

Spring 1986

User-Friendly Financial Statements: A Proposed Model

Kenneth Yale Rosenzweig

University of Dayton, krosenzweig1@udayton.edu

Andrew A. Fioriti

University of Dayton

Follow this and additional works at: https://ecommons.udayton.edu/acc_fac_pub



Part of the [Accounting Commons](#), [Business Administration, Management, and Operations Commons](#), [Business Law, Public Responsibility, and Ethics Commons](#), [Corporate Finance Commons](#), and the [Nonprofit Administration and Management Commons](#)

eCommons Citation

Rosenzweig, Kenneth Yale and Fioriti, Andrew A., "User-Friendly Financial Statements: A Proposed Model" (1986). *Accounting Faculty Publications*. 13.

https://ecommons.udayton.edu/acc_fac_pub/13

This Article is brought to you for free and open access by the Department of Accounting at eCommons. It has been accepted for inclusion in Accounting Faculty Publications by an authorized administrator of eCommons. For more information, please contact frice1@udayton.edu, mschlangen1@udayton.edu.

User-Friendly Financial Statements—A Proposed Model



**Kenneth Rosenzweig, Ph.D., CPA,
CMA, CIA**
Associate Professor
Department of Accounting
University of Dayton
Dayton, Ohio

Andrew A. Fioriti, MBA, CPA
Associate Professor
Department of Accounting
University of Dayton
Dayton, Ohio

Introduction

In contrast to early bookkeeping systems whose only role was to assist the resident owners, financial reporting today serves to protect various nonresident parties with interests in the enterprise, such as absentee shareholders. It provides them with information useful for monitoring the operations of the enterprise and for making decisions concerning it. The Financial Accounting Standards Board (FASB) formalized this concept of usefulness when it stated:

Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.¹

The purpose of this paper is to explore these issues, making beneficial proposals toward the creation of financial statements that offer significantly more utility to the user.

In recent years, financial reporting standards developed by the Accounting Principles Board (APB), and later the FASB, have been criticized for being developed piecemeal in response to current crises. As a consequence, such standards have often been seen by user groups and others as inconsistent with one another. The resulting dissatisfaction led to pressure on the accounting profession to define objectives and frameworks that would guide the establishment of financial reporting standards. Recent efforts in this area included APB Statement No. 4² and the Trueblood Committee Report.³

The attempt by the accounting profession to respond to dissatisfaction with financial reporting led to the FASB's Conceptual Framework Project in the mid-1970s. The project included a 1981 exposure draft, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises*.⁴ This draft, which served as the basis for our study, contained a number of innovative ideas about how financial statements might be structured to enable users to better assess various company characteristics, such as operating leverage, financial leverage, and financial flexibility. This draft was superseded by another exposure draft dated December 30, 1983, titled *Recognition and Measurement in Financial Statements of Business Enterprises*.⁵ Unfortunately, this draft deleted much of the discussion of financial statement structure and, instead, focused primarily on the

question of criteria for recognition of items in the financial statements. We feel the FASB erred in deemphasizing financial statement structure and are of the opinion that it can play a significant role in making financial statements more useful.

Objectives

The authors have used some of the suggestions contained in the aforementioned 1981 FASB exposure draft and have transformed them into a model for potential financial information disclosure.

In contrast to external financial reporting, information for company managers is generally produced only when the benefits, in terms of usefulness for decisions and other purposes, are perceived by company management to exceed the cost. Managerial information is not required to be produced by any agency, such as the FASB or the SEC. Consequently, usefulness for decision making is a much more pervasive element of managerial accounting information than it is for external financial reporting. It is therefore natural that the principles incorporated in our proposed model of financial information disclosure are derived from managerial accounting.

"We feel the FASB erred in deemphasizing financial statement structure and are of the opinion that it can play a significant role in making financial statements more useful."

The central focus of the paper is to enable the user to analyze interrelationships of information within the income statement and thereby make predictions of future income. Two forms of interrelationships are analyzed: that of the behavior of expenses and revenues (cost-volume-profit analysis) and that of the income of different segments. Both cost-volume-profit analysis and segment reporting have been extensively examined in the accounting literature and are widely used in practice. In addition, segment reporting is currently required by SFAS No. 14⁶ in conventional financial statements for certain companies. What is new to this paper is the simultaneous application of these two forms of analysis to external financial reporting.

Financial Statement Illustration

This section presents the proposed financial statements contained in Schedules A through D, explains the general nature of the statements, and defines the terminology used in them.

Since our interest is in restructuring the income statement to facilitate user predictions of future income, our model focuses on the operating section of the income statement. Items outside of the operating section are less predictable and are thus excluded from our model.

Schedule A reports all the elements of income from continuing operations, e.g., operating revenues and expenses. The essential difference between Schedule A and the operating section of a conventional income statement is that the expenses are classified by their behavior with respect to

changes in sales volume. The idea for this classification is derived from contribution income statements commonly used by management accountants.[7:54] In these statements, expenses are classified as variable or fixed. Variable expenses are subtracted from revenues to obtain contribution margin. Then fixed expenses are subtracted from the contribution margin to obtain net income (income from continuing operations).

However, the 1981 exposure draft referred to earlier suggests that a three-way classification of expenses may be more useful for financial statement users. It recommends reporting separately

- 1 Expenses that vary with volume of activity
- 2 Expenses that are discretionary
- 3 Expenses that are stable over time or that depend on other factors, such as the level of interest rates or the rate of taxation [4:20]

We interpret category one to include strictly variable expenses. These are expenses which must increase directly and proportionately as volume increases. The expenses in category 2 are determined by management decision. In a given year, they may be raised or lowered in accordance with management's perception of the appropriate level of expenditure. The third category, which we call period expenses, are not changeable by management within the context of a single year under ordinary conditions.

Since expenses are classified in three categories instead of two, two forms of contribution were necessary instead of the single contribution margin in a conventional contribution income statement. In Schedule A, variable expenses are subtracted from sales to obtain contribution margin. Then discretionary expenses are subtracted from contribution margin to obtain contribution to period expenses. Finally, period expenses are subtracted to obtain income from continuing operations.

Expenses may not always fall neatly into one of the three categories. For example, production labor costs (included in cost of goods sold) normally assumed to be variable are often constrained by union contracts and other inflexibilities, so they do not behave in a strictly variable manner. Also, period expenses, such as officers' salaries, may be subject to limited changes, such as those necessitated by administrative cost reduction programs.

If income statements, such as those we propose, are required for external financial reporting, management's responsibility would include assigning expenses to one of the three categories, based on their best judgment of the expenses' predominant behavior. Such judgments by management are already an integral part of external financial reporting. For example, management is responsible for judging whether costs should be capitalized or expensed and, if capitalized, what should be the appropriate useful life for depreciation purposes. Such judgments must be made even when future events may significantly influence the actual outcomes.

Schedule A

ABC Company
Statement of Income and Contribution Margin
For the Years Ended December 31, 1985, 1984, 1983

	1985	1984	1983
Net sales	\$4,753,000	\$4,985,000	\$4,467,000
<i>Variable expenses:</i>			
Cost of goods sold	1,903,000	2,000,000	1,789,000
<i>Selling:</i>			
Advertising	47,000	50,000	44,000
Sales commissions	95,000	100,000	89,000
Bad debts	19,000	20,000	18,000
Supplies	9,000	10,000	8,000
Storage	28,000	30,000	26,000
Miscellaneous	20,000	20,000	19,000
Total selling	218,000	230,000	204,000
<i>General and administrative:</i>			
Office salaries	10,000	10,000	9,000
Office supplies	10,000	10,000	9,000
Total general and administrative	20,000	20,000	18,000
Total variable expenses	2,141,000	2,250,000	2,011,000
Contribution margin	2,612,000	2,735,000	2,456,000
<i>Discretionary expenses:</i>			
Cost of goods sold	302,000	300,000	301,000
<i>Selling:</i>			
Advertising	10,000	10,000	11,000
Supplies	5,000	5,000	5,000
Miscellaneous	5,000	5,000	5,000
Total selling	20,000	20,000	21,000
<i>General and administrative:</i>			
Office supplies	6,000	5,000	5,000
Total discretionary expenses	328,000	325,000	327,000
Contribution to period expenses	2,284,000	2,410,000	2,129,000
<i>Period (fixed) expenses:</i>			
Cost of goods sold	600,000	600,000	600,000
<i>Selling:</i>			
Sales people's salaries	300,000	300,000	300,000
Depreciation, equipment	100,000	100,000	100,000
Officers' salaries	50,000	50,000	50,000
Storage	20,000	20,000	20,000
Miscellaneous	5,000	5,000	5,000
Total selling expenses	475,000	475,000	475,000
<i>General and administrative:</i>			
Officers' salaries	100,000	100,000	100,000
Office salaries	80,000	80,000	80,000
Office supplies	5,000	5,000	5,000
Insurance	50,000	50,000	50,000
Depreciation, furniture and fixtures	70,000	70,000	70,000
Depreciation, automobile	50,000	50,000	50,000
Total general and administrative	355,000	355,000	355,000
Total period expenses	1,430,000	1,430,000	1,430,000
Income from continuing operations	\$ 854,000	\$ 980,000	\$ 699,000

An additional management responsibility would be to specify, perhaps in a footnote to the financial statements, a relevant range of volume within which the three categories of expenses are expected to behave in the manner indicated. The relevant range should include all normally expected volume levels.[7:48]

It is our opinion that company managers could assign expenses to one of the three categories without undue difficulty. If significant uncertainties existed with respect to the classification of certain items, these could be explained in a footnote to the financial statements.

Naturally, any prediction of future income based on our proposed statement would be predicated on the assumption that the expense structure will remain constant in the future. Such factors as technology and prices are therefore assumed to remain constant. Changes in these factors, along with acquisitions or disposals of operations, could possibly be taken into consideration by making upward or downward adjustments of the results of the income prediction. In any case, such changes should be disclosed in the financial statements to enable users to judge for themselves the extent to which income predictions would be reliable.

The 1981 exposure draft also suggests that aspects of the income statement be distinguished that are affected in different ways by changes in economic conditions. [4:20] Separate product line or segment reporting is likely to provide such information, since different product lines or segments frequently have different risk, profitability, and growth characteristics. We have elaborated

Schedule B **ABC Company**
Statement of Income and Contribution Margin by Product Line
For the Years Ended December 31, 1985, 1984, and 1983

	Product Line 1		
	1985	1984	1983
Net sales	\$2,253,000	\$2,363,000	\$2,117,000
<i>Variable expenses:</i>			
Cost of goods sold	653,000	685,000	614,000
Selling	125,000	130,000	117,000
General and administrative	9,000	9,000	9,000
Total variable expenses	787,000	824,000	740,000
Contribution margin	1,466,000	1,539,000	1,377,000
<i>Discretionary expenses:</i>			
Cost of goods sold	139,000	138,000	139,000
Selling	10,000	10,000	10,000
General and administrative	2,000	2,000	2,000
Total discretionary expenses	151,000	150,000	151,000
Contribution to period expenses	1,315,000	1,389,000	1,226,000
<i>Period (fixed) expenses:</i>			
Cost of goods sold	260,000	260,000	260,000
Selling	27,000	27,000	27,000
General and administrative	---	---	---
Total period expenses	287,000	287,000	287,000
Contribution from continuing operations	<u>\$1,028,000</u>	<u>\$1,102,000</u>	<u>\$ 939,000</u>

the statement of income and contribution margin in Schedule A into product line statements which are shown in Schedules B and C.

The structure of Schedules B and C is essentially the same as that of Schedule A. For each product line (1 and 2), variable expenses are subtracted from sales to obtain contribution margin. Then discretionary expenses are subtracted from contribution margin to obtain contribution to period expense. Finally, period expenses are subtracted to obtain contribution from continuing operations for the respective product lines.

As is always the case with product line statements, many expenses cannot be directly assigned to the product lines. Such expenses are common to the different product lines and can only be allocated to them on an arbitrary basis. Though SFAS No. 14⁶ recommends allocating some of these common expenses, such as revenues, to segments on an arbitrary basis, doing so would limit the use of the statements for cost-volume-profit analysis, since allocated expenses are not directly related to segment revenues. An alternative approach, which we adopt in this paper, is to not allocate these expenses to the product lines.[7:505] As a consequence, the total of the contribution from continuing operations for the respective product lines does not equal income from continuing operations on Schedule A. Schedule D reconciles the product line contributions with income from continuing operations on Schedule A by subtracting these unallocated expenses from the total of the product line contributions from Schedules B and C.

Schedule C **ABC Company**
Statement of Income and Contribution Margin by Product Line
For the Years Ended December 31, 1985, 1984, 1983

	Product Line 2		
	1985	1984	1983
Net sales	\$2,500,000	\$2,622,000	\$2,350,000
<i>Variable expenses:</i>			
Cost of goods sold	1,250,000	1,315,000	1,175,000
Selling	90,000	97,000	84,000
General and administrative	6,000	6,000	4,000
Total variable expenses	1,346,000	1,418,000	1,263,000
Contribution margin	1,154,000	1,204,000	1,087,000
<i>Discretionary expenses:</i>			
Cost of goods sold	130,000	129,000	129,000
Selling	7,000	7,000	8,000
General and administrative	3,000	2,000	2,000
Total discretionary expenses	140,000	138,000	139,000
Contribution to period expenses	1,014,000	1,066,000	948,000
<i>Period (fixed) expenses:</i>			
Cost of goods sold	240,000	240,000	240,000
Selling	23,000	23,000	23,000
General and administrative	---	---	---
Total period expenses	263,000	263,000	263,000
Contribution from continuing operations	<u>\$ 751,000</u>	<u>\$ 803,000</u>	<u>\$ 685,000</u>

Uses of the Proposed Financial Statements

The following section demonstrates how an investor, or other user of the proposed financial statements, could analyze them to derive valuable information in order to make decisions about ABC Company. All of the analyses involve various illustrations of the prediction of income from continuing operations for a future period, given various assumptions about changes in sales. The chief advantage of the proposed statements of income and contribution margin is that they facilitate such predictions by classifying the expenses in terms of their behavior with respect to changes in sales volume. ➤

Illustration I

This analysis involves the prediction of 1986 Income from Continuing Operations based on an estimated 10% increase in 1985 sales.

Discretionary expenses are expected to remain fixed and the mix between Product Line 1 and Product Line 2 sales is expected to remain constant. The calculation is as follows:

1985 net sales from Schedule A		\$4,753,000	
	x	110	%
Predicted 1986 net sales		5,228,300	
Contribution margin percentage from Schedule A	x	55	%
Predicted 1986 contribution margin		2,875,565	
Less: Discretionary expenses from Schedule A	327,000		
Period expenses from Schedule A	1,430,000	1,757,000	
Predicted 1986 income from continuing operations		\$1,118,565	

Schedule D

ABC Company Reconciliation of Product Line Operations For the Years Ended December 31, 1985, 1984, and 1983

	1985	1984	1983
<i>Contribution from continuing operations:</i>			
Product Line 1 (Schedule B)	\$1,028,000	\$1,102,000	\$ 939,000
Product Line 2 (Schedule C)	751,000	803,000	685,000
Total	\$1,779,000	\$1,905,000	\$1,624,000
<i>Not-assignable expenses:</i>			
<i>Variable:</i>			
Selling	3,000	3,000	3,000
General and administrative	5,000	5,000	5,000
Total	8,000	8,000	8,000
<i>Discretionary:</i>			
Cost of goods sold	33,000	33,000	33,000
Selling	3,000	3,000	3,000
General and administrative	1,000	1,000	1,000
Total	37,000	37,000	37,000
<i>Period:</i>			
Cost of goods sold	100,000	100,000	100,000
Selling	425,000	425,000	425,000
General and administrative	355,000	355,000	355,000
Total	880,000	880,000	880,000
Total not-assignable expenses	925,000	925,000	925,000
Income from continuing operations for total company (Schedule A)	\$ 854,000	\$ 980,000	\$ 699,000

The contribution margin percentage is derived by dividing the contribution margin from Schedule A by net sales for each year and taking an average. Like other financial measurements, there is likely to be a certain amount of year-to-year fluctuation in the contribution margin percentages due to random deviations, such as unusually low or high expenses in a given year. The averaging procedure is designed to neutralize these deviations.

Illustration II

Illustration II assumes the same facts as the prior one except that discretionary expenses are assumed to be variable. The calculation follows:

1985 net sales from Schedule A		\$4,753,000
	x 110 %	
Predicted 1986 net sales		5,228,300
Contribution to period expenses percentage from Schedule A	x 48 %	
Predicted contribution to period expenses		2,509,584
Less: period expenses from Schedule A		1,430,000
Predicted 1984 income from continuing operations		<u>\$1,079,584</u>

The contribution to period expenses percentage is calculated by dividing the contribution to period expenses from Schedule A by net sales for each year and taking an average.

In each of the prior illustrations, the sales mix was assumed to remain constant. In other words, the 1986 sales increase had the same relative proportions of Product Line 1 and Product Line 2 sales as 1985 sales (about 53% and 47%, respectively, from Schedules B and C). However, for many companies, different product lines may have different potential for sales increase, and this may have an important impact on profit prediction.

Illustration III

The sales increase in Illustration III is still assumed to be 10% over 1985 sales, but 75% of the sales increase is assumed to be Product Line 1, and only 25% is Product Line 2. Discretionary expenses are assumed to be fixed, as they will be for the remainder of the illustrations, though a similar analysis can easily be developed assuming they are variable. The calculation follows: ➤

	Product Line		Total Company
	1	2	
1985 net sales from Schedule A			\$4,753,000
	x 10 %		
Predicted increase in sales			<u>\$ 475,300</u>
Product line percentage of increase	x 75 %	x 25 %	
Predicted increase in sales	356,475	118,825	
1985 net sales from Schedule B & C	<u>2,253,000</u>	<u>2,500,000</u>	
Predicted 1986 sales	2,609,475	2,618,825	
Contribution margin percentage from Schedule B & C	x 65 %	x 46 %	
Predicted 1986 contribution margin	<u>\$1,696,159</u>	<u>\$1,204,660</u>	<u>\$2,900,819</u>
Predicted 1986 net sales			5,228,300
Not-assignable variable expenses percentage from Schedule D			x 1.7 %
Predicted 1986 not-assignable variable expenses			88,881
Discretionary expenses from Schedule A			327,000
Period expenses from Schedule A			<u>1,430,000</u>
Total deductions			<u>1,845,881</u>
Predicted 1986 income from continuing operations			<u>\$1,054,938</u>

The analysis is similar to that in the first illustration, except that specific predictions are made of the respective product line sales and specific contribution margin percentages are applied to them. An additional difference derives from the fact that some of the variable expenses, though varying with total company sales, were not assignable to specific product lines, as is

indicated in Schedule D. An example would be sales order processing costs for a company that did not distinguish the time devoted to processing Product Line 1 and Product Line 2 sales orders. The additional not-

assignable variable expenses, associated with the 10% increase in sales, are deducted from the total company product line contribution margins, along with discretionary and period expenses, to obtain predicted 1986 income from continuing operations.

Sensitivity of Income to Sales Changes

The user might desire to develop a way to predict quickly the effect on net income of various changes in overall company and respective product line sales. The contribution

margin percentage is the portion of each sales dollar which increases (or decreases) income from continuing operations when sales increase (or decrease). The respective contribution margin percentages are itemized below:

Total company contribution margin percentage from Schedule A		55%
Product Line 1:	Contribution margin percentage from Schedule B	65%
	Less: Not-assignable variable expenses percentage from Schedule D	-2
	Adjusted contribution margin percentage	63%
Product Line 2:	Contribution margin percentage from Schedule C	46%
	Less: Not-assignable variable expenses percentage from Schedule D	-2
	Adjusted contribution margin percentage	44%

The product line contribution margin percentages must be adjusted for the effect of not-assignable variable expenses. When the sales of a particular product line increase, total company sales also increase, causing a proportionate increase in not-assignable variable expenses.

Apart from any prediction of income, the product line contribution margin percentages reveal to the user of the financial statements the relative sensitivity of income from continuing operations to changes in the respective product line sales. For ABC Company, income from continuing operations is much more sensitive to changes in Product Line 1 than Product Line 2 sales. The contribution margin percentages can be used to make a quick prediction of the change in income from continuing operations, given a change in sales.

Illustration IV

This calculation assumes a 20% increase in 1985 sales and no change in the mix between Product Line 1 and Product Line 2 sales. The calculations follow:

Note that no changes are expected in discretionary or period expenses, so they are not included in the change in contribution margin.

1985 net sales from Schedule A	\$4,753,000
x 20 %	
Predicted increase in net sales	950,600
Total company contribution margin percentage	x 55 %
Predicted change in contribution margin	522,830
1985 income from continuing operations from Schedule A	+ 854,000
Predicted 1986 income from continuing operations	<u>\$1,376,830</u>

Illustration V

In this situation, the sales increase is again assumed to be 20%, but 60% of the increase is Product Line 1 sales and the remainder is Product Line 2 sales. Here are the calculations:

	Product Line 1	2	Total Company
1985 net sales from Schedule A			\$4,753,000
			x 20 %
Predicted increase in net sales			<u>\$ 950,600</u>
Product line percentage of increase	x 60 %	x 40 %	
Predicted increase in net sales	570,360	380,240	
Adjusted contribution margin percentage	x 63 %	x 44 %	
Predicted increase in contribution margin	\$ 3,59,327	\$ 167,306	\$ 526,633
1985 increase from continuing operations from Schedule A			+ 854,000
Predicted 1986 increase from continuing operations			<u>\$1,380,633</u>

Illustration VI

All of the analyses so far have involved increases in income from continuing operations due to increases in sales. Similar analyses could be developed involving the effect of predicted decreases in sales on income from continuing operations. The user of the financial statements may be especially interested in assessing the risk that sales decreases will reduce profits and even cause losses. One measure that he may want to calculate is breakeven sales, i.e., that level of sales at which profits will be zero. In order to perform such a calculation for a multi-product firm like ABC Company, he must make some assumption about the sales mix at the breakeven point.

In this example, the mix between Product Line 1 and Product Line 2 sales is assumed to be the same at the breakeven point as it was in 1985. The well-known formula for calculating breakeven sales is as follows:

$$\text{Breakeven sales} = \frac{\text{Fixed expenses}}{\text{Contribution margin percentage}}$$

In the illustration both period and discretionary expenses are assumed to be fixed so the calculation is as follows:

Discretionary expenses from Schedule A	\$ 327,000
Period expenses from Schedule A	<u>1,430,000</u>
Total fixed expenses	1,757,000
Contribution margin percentage	<u>+ 55 %</u>
Breakeven sales	<u>\$3,194,545</u>

Illustration VII

In Illustration VI, the sales mix was assumed to be unchanged as sales were reduced to the breakeven point. However, for many companies, the risk of sales decrease may be much greater for one product line than for another. The breakeven point can be calculated assuming any sales mix. Illustration VII shows the sales of Product Line 1 at the 1985 level, but Product Line 2 sales are reduced to the breakeven point. Note the following calculations:

We showed earlier that the contribution margin percentage was the portion of each sales dollar which increases (or decreases) income from continuing operations when sales increase (or decrease). In order to reduce income from continuing operations by \$854,000 to the breakeven point, Product Line 2 sales must be reduced by \$1,940,909. Note that breakeven sales are lower, assuming only Product Line 2 sales are reduced, than they are when both product line sales are reduced in the same

proportion. This is due to the fact that Product Line 2's adjusted contribution margin percentage is lower than Product Line 1's. Thus, as sales decrease, a larger portion of the more profitable Product Line 1 is in the sales mix and it therefore takes less sales dollars to reach the breakeven point.

Incorporation of Uses in the Financial Statements

The purpose of financial statements is to provide a solid base of information on which intelligent decisions can be made by the user. The need for financial statements to present information well suited for such decisions is more important for the nonsophisticated user, i.e., the average stockholder, than it is for the sophisticated user, i.e., the financial analyst. The sophisticated user is likely to have available other sources of information and to be

1985 net sales from Schedule A		\$4,753,000
1985 income from contribution operations from Schedule A	\$ 854,000	
Adjusted Product Line 2 contribution margin percentage	<u>+ 44 %</u>	
Product Line 2 sales reduction to breakeven point		<u>- 1,940,909</u>
Breakeven sales		<u>\$2,812,091</u>

able to adapt information in the conventional financial statements for his own uses. For example, the sophisticated user might be able to develop reasonable approximations of future net income by estimating the fixed or variable behavior of expense items listed in conventional financial statements on the basis of prior knowledge.

To assist the nonsophisticated user to make predictions of income, worksheets might be included in the financial statements either on the statement itself or in the form of a footnote. For example, similar to the analysis in Illustration I, the following might be presented:

Other worksheets might be developed under the other assumptions described in the "Uses of the Proposed Financial Statements" section.

Conclusion

The need for more informative and meaningful financial statements is quite pressing. The proposals made in this paper are designed to provide information that is more suitable for decision making. Such information can enable users to predict income based on their own sales change and product mix assumptions and to assess the sensitivity of net income to sales changes.

Notes

¹Financial Accounting Standards Board, *SFAC No. 1. Objectives of Financial Reporting by Business Enterprises* (Stamford, Conn., 1978).

²Accounting Principles Board, *Statement No. 4. Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises* (New York: American Institute of Certified Public Accountants, 1970).

³*Objectives of Financial Statements, Report of the Study Group on the Objectives of Financial Statements* (New York: American Institute of Certified Public Accountants, 1973).

⁴Financial Accounting Standards Board, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises, Exposure Draft of Proposed Statement of Financial Accounting Concepts* (Stamford, Conn., 1981).

⁵Financial Accounting Standards Board, *Recognition and Measurement in Financial Statements of Business Enterprises, Exposure Draft of Proposed Statement of Financial Accounting Concepts* (Stamford, Conn., 1983).

⁶Financial Accounting Standards Board, *SFAS No. 14, Financial Reporting for Segments of a Business Enterprise* (Stamford, Conn., 1976).

⁷Hornsgren, Charles T., *Cost Accounting, A Managerial Emphasis* (Englewood Cliffs, N.J.: Prentice-Hall, 1982).

Worksheet for Prediction of 1986 Income from Continuing Operations (assuming discretionary expenses remain unchanged)

1985 net sales from Schedule A			\$4,753,000
User prediction of percentage increase in net sales	[]%	= x []%	
	+ 100		
Predicted 1986 net sales		\$[]	
Contribution margin percentage from Schedule A		x 55	%
Predicted 1986 contribution margin		\$[]	
Less: Discretionary expenses from Schedule A	\$ 327,000		
Period expenses from Schedule A	1,430,000		- 1,757,000
User prediction of 1986 income from continuing operations		\$[]	