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Are the Financial Statements of Savings Banks Prepared for the Benefit of Their Depositors?

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I am sure that you have all heard and probably engaged in discussions concerning the presentation of financial statements by savings banks. I am also sure that most of you are quite satisfied with the statements presently being published by your individual banks and probably with those of other similar institutions. I should like to state, quite frankly, that I, as an accountant, feel there is substantial room for improvement in the statements which some savings banks are presenting to their depositors.

I have no criticism generally of statements prepared for management use by the accounting departments of the various institutions with which I am familiar. Although these statements vary materially from bank to bank in both form and content, their design meets the specific requirements and desires of the management of each individual institution. However, this is an area in which it would be inappropriate to generalize to a group whose members are so experienced in the management of savings institutions.

Rather I wish to direct discussion this evening to the financial statements, counter statements, or financial reports made available by the various mutual savings banks of New York to their depositors. These banks cite as their operating theme that they are operated solely for the benefit of their depositors. At those institutions with which I am personally familiar, I have seen numerous incidents which reflect this management approach. In your day-to-day operations, the mutual savings banks of New York are certainly operated for the benefit of the depositors. However, are their financial statements prepared for the benefit of these same depositors? I think our answer to this question is not so clear-cut, and may vary from one bank to another.

It is a frequent comment of accounting officers of savings banks that their depositors do not have the same interest in the operations of their savings bank as do the stockholders of commercial banks. If this is true, it is unfortunate. Obviously your depositors are the equitable owners of your savings banks. Why then are they disinterested in your operations? Why do they not identify a particular savings bank as their bank in the same way that stockholders—even very small stockholders in large corporations—think of their companies possessively?

One reason may be that our savings institutions have never made a concerted effort to interest their depositors in operations of the bank. This is a public relations area that I am certainly not qualified to discuss at any depth. As an example the statements I periodically receive from the two savings banks with which I personally do business are not designed to either interest or inform me. They are inconclusive in a number of respects and perhaps misleading in several others.

Perhaps the old saying "If a thing is worth doing, it is worth doing well" applies here. If it is worth while to make any financial report available to your depositors, then it is worth while to make that report the most complete and informative possible. A report designed to attract interest might include statistical presentations and comparative financial statements, items now rarely seen in savings banks' reports.

Certain standards of financial reporting have evolved in the United States over the last twenty-five years and are now almost universally applied by industries other than banking. This evolution has been significantly assisted by the Securities Act and the Securities Exchange Act and, I believe, to a considerable degree, by the bulletins issued from time to time by the American Institute of Certified Public Accountants. It is now possible for a reasonably informed reader to extract really meaningful financial information from the published reports of most industrial or commercial companies of significant size.

The financial statement that most readers find of greatest value is probably the income statement. After all, what is of more concern to someone with an interest in the equity of a particular business than the way in which it receives its income, incurs expenses, and produces its profit or loss? Certainly you gentlemen who are stockholders in corporations will agree that this is information of vital import in your investment decisions. Yet, it is unusual for even a summary income statement to be made available by savings institutions to their depositors. This seems most strange to me. The type of operations conducted by your banks is such that a very simple income statement would be completely appropriate. Based on my own experience, I think that it would be most beneficial to the administrators of the average bank if their depositors knew the small administrative cost of their operation in relation to the portfolios managed and the dividends paid depositors.

Perhaps you bankers who have grown up with these really remarkable statistics do not appreciate how impressive they are to one outside of your profession. I think many of you are hiding your light under a bushel.

A related point should be observed; the recent attempts to change the basis of taxing savings institutions might present less of a peril to your operations if your millions of depositors understood that what is proposed is, fundamentally, new taxes on those who save. If this great mass of voters understood that the proposed taxes would be on them rather than on some remote banking institution whose finances they do not understand, I think that few legislators would find the proposals appealing.

However, since the practice among savings banks is to avoid public presentment of income statements, it might be constructive if we here this evening devoted our time to the statement of condition, the one financial statement that every savings bank makes available to the public.

In a regulated industry such as yours, a reader might expect to find a great deal of uniformity among the financial statements of the various members of the group. This would certainly be true in the case of railroads or public utilities or insurance companies. Strangely enough, it is not true of banking institutions generally and this includes commercial banks. There is a great lack of uniformity in reporting practice, if not terminology, among banking institutions. Generally speaking, however, this lack is not apparent to a reader who might in fact be misled in attempting to compare the financial statements of two savings banks. One reason that basic differences may not be apparent is that the statements usually contain extremely abbreviated captions and lack footnotes of the type used by companies in other industries to describe the bases on which the various significant accounts are carried.

Perhaps the simplest approach to this discussion would be to take a sample savings bank statement of condition and run down its captions item-by-item. This statement would perhaps be typical of all savings banks' statements of ten years ago and of many still currently published. Great improvements have been made by some banks but the statements of others have seen little change in that period.

There isn't much to say about cash on hand and in banks or in vaults or on deposit. We all would assume that the dollar extension of this caption represents exactly what it purports to represent.

The second item in our typical statement, however, is subject to gross misinterpretation. This caption might read "United States Government Securities" or some similar expression. There is now going around Wall Street a remark that if a person wants to invest, he buys common stocks, if he wants to speculate, he buys government bonds. When we consider that in some savings institutions, government securities represent 30 per cent or more of the total assets of the bank, it becomes apparent that our method of presenting this particular item materially affects the balancing undivided-profits figure. Generally, savings institutions will report government bonds on a basis reflecting some variation of original cost; however, this is far from a universal practice. I know of one savings bank that has even carried this figure in its statements at par value.

My recommendation would be an amortized cost basis, with a parenthetical expression of market valuation. Banks follow various methods of accounting for amortization of premium and accumulation of discount. This lack of consistency is probably not a great problem even in today's dynamic bond market, but disclosure of method would certainly improve the fairness of a statement's presentation.

A commercial company having substantial holdings in securities would show parenthetically in its financial statements the present market valuation of these securities together with the carrying value in the statements—normally cost. This is certainly not generally done by savings banks, although it appears to be information basic to an appraisal of the bank's current position.

In some cases the *United States Government Bonds* caption would include the expression *Less reserves,* usually without indication of the dollar value of the reserves. A reader might assume that these reserves represent a mark to market but we know that this is not always so.

Generally speaking, everything that has been said about government bonds is equally true in relation to the other investment areas such as corporate stocks and bonds. We might add that although these other investments may be substantial in amount, there is often no breakdown by type, that is, groupings of common stocks, preferred stocks, corporate bonds, etc.

Possibly the most important type of asset in which a typical savings bank deals is its real estate mortgages. Here practice shows great variance in the details revealed. Obviously the bank's risk and earnings in a particular situation are affected by an FHA or VA guarantee on a mortgage. An ever-increasing group of banks recognize the financial significance of such guarantees and therefore report separately their conventional mortgages and their guaranteed mortgages. This is certainly a desirable practice. Again, concerning mortgages, we usually find no statement of the method of amortization of any initial costs of obtaining them. Here again we also find in some cases the expression *Less reserves* and are again puzzled by the questions, "How large and for what are the reserves?"

Probably no area in the statement receives such wide variance of treatment as does the valuation of banking houses and equipment. We see almost a complete range of treatment from those banks that carry their capital assets at a nominal valuation to those that carry them at full original cost. There is great merit in the practice followed by many banks of carrying their capital assets on a basis of original cost less depreciation. This practice corresponds with that followed almost universally by other industries. However, even those banks that do follow this practice usually extend in their statement of condition only the net carrying value of these assets without showing the amount of reserve for depreciation that has been built up.

Another very significant item, although generally small in relation to total assets, is accrued interest. Here again we have considerable variance in the method followed to accrue interest. While any of several methods might be equally acceptable, it would be beneficial if the method were revealed, particularly when this method has been changed from one year to the next, thereby distorting income and producing a statement of condition not directly comparable to that of the prior year.

On the statements of some banks there would be detailed assets of other types but I believe that we have covered those common to virtually all savings banks. Let us now look briefly at the liability side. I say *briefly* because in the statements of a typical bank the liability side is extremely condensed.

The balances due depositors require little exploration. It is customary for some banks to report separately Christmas Clubs, School Savings Depositors, etc. These classifications might not seem to be very significant to a reader.

Frequently all the other liabilities of the bank are lumped in a single figure under a caption such as *Other liabilities* or *Accrued* *liabilities* or *Accrued for taxes and expenses.* This is probably reasonable in most cases because of the small amount concerned.

The last group of accounts is combined in many statements into a single figure on the liability side under a caption such as *Surplus, undivided profits and reserves.* Let us consider just what this caption means.

The segment comprising surplus is readily identifiable. Certainly a bank's surplus is no secret and therefore it appears that surplus might well be shown separately from undivided profits. In fact, this is the general practice in commercial banks but not in savings banks.

Next, *Undivided profits* is a caption that seems to mean many things to different people. It is first of all the aggregate profits of the institution that have not yet been paid out as interest or transferred formally to surplus. It also represents the vague "other" side or any adjustments that may have been reflected in the valuation of the bank's assets. Even though it is, in the normal case, a definitely hybrid figure, it deserves to be separately stated.

The last item is *Reserves.* For some years there has been a campaign among accountants to limit the use of the word *Reserve* in accounting terminology. This campaign reflects the frustration felt by readers of financial statements in trying to determine which of the various meanings of the word *Reserve* is intended in a particular caption of a particular statement. In some uses the word denotes simply a segregation of surplus. Where this is true, it should be presented near *Undivided profits.* If there is any direct need for the reserve, it certainly does deserve to be stated separately. As a minimum, it appears necessary to indicate whether the reserves, which are frequently significant in amount, are of a contingent nature, or are of a liability or valuation type.

If these reserves are intended as valuation reserves, as for example, reserves for depreciation of banking houses or reserves for losses in government securities, it is even more difficult to support their being combined with surplus. If the management of a bank feels it necessary to provide these reserves, it seems clear they will probably not be available for eventual distribution to depositors. The best treatment would be to apply them directly against the assets to which they relate.

I hope that these remarks have been of sufficient interest to start some additional discussion toward making your financial reports more informative. I realize that this is well-trod ground and that others have addressed this group along similar lines. I know, however, that this repetition of topic will not produce apathy on the part of you who influence the financial policies of your various institutions. Actually, members of your group have been among the most aggressive leaders in the very substantial improvements made in bank reporting of financial statements over the period of the last ten years. The thought that I should like to leave with you is this: In spite of the improvement achieved, the information presented in the statements of a number of savings banks does not compare favorably with the information reported by many other savings banks or by commercial and industrial enterprises of comparable size. Since industry looks to the banking community for leadership in matters financial, this is particularly unfortunate. I submit that you would not accept from customers soliciting loans, financial statements as incomplete as those some savings banks present to their depositors, the equitable owners of the institutions that you serve and for whose benefit the statements should be prepared.