. The line chart would have been more effective. More significant comparisons are made in a chart in the United-Rexall Drug, Inc., report in which the common stock equity is compared with funded debt and preferred stock.

Other balance sheet comparisons which might be made include: fixed assets to fixed liabilities, book value of common stock by years.

**Sales Charts.** Thirty reports contain bar or line charts showing sales over a period of years. The P. R. Mallory & Company, Inc., chart covers 30 years and the General Foods Corporation chart contains data for an 18-year
period. Unfortunately many of the charts do not include any years prior to the war period. In addition to this group of sales charts, nine reports contain charts which show types of sales or sources of income for a period of years. The sales data is classified according to: foreign or domestic, war or civilian goods, and sales to various industries or types of customers.

All of the above charts should be based on data contained in the comparative income statement, consequently the charts merely "point up" the movement of sales over a period of years. These charts have some interest value probably, but they make little contribution to better understanding of the factors which have affected sales and are likely to affect sales in the future. In this connection, five reports contain charts which show sales in relation to some asset factor or factors. They are:

Relation of sales to net fixed assets, 1939-1946
Sales per dollar of gross plant, 1937-1946
Ratio between sales and working capital, 1940-1946
Sales and inventories, 1940-1946
Percentages to annual sales of year-end investments in inventory, current accounts receivable, and deferred payment accounts receivable, 1937-1946.

Four reports contain charts which show the increase in price of the Company's products in relation to competing products:

Price increases on building materials by types, 1926-1946 -- Marquette Cement Manufacturing Company
Trend of wages, milk prices, and other grocery prices, 1940-1946 -- Borden Company
Average monthly prices of silk, wool, Celanese, and cotton fibers, 1937-1946 -- Celanese Corporation of America

Eastman sales prices and major costs of photographic products, 1940-1946 -- Eastman Kodak Company

The last nine charts referred to extend the scope of the report beyond the data which are in or should be in the comparative income statement. Another interesting and instructive chart is the line chart in the Caterpillar Tractor Company report which compares "Caterpillar" man-hours worked with the Federal Reserve Board Index of Industrial Production. An explanatory note below the chart reads:

"Volume of company operations and volume of national production for the past fifteen years are shown above. Company operations are measured by the number of man-hours worked by hourly-paid employees. National production is as shown by the Federal Reserve Board Index of Industrial Production.

"It will be observed that there has been a close relationship between the national and the Company trends. Although there is no assurance that this relationship will continue into future years, those who may desire to estimate the trend of the Company's future operations may be aided in that purpose by watching the trend of the Federal Reserve Board Index, as periodically forecast by leading economists."24

Five other reports contain charts or tables dealing directly with sales data:

Sales, average number of stores, and meat sections
Average number of salesmen
Number of orders
Sales volume per man
Income by quarters -- six quarters in 1945-1946

24 1946 Annual Report, p. 5.
The Caterpillar and the other nine charts referred to immediately above give an idea of the type of sales data which can be presented advantageously—data which increases the fund of information in the report and aids the reader in a proper interpretation of it. Managements interested in achieving full disclosure should weigh carefully the desirability of giving answers to question such as those listed below. Though some narrative explanations would be required, comparative statistics should supply the outline.

The sales data in most current annual reports answer only one question: did we receive more or less from customers for goods and services than last year or during each of the last five years? There are other important questions:

What is the source of income by major products or lines? For example, in the case of the meat packing company, what part of the income is derived from meat packing, what part from by-products, what part from sporting goods operations, etc.? Which of the lines or operations is proving most profitable?

How important are our sales in the industry? Is competition decreasing or increasing? Who are our main competitors? What is the difference in the competitive factors affecting the markets for each of our types of operations?

Did any of our products (or services)—new or old—make significant gains or losses? Are certain demands expanding or retracting?

To what extent did increases or decreases in the sales figures represent changes in unit volume and to what extent were these occasioned by price changes?

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25 A detailed breakdown appears in the International Harvester Company report. See pages 277 and 278.
What is the character, location, and number of customers served? Did the average customer buy more or less than in prior years?

In what way are production problems affecting sales? Are production factors becoming more or less favorable?

A few reports contain comparative charts or tables on phases of production which, when accompanied by narrative interpretations aid materially in the analysis of the sales figures. Nine of the items are captioned as follows:

Body and body parts production, 1938, 1939, 1940, 1941, 1946, and estimate for 1947 -- Briggs Manufacturing Company


Growth Trends of the two major types of man-made fibers, 1932, 1939, and 1946 -- Celanese Corporation of America

Livestock purchases, 1937-1946 -- Cudahy Packing Company

Increase in twisting spindles, 1937-1946 -- Duplan Corporation

Goodyear tire production for motor vehicles (accumulative), 1940-1946; unit tire production in the U. S. A. by passenger and truck and bus, monthly average for 1940 and 1941 and monthly production during 1945 and 1946 -- Goodyear Tire & Rubber Company

Oil production and refinery runs, 1937-1946 -- Standard Oil Company (Indiana)

Paper and paperboard production by tons, 1900-1946 -- West Virginia Pulp and Paper Company

Scheduled and actual production by months, 1946 -- Standard Oil Company (New Jersey)

Backlog -- Dresser Industries, Inc.
Charts and Tables Showing Taxes. Next to sales and earnings, more charts and tables are devoted to taxes than any other income statement item. According to content, the charts may be classified as follows:

11 -- Taxes paid in relation to net earnings for periods of five to eleven years
3 -- Breakdown of taxes by types for periods of two to six years; taxes per share in two cases
1 -- Taxes for 1929, and 1934 through 1946
1 -- Taxes per share, 1941-1946
1 -- Taxes paid compared with wages and dividends, 1939-1946
1 -- Profits before and after taxes, 1931-1946

The purpose of these charts is to emphasize taxes. The amount of taxes paid is of interest to stockholders, employees and the general public. At the same time, the charts and tables in the reports over-emphasize taxes in comparison with some other expense items -- wages, for example. Management is apparently trying to say through most of the charts which show taxes that the tax rates on corporate income are too high. Some of them seem to suggest

27 A breakdown of taxes by types in every report is believed desirable.

28 The comparison of taxes with several other items will be noted in sections which follow.

29 This chart shows "profits before all taxes," "all taxes," "profits after all taxes," and "percentage of reduction of profits due to taxes." There is as much reason for showing "percentage of reduction of profits due to wages."

30 For example, the use of one-half page in reporting that taxes and duties were the third largest factor in 1946 costs. The explanation follows:
that if the taxes were reduced, stockholders, employees, and
the general public would be the beneficiaries. This might
or might not be the case. It is misleading to show taxes
as a percentage of sales, and a comparison of taxes with
wages and dividends means very little. Better comparisons
would be between taxes and total expenses and taxes and net
worth.

Charts and Tables Emphasizing Earnings. There are
eleven charts which show net earnings for periods ranging
from two to twelve years. One of these shows earnings
broken down into domestic and foreign sources. Eight charts
and tables compare sales and earnings for periods ranging
from 5 to 47 years, with four of the charts showing
data for 15 years or more. This group of charts is
open to essentially the same criticism as the pie charts

30 (Cont.)
"Next to materials and wages, taxes represented the
largest item in the cost of Goodyear products in 1946.
During the year, the company paid out $100,281,000 in
taxes and duties, including federal, state and foreign
income taxes, excise and social security levies.

"RATIO OF TAXES TO WAGES
The Company paid 58¢ in taxes for every dollar paid to
employees as wages."

Below this half-page statement is a bar chart showing
taxes for 1939 and 1934 through 1946. But why is a tax
chart used in preference to materials and wages charts? The
cost of these items cannot be located at any point in the
report. They may have increased relatively as much as taxes.
So may have the Company's net worth and personal income taxes.
showing the distribution of the sales dollar. The Blue Bell, Inc. report shows in a multiple-bar chart net profits (before and after taxes) as a per cent of sales. The National Dairy Products Corporation report has a "Profit per dollar of sales" chart for 1937-1946. The Marquette Cement Manufacturing Company report contains a chart which makes an unusual comparison: Marquette's net income to domestic consumption of Portland cements, 1937-1946. There is no interpretation of the chart, therefore, one must ponder its significance.

The one relationship which needs most to be emphasized is incorporated into comparative charts by only five of the reports: earnings rate on capital invested.

Charts and Tables Showing the Distribution of Net Income. Three charts and one table show the "distribution

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31 See Chapter 8, pp. 318-323.

32 See page 316 for the names of these reports.

33 Three charts show the distribution of sales income. The Standard Oil Company (Indiana) chart shows gross income, costs, dividends, and earnings retained. The Swift and Company chart shows livestock and other raw material, wages, salaries, supplies, freight, taxes, etc., and net earnings. ATF Incorporated shows on a component-line chart materials, payrolls, expenses (a poor designation), taxes, reconversion reserve, and net income. As was probably intended net income is almost pushed off each of the charts. The charts are open to the same objection as the pie sales-dollar charts except that the comparative data demonstrates that the distribution varies each year.
deliberately, the opportunity to display graphically and comparatively the essential relationship of dividends to capital invested.

**Other Comparative Charts and Tables.** There are 25 additional charts and tables which compare three or more elements. Because of the number of elements, 14 of the 25 are in table form. An indication of the general nature of these charts and tables is given by the following breakdown:

13 - The chart or table begins with net sales; two or more of the following items are added: sales tonnage, earnings, per cent of profit to sales, earnings per share, dividends, dividends per share, taxes, payrolls, profits before taxes, profits after taxes, contingencies, net profit.

6 - The chart or table begins with net income; two or more of the following items are added: taxes, earnings retained, dividends, net plant investment, dividends per share, book value per share.

6 - Miscellaneous; the chart or table includes from three to nine items.  

Most of these presentations contain too many items for easy reading and satisfactory interpretation. For example, the Union Bag and Paper Corporation report contains eight items on a line chart. Ordinarily not more than four lines should be used, and for annual report purposes it is suggested that the number be held to two or three.

34 The comparisons contained in the Belden Manufacturing Company and Safeway Stores Incorporated reports are commendable in that net worth and income items are shown. The Belden table shows: capital and surplus, net assets per share of preferred stock, book value per share of common stock, dividends paid per share of common stock, net earnings per share of common stock.
General Criticisms of the Comparative Charts and Tables in the 100 Reports. Comparative charts and tables are not being used in all reports and not effectively in most of the reports. The period covered by the data now included is too short in at least 75 per cent of the cases. A ten-year period, or the life of the firm if it is less, is urged as a minimum.

Though good charts can aid in making the total report outwardly attractive, each chart should be justified on the basis of the pertinence of its message to the readers. To show the ratio of dividends to net sales is worthless; to show the ratio of dividends to capital investment is of vital importance to every reader.

The charting of one item for a period of years, especially when given without comment or interpretation, is less significant than the charting of two functionally related items. For example, charts showing earnings or sales for a series of years have a limited meaning and can be very misleading. Earnings, whether increasing or decreasing, must be related to capital invested in order to judge the change in annual earnings over a period of years.

35 See annex, pp. 127-131, for related comments.

36 For excellence in technical detail, informative content, and general appearance, the Caterpillar Tractor Company charts are outstanding.
Charts and tables, however well prepared, cannot satisfactorily substitute for complete comparative financial statements. Charts can be used effectively by management in interpreting the significance of selected data from the comparative statements.
SELECTED BIBLIOGRAPHY


"Two Kinds of Comparative Data," Trusts and Estates, Vol. 81, No. 4, October 1945, pp. 231-236.
CHAPTER 10

EMPLOYER RELATIONS AND ANNUAL REPORTS

Labor has long been recognized as one of four factors of production. Labor, like each of the other factors, is essential. Production and enterprise results hinge on the proportions of these factors and the way in which they are combined in a given situation. It is the primary function of the management factor to apportion the factors of land, labor, and capital in such way that the enterprise will be profitable.

Management is always faced with the following problems: should the proportion of labor be increased or decreased, and, if so, how much? Should it be increased by training and up-grading or by hiring additional laborers? Should the proportions of capital and land be increased or decreased, and, if so, how much? In answering these and concomitant questions, some objective data are available to management, but management is forced to make estimates as to the propriety of increasing or decreasing the proportion of labor, land, or capital in the productive and distributive processes.

Industrialization has brought bigger and better machines. Manufacturers spend huge sums of money in developing and perfecting machines and in determining the best
operating and maintenance practices. They also provide engineers who install the machines properly, or they give detailed installation and operating specifications. These machines are serviced regularly, the best and many types of specially prepared oils and greases are used, and when operating difficulties arise, all of the staff engineers are kept busy working on the problem, and often outside experts are called in to check the equipment.

Unfortunately, industrialization did not bring with it the same type of consideration for the labor factor as the capital factor. Consequently, a large part of management's present-day troubles can be traced to the disproportionate amount of money and time (even more important than money) devoted to engineering and distribution problems in comparison with personnel and its problems. There is much evidence that management has not been as careful in handling the workers as the machines. The machine is checked and inspected regularly to make sure that it is operating properly and is not being damaged in any way. Conversely, the employee has been expected to take almost full responsibility in adjusting himself to the job conditions.

In recent years, most corporation managements have come to a better realization that the labor force must be carefully selected and placed, properly oriented and trained, paid a reasonable wage, have a sanitary and pleasant working
environment, and have a feeling of reasonable security and satisfaction in the work which it does. Good management knows that the efficiency of workers is apt to be unprofitably low unless these conditions are predominant.

Management continues to show increasing concern for improvements in personnel relations as means of increasing and maintaining the efficiency of the employees, and in turn the profitableness of the business. In view of this fact and others enumerated above, it is paradoxical that so little space is currently devoted to the labor factor in annual reports. Most of the reports show little cognizance of the relative importance of employee effort and welfare to the success of the Company, and the dependence of management and stockholders upon the effectiveness of employee efforts.

**Personnel Administration Coverage in the Reports**

Corporate policies and practices in relation to wages, vacations, retirement, pensions, training, medical aid, employee and executive bonuses, employee suggestions, safety, thrift plan, promotions, recreational facilities, and group insurance programs are of primary importance to stockholders as well as management and employees. It is as important for stockholders to know of the personnel administration decisions made by management as it is for them to
know of the purchase of a tract of land or new equipment, changes in products, etc. In contrast, the annual report reader gets relatively little information on personnel policies, problems, and plans. The employee does not exist in so far as 28 of the 100 reports show. In the remaining 72 reports only 143 pages are devoted to employee topics. This represents far less coverage than is given to photographs (including a few employee pictures), products, or plants. There is some (though often only a line or two) reference to the following general employee topics in the reports as indicated below:

<table>
<thead>
<tr>
<th>No. of Reports</th>
<th>Topics</th>
</tr>
</thead>
<tbody>
<tr>
<td>21</td>
<td>A general policy statement</td>
</tr>
<tr>
<td>26</td>
<td>Wages</td>
</tr>
<tr>
<td>26</td>
<td>Insurance -- life, accident, hospitalization, etc.</td>
</tr>
<tr>
<td>22</td>
<td>Training</td>
</tr>
<tr>
<td>22</td>
<td>Retirement and pensions</td>
</tr>
<tr>
<td>16</td>
<td>Vacation pay</td>
</tr>
<tr>
<td>16</td>
<td>Safety</td>
</tr>
<tr>
<td>16</td>
<td>The work of veterans</td>
</tr>
<tr>
<td>11</td>
<td>Medical program</td>
</tr>
<tr>
<td>11</td>
<td>Suggestion plan</td>
</tr>
<tr>
<td>10</td>
<td>Thrift plan</td>
</tr>
<tr>
<td>8</td>
<td>Employee bonus</td>
</tr>
<tr>
<td>51</td>
<td>Miscellaneous, including recreation, length-of-service awards, union relations, cafeterias, employee magazine, turnover, promotion policy, etc.</td>
</tr>
</tbody>
</table>

Information is not Specific in Many Reports. Even in the case of the 72 reports which contain some employee references, the tendency is to make a few remarks which are
Generally uninformative. Two such statements are given below. These excerpts are the only references in the reports to employees or employee welfare:

"At this point, there should be recorded a tribute to the whole-hearted and effective cooperation of all of the Corporation's employees which played such a vital part in the successful completion of our reconversion to peacetime operation in the fourth quarter of 1946."

"Like most other companies, during 1946 we have experienced shortages of labor, absenteeism and a high rate of turnover. These conditions are still prevalent, in greater degree at some of our plants than at others. Despite this, however, our relations with our employees and with the unions representing them have been good and in our opinion are steadily improving. With the return of more settled conditions we anticipate that many of the difficulties we have encountered in the past year will be eliminated or reduced and that our labor relations will be correspondingly improved. Since the year 1940, through the year 1946, total wages and salaries paid to all the employees of the Company and its subsidiaries have increased by about forty per cent.

To our employees we extend our sincere thanks for the loyal services rendered under the trying conditions of 1946."

Specific Facts Given in Few Reports. Relatively few of the reports contain specific facts on the several phases of the personnel program. The limited space devoted to the topics placed a limitation on the facts which could be included. Only 20 of the 72 reports devote three pages or more. The most complete coverage appears in the General

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Corporation report. General Electric Company, General Motors Corporation, Schenley Distillers Corporation (using four charts) and Swift & Company give the most complete coverage on various expenditures for the benefit of employees. More factual data on wages and the several employee benefit programs is the primary need in most of the reports. As noted in a previous chapter wage payments and other payments made for the direct benefit of employees are not detailed in the income statement or in a schedule thereto. The best coverage, though non-existent in a majority of reports and incomplete in others, appears in the form of charts.

Nine charts compare total wages and salaries for periods ranging from seven to twelve years. These can be misleading since the effect of changes in number of employees is included. Recognizing this, the Allied Stores Corporation chart shows separately the increase due to higher wage levels and increases in number of employees. More informative charts are the nine which compare average annual, weekly, or hourly wages for periods ranging from two to eighteen years. The data is shown annually for a 15-year period by Burroughs Adding Machine Company and Caterpillar Tractor Company. Annual data is preferable to the alternate-

3 Five of the charts show the approximate number of employees which partly cures the defect.
Year presentation (covering 18-year period) of General Motors Corporation and the selected years (1941 and 1946) as used by W. L. Douglas Shoe Company and Plomb Tool Company. Four reports contain charts which are complementary to the prior group. Three of these compare the company's average wage rates for a period of years with an index for "all manufacturing" wages and one compares "take home pay," "hourly rates," and "living cost index."

The W. L. Douglas Shoe Company report contains another chart which compares hourly wages and production (pairs produced) for 1941 through 1946. There is also discussion of wage rates and production in the president's letter. This represents a type of chart which deserves wider use in preference to some of the charts which make relatively insignificant comparisons, such as the following:

- Number of employees and stockholders (three charts)
- Payments to stockholders and employees (one chart)
- Number of employees (four charts)
- Loss of wages to hourly-rated employees due to absenteeism and strikes (pie chart for 1945)
- Wages and salaries to dividends (two charts)
- Profit and employee compensation (one chart)

U. S. Steel Corporation uses a table containing much more pertinent information than is included in any one chart. For a 19-year period information is given as follows: average number of employees, total man-hours worked, total annual payroll, average weekly hours, average hourly earnings, average weekly earnings.
There is a miscellaneous group of charts and tables:

- Wages & salaries, taxes, dividends, etc. (five comparative charts)
- Ratio of wages and taxes to net earnings, 1937-1946
- Length of service of employees (two charts)
- Other (four)

Aside from the critical comments already made, there is one fundamental weakness in all of the wage charts and tables. The chart or table pertains to only one segment of the employees, or there is doubt as to whether all are included, and there is doubt as to the inclusion of executive compensation. The data should not leave such questions in doubt.

Summary Evaluation of Personal Data in the Reports.

About one-third of the reports contain no employee data or so little data that the stockholder or other reader gets a wholly inadequate impression of the part which employees must play in a successful undertaking. Employees as contributors to the success or failure of the enterprise are ignored.4 The content of this group of reports is unbalanced and incomplete.

In another one-third (and maybe more) of the reports, irrelevant relationships are emphasized with the intent to show that employees are already receiving as much or more than they should. The most-used device for demonstrating this "fact" is the percentage distribution of the sales dollar.5

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4 Such omission is in direct conflict with management's oft-heard claim that employees are partners in the enterprise.

5 See supra, page 319, for an indication of the prevalence of this type of emphasis.
A typical presentation of this type is in the Rockwell Manufacturing Company report. The Chairman of the Board gives the "complete" employee story in three paragraphs:

"In general, we can report that labor relations at all plants are normal. At one plant we have been sued for $3,000,000 in a portal-to-portal pay suit, but this suit follows the same pattern as countless similar suits which have swept the country as the result of a recent highly disputed court decision. In a move which received much public attention, we filed an answer and counterclaim in amount of $15,000,000 against the Union and its officers. Our counter-suit is based on work slow-downs and early quitting substantiated by our records.

"In current wage negotiations and public discussions, we feel that too little emphasis is placed on the proportion of total income which is allocated to the employees. Contained in this report are some easily understood charts and figures (referring, of course, to the "distribution of the sales dollar" chart and table) which show that in 1946 32% of our total income was paid out to our employees. If we consider the labor which is a part of the material and supplies we purchase to produce our goods, it could be safely stated that over 85% of all our income was returned to labor or government. Then, when we note that the shareholders have an investment of $2,638 per employee, and that the dividends received by these shareholders were only 1.3% of the total income, we believe that even the strongest proponents of the theory of increasing the proportionate return to labor will give pause.

"At the conclusion of the year we were ready to install a new Uniform Insurance Plan for all employees at all locations. This plan included Life Insurance, Death and Dismemberment Insurance, Hospitalization, Medical and Surgical Reimbursement Benefits, and Sickness and Accident Insurance. A substantial part of the cost of this insurance is borne by the Company."

The content of the reports in this group is not only unbalanced and incomplete, but inaccurate. This type of
report is much more harmful than the one which merely omits pertinent facts.

Not more than one-third of the reports give relatively satisfactory emphasis to employee efforts, costs, and rewards. In most of these the factual coverage could be more complete.

The Way in Which the Reports Are Addressed and Employee Coverage

In Chapter 4 it was indicated that 15 of the 100 reports were addressed to stockholders and employees and that 3 other reports were directed to one or more groups in addition to stockholders. An examination of these 18 reports does not reveal any noticeable difference in employee coverage from the remaining reports. In four of the reports addressed to stockholders and employees there is no recognition of employee efforts, costs, and rewards except a "we take this opportunity to express our appreciation and convey our sincere thanks" line to employees in the last paragraph of the presidents' letters. On the other hand, some of the reports which give effective emphasis to the company's personnel policies and practices are

7 See the 1946 Annual Reports of Foster and Kleiser Company, Walt Disney Productions, Reliance Manufacturing Company, and Universal Pictures Company, Inc.
addressed to stockholders only. Notable in this group are the reports of General Motors Corporation, Schenley Distillers Corporation, and Swift & Company.8

**Analysis of the Content of Six Separate Employee Reports**

Six of the 100 companies whose reports are included in the study make separate reports to employees. A comparison of the length of the two reports is given below:

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Pages in Employee Report</th>
<th>Pages in Stockholder Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATF Incorporated</td>
<td>24</td>
<td>26</td>
</tr>
<tr>
<td>Fruwaler Trailer Co.</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td>Hoover Company</td>
<td>6</td>
<td>26</td>
</tr>
<tr>
<td>Glenn L. Martin Company</td>
<td>16</td>
<td>32</td>
</tr>
<tr>
<td>Whirlpool Corporation</td>
<td>8</td>
<td>32</td>
</tr>
<tr>
<td>Swift &amp; Company</td>
<td>44</td>
<td>28</td>
</tr>
</tbody>
</table>

**Average**

17 2/3  
28 2/3

8 The presentation of Swift and Company is worthy of special comment. A three-page simply written statement captioned "66,000 Employees...63,000 Shareholders" explains the Company's operations in terms of the average stockholder and employee. Various "per" stockholder and employee amounts are given, including the per cent of return to the stockholder on his investment. A fourth page contains detailed figures on employee-benefit programs. It is also interesting to note that there is a "distribution of the sales dollar" pie chart in the report, but no attempt is made to prove a point by it.

9 Includes cover pages.
Draft #5

Page 1

Dear Mr. Martin Company

The following narrative except for... and one

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Recover Company

Page 3

Page 4

Page 5

Page 6

Page 7

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Studebaker Corporation:
  Letter from president -- 1 page
  General statement on the year's results -- 2 pages
  Explanatory income statement (same) -- 1 page
  Graphical presentation of scheduled and actual production, etc. (same) -- 2 pages
  Picture of assembly-line operation (same) -- 1 page

Swift & Company:
  Letter from president -- 1½ pages
  "66,000 employees -- 63,000 shareholders" (about the same) -- 1 page
  Explanatory income statement and balance sheet -- 2 pages
  Distribution of 1946 sales dollar (same) -- 1 page
  Statistics on employee benefits (same) -- 1 page
  Pictures and names of employees at work, highlighting returned veterans, production and distributing processes, employee suggestions, research, new products -- 10 pages
  Tribute to long-service employees, alphabetical lists and some pictures organized according to years' service -- 23 pages
  Product pictures (same) -- 2 pages

Evaluation of Content. The employee, and not unlike the executive or capitalist except possibly in degree, is always conscious of his need for higher wages. His attitude toward his employer is closely related to his own conception of whether his work is "worth" more to the company than he is being paid. The natural inclination is for the employee to believe that he is being underpaid. Unless management

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10 "Closely related" is appropriately used since the employee must have more from his job than a "reasonable wage" and "security." In addition to these, and maybe instead, the employee must secure from his job a feeling of accomplishment, a feeling of amounting to something as an individual, a satisfaction in the work of today.
gives the employee pertinent facts which he can use in comparing his reward (for his work) with that of others, he is likely to believe that he is underpaid. With the pressure of an increasing price level, union-leader encouragement, and incomplete financial facts, the employee is sure to reach the conclusion that he is being underpaid.

What are the facts of primary significance to an employee who tries to appraise objectively the wages paid him? It is suggested that management should answer the following questions, as a minimum:

How much did the Company pay in regular wages to employees (not including executives)?
How much did the Company spend for employee bonuses and various employee benefits (not including executives)?
How much did the Company pay in regular salary to executives?
How much did the Company spend for executive bonuses, retirement benefits, etc.?
These payments, averaged how much per employee and per executive? 11
How do these payments compare with payments in previous years?
What are the percentages of the total executive and employee payments to total expenses for a period of years?
What is the ratio of employee payments to production in units for a period of years?
What is the ratio of employee payments to dollar sales for a period of years?
How have average wages moved in relation to the cost of living?
How have employee wages moved in relation to executive salaries?

11 For a more detailed breakdown, see Chapter 7, p. 289.
How much is the net income for the year? This represents what percentage of the capital invested?
How much did the Company pay to common stockholders in dividends (cash and stock)? What was the percentage of dividends to capital invested?
How do the percentages of earnings and dividends compare with prior years?

The six reports contain but few of the answers and provide very limited information which can be used in computing the answers. Five of the six reports give the distribution of the sales dollar which partially answers the least significant question in the list. Two of the six contain data which would enable one to compute the percentages of dividends and earnings to capital invested. Five of the six reports show an amount paid in wages and the amount can be computed from the data in the sixth report. (There is some doubt about the inclusiveness of some of the "wages" items.) No information on the remaining questions is given.

There are only two distinguishing features between these employee reports and the stockholder reports:

1. The employee reports are more simply written.
2. The employee reports contain less of the information which is needed by employees.

Management is "sharing" little information with employees in employee reports. The pertinent facts are not put side by side in understandable language. Instead, the distribution of the sales dollar is given greater play than in reports to stockholders. The employee is shown that he
got most of the sales dollar and consequently received preferential treatment in comparison with executives and stockholders. \(^\text{12}\) How absurd! Until management correctly and consistently interprets wages and profits to employees, it is certain that employees' estimates of the size and reasonableness of corporate profits cannot be satisfactory.

**Special Employee Report vs. One Report for All Groups**

In the modern large corporation management is in a trustee relationship to stockholders, employees, consumers, and other groups, as well as the general public. One of these economic groups cannot adequately appraise its position without knowledge of the relative status and position of other contributing factors. The questions listed above as ones which should be answered for employees also need to be answered for stockholders and other groups if they are to interpret the report satisfactorily.

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\(^\text{12}\) An extension of this reasoning in some reports is to the effect that if management worked for nothing, each employee could be paid only a few cents a day more! Why suggest unreality in preference to reality? Such comparisons only suggest to the employee that executive salaries are too high, or specific amounts would be given. See 1946 Employee Report of Fruehauf Trailer Company; Marvin F. Barlion, "Financial Reports to Employees," Harvard Business Review, Vol. 20, No. 1, Autumn 1941, p. 128.
The contention that separate reports should be prepared with the stockholder report containing detailed financial data and the employee report consisting largely of a pictorial presentation is untenable. Neither can the view be substantiated that financial statements need not be included "if a company wishes to issue an annual review of its activities and achievements for the information of others than stockholders and prospective stockholders."¹³ Financial statements are an essential part of any satisfactory employee report.

There is a basic objection to a separate employee report only if its content is incomplete, inaccurate, or confusing. Stockholder reports may be objectionable on the same basis. If corporations make annual reports to stockholders, employees, and the general public, as this writer believes they must do in the general welfare and in their own self-interest, one report can best serve the needs of the several groups.

¹³ This view fails to take into account the change in the status of large corporations during the last half-century. See R. Layall McLaren, Annual Reports to Stockholders, Ronald Press Company, New York, 1947, p. 323.
SELECTED BIBLIOGRAPHY


CHAPTER 11

GENERAL CONCLUSIONS

The activities of large corporations touch directly the lives of every individual. Stockholders, employees, consumers, creditors, raw material suppliers, financial institutions, and the general public are directly concerned with the ways in which all corporations, particularly large corporations, function. If the corporation is to function to the greatest mutual benefit of the various interested groups, the several groups must collaborate effectively. Each of the interested groups expects to receive from that product or service produced a return equal to its contribution. Unfortunately there is no formula whereby a determination can be made as to the exact payment to a given interest which is equitable at a given time. Many social, economic, political, and moral questions are involved. The future of our economic system and our nation depends, in part, on the way in which the conflicting interests of the several groups are resolved and the understanding and appreciation which each group has of these complex relationships. The annual report, being the primary financial communications link between the corporation and all of those
individuals and groups having an interest in the corporation and its activities, must provide a sound basis for understanding and appreciation.

All who are participating in the preparation of current annual reports recognize that the annual report is not now serving as a perfect communications medium. Reporting progress has not kept pace or always in step with the changing status of the corporation in the society. Though there has been notable improvement in annual reports within the last decade, there are major shortcomings in most of the reports. Among the more important of these are: omissions of pertinent data, an excess of pictorial material, a shortage of interpretive material, confusing and misleading terminology, and misplaced emphases.

Though the annual report deals with what appears on the surface to be objectively determined numerical data, this is true only in part. The inherent complexity of the nature of man and of our economic system make the preparation of completely objective annual reports impossible. It follows that even the most enlightened management has a difficult task in properly disclosing the results of its operations to stockholders, employees, and others. In the preparation of the report management should be guided by a set of criteria, though subjective they must be, in determining the data to be included in the report, the way in
which the data is to be displayed, and the way in which
certain parts of the data are to be emphasized. The fol-
lowing criteria set forth the minimum essentials of any
good annual report:

1. **Accurate**: the content should be free
   from error; the report should tell the truth without
   any avoidable misleading inferences.

2. **Complete**: the report should include all
   information which the report recipient has a legi-
   timate interest in or right to expect.

3. **Clear**: the presentation of the data should
   be such that most of the recipients can get the
   correct meaning without difficulty.

4. **Interesting**: the report should have suf-
   ficient reader appeal to encourage its being read.

5. **Balanced**: proper emphasis is essential;
   the presentation should be such that the pertinent
   facts and relationships are emphasized and color,
   pictures, graphics, and similar devices are used
   only incidentally in the telling of the story.

In preparing a report which meets these criteria it
is essential for management to approach the preparation of
the report with the idea of reporting all significant finan-
cial facts rather than with the idea of presenting as
simplified a report as possible. In view of the many
omissions of pertinent facts in current reports the problem is not merely one of simplifying the factual data now found in most reports. A failure in the future to supply more complete and significant factual data is sure to lead in time to government regulation of annual reports because full light of publicity is essential to the interests of stockholders, employees, management, and the general public.

The financial statements' section of the annual report is the most important part of the report. Incomplete or inaccurate balance-sheet presentations make the whole report unsatisfactory. Many of the balance-sheet presentations in current reports can be measurably improved through better classification of accounts, better treatment of "reserves" and other easily misunderstood items, better explanations of valuation bases, and greater use of explanatory schedules. Though the form of the balance sheet can add to the readability of the report the content of the balance sheet is relatively more important.

The income statements in current reports are more unsatisfactory than the balance sheets. The detail in most income statements is incomplete, the emphasis on particular items is often misplaced, some of the terminology is incorrect or confusing, and the bases on which some expenses (such as depreciation, bad debts, and maintenance and repairs)
are determined are not given. Particularly, incomplete information is often given on sales, wages, and executive compensation. If the detail of the income statement is complete the form of presentation is relatively unimportant. Either the multiple-step form or the single-step form can be used advantageously as the primary income statement. As a more readable statement for the group of readers who have had little financial training or experience, the functional- or explanatory-type of income statement may be included also.

Management is not expected to predict future events. However, the report should be of as much value as is possible to its readers in helping them to make independent estimates of probable future developments so far as these can be predicated on a record of the past. The balance sheet is intended to show the financial position of the corporation on the balance sheet date and the income statement is intended to show the results of operations for the year ended. Consequently, single-year statements represent only a small part of the past record. By the very nature of financial statements not much dependence can be placed on the showing of single statements. Every annual report should therefore contain comparative financial-statement data covering a period of several years. As a minimum, the
period covered should include at least a ten-year period, a period of a complete business cycle, or the life of the corporation.

The report should recognize that the welfare of employees is so tied up with the corporation’s success or failure that each employee has a legitimate and vital interest in annual-report topics. The employee is entitled to know what his wages are in relation to the wages of others, and what total wages are in relation to executive compensation, return on stockholder’s investment, unit production, and other costs. Since good industrial relations are a requirement for optimum business success, there is no sound foundation for industrial peace other than pertinent facts correctly interpreted. Many of the pertinent facts are not now available in corporation annual reports.

The report must be primarily a presentation of factual data in understandable language; partial truths jazzed up through the use of color, pictures, charts, and clever phraseology will not survive the test of time. Though the report is an important public relations medium the tendency for it to become a typical advertising brochure or public relations document is regrettable. The report should not be used as a means of proving certain points; emotional reporting is unsatisfactory. Color, pictures,
and charts can contribute to better reporting but the relative worth of the reports depends on the pertinence and volume of factual data contained and the degree to which these facts are adequately displayed and emphasized.

The report of the future must go further in detailing the favorable and unfavorable factors affecting the company. No doubt comprehensive data is now omitted from some reports because of the fear that the data in certain years compares unfavorably with that of previous years. Instead of attempting to avoid mention or presentation of unfavorable data management should educate report readers to the inevitableness of ups and downs which result in a profit for one year which does not compare favorably with the profit figure for one or more previous years. As a safeguard to the interest of the stockholders, the employees, and the general public management has the responsibility to present and interpret the pertinent facts--favorable or unfavorable; incomplete information and good imaginations connive to the good of nobody.

Perfect reporting is an unachievable goal; nevertheless, it is a goal which should be held by the management of every large corporation. Better reporting represents a great challenge to the best in business leadership. Some managements have been striving to make their reports more informative and in line with the needs of various reader groups. But as this study has revealed, much is yet to be done.
APPENDIX

The 100 Companies Whose Reports Are Included in the Study

Adam Hat Stores, Incorporated
Allied Stores Corporation
Aluminum Company of America
American Can Company
American Chicle Company
American Home Products Corporation
American Rolling Mill Company, The
American Sugar Refining Company, The
ATF Incorporated
Belden Manufacturing Company
Bigelow-Sanford Carpet Company, Incorporated
Black, Sivalls & Bryson, Incorporated
Blue Bell, Incorporated
Borden Company, The
Bridgeport Brass Company
Briggs Manufacturing Company
Bristol-Myers Company
Brown & Bigelow
Burroughs Adding Machine Company
Butler Brothers
Canada Dry Ginger Ale, Incorporated
Carborundum Company, The
Carrier Corporation
Caterpillar Tractor Company
Celanese Corporation of America
Coleman Company, Incorporated, The
Cudahy Packing Company, The
Dayton Rubber Manufacturing Company, The
Disney Productions, Walt
Douglas Shoe Company, W. L.
Dr. Pepper Company
Drackett Company, The
Dresser Industries, Incorporated
Duplan Corporation, The
Eastman Kodak Company, The
Electric Boat Company
Ferro Enamel Corporation
Flintkote Company, The
Food Machinery Corporation
Foster and Kleiser Company
Fruehauf Trailer Company
Gair Company, Robert, Incorporated
General Electric Company
General Foods Corporation
General Motors Corporation
General Shoe Corporation
General Time Instruments Corporation
Godchaux Sugars, Incorporated
Goldblatt Brothers, Incorporated
Goodyear Tire & Rubber Company, The
Hamilton Watch Company
Harris-Seybold Company
Heywood-Wakefield Company
Hoover Company, The
International Harvester Company
International Minerals & Chemical Corporation
Kennebec Copper Corporation
LaPlant-Choate Manufacturing Company, Incorporated
Lerner Stores Corporation
Lorillard Company, P.
Macfadden Publications, Incorporated
Mallory & Company, P. R., Incorporated
Marquette Cement Manufacturing Company
Martin Company, Glenn L., The
Maryland Drydock Company, The
Mead Corporation, The
Minnesota Mining & Manufacturing Company
Morris & Company, Philip, Limited, Incorporated
National Breweries, Limited, The
National Dairy Products Corporation
National Lead Company
Pacific Mills

Pettibone Mulliken Corporation

Pillsbury Mills, Incorporated

Plomb Tool Company

Reliance Manufacturing Company

Rockwell Manufacturing Company

Safeway Stores, Incorporated

Schenley Distillers Corporation

Shattuck Company, Frank G.

Simmons Company

Simplicity Pattern Company, Incorporated

Staley Manufacturing Company, A. E.

Standard Oil Company (Indiana)

Standard Oil Company (New Jersey)

Stetson Company, John B.

Studebaker Corporation, The

Sunshine Biscuits, Incorporated

Swift & Company

Union Bag & Paper Corporation

Union Carbide and Carbon Corporation

United Aircraft Corporation

United Electrical Coal Companies, The

United-Rexall Drug, Incorporated

United Specialties Company

United States Steel Corporation
Universal Pictures Company, Incorporated
Vick Chemical Company
Walgreen Company
West Virginia Pulp and Paper Company
George Thomas Walker was born at Wyatt, Louisiana, on March 2, 1913. He graduated from the Amite, Louisiana, High School in 1930, and entered Northwestern State College in September, 1932. After completing work for the B. A. degree in business education in August, 1935, he accepted a teaching fellowship at Louisiana State University effective in September, 1935. He was awarded the M.S. degree in the Spring of 1936. In the regular and summer sessions of the period 1936-1940, he taught accounting and other business courses in Northeast Junior College, Southeastern Louisiana College, Southwestern Louisiana Institute, and Louisiana State University. In September 1940, he accepted the position of supervisor of business education in the Louisiana State Department of Education. He left this position on leave in August, 1942, to go to the New Orleans Port of Embarkation as director of civilian training and employee relations. Soon after the end of the war, he resigned from the latter two positions, and reentered the Graduate School of Louisiana State University in September, 1945. While continuing his graduate studies he served as director of counseling for the men in the Junior Division. He is a candidate for the degree of Doctor of Philosophy at the Spring Commencement in May, 1946.
EXAMINATION AND THESIS REPORT

Candidate: George T. Walker

Major Field: Business Administration

Title of Thesis: A Critical Analysis of the Form, Content, and Nature of Corporation Annual Reports

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