CHAPTER XI

FINANCIAL STATEMENTS DESIGN

1. Purpose of Financial Statements

Financial statements are prepared for the use of owners, and for regulatory and other purposes. The best form of presentation of financial statements is that which serves those purposes in the most reliable and expedient manner.

Sometimes it is necessary to prepare a statement in different manners to serve several purposes. When this is done, they should be easily reconciable with one another. Regardless of the purpose or purposes for which the financial statements are prepared, they should always present a substantially sound view of the facts to those to whom they are addressed or presented. Finally, since reliability is the main objective of financial statements, there should be a full disclosure of the facts.

While form and terminology may be helpful in achieving precision, they should be ignored should they obstruct full disclosure of material facts. The captions and sub-divisions of the financial statements must be descriptive and give information of their nature and contents. This procedure will be conductive to a better understanding of the facts. In the opinion of several authorities in accounting, whenever the facts are submitted to an intelligent reader, the interpretation could be left to him, and any action made by the reader on the strength of such financial statements will be on his own account.

The principal business executive must be provided with statements of financial condition and results of operation objectively as to facts reported, but subjectively as to an understanding of their needs. Statements assist even the most constructive and imaginative efforts of the executive, which efforts must be based upon a clear understanding of the financial condition, costs of operations, and resulting income of the business.

To the management, the financial statements are the barometer and compass of the business. It is through these financial statements that the management can formulate scientific planning and intelligent action, and hence make profit where others had failed.

2. Need for Uniform Statements

Statements can be misleading if not presented uniformly from period to period. Financial statements can be more easily analyzed if the figures in the statements can be compared with the figures or groups of figures in equivalent statements of prior periods. The comparison of figures or group of figures which can be expressed in terms of ratios or percentage, can indicate significant trends. Graphic presentation of the same ratios over a period of time can be an effective means of disclosing general trends.

All of these must be borne in mind by the system analyst. Uniformity of charges and credits to the accounts is covered by the chapter of "Chart of Accounts." Each account can be properly analyzed and defined as to scope, contents, and purpose. However, in order to make financial statements uniform from period to period, a sample form of the financial statements may be prepared in order to be rendered to the management.

3. The Design of Financial Statements

The present standard forms of financial statements are the unsatisfactory outcome of a series of compromise between conflicting aims and modes of thought; the balance sheet, as the oldest and for a long time the principal or only statement issued, displays these characteristics most clearly. It is a compromise between the modes of thought of those who prepare it and those for whom it is designed. Originally, it was recognized as a statement of balances and a product of accounting technique, as the symbols--"Dr" and "Cr" by which its two sides were headed indicated. Later, an effort was made to give it a more authoritative character; the inexact but less esoteric headings "Assets" and "Liabilities" were substituted, and the document was described as a statement of assets and liabilities, or of financial position or as showing the state of the company's affairs. Such descriptions gave rise to the belief that it is necessary to define "assets" and "liabilities" when used as balance-sheet headings, as connoting only balances that are or should be carried forward when books kept by double entry in accordance with generally accepted accounting practices are closed.

The cycle thus completed is matched in the history of the income account or statement. Actually, there are two kinds of forms designed for income statements. One is T account form, another is in form of statement. Formerly, the charges to the trading or profit and loss account were usually classified according to the nature of what was purchased or consumed - raw materials, supplies, wages, etc. Analysis of expenditures according to the purposes for which they were made became general with the development of cost accounting as an integral part of the general bookkeeping system. New categories then came into general use in the income account.