ARE FINANCIAL STATEMENTS STILL RELEVANT?

Eliseo A. Aurellado

Since the time of Fra Luca Pacioli, inventor of the double-entry bookkeeping system that eventually led to the accounting profession, various stakeholders have been looking at financial statements as a way of measuring the financial health and performance of an organization. Based on this analysis, they have tried to make predictions of its future, the assumption being that past performance is an indicator of potential. If things remain the same it is reasonable to expect that the organization will continue to perform just as well. Yes and no. As the external auditor indicates in his audit report, the balance sheet is merely a snapshot of the organization's health as of a given date and that the results of its operations are merely for a given period. Thus, anything can happen beyond that timeframe. The future is anybody's guess and divining it takes a lot of analysis of variables that could change over time. Consequently, we observe the accountancy profession's emphasis on standards that every practitioner and organization must adhere to. While the adoption of international standards to make financial statements comparable across geographic boundaries is desired it is not always followed because of peculiarities in the way other countries operate. Yet, there is wisdom in having financial statements conform to standards that are familiar to advocates of the profession so that investment, financing and operational decisions can be made with relative comfort across the globe.

While comparability of financial statements is aspired for, there is also the issue of valuation. Looking at audited financial statements is like looking at an old newspaper carrying events that may have lost their relevance because *passé*. By analogy, acquisition or historical cost as a means of measuring the value of an asset, while easily verifiable, has lost some of its significance. The introduction of mark-to-market values as well as appraised values are some ways that the accounting profession has tried to address the issue of relevance and what is considered fair value. At the end of the day, what is the true measure of an organization's worth? Is it the picture shown by its historical past or is it the promise of its future?

Many investors who wish to acquire a new company or make an investment try to foresee the future by making financial projections. This potential stream of cash flows is then translated to its present equivalent by adopting an appropriate discounting rate and using the time value of money. This discounted cash flow analysis is familiar to all students of finance and accounting. What it does is to try to make an educated guess of what an organization is really worth, not by looking at its past but by concentrating on its future. This forward-looking view is deemed to be a more useful way of establishing values. However, it does not have the same verifiability feature of accounting as we know it. Perhaps the accounting profession can look at it as a way of providing additional information to the interested public who may wish to make investments on the basis of what they see in the financial statements.

About the Author

Eliseo A. Aurellado, PhD is a CPA and member of the Board of Accountancy. He teaches at the Ateneo Graduate School of Business and is Vice Chairman and COO of Metro Stonerich Corporation, a Triple A ISO-certified construction firm.