

1932

## Certified public accountant, 1932 Vol. 12 January-June

American Society of Certified Public Accountants

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### Recommended Citation

American Society of Certified Public Accountants, "Certified public accountant, 1932 Vol. 12 January-June" (1932). *Newsletters*. 61.  
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**THE  
CERTIFIED PUBLIC  
ACCOUNTANT**

**VOL. 12  
January to June  
1932**



20 Cents

The

January, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants



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# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

JANUARY, 1932

NUMBER 1

*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Application for second class privilege pending at post office, Richmond, Virginia.

## The President's Column

### A Suggestion for the New Year

THE necessity of a careful effort to classify the various services of the Certified Public Accountant, so that the members of the profession as well as the general public would each understand the scope of work indicated by specific titles, has long been acknowledged by everyone familiar with public accountancy. After the comprehensive report rendered at Memphis, expressed themselves by resolutions as being desirous of disseminating the valuable information to accounting instructors, business and financial groups.

In this work of dissemination, the members of The American Society are afforded an excellent opportunity to assist. The annual audit rush is here; in a short time reports of certified public accountants will be flooding business and financial organizations in every State of the Union. The period is most opportune for accountants to familiarize themselves with, and give publicity to the classification of accountancy services and certificates as adopted in principle by The American Society and several State organizations of certified public accountants. The new engagement, or the old engagement renewed, should be classified under one or more of the divisions recommended by the Commit-

tee, and the client informed thereof. The text of the auditor's report should be changed from its old form if necessary, and the accountant's invoice should also contain the wording of the class of service rendered in conformity with the Committee's recommendations.

It is human nature doubtless to expect the organization, State or National, through its officers and its committees to do the work and smooth the road for the benefit of the individual members. The members of this organization, each working in his own circle—large or small, can spread the principles of Classification and smooth the road of better mutual understanding more effectively, and more universally, than a handful of officers and committeemen, no matter how competent and resourceful.

For the New Year, therefore, it is suggested that every member of our Society familiarize himself with the report of our Committee on Classification and Certification of Accountancy Services to the end that with the opportunity afforded by annual audits now under way, each one will do his individual share toward spreading the helpful idea. Do this and the committee work to follow will find a fertile field and results will be more rapidly attained.



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# Accounting and Credits\*

By HENRY H. HEIMANN

*President, National Association of Credit Men*

**M**R. Chairman and Gentlemen: To begin with, I bring to you, of course, the greetings of the association I represent, which is the National Association of Credit Men.

In order that you might have a picture clearly in mind of the type of organization, (not that I am going to impose on your graciousness to do any advertising) allow me to say that we deal with wholesale credits as distinguished from individual or personal credits. In other words, we pass on the credits of jobbing concerns, wholesalers and manufacturers.

I think I can fairly say that my note of greetings to you carries with it a sense of sincerity that might ordinarily not be found in these platitudinal expressions, when I tell of some developments immediately after I went into this work. I did, in my own private industry, serve as auditor, and if I am to let you in on any of the secrets of my ambitions in life, I would say to you in all frankness that I hope some day I might get to be a certified public accountant. But in my business I went from the auditing field to the finance field, from the finance to the sales, and when I left private industry I was vice-president of the Kawneer Company, in charge of sales.

When I went into the present work, which I would have you understand is largely a labor of love, I called in the secretary-managers of our organization. We have some one hundred secretary-managers located throughout the country who handle our work. At this meeting I suggested and was given the assurance that if I took the assignment each and every local unit of my organization would present me with a certified public accountant's statement twice annually. Further than that, I am to pass upon the accountants who might be qualified to give that audit. I have no hesitancy in saying that if I understand this organization correctly, and if I

understand the American Institute correctly, membership in either of these two organizations would automatically call for approval on my behalf. I mentioned that to illustrate to you just how I feel toward a C. P. A. balance sheet. We credit men, I feel, can do as much to promote our own interests selfishly, if you please, and can do as much to promote your interests, by insisting on C. P. A. audits from anyone who might apply for credit, as any organization in the country.

Furthermore, there is a mutuality of interest in our work that I am sure would be helpful to us if we co-operated along certain definite lines.

Permit me at this time to make some observations with respect to your own field. I have often felt that if certified public accountants could bring home to the small merchant the value of a certified public accountant examination and audit, you would not only be rendering a service to business, but you would be rendering a service to human welfare as well, for in all of my experience as a credit manager of an industrial company, I can honestly and truthfully say that a man who knew what his business was about and who was posted on the details of his business was an unusually good credit risk. The unfortunate thing about the small merchant is that he does not know. While from a monetary point of view it might not be fruitful to develop that small merchant's business, I take it you are in a profession, and everyone in a profession must do many things for which adequate compensation is not received, by way of earnings at least, in order that the profession might bring added prestige and further service to humanity.

If there is any one thing lacking in the country at the present time, it seems to me that it is old-fashioned spunk or courage. You people in the next year must exercise courage in every respect, for you are going to be faced, as I see it, with situations which cannot be glossed over and in the handling of which you

\*Address delivered at the annual meeting of The American Society of Certified Public Accountants, October, 1931.

must not only exercise courage but you must frankly interpret the facts.

I have been interested in the recent English decision, and I am wondering how far the accountant would have gotten in the United States in that case. I am satisfied that men not engaged in your work as a profession would have immediately concluded that at least he was incompetent, if, indeed, he was not civilly liable.

I am wondering what the attitude of the accountant is going to be this year with respect to inventory. Delicate questions are going to be put up to you in this respect. Certainly there will be an inflation in inventories; make no mistake about that, particularly in the finished goods. There is a question that is going to call for an unusually high degree of courage. May I say, when I suggest these matters, that the accountants I have had to do with have, I am happy to inform you, always possessed a high degree of courage.

It seems to me that you can be of service to your country at this particular time with respect to advising in matters that may affect national welfare. After all, you haven't any iron in the fire. You are not pulling for this industry or for that industry. You stand in an unprejudiced light, just as does the organization I represent. Can you tell me who is the better qualified to pass upon an equitable tax law than the certified public accountants of this country? I should like to see a measure of co-operation with respect to national tax legislation which would have in mind the working out of that legislation, so as to distribute the burden equally, and in such a way as not to be harmful to business.

We have occasion in our work to use accountants' audits, not only in our own program but likewise in the program that we have in what I might call our fraud prevention work. We went out to the nation some four or five years ago and raised a fund of two and one-half million dollars. Perhaps I can explain to you the use to which that fund is put, when I take a sample case out of my portfolio.

Julius Kohn, let us say (we will just call him that), looking towards Mr. Springer's home, Ann Arbor, sees a fine place in which to go into business. He gets into the city and ingratiates himself, first of all, with all of the ministers of town. Oh, Julius is a man who hasn't any particular religion in mind, but he

is very gracious toward all of them. He goes around and makes a donation to the Catholic priest. He next remembers the rabbi. He then gives the Methodist minister some money. Julius Kohn is building local good will. Soon he begins to go to the leading attorney's office, and tells him that he wants to incorporate his business; he is going to locate in the town. It is a fine little town, and he and his family are going to move in and become a part of it.

This he does, and he pays a handsome fee for the incorporation. He opens up his shop and sits down and orders merchandise. He pays his bills promptly for six to eight months. Get that! He pays his bills promptly for six or eight months. Then one night Julius sits down from twelve to two o'clock in the morning, and he scatters broadcast orders for \$138,652.20. I am giving you an exact, typical case. The merchandise is shipped to him, and immediately something goes wrong in the affairs of Julius. His wife begins to complain. Things are breaking rather badly. Money is coming rather difficult. He is having a hard time making a success out of his business. Soon you see the sign "Cash Clearance Sale" over his door, and Julius has a clearance sale, and he cashes in to the tune of \$50,000 or \$60,000, and Julius blows town, or otherwise stands in front of the door wringing his hands and wailing and bemoaning his fate.

All right. We had a fund of two and one-half million dollars. We have fifty investigators scattered throughout the United States. One of the investigators gets on the job. Immediately we see the wisdom of Julius having contacted the various people in the town, for the sympathy of the people is entirely with Julius. "Why, hasn't he been the most generous hearted soul? He gave to our church. He gave to every civic enterprise we had." There could be nothing wrong with Julius, not a thing.

We go to the local officer's office, and we find there, too, Julius tilled the field and cultivated it rather extensively. It looks as though you couldn't get an indictment against a man of that type—impossible. But we persist, and we begin to get the co-operation of the national government, and soon our investigator and the postal inspector gets on the job. A woman enters into the case. We soon find communications between Julius and the



nurse, and learn that Julius has not only taken this money and cached it in one of the Southern banks, but that such merchandise as Julius could not sell, he has secreted, with the result that in the period of just thirty or sixty days we get all the evidence on Julius, and in this particular instance we find that he plans on opening up in Leavenworth, Kansas, I don't know why. Our investigators went down to Leavenworth, and on Thanksgiving Day walked into Julius' home and partook of a wonderful Thanksgiving feast that Julius intended, certainly, for his own consumption. Julius was given two years and two days for the use of the mails to defraud.

I will remind you of the fact that this two and one-half million dollar fund that we have raised has been responsible for the conviction of 1,179 for commercial crime.

When a man can no longer, in safety, go out and hold up a man on the street and take the risk and the chance, he gets into commercial crime. I give you this illustration so that in case you are called in on audits of that character, you will know what sanitary work we are trying to do, and you will be of assistance to us and will do, if anything, an unusually good job on an assignment of that kind. We are endeavoring in all ways we possibly can to keep credit well defined, to keep it well disseminated, to keep standards and ethics about its dissemination, for if you fail in that, your entire business structure becomes out of joint. Bad credit is like so much counterfeit money. It ruins everybody that touches it. Why, the problems of the world today are problems of credit.

You have as a base your gold standard, an infinitesimally small amount. From that point forward, every business transaction that you have is a matter of credit. I mention this to you to illustrate the character of work that we are doing.

As I travel about the country, as I told you a moment ago, I am impressed with the fact that there seems to be a lack of courage. There seems to be, if I may say so, in a certain measure at least, a lack of leadership. What is leadership? Leadership doesn't necessarily mean a rugged physical being. Quite the contrary. I have in mind at the moment a man who lives on bird-seed, who weighs ninety-six pounds, and whose entire habiliment wouldn't make one bath towel in the hotel. Mahatma Gandhi is a leader. Whether or not

he espouses the cause we would like to have him espouse, he is a leader. Benito Mussolini is a leader. He is a leader because he inspires. It seems to me that business must take on a certain amount of leadership if we are going to emerge in short order from this depression. Everyone knew, for instance, when the debt moratorium was under discussion, that a moratorium for a year was merely a matter of a few days of grace, that the issue would have to be met again. But the business leadership of the country did not demand that it be met immediately so as to bring about the elimination of that period of uncertainty through which we are going. Leadership! Leadership in the matter of wages! I am not here to tell you whether wages should be reduced, or whether wages should not be reduced, but I am here to say this, that it doesn't promote an emergence from depression, to see concerns declare extra dividends and at the same time announce a reduction in wages. Every man must meet the situation as he finds it, but you people know, if you are at all alive and have your ears to the ground, that a few of our business leaders have dismissed at the front door, and re-employed labor at the rear door at a reduced wage. I am here to tell you that by and large labor has been pretty decent to capital. They both traveled down the highway to prosperity by reason of their co-operation. If there is one thing that will kill it quickly, it is to dismiss men at the front door and re-employ them at the rear door at reduced wages. It seems to me that a business man who does that is acting the part of a sneak thief, for he will build more self-respect, more confidence in industry, and confidence is what is needed today, if he will frankly tell the men the situation that confronts him, and then deal with them in that way. They will have more respect for him and he will have more respect for himself.

Modern civilization, naturally, brings with it its problems. I guess by way of contrast, primitive society didn't know what a depression was. Instead, disease and starvation automatically decimated its ranks. I am not surprised at the present condition of things, and I am not alarmed at the storm. The tragedy of the thing to me is if we emerge from this storm unprepared in the future to iron out these curves, to get them on a more normal basis. We are going to have periods of prosperity and periods of depression so long as

the world exists, so long as man is selfishly constituted. But there needn't be the swing of the pendulum to the extent that it is at the present time.

The amazing thing to me is that so many people are astonished at the fact that in this day and age, with civilization developed to such a high degree, with the necessity of a delicate balance, of a perfect synchronization, we should have these maladjustments. It seems to me they are logical, although the present one, to be sure, is abnormal. But show me a parallel for the World War.

Further than that, it seems to me that if out of this depression we emerge with a real, definite program to limit the extent of suffering in future depressions, then, perhaps after all is said and done, we may have learned something from our present experience.

Almost everyone in the United States has been blamed for the present depression, including the New York Stock Exchange. The New York Stock Exchange, of course, is a necessary institution. But I am here to tell you that unless they regulate their own house, government will try to regulate it for them, and I pity any business which government tries to regulate.

I am here to make this observation, that sometimes by legislation, either direct or indirect, we do things which, in the practical working out of the problem, contribute a great deal to the orgy of gambling.

Has it ever occurred to you, as it must have no doubt, as you are accountants, that non-par stock was the basis of the entire inflation in the Stock Market? Some one mentioned to me as I came into the room, "A certain stock is selling at \$16 a share. Can you imagine it?"

I said, "It is high. I bought it five years ago at \$72 a share, and I have six shares for one. The stock that I bought five years ago at \$72 a share is selling today at \$96 a share."

The trouble was that the injection of non-par stock brought on an inflation and took away from men's minds a proper and true appraisal of the things that might really constitute the values in these stocks. So it is things of that character that have contributed. Accountants can be of considerable help in that. I expect to see the day when you accountants will report not upon the per share earnings (that doesn't mean a thing to me) but on the earnings per dollar of invested capital; that does mean something to me.

Perhaps I have gone afield. I return to the subject of courage. My mind goes back several centuries, and we find a band of people anxious to establish themselves in a new country, making a perilous journey. Sometimes when within sight of our shores, they were driven back, only to resolutely carry on, until eventually they land. When they land, instead of the Utopia that has been promised them, they find a wilderness, a wilderness nevertheless possessed of great natural resources. Do they sit down and complain and fume and whine? Quite the contrary. They dig their toes in and begin to wrest from a virgin soil their daily bread. After working all day, at night they fight the savages in defense of their homes and their families. In the fall of the year we find them gathered together for what? Gathered together in thanksgiving, thanking Providence for the opportunity that was theirs to pursue life in accordance with the inalienable rights that man possesses.

We turn the chapter of history. We go on to the war for independence, and here again we find at Valley Forge that small band of men courageously fighting on and winning for us the freedom that is ours.

We go on to the Civil War, and our stream's run red with patriots' blood, north and south. I can say this for I had people in both the north and south—patriots all. They fight on for four years until finally that issue is decided.

We turn another chapter, and we find that we are in the World War. Some several hundred thousand of our young men go across the sea and give their lives in defense of those things that our forefathers held so dear.

The point I want to make is this, that all of the battles aren't out on the field of war. This is a battle you are in today, a peace-time battle, if you please, and the challenge that comes down to you and to me is "Is the American nation running thin of blood?" That is the challenge that you must answer both in your professional work and in your citizenship duty, bearing in mind that character was never molded except in periods of adversity. Let us all gird for the battle, give the best we have; dig in our toes, and soon you will find that the clouds will roll by if, indeed, they are not now slowly but surely rolling by.



# Monetary Status of the Present Day\*

By JOHN T. MADDEN, C.P.A.

THE foreign situation, of course, does affect every one of us in this country. Mr. Gandhi persuaded the Hindus to abandon the custom of not washing their cotton turbans. The result was a very great decline in the consumption of cotton cloth in India, which, of course, affected the output of the Lancashire mills and affected the demand of Southern cotton, which, of course, reduced the purchasing power of our Southland, which, of course, reduced the consumption of industrial products of the East and the West. So that the vagaries of a little sect in India have their repercussion upon each and every one of us.

The demand deposits of the New York member reporting banks in New York for the last week increased \$200,000,000. That increase was brought about very largely by the sales of foreign-held American securities. Some of it was interior selling in this country. But that amount is a potential claim upon our gold and, of course, affects the credit structure of this country and has a repercussion, also, upon the credit structure of other countries. So that the world today is a unit, and nothing can happen in any part of the world which may not affect us individually in one way or another.

I have made a few notes for a very hurried presentation of circumstances as they exist today. No one can tell from one day to another what is going to happen, because what happens will depend very largely upon the psychology of the several hundred millions of people who are involved.

The latest upset, of course, was the abandonment by Great Britain of the gold standard, with the result that other countries promptly followed suit, and we are back to the year 1921 as far as the international currency situation is concerned. A great deal of the constructive work that was carried on in the last ten years in the stabilization of currency is practically ruined.

It is impossible to state, prior to the general election which has been ordered in Great

Britain, the point at which the pound sterling will be stabilized. After the new general election, measures will undoubtedly be taken to stabilize the pound at some definite figure, in the same manner that France stabilized the franc.

We must all admire Great Britain's valiant attempt to maintain parity of the pound. It is the Britisher's proud boast that he has always paid on the nail. Undoubtedly, Great Britain could have carried out its project if conditions in Continental Europe had been different and if conditions as to British manufacture and British industry had been different. Unfortunately, Great Britain's labor has been largely a protected labor. Her costs of production have been high. Her plants are obsolete and out of date. Rationalization has made less progress in Britain than anywhere else in the world.

Moreover, the Treaty of Versailles which permitted Germany to pay part of the reparations in kind, adversely affected British industry. It put the Germans in a competitive position, injurious to Great Britain in regard to its manufacturers, injurious to Great Britain in regard to its coal industry, injurious to Great Britain in regard to its shipping industry. No small portion of Britain's present plight, in my opinion, can be attributed to Mr. Lloyd George.

The depreciation of the pound sterling will tend to stimulate British exports. The present decline of approximately twenty per cent in the valuation of the pound practically results in an export subsidy of twenty per cent in favor of British manufacturers. That is likely to be offset by other factors which I shall mention in a moment.

The devaluation of the pound will also tend to limit British imports, because the British importer will have to give a larger number of pounds in exchange for the merchandise which he imports, and already British importers have cancelled orders for importation into Britain amounting to many thousands of pounds sterling.

However, the stimulation of British exports and the reduction of British imports will help Great Britain in balancing its inter-

\*Extemporaneous remarks made at the annual meeting of The American Society of Certified Public Accountants, October, 1931.

national payments. The less that Britain has to pay other countries for imports, and the more it receives in exchange for its exports will favorably affect its balance of payments on international account.

One of the greatest sources of invisible exports of Great Britain is the fact that Great Britain is the world's international money center. A revenue is derived by the City of London estimated at between 50,000,000 and 60,000,000 pounds in financing international trade. London, of course, is the greatest acceptance market in the world, and all kinds of bills originating in international trade are financed on the London market. England's great insurance companies and her great shipping companies create millions of pounds of international acceptances. Many of the world's commodity markets are in London, such as rubber, tin and so forth. The result is that this great international money center helps Britain on its international balance of payments by the revenues derived from the financing of international trade.

New York and Paris, of course, have become increasingly important as international money centers. Paris has made a very serious effort to develop its acceptance business. But the acceptance business is a peculiar business in which the Britishers have had long experience, and in which the French have had little experience. It was not until recently that any acceptance business at all could be developed in France, because no one knew, prior to the re-organization of French finances in 1926, whether he could get silver or gold for French exchange, because the Bank of France had the right to pay in silver if it wished to, on an international acceptance. But with the abolition of that regulation, Paris has become increasingly important as an international money center.

New York, of course, has financed international trade to an increasing extent, but New York, likewise, does not have the machinery in existence, nor the experience for the development of a world-wide acceptance market. In New York, the principal money market is the call market. The call market in England or in other international money centers is very much less important. As long as we have in New York the preponderating importance of the call money market, we shall probably not go very far in the development of an international acceptance market.

London has always operated on a very thin margin of gold, and London could safely operate on a very thin margin of gold as long as there was confidence in the world that bills due in London would be paid on the due date, and London bankers manipulated their acceptance market so cleverly that England could do a tremendous volume of acceptances on this extremely thin margin.

However, the balances on international account which had been piled up in London, threatened London's gold. France last year, for example, had balances of over \$600,000,000 in London, and the French bankers, quite properly, began to question whether they would ever get payment, because if France presented immediately a demand for the balances due her, every pound of gold in Britain would be drained out. The Bank of France has been accused from time to time of working against the London money market, by calling for the payment of these balances, and there perhaps is a well-founded suspicion that when France wished to bring political pressure on Great Britain on any international question, pressure to the money market was applied. I do not think there is any question about that, although, of course, there is no proof of it.

However, these great potential and actual demands upon the London market have been primarily responsible for the existing situation. There arose a lack of confidence in the ability of the London market to pay, and, consequently, various nations, the Hollanders, the Swiss, the Germans and the French, and the Americans, and even some nationals of Britain, began to lose confidence in the British market.

There has undoubtedly been a very substantial flight from the pound by Britishers themselves who have sold British securities and re-invested the proceeds in American and Canadian securities.

Now, the depreciation of the pound may upset the British budget, even the revised budget which has been presented by Chancellor Snowden. That will come about in this way: Great Britain imports large quantities of foodstuffs and raw materials, cotton, for example. It will require, therefore, a larger quantity of pounds to pay for the food necessary to feed the English population. That will have a tendency to increase the cost of living in Great Britain. Moreover, the discount



rate of the bank has been raised, and that will increase British overhead costs by increasing the cost of borrowing money and doing business. Furthermore, the tremendous increase in taxes levied upon Britishers by the necessity for balancing the budget will also increase British overhead costs. So that while Britain will benefit by this export subsidy in the stimulation of its exports, there will be an offsetting factor, due to the increase in the cost of living and the increase in the overhead cost of doing business. To what extent that increase will offset the benefit, of course no one can tell. But reliable economists estimate that the increase in the cost of living and the cost of doing business will probably not be less than ten per cent.

Great Britain's international balance of payments and the effect of the declining British trade can be seen by examining the position of British trade in international trade. Great Britain's position in international trade has been continually declining from 1914 to the present date. Incidentally, I may say that I believe personally all British bonds stated in dollars are safe. Those who hold British bonds stated in dollars will be paid, without any question.

So, therefore, Britain must immediately reorganize its industry. First, it must abandon its obsolete plants; second, protected labor must surrender some of its present privileges; third, the cost of the social service which Great Britain is incurring today must be immediately reduced. Unfortunately, unemployment is still increasing in Great Britain, and the stimulation of British exports has not reflected itself yet in a decline in unemployment. So much for Great Britain.

Germany. The main problem of Germany is attempting to maintain the stability of the mark. As long as Germany can maintain the stability of the mark, she can remain on the gold basis, and Germany has announced her intention of remaining on the gold basis. They have, of course, in Germany the keen recollection of the period of inflation through which they recently passed. You may rely upon it that the Germans will do everything possible to maintain the stability of the mark. However, the stability of the mark depends entirely upon the state of German trade. Germany cannot maintain the stability of the mark unless she has favorable foreign trade, unless the

balances on international account shall run in favor of Germany.

The renewal of the moratorium undoubtedly will be necessary, that is the period must be extended, if Germany is to maintain the stability of the mark. Furthermore, the problem of reparations must again be undertaken, because the payments by Germany were fixed upon a price level greater than that which now obtains. Consequently, the whole reparations business and the whole question of allied debts must be re-examined if our present price level is to exist.

In Germany the unfavorable factors are that business is, at the present time, decreasing and that unemployment is increasing. Furthermore, the taxes in Germany have increased, and government revenues have decreased. The present favorable factors in Germany are a reduction in municipal and federal expenditures. The government has reduced civil salaries, and it is making reductions in the cost of social services. The other favorable factor is the present large excess of exports on the part of Germany. German industry is dumping manufactured goods very much in the same manner that the Russians dumped agricultural and natural products. That is not because Germany wants to do so; it is because Germany is forced to do so because of her present international position.

Another favorable factor in Germany is the steady banking conditions which have been maintained there. Germany has adopted one of the most rigid financial measures ever known in the history of the world, the details of which I will not take the time to explain. It is known as the restriction of credit, where the Central Bank absolutely restricts the amount of credit which any industrial or trading undertaking is allowed to have. Whenever this policy of restriction of credit is introduced, it helps the German's national economy to steady the banking conditions of the country.

The merits of German bonds held in this country depend entirely upon the ability of Germany to maintain the stability of the mark; that is to say, if Germany can maintain the stability of the mark, anyone holding German bonds does not need to worry about what the present market price of these bonds may be.

Just a word about France. In France, the business depression is increasing. This will

result in an upset in political conditions. Unemployment is increasing. When I was in France last year, the government figures showed only 1,000 in the whole nation who were unemployed, and at that time there were between 25,000 and 30,000 Italians engaged in the construction of fortifications. Those Italians have been shipped back to Mussolini, but unemployment in France has increased tremendously. No official figures are published by the government, but it is estimated that close to one-quarter million at the present time are wholly unemployed in France. French banks are, of course, adversely affected by the decline in the pound. Their balances in London are estimated at the present time to be about \$400,000,000, and naturally, of course, they have got to be converted on the devalued basis.

Lack of confidence on the part of Frenchmen is having an effect in this country, because France has a tendency to convert its balances held in this country, into gold. The Federal Reserve Board does not publish any figures as to who earmarks gold in this country, but it is quite generally known that a large portion of the increase in earmarked gold is on account of France. In other words, the lack of confidence of the French extends even to this market, and they are converting their deposit balances into gold.

The Scandinavian countries have been very hard hit by the decline in the shipping industry, and by the decline in the fishing industry. They have also been hard hit by the devaluation of the pound, because they have close and intimate relation with the London market.

Sweden is in the best position. Norway is in the poorest position. The currency of those countries will continue to fluctuate until the value of the pound has been fixed, and the return of their currencies to gold depends entirely upon the situation in Great Britain.

Austria-Hungary. Both countries need foreign loans in order to maintain the stability of their currencies. The recent decision of the World Court in the declaration of the illegality of the customs union further complicates the problem. Those of us who are invited to aid in having the United States join the World Court should realize that the decision of the World Court was made wholly on political lines and decidedly in disregard of normal economic relations between Austria

and Germany. Austria's position has undoubtedly been very adversely affected by the failure to realize a customs union with Germany.

Hungary is naturally an agricultural country, and it is very hard hit by the decline in the prices of wheat and corn.

Reduction in expenditures in both countries is necessary and, in my opinion, the League of Nations' control of the finances of both Austria and Hungary will very soon take place. The League of Nations, you will remember, took Austria under its wing and took Hungary under its wing, appointing, in the case of Hungary, an American, Jonathan Smith, of Boston, as financial adviser, really financial dictator.

Switzerland and Holland both have been hard hit by frozen credits in Germany. They have invested large sums of money in Germany. The Germans, on the other hand, have shipped a great deal of their free funds to both Switzerland and Holland. In other words, there has been a flight from the mark into Switzerland and Holland and a re-borrowing by Germans from Switzerland and Holland, with the result that the credits in Germany due to Swiss and Hollanders are now frozen. Furthermore, of course, both countries have intimate relations with Great Britain and are vitally affected by the situation of the pound.

South America is a continent which has great natural resources, the prices of all of which are now at the lowest levels. Those countries, of course, must reduce their imports and must try to increase their exports, but undoubtedly the balances of all of them on international account will be adverse, and there is no hope of any permanent improvement in South America until the price level is stabilized or raised above the present level.

As far as the United States is concerned, the unfavorable situation of foreign currencies means that it is going to be very much harder for us to export. Our exports undoubtedly will be adversely affected. We cannot import much because there is no way by which the foreigners can pay us. We have erected a tariff wall against their goods. We cannot loan them money because there is no one who will buy foreign bonds, and they have no gold with which to pay us. So that our exports undoubtedly will be adversely affected. Of course, everybody has a panacea for the correction of conditions here. I do not

*(Continued on page 27)*

# The Louisiana Regulatory Accountancy Law<sup>\*</sup>

By EMILE BIENVENU, C.P.A.

THE prime objects of a regulatory accountancy law, as I understand them are: the protection of those employing the services of public practitioners; the insurance that no person shall practice public accountancy unless that person is qualified to do so from the viewpoint of education, character, ability and experience; and the protection of the competent and ethical practitioner against the "charlatan" who knows no standard of efficiency or decency.

There are some members of the profession who, in discussing accountancy legislation, refer to "regulatory" laws as restrictive or monopolistic. They seem to get away from the real objects and purposes of regulation.

The law of the State of Louisiana does not "restrict the practice of accountancy to certain of her own citizens," nor does it "place restrictions of varying character and severity upon the practice of accountancy within the State of citizens of another State." It provides, however, that any person practicing public accounting in Louisiana *must*—as is required of all other professions—qualify to do so in accordance with the law of the State.

No one has a natural or absolute right to practice public accountancy but the right is one granted on condition. Though the State cannot prohibit the practice of public accountancy, it can regulate it within reasonable bounds by defining qualifications of the practitioner and requiring a certificate showing possession thereof.

It is true that the laws of some states are more severe than others—perhaps unreasonably so—but it should not be argued that it is unfair to tell the practitioner from one State that he cannot practice in another State unless he meets the same requirements of the law *demanded* of the local man.

The Louisiana law does not prevent the outside accountant from coming into this State to audit the accounts of a branch house or

handle isolated engagements, but if he undertakes to render professional services to Louisiana businesses and institutions, the law demands that he first qualify to practice in the State by securing a C. P. A. certificate therefrom. If a person is in good standing as a C. P. A. of another State he will have no difficulty in obtaining a reciprocal certificate from Louisiana, unless the difficulty originates with the State issuing the original certificate which, though demanding entrance in our State for its C. P. A's, refuses to grant the same privilege to Louisiana practitioners.

The ideal condition, to my mind, is to permit the holder of a C. P. A. certificate from any State to practice in every other State with the sole provision that he is answerable to the laws of the states in which he performs his work.

I have deviated somewhat from regulatory laws to talk reciprocity but the two interlock to some extent.

Although every State in the Union has its C. P. A. law, only ten of them have enacted the so-called regulatory law. In Louisiana, Act 136 of 1924 provides that only persons who have qualified for C. P. A. certificates under its provisions shall practice public accountancy in Louisiana. The Act further provided, however, that those persons who were, at the time of its passage, practicing public accounting, and were of good moral character, would be registered by the State Board under the designation of "Public Accountant."

This law—a compromise measure—was brought about to prevent the introduction of legislation by non-certified men every two years to reopen the "waiver" clause in order to secure their C. P. A. certificate. At every session of the Louisiana legislature from 1910 to 1922, the Society of Louisiana C. P. A's successfully fought the waiver clause. However, the more we argued the matter the stronger grew our conviction that it was necessary, for the good of the profession and the public, to accord some legal recognition to non-certified

<sup>\*</sup>Address delivered at Four-State Meeting, Shreveport, Louisiana, November 16, 1931.

men who were practicing public accountancy, many of whom we knew to be capable and ethical practitioners. The law of 1924 resulted, leaving the "certified public accountants" undisturbed and registering "public accountants" as such.

Now, as to the effects of the new law. The business public acclaimed it as an additional protection to those who employed the services of the public practitioner. The bankers, particularly, endorsed it highly, and, although partial to "certified public accountants," in many cases they employed or recommended the services of "public accountants."

The "certified public accountant" assumed that a rather delicate problem had been solved, that in due course of time the "public accountant" would recognize the benefits to be derived from qualifying for his C. P. A. certificate by examination and that, through that process, the Louisiana designation would gradually reduce itself to but one; "certified public accountant."

For a while the "public accountants," happy in their legalized designation, and with the knowledge that they had practically all the rights and privileges of the certified men, showed a decided inclination to eliminate the factionalism previously existing, and to work shoulder to shoulder with the C. P. A's for a greater and better accountancy.

In the course of time, however, the newness of the situation wore off and the attitude of the public accountants began to change. They claimed that since they had all the legal rights accorded certified public accountants it was unfair that they should be classed separately and placed in a secondary position before the public. One of their contentions was that many of them were associated in partnership with certified public accountants and that the senior partners of these firms were mostly "public accountants." They had no permanent organization of their own and were ineligible for membership in the C. P. A. Society. They in various other ways indicated their resentment at what they termed the "line of demarcation," and their discontent finally culminated in the introduction of a bill in the Legislature of 1928, granting C. P. A. certificates without examination to "public accountants" who held unrevoked certificates of registration under Act 136 of 1924. This bill, through the efforts of the Society of Louisiana

Certified Public Accountants, died in committee.

Thus, although we had definitely eliminated the probability of reopening the waiver clause, another problem—the legal conversion of the P. A. registration into a C. P. A. certificate—was before us for solution. The public accountants decided that they would reintroduce their bill, with some modification, before the Legislature of 1930. Several of the leading public accountants in the State, however, now took the position that although they were in favor of the measure, they would not support it unless it was approved by the Society of Louisiana Certified Public Accountants. Such an attitude on the part of these men brought to their support several outstanding C. P. A's. The bill was considered at a special meeting of the Louisiana Society, thoroughly discussed, but voted down as undesirable and inadvisable. The public accountants accepted the conclusions of the Society and did not introduce the bill.

I want to say here that the action of the "public accountants" of Louisiana was very gratifying because it showed an attitude of complete co-operation and a surrender of the prospect of personal gain for the good of the accounting profession. All honor, then, to those leaders among the "public accountants" because it is in great part due to their broad-mindedness and unselfishness that today Louisiana is free of any dissension and Act 136 of 1924 is upheld in all its provisions. It is also gratifying to state that twenty-seven public accountants have passed the C. P. A. examination since the passage of the regulatory law.

Under the law of 1924 there were 138 registrations as "Public Accountants." Following is an analysis of this number as of this date:

Qualified as C. P. A's.....	27
In practice as "P. A's".....	68
On staff of other accountants ..	7
Abandoned practice .....	26
Deceased .....	10
Total .....	138

The next problem confronting us was whether accountants from other states had a legal right to practice in Louisiana unless they qualified as C. P. A's under the law of 1924. I commented on this matter in another paper some time ago, but it will bear repetition here.

The Attorney General of the State is confirmed in his opinion that as a prerequisite to practicing public accounting in Louisiana a person must first comply with the law. Judge Jerry Cline, of the 14th Judicial District Court of Louisiana, in a case involving a claim of compensation for services rendered in this State by a C. P. A. of another State, denied a judgment to the latter on the grounds that he was practicing unlawfully in Louisiana in that he was not licensed to practice his profession in this State under the provisions of Act 136 of 1924 and, therefore, could not recover for services rendered under an agreement entered into in Louisiana because the laws of this State—Civil Code, Articles 1891 and 1892—forbid him as a resident of another State to assume the very position he took and had to take to carry out his agreement with the defendant.

The case was appealed and the Court of Appeals sustained Judge Cline. In its dictum the Court of Appeals says that "the principle of law here involved seems to have been well settled by the jurisprudence of the country." In referring to other regulatory laws the Court of Appeals even maintained that:

"Where the law does not contain the prohibition but imposes a penalty for its violation, it seems to be generally held that the penalty implies the prohibition." The decisions to that effect are based on the well-known principle that "the law will not lend its support to a claim founded upon its violation."

It is held by some who question regulation that in every reported case on which the legality of a State Accountancy Act was so worded as clearly to require a license as a condition precedent to the doing by an accountant of accountancy work for the public has been decided, the courts have ruled that such an Act contravenes the Constitution of the United States. Judge Cline's conclusions on this point are very interesting and I ask your indulgence while I read the following extracts from his decision:

"Practice as a physician or as a lawyer is universally prohibited except by those deemed qualified, and so certified by public authorities. In these professions the formal license issued by the State follows as a result of the qualifications of the licensee, and not primarily in consideration of the payment of the license fee. In some other callings, the license is merely a receipt for payment of an occupation tax. . . ."

"... the moderate fee to be paid for the

certificate cannot be considered the moving cause of the enactment; it is merely incidental to the regulations deemed important in the public interest, and at most, designed to relieve the State itself of some of the cost of such regulations. . . . it must be held that the public policy of the State places accountancy in the class of learned professions, and for the public protection, prohibits its practice under penalties, by those not duly qualified under the Legislative Act."

Again, the following quotations from the decision of the eminent Louisiana jurist are of much importance:

"A competent accountant must doubtless possess certain natural qualifications, improved by education and experience. It is clear that an incompetent accountant might injure the public seriously by malpractice. In *State v. DeVerges*, which appears to be the only Louisiana case on the subject, it is said that accountancy did not affect the morals, health or safety of the public, however incompetent the persons practicing the profession might be. But the later policy declared by the Legislature, in its Act of 1924, is controlling and can be deduced only from the Act itself. . . . It is seen that the public policy of the State as set out in the Act of the Legislature, considers public accountancy as a highly skilled profession, and the regulation of its practice to be essential to the well being of the public. . . ."

"It may be said that the rigid terms of the statute were not intended to apply to qualified public accountants of other states who pursue their calling in Louisiana. The terms of the statute itself are to the contrary. Such an accountant, at the discretion of the Board, may have his certificate registered without the usual examination, provided, his home State grants the same privilege to Louisiana accountants; but this is a discretionary grant. Certainly the Board would inquire as to good character, and presumably as to education and experience before granting the registration. Practice without such precautions is the exact thing from which our lawmakers sought to protect the public."

In view of the Attorney General's opinion, Judge Cline's decision, and the sustaining of the latter by the Court of Appeals, it is reasonable for us in Louisiana to believe that Act 136 of 1924 is truly regulative, and would withstand any attack on its constitutionality.

In conclusion—expressing my individual opinion—I would say that although our experience with a regulatory law has been satisfactory, the ideal situation cannot be reached nor our big problems met unless and until we

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# Average Ratios of Twenty Representative Industrial Failures<sup>\*</sup>

By PAUL J. FITZPATRICK, Ph.D.

IN recent years, increasing attention has been given to financial statement analysis as a means of ascertaining the solvency, the earning power, the sources of capital, etc., of a business enterprise; and also for the purpose of detecting any symptom of business disease or ailment which, if not corrected, may lead to the formation of a creditor's committee or to receivership.

As a result, accountants, business managers, credit executives and other interested parties are becoming more and more interested in the use and interpretation of accounting ratios. Financial statements express business relationships. The items in themselves may not be significant, but the relationships between them are. Thus, ratios are useful tools or devices in ascertaining the relationships. Like all tools, however, ratios should be used only within the range of their efficient or appropriate use.

Nevertheless, a question often asked and as often unanswered is, "What was the nature or state of the ratios at the time a business failed, and also several years prior to the failure?" Furthermore, "Were the ratios favorable or not; and which ratios were favorable and which were unsatisfactory and to what extent?"

The writer has analyzed the published financial statements of twenty representative industrial enterprises which failed during the period of 1920-1929 for the purpose of ascertaining the condition of several well-known and widely used ratios at the time of failure as well as several years prior to failure. Certain results disclosed by this investigation will be pointed out in this article. The term, industrial enterprise, is here used to mean a business concern engaged in manufacturing or trading activities or both.

<sup>\*</sup>The data used in this article are taken from a recent investigation, "Symptoms of Industrial Failures," a Ph.D. dissertation by the writer, at the Catholic University of America, Washington, D. C.

## STATISTICAL PROCEDURE

At the outset, it may be advisable to give a brief explanation of the statistical terms used in this article. An *average* is a terse or summarizing expression employed by the financial or credit analyst for the purpose of describing in a single phrase the common characteristics of a series of items. In other words, a summary figure is desired in order to serve as a representative of the group. There are several types of averages or measures of central tendency such as: (1) the arithmetic average or mean; (2) the median; (3) the mode; and (4) the geometric average. Of these types, the arithmetic mean and the median are commonly used in economic and business investigations.

The arithmetic mean is the result obtained when the sum of the items in a series is divided by the number of items. It is a numerical concept or idea. It has the advantage of being simple to calculate and thus is widely used. Moreover, it is probably more readily understood than any other average because of its simplicity. There is, however, the disadvantage that it emphasizes the extreme items, whether they be exceptionally large or small, which in most cases is undesirable. Thus in such cases it is not a satisfactory average. As an example, the arithmetic average of the series, 26, 48, 85, 89, 99, 138, 156, 191, 195, 203, 211, 226, 274, 287, 328, 468, 507, 619, 734, 2,525 is 370. These items represent the current ratio of twenty representative industrial failures in sixteen lines of business. Thus, the average current ratio is 370 per cent. If the extreme item, 2,525, is removed from the series and the sum of the items divided by 19, the number of cases, then the average current ratio is 257 per cent—a much lower figure and probably a more representative average.

The median is the middle item in a series when arranged consecutively, so that 50 per cent of the items in a series are above it and 50 per cent of the items are below it. Thus

this average is determined by position and not by calculation. Moreover, it is not influenced by extreme items or variants to the same extent as is the arithmetic mean. Therefore, arranging the twenty current ratios in the order of magnitude, as stated above, we find the median to be 207 per cent. If the extreme item, 2,525, is omitted then the median of the nineteen ratios is 203 per cent. This is, indeed, an illustration of how little influence extreme items have in the computation of the median. Because of this, the median is generally considered as a more typical average than the arithmetic mean.

*Variation or dispersion.* One of the other purposes of an average is to establish a central point or so-called norm from which to measure the dispersion or variability of the individual items in the series. In other words, we are interested in ascertaining not only what is the average or typical case, but also how much do the individual items of a group vary above and below this central tendency. When the variability is small the several items in the series are not widely different and thus the average may well represent the group. When it is large, however, the several items differ widely and the average does not well represent them. There are several statistical methods of measuring this variability: (1) the range; (2) the quartiles or interquartile range; (3) the average deviation; (4) the quartile deviation; and (5) the standard deviation. In this article, only the quartiles are employed.

The quartiles are values which divide the items of a series into four equal parts. There are three quartiles. The upper quartile ( $Q_3$ ) is the point above which are the highest one-fourth of the items. The median is generally the second quartile. The lower quartile ( $Q_1$ ) is that point below which are the lowest one-fourth of the items. The interquartile range, then, is the distance or difference between the upper and lower quartiles within which the middle 50 per cent of the items or cases fall. This is the zone which we are interested in for observation and analysis, the extreme items below the first and above the third quartiles being ignored. Thus this zone or area generally contains typical cases. Moreover, it is the zone wherein random items are most likely to fall.

The average ratios as shown by tables No. 1 and No. 2 are an average (arithmetic and me-

dian) of the respective annual ratios of twenty representative industrial enterprises which failed during the period 1920-1929. Furthermore, these average ratios were grouped according to the corresponding years before failure. It is not, however, the intention of the writer to regard these average ratios, thus obtained, as standards or norms typical of failed enterprises generally. The sole purpose, indeed, is only to show the condition of the ratios one and two years prior to failure. The quartiles are pointed out by table No. 3.

#### INTERPRETATION OF TABLE NO. 1

In inspecting this table, one finds the current ratio to be 370 per cent the second year prior to failure if the extreme item, 2,525, is present. It is 257 per cent, however, when this exceptionally large item is removed. In either case, the condition of this ratio is favorable as the customary and minimum "standard" for the current ratio is 200 per cent. But in the first year prior to failure, it is only 178 per cent—being below this so-called standard.

The quick ratio is 163 per cent if the extreme item, 1,275, is present; and 105 per cent, when it is removed, for the second year before failure. This condition is barely satisfactory. In the final year before failure, it is only 67 per cent and this indicates an unfavorable condition. The normal or customary rule, even though a minimum one, is 100 per cent.

The four sales ratios, for which there are no so-called standards as yet established, are interesting. Sales to fixed assets ratio drops from 245 per cent in the second year to 137 per cent in the final year prior to failure. This, therefore, suggests a strong tendency towards over-investment in fixed assets. Sales to inventories ratio shows practically no change from 393 per cent to 394 per cent. Sales to receivables ratio, whether the extreme item is eliminated or not in each year, reveals a favorable upward trend. Sales to net worth ratio shows a strong upward movement from 139 per cent to 274 per cent if a very large extreme, 1,320, is included. However, the trend is downward from 139 per cent to 125 per cent when the influence is removed. This downward swing suggests that too little business is being done in proportion to the funds invested in it.

The net worth to debt ratio shows a decided decline from 191 per cent to 132 per cent. This is an unhealthy sign because it reveals

that the business is operating more on outside capital than on its own capital.

Net worth to fixed assets ratio reveals a drop from 173 per cent to 134 per cent and indicates over-investment in fixed assets. This is conclusively proved as the sales to fixed assets ratio is also declining. Net worth to fixed assets ratio should always be supplemented by the sales to fixed assets ratio because if both ratios are declining or are below normal, the conclusion is obvious that there has been an undue expansion of the plant.

Inventories to receivables ratio, regardless whether or not the extreme item, 1,774, is removed for the final year prior to failure, reveals a trend toward over-investment in inventories. It also explains why the quick ratio is not satisfactory.

Net profits to net worth ratio is conclusive. It shows a 7.4 per cent profit on the net worth investment for the second year, while a loss of 13½ per cent is disclosed for the final year prior to failure.

Current assets to total assets ratio must be interpreted in the light of the changes taking place with the ratio of fixed assets to total assets. These two ratios reflect a pronounced tendency toward over-investment in fixed

assets at the expense of the current assets, thus impairing the working capital position. The current assets drop from 41.4 per cent to 34.2 per cent while the fixed assets are increasing from 44.9 per cent to 51.6 per cent.

Other assets to total assets ratio reveals practically no change. It is 13.5 per cent for the second year, and 14.1 per cent for the final year.

#### INTERPRETATION OF TABLE NO. 2

While revealing the same tendencies as table No. 1, nevertheless table No. 2 appears to portray a clearer and better picture of the serious condition of the several average ratios. In addition, this table, which uses the median as an average, seems to be more representative or typical, because the influence of extreme items or variants is considerably reduced.

The current ratio is barely satisfactory for the second year prior to failure being 207 per cent, and is very unfavorable for the first year when it reaches the low point of 125 per cent.

The quick ratio is very unsatisfactory both for the second and the final year prior to failure, being 87 per cent and 58 per cent, respectively. This is, indeed, an ominous sign. Thus, both the current ratio and the quick

#### AVERAGE RATIOS OF TWENTY INDUSTRIAL FAILURES USING THE ARITHMETIC MEAN

TABLE NO. 1

<i>Type of Ratios</i>	<i>Year prior to failure</i>	
	<i>Second</i>	<i>First</i>
	370*	
1. Current assets to current liabilities .....	257†	178
	163*	
2. Quick assets to current liabilities .....	105†	67
3. Sales to fixed assets .....	245	137
4. Sales to inventories .....	393	394
	684*	799*
5. Sales to receivables .....	562†	591†
		274*
6. Sales to net worth .....	139	125†
7. Net worth to all liabilities or debt .....	191	132
8. Net worth to fixed assets .....	173	134
		288*
9. Inventories to receivables .....	178	211†
10. Net profits to net worth .....	+ 07.4	— 13.5
11. Current assets to total assets .....	41.4	34.2
12. Fixed assets to total assets .....	44.9	51.6
13. Other assets to total assets .....	13.5	14.1

\*Contains a large extreme item.

†When the extreme item is removed.

ratio indicate the serious impairment of working capital. Current or working assets represent the lifeblood of the business. It is the principal means of earning profits. Cash is spent by a manufacturing enterprise to procure raw materials; raw materials are transformed into finished products ready for sale; finished products are sold and accounts receivable are created or cash is received; the accounts receivable are collected and cash takes its place; cash is spent for more raw materials and the cycle begins again. Consequently the maintenance of ample working capital is essential to the profitable development of an enterprise. The lack of sufficient working or circulating capital seriously retards operations.

Sales to fixed assets ratio together with the ratio of net worth to fixed assets point out unmistakably the over-investment in fixed assets. The former is declining from 224 per cent to 140 per cent while the latter drops from 144 per cent to 96 per cent, for the second and first years, respectively.

Sales to inventories ratio shows a downward tendency from 369 per cent to 341 per cent. This is a contrast to table No. 1 where there is practically no change, being 393 per cent and 394 per cent, respectively.

Sales to receivables ratio is favorable, increasing from 579 per cent to 717 per cent.

Sales to net worth ratio is declining from 142 per cent for the second year to 123 per cent for the first year prior to failure. This indicates that too little business is being done in proportion to the net worth investment.

Net worth to debt ratio shows a sharp drop from 164 per cent to 89 per cent. In other words, there are only \$89 of net worth for every \$100 of debt. Thus it becomes very evident that the short-and long-term creditors have more equity in the business than the owners or stockholders. Furthermore, the real significance is clearly apparent when one considers that net worth is permanent capital contributed by the stockholders and that debt is only temporary capital advanced by the creditors.

Inventories to receivables ratio reveals a slight trend toward over-investment in inventories, being 199 per cent for the second year as compared with 207 per cent for the final year.

The ratio of net profits to net worth points out the unprofitable nature of business activities. A loss of 03.3 per cent was sustained the second year and a loss of 12.8 per cent the final year prior to failure.

The current assets to total assets ratio is declining from 39.5 per cent to 29.1 per cent, while the fixed assets to total assets ratio is increasing from 37.3 per cent to 49.8 per cent. This, indeed, reveals the policy of over-expansion of plant at the expense of the current assets—a very unwise financial policy.

Other assets to total assets ratio registers practically no change.

#### INTERPRETATION OF TABLE No. 3

In the interpretation of this table, it should be kept in mind that the first or lower quartile is that point below which fall the lowest one-

### AVERAGE RATIOS OF TWENTY INDUSTRIAL FAILURES USING THE MEDIAN AS AN AVERAGE

TABLE No. 2

<i>Type of Ratios</i>	<i>Year prior to failure</i>	
	<i>Second</i>	<i>First</i>
1. Current assets to current liabilities .....	207	125
2. Quick assets to current liabilities .....	87	58
3. Sales to fixed assets .....	224	140
4. Sales to inventories .....	369	341
5. Sales to receivables .....	579	717
6. Sales to net worth .....	142	123
7. Net worth to all liabilities or debt .....	164	89
8. Net worth to fixed assets .....	144	96
9. Inventories to receivables .....	199	207
10. Net profits to net worth .....	— 03.3	— 12.8
11. Current assets to total assets .....	39.5	29.1
12. Fixed assets to total assets .....	37.3	49.8
13. Other assets to total assets .....	06.3	06.9

fourth of the companies. The third or upper quartile is that point above which are the highest one-fourth of the companies. Between these two points, then, is the interquartile range which contains 50 per cent of the cases (i. e., the range of the middle half of the ratios) which may be regarded as typical or representative. This is the zone which we are interested in for observation and analysis.

As to the current ratio, one finds that the ratios between the first and the third quartile are from 138 per cent to 328 per cent for the second year prior to the failure. In other words, the middle half or 50 per cent of the companies had a current ratio anywhere from 138 per cent to 328 per cent. For the final year, the range between the first and the third quartile is from 76 per cent to 207 per cent. In other words, the middle half of the companies had a current ratio anywhere from 76 per cent to 207 per cent; besides, three-

fourths of the companies had a ratio not exceeding 207 per cent. Inasmuch as 200 per cent is the customary and minimum "standard," this condition is not favorable.

For the quick ratio, it can be seen that the ratios falling between the first and the third quartile are from 46 per cent to 160 per cent for the second year. For the final year prior to failure, they are from 31 per cent to 83 per cent—a very poor showing—in view of the fact that the customary and minimum "standard" is 100 per cent.

Thus, three-fourths of the companies are below this rule-of-thumb, and reveal the urgent need of more working capital.

The several sales ratios were not studied on account of the limited number of cases available—only eight or ten cases being available in most instances.

The net worth to debt ratio is from 83 per cent for the first quartile to 231 per cent for

#### RATIOS OF TWENTY INDUSTRIAL FAILURES SHOWING THEIR POSITION BY MEANS OF QUARTILES.

TABLE NO. 3

<i>Type of Ratios</i>	<i>Year Prior to Failure</i>	<i>First Quartile</i>	<i>Median</i>	<i>Third Quartile</i>
1. Current assets to current liabilities .....	Second	138	207	328
Current assets to current liabilities .....	First	76	125	207
2. Quick assets to current liabilities .....	Second	46	87	160
Quick assets to current liabilities .....	First	31	58	83
3. Sales to fixed assets .....	Second	*	224	*
Sales to fixed assets .....	First	*	140	*
4. Sales to inventories .....	Second	*	369	*
Sales to inventories .....	First	*	341	*
5. Sales to receivables .....	Second	*	579	*
Sales to receivables .....	First	*	717	*
6. Sales to net worth .....	Second	*	142	*
Sales to net worth .....	First	*	123	*
7. Net worth to debt .....	Second	83	164	231
Net worth to debt .....	First	57	89	151
8. Net worth to fixed assets .....	Second	91	144	244
Net worth to fixed assets .....	First	58	96	163
9. Inventories to receivables .....	Second	179	199	268
Inventories to receivables .....	First	146	207	290
10. Net profits to net worth .....	Second	— 10.5	— 03.3	+ 05.0
Net profits to net worth .....	First	— 30.5	— 12.8	— 02.0
11. Current assets to total assets .....	Second	30.4	39.5	55.3
Current assets to total assets .....	First	20.7	29.1	44.6
12. Fixed assets to total assets .....	Second	27.5	37.3	54.1
Fixed assets to total assets .....	First	34.1	49.8	66.7
13. Other assets to total assets .....	Second	03.2	06.3	25.5
Other assets to total assets .....	First	04.0	06.9	25.9

\*Not available owing to the limited number of cases.



the third quartile for the second year prior to failure. As to the final year, it ranges from 57 per cent to 151 per cent. In other words, three-fourths of the companies do not exceed 151 per cent—a poor showing. The customary and minimum “standard” should be, at least, 100 per cent. It is a credit axiom that the owners of an industrial enterprise should have, at least, an equal investment with creditors. When, this is not the case, the inference is generally drawn that the owners do not have confidence in the business. Furthermore, if too much outside capital is being employed, there is the risk of losing control.

As to the net worth to fixed assets ratio, the range is from 91 per cent for the first quartile to 244 per cent for the third quartile for the second year prior to failure. For the final year, it is from 58 per cent to 163 per cent. This unsatisfactory condition reveals over-investment in fixed assets.

Inventories to receivables ratio ranges from 179 per cent to 268 per cent for the second year, whereas it is from 146 per cent to 290 per cent for the final year. This condition reflects the over-investment in inventories. It also explains the poor showing of the quick ratio.

Net profits to net worth ratio shows a loss of 10½ per cent for the first quartile to a

profit of 5 per cent for the third quartile for the second year prior to failure. In the final year, the range is from 30½ per cent loss to a 2 per cent loss. In other words, three-fourths of the companies reported losses for the final year.

As to the current assets to total assets ratio for the second year, the range is from 30.4 per cent to 55.3 per cent. In the final year, it is from 20.7 per cent to 44.6 per cent. In other words, the middle half of the companies had a ratio anywhere from 20.7 per cent to 44.6 per cent; besides, three-fourths of the companies had a ratio not exceeding 44.6 per cent. Industrial enterprises generally have 50 per cent or more of their assets in the form of current assets.

Fixed assets to total assets ratio is from 27½ per cent for the first quartile to 54.1 per cent for the third quartile for the second year prior to failure. In the final year, it is from 34.1 per cent to 66.7 per cent—a clear indication of over-investment in fixed assets.

As to the other assets to total assets ratio, one finds that the range is from 03.2 per cent to 25.5 per cent for the second year. In the final year, it is from 04.0 per cent to 25.9 per cent. This reveals a tendency towards too much intangibles such as goodwill, trademarks, prepaid expenses, etc.

## Classification of Accountancy Services and Responsibility of Accountants\*

By ROBERT E. WARREN, C.P.A.

AS the title of my discussion indicates, there are two phases to the subject assigned to me. And while it might have been better, if time permitted, to assign a separate phase to two speakers, the plan of the program committee—aside from their choice of a speaker—has much to recommend it.

For the responsibility of the accountant, to which we are forced to give considerable thought, is inseparable from the classification of accountancy services to which until recently

only too little careful and logical consideration has been devoted.

Considerable concern has been engendered in the profession because of the growing responsibility of accountants. This was instanced in a striking manner by the Ultramares case with which you are no doubt familiar. As a result, committees of our various societies have undertaken a classification of accounting services and have urged the various State societies and professional bodies to thoroughly discuss the subject and adopt a classification.

In order that the consideration which we

\*Address delivered before the 1931 Fall Meeting of the Ohio Society of Certified Public Accountants, Dayton, Ohio.

give the subject may be in the light of all the attendant circumstances, it will be well to review the developments which have given rise to the need for classification.

Not so long ago the classification of accountancy services was a simple matter. This was due to the limited scope of service and to the type of individual served. With rare exceptions the services of the accountant were limited to audits and a relatively small field of special service such as system installation and cost work. Audits were for the most part of three general types: First, complete or detailed audits, in the course of which all transactions were completely verified or at least adequately checked; second, limited or balance-sheet audits which were restricted to a verification of assets and liabilities and, a more or less limited test of operating transactions; and finally special investigations, limited to a verification of certain phases of an organization's activities, such as cash, purchases, et cetera.

Speaking in general terms it was recognized that the accountant's liability in the case of these classes of audits was as follows:

1. The accountant was responsible in the case of the complete or detailed audit for the accuracy of all recorded transactions, except those specifically excluded by means of a qualification.

2. In the case of the limited or balance-sheet audit, he was responsible only for the correct statement of the assets and liabilities.

3. Special investigations involved liability only for a correct and complete report upon the particular phase of the business which was examined.

This short and simple classification of services and responsibility was then satisfactory alike for the profession and the laity. For the laity, at least as far as the profession of accountancy was concerned, was relatively limited. It consisted of bankers, financiers and business men, who for the most part were thoroughly cognizant of the various types of services rendered by accountants and the extent to which they might reasonably hold the accountant responsible.

In short, in those days an audit was either an audit or it was not. An accountant was either responsible for the accuracy of all recorded transactions or he was not. And incidentally I think we can all agree that the number of detailed or complete audit engagements is now relatively smaller than it was

fifteen or even ten years ago. But—and this is the important thing to bear in mind—the responsibility of the accountant has not correspondingly decreased but if anything has increased.

The reason for this anomalous situation is not hard to find.

For reasons with which you are all familiar the scope of the accountant has, fortunately, been enormously broadened. Not only have the type of services been increased but the character of the audits required has changed. Mergers, consolidations, long distance financing and management have wrought an important change. The profession has been called upon to prepare statements for many and varied purposes and after examinations limited in a manner that makes the old three-way classification obsolete.

At the same time the lay community which looked to the accountant for authentic statements was broadened and changed in character. The income tax, the desire of various trade and business associations for uniform accounting and the necessity for more accurate and clearly interpreted data, among other things, brought a larger number of the business community to the office of the accountant seeking various types of services. The contemporary growth in the public's interest in securities also gave the general public an interest in financial statements and in the work of the public accountant. It is obvious that many of the public are qualified by neither training nor experience for the interpretation of financial statements to say nothing of the responsibility properly attributable to accountants.

As a result of these factors, accountants are faced with the necessity for clearly defining and limiting their responsibilities. As responsibility varies with the class of services rendered, it is logical to first classify our services.

As accountants we classify our services into two general categories, viz: auditing and other types of service. In turn we have come to recognize that there are various types of audits, balance sheet and detailed, limited, qualified, general and special, cash, payroll or what have you. Roughly speaking, we feel that an accountant is responsible for all errors and omissions only if he has verified all transactions, and that in the stated absence of a complete and detailed verification he is re-

sponsible only for the accuracy of those items or accounts which have been verified.

And in this connection it is pertinent to note that this reasonable but none the less self-protecting view was not established by accountants with their selfish interests at heart. It was forced on them by clients and the lack of interest on the part of those financially interested in the accuracy of the clients' statements.

For I believe that I am safe in stating that there is not an accountant extant who would not welcome full responsibility and legal liability on every engagement if every engagement involved a detailed audit at full per diem rates.

Regardless of where to place the blame for the situation, however, the fact remains that the accountant in the case of audits feels that his responsibility, and also his legal liability, is limited exactly as the scope of his examination is limited. And as time goes on it is surprising how the scope of the examination can be constricted.

What of the laity? And in referring to the laity I do not limit the title to the man in the street or the man with the hoe. I include bankers, lawyers, credit men and financial writers. With little exaggeration it can be said that the laity feels that any statement, certified or uncertified, on the letterhead of an accountant or accounting firm has been duly and completely verified and is published by that firm or individual as a true, correct and comprehensive statement of the affairs of the business organization to which it pertains. Certainly it can be said conservatively that if errors or misstatements are discovered in such statements the accountant is embarrassed by the unjustified imputations which are made by the laity.

This assertion is substantiated by the fact that many firms refuse to allow their names to be used on any statements, report backers, or letterheads where such statements have been made from the books without verification. Indeed, the Committee of The American Society, in the report which I will quote later, recommends that this policy be followed in the case of services of this character.

I am of the opinion that, although some of you may look upon my assertion as to the intelligent laity as an exaggeration, a review of your own experience will cause you to agree with it.

In the face of these circumstances we are forced to the conclusion that as regards the laity we must admit the truth of General Foch's statement "It is not what they know but what they believe that is important." This situation places a responsibility upon the profession that is more onerous than the legal liability involved. For, regardless of our legal liability for damages, if the public is inclined to hold us responsible we must either assume and discharge the responsibility or take steps to relieve ourselves of it.

In other words, we can selfishly fall back upon the standards fixed by law and allow the laity to take care of itself. Or we can attempt to protect the laity from itself by clearly classifying our services, defining the responsibilities attendant upon the various classes of services and educating the laity to a proper conception of the classification of services and responsibilities. In short, we can either discharge our legal liability or our responsibility to the public.

Happily our various societies and organizations have undertaken the latter course. Among other steps that have been taken The American Society of Certified Public Accountants appointed a Committee on Classification of Accountancy Services. That committee after diligent research and consultation and the review of 5,000 typical engagements, published three reports. The last of these reports, dated July 9, 1931, contains the most recent classification recommended by the committee, together with suggested forms of certificates.

In mailing the report Secretary Springer of The American Society said:

"Endorsements of reports of this character do not indicate that in the judgment of the individual members of the organization the report is perfect or will never need amendment. Such endorsements indicate rather that the profession is on the way to a thoughtful determination of its possible service and responsibility to the public."

Time will not permit reading the report in its entirety. I will, however, give the pertinent facts and submit such criticism both favorable and unfavorable as in my opinion the report merits.

The committee has divided the services in six different classes. Five of these are audit and the sixth is "Other Services." Because the sixth class is the least important from the viewpoint of responsibility and because the titles of the various types of services which

are included in this class are almost self-explanatory, I will refer to them first.

The committee has included in Class 6, "Other Services," the following:

First: Investigations of Specific Matters.

Quoting from the report, the committee states:

"Such investigations comprehend examinations of one or more specific features of a business and are undertaken usually in connection with such matters as suspected fraud, disputes regarding payments of royalties, etc., reasons for increases or decreases of profits, financial policies, determination of possible extent of civil liability, measurement of contract obligations, insolvency, bankruptcy, measurement of rate-making factors of utilities and carriers, and other financial or administrative matters."

Second: Preparation of Statements from Books or Records Without Audit.

Respecting this type of service, the committee says in part:

"Statements prepared from the books or records without audit, should be made preferably on unwatermarked paper, bound (if at all) in a plain back, without any indication in the statements themselves or in anything attached to the statements that they were prepared by public accountants. If, on the other hand, watermarked or regular stationery is used, a footnote should be added to the balance sheet or other statements showing that they have been prepared from the books of account without audit.

"In cases where it is necessary to include in a report any statements which have been prepared from the books without audit, or only partial audit, such statements should be marked under the descriptive heading and at the bottom, so as clearly to indicate that they were prepared from the books without audit or with only such audit as is indicated opposite the respective items, depending on the situation."

Third: Tax Service.

Fourth: System Service.

Fifth: Budgetary Services.

Sixth: Opinions.

Seventh: Miscellaneous, which as the report states includes:

"Services not comprehended in the foregoing classes, such as acting as liquidating trustee, as advocate in the arbitration of commercial disputes, as arbitrator in commercial disputes, as umpire in accounting controversies involving accountants, or clients, or as comptroller, auditor, or bookkeeper, giving testimony in court and arbitration cases, interpreting financial data, rendering advice in accounting matters, preparing and recording bookkeeping entries,

instructing bookkeepers, and checking statements, etc., etc."

This general classification, for reasons which will appear later, can be objected to only because there is included under Type 1:

"Investigation of Specific Matters, such examinations of one or more specific features of a business as are undertaken usually in connection with such matters as suspected fraud, disputes regarding payments of royalties, etc."

It is my opinion that such services are auditing services and should be included in the fifth class of audits, which will be discussed later and which is titled "Audits of Specific Accounts."

Next we take up the first five classes of services which may be referred to as the various classes of audits. These are as follows:

"I. Examination of Financial Condition and Detailed Audit of Transactions for a Period. Short Title—Detailed Audit."

"II. Examination of Financial Condition and Audit Tests of Transactions for a Period. Short Title—Test Audits."

"III. Examination of Financial Condition and Review of Operations."

"IV. Examination of Financial Condition."

"V. Audit of Specific Accounts."

Briefly, we then have five classes of services:

1. Detailed Audit.
2. Test Audit.
3. Examination of Financial Condition and Review of Operations.
4. Examination of Financial Condition.
5. Audit of Specific Accounts.

The short titles for the first two classes are self-explanatory. Briefly, in the first class, "Detailed Audit," every transaction is verified. In the second class, "Test Audit," the assets and liabilities are verified and tests are made of the transactions.

With respect to this class the report states:

"A test audit has as its purpose substantiation by audit procedure of the correctness of the assets, liabilities (actual and contingent), reserves, capital, and surplus as at a balance sheet date, and selective audit tests of the transactions for a period ended on the balance sheet date. The character and extent of the tests will be governed by the circumstances of each case and should be so designed as to satisfy the auditor of the general correctness of the recorded transactions for the period, although such tests

will not necessarily disclose every irregularity.

"The audit report, addressed to the client, may take the form of a balance sheet, and a statement or statements of income and surplus for the period, together with comments in which a certificate may be incorporated. The certificate may be appended to the financial statements, provided that any essential qualifications are incorporated in the certificate."

To understand the type of services which come within the third classification it is, you will note, only necessary to differentiate between "Audit Test of Transactions for a Period," the phrase used in describing the "Test Audit" and "Review of Operations" used in the third class.

Let the report speak for itself:

"An examination of financial condition and review of operations is distinguished from a test audit by omission of the audit of cash transactions, and by analytical study, comparison, investigation, statistical and other tests of the income, expense, profits and losses rather than by selective audit tests of the transactions reflected in those accounts."

The fourth class, "Examination of Financial Condition," is briefly commented upon as follows:

"An examination of financial condition has as its purpose substantiation by audit procedure of the correctness of the stated assets, liabilities (actual and contingent), reserves, and capital at a balance sheet date, and an analysis of surplus, including as an incident to the substantiation of the balance sheet accounts, examination of such transactions at or about the balance sheet date as may affect the stated financial condition."

"A report on an examination of financial condition, addressed to the client, may contain properly a certified balance sheet, but if a statement of income and surplus is included in the report, it should be qualified as having been prepared from the books without audit of the transactions for the period."

Class V. "Audit of Specific Accounts" has a title that is self-explanatory. Regarding this class the report says:

"This class of service may cover any particular account, or accounts, of which the following are examples:

- "(a) Cash.
- "(b) Securities.
- "(c) Payroll.
- "(d) Manufacturing cost.

"An audit report on an account, or accounts, falling in this group, may take the form of a statement of the account or accounts audited, together with comments in

which a certificate may be incorporated, or the certificate may be appended to the statement, provided that any essential qualifications are made a part thereof."

To summarize the classification proposed by the committee, we have six main classes of services:

1. Detailed Audit.
2. Test Audit.
3. Examination of Financial Condition and Review of Operations.
4. Examination of Financial Condition.
5. Audit of Specific Accounts.
6. Other Services.

In order to determine the sufficiency and accuracy of this classification, the circumstances which necessitated it and the purposes for which it was made should be reviewed.

At the outset I referred to the increase in the types of services rendered, in the character of the laity and to the resulting confusion in the mind of the public as to responsibility of the accounting profession.

The Committee on Classification prefaced its report with this enunciation of purpose:

"A classification of accountancy services affords an intelligent basis for action in the following respects:

- "1. Negotiating with clients and arriving at a clear understanding as to the service to be rendered.
- "2. Administering practice: planning and supervising field work, reviewing reports, correspondence, judging performance on the part of members of the staff, compiling statistics of operation.
- "3. Contact with other professions or lines of activity; attorneys, bankers, credit men, engineers, appraisers, investment houses, etc.
- "4. Litigation, threatened litigation, controversies with clients concerning negligence, etc.
- "5. Publicity concerning the certified public accountant and his work."

Then this paragraph is added:

"Instances are numerous of time and effort economized and of friction avoided by partners, principals, and staff, through the use of a common language afforded by the classification.

"The classification should serve not only as a means of assistance to the profession, but as a guide in the formulation of study courses designed for students who are preparing to enter the profession."

These, then, are the announced purposes of the classification. It is fair to state that where the proposed classification serves the purposes



it is satisfactory; when it fails to meet the self-imposed purposes of the committee, it should be revised.

With only slight reservations, I think the proposed classification serves the first two purposes admirably. Certain shortcomings, which occur to me and which I shall refer to later, are of little importance in negotiating with clients. In such negotiations the wise practitioner will reduce the terms of the engagement to writing, with such elaboration as may appear necessary.

When it comes to the second purpose, administering our practice, the classification can be explained and if need be elaborated upon to fit the peculiarities of each office.

It is, therefore, my opinion that the classification serves these two purposes admirably. Likewise, it could well be made the basis for formulating courses in accountancy.

But, in my opinion, the classification falls short of accomplishing the other purposes which it was intended to serve. With appreciation of the painstaking services of the committee, I think the report suffers from an evil that curses our profession and that recent efforts of various committees have done little to alleviate. I refer to the continued use of terms which lack definitiveness—terms which are in many cases synonymous in the minds of the laity and which lack clear definitions in the profession.

Indeed, the greatest need of the profession is a Daniel Webster who will start every discussion with that challenge "Define your terms, sir, define your terms!"

To be specific you will note that the report uses three terms to describe the work that an auditor does in securing data for the compilation of statements. These words are "audit," "examine" and "review." Only one of these words is defined by the report. That word, audit, is defined as follows by the committee:

"Auditing, as used in a professional sense, may be defined as the procedure whereby one undertakes to pass judgment on the correctness of financial statements and accounts, by scrutinizing accounts, vouchers, documents and other supporting data and records, corresponding if necessary with independent third parties and orally questioning officials and employees."

If this be "auditing" and the definition seems acceptable, what is "examining" and what is "reviewing"? When do I cease to be an auditor and become an examiner, and when

do I pass from the role of examiner and become a reviewer? Or are the terms synonymous? You will note that in describing the first and second classes the terms seem to be used synonymously. On the other hand, in explaining the third classification the terms are so used that a distinction is implied.

I have no doubt that answers to these questions would be as numerous as the practitioners who undertook to answer them. It is undoubtedly true that most of us recognize, however vaguely, a distinction between the terms. In our own minds the lack of definitive terms would cause little confusion. But what of the laity? In our contact with the other professions, attorneys, bankers, credit men, engineers, etc., referred to in the second avowed purpose, can we expect even a hazy recognition of the distinction between our services as auditors, examiners and reviewers? As I once heard a surgeon remark, "There are two classes of operations—major and minor. But every patient feels that there is no such thing as a minor operation."

To my mind this request for clear-cut terms is more than an academic aim at nicety of words. It is the crux of the entire undertaking. If the classification is to serve the last three purposes, viz., contact with other professions, litigation and controversies with clients concerning negligence and, especially, publicity concerning the C. P. A. and his work, we must classify by the use of terms which define and which are used in the generally accepted meaning attributed to them not only by the profession but by the public as well.

With this in mind it seems to me that we must make use of the present beliefs and opinions of the laity as far as that is compatible with a reasonable limitation of our responsibility. I have already mentioned that the public is inclined to feel that any statement prepared by a public accountant is an audited statement. It goes without saying that we cannot accept the responsibility which this opinion imputes to us. But it is also equally questionable whether we can entirely disabuse the laity of this opinion. Certainly it is exceedingly doubtful whether we can educate the laity to the nice distinctions between audit, examine and review. Distinction with which, incidentally, we are not any too familiar ourselves.

Until we do so educate them we will have

*(Continued on page 51)*

## Commercial Arbitration

THE New York Arbitration Law has been further strengthened by a recent decision of the New York Court of Appeals, handed down by Judge Cordozo in the case of *Newburger, Henderson & Loeb, stockbrokers, vs. Jacob J. Lubell*. The decision establishes that one of the parties to an agreement to arbitrate a future dispute may not defeat the agreement by refusing to admit a controversy or by refusing to participate in the arrangement of an arbitration.

The plaintiffs, *Newburger, Henderson & Loeb*, bought and sold securities for Mr. Lubell under a written agreement containing the standard arbitration clause of the American Arbitration Association, providing that any controversy arising between them should be determined by arbitration. As a result of these transactions, the stockbrokers claim that Mr. Lubell had become indebted to them on January 2, 1931, in the amount of \$48,937.23. When the stockbrokers sought to ascertain whether there was a controversy as to the amount due, so that it might be submitted to arbitration, the defendant failed to respond to their inquiries and kept silent as to his position.

It has been generally assumed heretofore when a party to a contract containing a clause providing for the arbitration of future disputes commences a suit in the courts, that he waives his right to demand arbitration thereafter. Fearful that an action at law to recover the balance claimed might constitute such a waiver, if it should develop that a controversy did exist, and also that a petition for the appointment of an arbitrator might be met with the objection that in the absence of a controversy there was nothing to arbitrate, the stockbrokers demanded a declaratory judgment in their favor.

The Court of Appeals, in affirming the action of the lower court and denying the motion of the stockbrokers, pointed out that there are certain circumstances under which the commencement of an action will not be considered a waiver of a party's

right to demand arbitration, and set forth the procedure to be followed by the stockbrokers to obtain a judgment or an award, as ensuing circumstances might determine.

"The plaintiffs," said the Court, "may sue at law and reduce their claim to judgment. If the defendant does not contest the debt, they will have judgment by default. On the other hand, if he does contest, with the result that a controversy develops, they will be free to discontinue, and get the benefit of the contract that whatever controversy arises shall be settled by arbitration. We see no force in the objection that a waiver or abandonment of the benefits of arbitration could be inferred from the mere commencement of an action in the absence of notice that a controversy existed . . .

"The plaintiffs are not restricted, however, to an action at law. If the defendant fails to pay the debt and refuses to declare himself as to the reason for the failure, leaving the plaintiffs uncertain whether he contests it or not, they may file their petition under section 3 of the Arbitration Act, alleging their uncertainties and praying that the defendant be required to submit to arbitration whatever controversies exist. If the defendant . . . disclaims any controversy and concedes the debt, the court will not appoint arbitrators to compose a non-existing difference or one not within the scope of the defendant's promise, but the defendant may be estopped in such circumstances from interposing a defense thereafter. On the other hand, if the defendant remains obstinately silent, the court may infer from the very fact of silence that the petitioner's demand is not so plainly and fully uncontested as to make resort to arbitration useless, and may then proceed to a decree accordingly."

Judge Cordozo, in his opinion, said, "One who has become a party to a contract for the arbitration of future differences must live up to his engagement according to its spirit. He will not be permitted to wrest it from its purpose and turn it into a shallow form by taking refuge in a disingenuous silence or in subtle and adroit evasions."

# TALKING SHOP

A Department Conducted by L. GLUICK, C. P. A.

HAPPY NEW YEAR!

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Everybody who has ever been in Washington knows who Harry Wardman is. If you want to know a lot about his and other dealings in Washington realty, read the Findings of Facts in two cases, Philips (24 B.T.A. 98, and Wardman (24 B.T.A. 102).

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An accountant has to put up with a lot from the bookkeepers whose accounts he audits. He finds anything from studied indifference to downright sabotage. The limit seems to have been reached in the case of the head bookkeeper for a New York garment house. N. L. Nathan relates the story. For many months one of his men had been making the audit regularly. Then he was compelled to lay him off and different men were sent. They reported nothing but trouble; the former man had never had any. Quiet but tactful investigation revealed the reason. The young woman was sore at the auditing firm because it no longer sent the man who was laid off. He was a good-looking young fellow, to whom the girl had taken a fancy; and she just didn't like the looks of his successors; hence she would not help them.

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The last word on the subject of annuities and similar computation (at least for many months) is presented herewith. It is entitled: "Handbook of Financial Mathematics," by J. H. Moore, published by Prentice-Hall, Inc. There are 1,206 pages. We would like to see an abridged edition for accountants, containing those chapters and tables most commonly used.

The beauty of this book in our opinion is the simplicity of treatment of a traditionally tough topic. The author assumes that the reader knows nothing and develops his subject by slow steps. There is much duplication, but of such a nature

as to hammer home by repetition, the points reiterated.

Table VIII, page 1,120 ff, will be found especially useful for installment payments.

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Station WCPA broadcasting on an infrequency of twelve meters. In response to several requests and a lot of dares, the Shop Talkers' Dramatic Association will present this evening a notsomellowdrama entitled, "The Accountant's Revenge," in two acts. The part of the patient is taken by Dash, his wife is played by Etta Broun. We wanted to cast Miss Adams for the part but she is a blond, and as gentlemen prefer but don't marry them, we had to get the dark-haired Miss Broun. That irresponsible juvenile, the Kid, plays the young physician. Your announcer is Old-timer.

As the curtain rises on Act one, we see Mr. Dash in bed and Mrs. Dash hurrying to answer a ringing doorbell. She returns with Dr. Kidd and says:

"Oh doctor, he's so sick!"

*Dr. Kidd:* "How long has this been going on?"

*Mrs. Dash:* "He came home complaining at dinner time."

*Mr. Dash* (weakly): "I started to feel pain about three o'clock. At five it was so bad I stopped in a drug store on my way home and got a big dose of bicarb and—"

*Mrs. Dash:* "When he got here I made him take a hot drink and after a while he felt a little better."

*Mr. Dash:* "Ouch! Oh! Doctor you're hurting me!"

*Dr. Kidd:* "Well, I didn't mean to but at that anyone who waits till two o'clock in the morning to get a physician after being sick since afternoon, deserves to be hurt."

*Mrs. Dash:* "But what is it?"

*Dr. Kidd:* "Appendicitis, and we've got to rush him to the operating table. I hope it isn't too late. Even an hour makes a difference in

an acute appendectomy. Where's your phone?"

*Mr. Dash* (very feebly): "Oh, doctor!"

*Dr. Kidd*: "This the hospital? Send an ambulance right away."

CURTAIN

Station WCPA. We now pause for a moment to set the scene for the second act. The time is five P. M., the place, Dr. Kidd's office. Dash enters.

*Dash*: "You sent for me doctor?"

*Dr. Kidd*: "Yes; I'm glad you're here. I've been so rushed that I haven't been able to make up my tax return and remembered that was your business, so I sent for you."

*Dash*: "Very kind of you (there is an ironic tone in his voice). It is just seven hours before the sixteenth of March. The blanks have been out for two months, and you wait till now to send for me."

*Dr. Kidd* (annoyed): "But there's really nothing to it; I expected to do it myself and started. See! Here are all my bank statements, my check book, bank book, broker's statements, everything you need. It shouldn't take you an hour."

*Dash*: "How do you know how long it should take? How did I know I had an acute appendix when I tried to treat a bad stomach, and you scolded me for it? It may take two hours and it may take two days. I won't know till I'm into it. You called it making an incision. You've pulled me away from my office at a critical time and if I'm going to touch the case, you're going to pay for it."

*Dr. Kidd*: "Oh, of course, I don't want anything for nothing."

*Dash*: "Nor are you going to get it. The balance I owe you on the operation is two hundred and fifty dollars. If I get your return into the mails in time, you cancel it."

*Dr. Kidd*: "Oh come, Dash, that's pretty steep!"

*Dash*: "All right, then do it yourself. But I call your attention to the penalties for delinquent returns as well as the possibility of making errors. That might cost you more in the long run."

*Dr. Kidd* (weakly): "Very well; go ahead. But it's an imposition."

*Dash*: "You have nerve! After what you said to me in October, and charged me in March, you object to paying extra because you waited till the last minute! I'm tempted to let the case drop right here."

*Dr. Kidd*: "You couldn't. It wouldn't be professional to abandon a client in distress."

*Dash*: "Is that so? Well why did you start by saying tax returns were my 'business'?"

*Dr. Kidd*: "I didn't mean any harm. Business or profession, I don't want to get into any trouble with Uncle Sam. Do your stuff."

*Dash*: "OK."

Station WCPA signing off. Goodnight!

The October 16th issue of the B.T.A. reports (Vol. 24, No. 2) contains two interesting Realty cases. The first is another one of those arising from the Florida boom and would call for no comment if it were not for dissents by Sternhagen, Murdock and Seawell (Rose Investment Co., p. 215). The other is on page 276 and involves too many individuals to name here. The findings of facts state, "In 1925 and 1926 the real estate business was booming in New Orleans." That probably is no news to our worthy president. Evidently Florida was not the only locality so favored. Nor were the methods used in selling lots a bit different than in Florida, to judge from the report. The commissioner disallowed, and the Board sustained him without dissent in disallowing European excursions, etc., as deductible expenses.

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Anybody interested in mining should consult the tabulation of allowable depreciation rates on mine assets (24 B.T.A. 241).

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H. C. Anderson, C.P.A., of Texas, won a rule 50 decision in the case of Hoffer (24 B.T.A. 22). T. C. Fuller, C.P.A., of Illinois did likewise in the case of Stevens (24 B.T.A. 52). J. L. Block (also of Texas) split a verdict in the case of Houston Baseball Club (24 B.T.A. 68). But Frank C. Miller got a clean cut "Judgment for the petitioner" for his client, Wray (24 B.T.A. 94).

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Barney Rosselle, C.P.A., of California, has sent us an interesting letter about how he handles installment payments of a loan to include both principal and interest.

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On the evening of December 8th, we heard Walter Stegman address a meeting held at the Hotel McAlpine; his subject

was Stock Exchange House financial statements, and if he had not been speaking from memory and a few notes, we would have had a fine paper to forward to Mr. Springer for publication. As it was Mr. Stegman said that as soon as time permitted he would write it up in regular form. We hope that profitable business keeps him busy indefinitely; but we trust he won't forget the readers of this magazine.

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The next night it rained the proverbial cats, dogs and nigger babies, but we were glad of it; staying in to read Mr. Mellon's proposals for tax changes seemed less of a duty. We shan't talk about them now; they will be thoroughly cussed and discussed in Congress and elsewhere; including this Shop at some other time.

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In the same edition of our favorite evening paper we also came across two items of professional interest. One reported a speech made by Valentine Howell, an actuary for the Prudential Insurance Company at a meeting of the Chartered Life Underwriters. He advocated that the insurance man should get copies of income tax returns from prospective "Jumbo Risks."

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The other item showed West, Flint & Company appearing as one of the petitioning creditors in bankruptcy proceedings against the suspended Stock Exchange firm of Palmer & Company. It is common for accountants to be involved in bankruptcy proceedings as auditors, receivers, trustees, and general unsecured creditors. But only once before do we recall seeing a C.P.A. appearing as a petitioning creditor and that was in a Jersey case about a year and a half back. Unless our memory is failing us the accountant was Burney O. Jackson.

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Finished with our work, we turned to a newly acquired book of *Russian Short Stories* (translated, of course) and stumbled into more merchandise for this Shop. It was in a story called "The Old Rat," which seemed to be the equivalent for the English "old fox" or "wise guy." The individual in question was humorously portrayed

as a meddlesome old bookkeeper. But in this story of a modern Soviet airplane factory, he was shown as using an *abaccus*!

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We lay no claim to using perfect language, although that is always our aim. But one thing we hold and insist on in our instructional work is that "Every Class is an English Class." Some of our colleagues do not agree with us; they say that it is our duty to teach accountancy and let the English faculty teach good usage. Well, one of them uses "irregardless," irrespective of the fact that there is no such word, which is just too bad. Recently, by way of putting our theory to a test, we asked our class to write letters of application for a position as junior accountant. The results were pitiful. The only good letter in the lot came (and you explain it if you can) from that student whose mark in the course was the lowest in the class. What good is it to teach students and have them learn technical accounting if they cannot express themselves well enough to obtain a job after graduation? Can you imagine the kind of audit report texts they would write, if ever they went that far?

## Monetary Status of Present Day

(Continued from page 9)

know what it is. But there is only one of two things that can happen; either we have got to allow the price level to continue to decline until it finally stabilizes itself at what proves to be the bottom, or we must attempt to stabilize it by some artificial means, that is by inflation. Inflation is a very dangerous instrument to monkey with.

In this country where we have sometimes a radical change in administration policies and where our political parties are so evenly divided, where our Federal Reserve System is not a central bank but really twelve regional banks, the difficulties confronting the bankers and the government officials in providing for a moderate stimulation, a moderate inflation, seem to be almost insuperable. But until the price level is stabilized somewhere, either at the final bottom or artificially stabilized by inflation, we have not gotten yet to the end of the vicious circle, and, of course, the United States is the only country in the world that is in a position to adopt a policy of inflation.



# The Amsterdam Stock Exchange

By HERRMANN HERSKOWITZ, C.P.A.

AS early as the fifteenth century, speculation made its appearance in Amsterdam in the form of trading in bills. In the beginning dealings were confined to a small place in the open air in a street called Warmoesstraat. In 1561 the business of the Bourse was conducted at Nieuwe Brug. The brokers traded in the open, and during inclement weather the Chapel of St. Olaf was the scene of their activities. It was not until 1613 that the traders established themselves in their own building. The first quotation list for merchandise and bills was published at that time.

Speculation in securities began with the formation of the Dutch East India Company. This company resulted from the consolidation of the smaller units doing business in the East Indies. The distribution of the large issues of stock was facilitated through the unlimited support and backing of the government given because of the paramount national importance of the undertakings of the Dutch East India Company. The millions required flowed in as the prospects for immediate profits were alluring. The company obtained a majority of the East Indies trading, and under normal conditions great returns on the invested capital were confidently hoped for. With the close co-operation of the Bourse and the Company, it was soon evident that rising prices were to be everyday affairs.

From the beginning speculation in shares was in futures. The Amsterdam Bourse absorbed all the business since the largest speculators did business there. Aiding the Stock Exchange actively was the famous Bank of Amsterdam, which was established on January 31, 1609. This bank became rich and prosperous and had in its coffers more gold and silver than any other similar establishment of its kind in Europe. The big volume of business on the Exchange tended to develop its methods, and it can be truly said that the peculiar technique of business on the modern Exchange owes its development to the Amsterdam Stock Exchange.

The international character of the Amsterdam Bourse made it a haven for many brokers, and in 1612 there were already three

hundred of them. Methods of trading were regulated, and there were fixed terms of settlement, fixed commission rates, units of trading, and option dealings as well as loans on collateral. The tulip mania in 1634 caused speculation to flourish among the mighty and the small.

Other nations cast covetous eyes over the great commercial development of the Netherlands, and soon the ravages of war cast their shadows over the country. With the invasion of the French and the sea battles with England, speculation in 1672 began to turn its attention to Government securities. Towards the close of the century, Amsterdam slowly developed into an international stock exchange. One of the first foreign loans to be brought out there was that of one and one-half million guilder, which the Emperor Leopold I borrowed in Amsterdam in 1695.

Transactions on the Stock Exchange were no longer made directly by the public but by dealers in stocks. It became necessary to inform the public about the transactions made, and this situation led to the publication of price lists. The first quotation list appeared in 1720. It enumerated the shares of thirty-four companies. The first complete stock exchange list on record was issued in 1747. It contained forty-four classes of securities embodying twenty-five State and Provincial bonds, three home shares, three English shares, four English Government securities, six German loans, and three miscellaneous securities.

The following decades witnessed the increasing importance of the trade in stocks. After many endeavors a separate stock exchange was finally formed as the trade in stocks had long ago created its own peculiar customs, regulations, and laws. The association was called the "Collegie tot Nut des Obligatishandels," and the date of its organization was about 1787. The manner of quotation was unsatisfactory. With securities undergoing violent fluctuations the differences arising from faulty quotations were considerable, and these conditions became burdensome. In 1833 a division took place, and a new or-

ganization called the "New Trading Association" was formed. An attempt was made by the secessionists to devise a uniform method of quotation, but their efforts were disregarded by the old Association. Prior to that time, the *Handelsblad*, a well-known Amsterdam newspaper started to publish besides the official rates the figures which corresponded to actual transactions and which were furnished by different stock jobbers.

The older group soon took cognizance of the public's preference for the more definite quotations of the new body. It was, therefore, proposed to combine the old and new methods, but this attempt failed. Further negotiations resulted in the adoption of a new method. A quotation committee was to be appointed, which was to publish the highest, the lowest, and the last rate of the day. This plan fell through, and it was not until 1848, that another important step was taken towards a reconciliation of the two hostile groups. When France was seething with revolution and the spirit of rebellion was kindled in other countries, the members of both bodies met to make a united stand. It was decided to terminate all dealings, and the Bourse was closed for a short period.

With the passing of the years, there came the realization that the business of the Amsterdam Stock Exchange should be carried on by one official body. In October, 1856, an appeal was signed by the two associations, and a committee was appointed to discuss the question. The new committee prepared regulations governing bourse transactions, but its labor was in vain, for the power of adequate enforcement was lacking. However, the aim of many years was finally realized, and the new and old organizations were united into one body in 1857 for certain administrative purposes. All professional dealers interested in Bourse transactions, stockbrokers, and jobbers signed the agreement. The fixing of the quotations was the chief task of this body. This was done every day at 2:45 P. M., and all members were required to assist. The rates quoted were the highest, the lowest, and the last for the day. The transactions on the Bourse were quoted by messengers while the members themselves at the daily meetings announced the rates at which they had done business. The quotations covered mostly the cash business, and in a separate column the prices of securities for forward delivery were given. The first list of quotations drawn up

according to the new principles appeared on May 1, 1857.

Trading in stocks was carried on in the inadequate "Stock Pit." This place was always crowded, especially as the increasing number of dealers had to contend with the idlers. A committee was appointed to look into the question of erecting a new Exchange building. In 1870 the Municipal Council was asked to furnish a plot of land for the erection of a building. As the wishes of the Association were not complied with, the members were determined to end this intolerable condition. On May 17, 1876 the work of the "Algemeen Beurscomite" and the "Effecten-Societeit" came to a close, and the completely merged "Vereeniging voor den Effectenhandel" numbering 465 members began its labors.

The ambition for a distinct commodity and exchange building where trading could be done in comfort was not lost sight of. In 1896 the Municipality set the wheels in motion for the construction of the "De Beurs von Berlage," and on May 29, 1903 in the presence of the ruling family the building was opened. As the room allotted for the trade in stocks was too small, an agreement was made with the Municipality for the building of a separate Stock Exchange. The building was financed by a loan of three million florins, and on December 22, 1913 it was opened with appropriate ceremonies.

The World War increased the importance of Amsterdam as a financial center, and the Stock Exchange participated in the increased benefits. By the passage of "The Stock Exchange Act of 1914," the Bourses were placed under the paternal guidance of the State. The Dutch Government could under certain conditions pass laws in contradistinction to the regulations of the Association. While rumblings of dissatisfaction are heard now and then against outside regulation, on the whole the members are satisfied with the liberal treatment accorded them by the government.

As constituted today, the Amsterdam Stock Exchange is under the aegis of the "Association for the Trading of Securities." It has duly elected officers consisting of a president, vice-president, treasurer, and secretary. The powers of government are vested in the committee of the Amsterdam Stock Exchange. The many activities of the Association are distributed among various committees, the most important dealing with questions of

quotations, arbitrage, admission of securities, and members.

In the by-laws of the Stock Exchange are contained regulations governing admission of members. Applicants must be Dutch citizens and must be recommended by at least twenty members. Naturalized citizens must show at least ten years continuous residence in Holland, and in addition they must have been connected with the securities or banking business for at least two years. Membership may be obtained by:

1. Traders, Commission Agents, Brokers, and Bankers who deal in securities and whose offices are located in Amsterdam.

2. Corporations with offices in Amsterdam dealing in securities provided its managers are also members or apply at the same time for membership.

3. Managers of corporations provided these corporations are members or apply at the same time for membership.

New members are required to pay an admission fee. Each member has to pay an annual fee, the amount of which is fixed every year. There is no restriction as to the number of members. The membership in 1927 totalled about 800 as against 750 in 1926 and 728 in 1922.

For the admission of new securities, domestic as well as foreign, the consent of the Minister of Finance is required. Besides the prospectus, the following information must also be submitted:

1. The authenticated copy of the Certificate of Incorporation and By-Laws and proof that the Company was organized in accordance with the laws of its domicile.

2. Certified copy of income account and balance sheet.

3. A written declaration from the company whereby they undertake to hold at the disposal of the shareholders annual printed copies of financial statements, all of which must be made available in Amsterdam.

4. To make dividends and interest payable in Amsterdam if such disbursements are made payable in Dutch currency.

Pending the final decision of the Minister of Finance and the Committee on Listing, the Executive Board may provisionally enter the security on the price list. When it is found that all conditions for admission have been complied with, the security is put into the class of "Definitely Quoted Securities," which in-

cludes, of course, the greater number of the list of quotations. Dutch securities must have at least an issued capital of 500,000 florins, and foreign securities must show an outstanding of 500,000 florins in Holland. (Florin equals 40.2 cents.)

The Bourse is open for official business from Monday to Friday from 1:30 P. M. to 2:45 P. M. and on Saturday from 10:30 A. M. to 11:30 A. M. All securities shown on the official price lists are quoted in per cents, and to be admitted to quotation transactions representing at least 2,000 florins of the nominal value of the securities, if the rate is below par, must be completed, and at least 1,000 florins, if it is above par. Trading on the floor of the exchange may take place only between members of the Association or their employees.

There are two methods employed in arriving at final quotations for "Definitely Quoted Securities." Under the first procedure, the final record presents the highest, lowest, and final rate. The second method is employed when trading is heavy. Group A provides for a division of the trading time into six ten-minute quotation periods and one fifteen minute period. For each of these periods rates are quoted, and this method is employed for different classes of shares. Under Group B, Dutch and Dutch East Indian Government bonds are included as well as the debentures of the Municipalities of Amsterdam, The Hague, and Rotterdam. Here the Bourse time is divided into one twenty minute, one half-hour, and one fifteen minute quotation period. These measures are taken so that the rates may be fixed as accurately as possible.

Most of the transactions which are officially quoted are done for cash, and deliveries must be made within four days. There is, of course, margin trading, which is made possible by loans for one month or three months. The value of securities deposited must show at least a margin of twenty per cent in the case of the loan of shorter duration and ten per cent for the longer period. Trading in options is permitted, but they are not officially quoted. Stock Exchange transactions are reported in the leading newspapers and economic journals.

The list of securities traded on the Exchange embraces a great number of foreign as well as domestic issues. Amsterdam is second only to the United States as the principal

*(Continued on page 54)*

# The Advantages of Audits to Cities and Towns<sup>\*</sup>

By A. LEE RAWLINGS, C.P.A.

ACCORDING to your official program, you were to be addressed at this time by Mr. Charles M. Johnson, Director of the Local Government Commission, Raleigh, North Carolina. Unfortunately, Mr. Johnson was prevented, by official business, from keeping his engagement to address you, and I was requested on yesterday to substitute for him.

The subject on which I am here to address you is a broad one, on which much could be said, but my time has been limited and I shall therefore confine myself to the most important points covered by the subject.

While accounting is one of the newest professions of today, I assume that all of those present are familiar, in a general way, at least, with its purposes, advantages, etc.

For a great many years past, banks, manufacturing and other business concerns have availed themselves of the services of public accountants for auditing their accounts, installation of improved accounting systems, preparation of financial statements, etc., but a great many cities and towns have been slow, so to speak, in availing themselves of such service.

While, under the subject assigned me, I am supposed to confine my remarks to cities and towns, I am going to take the liberty of including counties and other functions of a public nature in my remarks.

I desire to liken the taxpayers of a city, town or county to the stockholders in a private corporation, and to liken the governing bodies of cities, towns and counties to the officers and directors of a private corporation, who are responsible to the stockholders for the proper and efficient conduct of the business. While I appreciate the fact that politics often play a large hand in municipal and other public affairs, I, nevertheless, believe that the same business methods and efficiency employed in private affairs should be adhered to, as much as possible, in public affairs.

What are the advantages of audits to cities and towns? I desire to state, that in my opinion, audits in many instances, are not of any real value, and often times represent a waste of money, unless a proper basis therefor is established. I mean by this, adequate systems. Auditing, as you probably know, consists of the verification of accounts, records and transactions, and where complete records or accounting systems are not maintained, an audit of the accounts is largely a matter of guess work and does not produce satisfactory results. It is, therefore, necessary that the accounts of any city or town be properly established and an adequate system maintained as a basis for satisfactory audits. This not only makes for efficiency, and reflects the true status of affairs, but also serves to expedite audits of the accounts at a minimum cost.

Municipalities, as you know, operate on a cash basis, nevertheless, it is necessary to keep the accounts on an accrual basis, in order to determine actual revenue and expense, which information is absolutely necessary for purpose of budgets, under which all cities and towns are supposed to operate.

While the State of Virginia, unlike many other states, does not prescribe a specific system for the use of cities and towns, the systems employed by many municipalities are not unlike those used by cities and towns in other states.

If I may be pardoned for the personal allusion, I will state that my firm has had over twenty years' experience in municipal work in Virginia and North Carolina, as well as in some of the other Southern States, and my remarks, therefore, are based upon actual contact and experience.

Many of you, no doubt, are familiar with, or have read accounts in the newspapers, of large shortages in the accounts of public officials, chiefly county treasurers, in the State of Virginia, in the past several years. A number of these shortages were discovered and checked up by my firm, and I say to you that with but few exceptions, the shortages in

<sup>\*</sup>Address delivered at convention of League of Virginia Municipalities, Norfolk, Virginia.

question resulted from inadequate accounting systems, and failure to properly audit and settle the accounts at regular periods, rather than to dishonesty on the part of officials.

This brings us back to the point previously made by me, that every city and town which has not a complete and adequate accounting system, should have such installed, and then follow with audits of the accounts at least annually, or oftener, if so required.

Some of the chief advantages to cities and towns of proper and complete audits may be summarized as follows:

1. Accurate statements of income and expense for given periods, and statements of financial condition at specific dates.
2. Detection of irregularities of both omission and commission, and the proper accounting for funds.
3. Information required in connection with sale of bonds, loans in anticipation of collection of revenue, etc.
4. Establishment of taxable values, bonding limits, sinking funds, etc.
5. Constructive criticism and recommendations as to improvements in accounting systems, administration of affairs, etc.

It is obvious that those responsible for the conduct of affairs of any municipality should know and be thoroughly familiar at all times with the financial condition of such municipality, which knowledge can be obtained only through complete audits of the accounts. This is especially necessary in the preparation of annual budgets.

Since the governing bodies of municipalities are responsible to the taxpayers, they should exercise every precaution for the protection of the funds under their control. The average public official is not an experienced auditor, and if he were so qualified, he could not be expected to devote the time required for such work—hence, certified public accountants should be employed to render the necessary service.

When it comes to selling bonds and borrowing money, the purchasers or lenders naturally desire statements prepared by independent accountants, as to the financial condition of the city or town, and its ability to assess and collect sufficient revenues with which to meet interest charges and provide for sinking funds, or other means of retiring the obligations, and here an audit plays again an important part.

Last, but not least, audits are both constructive and instructive, and make for efficiency. The best of us are more careful when our work is subject to the scrutiny of others. The more careful we are, the more efficient, and the more efficient, the more resourceful.

I could dwell at length on the advantages of audits, but I think the points already made will suffice for this occasion.

I desire, however, to tell you something about the manner in which the accounts and finances of municipalities are handled in the adjoining State of North Carolina.

Under the provisions of the Local Government Act of the State of North Carolina, the financial affairs of cities, towns, counties, schools, etc., are under the supervision and control of a commission at Raleigh, of which Mr. Charles M. Johnson is director.

The above mentioned commission prescribes the systems to be used by the various municipalities, counties, etc., in the State, but does not attempt to audit the accounts, which work is let to public accountants, under the supervision of said commission. All contracts, however, for such work and the compensation therefor, have to be approved by the director of the Local Government commission, with whom copies of auditor's reports are required to be filed. The Commission also has final say as to the issuance of bonds, temporary loans, etc., by municipalities, counties, etc.

In other words, no municipality or county in North Carolina can issue bonds, or even secure temporary loans, without the approval of the Local Government Commission, and the law also requires that the bonds and loans be sold through bids at Raleigh, North Carolina.

The above mentioned law has been most helpful in the regulation and stabilization of municipalities in North Carolina, as would no doubt be told you by Mr. Johnson, if he were here.

I might add that the costs of audits of municipalities and counties in North Carolina are borne by the municipalities and counties, but since such audits, and the cost thereof, are subject to the approval of the Local Government Commission, much unnecessary work and exorbitant charges, which previously obtained in some instances, have been eliminated.

As you probably know, the auditing of counties and municipalities in Virginia, when so requested in the case of municipalities, is

under the control of the Auditor of Public Accounts, at Richmond, which said work is supposed to be done by the members of his staff. Unfortunately, however, the services of the Auditor of Public Accounts has not been very effective in the past, due largely to the lack of experienced men for doing the work in question. As a result of this condition, and the lack of proper accounting systems, a number of county treasurers in the State have gone short in their accounts for large amounts. In this connection, I mention shortages of the treasurers of the following counties in the State of Virginia, of which I have personal knowledge:

A—Approximately \$155,000.00

B—Approximately \$98,000.00

C—Approximately \$100,000.00

There are a number of other treasurers who have gone short in their accounts, of which you have no doubt read in the newspapers. The treasurers of A and B Counties resigned after shortage in their accounts was established, and the bonding companies paid the claims, but the county treasurer of C County is still in office, notwithstanding the efforts of the Governor to remove him.

I do not recall at this time any shortages which have occurred in the accounts of city and town officials in the State of Virginia, but admitting that all such officials have been honest in the handling of funds intrusted to them, the necessity for and the advantage of auditing municipal accounts in the State nevertheless exists. The results to the taxpayer are the same, i. e., loss of revenue—whether the funds become dissipated through dishonesty or lax accounting methods, which, in either case would be detected through proper audit of the accounts.

I have often heard the remark, "audits cost money—can't afford the expense of them," but just let something happen, and the very fellow who opposed the audit will be willing to spend untold money to get at the facts. It is often times a case of locking the stable door after the horse is gone. They will say to you, "Bill is all right—there is no necessity for checking his accounts." Supposing "Bill" is all right, then there should be no objection to checking him up, but supposing "Bill" isn't all right, then he should be checked up.

It is impossible to tell from the face of accounts, or unverified statements prepared from them, exactly what exists, or may be con-

cealed, in said accounts, and the only way to secure the facts is by a detailed audit and analysis of the accounts in question. Cities and towns should provide for audits of their accounts the same as they do for insurance and other ordinary expenses.

The last Legislature of Virginia authorized the Governor to appoint a commission for the purpose of making a study of county laws and administration, and to make recommendations to the Governor for consideration and submission to the next Legislature. Dr. Robert H. Tucker, President of Washington and Lee University, is chairman of said commission, which has not as yet, as far as I know, completed its work and report. It is, therefore, not known at this time, what bearing, if any, the report will have on cities and towns in the State. It is apparent, however, that some material changes and improvements should be made in the present laws governing the administration of counties, and some cities and towns in the state.

Before closing, I desire to impress upon you the importance of employing accountants to audit the accounts and install improved systems for your cities and towns, who are familiar with and experienced in this particular line of work. Often times an accountant may be experienced in one line of work and not experienced in another.

While my remarks are not intended to reflect upon any accountant, I think you will readily appreciate the advantage of employing accountants for your work who are experienced in municipal accounting. Let me also suggest that you select an accountant who can be depended upon to render efficient service and make a reasonable charge for same. Don't ask him to bid a flat price for your work—you can't expect to get \$100.00 worth of service for \$50.00.

I recall two cities in a nearby State which elected to let their audits to the low bidder for a flat fee. Shortly after the audits were completed it developed that the tax collector of each town was approximately \$30,000.00 short in his accounts. The accountants who did the work simply skimmed over the records, without delving into them, in order to avoid sustaining loss on the engagements.

A thorough and complete audit made by any experienced and responsible accountant, is usually worth every cent it costs, while as

a rule, the amount spent for partial or incomplete audits, represents a waste of money.

Efficiency in all lines of business is the slogan today. Those charged with the keeping of the accounts of a municipality, or for any other business, should exert every effort to properly record the transactions and keep the accounts in balance. Don't leave a lot of ragged ends and adjustments to be made by the auditor when he is called in. This will simply serve to retard his work, and increase the cost of the audit, in addition to inviting

unfavorable criticism as to the condition of the records.

A list of the certified accountants and public accountants in the State of Virginia may be obtained upon application, without cost, from C. S. Goldston, secretary, Virginia State Board of Accountancy, at Richmond, and if in doubt as to the accountant to be engaged, it will be well to consult such list.

It will also be advisable to require accountants to furnish names of some of the cities and towns for which they have done work.

## Municipal Finance<sup>\*</sup>

By W. A. MAGEE

IT behooves Pittsburgh and all the other spendthrift cities to observe the fate of Fall River and put their houses in order before the Legislature takes the management of their affairs from them. The Legislature of Massachusetts at the demand of the creditors of Fall River, a city of 125,000 people, appointed a Finance Commission of three persons with full power to control the financial operations of the City. This Commission has stripped the city authorities of everything except the means to operate the primary functions of government and these on a minimum basis.

All public improvements except a few emergency jobs and all rubbish collection have been abandoned; the recreation and playgrounds, libraries and city dispensaries have been closed. The scope of operations and the personnel in all remaining city departments have been very greatly reduced and all city employees still retained are to suffer salary cuts of between twenty and forty per cent. Eight schools have been closed. The kindergartens and all the auxiliary activities of the school system have been eliminated while the teachers have had a decrease of twenty per cent in pay.

The effect of all this has been to greatly reduce the total of city expenditures but on the other hand the people have stopped paying taxes to a large extent, with the result

that the tax return for 1932 has been fixed at the almost incredible figure of forty mills. While the City of Fall River has a Mayor and Council and a School Board who continue to go through the forms of legislation and management of the city and the schools so that in outward appearance it seems like a self governing democratic community, yet it is not so. The Finance Commission is the real governing power. It is the dictator of every policy involving money expenditure. The elected officials and the community lost their civic liberty by the same career of extravagance which all cities have been indulging in during the post-war period. The depression from which the country at large has been suffering since 1929, struck New England a few years earlier. If the prevailing depression continues for a couple of years more the taxpayers of Pittsburgh and other cities will gradually lose their ability to pay their current taxes with the result that the levy upon those who can pay will constantly mount and as it becomes higher and higher the number of delinquents will grow proportionately.

One of the things grossly apparent upon the face of our budget in Pittsburgh is the over estimate of revenue. It is a species of cowardice not to face facts. Although Pittsburgh had never collected more than eighty-nine per cent of the tax levy during the current year, nevertheless our city officials a year ago estimated a return of eighty-six and one-half per cent, a wholly unjustifiable expectation. The amount received was four per

<sup>\*</sup>An address delivered by the former mayor of Pittsburgh before the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants.



cent less than that estimated, the result was a deficit in revenue from that item alone of \$700,000. The same mistake is being made in the budget that is now being considered for 1932. Although the Treasurer collected only \$18,450,000 on current taxes during the year 1931, on a basis of twenty-five and one-half mills land tax levy, it is now being estimated that \$18,500,000 or \$50,000 more will be collected in 1932 on a twenty-five mill tax.

Everyone has a right to make his own guess as to the degree of business prosperity for the forthcoming twelve months, but I claim that in a matter of such concern as this, caution should be exercised. Instead of guessing that \$18,500,000 will be received from the tax levy, I will guess that \$18,000,000 will be closer to the mark. In that single item of revenue I think the city officers are starting off the year with a first contribution of half a million towards a new deficit to plague them. The purpose of over estimates of revenue is to postpone painful reductions of expenditures in the hope that fate will intervene. A year ago the city officers did not manfully face their task. It was plain to see then that city expenses must be slashed, nevertheless to postpone the evil day the city officers included two items in their revenue for 1931 which are not revenues at all, one of them was the Bank Depository fund of \$500,000 and the other the refund from the Garbage Company of nearly \$400,000. In the estimate of revenue a year ago other items were over-estimated, the total being nearly \$1,500,000. An actual deficit of that amount would have occurred and has only been avoided by shutting off the purchase of a large amount of supplies and by furloughing the entire city payroll. These furloughs are a manifest danger. The city has skilled men at certain critical points and in certain employments whose absence from their posts would not be tolerated by a prudent management. The same situation should be more frankly and courageously faced now than it was last year.

To sum it all up \$2,000,000 of reductions in the 1932 appropriations will not be sufficient to bring about any cut in the present tax levy. A three mill reduction as demanded by the Real Estate Board will require reductions of more than twice \$2,000,000.

The situation confronting the city requires plain speaking. Too much of the responsibility in my judgment is being placed upon the executive department. As between the city of-

ficers the greater responsibility is upon the legislature department. But in my humble judgment the largest part of the blame for the tremendous increase of the city liabilities both in bond loans and annual expenditures should lay upon the people and particularly upon the numerous civic organizations, general, special and upon the groups and localities variously organized which constantly initiate new improvements, further extension of municipal functions, greater extent of municipal services and higher standards of municipal performance in every way. So far as these things are done extravagantly and wastefully or to provide employment for the supporters of the political machine the responsibility is with the city officials, but so far as expenditure is unavoidable once the policy has been decided upon and when that policy has behind it the unanimous support of all the civic organizations and business organizations with no dissenting voice made public, in that case I say the city officers should not be wholly blamed. In my humble judgment it behooves every city booster, every socially minded idealist and in fact every community enthusiast to stop and reflect before he condemns the city officials utterly.

There are two aspects of expenditure, one is the policy aspect, the other is the administrative aspect. Whether or not the city should foster annexation, whether or not it should tax the whole body of citizens to help pay the water bills of a certain section, whether or not it should have street lighting de luxe, whether or not a certain public improvement should be undertaken, whether or not policemen and firemen's wages should be raised and scores of other like things should be done or left undone are questions of policy. Whether they are executed economically and efficiently or extravagantly is the responsibility of the administration, but none of these new adventures which entailed so many millions of recent additions to the budget were without a great measure of support from influential parts of the public. Justice would put a large share of the blame upon the public itself. The blame that should attach to a public officer when he participates in an unwise public venture backed by all the organs of public opinion is that he was not courageous enough when, with the bird's-eye-view of his position to see all the consequences of the undertaking and its relation to all the other obligations of the city, he did not warn

and resist to the bitter finish what he knew to be ruinous policy. Only a few public servants have given the necessary study to public problems and possessed the requisite courage to resist group and sectional clamor in the interest of the higher and more ultimate advantage of the community at large.

The mistakes of public policy initiated or concurred in with the active backing of groups, associations and localities are too numerous to recite at this time. One of these however is so far outstanding that mention of it should not be avoided. The Pittsburgh policy of annexation is plainly leading us to ruin. The last five wards which have come into the city have increased its area, to the extent of almost ten square miles which is an increase of twenty per cent, while they have brought with them taxable valuations of only \$43,000,000 an increase of only about three and one-half per cent. Is it not plain without detailed analysis what the consequences to the balance of the city will be? To bring the new territory up to city standards in street and sewer improvements, police and fire service, health protection, street cleaning and lighting, garbage and refuse collection, equalizing water rents and the numerous other city services puts a crushing load upon the older and more

developed sections. I will cite only one illustration. One of the new wards has less than \$3,000,000 of taxable valuations which at the 1931 tax rate will yield not more than \$40,000. One single item of city expenditures (the fire engine house) will consume about three-fourths of the whole revenue from that one ward. I think it safe to say that one of the new wards will cost the city treasury more to administer than the Second ward which contributes \$5,000,000 or about twenty-five per cent of the total tax levy.

What I am saying as to mistaken policy with reference to annexation runs all through the budget. Without in any degree condoning administrative extravagance or councilmanic responsibility I fear that the wild and panicky efforts of the city officials to retrench under the strain of the changed attitude of the public will result in the kind of public harm which I think I see in the Massachusetts City and in Chicago.

It is most unfortunate that the budget was not prepared two months ago. When the numerous policies adopted during the last five years were decided upon the only element considered was community pride. Now they should be calmly, deliberately reviewed from the viewpoint of cost but the time to do so is not sufficient.

## New York State Society

THE Secretary, on invitation, attended the dinner of the New York State Society of Certified Public Accountants held at the Waldorf-Astoria on Monday evening, December 7.

Five hundred members and guests filled the grand ball room. Forty-three guests of honor were listed, including presidents and secretaries of accounting and financial organizations, Federal and State governmental officials, and editorial writers, both magazine and newspaper. The dinner was served under the personal supervision of Oscar. Throughout the dinner the Waldorf-Astoria orchestra rendered music of a type for which they are famous.

Following the dinner, the program proper was presented, the presiding officer being Col. Arthur H. Carter, president of the New York

State Society. During the program Miss Antoinette Consoli, Miss Alma Micheline and Miss Stephanie Wall, operatic soloists, each presented a group of songs. President Carter traced rather hurriedly the development of the New York State Society from March 30, 1897, when in the old Waldorf-Astoria eighteen accounting pioneers organized the society, to the present time when its membership represents practically a hundred-fold increase. He also called attention to the development which has taken place in the relative importance of the profession in the business world.

George P. Auld, C.P.A., formerly accountant general of the Reparations Commission, spoke on the subject "International Debtors and Creditors." Mr. Auld's presentation was illuminating in view of his former relationship

to the commission which enabled him to present conclusions having the benefit of a background of personal experience not possessed by the ordinary writer on such a subject. Mr. Auld felt that it was impossible that the reparations debt could be completely wiped out at this time but he said:

"To this country the maintenance of the reparation system through the maintenance of the inter-ally debts means nothing in comparison with our stake in the stability of Europe. The average annuity of \$317,000,000 receivable by the United States represents \$2.60 apiece each year, and this inconsequential benefit would, year by year, with the increase in our population, become even more insignificant.

"The annuity receivable amounts to two and one-half per cent of our national and local government costs and four-tenths of one per cent of our recent national income. The idea that the payment of the inter-ally debts is important to our taxpayers has no foundation in fact. But the losses imposed upon our whole population as a consequence of the recurrent agitations in Germany against the further payment of reparations are real and substantial."

The second speaker of the evening was Mr. Geoffrey Parsons, chief editorial writer of the *New York Herald-Tribune*, who discussed "Forces That Transcend Economics." Mr. Parsons' thesis was that as much as we talk about economics and the underlying economic principles involved in various subjects, such as the gold standard, tariff, reparations, depression etc., the fact remains that our policies never had been based on economic principles but had rather been conceived and carried out as the result of human factors. The emotions more often determined the governmental attitude than scientific economic reasoning. Extravagant enthusiasm or increasing fears have determined governmental policies to a much greater extent than economic beliefs.

The evening was an exceedingly profitable one for all present. Whether one agreed with the conclusions of either of the speakers or not is relatively immaterial. The presentations made compelled thought on the part of all listeners and viewpoints will be changed from time to time as, in connection with the present session of Congress just entered upon, the

various attitudes of members thereof will be noted and checked against the factors of sound reasoning, intense nationalistic belief, an international viewpoint, a humanitarian attitude or the political opportunist.

In connection with the trip the Secretary conferred with representatives of several organizations with which The American Society has established a group contact, the National Association of Cost Accountants, National Association of Credit Men and the American Bar Association.

The Secretary was also able to confer with the chairmen of the several committees of The American Society residing in New York City: Homer Dunn, Commercial Arbitration, Joseph J. Klein, Federal Legislation, and John R. Wildman, Classification and Certification of Accountancy Services.

Before getting the night train for Washington Tuesday evening, the Secretary attended the reception and dance of the freshman class of Pace Institute in the grand ball room of the Hotel New Yorker. It was estimated that in the neighborhood of 1,200 freshman students and their guests were present. Those who were present at the meeting of The American Society held in New York City in 1929 and recall the entertainment which Fred Schaeberle as chairman of the local committee presented for our enjoyment, need only be told that an equally good job was done in connection with this affair, the general plans for the evening being directed by him.

An interesting feature of the evening was the presentation through Harvey Kelley, head of the department of English, of two class banners, one for the freshmen in the School of Secretarial Practice and the other for the freshmen in the School of Accountancy and Business Administration. All present stood on the dance floor in front of twenty-five members of the faculty while Mr. Kelley made a six-minute address to the freshmen, emphasizing the attitude which should be taken by students looking forward to a professional career. He closed by reading a telegram from Homer Pace who was in California on a short visit.

"Don't do too much worrying. Tackle the duty that lies next to your hand."

—Bruce Barton.

## How to Attack the C. P. A. Examinations

### The Ruminations of a Savage Examiner

COME to the examination room with a heavy black pencil that smears easily; if unobtainable, procure an HHH grade that scarcely makes a mark. The idea is not to prepare wholly legible solutions. What the examiners can't read won't hurt them.

Do not study the problem. It isn't necessary. Problems are made to work, not to theorize over. Omitted details can be inserted at the end, if at all.

Pay no attention to instructions. They are of the conventional type anyway. With all the study you have behind you, you should by this time be outside the pale of being told what to do.

Cover as many pages of paper as you can. No problem that can be answered on two pages should be answered on less than ten.

Don't be afraid of being verbose. Examiners are unusually impressed by long-winded arguments, especially those that have nothing to do with the matter in hand. After they've read a page or two they'll quit and give you the credit you deserve.

Always prepare uncalled-for work-sheets, even for the simplest problems, for it proves that you can reason on paper, if not in your head. On the other hand, omit required exhibits here and there. The imagination of the examiner may be relied on as active, and it will supply any seeming deficiency.

Follow the principle of artistic restraint and do not tell all you know. Merely suggest that you know, at such length and in such polite language as the occasion may demand. For example, should the examiner ask you bluntly what you regard as the safest method of inventory valuation, you should retort to the effect that many methods are safe, some safer, but none safest. You can then proceed to give an illustration of almost any large industrial corporation which has sought in vain to find the safest method; but look! it has had to cut its dividend in this period of depression. This is not telling all you know.

When in doubt, consult the man across the aisle; if the examiner sees you, you may expect him to be impressed by your avidity for facts.

Jot down here and there clever witticisms, occasionally in lieu of solutions. Marking papers is a tedious business and a casual bon mot now and then will cause your grades to react in accord with the spirits of the examiner. Examples: "This problem is unfair. It is too hard." "We were never given this type of problem in our C. P. A. review course and I am unable, therefore, to work it."

If you cannot solve a problem, outline in great detail, for the examiner's benefit, the procedure you would have followed if you had had time to work it. Preparing the outline may consume more time than the solution, but you will be playing safe and the examiner may never know it.

Orderly work-sheets are old-fashioned. In fact, no exacting methodology ought to be recommended. The answer's the thing. Merely make sure you have the correct monetary amount somewhere on your paper.

Never forget "Did not have time to finish." It may not be inadvisable to put it after every problem. Nobody can do justice to the examination within the given time-limits.

Do not put your papers in the proper sequence; the examiners employ clerks for that purpose.

Finish the examination as quickly as possible in order that you may be the first to leave the room. You will thereby confirm your reputation for brilliance. Imagine the pleasure of walking out before the rest!

Finally, play politics. Have your employer or somebody friendly to the governor call up the chairman of the Board and remind him of your sterling qualities as an auditor. A word or two to the effect that you were sick on the days of the examination will serve as the extenuating circumstance justifying the call.

# C. P. A. Examination Questions\*

November, 1931

## Practical Accounting

### Problem 1:

On November 2, 1931, you are called upon by the Monmouth Clothing Company to determine the amount to be paid in cash to each of the partners of the Better Price Garment Distributors for their business. You are furnished with a copy of a contract dated October 31, 1931, signed by all the parties, under the terms of which the assets and liabilities of the Better Price Garment Distributors were to be taken over on the same date by the Monmouth Clothing Company. Pertinent details of the contract and other information follow:

(1) C. L. Bodd and Floyd Gesser are the partners. A third partner, George Gash, who was to have had, in addition to a regular commission of 12½ per cent on his sales, a one-eighth interest in the partnership profits (in return for his services as a salesman) from January 1, 1930, was discharged on December 31, 1930, and was given his accrued commissions and \$4,500.00 in cash in lieu of his share in the profits and in full settlement of his interest in the partnership.

(2) Bodd and Gesser contributed \$50,000.00 and \$20,000.00, respectively, at the outset of the partnership (April 1, 1929), and drew monthly salaries of \$300.00 each which everyone considers a fair compensation for their services as managers. They were to share in any remaining net profit or loss of the business two-thirds and one-third, respectively.

(3) For their interest in the partnership, Bodd and Gesser are to be paid in cash the sum of the following:

- (a) Assets at their cost less depreciation, if any, less all liabilities, and
- (b) Good-will, in an amount equal to one-fourth the total net profit for 1929 and 1930. No deduction is to be made for 1931 losses.

(4) Operating expenses are to be regarded as having accrued in the year in which paid. The cost of merchandise sold and bad debts are to be prorated over

\*The Service of Examination Questions conducted by The American Society furnishes practically twice as many questions in Theory, Auditing, Commercial Law, and Economics and Public Finance as could be used by any State Board for a four-hour examination period, and twice as many problems in Practical Accounting as would be required for two examination periods of four to five hours each. A Board using the service makes its own selections and adds any special questions or problems which it desires. Eight boards used the November, 1931, service. Every suggested question or problem, except two, was selected by at least one Board, and only five were selected by every Board. Two boards added questions with a local bearing. Part of the Practical Accounting problems follow.

each of the various years in proportion to net sales. Inventory depreciation at November 2, 1931, is to be spread three-fifths to 1931, and two-fifths to 1930. Fixture depreciation is to be computed at ten per cent per annum.

No satisfactory books of account have been kept, but you are able to compile an accurate analysis of cash receipts and disbursements as follows:

	Receipts	Disbursements
1929 (from April 1)		
Capital contributed by partners .....	\$ 70,000.00	
Bank loan .....	10,000.00	
Collections from customers.....	184,062.28	
Withdrawals—Bodd .....		\$ 500.00
Withdrawals—Gesser .....		100.00
Merchandise creditors .....		165,242.18
Operating expenses .....		80,345.60
Partners' salaries .....		5,400.00
Fixtures purchased (April 1) .....		3,450.00
1930		
Collections from customers .....	359,391.05	
Withdrawals—Bodd .....		547.20
Withdrawals—Gesser .....		5,000.00
Commissions paid to George Gash.....		12,500.00
Merchandise creditors .....		200,682.84
Final payment to George Gash .....		4,500.00
Operating expenses .....		83,087.23
Partners' salaries .....		7,200.00
Fixtures purchased (July 1) .....		4,365.60
1931 (to October 31)		
Collections from customers .....	114,769.27	
Withdrawals—Bodd .....		7,006.52
Merchandise creditors .....		102,453.61
Operating expenses .....		51,641.82
Partners' salaries .....		4,200.00
Sales were:		
1929 (9 months) .....	\$250,922.56	
1930 .....	376,383.84	
1931 (10 months) .....	125,461.28	

Of the balance of accounts receivable at October 31, 1931, \$94,545.08, you estimate that \$9,000.00 is uncollectible.

The inventory of merchandise on hand, at cost, is \$44,663.75, and included \$23,851.52 which had not been paid for at October 31, 1931. It has been agreed that the inventory has depreciated 50 per cent.

Aside from the unpaid purchases, the partnership liabilities consist of the loan from the bank, made in 1929, and unpaid partners' salaries for three months.

## Problem 2:

You are called upon by a committee appointed by certain common stockholders of the Premier Tester Company and certain preferred stockholders of the Premier Corporation to investigate the facts behind the recent organization of the latter

company. For the purposes of this problem, your solution is to consist of a re-drafting of the company's balance sheet and the auditor's certificate, both of which appeared in a report to stockholders as at August 31, 1931. You are also to prepare a statement of reconciliation between the net worth of the predecessor company, before adjustments, if any, and the net worth of the Premier Corporation as determined by you.

You are permitted access to the books and other records of both companies and from them you ascertain the following facts:

(1) Premier Tester Company, due to the depression and to possible mismanagement, was in financial difficulties early in 1931, at which time it owed the Foothold State Bank on a demand loan \$150,000.00. A subsidiary of the bank, Foothold Securities Company, was called upon in an attempt to reorganize the finances of the business in such a way that sufficient working capital could be obtained to take care of current obligations. The company had always paid substantial dividends and was deemed capable of earning in excess of \$500,000.00 per annum under a responsible management.

(2) On August 7, 1931, an agreement was drawn up containing, as its principal provisions, the following:

(a) Parties to the agreement: Premier Tester Company, George Gimmel, and Foothold Securities Company, designated respectively as first, second, and third parties.

(b) Second party to form a new corporation immediately to be known as Premier Corporation, to be incorporated under the laws of the State of Delaware, and to have authorized issues of 75,000 shares of \$3.00 cumulative preferred no-par-value stock having a stated value of \$37.50 per share, and 25,000 shares of no-par-value common stock having a stated value of \$1.00 per share; at stockholders' meetings each share of preferred stock to have voting rights equal to each share of common stock.

(c) Third party agrees (1) to buy on or before August 31, 1931, all authorized preferred stock of the new company, (2) to pay for same \$40.00 per share in cash or in property, the latter at values as may be determined by the Board of Directors, and (3) to sell such stock to the public, as a new issue, at \$50.00 per share or more.

(d) First party agrees to sell (vendee not specified) its plant (i. e., fixed assets) for \$1,000,000.00 in cash, and its remaining assets (excluding cash) and business, less liabilities, at August 31, 1931, for the 25,000 shares of no-par-value stock of the new company.

The above agreement was at once approved by the stockholders of the Premier Tester Company, and the president, George Gimmel, was authorized to carry out the company's obligations thereunder.

(3) The balance sheet of the Premier Tester Company at August 31, 1931, immediately before its assets were turned over to the new company, was presented to you as follows:



PREMIER TESTER COMPANY  
BALANCE SHEET—AUGUST 31, 1931

ASSETS	LIABILITIES
Cash .....\$ 214.52	Foothold State Bank .....\$ 150,000.00
Customers ..... 158,539.18	Creditors ..... 622,485.61
Inventories ..... 47,663.20	Reserve for depreciation..... 1,002,640.95
Plant ..... 5,899,135.96**	Capital stock ..... 5,000,000.00
Total assets .....\$ 6,105,552.86	Deficit ..... 669,573.70*
	Total liabilities .....\$ 6,105,552.86

\*Red.

\*\*Net sound value, per appraisal report of American Appraisal Co., as at August 6, 1931, \$1,001,256.84.

(4) Balance sheet and auditors' certificate extracted from printed report to stockholders of the new corporation (date of incorporation, August 15, 1931):

PREMIER CORPORATION  
BALANCE SHEET—AUGUST 31, 1931

ASSETS	LIABILITIES
Cash in bank .....\$ 409,629.35	Creditors .....\$ 347,856.26
Receivables (net) ..... 89,269.59	Preferred stock ..... 2,812,500.00
Inventories, at cost or less..... 21,932.79	Common stock ..... 25,000.00
Plant ..... 3,050,000.00	Surplus, available for dividends 385,475.47
Total assets .....\$ 3,570,831.73	Total liabilities .....\$ 3,570,831.73

"We have examined the books and accounts of the Premier Corporation and its predecessor, the Premier Tester Company, as at August 31, 1931, and the agreement dated August 7, 1931, between Premier Tester Company, George Gimmel, its president, and Foothold Securities Company. We hereby certify that in our opinion the above balance sheet is in conformity with the books and presents a true picture of the financial condition of Premier Corporation at August 31, 1931, subject to the following:

"(a) Capital assets, \$3,050,000.00, acquired from the predecessor company, have been recorded on the books at values given to them by the Board of Directors, which represent substantial reductions in the value thereof reflected in the books of the predecessor company. Certain non-recurring charges and other financing, legal, and rehabilitation expenditures totalling \$50,000.00, have been capitalized.

"(b) Customers' accounts have been valued on the basis of 50 per cent of the receivables from customers appearing on the books of the predecessor company, which we believe to be conservative. Inventories have been depreciated something more than 40 per cent, owing to the desire of the president, Mr. George Gimmel, to meet declining price levels.

SWEET AND SHORT,  
*Accountants and Auditors."*

(5) On the books of the Premier Tester Company you find six journal entries recorded after the balance sheet had been prepared. The explanations attached to these entries, except as noted elsewhere, you find are substantially in accord with the facts.

## (1)

Cash in bank .....	\$ 525,370.65	
Reserved for depreciation .....	1,002,640.95	
Foothold State Bank .....	150,000.00	
Creditors .....	274,629.35	
Deficit (interest paid but not accrued) .....	1,000.00	
Deficit .....	3,955,495.01	
Plant account .....		\$ 5,899,135.96
Customers .....		10,000.00

Sale of plant to Parlous Shearer, nominee for Foothold Securities Company, including assumption by him of certain pressing obligations of our company which he immediately paid off in cash in full, and the assignment to him of an account guaranteed by Foothold Securities Company, the proceeds of which are to be turned over to our company's successor.

## (2)

Deficit .....	74,269.59	
Customers .....		74,269.59
Estimated loss from bad debts, our company never having had a reserve therefor and many accounts now believed uncollectible; authorized by Board of Directors August 31, 1931.		

## (3)

Deficit .....	25,730.41	
Inventories .....		25,730.41
Estimated decline of 53.9838 per cent in value of inventory per instructions of Mr. George Gimmel, our president.		

## (4)

Capital stock—Premier Corporation .....	2,500,000.00	
Creditors .....	347,856.26	
Deficit .....		2,751,653.88
Customers .....		74,269.59
Inventories .....		21,932.79
Profit from sale of accounts receivable and inventories, less creditors, in exchange for common capital stock of Premier Corporation.		

## (5)

Deficit .....	525,585.17	
Cash in bank .....		525,585.17
Liquidating cash dividend paid pro rata to our stockholders per authorization of Board of Directors August 31, 1931.		

## (6)

Capital stock .....	5,000,000.00	
Deficit .....		2,500,000.00
Capital stock—Premier Corporation .....		2,500,000.00
Distribution to our stockholders, some of whom refuse to surrender their certificates of stock of our company, consisting of 25,000 shares of no-par-common stock of Premier Corporation.		

(7) On the books of the new company you find the following opening entries ·

## (1)

Plant .....	\$ 3,000,000.00	
Preferred stock .....		\$ 2,812,500.00
Surplus .....		187,500.00

Purchase from Parlous Shearer of plant, title transferred to-day, for all of preferred stock authorized; and creation of surplus available for dividends (under Delaware law, per opinion of Mr. F. A. Straight, of counsel), per resolution of Board of Directors and of stockholders, both dated August 31, 1931, stock issued as follows (by direction letter from Foothold Securities Company):

## Certificate

Number	Stockholder	Shares	Consideration
1	Foothold Securities Company	50,000	Plant.
2-58	Individual (new) stockholders	25,000	\$1,250,000.00 cash (paid to Foothold Securities Company).

The preferred stockholders who have employed you belong to the second group shown immediately above.

## (2)

Customers .....	\$ 74,269.59	
Inventories .....	21,932.79	
Cash in bank .....	474,629.35	
Creditors .....		\$ 347,856.26
Common stock .....		25,000.00
Earned surplus .....		197,975.47

Receipt of above assets and liabilities in exchange for issue of all no-par stock of 25,000 shares having stated value of \$1.00 per share, and realization of earned discount on purchase of \$197,975.47 from which dividends are payable in accordance with above opinion of counsel.

## (3)

Receivables—Loan to G. Gimmel, president .....	15,000.00	
Plant, for disbursements to—		
G. Gimmel .....	12,500.00	
Foothold Securities Company .....	37,500.00	
Cash in bank .....		65,000.00

Cash disbursements on August 31, 1931; charges to plant authorized by Board of Directors for personal services in purchasing the plant at its scrap value.

Cash in bank and the amount owing to creditors on the certified balance sheet of the new company you determine to be correct. The appraisal of the plant you find has been carefully done and the value shown therein corresponds closely to the book value after adjustment for proper allowances for depreciation and obsolescence which have not been made for the last ten years. The plant is old and in a state of poor repair. A 50 per cent reserve for bad debts on accounts with customers (\$74,269.59) you conclude is correct. However, the valuation of the inventories is in excess of the salable merchandise on hand and from information made available to you during your examination, you estimate the correct amount, based on market values which are less than cost, should have been \$5,245.80. You are to

provide a good-will account, if necessary, for any excess of stated values over tangible assets acquired.

Problem 3:

Murray Rand, one of three trustees appointed under the will of the late Arthur Seller, asks you to prepare a consolidated balance sheet of the various interests controlled by the trustees. These interests consist of undistributed income, and 90 per cent of the stock of the Cortex Corporation. The Cortex Corporation owns 96 per cent of the stock of Downey Investments, Ltd., an English corporation. These corporations were established by Mr. Seller for the purpose of holding investments made by him. Mr. Rand, his son-in-law, who has always managed these companies, owns the minority stock of both.

Under the terms of the will, the three trustees are to act as directors of the two corporations, pay the widow a minimum of \$30,000.00 annually for her maintenance, and reinvest any surplus. They may also combine the two corporations or dissolve them at their pleasure. You are informed that the trustees are considering the desirability of an immediate consolidation of the various interests under one head.

You find that the three trustees account for their transactions as follows:

Particulars	Investments in Bonds	Stock of Cortex Corporation	Cash in Bank
On hand at date of death (April 10, 1925) .....	.....	\$ 1,315,155.73	.....
Dividends from Cortex Corporation .....	.....	.....	\$297,000.00
Purchase of bonds .....	\$186,870.83	.....	186,870.83*
Sale of bonds .....	136,808.33*	.....	137,647.45
Interest received .....	.....	.....	99,023.32
Distribution to Mrs. Seller .....	.....	.....	336,966.19*
Taxes and expenses .....	.....	.....	7,345.28*
Balance—September 30, 1931 .....	\$ 50,062.50	\$ 1,315,155.73	\$ 2,488.47

\*Red.

The last coupons clipped from the 6 per cent bonds on hand on September 30, 1931, bore the date of September 15, 1931. The par value of the bonds is \$50,000.00 and their cost and present market value, \$50,062.50. The investment in the Cortex Corporation is shown at the value reported for Federal estate tax purposes which the trustees believe to be fair. This value represents the original cost of \$900,000.00 plus appreciation of securities and the gain from conversion of the foreign holdings at the then current rate of exchange.

The Cortex Corporation was established on July 1, 1921. You find that its financial position on various dates has been as follows:

ASSETS	July 1, 1921	April 10, 1925	September 30, 1931
Cash in banks .....	\$ 1,000,000.00	\$ 124,528.20	\$ 195,353.39
Investments, at cost .....	.....	1,905,724.91	1,628,958.52
Accrued interest .....	.....	15,733.60	37,692.08
Stock in Downey Investments, Ltd. ....	.....	336,303.36	336,303.36
Total assets .....	\$ 1,000,000.00	\$ 2,382,290.07	\$ 2,198,307.35

## LIABILITIES AND NET WORTH

Notes payable .....		\$ 1,036,000.00	\$ 436,000.00
Capital stock .....	\$ 1,000,000.00	1,000,000.00	1,000,000.00
Earned surplus .....		346,290.07	762,307.35
Total liabilities and net worth .....	\$ 1,000,000.00	\$ 2,382,290.07	\$ 2,198,307.35

For Federal estate tax purposes, the investments at April 10, 1925, were valued at \$1,986,324.87, their market value at that date. Of this amount securities which cost \$775,692.00 and had a market value of \$789,620.00 at April 10, 1925, were on hand at September 30, 1931. The market value of all the securities at the latter date was \$1,702,340.90.

Balance sheets of Downey Investments, Ltd., which was incorporated as at January 1, 1925, were:

	January 1, 1925	April 10, 1925	September 30, 1931
<b>ASSETS</b>			
Cash in bank .....	£ 74,000	£ 25,000	£ 64,000
Investments, at cost .....		105,000	100,000
Total assets .....	£ 74,000	£130,000	£164,000

## LIABILITIES AND NET WORTH

Note payable .....		£ 50,000	.....
Capital stock .....	£ 74,000	74,000	£ 74,000
Earned surplus .....		6,000	90,000
Total liabilities and net worth .....	£ 74,000	£130,000	£164,000

The market value of the investments on April 10, 1925, as determined for Federal estate tax purposes, was £105,800, or \$505,618.20. Of this total, securities purchased on January 2, 1925, which had cost £25,000, and had a market value of £25,500 on April 10, 1925, were still on hand at September 30, 1931; the balance of £75,000 had been purchased on February 3, 1931. On September 30, 1931, the market value of all the securities on hand was £130,000; there was no interest accrued on them. No dividend has ever been paid by Downey Investments, Ltd.

Rates of exchange on various dates were as follows:

January 1-2, 1925 .....	4.734
April 10, 1925 .....	4.779
February 3, 1931 .....	4.75
September 30, 1931 .....	3.915

Mr. Rand requests you to accept, in lieu of cost for balance sheet valuation purposes, the market value of the securities at the date of death in order that the accountability of the trustees for subsequent events may be properly displayed. You may, of course, qualify your balance sheet in any way. You are also requested to give such summary figures under the heading of net worth as will indicate the disposition, if any, of earnings. Mr. Rand's investment is to appear as a minority interest with such details thereof as you believe will be of interest to him.

Your solution is to consist of a consolidated work sheet suitable for presentation to the trustees, together with a balance sheet prepared therefrom. No reserve (on account of the present depreciated pound) need be provided on the cost of the

securities owned by Downey Investments, Ltd., owing to the offsetting increase in market values. Market prices of securities should be shown parenthetically only.

Problem 4:

A, B, and C are partners and on July 1, 1928, decided to sell their business.

The following schedule shows the original contributions, the profit and loss ratio, and the status of their capital accounts:

Name	Original Contribution	Share in Profit or Loss	Capital Account July 1, 1928
A .....	\$ 20,000.00	2/5	\$ 41,816.38
B .....	10,000.00	2/5	48,434.62
C .....	10,000.00	1/5	12,514.37
Totals .....	\$ 40,000.00		\$102,765.37

Included in the assets and liabilities were the following balances of salary accounts:

Name	Dr.	Cr.
A .....	\$3,002.66	
B .....		\$ 236.43
C .....		4,360.54
Totals .....	\$3,002.66	\$4,596.97

The net assets, exclusive of partners' personal accounts, and of \$10,205.20 cash on hand, were sold for \$85,000.00, of which \$25,000.00 was to be paid immediately in cash and the balance in four equal annual instalments without interest. In case any of the four instalments were missed, the business was to revert to the three partners without reimbursement for any instalments already paid. You were called in to devise a plan of distributing the payments among the partners. They informed you that the success of the new proprietors was not assured, and that if they (the partners) were compelled to take the business back, the remaining assets would be of little, if any, value. Having devised a plan of distribution, you are now recalled, three years later, and informed that the third of the four instalments was not paid. Accordingly, the business is returned to the partners, the net assets being worth \$25,400.00.

Prepare a schedule showing how you would have handled these matters for the partners, assuming that the debit balance in A's account at the time of the sale was a withdrawal of profit for 1928, and that the other two partners, on the first distribution, were entitled to their salary accounts and withdrawals proportionate to A's current overdraft, notwithstanding any excess of withdrawals in previous years.

Problem 5:

In 1927, a certain group of business men believing that farm land values had reached bottom in the rapid decline of prices, decided to acquire for operation and speculation several financially distressed farms adjoining each other in the Middle

West. Accordingly, the Western Farms Corporation was organized in 1928 with an authorized capital of \$250,000.00 represented by 2,500 shares of common stock, par value \$100.00. Four farms were acquired by the corporation, the details of the purchases appearing in the journal entries shown below. A set of books, on the accrual basis, was opened March 1, 1928, and financial statements were prepared each year therefrom.

The venture, however, proved unprofitable and with land values declining, the company on February 15, 1931, removed all its personal property from the farms known as the Three and Four, gave a quit-claim deed to the second-mortgage-holder on Farm Three which was accepted by him and notified the holder of the mortgage on Farm Four of its abandonment and intention to default on further mortgage interest and principal payment. The fair market value of Farm Three was estimated to be \$40,000.00 and of Farm Four, \$5,000.00. In connection with the abandonment, the bookkeeper made a journal entry on the books which he believed was proper, but did not post to the general ledger.

From the following trial balance and particulars prepare (1) a profit and loss statement for the year ending February 28, 1931, and (2) a balance sheet at February 28, 1931, which, in your opinion correctly reflects the financial condition of the company.

#### TRIAL BALANCE—FEBRUARY 28, 1931

ACCOUNT	Dr.	Cr.
Cash in bank .....	\$ 459.60	
Advances to employees .....	175.00	
Unexpired fire and tornado insurance .....	1,535.39	
Due from Farmers Co-op. Elevator Co. ....	17,673.34	
Horses and harnesses .....	875.00	
Inventory of cattle and hogs at market value, February 28, 1931 .....	11,918.20	
Inventory of crops at market value, February 28, 1931.....	4,931.10	
Land .....	705,290.00	
Buildings and improvements .....	77,109.58	
Reserve for depreciation on buildings and improvements .....		\$ 5,940.35
Farm machinery and equipment .....	13,324.67	
Reserve for depreciation on machinery and equipment .....		2,932.50
Accounts payable .....		29,167.40
Chattel mortgage notes payable, dated February 28, 1930, and due February 28, 1932 .....		21,392.85
Accrued taxes payable .....		12,837.65
Accrued interest payable .....		31,115.27
Accrued wages—February 28, 1931 .....		300.00
First mortgages payable .....		471,867.35
Second mortgages payable .....		117,589.00
Loans from officers of company .....		22,688.41
Capital stock, 2,100 shares .....		210,000.00
Surplus, balance February 28, 1930 .....	66,355.06	
Income from sale of cattle .....		29,844.50
Income from sale of hogs .....		6,435.69
Income from sale of wheat .....		16,900.24
Income from sale of corn .....		8,616.54

	Dr.	Cr.
Income from sale of hay .....		\$ 450.00
Market value (February 28, 1931)—		
Corn harvested and retained .....		2,165.50
Wheat harvested and retained .....		1,890.60
Hay harvested and retained .....		875.00
Market value of crops harvested and fed to stock during the year .....		7,363.45
Settlement received from railroad company for losses in shipment of stock .....		1,500.00
Farm manager's salary .....	\$1,800.00	
Farm labor—cattle and hogs .....	1,162.50	
Farm labor—crops .....	3,409.00	
Cattle and hog feed purchased and used .....	5,831.40	
Market value of own corn crop fed to stock .....	5,313.45	
Market value of own hay crop fed to stock .....	2,050.00	
Inventory adjustment account .....	44,321.75	
Machinery operating expense and repairs .....	2,496.50	
Building repairs .....	344.75	
Depreciation—farm machinery (to February 28, 1931) .....	1,350.00	
Depreciation—buildings (to February 28, 1931) .....	4,374.92	
Administrative expenses .....	3,640.25	
Taxes (expense) .....	5,297.99	
Miscellaneous supplies .....	547.69	
Interest expense .....	20,285.16	
	<u>\$ 1,001,872.30</u>	<u>\$ 1,001,872.30</u>

Journal entries covering purchases of farm properties follow:

MARCH 1, 1928

Land .....	\$682,290.00	
Buildings and improvements .....	77,109.58	
First mortgages payable .....		\$451,867.35
Second mortgages payable .....		117,589.00
Cash in bank .....		189,943.23

To record purchase of three farms, one, two, and three, subject to mortgages thereon as listed below and existing previous to purchase; liability therefor not assumed by corporation.

Farm	Appraised Value Buildings and Improvements	Appraised Value of Land	First Mortgages	Second Mortgages
One .....	\$ 45,709.08	\$492,290.00	\$326,867.35	\$ 92,589.00
Two .....	31,400.50	125,000.00	75,000.00	15,000.00
Three .....		65,000.00	50,000.00	10,000.00
	<u>\$ 77,109.58</u>	<u>\$682,290.00</u>	<u>\$451,867.35</u>	<u>\$117,589.00</u>



## DETAIL OF MORTGAGES PAYABLE ON ABOVE PURCHASES

Farm	Date Drawn	Date Due	Amount	Interest Rate
				Per Annum, Payable Semi-annually
One .....	3- 1-22	3- 1-32	\$326,867.35	6 %
One .....	12- 1-26	12- 1-31	92,589.00	6½%
Two .....	6-15-23	6-15-32	75,000.00	6 %
Two .....	11-20-26	11-20-31	15,000.00	6½%
Three .....	9- 1-22	9- 1-32	50,000.00	6 %
Three .....	9- 1-26	9- 1-31	10,000.00	6½%

Total mortgages on properties purchased ..... \$569,456.35

September 1, 1928

Land .....	\$ 23,000.00
First mortgage payable .....	\$ 20,000.00
Cash in bank .....	3,000.00
To record purchase of Farm Four and record purchase money mortgage given of even date, signed by the corporation and due in five years, at 6% interest per annum.	

February 15, 1931

First mortgages payable .....	70,000.00
Second mortgage payable .....	10,000.00
Loss on abandonment of Farms Three and Four .....	8,000.00
Land .....	88,000.00
To record abandonment of Farms Three and Four at February 15, 1931.	

## ANALYSIS OF ACCRUED TAXES PAYABLE FEBRUARY 28, 1931

3- 1-30	Balance—Unpaid general property taxes on Farm Three for calendar year 1929 .....	\$ 1,125.76
3- 1-30	Balance—Unpaid general property taxes on Farms One and Two for calendar year 1929 .....	6,413.90
8- 1-30	General property taxes on Farms One and Two for first half of calendar year 1930 .....	4,250.13
8- 1-30	General property taxes on Farm Three for first half of calendar year 1930 .....	904.61
2- 1-31	General property tax on Farm Four for calendar year 1930 .....	143.25

Total per general ledger ..... \$ 12,837.65

The real estate tax rate for the current year is determined in February of that year, and taxes billed in two instalments as of June 30 and December 31. No change in rate or assessed valuations were made in 1931.

## ANALYSIS OF TAXES (EXPENSE), FEBRUARY 28, 1931

8- 1-30	General property taxes on Farms One and Two for the first half of calendar year 1930 .....	\$4,250.13
8- 1-30	General property taxes on Farm Three for first half of calendar year 1930 .....	904.61
2- 1-31	General property tax on Farm Four for calendar year 1930 .....	143.25

Total per general ledger ..... \$5,297.99

## ANALYSIS OF ACCRUED INTEREST PAYABLE FEBRUARY 28, 1931

3- 1-30	Balance—	
	First mortgage on Farm One, to February 28, 1930 .....	\$ 9,806.02
	Second mortgage on Farm One, to February 28, 1930 .....	1,504.57
	First mortgage on Farm Two, to February 28, 1930 (in arrears) .....	3,250.00
	Second mortgage on Farm Two, to February 28, 1930 (in arrears) .....	1,002.02
8-31-30	Six months' accrued interest on first and second mortgages on Farms One and Two, as charged to interest expense account....	15,552.66
	Total per general ledger .....	\$ 31,115.27

## ANALYSIS OF INTEREST EXPENSE, FEBRUARY 28, 1931

8-31-30	First mortgage on Farm One, 6 months accrued .....	\$ 9,806.02
8-31-30	Second mortgage on Farm One, 6 months accrued .....	3,009.14
8-31-30	First mortgage on Farm Two, 6 months accrued .....	2,250.00
8-31-30	Second mortgage on Farm Two, 6 months accrued .....	487.50
9- 1-30	Interest paid on first and second mortgages on Farm Three, due September 1, 1930 .....	1,825.00
9- 1-30	Interest paid on mortgage on Farm Four, due September 1, 1930.....	600.00
2-28-31	Interest paid on chattel mortgage notes to February 28, 1931.....	1,497.50
2-28-31	Interest paid on loans from officers to February 28, 1931.....	810.00
	Total per general ledger .....	\$ 20,285.16

## ANALYSIS OF INVENTORY ADJUSTMENT ACCOUNT, FEBRUARY 28, 1931

Date	Particulars	Dr.	Cr.
8- 1-30	Inventory of crops on hand at 2-28-30 .....	\$ 7,644.59	
8- 1-30	Inventory of cattle and hogs on hand at 2-28-30 .....	48,595.36	
8- 1-30	To set up cattle and hog inventory at August 1, 1930....		\$ 29,836.74
11- 1-30	To set up cattle and hog inventory at November 1, 1930		13,457.95
2-28-31	To set up cattle and hog inventory at February, 28, 1931		11,918.20
2-28-31	To adjust inventory account of cattle and hogs.....	43,294.69	
		\$ 99,534.64	\$ 55,212.89
	Balance per general ledger .....		44,321.75
		\$ 99,534.64	\$ 99,534.64

## Classification of Accountancy Service

(Continued from page 23)

difficulty in the discharge of the responsibilities they impute to us.

I realize that adverse criticism without the submission of a constructive alternative is always subject to the accusation of unfairness. I am sure, however, that you will realize that such adverse criticism is not hostile but is in fact the first step in construction or reconstruction. The remedying of the faults of the proposed classification is a matter that

must come from deliberation and discussion. If my remarks are provocative of these, they shall have served their purpose.

Meanwhile, I think the committee is to be congratulated. The proposed classification is excellent for use within the profession and as a beginning is much better than might have been expected. I hope that before this session ends, the Ohio Society will ratify the classification, subject to such amendments as may be suggested by a committee which should be appointed forthwith. The problem is one that should no longer be neglected. The Ohio Society will, I am sure, take an active part in its solution.

# The Abolition of Economic Illiteracy\*

By H. G. SHIELDS

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THE abolition of economic illiteracy is a task for all teachers from the early grades through the university levels. There are so many economic misconceptions and forms of misinformation to which children are subjected that the teaching of economic concepts on the upper levels is difficult because of the strong impressions formed in the early years. Economic illiteracy is common enough; much of the economic thinking of business men, of teachers, of professional people, of working people, is in quite sharp disagreement with the findings of professional economists.

Our economic knowledge is hampered because in this day of specialization it is difficult for people to see the economic process as a whole. Most of us for the most part see only small segments of it. Many bank employees, for example, know little or nothing about the operation of fundamental banking principles and much less about the federal reserve system. Workers and managers in grocery stores rarely know the part they are playing in the great marketing system with which they are concerned. Many teachers know but little about the taxing system which is such an important determinant of their own welfare. It is small wonder, then, since our major activities take such a large part of our attention that we are unable to see the economic world as a whole and that economic illiteracy is so common as a result.

An understanding of the economic order in all its details would be an impossible task for anyone. Economists themselves are mystified and uncertain concerning many of the details but the larger outlines are fairly discernible and an appreciation of the workings of the economic system is easily within the comprehension of all. Primarily the abolition of economic illiteracy among all groups is a question of seeing the relationships. A bank clerk, or anyone else, does not need to know all the details concerning the federal reserve system

but an awareness and an understanding of the relationship of the system to banking as a whole and the individual's bank in particular would make him a more intelligent employee and citizen. The same is true of the teacher, the doctor, the average citizen in any walk of life, with respect to the relationship of their task to economic life in its entirety.

Much of the trouble in connection with the teaching of economics is due to the limitations of the learner's economic experience and the difficulty of divorcing this experience from the broad general principles involved in a study of this field. The attitudes and emotions one brings to economic problems are always colored by previous experiences as a result of such things as the social class or the occupational status of the learner or his family. It is extremely difficult to change prejudices, emotions, and attitudes. The field of economics, unlike many other fields of learning, is full of such. Hence the importance of early instruction in the field. A steelworker's son has quite a different outlook on economic life than does a banker's son.

Economic illiteracy is common enough because school organizations, especially on the elementary and secondary level, have done but little to eliminate it. Rapid strides have been made in getting rid of the reading and writing type of illiteracy but economic illiteracy prevails. Health education of a particular kind has made splendid gains but that form of education which would make possible continued health in adult life has received meager attention. Economic education is concerned with the problem of aiding the individual in the making of a livelihood without which adequate health is well nigh impossible.

That economic illiteracy is common is evidenced from the number of fallacies frequently revealed in conversation, speeches, writing, and thinking generally. It is not confined to any particular group—day laborers, doctors, even college graduates who have had formal courses in economics frequently reveal in their discourse that their economic knowledge is superficial and fundamentally unsound. A list

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of characteristic common fallacies, by no means complete, is given below:

1. That chain stores are detrimental to local communities.
2. That advertising increases total demand.
3. That big businesses are always more efficient than small concerns.
4. That demand may be increased without increasing purchasing power.
5. Money wages and real wages are the same.
6. That putting money in savings banks is always the best form of thrift.
7. That women workers undermine the wages of men.
8. That anything which will make more work for the people is desirable.
9. That machinery reduces the demand for labor.
10. That importing commodities which can be made here impoverishes us.

As indicated before, this is by no means a complete listing of economic fallacies. No comprehensive study of economic myths is available and would not be practicable but if such study were made, undoubtedly many more would be revealed. Nor do these fallacies always occur in the form given in the list above. Many variants of the list of ten constantly crop out in ordinary discussions of economic problems.

Many of the fallacies, for example, the chain store controversy, the tariff fallacy, arise essentially out of a constant confusion of money and the real nature of wealth. In a highly specialized society such as ours, people fail to see the whole productive process. Their contributions to production are usually rewarded in money and the constant emphasis is upon money. Money becomes an end and not the means. On all sides money is emphasized and children, especially urban children, recognize money as the be-all and end-all which will give them what they want at the drug or grocery store. Their thinking does not go beyond the drug or grocery store and the question as to how the constant flow of goods and services comes to them is not of any real concern. Money becomes not a hand-maiden of the productive process, which it really is but an end in itself. Hence when adulthood is reached such ideas as "the chain store is undesirable because all the money goes to big cities" or "buy products which are produced in X town of Y state because it increases the circulation of funds in those immediate communities" find immediate and uncritical acceptance. We fail to see that such an attitude

overlooks the benefits of specialization and expenditures for products from out-of-community or out-of-state firms may provide extra purchasing power for other things.

The advantages of specialization can be seen in small situations or in individual cases but it is common to overlook the same application to communities, states, or nations. We can all see that it pays a lawyer, even though he be the best stenographer in the state, to spend his money to hire a stenographer while he works at his law but we fail to see that the same concept applies to city, state, or national situations.

Why are these fallacies so prevalent? Part of the difficulty is due to the fact that professional economists have been but little concerned with economic education during the early years. Part of the difficulty is due to the failure to see the economic process as a whole. Part of the difficulty is due to a constant confusion of money and wealth.

The teaching of elementary economics on the lower levels has been hampered because economic problems are rarely considered from the standpoint of the learner and when the teacher does introduce economic material, he or she has been prone to adopt the jargon of the professional economist. The ideas and concepts connected with the field are essentially simple and failure to make the necessary language adaption has often made economics abstruse and unreal. The teaching difficulties are largely verbal rather than conceptual.

How can economic illiteracy be abolished? There are several steps: (1) economic education should be extended to all levels of education, (2) recognition of the fact that economic education constantly goes on outside the classroom should be made, (3) language adapted to the pupil's understanding must be developed, (4) teachers must have a working knowledge of the economic system.

Economic education must not be confined to the upper levels. At the present time instruction in economics is given to relatively few. In 1928 the Bureau of Education reported 147,035 students taking the elementary course in economics on the secondary school level, a small fraction compared to the total secondary school enrollment. Economic education is particularly needed by those groups which leave school at the earliest period because dropping out is most always a result of economic pressure. Economic education is, of

course, needed by all groups but the environment of the lower income group which leaves school at the early period is such that their economic education from nonschool forces is meager. Another reason for giving economic education early is that the first impressions are strongest; hence the difficulty of eliminating economic fallacies acquired in early youth.

Much economic education goes on outside the classroom. All advertising is a form of economic education. The classroom teacher's most formidable competitor is the writer of advertisements. Advertising is colorful, emotional and subtle. Frequently it is prepared by persons better paid and more highly trained for their work than are teachers. Some types of advertising are socially desirable and serve the individual's welfare. On the other hand, many advertising appeals contain only half truths which guide the student into paths neither socially desirable nor individually wise. That the student be taught to be a skillful and discriminating reader of advertising is one of the teacher's important responsibilities in the matter of economic education.

Advertising is, of course, not the only source of out-of-school economic education. The parents' discussion of the rent problem, contacts at the corner grocery, getting an after-school job, are all examples of the type of thing which results in economic education of a realistic nature. Much of the out-of-school economic education may be enriched and made more worthwhile if it is fortified by training which will enable the student to see himself in relationship to the economic world and its processes as a whole. Whether the learner likes it or not, he is pushed into an intensely competitive economic world and the school's main contribution is to aid in the adjustments which he must necessarily make.

Much of the difficulty of classroom work in economics has been the result of inadequately prepared materials. The usual text in economics is poorly adapted, from the point of view of language, to the understanding level of the learner. Economic theory, with its technical jargon, has too often found its way into the elementary texts with the result that the student consumer of such books may get a linguistic and verbal knowledge of economics with no real appreciation that results in behavior change. Pictures, cartoons, graphical presentations, and most important of all, an

interesting and exciting language are all too rare in such books. In the absence of such materials, the problem presents a challenge to the ingenuity of the teacher who is keen enough to recognize the problem.

Economic illiteracy has not been abolished, in spite of the great increases in school attendance, because teachers themselves need to be informed concerning economic affairs. It is rather apparent that teachers themselves need economic education when one finds that they are frequently the victims of stock-selling schemes and the like. The first step in abolishing economic illiteracy is that the teachers of every level of education become interested and observant students of American and international economic life.

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#### FEDERAL LEGISLATION

The American Society sent a letter to all members concerning proposed Federal tax legislation of a retroactive nature. If our readers have suggestions as to changes which should be made in the tax law, please notify us immediately so that our Committee on Federal Legislation may have the benefit of your opinion in its presentation to Congress.

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### The Amsterdam Stock Exchange

*(Continued from page 30)*

creditor of Germany for post war loans. Large blocks of all the important German issues in the United States and England were taken over by Amsterdam banks. Furthermore, the number of French, Belgian, Italian, Danish, Swiss, and other issues is increasing steadily. The important home securities of international significance include the Royal Dutch, with a capital of 550,000,000 guilders, Margarine Unie, with a capital of 250,000,000 guilders, and other gigantic units. (Guilder equals 40.2 cents.) At the end of 1926 the number of securities quoted on the Amsterdam Stock Exchange amounted to 2,546.

The importance of the Amsterdam Stock Exchange has not been impaired with the passing of centuries. Like old wine, the Mother of the Stock Exchanges improves with age. Holland is still mighty and wealthy, and no doubt the Amsterdam Stock Exchange contributed its share in the growth and development of a great race.

## To the Northwest

THE Secretary left Washington, Monday afternoon, October 26th. Tuesday noon with the presidents of the Michigan Association of Certified Public Accountants and of the Michigan Society of Public Accountants a luncheon was held at Lansing attended by representatives from Jackson and Battle Creek. The same evening accountants from Grand Rapids, Kalamazoo, Grand Haven and Muskegon gathered with those at Grand Rapids for a dinner in the English room of the Hotel Rowe. At both of these meetings the general problems affecting the profession were discussed.

Wednesday the Secretary spent at Chicago lunching with officers and chairmen of committees of The American Society in Illinois.

Thursday he lunched with representatives of the Minnesota Society and other certified public accountants at Minneapolis.

The first item on the Secretary's schedule Friday morning was an address before the Association of Governing Boards of State Universities. Later he spoke to the advanced accounting students in the School of Business Administration of the University of Minnesota. Dean Stevenson arranged to have the Secretary meet the faculty of the school at a luncheon that same day. In the evening a dinner meeting was held at the Radison Hotel to which had been invited not only the members of the Minnesota Society, but other certified public accountants and members of their staffs. At that meeting the Secretary discussed "The C. P. A's Place in the Business World Today and in the Future."

Saturday, Irving Grover, vice-president of the Minnesota Society, was host in an auto trip from Minneapolis to Duluth where, in the afternoon, the Secretary discussed informally with the members of the Duluth Chapter the same subject on which he had spoken more formally at Minneapolis on the preceding evening. Between the afternoon and evening sessions the members dined at the Hotel Duluth where the meeting was held. An early adjournment was had in order that those

present might take part in the Halloween parties which were numerous.

Sunday the Secretary went from Duluth by bus through upper Wisconsin to Marquette, Michigan, where on Monday a meeting was held of the accountants and their staff members of the Upper Peninsula. Only two public accountants in the Upper Peninsula were not present and one of those was out of the State, some of the men having come more than two hundred miles. The meeting was held at the Marquette Club and occupied six hours, part of which was devoted to a dinner. Informal in character, all who were present felt able to express themselves with regard to the profession in that section of Michigan which is, as a matter of fact, more closely allied to Wisconsin and Minnesota than to Michigan. The Upper Peninsula Michigan Accountants Association was organized, representing certified public accountants, public accountants and staff members. The decision was reached to hold semi-annual meetings. Officers elected were: President, Lee McGinley, Marquette; Vice-Presidents, E. C. Kelso, Escanaba, W. E. Dixon, Sault Ste. Marie; Secretary, Elmer England, Ironwood; Treasurer, J. E. Tobin, Marquette. John D. Morrison of Marquette and E. E. Petersen of Escanaba were appointed along with the officers as a committee to draw up a working set of by-laws.

Tuesday was spent at Milwaukee. The Secretary lunched with the president of the Wisconsin Society, called on several of the certified public accountants, and in the evening at the City Club, following dinner, spoke to the accountants on "The Future of the Profession."

Wednesday morning the Secretary addressed the advanced students in accounting of the School of Business Administration at the University of Wisconsin, Madison, and in the evening met with the accountants for a dinner at the Hotel Lorain, following which he conducted a round table discussion on points raised by those present.

## Around the Circle

THE Secretary started for the Four-State meeting at Shreveport, Louisiana, on Tuesday night, November 10th.

Wednesday he met the Charlotte accountants at a luncheon meeting presided over by G. H. Emery of Statesville, president of the North Carolina Association of Certified Public Accountants. Following the luncheon an informal discussion of accounting problems was indulged in.

The Carolina Golf Club established a rather unique policy in providing for special days, open to members of a profession or a particular line of business, to be utilized on the occasion of a visit of an outside representative of that profession or business. On these occasions the club sends an invitation to all of the Charlotte residents interested in that particular profession or business. For this day the invitations read:

"The Carolina Golf Club extends to the Accountants and their ladies the courtesy of golf Wednesday, November 11th, in honor of D. W. Springer, Secretary of The American Society of Certified Public Accountants."

Thursday, November 12th, was spent at Atlanta, Georgia. Atlanta boasts of two accounting organizations. The chairman of the Atlanta Chapter of the Georgia Society of Certified Public Accountants was T. G. Douglas, who recently removed to California, and the first vice-chairman, N. D. Cann, Internal Revenue Agent, is pinch-hitting for the balance of the year. The Accountants' Club of Atlanta is presided over by Lewis L. Davis. Due to the fact that L. F. Bennett is treasurer of both organizations, it is easily seen that they are working together harmoniously.

During the day the Secretary called on all the certified public accountants having downtown offices. The Atlanta Chapter had issued a printed complete program of seven meetings to be held, in conjunction with the Accountants' Club, at the Atlanta Athletic Club. The meetings are preceded by dinner at 6:30. Their program is a good

illustration of the possibility of establishing group relationships.

In September, the speaker was Marion Smith, an attorney. In October, Elva G. Maxwell, vice-president of the Citizens and Southern National Bank, presented his views on the need for closer co-operation between bankers and accountants. In November, Eugene R. Black, Governor of the Federal Reserve Bank at Atlanta, was the speaker. In December, the speaker was Robert Strickland, Jr., vice-president of the First National Bank. The January and February meetings are omitted in the expectation, as well as a hope, that the members will all be busy. In March, Roland Ransom, vice-president of the Fulton National Bank, will explain the operations of a modern trust company. In April, the address will be given by Harrison Jones, the executive vice-president of the Coca-Cola Company. Following each speaker opportunity will be given for questions and discussion. The annual election of officers will occupy the time and attention of the May meeting.

Friday the Secretary was at Birmingham, Alabama. He was able to call on most of the certified public accountants with offices in the center of the city, and at night the Council of the Alabama Society of Certified Public Accountants dined together, Carl Jamison, the president, having come over from Tuscaloosa. The Alabama Society is at work on plans which will be of importance to the profession throughout the State.

Saturday the President and Secretary of The American Society spent the day with the Mississippi Society of Certified Public Accountants in connection with their annual meeting, a report of which was given in our last issue.

The State Bar Association of Mississippi, at its spring meeting, had approved the principle of the organization of the bar following the California plan, and a copy of the proposed State Bar Act was released November 15th.

Sunday the President and Secretary

journeyed over to Shreveport, where Monday and Tuesday were spent with the accountants of Arkansas, Louisiana, Oklahoma, and Texas, a report of which appeared in the December issue.

Leaving Shreveport Tuesday evening, November 17th, the Secretary reached Detroit Thursday morning, November 19th, for the purpose of the fall C. P. A. examinations and attending the Seventh Annual Michigan Accountants' Conference sponsored by the Michigan Association of Certified Public Accountants and the Michigan Society of Public Accountants. Seventy-four applicants appeared for the examination.

The Conference was fully up to the standard. About one hundred and fifty were present at each of the three meetings, all of which were held in the Book-Cadillac Hotel. The addresses of the morning were given by L. W. Stafford, District Manager, American Appraisal Company, on the subject, "Depreciation, Appreciation, or Both," and by Professor David A. Himmelblau, head of the Accounting Department of the Northwestern University and also practicing on his own account as a certified public accountant in Chicago, on the subject, "Current Thoughts for Accountants' Certificates." These papers were followed by questions and discussion.

Provision had been made for a noon-day luncheon for the ladies, followed by appropriate entertainment during the afternoon.

At the afternoon session Walker D. Hines, practicing attorney of New York

City and formerly director of the United States Railroad Administration, spoke on "The Effect of Proposed Railroad Consolidations," and L. P. Alvord, vice-president of the Ronald Press Company, New York City, and editor of *Management's Handbook*, spoke on "The Accountant's Place in Management." Again questions were asked and opportunity for discussion was afforded.

At 6:30 the usual banquet was held. The invocation was delivered by Dr. Herbert B. Rhodes, of the Boulevard Temple M. E. Church. During the serving of the dinner, Frank Gillan and his orchestra furnished "Melody Moments," according to the program, and the music was enjoyed by all who were present. Paul W. Pinkerton, past-president of The American Society, acted as toastmaster. The Cass Harp Ensemble and the Welsh Male Chorus were scheduled to furnish "The Loveliest in Music" and "Songs of the Ages." Both groups were enjoyed. Anne Campbell, Detroit's poetess who furnishes verses daily for the *Detroit News*, gave a delightful reading of many of her poems, interspersed with anecdotes showing the human side of this daily preparation for the pleasure of her readers. The Lincoln Male Quartette (colored lads) recalled the music of Plantation Days. John R. Millen, Director of Detroit Zoological Park, delivered an address which was scheduled as "On a Non-Technical Subject," which it proved to be, from an accounting standpoint. It was, however, a presentation of amusing episodes which had come to him during his experience of many years with Hagenbach, the celebrated collector of animal life.

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## The Accountants Club

At a meeting of the Board of Directors of the Accountants Club of America, held on December 2, 1931, the following officers were elected: President, James F. Hughes; First Vice-President, S. D. Leidesdorf; Second Vice-President, Joseph L. Morris; Secretary, Percy R. Everett; Treasurer, Cecil D. Giles. Charles H. Town was elected Assistant Secretary, and Conrad B. Taylor was elected Assistant Treasurer.

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## State Board News

### MASSACHUSETTS

Charles F. Rittenhouse, C.P.A., of Boston, has been reappointed to the Board of Registration of Certified Public Accountants of Massachusetts by Governor Ely, and has been elected Chairman of the Board for the ensuing year.



## ANNOUNCEMENTS

Sternrich & Siegel, Certified Public Accountants, announce the removal of their offices to the Lefcourt Newark Building, 1180 Raymond Boulevard, Newark, New Jersey.

\* \* \*

The Audit Company of New York announces the removal of its offices to the 26th floor of the Bankers Building, 105 West Adams Street, Chicago, Illinois.

\* \* \*

Mark I. Fleischer announces that he has admitted Louis Hochen, C.P.A., as a general partner, and will continue the public practice of accountancy under the firm name of Mark I. Fleischer & Co., General Motors Building, 1775 Broadway, New York City.

\* \* \*

Lawrence Scudder & Co., Certified Public Accountants, announce the opening of an office at 727-728 Hightower Building, Oklahoma City, Oklahoma, in charge of Mr. J. D. Dunn.

\* \* \*

Michaelson & Kraft, Certified Public Accountants, One Madison Avenue, New York City, announce that I. H. Finkelstein, C.P.A., has been admitted as a partner.

\* \* \*

Arthur E. Blumenshine, C.P.A., has removed his offices to 744 Broad Street, Newark, New Jersey.

\* \* \*

James P. Cornetet, C.P.A., is now located at 16 East Broad Street, Columbus, Ohio.

\* \* \*

Haskins & Sells announce that Orion N. Hutchinson, C.P.A., of Charlotte, N. C., has been admitted as a member of the firm.

\* \* \*

A. Lee Rawlings and Company, Certified Public Accountants, announce the opening of offices at 623 North Carolina Bank & Trust Co. Building, Greensboro, North Carolina, with Allen E. Stand, C.P.A., resident manager.

\* \* \*

John A. Schur & Co., Registered Public Accountants, announce the removal of their offices to Suite 319, Monroe Building, 104 South Michigan Avenue, Chicago, Illinois.

## NOTES

Herman C. J. Peisch was one of the speakers at the fall initiation banquet of Rho Chapter of Beta Alpha Psi held at the Nicollet Hotel, Minneapolis, Minnesota, December 10, 1931. He had for his subject "Some Observations on Trends in Accounting." Mr. Peisch is the first honorary member of the chapter.

\* \* \*

Herrmann Herskowitz, C.P.A., is a member of the faculty at St. Johns College, Brooklyn, New York, teaching Corporation Finance.

\* \* \*

Mervyn B. Walsh, C.P.A., addressed a large gathering of Pace Institute alumni at a luncheon at the Machinery Club, New York City, on Saturday, November 28th. He spoke on "The Value of a Depression."

\* \* \*

Howard L. Chambers, C.P.A., addressed the League of Women Voters of South Bend, Indiana, on the subject of "Distribution of the Tax Dollar and Some Evils of Taxation," on November 3d.

\* \* \*

Pierce C. Davis, C.P.A., of Seattle, Washington, was elected secretary of the Artic Club, Seattle, at the annual election of the club's officers on November 28, 1931.

\* \* \*

William Lewis McGee, C.P.A., member of the Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants, has been appointed Assistant Secretary of Banking for Pennsylvania. In this capacity Mr. Lewis has supervision over banking institutions of the Commonwealth that failed during the recent upheaval of financial institutions and which are in the hands the Secretary of Banking for liquidation.

\* \* \*

George K. Watson, C.P.A., also a member of the Philadelphia Chapter of the Pennsylvania Institute, has been appointed by the Governor as Receiver of two of the banking institutions in the suburbs of Philadelphia.

# STATE SOCIETY NEWS

## ARKANSAS

The Arkansas Society of Certified Public Accountants held a meeting at the Hotel Marion, Little Rock, on December 11, 1931.

The *Arkansas Democrat*, a local newspaper, had extended the use of their columns for the purpose of acquainting the public at large with the work of the public accountant. At this meeting a committee was appointed to prepare subject matter for such publication.

The society accepted the invitation of the Oklahoma Society to meet with them some time in 1932 at Oklahoma City, together with the State Societies of Louisiana and Texas.

The society also accepted the suggestion made at the Shreveport meeting that each society of the above four states appoint a member to represent them on a general Four-State Committee to work out problems similar in nature which affect the profession in that territory. By so doing the society recognized that greater progress could be made than by waiting to discuss once a year only subjects of a general nature.

The next meeting of the society will be held January 15th, at Hotel Marion, with members of the Little Rock Clearing House as special guests.

\* \* \*

## LOUISIANA

The Society of Louisiana Certified Public Accountants held their quarterly meeting in the Gold Room of the Roosevelt Hotel, New Orleans, on Thursday evening, December 10, 1931.

Wm. B. Castenholz, C.P.A., of Chicago, presented a paper on "The Accountant's Attitude on Appreciation of Values." E. J. deVerges, C.P.A., of New Orleans, presented a paper on "The Responsibility of Accountants in Tax Matters."

\* \* \*

## MASSACHUSETTS

The Legislative Committee of the Massa-

chusetts Society of Certified Public Accountants, Inc., held a members' hearing at the Parker House, Boston, on Wednesday, November 25, 1931, to consider the form of two certificates to be recommended by the society for consideration by the Commissioner of Banks. While there were differences of opinion during the discussion on some of the details, there was general agreement on the forms finally adopted, which are as follows:

### Proposed Certificate of C. P. A. on Corporations Borrowing from a Massachusetts Savings Bank

..... have made an examination of the books of accounts of..... as at the close of business....., 19....., and hereby state under the penalties of perjury that, in..... opinion, the accompanying balance sheet subject to the explanations and answers to questions contained in this report exhibits the financial condition of the corporation as at that date as disclosed by its books.

Date .....

Approved Certificate No. ....

### Proposed Certificate of C. P. A. on Examination of a Massachusetts Savings Bank

....., Mass., ..... 19.....  
To the Auditing Committee of the  
..... Savings Bank.

In accordance with the requirements of law and the instructions given by the Commissioner of Banks, I have made an examination of the books and accounts of the ..... Savings Bank of..... for the period beginning..... 19....., and ending..... 19....., and hereby state under the penalties of perjury that, in my opinion, the accompanying balance sheet subject to the annexed report exhibits the financial condition of the bank at the latter date as disclosed by its books.

.....  
Certified Public Accountant.

\* \* \*

## MICHIGAN

The Michigan Association of Certified Public Accountants held a meeting on

Thursday evening, December 10, 1931, at the Cadillac Athletic Club at which time credit men of the various banking organizations were invited to attend.

Mr. Griswold Adams, of the Highland Park State Bank, addressed the meeting on the subject "Accountants' Relations with the Banker." Edward J. Barr spoke from the accountants' viewpoint, quoting from The American Society's report on Classification of Accountancy Services and other similar publications.

Mervyn B. Walsh led the discussion which followed and which included reading from the questions and answers that were used in a similar meeting of the Pennsylvania Institute. Mr. E. T. Garner, of the People's Wayne County Bank, took part in the discussion.

The meeting adjourned at an early hour to join a meeting of the Cost Accountants being held in the same hotel that evening.

\* \* \*

At the annual meeting of the Michigan Society of Public Accountants, held on October 6, 1931, the following officers were elected: President, William J. Lawton; Vice-President, Alton J. Richwine; Treasurer, Cecil M. Miner; Secretary, Joseph L. Staud; Directors, H. G. Mounteer, Harold Moran, Harry Hathaway; Auditor, Ellis Newton; State Board Representative, D. W. Springer.

\* \* \*

#### NEW JERSEY

The Society of Certified Public Accountants of the State of New Jersey has joined the ranks of Society Bulletin publishers. It is to be congratulated on *C. P. A. Bulletin*, Vol. 1, No. 1, issued as of December, 1931.

\* \* \*

#### NEW YORK

The January 11th meeting of the New York State Society will be in charge of the technical committee on Realty. Max Fink, chairman, promises an interesting program with a prominent realtor as guest speaker.

\* \* \*

#### OHIO

Columbus Chapter of the Ohio Society of Certified Public Accountants met in the Grill Room of the Deshler-Wallick Hotel

at 6:30 p. m., on Wednesday, December 9, 1931.

Clarence D. Laylin, Special Counsel of the Joint Legislative Committee for Ohio of the Manufacturers' Association, foremost authority on Ohio's New Classified Tax Law, was guest speaker. He particularly stressed the preparation of returns, and discussed and explained the new tax forms.

\* \* \*

#### PENNSYLVANIA

A meeting of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants was held at the Keystone Athletic Club, December 2, 1931, at 6:30 p. m.

Councilman Clifford B. Connelley, ex-Select Councilman, Mr. Rall, Sr., and City Assessor, Sam Reno were special guests, and each made a brief talk. Honorable William A. Magee, ex-mayor of the city of Pittsburgh, who is regarded as one of the foremost authorities of the country on municipal government, was the speaker of the evening. His subject was "Municipal Finance."

\* \* \*

At a meeting of the Philadelphia Chapter of the Pennsylvania Institute, held on November 16, 1931, Walter A. Staub, C.P.A., of New York, delivered an address on the subject of "Depreciation on Appreciated Values."

The annual Christmas party of the Philadelphia Chapter was held on Wednesday evening, December 16th, at the Art Club with an attendance that far outnumbered that of any of the previous years. The Adelphia Quartette furnished music for the occasion, after which Santa Claus distributed "gifts" to each one present.

The speaker of the evening was Sir Frederick McGill, of London, England, author, traveler and columnist, whose address was of a humorous nature, interspersed with the serious side of life.

Weekly noonday luncheons have for some time formed an important part of the activities of the Philadelphia Chapter. At each meeting half an hour is provided for discussion of current accounting topics. William Lewis McGee, C.P.A., Assistant Secretary of Banking, was the speaker at the first luncheon meeting. Frank S. Glendening, C.P.A., ad-

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dressed the second meeting on the subject of "Use and Occupancy Insurance." The next meeting was devoted to a Round Table discussion of questions growing out of a recent joint meeting with the Robert Morris Associates. At the meeting Monday noon, December 21, H. Robert Drew spoke on "Some Phases of Income Tax Returns."

\* \* \*

#### WASHINGTON

The Seattle Chapter of the Washington Society of C. P. A's held its annual turkey shoot Wednesday noon, November 25th. Henry F. Moore carried off the bird this year.

\* \* \*

#### WISCONSIN

The regular quarterly meeting of the Wisconsin Society of Certified Public Accountants was held on Monday evening, December 7, 1931, at the City Club, Milwaukee.

Fifty-five members and guests attended the dinner which preceded the regular meeting.

The speakers of the evening were A. H. Petersen, who presented a paper on "Inventory Valuation," and H. A. Sinclair, who spoke on "Depreciation." These papers were followed by spirited discussion on the part of the members.

The Wisconsin Society has been holding, with quite a degree of success, luncheon meetings on the first and third Thursdays of each month.

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### The Louisiana Accountancy Law

*(Continued from page 12)*

have only one class of practitioners, and that the "certified public accountant." The double classification is confusing, often misunderstood, and at times embarrassing. Therefore, old laws should be re-enacted or new laws enacted, to establish definitely the professional designation of "certified public accountant." Then the State Society will become the controlling factor in the practice of accountancy that the bar association is to the practice of law, for the public would look with askance upon any certified public accountant not a member of his State Society, whether he possessed all the requirements for membership but willfully refrained from affiliation therewith, or because he failed to meet the requirements for membership therein.

### What About 1932 and You?

The other day a postal card announcement came to our desk which so completely proposes to solve everybody's difficulties that, without mentioning the particular article in question, we are passing on to our readers the claims made for the \$1.00 article in question, along with each copy of which there goes a guarantee of satisfaction.

This document "reveals that Good or Adverse hourly predictions and warnings pertaining to sales, collections, changes, contacts, travel, speculation, love, contracts, business, expansion, health, employment, commercial or social affairs and problems, etc."

It further announces that "your MAJOR PLANS, activities, contacts, interviews and proposals should be more harmonious and fruitful on the auspicious Days or Hours for action or when to guard against negative conditions and avoid friction, haphazardly, guesswork."

Not having been favored with any sales territory, we are only able to indicate what you are missing even though you are retaining the dollar which it would otherwise cost you.

\* \* \*

Another unique card which has come to our desk is one which styles the distributor, whose picture occupies half of the space, as an Efficiency Expert handling commercial accounting, salesmanship, church work, financing and musical direction. After fifty years of experience, small businesses will be "experted" at \$5.00 a day and large businesses at \$10.00.

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### Success

"Ideals are as different as viewpoints; but real success is not wealth, nor fame, but helpfulness. Do something worthy your powers. Shoemakers and stakers are as necessary as scientists or statesmen, and any helpful work is honorable. But to be a tinker when you might be a thinker is to be unsuccessful. He who molds iron when he could shape destinies, or guides a ship when he could direct an empire, fails. Success consists in never being discouraged, but to move forward, to cheer, to help, to be your best and leave the world better for your life."—A. R. Johns.

*The dollar you spend now  
is worth \$1.50*

*The dollar you save now  
is worth 75c*

A lot of people feel just now like the old Negro who came to the crossroads and saw one sign pointing to heaven and another sign pointing to hell. He shook his head and said to himself, "Ef Ah goes to Hebben, gotta fly all the while; ef Ah goes to Hell gotta jump all the while. Ah giss Ah'll jes' set here an' rest mahse'f."

But resting is rusting. This is true of dollars.

If those of us who *have* money just *leave* it to *rest*—the wheels of industry keep on rusting. Wheat and cotton and corn keep on piling up in warehouses. Our neighbors keep on hunting for jobs that don't exist.

Now, it's wrong to spend our dollars foolishly, just for the sake of spending. But a lot of us are *saving* dollars foolishly—just for the sake of saving—without realizing that the dollar we save today has a decreased *earning* power compared with the dollar we saved in 1929. But the dollar we *spend* today is worth \$1.50 in value received.

Most prices are way down—further down than they were even in 1921. Eggs and butter and flour and clothing and furniture are way down—and that means values are way *up*. This is the greatest *buying* time we'll see again for many years.



Pretty soon, these prices are going to start up—some prices have already started up. When they do, we'll have to pay *more* for the things we need *right now*. We shall have lost the chance to get that new suit or dress or chair or bed or radio or automobile—at a bargain!

Besides, if we buy these things *now*, we'll put somebody to work who needs a job even worse than he needs charity. If we put him to work, he can buy the things *we* make or sell, and that will help *us*.

Hard times? Not if we harness our dollars and hitch them to the wagon, instead of leaving them in the stable.

## The National Publishers' Association

*"To use available income to purchase goods normally needed and in the replacement of which labor is employed, is a condition precedent to any hopeful program to constructively increase employment."*

From the Recommendations of the Committee on Unemployment Plans and Suggestions, of the President's Organization on Unemployment Relief.

# In Memoriam

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LEWIS E. CROOK, C.P.A. (Miss. No. 9, Oct. 1, 1920 and La. No. 280, Jan. 4, 1926), of Meridian, Mississippi, died suddenly from a heart attack in his hotel room in Jackson, on Thursday evening, October 29th.

Mr. Crook, who was sixty-two years old, had been in the field of public accounting for the past thirty years. For eighteen of the past twenty years he had personally supervised the auditing of the books and accounts of Meridian, his home city, and Jackson, the capital city.

Mr. Crook had twice served his State Society as president, and had been a member of The American Society since 1922. In The American Society he had served as State Representative four terms, and for two years was a member of important committees. His loss is keenly felt by all with whom he came in contact. The local newspaper editorially paid the following tribute:

Lewis Crook is gone—a loss to his friends, a loss to this community and state which he both loved and served.

As president of the Meridian Rotary Club, Mr. Crook offered to Rotary and to his neighborhood a real, abiding service.

In his professional activities he measured up to every code and helpfulness.

As a private citizen, he kept the faith with his community, with his fellow-man and with his God.

In civic, social and religious circles he occupied a place which will prove difficult to fill—

As a leader in the things of business and of civics, he offered earnest effort and enduring leadership.

One of those souls whose passing brings a tearful sadness—

Mourning for the man whom thousands knew as friend and confidant.

Sorrow at his passing brings its certain solace in the sweet and happy thought that one who lived so helpfully on earth must find a corresponding place in Heaven.

For it may be said of Lewis Crook, that he offered to his fellow-man and to his God the tribute of his best—

Which is all—or more— than can be said of most of us.

# *Prescribed Course*

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0	0	79.75	565	11.25	3.25	0	0	0	0	0	1.75	0	0	0	0	0	0	0	0	0	0	0
0	0	115.50	681	23.50	1.25	1.25	4.50	2.50	0	2.50	0	1.75	0	0	0	0	0	0	0	0	0	0
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1.25	1.30	1.50	2.00	1.75	3.00	1.75	2.00	1.50	2.00	1.75	3.75	2.25	2.75	2.25	1.50	1.50	1.50	1.50	1.50	1.50	1.50	
1.65	1.50	2.00	1.75	3.75	2.25	2.75	2.25	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	
7.40	10.80	6.50	7.60	6.25	11.50	7.40	7.00	14.00	12.20	9.00	15.30	23.40	13.70	26.00	20.75	37.25	16.80	16.35	37.20	28.35	23.50	
22.70	34.20	20.20	26.00	20.75	37.25	16.80	16.35	37.20	28.35	23.50	32.50	32.50	32.50	32.50	32.50	32.50	32.50	32.50	32.50	32.50	32.50	

20 TOTALS

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100.00	NY 23	BAL. FORWARDED	17.75	100.00	100.00	22.75	22.75	22.75	22.75
117.75	NY 11	INV 405	11.50	117.75	117.75	243.25	243.25	243.25	243.25
106.25	NY 11	Q/R 1922	70.00	106.25	106.25	31.25	31.25	31.25	31.25
31.25	NY 23	CASH 195	28.50	31.25	31.25	281.75	281.75	281.75	281.75
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February, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants



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# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

FEBRUARY, 1932

NUMBER 2

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*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Application for second class privilege pending at post office, Richmond, Virginia.

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*"Fight your worries. The quicker you meet them the better your chance to beat them."*—HERBERT KAUFMAN.

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## The President's Page

### Mortician or Diagnostician?

THE old year is dead and business calls upon the Certified Public Accountant for his report. How the engagement is discharged determines whether our work resembles the Morticians or the Diagnosticians.

If we simply display our various services, Detailed Audits, Test Audits, Review Audits, Examinations of Financial Condition, etc., and ask the client to make his selection, giving him prices on each class, we perhaps resemble the Mortician. We are offering to bury the old dead year. We are displaying shrouds and caskets of varying styles leaving the client to select one that strikes his fancy or suits his pocketbook. To be sure, we explain the advantages of each, even as the Mortician discusses the texture and quality of shrouds and the merits of wood and metal in a casket.

The selection made—on with the work. It is assigned, started as soon as the rush of work permits, finished as quickly as possible. The report, of the class selected, is written, checked, typed, rechecked, signed, and presented to the client. The bill is rendered, and that ends the burial. We could well write in our certificate, "Here lies Last Year, he experienced Income and Expense, and died with a Loss, leaving his Financial Condition as stated on the Balance Sheet." Of course that is provided the "Funeral" selected was expensive enough to permit the omission of qualifications.

That type of service classifies us as a sort of business Mortician, which unfortunately seems to be a rather popular conception of the Certified Public Accountant. As long as we are satisfied to recognize this view, by the class of service we render, business will continue to regard us as an unpleasant expense, though somewhat necessary.

If, on the other hand, we make an honest effort, not so much to bury the dead year, as to diagnose the business of the dead year, we elevate our classification. Then we display our various services only after a discussion of the case. We

ascertain first of all, the purpose of the audit, then the condition of the records, internal check, etc. Like the Diagnostician, we get as far as possible the history of the case. When we submit our wares, we do not leave the selection entirely to the client, but recommend the one we think is most needed.

After the engagement is secured, the work takes on the nature of a business autopsy, to ascertain causes, for the purpose of suggesting cures, against a possible recurrence. The report should not be a shroud nor a casket, but a clinical discussion of findings, together with a prescription to promote improvement in the future.

At this season time is limited — still the diagnosis and prescription in some degree at least could be included in practically every audit. Cut down on schedules of accounts changed since Balance Sheet date and of little use except as filler, and give the time saved to analysis and suggestions.

Service of this kind is constructive and helpful in the present. It tends to make the Certified Public Accountant's work a service for the living year instead of a requiem for the dead one. Business cannot help but seek such assistance, and pay the cost more cheerfully, contemplating the expenditure as a live investment, rather than a dead expense.

Pause a bit, during the rush season, and consider. Diagnostician or Mortician? —make your choice.

HENRY J. MILLER.

## *“Rise . . . and Walk”*

The San Francisco earthquake, if I may use that forbidden word, cured hundreds of cripples. They jumped up and ran for their lives. They weren't as badly crippled as they thought they were. They didn't know that they could run until their houses began to shake.

The Good Book, too, tells the story of a cripple whose weakness was more in his mind than in his legs. The Master said to him: “Arise, take up thy bed and walk.” He rose and walked and carried his bed.

So, here is the thought that I would like to send out to the business men in America: “You are depressed. You think you are crippled. You are afraid of the future. You are full of fears.

“You have half the gold in the world and half of the machinery and most of the automobiles and all the skyscrapers. You have the greatest home market in the world and the largest corporations the world has ever seen. You are ruled more by ideas and less by tradition than any other people in the world. You have usually done what you thought you could do.

“How can it be possible that a progressive nation of 120,000,000 people can be wrecked by the speculations of a little handful of fools in Wall Street. The prices were forced too high and had to come down. Today all the prices are too low. There is now a golden opportunity for every man who has eyes to

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\*This unsigned article has been utilized by several concerns. It is worth rereading if it has previously come to your notice.

see it. Dollars are now being sold for thirty cents. Practically every security in the United States is now being sold for less than its value. *The way to create a fortune is to buy from the pessimists. Pay your money and take the risk.*

"Frick started his career by buying coke ovens in the slump of 1873. Carnegie made \$300,000,000 by buying steel plants in slumps. Hundreds of fortunes have been made by buying from pessimists. Ye gods! What a chance there is at the moment!

"In five years from now most American business men will belong to the 'I-wish-I-had-Club.' Then it will be too late to buy a dollar for thirty cents. The opportunities will be gone.

"When a horse balks, the balk is in his head, not his legs. He moves when he thinks he will. And when an American business man is depressed the slump is in his head. There is nothing serious to prevent him making money if he thinks he will. When fear rules the will nothing can be done, but when a man casts fear out of his mind the world becomes his oyster. To lose a bit of money is nothing, but to lose hope—to lose nerve and ambition—that is what makes cripples. This silly depression has gone on long enough. Get rid of it. It is inside of you."

## *Some Facts About Accounting and Auditing*

One of our members has prepared a 3½ x 6 leaflet which he inserts in his regular correspondence and which presents such a satisfactory statement regarding a common condition found in the business world that we are reproducing it:

"Accounting is a profession and is so recognized by the State of . . . as well as by other states in the Union. There are a number of good accountants in your city or community, but many concerns select their accountant or auditor without proper investigation as to their standing and qualifications for the particular work to be done.

"You should select your accountant just as you would your lawyer or doctor. Inquire of your banker—he will be glad to recommend an accountant for your work. Select an accountant in whom you have confidence and rely upon him to render you efficient service at a reasonable price. Don't ask him to bid a flat price for your work. You can't expect to get \$100 worth of service for \$50. If an accountant can be relied upon to render proper service, he likewise should be relied upon to make a proper charge for same. He cannot be honest in the one instance and dishonest in the other."

## *What Caused the Depression?*

Some one has described the depression as having been caused by the inability of the \$50,000 a year executive to direct his \$25,000 a year assistant so successfully that he could induce his \$10,000 a year sales manager to pep up the \$5,000

a year salesmen so that they could secure enough orders to keep their \$1.00 an hour workmen busy.

A C.P.A. in Chicago prepared a page letter for his clients, in which he reprinted an editorial appearing in *Harper's Weekly*, October 10, 1857, reading as follows:

"It is a gloomy moment in history. Not for many years—not in the lifetime of most men who read this paper—has there been so much grave and deep apprehension; never has the future seemed so incalculable as at this time. In our own country there is universal commercial prostration and panic, and thousands of our poorest fellow citizens are turned out against the approaching winter without employment, and without the prospect of it.

"In France, the political caldron seethes and bubbles with uncertainty; Russia hangs, as usual, like a cloud, dark and silent upon the horizon of Europe; while all the energies, resources and influences of the British Empire are sorely tried, and are yet to be tried more sorely, in coping with the vast and deadly Indian insurrection, and with its disturbed relations in China.

"It is a solemn moment, and no man can feel an indifference (which, happily, no man pretends to feel) in the issue of events.

"Of our troubles no man can see the end. They are, fortunately, as yet mainly commercial; and if we are only to lose money, and by painful poverty to be taught wisdom—the wisdom of honor, of faith, of sympathy and of charity—no man need seriously despair. And yet the very haste to be rich, which is the occasion of this widespread calamity; has also tended to destroy the moral forces with which we are to resist and subdue the calamity.

"Good friends—let our conduct prove that the call comes to men who have large hearts, however narrowed their homes may be; who have nothing but manhood, strong in its faith in God, to rely upon; and whoever shows himself truly a God-fearing man now, by helping wherever and however he can, will be as blessed and beloved as a great light in darkness."

This was followed with the statement, "Depressions have occurred in American business since the Revolutionary War, and every one has looked black, and seemed unending. Every one has been followed by recovery — and prosperity."

## Our Government

On several occasions the editor has expressed his opinion that the two most disturbing factors in producing the unsettled business conditions through which we have been passing for some time and which are still with us, have been the banks and the politicians.

Merle Thorpe, editor of *Nation's Business*, in the January issue, calls attention to the writings of Herbert Spencer, economist of note who, some fifty years ago, anticipated conditions with which we are confronted today. Three quotations follow:

"A comparatively small body of officials, coherent, having common interests,

and acting under central authority, has an immense advantage over an incoherent public which has no settled policy, and can be brought to act unitedly only under strong provocation. . . . An organization of officials, once passing a certain stage of growth, becomes less and less resistible.

"The more numerous public instrumentalities become, the more is there generated in citizens the notion that everything is to be done for them, and nothing by them. Each generation is made less familiar with the attainment of desired ends by individual sections of private combinations, and more familiar with the attainment of them by government agencies; until eventually, government agencies come to be thought of as the only available agencies."

The situation to which Spencer referred has been greatly accentuated since the introduction of State-wide primaries into the political program. Actual and prospective office holders have, with each passing year since that time, endeavored to develop policies having vote-getting value.

In the primary, increasing attention is devoted by actual office holders to presenting plans by which they expect or hope to assist their constituents rather than in explaining what they have actually accomplished in the interest of their constituents. The prospective office holder must always build his campaign around some specific panacea for present ills and he succeeds in making as good a case in good times as in bad times. The average man is always willing to "let George do it."

As one studies the efforts made by political leaders to cope with present-day conditions, the fallacy of the continued and extending entrance of government into activities of all sorts becomes more apparent.

During good and bad periods the increasing power of suggestion by the politicians that the government can cure all ills, coupled with the extended entrance on the part of government into new avenues of private enterprise, has produced a situation wherein the old slogan "the world owes me a living" has been changed to "the government owes me a living." The politician has so placed himself in the forefront with the idea of assuming leadership that he has saddled himself with responsibilities which he cannot avoid. An editorial in the New York *World Telegram* for Monday, January 11th, entitled "Leadership" is opened as follows:

"Prince von Buelow, in his *Memoirs*, sizes up a certain Reichstag party chief of the decade before the war: 'His attitude reminded me of a *mot* of the Paris *prefet de police*, Caussidiere, who, in 1848, had wandered the boulevards in the midst of an unruly mob. Asked by a friend how he could associate himself with such a following, he had answered: "I am their leader; I have to follow them."'"

From a position of leadership once possessed, the politician has by his own efforts placed himself where he must respond to the demands of those whom he has taught to depend upon him.

Economic laws cannot be changed by legislative fiat. For the purpose of securing votes the politicians preach the doctrine that government can do for individuals and groups that which only the individual alone or in groups can do. They have educated the citizenry to become *dependents* rather than *independents*, with disastrous results.



# Forces that Transcend Economics\*

By GEOFFREY PARSONS

AT the present moment, when the gold standard is the leading topic of dinner conversation and the general assumption everywhere is that if tariffs, overproduction, debts and moratoriums could be readjusted the world's troubles would be ended, I am going to ask you for a few minutes to look at the world, and Europe especially, from a quite different angle.

I realize that economics is the magical word of the hour. Not, to be sure, the economics that I learned in college in another century. There have been several brand new models of economics since then. I recall the theories of money, for example. The quantity of currency controlled values in those dull, prosperous and happy days. Rapidity of circulation was touched upon, but lightly. Here was a delightfully neat theory that solved all the problems of currency upon the simple formula of the amount of money in existence multiplied by the speed with which it circulated. I do not say that this theory has been discarded. But the conception of what is money and what is circulation has been so expanded and the formula has become so complex that the silk handkerchief has been changed into a rabbit before our eyes—and a rabbit very hard to catch, too.

So while the magicians of economics are running after their rabbits, I am going to try to suggest for your attention certain other basic factors which have not changed and are not changing, so far as I can discover. They existed before Adam Smith and to this day they pay no attention to such institutions as the Harvard Business School, or The New York State Society of Certified Public Accountants. They are human

factors, items built into the structure of human beings and of society. I do not pretend to say that they cannot be changed. I hope some of them will be changed—slowly over the decades. But I do hold that unless they are recognized, understood and faced, it is idle to discuss economic factors as if they, by themselves, could really control the destiny of anyone. By all means study the gold standard—I study it myself and hope to understand it some day when the various schools of financial experts reach an agreement about it. I concede that reparations and debts are important when their figures are translated into human terms. The rising tide of tariffs obviously raises a serious problem. Almost everywhere they have mounted rapidly since the war. With the surrender of England, the last stronghold of free trade, the principle of protection has now a practically universal triumph in the world of actuality, while in the realm of theory, most economists are still frantically sweeping back the waves with their statistical brooms. By all means, let us study the latest tariff theories of the economists; but let us, not less, and regardless of which view is correct, try to understand the causes of their defeat in the minds of practical men everywhere. Only after we have clearly comprehended the latter can we possibly make effective use of the former.

Perhaps I can make clearer my conception of these intangible factors which control the great issues that make for peace and war, by a concrete illustration. It would seem as if reparations, a simple matter of payments in money or in kind, ought, of all war items, to be rigidly controlled by economic principles. Yet I venture to assert that they never have been so controlled—that they were conceived in emotion, were resisted on emotional grounds and will ultimately be cancelled in large part, for no economic reason whatsoever. Everyone will agree now, I think, that in devising reparations the Allies turned their backs on the economists. They did not fix any total at Versailles, it will be recalled, but the items included at the instigation of Mr. Lloyd George, fresh from winning a khaki elec-

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\*Address delivered at dinner of the New York State Society of Certified Public Accountants, Waldorf-Astoria, December 7, 1931. Reprinted by permission from January, 1932, *Bulletin* of the New York State Society of Certified Public Accountants.

Mr. Parsons is the chief editorial writer of the *New York Herald Tribune*, and author of *The Stream of History* and other historical and political works. He speaks on the political and other international aspects of the present crisis.

tion, were so extensive that the German people could not have met them in a hundred years. Reparations as laid down at Versailles represented abstract justice, revenge, hate, the political needs of British demagoguery—anything but an economic measurement of actualities. That exceedingly able and astute financier, Mr. Bernard Baruch, came back from Versailles lamenting the impossible figures used and suggesting nine billion as a sensible sum from the economist's point of view. In 1921 the Reparation Commission fixed a total of thirty-one and one-half billion dollars. Well, in 1924, three years later, the first steps toward a return to reason were taken by one of the ablest groups of economists who ever considered a world problem. I mean the devisers of the Dawes Plan, aided by such experts as my friend George P. Auld. Here let us agree that for an hour the economists took charge and reached a conclusion that might easily have been reached at Versailles if man really were an economic animal. Four years later the Young Plan carried forward the experts' work and finally fixed the total of German reparations at about nine billion dollars, reduced to cash value. That was in the spring of 1929.

We innocent bystanders who were caught in the panic of the next autumn have at least one consolation—that the wisest experts from seven countries, a debtor and its creditors, debated exhaustively the economic status of the world only a few short months before the collapse of everything, and nobody on either side, so far as I can discover, saw the storm signals flying. The Young Plan contains machinery for postponement and revision but had either Germany or the Allies foreseen the depth and breadth of the chasm upon the brink of which they were standing, it is safe to say that the plan would have provided for a far greater flexibility. That is by the way, however. Economics had its hour under the able leadership of Messrs. Dawes and Young, and I am satisfied in my own mind that the formula achieved was sound and practicable, that the German annuities could have been collected and transferred had the German people in good faith wished to do so. Even the great depression could have been weathered within the framework of the Young Plan, had economic factors controlled. But they did not control, they are not in control today, and when reparations have been finally cut to a sum which can be paid in cash—within the possibility of a bond issue, that is, given good times and confidence restored—the compelling force will

not be economic.

I do not ask you to take sides in the long controversy between Germany and the Allies over reparations. My point holds good whether you think the Allies are wicked ogres who have sought to drink the life-blood of Germany, or whether you think the Germans are sentimental cry-babies, ruined by self-pity. The fact is that the sort of reparations which the Allies sought to impose, extending over almost three-quarters of a century, whether just or unjust, cannot be enforced so long as human nature is human nature. I believe, and I think the best opinion holds, that the schedule of payments under the Young Plan is easily within German capacity to pay. But short of enslavement, I do not believe any nation can be made to try to pay such large sums over three generations—and since enslavement would wreck the German industrial structure, this amounts to saying that no way of forcing the collection of the Young Plan annuities exists. I believe it was Bernard Shaw who remarked that no nation could spend sixty years sitting on the head of another people to collect a debt.

All this is only incidentally a matter of dollars and cents—or francs or marks. The fundamental matter is sheer emotion, call it pride of nationality, love of independence, self-pity for an injustice, real or fancied, despair, or plain spite. The emotions are mingled and vary with each individual, depending upon whether you are a Hitlerite or a Communist. But for one emotion or another, and by whatever method opposed, I am convinced, and I think most of those who have studied the problem are convinced, that the long-term collection of large annuities provided in the Allied scheme of reparations and so ably and fairly embodied, so far as economics went, in the Dawes and Young plans, is a flat impossibility.

It will perhaps make my view clearer if I say that I am one of those who still believe that Germany was principally responsible for the outbreak of the Great War, and should be punished therefore like any aggressor who is made to bite the dust. Nor have I much patience with those sentimentalists who object to reparations because they fasten the sins of parents on younger generations. The younger generations in Germany, like the younger generations in any other nation, are just as good Germans as their elders, in my observation, and propose to carry on their nation as a strong, growing and successful concern. They enjoy its assets and should share in its liabilities.

But abstract justice cannot control the repara-

tion problem, in my judgment, any more than can economics. We must learn to be realists in approaching these international problems and what I am asking you to accept is the fact that the realest thing in Europe today—as in this country—is nothing material that the economists can count and measure, but a deep, controlling loyalty, often in direct conflict with economic forces, and centering about a man's farm, the land he and his ancestors have tilled, a man's friends and neighbors, a man's countrymen who speak his language, read the same ideas in the same books and newspapers, and share the same myths and heroes. You will recognize that I am speaking about that unfashionable thing called patriotism. We shall come back to it later on.

There is an illustration of my conception closer at home. It has been confused by generations of political guff and economic motives have always played a powerful part in its settlement. But if you will take a long view of its history I think you will agree with me that here, too, nationalism has been the decisive factor. I mean the tariff and the whole doctrine of protection, and because it is closer to home I can perhaps trace a little more sharply the development of the emotions I have in mind.

How comes it that protection has marched to victory over the dead bodies of the embattled economists? I, for one, was tremendously impressed by the free trade argument when I studied economics in the '90's of the last century. It seemed to me unanswerable then and it seems to me unanswerable now—if economics were all. I mean to say that in a perfect world the cheapest way to produce would unquestionably be under free trade. Thereby every bag of wheat would be grown, every nut and bolt would be manufactured at the spot and by the people who could grow it or manufacture them most economically. By contrast, we pay a price for protection. It is not exactly a tax added to the cost, etc., as the pure doctrine of free trade would have it, but it costs money to you and to me. The tariff debate, like most political debates, has often raged vociferously about this economic issue. Facing it, the protectionists were beaten before they began to fight, in my judgment.

Why, then, has free trade gone down to ignominious defeat, even in Great Britain where the goddess of Free Trade was born, springing full grown from the brain of Adam Smith? For the simple reason that here, as everywhere, the economic view of life sees only a part, and the

smaller part, of man's motives for action. The fallacy of the economist lies in regarding man as a creature who instinctively and inevitably pursues material wealth, buying cheap and selling dear, perpetually seeking material gain for himself. The truth is that man never was and is not today preponderantly an economic animal. For the matter of that, what animal is? When a bird spends weeks in building a nest and weeks in sitting on eggs and days in collecting food for hungry mouths, it is doing one of the most uneconomical things imaginable. The bird is, to be sure, dealing in material items, but it assembles them only to give them away. It buys them dear, with the hardest kind of days' work, and sells them for nothing, unless the silencing of wide open mouths constitutes a consideration. As the father of four children I sometimes feel closely akin to this bird. My point is—and I think it is of capital importance because so often ignored—that the motives which spur any parent to action and largely control his conduct are flagrantly uneconomic. If you prefer to call his motives merely an enlarged selfishness, I am not going to quarrel with you. I will gladly agree that a large element of selfishness enters into almost everything we do. If we are going to be realists about America or Europe, or tariffs, or anything else human, we must accept that fact. But loyalty to a family, like loyalty to a nation, in the lowest interpretation, brings other human beings into the circle of selfishness. The parent, like the citizen of a modern nation, will, when a real crisis comes, make almost any sacrifice for the larger group to which he belongs. After all, being a human being is one of the loneliest things in the world—perhaps most lonely of all in a modern cave-dwelling city. So what more natural than that we should put great store by those groups, small or large, which give us a sense of comradeship, support, sympathy, and are symbolized by a hearth or a flag. The modern nation may be a new invention—some four centuries or so old—but loyalty to one's kind is as old as the hunting pack. So we should naturally expect to find strong motives, based on loyalty to others, running directly counter to those motives of selfish profit around which the science of economics is necessarily built.

But I did not mean to digress into the doubts and speculations of psychology. The facts as to the tariff are clear enough. There is plenty of hoggishness in the way any particular American tariff is framed. So far as appeals to the voter are concerned, the full dinner pail has been a fav-

orite symbol of protectionism—or was until the bottom dropped out of it in 1929. But I think it clear that something more than the maneuvers of selfish groups lies behind the extraordinary success of protection over the decades. It has triumphed, it seems to me, because it offers the surest means by which a modern nation can develop itself into a strong, secure, relatively self-sufficient and courageous unit. You will recall that it was as the great "National Policy" that protection was first sold to the American people. Well, I think it has prevailed and endured precisely because this was a correct description. America might have made more money if it had stuck to agriculture and those few industries for which it was peculiarly equipped by nature, as the free-trade pleaded to have it do. But it would not be America as we know it, a balanced nation, still strongly agricultural, yet highly industrialized and able to hold its own as a great power, come what may. The processes of politics in a democracy are so blundering and inexact that oftentimes the voters themselves do not realize what they are doing until they have done it. Most of our individual actions share the same element of surprise and experiment. To make matters worse, politicians shun real frankness as if a plague. A major part of their duty is to invent superficial reasons, which is to say excuses, calculated to make sense with the voter in a hurry. The real course of national history runs far deeper.

I know that the free trader likes to believe that it is the Machiavellian guile of the protected industries which has led the country astray and made it vote against its best interests, decade after decade. I cannot pretend to enough wisdom to answer these suspicions with finality. It is hard enough to analyze the confusion in one's own mind and to decide just why one voted for Mr. Hoover or for Mr. Smith or against either, or stayed at home. The complexity of a plebiscite by millions presents to the analyst a hopelessly addled ocean of assorted reasons, prejudices, slogans, antipathies, hates.

I hope I have made clear the limits of what I am trying to set before you. It is simply that the economic viewpoint was insufficient to give a sound decision of the tariff issue and that, as a matter of fact, it has not decided it, despite endless economic arguments put forward by both sides. It has been decided, judged from a long-term viewpoint, upon the much broader ground of nation-building, of loyalty to one's own kind of people and the desire to see them grow great

and flourish. There is for many an incidental satisfaction of selfish individual wants involved, yes. But there is far more and until the free traders and the economists appreciate what that far more is, they will never persuade the country to their view.

The political economists have shifted their conception of man a number of times since the early writers posited him as a sort of gainful animal, working as little and eating as much as he could. The modern writers recognize his cultural, spiritual and social wants, involving the use of leisure and the enjoyment of luxuries. But I think they still under-estimate his motives. I regret to say that our friends the pacifists, who are seeking to end war once and for all, seem to me guilty of the same error. The politician knows better—in the immortal phrase of the Tammany orator, he "panders to the better element" whenever votes appear to stand under that banner. I wish the idealist could learn to imitate him. I am speaking now not of those practical internationalists who are slowly and painfully trying to improve the organization of the world so that war may become a little less likely as the decades pass, but of those Utopian pacifists who insist upon a miracle and actually believe that war can be ended by a covenant or a super-state, or by the oath of enough clergymen and non-resistants—who never have fought and never would be expected to fight—not to go to war.

If you will go over the history of pacifism I think you will be astonished at the selfish motives to which its advocates have frequently appealed. I gladly grant them a high aim, the ending of a great evil. I am speaking now of their propaganda, the terms into which they translate their movement and seek to make it appeal to the general public. What has been the chief stock-in-trade of peace propaganda in recent years since the war? A frank appeal to the timidity of mankind. The Great War was bad enough. The next will be far worse. Regiments, whole cities, will be snuffed out by poison gas. New and terrible machines will make war so destructive that civilization cannot possibly survive it. Whole books have been written on the subject. Essentially it is memories of the horrors of 1914 to 1918 upon which this pacifist appeal relies.

Those memories were bad enough—so bad that the shrewd people who edit our magazines and books and make our movies let nearly a decade go by before they touched them. The theory was that no one wanted to hear the war mentioned. Then

suddenly some one discovered, I suppose by accident, that if this condition had ever prevailed, it was ended. A good war film made an enormous financial success and the movies have been full of Zeppelins and barbed-wire dugouts ever since. So, too, with the magazines and the books. Even a book like Remarque's, intended as a savage anti-war document, was read almost like a novel. Horror was piled upon horror on screen and printed page and yet save for the few with too poignant memories, the result proved too exciting to be depressing, too magnificent to cause terror.

Here is, I think, the fatal weakness in the fear argument as it has been used by the pacifists. Perhaps it might have worked if they could have achieved their miracle swiftly and abolished war while memories of the trenches were still vivid. I doubt even that. I doubt if man can ever be frightened into doing anything he does not want to do, and I rather respect him for his stubbornness. He would not be where he is today if the pacifists were right in their estimate of him. At any rate, time heals all scars. A new generation arrives. I asked my oldest son the other day, aged twenty-three, what he remembered of the war. "The chief thing I recall is that the bread wasn't any good," he said. Well, he was ten when the war ended. I hate to think that a new generation has arrived since the war, but it has—a new public for the movies, for the books, new voters, new armies.

I spent a few weeks in Europe this summer at the peak of the tension—when sober-minded men everywhere were shaking their heads and war, a real war, seemed a realer possibility than at any time since 1918. If the pacifists were right everyone would have been jumping up and down and crying "Peace!" To the contrary, the general attitude on both sides of the Rhine and to the south of Switzerland seemed to be a fatalistic acceptance of a conflict regarded as inevitable. Nobody actively wanted war—I doubt if large numbers of people have ever wanted war. But there was no visible fear of it. If a new Europe, too afraid to fight, had arrived, I could not find it.

If fear is worthless as a motive for keeping the peace of the world, I think that Senator Borah's appeal to the pocketbooks of the world is even sillier. I regret to say that the Administration at Washington seems to share the view that disarmament at Geneva in February will be powerfully aided by stressing hard times and the great cost of armies and navies. The idea is a favorite

rainy day subject for certain cartoonists—you have doubtless seen it, the figure of Europe staggering hopelessly to destruction under a colossal weight of armaments. But the cartoonists have at least the excuse that they must draw something and the idea holds a quick and easy picture. Here is, it seems to me, the acme of futility—attempting to oppose the economic appeal to the national appeal. Even as economics, the argument is not much. But what a grotesque misreading of human nature is involved! As if the saving of a few dollars could possibly outweigh the habits and loyalties of generations with respect to institutions believed, rightly or wrongly, to guard home, happiness, life itself!

One recalls those pathetic believers in peace via the economic road, who so confidently predicted in the summer of 1914 that there could not possibly be a European war because of the economic ties of modern international commerce. The great bankers would not permit a great war. The trade unions would refuse to fight. The predictions continued with assurance until the guns drowned them out.

I took down from the shelf the other day a volume that has been there since 1910, the year it was published. It is, in my judgment, the ablest book in behalf of peace that has ever been written. I mean "The Great Illusion" by Norman Angell. It was written in those closing years of an era, when Europe was lurching down-hill swiftly, inevitably, into the most stupendous events of all time. In this country hardly anyone even knew that anything was afoot. In England the wise men and the prophets, like Lord Roberts, were in a pathetic minority. Fortunately for England, the practical men of the Admiralty were silently building up the fleet and maintaining it ready for action—then as now. Norman Angell saw the dangers clearly. He saw equally the futility of the pacifists of that era. Their arguments were chiefly humanitarian and moral—based on Tolstoy and the Beatitudes. Mr. Angell described well the weakness of this appeal in a world of struggle and grim competition. He was deeply sympathetic with the spirit of the pleas of the pacifist leaders—of one Ramsay MacDonald, for instance. But he felt sure that they were accomplishing nothing. The naval race between Germany and Great Britain was then at its keenest. There is Greek tragedy in re-reading "The Great Illusion" today. Some of you may recall the conclusion that Mr. Angell reached. He rejected the humanitarian appeals as ineffective—appeals to

emotion, yes, but to emotions potent in a negligible fringe of idealists too delicate of spirit for the rude world most humans are obliged to live in. Nor had he any faith in arguments addressed to the pocketbook as usually put forth on the basis of military expense. He attempted a quite different economic appeal founded on the conviction that war, whether of defense or conquest, never had paid and never would pay. He proved his case, too, I have always felt and proved it by an exceedingly able analysis of history. Here was the economic argument presented in its most practical form, you will observe, with no suggestion of a miracle or speedy reform, but in the hope that gradually the financial and industrial leaders and workers of England and Germany might be turned against an unprofitable enterprise.

The main thesis of the book was certainly not disproved by the war. This country, which stayed out of the war until the last minute, was the one nation to profit hugely by it. Probably every other country lost hugely. Yet I regret to say that I can see no real indication that even this able economic argument against war, fortified by a laboratory demonstration of its truth, within the very next decade, has made many converts.

Is the reason not precisely the point from which we started, that no international issue, whether of reparations, protection, or war itself, is decided upon economic grounds, of profit or loss, immediate or remote? In the last analysis did not Mr. Angell repeat the fundamental error of the emotional pacifist and ignore the real sources of war, in man's long established loyalty to his own kind, sharing in a great adventure and living without alien interference? As soon as a way can be devised which will insure national growth and independence without armies and navies, they will be abolished. Not before.

Now, having patiently listened to this pessimistic criticism of others' peace efforts, some of you may wish to arise and ask me to name my own remedy. That is a natural retort. But I hope I have already made it clear that I have no remedy and that I regard the present vague, widespread belief that there is somehow, somewhere, a remedy that will enable us soon to beat our swords into ploughshares, as false and dangerously misleading. I doubt if we can effectively concentrate on the slow, laborious efforts needed to make war less probable, until we have dismissed from our minds the belief that it can be made impossible here and now.

The two methods of approach have little in

common. At many points they are flatly contradictory. Your complete pacifist sees chiefly hate, envy and bloodthirsty rivalry in European nationalism. I see in it the logical expression of that individualism and localism which have made the brilliant progress of the western world possible. Perhaps the division of the Scandinavian people into three small countries is the most extreme example of nationalism run mad that the world has ever seen. But when such madness, despite the many wars it involved, yields three such highly civilized and admirably individualized peoples as the Swedes, the Norwegians and the Danes, who can say that it is not a highly precious form of insanity? In the Balkans the picture is quite different, and nothing done at Versailles was as unsound and backward looking as the increase in the number of small nationalities accomplished in the name of that high sounding and supposedly forward looking principle, self-determination. The net result of it has simply been to transfer the factor of protesting minorities from one side of certain boundaries to the other side. There is certainly nothing sacred in the principle of nationalism—it works well in Scandinavia, not too well in Central Europe, and terribly in the Balkans. We should treat it, therefore, as a highly useful institution in the development of Europe, to be cherished for the good it does in stimulating peoples and ideas—as did the city governments in Ancient Greece—but certainly not to be applied to peoples hopelessly confused as to race and barely started on the road of self-government.

As for the problem of nationalism, when it causes a smoldering, traditional rivalry such as that between France and Germany, fed by divergence of race, language, and national traits, lasting from generation to generation and bursting into flames at intervals, I do not see any new principle that can be applied. The Geneva League has definitely failed to measure up to the task of settling disputes among the major powers. The World Court may yet rid itself of its political handicaps and prove of service in developing principles of international justice of solid worth to the cause of peace. But no machinery now in sight seems likely to be capable of damming the flood of emotion which spring from the ancient loyalties and rivalries of Europe. New habits of international intercourse and mutual understanding would help. But against their formation the bars of language present an almost insuperable obstacle. Travel, as we all know, stirs fully as

much antipathy and irritation as accord. Your Englishman is inspired to murder when he hears a Chicago accent, precisely as we are rendered bloodthirsty by an Oxford accent. You probably all know doughboys who came back from the war insisting, if they had been in France, that in the next war we must fight France, or if they had been in England, equally sure that we must fight England. International understanding appears to be a delicate attunement, difficult to pick out of the ether, and liable at any moment to be drowned out by static, as recent events in Japan have demonstrated.

I do feel, and probably many of you feel, that the closer bonds of trade and finance, of intercommunication in general, in which the world finds itself today should in the long run bring the world closer together in spirit. This country even with its vast territory, is far more closely knit than were the thirteen original colonies. Here is unquestionably a factor that over the years should help—help the interchange of ideas and the growth of friendships, bring an increasing realization of how mutually dependent the modern nations are. It seems to me reasonable to look forward to a day when a new solidarity will prevail, which without lessening loyalty to country will add to it a generous interest in other countries that will make it increasingly difficult to awaken the war spirit.

Yet distances in Europe are not great. There is no lack of communication or trade across the Rhine Valley. The British Channel is a narrow sheet of water, but I do not suppose there are any two nationalities that understand each other less and annoy each other more than the English and the French. The Balkan countries lie cheek by jowl—the better to make faces at one another. Evidently mutual economic dependence and easy, constant intercourse, have not united Europe. Almost to the contrary, it would seem, propinquity has lent disenchantment. In Europe there are plainly ancient traditions of rivalry which the ease of modern intercourse and modern interdependence have thus far failed to touch. We can hope for progress without shutting our eyes to the inescapable fact that it is exceedingly slow in arriving.

If you wish to read a thoroughly pessimistic analysis of the European situation in all its painful details, I recommend Frank Simond's new volume "Can Europe Keep the Peace?" I have not attempted tonight to present those details but rather to sketch in broad outlines the emotions

and loyalties which create them. And I hope you do not think I am a pessimist. For I like the world and I refuse to despair of Europe, even though it insists upon being old. I doubt if I should really enjoy a world run by pacifists and I know I should not enjoy a Europe that was new.

I suspect that it is largely because pacifists of the Utopian type breed pessimism that I am so much against them. They measure men, Americans, Frenchmen, Germans, Italians, Japanese, by the stature of angels and because the measurements are disappointing they turn to despair. They weep because the League is not accomplishing what it never should have been expected to accomplish. They complain because the American people refuse to meddle in European concerns of which they are as completely ignorant as Europeans are of this country—well, not quite, but almost. It is like the depression. The despairers and viewers with alarm are insisting upon a plan, a marvelous plan, by which days will always be happy henceforth and forevermore. This must be a depression to end depressions, like the war to end wars. Well, those who have accepted the depression as just another depression, much worse than 1907, but not as bad as 1873 or 1892, have been astonished to find how much wisdom could be taken from it—for instance as to how much more important an old friend was than a new motor car—not to say how ably an old motor car—an antediluvian model, two years old—will perform. And, having actually spoken of patriotism as if it could sometimes be a generous and noble emotion, I do not see why I should not go on and boldly suggest that war, even war, has its noble moments. I would recall to you a play, "Journey's End," which many of you doubtless saw. To my mind it was the most perfect of utterances upon the terror, the filth, the waste, the futility of war. Yet I felt, and I think most people felt—something else—the incredible magnificence of mankind there displayed. Personally I do not think that ever before did I see so clearly the immortal fire that is a human soul. I know that I never before felt so proud that I was a human being.

Perhaps a little return to the philosophy prevailing during the war would help us now. In the post-war slump too many have refused to accept the hard facts of Europe and ourselves, they have preferred to live in a fool's paradise, hoping, pretending that mankind had in some mysteri-

*(Continued on page 128)*

## U. S. Supreme Court, in First Test Case Declares Federal Arbitration Act Constitutional

THE constitutionality of the United States Arbitration Act, which had been attacked in the case of the Marine Transit Corporation, et al. v. Dreyfus, et al., in an appeal from the lower courts, was unanimously upheld by the Supreme Court of the United States in an opinion handed down by Chief Justice Hughes on January 4th, in what is regarded as the most important decision affecting commercial arbitration, particularly in its national and international use, which has yet come from the courts.

The United States Arbitration Act was passed by Congress in 1925, and is "an act to make valid and enforceable written provisions or agreements for arbitration of disputes arising out of contracts, maritime contracts, or commerce among the States or Territories or with foreign nations." The case in question arose out of a maritime transaction, and after an arbitration had been ordered and the resultant award confirmed both by the District and Circuit Courts, an appeal was taken to the Supreme Court, in which appeal the constitutionality of the Arbitration Act was questioned as well as the interpretation of certain of its provisions.

So serious did the American Arbitration Association and the Chamber of Commerce of the State of New York regard the questions raised, since they involved the continued use of arbitration under the Federal Arbitration Act, that they

petitioned for leave to intervene, as *amici curiae*, and filed a brief in support of the Act prepared by Julius Henry Cohen and Kenneth Dayton, of New York, on behalf of the two organizations.

Although the case in point involved a maritime transaction, the broad construction of the Act by the Supreme Court appears to make it applicable to and enforceable in all cases that normally come within the jurisdiction of the Federal Courts.

The Supreme Court decision specifically held that the Arbitration Act making valid provisions in maritime contracts for the arbitration of disputes and authorizing courts of admiralty to enforce the awards of the arbitrators is constitutional; and further, that an arbitration clause in a maritime contract, which provided that the award of the arbitrators should be "final and binding," authorized an admiralty court to enter its decree upon the award, although the contract for arbitration did not in terms provide for the entering of a decree upon the award.

The decision further held that an award signed by a majority of the arbitrators was binding, although the Arbitration Act does not expressly provide for such a majority award, since the rules of procedure referred to in the arbitration provision of the contract, which would govern in the absence of statutory requirement, did not require unanimity.

## New York-London Arbitration Service Established

AFTER several months of negotiation and preparation, plans for the first comprehensive and practical commercial arbitration service ever to be established between two countries have been completed by the American Arbitration Association and the American Chamber of Commerce in London. Under this plan, parties to an arbitration

agreement may have the proceedings conducted either in New York or London, as they may elect. The cooperation arrangement concluded by the two organizations provides for arbitration under a standard procedure and at a scheduled, minimum cost, conducted under the arbitration law of either England or the United States.



This New York-London Arbitration Service, which is now ready for use, provides facilities for settling with rapidity, certainty and at little expense, in the most important commercial cities of the world, controversies arising out of trade between the United States and its largest customer abroad. Although the value of our exports to the United Kingdom declined sharply in 1930, this trade amounted to \$678,000,000 in that year, or over seventeen per cent of our total exports.

While it is expected that the arbitration machinery made available by this plan will primarily be used as a result of arbitration clauses included in contracts between business men of the two countries, it is also available immediately for the arbitration of disputes arising from the abandonment of the gold standard by Great Britain, the fluctuation in the value of exchange, the recent imposition of high tariffs on imported goods and other causes.

Included in the plan are two arbitration clauses, one providing for arbitration in New York under the rules of the American Arbitration Association, the other for arbitration in London under the rules of the American Chamber, the choice of clause to be included in the contract depending upon the desire of the parties as to the place in which the arbitration is to be held. When, however, a controversy arises and the contract does not contain an arbitration clause, but the parties desire an arbitration, they may apply to either of the organizations for the necessary submission forms and information as to the proper procedure.

Both the Association in New York and the Chamber in London have established standing

panels of highly qualified persons from which arbitrators may be selected by the parties, although the selection of arbitrators is not confined to these panels. While this special panel in New York is made up of business men who are outstanding leaders in domestic and Anglo-American trade, these arbitrators give their services without compensation. The fact that neither of the organizations cooperating in the New York and London Arbitration Service makes any profit from the arbitrations they conduct accounts for the low cost of the proceedings, although, under the rules of the American Chamber, the members of the London panel receive a small fixed fee for their services.

The successful development and operation of this commercial arbitration service between New York and London is believed to be assured by two recent court decisions. One upholds the constitutionality of the United States Arbitration Act and was handed down by Chief Justice Hughes on January 4th. Another important decision affecting international arbitration agreements was that of the Court of Appeals of the State of New York, in 1931, in the matter of *Gilbert v. Burnstine & Geist*, in which the court upheld the validity of an arbitration clause in a written contract entered into between a British subject and an American citizen, providing that all differences were to be "arbitrated at London pursuant to the Arbitration of Great Britain." The Court of Appeals held that such an agreement cannot be ignored by the American when a controversy arises and the British subject demands arbitration under the terms of the clause.

## This Subject—Ethics

By JAMES I. MASON, C.P.A.

MUCH use is made of the word. We find it flung in conversation here and there as well as the negative thereof, unethical. It is often, in all probability, used without conception of its true meaning. This idea comes to mind from the "rules" on so-called "Professional Ethics," and committees thereon. Everyone is familiar with the more or less ancient song "Yes! We Have No Bananas," and what of ethics? It would seem that it might be said "Yes! We Have No Ethics!" How can we possibly have when we

style them "Professional Ethics." Do we mean by that, we must be professionally ethical? Can we be merely professionally ethical or can we make a profession of our ethics (supposedly engaging our attention some eight hours a day with possibly Saturday afternoon off)? It is probably true that we make too many pro(con)-fessions of our ethics and denounce the lack of them in our fellows.

Without trying to bring in the religious issue (though a great resemblance can be seen) the

thought persists of that Biblical quotation, "Thou hypocrite, cast out first the beam out of thine own eye, and then shall thou see clearly to pull out the mote that is in thy brother's eye." If we would do this it must be convincingly true that our ethical standards would greatly and rapidly improve.

Dr. Eliot's five foot book shelf and fifteen minutes a day result in great improvement. In the case of ethics one can dispense with the five feet. One's brain and fifteen minutes a day for a few months or even one day's applied thinking with or without a text book on ethics is bound to bring a new conception to one who desires to be, or to improve, his ethical understanding.

What occupation requires more ethical practice than accounting? None that can be thought of and the only one which is equivalent is medicine. One not only has to think of his client's welfare and interest but must consider any one else who might then or later be interested in his work or the results thereof, and must so conduct himself so as not to bring the profession as a whole into disrepute.

It seems obvious that no such thing as professional ethics exists. Certainly one cannot engage in the professing of ethics if he is not possessed of an ethical nature or desire. If he is so possessed then why term it professional ethics. He has no professional ethics nor does he practice the ethical profession, knocking off, so to speak, and leaving them on his office chair together with his professional manner when leaving the office.

One's ethics are practiced at all hours, in sports, home life, in social intercourse as well as in his professional contacts and even in his sleep, when the old subconscious is on the job, his ethics prevail of whatever quality they be and if any are had. If one is totally void of an ethical standard then he cannot be ethical in the practice of public accounting. Ordinarily we feel this to be a dry subject, but it can be found to be most interesting and entertaining.

If you are unethical in your sports or other activities how can you expect to be truly ethical in the practice of your profession? It is hardly possible to confine your errors of life to certain parts of your activities.

Probably some persons are not in the slightest degree interested in this subject, but that type should not be allowed in the profession, or at least an effort should be made to prevent their

getting in. This can be done to some extent by a rigid and important part of the Certified Public Accountant Examinations being in the subject of ethics. Certainly if one proved his knowledge of the subject before acquiring a certificate he would be more logically and fairly called to task when he fails to put his knowledge into practice. One who is truly ethical could safely be given a certificate without any examination in accounting knowledge. He would never harm the profession. If he were incompetent to perform work or any special part of work he would admit his incompetence or inability and thus would be avoided some of the sad specimens of work that are found. This would even be true in the case of ignorance, as one who has a true conception of ethics would be positive he was competent and should the question, after a thorough searching of his innermost soul, be apparent he would gracefully, if not frankly, decline.

A regular column in this periodical should be given over each month to expressions on this subject from C.P.A.'s. It might be extended to ideas on ethics from those outside the profession. It would provide most interesting reading and would keep the subject before the members of this Society at least.

It will be well worth while for each of us to give profound thought not only to our ethical theories but to what is still more difficult, their practical application; not only in our professional contacts, but in all of our acts.

An ethically perfect man would be the second "Perfect Man" which we are taught cannot be attained at least in this "vale of tears," but we are likewise taught to struggle onward toward that goal that, although impossible of attainment, unless we valiantly battle in that direction we will become soft and decline to such a degree that there is no hope for us.

The desire is within me to improve my ethics. The field is endless. Are you possessed with this same desire? If so, fight to strengthen it and we are bound to have an upheaval toward better ethics. Remember, it is a job to cultivate our own individual fields of ethics. We need not instruct the other fellow other than by precept. Each one of us who causes our own field to blossom will make it so attractive that he need not worry about the one who neglects his field of ethics. Also of necessity one must encounter growing pains before the fields will blossom. That part of the public which does not appreciate higher developed ethics is not worth while.

# National Conference on the Relation of Law and Business

Reported by ANNABELLE G. CORRIGAN

A NATIONAL conference on the relation of law and business, with specific emphasis on the anti-trust laws was held at New York University, on October 26th and 27th, three sessions each day, under the auspices of the School of Law and the School of Commerce.

Walter Wheeler Cook, professor of law in the Institute of Law of Johns Hopkins University, laid the foundation for the discussion in a paper on the "Economic, Social, and Legal Background of the Anti-trust Laws." In concluding his address, and after pointing out the fact that we do not all define the word "competition" to mean the same thing, he said, "My obiter dictum is this: In discussions of our subject, objection is often made to governmental interference with freedom of contract or with the working out of 'economic law.' Now all law restricts the freedom of the individual; that is its purpose. The business man who calls upon a court to give him damages or an injunction against another business man or a labor union is asking a government agency to limit the other man's freedom to act. The very essence of the legal institution of private property itself constitutes an enormous invasion of the freedom of the individual to act. What is often overlooked, it seems to me, in discussions of this kind is that limitations upon our legal liberty or freedom to do as we please may, and often does, result in greater actual physical freedom for all of us: witness the effect of good traffic regulations. Again, the opposite may be the case: witness bad traffic regulations. The economic activities of civilized human beings are necessarily carried on through the mechanism of law, which means coercion of the individual and limitation of freedom to act. Our real problem, therefore, is by the process of trial and error to work out the type of regulation which in the long run will give the greatest number of us the largest measure of things we desire."

Hon. James A. Emery, counsel of the National Association of Manufacturers, presented a paper on the "Legislative Development of Anti-Trust Laws." "We want no enlargement of the detailed

public supervision of private business," said Mr. Emery. "We do need practical improvement of our administrative machinery to determine with greater expedition and efficiency the permissible limits of beneficial private business co-operation. Our own determination," continued Mr. Emery, "to clarify public understanding of that need and to advance self-government in industry under intelligent and honorable business leadership is the surest guarantee for the rationalization of commercial control and a lessened demand for the supervisory interference of the state."

Professor Myron W. Watkins, of New York University, was not so certain that regulation would meet the needs of the situation and pointed out that the regulation of public utilities had not produced such results as warranted complete confidence in this feature of social policy.

The present plight of the oil industry and the effect of the uncertainty which prevailed as to the legality of the steps proposed to remedy the conditions in that industry were discussed by Judge C. B. Ames, vice-president of the Texas Company, in his paper on "Petroleum and the Law." After showing the chaotic conditions in the industry, Judge Ames said that the welfare of the petroleum industry was hindered and not helped by the laws. "There is insufficient restraint upon the production of crude oil and excessive restraint upon the distribution of the products. The maladjustment between the law and the facts is worthy of the serious attention of our lawmakers."

The conditions in the bituminous coal industry were set forth by Charles O'Neill, vice-president of Peale, Peacock and Kerr, Inc., of New York, in his discussion on "Coal and the Anti-Trust Laws." He criticized the rail rates charged on bituminous coal and stated that a reduction of thirty per cent would place coal in competition with hydro-electricity, gas and oil, and enable it to recover its lost business. "Freight rates are excessive," said Mr. O'Neill, "to the extent of fifty cents to one dollar per ton and we submit

that the coal industry cannot continue to pay such tribute to a sheltered industry. It is my opinion," said he, "that the most important thing that can be done to improve the situation in the industry is for the railroads to awaken to this fact and put the destination price where coal will successfully meet its present-day competitors."

Cornelius F. Kelley, president of the Anaconda Copper Mining Company, discussed "Copper and the Anti-Trust Laws." After describing the situation in the copper industry, he made a concrete proposal. "Why may not a reasonable constructive statute be enacted," said Mr. Kelley, "vesting the right to protect business, and the public primarily, in the Department of Commerce?" He then proposed a statute which in substance would provide that agreements made between persons engaged in production, whether competitors or not, for the limitation of production be filed with the Secretary of Commerce and should be exempted from the provision of the anti-trust act until condemned by the Secretary. He would place upon the Secretary of Commerce the obligation of receiving complaints from aggrieved parties, conducting hearings thereon and rendering a decision which would be subject to a proper review by a court of law, if desired. He would extend the plan to consolidations and mergers. "If some sensible and flexible administrative methods could be adopted, where industry would be able to deal in the open particularly in regard to those matters the legality of which have not yet been determined, and the criminal process could be made applicable only to definite fixed understandable and recognized evils, then industry could with greater feeling of certainty and assurance take such measures as it felt were essential to meet our changing conditions."

Mr. Wilson Compton, secretary and general manager of the National Lumber Manufacturers Association, discussed the situation in the lumber field in his paper on "Lumber and the Anti-Trust Laws."

"The Textile Industry and the Anti-Trust Laws" was the subject assigned to Hon. Walker D. Hines, president of the Cotton Textile Institute. Mr. Hines emphasized the excess productive capacity of the industry and the great variety of forms of competition in the distribution of cotton goods. He urged that steps be taken to assure stability in the industry and said that the restraint of trade which instability causes is a great public evil. "The best way," said Mr. Hines, "to promote stability in any industry is to plan to avert

over-production, while at the same time doing everything practicable to expand demand. My proposition is that arrangements of this character, even though amounting to agreements binding upon the parties, would not violate the anti-trust laws." Mr. Hines ended his discussion by saying: "There is a great deal of discussion about changes in the anti-trust laws. It may well be that changes in those laws to facilitate their administration in the light of their true principles would be helpful. It seems to me, however, that the sound approach to the subject is along the line that the law was never intended to prohibit arrangements whose purpose and effect would be to promote trade and commerce and that with the law as it stands, and with the Supreme Court interpretations as they stand, a great deal can be done to eliminate the existing chaotic conditions, certainly to the extent that they are due, as they are now primarily, to a state of great over-capacity and a consequent chronic over-production."

"Radio and the Anti-Trust Law" was the subject of a paper by John C. Cooper, Jr., chairman of the Legislative Committee of the American Academy of Air Law and president of the Florida Bar Association. Speaking for himself, Mr. Cooper said: "I feel that the anti-trust laws should be continued in force and effect for the full accomplishment of that purpose, consistent with proper protection of the legitimate rights of owners of patents." He urged a revision of the radio act of 1927 and criticized the present policy of Congress in refusing authorization of the consolidation of wire and wireless communication companies.

Charles Neave, vice-president of the Bar Association of the City of New York, presented a paper on the "Relation of the Patent Statutes and the Anti-Trust Laws." "It is unquestionably true," said Mr. Neave, "that, judging from the present trend of the decisions of our highest court, we are now in a period in which the things that may properly be done under patents are being curtailed, and the feeling that too much has been done under them is reflected in further legislation proposed in the last few years."

Mr. Chester W. Cuthell, general counsel of the Curtiss-Wright Corporation, presented a paper on "Aeronautical Transportation and the Anti-Trust Laws." He favored the amendment to the anti-trust law suggested by the American Bar Association, but stated that the anti-trust laws were not one of the problems of the aviation industry at present.

The bill proposed by the American Bar Association seemed to find favorable consideration from most of the speakers. However, an opposing point of view was expressed by James Harvey Williams, president of J. H. Williams & Company, who argued that the bill was advantageous only as to proposed mergers. In its present form he said that the bill left untouched the problem of practically all distributors and most of the producers—the problem of price demoralization. “None of these bills go to the root of the matter by attacking the mistaken underlying economic philosophy of our own unique prevailing system,” said Mr. Williams. Mr. Williams quoted liberally from the debates in Congress and the utterances of statesmen of that period to show that Congress never intended such a development of our philosophy as now exists because of the Trenton Potteries case and others. He suggested as remedies the appointment by Congress of a committee to investigate carefully the working of all the anti-trust laws; to review and determine what our national economic philosophy should be; what type of competition will best serve our national needs; what are the elements that compose “the public interest”; what tendencies we should promote but not regulate between production and consumption; what industries will best serve the national interest as regulated monopolies and which as unregulated competitors.

Dean Madden, of the School of Commerce, read a paper on “Cartel Operations in Europe.” Centralizing his discussion particularly on Germany, he said that the cartel was undoubtedly responsible for the great progress that Germany has made industrially, but that the experience there has shown that cartels must be regulated and that industry cannot be permitted to regulate itself without some form of social control. Emphasizing the differences that existed between Germany and the United States in the concept of the state and the philosophy of government, Dean Madden concluded that no such similar system would be advantageous here, but that the cartel experience of Germany would be useful to us in showing how to avoid the mistakes which Germany had made.

The final session held on Tuesday evening was presided over by Gilbert H. Montague, Esq., chairman of the Committee on Anti-Trust Laws and Federal Trade Commission of the Merchants’ Association of New York.

Hon. William J. Donovan, former Assistant Attorney-General of the United States, discussed freely and fully the development of common law

and the economic implications of restraints on trade. He said: “My own view is that a most important element in the enforcement of the anti-trust laws lies in the theory and method of administering those laws. There are measures that could be adopted, not fundamental in their nature, but which would enable industry to know better what it could properly do in a given circumstance without the fear or threat of criminal process. I, of course, can speak only from my own experience. In the Coolidge administration a definite policy was adhered to of giving opinions in advance concerning proposals which might come within the prohibitions of the law. It was felt that the purpose of the law was to prevent the organization of combinations and agreements that might be violative of the law, and that the most effective way to deal with such activities and to protect the public was to prevent their coming into being and not to wait until they had actually been effected and worked their harm.” Mr. Donovan concluded by saying: “The administration of the anti-trust laws, however, can and should be changed, so as more nearly to conform to the purpose for which they were enacted. That purpose was not to conduct a series of raids upon industry, but to ensure that industry would conform to certain standards of business conduct. It must be recognized that efficiency and economy in industry can only be attained by full opportunity for the legitimate growth and consolidation of business units and that inherently there should be no conflict between legitimate business and government.”

Hon. Rush C. Butler, chairman, Committee on Commerce of the American Bar Association, pointed out that the evils of the present law are that business men are unable to know what the law is and have no means of ascertaining whether their contemplated conduct is legal or not, but in addition to this they are actually threatened with criminal punishment in the event they have unwittingly transgressed the law. “It may be quite proper,” said Mr. Butler, “for the government to prevent and stamp out business practices inimical to the public welfare, but it should provide an understandable standard and use intelligent means to enforce compliance with it. The greatest menace of the Sherman law,” said he, “is its effort to cudgel men into obedience with the club of criminal prosecution.” He pointed out that under the Sherman law the government is in business to a degree that cannot be over-stated. The problem is to remove government from business without

impairing the beneficial influence of the statute. He also stated that the question involved in the Sherman law controversy is economic and not legal. "Whether a given set of facts constitutes a reasonable restraint of trade is a business problem," continued Mr. Butler. "It is economic. Under present practices the Supreme Court of the United States is in effect the sole arbiter of a Sherman law proceeding, but is not called upon to function until years after the contract in question has been entered into and acts have been done in performance of it. In Sherman law cases it answers economic questions, decides economic cases."

Hon. James W. Gerard, former Ambassador to Germany, and general counsel of the National Civic Federation, delivered a brief address. Mr. Gerard said: "I have read the law proposed by Mr. Rush C. Butler, by which, in substance, the right is given to those desiring to form a combination, which today might be held by the court of last resort a violation of the Sherman Act, to go before the Federal Trade Commission, lay their proposed contract of combination before that commission, and, if the commission finds that it is not unreasonable, not injurious to the public, the consumer or the trade, the commission may then put the seal of its approval on the contract, and thereafter no criminal prosecution shall be instituted against the parties to that contract." Mr. Gerard then went on to say: "I do not believe that this is a delegation of judicial powers which should be vested in the courts alone, to a commission or quasi-judicial body. We have set up many commissions in many of our states and the laws setting them up have been held constitutional. The Public Service Commission of the State of New York determines, after a hearing, whether an electric light company, for example, seeking to render service to a town, may do business in that town when there is already a company rendering service in that locality. This is only one example of the exercise of quasi-judicial powers similar in nature to the powers proposed to be vested in the Federal Trade Commission by Mr. Butler's Act."

Oscar Sutro, Esq., vice-president and general counsel of the Standard Oil Company of California, delivered a masterly analysis in his presentation of the legal and economic operations of the Sherman Anti-Trust Act. Mr. Sutro said: "It would be unreasonable to attribute our present economic distress to the Sherman Law; it would be absurd to ignore its effect in promoting that distress. It has become a force hostile to our eco-

nomic welfare. We can not longer overlook it. A statute designed to promote the business of the country has become an incubus that retards the recovery of business; a statute which by its title is "an Act to protect trade and commerce against unlawful restraints and monopolies," has become a statute that renders business defenseless in the face of demoralization through economic laws and makes it the victim of fierce and destructive competition." Mr. Sutro concluded his paper as follows: "Mr. Rush Butler has pointed to two fundamental features of our anti-trust laws which give them a baneful effect far beyond their theoretical scope, namely, (1) the indefiniteness of the prohibition of unreasonable restraints (for what lawyer will presume to forecast the views of the Supreme Court or the majority of the court on that question?); (2) the provisions for criminal punishment for violation of the act.

"Granting that all that the act prohibits should be prohibited; assuming that under the rule of reason the statute interdicts only unreasonable restraints; the difficulty is that in practice the statute checks many transactions which on final adjudication would not fall within the prohibition of the law. The Department of Justice is not authorized to advise. The Federal Trade Commission is powerless to decide. And agreements to end ruinous competition and to control untoward waste, which the chaotic condition of our business makes imperative, proposals to control the senseless waste and over-production of irreplaceable natural resources, are abandoned, often not because they infringe the law, but because of the fear that they may violate it. And so the law operates to check not only that which should not be done, but that which should, and the public as well as business suffers. Business may not need relief from the law so much as it needs relief from what Mr. Butler so aptly described as the power beyond the law—the fear that the Sherman Law prohibits more than it actually prohibits.

"The discussions have established that all are agreed on two points:

"First, that it is not in the interest of the people that the Sherman Law should be repealed—the law against monopoly is sound. Second, that the industrial welfare and economic welfare of the country require some loosening of the present shackles which our anti-trust laws impose on business and on the conservation of our natural resources.

"I am in sympathy with the proposal that parties to trade agreements may seek the advance

approval of the Federal Trade Commission, and, having obtained it, shall be immune from the criminal proceedings provided by the anti-trust laws. But it does not go far enough. The law should not be merely negative, it should be constructive as well. Business is entitled to know that it is right when it is right; not merely to be assured that when its acts are in the public interest criminal prosecution will not follow. Important trade agreements are not lightly made. Conservation programs dealing with our natural resources are at best difficult of consummation. In the face of danger of annulment these become impossible. With the direct sanction of Congress the plan for the unit development of the Kettleman oil fields in California—perhaps the country's greatest oil field—was completed last year at the eleventh hour under a permissive statute passed for the purpose. Without that sanction the plan

would have been impossible. Yet it was an enlightened step, and has without question saved the oil industry on the Pacific Coast, and probably throughout the nation from unimaginable demoralization and preserved from wanton waste the greatest and most valuable reserve in oil known to the country."

Dean Frank H. Sommer, of the Law School, very briefly summarized the proceedings of the Conference, and a vote was taken that the conferences should be continued. Short addresses were also delivered at the Conference by Mr. Fred I. Kent, president of the University Council; Mr. Charles A. Boston, former president of the American Bar Association, representing Mr. Guy A. Thompson, president of the American Bar Association; and Mr. John M. Redpath, manager, research department, Chamber of Commerce of the United States.

## The Thirteen-Month Calendar

By JOHN H. SCHMIDT, C.P.A.\*

THROUGH history and research we know that in the various stages of the past, the people of the world adopted certain standards and customs upon which the basic principles of all business transactions were governed. We also know from history, research and actual experience, that in the march of progress, as business became more involved, many of the standards and customs which were received from past generations were constantly being challenged and oftentimes modified.

This was due, chiefly, to the fact that their economic use did not conveniently fit into current business practices and relations. Changes invariably reflect progress. Thus we can attribute some of the remarkable advancement business has made to the constant improvements in standards and customs.

However, in the evolution of business, we find there has been neglected for a great many years, one of the most frequently used and inconsistent elements—the regular calendar year. The disturbing and unsettling factors in this measure-

ment for the passing of days throughout the year, are not readily appreciated without some analysis.

In this measurement of time there are only four parts which are definitely set—the second, the minute, the hour and the day. Beyond these four units of time, irregularity is very much in evidence. The number of days in various months is different, running from twenty-eight all the way to thirty-one days . . . the quarter varies from ninety to ninety-two days and the half year may shift from one hundred and eighty-one to one-hundred and eighty-four days.

Neither is each month an exact multiple of the week with the exception of February. The first day of almost every month is different and the number of individual week days is unlike in many months. Where do we find anything more decidedly inconsistent and yet so greatly utilized in our every-day sphere of human activity?

By selecting a simple comparison from the many which are available, let us see what effect this irregularity has in business. Assume, as an example, an industrial concern operating under a five and one-half day or forty-four hour week plan; eight hours for five days and four hours on Saturday.

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\*Assistant Treasurer, Western Clock Company, which has operated under the thirteen-month calendar for nearly forty years.

Beginning with the month of February in a regular year, the first day of the month falling on Wednesday, the concern would operate twenty days of eight hours each and four Saturdays of four hours each, or a total of one-hundred and seventy-six operating hours.

In the next month (March) there would be twenty-three operating days of eight hours each plus four Saturdays of four hours each or two hundred working hours. This shows an increase of thirteen and six-tenths per cent in operating hours over the month of February because of complications in the make-up of our calendar. When we follow the example along into April, we find this month contains twenty operating days of eight hours each and five Saturdays of four hours each. This totals one hundred and eighty hours, or a decrease of ten per cent from March, this shrinkage being entirely due to calendar irregularities. Further comparisons are unnecessary to show how the magnitude of such variations affect comparative reports and statistics.

Let us also visualize what's in store for the future. We hear considerable about the five-day week. Some industrial concerns have already adopted this method. In many cases, variations in the straight five-day week plan would be of greater importance than under the five and one-half-day week plan that we have just cited.

It should not be necessary to pause and wonder at the present time, why we are witnessing the aggressive challenging of today's calendar system, not only by business, but by many of the people throughout the world. This challenge is far from new. Business has questioned the economic convenience of the regular calendar in the United States for at least the last forty years. However, little serious thought was given the subject by the general public until the last few years.

At the present time the proposed simplification of the calendar is a live topic and the interest has been increasingly manifested in commercial, industrial, scientific and educational circles. We know there is an increasing demand for calendar improvement in the United States. In this movement, the National Committee on Calendar Simplification, after much research and study, has submitted two plans of calendar systems to supplant the present one, namely:

Plan 1. The International Fixed Calendar which contains thirteen months of twenty-eight days each, the first day of each week and the

first day of each month falling on Sunday.

Plan 2. The French Calendar containing twelve months, of which March, June, September and December have thirty-one days, and the remaining eight months thirty days.

In addition a new calendar, known as the World Calendar has made its appearance and is presumed to be an improvement over the French Calendar. It is not desired to enter into a discussion as to the merits or demerits of the French or World Calendars. However, in passing, it is recommended that everyone familiarize himself with the various plans offered through the information compiled by the National Committee.

That Plan 1, the International Fixed Calendar or the proposed Thirteen-Month Calendar, is preponderantly favored in the United States, is disclosed in the supplementary report issued this year by the National Committee on Calendar Simplification for the United States. It is also shown that one hundred and forty known industrial and commercial concerns have adopted a thirteen-month type calendar for their internal operations, inauguration of the plan dating as far back as the year 1892.

This long period of actual usage of this type of calendar provides us with much practical experience. From the reliable information secured by this committee, it is clearly evident that the Thirteen-Month Calendar is not something that is in the laboratory stage, but a proven practical and convenient standard for efficiently measuring the time element in business operations and is in waiting for general acceptance.

To conduct business efficiently and to secure guiding and accurate information, accounting and operating reports are indispensable. These reports must not only be factual but must be comparable, one period with another. In business, accounting and operating statements usually represent the period of a month's activities. Such statements covering a short period of performance give the prompt accurate story.

In operating under the regular calendar, monthly periods are so inconsistent with one another it is impossible at all times to secure comparative figures without reconciliation. Such treatment of figures in reports often complicates matters and is also laborious and costly. Reports secured without making adjustments for the disturbing time element in our regular calendar are but factual, and after preparation their only function is to occupy a place in the files, along with the historical records of the concern.



After years of functioning under the regular calendar, the management of the Western Clock Company encountered its inconsistencies and realized the benefits that could be obtained under the Thirteen-Month Calendar. This plan was adopted for our internal use in the year 1892—thirty-nine years ago.

The foresight of this move can be appreciated by the management today, as they observe the highly competitive condition and complicated stage which business has reached. Today up-to-date guiding and accurate reports are more essential than ever before in assisting the executives of any concern in solving their problems.

The Western Clock Company calendar is composed of thirteen months, each month having four full weeks of seven days each, the first day of every week and month falling on Sunday. This makes thirteen months of uniform duration—twenty-eight days. It is evident that thirteen months of twenty-eight days each accounts for only three-hundred and sixty-four days every year, so provision must be made to take care of the extra day.

This is done by carrying the extra days forward from year to year until seven have accumulated, at which time our calendar provides for a month of five weeks or thirty-five days.

This works its way around once every five or six years, depending on whether there are one or two leap years coming within the period. The odd week is included in our seventh month and accounts for the only variation in our whole calendar system. We do not experience any difficulty and do not find it complicated to make this adjustment. This calendar, with but one exception, is used in every phase of our organization, the lone exception being in our outside contact with the trade and public.

Budgets form the basis of controlling and coordinating the activities of the various divisions of our organization. In determining the budgets, the assistance afforded by our calendar having equal periods of time is invaluable. From the sales quotas and general budget, production schedules and manufacturing budgets are established.

These major budgets are broken down into departments. The simplicity of establishing the budgeted amount for any period or fraction thereof and the ability to make comparison with any other period, either past or present, is a distinct advantage. This advantage cannot be fully appreciated without taking into consideration the

endless number of problems involving the daily production of thousands and thousands of time-pieces of different designs.

Conforming with our thirteen-month calendar, we have two payroll periods every month, each consisting of two weeks duration. Salaries are paid in accordance with our plan of operation. Thus we have no splitting of pay periods to interfere with our accounting procedure, and the elimination of this factor in our accounting system lends its ease in systematic routine. Labor turnover is figured thirteen times a year and all labor and employment reports issued to coincide.

One of the common objections raised by other concerns in connection with any thought of adopting the thirteen-month calendar plan, is that an organization making up its reports upon a monthly basis, will require thirteen monthly reports instead of twelve. They assume that the additional closing period creates additional labor. Experience has convinced us that this is not true in our case.

Our employees are all educated to the thirteen-month plan calendar. "Month ending" does not mean to them the end of a regular calendar month but the end of one of our thirteen months, and is the only calendar language spoken in the concern. There is no confusion whatsoever with the regular calendar.

Our employees thoroughly understand every second week of the month means the closing time for payroll purposes, and every fourth week as the closing of the month. Definite standards have been set and these standards demand the completion of each report on scheduled time. As there are no periods of unequal length and the closing process always begins promptly on a Monday, the morale and custom have been built up to a point where closing causes no more concern than any other period in our planning and accounting program. We believe the prompt and systematic manner in which our reports are completed more than compensates for the one extra report.

In our external operations, where transactions are carried on in accordance with the regular calendar, we experience no difficulties. Our credit and sales departments function without noting the difference. Merchandise is billed to the customer on the date of shipment and our terms and date of collection conform to the regular calendar. Purchases are treated in the same manner. We post in our records **all** purchases upon receipt of invoices, discount all bills

and strictly adhere to the terms of the vendor. All external correspondence is, of course, governed by the regular calendar.

Accruals of expenses such as taxes, interest, etc., are performed in the usual manner and in accordance with our thirteen-month calendar. Likewise, deferring of certain expenses are also handled without complications.

The accounting methods of branch offices and subsidiary companies are generally defined by the parent company, and are usually in conformity with the method it employs. We operate several branches and control several subsidiary companies, all functioning under our thirteen-month plan. Consequently in the preparation of consolidated reports, no calendar adjustments are required. We find that our branches and subsidiaries operate with marked efficiency under the plan.

Reconciling of bank accounts could readily be taken care of regardless as to the date of receipt of bank statements and cancelled checks. However, we operate our plan to the utmost detail and supply the banks with our month-ending dates and receive our bank statements accordingly. Thus our bank accounts are reconciled thirteen times every year.

The securing of data for governmental and trade association reports require some reconciliation as statistics compiled by such agencies are in accordance with the regular calendar year. As all of our transactions covering the data issued for such purposes are recorded daily, we find it a simple matter to secure the desired information from our records. Due to the very small amount of labor involved in obtaining this information, we look upon it as a very minor matter.

With thirty-nine years of continuous contact with the thirteen-month calendar plan, and our entire scheme of operations woven around it, we have found the plan to be very beneficial and have not a single objection to voice against it. Due to the many advantages we have experienced we are naturally in favor of the proposed thirteen-month calendar. Briefly we advance some of the chief advantages secured by us in operating the plan.

1. All operating periods of equal length of time, each period beginning on Sunday and ending on a Saturday.

2. Obtaining accurate and guiding comparative reports covering short periods of operation without having to consider the element of

time due to calendar variations in their analysis.

3. Standardization and equalization of budget periods, facilitating ease of operation.

4. Uniform payroll periods with no split payrolls.

5. More efficient clerical routine due to the systematic flow of work with greater precision thus effecting economy.

The thirteen-month calendar submitted by the National Committee on Calendar Simplification known as Plan 1, the International Fixed Calendar, if adopted, will be an improvement over any known thirteen-month plan now in operation. Under the method stipulated in Plan 1, there would be thirteen months of twenty-eight days each, adding a new month to our calendar to be inserted between June and July. To take care of the additional day in every regular year, we would have what would be known as "Year Day" which would be inserted between Saturday December twenty-eighth and Sunday, January first. Leap Year would be taken care of in a similar manner between Saturday, June twenty-eighth and Sunday, the first day of the new month.

Briefly, the important features of this calendar are:

1. The date of week-days would be perpetually fixed.

2. Every four-week month would have twenty-eight week days and all months would be equal having exactly the same recurring twenty-eight week days of equal monthly value.

3. All holidays would be fixed to the same date and week-day each year.

Some say, "Well this thing might be all right for business, but what benefits will the public derive?" This could be answered in many ways. There really is no line of demarcation between business and the public. Business comprises large organizations, the corner grocer and the family unit. As business moves the so-called public follows. How true this is today. How many people of the world are not affected by the present abatement in business? Not many. Business and the so-called public are so integrated they cannot be divorced.

The fundamental basic principle of business is to serve, and the more efficiently business is permitted to be operated the more benefits can be passed on to the public. We believe the thirteen-month calendar a necessity in endeavoring to reach the peak in efficiency.

As accountants we all know the need and importance of vital statistics and reports. We know

*(Continued on page 121)*

# Depreciation and the United Railways Case

By HARRY BOGGS, C.P.A.

THE subject of depreciation has probably been cussed and discussed more than any other subject in the accounting category. Especially has it been a controverted element in the public utility field, where it has had to bear not only the well-informed analysis of the professional certified accountant, but the uninformed attentions of the layman. Everyone should agree that depreciation exists as an actual fact, and that unless this "inevitable march to the scrap-pile" is recognized, the books of account will not tell the whole truth. Payment of dividends without prior provision for adequate depreciation will inevitably result in unconscious liquidation, and the time will arrive when plant values represented on the books will be found to be almost worthless, with resultant financial disaster.

Prior to the recent decision of the Supreme Court of the United States in *United Railways and Electric Company of Baltimore v. Harold E. West, et al.*, 280 U. S. 234, the labors of public utility accountants and regulatory commissions had resulted in a fairly well defined and agreed upon doctrine and procedure. It had come to be generally accepted that the object of depreciation accounting was to reflect the operation of this important item of expense on the earning statement and to show at any given time the extent to which the original investment had depreciated, also to show the amount that was necessary to reserve from earnings in order that at the expiration of the life of any given unit of property, a sufficient reserve had been built up to equal the original dollar cost of that unit.

Now comes this decision of the highest court of the land to add to the complexities of the subject and the problems of the public utility accountant. The Supreme Court holds that for the purpose of determining whether rates enforced by public authority are confiscatory, the allowance for annual depreciation should not be based upon cost, but should be based upon "present value." In rate cases, the inconsistency between basing the return to the utility upon present values, reflecting higher or lower price

levels than original cost, while basing annual depreciation accruals upon original cost, without considering such changed price levels, had long been obvious. In *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 13, a case decided before the great change in price levels had become acute, the Supreme Court of the United States had clearly hinted at this problem in stating that the utility is entitled to have "the value (not the cost) of the property invested" kept unimpaired. In several more recent cases, State supreme courts have held that depreciation accruals must be based upon the new price level, *Michigan Public Utility Commission v. Michigan State Telephone Co.*, 228 Mich. 658, 666, 200 N.W. 749; *State ex. rel. Hopkins v. Southwestern Bell Telephone Co.*, 115 Kans. 236, 223, Pac. 771, and *United Railways etc., Co. v. West*, 157 Md. 70, 145 Atl. 340. Indeed, the Supreme Court, through Mr. Justice Brandeis, had strongly hinted at such a result in *Georgia Railway, etc., Co. v. Railroad Commission*, 262 U. S. 625, 633.

There probably will continue to be disagreement with the economics of these decisions, as well as with the public policy which they reflect. In general, price levels steadily but slowly increased until the beginning of the Great War, then advanced with great rapidity until 1919 or 1920, then broke sharply for a year or two, and then remained fairly constant until the last year or two, when a downward trend began to appear. At this time, the present-value rule for depreciation in most cases will result in a substantially higher annual allowance than the orthodox original-cost rule. But this is not true in all cases even at the present time, and if price levels continue to decline it will become increasingly untrue in the future. It may turn out that the application of this rule will reserve less for depreciation than the original cost of the property retired and many would deplore its effect upon established financial structures.

Many also will fail to agree with the Supreme Court that there is any inconsistency between restoring the stockholder's dollar, as far as de-

preciation is concerned, while basing his requirements for return upon values reflecting present price levels. They will contend that these are two entirely separate and distinct questions, that for every dollar invested, the stockholder is entitled to reserve from earnings one dollar, neither more nor less, up to the retirement of the property purchased with it, even though his earnings, distributable in the form of dividends, should keep pace with the purchasing power of a dollar, as in other lines of endeavor.

However this may be, for the present at least, the Supreme Court seems to have definitely decided the question. It is not within the province of the accountant to quarrel with the decision, but to apply himself to the problems which it creates.

The principal problems which this decision creates for the accountant are four in number: (1) How shall the annual charge for depreciation for rate case purposes be determined under the "present value theory"? (2) To what extent, if any, shall the annual charge so determined be carried upon the books of account? (3) To what extent, if any, will the charge so determined under the "present value theory" be recognized for income tax purposes? (4) To what extent, if any, will the principle of the case apply to the book-keeping and income tax problems of manufacturing and mercantile establishments, which are not public utilities?

The writer claims no heaven-sent mandate to solve these problems and no special inspiration as to their solution. However, having struggled with the first two problems in a recent confiscation case, he has arrived at some conclusions which appear sound and which may at least throw some light on this rather difficult subject. The last two queries, however, are filed away for possible future discussions.

### I

In the *United Railways Case*, the Supreme Court said:

"The allowance for annual depreciation made by the commission was based upon cost. The court of appeals held that this was erroneous and that it should have been based on present value. The court's view of the matter was plainly right. One of the items of expense to be ascertained and deducted is the amount necessary to restore property worn out or impaired, so as continuously to maintain it as nearly as practicable at the same level of efficiency for the public service. The amount set aside periodically for this purpose is the so-

called depreciation allowance. Manifestly this allowance cannot be limited by the original cost, because, if values have advanced, the allowance is not sufficient to maintain the level of efficiency. The utility is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning.' *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 13, 14, 53 L. Ed. 371, 380. This naturally calls for expenditures equal to the cost of the worn-out equipment at the time of replacement; and this, for all practical purposes, means present value. It is the settled rule of this court that the rate base is present value, and it would be wholly illogical to adopt a different rule for depreciation."

The Supreme Court definitely holds that the total depreciation which a utility is entitled to reserve over the entire life of the equipment is "equal to the cost of the worn-out equipment at the time of replacement." The Supreme Court further says that for all practical purposes this means "present value." In other words, for the "practical purpose" of determining the depreciation charge in a confiscation case for this year, the cost of replacement this year must govern. The Supreme Court, doubtless, had in mind that year by year during the life of a given unit of utility property its cost of replacement will probably change many times. The curve may be steadily upward, steadily downward, or may represent a violent fluctuation from year to year. But it will certainly change, and it is impossible to predict at any given time what it will cost to replace the unit when it is retired. All that can be determined with certainty is what it would cost to replace it at the time of the inquiry. The nearest we can come to the cost of replacement at retirement is the cost of replacement now. Values have advanced or declined from the original cost to the present value. This is all that is known, and speculation as to the future should not be indulged. For practical purposes, we must stop with the legal presumption that the present value, established at this time, will continue, for it is impossible to prove anything else.

The Court also, doubtless, felt that for the purpose of a confiscation case now, it was not concerned with the question of what the accruals for depreciation should be three years from now, or with whether the total accruals during the life of the property will turn out to be adequate or inadequate. It had already held that in such cases it is not concerned with whether past de-

preciation accruals have been excessive or inadequate, any more than it is concerned with whether past net earnings have been excessive or inadequate. While the accumulation of a demonstrably excessive depreciation reserve is some evidence as to the reasonableness of using the old depreciation calculations for the future, *Smith v. Illinois Bell Telephone Company*, 282 U. S. 133, it is settled that excessive accruals in the past, if any, are the property of the utility, just as inadequate accruals are its loss; that the accruals to be budgeted against the rate-payer this year must be determined on the basis of present requirements, and that no deductions can be made therefrom on account of past excessive accumulations, and no additions made thereto on account of past inadequate accumulations, *Board v. New York Telephone Company*, 271 U. S. 23, 31.

In short, in a confiscation case the Court is not at all concerned with anything except the utility's requirements on the basis of values as they now are. So far as depreciation is concerned, what the consumer this year is using up is a year's life of property which would cost a given amount to replace now. It is obvious that if a utility had a confiscation case every year during the life of its property, and if its depreciation requirements each year were fixed and reserved on the basis of values as they then existed, it would be purely accidental if the total accruals so determined over the entire life of the property would equal its cost of replacement at the end of its life. As we shall see, this is one of the difficulties with carrying such accruals upon the books of account. But in a confiscation case, the determination of the annual depreciation accrual is a "practical" matter of adjusting equities between the utility and the rate-payer as of the time of the inquiry, and for this purpose, undoubtedly, "the cost of the worn-out equipment at the time of replacement \* \* \* for all practical purposes means present value."

However, in regulatory circles the term "present value" is sometimes used with a secondary meaning, viz; cost of reproduction depreciated, as distinguished from cost of reproduction and cost of replacement new. It has been suggested in some quarters that in the *United Railways Case* the Supreme Court used the term "present value" with this secondary meaning. But it must be remembered that the question before the Court was *undepreciated original cost* (not *depreciated original cost*) as against present value, for no

one had ever thought of contending prior thereto that the total depreciation reserved over the life of the equipment should be less than the undepreciated original cost.

Further, the term "present value" as used in the *United Railways Case*, has been construed to mean cost of replacement new in several recent cases. In *Board v. Elizabeth Water Co.*, (C. C. A. 3) 43 Fed. (2nd) 478, 480, the Court said:

"The court recognized the propriety of such an allowance in order to restore property worn out or impaired and the necessity continuously to maintain it as nearly as practicable in the same level of efficiency for public service. This, of course, calls for expenditures equal to the 'cost' of worn out equipment, the question being, whether the cost at the time of purchase or cost at the time of replacement, the latter meaning present value. The court said \* \* \* present value."

In *Telephone and Railroad Depreciation Charges*, 177 I.C.C. 351, 378, the Interstate Commerce Commission, construing the term "present value" in the light of the context, said:

"Presumably what is meant is the cost of replacing the worn-out equipment with the equipment of the same kind."

In this decision, the Commission used the words "current replacement cost or present value" interchangeably (pages 376 and 377) and said:

"The court held in determining what return these fares would produce, the allowance for accruing depreciation should be estimated on the basis of replacement cost" (p. 380).

It appears, however, that while the proper construction is cost of reproduction new, it makes no difference which construction is adopted, or whether cost of reproduction new or cost of reproduction depreciated is used as a base, provided we have clearly in mind what we are doing, and provided we apply to whichever base we use a percentage properly constructed for application to it. The essence of the rule is the recognition of changed price levels, and the reflection of the new price level in the annual charge. While the Supreme Court has handed down the rule, it does not tell us how to compute the annual charge. Whether it should be determined by using cost of replacement new as a base, and applying to it a percentage arrived at by considering the entire life of new property, or whether, on the other hand, it should be determined by using cost of replacement depreciated as a base, and applying to it a percentage arrived at by considering the remaining service life of the depreciated property, is left to be de-

terminated by considerations of practical convenience. However, the use of cost of reproduction new base and the entire life percentage is much more logical, involves fewer complexities, is much easier to understand, and much easier to compute.

It must be perfectly obvious, however, that to apply the cost of reproduction *depreciated* a percentage which is based upon a consideration of the entire service life of new property, and is designed for application to original *undepreciated* cost or to cost of reproduction new, would be absurd. It would produce an entirely meaningless result. If cost of reproduction *depreciated* is used as the base, a new percentage, based on the remaining service life of the property, and designed for application to cost of reproduction depreciated, must be developed.

The application of the new percentage so developed to cost of reproduction will accumulate the cost of reproduction depreciated over the remaining service life, whether the base and percentage now determined are used without change during the whole period, or whether they are annually redetermined, always assuming, of course, no change in the price level. Similarly, the application of a percentage based upon the entire service life to cost of reproduction new will not only produce the cost of reproduction over the entire service life, but will produce the cost of reproduction depreciated, as at any given time, over the remaining service life, with no necessity for any change in the depreciation base, or any re-computation of the depreciation rate so as to reflect the lessened service life. The use of cost of reproduction new as a base and a depreciation rate calculated upon the entire service life, is not only more in harmony with the methods of computing the annual charge heretofore in use, but has an important practical advantage.

This will very clearly appear from a simple illustration. Assume a composite new property costing \$100,000.00, whose cost of reproduction remains constant during its composite service life, which we will assume to be twenty years. For the sake of simplicity we shall eliminate consideration of salvage. The first year five per cent of \$100,000.00 is charged, for at the beginning cost of reproduction and cost of reproduction depreciated are the same. If during each of the remaining years, five per cent of \$100,000.00 is also charged, the cost of replacing the property will be accumulated at the end of twenty years. If however, the second year five per cent of

\$95,000.00 is taken, the third year five per cent of \$90,000.00 and so on, the cost of replacement will never be accumulated.

Now, let us assume that at the end of about five years the evidence shows the reproduction cost new to be \$100,000.00 and the cost of reproduction depreciated or present value to be \$75,000.00. It is perfectly clear that we must accumulate \$75,000.00 during the remaining fifteen years (not twenty years). We can do this very simply by taking each year for the remaining fifteen years five per cent of the cost of reproduction, viz: \$100,000.00. During the remaining fifteen years this operation will accumulate \$75,000.00, the present value.

If we had but one individual unit of property to deal with, and if we wished to go to the trouble, we could take the remaining service life of the one unit, which would be fifteen years, divide it into one hundred, obtain a new per cent, viz:  $6.6666 + \%$  and apply this new per cent to the present value, viz: \$75,000.00. This would produce \$5,000.00 per year, or \$75,000.00, the exact amount that would have been produced with much less trouble, if we had not concerned ourselves with the troublesome question of what the remaining service life of the property should be and a long decimal. However, when we attempt to obtain a separate percentage for each of the many hundreds of diverse units which constitute an entire utility property, we must first obtain for each separate unit its present value, the term or period of its unexpired life, and its salvage value. It is obvious that this process would require a long period of time, would involve considerable speculation and would be very expensive. The annual requirement produced by this process would be exactly the same as would have been produced by using cost of reproduction new with the entire service life percentage. It is mathematically obvious that no matter what the remaining service life of the depreciated property is, once you obtain it, divide it into one hundred, and apply that per cent to the present value, you will produce exactly the same annual result as if you had taken the entire service life of new property, divided it into one hundred, and applied that per cent to the cost of reproduction new.

Any one with experience in utility rate cases is familiar with the highly controversial problems, both of law and fact, involved in ascertaining present value as based on cost of reproduction new depreciated and will readily concede that

any computation of the annual depreciation charge under the present-value rule which would eliminate such controversial elements would be highly advantageous. While the Supreme Court of the United States has held that the actual inspection method is preferable to the use of theoretical life tables in ascertaining the extent to which the property has depreciated, *Pacific Gas & Electric Co. v. San Francisco*, 265 U. S. 403, *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, the Interstate Commerce Commission remains unconvinced, *Telephone and Railroad Depreciation Charges*, *supra*. Many troublesome questions can be avoided if we compute the annual charge for depreciation under the *United Railways Case* by using the cost of reproduction new and the entire service life percentage.

Doubtless for these reasons, the cost of reproduction new base and the entire service life percentage was adopted by the Supreme Court of Kansas in the *Hopkins Case*, *supra*, and by the three-judge federal court in *Michigan Bell Telephone Company v. Odell*, 45 Fed. (2d) 180. From the Master's report in that case, it clearly appears that the Master found, and the court held, that the application of "entire service life" rates to cost of reproduction new will not only "maintain" the cost of reproduction new over the entire service life, but will "maintain" the cost of reproduction depreciated over the remaining service life, which is, of course, substantially less. While the *Michigan Case* has been referred back to the Master for findings separating interstate operations, 45 Fed. (2d) 186, the authority of the case as to all other matters remains unimpaired.

## II

What has already been said in discussing the first question has probably suggested the answer to the second. It being impossible to predict the cost of replacement of any given unit of property at any given future time, it is likewise impossible to put on the books of account year by year accruals to a depreciation reserve which will equal the cost of replacement at retirement. Radical adjustments in the reserve would have to be made just prior to retirement in order that the reserve might coincide with the cost of replacement. This condition, which in the nature of the case does not embarrass courts in determining what the annual charge against the rate-payer for depreciation should be this year, is difficult for one whose task is to build up a

reserve which will have a definite purpose and meaning at the time of retirement. Difficult as is the task of accumulating a reserve which will equal original cost at retirement, it is at least possible. But in an endeavor to build up a reserve which will equal cost of replacement, the unknown and the unknowable end to be reached, gives the accountant no course to pursue and no chart for his course.

As far as the writer knows, none of the uniform systems of accounts prescribed by the various regulatory commissions provide for depreciation accounting on the basis of present value or replacement cost. They all provide for charges to operating expenses based upon original cost, which charges are concurrently credited to depreciation reserve. Like the fixed capital accounts the depreciation reserve is required to be kept entirely upon original cost basis and retirements are based on the ledger cost of the unit retired. The writer knows no way in which a depreciation accrual determined on the basis of the *United Railways Case* could be reflected in the utility books of account without violating the existing classifications.

Shall the systems of accounts be revised so as to permit depreciation to be carried on the basis of the *United Railways Case*? The only Commission which has passed upon this question is the Interstate Commerce Commission, which has jurisdiction of the accounts of railroad and telephone companies. In *Telephone and Railroad Depreciation Charges*, 177 I.C.C. 351, 372-382, the question was thoroughly discussed, and the conclusion reached that so far as the books of account are concerned, depreciation should continue to be carried on the basis of original cost. The Commission pointed out that this question is entirely distinct from the question decided in the *United Railways Case*:

"In the *United Railways Case* the Court was not passing upon accounting regulations or the authority to prescribe them. The issue was whether or not certain fares which had been prescribed by the State Commission would result in confiscation. \* \* \*

"It is not essential that the accounts should correspond in all respects with the facts which may be controlling in a confiscation case. In such a case the fact with respect to property which is ascertained is its fair value, but we know of no system of accounts which undertakes to disclose this fact with respect to physical property. On the contrary, such property is normally stated in the investment account at cost." (Pages 380, 381.)

The reasons assigned by the Commission for this conclusion were:

(1) That on account of the constant shifting of values, under the present-value rule, the depreciation reserve, while no longer designed to accumulate original cost, would fail to accumulate cost of replacement. (Pages 377-378.)

(2) That the present-value rule is wholly inconsistent with the principle of carrying the investment accounts on the basis of original cost, and to change the investment account to a present-value basis would be undesirable.

At first blush, it may seem strange to advocate a rule as to depreciation in rate cases which is not and cannot be carried on the books of account. But as the Interstate Commerce Commission points out, this is true of many other controlling facts in rate cases. The value of the property is not reflected on the books of account.

The operating expenses are reflected on the books of account because they were actually incurred, but they may or may not be accepted by a rate-making tribunal as the reasonable and necessary operating expenses. The proof may show that the necessary and reasonable operating expenses for the future will be considerably higher or lower than those incurred during any given past period.

The conclusion of the matter is that the *United Railways Case* will not disturb the usual routine for depreciation accounting, but that in confiscation cases, depreciation requirements can no longer be established solely with the information reflected by the books of account, but must be substantiated by special exhibits and supported by intelligent testimony for the reason that original or investment cost has been replaced in such cases with the judicial concept of "fair value."

## Proper Preparation for Admission to the Accounting Profession\*

By HERMAN C. J. PEISCH, C.P.A.

WE are inclined to believe that experiences have taught us all there is to know, and have been sinking into a complacency which, I believe, is proving fatal. This, I believe, applies to all and particularly to our profession.

We are living in the age of the business man; he is the dominating factor, and serving the business man as a profession we can well afford to study his problems in order that we may have a better understanding of what our relationships are to be to him.

Business is constantly on the move and changes rapidly from day to day. Therefore, we are forced, as business finds itself, to change in order to meet business conditions. Consequently, let such changes be done with the least amount of confusion and loss and at the same time keep pace with the progress of today.

As business looks to us for help and assistance it is my opinion that the greatest reward lies in being able to chart the path rather than determine what has happened in the past. The

program which we must consider as a profession must deal with what lies ahead in the future rather than what has transpired and taken place in the past, and in order to progress we must remember that a proper foundation and understanding of the principles of business lies not in mere cleverness, but rather in the efforts of sturdy character both as to individuals and groups; and as a result thereof, the profession itself will advance in the esteem and opinion of those it serves.

It may be worth our while to consider just what business really is and what are its ideals. I know of no better definition or no better set of ideals than those which have been laid down in the "Principles of Business Conduct," by the Chamber of Commerce of the United States, which are as follows:

"A Resolution passed at the Twelfth Annual Meeting of the Chamber of Commerce of the United States at Cleveland, Ohio, May 8, 1924.

"The function of business is to provide for the material need of mankind, and to increase the wealth of the world and the value and happiness of life. In order to perform its function it must offer a sufficient opportunity for gain to compensate individuals who assume its

\*Address delivered at the annual meeting of the American Association of University Instructors in Accounting, Washington, D. C., December 29, 1931.



risks, but the motives which lead individuals to engage in business are not to be confused with the function of business itself. When business enterprise is successfully carried on with constant and efficient endeavor to reduce the cost of production and distribution, to improve the quality of its products, and to give fair treatment to customers, capital, management, and labor, it renders public service of the highest value.

"We believe the expression of principles drawn from these fundamental truths will furnish practical guides for the conduct of business as a whole and for each individual enterprise.

#### I

"*The Foundation* of business is confidence, which springs from integrity, fair dealing, efficient service, and mutual benefit.

#### II

"*The Reward* of business for service rendered is a fair profit plus a safe reserve, commensurate with risks involved and foresight exercised.

#### III

"*Equitable Consideration* is due in business alike to capital, management, employees, and the public.

#### IV

"*Knowledge*—thorough and specific—and unceasing study of the facts and forces affecting a business enterprise are essential to a lasting individual success and to efficient service to the public.

#### V

"*Permanency* and continuity of service are basic aims of business, that knowledge gained may be fully utilized, confidence established and efficiency increased.

#### VI

"*Obligations* to itself and society prompt business unceasingly to strive toward continuity of operations, bettering conditions of employment, and increasing the efficiency and opportunities of individual employees.

#### VII

"*Contracts* and undertakings, written or oral, are to be performed in letter and in spirit. Changed conditions do not justify their cancellation without mutual consent.

#### VIII

"*Representation* of goods and services should be truthfully made and scrupulously fulfilled.

#### IX

"*Waste* in any form, of capital, labor, services, materials, or natural resources, is intolerable and constant effort will be made toward its elimination.

#### X

"*Excesses* of every nature, inflation of credit, over-expansion, over-buying, over-stimulation of sales, which create artificial conditions and produce crises and depressions are condemned.

#### XI

"*Unfair Competition*, embracing all acts characterized by bad faith, deception, fraud, or oppression, including commercial bribery, is wasteful, despicable, and a public wrong. Business will rely for its success on the excellence of its own service.

#### XII

"*Controversies* will, where possible, be adjusted by voluntary agreement or impartial arbitration.

#### XIII

"*Corporate Forms* do not absolve from or alter the moral obligations of individuals. Responsibilities will be as courageously and conscientiously discharged by those acting in representative capacities as when acting for themselves.

#### XIV

"*Lawful Co-operation* among business men and in useful business organizations in support of these principles of business conduct is commended.

#### XV

"*Business* should render restrictive legislation unnecessary through so conducting itself as to deserve and inspire public confidence."

Business is a science. It is founded upon principles. It has its laws just as have physics, chemistry, engineering and medicine. The successful business executive is an accountant, an engineer, an economist, and a psychologist all in one. He not only must know facts, he must know principles. A man can learn facts from experience, but a knowledge of principles must usually come from real study.

The accountant who serves business tomorrow must have, as part of his technical training, a thorough understanding of economics, the fundamental science upon which business rests, in order that he may be able to properly comprehend the problems of business, and through accounting interpret actions of business so that business may deal properly with such problems as are before it. In considering some of the essential problems of business today the accountant must be able to consider the following:

What determines profits? Authorities have cited that approximately fifty-five per cent of the business profits are due to changes in external conditions and but forty-five per cent result from individual effort. In brief, profits are largely determined by the application of one's knowledge of fundamental business conditions. Upward and downward trends in business cycles have brought

success and bankruptcy to business. The business man seems to be wholly unprepared for the reactions and never before was this truth so strongly emphasized as it was during the depression of 1920-1921, and the present one. To be able to meet changing conditions or rather anticipate them is one of the great problems of business today, the lack of which has been the occasion for tremendous losses. Business must not only know the trend of business, but must also be able to anticipate the resultant effect.

Stabilizing profits, scientific purchasing, management of men, and markets are all problems which the accountant must have full knowledge of to be in a position to serve business. It is not only the knowledge of business, who is doing business, and the trend of prices, but greater consideration must be given in the future to human factors in business if we are to enjoy true success.

I submit all of this, not for the purpose of building up new business for the accountant, but for the purpose of showing that the accountant, if he is to be a real factor, must be something more than a person who is able to prepare financial statements or keep the accounts of any particular business. If he is to interpret business he must know business, and to know business means that he must be a student of all phases of business. It is my opinion that technical training which will qualify an accountant to meet these requirements is insufficient if it does not consider the aims and ideals of business and of the accounting profession.

In the "Principles of Business Conduct" previously quoted, we find that the foundation is character. Character is the basis of all human action and is the most important individual factor in human relations and in the administration of business and social affairs. The following clipping from a trade journal is very timely:

"Constant betterment of our methods must go hand in hand with resolute determination to maintain the quality and standards of our goods. Mere cleverness, either in a man or in his merchandise, cannot long be successfully employed as a substitute for sturdy character. The farther away we send our goods, the greater is our obligation to stand behind them. Any other policy is foredoomed to failure."

We do not judge a man so much by his looks and appearance but by the character of his life. Measure a man by this standard rather than by the last position he has held or by his testimonial letters and not so much by his personal appear-

ances. We must not confuse character with reputation. Reputation is that which others think of you, rightly or wrongly, and a man may be better than his reputation but never better than his character. The accountant, in my opinion, should be trained in the fundamental human relations. Such training should start in the kindergarten and continue through his entire school life if he is to thoroughly understand the responsibility which will be his if he participates in the activities of the business world. The accountant can well afford to consider the following principles:

1. That confidence is the foundation of all professional relationship.

2. That confidence is built upon integrity, fair dealing, efficient service, and mutual benefit.

3. That equitable consideration in all our dealings is due alike to the public, our clients, and the members of our profession.

4. That permanency and continuity of service are essential to the establishment of sound relationships between client and accountant, since knowledge gained in serving a client should be given the opportunity for full utilization in the furthering of efficiency and confidence.

5. That we should discharge all obligations in a manner which will increase the confidence and recognition granted us by the public, discountenancing the use of ambiguous qualifications and statements that avoid fair and reasonable responsibilities which should be discharged by those acting in representative capacities as conscientiously as when acting for themselves. The form of service does not absolve from or alter our moral obligations.

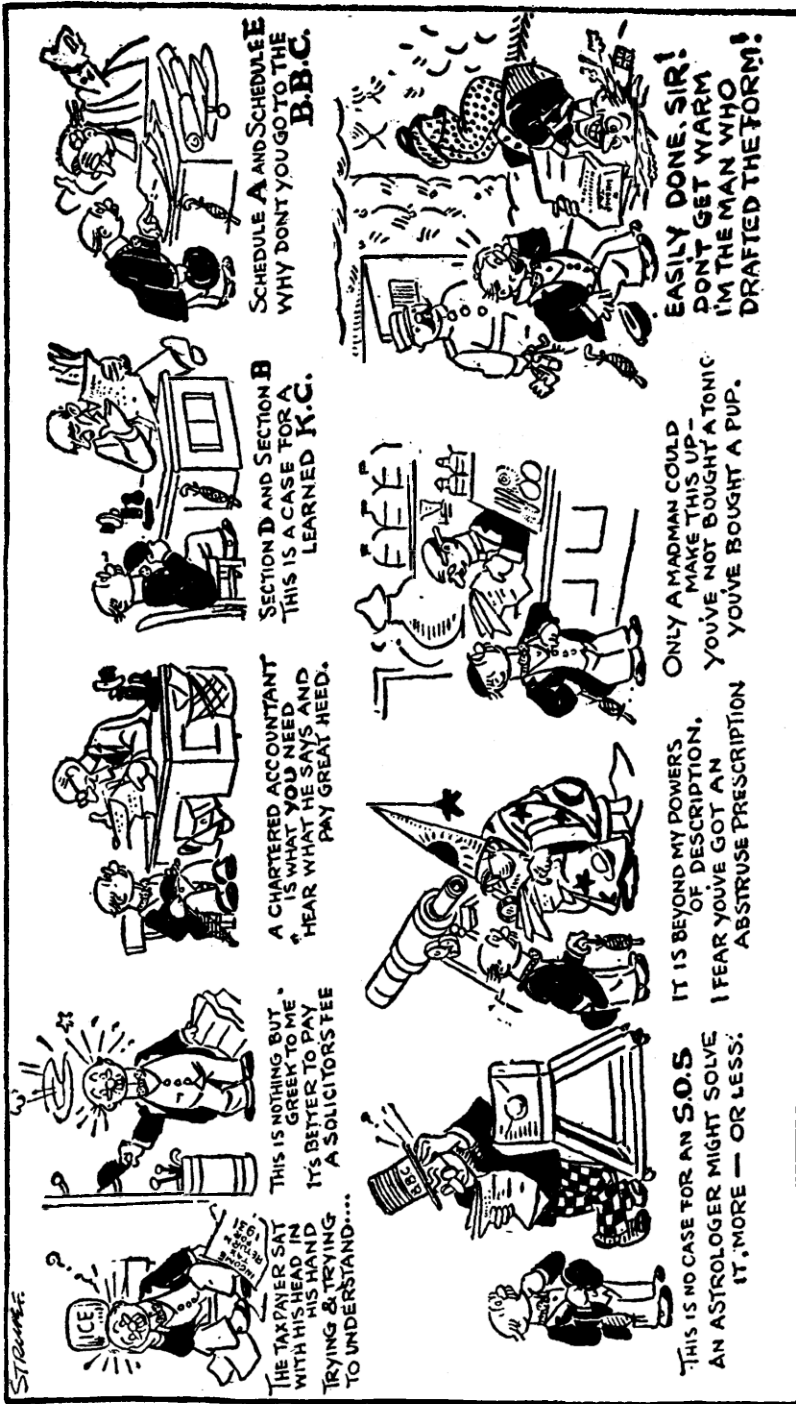
6. That, as members of a profession serving the public in a confidential manner, we must strive first to observe these principles and seek no success that is not founded upon the highest justice to all.

Then I would have the accountant an individual with determined will power. A will to do and a consciousness that he cannot live for himself alone, that he must live with and for and not off of his fellow men, and an enthusiasm for his work that will carry him on to success.

We must remember that advancement is in the man and not in the job. It is a personal quality and not a job quality. No one can give individual advancement, it has to be earned. We have to seek it; it must be won, usually by means of a change which takes place within us. The ad-

*(Continued on page 123)*

## THE BRITISH INCOME TAX RETURN



The London Daily Express pictures the struggles of an average citizen trying to work out his income tax.

The *New York Evening Post* reproduced these struggles in its issue of Saturday, April 25, 1931. Not knowing what Congress will do in the 1932 tax act we are passing it on to the Certified Public Accountants.

## Federal Legislation

Joseph J. Klein, Chairman of the Committee on Federal Legislation of The American Society, came to Washington in the early part of January and, after checking up on the situation, prepared a suggested report which was sent to each member of the Committee asking for a telegraphic endorsement in principle, or statement of objections. It appeared from the preliminary study that Congress would concern itself more largely with finding places where additional taxes could be secured than they would with reference to discussions of matters of administration and it seemed better that The Society should concentrate its efforts on a few general points rather than attempt to make suggestions as to detailed changes.

The Society was represented at the hearing before the Ways and Means Committee on Monday morning, January 25th, by Messrs. Klein, Beck and Springer. Dr. Klein made the presentation on behalf of The Society and filed a formal brief signed by the committee members who had replied.

After completing his remarks as Chairman of the Committee of The American Society, Dr. Klein submitted three personal recommendations:

1. A temporary suspension of that provision in the existing law which permits the carrying forward of a net loss so that it may reduce the taxable income of the two succeeding years.
2. A special tax on the profits resulting from short sale of securities.
3. A serious attempt should be made to collect the equivalent of a tax from speakeasy operators and other sources of income unlawful under the Federal statute.

At the conclusion of the presentation, the Ways and Means Committee invited Dr. Klein to prepare for them drafts covering his second and third suggestions.

Howard Beck, another member of the Committee, was given permission to file a supplementary personal memorandum. The points recommended by Mr. Beck were:

1. That personal exemptions be fixed at \$2,500.00 for a married person and \$1,000.00 for a single person.
2. That the twenty-five per cent credit for earned income be eliminated and in lieu thereof

the normal tax rate on the first two thousand dollars be fixed at one per cent, on the next two thousand dollars at two per cent, on the next four thousand dollars four per cent and six per cent on the remainder.

3. That the present provision allowing an exemption of \$3,000.00 on corporation incomes of not more than \$25,000.00 be eliminated and that in lieu thereof a definite exemption of an amount agreed on by the Committee be allowed on all corporations, irrespective of their incomes.

It will be noted that the Ways and Means Committee has already decided not to recommend retroactive taxes and definite announcement to that effect has been made.

### FORMAL BRIEF

*Committee on Ways and Means,  
House of Representatives.*

*Gentlemen:*

The American Society of Certified Public Accountants has a membership of 2,639. Its roster is representative of certified public accountants from every State and other governmental unit, and they serve in the neighborhood of half a million individuals, firms and corporations. The Society is the only national organization which restricts its membership to certified public accountants who have received their certificates from the several states and the District of Columbia.

The membership of The Society is in a peculiarly strategic position to know and to interpret the business sentiments and needs of the entire country. It is safe to assert that the views of the membership of The Society represent a real cross-section of the most enlightened industrial, agricultural and commercial sentiment of the country.

The Society's Committee on Federal Legislation consists of members of The Society who have specialized in federal tax procedure. The members of the Committee are familiar with the growth and development of our system of income taxation, and many of them have played important parts in the improvement of income tax procedure. The members of the Committee are aware of the serious fiscal problems con-

fronting the nation and sympathize with you in the duty and responsibility which are yours by virtue of the fact that you must originate tax legislation. The Committee does not seek to offer its views with respect to the many aspects of the tax problems with which you must wrestle, but does venture to offer certain concrete views with respect to four fundamental phases of the tax proposals now before your Committee. They are:

- (1) The question of retroactive application of increased taxes.
- (2) The question of definitely limiting the period during which increased rates are to apply.
- (3) The question of the deductibility of realized security losses.
- (4) The question of the urgent need of a definite pronouncement of tax revision conclusions.

#### *1. Retroactive Application of Increased Taxes*

Throughout the country there is clearly manifest a continued retardation of trade and commerce. This regrettable phenomenon is made evident in a variety of ways, among them, hoarding (which is probably nearer one and a half billion than the recently published estimate of one billion), declines of imports and exports, unemployment. Declining prices have not stimulated trade in basic commodities and in the security markets. Economists have observed in this phenomenon an apparent contradiction of their pronouncement that lowering of prices tends to increase volume of sales. Actually, rising prices sometimes stampede buyers into action, while falling prices frequently produce decreasing volume of sales. This has been observed to be true of the stock and commodity exchanges. Merchants and manufacturers claim that it is true of their activities, because drastic lowering of retail prices has not increased sales to nearly the extent anticipated.

Throughout 1931, those who enjoyed incomes were undoubtedly influenced by the prevailing depression atmosphere. Bank closings, business failures, decreased and passed dividends, a railroad receivership, combined to restrict the spending instinct. It is fair to assume that the larger income earners—corporate and individual—incurred obligations and made disbursements with due regard to the tax rates to which income was subject.

If, now, in 1932, by retroactive legislation, Congress should impose a heavier toll on 1931 incomes than is provided under existing laws, the business of 1931 would not be retarded or

handicapped. *But, 1932 operations would probably be adversely affected.* Mr. A or Corporation B might reasonably be expected to be more conservative than ever in the making of commitments or in spending, because of the *uncertainty* of the tax liability on current income. In fact, because of the apprehension which has already been engendered by retroactive tax threats, current business may be less active than it would otherwise be and respond more feebly to the relief measures already enacted and still under consideration by Congress. Moreover, the general interests of the nation would be best served if Congress could speedily agree to give assurance that there would be no retroactive tax legislation. In our opinion, apprehension and uncertainty are among the most potent business-disturbing factors.

It is sometimes asked, why is retroactive tax decrease less reprehensible than retroactive tax increase? The answer is simple: Unexpected good fortune cannot injure or cause ills. Surprise levies are disconcerting and induce fear; they tend to retard business undertakings; apprehension of retroactive tax increases, of unknown amount, shrivel up the impulse to venture into business transactions. And if Congress now increases the tax rates applicable to last year, why will it not next year still further raise the rates on this year's income? So fear begets fear, and palsies the impulse to embark on business ventures.

Finally, why is it less expedient now than during the period of the war, to enact retroactive tax legislation, in view of the admitted fact that the country's need for income is almost equally as great? The answer, too, is simple: During the period of the war, prosperity was with us; opportunities to profit were available; the business outlook was good. Now, we are in the depths of depression, and the outlook is gloomy. In the war days, the civilian population regarded taxes as a matter of course or as a patriotic contribution to war needs; also, after all, what difference did it make whether the government took more or less from plenty? To-day, efforts should be bent to speed up the wheels of industry and enterprise; fear of retroactive legislation is paralyzing.

#### *2. Increased Taxes Should Be Provided for a Definitely Limited Period of Time*

We appreciate the foolhardiness of attempting to prophesy future business trends. We there-

fore realize the probable need of later revision of any time limit set in the pending legislation as to the period during which there shall be applicable increases in tax rates and additional tax levies. Nevertheless, we are of the opinion that it is advisable, in the interest of business confidence, expressly to set a time limit for the prospective increases in tax rates and new levies. While such limitation may unhappily prove to be merely an idle gesture, it can obviously do no harm.

While it is true that, under the Constitution, Congress may increase tax rates just short of the point of confiscation, tax practitioners are familiar with ample confirmation of the economist's *dictum* relating to diminishing returns. If rates are made unduly high, incentive to the taking of business risks is discouraged. This is why the Treasury, from its experience, has so frequently asserted that yields may be greater from a lower tax rate than from a higher. The problem of the legislator is to find the happy (which here means the most lucrative) mean. But there is another reason, aside from the diminishing return of an unduly harsh tax burden, which must not be overlooked. Capital instinctively flees from burdens unduly harsh and *media* unconsciously hostile. If the tax rates are too greatly increased, and if there is not at least an indication that the increases are more or less temporary, foreign and more friendly jurisdictions will be sought for the habitat and operations of capital. If, therefore, your Committee can see its way clear to limit the period during which the increased rates will operate, say, to two years, the undersigned believe that the incentive for personal property to seek foreign jurisdictions will be considerably lessened.

### *3. Actually Realized Security Losses Should Continue to be Allowable Deductions*

There are those who advocate that losses resulting from the sale of securities should not be permitted to reduce gross income. We believe that the vociferousness of some of the advocates of this doctrine has misled inexperienced observers into believing, contrary to the fact, that there is quite general sentiment in favor of eliminating this deduction from our income tax system. Actually, there is no reasonable warrant for wishing to exclude from among deductions the losses resulting from the sale of securities. So-called "wash" sales should never have been permitted as deductions and are now not allow-

able deductions. But why a taxpayer, who has seen his securities drop in value and who has, very often, reluctantly disposed of them at a loss, should not be permitted to offset such loss against his reduced income from interest and dividends, salary, and profits, is incomprehensible. The suggestion is probably related to the desire to punish those who indulged in short sales. But this group, during 1931, probably profited from short operations, so that the proposal to exclude realized security losses would not reach them. If the proposal is advocated because so-called capital losses are not deemed to be losses which should be permitted as deductions, then the answer is that there is an inherent element of unfairness in now forbidding the deduction of capital losses, although capital gains have been taxed for many years and, as your Committee knows, has been a source of very considerable income to the Treasury. It may be profitable and desirable to survey the entire problem of so-called capital gains and capital losses, but we do not believe that the existing needs of emergency tax legislation will afford sufficient time for such a survey, and it is therefore recommended that no change be attempted with respect to capital gains and capital losses during the pending revision. And as to the suggestion that realized losses from the sales of securities, whether ordinary losses or so-called capital losses, shall be retroactively excluded from deductions—the proposition is unthinkable. What is said in Point 1, above, with respect to the evils of retroactive increases in taxation, applies even more forcefully to the suggestion under review.

### *4. A Speedy Enactment of Revenue Legislation is Greatly Desired*

It is evident that immediate governmental needs cannot adequately be met by taxation alone. Great reliance must continue to be placed on borrowing. Nevertheless, taxation of present sources must be increased and additional sources found. The task is one which is destined to be no more pleasurable to those who will bear the increased burdens than to those who, under the law, are charged with the responsibility of recommending tax revision. In this task no one envies your Committee. All that can be definitely prophesied is that, regardless of how inspired you may be in your determinations, no such thing as an ideal revenue measure will be hailed by the citizenship. But even more important, if possible, than the futile endeavor to create a pleasing revenue

measure, is the need to remove the apprehension in which the business community dwells while it awaits the outcome of your deliberations and the later action of Congress. If, then, the devotion of endless time cannot, in all probability, result in the production of a revenue bill which will be regarded as more perfect than one which your Committee, in cooperation with Treasury officials and other experts, can prepare in short order, we feel justified in urging as speedy a report as possible, so as to initiate the process which will result in the enactment of a bill to the end that, whether it be good or better, or bad or worse, at least the brake on business enterprise and future commitments be released at the earliest possible moment.

"If it were done when 't is done, then 't were well  
It were done quickly."

Meanwhile, we respectfully urge upon your Committee consideration of the wisdom of IMME-

DIATELY making a formal announcement—unanimous, if possible—that the Committee on Ways and Means will *not* recommend retroactive increases in tax rates or retroactive elimination of deductions for realized security losses. Such action would undoubtedly be a most constructive and helpful force.

Respectfully submitted,

COMMITTEE ON FEDERAL LEGISLATION.

Joseph J. Klein, *Chairman*, New York

Howard C. Beck, Washington, D. C.

Harold Benington, Chicago, Illinois

James J. Fox, Boston, Mass.

John S. Glenn, Nashville, Tenn.

Roy A. Janz, Minot, North Dakota

George B. Middleton, Boise, Idaho

Edward J. Stegman, Baltimore, Md.

Louis F. Tanner, Morgantown, W. Va.

Raymond H. Walker, Lincoln, Nebr.

## Sudden Setbacks

### Meeting Them Hinges on Frame of Mind Formulated in Advance

By MAURICE C. MOORE

WHAT is success?

Easy enough to answer that, you may say. In a nutshell, to pull off what you want. Carnera wants to beat the Oklahoma Hammerer—or whoever the latest victim may be. He does it, and there you are. Or Shakespeare wants to write plays. He writes some of the best ever, and that's his satisfaction. *You* want to run a store or manage for the boss; may you achieve it, whatever it is! *I* want to please you with this article, and more, to make you feel that here is a man of common sense with something to say and able to say it in a way that gets a fruitful idea over.

But of all things, I count success to be *finding out about yourself*.

Administer that K.O. to every pugilist near your weight in creation, pile up the shekels so that they have to get a shovel to dig you out from underneath—and you have failed if at the end you don't know absolutely what you are.

Self knowledge. To reach that any and every experience is worth while.

Here's a concrete case. It happened last week.

A business man I had admired for working his way through met a sudden setback. To my astonishment, it cracked him. I had imagined this type of man could stand up to such a blow easily. But he went to pieces. I not only felt sorry for him. I had a kind of shame on his behalf that he had not been able to take this lesson along with his other lessons. The reason simply was that he did not *know* himself on that side. He had not prepared himself for just this sort of contingency and visualized in advance how he would react to it. It was like a little child weeping when for the first time he got cold feet in the snow.

Of course we don't know how precisely we would act in, say, an earthquake. But we can know in advance what attitude of mind we need to have towards it. We ought to be able to tell—if we come through—what is best to be done to recover from disaster.

We ought not to be caught out and left wallowed.

It was equivalent to an earthquake, in his world, which got this man down so sensationally.

I am not judging, only trying to clear up the point about success—saying that although he had reached the top he was, unhappily, intrinsically a failure. He had not explored all that he was. There were forces in him, responding to this trouble, that came out of his depths, took him by surprise, rose up against him and ended him. Had he been able to live it down, then, at last, he would have been nearer to being his complete personality. Only part of him had got through, for there was at least one experience to which he was liable at any moment that could floor him.

Perfect realization of self I count success.

A man must be able to say it with conviction about himself; it is no criterion whatever the world thinks. We may look magnificently sufficient from outside, but what is the stage of completion within?

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## State Board News

### KANSAS

Announcement is made of the appointment of J. K. Brelsford, of Topeka, to membership on the Kansas State Board of Accountancy Examiners.

### NEW MEXICO

The present membership of the New Mexico State Board of Accountancy is as follows: President, Rodney B. Horton, Albuquerque; Secretary-Treasurer, J. B. Stephenson, Albuquerque; and Member, G. A. Douglass, Silver City.

### NEW YORK

At a meeting called by Dr. Harlan H. Horner, Assistant Commissioner of Education for the University of the State of New York, the New York State Council on Accountancy organized January 6, 1932. Colonel Robert H. Montgomery was elected Chairman, Dean John T. Madden, Secretary. The other members of the Council are S. D. Leidesdorf and Charles Hecht of New York City, and Samuel J. Lasser of Jamestown.

### PENNSYLVANIA

William F. Marsh, C.P.A., of Pittsburgh, and Henry W. August, C.P.A., of Philadelphia, have been appointed to the State Board for the Examination of Public Accountants to succeed Frank Wilbur Main and Joseph M. Pugh, resigned.

## OFFICIAL NOTICE

January 15, 1932.

By authority of Article XI of the Constitution the amendments to the Constitution and By-laws submitted to the members under date of October 29, 1931, are declared effective as of this date. In all cases more than two-thirds of the members voting thereon within a period of two months from the date of the mailing of the ballot forms voted in the affirmative. Except for one amendment less than five per cent of negative votes were cast in any ballot.

HENRY J. MILLER,  
*President.*

## Practices What He Preaches

The President of The American Society has recently had occasion to get a new stock of auditor's report covers. On the front inside, the following notice is carried:

### NOTICE

The American Society of Certified Public Accountants, the national organization of certified public accountants in the United States, classifies Accountancy Services as follows:

Detailed or Complete Audits,  
Test Audits,  
Review Audits,  
Examinations of Financial Condition,  
Reviews of Operations,  
Audits of Specific Accounts,  
Investigations,  
Tax Services,  
System Services,  
    Surveys,  
    Costs,  
Budgetary Services,  
Opinions,  
Preparation of Statements from Books  
    without Audit,  
Miscellaneous Services.

The scope of this engagement is clearly indicated in the text of the attached report, and no conclusions should be arrived at by those interested, except after full and careful reading thereof.

We assume no responsibility for this report unless it is used in its entirety.

CABALLERO and MILLER.



# Audits of California Counties<sup>\*</sup>

By WALTER K. MITCHELL, C.P.A.

WHEN I first started to work on this talk, I thought that I would discuss briefly the law relating to the subject; the contract for these audits somewhat specifically, and say something about each department of the county, as to its function and what should be done to audit its transactions. But after dictating some twenty pages of text, which would take about forty minutes to deliver, and getting no further than the letter "F" with the departments, I had to modify my original intention and cut down the subject considerably, because I was asked to limit my talk to about twenty or thirty minutes. Consequently, I thought that I would devote my time to a discussion of the following divisions of the subject:

1. The differences between county and commercial audits;
2. A very brief explanation of some legal matters;
3. The form of the contract for the audit and with whom it should be made;
4. And also give you some information about five of the most important departments of the county.

## DIFFERENCES BETWEEN COUNTY AND COMMERCIAL AUDITS

The duties of an auditor engaged in county work have a two-fold aspect. He must, of course, see that all items of revenue that should have been received, have actually been received, that all receipts have been properly deposited in the county or State treasuries, and that all disbursements have been for legitimate purposes, just as he would attend to these things in the audit of a private business.

Beside this, the auditor must see that the transactions have been according to law.

The law creates these subdivisions of the State and they have only the powers granted to them. They may not do all things not prohibited, as an individual may. They can do only the things the law says they may, and can spend public funds for only authorized purposes, and these expenditures must be made in accordance with

the procedure prescribed. The law provides for the collection of certain sums, and they, and no others should be collected. Also, these funds must be collected in the manner prescribed by law.

The legal angle of the audit is what makes it most difficult for the average practicing accountant. This side of the work is so involved, so beset with pitfalls, and at the same time so vitally important that no accountant should ever undertake an audit of this character until he has trained himself to master the situation, or unless he engages some one to assist him who is qualified to handle this phase of the work. I do not, of course, intend to infer that you men who have made county audits have not done this.

## EXPLANATION OF THE LAW

At this point, it might be well to make a few statements about the California law, where and how it may be found, etc.

The supreme law of this State relating to county fiscal matters is found in the California Constitution. Should there ever be a conflict between a revision of the State constitution and the Constitution of the United States or any treaty made by the Federal government, the latter would prevail, but it is not likely that you will ever be required to look beyond the first named instrument. The legislature, which is created by the constitution, has enacted many laws and adopted the codes to be named hereinafter, for the purpose of carrying out the duty imposed upon it by the constitution, and to provide orderly and regular means for conducting the public business.

When a law is first enacted, it is printed in a volume called the "Statutes," followed by the name of the year in which the law was enacted, these statutes also contain the initiative measures adopted by the people. After laws are reported in the statutes, they are classified into the codes and general laws. We have in California four codes, subdivided into sections, and in addition, a large number of laws relating to various and sundry matters which are classified as general laws.

At least two publishers have classified the gen-

<sup>\*</sup>A paper read before the Los Angeles Chapter of the California State Society of Certified Public Accountants.

eral laws (which laws are also known as Acts), and have assigned numbers to the various ones. These numbers have no legal significance, so consequently, the legislature does not amend the general laws or create a new act under a certain number of the general laws, but refers to such acts by title. But when a change is made in one of the codes, the change as made under the section number and name of the code.

The four codes are as follows:

"Code of Civil Procedure," which contains laws relating to civil actions and special proceedings in the courts;

"Civil Code," which contains laws of contract, marriage, corporations, and other civil matters;

"Penal Code," containing the criminal laws as well as the rules relating to criminal procedure; and

"Political Code," containing laws relating to the State, counties, cities, schools, and special districts.

In addition to searching the indexes of the codes and general laws, it is often necessary to make a further search to find a law relating to a particular matter, or to a decision of one of the courts interpreting a law. A knowledge of places to search for the information needed is of considerable value to an auditor in making an audit of a county, because there are many conflicts in the codes, general laws, and constitution, and it becomes necessary quite often to find the governing rule.

There is a publication called *Digest*, in which decisions by the California Supreme Court and the District Court of Appeals are digested by subjects, reference being made to the reports of the two courts for a full report of the cases digested.

There is another publication called *Citator*, which cites court decisions under codes by sections; statutes, by year and page; the constitution by sections; and other court decisions by volume and page. The statutes, as I previously stated, except those affecting the codes, are arranged in the volumes of general laws, and there is shown in the latter the unofficial act numbers, the full titles of the acts, and the references to the volumes and pages of the statutes where they may be found. If you should desire to know whether or not the courts had interpreted, say Section 4076 of the Political Code, you could turn to the Political Code section of the *Citator*, find section 4076 in heavy black type, and underneath it, the volume and page number of all the court

decisions relating to that section would be listed.

The decisions by the California Supreme Court are published and bound in book form, and are referred to by volume number, name of court, and page number. The abbreviated form commonly used is something like this—67 Cal. 531; meaning Volume 67 of the Reports of the California Supreme Court, Page 531.

Prior to the time that these decisions are bound, they are published in pamphlet form and are known as California Decisions.

The reports of the District Court of Appeals are published in the same manner, the bound volumes being referred to as "Cal. App." and the pamphlets as "Cal. App. Decisions."

Counties are subdivisions of the State, and their officers perform both State and local functions. Counties are governed by either general laws, or by special charters which the constitution authorizes counties to adopt, if they so desire. In enacting laws for counties generally, the legislature divides the counties into classes and provides that in counties of the blank class there shall be certain officers whose salaries shall be the amount named, etc., etc. There are fifty-eight classes of California counties, and so far as I know, there is only one county in each class. Counties operating under these general laws do not have the freedom that the charter counties have, because of the fact that the legislature meets only once every two years, while boards of supervisors meet weekly or monthly, and these boards which govern the charter counties may enact ordinances and adopt resolutions to accomplish results without any great loss of time.

#### THE CONTRACT FOR COUNTY AUDITS

If an accountant is requested to conduct an audit of a California county, the request will come from either

1. The Grand Jury, or
2. The Board of Supervisors.

The Board of Supervisors have power to engage auditors to audit the accounts of the county, but the law does not make it their duty to do so. Their powers are much broader than those possessed by the Grand Jury, and they may engage a firm of auditors for either a flat sum or upon a per diem basis.

On the other hand, the law makes it the express duty of the Grand Jury to either conduct an audit itself, or to engage an expert for that purpose. Section 928 of the Penal Code relating to audits by grand juries, provides specifically

that, if in the judgment of the Grand Jury the services of an expert are necessary, they shall have power to employ one and fix his compensation and if they deem that the services of assistants to such experts are required, they shall have power to employ such assistants and fix their compensation. It should be carefully noted that the power to engage assistants is limited to the Grand Jury, and that that body does not have the right to engage an auditor and permit the auditor to engage his assistants at the expense of the county. However, it might be legal for the Grand Jury to employ the expert and the expert in turn engage assistants to be paid out of his own compensation. While this might be permissible, it undoubtedly was the intention of the legislature that the Grand Jury itself employ the auditor and also employ the assistants and fix the compensation of each.

It has happened that some accountants have permitted the Grand Jury to engage their employees as assistants, and when the payments for their services were made to these assistants, the checks would be turned over to the principal auditor. This procedure undoubtedly is unlawful, and possibly violates other laws which make it a crime for an employer to take any part of the compensation of an employee engaged in public work.

By reason of the fact that the grand juries must provide for an audit of the accounts of the county each year, in about half of the counties of the State, boards of supervisors do not arrange for an audit; but whenever you are asked by a grand jury to make an audit of a county, it might be well to consider the advisability of having the Board of Supervisors let the contract for the work and arrange for the compensation. The contract, of course, could provide that the work would be done under the direction of the Grand Jury, that the reports would be filed with it, and copies filed with the Board of Supervisors.

#### AUDIT OF DEPARTMENTS

The work of conducting a county audit tends to naturally divide itself into divisions conforming to the departments of the county, but as I stated previously, there is not sufficient time to cover all of the departments, so none but the five most important ones from a financial viewpoint will be mentioned. These five are:

- The Board of Supervisors
- The County Auditor
- The Tax Assessor

- The Tax Collector, and
- The Treasurer.

I have not yet corrected my index of county laws to take up the 1931 enactments and amendments, on account of it being used in connection with some work for the last fiscal year, so what I have to say in this talk about the law has reference to it as it stood at the beginning of the year 1931. However, I know of no radical change that was made by the Legislature in the spring of this year which would have a material bearing on the matter we are discussing.

One of the most important departments of the county is:

*Board of Supervisors.* This body corresponds to the board of directors of a corporation, and its members when acting as committeemen correspond to the managing officers of a corporation. It is charged with the duty of raising sufficient revenue to carry out the functions of the county government and to authorize expenditures made in accomplishing that purpose. It levies taxes, authorizes and sells bond issues, sells county property not needed, lets contracts, awards franchises, and makes collections of revenues flowing from them.

Most of the expenditures of the county must be made on claims or demands or vouchers filed therefor, and allowed formally by the Board, before warrants are drawn by the county auditor in payment. Certain disbursements of the county, however, namely, those fixed by law, such as for salaries, the payment of bond coupons and the redemption of bonds, are paid by warrants of the county auditor without any action on the part of the Board of Supervisors. Other county charges are also payable by the county auditor on court orders without the approval of this Board.

There should be kept in this office, receipt forms in duplicate or triplicate, a cash book, and a record of certified checks deposited with bids. The auditor should see that all payments due the county under franchises have been collected and that all amounts received as shown by the records have been deposited in the county treasury. The minutes should be read and notations made of all important matters affecting the finances of the county. The auditor should determine whether or not contracts are being let in accordance with the requirements of law.

With respect to the latter, the duties of the Board differ in counties having purchasing agents and in those counties not engaging those agents. Certain items may be purchased under one set

of conditions and other items under other conditions, so it is necessary to carefully review sections 4041.13, 4041.18, and 4048 of the Political Code, as well as the other sections of this code and of the General Laws relating to special district matters.

*Auditor.* This officer is the comptroller and bookkeeper for the county. He keeps a record of the various funds of the county and of the special districts under the jurisdiction of the Board of Supervisors, as well as of the school and trust funds. In the larger counties such as Los Angeles, an elaborate system of general ledger accounts is maintained in addition to the fundamental fund record of receipts and disbursements. In this county the general ledger is divided into three subdivisions: namely, county, school and trust. The county and school divisions are subdivided into General or operating, and Capital, and for each of these four divisions, namely, Capital County, General County, Capital School and General School, there is maintained a group of general ledger accounts which is self-balancing and which is known as funding accounts.

The ordinary asset, liability, revenue, and expense accounts are referred to as proprietary accounts. The funding accounts contain information and facts relating to revenue and fund requirements, appropriable revenue and funds, appropriations, available funds, collectible funds, appropriation encumbrances, and reserves for outstanding orders and contracts.

The following is a brief summary of the entries made in the general county funding and proprietary accounts:

1. When the budget is adopted, Estimated Revenue Requirements is debited and Appropriable Revenue is credited.

2. When appropriations are authorized by the Board of Supervisors, Appropriable Revenue is debited and Appropriations credited.

3. When purchase orders are issued or contracts let, Appropriation Encumbrances is debited and Reserve for Orders credited.

All of the entries just mentioned are made in the funding account group.

4. When taxes are levied, Collectible Funds is debited and Estimated Revenue Requirements credited, in the funding group. At the same time, there is made in the proprietary group an entry charging Taxes Receivable and crediting Revenue.

5. When taxes are collected, in the funding group, Available Funds are debited and Collectible Funds credited. At the same time in the proprietary accounts the Treasurer is debited and Taxes Receivable credited.

6. When a voucher is prepared, in the funding group, Appropriations is debited and Available Funds credited. This entry is made so that the Available Funds account will show the amount of money that will be on hand when all authorized liabilities have been paid. At the time this entry is made, the entry previously described accounting the purchase order or contract is reversed by debiting Reserve for Orders and crediting Appropriation Encumbrances. The corresponding entries in the proprietary accounts debits Expenses (if it is for an expense item), and credits Vouchers Payable.

7. When the voucher is covered by a warrant, no entry is made in the funding group of accounts as the Available Funds and Appropriations have already been reduced, but in the proprietary section, Vouchers Payable is debited and the Treasurer credited.

If the expenditure used as an illustration was for the purchase of a capital asset payable from current revenue, in the proprietary section of the ledger, an account termed Contributions to Capital Account would be debited, and in the proprietary capital section, Fixed Property and Equipment would be debited, and Contributions from General Account credited.

There are a great many other entries that have to be made, and a considerable amount of skill is required to keep the numerous sections of the ledger in balance, and the corresponding funding and proprietary accounts in reconciliation. The entries recited, however, will give you an idea as to how these accounts are operated. The primary reason for keeping the accounts separated into general and capital is to take out of the Current Surplus Account that part of it which has been invested in property and equipment and is no longer useable.

Section 18, Article 11 of the State Constitution makes it unlawful for counties to incur in any one year liabilities in excess of the revenues provided (except by vote of the people), and that makes it necessary from a legal point of view to maintain appropriation accounts so that the revenues will not be overexpended.

No expenditure is authorized by the Board of Supervisors unless it is informed by the county auditor in regular course that there is a sufficient

balance in the particular appropriation account to cover the contemplated expenditure. It is the practice of the county auditor to certify on the purchase orders issued the amount remaining in the appropriation to be charged, after the expenditure in question is made. If the contemplated purchase exceeds the amount of the balance in the appropriation account to be charged, it is not made.

In the smaller counties, these elaborate records will not be found, and many of them keep hardly anything more than a record of receipts and disbursements.

The auditor of this county also keeps an elaborate record of bond issues, of trust deposits, of fixed property and equipment owned, and of delinquent taxes. The records of this type in other counties with which I am familiar are not nearly so complete, and in some of the other counties some of these records are not maintained at all.

The county auditor is charged by law with the duty of maintaining the records of delinquent taxes and of preparing certificates of redemption when property is redeemed from tax sales. He is also required to apportion the moneys thus collected to the correct funds. There have been a great number of amendments to Section 3817 of the Political Code covering the penalties and interest which must be collected when property sold to the State is redeemed, and these amendments must be considered in connection with a decision by the supreme court to the effect that the legislature did not have power to increase the burden of redemption, but that in those cases where the penalties and interest charges were increased, the law in effect at the time of the sale of the property would govern the amounts to be paid upon its redemption. However, if the amendment to the code section reduces the burden of redemption, then those amendments are retroactive in their effect.

I spent a considerable amount of time in compiling a schedule of amounts to be paid on redemption, and found that the requirements differ in the following periods:

For years prior to 1894

1894 and 1895

1896 to 1899

1900 to 1931.

In making county audits, it must always be kept in mind that there are changes in the laws every two years, and this increases the work of the auditor considerably. He may make a study

of these matters one year, but will not be able to use his information more than two years without making a further study of all the amendments to the old laws, and of the new ones enacted.

A very careful reading of the laws relating to redemptions is necessary, because some of them are different from what one would ordinarily expect them to be. For example, the ten per cent and five per cent penalties and the advertising costs shown on the tax roll for a second year of delinquency are not collectible at the time of redemption. The auditor is required, by reason of the fact that they are not mentioned, to ignore these amounts when the certificate of redemption is prepared.

The laws relating to the apportionment of delinquent taxes and of the redemption penalties are not clear, so you will find different methods in use in the different counties.

Some years ago I made a special study of this subject, and with the aid of the attorney general, county counsel of this county, and its district attorney, concluded that the following general rules should be followed.

Delinquent taxes collected should be apportioned to the funds for which they were levied. Redemption penalties should follow the tax apportionments. Interest collected on delinquencies should also follow the taxes. The delinquent penalties, except those collected for other governmental bodies but including special districts such as roads and schools, all go to the general fund of the county. The fifty-cent advertising cost should be apportioned to the county salary fund in all cases.

When property is sold to the public after it has been deeded to the State, the amount should be apportioned according to the rules just stated unless it is sold at a discount, in which event the total amount received, except the cost of the sale, is apportioned on the basis of the tax rates. Sales of property for delinquent taxes to the public before the property is deeded to the State is apportioned on the same basis. The apportionment of these latter two items has nothing to do with the redemptions from tax sales, but are mentioned along with the apportionment of redemption moneys for convenience.

The actual payment of moneys on redemptions should be made to the county treasurer, but inasmuch as the county auditor is required to prepare the certificates of redemption, and keeps the delinquent tax rolls, the receipts of money from

this source are usually audited in connection with the office of the auditor.

The county assessor is charged with the duty of collecting taxes on personal property and on certain real property where, in his judgment, the taxpayer does not own real estate of sufficient value to secure the payment of the taxes. The county auditor is required to furnish to the assessor for this purpose, the receipt books the assessor must use, and later require the assessor to account for them. Under a fairly recent amendment to the constitution, the assessor collects taxes on personal property at the tax rates of the previous year, and no further adjustment of these collections is required. When he collects taxes on real property, such as improvements on exempt land, he uses the rates of the previous year, but when the Board of Supervisors fixes the rates for the current year, if they are less than those used by the assessor, the county auditor must compute the excess collections, which excesses are refundable to the taxpayer. If the new tax rates are higher than those used by the assessor, the auditor computes the deficiencies and these latter must be collected by the tax collector.

The auditor must audit the accounts of the assessor within fifteen days after the first Monday of August, and it is customary for the outside auditor to use the work of the county auditor in auditing the accounts of the assessor.

On November 8, 1910, the people of California adopted an amendment to the constitution, usually referred to by county officers and employees as Amendment No. 1, which provided for the division of the property in the State of California into two parts, one called Operative and the other, Non-Operative. Generally, the operative property consists of railroads, telephone and telegraph companies, sleeping car and express companies, along with banks, insurance, and public utility companies. The State took over the taxing of these operative companies for State purposes, while the non-operative properties were left for the county to tax.

At the time of this separation, there were numerous bond issues outstanding, so it was provided that all properties, both operative and non-operative, would continue to be subject to taxation to redeem these bonds and pay the interest on them. To accomplish this, the law provides that a separate tax roll shall be made up by the assessor for the operative properties, that the Board of Supervisors shall fix separate tax

rates for these properties, that the county auditor shall extend the taxes on the operative rolls, and make a claim against the State for them. In many of the counties the prescribed procedure relating to the operative roll is not followed.

When truck and bus lines were withdrawn from local taxation as of October 1, 1925, the law for the same reason set up the same procedure to be followed by county officers in collecting taxes on these properties to pay their share of bonds outstanding at that time and of the interest on those bonds.

With respect to the regular tax rolls, it is the duty of the county auditor to extend the taxes on the rolls and to charge the tax collector with the amount of them. He is also required to charge the tax collector with the ten per cent delinquent penalty accruing in December on the first installment of real estate taxes and of all the personal property taxes.

The five per cent accruing in April on delinquent first and second installments is, in this county, added to the rolls and charged to the tax collector, although the law does not make it the duty of the county auditor to do so. He also charges in the same way the fifty-cent advertising cost, although the law does not make this his duty. However, these amounts must be taken into consideration by the auditor in settling with the tax collector, so it is proper of course, that he should charge them to the tax collector along with the other items mentioned. In one other county with which I am familiar, the auditor does not charge these later amounts to the tax collector, and his failure to do so makes the audit of the tax collector's accounts more difficult.

On May 10th the tax collector must attend at the office of the auditor with the tax rolls, on which there must be noted all taxes collected. He must also present to the auditor a delinquent roll which the tax collector has prepared, and which contains all the items on the original rolls not marked paid. At this time, the auditor must have a settlement with the tax collector. Thereafter, the tax collector is charged with the amount of the delinquent roll by the auditor, and the former collects taxes on that roll until his final settlement, which the law requires the tax collector to make with the auditor on or before the last day of June. In making this settlement, the auditor credits the tax collector with the moneys he has paid into the treasury and with the amount of the delinquent taxes uncollected.

The law provides that property, when the

taxes on it are not paid, is automatically sold to the State, and that it must be thereafter assessed for five years, but there is no further sale to the State if taxes of subsequent years are not paid. At the end of these five years it may be sold at public auction for the taxes, and if it is not so sold it is deeded to the State. Thereafter it is not assessed. Any time after deed to the State, if the State has not disposed of the property, it may be redeemed by the former owner.

In auditing the accounts of the tax collector, it is customary to make use of the work the law requires the auditor to do, and check the accounts in total as much as possible, and not the individual amounts received. This is not an ideal way to audit these accounts, but it is the most practical one.

If taxes are paid and not so marked on the roll, the law prescribes the following scheme for bringing this to the attention of the taxpayer. The auditor is required to notify the assessor of sales to the State and of redemptions from these sales. The assessor is required to show the fact of sale on the tax roll for the following and subsequent years for each piece of property sold, and the tax collector is required to show the same information on the tax bills covering this property. The kind of check usually made tends to show that the tax collector has accounted for what he has been charged with, either in money or delinquent taxes in total, but it does not show whether the tax collector has collected and retained more money than appears upon the tax rolls.

All moneys paid into the county treasury must be on a deposit permit prepared by the county auditor, and the preparation of these permits gives him a control over the cash received by the treasurer and furnishes information as to the amounts deposited by the various county officers.

In auditing the disbursements, the usual procedure is followed with respect to determining the sufficiency of the vouchers and the propriety of the expenditure, but in order to perform a satisfactory audit the auditor should also be qualified to pass upon the legality of the expenditures and to determine whether or not they have been made from the correct funds. There is no authority to pay money from the county treasurer except for purposes authorized by law, and in many cases of expenditure, the rule expressed by the supreme court in an early case, that "the mode prescribed measures the power" is applicable.

After some thought, it seemed best not to attempt to recite the usual purposes for which public funds may be expended, nor name the funds from which they should be paid, but an auditor should become familiar with these matters before he attempts a county audit.

Sections 4075 and 4076 of the Political Code govern the form of claim that must be used for the payment of public funds, and there have been so many changes and additions to the latter section that it is almost impossible to determine at the present time just what is required.

In connection with Section 4075, it might be interesting to mention a decision by the District Court of Appeals concerning it. The first part of the section provides that the Board of Supervisors must not hear or consider any claim, nor allow the same, unless it is itemized, giving names, dates, particular service rendered, character of work done, and number of days engaged, etc., etc. The latter part of the section goes on to say—if in case of any claim which requires itemizing the board does not consider the same because it was not itemized, they shall notify the claimant and give him time to have the claim itemized. By reason of this latter provision, the district court held that the first part of this section was directory and not mandatory, and therefore the board may allow a claim which is not itemized.

There is no right at common law for counties to refund amounts paid to them in error, but we have in this State some statutes on the subject, which statutes must be followed and whose terms must be met before any refunds may be legally made.

Some of the principal county officers—those collecting fees, the justices of the peace, the judges of the superior courts, and the court reporters—are required to file certain affidavits with the auditor before he can legally pay their compensations, and an outside auditor should see that those affidavits are filed.

It is unlawful to attach the wages of a public officer or employee, but the law provides that transcripts of judgment against these people may be filed with the county auditor, and for such filing he must collect a fee of fifty cents. The public auditor should see that these fees are collected and paid into the county treasury.

The fund ledger of the auditor should be reconciled with a similar record maintained by the county treasurer and with such a record con-

taining school funds maintained by the county superintendent of schools.

There is considerably more that should be said about this office, but I do not wish to tire you with too many details.

*Treasurer.* This officer has custody of all the county, school, trust and special district funds. As a departmental officer, distinguished from his duties as treasurer of the whole county, he is required to collect inheritance taxes for the State, certain payments on State lands, and some other miscellaneous items. He should maintain a fund account with each of the funds, and disburse moneys only on warrants issued by the county auditor, except when settling with the State. Paid warrants are returned to the county auditor and filed by him.

The treasurer is required to make a settlement with the State twice a year, and for that purpose the auditor prepares statements on forms furnished by the State, showing the amounts due the State for tax redemptions, sales of property for delinquent taxes before deed to the State and after deed to the State, the amounts due Whittier, Preston, and other State schools for county charges in them, and the net amount of inheritance taxes due the State. This statement should also show the amounts due the county for the State's proportion of the refund of erroneously collected taxes, etc., and any other amounts that might be due to the county or due to the State.

The funds in the hands of the treasurer may be deposited in banks under certain rigid restrictions, and a careful reading of the law relating to that matter should be made by the auditor. There are two sections in the constitution pertaining to it, and one act in the General Laws. To me they seem to be somewhat in conflict, and I am now trying to get the matter clarified by the Legislative Counsel Bureau at Sacramento. I have received some assistance from a district attorney and from a county counsel, but the opinions rendered by these two officers are in conflict.

*Assessor.* As previously stated, this officer collects taxes on unsecured personal and real property, using receipts furnished him by the county auditor. He is also required to prepare the tax rolls. He should keep a record of every piece of property in his county, arranged so that the assessments for the various years will appear in perpendicular columns. By maintaining this record, he can prepare his tax rolls from it, and thus

determine that every piece of property in the county subject to taxation has been assessed.

This concludes the paper I prepared to fill up the time allotted me. I thank you very much for your kind attention.

#### SUPPLEMENTAL

(After the foregoing was presented, a request was made that the other departments of the county be covered so that this paper in somewhat complete form might be published for the use of the membership interested in this matter. In compliance with this request, the following has been prepared.)

It should be kept in mind that an attempt has been made to make this paper interesting, and not fill it with so many details of the work that must be done that it would have the opposite effect and tire the reader.

*Apiary or Bee Inspector.* This employee may from time to time sell property, the proceeds from which sales should be deposited in the county treasury.

*Cemetery.* Sometimes fees are charged for the right to make disinterments, and when these fees are required to be collected, the auditor should see that they are properly deposited in the treasury.

*County Clerk, who is also Clerk of the Superior Court and Clerk of the Board of Supervisors.* This officer collects fees and fines, forfeitures, and trust funds consisting of tenders, cash bonds, payments for jury fees, etc. Most of the fees he collects are provided for in the Political Code. He keeps the minutes of the court, and the Registers of Actions, which correspond in a general way to an accounting journal and ledger, respectively. An examination of the register of civil and probate cases will indicate the fees that should have been collected by this officer, and an examination of the register of criminal actions will furnish information concerning the fines and forfeitures which should have been collected. However, it is possible that actions may be taken affecting the public finances and recorded in the minutes, but through error or otherwise, not posted to the registers of actions.

Most of the fees collected by this officer should be deposited in the salary fund, but Section 4190 authorizes an additional fee of \$1.00 in certain cases which must be deposited in the Law Library Fund. The laws relating to fines and into what funds they shall be deposited are too num-



erous to mention in detail. Most of the fines go to the General Fund of the county, some to the State, some partly to the State and partly to the county. Some go into other funds of the county. There is a lack of instruction in some of the laws relating to forfeitures. In the absence of special mention of a forfeiture in a law directing that a fine be deposited in a fund other than the general, it might mean that the forfeiture should follow the fine, or that it should be deposited in the general fund, after of course it has remained in trust for the required length of time.

Section 1305 of the Penal Code as amended in 1927 implies, when read in connection with Section 1306 of that code as amended in 1929, that cash bail bonds ordered forfeited should remain in the trust fund for ninety days before they are transferred to the funds of the county or city, or in certain cases to the State.

Section 1306 provides that when a bail bond is ordered forfeited and is collected, the amount received shall be paid into a bail bond trust fund in the treasury of such city or county, properly designated with the title and number of the criminal action out of which it arose. That if at any time within a year after the entry of judgment of forfeiture, the defendant is returned into custody and is subsequently convicted of the highest offense charged in the complaint, information, or indictment, the principal amount of the judgment of forfeiture, less all charges resulting from the capture and return of the defendant shall be paid in the same manner as are other payments to such surety, provided the latter file with the application for refund an affidavit that the absence of the defendant was not with his connivance.

The section further provides that if the defendant is not so returned within one year after the entry of the judgment, the amount thereof shall be deposited in the general fund of the city or county, and all liability for the return thereof shall terminate.

It is presumed that if the bond was put up in an action which required fines and forfeitures to be paid to the State, that upon transfer from the trust fund, the amounts would go to the State and not to the general fund of the city or county.

This officer should maintain a record of all trust moneys received, deposited in the treasury, and ordered refunded.

While it is not generally known, jurors in civil cases are paid by the county under certain circumstances. Act 2498 of Deering General Laws

covers this matter, and imposes some duties on the County Clerk with respect to the records and reports that have to be made in connection with it.

When defendants are out on bail and fail to appear, the public auditor should see that the bail is ordered forfeited, and if it is a bond, that it is subsequently collected, and finally that the moneys are deposited in the treasury. As a rule, the court proceedings are not checked as thoroughly as other parts of the county records, and for that very reason special attention should be given to them.

The auditor should see that the official bonds required by law to be filed with the county clerk are actually on file, and that the inventories which the county officers must file are also in his office. The clerk's bond must be filed with the county treasurer. The auditor should see that the fees in naturalization proceedings are properly handled.

*Coroner.* This officer should keep a record of each case handled by him, and a cash book for recording the various sums found on the bodies of deceased persons, sales of property of deceased persons, sales of transcripts, and fees he receives when acting as sheriff or county clerk.

*Constables.* Constables act as peace officers, assist the sheriff, attend courts of the justices of the peace, and serve papers in civil cases.

You will find a number of different methods used to compensate constables for their services, and a careful examination should be made of the section of the Political Code relating to the salaries of the officers of the particular county being audited, and of Section 4300-D of the same code. Special attention should be given to their mileage charges. These officers should maintain a fee book for showing the fees they have collected, and in which there should also be entered the trust funds received. They should maintain a docket or register of actions showing the services they have performed.

*County Counsel.* In Los Angeles County, the office of county counsel has been created to handle civil law matters for the county, which matters in the counties governed by general laws are under the direction of the district attorney. This officer prepares contracts, approves claims as being legal charges against the county funds, forecloses under liens filed by the horticultural commissioner, performs legal services for the public administrator for which a charge is made against the estates, collects judgments, and collects other sundry items.

The principal thing to be done by the auditor in this particular office is to see that suits filed have been properly prosecuted and that all amounts collected have been paid into the county treasury.

*County Farm.* This institution is sometimes referred to as the "poor farm." On it live certain classes of indigents at the expense of the county, and generally, there is in fact a farm in operation on which crops are grown, and sometimes live stock raised.

The source of cash receipts consists of sales of the products of the farm, of meals occasionally, payments made by what are termed "pay inmates," and miscellaneous items, refunds, etc. Certain formalities are required for the sale of county property, and the auditor should see that those requirements are observed. They are found in the Political Code at Section 4041.21.

*District Attorney.* This officer has the privilege of using a secret service fund and collects refunds of traveling expenses advanced in criminal cases. The secret service fund should be audited in connection with the section of the Political Code authorizing it.

It is the duty of the district attorney to represent the county in all legal matters except where there is a special office created for the handling of civil matters. Nearly all amounts necessary to expend in this connection constitute legal charges against the county. The district attorney has very broad powers in this respect.

The State pays the cost of deporting aliens and non-resident public charges, and also pays for the cost of extraditing fugitives from justice when they are returned and tried. The district attorney should attend to these latter matters, and when advances have been made by the county to public officers for the purpose of returning fugitives, see that the proper expense accounts are filed and that the fugitives are properly tried.

*Forester.* This officer sometimes receives money from the United States for fighting forest fires and sometimes from individuals for the same service. Amounts are also received for building fire breaks and for other services.

*Free Library* collects small fines for overdue and lost books, sells waste paper, discarded books, etc., and has other minor receipts.

*Health Officer* in some counties serves the county hospital, but in Los Angeles County there are numerous physicians especially employed for that purpose. Sometimes this officer collects registration fees for the county clerk, fees for dairy

and slaughter house permits, and other miscellaneous items.

*Horticultural Commissioner* performs services for the horticultural interests of the county, for which charges are made in some cases, and if these charges are not paid they are converted into liens against the property on which the work is done. In some of the counties he also sells poison and poison grain.

*Hospital.* In the large counties the hospital is an institution of considerable size and collects and expends enormous sums of money. In some of these hospitals elaborate accounting systems are maintained. In the smaller counties, however, the records are not so complete. The principal source of income is from pay patients. Many patients dying in these institutions leave items of personal property which should be properly accounted for.

*Jail.* The jail is under the jurisdiction of the sheriff, and the auditor will have occasion to examine the register of prisoners many times in connection with his audit of the courts, in checking the alternative sentences rendered by the judges. In those cases where a defendant is given the right to pay a fine or serve time in jail, the auditor should see that the prisoner was actually in jail if the cash book of the clerk of the court does not show the receipt of the fine. It often happens that sentences are partially served and the balances satisfied by payment of fines at the jail, and sometimes cash bail is deposited with the jailer. Stores are often maintained to supply the prisoners with tobacco and other articles.

*Janitor.* This employee usually has receipts from slot machines, as well as other miscellaneous items.

*Judges* have power to order the payment of certain expenses of the county, and the auditor should be familiar with the laws governing these matters. He should also be informed of the laws relating to the payment of jury and witness fees, as some of these rules are irregular. This also applies to the fees of court reporters.

*Justices of the Peace.* In the smaller courts each justice should maintain a register of actions or a docket, and a fee book designated so that fines and trust funds may also be recorded in that book. The auditor should see that all fees for services in civil cases are recorded in the fee book, and that all fines and forfeitures are also entered in that book.

In the larger justice courts, more complete records are maintained, and you may find in

some of these courts a complicated system of accounting to take care of cash paid in prior to the time that any service is rendered, which payments are treated as trust funds on deposit, and from which amounts are transferred to the salary fund as services are performed. The law provides that services shall not be performed until the fees therefor are paid, and it often happens in civil cases that the amounts of fees to be paid are unknown at the time of the filing of the first papers, so the attorneys deposit enough money to take care of all the charges that are likely to be incurred.

Sometimes complete records are kept of forfeitures which, as has been explained, must be held in trust for a certain length of time before they may be claimed as county funds.

*Juvenile Hall.* This institution is something like the county farm, and has receipts from the sale of things made and grown.

*Law Library.* The principal source of revenue for this department comes from the \$1.00 fee mentioned in connection with the office of the county clerk. In addition to that fee, some of the libraries charge membership dues.

*License Collector.* The laws relating to licenses are somewhat antiquated and generally are not followed by the license collector or the county auditor. It is the duty of the latter officer to seal and sign the license forms used and deliver them to the license collector from time to time.

Section 3358 of the Political Code states that the auditor must keep in his office the stumps of all licenses by him delivered to the tax collector, (who is the license collector). It further provides that a correct statement of the collector's license account must be certified to the county treasurer each month by the county auditor.

Section 3363 of the Political Code provides that on the first Monday of each month the collector must return to the auditor all licenses unsold, and with the auditor, appear at the treasurer's office and pay into the county treasury all moneys collected for licenses.

*Mechanical Department.* This department has charge of the county's automobiles and should keep a record of the cost of operating and maintaining each one, and see that these costs are charged to the departments using them. In this particular county the Mechanical Department also operates some water districts, and has receipts from consumers just as a private water company would have.

*Museum of History, Science and Art.* Small

amounts are received by this institution from the sale of catalogs and pamphlets, subscriptions to bulletins, commissions on the sale of exhibits, etc., etc.

*Olive View Sanitarium.* Olive View Sanitarium is the name of a Los Angeles institution, but other counties may have similar departments. The sources of cash receipts are about the same as they are at the county farm and hospital.

*Otis Art Institute.* As the name implies, this is an art institute, which institute counties are authorized to maintain. Such departments receive tuition fees, locker rentals, miscellaneous items, and trust funds deposited for locker keys, etc.

*Outdoor Relief Department.* This department, like many others in the county, is primarily a service department and its receipts are negligible. However, amounts are received in the nature of refunds, and sometimes from the sale of salvaged goods and articles manufactured by certain types of indigents.

*Probation Officer* collects money on court orders and usually for specific purposes. He should maintain a register of actions in which should be recorded his activities concerning each case under his jurisdiction, and should also maintain a record of cash received and disbursed, and a ledger account with each person required to make payments to him. In this county, there are three probation officers, one for adult cases, one for juvenile cases, and one for psychopathic cases.

*Public Administrator.* It is the duty of this officer to take charge of the estates of persons dying within his county as follows: (1) for which no administrators are appointed, and in consequence of which the estates are not being cared for; (2) of the estates of decedents who have no known heirs; (3) the estates ordered into his hands by the court; (4) the estates upon which letters of administration have been issued to him by the court.

This officer should maintain a register in which should be recorded all transactions affecting each estate being administered by him, and should maintain a record of cash receipts and disbursements. The register of actions should be ruled so that the cash transactions in and out of each estate may be shown on the same page with the other matters to be recorded.

It is the duty of this officer to perform the services for estates which the executors and administrators of private estates perform. He collects fees for his services which may or may not

be retained by him, depending upon the law covering the particular county being audited.

*Public Defender.* It is the duty of this officer, among others, to represent persons charged with violations of the criminal laws, who are unable from a financial standpoint to engage an attorney to represent them. He collects court costs and receives trust funds in settlement of claims. A register of actions should be maintained, as well as a cash book. The register should be ruled so as to permit the recording of the receipt and disbursement of trust moneys.

*Public Welfare Commission.* This commission performs different duties in different counties. Sometimes it does the work performed by the Outdoor Relief Department in this county, prepares claims against the State for State aid to orphans and others, and holds in trust for the use of indigents, moneys paid to them by the county, paying out the same as the needs of these indigents arise.

*Recorder.* This officer receives fees for recording and filing documents and preparing certified copies. He should maintain a record of cash received, and in entering fees for documents recorded, sufficient information should be shown so that the amount of the fees may be verified by an examination of the records and the law prescribing the fees to be charged.

*Registrar of Land Titles (Torrens.)* What has been said about the county recorder in a general way applies to this officer.

*Registrar of Vital Statistics.* These officers collect fees for preparing certified copies of birth and death certificates, and some of them are paid by the county for their services as registrars. Paragraph 20 of Act 9008 of Deering's General Laws provides that the State registrar shall quarterly certify to the auditors of the several counties the number of births and deaths properly registered, with the names of the local registrars and the amounts due each at the rates fixed; provided that no fee shall be paid by the county to or for the services of any local registrar who is also clerk or health officer in any city or town, and whose salary as such clerk or health officer is by law his sole compensation for his services.

*Registrar of Voters.* The title of this officer also suggests his duties. He receives small amounts of money from the sales of indexes of registrations, certified copies of the same, filing fees from candidates, and other miscellaneous sums.

*Road Department.* This department functions differently in the several counties, so that the accounting records required vary correspondingly. There are also differences in the classes of services performed for which moneys are received. Generally, however, this department receives moneys for re-surfacing roads, work for real estate companies, donations, sales of blue prints, etc., etc. It should keep analytical and detailed cost records of all road construction and maintenance, which records should supplement the records maintained by the county auditor of these expenditures.

*Sheriff.* This officer is the chief county peace officer, serves the Superior Court, has charge of the jail, and road camps, and transports prisoners to the State penitentiaries. He receives various fees for services and sometimes maintains records to account the prepayment of fees in the manner described in connection with the larger Justice of the Peace courts. Some of his duties at the jail have already been mentioned, so will not be repeated here.

*Superintendent of Schools.* This officer has supervision of all the schools of the county, apportions, according to complicated laws, State and county school funds to the various districts of the county, holds institutes, collects fees for certificates issued to teachers, and collects contributions by them to the teachers' pension fund. He must pass on all warrants expending school funds except those paying bond coupons and redeeming bonds, and maintains a fund ledger which should be kept in reconciliation with the ledgers of the county treasurer and county auditor.

*Supervisors.* The Board of Supervisors is mentioned near the beginning of this paper, and therefore needs no further comment.

*Surveyor.* This officer is the official surveyor for the county and collects moneys for various and sundry purposes, such as sales of blue prints, making special surveys, appraising land, sales of maps, fees for recording subdivision maps, preliminary expenses in connection with public improvements, etc., etc.

*Tax Collector.* This officer was mentioned in connection with the discussion of the county auditor.

*Treasurer of the County* was also discussed in the earlier part of this paper.

*Trustee of Superior Court* collects moneys from husbands and fathers in failure-to-provide

(Continued on page 128)

## TALKING SHOP

A Department Conducted by L. GLUICK, C.P.A.

It is three years since we made our first appeal to our readers to tell us of their scholarly attainments. We have repeated it at intervals with indifferent results. Accountants are traditionally self-effacing. We appreciate that attitude to the lay public, but right here in this professional shop, it is no harm to tell about your achievements. Here is the latest crop we garnered.

For the degree team: Edwin L. Theiss, C.P.A., of Illinois. He received the degrees of A.B., Ph.B., and A.M. from North Central College, Naperville, Illinois, and Ph.D. from the University of Chicago. Herrmann Herskowitz, C.P.A., of New York. He received the degrees of B.C.S. and M.C.S. from New York University and LL.B. and LL.M. from St. Lawrence University.

Now for the Phi Beta Kappa men: Charles J. Rowland got his key from Cornell in 1917. He is certified in Pennsylvania where he teaches at the State College. Edward J. Filbey, who is also a Ph.D., won his key at Lawrence College, Wisconsin, in 1901. Illinois issued his certificate. Perry Mason and W. A. Paton won their honors at the University of Michigan in 1921 and hold Michigan C.P.A. certificates.

Who is next to demonstrate that accountancy is a *learned* profession? Sigma Xi men especially wanted.

The estate of Robert Todd Lincoln, son of the Great Emancipator, figured in a lengthy case, starting at 24 BTA 334. The case is notable, aside from that, in the number of *amici curiae* brought in, among them Elihu Root, Jr., and three members of the firm of Murphy, Lanier and Quinn. Also there were four dissents to the Rule 50 decision. An appeal is inevitable.

The following certified public accountants are noted as having won Rule 50 decisions in 24 BTA: Frank C. Miller, page 331; W. B. Finlay, page 360; Morris Metz, page 429.

To any one interested in accounting machinery the illustrated article in the January number of *Fortune* will be very illuminating. To those who

have not hitherto been interested, it should prove most instructive. Mr. Wm. B. Castenholz mentioned the last time we saw him, that one of his clients got out 302 Profit and Loss statements per month, one for *each* of the sales territories. With the aid of machinery they were out between the fifth and tenth of each month.

Max J. Wasserman had an article in the December number of the *Accounting Review*. He also read a paper at the meeting of the A.A.U.I.A. in Washington on December 28. Both article and paper dealt with accountancy in France, and to supply local color Mr. Wasserman wore a real French costume while reading the paper.

Keeping people of like names distinct is never easy. But when tax service reports show two consecutive cases handled by C.P.A.'s of the same surname, it is confusing. We mean the Klingman Furniture case, in which F. E. Seidman got a Rule 50 decision; and a whole group of cases (Docket No. 27109ff) on which M. L. Seidman got a rather substantial victory for his numerous clients. The second Seidman was assisted by Benjamin Grund, C.P.A.

The Youngstown Sheet & Tube Co. case (Docket No. 35511) is interesting for the light it throws on the methods of a very large corporation. The findings of fact show that the corporation had "a tax counsel," a "tax accountant," a comptroller whose partial duties "consisted in supervising tax liabilities," and last, but not least, the same auditors for twenty years. Verily, in a multitude of counselors there is wisdom.

From the case of Littauer, promulgated December 31, 1931 we learn that a certain Dr. Eliasberg charged \$500 for administering an anaesthetic, but compromised on \$250. If only accountants could get such fees!

The case of Bowman-Biltmore Hotels, promulgated December 19th last, is unusually long and,

in view of a five-man dissent, quite important. It involves not only methods of treating leaseholds, but the liabilities of successor corporations.

From Los Angeles, California (are you going to the Olympics?) comes the annoying case of Richard H. Oakley. In the findings of facts it is stated: "The office manager was unable to set up complete records. At his suggestion certified public accountants were employed." That was a smart manager. He deserves to have his name—Theodore Martin—mentioned. But why are the auditors left unnamed? Why should we be thus discriminated against?

As we send this to press we are busy. But never have we been working so hard and collecting so little; and not an accountant of our acquaintance who does not report the same. Fees cut to the vanishing point and hard to get even then. The old complaint: "You know better than any one else how things are with us." But a new refrain. "If this new tax legislation goes through, you will all have plenty to do." Doubtless. Most of it being economically unsound, more figuring must ensue. But collections are going to be harder than ever. Here is a fine opportunity for our profession to show itself at its best by vigorously opposing most of the provisions. Above all, anything like a general sales tax.

"Gosh, I am sore," said the Kid. "These guys who once worked for a few months for a public accountant, and then got out of the game because they weren't good enough for it, are always so darn patronizing forever afterwards. 'I used to be an accountant myself,' just as though they were something better now."

"Go easy, young fellow" said Oldtimer. "Some of them quit public accounting because they were good; really good. That was why the client wanted them for internal auditor or comptroller."

"Yes" replied the Kid, "But I'm not talking about that kind. The good ones respect us. I'm talking about the hams who couldn't stand the gaff, who gave up trying to be a C.P.A.; those are the birds that get my goat."

"I don't blame you," said Dash. "They are a pest."

"Don't be so general," said Blank. "Frequently I have found a very well-kept set of books in the hands of a man who had spent a couple of years as a public accountant, and for tempera-

mental or marital reasons had quit to go into private work. He was good in his job; fine. But just not fitted to be a C.P.A. And if they do act a trifle up-stage, what of it?"

"It's worse in the publicity business," remarked Sinbad.

"How do you know?" asked the Kid.

"Well, for one thing," answered Sinbad, "I have a cousin in the business; my uncle, his father, was before him. And also several close friends. And two of my clients are advertising agencies."

"Now that you have qualified as a witness," said Oldtimer, "proceed with your story."

"You see it's like this. There is no place for making contacts like newspaper work. Or for learning how to write good crisp English," Sinbad was saying when the Kid broke in.

"How about the tabloids?"

"Especially them," said Sinbad. "It may lack polish and even be ungrammatical, but it does carry a punch. Anyhow many men get into the newspaper game with no intention of remaining in it. Others who want to remain, lack the certain something necessary, and are put out. Then they drift into advertising. Maybe a corporation department; maybe an agency. But forever afterward they talk about "When I was a newspaper man" just as though they had really been one; and how it riles the real legmen."

"Meaning who?" asked Dash.

"The real full-time reporters, who get the news. They call them the 'we boys.' There have been several disgraceful rackets perpetrated by some of them. Always beware of them."

"As I recall it," said Oldtimer, "the real boys formed their *Newspaper Club* as a protest against the old *Press Club* for admitting any one who had worked for a newspaper."

"Right," said Sinbad. "And I don't blame them. When a real honest-to-gosh man who has a police card, finally does get out of the newspaper world to become a publicity expert, as my cousin did, the real men of the press know him and respect him; and he in turn, never pulls the 'we boys' gag on them. It is only the short-timers they despise, just as the Kid got sore at some one in our profession today."

"It's interesting to see how it works in other lines too," said Dash. "There's many a school teacher, who for any number of good or bad reasons, has gotten into something else. I'm not one of them, so I can speak without bias. And how most of them do manage to convey, by

(Continued on page 121)

## C. P. A. Examination Questions\*

November, 1931

### Accounting Theory

#### Question 1:

You are called upon by members of a partnership to suggest the points relative to accounting which should be covered in their partnership agreement. Give at least eight provisions of such an agreement which are important to a proper accounting.

#### Question 2:

The capital account of George Mohr, sole proprietor of a certain business establishment, was \$26,419.30 at June 30, 1931.

Make the proper entries to admit Fred Price as a partner under each of the following conditions:

(a) Price pays \$25,000.00 for a one-half interest, the money to remain in the business. The capital of the new firm is to be \$50,000.00.

(b) Price pays \$15,000.00 for one-half interest, Mohr to keep the money and the firm capital to remain at \$26,419.30.

(c) Price pays \$14,000.00 for a one-third interest, the money to remain in the business, and the capital of the new firm to be increased to \$42,000.00.

#### Question 3:

You are preparing a manual of general accounting procedure for a large industrial concern. Outline therefor a plan of providing for bad debts and a bad debt reserve. Monthly financial statements are contemplated.

#### Question 4:

The greater portion of the business transacted by The Georgian Company is on a contract basis. Customers are billed periodically as work on their contracts progresses.

On December 31, 1930, the status of unfinished contracts was summarized as follows:

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\*The Service of Examination Questions conducted by The American Society furnishes practically twice as many questions in Theory, Auditing, Commercial Law, and Economics and Public Finance as could be used by any State Board for a four-hour examination period, and twice as many problems in Practical Accounting as would be required for two examination periods of four to five hours each. A Board using the service makes its own selections and adds any special questions or problems which it desires. Eight boards used the November, 1931, service. Every suggested question or problem, except two, was selected by at least one Board, and only five were selected by every Board. Two boards added questions with a local bearing. The questions in Accounting Theory and Economics and Public Finance follow.

Job No.	Cost to Date	Estimated Cost to Complete	Contract Price	Billings to Dec. 31, 1930
4163 .....	\$ 46,318.26	\$ 5,000.00	\$ 75,000.00	\$ 55,000.00
4166 .....	59,416.83	11,500.00	60,000.00	48,750.00
4172 .....	8,727.45	19,400.00	40,000.00	10,000.00
4173 .....	12,487.27	41,100.00	60,950.00	12,450.00
4174 .....	3,804.93	12,300.00	15,000.00	2,000.00
4179 .....	22,063.60	60,000.00	125,000.00	.....
Totals .....	\$152,818.34	\$149,300.00	\$375,950.00	\$128,200.00

No profit or loss is taken up on the books until the contract is completed; the cost to date is treated as an inventory item under current assets while billings thereon are set up on the balance sheet as deferred income, immediately following current liabilities. The company is able to compute the cost to complete each contract with great accuracy.

Do you approve of the accounting procedure followed and the balance sheet valuations and arrangement?

Question 5:

You are engaged by the Smith Manufacturing Company, a newly organized corporation, to install a complete system of accounting. In devising the procedure for determining manufacturing costs, you must take into consideration the fact that monthly statements will be prepared from the books. Describe the fixed asset ledger you would set up that would make it possible to charge depreciation through factory production centers. Your system must permit the application of a rate of depreciation based on the estimated life of each machine and facilitate the preparation of entries necessary when assets are retired. Prepare a summary of the instructions you would issue for the use of the company's accounting department.

Question 6:

In the preparation of a balance sheet of a dealer in period furniture and objects d'art, to be used for credit purposes, you ascertain that for the past twenty years his stock in trade has had an average turnover of once every three years. Would you include the said stock in trade among the current assets? Would it make any difference in your method of handling the inventory if you were told that the balance sheet was not to be used for credit purposes?

Question 7:

You are asked to draw up schedules for the bookkeeper of M. Company to cover the following items which he must adjust monthly:

- (a) Insurance premiums.
- (b) Interest.

What forms would you use that would provide a detailed analysis of the balance sheet and profit and loss figures? Explain how these forms would be used.

Question 8:

The International Traffic Bureau is a personal service organization representing American importers in their claims against marine transit companies for overcharges in ocean freight and for deterioration of merchandise during transit. As compensation the Bureau receives in cash twenty-five per cent of all claims settled; it pays all its own legal and other expenses.



To add prestige to its business, the International Traffic Bureau entered into a special contract with a large importer whereby in lieu of receiving cash for claims settled, it accepts stock of the importing company at par. In addition, as part of the contract, the Bureau bought outright for cash \$5,000.00 in stock at par value.

It is admitted that the stock is not worth par value. At the close of the fiscal year, the International Traffic Bureau had on hand, as a result of the above contract, stock having a par value of \$20,000.00, with an estimated fair market value of \$10,000.00, and an accounts receivable of \$1,250.00 for claims settled but not yet paid for in stock.

How should this transaction be considered on the company's:

- (1) Balance sheet.
- (2) Statement of profit and loss.
- (3) Federal income tax return.

Question 9:

What classes of auditing, accounting and allied services do accounting firms render? Describe each briefly.

Question 10:

What is the proper accounting procedure involved in the following:

- (1) Gain arising from the cancellation by a parent company of advances to a subsidiary.
- (2) Profits on the sale of plant assets.
- (3) A deficit from current operations, there being paid-in but no earned-surplus.
- (4) Good-will or other intangible assets which an officer of the company has proposed to write off by charging them against surplus arising from the appraisal of the company's fixed assets.

Question 11:

A corporation purchased \$300,000.00 of its outstanding serial bonds at an average price of 65 on the open market. It desires to show the saving as a current year's profit to be carried to earned surplus. Have you any objections? Is it available for dividends? What immediate disposition, if any, should be made of the unamortized bond discount and expense applicable to the above bonds?

Question 12:

What disposition should be made of rent paid or accrued during the period that a retail business is being equipped?

Question 13:

Would good financial procedure demand that (1) organization expenses and (2) discount on stock be written off fully before dividends are paid?

Question 14:

Describe the following terms used to designate divisions of surplus:

- |              |                        |
|--------------|------------------------|
| (1) Earned.  | (5) Appropriated.      |
| (2) Capital. | (6) Free.              |
| (3) Paid-in. | (7) Undivided profits. |
| (4) Donated. | (8) Revaluation.       |

Question 15:

Describe briefly, from the financial or accounting point of view, several objections to no-par-value stock. Do these objections in your opinion outweigh the advantages of this type of stock?

Question 16:

Discuss the relationships and distinctions between the following:

- (1) Sinking fund reserve and funded debt.
  - (2) Sinking fund and sinking fund reserve.
  - (3) Depreciation reserve and sinking fund reserve.
  - (4) Sinking fund reserve, immediately after the retirement of a bond issue,
- and (a) earned surplus, (b) cash dividends, and (c) stock dividends.

Question 17:

You are engaged by a manufacturer of railroad equipment to install a record of control for the purchasing department.

Outline briefly a system which will permit the company's accountant to determine the complete liability to creditors at the close of an accounting period.

Salient points to be considered are:

- (1) Record of quantities delivered on purchase contracts.
  - (2) Goods ordered but not received.
  - (3) Invoices received before the delivery of goods.
  - (4) Systematic checking of (a) goods received against purchase orders and
- (b) prices and extensions.
- (5) The transfer of invoices to the accounting department.

Question 18:

For income tax purposes it is necessary to regard cash, property, and stock dividends as having been paid from income earned in particular years. Disregarding the actual rule which must be followed under the Revenue Act, but having regard for good financial theory, formulate a simple rule which will permit such an allocation.

Question 19:

Two corporations consolidated in 1929, stock in a new corporation having been exchanged, par for par, for the stock of the two old corporations which thereupon transferred their assets to the new corporation and dissolved. There was no change in or addition of stockholders. Substantial earned surplus accounts existed on the books of each old company. Appraised values of fixed assets (which exceeded the book values thereof) were declared by the Board of Directors of the new company to be their fair values which should be transcribed on the books of account.

(a) Should the earned surplus accounts have been transferred as such to the books of the new company?

(b) For income tax purposes what basis should be followed in determining depreciation expense?

Question 20:

A movement has been on foot for several years to classify accounting services. Of what value to the certified public accountant would such classification be?

## Economics and Public Finance

Question 1:

Define economics, utility, income.

Question 2:

Explain the terms wealth, capital, money.

Question 3:

Explain the types of specialization now dominant in the industrial system and the effects of such specialization.

Question 4:

Bye in *Principles of Economics* says: "Universal as is competition in economic life, cooperation is equally prevalent and just as fundamental. This may seem paradoxical but it is none the less true. In fact, cooperation arises out of competition." Illustrate and explain.

Question 5:

Outline the basis of Russia's Five-Year Plan and indicate the successes and failures which it is meeting.

Question 6:

Explain the law of diminishing returns.

Question 7:

List the various suggested means of decreasing the number of unemployed, indicating whether each, as listed, should be considered as a temporary expedient or as a permanent cure and also criticizing the suggestion from an economic standpoint.

Question 8:

List the risks in modern industry (a) of the management, (b) of the capitalist, (c) of the laborer. How may the various risks be met?

Question 9:

What has been the effect on American economic problems of the abandonment of the gold standard by Great Britain?

Question 10:

Frank H. Simonds in his Sunday letter for October 18th, said "War debts and reparations are both dead. The attempt to renew the process of payments by which the United States lent money to the Germans, who paid it to the Allies, who paid it to us, is not to be renewed. We have \$3,000,000,000.00 tied up in frozen credits in Germany now and the British about half as much. If Germany goes in for a Fascist dictatorship, we shall never get a penny back and neither will the British." Would you favor a cancellation of these claims based on a disarmament agreement? Give reasons.

Question 11:

Explain the theory of business cycles.

Question 12:

Railroads have applied for a fifteen per cent freight rate advance. It is conceded that the present rates are not producing sufficient income in view of the volume of freight being hauled. For the economic good of the country should such an advance be granted? Give reasons for your answer.

**Question 13:**

Explain the influence of standards of living upon the non-competing groups.

**Question 14:**

Mark Sullivan in his Sunday letter of October 18th, referring to a recent newspaper headline said, "What was \$1.00 five years ago (in purchasing power of food or wheat or copper or any other commodity) is now \$1.64." Illustrating this as it affects the wheat farmer who borrowed money five years ago, he said, "The debtor finds his burden tripled; the creditor, on the other hand, finds his wealth tripled." Referring to the usual argument of the political demagogue that all debtors are in one group and all creditors belong to another group he said, "That is not true. The great majority of us are in both classes." He also referred to another false political claim recently enunciated by a U. S. Senator that "The boosting of the value of the dollar is undoubtedly a concerted effort to make it more difficult for debtors." Explain your ideas on these points.

**Question 15:**

Explain the plan and the expected value of the National Credit Corporation.

**Question 16:**

President Hoover, in a letter addressed to The American Society of Certified Public Accountants, through its president, in connection with the recent annual meeting, said, "Certified public accountants are close students of economic problems relating to business and their application to the affairs of their clients. It is possible that through you some suggestion may come that would be of assistance in mitigating the effects of the present depression \* \* \*." What suggestions would you make if called into a conference for the purpose of discussing efforts that should be made not only to mitigate the present situation but to prevent its recurrence?

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## Talking Shop

*(Continued from page 115)*

tone, rather than words, their imagined superiority to the woman who is still teaching."

"Men aren't much better," said Oldtimer.

"Well," said Blank, "I heard one who is. I was at a meeting recently in Washington; teachers of accountancy and law in collegiate schools. And the best speech of the whole affair was given by a Certified Public Accountant, who never once mentioned that for nearly ten years he had been a teacher in Mr. Pace's school."

"That comes back to what I said before," replied Oldtimer. That man has achieved real prominence; he could have talked all he wanted about when he was a teacher, and I don't think any one could have taken umbrage at his tone or words. But the good men stand on their own

present positions, and sometimes go almost too far in avoiding the "When I was—" and "I knew him when—."

"There ought to be more of that kind," said the Kid.

"So say we all of us" sang the crowd.

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## The Thirteen-Month Calendar

*(Continued from page 87)*

something about the demands of aggressive business leaders for information that is vital and guiding. The result obtained from our work is an indication of our ability to serve and something we are always trying to improve. Could we not increase our capacity to serve and contribute more to business if the proposed thirteen-month calendar were adopted?



<i>Title and Description</i>	<i>Author</i>	<i>Year</i>
The Gentlemen's Complete Bookkeeper .....	Richard Hayes .....	1741
Traite des Parties Doubles .....	M. Barreme .....	1741
A Treatise of Bookkeeping .....	Alexander Malcolm .....	1741
A Treatise of Bookkeeping .....	Alexander Malcolm .....	1743
An Essay on Bookkeeping .....	Wm. Webster .....	1752
The Science of Business .....	M. Porte .....	1753
Instructie of Grondige Onderregting Boekhouden .....	M. F. Fortach .....	1755
Essays on Bookkeeping, the Art Fully Explained .....	William Webster .....	1758
Mercantile Book-Keeping By True Italian Method .....	W. Everard .....	1764
Journal of Wm. Sumner at London .....	.....	1773
The Man of Business and Gentleman's Assistant .....	W. Perry .....	1774
The Universal Accountant and Complete Merchant, Vol. I .....	William Gordon .....	1777
The Universal Accountant and Complete Merchant, Vol. II .....	William Gordon .....	1777
An Introduction to Merchandise .....	Robert Hamilton .....	1777
Theoretische Ubhandlung vom Doppelten Buchhalten .....	Georg Thomas Flugel .....	1781
The British Youth's Instructor—Arithmetic .....	W. Burbidge .....	1787
Unweifung Zur Leichten und Grlernung der Buchhaltung—I... ..	Samuel Friedrich Helwigs .....	1790
Unweifung Zur Leichten und Grlernung der Buchhaltung—II... ..	Samuel Friedrich Helwigs .....	1790
Bookkeeping Modernized .....	Mair, John .....	1793
English System of Bookkeeping .....	Edward Thomas Jones .....	1796
The Young Bookkeeper's Assistant .....	Thomas Dilworth .....	1798
An Epitome on Book-Keeping By Double Entry .....	Thomas Turner .....	1804
Merchant's Accounts or Bookkeeping by Double Entry .....	R. Langford .....	1808
The Elements of Bookkeeping .....	Kelly, P. .....	1811
Die Landwirthschaftliche Buchhaltung .....	F. W. Gutsche .....	1814
The Elements of Bookkeeping .....	P. Kelly .....	1815
Double Entry by Single-New Method of Bookkeeping .....	F. W. Cronhelm .....	1818
La Tenue Des Livres Rendue Facile .....	Degtange, M. Edmund .....	1818
The Elements of Bookkeeping .....	Morrison, J. .....	1818
The Elements of Bookkeeping .....	Kelly, P. .....	1821
A Complete System of Practical Bookkeeping .....	Morrison, J. .....	1823
The Elements of Bookkeeping .....	Morrison, J. .....	1825
A New Check Journal upon the Principle of Double Entry .....	Jackson, G. .....	1826
The American System of Practical Bookkeeping .....	James Bennett .....	1826
Die Kunst in Drei Stunden ein Buchhalter zu Werden .....	C. O. Meisner .....	1828
The Mercantile Teacher's Assistant .....	James Morrison .....	1829
The Accountants Guide for Elementary Schools .....	William Morris .....	1833
A Complete System of Practical Bookkeeping .....	Morrison, C. .....	1843
Double Entry Elucidated .....	B. F. Foster .....	1849
The Science of Double Entry Bookkeeping .....	C. C. Marsh .....	1851

## Proper Preparation

(Continued from page 95)

vancement in position is merely the outward manifestation of inward growth, remembering it can be a piece of work which involves three steps. First, ideas; second, plan; and third, putting it through. Success is not earned by any one but by the working out of all three.

In conclusion, the technical training of an accountant must embrace all of the factors which make up business. A full knowledge of underlying truths is not only essential but absolutely necessary. But the greatest need of today and the future is for the man and woman of strong and sturdy character in order that there will be

no substitution of quantity and profits in the place of character.

Centuries ago the wise men who gathered in the market places of Jerusalem repeated the saying "where there is no vision the people perish." Business has its vision, ideals, and has become one of the dominant elements in modern life. Those who aspire to leadership, who will eventually become the leaders, will be those who most completely shared this vision and have bent every effort to realize these ideals.

The world we live in today we should know. It is what we make it, therefore we must know man, in short, ourselves, and realize the forces within us, those which will drag us down and those which will lift us to higher planes of achievement.

## ANNOUNCEMENTS

Keller, Kirschner & Martin, Certified Public Accountants, First National Building, Columbus, Ohio, announce the admittance of John G. Keller, C.P.A., to membership in the firm.

Gleason & Sirota, 175 Fifth Avenue, New York City and Kraus & Kraus, 235 Fourth Avenue, New York City, announces a consolidation of their practices under the firm name Sirota, Kraus & Gleason to continue in the public practice of accountancy at 175 Fifth Avenue, New York City.

Lawrence Scudder & Company have removed their offices to the twelfth floor of 500 Fifth Avenue, New York City.

William Dolge & Company, Certified Public Accountants, are now located in the Balfour Building, 351 California Street, San Francisco, California.

Announcement is made as of December 31, 1931, of the dissolution of the firm of Griffith, Rockey & Co., Certified Public Accountants, Philadelphia, Pa.

Horace P. Griffith and Robert H. Rissinger, Certified Public Accountants, announce the organization of a partnership under the firm name of Griffith and Company, Certified Public Accountants, to continue the practice of accounting in the Bankers Trust Building, Philadelphia, Berks County Trust Bldg., Reading, and 12 N. Seventh Street, Camden, N. J. Associated with them are Munro S. Coulter, C.P.A., J. Dean Kitchen and George R. Saunders.

Charles S. Rockey, Thomas W. Evers, William H. Welcker, David M. Fillman and Sydney V. Young, Certified Public Accountants, will continue their practice of accountancy under the name of Pace, Gore & McLaren, Bankers Trust Building, Philadelphia, Pa.

Haskins & Sells announce Thomas H. Lawrence as Resident Partner in San Francisco, with offices in the Crocker Building, succeeding John F. Forbes who has retired from the firm.

Haskins & Sells announce that Andrew Stewart, C.P.A., of New York, has been admitted to membership in the firm.

Wilmer Black and Robert W. Black announce that Edward G. Shipley, C.P.A., has become a member of the firm of Black & Company, Certified Public Accountants, 902 Garrett Building, Baltimore, Maryland.

### GEORGE W. ROSSETTER

Each of the Chicago papers for December 19 carried the announcement that George W. Rossetter, Certified Public Accountant, had been nominated the day previous as president of the Chicago Association of Commerce for the year 1932. His actual election to the office occurred January 13 and his official installation took place January 27. He has served the Association in some official capacity for the past fifteen years.

In the *Chicago Journal of Commerce* for December 26, Louis A. DeBord draws what he terms "a word etching of George W. Rossetter" and finds the incoming chief of the trade organization a many-sided personality with qualifications for leadership. A few quotations from this interesting article are given for the benefit of those members of The American Society who have not had the pleasure of meeting one who has been a member of two of its committees, State Representative, Treasurer and Director.

"Outwardly, Mr. Rossetter's white hair is the most impressive thing about him. Inwardly, his most impressive characteristic is an intelligent attitude toward life. Business to him, is not life, but a phase of life.

"Mr. Rossetter comes of colonial stock, . . . being a descendant of Edward Rossetter, who . . . came to America from England in 1630. . . . He is of the tenth generation in the line in this country. . . . His grandfather came to this village in the forties and operated one of the first hotels in the frontier community of that day.

"He is a gentleman, a man of generous impulses, and a thinker. He values the cultural side of life quite as highly as the making of money and has mastered the art of living to a far greater degree than most men. He fishes for trout, plays golf, and rides a horse, the horse being both his chattel and his friend. He defies easy classification, for he is a many-sided man; but, if I were writing for the elevator operators in the Foreman-State Bank Building, I should simply say: He is a fine guy."

## STATE SOCIETY NEWS

### CONNECTICUT

The regular fall meeting of the Connecticut Society was held in New Haven on December 2, 1931.

The Bridgeport members presented a resolution which had been unanimously adopted at a meeting of the Bridgeport Clearing House Association on November 10:

"RESOLVED: That it is the desire of the members of the Bridgeport Clearing House to receive from all larger borrowers complete certified public accountant reports with balance sheet, profit and loss statement, reconciliation of surplus account, and full comments concerning contingent liabilities, age of accounts receivable, verification of inventory, etc."

This resolution was transmitted by the Secretary of the Bridgeport Clearing House Association with the added statement:

"We are sending you a copy of these minutes with the thought of building up a better understanding and spirit of co-operation between the accountants and bankers of this city. It is our belief that a full financial report as referred to above will prove beneficial to all concerned."

This communication was referred to the State Society Committee on Cooperation with Bankers and Other Credit Factors as a suggestion of a species of cooperation with another group which can only come after confidence has been attained.

### GEORGIA

The Atlanta Chapter of the Georgia Society of Certified Public Accountants recently issued a twelve-page monograph on "Verification and Display of Merchandise Inventories" which is exceedingly valuable as an illustration of a type of constructive work which can be done by a State Society. There are four sections relating to definition, verification procedure, display and bibliography. In the bibliography 56 references are presented.

### KENTUCKY

The annual meeting of the Kentucky Society of Certified Public Accountants was held on Mon-

day evening, December 28, 1931, at the Brown Hotel, Louisville.

A resolution was adopted amending the charter and by-laws to provide for holding the annual meeting and election during the second week of June each year, officers to assume duties as of July first which was also made the beginning of the fiscal year of the society.

The society received and accepted a report of a Special Committee which had been appointed for the purpose of conferring with a Committee of Bankers in connection with the distribution of a pamphlet by the Louisville Clearing House Association, showing the information which the bankers would require in an audit report for credit purposes. Members of the Kentucky Society unanimously agreed that they would prepare their audit reports in accordance therewith.

The president appointed the board of directors as a special committee to consider the matter of securing the passage of a new accountancy law at the session of the Legislature which convened on January 5, 1932.

O. S. Meldrum, Buell E. Henry and S. W. Eskew were elected directors for the ensuing year. Officers elected were: President, O. S. Meldrum; First Vice-President, P. Robt. Miller; Second Vice-President, A. J. Nauman; Secretary-Treasurer, Buell E. Henry.

Wives of the members were invited to attend and after the business session the evening was spent in playing bridge and dancing on the Brown Roof Garden.

### MASSACHUSETTS

A meeting of the Massachusetts Society of Certified Public Accountants, Inc., was held at the Parker House on Monday, December 21, 1931.

About ninety-nine members and guests attended the buffet dinner which preceded the meeting, those coming in later increasing the total attendance to 115.

By unanimous vote George Lyall, president of the Certified Public Accountants of Massachusetts, the predecessor organization, during 1920-21, was elected to honorary membership.



The remainder of the meeting was devoted to the discussion of current accounting problems under the direction of J. Harold Stewart.

James D. Glunts spoke briefly concerning commercial arbitration in Massachusetts and read a letter from Mr. Homer A. Dunn, of New York City. After a brief discussion it was voted to refer the matter to the Executive Committee for further study.

#### MICHIGAN

The Michigan Association of Certified Public Accountants held a meeting on Thursday evening, January 14, 1932.

Professor Leonard L. Watkins of the Economics Department of the University of Michigan, presented a very interesting paper on "The Gold Standard and Its Relation to International Banking," which was followed by an hour's discussion.

Thursday evening, December 17th, 1931, a meeting was held at the Pantland Hotel, Grand Rapids, under the auspices of the Western Michigan Chapter of the Michigan Association of Certified Public Accountants, to which meeting bankers and accountants were invited, the Michigan Bankers Association having concurred in the meeting.

Bankers and accountants were present from a dozen cities on the western side of the State. Following dinner, Fred Marin, Deputy Commissioner of Banking, the Chief Bank Examiner for the State of Michigan, spoke on "What the Examiner Expects or Would Like to Find in the Credit Files of Banks." He was followed by D. W. Springer, Secretary of the Michigan State Board of Accountancy, who spoke on "Cooperation Between Certified Public Accountants and Bankers." Following the addresses an opportunity was given for questions, and when the meeting broke up, informal discussions between bankers and accountants occupied nearly another hour.

#### NEW JERSEY

The Sixth Annual Afternoon and Evening Conference of the Society of Certified Public Accountants of the State of New Jersey was held at the Elk's Club in Newark, on Thursday, December 10, 1931. Henry B. Fernald, president of the Society presided over all sessions.

In the afternoon Leopold A. Chambliss, assistant vice-president of the Fidelity Union Trust Company spoke on "As Bankers View Accountants' Audit Reports and Certificates." William H. Bell, a member of the firm of Haskins &

Sells delivered an address on "Accountants' Certificates."

Discussion by the members was capably lead by Henry B. Fernald, Harold A. Eppston and Maurice E. Peloubet. Theodore Krohn and Leopold Frankel, attorneys, both spoke on the subject from a legal standpoint.

At the dinner session, Dr. John T. Madden, Dean of New York University School of Commerce delivered a comprehensive address on "World-wide Economic Conditions." Paul Stillman, president of the National State Bank of Newark, spoke on "The Present Banking Situation." Judge Charles H. Stewart, president of the Essex County Bar Association, also addressed the members.

The conference was well attended by the members and their friends. Among those present were the following: James H. McNish, deputy commissioner of Banking and Insurance; J. C. Moyer, chairman of the special Advisory Committee of the Internal Revenue Department; Dean Herbert C. Hunsacher of the Seth Boyden School of Commerce; S. P. Jensen, agent in charge of the Internal Revenue Department; J. P. Coakley, financial editor of the Newark Evening News; Harry Green, special counsel of the New Jersey Motor Vehicle Department; and Edward Gano, president of the New Jersey Society in 1909 and 1910.

#### OREGON

The Oregon State Society of Certified Public Accountants is, through its Publicity Committee, carrying on along educational lines by using the *Oregon Voter* twice a month for putting before the citizens of the State information with regard to what a C. P. A. is, the things he stands for, and the qualifications that are necessary before he can receive a certificate from the State Board. Once a month they carry a full-page ad. In alternate issues they carry a one-third page ad.

#### PENNSYLVANIA

A special meeting of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants was held at the Keystone Athletic Club, January 5, 1932 at 12:15 P.M.

The chapter unanimously passed the following resolution:

"THAT, The Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants go on record as opposing any retroactive legislation pertaining to Federal Taxes, and that, the Secretary be instructed to send a copy of this

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resolution to the Secretary of the Pennsylvania Institute of Certified Public Accountants."

Dr. A. B. Wright, Dean of the School of Business at Duquesne University, Pittsburgh, was introduced as the luncheon speaker and talked about the business outlook for 1932.

#### UTAH

The Utah Association of Certified Public Accountants recently elected the following officers: President, Lynn Baxter; Vice-President, Frank L. Ostler; Secretary-Treasurer, Leon H. Jackson.

#### VIRGINIA

The Virginia Society of Public Accountants has issued an eight-page monograph, with cover, containing the classification of accountancy services as adopted by the society and a roster of membership as of November 1.

Regular standing committees are provided on arbitration, auditing, legislation and membership. Special committees this year are on cooperation with the American Arbitration Association, education, natural business year, promotion of uniform county administration, relations with national societies, spring meeting.

### Forces Transcend Economics

*(Continued from page 76)*

ous fashion been transformed, and that the old Adam in each of us, who caused the Great War, was dead, or at least could be killed painlessly by a little chloroform dexterously applied from Geneva. As a result, they have shut their eyes to nothing less than the great adventure of living, of struggling to prevent war, to make the world a little better, of trying and failing and still struggling on. They have forgotten, too, oddly enough, very much as did the soldier in the Bairnsfather drawing, that after all, this is the only world we have. There is, here and now, no better world to go to.

The American Society received best wishes for Christmas and the New Year radiographed from the Society of Incorporated Accountants and Auditors, London, England. Greetings were also received from the offices of the Institute of Accountants and Auditors of the Province of Quebec, Montreal, Canada, and the Business Library of Bangkok, Siam.

### Audit of Counties

*(Continued from page 113)*

cases, and pays it over to the persons entitled to it, all of course on order of the court. A cash book should be maintained showing these receipts and disbursements, and a ledger account should be kept for each case.

#### OTHER DISTRICTS OF THE COUNTY

Section 928 of the Penal Code previously mentioned as relating to the duties of the Grand Jury, requires that in addition to auditing the accounts of the county, the Grand Jury shall audit or have audited the accounts of every city Board of Education within the county, and further provides that the jury, when making an examination, shall include all the books, records, and accounts of all the officers of such county which are kept in their ex-officio capacity as officers of any special legislative district or other district created by or under the laws of the State of California in their respective counties. In this connection, it might be well to point out that city Boards of Education govern the school districts of cities operating under special charters, and not under the general laws of the State. Other school districts are managed by Boards of School Trustees. Besides the school districts, there are a great many other kinds of districts, but it does not seem wise to discuss an audit of them as a part of this paper. Most of these districts are audited along with the regular transactions of the county, the only distinction in many cases being that the monies go in and out of special funds instead of the funds of the county as a whole. Special work, however, is required in the offices of the city Boards of Education, which boards maintain records relating to their own transactions in considerably more detail than will be found in the office of the County Auditor or the County Superintendent of Schools.

Two Georgia darkies were discussing the financial condition of the country. They didn't agree. "You's all wrong," one vociferated. "Dey ain't no money sho'tage. Ah asked mah bankuh is he out o' money and he tuk me in de vault and showed me piles an' piles o' money. An' I says could he let me have jes' a little. An' he says sho' he could. Has Ah any collat'rul? An' Ah hasn't. Now dat's what's de mattuh wif dis country. Dey's plenty o' money but we'se jes' running' sho't on collat'rul."

—*The Bankers Monthly.*

# Concerning Our Graduates

- ¶ Employed in 29 states and 14 foreign countries.
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Engaged in public accounting practice on their own account . . . .	44
Comptrollers, credit managers, and branch managers . . . . .	28
Engaged in public accounting as seniors . . . . .	65
Resident auditors and traveling auditors . . . . .	63
Assistant treasurers, assistant comptrollers, etc. . . . .	45
Office managers, accountants, and statisticians . . . . .	191
Cost accountants . . . . .	15
Income tax work . . . . .	18
Engaged in educational work . . . . .	30
Buyers, collection managers, merchandise managers, etc. . . . .	58

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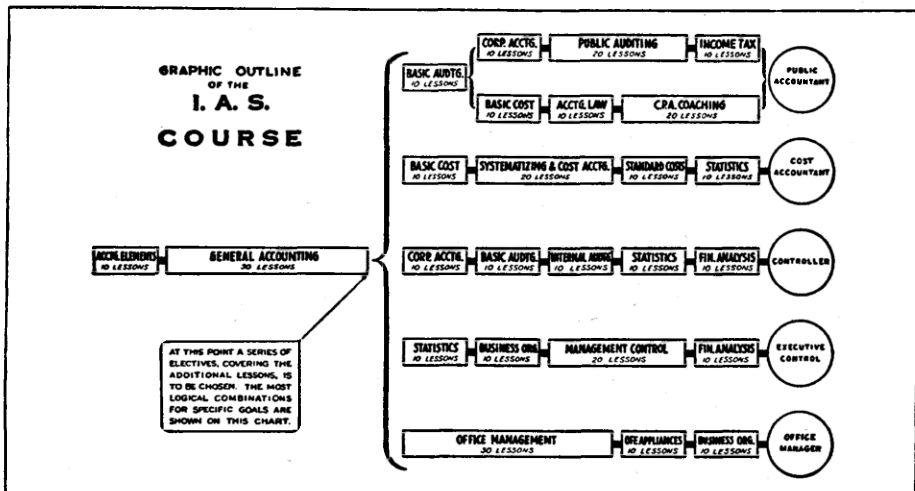
March, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants

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# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

MARCH, 1932

NUMBER 3

*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Entered as second-class matter, January, 1932, at the post office at Richmond, Virginia, under the act of March, 1879.

*"I always have to feel well tomorrow. If you live today so that you will feel all right tomorrow you do not get into much trouble."*

—Strickland Gillilan.

## The President's Page

### FEES

HENRY J. MILLER, C.P.A.

MUCH has been said of compensation for the services of Certified Public Accountants. Practically every possible basis of computing fees has been advocated. Each has had its champions, each its opponents, and no mutual agreement has ever been possible.

Today the situation has grown perhaps still more complicated by the fact that unprofitable operations have sent the business man out with his pruning shears to snip every possible expense.

The problem that confronts us is how to obtain just and fair compensation commensurate with services, giving due consideration to the vicissitudes of business, but still securing fees that permit practitioners to maintain their self-respect as members of a recognized profession.

Without attempting to start a controversy regarding the proper basis for computing fees, it is submitted that many engagements possess peculiar circumstances that sometime warrant either increase or modification of the usual fee charged. Too much stress is oftentimes placed by accountants on uniform per diem fees, which react sometime to financial detriment, or loss of professional prestige.

A fair and just fee cannot always be measured by hours at so much per hour. A fair and just fee must consider not only time, but the importance of the task performed, resulting benefits, ability of the client to pay, and even past relationship between the client and the Certified Public Accountant. Per diem fees, it is true, provide for the ability of staff members, charging more for Seniors and less for Juniors, etc., and also are graded in accordance with types of work, such as Audits, Systems, Tax Services, etc.

There are occasions, however, when they should be doubled or even trebled, because of the importance of the recommendations, or findings, or seriousness of



the evils avoided through the sound counsel of the accountant. Conversely, there are times when an engagement appearing at first to require specialized skill proves simply a matter of routine, easily within the ability of the most ordinary Junior assistant. Falling in a class of service that usually takes a high rate per diem, the engagement proves of no importance, and its completion is of no particular value to the client. A just and fair professional charge would surely be less than the highest per diem rate ordinarily applicable.

The absurdity of attempting to measure professional services by per diem fees alone, reflected itself some months ago in a decision rendered by the Supreme Court of Louisiana (No. 29, 334, April 27, 1931). Endeavoring to fix a fee for Tax Services, the court resorted to the per diem basis, largely because of testimony given by Certified Public Accountants called in by both sides. The court ruled that the time put in on checking records, gathering data, writing briefs, and preparing the defense of the taxpayer, was worth \$25.00 per diem, but that from the time the accountant left his office, boarded a train for Washington (expenses paid by the client), his compensation, including traveling time, should be \$50.00 per diem.

All of the thought, reference work, technical knowledge involved in preparing for the successful presentation the claim of the taxpayer, was valued at half the rate allowed for riding a train in comfort and interviewing Bureau officials in Washington. Yet, a sound basis for the decision was laid by the testimony of reputable practitioners, who advocated per diem charges.

The thought is presented here, that consideration could well be given by individual Certified Public Accountants and by their State Organizations, particularly at this time, to the need for frank and honest discussion of proper professional measures of compensation. Newcomers should be given the benefit of hearing and joining in such discussions, for fees are more often reduced below professional standards, through ignorance, than through deliberate intent.

No hard and fast rule can ever be devised to measure the value of our services. Were such possible, we would lose much of our professional standing. Discussions informally and at State Society meetings, however, can do much to awaken a professional consciousness of our duties in the matter of adequate fees, to the end that they will ever be just and fair to the client, the profession, and the practitioner himself.

## *Society Award*

The Illinois Society of Certified Public Accountants, the winner of the first Society Award last year in the second class, namely, the State producing the largest number of members for The American Society during the year, finding itself in extraordinarily good financial condition, has returned the same to The Society with the request that it be used for some other purpose in which The Society is interested. It will be added to the allowance for expense in connection with publicizing the report of the Committee on Classification of Accountancy Services.

## Accountancy Legislation

The *Kentucky* Society of Certified Public Accountants prepared a regulatory law and had it introduced. The large part of the time and attention of most legislatures meeting this year is necessarily concentrated on matters of finance. Attempts to reduce expense and increase income keep the average legislator busy. Legislation of a professional nature is supposed to represent a minor interest and the probabilities are that the Kentucky Legislature will adjourn without taking any action on the proposed bill.

The Accountants' Association of *New York* has introduced a regulatory bill with practically the same conditions as that which they sponsored last year. No information has reached this office with reference to any legislative action.

In *Virginia* a bill was introduced, sponsored by some of the public accountants, but not all, which would have automatically granted a C.P.A. certificate to the holder of a Public Accountant certificate at the expiration of five years of practice thereunder. The committee to which the bill was referred had a hearing, at which some of the public accountants attempt to justify the passage of such a bill. The Virginia Board and the Virginia Society made such a convincing presentation that the committee decided that the bill should not be reported out.

In *Massachusetts* and *New York* other bills affecting certified public accountants are being considered in the legislatures. In *Massachusetts* it is proposed that at the annual meeting of stockholders of a bank an auditing committee shall be elected, which auditing committee shall cause to have at least once a year, and oftener if required, an examination made by a C.P.A. not connected with the bank, which accountant must be approved by the Commissioner.

In *New York* a bill proposes to authorize an examination of the books and records of dealers, solicitors, brokers and agents by certified public accountants designated by the State Commission.

## Government in Business

With the passage of the Reconstruction Finance Corporation Act by Congress the Federal Government entered into another field of business activity, based on an emergency need.

The American Society presented a brief to the Corporation covering certain phases of its problems. Copies of the same were sent to all members of State Boards, officers of State Societies and officers of The American Society. This particular situation seemed to warrant group notice, not only at Washington but in the various states where the administrative activities of the Corporation would be carried out. Many letters from those receiving copies of the brief, as above indicated, have requested that it be printed for the benefit of the membership at large and several have suggested that a special request be made that each member read the entire communication, hence this notice and the appearance of the brief on the following pages.

# Reconstruction Finance Corporation

When the Reconstruction Finance Corporation was provided by act of Congress and appointments had been made by the President, The American Society filed with each individual member of the Corporation a brief, copy of which follows. This is presented in order that you may have first hand information as to the position taken by The American Society in the interest of the certified public accountants as a group.

While it was generally accepted in the preliminary discussions with reference to the Reconstruction Finance Corporation that it would be largely operated with persons already engaged in some other governmental service, The American Society felt that the availability of the accounting profession, as represented by the certified public accountants, should be formally brought to the attention of the Corporation. It has at all times been the policy of The American Society to present the group availability to all other groups dealing in any way with problems involving accounting or auditing procedure.

\* \* \* \* \*

## BRIEF TO FINANCE CORPORATION

One of the problems confronting your organization, in its efforts to relieve the financial difficulties in which this country finds itself, will center around the policy to be pursued in securing the needed information upon which to determine what assistance should be rendered the various applicants. In general either of three plans may be adopted.

1. Build a sufficient central force to secure, under your immediate direction, the needed information—in addition to establishing the force which will certainly be needed to work out from the information thus secured the decisions to be reached.

2. Borrow from other governmental agencies already in existence a sufficient force to secure the needed information.

3. Utilize independent organizations, already in existence, to secure the needed information, whether accounting, engineering or legal.

The tendency in establishing any new governmental agency is to immediately feel that its success can be more easily proven by the length of the payroll which it can develop than by any

other standard. Former Governor Lowden remarked at one time that one of the best evidences of immortality he knew was the tenacity with which established governmental institutions hang on to life.

It is not probable that with the experience which the members of the Reconstruction Finance Corporation have had they will feel like adopting the first plan. The life of the Corporation is fixed, although, of course, it is well known that Congress can and easily does extend these "lives" with the same freedom that they extend "leave to print."

In this particular case the immediate need for informational investigations will be the greatest ever experienced in the life of the Corporation, no matter to what extent it may be renewed, for one of the provisions is that loans shall be made within the period of one year, although that time may be extended for another year. To establish a force sufficient to care for immediate needs would result in bringing together a large temporary organization which would either have to be disbanded or would be a source of continued expense to the government after the period of its usefulness had passed.

The second plan is nearly as bad. If the government, in its other departments, has a sufficient number of trained investigators whose services are not needed in the positions they now occupy so that a force can be secured in that manner, it will be an acknowledgment on the part of the government of a condition which has continually been charged against governmental organizations that they are over-manned and that if private business was conducted with as relatively a large force as the government maintains, the possibility of the government being benefited by reason of profits arising from private business concerns would be greatly lessened.

The utilization of already existing private agencies for securing needed information would enable the investigations to be started immediately and carried on simultaneously in every section of the country. No time would be lost as in all cases specially trained organizations are immediately available.

The previous conclusions are presented on the theory that the Reconstruction Finance Corporation will probably desire to have verified financial

statements from the organizations desiring their assistance.

Referring to the information needed from an accounting or auditing angle, permit the following observations. Every State has a Board functioning in the granting of Certified Public Accountant certificates, following examinations, in ways similar to State boards in other professions. Holders of C.P.A. certificates are, therefore, in a position where their acts are subject to the scrutiny of the Board granting such certificates. The possession of a C.P.A. certificate granted by a State indicates that a certain amount of reliability can be placed upon the holder both as to competence and integrity.

The Board of Tax Appeals, in establishing its rules of practice after a careful study, and the Board which established the rules was largely composed of attorneys who were formerly government officials from the Internal Revenue Department, determined that the experience of the government prior to that time had been such that they should recognize a certified public accountant as entitled to practice before the Board on the same basis as an attorney; not because he was familiar with procedure practices but because he was trained in securing and presenting facts, which was an essential element in the work of the Board.

The experience of Nebraska in utilizing certified public accountants in a State-wide investigation of its failed banks is a specific illustration of the fact that this method secures quicker results than could possibly be obtained by either developing a force or borrowing a force. It was my privilege to have played a small part in getting that investigation under way. Something like six hundred bank failures in the State, with a guaranteed law, had raised the question as to whether or not the State Bank Guaranty Fund was bankrupt. These banks had been under State supervision so that they had been subject to the usual State bank examinations. Former Governor Shallenberger, now Congressman, a Democrat, was placed in charge of the investigation by the Republican Governor and he utilized the certified public accountants of the State for the work so that no time was lost in getting started and at the conclusion he had nobody on his hands with a job that needed to be maintained. This reference is made with his permission and I am sure that he would endorse the general plan as having been a success.

Another suggestion which might be borne in mind—banks, while gradually, year after year, increasing their demands for certified audits, have not to the same extent followed the policy of having their own books and records audited by these independent accounting practitioners.

A checking now being made of bank failures for the purpose of ascertaining whether there was any marked difference in the percentage of failures of banks with such independent audits as compared with the banks with only the usual State or Federal audits, has so far indicated that the independently audited banks have weathered the storm much more successfully than the others. That, of course, may be due to the fact that the bank officials who recognized the value of this outside audit possessed a wider and better business experience and ability than did those who merely took what under the law they were obliged to take. Probably the State of Massachusetts has a larger percentage of independently audited banks than any other State and its record of bank failures stands well at the top. In that State the failure of National banks has been more serious than the failure of State banks.

These observations are not made with the idea of disparaging governmentally conducted investigations or audits but merely as indicating that the Certified Public Accountant as a professional individual, or group, is in a position, by reason of his or its past record, where the Reconstruction Finance Corporation could utilize the services that are thus available to the advantage of the government. It would be an easily obtained service without creating any possible difficulty when it was no longer needed, as each report would be an independent and completed affair.

In conclusion, allow me to offer any assistance in the way of furnishing information as to the stringency of control in various states, or on any other point upon which you may make a request. It has been our privilege to furnish different branches of the government with information on many occasions. It is believed that the Corporation might well adopt as a principle the requirement that applications for assistance should include a report from a Certified Public Accountant when the Corporation desires anything further than a sworn statement on the part of the applicant that the facts enumerated therein are correct.

Respectfully submitted,

D. W. SPRINGER, *Secretary.*

# International Debtors and Creditors<sup>\*</sup>

By GEORGE P. AULD, C.P.A., New York City

OUR fathers and our forefathers had their full measure of afflictions of economic origin, both permanent and recurring, and those afflictions bore on them just as heavily as the distresses and anxieties of today weigh on our present population. But life in those days was vastly simpler. The economic scheme revolved around small local groups. The individual could discern most of the causes of his difficulties close at hand and he was able to grapple with them directly. He did not have to know much about what the rest of the world was thinking and doing or how it was prospering.

In the last century, however, science came along and changed all this. Great elemental forces were released from the earth and harnessed to the service of production, communication and transportation. These forces transformed the fundamental conditions of human life—greatly accelerating its pace, and bringing a bewildering complexity into the scheme of economic causation. The old system of self-sufficient local groups was swept away, and the individual became a cog in a world-wide mechanism, which linked the fortunes of producers at home to those of consumers across the oceans and at the ends of the earth.

All this has been said many times before, and it has been accepted as a truism. But a good many of its implications have been accepted incuriously. In this country particularly there has been little real appreciation of the world-wide basis of the economic mechanism by which we live. It is, indeed, only a matter of months since the thunderbolts of an international panic revealed to us that the economic interdependence

of the nations is something more than a pretty phrase coined by theorists and other suspicious characters with an international slant. It is only lately that the repercussions in this country of the German credit collapse and the unseating of the pound sterling have made us actively aware that the principles of international interdependence and international cooperation cut both ways—that our own economic life, though rooted in the greatest industrial development of history, can still be menaced or deranged by economic, political and psychological disturbances abroad.

Though we are only now waking up to these things, it can nevertheless be said that we have made fairly rapid progress, as time is counted in measuring the development of the human mind. For, it is not yet twenty years since the United States emerged from a more or less passive role in the modern world system; and that system itself, with its far flung and intricately organized commodity and money markets, had then existed hardly more than half a century since the days of its rudimentary beginnings.

For its bearing on world problems today, it is worth while briefly to recall our pre-war national circumstances. During the first century and more of our existence as a nation, the thoughts and energies of our people were turned inward. They were engrossed in the problem of domestic development—in the opening up of a continent, in the initial exploitation of its vast resources and in the building of a great railway system. They were establishing the foundations of an ordered economic system on a scale commensurate with the area, the resources and the potential population of the country. They were laying the groundwork for its present vast productive capacity. They were plowing back their savings into new productive facilities, and over and above those savings they required still more new capital for the same purpose.

That demand was satisfied for us by Europe, particularly by the English, who up to 1914 had invested in the expanding enterprises of this country over three and one-half billion dollars of British capital, for which we gave American long term securities. We were in

<sup>\*</sup>Address delivered at dinner of the New York State Society of Certified Public Accountants, Waldorf-Astoria, December 7, 1931. Reprinted by permission from January, 1932, *Bulletin* of the New York State Society of Certified Public Accountants.

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those days only dimly aware of that process of international investment of which we, as well as the lenders, felt the benefits. We had no great incentive to be curious about it or to speculate on the significance that that same process, reversed, would one day have for us, when our plant would be equipped up to and above the level of contemporary world development, and our productive capacity would provide us each year with a surplus of capital for export and investment abroad.

With each decade our industrial power became more firmly integrated, until when the war came it had reached the bursting point. But we were not prepared for the exacting role of the greatest surplus-producing, surplus-exporting and surplus-investing country, into which we were abruptly plunged. Almost overnight we became the one great nation which was a creditor on current account with the world, while England, despite substantial sacrifices of her foreign investments, was still to retain an important creditor position on capital account.

The unprecedented economic overturn that marked the war period is best portrayed by the trade and balance of foreign payments figures, as estimated or cited by the Department of Commerce, which I have arranged so as to bring out, as I see them, the nature of international capital movements and the processes of settlement therefor. During the four war years the United States exported a surplus of about eleven and one-half billion dollars of commodities, over and above imports, and in the succeeding twelve years to the end of 1930 our combined export surplus of commodities and services, over and above all incoming items, was estimated at nine and one-half billion dollars.

This great outward movement of twenty-one billion dollars of American capital was settled for by the liquidation of our pre-war net debt to Europe, estimated at two and one-half billion dollars, by the acquisition of the inter-ally debts at ten billion dollars, by the acquisition of a net commercial investment abroad estimated at the end of 1930 at nine billion dollars and by taking nearly two and one-half billion dollars of monetary gold, which more than doubled our previous stocks of that metal.

This estimated total of twenty-four billion dollars of net debts, titles to property and gold, received in settlement for an estimated capital export of twenty-one billions, indicates a discrepancy somewhere of three billion dollars. The

difference is quite probably due in large part to an overstatement of our net foreign holdings at the end of the period, arising from an underestimate of the amount of American investments held by foreigners, the accurate determination of which presents great difficulties. Our gross foreign investment is included in the figures at fifteen billion dollars, and the offset for foreigners' long and short term investments here is included at six billions. On the assumption that the latter figure is considerably underestimated, our net foreign commercial holdings at the first of this year, instead of being stated at nine billion dollars, would appear in our international capital account at say six or seven billion dollars.

These foreign operations of ours over the sixteen-year period since 1914 have been greeted with a chorus of discordant voices, variously interpreting their meaning and variously weighing their observed results and probable future consequences. Broadly, the comments have been of two kinds. European authorities emphasize that the flow of two and one-half billion dollars of gold to this country was a highly unnatural process—one which was profoundly disturbing to the monetary systems of the world and which in their view was caused by an egregious failure of this country as a creditor nation to fully invest abroad its current credit balances derived from its foreign operations. We have not played the game, they say, according to the rules.

In this country, on the other hand, looking at the figure of fifteen billion dollars of gross foreign investment, people are disposed to believe that we are over-extended as it is, and at the moment there are many who insist that we must in future drastically curtail our foreign investing activities. Let Europe, they say, make its own rules and play its own game.

Both these views have substantial elements of reason underlying them, but in their final conclusions in each case they miss the vital point. As an exposition of economic theory, the European has the best of the argument up to the point of assigning causes. At that point, however, he very humanly succumbs to the temptation to find someone else responsible for his troubles and those of the world generally. It is true that in a normal world our current credit balances ought to have been fully funded. It is correct that the funding fell short of this ideal by the amount of the gold import, or at the average rate of 150 million dollars a year over the sixteen-year period. But considering the

fact that without the contra investment by Europe here, we would have largely over-funded our balances, and the flow of gold would have been in the other direction, it is clear that the reasons for the failure reach considerably deeper than a refusal by this country to play the rules of the game. Europe must look closer home for some of the causes of the accumulation of gold in this country.

I do not mean to suggest that there should not normally have been a considerable contra investment of European funds here. It is clearly not to be expected that international investments will be all on one side or all on the other side. The estimate used of our 1914 net debt to Europe (which was assembled from other sources in a recent book by Professor James Harvey Rogers of Yale) showed \$2,350,000,000 of our funds invested abroad against five billions of foreign funds invested here. On those estimates, the smaller contra investment was 47% of the preponderating investment on the other side. So that if Europe before the outflow this fall of \$700,000,000 in gold from the United States, had six or even eight billions invested here, against our fifteen billions abroad, it is not to be assumed that the situation was necessarily an unnatural one.

Considering everything, however, it cannot reasonably be alleged that this country has not done its full share and even more toward the establishment of a normal distribution and long term funding of capital during the period since 1914. We entered this unfamiliar field of foreign financing and investing on a scale much larger than was ever undertaken in a similar period by Europe in the days of her primacy. Our people did this at a time of urgent need of world reconstruction, in the face of conditions abroad calling for considerable courage on their part, and as a consequence they are going to sustain losses (though by no means so large as the pessimists would have us believe). After all, Europe had some responsibility for the preservation of her own institutions—she had some interest in the protection of her own monetary systems from disaster, and if the fifteen billion dollars of securities which we took were not enough to balance the international account, Europeans owed it to themselves to curtail the remittances of funds which they were continuously sending here in large amounts, partly for super-safety and partly for speculation. On any judicious weighing of the facts, it was the remittances

to this country by Europeans themselves that piled up the mountain of gold in the United States.

But though this is, I believe, a fair statement, it still falls far short of making a case for our economic isolationists. We may profitably consider whether we have any alternative outlet in sight for the surplus productive capacity which we now employ on foreign account, and if not we will hesitate to promote the formation in this country of a standing army of unemployed for the dubious satisfaction to be obtained from letting the rest of the world stew in its own juices. The movement of our capital abroad took place under the pressure of powerful economic forces, and though some of the investments were injudiciously placed, it is worth the while of sensible persons to examine the facts coolly as a problem to be solved, rather than to indulge in vain and exaggerated condemnation of Europe and our own bankers.

If we have any idea, born of the depression, that the United States is not going to produce and to market abroad a substantial annual exportable surplus, we ought to correct our perspective. Retaliatory tariffs may grow up around us. They may conceivably diminish our great export trade (which for the seven years prior to 1929 averaged \$4,850,000,000 annually, while imports averaged \$4,260,000,000). They may also operate to curtail our import trade by throwing some of our diverted export product into our home market, though it may be that while English manufacturers, for example, are turning their product into their newly protected home market some of our diverted exports will go instead to her present foreign customers. But even though both sides of our foreign trade account may be reduced, the current credit balance will still remain. This balance which from 1922 to 1928 ran at an average of \$570,000,000 a year, (i. e. a net credit of \$595,000,000 on commodity trade, less a net debit of \$25,000,000 for services), represents our exported surplus production in excess of our own requirements for consumption and new capital, and it will still arise, based as it is on our superior industrial power and methods. It will still find foreign markets, as it has in the past, partly on a quality and partly on a price basis.

You may dispute this and point to the present prostration as evidence that the production of unmarketable surpluses is possible. But the truth is that the present considerable paralysis of pro-

duction is a symptom of a world-wide breakdown of credit, and so far as it is traceable to the prior condition of the commodity markets it results from unbalanced production—from overproduction of particular commodities. It is still true that in normal times when the world credit system is working properly there can be no such thing as overproduction as a whole, until, as Sir Arthur Salter says, the last Hottentot lives like a millionaire.

Now, at the risk of being tedious, I should like to elaborate a little on the somewhat abstruse but important question of the economics of international capital distribution and repayment. Every civilized nation, in normal times, produces a surplus over consumption. Whether that surplus will be sufficient for its new capital requirements depends, as I see it, on the relation for the time being between the level of its own industrial development and the general world level. If its own development is under the general level, the country is for the time being a natural debtor and will require the importation of new capital from such countries as occupy for the time being the opposite status of natural creditors. In those more highly organized countries the capital reservoirs fill up and spill over to fertilize the rest of the earth, in obedience to economic forces ceaselessly at work to equalize the general world development.

The importation of this capital into the debtor country takes the form of capital equipment or (what comes to the same thing) of consumption goods or services the acquisition of which will leave home industry free to produce the necessary fixed capital goods. This imported capital is, therefore, intended, directly or by substitution, for long term lock-up in plant or public works, and when and as imported it should be covered, and in normal times will automatically be covered, by the investors of the creditor country, say the United States. They will take up the new long term capital issues of the debtor country, say Denmark, or through triangular transactions, the capital issues of some country debtor to our debtor, say Norway. That this will happen automatically, assuming sound credit conditions abroad, is obvious, for the American investor will not find at home new capital issues for these amounts, since they represent our country's surplus saving over and above the requirements of our own industries.

This international distribution of securities is

clearly a natural and inevitable economic phenomenon. And it is the only one available as means of settlement for the international movements of real capital. The function of gold is a monetary function. It is needed in the central banks everywhere as national monetary reserves, and is not properly available as a means of settlement for the great movements of capital on their long term swings. As an instrument of settlement it is logically limited to the fine day-to-day adjustments on account of current remittances.

Going one step further, I should like to emphasize the fallacy of the widely held ideas that, failing to take gold, we must take more goods in settlement for our current credit balances, or alternatively that if we do continue to lend abroad we must ultimately be submerged by an influx of foreign commodities when the debts are paid. These ideas are based, to my mind, on a complete misconception of the economics of capital distribution. For, when the time arrives, in the long cycle of capital distribution, when the world level of industrial development is raised above ours, we will once more be in the market for foreign capital. And real capital, be it remembered, is nothing more nor less than commodities and services. Those future imports of commodities and services, then, will not be embarrassing to us. They will arrive in response to our demand for new capital, and as I have already suggested, they will either be in the form of the required fixed capital equipment or they will release home capacity for the production of that equipment.

Now, to return for a moment to one of our present debtors, let us say Germany. Germany has been incurring foreign commercial debt in the manner just discussed and in normal course she should before long emerge into a creditor position. In proportion as the proceeds of the loans have been properly applied, and the proportion is a large one, the result has been to strengthen the productive power of the country. By this process, combined with the reinvestment of her own savings, the level of industrial development in Germany has been rising, and at the point where it begins to top the general world level, she will commence naturally to produce an exportable surplus of her own. That surplus she will send abroad, as we sent ours during the war, liquidating first her foreign debt and thereafter undertaking foreign investing on her own account. Meantime, while she is still build-



ing up her plant, the investment earns its own carrying charges and the savings set aside to meet the maturing interest obligations will be reinvested where they lie by the foreigners for whose account they accrue. It is obvious that such a process of reinvestment does not imply, though it is often said, that a debtor country, whether the United States before the war or Germany in recent years, is paying its maturing interest charges out of new loans. It sets them aside out of income and the creditor reinvests them.

This process of investment and reinvestment of earnings on foreign account was always typical of the pre-war relations between England as the great creditor nation of history and her debtors. The principle is the same today as it was before the war. England's current balances, as it happened, were credit balances of ocean freight earnings, interest and other services, net, after deducting a commodity debit balance, while ours today are commodity credit balances, net, after deducting a debit balance of services. But the principle remains the same. The fact that England as a creditor exported more services than she received but received more commodities than she exported may account for the widely held idea that a creditor country must be an importer on balance of current commodity trade. But it does not make the idea any the less absurd. We are a creditor nation because our balance on commodity trade is the other way. But a credit balance is a credit balance, however arising, and we fund our credit balances in the same way that England did.

This seems to me perfectly clear. Yet no operation in the field of economics has, since the war, suffered from more general misapprehension and confusion of thought. For, back in the days when the war debts were created, someone invented the so-called transfer problem to prove that the service of those debts could not be properly taken care of unless the debtor country had an export surplus and unless the creditor countries accepted that surplus in the form of imports—each of these assumptions being, as I have pointed out, the statement of an absurdity.

As to the service of the reparation debt, the truth, as I see it, is that these charges, when raised in normal times by taxes under a balanced budget, were automatically taken care of by Germany in the same natural way as the service of her commercial debts. For, taxes pro-

vided out of income under a balanced budget constitute savings or new capital just as surely as does interest provided out of corporate income, and its reinvestment by the creditors presents no different set of problems. And the fact that the interest is reinvested where it lies indicates the fallacy of the idea that the raising of tariff barriers in the creditor country tends to prevent settlement of debts owing to it. This idea is merely a variation of the fallacy already discussed that we must take more goods in order to receive settlement for our current credit balances. Unsound as is, in my view, the tendency to raise tariffs, such a policy does not have to answer this particular indictment.

Now as to the real magnitude of our present creditor position on capital account. It is to be noted that the war-debts and the net amount of all our other foreign holdings, taken together, come to less than England's pre-war foreign investment of \$20,000,000,000—a position which despite her war losses had been reconstituted by the end of 1930, according to estimates of the *London Economist*, to that same figure in gold, from which, so far as it consisted of sterling securities, it has, of course, now fallen as a result of the depreciation of the pound.

And lest it be suggested that the comparison with England, considering her present plight, is not a happy one, it is worth emphasizing that England's troubles are not attributable to the magnitude, as such, of her long term creditor position. Not only is it clear in these days of falling prices that the lot of creditors generally is more comfortable than that of debtors; it is also apparent in particular that England's monetary crisis was precipitated as a consequence of the vulnerable technical position of the London short term money market, whereby her current liabilities to foreigners, amounting to around \$3,000,000,000 gross, dangerously exceeded her current claims on foreigners, while at the same time some of those claims were not in reality liquid.

It was not the magnitude as such of her creditor position on long term account that embarrassed England, but the fact, among others, that in recent years she had been building it up in an abnormal way. She had been adding to her portfolio of long term foreign securities, not by funding current surpluses on foreign account, which in fact were dwindling to the vanishing point, but out of short term money taken into the London discount market from

abroad. She was, as the phrase goes, "borrowing short and lending long."

The long term foreign securities taken by England over the past seven years have exceeded her foreign earnings during the same period by an amount estimated at \$1,200,000,000. This fact, and not a Franco-American plot, as some Englishmen seemed to imagine, was among the important antecedent causes of the drain of gold from England which was set up when the various crises on the continent resulted in the calling of a considerable portion of her short-term liabilities.

This recent tendency of England to over-invest abroad makes it apparent that her foreign financing and investing tradition has strongly persisted in the face of a serious impairment of the efficiency of her industry. The equal partnership of British finance and of British industry, in the days of its primacy, made England great. Recently, with her industry lagging behind and her export trade and other foreign earnings falling off, her international banking machinery has still been geared up to the old pace. The London money market has still been moving vast quantities of foreign goods with short money brought in from every part of the world, and British investors have still been taking up large amounts of long term issues floated in London through long habit by borrowers in every continent.

England's energies now need to be, as ours were before the war, turned inward. She has ahead of her, as her soundest thinkers are agreed, a drastic reorganization of her industries, implying the plowing back of her current savings into internal development projects. This will mean at least a partial liquidation of her foreign holdings, and it may conceivably involve long term borrowing by her abroad for her domestic purposes.

Thus, if the economic equilibrium of the world is to be maintained, our country, far from being at the point of drawing back into its shell, is bound further to develop its international banking and foreign investment machinery by taking over a portion of England's position and even by assisting in the reconstruction of her industries. Our economic situation makes this inevitable; and our interests otherwise will demand it. For we cannot get along without England. She is a great customer of ours, rather than a competitor, having taken in 1928 \$850,000,000 of our products and, on the assumption suggested

by the Department of Commerce that our grain exports to Canada are actually destined for Europe, the United Kingdom and not Canada ranks as our leading customer. We need moreover to see England's productivity reestablished, in order that her international banking organization may be protected in its fullest usefulness and remain available to carry a share, with the United States and France, of the burdens and risks of world finance.

In the period ahead, to the extent that we may take over England's long term commitments or participate directly in the reconstruction of her industries we shall be diversifying our foreign holdings to good purpose. In the one case we shall acquire holdings that have passed the high credit standards of British investment banking and in the other case we shall be participating in the home enterprises of a race that, whatever its shortcomings, is unsurpassed in the possession of the fundamental credit factors of moral stamina, financial integrity and demonstrated capacity for self-government.

Our European investment position today suffers from our having too many eggs in the German basket. About three and one-half billion dollars of long term money, as estimated by the Wiggin Committee, is invested in Germany, of which we have supplied nearly a billion and a half, as estimated by the Department of Commerce. We should be under no misapprehension, however, as to the basic economic credit-worthiness of Germany, as one of the two or three most powerful economic organisms that the world has ever seen. Germany, for the long term, is a first-class economic risk. Since the great inflation of the early 20's, her industries have been reconstituted, her plants are now equipped up to the minute and her people are industrious, intelligent and highly skilled.

Germany's real trouble is reparations. I do not mean that the reparation payments constitute, as is often alleged, an impossible economic burden in normal circumstances. It seems quite clear to me that they do not. The average annuity of \$475,000,000 under the Young Plan amounts to \$7.50 a head per annum or 4% of Germany's national income in 1925, as estimated by Harvey E. Fisk. This is a sizable burden, no doubt, and one the weight of which has been increased some 20% by the recent fall in prices. But it is a long way from being economically impossible.

The real weight of the reparation burden on

the German people and in consequence on the whole system of international trade and finance is psychological. The reparation problem is primarily a political problem—one which offers a continuous threat to the international stability on which the economic well-being of the world depends. With every recurring dip of the trade cycle—and we all know that these dips will recur as long as human beings are governed alternately by extravagant enthusiasms and unreasoning fears—the reparation problem will inevitably become the football of German domestic politics. There will be no escape from the return of these reparation crises as long as the debt stands at any substantial figure, and the events of the past year are evidence enough of the grave menace to the world which such crises offer.

Men everywhere like to ascribe their troubles to some external cause, and the Germans are no exception to the rule. The Hitlerite agitation in Germany lays the economic ills of the country to reparations, and advocates repudiation on that ground, as well as on the ground that the payments constitute a tribute, saddled on the defeated, which ought not to be longer borne. Today England, the United States, and the rest of the world are struggling with a widespread crisis of confidence. The preliminary phase of the economic depression had a broad economic origin in the collapse of a boom. It would not be rational, in my view, to attribute to reparations any great part in bringing on that collapse. But, with the gradual appearance of hard times resulting from a catastrophic decline in prices and with the consequent unbalancing of the German budget, the reparation question raised its ugly head.

That ominous second phase, the beginning of the international crisis of confidence, came as a direct result of the Hitlerite agitation and its threat to the stability of the German republic during the autumn of 1930. Nine months later the third and virulent phase of international panic, through which we have just been passing, had a similar origin, though reinforced on that occasion by the Austrian bank crash.

It cannot be doubted that the Hitlerite campaign against the further payment of reparations contributed as much as any other one factor to the dangerous withdrawal of funds from Germany. Germany, like England, had too many short term liabilities, estimated at about two and one-half billion dollars gross. Out of this combination there arose last June the specter of an

international financial disaster of great magnitude, which was narrowly averted by the moratoria initiated by President Hoover affecting the reparation debt and by the Wiggin Committee of bankers with respect to the payment of German private short term obligations. After this came the shock of the English crisis and the unseating of the pound sterling, which though traceable to deep underlying causes, was precipitated largely as a result of the German breakdown.

My view of reparations is that the debt is economically possible of payment but that it is not the part of wisdom for this country to maintain it in the political landscape through insistence on the payment of the inter-ally debts. One criticism of this view has been expressed in language like this: "Well, if you conclude in the end that we ought to cancel the debt, why so much conversation tending to show that it is economically possible of payment?" My reply would be that truth has value for the solution of any problem—and that a solution of this particular problem depends on an understanding of its real elements by the American public.

What convinces me that the reparation problem will not cease to be a dangerous irritant in international relations and a constant threat to world stability until the debt is cancelled or very substantially reduced, is the difficulty of finding a satisfactory answer to the second part of the Hitlerite doctrine—the cry that the payment of a tribute is no longer to be tolerated by Germany. Now although all parties in Germany do not regard the repudiation of the debt as expedient, since the immediate and most destructive consequences of such an act would fall on Germany herself, all Germans without distinction are united in an intense antipathy to reparations as a humiliating indemnity, the discontinuance of which after thirteen years is, in their opinion, long overdue.

If it could be demonstrated that the payment of reparations gives effect to some great principle of international justice such as the equitable distribution of the fiscal and social burdens imposed on the European belligerents by the war, it is conceivable that the German nation would be less restive under the obligation. But the equity or inequity of the redistribution which is effected by the payment of reparations cannot be determined. The statistical difficulties of the subject are beyond the capacity of the human mind to deal with adequately. All the nations of

Europe sustained fearful losses from the war and its aftermath, and no one can say which suffered the most.

The upshot of it all is that reparations are played out. From 1918 to July 1, 1931, the effective date of the Hoover moratorium, Germany paid approximately \$4,500,000,000, and the allies paid us about \$2,500,000,000, of which England paid about \$1,800,000,000. I have computed that the payments by Germany are the equivalent of principal and interest at 5% on a capital sum of the order of \$3,400,000,000 and those by the allies on a similar basis are the equivalent of about \$1,800,000,000, of which England's share has been over \$1,300,000,000. It is time to wash the slate clean. A new and vigorous generation is growing up in Germany, to whom the iron necessity that confronted their fathers at the Hall of Mirrors in 1919 has no meaning whatever. It is no longer practical and it is certainly not profitable to attempt to tie a highly civilized, virile and self-respecting nation of 65,000,000 people to the continued payment of a war indemnity. It is dangerous to the peace of the world to press the liberal German republic by this means into the arms of a nationalist reaction.

No close observer believes that Europe can solve the reparation question by itself. Too many practical facts tie the inter-ally debts into one indivisible whole with reparations. Two-thirds of the reparation payments normally come through to us. The allies are in fact largely out of the picture and we in reality are face to face with Germany for the adjustment of this most formidable of all the problems left by the war.

To us the maintenance of the reparation system through the maintenance of the inter-ally debts means nothing of advantage, compared with our stake in the stability of Europe. The average annuity of \$317,000,000 receivable by the United States represents \$2.60 apiece each year, and this inconsequential benefit would, year after year, with the increase in our population become even more insignificant. The annuity receivable amounts to 2½% of our national and local government costs and 4/10 of 1% of our recent national income. The idea that the payment of the inter-ally debts is important to our taxpayers has no foundation in fact. But the losses imposed upon our whole population as a consequence of the recurrent agitations in Germany against the further payment of reparations are real and substantial.

That the reparation debt can be completely

wiped out at this time seems impossible. The English can probably be expected to support such a project. But France still attaches importance, unwisely as many of her friends believe, to the approximately ninety million dollars a year which under the Young Plan she stands to receive, net, after taking care of her present inter-ally obligations to the United States and England. However, the collapse in prices now offers a convenient opening for the adjustment of the whole debt on the ground of its increased burden, provided that the United States will participate in the adjustment, as creditor on inter-ally debt account. If we can make up our minds to embrace this opportunity of making a deep cut in the debts, without reference to the principle of capacity to pay, we shall certainly witness a revival of confidence throughout the world that will restart the wheels of industry and add billions to our national income within the first few months.

At the present moment, the old question of relative priority of Germany's reparation payments and her private external debts has been revived. In my view, the importance of the subject has always been exaggerated. The question arose in the past on the presumption that German capacity for payment on both kinds of debt over the years would in some mysterious manner prove to be less than her capacity to set aside interest and sinking fund payments out of income, which, to my mind, as I have indicated, is an absurdity. At the present time the question seems to be concerned more specifically with the rights of the reparation creditors *vs.* the rights of the holders of overdue private short term debts. But both classes of payments are at present in suspense under the moratoria. As for the future, political considerations suggest that it will be a long time, if ever, before the payment of reparations on the old scale will be resumed. And for reasons connected with the proper functioning of the monetary systems of the world it seems likely that a considerable part of Germany's private short term debt will, perforce, be funded into intermediate or long term obligations.

The excessive amount of short term money which in recent years has been crashing back and forth between the great international money centers is obviously a grave menace to the monetary and credit systems of the nations as economic entities, just as floating debt is a menace in corporate and in governmental finance. The reduc-

tion of these balances by funding is the most important technical problem of the world-wide break-down of credit, and their orderly reduction is part and parcel of the over-all problem of the reestablishment of fundamental credit factors, largely psychological and political, particularly, as I see it, in Europe and India. For such a restoration we must look to the statesmen of the world for inspired leadership.

Along with that restoration, the responsibility of the bankers will extend to the improvement of the methods of foreign investment. For it is true beyond all doubt that the ebb and flow of the tides of capital around the earth are essential to the welfare of creditors and debtors alike, and that they cannot go on effectively without highly developed machinery.

For its proper operation, the machinery of international finance and investment will continue to require the broadest type of intelligence, combining great technical skill with a sound insight into economic and political conditions. And the necessity rests on the more intelligent sections of our public generally to follow foreign affairs more closely than in the past. The times are a challenge to the intelligence of all of us. The requirements are exacting, but they are part of the price to be paid for prosperity, and our prosperity, though it may now seem deeply submerged, is still basically with us and is bound to come to the surface again, in response to powerful recuperative forces which the depression itself has brought into action.

## Business and Statistics\*

By HARRY C. CARVER, Professor of Mathematics, University of Michigan

IN this paper I wish *both* to call your attention to the fact that the trend of business statistics is, and necessarily must be towards the mathematical end of the statistics spectrum, *and* to stress the fact that mathematical statistics—essentially a combination of probability and pure mathematics—is sadly in need of a rigor which only specialists in pure mathematics can supply. I am very certain that if more of you were aware of the numerous interesting problems that abound in this branch of applied mathematics, the number of these problems which we now regard as unsolved would be diminished rapidly. On the other hand I can promise you that each problem solved will probably suggest ten new ones—but that is a sign of progress.

\* \* \* \* \*

It can be said that, with few exceptions, the data collected in the course of any statistical investigation is essentially but a single sample which is more or less representative of a larger parent population, and the determination of the probability that the phenomena of the parent population does not differ from that observed in the sample by more than a specified amount constitutes the most important problem of mathematical statistics. Although much has been ac-

complished in recent years along these lines, especially by R. A. Fisher, "Student," and Pearson, we have scarcely scratched the surface of the general problem since practically all the results are limited to the case of infinite parent populations and assume that the parent populations obey the Normal Law of distribution. An excellent survey of this subject written by Paul Rider appeared in the *Annals of Mathematics*, issue of October, 1930.

The balance of my remarks will be restricted to Business Statistics.

During the past twenty years, the larger corporations of this country have been confronted by problems of administration and production, the solution of which seemed to hinge upon a successful application of statistical methodology. Broadly speaking, these problems can be classified under either of the two headings:

(a) The theory of sampling.

(b) The analysis and projection of time series.

For the most part, the need for sampling theory has originated in problems of production and engineering. It is as important to record the percentage of defective parts in samples from day to day, as it is to count the number of bacteria in samples of water taken daily from the water supply of a city. In either case a certain *tolerance* is permitted, and just as soon as it is quite certain that this tolerance is being exceeded by an arbitrary amount, something must be done

\*Excerpts from a paper presented before the Mathematical Association of America.

to correct the situation. A rather recent book by Dr. Fry on "Probability and its Engineering Uses," published by Van Nostrand, affords an excellent survey of this field. In addition it affords an excellent background for a more intensive study of mathematical statistics.

It is greatly to be regretted that that phase of business statistics dealing with the analysis and projection of time series rests on an exceedingly unstable foundation—there is absolutely no excuse for this state of affairs. For the most part this work is being done by economists and "professional forecasters" who are far more interested in making predictions than they are in estimating the probability that the actual occurrences will differ from their forecasts by more than a specified per cent.

Most of you are acquainted with various organizations which very properly describe past events by actual numerical data, but somehow insist on predicting the future trend of the same phenomena in statements that are so vague and contain so many "ifs" that the forecasters scarcely commit themselves. I insist that with very few exceptions the estimates of the future terms in time series should be expressed numerically and in precisely the same terms that will subsequently be employed in recording the corresponding facts for historical purposes. Just as soon as this is done, we can at least obtain empirical approximations for the probable errors of these estimates, and we may then expect that competition among forecasters will result both in an increase in the reliability of forecasts and in a corresponding decrease in the number of forecasters.

The usual excuse that is offered by economists for not employing mathematical statistical methods in their work is that the data is so subject to error that the use of more refined methods is not warranted. As a matter of fact, the best reason for employing mathematical methods is the fact that the data is so inexact—if the data were exact and obeyed a simple law there would be no use for mathematical methods. The problem of combining and weighing the various elements so as to make the best of a bad situation is essentially a problem of maxima and minima, the probable errors are functions which require the determination of these maxima and minima, and these operations cannot be carried out properly by any individual who is without training in calculus and the theory of probability. It is highly desirable

that our students of business administration possess a sufficient mathematical background to enable them to know at what point in their work they should ask the aid of mathematically trained statisticians.

But do not infer by these remarks that the mathematical statisticians are at the present time capable of solving all the problems that might reasonably be submitted to them. Nothing could be further from the truth—for instance the entire theory of sampling will probably require fundamental alterations in order that it may be applied to time series, since each sample contains ordered variates with respect to time.

I believe that by the time the mathematicians realize the importance of this branch of applied mathematics, the business world will be insisting on a better cooperation of mathematics and economics, and forecasting will have ceased to be a racket.

The foregoing remarks were augmented by a discussion of the results obtained by the various forecasting agencies. It was suggested that much might be gained if some prominent publication, such as the *New York Times*, were to sponsor a project of competitive forecasts. That is, representative agencies might be given the opportunity of presenting numerically each month their estimates for each of the following six months for each of say six series, to be selected in advance by the paper from a list of series that are of real national and economic significance. Such a group might be composed of such representative agencies as Harvard School of Business, A.T. and T., Cleveland Trust, Babson, and Standard Statistics. We would all like to see the results of such a contest, especially if each would accompany its estimate with an index of its reliability.

Mathematical statistics have now reached a stage where it is possible to make such predictions and accompany them with their empirical probable errors for any limited number of months ahead. Admittedly these probable errors are large, sometimes as great as 100%, but it is far better to be honest and admit a great degree of inaccuracy in an estimate than to publish an estimate and expect the consumer to draw his own conclusions as to its accuracy.

The first step in improving our forecasts is to publish all forecasts numerically and accompanied by their indices of reliability; the second step is to encourage research endeavoring to reduce these probable errors.

## Accurate Construction Costs<sup>\*</sup>

By CARL E. DIETZE, C.P.A., Milwaukee, Wis.

THE subject assigned to me for discussion is a most important one although the question has been well asked—of what good are costs in times like these when no one pays any attention to them? Judging from many of the bids which are submitted, this is apparently true. Much of this type of bidding is done by irresponsible concerns who probably are working and using up some one else's capital, or are skimping on material and workmanship. Many old established firms at the present time are taking work at prices that will only cover their actual labor and material costs, possibly their actual job overhead costs, and some, or none, of their administrative expenses. Work taken by responsible firms on this basis, under actual costs, is usually to tide over a temporary period only, and is primarily for the purpose of maintaining their organization and in endeavoring to save as much on their overhead expenses as possible, as many of these expenses are fixed and will continue regardless as to whether the firm is busy or idle.

The unfair and unscrupulous competition must necessarily be eliminated through a concerted action of responsible contractors, bankers, material supply and equipment dealers, and bonding companies, by their demanding that all bids submitted must show financial responsibility and constructive competence before their bids are accepted. This will naturally mean a material saving in bad debt losses to all concerns lending credit to these irresponsible companies. It will leave the field open to responsible contractors who will then know that an estimate, based on costs, will again have its inning.

There can be no question of doubt that irresponsible bidding, at less than actual costs, can not long continue as it means a gradual eating up of working capital, a curtailment and loss of credit, and a loss of position.

Irresponsible bidding based on ignorance of contractors as to true costs must naturally lead to their schooling into the art of keeping both

good accounting and costs records, and into their making proper use of these records when so obtained. It is in this way only that the contracting industry will attain the position to which it is entitled and which the public expects of it.

In the time that is at my disposal, it will be impossible to go into much of the mechanics of keeping costs, talking about the proper forms to use, of how time should be kept, material ordered, checked and used, or how to treat overhead expenses. I feel that everyone knows more or less about the subject under discussion here today. When you stop to think of what accounting and cost keeping really is you will readily agree that it is an application of common, ordinary, horse sense. Unfortunately, the application is not used as much as it should be, but we all live and learn, some of us through costly experience, others through seeing a light and profiting by the experience of others.

In speaking of costs, we naturally mean expenditures made for production. These can be in the form of direct labor, direct materials, or overhead, the purpose of which is to create marketable assets, finished products, or services to be sold. The keeping of these records is called Cost-finding, or Cost-keeping. Cost-keeping has been defined as the service rendered a business by accumulating expenditures made for production, by determining quantities produced, and by developing their unit costs. This accumulation of data and the development of costs have for their primary object the study of actual production costs, and their reduction whenever possible. Cost-keeping analyzes the sources to determine where production losses can be reduced and profits increased.

In most lines of business, the keeping of cost records is for the primary object of first determining costs and then fixing the selling prices. In contracting, however, the selling price of construction work is generally agreed upon in advance, before the actual cost of work contracted for can be determined. This latter statement is, of course, true as far as costs are concerned on the particular work bid on, but the selling price

<sup>\*</sup>Delivered at the Annual Convention of Associated General Contractors, Milwaukee, Wisconsin, January 20, 1932.

quoted was naturally based largely on experiences gained and costs determined on previous jobs, which makes the keeping of costs of two-fold importance—first, to maintain a control over the cost of production while the work is in progress by analyzing unit costs with a view of securing the minimum of costs possible under existing conditions, and second, to obtain accurate information which can be used as a basis in determining prices of future work.

Grant, in his book on Practical Accounting for General Contractors says that "As a result of the analysis of unit costs, followed by a comparison of the items with the corresponding items of similar work previously done, the management may discover:

1. Excessive use of materials in erecting a given structure.
2. Excessive use of supplies such as coal, lumber, etc., in operating a plant or in construction work, whether due to ignorance, carelessness, or theft.
3. Inefficiency of foremen.
4. Inefficiency of workmen.
5. Padded payrolls.
6. Excessive waste of time due to plant breakdowns, the shifting of plant, waiting for materials, supplies, and so on.
7. Improper design of plant."

Cost-keeping brings out other things that reflect themselves in more accurate and cheaper costs as is shown in the case of supervision. It has been found that fewer bosses are required in certain classes of work, and that one skilled manager can direct more men with greater effectiveness than is possible where a cost system does not exist. The studying of costs leads to ways and means of reducing the same. This is amply evidenced by the efficiency and savings gained through the introduction of machinery in the past.

The keeping of costs is nothing new; the keeping of accurate costs and of uniform costs in industries is, however, relatively recent and much more scientific.

You have all heard of the establishment of Standard Costs by most of our foremost manufacturing companies, and of the Budgetary Control of running a business. You gentlemen will not admit that other lines of industry, be they manufacturing or trading, need safeguards that you must not have in your own business in this day and age when work is done on a larger scale, needing greater supervision and control than ever, and with competition hungrier than

ever before. You, too, must have your Unit and Standard Costs, and a budget, if you please. Your estimates, which are your estimate of receipts and costs, correspond to the estimates of receipts and expenditures of the business operating under budgetary control, your budget, of course, differing in that it covers the individual contracts for which estimates are made and bids submitted.

The importance, therefore, of making up your estimates cannot be over-emphasized. These estimates must necessarily be made up by engineers or estimators who are thoroughly competent, efficient and accurate. The material prices which they use must be up to date, probable trends must be considered, they must know unit costs, and be thoroughly versed on the labor market, not only as to the wage scales but also as to the efficiency of labor. All work must necessarily be done with great detail, properly summarized, re-checked for prices, extensions, and additions, before submission as bids for work.

The selling price of your efforts are made up by your estimators, plus any margins added for overhead and profits put on by the executives in charge or by the contractor himself. No amount of accurate cost keeping will be able to offset material mistakes made in your estimates. Recently a Milwaukee contractor submitted a bid which would have resulted in a material loss to him had it been accepted prior to its withdrawal, due to an error in using a wrong cost price of a certain material which was to be used extensively in the construction of the building. Many contractors have not been so fortunate in being allowed to withdraw their bids after their submittal, after having discovered errors in the bids submitted due to various reasons.

It is said that the real profits made in contracting are in beating the estimates as originally made. Estimates entirely too low cannot be beaten and often result in material losses on the entire undertaking. Beating the estimates and trying to offset errors made in the estimates is, of course, what has led to much of the present day efficiency in contracting. A large contracting firm in the East some years ago discovered after they had submitted their bid that they had omitted an entire page of their estimate computations, the total of which was omitted in the bid submitted. Nothing but a heavy loss stared them in the face if they were to complete the contract under the old methods used in con-



tracting, but necessity being the mother of invention led them to revolutionize the method of pouring concrete, thereby turning an apparent loss into a material gain. Unfortunately every contractor has not had this good fortune. With a result that many have been completely wiped out in the past due to errors made in their submitted bids, and also to other reasons some of which were unforeseen and some beyond their control.

The old-type contractor, such as the specialist whose building operations were small but of importance, worried little about accurate construction costs, and less of overhead expenses.

In this day and age there must be proper keeping of financial records, and of accurate construction costs.

#### DISTRIBUTION OF EXPENDITURES

In analyzing the various costs entering into the construction work undertaken, be that of erecting buildings, dams, bridges, roads or the laying of sewer and water mains, we find that they consist of

- Direct Labor,
- Material,
- Overhead Expenses.

These are oftentimes further classified as

- Direct Labor,
- Material,
- Sub-contractors,
- Equipment Rental and Expense,
- Overhead Expense.

Knowing that the expenditures which are to be made are not all of the same classification, it is, of course, necessary that proper records be kept in which these various expenditures can be properly recorded, showing not only the financial liability incurred in purchasing these various items, but also in properly distributing them to the contracts and jobs for which they were incurred. Not only must the expenditures be charged against these various accounts, but there must be a further distribution to the various groupings, classifications, and sub-classifications as shown by the estimates prepared.

Every contractor must necessarily have sufficient accounting records. The bigger the undertakings the more records and detail required. For keeping costs, there must be both efficiency and simplicity. The former is naturally the more important, and whatever records are necessary to give this efficiency will naturally determine just what records should be kept in keeping costs. Ordinarily distribution sheets or printed forms are all that are necessary. These can be

made to serve many purposes, not only of the distribution of labor, material, and overhead costs as between contracts but as between groupings and classifications. These costs should be summarized weekly, and comparisons made with estimates in detail. There must be job reports from the foreman on the job showing progress of work, the amount of material used, distribution of labor, and of work completed. This would show the number of bricks laid, or the cubic yards of concrete poured, the time taken, number of men employed and hours worked, and the material used. From this latter information unit costs are worked out.

In making these distributions, no difficulties should be encountered as practically all expenditures are direct costs. There is not the overhead distribution problem which is faced by the manufacturer. Distributing overhead expenses between various groupings and classifications on a certain contract may, of course, give some little additional work, but not necessarily any difficulty as to the method used.

In the matter of labor costs, it is, of course, of first importance to see that each laborer's time is properly recorded on daily time sheets by the time-keeper and a proper summary of time made at the end of the week showing the total hours worked, the rate per hour, and the extension showing what the wages amount to in dollars and cents. In addition to this keeping of time, it is incumbent on the foreman to show a proper distribution of this time as between various contracts, and groupings and classifications thereunder in order to get the labor costs properly charged to that classification causing its outlay.

Material costs must be properly controlled, first through the proper ordering of material, second as to proper deliveries, which should show the contract or job to which delivered and quantity of material delivered, a proper checking of these deliveries by material checkers, and a proper checking of invoices by the bookkeeping department when received. Care must be taken that all material taken from stock is charged to the contract, and that all unloading and delivery costs be included as a part of the material costs. The foreman on the job must report all material used in construction which will enter into the computations of unit costs, and for computing actual costs to be used in comparing with the estimates. Credit should be given for all material and containers returned.

No particular difficulties should be encountered in dealing with sub-contractors as far as accurate costs are concerned. The contract made with the sub-contractor will necessarily bind him at the specified price agreed upon, giving effect, of course, to any additions or changes agreed upon from the original plans and specifications. Many times losses have been suffered by contractors through the defaulting of sub-contractors, whereby it was necessary for the general contractor to complete the work himself at costs in excess of the original estimates. In order to safeguard himself against this contingency of loss, a bond should be demanded of the sub-contractor when deemed necessary.

All construction work necessitates the use of equipment, the bigger the undertaking the bigger and more costly the equipment which is to be used. No work undertaken therefore is devoid of equipment costs.

In the case of the purchase of new equipment it should be charged directly against the contract for which it is to be used. Some of this equipment so purchased will necessarily be used up completely during the course of construction, leaving no salvage value whatsoever. This will, of course, leave no credit to be allowed the contract for equipment on hand at the completion of the work, the entire costs of the equipment therefore being a part of the cost of construction. In the event, however, that some of this equipment is on hand at the completion of the work, a salvage value should be placed thereon and the contract given credit for such salvage amount. In addition to these actual outlays for equipment, all repair and maintenance expenditures are to be charged to the costs.

Where the purchase of new equipment is not necessary, due to the firm having all necessary equipment required, care must be taken that a proper charge is made for all equipment used. All equipment depreciates and sooner or later must be junked and replaced. This means the loss of the original investment, and this loss must be provided for. This is done through making a rental charge for the equipment so used. What constitutes a proper rental charge is based on several factors. First, a rental cost should not exceed the rentals charged by equipment companies renting out equipment at specified rentals. Second, a rental charge made up should take all factors into consideration which are

Economical length of life of the equipment

Annual depreciation  
Equivalent annual interest at  $6\frac{1}{2}\%$   
Annual shop repairs  
Annual field repairs  
Storage and incidentals  
Insurance and taxes.

The sum of these expressed in percentages will give the annual charge per cent of initial investment. In making this statement, I am but calling your attention to your own "Equipment Experience Tables," prepared by your own Association and adopted in 1908, revised in 1916 and 1921, and for all intents and purposes is as proper today as it was then.

Knowing what various expenditures enter into the annual charge of equipment, one more factor must be known before proper rental charges can be determined upon and that is idle time. How much of the time is the particular equipment in use and how much unused or idle? Your own experience records should best determine that question. This will naturally also vary from year to year. At the present time, due to the lull in construction, equipment is used but little. Equipment properly housed will depreciate but little when not used, although such items as interest on investment, insurance, and taxes go on nevertheless. From the experience table referred to, it is seen that a steam mixer's total annual charge is 40% of the initial investment. Suppose that this mixer is used on an average of 26 full weeks a year; this means that while this mixer is so used, that this 40% must be provided for out of these 26 weeks, or at the rate of 1.54% a week. A mixer costing \$1,000.00 would entail a rental charge of \$15.40 a week, which amounts to \$400.40 for the 26 weeks of actual usage, equivalent to the annual charge.

The use of the above mentioned table, which I commend, should be universal by all contractors so as to get conformity into estimating costs as far as equipment costs are concerned.

Where the equipment rental basis is not used, care must be taken that adequate depreciation charges are made in all cases. The life of the equipment depends on usage made. For depreciation rates, I again refer you to your own Experience Tables.

The element of job overhead expenses naturally varies with the size of the work at hand, the bigger the job the greater the outlay for expenses. Included in these expenses are salaries paid to engineers and assistants, foremen, time-keeper, material checker, watchman, water boys, architect fees, office expenses, including field

office construction, heat, light, telephone, and supplies, insurance, and bond costs.

General and administrative overhead expenses naturally are as important to contracting as actual direct job costs. These expenditures include salaries of executives, estimators, clerical force, traveling and soliciting expenses, office rent, and expenses, insurance, interest, taxes and miscellaneous.

The distribution of these overhead expenses is usually done by several methods,

1. Labor hour
2. Material and labor costs
3. Arbitrary methods.

The second is the more popular as it is the easiest to use.

Having discussed hurriedly and briefly the various elements of costs entering into construction costs, no job is complete unless something is done with all the information gathered showing the expenditures made, reports of foremen or engineers who have weekly reported on the construction progress made, and of the material and time used. Proper unit and standard costs should be developed from this information which will be available in preparing future estimates. It is naturally presumed that the general books of accounts have been properly kept and showed at all times what the receipts and expenditures were, amounts owing and due, and of the final profits and loss. Accurate cost records must necessarily tie in with the expenditures shown by the company's general books of account. This naturally checks one against the other and shows the relative importance of a good accounting system as well as accurate construction costs.

Unit and standard costs are as important to contractors as standard costs are to manufacturers.

The laying of 1,000 bricks constitutes a productive unit. The cost of laying these 1,000 bricks, including labor, material and overhead, constitutes a standard cost of laying 1,000 bricks. These costs naturally vary for laying different types of brick and on different types of work. Pressed brick cannot be laid as fast as common brick, and it takes longer to build a chimney than a wall. Standard costs must therefore be computed on each separate unit of production.

A contractor having standard costs must necessarily be on guard to watch for fluctuations in these costs. Changes in material prices, wage scales, and of labor efficiency must all be taken into consideration in adjusting these costs when using them as bases in making future estimates.

Nothing has been said about costs for labor and material in erecting and installing proper sheeting, braces, shoring, concrete footings, wall trenches, and all other structures which may be necessary to erect foundations, walls, floors, etc. In some instances these costs may exceed the actual costs of the work contracted to be done as is seen in the construction of a coffer dam often exceeding the cost of the dam itself.

All these costs naturally enter into construction costs and are so taken into consideration in making up estimates.

The keeping of accurate construction costs should be as important in cost plus contracts as in lump sum contracts as the purchaser is entitled to be served to the best of the contractor's ability and at the lowest costs. Being so served, it creates confidence in the contractor and redounds to his future benefit.

Due to the lack of time and also to the talks given by the previous speakers, many things have necessarily been omitted entirely or but briefly referred to, including the evil practice and resulting losses of taking second mortgages or preferred stocks in part payment of the contract consideration, which adds an element of uncertainty to costs due to these losses. Technicalities were purposely omitted, and certain deviations from the subject proper were made due to conditions prevalent in the contracting industry, as well as in other lines of industry, during this present period of depression.

In closing I want to take this opportunity of thanking you on the part of myself and also on the part of The American Society of Certified Public Accountants, whom I represent here today, for this privilege of addressing you, and repaying in part for the splendid talk which your Mr. Ragsdale, of Memphis, made at our Memphis Convention last October. Thank you.

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#### THE CONTAGIOUS SMILE

Smile a smile;  
While you smile,  
Another smiles;  
And soon there are miles  
And miles  
Of smiles,  
And life's worth while  
If you but smile.

# Stop—Look—Listen

By HOMER A. DUNN, C.P.A., New York City

THE accountancy profession is presumed to hold no briefs and to have capabilities for developing, classifying, analyzing, and bringing facts into relation with other facts. A movement has been launched, with the hope of legislative approval, which calls for the exercise of these professional attributes and which warrants the use of this headline.

This movement has for its objective the election of a corporation's accountant by its stockholders at their annual meeting, which would be in conformity with British practice under compulsion of law. A bill embodying that feature is reported to have been introduced in the legislature of the State of New York, with the hope, of course, that it will be a precursor to similar enactments in other legislatures. This proposal is but one of many that have been born out of the mental disturbances arising from the deflation through which we have been and are now passing. But, if put into effect, would it be a future preventative or palliative of such conditions? In his concern over the public welfare, that is the question upon which the professional accountant will concentrate his intelligence, his experiences, and his observations.

At first blush, and without stopping to consider certain facts and bring them into relation with other facts, this proposal would seem to be a move quite in the interest of the public welfare and at the same time favorable to the accountancy profession, but let's see if it is.

In our geographical spread of shareholdings and consequent manner of carrying on meetings of stockholders; in our variety of law conditions, economic conditions, and habits of thought in the various states; and in our variety of corporate organization conditions and customs, there is an entire absence of analogy with corresponding conditions in Great Britain.

Consideration of the application of such a restriction well may be confined to corporations whose stocks are listed on exchanges because of the distribution of their stocks among many holders. It is a notorious fact that the representation of stockholders at the annual meetings of corporations of the latter class is almost wholly through the medium of proxies. Obvi-

ously, under such conditions, the same proxy voters who elect the directors would elect the accountant. Here, again, is lack of analogy with conditions which obtain in Great Britain, where annual ordinary meetings of shareholders are attended by a sufficient number in person to either exercise control or to command consideration. Distances there are not so great as here, besides which there is a more pronounced disposition on the part of shareholders there to have a personal "look in" on the proceedings and hear the reports read, even though meager in information, and the statement made by the chairman, even though equally meager. And here and there a shareholder may be found who gets a personal satisfaction out of doing "a bit of hectoring," though it be to no avail.

The Chamber of Commerce of the State of New York is to be congratulated upon seeking to serve the public interest through the appointment of a committee to consider and report on the question of the desirability in this country of placing upon the stockholders the responsibility for electing the accountant who shall audit and report on the corporation's accounts and affairs, and especially upon having included in that committee two members of The New York State Society of Certified Public Accountants who have both rendered distinctive service heretofore to the public and the profession and one of whom is president of the Accountants Club of America, and a past-president of The American Society.

The question has been debated in The New York State Society of Certified Public Accountants, but with the preannounced purpose of stimulating thought on the part of members in respect of the three angles—stockholders, directors, or management—and not for the purpose of having the Society take any position on the questions involved. The debate resulted in the expression of a variety of views and it became manifest that not all of the debaters had a particular relish for their assignments. It is suggested at this point that if there should develop a considerable agitation of the question of the source from which the public accountant should derive his appointment, it will become desirable

for the profession as exemplified in the Certified Public Accountant to take at least an advisory position, since there are none better qualified by experience to serve in such a capacity.

Inasmuch as the responsibility of directors to stockholders is inground into our laws and customs the professional accountant well may look charily upon any movement which might place him between two such millstones, and he and others may well question whether having him so placed would tend to serve the public welfare. The most reasonable and logical movement would seem to be one that would make the responsibilities of the directors statutorily better defined and more potent. Some recent situations have, in fact, indicated such a need. Citations would take up too much space. Those who have kept abreast of the times know of them. Those who keep informed know also of the measures which have been adopted by the New York Stock Exchange to force corporations into publishing more informative reports and giving them greater publicity. Such measures are bound to contribute to the public welfare, and in that the professional accountant has a part to play, remembering that, "Rome was not built in a day."

In the consideration of the responsibilities of directors, in situations where a professional ac-

countant is retained to audit and report on the accounts and affairs of a corporation, a very practical measure would seem to be to impose on the accountant an obligation to render his full report to each and every director and, so, leave to none such an excuse as some have sought to employ in connection with efforts to defend themselves against civil and criminal actions at law, either or both.

Political forces are often charged with a tendency to restrict or hamper human initiative and progress to a degree that necessitates constant watchfulness and effort to circumvent or overcome it. If this restriction which is proposed should be imposed on corporations, thereby placing the professional accountant in a kind of privileged class, the next restrictive movement, judging by legislative tendencies, might be to hedge him about with regulations, formulæ, and forms and thereby impose upon him a rule-of-thumb sort of procedure instead of leaving him free to follow the technical procedure which has been and which may in the future be developed within the profession. Are there not, therefore, lurking around the legislative corner possible dangers sufficient to make it desirable for the accountancy profession to "Stop, Look, Listen?"

## Offers in Compromise of Federal Income Taxes<sup>\*</sup>

By PAUL K. OWEN, C.P.A., Newark, N. J.

**O**FFERS in compromise constitute one of the relief provisions in the present tax law provided for the benefit of those upon whom payment of taxes for deficiencies would work a real hardship.

In years past the principal use made of these was for purposes of eliminating the \$1,000 specific penalty for failure to file returns on time. Minimum amounts for which settlement could be made were \$5 for individuals and \$10 for corporations. Then again offers in compromise were frequently made use of for the avoidance of the penalties incurred through failure to pay on time. The 5% penalty and 1%

interest per month could in ordinary cases be compromised for one-half of 1% per month.

However, at the present time, the offers in compromise find a place in the regular scheme of things for more important use. After the determination of a deficiency wherein all the merits of the particular case had been decided on and the taxpayer is resigned to the amount payable but finds his financial condition to be such as to make it practically impossible to make payment in full, the offers in compromise permit a thorough review of his ability to pay and his liability may be settled accordingly.

The change in conditions brought about by the panic of 1929 finds numerous taxpayers with no visible means of paying deficiencies determined subsequent thereto for periods prior,

<sup>\*</sup>Delivered at meeting of The Society of Certified Public Accountants of New Jersey, on February 10, 1932.

and, even the taxable year 1930 may have disclosed profits that happenings in 1931 eliminated the possibility of paying for.

A compromise such as contemplated herein is not such a one as is reached prior to the determination of the sum due. This eliminates from consideration the various items that may come up during the course of a field or other examination wherein the examining officer may waive certain items because of incomplete proof in consideration of certain other disallowances which the taxpayer agrees not to contest. The items just enumerated come before the possible signing of a consent to an assessment or waiver of appeal to the Board. Offers in compromise are in order even thereafter.

It is unnecessary to cite laws and regulations in this connection as they are available to any one. The local practice at the present time appears to be as follows: An offer in compromise is filed in duplicate with the collector. The offer sets forth that it is to be actually accepted by the Commissioner with the advice of the Secretary of the Treasury (and recommendation of the Attorney-General is filed subsequent to commencement of an action), before being considered as affording the relief requested.

The taxpayer at the present time is also required to waive any right to payments previously made, also to any refunds he may be entitled to not in excess of the liability attempted to be compromised as well as to the benefits of the Statute of Limitations during the pendency of the offer, for a maximum period of two years.

Offers in compromise are classified as being under \$500 or over \$500. Those that are under \$500 are handled by the Collector's officers exclusively, who investigate and transmit their recommendations to the Commissioner direct. The larger offers are simultaneously handled by both the office of the collector and that of the Internal Revenue Agent in charge.

Representatives of both offices call on the taxpayer. A balance sheet is requested and examined carefully, in a manner similar to that which a credit man would make. A thorough analysis of assets is made even to the extent of determining liquidation value and availability subsequent to secured claims. Taxes, unless reduced to liens, are preferred to unsecured creditors and consideration is given to the realization and liquidation value of the balance sheet. The statement that the examination is like that of a credit man has been used advisedly for the De-

partment's representatives are very careful not to disturb the credit standing of the taxpayer to any extent whatever. For instance, ordinarily no direct inquiries are made from creditors in a position to injure a taxpayer by an immediate demand to liquidate loans.

After the investigation of the balance sheet, the agent's and collector's representatives work independently of each other, investigating matters not disclosed by the books such as ability to continue in business and remain a taxpayer if a favorable report be rendered on the offer; adequacy of the amount offered taking into consideration all the special circumstances of the individual case; arranging for increasing the offer if circumstances warrant with the possibility of immediate additional payments or in installments; determination of the bonafideness of inability to pay in full; consideration of possible legal insolvency of taxpayer upon failure to accept offer and numerous other angles that may present themselves.

The agent's and the collector's representatives then advise each other of their findings which are made to conform in the results and recommendations and then have same transmitted through their respective offices to Washington.

The investigation must disclose insolvency to permit compromise of the actual tax itself. However, the penalty and interest may be compromised on the merits of the case without actual insolvency.

The Commissioner is given a wide latitude in the compromises permitted. Considerations of justice, equity and public policy may warrant a reduction of the amount to be collected as penalties which are unduly severe in view of the culpability in accordance with 31, Attorney-General's Opinion 459.

Revised Statutes, Section 3229, permits the compromise of civil or criminal cases arising under the tax laws. Amounts offered in compromise are placed in a special deposit account until the offer is accepted or rejected at which time said sums are either returned or transferred.

The above Revised Statutes Section has been supplemented by Section 616 of the Revenue Act of 1928 which reads as follows: "Any person who, in connection with any compromise under Section 3229 of the Revised Statutes, as amended, or offer of such compromise, or in connection with any closing agreement under

*(Continued on page 156)*

# Professional Prerequisites to the Attainment of State Certificate<sup>\*</sup>

By CADDIE H. KINARD, C.P.A., El Dorado, Ark.

A NUMBER of prerequisites should be considered in the attainment of the State C.P.A. Certificate. However, because of limited time, I shall not attempt to discuss all of them, but shall confine my remarks to those which, in my opinion, are the most important. These may well be placed under three major headings, namely:

1. Care and thought in selection of accounting as one's chosen profession.
2. Training:
  - (a) Academic.
  - (b) Professional.
3. Examinations.

Before making his final decision to train for the profession of accountancy, the aspirant should be sure of his natural capacity or ability for that work. In other words, he should be confident that he is suited to the work and the work to him. This being true, it follows that he will have a desire to put his best into it, and to carry on the high ideals of the profession. It might be well for him to take an inventory of himself to determine how many of the following qualities he has or can cultivate, for upon these largely depends the success of the auditor:

First, there are certain mental faculties which are necessary in public accounting. Two of these are the analytical faculty and the imagination. Analytical ability enables one to more readily grasp all the elements of a problem, and to make such an analysis as will distinguish between a superficial resemblance and an essential interdependence. Through the proper use of imagination, one may keep before him an image or mind-picture of the entire field to be covered, so that sight will not be lost of one part during the time that attention is being concentrated on another part.

Tactfulness is another quality that will prove invaluable in every phase of professional life. Although there are times when the professional auditor must take a firm stand, still in a vast

majority of instances kindness and persuasion will yield results when everything else has failed. If the auditor is considerate of the feelings of the client and his staff, he will ordinarily have every courtesy shown him.

Respect for confidence is an art which should be developed by the student of accountancy. After the professional auditor has completed an engagement, he is supposedly informed as to all the private business matters connected with the concern examined. Such information should not be imparted except to those justly entitled to receive it. This being true, then it is imperative that the auditor be exceedingly careful as to when he discusses his finding and to whom the information is given. Good ethics demand that discretion be exercised in every walk of life.

A good personal appearance is indispensable. No progressive or modern executive approves an untidy representative. Cleanliness invites patronage. The clientele, present and prospective, prefers the professional man who is neatly clad and whose person is not neglected.

The academic training of prospective accountants varies. Most of the laws regulating the practice of public accounting require that the aspirant for the C.P.A. certificate have at least a high school education or its equivalent. A college education is more desirable because it provides a better foundation upon which to build a professional career. The American Institute of Accountants through its Bureau for Placements is endeavoring to induce young men who have a college education to enter the profession.

Most C.P.A. examinations being rigid, as they must be in order to maintain the high standards of the profession, it is essential that the aspirant be well trained. The training must of necessity consist of a professional course of a high order and an extremely varied experience in accounting work. I feel that academic education alone will not make a finished accountant. It is necessary that rules and facts be understood and the

<sup>\*</sup>Address delivered at Four-State Meeting, Shreveport, Louisiana, November 16, 1931.

underlying principles be reached. In other words, one must not be satisfied simply with the "how" but must know the "why."

I do not know of one who expressed this idea more clearly than did Dr. Henry Van Dyke when he said: "The chief benefit that a good student may get in a good college is not a definite amount of Greek and Latin, Mathematics and Chemistry, Botany and Zoology, History and Logic, though this in itself is good. But far better is the power to apprehend and distinguish, to weigh evidence and interpret facts, to think clearly, to infer carefully and to imagine vividly."

I have always been inclined to take the position that the professional auditor is a historian and not a prophet. I still cling to that opinion to a large extent, but in this modern age, conditions are rapidly changing, and if the Certified Public Accountant is to render his client an invaluable service, it is essential that he be in a position to estimate the ultimate outcome far enough in advance to inform his client regarding future business trends and conditions. My experience has been that executives not only appreciate, but welcome constructive suggestions and business counsel from a competent source. After the examination has been finished and all the facts and figures on any particular engagement are before him, I know of no one in a better position to intelligently discuss the problems of that enterprise than the professional auditor.

In every State, territory and dependency of the United States, there is a law governing professional accountancy. In some states, however, the practice is restricted to the holders of C.P.A. certificates with the exception of those persons allowed to practice as Public Accountants until they have been able to pass the examinations admitting them to practice as Certified Public Accountants. Other states permit any one to practice public accounting, but only those who have met the legal requirements may style themselves as Certified Public Accountants. The aspirant for the C.P.A. certificate is required to pass an examination as set or conducted by the Board of Accountancy in the State, territory or district in which he is seeking registration. An application must first be filed with the Board of Examiners, using the special form provided by that body, who must have satisfactory evidence that the applicant has reached the age

provided by law and that he is of good moral character and possesses the necessary academic and professional training. Usually it is compulsory that the application be filed several days prior to the dates set for the examination, and that it be accompanied by a fee legally fixed by the local government.

At the present time, thirty-five states and territories use the examination questions prepared by the American Institute of Accountants, and eight states and the District of Columbia are using the Examination Service furnished by The American Society of Certified Public Accountants. The total number of candidates taking the examination is practically the same in each of the two groups. The remaining states and territories use their own test questions and problems.

The rules of the Board of Examiners of the American Institute of Accountants provide that the "examinations shall include questions in (1) Accounting theory and practice, including optional problems in the elements of actuarial science, (2) Auditing, and (3) Commercial law. The time required shall not exceed two days."

The subjects covered in the Service furnished by The American Society of Certified Public Accountants are practically the same as those used by the Institute, except no mention is made of actuarial science, but they include economics and public finance. The time allotted for these is three days.

In the states and territories not using the questions as set by the American Institute or the service of The American Society, the subjects vary to some extent, but usually include (1) Theory of accounts, (2) Practical accounting, (3) Auditing, (4) Commercial law as affecting accountancy, and (5) such other subjects as the board may deem advisable, or as the law may designate.

Many applicants have taken the examination more than once before they were authorized to style themselves as Certified Public Accountants. Others have passed the first time they sat for the test. I know of an instance in which the examinee, in addition to his practical experience, was a graduate of an accredited School of Commerce. A few days prior to the test, he carefully reviewed each lecture in the course six times, which naturally increased his knowledge of theory. When one has a thorough understanding of accounting principle, it renders practical application less difficult.

*(Continued on page 183)*



# TALKING SHOP

A Department Conducted by L. GLUICK, C. P. A.

At the time we write this paragraph there is at the Bijou Theatre, New York, a play entitled "Springtime for Henry." The star is one Leslie Banks. We wonder if he is any kin to the firm at 21 West Street.

And another mild chuckle is had from the fact that John T. Sells, C.P.A., of Wisconsin, is not of H. & S., but with P. W. Shakespeare said it! (R. & J. Act II Scene 2).

An amazing thing about the new revised *Accountant's Handbook* is the omission of the section on Economics. In the face of a slowly but steadily increasing number of states making economics a prerequisite for a certificate, the omission is startling. Since the new book contains about 300 pages more than the old, certainly space condition should not have been responsible for dropping 45 important pages. Otherwise the volume is "bigger and better than ever."

On February 10 we had the pleasure of attending and speaking to the dinner meeting of the New Jersey Society. Another State society, or chapter thereof, not too far from our office, which desires our presence at any meeting, may have it on due notice.

Mr. E. I. Anfinsen, of New Jersey, tells us we should read "The Million Pound Deposit," by E. Phillips Oppenheim. It is full of interesting accountants and accounting.

For human interest in taxation the findings of fact in two recent cases deserve reading carefully. One (Hecht, Court of Claims, January 18) relates to a salary of \$140,000.00—paid by a father to his son, just out of college. The other (Britten Estate, Circuit Court of Appeals, District of Columbia, January 25) gives an insight into how American parents buy foreign titles for their daughters. We are astonished that the family ever allowed such details to come to court.

The *New York Times* for January 31 had a full column article headed "Urge write-down of Fixed Assets. Many brokers hold industries

would thus be able to show higher earnings. Lower depreciation costs. Accountants advise caution." The whole article is worth reading. But what continues to get a rise out of us, is the anonymity given the accountants. Why did the *Times* not mention their names? Or maybe the accountants requested they be omitted. If so, why and wherefore? Nothing more conservative than their opinion could be imagined. Why the modesty? In pleasing contrast was Arthur Train in his article in *Colliers Weekly*, dated February 20. On page nine he comes out with the names of the accountants who audited Mr. Hoover's books on the Belgian Relief Commission. Read this fine article yourself if you want to know who they are.

We are in receipt of Volume I, Number 1, of a new quarterly publication titled *The American Scholar*, sponsored by Phi Beta Kappa. If you want to read some really stimulating articles and have some beneficial mental gymnastics, send in your two dollars for a subscription. One article alone sent us to an unabridged dictionary four times. More P.B.K.'s and Ph.D.'s will be listed next issue.

On the Washington birthday "triple holiday" we made a trip to Connecticut, which was a rare combination of business and pleasure. Saturday we had lunch in Hartford with J. G. Robinson. He is an accountant who was fiscal advisor to Governor Trumbull (Republican), and now fills a similar post for Governor Cross (Democrat). Not that we ever doubted he was good, but this circumstance proves it. If space permitted we could fill this page with interesting material about governmental accounts which he told us.

Sunday we had supper in New Haven with Alphonse Carnavale. Here is a young man who, after several years of public accounting in New York and New Haven, went as "auditor" of the *New Haven Times*. Just three days before we saw him he had been appointed "business manager." But he still insists he's going to be a C.P.A. some day. More power to him.

Monday morning we got up very early to attend a Yale class at 8:20. Mr. Smith's course is in elementary accounting, and he called upon us to speak informally to the students. We hope they enjoyed it as much as we did. Incidentally, we learned that the University has some account books of the Revolutionary and Colonial period that would gladden the hearts of Messrs. Myer and Herskowitz. Some day we hope to have time to inspect the inside of the huge Sterling Library.

Well, Oldtimer, what's on your mind?" said Dash as the elderly C.P.A. seated himself at the dinner table.

"This war in Japan" responded Oldtimer. "My boy went down to Navy headquarters today to see about getting into it. But even aside from that, it's a sinful shame that we should be faced with another world war."

There was a chorus of assent and then Blank spoke. "Last summer in a news reel old Ludendorf predicted it. Critics all laughed him down. Said he was an old madman. Who's looney now?"

"The Japs," broke in Star, "to think that they can lick the world. And believe me, Oldtimer, send your boy around to me, and if I can't dissuade him from jumping in before he just has to, then nobody can. What the hades good did I get out of my wound and citation?"

"Yeah," said Sinbad, "and I'll bet right now you've been polishing up the old Sam Brown, waiting for your call."

"I have no Sam Brown," retorted Star. "Never did have. And I'll bet you are the guy who's ordering new uniforms."

"I say," broke in the Kid, "I think one of the major horrors of war is the talking about it. Here you two are starting to bicker like a couple of school boys."

"That's all right Kid," said Star. "We've a right to. You weren't old enough in the 1918 war, but you're not quite too old for this one."

"All right," said the Kid, "I'll go if I'm needed. But let's not gabble about it."

"Right," said Dash. "Let's be dignified."

"Dignity be damned," said Blank. "I fired a man yesterday for it. Thought he was being degraded because I told him to carry a comptometer. What would the clients think of a semi-senior carrying a machine? And so forth."

"It would be more beneath his dignity, if any,

to waste his time on mental footings," remarked Dash. "But some people have queer ideas of what is becoming to a professional man. They all want to be like Oldtimer, before they've achieved anything."

"Ha, ha, that's good," laughed Oldtimer. "I wish that man of yours could have seen how dignified I was yesterday."

"Tell us about it," said the Kid.

"Well, I had one of those hectic days, trying to be in seven, actual count, places at nearly the same time. The only possibility at first seemed to be to skip lunch. But that is bad for me—gives me a bad headache. So I dove into a cafeteria for a quick bite. Grabbed a sandwich and a cup of coffee. Then I noticed that the sandwich was wrapped, so I stuck it in my pocket, gulped the coffee, and ate the sandwich on the street car going to the clients."

"That's good," said Blank. "I think—"

"Not through yet," continued Oldtimer. "As I got off the car, I spied some unemployed apples, bought one, and ate it for dessert while talking things over with the client. I offered only the explanation that I was in a hurry, and he didn't seem to notice it or care. He wanted to see me; there I was."

"Well, I hope that boy I fired learns, in time, that dignity is in the man, not the act," said Blank.

"Good epigram, that," said the Kid. "Where did you get it from?"

"If I got it from anywhere but my own head, I don't know it," replied Blank.

"Listen," said Sinbad, "and no fooling. You send that boy to me. If he's otherwise sound, I'll manage to take him along with me when the war starts, and he'll learn what dignity is by scrubbing decks."

Blank laughed, "I'll do it. The thing that peeved me most about his refusal was that he's a husky lad who could carry the 18-pound machine as easily as I could carry a 7-pound typewriter."

"If you don't mind changing the subject," said Star, "What do you think of this new Comptroller's Institute?"

"All right, in its place," said Oldtimer. "We have too many accounting organizations as it is and I hope some day to see a merger. But meanwhile I do believe there is a field for such an institute."

"Agreed within limits," said Star. "If they will categorically define a comptroller, and limit

their membership rigidly to bona-fide comptrollers, it will be fine."

"You imply the dangers of admitting mere students and clerks?" queried Sinbad.

"I certainly do. It has been ruinous in some cases," replied Star.

"But we don't want it too rigid," said Dash. "That would keep us out, and as we agreed last month, a better liaison between internal comptrollers and outside auditors, is vital to a successful audit."

"Well, as I understand it," said Oldtimer, "that is one of the new organization's objectives. C.P.A.'s are provided for as associate members."

"Great," said Blank.

"Again, I agree within limits," said Star. "If they admit us as associates, the first thing you know they'll want us to admit them into our society as associates."

"Good point," said Sinbad. "But isn't the Accountant's Institute doing a little of that already?"

"Come, come," broke in Oldtimer, "the first thing we all know we'll be fighting the old Institute versus Society battle over again and that *will* be a horrible war."

"All right," said the Kid. "I want to put a question to you and I know the answer."

"Then why ask it?" said Dash.

"Because I consider it of importance," replied the Kid. "Last summer when it came up I didn't know how it would turn out. I have one small client who worried me. For five successive semi-annual audits he absolutely refused to accede to my suggestions, recommendations and protests about the way in which his cash was handled. In fact he told me he didn't want me to do anything but give him a certified statement of his financial condition. I had the thing up with his attorney and he told me I was right. I wondered as a question of personal reputation more than ethics, if I had a right to continue as auditor. I brought the thing up at a committee meeting one day after the business was over and the group was talking shop, and five out of six present told me I ought to quit. But one hates to give up a fee, even if a small one, at any time, and last summer especially. So I stuck. Well, in January I closed the books and went at them again, harder than ever. I had determined that I'd make it so strong that they would either fire me or do as I told them."

"Pardon the interruption," said Oldtimer, "but I'll answer the question before you ask it. You

want to know what we would have done. Right. Well, I know I would have done just as you did. And what is more, I know what happened; if it had not you would not have mentioned it now. Your client capitulated. So you are vindicated."

"You are correct," said the Kid. "But supposing he had not?"

"Trouble probably was," said Blank, "that your first five protests were not strong enough. If your sixth one had been second you would have saved a lot of trouble."

"Not necessarily," said Oldtimer. "Persistence is cumulative in effect. I've had plenty clients like that. As long as the Kid was not asked to condone something downright illicit he was all right; especially as long as he was on record."

"Well, I doubt if I would have had the patience," said Star. "But anyhow, I'm glad you won, and we've talked more than enough for this session. I move we adjourn."

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## Offers in Compromise

*(Continued from page 151)*

section 606 of this Act, or offer to enter into any such agreement, willfully (1) conceals from any officer or employee of the United States any property belonging to the estate of a taxpayer or other person liable in respect of the tax, or (2) receives, destroys, mutilates, or falsifies any book, document, or record, or makes under oath any false statement, relating to the estate or financial condition of the taxpayer or other person liable in respect of the tax, shall, upon conviction thereof, be fined not more than \$10,000 or imprisoned for not more than one year or both."

The importance of this section cannot be stressed too much as it has already been invoked in the case of Ralph J. Capone against the United States wherein the appellant, Capone, was successful in obtaining a reversal on a conviction for concealment of assets in connection with an offer of compromise but only because there was no similar section in the law at the time of the said concealment which occurred in 1927 relative to taxes for the year 1925, Section 616 having become effective on May 29, 1928.

Practitioners should under no circumstances permit the violation of this important section.

# Real Property Law and Its Relationship to Accounting

By MICHAEL S. FOREST, C.P.A., Member of New York Bar

THE solemnity with which the learned justices of the past decided cases involving real property adds to this branch of our law a profundity not akin to any other legal phase of our jurisprudence. From the minds of the many academician jurists who oftentimes rendered decisions, more verbose than enlightening, has fortunately come to us a rigid structure, our real property law.

Many aspects of real property law are extremely legalistic. We, therefore, shall endeavor to give them a comprehensible interpretation and then correlate them to accounting principles and practices.

By real property we mean, land, buildings, and anything permanently attached thereto. It is not necessary here to elucidate the phrase "permanently attached thereto." Suffice it to say that anything attached to the land or building with the intent that it become a permanent part thereof would be considered real property.

Whenever the single account Land and Building is used in this article it is understood that there would be two accounts. Land would include that portion of the value relating to soil and Building would include the value of the "built on" property. For purposes of determining appreciation and depreciation the separate values should not be combined in a single account.

The accountant's interest in real estate extends to clients who are actively engaged in the real estate business and to the client who buys real estate in the form of a factory site, etc., as an incidental to his regular business.

There are varying degrees of interests in real property, from the Fee Simple, wherein the owner has the absolute right to dispose of the property as he desires, to the ordinary Tenancy, wherein the tenant only has the right to the use and occupancy of the property, title, however, remaining in the true owner.

The presumption that the item "Land & Buildings," or any similar account is an indication of ownership in fee (fee simple) is a speculative one. The question that arises is, what limitations are there on ownership?

Beside the ownership limitations imposed by the State, such as police power, eminent domain, and others, there are many limitations the accountant should be familiar with for a truer understanding of their financial effects.

The scope of our inquiries is often very scant. Should the accountant who determines, from the client's records, that property is subject to a mortgage be satisfied that his examination into these matters is complete? Is he certain as to the exact amount, the terms, the due date, etc., of the mortgage? Is his information based on the client's statements, the client's attorney's statement, or the report of a title company? Should the accountant make an individual search of the property? It is with the intent to be of greater service that the accountant should seek to answer these questions. These questions, and others, will be answered in the course of this paper.

The author feels certain that he expresses the sentiments of the accountant when he says that it is not the intent to trespass on the attorney's domain. No accountant should endeavor to draw contracts for the sale of real property, or any other documents pertaining to real property. He should seek to interpret these documents in the light of accounting principles. Often he will consult with the client's attorney for further enlightenment. When the accountant does this he should show a working knowledge of the subject and a familiarity with legal phraseology and terminology.

By police power of the State we mean the right of the municipality to restrict the use of realty for the protection of the public. The rules and regulations in New York City of the Health Department, Police Department, and other such departments, are exercises of the police power. The accountant's interest in this phase of our law is limited. Where he is consulted as to the advisability of transforming certain buildings into factories he might advise the client to be certain that the district is or is not restricted as to factories, or that the client should first consult the proper authorities, or counsel, as to the permissibility of his undertaking.

The right of eminent domain is the inherent power of the State to take the owner's land when necessity arises. The owner receives the fair valuation fixed by expert appraisers. The accountant can be of service in many ways when the question of eminent domain arises. He may assist in determining the fair valuation of the property. His figures may be used as evidence by the court in addition to the evidence of the expert appraisers.

Where the State or municipality pays more for the land and building than is shown on the books should the excess be treated as income for the year or should the excess be divided equally over the length of time the land and building was owned? The latter method is more correct. The theory for this method is that too great a reserve for depreciation was set during such years and therefore the surplus of each year should be adjusted, and not the income for the year in which the profit was made.

Where, however, the municipality pays less for the land and building, then the loss should be charged to the surplus of each year the land and building was owned for the reason that too little depreciation was deducted annually.

The entries, in the most simplified form, would be as follows:

	(Dr.)	(Cr.)
City of New York	\$10,000.00	
To Land & Building		\$10,000.00
(To record the sale of Land & Building to New York City)		
Cash	\$10,000.00	
To City of New York		\$10,000.00
(To record the receipt of cash in full for the sale of Land & Building)		

Where, however, the receipt of cash is simultaneous with the sale, the entry is:

	(Dr.)	(Cr.)
Cash	\$10,000.00	
To Land and Building		\$10,000.00

Where there is a mortgage on the property and the owner of the property is to pay the mortgage from the funds received from the city then we debit mortgages payable and credit cash for the amount of the mortgage. In the case where the city assumes the payment of the mortgage the entry is:

	(Dr.)	(Cr.)
The City of New York	\$8,000.00	
Mortgages Payable	\$2,000.00	
To Land and Building		\$10,000.00
If there are other liens or incumbrances re-		

corded on the books such as Taxes Payable and the city assumes to pay or cancel same, the entry is the same as directly above, but instead of debiting one liability such as Mortgage Payable, we debit a number.

Where negotiations are pending between the municipality and the client, the negotiations should be commented upon in the accountant's report. If an accountant is to report to interested third parties, such as creditors, they should be fully informed by the accountant of the existence of such negotiations.

It is advisable before certifying to the existence of land and building to determine the actual ownership interest the client has. If the client has merely a life estate, the asset account Land & Building, or such similar account, should not appear on the books. A life interest is best illustrated by the following example: a man gives land to A for his life and at A's death the land is to go to B. A is considered as a life tenant. B is known as the remainderman. To evaluate the life tenancy may be somewhat difficult. We may need to employ actuarial science and delve into mortality tables and the like, and after we determine the value set this amount on the books as an asset. Or we may arbitrarily assume a value. It would, however, be necessary to annually write off the decrease in value of such tenancy. The name of the asset account that is set up on the books to represent such an interest is immaterial. It can be called "Life Estate in Land & Building."

If A, the life tenant, invests his tenancy in a partnership the proper method of treating such property is at an agreed value by the partners. The account should not be merged with any land acquired with partnership funds because at the death of A the property reverts to B, the remainderman. At A's death the account set up for the property he so invested should be closed to A's capital account.

To illustrate:

<i>Land (Life Estate of A)</i>			
(1)	\$15,000	(3)	\$15,000
Cash		(2)	\$15,000
		<i>A-Capital</i>	
(3)	\$15,000	(1)	\$15,000
		Land	
		(2)	\$15,000

It is advisable to keep a separate account for land and one for building. Land, as a general rule does not depreciate in value, except such land as farms, mines, etc. Buildings, on the

other hand depreciate in value and for purposes of figuring depreciation it is better not to merge the value of the building with the land in one account.

A lien is the right given to a creditor to have a debt or charge satisfied out of the property belonging to his debtor. The subject of liens is important and the accountant should seek to report fully on property encumbered with liens. Liens are either specific or general. A specific lien refers only to a certain piece or pieces of property of the debtor. A general lien refers to all the property of the debtor. Specific liens are mortgages, taxes, assessments and mechanic's liens. The common general liens are judgments, transfer tax, corporation franchise tax. A lien should be considered from several aspects. Whether the accountant should record the existence of liens in the financial books of a concern or omit such record and merely report the existence of a lien in financial reports is a question that is practical as well as theoretical.

A lien is the creditor's security that if the original debt is not paid then he can look to the security.

Where an asset is given as security for a debt the entries can be made in the following manner:

<i>Cash</i>			
Bal.	\$1,000	(3)	\$5,000
(1)	\$5,000		
<i>Securities</i>			
Bal.	\$6,000	(2)	\$8,000
(4)	\$8,000		
<i>Notes Payable</i>			
(3)	\$5,000	\$5,000	(1)
<i>Securities in Hands of Creditors</i>			
(2)	\$8,000	(4)	\$8,000

(1) To record the loan to us.  
 (2) To record the giving of security.  
 (3) To record the payment of the loan.  
 (4) To record the return of the security.

Where, however, no particular asset is given as security, but instead the creditor is given a right in case of default to attach and sell some asset to satisfy the debt we may adopt the following procedure to record in the financial books such facts.

We may have an account called "Liens on Real Property" and the other account can be called "Lien Holders," when the lien is put on the property, we credit "Liens on Real Property" and debit "Lien Holders." We reverse the entry when the lien is removed. In my opinion it may be carrying theory too far to record in such detail the existence of liens. However the accountant should have a complete and detailed

record in his work sheets of all liens that are in existence against the property of the concern whose books he audits. The amount due creditors should be separated into those unsecured and those secured either by having liens on the property or else by having received something of value from the concern as security. Quite frequently large parcels of land and buildings are sold to satisfy a small lien and even though the law has sought to be equitable to all interested parties by having such sales advertised, etc., creditors are deprived of their just due because of lack of knowledge of the existence of any lien until the sale is over. Where the accountant reports either for a creditors' committee or other interested third party he should bring to the attention of such body the existence of the lien and they in turn may pay off the debt thus wiping out the lien, and saving the property from forced sale and thereby protect their interests.

Where a judgment exists against a person this is considered as a lien on his property in general and should be noted by the accountant.

There are certain encumbrances against real property as well as personal property which are not true liens. These are called conditional bills of sale. In cases of this kind title remains in the seller, possession in the buyer. The conditional sales agreement is filed in the County Clerk's office. The accountant should note that the merchandise so purchased is to be treated as consigned merchandise. The debit should be made to Conditional Purchases and the credit to Conditional Vendor. Such merchandise may be taken into inventory with the notation that the contra account to this inventory figure is the conditional vendor's account.

Where the accountant seeks to report all possible liens and encumbrances, he may report on such encumbrances which, although not liens must be considered, including easements, covenants and restrictions.

Easements are rights of others to have certain uses of one's property, usually the right of way over one's property. These easements are usually recorded or referred to in the deed of the property. Covenants and restrictions arise through agreements contained in deeds between interested parties. Their effect is to limit the use of the property and to provide that certain things may or may not be done with it.

Where the accountant seeks to determine the existence of liens on particular property he must

search in the Register or County Clerk's office, wherein the property is located. The usual and customary method of obtaining this information is to consult counsel. An attorney is in a position to make this search or else have the search made on his behalf by a title company. When he receives from the title company the report, the accountant should go over the report with him to determine the nature and extent of the lien.

Where there is an exchange, sale or purchase of realty, it is essential for the accountant to be familiar with the relationship and obligations of the respective parties. Like all contracts, a contract for the sale of realty, must have all the attributes of a valid contract. There must be an agreement between two or more competent parties based on legal consideration to do or not do some legal act. In addition to these requirements, all contracts involving real estate must be in writing. To elucidate this phase of contract law would involve too lengthy a discourse and would be to a great extent a mere repetition of principles of law the accountant has acquired in his study of commercial law.

The accountant should be fully familiar with the important factors found in realty contracts. How should the contract obligations be treated in the accountant's reports? How should extracts from the realty contract be made for working sheet records? In his advisory capacity, how will the terms of a proposed contract affect the conditions of the client's business? These, together with numerous other points of interest, will be discussed at greater length later on.

For our purposes, suffice it to say that anything left out of the written contract, even though agreed upon in the discussion leading to the contract, is unenforceable. The accountant will do well to read through a contract of sale involving real property.

Such forms are usually printed by Title Insurance Companies.

If the accountant is consulted prior to the closing of a realty contract, as to the advisability or ability of the client to enter into such contract, his advice should be based on that portion of the contract usually referred to as the Financial Statement. That statement usually commences with the words "The price is—." Then are set forth the provisions with respect to amount and terms of payment of the purchase price. From this information, the accountant can tell whether the client is investing too heavily in fixed assets,

whether the client can amortize the mortgages conveniently according to the terms of the contract, whether the client can expect to meet the cash payment due at the time the title is to pass, and other matters the accountant sees fit to present, according to the condition of his client's affairs.

The contract usually sets forth the gross price, which is divided into:

1. The deposit to be paid on the signing of the contract.
2. The cash to be paid on the closing of the contract.
3. The amount of the existing mortgages the property is subject to.
4. The amount of the purchase money mortgage.

By way of explanation, a purchase money mortgage is given by the purchaser to take the place of cash for part of the price. The amount usually paid as deposit on the contract varies anywhere from five to ten per cent of the price. This deposit is forfeited if the purchaser defaults in carrying out the contract.

Where the contract of sale is entered into the accountant should see the contract and extract from there in detail, the financial statement, the location of the property, and the date of closing.

Where the deposit payment is made, and this usually occurs at the time of the signing of the contract, the proper entry for the accountant to make would be to debit "Deposits on Land and Buildings," and credit "Cash."

When title is closed, the cash payment usually consists of numerous items due to adjustments of insurance, rents, taxes, interest on mortgages. This payment should be treated in the following manner. "Prepaid Expenses" debit, (these expenses can be itemized) then credit cash. These prepaid expenses include Taxes, Insurances and other items paid by the seller for the full year or so, but the time has not elapsed and the buyer, therefore, is going to derive the benefit of such payments, therefore he should pay for same. If, however, the buyer desires, he may cancel such insurance policies and take out new insurance.

The payment on the land proper should be charged to "Land," and the payment on the building proper should be charged to "Building," both credited to "Cash." To illustrate these points more clearly, I set forth a closing statement and the entries that should be properly

made. The names of the accounts are immaterial, their significance is most important.

Sale of (location of property) New York City  
 Purchaser—John Doe  
 Seller—Richard Roe  
 Closing held at office of — on June 30, 1930.  
 Purchase Price .....\$150,000  
 Taxes Prepaid (half year) ..... 3,000  
 Insurance Prepaid (see list of policies  
 and statement attached) ..... 150  
 Rent Uncalled for June ..... 250  
 Deposits on Gas Ranges, etc. .... 1,000  
 Coal on Hand ..... 500

\$154,900

Cash on Contracts .....\$ 15,000  
 First Mortgage ..... 80,000  
 Int. due on 1st Mtg. to 6/30/30 ..... 3,000  
 Int. due on 2nd Mtg. to 6/30/30 ..... 30,000  
 Int. due on 2nd Mtg. to 6/30/30 ..... 500  
 Taxes due on Water (see meter  
 reading) ..... 150  
 Purchase money Mtg. .... 20,000

Net .....\$148,650

\$ 6,250

On the books of the Purchaser the following entries should appear. The arrangement set forth here is arbitrary and mostly explanatory. The accountant can re-arrange and combine such entries as he sees fit.

*June 1, 1930*

Deposit on Land and Bldg. ....\$15,000  
 Cash ..... \$15,000  
 To record payment of deposit on land  
 No.—N. Y. C.

*June 30, 1930*

Land and Bldg. (2 accounts) ....\$15,000  
 Deposit on Land and Bldg. .... 15,000  
 To transfer to proper account.

*June 30, 1930*

Land and Bldg. (2 accounts) ....\$130,000  
 Mtg. Pay. 1st ..... \$80,000  
 Mtg. Pay. 2nd ..... 30,000  
 Mtg. Pay. P.M. .... 20,000

*June 30, 1930*

Land and Bldg. (2 accounts) ....\$ 5,000  
 Taxes prepaid ..... 3,000  
 Insurance prepaid ..... 150  
 Rent receivable ..... 250  
 Deposits on Gas Ranges, etc. .... 1,000  
 Coal ..... 500  
 Int. Payable on 1st Mtg. .... \$ 3,000  
 Int. Payable on 2nd Mtg. .... 500  
 Taxes Payable (Water) ..... 150  
 Cash ..... 6,250

The expenses of searching the property, which expenses are borne by the purchaser, are properly chargeable to the Land and Building accounts. Such expenses should also include the attorney's fees, and accountant's fees.

On the seller's books the entries appear as follows:

Cash ..... \$ 15,000  
 Deposit on Sale of  
 Land and Bldg. .... \$ 15,000  
 Deposit on Land and Bldg. .... 15,000  
 To Land and Building  
 (2 accounts) ..... 15,000  
 Cash ..... 6,250  
 Mtgs. Payable (1st, 2nd)..... 110,000  
 Purchase Money Mtg. .... 20,000  
 Int. on Mtgs. (1st, 2nd) .... 3,500  
 Taxes (Water) ..... 150  
 Taxes ..... 3,000  
 Insurance ..... 150  
 Rent Income ..... 250  
 Deposits on Gas Ranges ..... 1,000  
 Coal ..... 500  
 Land and Buildings  
 (2 accounts) ..... 135,000

Then close Reserve accounts into Land and Bldg., then close the balance of Land and Building into Profit and Loss.

For tax purposes the matter of profit or loss on sale of a building, for cash and mortgages is not dealt with here. This subject is dealt with in tax texts as well as the tax regulations.

Where, however, taxes on property to be bought have remained unpaid for any length of time and the purchaser assumes the payment of such taxes, the proper charge on the purchaser's books is the asset account "Land and Buildings." In tax sales this question often arises and it is improper to consider such payment of the taxes as expenses. It merely is the added cost of obtaining the property.

Where litigation is resorted to in order to obtain property contracted for, such litigation increases the cost of the property and should be capitalized and written off over a period of years depending upon the life of the asset.

Where however, such property is not obtained after seeking such specific performance the expenses are charged off as current expenses.

Where there is an exchange of land without the payment of cash, the amounts agreed upon and stated in the contract are usually nominal. Quite frequently such amounts are inflated. The accountant may disregard such figures and merely debit and credit the property account for the amount shown on the books, taking into consideration the reserve accounts. There should not be an increase or decrease on the books of the asset Land and Building, as there was for all intent and purposes an equal exchange of property. In the work sheets a comment can be made with regard to the fact that the contract prices



are merely nominal. The possible reason for inflating the value in such exchange contracts is to be able to sell the property at a higher figure by showing that it cost so much according to the exchange contract.

Where property is sold at auction the transaction is recorded as a regular sale of property (see *supra*). The law does not restrain any property owner from selling his property at auction. If the owner thinks he can get a better price by a sale at auction he is at liberty to do so.

Where, however, there is a sale by an involuntary auction, that is where a lienor, the mortgagee, or any other lienor, steps in and compels the sale of the property to satisfy his lien, the proceeding is referred to as a foreclosure. On the books of the purchase the entries merely reflect the increase in the land and building and the decrease in cash or in the increase of the liability "Mortgage Payable."

To illustrate: A notice of foreclosure is published in the newspaper showing that certain property is being foreclosed and is subject to a first mortgage only. The notice usually reads, in part, as follows:

"The approximate amount of the lien or charge, to satisfy which the above described property is to be sold is \$5,878.47 with interest thereon from the 18th day of October, 1930, together with the costs and allowance amounting to \$424.46 with interest from October 22, 1930 together with the expenses of the sale. The approximate amount of the taxes, assessments and water rates, or other liens, which are to be allowed to the purchaser out of the purchase money, or paid by the referee is \$1,150 and interest."

On the purchaser's books he must record the payment of the lien of .....\$5,878.47  
Interest thereon from Oct. 18 to date

of Purchase, Nov. 14 .....	26.45
Cost and allowances (Court) .....	424.46
Expenses of Sale (Approximate) .....	150.00
	<u>\$6,479.38</u>

The purchaser pays the referee the \$6,479.38 and the referee gives the purchaser a deed to the property. The property is free and clear of all encumbrances. The referee is to pay taxes, etc., of \$1,150 plus interest. The purchaser, therefore, debits land and building and credits cash for \$6,479.38. It is advisable in the explanation of the entry to show how the figure was arrived at.

If, in the above case a second mortgage was foreclosed and there was a first mortgage of

\$10,000 the entry would be to debit Land and Building for \$16,479.38 and credit cash for \$6,479.38 and credit Mortgage Payable for \$10,000, and if there is \$150 interest due on the mortgage then debit Land and Building for \$16,629.38 and credit cash for \$6,479.38, credit Interest Payable for \$150, credit Mortgage Payable for \$10,000.

Bear in mind that all the costs incurred in acquiring the property are properly chargeable to the asset account. The expenses prepaid should be charged to the expense accounts as they are consumed.

Where one who has acquired property by gift, devise or in any manner which did not necessitate his paying for it, and he invests this property in his business the book value of the property is based upon a fair valuation of the property.

The accountant does not actually examine the records to determine who is the real owner of the property. This is usually done by an examiner who makes an abstract of the record. This abstract shows all previous owners, encumbrances, mortgages, etc., down to the present owner. This abstract is referred to as an abstract of title.

When a purchaser of real property seeks to have the title to the property insured, such insurance is part of the cost of acquiring the property and should be treated as a capital expenditure. The insurance is paid but once and that is at the time of the purchase of the property. If subsequently additional title insurance is taken on the property due to improvement, such insurance should be treated as a capital expenditure. It might be contended that such insurance should be written off over the life of the property.

In the matter of computing time in real estate transactions it is customary to use the 360 days basis. The time from February 5, 1929 to March 4th, 1929 is usually considered as one month or 30 days. Where, however, a considerable sum is involved then the exact number of days is used.

Where a mortgage loan is to be recorded it is well to remember that the borrower pays all the expenses. The lender before he loans the mortgage money will have the title to the property examined to be certain that the borrower is the true owner. For this title examination the borrower pays. He also pays the recording fees and the cost of preparing the bond and the mortgage. Assuming the mortgage loan to be \$10,000 and the title examination cost is \$75 and the cost of preparing the bond and the mortgage

\$20 and the recording fees \$5.00, the entries on the books of the borrower are:

Cash \$9,900  
 \*Expenses 100  
 To Mortgages Payable \$10,000  
 \*This item of expense can be itemized.

Where the borrower is required to pay to the lender a bonus, the amount may be treated as an expense. It has been held that where the payment of a bonus can be proven to be an additional interest charge which would make the transaction a usurious one, the borrower need not pay either the principal or the interest.

Where the accountant is confronted with the problem of certifying the existence of the asset Leasehold there are certain steps with which he should familiarize himself.

A lease may be either written or oral. In New York the statute requires all leases for more than one year to be in writing. If the lease is written the accountant will do well to read the lease and extract therefrom such information as can be used. The name of the lessor (landlord) and the amount of rent agreed upon is of value to the accountant. Checks drawn to persons other than the landlord should be questioned. The term of the leasehold, the amount deposited with the landlord as security, the interest rate on such deposit, and a brief description of the property leased, should be extracted.

The asset leasehold should not be set upon the books unless the lessee (tenant) sells the lease. The purchaser of the lease may set the purchase price of the lease on the books and write it off annually as rent over the period of the lease.

Where a lease is sold and no value was previously placed on the leasehold the seller debits cash and credits profit on sale of leasehold or any such similar income account.

In brief, it is the law in most states that where the tenant fails to comply with the terms of the tenancy, either by his failure to pay the rent agreed upon, or for any other breach, the landlord has the right to institute dispossession proceedings. These proceedings, if won by the landlord establish his right to recover possession of the leased property.

If the landlord keeps his records on a cash receipt and disbursement basis, the expenses paid in the dispossessing of a tenant are recorded during the period they are paid for. If the premises are vacant for several months and then subsequently re-let, during the period the property was

vacant no rent income is recorded. If, however, the landlord keeps his records on an accrual basis then it is necessary for him to record monthly an increase in an asset such as Rent Receivable and credit the account Rent Income. This entry is made even though the property is vacated by the tenant. To better illustrate: Assume Adams leases from Jones a building for two years from May 1, 1930 to April 30, 1932 at a monthly rental of \$1,000. That on April 1, 1931 he is dispossessed. Jones keeps his books on an accrual basis. The entries are as follows:

*May 1, 1930*

1. Rent Receivable -to- Rent Income  
    (Rent due) .....\$1,000.00
2. Cash -to- Rent Receivable  
    (Rent paid) ..... 1,000.00

These entries are made until April 1, 1931, then the following entries are made:

*April 1, 1931*

3. Rent Receivable -to- Rent Income  
    (Rent due) ..... 1,000.00
4. Rent Receivable -to- Cash  
    (Expenses of dispossession proceedings to tenant's account in the form of rent) .... 25.00

*May 1, 1931*

5. Rent Receivable -to- Rent Income 1,000.00  
    (This entry is made until the premises are relet).

Assuming premises are relet as of June 1, 1931 at \$800 per month.

*June 1, 1931*

6. Rent Receivable (New tenant) -to-  
    Rent Income ..... 800.00
7. Cash -to- Rent Receivable ..... 800.00
8. Rent Receivable (Old tenant) -to-  
    Rent Income ..... 200.00  
    (to charge old tenant with the deficiency in rent) the 6, 7 and 8th entries are made up until the expiration of the lease.

If the old tenant is financially irresponsible then the Reserve for Doubtful accounts is adjusted accordingly.

Where a tenant is required by the terms of his lease to make repairs, the payment of such repairs can be considered as additional rent. If the cost of the repair is very large it can be properly charged off over the period of the lease. Likewise with permanent improvements made by the tenant that are to become the property of the landlord at the expiration of the lease.

It is proper to treat the security deposited by the tenant with the landlord as an asset on the tenant's books, and any interest accruing thereon should be recorded periodically.

The general rule with regard to keeping accounts of a builder is that all the costs incurred

*(Continued on page 183)*

## Decision in Bankruptcy Case of Concern to Accountants *of Interest to Lawyers*

A DECISION recently handed down by Judge Woodrough, sitting in the United States District Court for the District of Nebraska, gives to the claim of a public accountant who has rendered service in connection with the administration of a bankrupt estate preference over the claims of the general creditors. It also establishes the administrative jurisdiction of the court, without reopening of the case, over unclaimed dividends turned over to the Clerk of the Court upon the discharge of the referee and the trustee.

It appears that John M. Gilchrist Company, certified public accountants of Omaha, Nebraska, had performed services at the request of the referee in connection with the administration of the estate of M. E. Smith & Co., Inc., bankrupt (52 F. (2nd) 212) and had rendered bills for such services aggregating the amount of \$1,029.75, that during Gilchrist's absence in Europe at a time when it was not contemplated that the matter of distribution to creditors would come up, application was made for and the court approved the payment of a dividend to the general creditors of the bankrupt estate, that the referee and the trustee procured their discharge upon the payment to the Clerk of the Court of unclaimed dividends aggregating the amount of \$1,158.68, that such amount was still in the hands of the Clerk of the Court when Gilchrist returned from Europe and caused a claim to be filed by his firm with the court for the amount of \$1,029.75, and that the court appointed a Special Master to take testimony, consider evidence, etc., and make recommendations in the matter to the court.

In his report Special Master Herman Aye discusses the testimony and the evidence, makes citations to numerous decisions in bankruptcy cases having a bearing upon the issue, and finds and recommends to the court:

That the Judge of the Court could, in the first instance, have administered the entire estate without referring the case to a referee, stating that it seemed clear to him that the Judge of the

Court, as distinguished from the referee, must and does have power to further administer the estate in so far as it may be necessary, after it has been closed by the referee, where one has been appointed.

That the claim of the claimant is one which should have been paid before the payment of any dividends; that the fund in the hands of the Clerk of the Court does not belong unqualifiedly to creditors; and that the creditors are entitled to their dividends only after all proper expenses of administration have been paid, and no wrong is done them by now paying what is clearly a legitimate item of expense of administration, not previously paid.

And that said claim should now be paid out of the unclaimed dividends in the hands of the clerk of the court, and that the court has power and jurisdiction to so order claimant's claim to be paid out of that fund and should do so.

The findings and decision handed down by Judge Woodrough were as follows:

"This matter, on the 14th day of August, 1931, having been referred to Herman Aye, as special master, to report his findings of fact and conclusions of law, and having read and considered said report, said report and findings of fact and conclusions of law are hereby ratified, approved, and confirmed. The court therefore finds:

(1) That there is now in the hands of the clerk of this court the sum of \$1,158.68, paid into the office of the clerk by the former trustee herein as unclaimed dividends.

(2) That the John M. Gilchrist Company is entitled to have allowed for services performed for the trustee and for the benefit of this estate as an expense of administration a claim for \$1,029.75, which should be paid out of the funds above found to be in the hands of the clerk of this court.

(3) That through inadvertence said claim was not allowed and paid while this estate was being administered by the referee, but that said claim is and was entitled to priority of payment over the claims of or dividends to general creditors.

(4) That the amount involved as compared to the amount of claims allowed against said estate,

*(Continued on page 183)*

# Research and Business Cycles<sup>\*</sup>

By A. E. WHITE

*Director, Department of Engineering Research, University of Michigan*

AN approach to the subject of research in business cycles might be from the standpoint of the great changes which have taken place in the world's civilization during the past several thousand years. This would be a portrayal of the rise and fall of world empires and an analysis of the causes producing them. Many of these causes were economic in character, though none of them can be tied in with research, as the influence of research has been intensively felt only during the past fifty years. Yet one does find this common ground with respect to the continuance of world empires and business; it is that as long as each gave as well as received, their continuance was assured. This condition is well set forth in the phrase "He profits most who serves best." This is not only true of individuals; it is also true of business concerns and nations. The day that this precept is first cast aside marks the beginning of the decline of the individual, the business or the nation, as the case may be.

This subject might also be approached by a review of the alternate periods of depression and prosperity which have been the part of American business activity since the United States became a nation. These valleys and peaks in the business curve, however, are the result of many contributing factors, of which war is the most outstanding. That is, following the War of 1812, the Civil War and now the World War, one finds primary and secondary post-war depressions with post-war prosperity periods. Also, during and immediately after each of these wars wholesale prices for materials rose over thirty per cent of normal. Likewise, each one of these periods of depression is more marked than the preceding one. This is due, not only to the fact that each war was conducted on a much larger scale than the preceding one, but also to the fact that the nation is becoming more industrialized with each succeeding year and, in consequence, feels the changes in business conditions more intensively. All possible encouragement should be given to the investigations proposed for the determination of the causes producing the peaks and valleys in the

business curve so that intelligent steps can be taken to counteract and offset these forces.

However, I propose to restrict this subject to an analysis of the relationship between the business cycles of various concerns or industries and research.

Developments in science are now front-page news. The advance of industrial technology are reflected in the quotations on the Stock Exchange. Recently a questionnaire was sent to 1,000 business leaders with a request that they indicate the first ten outstanding corporations in the United States. The poll showed the following companies: American Telephone, United States Steel, General Electric, Standard Oil, General Motors, Anaconda Copper, Electric Bond and Share, United Corporation, Radio Corporation, and Westinghouse Electric and Manufacturing. All of these with the exception of the United Corporation, which is a holding company, now maintain large research organizations. In fact, the research activities of some of these companies have been so pronounced and so successful that one does not think of them without thinking of their research accomplishments. This is especially true of the American Telephone, General Electric, Standard Oil, General Motors, Radio Corporation, and Westinghouse Electric and Manufacturing Company. The success of the United States Steel in the past has been due to its large holdings of natural resources, the development of ways and means to economically transport these resources from mine to mill, and the carrying forward of manufacturing operations on a large scale. The same is true with the Anaconda Copper Company. Both concerns, however, are now turning to research as the next step to assure them of continuance of operation, for the public is demanding new and improved products, and these are possible only through the channels of research.

The price which many companies have paid for failing to recognize the service of research is a matter of record and history. One of the outstanding examples is that of the Victor Talking Machine Company. Up to about 1920, its history had been one of almost continual growth. Be-

<sup>\*</sup>Radio talk delivered on December 19, 1931, from Ann Arbor, Michigan.

ginning about that time, the radio industry interfered materially with the activity of the Victor Talking Machine Company. Furthermore, about that time, the American Telephone and Telegraph Company, in its work relating to the further improvement of telephone transmission, discovered how imperfect the then existing records were in the reproduction of all of the high and low tones. With this finding, steps were taken to improve the character and the quality of records, with the result that there are now, or will shortly be, available records which give almost perfect reproduction. One can say very definitely that the Victor Talking Machine has passed through a definite business cycle because of research. It had its peak and then its valley, and now it is on a normal basis.

Let us take another example. The cotton industry has been hard hit, particularly that part of it making women's stockings and lingerie. It was hard hit in the days of '28 and '29, which were years of unheralded prosperity. Therefore, the failure of the public to buy cotton goods could not be charged against the world's economic condition. The trouble was due to the fact that rayon, an artificial silk, was meeting with marked favor from the buying public. Those operating cotton mills had failed to be guided by certain fundamental principles. The first question they should have asked was, "what is the most popular type of fabric?" The answer undoubtedly would have been "silk." They should then have asked, "why is not silk used more extensively?" and the answer would have been, "because of its cost." They should then have taken steps to find or develop a fabric like silk and yet considerably less expensive. Had they done so, they would have found rayon because, in principle, it was known since 1846 and was exhibited by Count de Chardonnet at the Paris Exposition in 1889. Had these concerns been awake to this situation, it is quite possible that many of the cotton mills now idle in the New England territory would have been active in the manufacture of rayon goods. This would have meant that plants now operating in other sections of the country would not have been constructed and would have, therefore, less complicated the entire industrial situation.

Another notable example is the malleable iron industry. Some years ago, this industry was in a declining state. This was due to the fact that the quality of the product was low and exceedingly uncertain. A research institute was established with the result that the average elonga-

tions for malleable iron have been increased over three-fold, namely, from five per cent to better than fifteen, and the tensile strength of the iron has been improved at least fifty per cent. All of this has been done with an assured continuity of quality and production. Such good malleable iron is now made that the steel casting industry is concerned and is taking steps toward improving its product.

The baking industry serves as another illustration. Twenty-five years ago, most of the bread in the United States was baked at home. One of the reasons why this was done was because the bread obtainable at bakeries was of such a varying quality. Today, as the result of the activities of the American Bakers' Association, most of the bread eaten in the United States is made in bakeries. The improvement in quality has been so great that, with all due respect to our housewives, bread of equal or better quality can be obtained in our bakeries than can be made in most of our homes.

This point is also brought out by the paper industry. Our paper mills are today not operating at capacity. This condition is, of course, accentuated by the present industrial situation. Yet one notes with interest that a two-million dollar plant is now being built for the production of cellophane, which we can view as a paper substitute.

Now, suppose we turn to a company in our own immediate vicinity which has not been appreciably, if at all, affected by the industrial depression, in spite of the fact that it is an important supplier of automobile accessories. The reason why it has not been affected is due to the fact that it has been carrying forward a constructive research program throughout the past few years, and as sales for a given product have become less it has been able to fill in the gap with new products.

Whatever other criterion you may set up in the evaluation of companies in which you may wish to make investments, include their attitude toward research. See if their executives back up their spoken interest in research by actual material support of it. Too many business leaders are willing to say nice things about research as long as it does not cost them any money. They don't take the thing home; they are too willing to find reasons and alibis for not incurring research expense for the companies which they represent. As long as they maintain that attitude, they are not building a proper foundation for the continuance of their companies, nor are they play-

ing fair with their stockholders and employees. A policy of this type must ultimately lead to bankruptcy and throw their employees out of employment, as well as cause the stockholders to lose their investments.

All concerns, possibly, pass through periods of prosperity and depression. Many of them bring this condition about as the result of their own individual policies. Some, of course, in fact all, are affected by periods over which they have little

control. In this present period, however, I venture to state, in closing, that, in spite of the necessary adjustment of the world's economic conditions before the depression can end, research will play its part as never before and that those industries which sponsor and support research and, in consequence, develop and produce new products for which there will be a general demand will be the ones in the forefront in the march from depression to prosperity.

## Cooperation Between Bankers and Accountants<sup>\*</sup>

By R. B. McPHERSON

*Vice-President, First National Bank of Shreveport, Louisiana*

I AM here this afternoon to talk with you on co-operation, as though we were in your office or at the bank, and there is much of what I am going to say that is not new to you.

Giving and receiving are equally important in co-operation and I shall first discuss the co-operation given by the bankers. Twenty-five or thirty years ago there were only a few credit departments in banks and those were in New York, Philadelphia and Chicago. Today there are several thousand banks each with from two or three up to one hundred and fifty people engaged in credit work. Those credit departments have increased greatly in efficiency and value to loaning officers, as well as in number, in recent years.

I believe I am safe in saying that until ten years ago our bank received no audited statements from borrowers, while we are now receiving quite a number regularly each year, and every little while a new one is added to the list.

I learned recently from a vice-president of one of the largest banks in New York City that approximately ninety-seven per cent of that bank's unsecured commercial loans of \$100,000 or more are supported by audited statements. I am sure all of you wish the banks in your own cities considered audits that essential.

I communicated recently with banks in Dallas, Houston, Fort Worth, Tulsa, Little Rock, New Orleans and Shreveport as to the per cent of unsecured commercial loans of \$25,000 or more

that are made against audited statements and the average was roughly fifty-five per cent with three banks reporting theirs at less than thirty per cent.

Another question I sought information on from these same banks was whether they have had an increase in the number of audited statements during the last few years. Every one of them reported an increase. Several of them wrote as though they were going to insist on many more in the future.

I am sure our chairman representing the minority State of Arkansas will be pleased to have me read a letter from one of the Little Rock banks indicating a progressive step recently taken by the Arkansas Society of Certified Public Accountants.

"We can truthfully state that within the past few years the number of audited statements submitted by our borrowers has increased. For the past two or three years, we have consistently been building our credit files to a more complete set-up and on large lines we have asked for audited statement. We are furthermore determined to make a very few exceptions from now on.

"Just last week the Credit Department representatives from each of the Little Rock Clearing House Association Banks met with the Arkansas Society of Certified Public Accountants for the purpose of establishing a closer relationship and it is the program of the Clearing House Association now to demand audited statements."

Unfortunately for the accountants there are still many banks willing to make large loans on bookkeeper statements. Sometimes it is more

<sup>\*</sup>Delivered at Four-State Meeting, Shreveport, La., November 16, 1931.

unfortunate for such lending bank than for the accountant, for such statements often fail to disclose important facts which have in some instances caused banks to sustain losses. One of the most common misrepresentations is for customers' receivables to contain a substantial amount due from officers, stockholders and allied concerns.

There are many benefits derived by a corporation in having its books audited annually and many of them want the audit made year after year, whether their banks require it or not. Now you are naturally anxious to see banks generally adopt a policy of requiring many more audited statements than they have been getting. I believe this improvement will come, but it is going to take time, and I might add that some of us are nearly as eager as the accountants, for a good increase in the number of audits.

The other side of the cooperation between the accountants and the bankers is where the accountant's effort comes in, namely: to produce as true and understandable a picture of the financial condition as possible.

Bank loans represent temporary financing, at any rate they are supposed to be for short terms only, and they are expected to be paid out of the current assets. Therefore banks are primarily interested in current assets and current liabilities. There are so many different opinions as to the classification of these items that I am sure bankers will welcome the day when these set-ups are more uniform.

The best guide I have ever heard of for the proper placing of such items is this:

"Current assets consist of cash and those items that are convertible into cash in the normal course of business within one year, to meet the current liabilities that are to be paid within one year."

Now let us test several items by that rule. Prepaid expense, often included in the current assets, represents money already spent once and could not be spent again unless an insurance policy were cancelled, stationery or supplies of some kind were sold, and that is not done in the normal course of business. Cash surrender value of life insurance is very often listed in current assets. It does not provide funds for meeting payrolls nor for paying for merchandise. The very fact that year after year there is an increase in the amount of this item shows that it was not used in the normal course of business to liquidate indebtedness.

In case circumstances have changed and the responsibility of the management no longer rests

on the shoulders of the insured, the board of directors may authorize the cancellation of the policy, in which event it would immediately become a current asset. Some will say that a loan could be made on the policy at any time the business needed money and the insurance would remain in force. This is true, but that is not done in the normal course of business. In such a case it simply becomes collateral and as such it would not provide \$5,000 emergency cash any quicker than would a \$5,000 first mortgage on a \$100,000 store building owned by the corporation.

In the event of liquidation, of course this cash would be realized from surrendering the policy but it should be remembered that the bank's analysis of the statement to determine whether it is willing to meet the borrower's need for funds is made at a time when the borrower is looked upon as a going concern.

Many owners seem to prefer to make banks out of their businesses and borrow from their companies rather than from the banks. There are possibly two reasons for this—they may not like to pay interest and they may not like to be called upon to repay the loan for a long time. The abundance of time usually taken to repay such loans is why they should not go into current assets. As a matter of sound business practice they do not belong in the statement at all, for the loan should be made at a bank. Personally I should like to see the title of "accounts receivable" changed to "trade accounts receivable."

Reserve for taxes is sometimes shown in deferred liabilities. While the exact amount may not be known, a check for something like the figure appearing in the statement is going to be issued within a year from the statement date and that puts it within the definition given a moment ago.

Sometimes a declared dividend is shown below the current liabilities. It is obvious that this represents a payment to be made within a year. Most of the above items are comparatively small, yet often cause quite a difference in the current ratio as figured by the accountant and the bank.

A reconciliation of surplus is essential where there is a discrepancy between the surplus for the current year and the previous year. I have seen some audits where no such reconciliation was included.

The client would object to having the statement show notes receivable segregated as to past due, current and maturities beyond twelve months, and past due and current accounts receivable.

However this would be of much value to the banks and it could be shown in a separate schedule. The reason I speak of this is because the Federal Reserve Bank has asked for that information on several occasions in connection with paper rediscounted, where the accompanying statement showed rather heavy receivables. Several months after an audit it is almost impossible for the client's bookkeeper to reconstruct the notes and accounts receivable totals and to determine the amount that was past due at the beginning of the year.

Each of the lending banks should be furnished with a financial statement and an operating statement, if not a complete audit. Moreover they should be given the opportunity of studying the complete report if there is no complete copy for them to keep. Sometimes the client claims there are not enough statements to go around, so the bank must borrow one and make a copy of what figures it wants. The books should indicate how many banks the client does business with and it seems proper to furnish each bank new figures whether there is a loan with all banks at statement date or not.

The analysis of income showing to what extent income was affected by sales volume and margin of profit, which is now being included in many reports, is a valuable addition.

Contingent liabilities are usually mentioned but not always. Instead of it being left a matter of doubt, would it not be desirable to put in the report something like this: "No contingent liabilities were disclosed during the audit and we were assured by the management that none exist"? For years some such certificate has been obtained from the management in connection with merchandise inventory.

The manager of the credit department of one of the largest New York banks has no time to go into an audit until he first reads the certificate. He used to say "all that glitters is not gold." He wanted to know the scope of the audit and not become overawed by the leather cover, watermarked stationery and the silk cord. I believe you will agree there is much to be desired in having the certificates clearer as to what was done during the audit.

Bankers are accustomed to dealing in dollars and cents and many times they would actually know more about the value of an audit if only the certificate could close with "Fee received \$50.00 or \$500.00," as the case might be.

Some are complete audits covering all income and disbursements for a twelve-month's period beginning with the previous audit, and a verification of everything except taking a physical inventory and verifying accounts receivable. Others are limited to an audit of the existing ledger assets and liabilities, while some that look just as good are simply "dolled up" balance sheets, which took but a few hours to prepare. This latter variety, in my opinion, should be labeled by the accountant "Not an Audit" so that no one would be fooled. Perhaps there may come a time when Certified Public Accountants will omit entirely the word "audit" if they have not actually audited the client's books of account.

There is also a third means of valuable co-operation and that is one in which there is more or less of a responsibility on the accountant as well as on the banker to help the client understand the meaning of the figures, point out favorable or unfavorable trends, some weakness that may be corrected before much damage is done. We all know that it is so much easier and less expensive to keep a business out of financial difficulties than to get it out after it is in trouble. I believe that it would increase the client's appreciation of the value of audited statements if the accountants and bankers would avail themselves of every opportunity to discuss these statements with the client and to offer constructive criticism freely.

The Robert Morris Associates, of which Mr. Moise and I have been members for several years, and the American Institute of Accountants, working together have accomplished a great deal in improving the standards of accounting and credit practice.

In closing, I want to assure you that the bankers and especially those handling credits, appreciate how dependent we are on the Certified Public Accountants for the underlying figure facts supporting loans running into billions.

As time goes on I am sure there will be even closer co-operation between bankers and accountants.

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The Department of Banking and Insurance of the State of New Jersey has recently published a 107-page report on an examination made of the Prudential Insurance Company of America. The report is signed by W. B. Wiegand, Chief Examiner of Insurance Companies for the State. Mr. Wiegand is a member of The American Society of Certified Public Accountants.



# Responsibility of Accountants in Tax Matters<sup>\*</sup>

By E. J. DEVERGES, C.P.A., New Orleans, La.

THE Certified Public Accountant has just reason to be proud of his profession and gratified at the strides that it has made.

Though accountancy was recognized as a profession a little over three score and ten years ago accounting or the keeping of records is undoubtedly as old as civilization itself and has been steadily developed through the ages, by nations, as varied and complex transactions of trade and credit were introduced, until today we find that the profession has grown and prospered until it has acquired the same distinction as the other learned professions.

Accounting is inseparably related to law. Laws are mandates, and to enforce its laws and carry into effect its mandates and perform its manifold functions the State levies taxes by virtue of its sovereignty. The determination by means of records of the value, the amount or the size of that right is the province of accounting.

The Babylonians made the first record of the ownership of property 2200 B.C. when registers were carefully prepared for the state as the basis of taxation.

The Egyptians, whose accounts were written on papyrus, kept careful record of the revenues and disbursements of state. Taxes in those days were usually payable in kind necessitating the recording of the commodities received by the state in payment of taxes.

A crude form of budget was developed by the Romans showing the need of the imperial household and army and they used the same as a basis for the levy of taxes.

The basis of England's earliest system of accounting was the Domesday Book about the time of Henry I (1100 A.D.) which recorded all taxable estates in the country.

It is obvious from the history of accounting that the accounting or recording of transactions was first brought about through the necessity of recording property for the purpose of taxation.

The business man of today looks to the Certified Public Accountant for assistance to guide his business and curtail his expenses rather than to determine what has happened. We have passed from the position of detective to counselor and adviser. Taxation is a matter of great interest to those who are charged with the guidance and destiny of every business regardless of its size.

While I sincerely believe that every business stands ready to pay to the sovereignty its just portion of taxes, our help and assistance is expected to determine, analyze and record the property and business transactions so that the schedules submitted for assessment, will show separately that property which is exempt from taxation. Therefore, as the growing appreciation of the Certified Public Accountant's services in tax matters has increased the demands upon the profession, it is but fitting that we should study the business man's tax problems, so that we may better serve him, because a great responsibility has been placed upon the Certified Public Accountant in handling tax matters.

As the subject of taxation is too broad for adequate presentation in the time allotted, I will not treat the subject in detail, but in a general way, so as to give a brief view of the field of taxation in so far as it should be understood by the accountant and not as it is approached by the student of law.

Taxes are not regarded as a debt in the ordinary sense of that word, because, the obligation to pay taxes does not rest upon any contract expressed or implied, or upon the consent of the taxpayer, but are the positive acts of the government, binding upon the inhabitants, and to the making and enforcing of which their personal consent individually, is not required. Taxes once assessed are not the subject of set-off, between the taxpayer and the State or Municipality for which they are imposed.

There is, properly speaking and as is generally understood, a clear distinction between licenses, assessments and taxes.

License fees are exacted for the primary pur-

<sup>\*</sup>Address at meeting of the Society of Louisiana Certified Public Accountants, December 10, 1931.

pose of raising revenues and regulating or restraining occupations deemed dangerous to the public or specially in need of public control, and are imposed in the exercise of the police power, and not within the scope of taxation.

While, in a broad sense, taxes may be said to include assessments for improvements, in practice and as is generally understood there is a clear distinction between the two terms. Assessments are special and local impositions upon those property owners who enjoy the benefits accruing from a public improvement, in the immediate vicinity of the property assessed.

It is the first requisite of lawful taxation that the purpose for which taxes are levied shall be for the public good.

These principles should be within the fundamental knowledge of every Certified Public Accountant.

There are numerous laws regulating the levy, assessment and collection of taxes and reference to those special laws could not be encompassed in this paper. It is the duty and obligation of every Certified Public Accountant to familiarize himself with all special laws, particularly tax laws, referring to the business whose accounts he is called upon to examine, or as to the future guidance of which he is consulted.

The ordinary commercial business presents many tax problems for the Certified Public Accountant, therefore, I will undertake to present a few:

The duty of the Certified Public Accountant extends further than to just ascertain if the quantities and values of the merchandise inventoried are correct. The public accountant is charged to ascertain the situs of the property for the purpose of taxation and whether the value of the merchandise as shown by the inventory should be reported for tax purposes and whether there is any merchandise inventoried which is only transiently in the State and has not become incorporated with the other property in the State.

It was formally the universal rule, fully entrenched in American jurisprudence, that personal property has its situs at the domicile of the owner under the maximum, *mobilia sequuntur personam*—and its necessary postulate that the State of domicile may tax the absent property of its domiciliaries. Such a theory furnished the several States a lucrative as well as satisfactory method of collecting taxes from residents as well as non-residents. But the United States Supreme Court readily recognized that the State where the goods

were kept had jurisdiction over them, afforded them protection and was entitled to tax them. It was not settled if this should be the sole tax until the issue was squarely put in the case of a corporation organized in Kentucky and on whose tangible property a tax was levied in other states. The court held "That where the State or situs of the property gains jurisdiction over it for purposes of taxation, the State of the domicile loses it, and that when the State of domicile loses its jurisdiction, it loses its power to tax, and that it taxes notwithstanding the fact that it has no power, in so doing it takes property without due process."

The dictum of the court in that case gives an insight of the departure from the existing view \* \* \* "in view of the enormous increase of such property since the introduction of railroads and the growth of manufacturers, the tendency has been in recent years to treat tangible property as having a situs of its own for the purpose of taxation and correlatively to exempt at domicile of the owner."

Article X of the constitution of this State provides that "no property shall be assessed for more than its actual cash value." This clause was interpreted to be the "price in cash for which property could be sold, free of all incumbrances, otherwise than at forced sale," i. e., in the ordinary course of business.

The Certified Public Accountant should ascertain whether the opening, closing or mid-term inventories or the mean amount of the several inventories taken reflects the true average of the amount of merchandise carried, for the assessment of the merchandise must be based upon the average amount of merchandise carried.

It is of frequent occurrence, especially with firms who are engaged in the exporting of merchandise, to include in their closing inventories, merchandise which has been purchased in other states just prior to the closing of their fiscal period. These goods are not intended to be offered for sale in the open market at the domicile of the firm, but are in transit between the State of origin and the State of destination, and therefore, are not lawful objects of taxation during their passage or transportation, provided the goods remain in unbroken packages—and have not become intermingled on arrival here with the general property in this State.

The Certified Public Accountant should also familiarize himself with what property is exempt from taxation under Section IV or Article X of

the Constitution of 1921 of the State of Louisiana.

Cash on hand or on deposit; loan or other obligations secured by mortgage on property located exclusively in the State of Louisiana and the notes or other evidence thereof; debts due for merchandise or other articles of commerce or for services; obligations of the State or its political sub-divisions, one or all of which forms part of the assets of every business which the Certified Public Accountant is called upon to examine are amongst the property which is declared to be exempt from taxation by that section.

It may also interest the Certified Public Accountant to know that bonds of any State of the United States and political subdivision of any such State, bonds of railways, railroads and other public utilities, manufacturing and industrial corporations and bonds secured by real estate, except such as are exempt from taxation by law, are made a separate class for the purpose of taxation and such property subject to taxation is assessable at ten per cent of the market value thereof.

The assessment schedules prepared for the taxpayer should list all the property at its actual cash value, which has been held to mean a price that any piece of real estate or personal or movable property would sell for cash, in the ordinary course of business, free of all incumbrances, otherwise than by forced sale, and should show separately that property which is claimed to be exempted.

Sections 14 and 25 of Act 170, of 1898, impose a duty upon every taxpayer to fill out a list of his property and return the same to the assessor within the time prescribed; and any refusal, neglect or failure from any cause whatsoever, to comply with this provision, shall estop the taxpayer from contesting the correctness of the assessment list filed by the assessor.

The guiding thought in presenting this paper has been to present such tax problems with which the Certified Public Accountant is confronted in everyday practice, and with which he should be familiar; the matter discussed being of an elementary nature.

To undertake a discussion of the laws relating to income taxation, legacy and inheritance taxes, while of utmost interest to the Certified Public Accountant, would consume more time than has been allotted, therefore, presentation of these particular classes of taxes has been reserved for a future date.

Your attention was directed to the distinction between taxes and licenses. The amount of license

a business man has to pay for the privilege of conducting his business is of no small interest to him. Therefore, the Certified Public Accountant should properly analyze the annual receipts of the business he is examining, so as to eliminate the receipts on which a license is not due, in calculating the license to be paid by his client.

I believe that the practice of accounting, with all the safeguards that now attend it, affords each and every man and woman who is privileged to append to his name the letters C.P.A. an opportunity to render as important service to his fellow man as the members of the other learned professions.

In conclusion, I want to admonish you, that in suggesting that you should, in the interest of your client, familiarize yourself with such tax laws relating to your client's particular business, so that you can better serve him, you should not undertake your activities beyond the great and honorable field of accounting by endeavoring to furnish information and advice to your client on technical legal problems that may present themselves.

## BOOK REVIEWS

TRADE ASSOCIATIONS—THEIR SERVICE TO EDUCATION, by S. Lewis Land. Published by J. J. Little and Ives Company, New York. 141 pages. Price \$2.00.

This book, which is the result of a decade of study and experience based on original first-hand sources, presents material which is new in the literature of trade associations.

The author reviews the development of educational efforts of trade associations; summarizes the educational activities of national trade associations in the building industry; analyzes types of educational services sponsored by trade associations; presents the respective and joint responsibility of both industry and school agencies in the organization and promotion of training programs for industry; indicates present tendencies and practices in procedures employed by national trade associations in the promotion of organized education; outlines specific suggested procedures to be employed by trade associations in the organization and maintenance of educational services; and points the way in a series of conclusions and recommendations to a more effective coordination of the activities of industry and school agencies to more adequately meet the needs of industry.

REORGANIZATION AND OTHER EXCHANGES IN FEDERAL INCOME TAXATION, by Robert N. Miller, Homer Hendricks and Ewing Everett. Published by The Ronald Press Company, New York. 448 pages. Price \$10.00.

A detailed analysis of the reorganization and allied features of Federal income tax. The volume is especially designed for corporation lawyers, public accountants, bankers and others who are confronted with such problems. The expert, already versed in reorganization work, will find an orderly and comprehensive exposition of the numerous fundamental factors involved. The less specialized practitioner will find it an intelligible guide, not only as to conditions under which he may work out problems for himself, but as to treacherous pitfalls to be avoided. Points about which uncertainty exists are distinguished from those upon which there is settled law.

The volume is divided into three major parts. Part I deals with the nature of income and the fundamental principles in regard to its realization, as indicated by the decisions of the Supreme Court of the United States.

Part II deals with the general subject of recognition of gain or loss and in particular with the non-recognizing statutory provisions of Revenue Act of 1928 and prior acts.

Part III discusses the subject of basis for gain or loss and miscellaneous related topics.

The Appendix includes a number of problems illustrating the manner in which questions of recognition arise in everyday practice and the steps by which their solution is worked out.

INTRODUCTION TO ACCOUNTING, by Dallas S. Bolon and George W. Eckelberry. Published by John Wiley & Sons, Inc., New York. 572 pages. Price \$4.00.

This book includes the material which is given in the first year's work in accounting at the Ohio State University. The first half deals with the affairs of a simple type of business, conducted by a single individual, developing from the smallest beginning into a typical merchandising concern of minor size. The plan of study includes: types of business transactions; analysis of business transactions from the accounting viewpoint and the recording of the results in the accounting records. The merchandise transactions are approached from the viewpoint of the perpetual inventory plan; development of special columnar

journals and special ledgers, discussing principles of control account; adjusting and closing entries illustrated with "T" ledger accounts and the work-sheet; preparation of financial reports.

In the second half the business develops into an enterprise conducted by a partnership and later by a corporation, a manufacturing department being then added. The plan of study here includes accounting for partnerships and corporations; accounting for specific items; valuation; analysis of statements, the ratio plan of analysis being presented in simple form.

ECONOMICS FOR ENGINEERS, by Edison L. Bowers and R. Henry Rowntree. Published by McGraw-Hill Book Co., Inc., New York City. 490 pages. Price \$4.00.

This book has been prepared to meet a long-felt need for a practical presentation of economic principles and problems designed especially for engineering students. Its contents include: the approach, standards of measurement, consumption, evolution of modern industry, business units, factorial proportion, financial structure, domestic marketing, international marketing and finance, competitive prices, controlled prices, fixed prices, wages and salaries, labor relations, management and profit, interest and rent, investments, insurance, secular price trends and financial contingencies, cyclical fluctuations and business uncertainties, work hazards and their remedies, consumers' risks and public control of business, socialism and the Russian experiment, Government finance and taxation, the efficiency of the economic machine.

ORGANIZED BUSINESS LEADERSHIP, by Merle Thorpe, editor of *Nation's Business*. Published by Harper & Brothers. 103 pages. Price \$2.50.

William Butterworth, former president of the United States Chamber of Commerce, concludes his Foreword to this little volume: "The author of this volume has set forth, candidly and frankly, the potentialities of leadership in these fields which offer so much not only to individuals, but to democracy itself. Mr. Thorpe has lived with the business organization movement for many years; he has been in it and of it; he therefore, speaks with the authority of sympathetic and intimate understanding."

Mr. Thorpe says: "Responsibility and organized action by communities and industries will bring about social and economic betterment, and with

no loss of America's far-famed individualism. If democracy is to endure, it must be protected against itself, and hope lies through enlightened and intelligent leadership of group activity."

**BOOKKEEPING AND ACCOUNTING**, by James O. McKinsey. Third edition. Published by South-Western Publishing Company, Cincinnati, Ohio. 398 pages. Price \$1.52, subject to usual school discount when ordered for class use.

This book was prepared to meet the needs of those who desire eventually to do accounting work, those who do not expect to do accounting work but who expect to enter some kind of business activity, and those who expect to pursue further courses in business in colleges and universities. Its purpose is to teach the student the method of collecting and presenting accounting and statistical data so that they can be used by the business man in the management of his business, and the method of using such data in the solution of business problems.

In this, the third edition, no change has been made in the objectives of the text or in the principal methods used. The revision has largely been concerned with the simplification of discussions and problems so that they can be more readily grasped by the average student.

**CREDIT MANUAL OF COMMERCIAL LAWS**, issued by the National Association of Credit Men. Published by J. J. Little & Ives Co., New York, 426 pages. Price \$4.00.

This book points out the legal considerations with which the reader should familiarize himself from the receipt of an order to the final disposition of the account. The following outline will show the completeness with which the subject matter is handled: 1. When You Receive the Order. Acknowledging the order; making the contract; signature of the order; legal status of foreign corporations. 2. When You Are Checking the Credit. With whom are you dealing? Corporations; partnerships; individuals; cooperative associations; trusts; receivers and trustees. Is the buyer responsible? Financial statements; exemptions; landlord's liens; insurance. 3. How Should You Sell—Cash, Credit or Security? Cash; open accounts; trade acceptance; promissory note; interest and usury; security; chattel mortgages; conditional sales; guarantees and endorsements; consignments; draft attached to bill of lading;

C.O.D. 4. When You Ship the Goods. Cancellations; risk of loss; tender; claims for loss and damage; stoppage in transit; rights of unpaid seller; right to examine the goods. 5. If there is a Breach of Contract. 6. While You are Collecting the Account. Checks marked "in full of account"; interest on accounts; dunning as libel; legal remedies of unpaid seller; jurisdiction of justices of the peace; attachment, judgment and execution; time limit for suit; bulk sales; mechanic's liens; liability of bank for default of correspondent; bankruptcy and assignments for benefits of creditors. 7. If there has been Fraud. Bad checks; false statements.

**MEASURES OF EXPORTS OF THE UNITED STATES**, by D. J. Cowden. Columbia University Press. Price \$2.00.

This is a fine specimen of a modern Ph.D. thesis in economics. It exemplifies statistical methods as currently used and also contains formulae of great intricacy, although with no practical value excepting to other ambitious researchers. (See page 68.) The numerous graphic charts are fine samples of what can be done to elucidate a text. However, the data pictured has only historical value now.

The author is a Phi Beta Kappa graduate of Grinnell College, Iowa, and is now engaged in economic and statistical work in New York City. The American Telephone & Telegraph Company, whose statistical department is the world's premier organization of its kind, gave this book a boost in its latest bulletin. "There's a reason."

## Library Additions

The *Cumulative Loose Leaf Business Encyclopedia*, 10 volumes, 4,000 pages, published by the John C. Winston Company, Philadelphia, Pa., has recently been received.

This encyclopedia covers in Volume I—The Executive Business Administration; Volume II—Production, Personnel, Cost Accounting; Volume III—Income Tax, Corporations, and Accounting; Volume IV—Economics, Banking, Finance, Investments; Volume V—Marketing, Salesmanship, Credits, Collections; Volume VI—Advertising, Correspondence, Office Management; Volume VII—Insurance, Real Estate, Public Utilities; Volume VIII—Transportation, Foreign Trade; Volumes IX and X—Business and Commercial Law.

This enumeration indicates that the encyclopedia is designed to cover the whole range of business activity. In view of the fact that business is not stationary, the material has been prepared in loose leaf form so that additions may be easily made, and subtractions as well when material has lost its value, as it sometimes does even for historical purposes. Completely indexed, both alphabetically and topically, the material presented is readily accessible to any who are looking for information in the field covered by the encyclopedia.

Three Certified Public Accountants appear in the list of associate editors and contributors: The late J. Lee Nicholson, holder of a New York C.P.A. certificate dated 1901 and California 1924, prepared the original material of 128 pages on Cost Accounting; Robert J. Bennett, holder of Michigan C.P.A. certificate dated 1906 and Pennsylvania 1913, is the author of the 80-page section devoted to Corporations; Nelson H. Prouty, C.P.A., Indiana, 1921, is the author of the 248-page section devoted to Accounting.

The second edition of the *Accountants Handbook*, W. A. Paton, editor, has just come from the Ronald Press.

The first edition, published in 1923, contained 1,596 pages representing the work of nineteen listed special contributors, Earl A. Saliers, professor of accounting at Northwestern University, having been the editor. Material in the first edition was classified in 32 sections with a 50-page index.

The present edition contains 1,873 pages, followed by an index of 63 pages. The sections number 33, with only three headings corresponding to those of the first edition. The editor, W. A. Paton, professor of accounting, University of Michigan and member of the accounting firm of Paton and Ross, Certified Public Accountants, lists 76 contributing and consulting editors (nineteen of whom prepared one or more sections).

In the publisher's preface, attention is called to the fact that this is "a new work rather than a mere revision" and it aims to cover "the entire field of commercial and financial accounting and allied subjects." That a work of this character filled a long-felt want was demonstrated by the sale of practically 100,000 copies of the first edition. The preface also announces "the primary object of the Handbook is to present accepted practice. Material has been drawn from the best sources wherever available, credit being given

freely in all cases. ... In a word, every effort has been made to present in the Handbook—in content, authority and convenience—a reference work of the greatest possible service."

## NOTES

In the January issue of *Credit and Financial Management*, the official organ of the National Association of Credit Men, there is an article by N. R. Catharin on "Should Business Men be Registered?" in which the first and last two paragraphs have an interest to accountants:

"The ease with which anyone can engage in business, and the apparent indifference to the unfortunate results for the community as a whole, is nothing short of appalling. This is a bold, broad statement, but is the conclusion, based upon eighteen years of intensive credit experience."

"Everyone, by law, should be compelled to keep a simple set of books. As it is, today many merchants keep very incomplete records as well as inaccurate records, with the result that it is impossible to determine the nature of the yearly transactions intelligently, and this is particularly embarrassing and trying where a failure has occurred.

"All states now operate a Bank Examining Division. Would it not be possible for the state to supervise the financial records of all businesses doing less than \$50,000 at a minimum cost and compelling all businesses doing in excess of that amount yearly to have their books audited by a recognized auditor, either a C.P.A. or private, so long as the auditor is in good standing?"

The efficiency of State audits is largely a myth. The desire to have things done at a minimum cost is always greater than the desire to have it done well. No government agency can make a thorough audit at a smaller cost than would be charged by an independent practitioner for an audit of a similar type.

With the December, 1931 issue *System*, a magazine with a thirty-year history of successful propagandistic work for and on behalf of that phase of business which its name denoted, was placed in the magazine graveyard and in January, 1932, *Management Methods* was established as its successor. No change was made

in the directing force but the sphere of influence was enlarged. Its first editorial was as follows:

"In America, we've been engaged for two years in too much conversation. We have wasted time and bewildered ourselves.

"Yet by words have we been persuaded. We have burned with a befuddled zeal over a new kind of religion. We've gone international.

"We exhort. We expound. We explain to each other just why business recovery is impossible until someone shall have invented an equation that will balance perfectly the factors of war, reparations, tariffs, money standards, and Mahatma Gandhi.

"We have talked ourselves first into belief and next into fear. Over the heads of our makers and distributors of goods hang clouds of doubt. But our people are tired of gloom and they chafe under our indecision.

"Let's shut our mouths and re-open our factories.

"Let's put the globe back in the library and drag forth again the old tack-studded map.

"Let's forget about the *why* of business and think about *how*.

"Thus do we, the editors of this publication, greet you."

The Department of Commerce has recently made public the results of a study of 612 bankruptcies in New Jersey during the years 1929 and 1930. Quoting from the January 10 issue of *Domestic Commerce*:

"Bankruptcies and other failures cause enormous losses, not only to those who fail but to their creditors. They raise the cost of living to consumers and are a disturbing factor in the business life of the community. The prevention of failure, to some degree at least, is the purpose of this study and the report deals specifically with the causes of failure."

"More than half the concerns studied either kept no books at all or kept inadequate records, and thirty-nine per cent of them never took an inventory. Poor credit methods were evidenced by excessive losses from bad debts. The average open credit losses of retailers were eight times as great and the average installment credit losses five times as great proportionately as those of going concerns."

"Regarding the causes of failure it was found that business depression and unemployment were

mentioned more frequently than any other casual factor. The creditors mentioned this factor less frequently than the debtors. The report discloses, however, that an analysis of the data seems to indicate that business depression was the occasion rather than the cause in many, if not most, of these cases. The real cause was the inefficient business practices of the one who failed."

A copy of the report, "Causes of Business Failures and Bankruptcies of Individuals in New Jersey in 1929 and 1930" may be secured from the Superintendent of Documents, Washington, D. C., for ten cents each.

The New York *Herald-Tribune* for Sunday, January 10, contains an announcement of the formation of the Controllers Institute of America, Inc.

Its purpose, as announced by the president, F. J. Carr, controller of American Airways, Inc., was to organize the privately employed accountants as contrasted with the public accountants. It is expected that this organization will furnish a professional home for accountants who have elected to go into private employment instead of entering the field of public practice and who look forward to attaining a position in the private field usually designated as controller.

A recently released report on "Comparative Tax Rates of 290 Cities in 1931," prepared by C. E. Rightor, of the Detroit Bureau of Governmental Research, appeared in the *National Municipal Review* for December.

This is the tenth annual compilation which Mr. Rightor has made and the figures show that "tax rates in 1931 still continued their upward climb." From the report we quote:

"One conclusion may be drawn—a study of the comparative tax rates on real and personal property does not afford an ultimate test as to the effectiveness or economy of any city. It must omit consideration of other sources of municipal revenue, a separation of sources as between the State and local government, tendency to cut down taxes by accruing deficits, the extent of pay-as-you-go policy, etc. Such a single test cannot be found, but rather several yardsticks must be applied involving the budget, assessing, borrowing, and expenditure policies."

The National Credit Office of New York, issued under date of December 23, last, the following letter:

"With the official endorsement of the Uptown Group of the Textile Industry, the Downtown Credit Group, and the credit men of the most important concerns distributing to, and the many banks financing, the textile industry, we are writing to urge you to employ Certified Public Accountants to take off your balance sheet showing the results of operations for the year 1931.

"We are further requested to suggest that you have your accountants make a complete certified audit, including the usual verification of accounts receivable and accounts payable, and to submit to us for our entire clientele interested in your account the detailed figures, including your profit and loss statement.

"These balance sheets and supplementary figures will be photographed and submitted to those interested exactly as received.

"It is hardly necessary for us to emphasize that the credit men of the important textile concerns and banks are well aware of the severity of the depression through which we have been passing and will judge your figures, fully understanding the difficulties under which you have been operating.

"May we request that you make every possible effort to submit to us a complete audit at the earliest possible moment?"

—  
Last year an "accountant" in one of our largest cities, who describes himself as a free lance, issued an energetic brochure entitled "And They Sent For Louie." Here it is:

"*Sometimes* it was the general office manager. He was not satisfied with the book value figures as revealed by balance sheet, profit and loss statements. Louie! Give all inventory accounts the third degree; fine tooth-comb those expense accounts. I want detailed analyses. Furthermore, subsidiary record balances do not tie up with ledger controls for past six months. Find differences. Age my accounts receivable.

"*At other times* public accountants, engineers, appraisers requiring dependable assistants to perform details of their audits, cost system installations, tax revision cases, etc. (They still send for Louie.)

"*Now and then*—Mr. Gozinto Business. (Louie! I wanna simple, inexpensive accounting system, inexpensive), or Geo. X. Individual who just can't

reconcile his bank statements or O. U. Shopkeeper employing no regular bookkeeper.

"*Still again* club treasurers have always found Louie glad to respond when disengaged.

"*Once in a while*—private schools. One headmistress had Louie rewrite the cash book for two years back and Louie! my plumbing bills on those new dormitories must be away off. They were. Louie only found \$1,900.00 in excess charges.

"*Summers*—generally find Louie wrestling with the bookkeeping problems of a summer hotel, country club or camp. (Some wrestler.)

"*Terms*—\$1.50 per hour; \$8.00 to \$10.00 per day; \$45.00 to \$50.00 per week (will depend on responsibility). Traveling anywhere at your expense.

"*Who is this Louie?*—Louie is just a free-lance bookkeeper and general accountant. Hopping off from one mixup to another for the past ten years, when he wasn't climbing mountains, Louie should know his onions.

"For open time, address . . . . ."

Evidently this sales talk did not sell, and those who had once bitten did not continue sending for Louie, for a year later the same gentleman addressed a business organization in another State: "This writer seeks an opening in your accounting department and will abandon free lancing."

—  
In the December 15 issue of *Forbes*, commenting on the fact that "out of 659 corporations issuing financial statements in October and November, 134 reported profit better than in corresponding periods of 1930." The editor says, "What 1931 has demonstrated beyond cavil is that the business organization which quits fussing about conditions external to the business and turns its searchlight inward can find ways and means to win."

—  
The standing committee in charge of Simplified Practice Recommendations on Commercial Forms of the Bureau of Standards, Department of Commerce, recently reviewed all comments and suggestions which had been received during the past year with reference to the national standard invoice form and unanimously agreed that no changes were necessary in the simplified invoice.

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Bouldin S. Mothershead, C.P.A., of Harlingen, Texas, is the author of an article in the February issue of *Texas Citriculture* on "A Phase of Income Tax Affecting the Citrus Grower."



## C. P. A. Examination Questions\*

November, 1931

### Commercial Law

#### NEGOTIABLE PAPER

##### Question 1:

John Williams, a contractor, does two jobs for Henry Black, under two separate contracts. The money owing under each contract will fall due August 1, 1931. John Williams on July 15, 1931 needs some money to pay Tom Carlson. He thereupon draws on Henry Black a draft or bill of exchange which is negotiable in form unless the ending "and charge to my account on the No. 18 Main Street job" makes it non-negotiable. Tom Carlson in his dealings with John Williams has made fraudulent statements. Williams discovers the fraud and notifies Black not to honor the draft when presented for payment. Carlson, prior to maturity, indorses the bill of exchange to Peter Dawson. Dawson presents it to Black at maturity for payment which is refused on account of the stop-payment order. Dawson seeks to hold Williams.

What must the court decide, and why, in respect to

- (1) The negotiability of the note. Is it negotiable?
- (2) The conditions under which Dawson must have acquired it. Will this be material if the note is not negotiable? Why?

##### Question 2:

Joe Maker on July 1, buys an auto from Tom Payee, giving Payee a negotiable check for the price, drawn by Maker and payable to Payee. Payee intending to defraud Maker then jumps in the car and drives away. Maker immediately stops payment on the check. Three weeks later Payee comes back into town, buys goods from N. Dorsee, and indorses and delivers the check in payment therefor. The drawee bank refusing to honor the check, N. Dorsee promptly notifies Maker and sues him. If you are representing Maker, what would you claim? Would you win out on your position?

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\*The Service of Examination Questions conducted by The American Society furnishes practically twice as many questions in Theory, Auditing, Commercial Law, and Economics and Public Finance as could be used by any State Board for a four-hour examination period, and twice as many problems in Practical Accounting as would be required for two examination periods of four to five hours each. A Board using the service makes its own selections and adds any special questions or problems which it desires. Eight boards used the November, 1931, service. Every suggested question or problem, except two, was selected by at least one Board, and only five were selected by every Board. Two boards added questions with a local bearing. The questions in Commercial Law follow.

## Question 3:

Which of the following statements are correct and which incorrect:

- (1) A note is not negotiable if it contains no express provision as to date of maturity.
- (2) A note is not negotiable if it is undated.
- (3) A change of the date by holder is not a material change.
- (4) A note payable when a person becomes thirty years of age may be negotiable if the person becomes thirty years of age.
- (5) A note payable in installments is not negotiable.
- (6) A note which provides for payment of attorney's fee if not paid at maturity is not negotiable unless it names the amount of the fee.

## Question 4:

What is the meaning of the indorsement, "with recourse?" In what cases should it be used? Define restrictive indorsement. When should it be used?

## Question 5:

Which of the following statements are correct and which incorrect? Why?

- (1) Altering the marginal amount of the note (the figures on the top or side) is a material alteration.
- (2) If a check is altered by a holder and then cashed in its altered state, the maker is the loser.
- (3) Same statement, adding "unless he used a check protector."
- (4) A person cannot claim title to a negotiable instrument through a forged indorsement.

## Question 6:

A note is made payable to bearer. The holder indorses on the back the words "Pay John Smith" and signs his name. Must John Smith indorse for further negotiation?

## PARTNERSHIPS

## Question 1:

Name as many differences as you can between partnerships and corporations.

## Question 2:

A, B and C form a partnership. C is much more diligent in the affairs of the concern than A and B, and puts in a great deal more time than A and B. C claims extra compensation for his services.

- (1) Is he entitled to extra compensation?
- (2) In a case in which a partner is entitled to extra compensation, can he prove up his claim in bankruptcy as against other creditors of the firm? Why?

## Question 3:

A is willing to invest with B and C, partners, \$10,000 it being agreed that in all events A should be indemnified against loss and have 6 per cent on his money. Is it possible under the law that A might not be a partner under such an arrangement? Is it possible that he might be? Explain fully.

## Question 4:

A and B are partners. A from his own pocket pays a debt of the firm; and also loans the firm \$5,000 nothing being said about interest. Upon voluntary dissolution, A claims

- (1) Interest upon his capital.
- (2) Interest upon the money owing him for the debt payment.
- (3) Interest on the \$5,000 loan.

Is he entitled to interest on any of these items?

## CORPORATIONS

## Question 1:

State the meaning of (a) authorized stock; (b) issued stock; (c) unissued stock; (d) treasury stock.

## Question 2:

What are preëmptive rights of stockholders? If a stockholder is notified that he must exercise his preëmptive rights within ten days, would he have to comply to save such rights? What is a stock dividend? Does it constitute income within the meaning of this income tax law? Why?

## Question 3:

Distinguish between the words: "bond"; "debenture"; "preferred stock"; "common stock."

## Question 4:

Henry Henderson owns 20 shares of stock in the Doolittle Company. He sells the stock to Elmer Wilson, and delivers to Wilson the certificate properly indorsed for transfer, but Wilson does not see that the transfer is recorded on the Company's books. Henderson dies and Nelson is appointed his executor. He attends a meeting of the Company, produces a certified copy of the letters testamentary and is allowed to vote. The company issues a stock dividend and delivers it to Nelson; and also pays cash dividends to Nelson. Nelson is ignorant of the sale to Wilson, and supposing the stock to have been lost applies to the corporation for another certificate, which the company issues.

- (1) Did the company run any risk in allowing Nelson to vote without producing the certificate?
- (2) Did the company run any risk in paying the stock dividend and the cash dividend to Nelson without his production of the certificate?
- (3) Did the company run any risk in issuing Nelson a new certificate without the production of the old?

## Question 5:

The legislature of the State of Illinois in 1850 by special act created the X Corporation. There was no law in force in the State of Illinois at that time reserving the right of the State to repeal corporate charters issued by it. Later, the State, without consent of the corporation, seeks to amend its charter in an important particular. Has the State the right to do this? Explain.

## Question 6:

J. P. owned certificates of stock in the P. D. E. Co. Two men falsely claiming to be agents of the company called upon J. P. and stated that they were sent by the company to pick up all the outstanding certificates of stock, for the purpose of making some corrections therein. J. P. thereupon indorsed in blank the usual assignment and power of attorney form on the back of the certificate and delivered same to the supposed agents. The stock was sold to M. K., an innocent purchaser at the market price. M. K. presented the certificate to the company for transfer, but the company having been notified of the fraud refuses to transfer the stock. Is M. K. entitled to the stock? (See 206 Cal. 334, 73 A. L. R. 1398.)

## CONTRACTS

## Question 1:

"April 19, 1922. I promise to pay my wife on conditionary, the sum of \$5,000 providing she stays with me while I live and takes care of things as she has always done; this note not due for six months after my death and to bear no interest until due.

D. A. FRAME."

Mrs. Frame, after her husband's death sues on above note, and shows that she performed the services required in the note, namely, household duties, keeping simple farm accounts, selling butter, etc.

Has Mrs. Frame a good case? (Frame v. Frame, 73 A. L. R. (Texas) 1512.)

## Question 2:

John Doe goes to Europe for a season, leaving his residence closed. A severe windstorm occurs during his absence and blows out one of the windows. Richard Roe, being a neighbor, notices the harm done and repairs the window so that rain, snow and cold cannot thereby enter the house. He puts in labor and spends \$5.00 for material. If John Doe refuses to recompense him, has he a case at Law? Explain.

## Question 3:

John Akers has two sons, who become of age. Peter Akers, one of the sons, leaves home and goes into business, becoming well-to-do. He writes home very seldom, takes no interest in his father's affairs and never helps him in any way. Walter, the other son, feels responsibility, stays at home, and works for five years after he becomes of age on his father's farm. The father dies leaving no will, his entire estate consists in the farm, worth about \$16,000. Walter keenly feels the injustice of his brother getting half of the estate, and he puts in a claim against the estate for the reasonable value of his services. Will it be allowed? Why?

## Question 4:

Junior Williams, being seventeen years of age, in writing appoints John Realtor to sell his real estate for him, and Realtor, acting under his power of attorney, deeds the land to Isaac Blumenthal.

Suppose John Realtor sues Junior Williams for a commission, nothing having been said or written about a commission. (John Realtor is in the real estate business). Junior defends (a) that being a minor he cannot be held; (b) that Realtor has no license to act as broker as required by law; (c) that as nothing was said about commissions, for that reason none are recoverable. Discuss each defense as though it stood alone.

Question 5:

In the above case, suppose that thirteen years later (when Junior is thirty) he brings suit to eject Rose, a purchaser from Blumenthal on the theory that as a minor he had no power to make contracts, especially no power to appoint an agent, and therefore cannot be held to have ratified by his long inaction.

Question 6:

D owes C upon an account stated the sum of \$1,000. D offers C \$750 if C will cancel the debt. C refuses; whereupon D sends C a check for \$750, which states upon its face that it is in full discharge of all liability. C cashes the check and sues D for \$250. Can he recover? Explain.

## BANKRUPTCY

Question 1:

M. Ployee works for M. Ployer, at a salary of \$200 per month. The contract of employment is for an indefinite term, i.e., M. Ployer may discharge M. Ployee at any time without liability. M. Ployee borrows \$1,000 from one Carruthers, assigning his right to salary as security therefor. Thereafter, and while the assignment is in force and effect, M. Ployee files a voluntary petition in bankruptcy. At the time the petition is filed M. Ployer owes \$200 unpaid salary. The trustee in bankruptcy claims the right to collect this salary. Is this correct?

Question 2:

When M. Ployee files the above petition, he has a life insurance policy which has a cash surrender value of \$500. The policy is for \$10,000. Can the trustee get any benefit from this state of facts? May M. Ployee, under the bankruptcy act, save himself the benefit of the insurance?

Question 3:

A general creditor of M. Ployee has a claim against him for \$1,000 arising out of contract dealings he has had with M. Ployee. The creditor gets judgment for this amount three months prior to the date of the filing of the bankruptcy petition. Under the law this judgment gives the creditor a general lien on all of the debtor's assets. Does the trustee take subject to this judgment lien? Why?

Question 4:

M. Ployee after the petition in bankruptcy is filed continues to work for M. Ployer at the same salary as before. Ignoring the effect, if any, of the assignment to Carruthers, does the trustee have any claim to the salary accruing and maturing after the petition in bankruptcy is filed and during administration? Why?

## FEDERAL INCOME TAXES

## Question 1:

X Company, a subsidiary of Y Company during 1930, sustained losses from operations for the calendar years 1928, 1929 and 1930. May the losses for 1928 and 1929, which were years prior to affiliation, be deducted from the net income of Y Company for 1930?

## Question 2:

(a) What credits against net income are allowed individuals for normal tax purposes?

(b) What credits against the tax payable are allowed individuals?

## Professional Prerequisites

(Continued from page 153)

I believe that discretion should be used in the pursuance of any course of study. If the mind is given a rest a few days immediately preceding the examinations, the applicant will be in better condition to meet the requirements.

The achievement of a passing grade usually brings about a happy feeling, but it does not eliminate the need for further study. The habit of study is indispensable, not only for the C.P.A. test but for the future career. The successful practitioner in any profession does not cease studying until he retires.

## Bankruptcy Decision

(Continued from page 164)

and the expense, time, and trouble involved in the reopening of this estate, is such as to justify this court in exercising its discretion in refusing to reopen said estate for the purpose of allowing the payment of said claim.

It is therefore ordered, adjudged, and decreed that this estate should not be reopened; that the claim of John M. Gilchrist Company for \$1,029.75, for services performed for the trustee herein, and for the benefit of this estate, should be and hereby is allowed in the sum of \$1,029.75, as an expense of administration; that the clerk is hereby ordered and directed to deduct from said amount of \$1,158.68, first, the cost of this proceeding taxed as \$——, second, a commission of one per cent, amounting to \$11.58, and, third, to pay to the claimant herein, the John M. Gilchrist Company, the sum of \$1,029.75, upon taking receipt in full from said claimant for said claim, and to pay to Herman Aye, as compensation for his services, as special master herein, the sum of \$——."

## Real Property Law

(Continued from page 163)

up until the time the building is finished should be charged to the cost of construction. After the building is income producing then a distinction is made between capital expenditures and expenses.

It is advisable to keep land costs separate from building costs. In keeping building costs a separate account should be kept with each contractor. A memorandum of the amount agreed upon to be paid to each contractor can be made in the contractor's ledger account. An account, with more or less detail, will appear as follows:

## Plumbing and Heating (\$30,000)

June 1, by cash	\$10,000	Sept. 1 to Cost of
July 1, by cash	10,000	Bldg. \$30,000
Aug. 1, by cash	10,000	
	<u>\$30,000</u>	<u>\$30,000</u>

## NOTES

John A. Conlin, C.P.A., New Jersey, appeared before the House Ways and Means Committee and discussed the provisions under which estates were taxed on the inflated market values of securities, as appraised at time of death, with attendant deflated values prior to the time of settlement of the estates.

Arthur F. Lafrentz, C.P.A., New York, has been elected President of the American Surety Company after five years of service as First Vice-President.

Milton E. Stover, C.P.A., has been appointed assistant secretary and assistant treasurer of Copeland Products, Inc., Mt. Clemens, Michigan.

# An Experience in Arbitration

By J. PRYSE GOODWIN, C.P.A., New York City

ARBITRATION in contrast with court procedure saves time, money, publicity, credit and friendship. Let me illustrate this by a case drawn from personal experience as an arbitrator.

The American Arbitration Association phoned to my office on a Friday to know if I would arbitrate a case at 2 P. M. on the following Thursday (in New York County Supreme Court it would take two to two and one-half years to obtain a hearing and another two years in case of an appeal).

At the appointed hour there appeared before me the plaintiff and his attorney, the defendant, and the secretary of the American Arbitration Association. With the taking of the usual oaths by the arbitrator to discharge his duty to the best of his ability, and by the plaintiff and defendant to tell the truth, the whole truth, etc., the attorney for the plaintiff proceeded to outline the case as follows:

His client had a claim for arrears of salary as secretary of the defendant, a corporation. These arrears had accrued over a period of months up to the date plaintiff left the employ of the defendant, amounted to approximately \$1,200 and were still unpaid.

The attorney then turned to the plaintiff, a man of approximately 35 with mechanical training and experience, and said: "Now you tell his honor the story and tell it briefly."

Sensing embarrassment on the part of the plaintiff, who apparently was more familiar with nuts and bolts than speeches, and visualizing the many sleepless nights he may have spent in nursing his grudge and preparing his story, to set him at ease I said: "Pay no attention to the instructions of your attorney, to tell your story 'briefly.' You have already saved two years by coming to arbitration instead of going to court. Further, arbitrators are not interested so much in saving time as in serving justice and saving friendships. You go ahead and tell your story in your own time and in your own way."

Don't forget that in this manner I felt more confident as arbitrator of obtaining a truer picture and a better knowledge of the facts of

the case. The plaintiff proceeded with his story somewhat as follows:

For nineteen years he had been in the employ of the defendant corporation, first as office boy, then as mechanics' helper graduating to mechanic, then to chief mechanic and ultimately to secretary of the corporation. About this time the corporation ran into financial difficulties. To ease its bank account plaintiff among others refrained from drawing his salary. Conditions instead of improving went from bad to worse, and to support a growing family, he had eventually to find another position. This he did, but all the while allowed his salary to remain in arrear. Some time later it came to his attention that another employee somewhat similarly situated, by threat of bringing suit had collected his salary arrears. Up to this time plaintiff was content and happy for his salary to remain unpaid, but when he heard that a contemporary by threat had collected, there was let loose within him all that jealousy to which human nature is heir. Even now he was loath to sue. A relationship borne of nineteen years does not readily accommodate itself to such action. In the interval, while hesitating between friendship on the one hand and injustice on the other, some one suggested *arbitration*. Here was a chance to obtain a fair hearing of his rights without committing an unfriendly act. It won its immediate acceptance, hence, the hearing.

The defendant corporation was represented by its vice-president, a man of sixty with wide experience and pleasing personality. On taking the stand, he straightway admitted the debt. However, he went on to explain, that while he regretted that the plaintiff found it necessary to leave, nevertheless, as he did leave, it would have helped the corporation had he made up his mind sooner, there being no work for him to do during the latter part of the period covered by the claim. He also stated that the corporation at that time was staving off a receivership, and that while it was still in business and in better shape financially, yet it would be difficult to pay out

\$1,200 at one time. (In the privacy of chambers this admission could be made without injury to the corporation's credit.)

On a suggestion from the secretary of the Association, I declared a recess in the hearing and urged the parties to adjourn to another room and, with his aid try to arrive at a basis for settlement. In twenty minutes they were back with a plan for payment to be spread over four months. With a stipulation of the terms signed by both parties, the one agreeing to pay and the other to accept, I now made the award for the plaintiff in full.

At this point up jumped the plaintiff's attorney and claimed interest for his client. "Your honor," he said, "if this case were tried in court my client would certainly be granted interest and I therefore so claim."

Addressing myself to the plaintiff I said: "In your testimony you spoke about some stock you had in the corporation. Tell me more about this." He replied, that as an officer of the corporation, he had received some stock, bonus stock, for which he had paid nothing but to which he felt he was entitled as, in his words, "there were no strings tied to it." "Well," I said, "you realize that as a bonus stockholder you share in profits and conversely you must be prepared to share in losses. I could not allow you interest while presumably there are other creditors who have not yet collected their principal. The claim for interest is therefore denied. However, I want to say this, your attorney was quite right in

making the claim. Had he not made the claim he would have been negligent in his duty to you."

Without a moment's hesitation the attorney was up again with "Your honor, I withdraw the claim for interest."

At this moment, exactly 3:15 P. M., the award was ready for signature and I delivered a copy to each party. The plaintiff then came forward, shook hands, thanked me for the service, and proceeded to take his leave. Then up stepped the defendant. He also shook hands and thanked me for the service. Before relinquishing his hand I said: "There is one thing would please me more than this." "Yes, your honor, what is it?" "Why," I said, "to see you two men shake hands. For nineteen years you have been together in business. I would feel that I had failed as an arbitrator if I did not somehow restore a friendship that had endured that long."

The old gentleman blushed and, if I may so put it, I sensed him swallow his "cud." In turn, I found myself coloring up. Then, all of a sudden, as though gripped by a great emotion, he swung around in the direction of the plaintiff (who by this time had reached the door) and, at the top of his voice, shouted, "Fred! come on over here." Fred came—they shook hands and walked out arm in arm.

Yes—arbitration saves time, money, publicity, credit and friendship.

Maybe this is one way of curtailing the depression:

## Your Modernization Program<sup>\*</sup>

By ERNEST B. HORWATH, C.P.A., New York City

**E**CONOMY, popularly expressed, is getting the most for your money in the long run, Webster's dictionary defines it as "management without loss or waste." It should be distinguished from parsimony, stinginess or frugality.

Prosperity or overabundance has never taught anybody to economize; it takes hard times to drive that training home. I feel certain that all of us have had to make a dollar last longer perhaps than ever before. Which of us during the last year or so has not had to

say to himself, "It can be made to last for a while yet," or "I'll mend it up and get the utmost use out of it"?

If in prosperous times we had realized the wisdom of economy and had practised it as rigidly as we are doing today. Dun and Bradstreet would have reported fewer business failures and fewer people by far would now be without the means necessary for daily existence.

The present economic trend, though disastrous to millions of people, may prove beneficial to millions of others. It is warning all of us to be more cautious in the future. The heavier the economic pressure is, the more

<sup>\*</sup>Summary of an address delivered at the Sixteenth National Hotel Exposition, New York City.



widely it extends over all lines of business and into all walks of life, the more impressive will be the lesson it teaches.

A few years ago, on the basis of the increase in our population and the development of business in general, the erection of new hotels was, in the majority of instances, justified. Naturally there were exceptions to this—cases where additional accommodations were not needed and the hotels should never have been built.

There is no doubt that the run-down condition of the then existing hotels was frequently the cause of the promotion of new ones. Whether or not the renovation of existing hotels during the very prosperous period, when labor and material were dear, was wise, is a question which must be answered individually for each case. However, if new hotels, even those recently built, are now permitted to deteriorate, the condition will become exactly the same as that which a few years ago brought about overconstruction in the industry. It won't be long before hotel building will begin all over again, on the grounds that the present houses have become shabby or old-fashioned.

In the long run it is more to the benefit of the owner than of the lessee to maintain the appearance and style of a hotel. This is true regardless of whether the owner is an individual, a financial institution, a group of bondholders or the original owning corporation. The condition of the hotel determines to a great extent the type of its clientele, and on the other hand the type of its clientele, together with the numerical strength thereof, is a factor in establishing realty values. The lessee's interest in the hotel lasts only as long as his lease; the owner's interest is permanent. The lessee's clientele may fall off in class and numbers as the direct result of neglect of hotel up-keep, but as soon as that happens, the realty value declines.

In many cases the agents or agencies now operating hotels—trustees for the bondholders, or receivers for the creditors, or mortgagees in possession—could serve the interests they represent in no better single way than by keeping the properties entrusted to them modern and up to the original standards of maintenance.

At the present time labor and material are lower than they have been for many years, and, according to authorities on economics,

lower than they will be for many years to come. This is, therefore, a wonderful opportunity to put hotels in order, outside and in—to repair, renovate and refurnish. No matter how new a hotel is, there are always some changes to be made, something to be added, improved or altered. This is the time to do it.

Of course no repairs or alterations should be undertaken until a thorough study has been made to determine whether or not they are justified. While every hotel has its individual problems and the factors deciding the advisability of renovation differ in each case, the following is a general guide in the matter:

1. There should be prepared detailed estimates of the additional income to be expected as a direct result of the rehabilitation of the hotel.

2. The additional expenses, operating and other, resulting from the improvements should be estimated in detail. If the improvements will effect savings in any of the present expenses, such savings should be deducted from the estimated additional expenses.

3. A careful summary should be prepared accounting for the additional income and additional expenses, and thus ascertaining in advance the final effect of the contemplated rehabilitation.

Will it pay to make the improvements? Generally speaking, any investment in modernization and improvement will be profitable if the additional net revenue resulting represents as high a rate of return on the investment as could be obtained through other investment opportunities. Several factors enter into the fixing of the rate of return to be expected. Among them: the current interest rate obtainable on a conservative investment; present competition; the uncertainty as to whether the estimated volume of additional business will be obtained and whether the additional expense can be kept within the estimate; the danger of sudden obsolescence brought about by the invasion of the field by a new hotel, etc.

4. The cost of any contemplated renovation should be carefully worked out, in as much detail as possible. All costs should be based on competitive bidding.

5. The probable loss of income during renovations should be estimated in detail because, while this cannot properly be included

in the cost of rehabilitation, it is an important factor to be reckoned with before definite steps are taken.

If it is found that the modernization will pay, the next question is where to obtain the necessary funds. Good financial policy requires that some of the earnings of the business be retained, rather than that all be paid out as dividends. If such a policy is already in force and if the business had been profitable in the past, the financing is no problem.

If the trustee for bondholders, the receivers, or the mortgagee in possession operates the hotel for the benefit of the investors, the renovation may, with the consent of the investors, be financed out of current earnings.

If the hotel has no funds available for this purpose and no credit to borrow from banks, there is but one course open—if the owner is making the application he must go to the first mortgagee; if the lessee, he must go to the owner. After all, the first mortgagee is the

person most vitally interested when the owner is without resources. It is to his interest that the property be improved to a state of greater productiveness. Owners and first mortgagees should be closer to each other during these times when values are greatly undermined and when the only way to bring about the return of better values is by most rigid maintenance and constant modernization.

If a hotel which earns the interest on the first mortgage and uses all surplus funds for amortization of the mortgage is badly in need of modernization, the first mortgagee should be induced to grant a moratorium of a year or two on the amortization. This should appear reasonable, especially in a case where amortization payments have already been made for a number of years.

Let us bear in mind that hotels do not wear out; they become obsolete, and they do so purely because there is no systematic program for keeping them modern.

## Our Canadian Friends

THE City Council of Ottawa, Canada, has recently been wrestling with the problem as to what constituted proper accounting fees, following a special City Audit and Investigation which has been conducted.

The bill which was rendered called for the services of the proprietor, 474¾ hours at \$60.00 per day of seven hours. The Chief Auditor on the job spent 990¾ hours at \$50.00 per day of seven hours. He had as assistants one man who devoted 772½ hours at \$40.00 per day of seven hours and another assistant who spent 611½ hours at \$35.00 per day of seven hours. Four senior clerks devoted 2,036 hours to the job at \$3.00 per hour; four intermediate clerks, 748¾ hours at \$2.00 per hour, and eight juniors spent 4,020¾ hours at \$1.00 an hour.

The statement was made in the meeting of the Council that the cost of the work still to be completed would not exceed \$3,000 additional to the thirty thousand some odd, covered by the above bill.

The *Citizen*, the local paper, carried the following editorial, which is reproduced be-

cause of the sanity with which the matter of the accountants' fees is discussed:

### CRAWLEY BILL AGAIN

"The Crawley company's bill is for professional services. To perform as some aldermen did at Monday's council meeting about the bill is to betray a paltry overzealousness and a mistaken sense of duty. No private individual questions a lawyer's bill—unless it is palpably exorbitant or clearly wrong. The Crawley bill is not exorbitant, considering what it has meant to the city in its efforts to clean house at the city hall.

"One argument used against the payment of the bill—which will have to be paid, of course—was the completely preposterous claim that the Crawley company does not pay its clerks at the same rates at which it charges for their services in the account. Of course it does not, and for perfectly clear reasons. The Crawley firm has other expenses apart from salaries. It has overhead. It has rentals and traveling expenses and other costs with which all business men, if not some aldermen, are familiar.

"As *The Citizen* has pointed out before, the Crawley bill is not merely for routine auditing. It is for professional services by a firm of chartered accountants, engaged by the corporation for special and specialized activities. Those services, as stated, are not confined to auditing. They include research, investigation, the preparation of reports and the formulating of recommendations on policy. They include plans for a system of bookkeeping and accounting that will prevent theft and corruption. They include suggestions which will provide the city with a modern method of handling finances and serve to preclude the inefficiency and slackness that have marked municipal operations for a decade. They include a score of carefully written reports on the investigations. They include inquiry and fact-seeking in other cities.

"To adopt an attitude of inquisitorial and pettifogging captiousness against the bill is to take an entirely wrong-headed view of the matter. No dignified person would make such an absurd fuss over a bill for professional services. We would not be surprised if the talk about more information on the part of one or two of the aldermen were simply camouflage to disguise an opposition to the Crawley firm which has more behind it than objection to the size of the bill. Those others who oppose must also run the risk of having their actions interpreted by the public as deliberate obstruction.

"The truth of the matter is that the Crawley company has rendered invaluable service to the city. This is the sort of thanks it receives at the hands of elected representatives. The latter ought to pass a vote of thanks rather than indulge in this brand of small town badgering.

"Had the city brought in a firm of 'outside experts' to do the work, the subsequent bill would have been passed without a solitary complaint. But a local firm is fair game for ill-considered criticism. We would not blame the Crawley company if it took its case to court at once and sued for the bill and costs. There is no doubt whatever which way the court would decide."

MARY B. NILES, C.P.A., (Pennsylvania, No. 34, June 4, 1900), of Philadelphia, passed away on August 29, 1931.

She was a member of the Pennsylvania Institute of Certified Public Accountants and a charter member of The American Society of Certified Public Accountants, holding membership certificate No. 59.

FRANK SAMUELSON, C.P.A., (New Jersey, No. 51, May 11, 1908, died of pernicious anemia on October 19, 1931, after a long illness.

Mr. Samuelson, who made his home in Arlington, New Jersey, was auditor of the Interborough Rapid Transit Company of New York. He was a director of the Kearney Building and Loan Association and a member of the American Institute of Accountants, The American Society of Certified Public Accountants, the Society of Certified Public Accountants of the State of New Jersey, the American Electrical Railway Association, the American Arbitration Association, the Metropolitan Museum of Art, and the American Academy of Political and Social Science.

HERMAN GERDAU, C.P.A., (Pennsylvania, No. 83, March 8, 1908), of Philadelphia, died suddenly on June 16, 1931.

Mr. Gerdau was a member of the Pennsylvania Institute of Certified Public Accountants and a charter member of The American Society of Certified Public Accountants.

PAUL R. GOERING, C.P.A., (Indiana, No. 348, August 15, 1921) formerly of the firm of P. R. Goering & Company, died suddenly at his home in Cincinnati, on August 30, 1931, as the result of a stroke of apoplexy.

For the past year Mr. Goering had been associated with the accounting department of the A. Nash Company. He was a member of the Indiana Association of Certified Public Accountants and of The American Society of Certified Public Accountants.

## STATE SOCIETY NEWS

### COLORADO

The Year Book of the Colorado Society of Certified Public Accountants has been issued. Very attractive. Contains a new feature in that in addition to some comments of the Colorado Society on the subject, there is reproduced the Classification of Accountancy Services as prepared by The American Society of Certified Public Accountants.

The committees of the Colorado Society cover the following subjects: Commercial Arbitration, Community Chest, Education, Grievance, Legislation, Membership, Meetings, C.P.A. Relations, Cooperation with Banks, Technical Affairs, Cooperation with Better Business Bureau, Taxation and History.

\* \* \*

### DISTRICT OF COLUMBIA

A joint meeting of the Baltimore Chapter of the National Association of Cost Accountants and the District of Columbia Institute of Certified Public Accountants was held at the Hotel Mayflower on Thursday evening, February 25. There is no chapter of the National Association of Cost Accountants in Washington, Washington members being affiliated with the Baltimore Chapter.

Frank A. Shallenberger, C.P.A., member of The American Society of Certified Public Accountants, is president of the Baltimore Chapter, and was the presiding officer of the meeting. James B. Grice, president of the District Institute, extended a welcome to the visitors from Baltimore. Frederic A. Tilton, C.P.A., Third Assistant Post Master General, was the speaker of the evening. His address will appear in the next issue of THE CERTIFIED PUBLIC ACCOUNTANT. Stuart McLeod, national Secretary of the National Association of Cost Accountants, was present and expressed the belief that the time was nearly ripe for the establishment of a Washington Chapter. He outlined industry as having four major functions—buying material, fabricating it, selling and distributing it, and financing the operation. Accounting was not a major function. It was essential for a proper maintenance of records. The Secretary of The American Society extended the greetings of that organization to the group, expressing in general

the belief that the accountant in industry had devoted a much larger portion of his time to a study of manufacturing costs than he had to the selling and distributing costs and that greatest possible future savings would come from the selling and distributing end rather than from the manufacturing end of industry.

\* \* \*

### MARYLAND

At the monthly meeting of the Maryland Association of Certified Public Accountants, held Tuesday evening, February 9, an advanced step was taken by the Association.

Over a period of several months a committee had been studying the possibilities of establishing an accounting library under conditions where it would be easily accessible to its membership for reference use. One of the suggestions was that arrangements might be made with the Maryland Bar Association but its library is not available for use in the evening and it was felt that many of the accountants, especially those preparing themselves for C.P.A. examinations, would need to utilize the library in connection with night study.

The present City Library is soon to be housed in a new building, a little distance from the business center but close enough to be easily available and in a neighborhood where there are relatively few distractions. The arrangement with officers of the library, agreed to by the association at this meeting, was to the effect that the library would set aside a convenient location in its new quarters for the establishment of a business library largely centering around accounting and economics. The library would continue to include in its regular budget the same amount which it had been heretofore spending each year for that type of books. The association makes a specific appropriation of \$500 as its initial payment towards establishing an accounting library and thereafter agrees to appropriate \$200 each year. Books to be purchased from the funds of the association will be determined by a committee of the association in cooperation with the librarian, so as to avoid duplication except in such books as duplicates

may be desired. A proper book plate will be provided, indicating their source. This special section will be used only for reference purposes and books may not be taken from the library by other than members of the Maryland Association who, on presentation of their membership card, may take a book for a period to be hereafter determined, probably three to five days, depending upon the demand for that particular book.

In view of the fact that this is somewhat experimental it was agreed that on six months' notice either party might terminate the agreement in which case the books purchased from the funds of the association would be turned back to them for such purpose as might then be determined.

The Secretary of The American Society spoke on the general set-up of the Reconstruction Finance Corporation, answering questions that were propounded to him, following his opening statement.

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#### MASSACHUSETTS

The meeting of the Massachusetts Society of Certified Public Accountants, Inc., held on Tuesday evening, February 23, 1932, had for the subject of discussion "Federal and Massachusetts Taxation."

\* \* \*

#### MINNESOTA

The Minnesota Society of Certified Public Accountants had as guests at their January meeting, held at the Curtis Hotel, members of the Minnesota Chapter of Robert Morris Associates and the officers of the banks in Minneapolis, St. Paul, and Duluth.

J. N. Peyton, Commissioner of Banks for the State of Minnesota, spoke on "The Problems of Our County Banks," and Arnulf Ueland, Vice-President of the Midland National Bank, Minneapolis, spoke on "What Information an Audit Report Should Contain."

Arrangements were made whereby the Minnesota Society of Certified Public Accountants, in conjunction with the Minnesota State Board of Accountancy, sponsored radio talks over KSTP as follows: February 10, Herman C. J. Peisch; February 17, J. A. Boulay; and February 24, Lyle W. Hines.

The Minnesota Society is building a roster of all certified public accountants in the State, regardless of whether they hold Minnesota certificates or certificates from other states.

Volume 1, No. 1, of the Minnesota Society *Bulletin* appeared in January, the Bulletin Committee being Messrs. Herman C. J. Peisch, Lyle W. Hines and John J. Reighard.

This is a method which many societies are finding valuable in building up a continuous interest in the work of the State organization. In their February issue, reference was made to the fact that it is about time to begin the consideration of an accountancy law to be submitted to the 1933 Legislature, and it was noted that the State Board of Accountancy in the November, 1931, examination had introduced some questions in economics and public finance for the first time, a very marked forward step.

\* \* \*

#### NEW JERSEY

The Society of Certified Public Accountants of the State of New Jersey held a dinner meeting on Wednesday, February 10, 1932. The evening was devoted to a discussion of "Recent Developments in Federal Income Taxation." An interesting paper on that subject was read by Walter A. Staub. Written questions were submitted by members and answered by Mr. Staub. Robert J. Caruba read a paper on "Reorganization from the Standpoint of Federal Income Taxes." Paul K. Owen also read a paper on "Offers in Compromise of Federal Income Taxes."

Discussion followed in which Mr. J. G. Jensen, Internal Revenue Agent in Charge of the Fifth District in New Jersey, and several members participated.

The evening was concluded with a talk by Mr. L. Gluck, editor of the "Talking Shop" Department of THE CERTIFIED PUBLIC ACCOUNTANT.

The meeting was conducted by Henry B. Fernald, president. Arrangements were made by Theodore Krohn, Secretary. The meeting was well attended by members and their friends.

The February issue of the New Jersey *C.P.A. Bulletin* contained a hopeful message from President Fernald, a list of newly created C.P.A.'s as a result of the November, 1931 examinations, and considerable newsy items of information.

\* \* \*

#### OHIO

The Columbus Chapter of the Ohio Society of Certified Public Accountants met on Wednesday evening, January 27, 1932.

Edwin S. Burdell, instructor in Sociology at Ohio State University, discussed the subject of "How the Community Subsidizes Industry."

# Men and Women of America: RECONSTRUCTION Is in *Your Hands!*



You have studied "depression" charts.

You have heard "depression" speeches.

You have read "depression" articles.

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If you are ready now to forget "depression" and give a thought to faith, common sense, and reconstruction, come with us through this page.

◆ First, some figures—

By the end of 1930, the national wealth of America had reached the astounding sum of one hundred and ninety *billions*—one hundred and thirty-four billions more than in 1914, an increase of 71%.

In our savings banks and trust companies, we have stored up more than twenty-nine billions.

In safe-deposit boxes, in private hiding places of all kinds, we have a billion or two more.

We have, ready for use, more than nine and a quarter million bales of cotton, valued at about three hundred millions; and four hundred and twenty-nine million bushels of wheat valued at more than two hundred and fifty-seven millions.

We possess uncounted millions of feet of unused lumber, tons of unused coal and wool and steel.

What do these stupendous figures mean?

That America has more resources than the next six nations—and can stand on its own economic feet.

That, if these resources are put to work, instead of being al-

## *The Re-Employment Drive Is On, Too!*

In nearly 11,000 cities and towns, local civic bodies, the labor organizations, employers in industry and commerce, and the American Legion, have joined together to put men and women back to work immediately. They are succeeding—by adding work, by making work, by spreading work. Already, community after community has reported employment increases. Each new employee means a new purchaser for more products of more workers. That's the circle which leads to prosperity. Go to your local organized headquarters and ask what *you* can do to help.

lowed to lie idle, America will rapidly approach a normal condition and benefit all the other nations of the world by showing a way out.

*Let's put this wealth  
to work—NOW!*

We're going to put this wealth to work—we're going to do the sort of thing we did in 1921. Back there, three years after the war, when the country was in the depths of economic despair, the War Finance Corporation helped lead us into the light of an unprecedented period of prosperity.

"We steadied the situation," said Eugene Meyer in the reconstruction year of 1922, "by taking over the slower loans that were good, removing the necessity for forced liquidation and putting the banks in position to carry their customers for a longer period and to make new loans where adequate security could be obtained. *But our loans have done more than this—they have provided that element which is so necessary in all businesses—the element of confidence.*"

The Reconstruction Finance Corporation, of which Mr. Meyer is Chairman and General Charles G. Dawes is President, has been empowered to use a vast fund of two billions of dollars to relieve credit stringency, to strengthen the sinews of business and to restore faith.

Let's get behind it and push!

## The National Publishers' Association

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From the Recommendation of the Committee on Unemployment Plans and  
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WHEN ANSWERING ADVERTISEMENTS MENTION THE CERTIFIED PUBLIC ACCOUNTANT

## Commercial Arbitration News

The Minnesota Society of Certified Public Accountants has established the relationship of affiliation with the American Arbitration Association. At a meeting held on December 22, 1931, that Society passed a by-law which provided for a standing Committee on Commercial Arbitration and defined its duties, and passed also a resolution authorizing and directing application for the affiliation, conforming to the outline recommended by the Committee of The American Society in its annual report, printed in the September, 1930, number of *THE CERTIFIED PUBLIC ACCOUNTANT*. The application was duly filed by Secretary Albert E. Larsen, of the Minnesota Society, and was acknowledged by President Lucius R. Eastman, of the Arbitration Association, in the following terms: "I am very glad indeed to welcome the Minnesota Society of Certified Public Accountants as an affiliated member of the American Arbitration Association. . . . This expression of belief and interest in arbitration and close association in our work is both an inspiration and an encouragement to those of us interested in the nation-wide development of arbitration."

The standing Committee on Commercial Arbitration appointed by President J. A. Boulay, of the Minnesota Society, is composed of Lyle W. Hines, chairman; Robert C. Anderson, and Fred B. Wilson.

This makes the eleventh State organization of certified public accountants to become affiliated with the American Arbitration Association, the previous ones being the organizations in the states of Connecticut, Indiana, Maryland, Michigan, Missouri, New York, Pennsylvania, Texas, Virginia, and Washington.

This circumstance attracts attention to a decision of the United States Supreme Court, November 31, 1931, in the case of *Hardware Dealers Mutual Fire Insurance Company vs. The Glidden Company, et al.*, affirming a decision rendered by the Minnesota Supreme Court in which the former upheld the constitutionality of a statute of the State of Minnesota which provides that in case of loss by fire on buildings, where a total loss is not sustained, and the claimant and the fire insurance company cannot agree on the amount of the loss, such loss shall be determined by an arbitration that may involve an appraisal.

## Bentley of Boston

Several educational institutions in Boston furnish opportunities for a high type of training in business administration. The Harvard School of Business Administration, at Cambridge, and the College of Business Administration, Boston University, represent departments of higher institutions of learning with a national reputation.

Last spring the Secretary made a trip into New England, to which reference was made in the May, 1931, issue of *THE CERTIFIED PUBLIC ACCOUNTANT*, and for the first time was privileged to get a close-up of the Bentley School of Accounting and Finance. With Harry Clark Bentley, its President, the Secretary has had an acquaintance covering a score of years. During that time accountancy has secured a professional standing and has attained a position of dignity and stability. Present-day methods of corporations require the services of men highly skilled in matters relating to accounting and necessarily highly paid. The accountant's services are essential today in the various phases of business and finance. The Bentley School of Accounting and Finance was the outgrowth of a realization on the part of Mr. Bentley that in view of this rapid development the field of accounting was so broad that a man who would make a real success in it must give his full time and effort to specialized preparation the same as he would have to do in fields of law, medicine or engineering. The school was established in 1917 with twenty-nine local students. The school year 1930-31 showed a total enrollment in both day and evening divisions of 2,711, California being represented as the most distant State, although some students from South America gave to the institution an international tinge. Only men are admitted to the Bentley School, graduation from high school or a school of equivalent grade being a requirement. Those subjects, only, are taught which directly apply to the training of an accountant.

As the Secretary addressed the students on the day he visited the school he was impressed with the apparent earnestness with which they were attempting to secure the best possible background for attacking the problems with which business and financial concerns are beset. The record of the graduates of preceding classes has been such that even in these times those who have finished the work at the Bentley School have had better than average success in finding openings.

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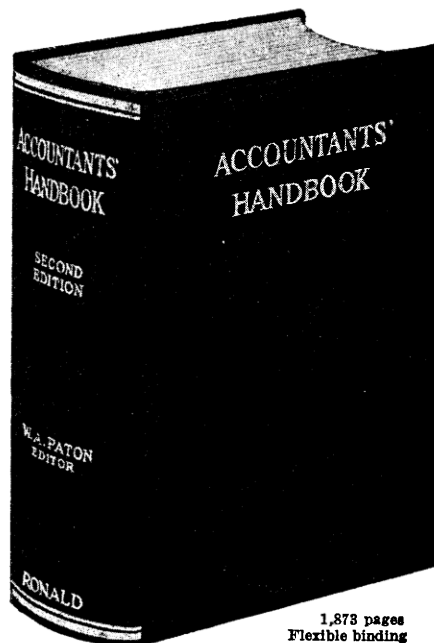
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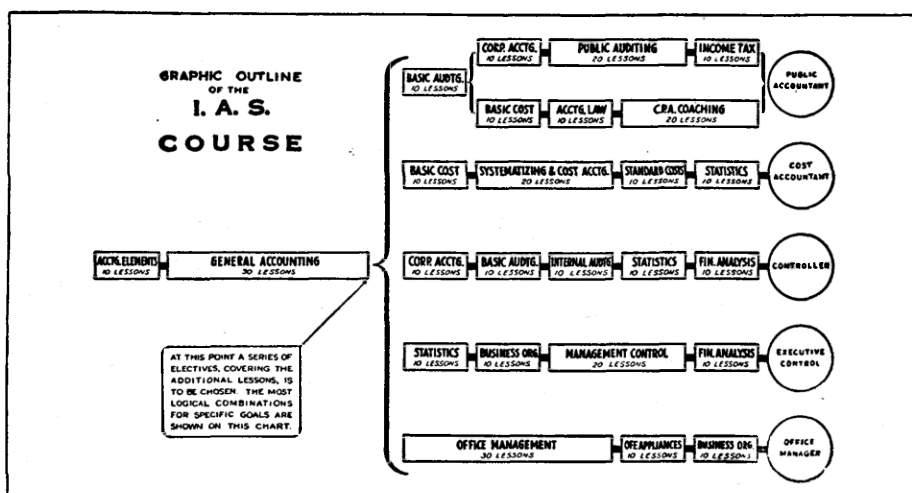
April, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants

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# INTERNATIONAL ACCOUNTANTS SOCIETY, INC.

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WHEN ANSWERING ADVERTISEMENTS MENTION THE CERTIFIED PUBLIC ACCOUNTANT

# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

APRIL, 1932

NUMBER 4

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*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Entered as second-class matter, January, 1932, at the post office at Richmond, Virginia, under the act of March, 1879.

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*"No man has earned the right to intellectual ambition until he has learned to lay his course by a star which he has never seen—to dig by the divining rod for springs which he may never reach."*

JUSTICE OLIVER WENDELL HOLMES.

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## The President's Page

### Taxation

HENRY J. MILLER, C.P.A.

TODAY the question of Taxation, Federal and State, is engrossing the mind of every citizen. The problem of balancing the budget of National and State government has become the most vital task of the times.

In matters of Federal Income taxation the members of our profession have through their energy, integrity, and ability, achieved a recognized standing. The United States Board of Tax Appeals at its creation acknowledged this by its ruling granting Certified Public Accountants the right to practice on the same basis as attorneys.

The American Society, active in seeking this recognition and maintaining it, has, through its officers and committees always coöperated with Federal governmental agencies, and Congress on all matters of Federal Tax Legislation. At the recent hearings of the Congressional Committee considering changes in the present Revenue Act, recommendations made by our Chairman of Federal Legislation, Dr. Joseph J. Klein, were welcomed and many were adopted.

There is no doubt but that our profession is doing its share on Federal Tax problems, but there seems much we can still do in State taxation that we are not now doing. Fundamentally, the problems are the same, yet in most of the states the C.P.A. has not received the recognition he deserves.

Coming legislative gatherings throughout the United States will be flooded with a mass of tax legislation. Those states whose legislatures are now meeting are experiencing some of the most turbulent sessions ever held over this moot subject. The time is most opportune for Certified Public Accountants through their State Societies to come to the front with suggestions and recommendations.

To be sure, proposed plans will be numerous and controversial; opponents and proponents actuated by business or political motives will oppose or favor this, that, or the other project. The professional accountant, student of economics, analyst of business, financial advisor, skilled and the recipient of national recognition, in Federal Income Tax matters, should not hesitate to thrash out the problems of his particular State, and through his State organization endorse and urge the tax proposal his judgment dictates is best.

Chambers of Commerce, business organizations, tax leagues, and associations of numerous kinds are at work in practically every State to secure equitable taxation. Here is a field for the Certified Public Accountant, that he should not hesitate to enter. The Congress of the United States welcomed the assistance of The American Society of Certified Public Accountants, in its tax problems; the legislature of your State will welcome the assistance of your State organization of Certified Public Accountants, if its members are only willing to devote the time and energy necessary to prepare a clear, unbiased, tangible recommendation after careful study of the particular problem.

This Society has always felt that the various states should regulate their own affairs, without outside interference. It has ever been willing, however, to assist State organizations whenever called upon. In the present vital question of equitable State taxation, the same policy will necessarily be followed. State Societies of Certified Public Accountants, requesting information, opinions, advice, or any other assistance, will receive hearty coöperation. The American Society is ever zealous to obtain and maintain recognition of every class of accountancy service, and matters of State and Federal taxation are not the least of the work of the Certified Public Accountant.

## *More Facts About Accounting and Auditing*

Following the reference in our February issue to a pamphlet prepared by one of our members we are in receipt of another four-page leaflet used by another one of our members in which is quoted an article prepared by the Robert Morris Associates, a national association of financial credit men, and which was published with their permission:

The importance of having financial statements audited by Certified Public Accountants is being recognized more and more each year by both business men and bankers. An intelligent audit should be of direct benefit in the operation of a company's business through the detection of inordinate expense, waste, errors and fraud, and the introduction of speedier and more economical methods. The management should look upon the audit as a productive investment. Furthermore, a balance sheet certified to without qualification by accountants of ability and high standing is a strong confirmation of good credit standing, particularly when the management is not personally known. Many note-buying banks refuse to purchase the obligations of companies whose statements are not audited.

The value of an audit depends upon the quality and scope of the examination made by the accountants. Care should be used in the choice of accountants. There are a number of firms whose work and reputations are known generally to banks throughout the country; there are also many small firms and individuals highly regarded in their own localities who are capable of doing good work. There are other accountants whose certificates, because of careless and incomplete methods, weaken rather than strengthen the value of a report when used for credit purposes. The standing of accounting firms can easily be ascertained through interested bankers.

The work of accountants should not be unduly restricted. The scope of their examination should be such that they can give an unqualified certification. This is especially true in regard to the certification of and responsibility for inventories. The business man may well discuss with the accountant the proper verification of inventories before the audit is undertaken. A qualified certificate indicating that the accountant has not had free scope in his examination may do injustice to the borrower out of all proportion to the additional expense necessary to prepare a complete report.

An audit limited to an examination of cash, receivables and payables and a checking of the footings and postings of the books may have a certain value to the management. A statement, however, in which a major item has not been substantiated can hardly be accepted unreservedly by those on the outside who are entitled to an independent expert opinion regarding the fairness of the balance sheet as a whole. Some accountants are reluctant to undertake a restricted audit, which can end only in a qualified certificate, believing that such service cannot in the long run be beneficial to borrowers.

In order to certify a balance sheet without reservations as to inventory, the accountant has to satisfy himself that the quantities on hand and the basis of valuation, as well as computations, are substantially accurate and reasonable. The accountant will not insist upon taking stock or even supervising the stocktaking if the company has a well organized system and adequate accounting records from which he can prove the essential accuracy of the inventory quantities. Manifestly, an accountant who makes a survey of the company's products, their distribution and the materials entering into them, as a foundation for his verification of the inventory, is better prepared to complete an intelligent audit of the other assets and of the liabilities.

Bankers have confidence in a financial statement supported by an unqualified certificate evidencing an unrestricted audit. A company cannot afford to have its credit jeopardized by the suspicions that may be aroused by qualified certificates or by employing accountants whose standards permit the use of an unqualified certificate with a careless or incomplete audit.

\* \* \* \* \*

*International Congress. The Accountant* for March 19, 1932, announces that the fourth International Congress on Accounting will be held in London during the week commencing the 17th of July, 1933.

## *The Ultramares Case*

The recent appointment by President Hoover of Benjamin Nathan Cardoza, Chief Judge of the Court of Appeals of New York, to be an Associate Justice of the Supreme Court of the United States, to fill the vacancy created by the resignation of Justice Oliver Wendell Holmes, naturally recalled to our readers the decision which Judge Cardoza rendered in the Ultramares case.

No legal decision in this country so interested the profession as did this one, wherein the court held that "The defendants certified as a fact, true to their own knowledge, that the balance sheet was in accordance with the books of account. If their statement was false, they are not to be exonerated because they believed it to be true. We think the triers of the facts might hold it to be false." "In this connection we are to bear in mind the principle already stated in the course of this opinion that negligence or blindness, even when not equivalent to fraud, is none the less evidence to sustain an inference of fraud. At least this is so if the negligence is gross." "Our holding does not emancipate accountants from the consequences of fraud. It does not relieve them if their audit has been so negligent as to justify a finding that they had no genuine belief in its adequacy, for this again is fraud."

Quoting the closing sentence in our editorial for February, 1931, "This decision would seem to narrow materially the ground which accountants have heretofore believed was covered by the general term of 'negligence' and correspondingly enlarge the sphere of what might be legally determined to be 'fraud'."

By reason of the very clear presentation which he gave in this case, accountants will naturally have a special interest in the decisions handed down by Justice Cardoza. The United States is congratulated on his appointment.

## *The Tax Bill*

In the preparation of the tax bill now before Congress, the House Ways and Means Committee held public hearings, the report of which covers 1,219 pages with seventeen added pages in the index.

The American Society of Certified Public Accountants was the only organization which announced as the first plank in its suggested platform that retroactive legislation under present conditions would be injurious to the desired return to normalcy at an early date. It was the only organization that suggested the urgent need of an early definite pronouncement on tax revision conclusions. It was one of two organizations emphasizing the value to business of designating these increased taxes for a definitely limited period of time. Of course in the discussion that ensued during the hearings, these three points were brought out by others though not in their briefs.

The United States Chamber of Commerce placed the recommendation that no retroactive tax should be included in the bill as the fourth item in its sug-

gested list. The representative of the National Retail Dry Goods Association indicated that it was their belief that such a tax would be practically impossible. The representative of the American Farm Bureau Federation, while indicating that that body had no official position on the subject, gave as his personal opinion that a retroactive tax would not be an advisable procedure except where it might be found from an investigation of individual cases that a report had not been accurately made. One individual letter from a Chicago lawyer opposed the idea, and one other letter from a New Yorker, written after the decision of the Committee against giving retroactive effect to any increases, endorsed their position. The representative of the People's Lobby favored a retroactive provision. In the printed hearings, the statements of Messrs. Klein and Beck, representing The American Society, together with the brief of the committee, occupy thirteen pages.

## *School Teachers, Economists and the Public*

This title forms the subject for the leading editorial in the October, 1931 issue of *Accounting, Commerce and Insurance*, published in Wellington, New Zealand. We quote:

"No doubt the finest profession in the world, at any time, is the teaching profession. If the teaching is good, it lays the foundation of character in the young; it creates the idea of thought, . . . But, while the teaching profession, as a profession, is a praiseworthy one, it has its limitations, inasmuch it deals too much in theory and too little in practical work. For limitations, however, we do not blame the teachers, having in view the class of material with which they work, namely, the young child and the young mind.

"Let us compare the school teacher with the economist: The economists, as a body and as a profession, are comparatively new in our business life. The economist does not devote a great deal of thought to human nature; the school teacher does. The economist sets out a theory that leaves out of the picture any idea of what good old human nature will do. He must; otherwise his theories would not fit in. We have economists the world over propounding the causes of our present financial depression. Few, indeed, of them can show any way out of the wilderness in which we have wandered. . . . In good times, of course, they are not heard; nobody takes any notice of them. The question is whether we should take any notice of them now. They are somewhat like the teacher—good in theory; but while the teacher does take some cognisance of human nature, the economist does not. He has his place as a guide to the business man, the general public, and the politician. He can, and does, point out, in the same way as the parson and the teacher, things that should not be done, but we should keep him as a teacher, and not treat him as a leader. Politicians are not statesmen; statesmen are leaders. Similarly, the economists and the teachers are not as a rule leaders of public thought, although they are useful.



"The reason for this little discussion is to point out to our readers that they should not be too depressed by the many works brought out recently by the economists. Good old human nature will find its way out of the financial trouble that we are in, and in a manner that none of us at the present time think about, and very much quicker than any of us might expect. The farmer is ploughing again this year, and his furrows are straighter than ever; his cows are giving more milk; there are more blades of grass growing than ever before; and altogether the outlook for this little country is better than for most countries.

"That we are not alone in our summing up of economists is shown to some extent in the following extract from . . . *The Bulletin* over the signature of Frederick Aarons, . . . 'One of the most curious phenomena of the financial debacle in this country is the way in which our academic economists have been deluging the bookshops and shivering the ether with precepts and panaceas. For several years thoughtful men had been prophesying in *The Bulletin* and elsewhere that an avalanche of IOU's was certain to slip down on Australia from the mountain of debt that our post-war politicians were piling up. During this period the preceptors of the science of national economy attached to our universities were as silent as deep-sea squid, whereas, concerted criticism of the prolonged policy of squander, falling upon public opinion from such high places, might have produced some restraint.

" 'Now that the horse has pushed down the makeshift sliprails and broken his neck in a neighbouring gully, the specialists in economic carpentry rush forth armed with bundles of statistics and axioms for the building of a solid gate, in case the nag should revive and get back into the paddock, preparatory to another suicidal outbreak.

" 'The shelves and tables of every bookshop in Sydney and Melbourne are groaning under the weight of this post-mortem furor scribendi, and the night air quivers under heavily-charged waves of radiated economic salvos.' "

## Keep the Faith

By SOL BLOOM, Associate Director,  
George Washington Bicentennial Commission

George Washington never felt sorry for himself. He wasted no time discussing conditions. He faced the job of winning a war with a ragged and hungry army; he was without adequate funds or supplies; he was surrounded by men who had lost courage. Yet his confidence in his country and its future never wavered. He overcame all his tremendous obstacles. Let us emulate his example as we celebrate his 200th birthday anniversary. We can stimulate ourselves and implant the great message of Washington's life in the hearts of others by proving our faith by our work.

## Standing the Gaff

By FRANK WILBUR MAIN, C.P.A.

(Reprinted from Volume II, No. 2, issue of *The Pennsylvania Certified Public Accountant*)

In the late 90's the expression that a man could or could not "stand the gaff" was heard far more often than it is today. There are probably many of our younger members who are not even familiar with the significance or the background of this expression. Prior to the opening of the Twentieth Century, cock fighting was one of the well-recognized sports in many parts of the country. The training of the birds involved a well thought out program. The first step in this program was to select carefully the most likely little roosters. An old bird was selected and there was fastened to his feet a pair of very much filed down spurs or gaffs. These gaffs were, however, very sharp, and they gave the old bird a decided advantage over a young bird, which was required to fight and kick with only his unprotected heels. Needless to say, while the young bird had the fire and vigor of youth, the old bird was able to do him considerable damage. If the young bird displayed the true fighting heart and fought even though he might be wounded and bleeding, his owner knew that he had the making of a real fighter. If he quit he was transferred to the fowls that were for the butcher. Thus came the expression "standing the gaff."

The accounting profession like all other professions and industries has been up against a severe test. Can it "stand the gaff?"

There is no question but that as a result of each period of depression it is necessary for the accounting profession to readapt itself to present-day conditions. This editor would be very glad to hear from members as to just how, in their opinion, our chosen profession is meeting the trying conditions of today.

\* \* \* \* \*

As was indicated in the article "Rise and Walk," printed in our February issue, it had come to our attention in different ways, without any indication as to its original authorship. It has now come to our notice that the article originally appeared in *Forbes* for August 15, 1930, under the heading "Buy During Slump," and was written especially for *Forbes* by Herbert N. Casson. As the editor regularly scans *Forbes* it is certain that the heading used in its first presentation did not appear as attractive as the title "Rise and Walk," the one given to it in subsequent unsigned reprints.

\* \* \* \* \*

It is not too early for you to consider your vacation plans. In making them, certified public accountants should bear in mind the annual meeting of The American Society which will be held at **Indianapolis**, the week of *September 26*. Detailed plans are now being arranged. It is suggested that you mark your calendar with an engagement to meet your professional brethren at Indianapolis.

# Joint Costs in the Post Office Department<sup>\*</sup>

By FREDERIC A. TILTON, C.P.A., Third Assistant Postmaster General

IT IS a pleasure to be invited to discuss the method of cost accounting in use in the Post Office Department with a technically-minded body of men. The Cost Ascertainment System in the Post Office Department is a highly complicated and technical piece of machinery. Let it be understood from the beginning that I take no credit for its origin, development, or present state of perfection. It was in full operation when I was brought into the picture. I have not seen fit materially to change its form. Credit for its development belongs to others, some of whom have passed on either from this life or into other fields of endeavor. Those at present in charge are carrying on.

While complex and highly organized, the Cost Ascertainment System is not a perfect system. By no possible means could postal expenditures be distributed with absolute accuracy, regardless of the amount of effort and expense that might be applied in that direction. The joint rendition of service makes necessary the segregation of expenditures between the classes of mail and special services by the application of mathematical formulæ, and the results can be made to rank no higher than a close approximation. Nevertheless, it is substantially accurate and complete, and has so far exceeded the uses to which it has been put that it can rest while the uses catch up. To no material degree has Congress ever availed itself by practical application of the results of the ascertainment, which have been known since 1923, by a revision of rates to correspond with costs. The need of a system of cost ascertainment arose through the consideration of rate changes. Prior to 1907 rates had always been fixed by rule of thumb influenced more or less by political considerations and expediency. Early in this century the

idea seems to have gathered force that the rates should be fixed according to relative costs. Even after the costs were determined, they continued to be and are still ignored as the measure of rates to be charged. In the last Annual Report of the Cost Ascertainment the value of costs as a measure of rates was described in the following words: "The results are subject to reservations in respect to any conclusions to be drawn therefrom. The allocation of revenues as to various classes of mail is without doubt substantially correct, but no method has as yet been developed which would fairly and incontrovertibly apportion the expenses to give weight to the quality of the service as distinguished from the quantity of service accorded the different classes. The apportionment and vision of expenses does not take into account the relative priority accorded first-class mail, the relative economic values of the several classes, nor the degrees of preference. Such intangible considerations cannot be reduced to mathematical formulas, and the usefulness of the results as a guide to rates to be charged is accordingly limited."

In only one instance has Congress declared that the rates to be charged shall follow the costs. In the Act of February 28, 1925, defining fourth-class or parcel post matter, is a provision that:

"The classification of articles mailable, as well as the weight limit, the rates of postage, zone or zones, and other conditions of mailability under this section, if the Postmaster General shall find on experience that they or any of them are such as to prevent the shipment of articles desirable, or to permanently render the cost of the service greater than the receipts of the revenue therefrom, he is hereby directed, subject to the consent of the Interstate Commerce Commission after investigation, to reform from time to time such classification, weight limit, rates, zone or zones or conditions, or either, in order to promote

<sup>\*</sup>Address before Baltimore Chapter, The National Association of Cost Accountants, and District of Columbia Institute of Certified Public Accountants, Mayflower Hotel, Washington, D. C., Thursday, February 25, 1932.

the service to the public or to insure the receipt of revenue from such service adequate to pay the cost thereof."

With a view to securing revenues more nearly proportionate to the costs of service and in accordance with the above-cited statute, the Postmaster General has filed a petition with the Interstate Commerce Commission for changes in certain rates which matter is now pending. The Cost Ascertainment System is a valuable instrument in determining the relative financial results of handling not only parcel post matter, but the facilities falling under special services such as registered mail, insurance, C.O.D., special delivery, money order and postal savings. With these exceptions it may be fairly stated that the rates to be charged are not now and will never be based upon the relative cost of operation by classes. The reasons for this situation are obvious. Long established practice and conditions relating to letter mail, publications and circular mail, have fixed entirely different values upon these classes. In respect of these it is not so much the relative cost as the relative value of service that controls. In this the postal service is not different from other public utilities where the value of delivered service is the measure of the charge. I may cite as examples, railroads, telephone, telegraph, gas and electric companies, theatres, etc.

In some respects our problem is comparable to that of the petroleum industry where various products are derived at varying market values out of a common conglomerate raw material. Similar problems are discovered in the chemical industry, as well as in paints and varnishes. In these instances, however, there is always a factor more or less absolute, the market value of the delivered product, which can be applied to the apportioned costs to determine a relative cost value somewhat consistent with the market value. In post office practice, however, there is no predetermined market value to use as such a factor and we are without a coefficient to apply to obtain relativity in costs. With these general observations I will now undertake to explain the operation of the cost system, its general theory and purposes.

The postal establishment is neither an industrial nor a commercial organization. It

manufactures nothing. It buys and sells nothing, except service.

It buys service in wholesale quantities, in the form of compensation to thousands of contractors, and in the form of salaries to hundreds of thousands of postal employees.

This service for which the Post Office Department expends \$800,000,000 annually is retailed to the public in the form of more than twenty-seven billion of units of service, for which the public pays an average of but two and one-third cents per unit.

The purpose of the Cost Ascertainment is to credit as accurately as may be practicable to each of the classes of mail matter, and to each of the special services its due proportion of the postal revenue, and to charge against each class of mail matter and each special service its proportionate share of the expenditures made from the several sums appropriated by the Congress for the maintenance of the Post Office Department and the Postal Service.

The principal source of revenue of the Post Office Department is, of course, from the sales of stamps.

When a patron purchases a supply of postage stamps he is not called upon to say what use will be made of them. He has merely paid in advance for so many units of postal service. He may use them for the payment of postage on any one or all of the four classes of domestic mail, on air mail, or on foreign mail, or he may offer them in payment of fees for registration, insurance, C.O.D. service, special delivery or special handling. In the accounts of the post office the transaction appears merely as a revenue from the "Sales of stamps."

In the fiscal year, 1931, the revenue from this source together with that from the stamped envelopes and wrappers amounted to more than \$524,000,000.

For administrative purposes records are maintained at all post offices showing, by each of the prescribed fees, the number of special service transactions — registration, insurance, C.O.D., and minor services. Thus the value of the stamps used in payment of fees for such services can be accurately computed, but for more than a century the Post Office Department depended upon estimates, that were little better than guesses, as to the amount of postage revenue derived from each of the classes of mail matter.

The growing annual postal deficit during the years following the World War gave birth to the Cost Ascertainment System of the Post Office Department. This system was first applied in an experimental way to the service of the fiscal year, 1923. It became an annual function of the Postal Service beginning with the fiscal year, 1926.

It being wholly impracticable to maintain a continuous count of the postage paid on each class of mail deposited each day in more than 56,000 post offices, stations and branches, the gross audited revenue from the sales of stamps and stamped paper together with the postage paid in money under permit can be segregated to the classes of mail matter only by processes of test, ratio and apportionment.

For the purposes of the Cost Ascertainment all post offices in the United States are grouped according to receipts, and from each group certain offices are designated to furnish detailed statistics as to revenue, pieces, weight and volume of each of the several classes of mail matter originating at those offices.

The total postal revenue of the post offices so selected approximates fifty per cent of the entire postal revenue from all post offices in the United States.

In an effort to insure the highest possible degree of accuracy in gathering, compiling and reporting the prescribed data, each feature of the work is explained in great detail in a so-called "Instruction Letter," issued in printed pamphlet form, relating exclusively to that particular feature. Thirteen such "Instruction Letters" are issued for the guidance of postmasters and the personnel of the designated offices.

Furthermore, to insure a thorough understanding of the purpose of the Cost Ascertainment, and to assist the postmaster and the supervisory employees in working out detailed methods for securing the required data with a maximum degree of accuracy and at a minimum expense for clerical labor, every Cost Ascertainment office, large or small, is visited, prior to the first statistical period at that particular office by a representative of the Division of Cost Ascertainment. At such times every detail of the work is discussed, and arrangements are made to have the data gathered experimentally during one or two full days in order to familiarize every employee with his duties in connection with the

#### Cost Ascertainment.

Four seven-day statistical periods are fixed at intervals approximating three months. This is in recognition of the seasonal variations in the relative volume of mails of the several classes. For a similar reason due care is taken also to cover in the four statistical periods, as nearly as possible, a complete cycle of days of the month.

During each of these statistical periods there is counted and recorded at each designated post office the amount of postage paid on all of the mail of each class originating at that office.

The combined results of the four seven-day tests, after having been subjected to close scrutiny for possible inaccuracies, are converted into the form of ratios, and the gross annual receipts from the sales of stamps and from postage paid in money under permit are apportioned accordingly.

Separate ratios are established for each of the fifteen post offices having receipts in excess of \$7,000,000 per annum. In the case of offices in the minor groups, ratios are established from the combined data reported by the several designated offices in each group during the four statistical periods, and the composite ratios for each particular group are applied at the close of the year to the audited revenues from all offices within that group.

By way of illustration: In the fiscal year 1931, there were fifty-three post offices in the United States with annual receipts between \$1,000,000 and \$7,000,000. Ten of these offices—Atlanta, Dallas, Denver, Seattle, Columbus, Memphis, Richmond, New Haven, Salt Lake City, Fort Wayne—were designated to supply Cost Ascertainment statistics. The combined actual counts from these ten offices for the four statistical weeks developed that of the total postage and fees paid in stamps or by permit, 52.03258 per cent was for postage on first-class mail. The actual stamp and permit revenue from all of the 53 offices in this group for the entire fiscal year was \$111,356,415.67, of which 52.03258 per cent, or \$57,941,617.10, was credited as revenue from first-class mail.

In a similar manner the revenues from each of the other classes of mail were computed, and from the combined results of all the apportionments for all offices in the United States, by groups, it was determined

that of the total stamp and permit revenue approximately 56½ per cent was from first-class mail, ten per cent from third-class mail, 23½ per cent from parcel post, and the remaining ten per cent from other classes of mail and the special service fees.

It is to be understood that the postage on second-class matter mailed by publishers and news agents at pound rates is paid in money and does not enter into these apportionments.

In the course of the work, either as a supplement to the Cost Ascertainment or as an essential part of it, there is computed by classes of mail matter, the number of pieces, the weight and the volume.

To determine the average haul of each class of mail matter, all the originating non-local mails of each class are weighed in bulk by states of destination. By applying to the weights, in each case, the distance from the center of population of the State in which the mailing office is located to the center of population of each State of destination, there is produced the total pound miles for each class of matter, which divided by the total weight of that class of matter develops the average haul.

The several processes above described are applied to all those classes of mail matter on which the postage is paid by stamps affixed, including also permit and metered mail on which the postage is paid in money.

In the case of publishers' pound-rate second-class matter, all necessary data as to weights and revenue are taken from the official records regularly maintained for administrative purposes, leaving only the number of pieces, the number of copies, the volume, and the average haul to be determined by Cost Ascertainment.

Periodical publications vary in frequency of issue from daily to quarterly, and in order to reflect a complete cycle of mailings at the designated offices, it is necessary that the mailings for an entire quarter be considered. Data is secured as to the number of copies and separately addressed pieces at each of the several rates comprising a complete single issue of each publication mailed at the designated offices during the December quarter of each fiscal year.

This data, in so far as it relates to the second-class matter on which postage is paid at pound rates, is applied to the quarterly

revenues and weights of the respective publications, both of which are a matter of definite record.

The revenue from publishers' second class on which postage is paid by stamps affixed, is computed from such postage paid on a single issue and the total number of issues mailed during the quarter.

As in the case of the data in connection with other classes of mail, these data relative to publishers' second-class matter are compiled separately for each of the offices in Group A and for the total number of offices in each of the other groups, thus establishing ratios from which there may be computed for the entire fiscal year, the number of pieces, the number of copies, the volume, and the average haul of each of the divisions and subdivisions of second-class matter.

#### EXPENDITURES

In a very few instances the entire expenditure from a particular appropriation can be allocated to a single class of mail matter or a single special service. The total expenditures from each of the several appropriations for the conduct of the Post Office Department and the Postal Service which cannot be directly allocated are apportioned in such a manner as to charge to each of the classes of mail matter and each of the special services, its proportionate share of the total expenditure.

In the case of each of these appropriations (of which there were seventy-one for the fiscal year, 1931), the basis of computation is the exact audited expenditure as reported by the General Accounting Office. To the actual expenditure there is added, in each case, the estimate of the Comptroller, Post Office Department, as to the amount of unliquidated obligations chargeable to the service of the year, thus changing from the cash basis to the accrual basis and accrued operating expenditure.

For the purposes of the Cost Ascertainment the several appropriations are grouped under general heads, as follows:

1. Post Office Service.
2. Transportation.
3. Railway Mail Service.
4. Rural Delivery Service.
5. Miscellaneous.
6. General Overhead.

This grouping is primarily in the interests of orderly arrangement and convenient reference, but serves also as an aid to analytical study.

Included in the Post Office Service are appropriations from which the expenditures exceed fifty per cent of the entire cost of the operation of the Post Office Department, and the Postal Service.

The largest individual appropriation for the Postal Service is that for "Clerks, first and second-class offices," which covers all salary expenditures to supervisors (other than postmasters and assistant postmasters), special clerks, clerks, substitute clerks, watchmen, messengers and laborers.

In order to establish ratios upon which to apportion the expenditures from the appropriation for "Clerks, first and second-class offices," tests are made at all of the designated cost ascertainment offices of the first and second class during each of the seven-day statistical periods.

Throughout each statistical period every clerk employed in these offices is required to account for every minute of his service. This accounting includes not only the regular hours of duty, but also any overtime service performed, and is in such form as to indicate what portion of his service was performed during the day and what portion during the night, this segregation being necessary in order to distribute equitably the ten per cent additional salary payments made to clerks performing night service.

If a clerk, during his entire tour of duty, is engaged wholly in connection with a single class of mail, or a single special service, he charges his entire time directly to that class of mail or special service. In the case of a clerk with diversified duties, he is required to account for his service in detail, showing the time of commencing and the time of ceasing employment in connection with each of the prescribed items of service throughout the day, even though engaged upon a particular class of work for so short a period as but five minutes.

To insure uniformity in these two reports, and to reduce to a minimum the clerical labor involved in their preparation, item numbers are used to designate the nature of the several duties required of the entire personnel of the post office force.

In a great many instances, and this is particularly true in the smaller offices, mails of several classes are handled simultaneously, and it is wholly impracticable to separate the mails into classes prior to distribution for the sole purpose of enabling the clerk to charge to each class of mail the exact time required in its distribution. This necessitated charges against "Mixed" items, with provisions for tests of such nature as to make possible a fair apportionment of the time charged to such "Mixed" items. For example, a clerk may spend part or all of his time in the distribution of packages of incoming letter mail. Such packages, although made up principally of paid first-class mail, may contain individual pieces of each of the other classes of mail, including franked and penalty matter. Tests are conducted daily at each designated office of the first and second classes during each of the four seven-day statistical periods for the purpose of determining the proportion of the number of pieces of each of the classes of mail in the packages of incoming letter mail. The ratios established from these tests are then used in apportioning to the several classes of mail the entire time charged by the clerk to Item 21, Mixed mails, incoming, letter section.

In the case of time charged to the distribution of "Mixed paper" and "Mixed parcel" mail, the ratios are based not upon the number of pieces, but upon the time spent in the distribution of each of the classes found in the test mails. This is in recognition of the wide variation in size and weight of the individual pieces of the several classes of such matter, these variations being such as to make a piece test inequitable.

Similar tests are made in connection with the other classes of "Mixed" service and the time charged to each is prorated accordingly.

In this manner the entire service of all employees of first and second-class post offices is allocated directly or is prorated on the basis of tests to the several classes of mail and special services, segregations being made according to the status of the employees:

Postmasters.

Assistant Postmasters.

Supervisors and Special Clerks.

Clerks below the grade of Special Clerk.

Substitute, temporary and auxiliary clerks.

Watchmen, Messengers and Laborers.

In the case of the City Carrier Service, which involves an annual expenditure of about \$126,000,000, the cost accounting procedure is essentially different.

The recognized classes of routes are:

Business.

Residential.

Mixed business and Residential.

Exclusive Parcel Post.

Parcel Post Delivery and Collection.

Collection, and

Exclusive Air Mail Collection.

The service of a city delivery carrier is partly performed in the post office, arranging the mail in the order of delivery. The time so spent is designated "office time," as distinguished from "street time."

In connection with each of the several classes of carrier routes, time tests are conducted for the purpose of apportioning equitably to the classes of mail matter and special services, the "office time" performed by the carrier.

The "street time" is segregated for cost ascertainment purposes, between "stopped time" and "walking time." Data is compiled in connection with the routes in such a form as to show for each trip made, what classes of mail are due to be delivered by the carrier at each stop on his route. In recognition of the fact that certain deliveries require a far greater amount of time than the average, time tests are regularly made for the purpose of determining the average amount of time required for a carrier to effect the delivery of matter of a particular class after he has reached the point where the delivery is to be made. The averages so ascertained used in conjunction with the number of stops made by the carrier on the trip for the delivery of each of the classes of mail matter, makes possible the computation of the total "stopped time" on the trip, and the proportion of such "stopped time" chargeable to each class of mail matter and special services.

Where two classes of mail matter or special services are involved in a single delivery, one-half a "stop" is charged to each; if three classes are delivered, one-third of a "stop" is charged to each, and so on.

Such of the "street time" as is not charged to "stopped time" is recognized as "walking time." The "walking time" is apportioned

to classes of mail and special services in proportion to the number of deliveries of each due to be made on the trip, without regard to the amount of time involved in effecting actual delivery.

The service of the postmaster and of the assistant postmaster, excepting such as is charged directly by them to a particular class of mail, special service or mixed item, is prorated as general overhead to the classes of mail matter and special services in proportion to the aggregate charges against those items at that office from the salaries of all those paid from the appropriations for clerical and carrier forces.

Following the close of each quarter, postmasters at designated offices are called upon to report the actual salary payments made during the quarter to the employees of their offices, segregated according to the status of the employees as above listed, the extra payments for night work being accounted for separately in each case.

By applying to the actual expenditure for the quarter for service in any particular status the ratios established by the time tests, there is computed the amount of salary expenditure chargeable at that office during the quarter to each of the classes of mail matter and special services by those serving in that status.

The summary of the results of these computations for the four quarters of the year forms the basis of ratios upon which the entire audited salary expenditure for the entire fiscal year is apportioned.

As in the case of the computation of revenues and miscellaneous statistical data, the expenditures for each of the very large first-class post offices, fifteen in the fiscal year 1931, are computed independently. In the case of the first-class offices of lesser size and of second-class offices the data is combined for the designated offices grouped according to their annual receipts and is applied proportionately to the total audited expenditures of all offices with approximately the same annual receipts, whether designated or non-designated.

Postmasters at third and fourth-class offices are permitted to engage actively in other occupations, and the clerical force employed in such post offices are not within the classified civil service.

At all designated third and fourth-class post offices, a count is kept of the number



of pieces of each class of mail handled and the number of each of the special service transactions performed during each of the four seven-day statistical periods. Observation tests are conducted by representatives of the Division of Cost Ascertainment at various times and at points widely scattered throughout the United States for the purpose of establishing the average time consumed in these smaller offices in the handling of a single piece of each class of mail matter, and in performing each of the special service transactions.

From the counts made by the postmasters at the designated offices used in conjunction with the time tests conducted by Departmental representatives, ratios are computed separately for third and fourth-class offices upon the basis of which there is apportioned the total salary expenditures to postmasters and clerks in all third and fourth-class offices during the fiscal year.

Expenditures for "Rent, Light and Fuel" are made for first, second and third-class offices only. The postmaster at each designated office is called upon to account for the use made of the entire floor space of the main post office, and all stations and branches.

There is reported in terms of square feet the space directly chargeable to each of the special services, and to "Outgoing and Incoming Mails."

Space used for "Outgoing and Incoming Mails" is apportioned to the several classes of mail in proportion to their volume, except that no account is taken of the volume of "Transit Foreign Mail" nor of mails in transit between territories and island possessions of the United States and foreign countries, and in the case of second-class matter but one-half of the volume is taken into account.

The "Transit Foreign Mail" consists of sealed bags of mail made up by a post office in a foreign country, which bags pass through the United States intact en route to the foreign country of destination. Such bags rarely or never occupy space in a post office.

But one-half of the volume of publishers' second-class matter is taken into account because of the fact that generally such matter does not pass through the post office of mailing. Such as does pass through the office of mailing is assumed to be fairly offset by the so-called "Outside Mail" which does not pass

through the office of destination.

The space reported as "Miscellaneous" includes that occupied by the offices of the postmaster and the general supervisory officers, and also the corridor and lobby space, all of which is recognized as "Overhead" space and is distributed accordingly.

The summary of these and the minor expenditures for Post Office Service in the fiscal year, 1931, distributes the total expenditure of \$411,000,000.

44 per cent to first class.

11 per cent to second class.

11 per cent to third class.

13 per cent to parcel post, and

21 per cent to foreign, franked and penalty mail and the special services.

#### TRANSPORTATION

Transportation of the mails involves an annual expense approximating one-fourth of the entire postal expenditures.

The rates of compensation to railroad companies for the transportation of mails are fixed by the Interstate Commerce Commission. The basis for the rate per mile in each case is the amount of space required for the mails, this having superseded the weight basis. Thus the cost for mail transportation in bulk is, in effect, measured by the cubic-foot-mile. Consequently the audited expenditure for the year is spread over the several classes of mail matter in proportion to the ascertained cubic-foot-miles of non-local mail of each class.

That portion of the compensation to railroad companies which is for railway post office service is prorated to the several classes of mail matter in proportion to their participation in this distribution space, as determined by a nation-wide series of tests too complicated to describe in detail.

The cost of mail transportation via electric line, power boat service and star route service is governed by the volume of the mail and the distance transported, consequently the gross expense is apportioned to the classes of mail matter on the basis of relative cubic-foot-miles of non-local mails.

The cost of transporting mails between the post office and the railroad station whether by motor vehicle service, mail messenger service or by railroad company employees is apportioned to the class of mail on relative volume of non-local mails.

The gross expenditure for all forms of mail transportation in the fiscal year, 1931, \$202,848,000 was distributed:

- 21 per cent to first class.
- 15 per cent to second class.
- 3 per cent to third class.
- 39 per cent to fourth class.
- 18 per cent to foreign mails, and
- 4 per cent to other items.

#### RAILWAY MAIL SERVICE

In the fiscal year, 1931, the cost of the Railway Mail Service—salaries, travel expenses, and miscellaneous expenses—was \$61,000,000. These expenditures were distributed to the classes of mail matter in proportion to their actual handling in the Railway Mail Service, as determined by elaborate time, piece, and volume tests:

- 34 per cent to first class.
- 16 per cent to second class.
- 10 per cent to third class.
- 29 per cent to fourth class, and
- 11 per cent to miscellaneous items.

#### RURAL DELIVERY SERVICE

Data for the apportionment of the expenditures for "Rural Delivery Service" are obtained from approximately 250 typical rural routes. These test routes are so selected as to secure a fairly proportionate representation not only by States but by classes of post offices in each State.

On each of these test routes, throughout each of the four statistical periods, records are maintained as to the classes of mail delivered and collected at each stop. The record of the stops in connection with each trip is converted into terms of "stop values" on the basis of 100 "stop values" for each stop. If but a single class of mail is delivered or collected at a particular stop, 100 "stop values" are charged to that class of mail. If two or more classes of mail are delivered or collected at a given stop the 100 "stop values" representing that stop are distributed equally between the classes of mail represented, the "stop values" for deliveries and those for collections being accounted for separately. In all cases the special services (registry, insurance, C.O.D., and money order) are made to share individually in the "stop values" on the same basis as classes of mail.

The total expenditures for *Rural Delivery*

*Service* are apportioned to the classes of mail and special services on ratios of the "stop values" as established by these tests, the cost of service on routes emanating from each of the four classes of post offices being computed separately.

The total expenditure for Rural Delivery Service in the fiscal year 1931 was \$106,000,000, which was distributed:

- 36 per cent to first class.
- 36 per cent to second class.
- 22 per cent to third class.
- 3 per cent to fourth class, and
- 3 per cent to miscellaneous items.

#### GENERAL OVERHEAD

The expenditures recognized in the Cost Ascertainment as "General Overhead" are from thirty-eight appropriations, totaling, in the fiscal year 1931, \$11,142,290.67 or 1.39 per cent of all expenditures for the conduct of the Post Office Department and the Postal Service.

The expenditure from each of the several "General Overhead" items is charged direct to a particular class of mail or special service, or is distributed upon the ratios of a co-ordinate field service, or is spread upon general ratios.

In the recapitulation the computed revenues from each class of mail matter and each special service are set up against the expenditures chargeable to each under our established bases of apportionment.

As stated at the outset, these processes of allocation and apportionment do not reflect the relative priority of services, the relative intrinsic and economic values of the mails of the several classes, nor the degrees of preferment in handling, except to such extent as they may involve actual additional expense. Such elements are intangible and cannot be incorporated into a mathematical ascertainment of costs. For this reason, the results of the Cost Ascertainment cannot be used as a sole guide for rate-making purposes, nor are they intended to be such.

Aside from such value as the results of the Cost Ascertainment may have as one of the elements entering into the fixing of postal rates, they furnish, year by year, reliable data as to the volume of each class of matter mov-

(Continued on page 231)

# A Proposal for a Permanent Credit Adjustment Among the Allied and Associated Powers and the Government of Germany

By CLARENCE R. BITTING, C.P.A., Detroit, Michigan

THE occasion of this memorandum is the recurring discussion of a moratorium of the debts due the United States from its creditors, the European Allies during the World War, to be reflected in turn by the postponement of payments due them from the Republic of Germany, and possible if not probable, complete and final repudiation.

If there is any weakness discernible in the present program, it is only that natural weakness that attaches to anything, however great, which is characterized by the word "temporary" or which tends to upset or disrupt constructive work of the past. Therefore, now is the time to lay the plans for a continuation of an economic program which will remove all questions as to what will happen in the future. In order to make secure the economic structure, certain definite suggestions of policy are made herein.

Cancellation of these debts, i. e., the outright gift to the European Allies of their debts to the Federal Government should not be considered seriously by anyone interested in either international relations or international trade. The United States must uphold the self-respect of both the government and the people. That some adjustment is necessary in both the reparation payments as well as the inter-allied debts is not questioned, but the people of the United States are entitled to more than the privilege of paying such debts through high taxes. They are entitled to a quid-pro-quo.

The purpose is to outline hereinafter a course of procedure looking toward perma-

nent, just and economic stabilization, reflecting itself in future terms and conditions which are certain, dependable, practical, and well-nigh essential as contributions toward economic recuperation. It is a simple business program which wholly ignores traditional points of view and prior nationalistic aims, with the view of meeting the world-wide change in economics induced by the present world-wide depression.

## A FUNDAMENTAL CHANGE

There must be a realization of a fundamental difficulty arising out of the present economic situation. Unless we realize what has actually happened we are in danger of demanding the impossible. We are today facing tremendous war debts contracted in a period of high prices, the entire world in a trough of economic depression, great excess supplies of both capital and consumable raw materials, world-wide unemployment and the misery which follows.

Throughout our history America has been debtor to Europe. We have been a tremendous borrower from abroad since our colonial infancy. We have developed our natural resources, our industries, our transportation, and our commerce, by the borrowing of foreign capital. That debt of the people of the United States had to be paid just as the debts of the Allied Powers and in turn the Government of Germany will have to be paid. We paid the principal and interest of our debt, not with the shipping of gold abroad, but more accurately by the shipping of goods abroad.

Unless the fact that our debts were paid through the only available means for such payment is faced fairly and squarely, without political hokum and self-serving explanations, the world is bound to face either a long continuation of the present depression or else an economic revolution beyond all precedent.

Even if the impossible could be accom-

\*In the Sunday papers of February 7th, the North American Newspaper Alliance carried copyrighted articles with reference to what has generally been spoken of as the "Detroit Plan." The author of that plan is a member of The American Society, with offices in Detroit and New York. On request Mr. Bitting furnished the article which now appears, with suggested lead story, summary of the plan and benefits of the plan. We have chosen to use the article in full.

plished and all of our foreign loans, investments, claims, etc., could be paid by shipping gold to this country, sober reflection would decry such action. Under such conditions we might better substitute pretty colored beads for our money base because such a tremendous supply of gold would cause an inflation even greater than the most inflationary dreams of 1928 and 1929.

We became an export nation—a nation with what is known as a favorable balance of trade and we paid our debts because we exported goods. The real value of exports was and still is labor. We took iron from the hills and it had very little value as ore in the ground. It was the hours of labor necessary to bring it to the surface that gave it value. We transported it to the furnaces, we converted it into pig. We converted it by hours of labor into steel. We fabricated by hours of labor that steel into finished products, and these products we shipped abroad.

We created, for example, the automobile. The steel, the glass, the wood, the rubber and the fabrics, entering into the finished automobile, reduced to the state in which they are found in nature have very little value. Iron ore is worth little in the earth, rubber little in the tree, sand little on the plain, cotton little in the seed, wool or mohair little on the sheep or goat.

Analyze any other of our exports and the answer is the same—wheat in the seed; copper in the ore in the earth; petroleum and its products before the drilling of the well; coal in the ground; lumber in the tree in the heart of the forest; and so on—all exports will be found to have an overwhelming portion of their value created by the application of labor.

We therefore pay and have paid our debts abroad, largely through exports, and these exports mean primarily American labor applied to raw materials. Thus we have rendered our debt service in interest and principal by shipping hours, days, weeks, months, years of labor which was expended in making raw materials into useable and hence valuable articles and commodities.

Today the situation has changed and changed radically. Europe is debtor to us and we, in our new role of creditor, must be prepared to assume the role of the importer with what is known as an unfavorable balance of trade. If Europe is to pay her debts it must

be in hours of labor which will have created values with which she pays.

America must accept Europe's hours of labor in order to permit our debtors to pay us what they owe.

Long years ago we learned how foolish it was to throw a man into jail until he paid his debts. The greatest service a creditor can render to himself is to so place and so treat his debtor that the debtor can earn enough to pay his debt.

To collect what is our due we then must face an unfavorable balance of trade from the debtor countries, we must import goods consisting largely of hours of European labor, and above these things we must make additional loans, capital loans, to provide our debtors with the means (machinery, factories, working capital and the like) of producing with greater ease those units of labor with which European debts shall be met.

America must recognize her new position as a creditor nation, and be prepared to readjust some of the older policies growing out of our former position as a debtor nation. That such action will mean the loss of our high standard of living may not necessarily follow if the problem is courageously and truthfully faced and the ability and ingenuity of our business men used to their fullest extent.

The tariff history of the United States was predicated upon America being a debtor nation. Our economic life was bound up in producing what we should normally consume and over and above this a surplus to be exported to pay our debts abroad. For nearly 140 years we have had a national tariff structure. That tariff has been presented always to the American people as a policy that made us rich. What the tariff really did was to protect us in the production of our own necessities and in the production of our surplus with which we paid our just debts and therefore became rich.

We have changed our basic economic position in the world from a debtor nation to a creditor nation, and this change has taken place almost over night. Today we hear that our high tariff is ruining foreign trade. But the nation experienced high tariffs from 1896 to 1913, during which time we were taught that those tariffs helped foreign trade. Both theories just can't be right. In fact, they are both wrong.

As a debtor nation the high tariff permitted us to produce for our own necessities and above this the surplus which we exported abroad to pay our debts. As a creditor nation we must be prepared to lose our so-called favorable balance of trade and import goods through which means Europe can pay its debt to us unless we devise a means of forestalling such a situation.

We must be prepared to make greater and greater loans abroad. We can never expect Europe to pay her debts, continue to borrow money from us, and then receive our surplus goods in addition. We just can't be paid and also enjoy a favorable balance of trade with our creditors.

What we must do is once and for all remove the tariff from politics though it has had one hundred and sixteen years of residence in politics. Four generations have been taught lessons on that tariff not applicable today.

We must be taught that what we consider an unfavorable balance of trade i. e., the excess of imports over exports, is the measure by which we are being paid the debts Europe owes us. An unfavorable balance of trade with Europe indicates that she is rendering her debt service to us, paying principal and interest. We must therefore, if we wish to continue as an export nation and still collect our debts look elsewhere for the bulk of our foreign trade surplus.

The idea that a family should produce all that it consumes was a basic factor in colonial days. Had such ideas prevailed until now our industrial development would have been nonexistent. Our whole national thought is based upon the family unit. We must admit facts, if just, fair and proper conclusions are to be reached. Our nation is but one family in a world of national families and to the extent that we maintain our colonial ideal as to the family in our international relations to that extent we retard the recovery and development of the world.

Without any undue hardship on industry, independent economic research could apply to the entire tariff problem a fitting readjustment that though it took two decades to work out would pay handsome dividends in our own national economic life.

This much is certain. It is a question of intelligent handling of this debt problem coupled with the tariff and based upon first

principles of economics or there will remain world-wide depression for many, many years to come with repudiation of public and private debts.

The situation that confronts America then is this. Historically we have had foreign capital loaned us with which to develop our natural resources. We have until late years welcomed the immigrant of all lands. That labor added to our own has contributed the surplus with which we have paid our debtors by maintaining a favorable balance of trade.

Now all is changed. We have shut off immigration. We still can produce a tremendous surplus.

But as respects Europe we must permit these debtors to pay us, which means we must take from them the product of their labor. We must do more. We must, if we are sincere in wanting our debts paid, render additional help to provide our debtors with machinery, factories, working capital, and the like in order that they may pay, out of applied labor, the debts due us. Any other principle of repayment ignores economics and economic history.

Whosoever becomes a creditor nation must buy the surplus labor hours of the debtor or sacrifice the debt.

The isolationist must deal with this surplus. He who would shut off trade and commerce with foreign nations, he who would shut off foreign loans, must deal with facts. If we do not put our debtors in position to pay we must expect repudiation. If we expect payment we must expect imports of materials on which foreign nations can make money out of which they pay us. We must expect imports from abroad as offsets to debt service.

The isolationist must content himself with the disestablishment of our export organizations. The manufacturer with the great export organization must welcome the banker with his foreign loans because the banker is providing the means of paying the manufacturer.

We must eradicate the idea that all foreign loans are alike and, from the practices of foreign capitalists when lending us money in the past, learn how to obtain concessions and interests of various kinds with both new and renewal loans. Foreign capital has not financed our various civic improvements, and here again we can profit by their example.

### REAL VS. NOMINAL PRICES

There is an age-long question as respects the ability and responsibility of the creditor to enforce payment from the debtor of debts contracted on high, inflated and expanded markets, but payable on low economic levels. It crops out during every depression under various names and panaceas.

In other words, the old question of real versus nominal prices tremendously affects a business man's thinking, particularly when a debtor class, entering into negotiations with every reasonable right to think it can pay, finds that an entire change in a world-wide economic structure practically denies the earning power with which to pay.

America had an historic example of this principle, following the great migrations preceding the Civil War, the immigrants had so established themselves that in countless thousands of cases they purchased land—farm land—during the inflated price markets of the war and the years that immediately followed it. With the resumption of specie payments a vast debtor class—consisting of the small farmer—found itself faced with debts contracted during inflated markets but payable during depressed decades. No economist who ever studied such a situation would reconcile the economic justification of carrying out the contract in the individual cases; it would have been far better to permit the mortgage to be foreclosed and the land repurchased on lower levels.

The vast war loans and war debts and reparations agreements entered into by the United States of America, the Allied Powers and the Government of Germany, were all contracted during the inflated and boom markets of the war and post-war period, when the buying power of the unit of exchange was small and nominal prices were extremely high—when inflation was world-wide. Such condition, if not confessed, is at least tacitly admitted in the various debt funding operations conducted heretofore with foreign debtor nations. During the ten years following the war, exceedingly high economic levels were reached in price indices.

Two years ago came the crash which, of necessity, must readjust every man's economic outlook and position. The present buying power of the unit of exchange is extremely high and the debtor class of the world,

whether it be of individuals or of nations cannot, except with extreme hardship, execute on 1932 levels its contracts entered into on the levels of 1919 and the years that followed. In other words, there appears to be an economic law, separate and distinct from the formal public law of contracts and negotiations, which must at least temper the enforcement of public law, irrespective of the willingness of the debtor to pay his debts or the insistence of the creditor that his obligations be met.

### "TO RENDER TO EVERY MAN HIS DUE"

Out of the ancient Roman writings there is the maxim fundamental in law that one man "shall render every man his due." The question arises as the world drags along in economic valleys—"What is the due of every man?" Certainly America never desired to place herself in a position to loan money to the nations Allied in the World War with which they could purchase foods, munitions and supplies largely from our own markets, and at prices as high as world-wide demand and the shortage of labor then dictated, only to receive its repayment during a period when markets would be depressed and world prices would be at low ebb.

### PRESENT SITUATION IN GERMANY

The chief source of all repayments to the United States Treasury on the part of the Allied Powers is their own receipts from the Government of Germany predicated upon the German War Debt and Reparations Agreements.

It is needless to go into the present economic situation of the German Republic. The world at large knows that Germany is hard pressed to the extent that her Government has gone the full limit in taxation, for over and above the present rates the Government fears its own people. The great mass of statistical data on the German Republic's budget is best understood by the keen students of finance who universally agree to the tragic economic condition of that Government.

It is a wise creditor that enables his debtor to pay him. It is almost too trite a suggestion to recall that the debtor can only pay out of surplus.

In the field of strict economics it must be stated that any nation in the world today, which is too hard pressed by its creditors and whose debts, whether justifiable or not, are too overpowering to the human mind to solve, must be expected to look with envious eye upon Russia with all that it connotes. It is a fearful and terrible idea for a nation to realize that the only power in the world without a national debt is the Government of Russia. If it looks long enough and enviously enough, such a nation may expect through its own pride to overcome the grosser evils incident to the establishment of the first Communistic state.

Our position should be that we cannot afford to have any people in the world looking longingly toward Russia. We are face to face with a deadly, ghastly thing called "Repudiation"—and just as Russia had everything to gain economically and nothing to lose economically—so when other nations center their thoughts solely in the realm of pure economics (forgetting the spirit of their national genius, their older political and racial traditions, their conservatism) under the pressure of creditors they repudiate all. This memorandum concerns itself with economics and not morals. The American business man may ask himself what it profits to have upon our books the debts of old Imperial Russia when principal and interest have been repudiated.

#### RUSSIAN SUCCESS

From a purely international point of view it is difficult to judge that Russia has been at all punished in her business relationships with America. No pride attaches itself to the Communistic regime and the refusal of our Government to recognize the present Government of Russia has not resulted in any serious non-intercourse in commercial relationships. The disruption that has occurred in commercial relations has no basis or foundation in governmental action.

The plain, blunt truth of it is that Russia has found herself relatively free to follow what no power in the world has hitherto followed, the plans—the blue prints—and the working drawings out of many of our basic industrial plants. Russia has secured the full coöperation of certain American business men in industrial plant layout, in plant and machinery plans and specifications, in line assembly and in engineering point of view.

Russia has imported America's technical men to advise and assist her in various elements of her development. Russia has received the maximum of coöperation in agricultural development at the hands of the nation which most stubbornly refuses her recognition.

We review these things for they are in the line of pure economics and they suggest the most optimistic and favorable and colored concept of Russia, which are the only concepts that a nation in distress entertains. It is always sad news for the merchant when he is informed that an individual owing him for a bill of goods "left town." It is sad news for the nations of the world—the creditor nations of the world—to learn that one debtor to them has left the traditional Town of Capitalism with its exactness in carrying out its stipulations and its contracts and moved into the new City of Communism where repudiation is the motto.

#### INFERENCES

A casual survey of world economic history is sometimes essential in bringing a smug generation to a realization of how dangerous the thoughts of peoples may become. Complacent America, trained in an economic structure which for a hundred years has witnessed the development of our tremendous natural resources at the hands of the most virile immigrant class a nation ever knew, finds it difficult to entertain concepts in accord with world history.

The history of the world, however, is dotted with revolutions and the history of the world has an economic background which every philologist must consider along with the other fundamental aspects of race, geography, tradition, language, religion, national aims, and national destiny. We need only recall the revolutions of the last hundred years, commencing a little further back with that most dramatic of all, the French Revolution, with its economic background. We recall, of course, the innumerable insurrections or revolutions due to the Colonial policies of the Empires of the World. We recall the vast industrial revolution inaugurating the ages of both steam and electricity. We recall the freeing of the slaves of the world and those endless political upheavals invariably intensified by economic distress—Germany in 1848 and Germany in 1918; France with its three Republics; China with the overthrow of the

Empire; Russia with its Communistic state; India in revolt; Italy with its Dictator; Spain with its insurrection and the overthrow of the Monarchy—nation after nation and people after people overthrowing governments long established until our beloved America, young in history, becomes old in point of constitutional government in the world today.

#### THE BASIS LAID

The President of the United States has appealed in a peculiar, unique and powerful way to the American business man in his announcement of a program to grant a year's moratorium on the debts due from the Allied nations in turn to be passed on and applied to the Government of Germany. It is not too early to consider ways and means to make permanent and secure the economic fruits of Mr. Hoover's proposal, to the end that a necessary, justifiable, moral and economic relief be granted the creditors who contracted, in the high markets of other years, debts to be paid in the low markets of this and ensuing years. And if the ensuing years become years of high economic indices, we shall have our reward. But lest the markets be decimated by world-wide revolution and repudiation, it is our responsibility to plan now a basis for permanent adjusted repayment.

#### A PROGRAM

It is the part of shrewdness for the creditor who desires the repayment of his debts, to place the debtor in a position to repay. Mere punishment of a debtor class is long since obsoleted, in favor of a more strictly economic attitude.

It is the part of shrewdness for the United States of America to place its debtors in a position to pay and this can best be done with most permanent value by making economic favorable terms with our debtors who were allied during the war and with the Government of Germany. To the business man there is a certain appeal in a program which permits the debtor to increase his earning power and his surplus which constitute his ability to repay. The American business man should look with extreme favor upon any plan which will incorporate provision that will aid our debtors and their debtor in turn to fulfill their respective obligations at the same time that it relieves them of economic burden.

America is historically an export nation.

She has for decades enjoyed a favorable balance of trade with the nations of the world, in the realm of visible exports. These visible exports are roughly and all inclusively divided into crude materials, foodstuffs, semi-manufactured goods and finished manufactured products.

Germany's continued and increased purchases from the United States over a period of years could be made to accomplish much, not only for our own substantial economic success, but also for the recuperation of Germany and for the improved economic position of nations now debtor to the United States as well as the world in general.

On the annual money-value of our exports to Germany, suggested as the basis for this rehabilitation, credit would be issued by the United States to apply to the liquidation of the debt now due to the United States from the Allied governments, and in turn passed on by them as a credit to apply toward liquidation of the war debt due to those nations from Germany. This credit would be in the ratio of One Dollar for each Seven Dollars' worth of goods and merchandise purchased from the United States by Germany. The American goods to which this credit would be applicable would include raw materials, foodstuffs, semi-manufactures and finished manufactures. This export credit would continue to apply throughout the period covered by the suggested plan.

If, under this plan, it were considered desirable to insure, in some measure at least, an increase of our exports to Germany and the other debtor nations, a limit could be placed on the credit issued by the United States. For example, the annual average dollar-value of our exports to Germany could be used as the basis of limitation—no credit being issued for an annual dollar-volume below the average, but credit being issued only in the one-to-seven ratio on the dollar-volume in excess of the average.

This credit could apply in a reduction of the amount due from the various creditor nations in the ratio of repayments due them from Germany, such nations in turn granting Germany similar credit. The individual or company making the purchase could use the credit against tax payments to his government.

This may be termed cancellation, but strictly speaking it is not because we are receiving a



valuable consideration for the forgiveness of the debt coupled with the opportunity of permitting the debtor nations to work out their economic salvation by increased and enhanced relationships with their creditors.

It is based upon the simple assumption that there is a normal profit in normal legitimate business dealings and that there is no profit that arises when there are no such business relationships. It attempts to augment and enhance America's export volume and as our abundance increases, we forgive our debtors their debts. It has a view to a long-term relationship because it seeks to credit annually a certain percentage on annual business done with the people of Germany. It encourages the debtor to go to work and work hard, knowing that rather than a penalty being imposed, a reward will be granted for work in the sense of international trade.

It selects Germany as the base for the very simple reason that the condition of Germany is more precarious than that of any other nation in the world and further because after all it is the payment of reparations from which it always has been assumed would be made the repayment of the war loans by the Allied nations to the United States. It has within the plan the element of attractiveness in the sense that the greater the relationships in commerce and trade between America and the people of Germany, the quicker will the entire international debts be cleaned up.

Under such a plan it might well be found advantageous to extend the period of repayment to from one and one-half times to twice as long a period as is contemplated under present agreements. It is contemplated that any debt balance each year would be settled as now provided, any excess credit being credited on the last year of payment.

It has within its program the permanent, self-adjusting, practical moratorium proposed in the sense that the greater is the trade between the German people and the United States, the less become the debts due by the Government of Germany to the Allied Powers.

It permits America, one of the oldest of the stabilized governments of the world, to attract the enthusiasm and the vision of the German people and permits them again to look westward on the course of their national destiny rather than reverse the age-old principle of progress and look East.

It attempts to inhibit and thwart the ab-

normal course of ideas from East to West which might include that dangerous and philosophically unsound Communistic principle of government. It re-attracts the mind of the world to western civilization rather than permitting it to settle upon Russia. It binds to us, for their own interests, all of the European nations on a friendly business basis.

#### APPLICATION TO OTHER COUNTRIES

The plan outlined for the adjustment of debt direct to Germany is intended to apply also to all of the direct creditor nations and to the extent used by them releasing for their own development any and all balances which may accrue beyond that due the United States. It may prove desirable to extend the method to all countries whereby the purchase by some country not involved in reparations would be given a somewhat similar form of credit equal, however, to a ratio of twenty to one instead of seven to one, which new form of credit would be transferable and assignable, thus taking on something of a resemblance to an international currency which could be used by such other nations (at some quoted value to be established in an open and free market without let or hindrance) in the purchase of commodities, etc., from the nations involved in reparations which debtor nation could in turn use it in reduction of debt to us. Such action would tend to speed the redevelopment of the world-wide trade and if, as we claim, we are prepared to take our share of world trade on a competitive basis will redound to our benefit.

#### MACHINERY

The machinery for accomplishment of the purposes outlined need be neither complicated nor cumbersome and should prove to be not only self-supporting but in addition pay into the Treasury of the United States a substantial profit.

The plan contemplates the formation of a corporation under a national charter whose credit memorandum on purchases as suggested hereinbefore would be the basis of settlement with the Treasury Department by the various governments involved, any exporter being entitled to the use of such credit memorandum upon the payment of subscriptions equal to one per cent of all exports.

The expenses of operation of such corporation would be paid from such subscriptions,

the balance being paid into the Treasury of the United States.

Upon the proper certification of the facts to the Honorable Secretary of the Treasury, there would issue a memorandum of credit from the Treasury of the United States to the debtor involved to the extent of his prorated credit. The duplicate memorandum could be sent to the Government of Germany as an indication of release to the extent of the aforesaid proportioned credit.

The various citizens of Germany and the debtor nations could in turn use the special invoice form properly endorsed to secure credit against taxes now imposed to meet the various state obligations.

#### EXCEPTION

Exception on purely financial grounds might be made to the direct loss of revenue normally expected to accrue by the payments of the present obligation to the United States Treasury. Such loss is inevitable if debts are repudiated or cancelled.

The indirect profits arising out of an adjustment such as is suggested herein may well equal the direct loss to the government through cancellation and quite possibly far exceed such loss. These indirect profits are:

- (a) The membership fee suggested hereinbefore.
- (b) Tax on profits arising out of the export business encouraged and developed by the plan.
- (c) Tax on profits arising out of the supplying of materials and labor in the primary stages of production of merchandise, etc., exported (i. e. tax on profits made on steel, iron, electricity, rubber, leather, wood, textiles entering into the product or merchandise exported as well as taxes on wages, salaries, interest and dividends arising out of the profits on such business).
- (d) Tax on profits of individuals and corporations arising out of the enduring prosperity that should be occasioned by such a tremendous impetus to business as a whole as may be expected to result from the greatly accelerated impulse on the part of other nations to import from this country.

The question may well be raised by the casual reader that the foregoing is self-contradictory in that the plan recommends that we should become an importing nation and

for this reason the tariff should be adjusted, and at the same time sets up a means that it is hoped will make our exports even greater than at any time in history. Such aims need not, indeed should not, be contradictory, they simply spell increased prosperity and a higher standard of living for all.

The tariff, which has been mentioned hereinbefore in connection with the whole subject of international settlements, need not and, in fact, for the protection of all concerned, should not be given a general slashing. Some items may be raised, others lowered, all under non-political auspices so as to accomplish the greatest benefit for the country, not for one year but for decades. We should import those things that other nations do best and export those which we do best and assist in the development of the world along the same lines that developed this country, namely, specialization of labor.

Objection might be raised that our industries could through excessive price overtax our creditors and Germany. Such objection is invalid, the limit of possible price advantage will be strictly governed by the limitation imposed by tax savings, that is if the excess price is equal to or exceeds the tax credit obtained by use of invoice then no advantage will accrue to purchases from the United States.

#### SUMMARY

When all is said and done, there are some twenty-one billion dollars due the Treasury of the United States from the nations Allied during the World War. In turn, the Government of Germany owes these nations sums even over and above this twenty-one billion dollars. The foregoing plan contemplates the importation by Germany and the creditor nations of upwards of 150 billion dollars worth of goods over and above normal imports before there is complete cancellation.

Gratitude is said to be a lively expectation of favors yet to be granted. Were debts to be cancelled outright, it would be unsound to anticipate that a favorable reaction would be more than momentary. Likewise, such cancellation would involve national expenditures, wholly contrary to certain American principles. To the business man, it is seemingly an infinitely superior plan to depend upon good business reasons for the purposes to be accomplished rather than upon expected gratitude for past favors.

*(Continued on page 225)*

# Futility of the Balance Sheet and Report Certificate

By E. R. SCHERICH, C.P.A., Los Angeles, Cal.

THE *Journal of Accountancy*, discussing editorially the effect of the decision in the "Ultramares Case," asked, "What is the accountant to do?" Continuing, it makes some observations and assumptions.

"For one thing, it seems fairly clear that every accountant's report will be addressed to the client only and that any use of the report by the client will be without the express knowledge of the accountant."

"It also seems probable that the accountant will divide his report into two sections, one dealing with fact and one with opinion."

"It has been suggested that accountants might incorporate and thereby limit liability, but that is an unprofessional form of practice and would not prevent litigation."

"The accountant perhaps should abandon certificates and merely make reports without accepting any liability whatever. The word certificate, which has been used for many years, is quite inappropriate and should be abandoned, in any case, especially with reference to any opinion. It is absurd to speak of certifying an opinion."

To say the least, it is clear that every accountant's report should be addressed to the client only. There is no logical reason to address it in any other way in this country such as there might be under English procedure. As to the use the client puts it, once having received it, that should not be taken for granted. The accountant who would properly dispose of his engagement which calls for a report will not overlook the purpose behind the work done and choose the right words to control the situation.

Separating fact from opinion is all very well, but there seems to be no very good reason why the two should be kept in entirely different sections of a report. Clarity of expression and continuity of thought would indicate the necessity of developing the two together but clearly differentiating between them. The attorney-at-law is very careful to

make this differentiation because it guards against the chance of misunderstandings and enables the reader to distinguish what is offered as fact and what is offered as opinion.

The suggestion of incorporating to escape liability is not to be taken seriously. Side-stepping responsibility does not tend toward progress. There are better and more direct ways of meeting the situation.

The last observation quoted amounts practically to a recommendation to discard the certificate and accept no liability of any kind on account of the report rendered. It may be an easy matter to discard the certificate but I greatly fear that accountants would eventually find that they had not automatically discarded their liabilities, either moral or legal, along with it. The idea of discarding the certificate, however, is intriguing to say the least. It is also novel, and being an unusual suggestion from a somewhat official source, I took it upon myself to dig up some notes that I had made about a year ago upon the subject of balance-sheet certificates, because those notes seem so pertinent to the issue raised and so in accord with the title of this article.

My observations on this subject, I find, are on a three-fold basis in answer to the three questions:

1. What are the purposes of a report and balance-sheet certificate?
2. Does the usual certificate serve these purposes?
3. If the usual certificate does not serve the reasonable purposes of such a certificate, what sort of certificate, if any, will do so?

The fundamental concept of an auditor is that he is a trained investigator. If he is truly trained he will look for the purpose in everything he comes in contact with. Sometimes I think only a small percentage of accountants are trained auditors. So few seem to perceive the reasons for the things they do. So it is with the use of the certificate on the balance sheet or report. There is so much vagueness concerning the reasons for that use. Custom no doubt has played a con-

siderable part, but custom is a subjective influence and subjective influences, for the purposes of this discussion, may safely be ignored in favor of the objective influences. The following outline is offered as the basis upon which objective influences leading to the use of a certificate upon published balance sheets and audit reports may be catalogued:

- a. Establish authenticity of the report and lend the dignity of officialdom thereto.
- b. Develop information:
  - (a) Concerning an audit, whether it has been made or not, and the nature and extent thereof;
  - (b) Concerning the report and statistical statements attached,
    - (1) Whether essential facts are all shown,
    - (2) Whether all essential facts are correctly stated,
    - (3) The basis upon which values shown are predicated.
- c. Declare the purpose of the report and define the use thereof.
- d. Define and/or limit the liability of the maker.

Are these purposes served by the usual balance-sheet certificate? That of establishing the authenticity of the report is, yes! One should remember, though, that authenticity and dignity are relative terms and that they may result as much from general impressions as from the use of affidavits, certificates, signatures, or seals. A document may be signed and sealed but until it has been delivered legally, it has no standing as an authentic instrument. On the other hand, an unsigned document actually delivered and published as an authentic instrument may, in certain circumstances, actually be considered as such. Authenticity, therefore, seems to be more a matter of legal publication and delivery than one of certifying and signing. However, the publication of a document without a signature is not good policy, and every report and balance sheet published by an accountant should be published over his signature. A certificate, however, is entirely superfluous.

In order to study the other purposes listed above in the light of the usual balance-sheet and report certificate, I have prepared a composite certificate which is the combination of all the ideas expressed in the certificates one usually finds attached to balance sheets and

audit reports. Classifying letters and numbers, as well as different type, have been used to separate the different elements of the certificate. This certificate is reproduced with qualifying and restrictive statements printed in italics and the matter in heavy type representing an unqualified certificate. The qualifications recorded are indicative of the usual qualifications but are not necessarily all inclusive. They are sufficiently extensive, however, to serve the purpose of this discussion.

#### CERTIFICATE

##### A. We have

- (1) Audited the accounts of John Doe & Company for the calendar year ended December 31, 1930:
- (2) *tested the computations and prices of the inventories which were taken by the employees of the company and valued by them;*
- (3) *verified the cash balances, accounts and notes receivable, and securities;*
- (4) *examined all charges to property accounts;*

and

##### B. we hereby certify that,

- (a) *in our opinion,*
- (b) *subject to provision for depreciation,*
- (c) *subject to provision for Federal Income Taxes,*
- (d) *subject to provision for loss that may be sustained on account of pending litigation,*
- (e) *subject to the company's valuation of inventories,*
- (f) *subject to the adequacy of reserves,*
- (g) *based on the records examined and information obtained by us,*
- (1) the accompanying balance sheet and statement of income and profit and loss correctly reflect the financial condition of the company at December 31, 1930, and the results of its operations for the period ended that date, respectively, and
- (2) said statements are in agreement with the books.

BLACK AND WHITE,  
Certified Public Accountants.

The information developed in the foregoing certificate is so meager that it might just as well be omitted entirely for all the weight it has with the consuming public. The reader

learns that an audit has been made and that the audit made covered a certain period. Of course, it is interesting to be assured on this fact, but the consuming public presumes, (whether it has the right to so presume or not), that a public accountant will not publish a report or a balance sheet unless it has been supported by an audit. The reader of the accountant's report expects that that report is backed by an audit unless he is informed in so many words that it is not supported by an audit, and it is just a waste of time and energy to write a certificate to tell him the thing he expects as a matter of course.

Qualifications in a certificate like the ones we find in this composite certificate are likewise just so much wasted time and effort. The reader does not appreciate their significance and it is foolish to expect him to do so. Every one of them is a technical statement, negatively put, and there never has been any attempt by the accountants themselves or by any one else to educate the general public to the point where such statements are generally understood.

And what about information which would enable the reader to judge the value of one report as against another? Take the example for instance: there is nothing contained therein which would give a layman any idea whatever as to the class of audit conducted in any specific cases. If he has any idea at all that audits are like merchandise, some good and some not so good, what is there in this certificate upon which a judgment as to its value might be predicated? Nothing! Not even a trained accountant could gather from such a certificate the kind of audit that was behind it. I have seen this certificate used alike by the leaders in the profession and by others whose ability did not go beyond the point of copying figures onto a form.

With respect to the information it supplies regarding the essential facts and whether or not such are all correctly shown, it is very little better. There is no direct reference to the subject but the statement that, "the accompanying balance sheet and statement of income and profit and loss correctly reflect the financial condition of the Company at December 31, 1930, and the results of its operations for the period ended that date, respectively," or the alternate statement sometimes used, "the accompanying balance sheet as of December 31, 1930, and statement of income

and profit and loss for the year ended that date are correct," is a statement of opinion meant to convey the impression that essential facts are all shown and are correctly stated. But by what sort of judgment have the essential facts been determined; by what standard have they been "correctly" shown? Again, I fear, the reader takes it for granted (whether justified in his presumption or not) that a balance sheet published by an accountant reflects all essential facts correctly.

Regarding the basis upon which the values shown in the statements are predicated, the only information gleaned from the certificate is contained in the declaration that, "said statements are in agreement with the books." Incidentally, this statement is usually omitted from the certificate entirely, and consequently in a majority of the cases the certificate reveals no basis whatever for the valuations contained in the statements. In fact, this statement, as here made, might just as well be omitted for all the good that it does. There is no presumption that the books are correct which would excuse the auditor from establishing their correctness by proper procedure. The real information which one would look for under this category is whether a particular fundamental concept of values is used throughout and what that concept is; whether such values have been adjusted for economic position and if so to what extent.

Underneath this whole question of putting information in the certificate are two dominant factors. Curiously enough, the first is a negative proposition. It is the urge of the individual to protect himself. It results in negative appeals, declarations that this and that was not done, to offset possible later attempts to place responsibility upon the accountant's shoulders for the omission. This proposition, however, is more pertinent to the purpose designated as "D," *supra*, to define and limit the liability of the maker, and it will be discussed more fully in a later paragraph.

The other feature may be expressed as a need for an effective means of reflecting in the report the relative merit of the report itself. This is a need which the usual certificate makes no attempt to satisfy. If the reader of accountants' reports is unaware of different standards of work behind the certificate, if he is unaware of the fact that there is a latitude as wide as the poles in the judgment which declares that a statement is correct, if

he is unaware of any possible disagreement between accountants relative to the proper basis of values to be used in a report, and gives as much credence to A's report as to B's, it is because accountants themselves have failed to reveal the underlying differences in reports. Certainly such differences will not be revealed in a few negative clauses in a certificate. A preponderance of negative information creates an impression of negation. That there is a need which is not satisfied by the usual certificate is very clearly evident. To arrive at any accurate conclusion as to how that need might be satisfied would necessitate a very careful analysis of different methods of audit procedure, different theories of valuation, different ideas in regard to balance sheet and statement form, etc., which would be out of all proportion to the purpose of this article. Anyway, I do not think it would be satisfied in a certificate.

Following the outline of purposes previously set down, the next for discussion is (C), to declare the purpose of the report and define the use thereof. Evidently this purpose has never been given much consideration when certificates were being drawn because the composite certificate utterly fails either to declare the purpose behind the rendering of the report, or the extent to which the report may safely be used. The absence of any reference to this subject in the certificates would lend weight to the idea that maybe this is not, after all, a purpose of a certificate. Nevertheless, if we are to have balance-sheet certificates, then this is a subject which ought to be taken care of in the certificate. An ancient school of thought within the profession held to a policy of publishing one balance sheet for all purposes. However, accountants have come to recognize the fact that the all-purpose balance sheet is not always a practical proposition and are giving more and more consideration to the preparation of the balance sheet to meet the particular needs of the client. In order that the reader be under no misapprehension as to the nature of the balance sheet, it is a matter of policy that he be informed in some manner as to the purpose it was prepared to serve.

Now comes the last purpose on the outline (D), to define and/or limit the liability of the maker. Being the last, it is not, however, the least important. Just at this time, it is a question that is receiving an unusual amount

of attention throughout the profession because of the court action in what is known as the *Ultramares Case*, and accountants everywhere are seeking the answer to the question, "What is the accountant to do?" In seeking to answer this question in our daily practice, we ought not to be stampeded into unwise and futile gestures. It is not going to be solved by addressing accountants' reports only to clients, nor by separating fact from opinion, nor by incorporation of the practitioner, nor by discarding the balance-sheet and report certificate.

The composite certificate which has been selected as representing the usual balance sheet and report certificate says nothing definite about the liability of its maker. If the liability of the maker is to be considered as limited in any respect, that limitation must be read into the certificate by inference. Such inference is to be found only in the italics, in the negative audit propositions, and in the qualifications. The value of the negative propositions and qualifications in a certificate to limit the liability of its maker is very doubtful. As to the moral issue, the reader is both judge and jury. These negative propositions and opinion qualifications are not couched in language that he understands, and his judgment will take one of two different courses. He will either decide that everything in the report is as it should be because he cannot recognize in the qualifications the possibilities they portend, or on the other hand he will recognize the qualifications as attempts to cover up, and conclude that the report is not reliable in any sense, nor the accountant who prepared it. It is a neat problem in psychology that the accountant would do well to appreciate, and govern his actions accordingly.

This moral issue may be concisely stated as a general rule of procedure and guidance in somewhat the following terms:

The accountant has a duty to his client and to the people with whom his client deals on the basis of the accountant's work to render an honest, fair and impartial service commensurate both with the purpose of the engagement and with the degree of skill and judgment expected of a member of the profession.

If the aim of the client in having an accountant perform a service is affected by an advance or decline in economic position, or by failure to heed the fundamental laws of

production, warehousing, transportation, marketing, financing, even management, then it is the duty of the accountant to reveal to his client whether or not these factors have been taken into consideration in the values stated and the opinions rendered.

On the strictly legal side of the fence there is the accountant's liability for (a) *negligence*, and (b) *fraud*, misrepresentation and negligence amounting to constructive fraud.

In the consideration of the question of negligence, it is well to define the classes of persons who might conceivably bring an action for negligence against an accountant. An outline such as the following will cover the subject.

1. Clients and persons who have paid a fee for work done or opinion rendered.
2. Persons who have received directly from an accountant statements prepared or opinions expressed, and who have paid no fee for the statements or the opinions.
3. Persons who have received the accountant's statements and opinions directly from the client without the expressed permission of the accountant but in line with the purpose of the engagement either expressed or implied.
4. Persons who have come into possession of accountant's statements and opinions legitimately but without the specific knowledge of either accountant or client.

The law reports are filled with cases upon the subject of negligence. It is surprising, however, that they are practically void of any cases pertaining to the accounting profession. The recent Ultramares Case is looked upon by many as the case governing the entire subject of negligence insofar as the accountant is concerned. It is a mistake to take that case too literally as being everything upon the subject. First, it is a New York State case and good only in New York. The courts of other states will lend their ears to it but may not necessarily be guided by it. Then it covers but one of the four situations outlined above, and while the language of the opinion is somewhat broader than that it is not safe to accept the opinion as covering more than the situation at issue.

The situation covered by the Ultramares Case is that outlined under (3), *supra*, wherein the client furnished to a third person the accountant's report in line with the purpose

of the engagement but without the expressed permission and knowledge of the accountant that the report was being furnished to the particular third person. Therein it was held that there was no liability of the accountant to the third person because there was no privity of contract. It may reasonably be expected that in a great majority of the states this principle will be adhered to, especially as it already represents the trend of opinion in cases (other than accounting) which involve loss or damage to property through misstatement of facts and misleading opinion.

The rule in this case, while enunciated relative to a situation as outlined under (3), *supra*, is just as applicable to a situation as outlined under (4). There should be no hesitancy relative to its acceptance as such, but accountants should hesitate about accepting it as applicable to the situation referred to under (2), wherein persons have received directly from the accountant a statement or opinion for which they have paid no fee. In such a situation it is altogether likely, even probable, that some court in some State some time will find in that situation either privity of contract or some element which will be substituted for privity. In that case there will be no difference in the final result between situations falling under (2) and those falling under (1). For the present, it is sufficient to draw the line of demarcation between the persons with whom the accountant has dealt and those with whom he has not dealt. The existence of privity of contract, or something resembling privity, is the guiding element in this latter classification. In this case where there was no privity of contract the court held that there was no liability. The case does not, however, cover the situation where there is privity of contract. It is universally accepted, nevertheless, that liability for negligence does exist where privity exists.

Sometimes I think that we accountants make too much of a to-do about our liability (legal) for negligence and not enough about doing those things that would prevent such charges being laid to our doors. And when it is said that accountants seek to limit their liability for negligence, if it is a natural liability that is meant, a liability that has accrued because some duty was not performed that should have been performed, I am resentful of the suggestion because it denotes a breaking down of character. On the other hand,

if it is meant to define the liability assumed in accordance with the scope of the investigation contracted for and the fee paid, and to limit that liability to those persons dealing directly with the accountant, then the situation is entirely different. The first is an immoral proposition, the second entirely moral. That distinction must be kept in mind when seeking the answer to our previously propounded question, "What is the accountant to do?" Accountants must be careful not to do the things which would result in an evasion of the natural responsibility. As pointed out in previous paragraphs, the answer is not in incorporation of practice firms, nor yet is it in the discarding of the balance sheet and report certificate. Still the usual certificate is entirely inadequate to define the scope of responsibility assumed and the extent of the class of users to whom that responsibility is offered.

Now just a few words on the subject of fraud! Liability for fraud is a natural responsibility for an overt act. It is not limited to privity of contract, to persons dealing directly with the accountant. And qualifications in a certificate are not likely to receive the remotest consideration. As a matter of public policy I think that accountants should protect themselves at all times not only against the consequences of fraud in their reports, but also against the imputation of fraud. It is not, however, a proper subject for the report certificate.

It is clear from the foregoing discussion that the usual balance-sheet and report certificate serves but one purpose and that to establish the authenticity of the report and lend the dignity of officialdom thereto. Even that, as we have seen, is a hollow accomplishment. As to the other purposes, regardless of their merit, the usual certificate accomplishes nothing really constructive toward their fulfillment. Insofar as the usual certificate is concerned, the title of this article is justified. With regard to the question of developing information such as will establish the merits of the report itself, or declare the purpose of the report and define its use, or define and limit the liability of the accountant, the usual certificate is but a futile gesture.

If we accountants are going to accomplish anything constructive toward making our position clear and understandable to the pub-

lic, we must stop making these futile gestures. And until we understand something of the value of psychology in business relations, we are apt to remain too self-centered to recognize the way out. Really, the balance sheet and audit report certificate in itself will never convey the light of understanding to the multitudes nor result in a general understanding of the work of the accountant and auditor. Sure! one can draw up a very creditable certificate which will establish the authenticity of the report, declare the purpose of the report and define its use, and define and limit the liability of the accountant making it. Contemplating that no report will be made or delivered to any person without a definite agreement with that person relative to the extent of the liability to be assumed by the practitioner, the following forms are suggested as discharging all the purposes of a certificate save that of developing information:

#### CERTIFICATE

We have audited the accounts of John Doe & Company for the calendar year ended December 31, 1930, with the idea of establishing the financial position of the said company for credit purposes; and

We hereby certify that the accompanying statements, consisting of balance sheet and report of income and profit and loss, were prepared pursuant to said audit and purpose.

The liability of this firm under this certificate is confined to those who have dealt directly with it.

BLACK AND WHITE,  
*Certified Public Accountants.*

#### CERTIFICATE

We have made a detailed audit of the accounts of John Doe & Company for the calendar year ended December 31, 1930, for the purpose of establishing the financial integrity of those accounts; and

We hereby certify that the accompanying statements, consisting of statistical exhibits and schedules as set forth in the attached index, were prepared from said accounts and are in accord therewith.

We caution the use of this report in any way inconsistent with the purposes expressed herein.

BLACK AND WHITE,  
*Certified Public Accountants.*



## CERTIFICATE

We hereby certify that the foregoing balance sheet was prepared pursuant to an examination of financial condition and detailed audit of transactions for the calendar year ended December 31, 1930;

And that the values stated are book values, being so stated on the basis of cost;

And that we have no knowledge of any factor which holds immediate prospect of materially affecting adversely the recorded values.

This balance sheet may be used for any reasonable purpose not inconsistent with the information revealed herein, but prospective creditors desiring more detailed information should examine the full report on said audit.

BLACK AND WHITE,  
*Certified Public Accountants.*

In these certificates, the subject of information developed is covered only incidentally. In fact, the obligation is too broad to be discharged fully in a short, workable certificate alone, and resort must be had to other means. What other means are available is a subject much more comprehensive than could reason-

ably be handled in this article. The theme, however, that I should like to have accountants understand as the big idea of this article, is the need of the profession to get away from meaningless forms of language, from meaningless expressions in their reports, and to substitute therefor color, life, individuality. Other professions are ever seeking something new, ever attaining new heights. Business has done wonderful things with production, warehousing, transportation, and marketing; it has studied and applied psychology and economics with equal facility. But the public accountant has been reactionary, has stuck to his archaic forms and expressions, has looked with doubt upon the new things of life, and figuratively speaking, the world has gone off and left him.

What quality we need in the profession more than any other at this time is constructive imagination. Then we need a broader education along fundamental lines. Starting with a greater degree of imagination, and a larger fund of learning, we should then look for the purpose in the things we do and our clients do, govern ourselves according to those aims, and we will see the profession take a much quicker step forward.

## Valuation of Patents

By ROBERT E. SADTLER, LL.B., Member of the Tennessee Bar

THE value of a patent is legally determined by the same test applied to other property, that is, fair market value, and it is this criterion upon which the accountant should base his computations. The special difficulties in the determination of the valuation of any particular patent, therefore, do not reside in the proper measure, but in the fact that the market value is in nearly every case a pure fiction. Unlike most property, each patent is entirely unique, and the accountant is unable to make use of experience with similar property as is almost always the case in valuing other articles. Even where the patent itself has recently been purchased for cash, the purchase price may very well be wholly erroneous as to the true value.

There are several possible methods of determination to overcome these difficulties, which may be summarized as follows:

1. Cost.

2. Income.
3. Savings due to the patent.
4. Expert opinion.
5. Nominal valuation.

### Cost

Cost is probably used in the large majority of cases where more than a nominal value is assigned to a patent. It, of course, may include various items which are not universally treated as elements of cost. In general, it would seem proper to include the cost of research in developing the patent, wherever such research expense can be reasonably apportioned, either to a particular patent, or to a number of inventions valued as a group.

The inclusion of research expense in determining patent cost is recommended by Montgomery (see for example his "Financial Handbook," p. 596.) There may, of course, be difficulty due to the delay in obtaining a

patent after the invention has been made, so that the accountant may have to treat the expenses themselves more or less arbitrarily at the time they are incurred, unless they are charged to a group of patents which have already issued, the latter being perhaps fair where the research is directed to improvement on the earlier inventions.

An item generally recognized as properly included in cost, is legal and other similar expense incurred in the actual prosecution of the application in the United States Patent Office. The Treasury Department authorized this treatment, and in fact generally requires it.

The seemingly inseparable item of legal expenses incurred in the protection of the patent after its allowance is not so uniformly regarded. To date, the Income Tax Bureau has not permitted such expenses to be capitalized, but requires them to be treated as ordinary business expenses.

This attitude of the Federal authorities is believed to be incorrect in those cases where the litigation is successful. It is recognized universally, of course, that where the patent is finally held invalid, the expense incident thereto cannot be capitalized, but must be written off, together with all past costs which may have theretofore been capitalized. But wherever the validity of the patent is sustained, there is no possible doubt that its value is actually increased. At least one large corporation has taken this stand and is prepared to maintain it. Wherever patents are valued on the cost basis, great care must be taken to see that all obsolete or obsolescent inventions are written off regularly. This includes all patents which have been held invalid, or as it may happen, have been held to belong to a third party.

The accountant must also calculate depreciation on all patents so valued. Inasmuch as this is true of any patent on which a value has been placed, the matter of its determination (or its amortization) will be discussed at a later point.

#### INCOME.

It is only rarely that it is possible to determine, with any degree of accuracy whatsoever, the value of a patent from the earnings under it. There are instances, however, where this method affords the best, and sometimes the only, practicable plan. For example, in

the case of the well known Steenbock patents covering irradiation by ultra-violet light, the basic patent is owned by the Wisconsin Alumni Research Council, and its use is licensed broadly, and the licensees supply all, or practically all, of its value. In such case, no objection is seen to placing a value on the patent, based upon a capitalization of the royalties earned. The Universal Oil Products Company was another example where this method might have been used, since it did no manufacturing whatever under its patents, but received all its profits from the licensing of the patents.

In most cases, however, this method is impossible, due to the fact that the owner of the patents himself manufactures under the patents. It is thought, however, that the amount of income earned by a patent may be carefully considered before finally placing a value upon the patent, regardless of the particular scheme of procedure followed.

Owing to the general irregularity of income from patents, and particularly that achieved as a result of the settlement of litigation, it is believed that a much more satisfactory result will be reached if the income for the whole previous duration of the patent is totalled and averaged, instead of using a one-year return. There may, of course, be special circumstances which would indicate a different course, as for example, where no effort has been made for a time to commercialize the patent or where because of litigation, or otherwise, it was impossible or inadvisable to do so.

#### SAVINGS DUE TO THE PATENT

Valuation on the basis of the savings achieved by the owner of the patent, due to its ownership may at times be an extremely good and useful procedure. Needless to say, however, it will generally be attended by difficulty.

There is not sufficient space in this article to dwell at length on the almost innumerable variety of savings that may be accomplished through the ownership of a patent. The most obvious is the ability to produce an article at a lower manufacturing cost, either because the patent enables the manufacturer to use cheaper or fewer materials, cheaper or less labor, or lower capital investment. The saving is by no means limited to these, however, but may include lessened selling cost due to

a monopoly on a patented product with its consequent elimination of competition. A more intangible saving, which in general is incapable of valuation, is that which may be achieved through control of prices, either because of the manufacturer's own monopoly on the product, or through his permitting a controlled license system.

Where the savings can be determined with any degree of definiteness, it is believed that a valuation based upon them is as fair a method of procedure as any. It is a method uniformly followed by the courts in determining the measure of recovery in equity cases under process patents, and if this method is thought definite enough for a court of equity in one set of circumstances, no reason is seen why it should not be perfectly proper in the other. Although not called so, the well known "standard of comparison" by which the measure of recovery is determined in patent cases other than product, really amounts to nothing more than a determination of the savings involved in the sense that savings are really gains.

#### EXPERT OPINION

Very recently, the Treasury Department has begun to acknowledge the use of pure opinion in the valuation of patents, and has even frankly permitted the opinion to be *ex post facto*—that is, to be in the light of events subsequent to the time at which the valuation is made.

Reference may be made to the following cases:

Adams vs. Commissioner, B.T.A.

Simmons Company, 8 B.T.A., 631.

Dwight & Lloyd Sintering Co., 1 B.T.A., 179.

From the accountant's standpoint, the cases amount to holding simply that the accountant should consider all of the evidence available and then make his own fair guess as to the proper value, or else accept that of some one logically qualified to make the estimate. This, of course, is not satisfactory to the accountant but in the final analysis simply puts patents in the same class as other property.

#### NOMINAL VALUE

Many corporations are confirmed in the belief that patents should be capitalized at merely a nominal figure. This practice has much to commend it, and is certainly to be preferred where it is desirable to maintain

a conservative accounting system. There are, however, many considerations which may lead to a different practice.

If the patent is sold, or if actual income is derived from it the fact that a nominal value has been placed upon it may lead to serious difficulties. For instance, if the patent has been sold for a considerable figure, an individual owner may find his tax considerably higher due to the fact that his income is in the higher brackets, whereas if he had capitalized his expenses as they accrued from year to year, the total tax would have been much less.

In the case of royalties, if a value has been put upon the patent, depreciation may, of course, be set off against the income, and produce a lower tax. To balance this, of course, expenses incurred in the early years of the patents, or before their issue would have to be capitalized, in general. As a rule, however, there is little or no net income in the early stages, so that there would be little or no tax anyway.

It likewise may be desirable to show a true value for the patent after carrying it on the books at a nominal figure. In such event the nominal figure may have a strong psychological effect in preventing the full valuation from being achieved.

## Main Street Analyzes the Depression

"Gee, times 'er tough, Horace. Times 'er tough I tell ya."

"They aint as tough 's they were in 1904—year 'o tha St. Louis Exposition. Ya got \$1.25 a day then fer labor. Work two days now'n ya get as much 's ya got in a week then."

"Yeah, that's so. But these guys gotta have their ottomobiles now. Th'aint happy 'nless they're runnin' their cars."

"Sure, they feel poor if they ain't runnin' to Playland 'n all the beaches in their cars. It's the way they feel."

"Sure, it's just the way they feel. Times ain't really so bad."

"No, times ain't so bad. It's just the way they're useta livin'. Yeah, that's right."

"Sure, it's what they're useta. Yeah, that's right."

—From *Credit Where Credit is Due*.

## Importance of Defining the Scope of an Audit

THE following editorial appeared in the January issue of the *Accountants Journal*, the official organ of the New Zealand Society of Accountants:

"A recent English case (*Maritime Insurance Co., Ltd. v. William Fortune and Son*) affords an excellent example of the importance of obtaining in writing, at the outset, a clear understanding of the scope and extent of an audit.

"The case in question was an action taken against a firm of Chartered Accountants for alleged breach of duty in certifying certain accounts of a branch of an insurance company. Irregularities occurred at the branch and remained undiscovered for some time, the monthly statements sent to the head office, bearing the certification of the auditors, being accepted without question. In the Court proceedings the actions of the auditors were subjected to a severe criticism, and it was contended that they had omitted to carry out elementary auditing tests of the accuracy of the books. The defence was that the work was first undertaken in 1900 when the office was an agency and not a branch, and the monthly statement was in the form prescribed by the Head Office, and all the auditors had to do was to see that the facts and figures were based on entries in the books. The fee agreed upon was a guinea a month.

"The judgment of Mr. Justice Roche is interesting.

"In giving judgment for the defendants, he said that the case was rendered the more difficult because of the fact that the employment of the defendants upon which a great deal turned started more than thirty years ago. There were three matters to be considered: (1) What was the scope of the employment? (2) Did the defendants perform their duties or were they guilty of negligence? (3) Was the loss sustained by the plaintiff the result of acts or omission of Messrs. Fortune?

"Two competing views as to the duties of Messrs. Fortune had been put before the Court. He thought that their duty was not to conduct what might be called a full audit,

nor was it simply to see that what appeared in the books was correctly stated or summarised in the monthly returns.

"He went on to point out the events that led to the arrangement that certain books should be kept at the branch and certain returns sent to the head office, and expressed the view that the employment of the auditors was confined to examining the books, seeing that they correspond with the books that had to be kept, and in that sense seeing that they were adequately kept and adequately summarised in the return to the head office. He considered that it would have been the auditor's duty to report if anything suspicious had appeared in the books, but, in his view, there was nothing which excited or ought to have excited their suspicions. They were not in possession of material which would have enabled them to know whether the business of the branch was being satisfactorily conducted or whether the books of account truly showed the state of affairs of the branch. He thought that the misappropriation of money was not detected before it was because there was no system in vogue by which the cash received could be checked. The acts and omissions which brought about the trouble were not the acts and omissions of Messrs. Fortune and Son, and they had been guilty of no breach of duty or negligence.

"Although the accountants secured a favorable judgment, much trouble and cost would have been avoided had there been in existence a written memorandum defining the scope of their audit arrangement."

### Permanent Credit Adjustment

(Continued from page 215)

The suggested plan holds the nations discussed under strict accountability, but at the same time it relieves that economic pressure that is so disastrous to an involved debtor class.

Either this or some similar plan or some plan which accomplishes like results is essential if chaos is to be prevented.

# Organized Cooperation Among Accountants<sup>\*</sup>

By R. J. LE GARDEUR, C.P.A., New Orleans, La.

THIS occasion is far too important in the history of Public Accountancy in the South, to permit me to dissipate the precious minutes allowed me so that I will enter at once, into a serious conversational discussion of the subject matter allotted to me.

Were we to accomplish only half of all we have in mind to accomplish at this Four-State Convention, the precursor, let us hope of many such conventions, we will have written a glorious and imperishable chapter in the history of Public Accountancy in the South.

If we do nothing else on this the last day of this historic convention, let us resolve to start a movement towards organized constructive coöperation among Certified Public Accountants, in this fair Southland of ours, and let this coöperation be practical and unselfish, aggressive and consistent.

In the dawn of ages, coöperation alone, began to uplift primitive savage man from his bestial state and urged him onward to that high pinnacle of civilized society which he has reached today.

The only price to pay, but this price must be paid, is the unselfish relinquishment of certain personal, individual liberty, or shall we say license, so that the whole shall profit even though apparently at the expense of the individual.

It was only through this unselfish coöperation, through this sacrifice of the individual, for the benefit of the whole, that civilized society has reached its present development, and in the final analysis, the primary and most important function of our civil authorities, is to see that this price is paid, so that chaos may be avoided, and civilization permitted to advance.

We accountants, must likewise organize and coöperate. We must willingly and generously pay the same inexorable price. We must effectively resolve that the individual must re-

linquish license and that objectionable personal liberty, in things or actions inconsistent with or detrimental to the profession as a whole, so that the profession may prosper, progress and advance, and paradoxical as it may appear to him, that he, the individual, may prosper, progress and advance. These facts are fundamental and beyond question, and their truth is attested by the successful experiment of organized society itself.

It appears to me that the profession of Public Accountancy has not, in these United States, received that recognition, attained that prominence, earned that respect and consideration, nor secured that legislative support, that England has accorded it for many years past.

It further appears to me that while this recognition is being gradually accorded to it in the financial, banking and industrial centers of the North and East, only little progress has been made towards securing this recognition in the South.

It certainly is not because of the personality or standing of the Southern accountant, because as a class, that typical accountant is the peer of any one, in tradition, culture, education, honor and ability, and deserves a place, nationally, in the front rank of the profession. Nor can the cause for this be laid entirely at the door of the financial, banking, industrial and legislative activities of the South.

The cause, primarily, if not solely, is chargeable to the members of this new profession in the South, and the full attainment of that much desired recognition lies entirely with them and can be secured through organized, intelligent coöperation.

The major obstacles in the path of this recognition, appear to me, to be in part as follows:

1. Lack of uniformity of purpose, ways, means and ideals, and a true appreciation of what the profession means.

2. Lack of intelligent and constructive organized coöperation by all for the benefit of the whole.

<sup>\*</sup>Read at Four-State Meeting at Shreveport, La., November 16 and 17, 1931.

3. Failure to adopt and enforce practical and uniform rules of professional conduct, practice and procedure.

4. When such rules are adopted, lack of the necessary power to enforce them, either by legislative enactment, or better yet, by the more efficient and far-reaching force of an aroused, enlightened public opinion.

5. Lack of facilities required to educate the public to the purposes of accountancy, its objectives, the benefits to be derived from it, and its supreme importance to our economic structure.

Due to these major causes and many others not enumerated, the following results:

1. Apparent misunderstanding of the major principles underlying professional conduct, practice and procedure, though certainly no real misunderstanding should exist.

2. Audit reports and particularly auditor's certificates which must be analyzed and explained before their true meaning is disclosed, apparently with one, intending to mean one thing and with another, quite a different thing, leaving the business public bewildered and confused and wondering what it is all about.

3. Preparation of balance sheet exhibits, which, not only do not reveal the true facts, but actually seem to conceal them, such as, by way of illustrating my meaning, failure to show separately from other receivables, loans made to officers, stockholders, partners, or employees; failure to indicate appreciation or deflation of assets, and carrying such appreciation or deflation to the regular earned or paid-in surplus; failure to disclose fully the true position, when subsidiaries and affiliates are carried on the balance sheet.

4. Failure to adopt and maintain a minimum standard of fees for services rendered.

5. Failure to regulate, as regards character, experience and efficiency, the employment of seniors and other staff members.

6. Failure to effectively prevent and to publicly stamp as obnoxious and dishonorable, the vile practice of the bargain-peddling of professional services, from door to door, as the tin pots and peanut vendors would do, and also the practice of maintaining soliciting departments, together with the unethical and bombastic advertising so positively outlawed in any dignified profession.

7. Failure by diplomatic, though none the

less effective, measures to compel recognition of those certified public accountants only, who are in good standing with and vouched for, by their State Society or by their State Board.

For all these ills, and many more that will come to your minds, and that must be cured before the profession can progress, what are the remedies?

It is my opinion that there is one, and only one, remedy, and from it, will spring all other remedial agents, which may be required to effect a complete cure of all these ills.

That remedy is organized coöperation, administered through a strong, active State Society of Certified Public Accountants, with high local professional recognition and standing.

Where such a State Society does exist, such amendments must be made to its charter and by-laws, as will permit it to fully meet the requirements contemplated.

The power and prestige of this Society must be such that every certified public accountant of the State will realize it to be not only his duty, but to his self-interest as well, to become an active member, for his professional standing shall be judged by his standing in his Society.

What are then, the main objectives that give this Society the right to exist and function?

1. It must adopt fair, practical and uniform rules of professional practice, procedure and conduct, and must have the power to enforce the observance of these rules, by fair trial and to impose suspension or expulsion as may be required.

2. It must obtain such a measure of importance and respect in its community, that, failure to join its ranks would be considered as a reflection on the professional standing of a certified public accountant. Suspension and particularly expulsion therefrom, should destroy the usefulness of the offender.

3. It must ignore the selfishness of the individual for the betterment of the whole, for its sole purpose is to establish and maintain the profession on that high plane of professional standing reached by the legal profession.

4. Through ethical publicity it must educate the financial, banking and industrial public to the needs of public accountancy as an important economic factor and to the imperative needs of recognizing only those certified

public accountants whose high standing and experience are vouched for by their membership, in good standing in their Society, and it must acquire that moral force and prestige which will permit it to enforce the recognition of these accountants to the exclusion of all others.

5. It must work in sincere and effective harmony with the State Board and assist it to the limit in compelling observance of its Code of Ethics.

6. It must enlist the constant, active support of the Clearing House Association, Credit Associations, Robert Morris Associates, the various Exchanges, particularly the Stock Exchange, the Civic, business and economic Boards and Societies and the Chambers of Commerce, to assist it, in realizing its high objectives, and for that purpose it must keep in touch, as often as may be required, with these various entities.

So far, this outlines a program for a State Society, but this does not reach far enough, for we secure only locally organized coöperation, and we are still isolated from and working independently of our Southern confreres.

Our purpose should be organized coöperation by and between all Southern societies, for the problems of the South are somewhat distinctive from the problems of other localities or sections, and I take it that we have met here primarily for the purpose of co-operating in the solution of these problems. The time therefore is most auspicious for these four societies to inaugurate the movement, and invite the other Southern societies to join us.

We would thus secure uniform rules, and the harmonious organized coöperation of all the societies of the South would be the most effective means of securing the position we feel justified in attaining. The question then presents itself as to what are the best means to adopt to secure this organized coöperation.

For the purpose of opening a discussion and of bringing the matter to each Society for earnest and serious consideration, I suggest that a committee, truly representative of each Society here present be appointed for the consideration of a plan, which I outline; the committee to consider my ideas, only in the abstract, and to recommend whatever other plan it may select.

I suggest a Congress of Southern Certified Public Accountants, with State Society repre-

sentation rather than individual. The Congress to organize as early as practicable, for the purposes, under such rules and regulations, and with such powers, restrictions and limitations as may hereafter be determined.

1. The committee to fully develop the idea, study the plan and devise ways and means to carry the matter to a successful issue.

2. The committee to report its recommendations fully to each State Society.

3. Each State Society to fully consider this report, and with comments and criticisms, notify the committee of its approval in whole or in part.

4. Each Society to appoint one or two delegates to meet this committee and harmonize differences. Said delegation must be fully authorized to conclude all negotiations required to create the Congress.

5. If the Congress is created, each Society will then appoint its representative or representatives to this Congress, bearing in mind that too few representatives constitute a more efficient working force than too many.

6. The expenses of this committee to be paid pro rata, as may be determined by the various societies interested.

7. If the idea of a Congress is finally approved, then this Congress shall be created as the societies may elect and it shall meet and organize.

Among the major items to be considered by the Congress, if and when organized, the following are suggested:

1. A campaign to have the public accounting laws made as uniform as possible.

2. A campaign to have banks and financial institutions refuse to accept for credit, loan and investment purpose any balance sheet or statement of financial position, unless prepared and signed by a Certified Public Accountant, a member in good standing and vouched for by his State Society.

3. A campaign to have all Southern Stock Exchanges refuse to list any security, unless at least the book value of said security has been determined upon a balance sheet, certified to by a Certified Public Accountant in good standing in his State Society.

4. Immediate preparation and adoption (a) of a practical, fair and reasonable code of professional conduct and (b) of a code of professional practice and procedure, the two together to be known as the "Code of Public Accounting Ethics."

5. Working out practical plans, for the periodical publication of a purely professional pamphlet or magazine, and ways and means to finance same. This magazine to be furnished free to banks, financial institutions, exchanges and chambers of commerce; others to pay a stated subscription price. In each publication shall be listed, alphabetically, under proper State heading, the names of all members in good standing of each Society.

6. The Congress should hold semi-annual, or surely annual, conventions.

Under a plan somewhat similar to this plan, we would secure an active, efficient, continuous organized coöperation, uniform in all respects, the State societies each working along lines, indicated by purely local conditions, the Congress, along broader lines required by sectional conditions and the two national organizations looking out for the interests of the profession along national lines.

Although I have given to it most thoughtful consideration and have carefully weighed the advantages against the disadvantages, yet it is with fear and misgivings that I submit for your consideration my last suggestion.

It becomes increasingly apparent that Certified Public Accountants are becoming more and more every year "Officers of the Court."

In these days of complicated business, and complexities in accounting procedure, with receiverships, bankruptcies, disputes among partners and stockholders, settlement of estates, organization of corporations, mergers, consolidations, and reorganizations, all of this further complicated by the requirements of the Federal income and estate tax laws, judges of our lower and supreme courts are constantly in need of the services of Certified Public Accountants, whom they themselves select and appoint to assist them in clarifying and explaining the financial and accounting facts underlying the action being tried before them. Many such cases could be cited, in the experience of many of us. Undoubtedly, while serving in that capacity, the Certified Public Accountant, is temporarily, at least, an "Officer of the Court," in no wise interfering but rather working in conjunction with that higher and more important court officer, the attorney.

Why then should not the Certified Public Accountant, upon the approval and recommendation of the supreme courts, become permanently and by legislative enactment an

"Officer of the Court?"

This undoubtedly would not only add dignity and prestige to the profession, but would place greater responsibility and accountability on the Certified Public Accountant.

The rules of professional conduct, practice and procedure, would then be approved by the various supreme courts, and when so approved, would be easily enforced and not open to question.

The State Boards, still supreme, as is the case in Louisiana, would still try and decide cases, with the right of review placed in the supreme court, thus substantially simplifying such litigation, as we of Louisiana well know by experience.

Let me well dissipate any thoughts that may arise in your minds that I am trying to place before the courts, our profession on a parity with the old revered profession of law, and encroach upon and share equally with it, its prestige, privileges and prerogatives. I know too well that many more years shall pass us before we acquire that prestige and importance that are the rightful heritage of the profession of law.

I do want to say however, that next to the Attorney, the Certified Public Accountant is the only other professional man that becomes more and more a necessity to the court, and should be by law, recognized as such.

My rambling thoughts for many months along these lines suddenly became crystalized by reading in THE CERTIFIED PUBLIC ACCOUNTANT a decision of the California Supreme Court. I became impressed with the fact that by substituting the word "Accountancy" wherever the word "Law" appeared and the term "Certified Public Accountant" for the word "Attorney," this decision would exactly fit the accountancy profession. This is really as it should be, for when all is said and done, the code of ethics of the accounting profession should not differ from that of the legal profession.

The California Supreme Court, in Barton vs. State Bar of California 289 Pacific Reporter 818, handed down a decision which touches on Canon 27 of the American Bar Association's Code of Legal Ethics.

A Board of Bar Governors had recommended the suspension of Barton for violating its rule No. 2, prohibiting the solicitation of professional employment by advertising.

The rules of professional conduct had



been approved by the supreme court as provided for by the law.

Barton claimed (a) that under the State Constitution, the Legislature could not delegate the power to formulate and enforce rules of professional conduct, and (b) that this particular rule was an unreasonable rule.

The supreme court held that objection (a) had no merit; that when the rules had been approved by the supreme court, they became the rules of the court and the power of the supreme court to make rules was not open to question. As to objection (b) the supreme court ruled in part as follows: "The Ethics of the legal profession forbid that any Attorney should advertise his talents or his skill as a shopkeeper advertises his wares" and referred to Canon 27 of the American Bar Association reading "The most worthy and effective advertisement possible, even for a young lawyer and especially with his brother lawyers, is the establishment of a well-merited reputation for professional capacity and fidelity to trust."

The court further said "Notwithstanding the declaration of the petitioner we do not believe that the profession of the law is or ought to be merely a highly competitive business, and because it is not and because it is necessary that the public should not be given the idea that it is so considered by the members of the profession, the rule against the solicitation of business by advertisement is a reasonable regulation."

As a profession we are not and can never be engaged in a "highly competitive business" and the sooner we emphatically implant that

fact in the minds of those who consider the profession in that light, the sooner will we purge the profession of the undesirables and secure from the public that respect, consideration and confidence to which we are entitled.

How smoothly and effective would the State Boards, assisted by State Societies, then function. A major violation is committed; after a fair trial according to law, the Board suspends or expels the offender; his appeal for review is direct to the supreme court, and the matter is quickly settled. Again what profound respect would be accorded to these rules of the State Board, by members of the profession, with the knowledge that these are also the rules of the supreme court, enacted for the guidance of a profession composed of "Officers of the Court," and that the supreme court is very positive in compelling observance of its rules. What prestige, dignity and confidence would be accorded the profession, when once its members had become honored and recognized by the supreme court, as "Officers of the Court."

I am not at all prepared to say what would be the attitude of the supreme court or of the legislature on such a proposition, but if it appeals to you as it appeals to me, and we can secure the approval and assistance of our local bar associations, I believe that success will reward our efforts.

The suggestion is both novel and drastic, but please do not "throw me out" until you have given the matter your earnest and thoughtful consideration, for I see in it positive and infinite possibilities for the betterment of the profession in the South.

## Cooperation With Commercial Credit Grantors

THE New York State Society of Certified Public Accountants, under date of January 25th, sent a communication to each of its members with regard to a symposium on Commercial Credit to be held in connection with the March meeting of the society.

Conferences have been held between the society's Committee on Coöperation with Bankers and Other Credit Grantors and representatives of the Uptown Credit Group of the textile industry, a division of the Silk Asso-

ciation of America. The Uptown Credit Group handles a billion dollars of credit a year in normal times, which credit is based upon something between 20 to 25 thousand audits annually, depending on business conditions.

The letter to members, referring to the desire on the part of the credit grantors for active coöperation from the accountants, makes reference to a letter (printed last month) sent by the credit grantor group to

a group of certified public accountants of Boston, under date of December 23, 1931, and to a letter of December 28, 1931, from the National Credit Office to its subscribers regarding their 1932 financial statements.

The notice also carries a statement from A. B. Heller, Chairman of the Committee on Accountants of the Uptown Credit Group, which we are permitted to present to our readers:

Doctors in far eastern countries used to be paid, tradition has it, for keeping a family in good health.

Business firms would not go far wrong in applying similar principles toward keeping their business healthy. The practise of calling in experts after business is on the rocks is far too prevalent. An ounce of prevention is worth a pound of cure. When weakness in business set-up or procedure is discovered early enough, it is possible to take measures to strengthen the weak point. When business gets too sick, it may be too late.

In forewarning business executives of the trend which their organization is taking, the Certified Public Accountant may be likened to the family physician. He checks up on all phases of business activity and presents a diagnosis for the guidance of organization heads. Preparation of a complete certified audit is ordinarily considered the chief function of an accountant. Such an audit is, it is true, extremely important in disclosing the actual condition of a business, and in preventing robbery and defalcation within the organization. The value of the accountant to a business house does not, however end here. When he is permitted to continue to serve the firm each month not only in checking up the records of the preceding month's transactions and preparing a monthly trial balance, but also interpreting the figures, real benefits will accrue to the business executive and his organization.

A paramount need of business today is the flexible adaption of operations to current conditions. This is especially true with our continually shifting public taste, and with the general uncertainty prevailing in regard to present business conditions. Modifications of this sort are facilitated if the executive has for his guidance first of all, a monthly trial balance. This trial balance should not only present the facts as they appear on books, but bring out each operation and its relation to

the entire business. It should be supported by a schedule showing each particular item of operation in relation to the total business transacted. If one item appears out of line with the other figures, an immediate check on all transactions is possible for the purpose of disclosing the reason and of making the necessary adjustments at once.

Still other facts, extremely important to the business executive, are made known through an accountant's monthly trial balance. Actual operating costs are disclosed, making it possible to determine what merchandise is being sold at a profit, what can be sold at a profit, and what lines should be discontinued. A month by month check on costs as compared with sales is a means too, of eliminating unprofitable and overbalanced inventory. The monthly trial balance also points out items on which reduction of costs is necessary to meet competition, and bring an individual firm into line with the market.

In addition to the Certified Public Accountant's value in preparing statistical summaries of the condition of a business, a firm can profit by its contact with a well informed accountant in the knowledge of comparative costs which he brings from his audits of other concerns. He frequently proves helpful in an advisory capacity, as he is in a position to advise on finances, purchasing, inventories and credit position, as well as providing help on budgeting and forecasting.

A full certified statement prepared by an accountant is indispensable to a firm's credit rating. Knowledge that this service is being obtained is always favorably considered by banks and bankers and others extending credit. The fact that a firm seeking credit keeps accurate records as to their operations instills confidence in itself.

Money spent in safeguarding health returns no more valuable interest to the individual than money spent on accounting does to the business organization.

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### Joint Costs

*(Continued from page 207)*

ing in the mails; they indicate, without bias, the extent to which each class of mail matter and each special service shares in the postal expenditures; and they make possible a close estimate as to the potential effect of proposed legislation involving postage rates or postal expenditures.

## TALKING SHOP

A Department Conducted by L. GLUICK, C. P. A.

Mr. Oliver Hand, our first correspondent, tells us that in the very issue in which we pointed out the need of accountants for good English, we had committed an error in grammar. He is correct. Now what other bright student can tell us just what the mistake was.

Despite our repeated assertions that our dialogue characters are composite personalities, inquiries are still received as to their supposed identities. The one in whom most interest is shown is Oldtimer. Which gave us the idea of finding out who is the oldest C.P.A. alive. We mean the oldest in years. Obviously Frank Broaker is the oldest in date of certificate. When making your nominations be sure to state date of birth and name of the State which issued the primary certificate. No prize will be awarded; but since all universities make quite a fuss about their oldest alumni, we will follow by giving as much space as possible to the oldest living C.P.A.

The following is taken from *A History of Printing* by J. C. Oswald, which is an Appleton book:

"It is an uncommon experience to find a book in which there is no misstatement. It does happen, but not often. I have not accepted any statement without making every possible attempt at verification."

Mr. Oswald would make a cracking good auditor.

The following is taken from Washington Irving's *Knickerbocker's History of New York* (Book III, Chapter 1):

"The very outset of the career of this excellent magistrate was distinguished by an example of legal acumen. He was interrupted by the appearance of a very important burgher named Wandle, who complained bitterly of one Bleeker, inasmuch as he refused to come to a settlement of accounts seeing that there was a heavy balance in favor of said Wandle. Having

listened attentively to the statement, he called unto him the constable and dispatched him after the defendant. This summary process was effectual. The parties being confronted before him, each produced a book of accounts. The sage took them one after the other, poised them in his hands and having counted over the number of leaves, fell straightway into a very great doubt, and smoked for half an hour without saying a word; at length with the air of a man who has just caught a subtle idea by the tail, he slowly took his pipe from his mouth, puffed forth a column of tobacco smoke, and with marvelous gravity and solemnity pronounced, that, having carefully counted over the leaves and weighed the books, it was found that one was just as thick and heavy as the other; therefore, it was the final opinion of the court that the accounts were equally balanced; therefore they should give reciprocal receipts, and the constable should pay the costs."

On March 8 the N.Y. *Post* devoted over two columns to an article by J. J. Mitchell, dealing with income taxes on securities. Next Monday the *Evening Sun* devoted three inches of its realty page to some remarks by the conductor of this shop. Then on Monday, the 14th, the *Women's Wear Daily* had this to say about Louis Simonoff, quoting the referee in bankruptcy: "It is my opinion that the accountant's testimony taken from the books is reliable and credible, and should be adopted."

From *Colliers* of March 19: "A bachelor friend of mine in Mississippi took it up with a married Certified Public Accountant, and they decided it was cheaper to pay the ten dollars tax than to support a wife." From the N.Y. *Mirror* of March 16: "Bookkeeping taught in three words: *Never Lend Them.*" From the N.Y. *Sun*, March 10: "The new Federal Tax Bill is not really a tax bill. It

is a vacuum cleaner. When a rich man passes on, an office full of tax agents becomes the next of kin."

W. M. Shaw, C.P.A. won a decision for his client, Sam Cook of Arkansas. (25 BTA 93) E. S. Gage, C.P.A. did likewise for E. B. Higley Company of Iowa. This case is interesting because the opinion distinguishes it from the Kirby Lumber case. (25 BTA 127).

T. A. Williams, C.P. A., of New Orleans, won a Rule 50 verdict (25 BTA 146). H. A. Mihills, C.P.A., did likewise for the Scovil Manufacturing Co., of Connecticut. (25 BTA 265).

The Old Mission Cement Co. case in which F. C. Rohwerder, C.P.A., figured in a rule 50 decision, presents some details about "contributions, subscriptions or donations" which are quite interesting. Only 25 out of 87 items were allowed as deductible. This case should prove valuable in assisting corporate taxpayers in determining the deductibility of such items. (25 BTA 305).

In a case (25 BTA 14) recently decided, the last sentence of the opinion is worth quoting: "Bookkeeping entries cannot prevail over facts."

We have been showing for years that B.T.A. findings of facts make fascinating reading in many cases. The stipulation in the Amtorg case (25 BTA 327) is most instructive as regards Soviet foreign trade. The Bolsheviks lost. And in this connection let us note that on March 10 we had the pleasure of hearing Professor Counts, of Columbia University, lecture on "Education in Russia." We enjoyed it.

Another case with an international flavor is Sir Robert Balfour's. (25 BTA 154).

We gratefully acknowledge the receipt of an eighty-page pamphlet by F. M. Babcock, of the University of Michigan. Its title is "Real Estate Valuation;" its contents are good.

The McGraw-Hill Company in a statement issued St. Patrick's Day announced its rules regarding the recognition of advertising agencies. Similar regulations are recommended by the Associated Business Papers, Inc. The whole statement is too long to reproduce here. The vital paragraph for us is:

"We require that any advertising agency desiring recognition furnish our company sufficient information of its financial condition to satisfy our credit requirements."

See our article in the March, 1925 issue.

W. B. Frese received his flat key at the University of Iowa but now teaches at the University of Illinois, from which State he holds a C.P.A. certificate. A. C. Littleton won his Ph.D. and key at the University of Illinois, where he is now an instructor. H. H. Baily, of the same staff is the holder of the Master of Arts degree, but fails to state what college awarded it to him.

All the foregoing neglected to give the years in which they won their honors. And we have several other names in our files for which such essential data are lacking. We have not the time to write each individual for amended information, but once more and for the last time, we will repeat what we want:

1. If you are the holder of three or more degrees (not counting certificates and licenses) when and where did you get them?
2. If you were elected to Phi Beta Kappa, Sigma Xi, Delta Mu Delta or Beta Sigma Gamma, what chapter elected you and in what year?
3. What states have granted you C.P.A. certificates, and when?
4. What other scholastic honors, including athletics (varsity letters) have you won? And when?
5. Don't forget those dates!

On a recent trip to Virginia we had lunch with Lee Rawlings and enjoyed hearing him relate some of his experiences. The habits of the sheriffs of certain counties in which Mr. Rawlings has practiced are somewhat disconcerting to the New Yorker, who fondly imagines that Tammany Hall is the only seat of irregularities.

The next day we were in Washington and learned something which had escaped us in all the years that we have been going to that wonderful city. The Naval Observatory houses one of the finest, if not the finest, collection of mathematical works in this country. Among them is a 1494 edition of Pacioli. The next time you go to Washington and have some time to spare take a Wesley Heights bus at

17th and K and go out to see this and other rare volumes of interest to all who deal with figures.

You may remember how *Alice in Wonderland* begins. She peeped into a book her sister was reading. "But it had no pictures or conversations in it, and 'what is the use of a book without them' thought Alice." We are not equipped to give you pictures, but Oldtimer and Co. are doing their best conversationally. Here they are!

"Do you know," said Blank, "the banking situation must be worse than I thought it was. I still think it is basically sound, but the attitude of the public needs vast improvement."

"What prompts that remark?" asked Oldtimer.

Blank responded: "For a good many years I have been contributing sporadic articles to a trade journal with a circulation of over one hundred thousand. I get paid for them too."

"Congratulations," interrupted the Kid.

"In January," continued Blank, "I prepared two brief articles dealing with checks; the first with the ordinary kind, pointing out in simple language the advantages, if not the necessity, of paying by check; and in the sequel the use of travelers' checks and kindred negotiable paper."

"Elemental," said the Kid.

"Of course," retorted Blank. "But you don't publish anything recondite in a trade journal of that kind. Anyhow after six weeks I got back the manuscripts. I was amazed. My first article had been submitted years ago as a venture. Ever since, most of my stuff had been at the request of the editor, and never a rejection. But this letter explained it." Blank reached into an inside pocket and produced it. "Listen: 'After mature deliberation I am obliged to return your good articles. They stress the need for keeping money in banks; of making the banker one's friend. That may be all right, but not now. The attitude of our readers is most hostile to all banks, due to the many failures, and I have on hand no less than six unsolicited articles condemning our banking system and demanding guarantee of deposits and other drastic remedies.' Now what do you think of that?"

"I think," said Oldtimer, "that your editor, whoever he is, is a coward. In the first place your subject matter was and is good at any time. 'Pay by Check' should be a universal business slogan, fostered by the banks. In the second place, and more important, just *because* his readers have no faith in banks, he should print it, to bolster up confidence. Let him print the other alleged side of the story too, so that he can avoid charges of bias."

"That's right," said Star, "but he won't do it. Editors are stubborn animals. They've got to be."

"Well," said Blank, "I found another trade journal editor who accepted the stuff."

"Fine," exclaimed the Kid. "But I'll bet that most of the demands for guarantee of deposits come from the very section of the country, around Nebraska, which has had such disastrous results with previous attempts. Those farmers won't learn."

"You're right," said Blank. "but you city slickers aren't so bright either. I'd like to have all the money which our little group dropped in the stock market since 1929, and we knew better."

"Ha," said Sinbad, "I didn't lose a cent there."

"No," retorted the Kid. "You had nothing to lose; you dropped it all in the Florida bubble."

"Hit, no change," laughed Sinbad, and then Oldtimer spoke:

"The pity of it is that guarantee of deposits ought to be the right thing. It is not, because to have it work successfully, a new race of men would have to be born; men who would accept administrative responsibilities; men possessed of a combination of honesty and ability rarely found. And when that day comes, we will have no corruption in Tammany; Chicago's taxes and teachers will all be paid; and—"

"I know," said the Kid, "every C.P.A. will have three hundred days a year work without overtime and a minimum fee of twenty-five dollars per diem."

"Yes," said Dash, "I went to church last Sunday and heard a fine sermon on the second coming of Christ. The preacher was sure He would come, but no one could say *when*."

"Virtuous man!" said the Kid. "What was

the matter; too rainy to golf?"

"Yes," retorted Dash, "but it does a man good to go to church once in a while, no matter what the cause."

"The saddest part of it all is," said Oldtimer, "that in nearly every church there is a Judas. The fiscal administration of most churches is quite inept. Incompetent people are permitted to handle the funds; weak ones are tempted by the lack of check, and presently the poor church finds itself with even less than it thought it had. My firm is now auditor for three of the largest churches here; but each engagement came only after serious defaults. There is room for a tremendous amount of accounting and auditing work in the religious field."

"Well, then," said the Kid, "why don't you go out and get it?"

"I wish I could," replied Oldtimer. "However there are difficulties. I may not advertise. I can't be a member of more than one church. And I couldn't afford to do many jobs at the rate we charge for the three we have."

"I thought as much," said the Kid. "The filthy lucre again."

"There is a remedy though," said Oldtimer. "Like most other things of the kind, time and patience are required. If each and every C.P.A. were to join a church and participate with reasonable zeal in its activities, he would soon find himself elected as church auditor. And any man can afford one such job."

"But suppose there are more than one accountant in the congregation?" asked Dash. "Should the work be divided among them?"

"Certainly," said Oldtimer. "An auditing committee could be appointed restricted to the C.P.A. members."

"In my congregation," said Dash, "there would be not less than twenty-seven members on the committee and what a fight there would be! No matter what system of rotation was used."

"Well, do they go without an audit on that account?" queried Oldtimer.

"No," replied Dash. "We have an audit. We need an audit. But we have it done by a man of an utterly different denomination."

## The Accountants' Club

The February issue of *Work Sheet*, the editorial organ of the Accountants' Club of America, Inc., has as its first item a message from President James F. Hughes, who was president of The American Society two years ago, and as its closing article a message from the editor. Sandwiched in between are accounts of its January meeting at which J. M. B. Hoxsey, Executive Assistant of the Committee on Stock List of the New York Stock Exchange, gave an interesting talk concerning the preparation of financial statements and the uses made of the same by the Committee on Stock List, and reports from the several club committees.

At the technical meeting of the Accountants' Club of America, held February 25, Walter A. Staub and Dr. Joseph J. Klein discussed the subject "The Trend in Federal Income Taxes." Dr. Klein referred to his appearance before the House of Representatives Ways and Means Committee as Chairman of the Committee on Federal Legislation of The American Society of Certified Public Accountants.

## A Business Story

One of the most interesting business stories which we have read recently appeared in the March 19 issue of *The Saturday Evening Post*, by Clarence Buddington Kelland. No accountant can read it without noting ways in which the points brought out may be utilized in connection with his practice.

In short, a business established by the father of the present owner was just ready to be wiped out of existence. The present owner was advised that he should study the business from the standpoint of a prospective buyer rather than from the standpoint of an actual owner. The result of the study was the discovery that the manufacture of the article originally marketed by the father when the business was established, was still producing a profit, all of which, and more, however, was being absorbed by the losses sustained in attempting to develop and build a profitable market for a dozen lines which had been added in the natural desire to expand.

# C. P. A. Examination Questions\*

November, 1931

## Practical Accounting

### Problem 6:

From the following information, you are asked to prepare a balance sheet as of June 30, 1931, of the M Company which is to be used for credit purposes, and statements for the year ending June 30, 1931, of profit and loss and of cost of goods sold.

Account	Trial balance June 30, 1931	
	Dr.	Ct.
First National Bank .....	\$ 5,675.13	
Notes receivable (for machines sold on deferred time payments) .....	200,435.17	
Accounts receivable (for machines sold on open account and for repairs) .....	100,128.35	
Reserve for loss on customers' receivables .....		\$ 6,613.77
Unexpired fire insurance premiums .....	749.49	
Cash surrender value of officer's life insurance policy on which the M Company is beneficiary .....	773.50	
Material inventory, June 30, 1930 .....	16,708.35	
Material purchases, July 1, 1930, to June 30, 1931 .....	94,790.57	
Cost of material used in manufacture and cost of repairs sold .....		87,873.15
Factory and office equipment .....	8,398.54	
Reserve for depreciation of factory and office equipment ....		5,831.47
Automobiles used by salesmen .....	5,590.00	
Reserve for depreciation on automobiles .....		615.60
Accounts payable .....		5,213.12
Salesmen's commission ledger .....	10,731.40	
Accrued officer's salary .....		2,325.84
Accrued office and factory salaries .....		435.67
Unearned income from finance charges at June 30, 1930 ....		6,225.00
Reserve for advertising .....		5,860.00
Dividends payable on common stock, declared August 2, 1930 .....		47,000.00
Dividends paid on preferred stock, fiscal year ending June 30, 1931 .....	3,500.00	

\*The Service of Examination Questions conducted by The American Society furnishes practically twice as many questions in Theory, Auditing, Commercial Law, and Economics and Public Finance as could be used by any State Board for a four-hour examination period, and twice as many problems in Practical Accounting as would be required for two examination periods of four to five hours each. A Board using the service makes its own selections and adds any special questions or problems which it desires. Eight boards used the November, 1931, service. Every suggested question or problem, except two, was selected by at least one Board, and only five were selected by every Board. Two boards added questions with a local bearing. Part of the problems in Practical Accounting follow, part having appeared in the January issue.

Capital stock, 7% preferred, par value \$100.00 per share, authorized and issued .....	50,000.00
Capital stock, 2,000 shares of common stock, no par value, authorized and issued .....	10,000.00
Surplus .....	62,147.19
Machine sales, 586 units at \$600 each .....	351,600.00
Machine repair sales .....	35,729.34
Material cost of machines manufactured .....	83,741.90
Material cost of repairs sold .....	4,131.25
Direct labor on machines manufactured .....	18,000.86
Direct labor on repairs sold .....	3,000.14
Indirect labor—Superintendent's salary .....	4,800.00
Freight and cartage on machines shipped .....	2,144.30
Parcel post and shipping expense on repairs sold .....	2,532.96
Rent for factory and general office .....	7,200.00
Power and light—Factory .....	1,342.18
Depreciation—Factory equipment .....	639.85
Fire insurance expense .....	968.50
Personal property tax .....	452.50
Commissions allowed salesmen .....	42,662.85
Miscellaneous sales expense .....	6,342.95
Officer's salary .....	24,000.00
Office salaries .....	10,298.50
Printing and advertising .....	14,834.27
Depreciation on automobiles and fixtures .....	1,597.50
Premiums on officer's life insurance policy .....	753.90
Loss on bad accounts .....	3,673.29
Other general expenses .....	13,071.79
Interest and finance charges earned on deferred time sales ....	16,199.84

Totals .....\$693,669.99 \$693,669.99

The books of the M Corporation are on the accrual basis, with the fiscal year ending June 30. The company is engaged in the manufacture and sale of a paint-spraying machine. The sales price of the machine is \$600.00 if paid for in cash within thirty days. A charge of \$30.00 is made for interest and financing expense on deferred payment sales which are evidenced by conditional-sales contracts and twelve notes payable monthly.

During the past fiscal year the company adopted the policy of sending machines out on sixty days' trial. The bookkeeper regards such trial orders as regular sales. At June 30, 1931, an analysis of accounts receivable disclosed forty trial orders. Of this number, twenty machines were placed by salesmen on which a credit of \$100.00 per machine had been made in their unearned commission accounts in the salesmen's commission ledger.

An analysis of the salesmen's commission ledger discloses the following condition:

Particulars	Cash Advances	Unearned Commission
Accounts with—		
Former salesmen, considered uncollectible ....	\$ 6,342.50	\$ 100.00
Active salesmen .....	18,345.90	13,857.00
Totals .....	\$24,688.40	\$13,957.00



The twenty trial sales mentioned above were made by active salesmen. In view of the past experience of the company with drawing accounts of active salesmen, a reserve of 50 per cent of the excess of advances over unearned commissions should be established.

As authorized by the Board of Directors, the president of the company, owner of 50 per cent of the outstanding stock, and the only officer receiving compensation for his services, is given as salary an amount equal to 25 per cent of the annual net profit of the company before deducting Federal income tax and the salary as an expense. During the year the bookkeeper has made an entry each month debiting officer's salary account and crediting accrued officer's salary account for \$2,000.00.

In the manufacture of the paint-spraying machines, the M Company buys the castings and other parts required to assemble a complete machine. A perpetual inventory record is maintained, and at June 30, 1931, all records including the accounts in the general ledger were adjusted to conform to the physical inventory taken on that date. Test-checks indicate that the pricing is at cost or market, whichever was the lower, and that extensions, footings, and quantities were correct. No completed or partially completed machines were in stock at either the opening or closing inventory dates.

You are to consider that three-fourths of the rent, fire insurance, and personal property tax is applicable to the factory and the balance to the general office. Also, all factory overhead is to be distributed between the cost of machines manufactured and the cost of repair sales on the basis of direct labor cost.

For the purpose of establishing a reserve for magazine advertising to be used during the ensuing fiscal period, the company authorized the bookkeeper to debit printing and advertising account and credit reserve for advertising account \$10.00 for each machine sold during the current fiscal period.

The reserve for loss on customers' receivables is considered ample.

The Federal income tax liability of the M Company should be determined as of June 30, 1931, at 12 per cent.

#### Problem 7:

In January, 1928, the Geneva Park Estates (a common law trust) purchased a 640-acre tract of land on Pine Lake for the sum of \$100,000.00. A portion of the tract, to be known as Unit No. 1, and valued at two-fifths of the cost of the tract, was immediately subdivided into 200 lots which were equally priced and offered for sale on terms requiring annual payments of ten per cent of the contract price. The sales prospectus stipulated that the Geneva Park Estates was to lay out roads, install water service and build a pier on the lake front. Competent engineers estimated that these improvements would cost \$10,000.00, and up to and including December 31, 1930, a total of \$8,465.73 had been spent thereon, with good prospects of the work being finished for the estimated amount. The improvements conferred equal benefits on each of the 200 lots.

A set of books was opened in January, 1928. Lot sales and the profit therefrom were handled according to the "cost-recovery" method whereby cash collections are first applied to the recovery of costs, and after such costs are recovered, further collections are considered as earned gross profit. When a sale was made, the bookkeeper debited accounts receivable, Unit No. 1, and credited unearned gross profit on sales; at the same time he debited unrecovered cost of lots sold, Unit No. 1, and credited inventory of unsold lots, Unit No. 1, for the cost of the lot. At the end of each year a journal entry was made adjusting the accounts of the unrecovered cost of lots sold and unearned gross profit on sales, according to the cash collections received during the year.

In 1931, the manager of the trust, believing that it would be more advantageous to accrue income by the "instalment" rather than "cost-recovery" method, hands you the following cumulative trial balances together with certain other information and asks you to prepare (1) the necessary adjusting journal entries to effect the change including therein a recomputation of costs based on good accounting practice, (2) a statement of profit and loss in columnar form for the years 1928, 1929, and 1930, respectively, and (3) a balance sheet as of December 31, 1930:

Accounts	Cumulative Trial Balance December 31		
	1928	1929	1930
Debit balances—			
Cash in bank .....	\$ 1,994.34	\$ 1,097.37	\$ 2,216.26
Petty cash .....	50.00	50.00	50.00
Accounts receivable—Unit 1 .....	17,425.00	33,440.00	53,940.00
Sundry receivables .....	275.00	695.00	1,100.00
Inventory of unsold lots—Unit No. 1	36,000.00	32,000.00	24,000.00
Inventory of unsubdivided acreage ...	60,000.00	60,000.00	60,000.00
Unrecovered cost of lots sold .....	1,425.00	1,440.00	1,500.00
Tractor, tools, and implements .....	700.00	700.00	700.00
Office furniture .....	300.00	300.00	300.00
Improvements in Unit No. 1 .....	3,500.00	7,385.46	8,465.73
Improvements in unsubdivided acreage	3,500.00	5,040.42	6,825.92
General and administrative expenses ..	3,349.58	6,698.75	9,345.68
Commissions paid on sale of lots ...	2,000.00	5,000.00	9,752.50
Interest paid .....	375.00	1,285.50	1,835.65
Total debits .....	\$130,893.92	\$155,132.50	\$180,031.74
Credit balances—			
Accounts payable .....	\$ 2,093.67	\$ 916.58	\$ 1,213.63
Notes payable .....	10,000.00	17,000.00	10,000.00
Capital account .....	100,000.00	100,000.00	100,000.00
Earned gross profit on sales .....	...	...	7,560.00
Unearned gross profit on sales .....	17,425.00	33,440.00	53,940.00
Interest earned .....	1,375.25	3,775.92	7,318.11
Total credits .....	\$130,893.92	\$155,132.50	\$180,031.74

Sales of lots for the three years were as follows:

Year	Particulars	Amount
1928	20 lots at \$1,000.00 each .....	\$20,000.00
1929	20 lots at \$1,000.00 each .....	20,000.00
1930	40 lots at \$ 900.00 each .....	36,000.00

Cash collections were:

Year	Particulars	Amount
1928	on 1928 sales .....	<u>\$ 2,575.00</u>
1929	on 1928 sales .....	985.00
	on 1929 sales .....	<u>3,000.00</u>
	Total .....	<u>3,985.00</u>
1930	on 1928 sales .....	4,000.00
	on 1929 sales .....	5,000.00
	on 1930 sales .....	<u>6,500.00</u>
	Total .....	<u>\$15,500.00</u>

In lieu of depreciation on the tractor, tools, and implements, and office furniture, the total is to be treated as an additional cost of development and pro rated on the basis of the original cost of the tract.

Disregard Federal income tax liability, if any.

#### Problem 8:

The net worth section of the balance sheet of the Simmons Athletic Company at December 31, 1929, appeared as follows:

##### Capital stock—

6% cumulative preferred stock; authorized and outstanding, 1,000 shares, par value \$100.00 \$100,000.00

No-par common stock; 40,000 shares authorized, 10,000 outstanding (no minimum or stated value) 42,030.00

Paid-in surplus 50,000.00

##### Earned Surplus—

Balance—January 1, 1929 \$ 36,419.27

Profit for year ending December 31, 1929 11,630.41

48,049.68

Total net worth \$240,079.68

No dividends have been paid on the preferred stock for three years.

At a meeting of the preferred and common stockholders on May 15, 1930, a resolution was passed whereby 20 shares of no-par common stock were to be issued for each share of preferred stock and dividends accrued thereon to December 31, 1929.

The Board of Directors at a meeting on December 28, 1930, voted a 4 per cent stock dividend payable in no-par common stock to common stockholders of record on that date; they also voted a bonus of 4,528 shares of no-par common to certain officers for past services, to be issued to them on December 31, 1930.

You are required (a) to set up the net worth section of the balance sheet as it should appear on December 31, 1930, showing changes in the capital stock and earned surplus sections of the balance sheet during the year, and (b) to compute the book value of each share of common and preferred stock at December 31, 1930.

A. M. Fare's taxable gross income for the calendar year 1930 consisted entirely of gains and losses from stocks and bonds and other assets owned by him. Mr. Fare is unmarried. His secretary has prepared the following summary of transactions from which you are asked to determine his liability for Federal income tax for that year:

1930		
January 7	Sale to Field Museum of Natural History of prehistoric pottery received as gift from Ojibway Indians in 1922 . . . . .	\$ 523.15
January 28	Sale of stock rights in Larson Company, representing rights to purchase 20 shares of common stock on 100 shares of common stock purchased in 1929 at \$43.40 per share and having a market value today of \$36 per share, ex-rights [you are to pro-rate cost] . . . . .	120.00
May 6	Sale of 50 shares of above stock of Larson Company . . . . .	1,750.00
May 8	Sale short of 50 shares of Larson Company stock; covered two weeks later by remaining 50 shares owned . . . . .	1,325.00
June 9	Purchased for cash a \$5,000.00 first mortgage, dated January 2, 1930, and maturing January 2, 1935, for \$4,500.00; discount . . . . .	500.00
July 29	Received in a financial reorganization of an office building in which Mr. Fare owned \$1,000.00 in first mortgage bonds originally purchased at par, cash settlement of . . .	250.00
October 10	Liability of \$7,600.00 to stock brokerage house on margin account closed in 1929 through selling out stocks, profits and losses on which were reported in 1929, compromised for \$3,800.00.	
November 10	Received insurance of \$500.00 on a robbery in which the following items were stolen—	
	Watch and rings, at cost . . . . .	\$750.00
	Cash . . . . .	125.00
		<hr/>
		\$875.00

November 15	Sold 100 shares Bright Moon A common stock, costing \$2,900.00 for \$350.00.	
December 1	Renewed Subscriptions expiring November 30 to the following financial services—	
	Moody's Investors' Service .....	\$250.00
	Investors' Counsel Service .....	500.00
	Wall Street Journal .....	25.00
December 6	Bought 200 shares Bright Moon A common stock for \$600.00.	
December 31	Summary of 1930 operations of a 36 apartment building—	
	Rents collected .....	\$22,320.00
	Expenses paid—	
	Real Estate taxes .....	1,426.00
	Interest on bonds outstanding.....	7,200.00
	Operating expenses .....	6,212.00
	Total expenses .....	\$14,838.00
	Net profit .....	\$7,482.00
	The building was constructed in 1926 at a cost of \$210,000.00. Depreciation is deductible at the rate of 2½% per annum.	
December 31	Contributions for the year consisted of the following—	
	United Charities .....	\$50.00
	Church .....	75.00
	Republican campaign fund .....	25.00
	Pledge to Pittsfield University on which \$100.00 was paid in 1930 .....	500.00
December 31	Interest and dividends were received as follows:	
	Interest—	
	On 2% tax-free covenant bonds .....	\$3,560.00
	On other bonds, mortgages, and bank balances .....	1,357.50
	On Fourth 4¼% Liberty Loan Bonds....	212.50
	Dividends—	
	On domestic stocks .....	8,795.00
	On Canadian railroad stocks .....	27.50
December 31	Alimony paid in 1930 (no children) .....	2,400.00

## Tax rates for 1930:

## Normal—

1½%	on first \$4,000.00.
3%	on second \$4,000.00.
5%	on balance.

## Surtax—

Amount	Rate
0 - \$10,000.00 .....	
\$10,000.00- 14,000.00 .....	1%
14,000.00- 16,000.00 .....	2
16,000.00- 18,000.00 .....	3
18,000.00- 20,000.00 .....	4

## Problem 10:

Certain stockholders and directors of the R Dairy Company became suspicious of the integrity of the vice-president and general manager; they engaged Orville Hemingway as their representative to take over the business and to continue operations until such time as he could reach a decision as to the desirability of continuing the business. Although the books had been audited at December 31, 1929, it was agreed to dispense with the 1930 audit.

Mr. Hemingway took actual possession of the property on January 16, 1931, but his stewardship is to date from January 1, 1931. He operated the business until August 31, 1931, when you were called in to audit the books.

Prepare a working paper which will indicate the adjusted real and nominal accounts at December 31, 1930, and August 31, 1931.

You are given the following financial statements as of December 31, 1930, prepared by the company's bookkeeper:

## EXHIBIT I

R DAIRY COMPANY  
BALANCE SHEET — DECEMBER 31, 1930  
ASSETS

## Current Assets:

Cash on hand and in banks.....		\$ 6,646.83
Accounts receivable .....	\$73,468.31	
Reserve for bad accounts .....	6,652.80	
		66,815.51
Inventories .....		49,002.20
Prepaid expenses—		
Insurance .....	1,830.00	
Rent .....	700.00	
		2,530.00
		\$124,994.54

## Machinery, Automobiles, Etc.:

Particulars	Cost	Reserve for Depreciation	Cost
Machinery and equipment .....	\$32,751.25	\$21,248.75	\$11,502.50
Automobiles .....	16,250.52	9,944.45	6,306.07
Horses and wagons .....	5,562.46	2,064.54	3,497.92
Furniture and fixtures .....	4,549.34	1,890.22	2,659.12
Totals .....	\$59,113.57	\$35,147.96	\$23,965.61
			23,965.61
Goodwill .....			29,703.10
Total Assets .....			\$178,663.25

## LIABILITIES AND NET WORTH

## Current Liabilities:

Accounts payable .....	\$36,759.32
Employees' deposits .....	10,000.00
Notes payable .....	3,250.00
Federal income tax .....	1,130.90
	\$51,140.22

## Net Worth:

## Capital stock—

6% cumulative preferred stock, authorized  
and outstanding, 500 shares, par value

\$100.00 ..... \$50,000.00

No-par common stock, 10,000 shares at a  
declared value of \$5.00 .....

50,000.00

100,000.00

## Surplus—

Balance—January 1, 1930 .....

19,579.74

Profit—Year ending December 31, 1930

(Exhibit II) .....

7,943.29

27,523.03

127,523.03

Total liabilities and net worth .....

\$178,663.25

## R DAIRY COMPANY

## EXHIBIT II

## STATEMENT OF PROFIT AND LOSS, YEAR ENDING DECEMBER 31, 1930

Particulars	Amount
Net Sales .....	\$416,440.08
Cost of Sales (Exhibit III) .....	272,527.30
Gross profit .....	\$143,912.78
Selling and Administrative Expenses:	
Drivers' wages .....	\$63,695.51
Maintenance—Delivery equipment, including depreciation. ....	19,236.10
Other selling expenses .....	15,341.99
Officers' and general salaries .....	33,340.00
Other administrative expenses, including depreciation and interest .....	3,224.99
	134,838.59
Net profit, before taxes .....	9,074.19
Federal Income Tax .....	1,130.90
Net profit (Exhibit II) .....	7,943.29

## R DAIRY COMPANY

## EXHIBIT III

## COST OF SALES, YEAR ENDING DECEMBER 31, 1930

Particulars	Amount
Inventory—January 1, 1930 .....	\$ 23,632.72
Purchases .....	194,107.73
Totals .....	\$217,740.45
Inventory—December 31, 1930 .....	49,002.20
	\$168,738.25
Dairy Expenses:	
Dairy labor .....	\$56,406.57
Dairy supplies, including cases, cans and bottles. ....	19,520.59
Rent .....	8,400.00
Other dairy expenses, including insurance and depreciation .....	19,461.89
	103,789.05
Total cost of sales .....	\$272,527.30

The following facts were also discovered by you:

(1) Mr. Hemingway has kept no books for the eight months he had charge of the business.

(2) Cash receipts from January 2 to January 5, 1931, were entered in the 1930 records and include the following:

Accounts receivable .....	\$24,361.18
Cash Sales .....	666.06
Total .....	<u>\$25,027.24</u>

(3) Checks dated in 1931, totaling \$14,391.05 were issued and entered on the books in 1930 and the following accounts were charged:

Accounts payable .....	\$11,000.05
Dairy supplies .....	3,391.00
Total .....	<u>\$14,391.05</u>

(4) Included in accounts receivable at December 31, 1930, were uncollectible accounts against former employees totaling \$19,624.85. Collectible accounts of employees at December 31, 1930, totaled \$1,611.12 and at August 31, 1931, \$2,461.29.

(5) The sales journal contained false entries made in 1930 overstating sales and accounts receivable by \$11,442.92.

(6) Analysis of the inventories at December 31, 1930, and at August 31, 1931, shows the following:

Particulars	December 31, 1930		August 31, 1931
	Per Books	Actual	Actual
Merchandise .....	\$29,379.02	\$19,773.76	\$14,304.99
Cases, cans and bottles..	19,623.18	7,652.76	6,331.56
Totals .....	<u>\$49,002.20</u>	<u>\$27,426.52</u>	<u>\$20,636.55</u>

(7) Cash receipts from January 1, 1931, to August 31, 1931, were:

Bank loan, less interest .....	\$ 29,550.00
Employees' accounts .....	4,565.03
Customers' accounts collected .....	208,000.03
Collected from insurance company .....	16,250.00
Cash sales .....	<u>26,105.00</u>
Total, including \$25,027.24, recorded in 1930,	<u>\$284,470.06</u>

The obligation to the bank is a ninety-day loan due September 15, 1931, and bears interest at the rate of 6 per cent.



(8) Cash disbursements from January 1, 1931, to August 31, 1931, were:

Notes payable .....	\$ 8,785.00
Accounts payable, including 1930 liabilities of \$7,093.75 which were not on books.....	135,510.88
Federal income tax .....	1,130.90
Merchandise purchased .....	3,435.90
Dairy labor .....	24,567.60
Dairy supplies .....	2,131.70
Rent .....	5,600.00
Other dairy expenses .....	3,834.10
Drivers' wages .....	32,546.17
Other selling expenses .....	2,492.90
Maintenance, delivery equipment .....	7,986.54
Employees' accounts .....	5,415.20
Officers' and general salaries .....	13,197.31
Receivers' fee .....	5,000.00
Total, not including post-dated checks of \$14,391.05 .....	<u>\$251,634.20</u>

The 1930 liabilities of \$7,093.75 were entirely for merchandise.

(9) Sales on account from January 1, 1931, to August 31, 1931, were \$202,143.57.

(10) Purchases on account from January 1, 1931, to August 31, 1931, were:

Particulars	Amount
Merchandise not including \$7,093.75 unrecorded purchases at December 31, 1930 .....	\$109,178.75
Dairy supplies .....	2,512.13
Other dairy expenses .....	5,112.90
Other selling expenses .....	1,884.16
Other administrative expenses .....	1,965.22
Total .....	<u>\$120,653.16</u>

(11) New equipment, scheduled below, was purchased on June 30, 1931. 6% notes were issued, the interest on which was paid to August 31, 1931, and included in other administrative expenses.

Particulars	Amount
Cost of new machinery purchased .....	\$26,250.00
Allowance on old equipment .....	1,000.00
Notes payable .....	<u>\$25,250.00</u>

The book value at December 31, 1930, of the equipment traded in was as follows:

Particulars	Amount
Cost .....	\$22,623.92
Reserve for depreciation .....	19,101.29
Book value .....	<u>\$3,522.63</u>

## (12) Depreciation rates in effect are:

Machinery .....	10%
Automobiles .....	25
Horses and wagons .....	16%
Furniture and fixtures .....	10

Depreciation on machinery purchased July 1, 1931, should be charged for two months only.

(13) Mr. Hemingway discovered that the general manager in collusion with the bookkeeper had padded the payrolls in 1930, thereby withdrawing funds amounting to \$16,250.00 which were collected in full from the insurance company in 1931.

The expense accounts overstated were:

Account	Amount
Dairy labor .....	\$10,125.00
Drivers' wages .....	6,125.00
Total .....	<u>\$16,250.00</u>

## (14) Uncollectible accounts receivable at August 31, 1931, were:

Particulars	Amount
1930 accounts .....	\$11,523.68
1931 accounts .....	2,122.10
Total .....	<u>\$13,645.78</u>

It is estimated that \$2,632.67 will be sufficient to absorb all other bad debt losses. No bad debts were written off in 1930.

## (15) The income tax liability at December 31, 1930, was computed thus:

Particulars	Amount
Profit per books .....	\$9,074.19
Non-deductible expense .....	350.00
Taxable income .....	<u>\$9,424.19</u>
Tax at 12% .....	1,130.90

## (16) The correct prepaid insurance and prepaid rent at December 31, 1930, and August 31, 1931, were:

Particulars	December 31, 1930	August 31, 1931
Unexpired insurance .....	\$1,830.00	\$2,495.79
Prepaid rent .....	700.00	700.00

## (17) Good will was computed as follows:

Particulars	Amount
10,000 shares no-par common stock at stated value of \$5.00 .....	\$50,000.00
Actual cash received .....	20,296.90
Charged to goodwill .....	<u>\$29,703.10</u>

## Commercial Arbitration News

A RECORD of 2,567 controversies submitted by disputants for adjudication in the Arbitration Tribunal, with the confirmation of arbitrators' awards carried to higher courts in only ten instances and every disputed award upheld by the courts, is one of the achievements noted in the recently issued report of the American Arbitration Association covering the six years of its existence. Matters arbitrated have covered nearly every kind of commercial dispute, from controversies arising out of mergers of corporations and dissolutions of partnerships to claims for household goods damaged in moving. Amounts involved in these claims have reached several millions of dollars, while in many cases the controversy concerned questions of rights under agreements or performance of contracts.

During the six-year period the association has completed its national system of arbitration by installing facilities for arbitration in 1,700 cities and in many trade groups. It has conducted arbitrations under this system at an average cost of one per cent of the claims involved, while its record for speed has been the disposition of 75% of its cases in one hearing. Plus this high speed and low cost, no decision rendered under its system has ever been reversed by a court, and the impartiality and integrity of its arbitrators have been maintained in practice and sustained by the courts whenever parties have sought to reverse an award on this ground.

More than 5,200 parties have appeared in the matters submitted to arbitration and approximately 3,000 men have served as arbitrators, generally without compensation as a public service to industry and trade.

In the beginning of the practice of commercial arbitration in the United States, most of the cases came from business men who were in controversy and who exercised submissions of their difference to arbitration. Today, according to the records of the association, seventy-eight per cent of the cases placed in arbitration come out of contracts in which the parties have agreed to submit to arbitration any disputes arising thereunder.

When the American Arbitration Associa-

tion was organized in 1926, there were only three states in which a comprehensive arbitration law was in effect—New York, New Jersey, and Massachusetts. Since that time ten states have been added to the list—Arizona, California, Connecticut, Louisiana, Pennsylvania, New Hampshire, Ohio, Oregon, Rhode Island, and Wisconsin, so that now these modern laws, the principal features of which have to do with the validity and irrevocability of arbitration clauses and the enforceability of awards, are in effect in states in which 56% of the country's manufactured products originate. These State laws are in conformity with the United States Arbitration Act, which was declared constitutional by the Supreme Court of the United States in a decision handed down by Chief Justice Hughes on January 4, 1932.

Other accomplishments during the period covered by the report include the development of arbitration from a more or less indefinite procedure to a standard practice under a "Code of Arbitration Practice and Procedure," the establishment of arbitration facilities for the settlement of disputes growing out of trade between the United States and Great Britain and operating either in New York or London, and facilities in New York City for the arbitration of disputes arising between business men of the United States and Latin American republics.

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### George Washington

The March issue of *The Analyst*, published by the School of Accounting, Commerce and Finance of St. Johns' College, contained a very interesting article on George Washington as a Captain of Industry. In summing up, the statement is made that at the time of his death his total wealth was three-quarters of a million dollars, exclusive of his wife's property, making him the second wealthiest man in the United States. At that time there was but one millionaire in the country. He was the largest land holder of his day, having an estate of 60,202 acres in addition to small parcels in eight different cities.

## OUR READERS' FORUM

Contributions for this section will be limited to in the neighborhood of 250 words. A free but short expression of opinion is requested on subjects in which the certified public accountant is interested.

### AN INTERESTING TAX PROBLEM

(Comments invited)

THE taxable income of "A" who is a citizen of the State of North Carolina, under the State Income Tax Laws, for the year 1931 amounted to \$20,000, of which, \$10,000 were dividends from the R. J. Reynolds Tobacco Co., a Delaware corporation, with its principal business in the State of North Carolina. Only 83% of the income of this corporation is subject to the North Carolina income tax laws. The income tax rate of corporations is  $5\frac{1}{2}\%$ .

The problem is to determine the income tax of "A" on his \$20,000.00 income. In order to do so, it is necessary to refer to certain sections of the law governing the tax of individuals.

Section 310—The rates applied to the income of individuals are graduated as follows:

First	\$ 2,000.00	2 %
Second	2,000.00	3 %
Third	2,000.00	4 %
Fourth	2,000.00	5 %
Fifth	2,000.00	$5\frac{1}{2}\%$
In excess of	10,000.00	6 %

Section 215—Section 215, paragraph "G" in effect, gives the individual an option of either returning his foreign stock (foreign corporations are those incorporated under the laws of another State) for ad valorem taxes, or pay the income tax on any dividends received from such stock. Citizen "A" did not list his stock for ad valorem taxes.

Section 311 $\frac{1}{2}$ —The following is a quotation of the entire section:

"Income from stock in foreign corporations, either in cash or stock dividends, received by individuals, fiduciaries, partnerships, or corporations, resident of this State, or by a non-resident fiduciary held for a resident of this State, as a condition of exemption of such shares of stock from ad valorem

taxation, conditionally provided in section 215 (g) of this act, shall be subject to a tax of six per cent (6%), without exemption or deduction for any cause, except as provided in this section, and upon failure to report such income and pay the tax herein imposed, the holder of such shares of stock shall be liable for the ad valorem tax on such stock at the place of residence of the owner. Every individual, fiduciary, partnership or corporation owning such shares of stock, and receiving dividends from same, shall report such income to the Commissioner of Revenue, at the times required by this act for reporting other income, and in a separate schedule on the income tax blanks to be provided by the Commissioner of Revenue for that purpose, and shall pay the tax herein imposed at the same time and in the same way as tax upon other income is payable. With respect to foreign corporations domesticated in North Carolina and paying a tax in this State on a proportionate part of their total income, the holder of shares of stock in such corporations shall be entitled to deduct from the total tax imposed in this section, an amount equal to the percentage of the corporation's North Carolina tax rate for the year applied on an amount representing the percentage of such dividends equalling the percentage of the corporation's income on which it paid income tax to the State of North Carolina for the year in which said dividends are paid, so that the total tax paid on such income shall in no case be less than five per cent of that proportion of the dividends received on which the corporation paid no income tax to the State of North Carolina plus an amount equal to the difference between what the tax on the balance of said dividends would be figured at the corporation's North Carolina income tax rate and what it would be figured at the rate provided for the individual stockholder."

## NOTES

James H. Collins, in the February issue of *Southern California Business*, tells the story of an eastern manufacturer of fire equipment who worked out a plan that did not need congressional activity to set it in motion.

He asked for volunteers from his salesmen all over the country in a ten-day attempt to put that particular business on the road to prosperity. The salesmen were asked to make a list of twenty prospects every night, to start calling on them at nine the next morning and work steadily until five, to waste no time between calls, to write the results on each call, to write a report every night and to drop the word "depression" during the ten days.

Every salesman volunteered regardless of whether he wanted to or not. The records show that for ten days the men averaged seven hours a day instead of three or four, nine calls a day instead of from three to six. Sales rose 274% in number and 90% in dollar value. The problems of that factory were solved, for at the end of ten days all the salesmen started out on a month's campaign.

That manufacturer believed that he was rendering a service to the public by providing it with the product which he was making. He believed that his product could be sold if the salesmen believed as he did and worked. He secured their coöperation in his attempt to solve his particular problem and everyone connected with the organization was benefited thereby.

Wilbur K. McKee, of New York University, speaking before the monthly meeting of the New York Chapter of the National Institute of Credit Men on "A New Day for the Credit Executive," as reported in the March issue of *Credit Executive*, the official organ of the New York Credit Men's Association, said among other things: "The accountants were the first business group to lead the way in the search for the security and respect of the public that has always been commanded by the professional man. Their degree of C.P.A., and their insistence upon professional preparation and initiation inspired other business groups to follow in the same path. Here the credit man has not been slow to follow." Thanks for the compliment. However,

"C.P.A." is not looked upon by the profession as a degree but rather as a title granted by the profession itself, as represented by the various State Boards of Accountancy, to those who have demonstrated by an examination that they may be trusted to carry on an accounting practice with the endorsement of the active practitioners in their own group.

An old auction bill, printed in 1850, contains some advice which the *Michigan Manufacturer and Financial Record* for February 6, says is very pertinent to the present day and generation. Its most striking sentence is quoted: "If people would whistle more and whine less, hustle more and holler less, work more and worry less, boost more and beef less, give more and grab less—business would be a darn sight better."

The *Credit Executive*, official publication of the New York Credit Men's Association, presented in its February issue a very interesting article by J. Pryse Goodwin on "Loss Prevention by Avoiding Receiverships."

The Bureau of Business Research, University of Illinois, has recently issued Bulletin No. 40, "A Demonstration of Ratio Analysis." This is the result of a study of 173 companies which have qualified securities under the Illinois Security Act. The purpose of the study was to ascertain the extent to which an analysis by means of balance sheet ratios, would have indicated the companies that were most likely to survive (as proven by subsequent operations). The results showed that ability to distinguish between prospective successful and prospective unsuccessful companies through balance sheet ratios proved that much more importance should be placed in a ratio analysis of new companies in the future than has been utilized in the past.

Recent estimates of the Department of Agriculture show that 59% of the farms in the United States operated by their owners were free of mortgage debt in 1930 as compared with 63% in 1920. The further statement is made that 38% of the mortgaged farms are mortgaged for over half their value and that 5% are mortgaged for more than their entire value.

The February 29 issue of *Domestic Commerce* contains an interesting chart relating to the financing of concerns that had failed in New Jersey. The first figure shows that the sources of capital at the time of organizing 420 business establishments which had failed in 1929 and 1930 had been as follows:

Entirely from owners—45.2%.  
From friends or relatives—11.3%.  
Wholesalers, jobbers and manufacturers—16.9%.  
Fixtures manufacturers—4.8%.  
Banks—18.2%.  
Miscellaneous—3.6%.

The second figure indicated that, exclusive of mortgages on real estate and liabilities for notes endorsed for others, the creditors of 476 business establishments which failed in the same period were divided as follows:

Due wholesalers, jobbers and manufacturers—35.6%.  
Individuals—15.1%.  
Preferred claims, taxes, rents, etc.—6.6%.  
Banks—20.2%.  
All others—22.3%.

Comparison of the two figures shows that the bankers' interest at the time of failure was only 2% greater than his contribution to the capital at the time of organization, but that the wholesalers, jobbers and manufacturers had claims against the failed concerns of more than double in percentage what was represented by their original investment to the permanent capital.

In the March *World's Work* Paul Hollister, Vice-President of Batten, Barton, Durstine & Osborn, presents a very interesting article on "Advertising Grows Up." In it he refers to a Code of Rules for retail advertising prepared by one of the New York newspapers which "stated simply that no invidious comparison of whatever kind might be made in its columns by any advertiser concerning another." In reality "this was censorship on a new level of common sense and on a new footing of candor for the buying public." "It means that in the advertising of any store there must be no reference to similar merchandise offered by any other store except it be comparison favorable to the other store which is not likely to happen this week." "It means that no store, within the letter of the Code, may say, 'You will find our prices lower, our values

higher, than anywhere else'." "It means that no store may say that it has a department larger than another, nor a stock broader nor more buyers nor keener foreign stylists nor brighter glassware nor better taste nor more cubic feet of this, that, or the other."

One State Board of Accountancy has two standards by which it measures the professional code of its certificate holders. It does not hesitate to classify as "unprofessional" any comparison of service which an accountant can render or hope to render to prospective clients with services rendered by other certificate holders. This is merely placing on a profession the same responsibility which at least one newspaper has found to be not only advisable but necessary in the interest of the buying public.

The February *Bulletin of Business Research* of the College of Commerce and Administration, Ohio State University, has an extremely interesting article on business conditions in Ohio and Ohio cities, the article containing eight tables and two charts. This is supplemented by a second article on "The Trend of Business," illustrated by nine tables and one chart and by a special article on the "Construction Activity in Ohio" with five tables.

B. A. Kiekhofer, of Milwaukee, is a member of the Board of Visitors to the University of Wisconsin, appointed by the alumni.

Duncan MacInnes, C.P.A., would have retired as Chief Accountant of the Finance Department of New York City under the age rule in January of this year. The Board of Estimates, however, passed a resolution under which he will remain in office for at least another two years. May his health be so good at that time that the Board of Estimates will grant him another renewal of life.

Harry F. Atwood, one of the strongest supporters of Constitutional Government, not by reason of his interest in any particular phase but as the result of a careful and life-long study of its provisions, lists the relations of the American statesmen to the Constitution as follows: Franklin prepared the Constitution; Hamilton forced its ratification; Washington created, Webster expounded, Marshall interpreted and Lincoln preserved it.

## STATE SOCIETY NEWS

### CALIFORNIA

The Fresno *Morning Republican* for January 10, 1932, referred to a meeting of the Fresno chapter as follows:

"Issuing a direct challenge to certified public accountants as members of one of the younger professions, R. W. E. Cole, of Los Angeles, first vice-president of The American Society of Certified Public Accountants, addressed members of the Fresno chapter of the State Society, following a banquet at the Hotel Californian last evening.

"In discussing the work of the national organization, Mr. Cole declared that one of its objectives was the encouraging of small groups of certified public accountants throughout the country to organize units of their own. In that connection he congratulated the Fresno chapter on their organization, which is one of three chapters in California, the others being located in San Francisco and Los Angeles.

"A splendid opportunity manifests itself during the present period of economic distress for certified public accountants to show their ability to not only help businessmen, but help business in general to anticipate the needs of the newer economic strides, which are bound to come out of the present chaos," declared Cole.

"Cole was introduced to the Fresno group by George W. Sims, president of the local chapter, and one of the three certified public accountants from California to attend the national convention held at Memphis, Tenn., last October. Cole was made an honorary member of the Fresno chapter, and was accompanied here by B. Young, certified public accountant of Los Angeles, who also spoke before the chapter."

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### LOUISIANA

The Society of Louisiana Certified Public Accountants held a joint meeting with the Robert Morris Associates on the evening of February 25, 1932, at which time Alexander Wall, Executive Secretary of the Robert Mor-

ris Associates, addressed the meeting on the relationship between bankers and accountants. His address was followed by an interesting and instructive round-table discussion.

A committee of the Louisiana Society was appointed to cooperate with the local chapter of the Robert Morris Associates.

\* \* \*

### MICHIGAN

A meeting of the Michigan Association of Certified Public Accountants was held on Thursday evening, February 11, at the Detroit-Leland Hotel.

The speaker of the evening was Clarence M. Justice, Vice-President of the Detroit Trust Company and formerly Assistant Deputy Commissioner of Internal Revenue, Washington, D. C., in charge of Income Tax and Estate Tax, who had for his subject "Current Thoughts on Income Tax." Following the talk there was an hour of discussion led by Paul W. Pinkerton.

Despite the fact that the meeting was held at a very busy time for accountants, it was the largest meeting the Michigan Association has had this year.

The Michigan Association of Certified Public Accountants is carrying a series of double column 4½ inch ads in the *Michigan Manufacturer and Financial Record*, each one asking a specific question and giving a concise answer. The ad is entirely impersonal, being sponsored by the association with the notation that inquiries may be addressed to the secretary with merely the address of the building in which his office is located.

\* \* \*

### PENNSYLVANIA

The regular monthly meeting of the Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants was held at the Art Club, February 23.

The speaker of the evening was Joseph K. Moyer, Chairman of the Special Advisory Committee, Bureau of Internal Revenue, Washington, D. C. He spoke at some length

with reference to the settlement of tax cases before his committee which otherwise would be delayed if subjected to the formal procedure of hearings before the U. S. Board of Tax Appeals. He laid special emphasis upon the care in preparing tax returns, both individual and corporate, and urged his hearers the necessity of answering all of the questions clearly, and that more consideration should be given to the preparation of Schedules as required by the returns or additional Schedules to elucidate items that were more or less complicated and technical and moreover non-recurring. He further stated that in preparing the briefs in cases of Claims for Refund, etc., that the choice of good English was essential.

\* \* \*

#### UTAH

The Utah Association of Certified Public Accountants have recently issued a Directory in which in addition to listing their officers and members, they have referred to the various types of services rendered by certified public accountants, quoting from the Bradstreet Company to the effect that "The successful business has an efficient system of accounts, supplemented by regular audits. Any firm having a regular audit of its records by certified public accountants has a far greater opportunity of securing the necessary credit for efficient operations and a greater assurance of continued success." They also quoted resolutions adopted by the recent annual State Convention of Taxpayers as follows:

"Whereas, the psychological as well as the practical aspects of the independent audit have been proved beyond question, and

"Whereas, the public officials as well as taxpayers have a right to know that public moneys are being properly expended and accounted for.

"Therefore, Be it Resolved, that we stand for the principle and practice of compulsory independent audits in all taxing units at stipulated intervals.

"Be it Further Resolved, that the auditing of all public accounts shall be entrusted only to men of proved reputation, skill, training, and of experience with the technicalities of accounting, and who hold certificates from the State Department of Registration as evidence of their ability."

#### WASHINGTON

The Spokane Chapter of the Washington Society of Certified Public Accountants has just issued Volume I, No. I, of the C. P. A., a 3½x6, four-page insert with cover, carrying the following material in its first issue:

##### BUYING A THOROUGH PICTURE OF YOUR BUSINESS

##### —NOT A COAT OF FINANCIAL WHITEWASH

In times like these there is grave danger that through a desire to "economize," business firms will be satisfied with an audit that will just "get by." They are apt to get not a true and revealing picture of the state of their business but a coat of what Alexander Wall, Secretary-Treasurer of the Robert Morris Associates, calls "financial whitewash." Whitewash is all right in its place, but is hardly adequate as a guide to the successful operation of a business in times of stress. It is hardly apt to pass the scrutiny of a keen officer of the bank which is asked to make or renew a loan.

It seems necessary to point out, in such times as we are now passing through that there is a difference between "economy" and "cutting expenses." It is all right to be economy-minded. It is a different thing and not always a good thing to be "cutting expense-minded." Not every outlay of cash is a reducible expense item. Certainly an audit that is incomplete or inadequate to the situation is not economy—no matter how much less it may cost than a satisfactory audit.

An audit should be something of productive value to the client of the Certified Public Accountant. It should bring into the picture a new, unbiased and trained viewpoint. It should do something else that is invaluable—bring to bear on the financial plans and the operating task of the business an *outside* viewpoint. This is something that the owner or the manager of the business cannot get from his own organization, no matter how competent or extensive. It goes without saying that if the firm has retained a competent and fearless Certified Public Accountant, that is the kind of an audit he will get—provided always that he does not limit the scope and destroy the exactness and value of the audit by a blind drive to "cut expenses."

Either an audit is a worth-while assistance to the proper understanding of a business operation or it is not. If it is not, it should be discontinued as a needless expense. If it is a help in giving a better, broader viewpoint of the facts, then it should be continued and its quality should not be lowered. Whoever heard of throwing away the



life preservers when the boat was in danger of sinking? Whoever recommended shutting off the fire engine while the building was burning? Rest assured that in troublesome times such as these, it is true economy to buy a greater, rather than a lesser, knowledge about one's affairs.

In the economic complications and drawbacks of today, we need all the knowledge we can get about every factor of our business. We can not afford to cloud the facts or delude ourselves as to the true condition by "cutting down" on the C. P. A. The auditor is worthy of his hire! Standards and scopes of examinations equal to or better than any of preceding years are what every firm and business man needs—now more than ever. That is the only rule for making 1932 a better year than 1931.

In the second issue of *The C.P.A.*, published by the Spokane Chapter of the Washington Society of Certified Public Accountants, they reproduced an article from the *Spokane Chronicle* covering the subject of periodic auditing.

## ANNOUNCEMENTS

Leopold Frankel, C.P.A. and attorney-at-law, announces the removal of his Paterson offices to suite 405 Fabian Building, 45 Church Street, Paterson, New Jersey.

\* \* \*

Joseph E. Lewis announces the removal of his office to the Chenango Valley Bank Building, Binghamton, New York, where he will continue his practice after February 1, 1932, in association with Benjamin L. Lathrop, C.P.A.

\* \* \*

Hamel, Park & Saunders, attorneys and counsellors, announce the removal of their offices to the Shoreham Building, Washington, D. C. James G. Stanley will be associated with the firm as counsel.

\* \* \*

C. William Wittman, Jr., and W. L. E. O'Bryan, announce their withdrawal from the firm of Mattison and Davey, as of February 15, 1932, and the formation of the firm of Wittman and O'Bryan for the general practice of accountancy at Matson Building, San Francisco and Esperson Building, Houston, Texas. Mr. C. S. Conrad, valuation engineer, will be associated with them in their Houston office.

A. Percy Block and Wilmer D. Zirkle, Certified Public Accountants, announce the formation of a partnership under the name of Block & Zirkle for the general practice of accounting with offices at 52 William Street, New York City and 207 Market Street, Newark, N. J.

\* \* \*

L. F. Bennett and Roy Karshner, Certified Public Accountants, announce their association as of January 1, 1932 for the general practice of accounting in the Hurt Building, Atlanta, Ga.

\* \* \*

Ames Nowell, C.P.A., announces that he is now located at 390 Ames Building, Boston, Mass.

\* \* \*

Joseph G. Weiss, C.P.A., announces the removal of his offices to 225 Fifth Avenue, New York City.

\* \* \*

The accounting practice heretofore conducted by Geo. S. Olive under his own name and that of Pace, Gore & McLaren, will be conducted under the firm name of Geo. S. Olive & Co., the offices remaining at 328 Chamber of Commerce Building, Indianapolis, Indiana.

\* \* \*

Charles F. Rittenhouse & Co., Certified Public Accountants, announce the removal of their offices to 1 Federal Street, Boston, Massachusetts.

\* \* \*

T. Coleman Andrews, C.P.A., of Richmond, has been unanimously confirmed by the Virginia General Assembly as Auditor of Virginia.

\* \* \*

George H. Emery, C.P.A., announces the opening of an office to continue the practice of public accounting at 614 Stearns Building, Statesville, N. C.

\* \* \*

Haskins & Sells announce the removal of their Jacksonville office to the Barnett National Bank Building, Jacksonville, Florida.

Black and Company, Certified Public Accountants, announce the removal of their offices to suite 1201-2-3-4 Garrett Building, Baltimore, Maryland.

Bernhard H. Frank, C.P.A., now occupies offices at One Madison Avenue, New York City.

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Leading accountants and financial executives everywhere are accepting this new edition, as they did the previous (1923) volume, as part of their everyday working equipment. A letter from Lybrand, Ross Bros. & Montgomery who have bought 650 copies says:

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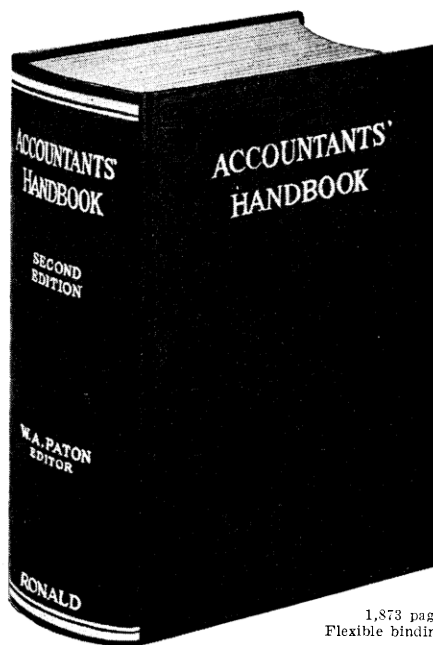
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WHEN ANSWERING ADVERTISEMENTS MENTION THE CERTIFIED PUBLIC ACCOUNTANT

## What Happened to the American Pocketbook 1929-1931

(Figures are Millions of Dollars)

Reproduced from *The Business Week*, February 17, 1932, by permission.

	1929	1930	1931	Per Cent Change 1931 from 1929
<b>WAGE AND SALARY INCOME:</b>				
Wages of wage earners attached to all industries.....	\$34,487	\$23,677	\$17,480	-49.31
Salaries of employees attached to all industries.....	13,101	9,232	7,229	-44.82
Pensions and compensations, industrial.....	310	273	222	-28.11
Total.....	\$47,898	\$33,181	\$24,932	-47.95
<b>BUSINESS INCOME:</b>				
Individual business and partnership income.....	\$12,431	\$9,208	\$6,833	-45.03
Dividends received by individuals from domestic corporations.....	5,438	4,544	3,271	-39.84
Earnings of private investors on investments abroad.....	876	826	524	-40.18
Interest received by individuals (on bonds, notes, mortgages, etc.).....	3,601	3,081	2,664	-26.00
Rents and royalties.....	5,144	4,104	3,283	-36.18
Net gain from sale of stocks, bonds, real estate and other assets.....	5,621	1,590	477	-91.51
Total.....	\$33,113	\$23,354	\$17,054	-48.50
<b>CIVIL AND FIDUCIARY INCOME:</b>				
Wages and salaries of federal, state and local government employees...	\$4,180	\$4,235	\$4,780	+14.37
Salaries of teachers in all public and private schools.....	1,484	1,556	1,648	+11.05
Life insurance payments to policyholders.....	1,961	2,246	2,600	+32.55
Pensions, bounties, gratuities, paid by all government divisions.....	946	1,090	1,429	+51.02
Total.....	\$ 8,572	\$ 9,129	\$10,457	+22.00
Grand Total.....	\$89,584	\$65,664	\$52,446	-41.46

This table, showing the drop in the combined income of all individuals by groups, is worthy careful study and reflection.

### The Editor's Lament

Getting out a paper is no picnic.  
 If we publish original matter, they say we lack variety.  
 If we publish things from other papers, we are too lazy to write.  
 If we stay on our job, we ought to be out rustling news.  
 If we don't print contributions, we don't show proper appreciation.  
 If we do print them, the paper is filled with junk.  
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(Signed) LYBRAND, ROSS BROS. & MONTGOMERY  
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Requisition No. Contract No.		Vendor's No. 2365	
A I CUSTOMER ANYWHERE U S A			
Shipped to & Destination Date Shipped 12/21/		From ANYPOINT	
Car Initials & No. NP 235767		P. O. No. ANYWHERE	
How Shipped and Route 26 10 DAYS		Prepaid or Collect PREPAID	
QUANTITY	DESCRIPTION	PRICE	AMOUNT
6	DZ	4 25	25 50
10	DZ	12 50	125 00
29	DZ	9 67	286 23
10%	DZ	3 12 1/2	32 59
1/2	DZ	2 25	11 53
			471 45
72	ONLY	1 12 C	161 24
			81
			162 05
			1 63
			160 42
			LESS FRT 608 LBS AT 26% CWT

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May, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants

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# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

MAY, 1932

NUMBER 5

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*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Entered as second-class matter, January, 1932, at the post office at Richmond, Virginia, under the act of March, 1879.

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*"Sometimes it ain' as much good to sympathize with a friend's trouble as to help him forget it."*

—UNCLE EBEN.

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## The President's Page

### *Adversity and the Profession*

HENRY J. MILLER, C.P.A.

THE claims of Certified Public Accountants that they are members of an honorable profession are now undergoing the acid test that will prove them gold or dross. Adversity such as has visited the whole world has not neglected to attack those in public accountancy practice, and the ideals and ethical standards developed since the birth of the title C.P.A., have probably never before been so sorely assailed.

When the purse is lean, men are more easily tempted to stretch their professional conscience, and step a little beyond the line for the thirty pieces of silver that made a Judas of an Apostle.

It is a source of just pride and satisfaction, that despite the temptations of the past two years, Certified Public Accountants as a whole have clung steadfastly to the ideals and ethical views fostered by their State Organizations and The American Society of Certified Public Accountants.

Complaints of violation of professional rules have been encouragingly few within both State and national bodies, and indicate that although the temptations of the next few months will hardly be abated, still the economic storm will not swerve the profession from its proper course.

So much is true of the men who having won their C.P.A., joined their professional bodies and endorsed and accepted rules of professional conduct carefully formulated and recommended by these organizations. Ethical fatalities have been much more numerous among certificate holders, who have preferred to practice without accepting the responsibilities of State and national society membership. Relieved of a pledge of any kind to rules of professional conduct, other than the stern limited precepts of the Law itself, deprived of association and exchange of views in regular meetings with their fellow practitioners, the



weaker ones could scarcely be expected to uphold the dignity of a profession in the face of unusual financial distress.

In quite a few communities today, financial, business and even civic organizations, are recommending only accountants who are affiliated with professional organizations of Certified Public Accountants. This practice is tending properly to elevate the member of State and national professional bodies, to a higher plane than the non-member. It is further placing such accountants in a position to at least enjoy opportunities of acquiring more desirable and lucrative engagements. While this recognition is of real value, still the fact remains that every time one not in the organization ranks, fails in his ethical conduct, the result is not only injury to himself, but to the entire profession.

It is urged, therefore, that especially now, members of The American Society should extend themselves to the utmost, to bring into their State as well as national organization, all C.P.A.'s who are eligible. It requires less actual time and effort to secure new members than is generally imagined. A personal visit, a clear statement of duty to one's calling, an explanation of the real benefits and professional recognition that today accrue to membership, and more will sign the application blank than will refuse to sign.

Every member within the fold makes it more certain that the acid test of adversity, to which we are now being subjected, will prove our right to the high professional classification we now enjoy.

## *I Am Still Rich*

ROY L. SMITH, in the *Hub* (Saskatoon, Sask.)

We have passed through a panic, suffered from a crash on the stock market, and are now more than half way through the depression, and I am still rich. It may be true that I have much less to live on than I had a year ago, but it is certainly true that I have just as much as ever to live for. The real values of life are unshaken and solid.

The depression has not lowered the value of a single friendship. Neighbors still greet us in the same old cordial way, business associates believe in us, and our sons hold us in high respect. The wife's welcome at the close of the day has not depreciated in the least, and our daughters continue to lavish their affection upon us with the same old extravagance.

My faith in the goodness of the universe is unimpaired. By that faith, I am emboldened as I face defeat and despair. The prayers my mother taught me and the faith in God instilled in me by a devout father remain as priceless treasures no depression can touch.

No nation becomes great by becoming rich. Neither does a man find enduring satisfaction in life by owning something — only by becoming something. The most degrading poverty is that which results from killing the spirit that the body may be served.

This depression is a challenge, not a catastrophe. A generation that has con-

quered the air and sent giant planes circling the globe, which has plunged into the deeps and disported on the ocean's floor, which has climbed above the clouds and lived in the stratosphere, is now faced with the challenge to rise above its dependence on mere things and seek an emancipation of the spirit of man.

The last six months have been for many men a thrilling spiritual adventure through which they have discovered their real wealth. Bereft of dividends and profits, they are discovering the sustaining powers of a strong religious faith, the abiding values of courage, heroism, honor, charity and trustworthiness.

A financial crisis can wipe out profits and bring business to a standstill, but character is beyond its reach. It can rob us of all we have, but it cannot affect what we are. The deepest satisfactions of life—those which come from sharing and serving—remain secure.

I am still rich because I am independently rich—none of my wealth depends upon business conditions or market reports.

## *Believe It or Not*

By FRANK WILBUR MAIN, C.P.A.

(Written for *The Pennsylvania Certified Public Accountant*  
and THE CERTIFIED PUBLIC ACCOUNTANT.)

For many years Mr. Ripley has been publishing every week-day and every Sunday, under the caption "Believe It Or Not," interesting, curious, and paradoxical facts. More recently Mr. Hix has been publishing through another newspaper syndicate the same type of facts under the title "Strange As It Seems." In all probability these men will be able to continue to find and publish, day after day, strange and unbelievable incidents, circumstances, and facts. When they cease, others will probably take up the task and in all likelihood for countless years like series will continue.

What is the inference to be drawn? Is it not that the unbelievable, the strange, and the unusual is, after all, the commonplace? From birth until death we are constantly seeking for standardization, for routine, for established and peaceful conditions. We turn away from the strange, the unbelievable, and the unusual. We want nothing so much as peace and harmony and to be let alone.

Among the first set of truths that we learn is that the Sun rises in the East and sets in the West. One of the first items in our education is that this truth is untrue. The Earth revolves around the Sun and not the Sun around the Earth. Later on we come to a realization that for all practical purposes the first truth was the truth. In other words, even truth is only relative and must be based upon its relation to other factors.

Economically we have been going through a period where the mighty have fallen and "Oh! Yeah?" has become the favorite comment. What is the lesson to the accounting profession? We, like all other citizens, have had our complacency upset; we have seen various sources of accounting business dry up,

and we are passing through a strange period when every concern is seeking not only to economize, but to obtain the maximum for every dollar spent.

"BELIEVE IT OR NOT" and "STRANGE AS IT SEEMS," this writer is convinced that out of the present distressing economic situation opportunities for service such as we have not had in the past will come to us; in fact, they are already here. For many years to come there will be a genuine interest in all types of governmental accounting, not with the idea of determining that cash books have been added up correctly and warrants properly entered, but with the idea of rendering genuine assistance in the revamping of governmental fiscal affairs and operations to the end that economies may be effected, governmental service improved, and taxes reduced. For a number of years there will again be genuine interest in the question of public utility valuations and rates. The public will not be satisfied with existing rates simply with the testimony of official employees. Outside, disinterested accountants and engineers will again find a place of service in this important field. Federal and State taxes will become even more important factors of corporate operation and the accountant who is qualified will here again find a useful field of opportunity. Other illustrations might be given. It is absolutely certain, however, that the routine type of accountant and the complacent, easy-going expert who is living on his past reputation will have a more difficult time. It may well be that during the next few years the accountant's golf scores may mount; there will, however, be a deadly earnestness about him in his work which will be more appreciated by his clients.

## *Revocation of C. P. A. Certificates*

Recent actions by State authorities in revoking the certificate of Certified Public Accountant further emphasizes the need, in the PUBLIC INTEREST, for a complete statutory regulation of the professional practice of accountancy.

The Indiana State Board of Certified Public Accountants served notice on John R. Foster, March 8, 1932, that at a hearing held on January 4, 1932, it had voided and cancelled its Certificate No. 441, issued to him, and that he could no longer practice the profession of accountancy under said certificate.

The Board of Regents of the University of the State of New York served notice on Herman Elias Goldschmidt, March 31, 1932, that its Certificate No. 540, issued to him as permission to practice in the State as a Certified Public Accountant, had been revoked, annulled and cancelled, under the provisions of section 1494 of the Education Law, and ordered the return of the certificate to the State Education Department.

Both cases had the same basis for action on the part of the State authorities, and in both instances the official body has done all that it can do under the law of the State; yet in each case the holder of the certificate has been penalized only to the extent that he can no longer practice in the State as a Certified Public Accountant without incurring the penalties provided for such infraction of the law.

Passing over any question of a blow to professional pride from the stigma of certificate annulment, the fact remains in each case that the individual is not deprived of the privilege of practicing public accountancy under any other style than that of Certified Public Accountant and that fact is to the potential detriment of the PUBLIC. If the laws in these states had been of the regulatory type, the offenders could have been deprived not only of their C.P.A. certificate and the right to practice thereunder, but they could have been deprived also of the right to further practice public accountancy in any manner whatsoever within the jurisdiction of the State.

Holders of C.P.A. certificates whose conduct warrants disciplinary action on the part of State authorities ordinarily are not professionally inclined, notwithstanding their designation as members of a profession. Conduct which warrants the revocation of a C.P.A. certificate is of such kind, almost uniformly, as to call for protection of the PUBLIC against further incompetency, misconduct or depredations under any style of accountancy practice. That protection can be afforded only through the medium of a regulatory law.

## Commercial Arbitration News

AT a meeting of the Executive Committee of the Massachusetts Society of Certified Public Accountants, recently held, it was voted:

"That a special committee on commercial arbitration be appointed by the president to consist of at least three members; that the duties of the committee shall be to promote and foster the use of arbitration as a means of settling commercial disputes, and to coöperate with other organizations in maintaining in this State the irrevocability and enforceability of a provision in a contract, or a contract especially entered into, for the submission of a commercial dispute to arbitration."

and in pursuance thereof there was appointed by the president of the society a committee consisting of James D. Glunts, chairman; Hollis H. Sawyer, and Raymond D. Willard.

Theodore J. Witting, of Denver, has been appointed a member of The American Society's Committee on Commercial Arbitration to fill a vacancy in the Colorado representation created by the removal of Thomas H. Lawrence to San Francisco. Mr. Witting is chairman of The Colorado Society's Committee on Commercial Arbitration, and has been active in the promotion of commercial arbitration in that State.

The Code of Arbitration Practice and Procedure and the American Arbitration Service, the latter of which is issued monthly, excepting July and August, were described in the May, 1931, number of this magazine, at which time special subscription rates were available to members of The American Society at \$3.00 for the Code and \$10.00 per year for the Arbitration Service. The Society's Committee on Commercial Arbitration is now able to announce that subscriptions for these worthwhile publications will be received by the American Arbitration Association, 521 Fifth Avenue, New York City, from members of The Society at \$1.50 for the Code and the recently issued Six-Year Supplement, and at \$6.50 per year for the American Arbitration Service. The Code, including indices, contains 324 pages and the Six-Year Supplement contains seventy-three pages of interesting and valuable matter. More than \$1.50 has often been paid for educational matter less valuable than that contained in the twenty-two pages of "Introduction" in the Code. The Arbitration Service contains current news of commercial arbitration activities, special information gleaned from authoritative sources, and citations to and reviews of the decisions of courts on appeals from arbitration awards and on efforts through legal proceedings to

avoid or evade compliance with a contract to arbitrate.

The Arbitration Service for March contains an opinion by an English barrister-at-law on "The Legal Liability of an Arbitrator" that will afford comfort to persons serving in that capacity. Arbitration is much more aged and firmly grounded in England than in America and has served the useful purpose of restricting the dockets of the English courts.

The Arbitration Service for April reports affiliation of the Minnesota Society of C.P.A.'s with the American Arbitration Association; standards for State Arbitration Laws which are to be found in the Federal Act, and in the laws of the thirteen states of Arizona, California, Connecticut, Louisiana, Massachusetts, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, and Wisconsin; formation jointly by American Fur Merchants Association and Fur Brokers Association of New York of an arbitration panel of sixty members; revision in the Arbitration Rules of The International Chamber of Commerce; announcement in *World Trade* for February that the Council of The League of Nations had decided to set up a rota of fourteen experts from which two governments involved in a dispute arising out of a commercial treaty may, by mutual agreement, select an arbitrator; and the establishment of the Ohio Association of Arbitration Tribunals.

It is reported that sixty-four cities in Ohio are represented in the National Panel of Arbitrators by 289 of the leading business men in Ohio; that the Ohio Association of Arbitration Tribunals, with principal office in Columbus, has for its purpose to unite the different tribunals in chambers of commerce and trade associations in a standard practice for the State; that the plan contemplates that all commercial arbitrations in Ohio will be referred to the Ohio Association or to some one of its member tribunals, except in cases where the American Arbitration Association has entered into agreement with a national trade association to supervise or conduct arbitrations for its members; and that the Ohio Association and all organizations comprised in its membership are empowered to make full use of the Rules of Procedure and the forms and standard arbitration clauses used or recommended by the American Arbitration Association and the National Panel of Arbi-

trators, and are given the sole right to use the name, "American Arbitration Tribunal," for tribunals which the Ohio Association, or its members, may establish in the State of Ohio.

### Prosperity Song

Play this on your piano,  
Whistle it on the street,  
Put it in every operation,  
And on the Balance Sheet

Everywhere I travel people seem so blue,  
Wondering what this country is a comin' to,  
Prices of commodities are way below their level,

Everybody's earnings have been travelling to the devil.

When we needed him most, Mellon threw up his job,

Assistance from Congress doesn't amount to a sob.

Prohibition 'twas said would keep prosperity,  
Where are those captains of industry?

Who can we find to swing Teddy's big stick?  
Of all the suggestions, not one's done the trick.

The Republican Party on the fourteenth of June,

Will be ready to give us their popular tune,  
They'll tell us that business has shown a good trend,

But can they advise when this depression will end?

I am no expert in high finance,  
But I feel my theories will values enhance,  
Business has been quiet, now it's noiseless,  
To help the situation, here's what I profess:  
Put all your money in circulation,  
Make everything rosy in this wonderful nation.

Ford's thrown in his millions,  
Let's match them with billions.

Buy a new auto and junk the old car,  
Roll up your sleeves and light a cigar,  
Work seven hours and a week of five days,  
You'll find that's the schedule that really pays.

We've had panics at intervals all thru our past,

But remember they never were able to last.  
Let's join in a band and go spending along,  
And put into practice my prosperity song,  
We'll bury depression and start a big boom,  
Bring out the sunshine and gone is the gloom.

EDGAR L. MYERS, C.P.A., Baldwin, N.Y.

# Current Thoughts on Auditors' Certificates\*

By DAVID HIMMELBLAU, C.P.A., Chicago, Illinois

THE topic assigned to me for this morning's program is "Current Thoughts on Auditors' Certificates." What are the comments when several auditors start discussing certificates? Usually three propositions are outstanding:

- (1) What is the legal liability on the certificate?
- (2) Will the proposed classification of accountancy services minimize legal liability?
- (3) What are the objections against the proposed classification?

Before I tread onto debatable ground permit me to set forth my views on certain basic aspects of the auditor's certificate.

## CERTIFICATE EXPRESSES AN OPINION

I use the phrase "auditor's certificate" to refer to any statement signed by the auditor purporting to express his opinion:

- (1) as to the financial condition of a business,
- (2) as to the results from operation of a business, or
- (3) as to any facts which the auditor, in his professional capacity, has investigated.

The certificate is usually sent to stockholders, banks, note brokers and others who may not be entitled to detailed information but who are entitled to assurance that the financial statements submitted to them are substantially correct. Its function is to assure the recipient of a certified statement that:

- (1) all essential facts are shown thereon, and
- (2) all the facts shown are substantially correct.

The auditor's certificate is his report on certain work which he has done. That report may be short or long and it may be qualified or unqualified. Many forms of certificates have been used and each has been

criticized. Twelve recently used are given in the appendix.

## KINDS OF AUDITS

In the first paragraph of his certificate the auditor should state whether he did or did not make an audit. In other words, has he taken the figures from the books, assembled them in balance-sheet form with the idea of properly setting out the financial condition as shown by the books, or has he taken steps to determine whether the books themselves are correct?

Unfortunately the word "audit" is meaningless because in common practice it is used to designate types of verification which differ greatly from each other. The reader of the certificate does not know what kind of an audit was made in a given case and hence does not know whether it is satisfactory to him.

This difficulty raises the question as to whether the certificate should specify what kind of an audit was made. If so, we have the problem of how to indicate the scope of audit without cluttering up the certificate with unnecessary explanation which would detract from its main function. There is only one practical method that I know of:

first, classify the various kinds of work done, second, make these classifications known to the public, and third, refer to the classification in the certificate.

## INFLUENCE OF THE CLASSIFICATION ON EDUCATION

Let us next consider the advantages of classification and the objections thereto.

You should have before you the third report of the committee of The American Society of Certified Public Accountants which is dated July 9, 1931. That report is identical with the one submitted by the New York committee. I haven't time to summarize the history of the movement leading up to the proposed classification of accounting services,

\*Address delivered at the Seventh Annual Michigan Accountants' Conference, November 19, 1931.

so I shall take up at once the effect of such classification on:

- (a) the teaching of students who expect to become professional auditors,
- (b) the teaching of students who do not expect to become professional auditors, and
- (c) the attitude of the user of a certified statement.

The importance of such a classification of accountancy services for *instructional* purposes in auditing courses will be obvious to any one examining (a) the variations in the designations given the various types of audits now appearing in the auditing text books and also (b) the variations in the scope of work to be done under a given designation.

From the standpoint of instructing students who expect to become professional auditors, a recognized classification of accountancy services enables the teacher to:

- (1) state definitely that there are certain recognized classes of audit work;
- (2) point out the objects to be accomplished by each class of audit;
- (3) state wherein one classification differs from the others with which it might be confused;
- (4) state the scope of the audit to be performed for each classification;
- (5) explain as to each class of audit work (a) what to do, (b) how to do it, and (c) how much to do.

It is obvious that more practical teaching produces better students; that better students become better staff assistants, and better staff assistants make more effective audits. The student completing such a course of instruction should have a tangible conception of the responsibility assumed under each type of audit.

The same factor arises in the accounting instruction given to students who do not expect to become professional auditors. Such persons undoubtedly will reach positions in which they will be called upon to use the statements prepared by professional auditors, either as executives employing such auditors or as individuals extending credit or making investments on a basis of such statements. Here the question arises as to the extent to which such individuals may rely upon the statements which they are using. Unless these individuals are informed as to the nature of

the various classes of accountancy services which might be rendered and are made acquainted with the scope of the verification made by the auditor in connection with the particular financial statement being used, it is very easy for these individuals to be misled.

#### TIE-UP BETWEEN CLASSIFICATION AND CERTIFICATES

It is not at all uncommon for a statement which was prepared on the basis of a limited examination of the accounts to reach the hands of a person who assumes that it was prepared on the basis of a complete audit. If it subsequently develops that the statement is not accurate due to inadequate investigation by the auditor, the user generally assumes that the auditor is incompetent and at times feels that the auditor has been so negligent as to warrant legal proceedings for damages sustained.

Most of the unsatisfactory situations existing in the teaching of auditing and in the use by individuals of financial statements issued by professional auditors can be avoided through the adoption of the proposed classification of accountancy services. If such a classification is adopted, it will gradually become familiar to all users of statements. It will then be possible for the auditor to fix the degree of responsibility he assumes in a given case by referring in his certificate to the particular classification under which his audit falls. If the user of a statement has any question as to the adequacy of the audit performed in connection with that statement, reference to the classification of services will quickly acquaint him with the scope of the work done and the degree of responsibility assumed by the auditor. If he is not satisfied with the scope of work done, he can reject the statement.

I see no other method whereby the public accountant can inform the user of the statement as to the extent of the audit made by him. As far back as 1905 Montgomery pointed out in connection with the liabilities of auditors that "The question appears to be capable of division under two heads, viz.: (1) What is the actual extent of the auditor's certification? (2) What is his legal responsibility in case of an error being subsequently discovered in the accounts that have been passed by him?"

The crux of the question in each case is—

What is the actual extent of the auditor's certification? From the standpoint of (a) the student, (b) the professional auditor, and (c) the user of the certified statement, that question is most clearly answered by adopting a classification of accountancy services and by having auditor's certificate state upon which classification the certified statement was based.

#### WORDING OF THE CERTIFICATE

Let us assume that the profession is willing to adopt in principle the two basic propositions which I have discussed,

- (1) A classification of accountancy services, and
- (2) Tie-up between the certificate and the classification.

The next question commonly discussed is how should the certificate be worded? The forms suggested by the New York Committee are Nos. 1, 2, 3, 4 and 5 of the appendix. Note that No. 4 clearly indicates that the examination was limited to the balance sheet. No. 1 and No. 2 are identical so the reader does not know whether the certificate is based upon a "detailed" audit or a "test" audit. Sometime ago I recommended that No. 1 be changed to read "we have made a detailed audit," and that No. 2 be changed to read "we have made a test audit." The objection was raised at the New York meeting that clients would not accept a certificate which bluntly states that only a test audit was made. Since most audits are test audits, I now recommend that only No. 1 be changed. If that be done, then a certificate which does not state the kind of audit made will be accepted as being based on a test audit. I doubt if any client will object to having the certificate disclose that a detailed audit was made. See No. 12 in appendix.

Since the *Ultramares* case the words used in the certificate have been closely scrutinized by lawyers as well as by accountants. To my mind this is most unfortunate. It would be far better for auditors to give more attention to the scope of the audit upon which the certificate is based instead of seeking a phraseology that might avoid legal liability for unsatisfactory work.

The suggestion has been made that the auditor's certificate should be addressed to the client as in Nos. 7, 8 and 9 rather than

merely headed "Auditor's Certificate." I doubt if it will accomplish the purpose of limiting the auditor's legal liability to the party addressed. If such a form would, in fact, limit the legal liability, it would not be at all surprising if that form is rejected by bankers and others who intend to rely on the certificate.

The profession must bear in mind that if it does not develop a certificate which gives the user all vital information, the form of the certificate will be imposed upon the auditor by outside forces.

Ohio already has a statutory form the auditor must use. So has Massachusetts. Canada and Great Britain have had statutory requirements for many years.

On September 19, 1931 Germany required all corporations to have their books audited annually by certified accountants. Under this statute the wording of the certificate must be explicit in stating that "... the system of accounting, the annual statements and the annual report all conform to the requirements of law, as shown by a properly conducted audit of the books and records of the concern, supplemented by statements and data furnished by its officers . . ."

In this connection it may be of interest to note that:

- (a) financial responsibility exists only if there has been a breach of duty resulting in direct damage to the complainant company.
- (b) in case of negligence, maximum liability for a single engagement is 100,000 marks.
- (c) if negligence is premeditated, there is no maximum liability.
- (d) claims for damages must be brought within five years.
- (e) auditor cannot limit his liability by contract with his client.

#### OBJECTIONS RAISED AGAINST CLASSIFICATION BY A.I.A.

In view of the definite advantages in favor of classification above mentioned, the question arises as to what the disadvantages might be. Under date of October 8, 1931 the American Institute of Accountants issued a circular giving five opposing arguments which I shall now discuss.



## FIRST ARGUMENT

"Years of study by various committees have failed to develop unanimity on what may be a proper classification."

With regard to the first argument I believe it is unnecessary to state that if we are to wait for *unanimity* on any point in accounting nothing would ever be accomplished. We have rules of professional conduct on which there certainly is no unanimity. The pamphlet "Verification of Financial Statements" was prepared by the Institute and published through the Federal Reserve without any unanimity on the part of the profession. If lack of unanimity is a valid objection, then the rules of professional conduct and the "Verification of Financial Statements" should be withdrawn.

## SECOND ARGUMENT

"The services which public accountants are prepared to render are so wide in scope and so varied in character that it is as purposeless to attempt to classify them as it would be to classify the functions of the physician or the lawyer. Each proposed classification of services has emphasized certain types of service at the expense of others, naturally reflecting the particular experiences of the members of the committee which prepared it. It is felt that every accounting firm and every individual practitioner would prefer a classification adapted to the type of practice in which he happens to be engaged, and that no standard classification would be applicable to all the practitioners in this country."

The second argument seems to be meaningless. If the services are so varied in character it would seem of the utmost importance that the profession definitely outline these various services so that the person purchasing the services will have a definite conception of what he is getting and what he is not getting. To the user of the statement it is of utmost importance that he know exactly what it is that he relies upon.

## THIRD ARGUMENT

"An attempt to define different types of audits is difficult and perhaps danger-

ous. Broadly, there may be said to be two types, the complete or detailed audit and one which deviates to any extent from the complete audit. Efforts to differentiate distinct types among the many possibilities of variation, for specific purposes, from the complete audit have been unsatisfactory because they did not reflect in true proportions the experience of representative practitioners as a whole."

As to the third argument we all agree that it is difficult to classify the various types of audits; but that is no reason why it should not be done. The argument also states that it is "perhaps dangerous" to classify but the question arises as to what is the danger. If it is so dangerous, why the difficulty in specifying exactly what the danger is?

## FOURTH ARGUMENT

"Adoption of a classification of services which would not be universally accepted by members of the Institute would hardly be a substantial contribution to the profession. There has been doubt in the minds of some members of the various committees dealing with this question whether or not any particular substantial purpose would be served by the classification."

The fourth argument stresses the idea that the "adoption of a classification of services which would not be universally accepted by members of the Institute would hardly be a substantial contribution to the profession." This is the same point referred to in argument one, and the same reply is pertinent, viz.: The pamphlet on "Verification of Financial Statements" has not been universally accepted by the members of the Institute, yet even those who have not accepted are willing to admit that it is a substantial contribution to the profession.

## FIFTH ARGUMENT

"Anything which might tend to standardize accounting services or to restrict even in the slightest degree the exercise of initiative, judgment and original thought by accountancy practitioners would be harmful rather than helpful. The exercise of judgment based upon experience and integrity

is chiefly what the accountant has to offer the public."

There is nothing in the fifth argument different from preceding arguments. If we are not to restrict the accountancy practitioner, "even in the slightest degree," then I again ask why have the pamphlet on "Verification of Financial Statements"; why have the rules of the American Institute as to the form of certificate to be issued in connection with financing; why have rule of the code of ethics which restricts the type of statements that the auditor may certify?

#### OBJECTIONS RAISED AT NEW YORK MEETING

It may be of interest to consider the objections which were raised at the New York State Society Meeting on October 14. Most of the objections were so vague that they do not constitute any argument for or against classification. Those which were specific are as follows:

The questioner says "Many engagements would not, however, come precisely within any one of the designations, or they would overlap two or more of the four designations. For example, where would an engagement consisting of a balance-sheet examination and a cash audit fall?" If the questioner had a tangible conception of the classification he certainly would not have raised the question because the answer is self-evident, viz., that the balance-sheet examination comes under section IV and the cash audit comes under section V(a). Consequently, under these circumstances the auditor would state in his certificate that he has made an examination of the financial condition together with a cash audit.

The questioner also asks "Where would a balance-sheet examination supplemented by partial tests of transactions for a period as requested by the client (but not an adequate test of transactions in the judgment of the accountant) be classified?" The answer to this is also obvious. The engagement qualified under section IV as an examination of financial condition. The additional work done was not sufficient to qualify same as a test audit; consequently the auditor merely certifies that he made an examination of the financial condition. If desired he could add

to his certificate a statement as to the additional work done. The reader would then have a definite conception as to the scope of the audit upon which the certificate was based.

The questioner also asks "Under which category is the engagement for a balance-sheet examination with the addition of only a few months' verification of petty cash to be placed?" This question would be answered the same as the preceding one.

The questioner also asks "Under which of the four captions would an examination of earnings for a period of years, where the purchaser-client states he is not particularly interested in the balance-sheet position because he is taking over the business with a specific agreement as to each of the assets which is to be acquired and with the liabilities all to be discharged by the seller, to be placed? It is apparent that such an examination would come under section VI, sub-section (1) and the auditor would be expected to submit a detailed report in which he states the exact scope of the work done.

#### EACH CLASSIFICATION IS ELASTIC

From the foregoing questions and similar ones raised by others it is apparent that many people have the impression that each of the proposed classifications constitutes an exact outline of the work to be done, from which there is no deviation. That conception is wholly unsound. A careful reading of the classification indicates that each classification covers a broad portion of the field and that within each classification there can be many variations. This permits all the lee-way necessary in actual practice. What is not permissible is placing a *skimpy test* in the same classification as an *adequate test*. That is its limitation and one of its fundamental advantages.

#### SUMMARY

In conclusion, may I summarize my views on certificates:

(1) The function of a certificate is to assure the reader of a certified statement (a) that all essential facts are shown thereon and (b) that all the facts shown are substantially correct insofar as a professional man is capable of so showing them.

(2) A certificate is appended to published financial statements or those sent to stockholders, banks, note-brokers, etc., who are not entitled to receive the detailed comments contained in the auditors' report.

(3) The ideal certificate is one that conveys precisely the right shade of meaning to any one who studies carefully its every word and at the same time creates the correct general impression in the mind of anyone who reads it casually.

(4) Certificates should be so worded that double meanings are impossible and no opportunity is given for drawing deductions not intended. In identical sets of circumstances the certificate of one auditor should mean precisely the same as that of another, and exactly similar meanings should attach to the words used.

(5) A certificate should be labelled "auditor's certificate" so that there can be no doubt as to what it is intended to be.

(6) Qualifications and explanatory data should be expressed on the financial statements so that a "clean" certificate can be given.

(7) If a qualification is necessary, avoid a context or phrasing which makes it difficult to grasp the significance of the qualification. The auditor may state briefly *what was not done* or state briefly *what was done*. In the first case the auditor refers to the items requiring special comment, the implication being that all items not commented upon were satisfactory. In the second case the auditor states what was done, the implication being that items not mentioned were not covered in the audit.

(8) The genuineness of the certificate should always be attested by the written signature of the auditor.

(9) To show the investing public what the position of a corporation will be after certain new financing has been consummated, the actual balance sheet is often adjusted to reflect (a) new funds to be obtained, (b) the proposed disposition of these funds, and (c) other internal readjustments incidental to the financing. The best practice is to limit such adjusted balance sheets to cases where the transactions have been definitely consummated but many statements are still issued on a "when, as and if" basis.

(10) The certificate should state the kind of audit upon which it is based.

(11) Accountancy services should be classified so that the reader of a certificate may ascertain the scope of the work done under each classification.

(12) If the auditor's certificate discloses the kind of audit upon which it is founded and the auditor makes certain that his staff performed the work adequately, then he need have little worry about whether the wording used in the certificate will minimize his legal liability.

## APPENDIX

### COMMITTEE RECOMMENDED FORMS

(1)

#### *Detailed Audit*

We have examined the accounts of Blank Company for the (period) ended (date), and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.

(Place) (Date) .....

(2)

#### *Test Audit*

We have examined the accounts of Blank Company for the (period) ended (date), and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date), and the results of its operations for the (period) ended on that date.

(Place) (Date) .....

(3)

#### *Examination of Financial Condition and Review of Operations*

We have examined the accounts of Blank Company as at (date), and have reviewed its operations for the (period) ended on that date, and, in our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of that company at (date) and the results of its operations for the (period) ended on that date.

(Place) (Date) .....

(4)

*Examination of Financial Conditions*

We have examined the accounts of Blank Company as at (date), and, in our opinion, the accompanying balance sheet sets forth the financial condition of that company at (date).

(Place) (Date) .....

(5)

SPECIMEN CERTIFICATE GIVING EFFECT  
TO FINANCING

We have examined the accounts of Blank Company as at December 31, 1930, and have reviewed its operations for three years ended on that date. We have inspected: an agreement dated January 15, 1931, providing for the issuance and sale of \$1,000,000.00 first mortgage five per cent bonds to be dated January 1, 1931; a report of Blank Appraisal Company, dated February 17, 1931, showing the appraised value of the company's property as of December 31, 1930; and the minutes of a meeting of the directors of the company, held January 15, 1931 (or the requirements of the underwriting agreement) (or a letter of the president of the company, dated ..... ) regarding the proposed application of the proceeds of the bond issue.

In our opinion, the accompanying balance sheet and statement of income and surplus set forth the financial condition of the company at December 31, 1930, and the results of its operations for the three years ended on that date, after giving effect to the aforesaid valuation of property and the proposed financing.

(Place) (Date) .....

(Note: If the application of the proceeds of new financing is not clearly disclosed in the heading of the statement, or elsewhere on the face of the statement, the manner of application should be set forth in the certificate.)

## ATTORNEY RECOMMENDED FORM

(6)

Date

*Certificate of Auditors*

To (Client):

We have examined your accounts as at

(date), and hereby certify that, in our opinion, the annexed balance sheet is in accordance therewith, after giving consideration and effect to information and explanations given to us by you, and, subject to provision for federal taxes on income, presents a true and correct view of your financial condition as at (date).

(Name of Auditors).

ACTUAL CERTIFICATES USED FOR  
ANNUAL AUDITS

(7)

To Client:

We have examined your accounts for the year ended December 31, 1930, and for the twelve preceding years, and

*We hereby certify* that the accompanying Condensed Consolidated Balance Sheet and related Summaries of Consolidated Income and Surplus in our opinion set forth the financial condition at December 31, 1930 and 1929, and the results of operations for the years ended those dates.

(date) (Signed) AUDITORS.

(8)

To Stockholders:

As auditors elected at the annual meeting of stockholders held on April 1, 1930, we have made an examination of the books and accounts of the x x x x x and its subsidiary companies for the fiscal year ending December 27, 1930, with the exception of the domestic and certain foreign selling companies and branches for which we were furnished accounts certified by the company's officials.

We certify that, in our opinion, the above balance sheet is properly drawn up so as to present a true and correct view of the financial position of the x x x x x and its subsidiary companies, and the relative profit and loss and surplus account fairly set forth the result of operations for the year.

(date) (Signed) AUDITORS.

(9)

*Auditor's Certificate*

To Stockholders:

We have audited the books of the x x x x x for the year ended December 31, 1930, and

(Continued on page 280)

# Audit Procedure in the Examination of N. J. Building and Loan Associations

By L. M. STERNRICH, C.P.A., Newark, N. J.

THE effect of proper supervision and compulsory auditing of building and loan associations is now generally recognized. An examination not only reviews the methods but helps to solve the practical problems of the association. The building and loan movement will continue in popularity as long as it holds the confidence of the public; therefore, every effort is being made to help maintain this confidence of the public.

One of the many lessons learned by the building and loan directors and officers during the period of deflation was that the old auditing committee was inadequate. This conclusion was also reached by the bureau of the Department of Banking and Insurance which sponsored the change in the law eliminating this committee and calling for the appointment of an *Examining Committee*, with new functions, new duties and new responsibilities.

To further amplify this new feature in the law, this paper was prepared, setting out the scope and nature of the examination of an association by the members of the examining committee or by their accredited representatives. It is, therefore, hoped that this paper will help clarify the uncertainty that exists in the minds of the directors of building and loan associations, as to the status of this body and as to how it should properly function.

The board of directors, by appointing a committee, does not absolve itself of all responsibility in connection with the proper management of the association, and of the necessity of determining its financial soundness. The directors as a group, therefore, must rely upon the committee which they appoint, to fulfill the requirements of the section of the Building and Loan Act quoted below, so as to have a thorough and efficient examination made of their association.

The amendment to the Building and Loan Act referred to, provides that:

"The board of directors shall annually appoint a committee of not less than three mem-

bers of the board who are not officers of such association, which committee shall be designated the 'Examining Committee.' It shall be the duty of such committee to make, or cause to be made, in a manner and form approved by the Commissioner of Banking and Insurance, a thorough audit and examination of the condition of such association, including a verification of shareholders' accounts. The report of the examining committee shall be signed and sworn to and one copy thereof filed with the Department of Banking and Insurance within sixty days after the close of the fiscal year of such association."

This section of the law is of great significance, in that it requires the examining committee to make, or cause to be made, a thorough examination of the books and records, and holds them responsible for the competency of the audit. Their report must outline the work done and the irregularities found during the conduct of the examination, in a manner and form that will bear the scrutiny of, and be entirely satisfactory to the Commissioner of Banking and Insurance. The responsibility, therefore, rests with the examining committee, and they have the choice of either making the examination themselves, or employing the services of trained auditors who are experienced in performing the type of services required.

A proper audit provides every possible safeguard to the investing public. It has taken years of systematic educational propaganda on the part of building and loan officials to impress upon the public the safety and reliability of this particular coöperative form of saving, and it is most important, therefore, that every precaution be exercised in the management of the building and loan associations so that they may retain the confidence gained in the past. A few defalcations by dishonest and disreputable officers have not shaken the confidence of the public, and the proof is written in the report of our Banking Commissioner which states that in the Calendar Year 1930

the associations in this State have progressed materially.

Following is a brief outline of the requirements of an examination:

1. A complete verification of the assets and liabilities of the association.

2. A complete audit of the cash and scrutiny of all cash transactions must be made for the period under review.

3. The Shareholders' Register must be completely audited and all accounts, withdrawals, maturities, loans and arrearages must be verified by direct communication with the shareholders, to determine that the books of the association are in agreement with the shareholders' records.

4. The Stock Certificate records must be examined in detail.

5. The system of accounting must be surveyed to determine its practicability to function efficiently.

6. The audit report, covering in detail the results of the examination must be submitted to the examination committee for approval; the committee in turn must report to the Board of Directors, which must file one copy with the committee, one with the Secretary, and one copy with the Department of Banking and Insurance.

The committee must next proceed to lay definite plans for conducting the required examination of the association. These plans must provide for a thorough and detailed examination of the books so that all transactions of the association, for the period under review, will be verified.

It is not my intention to present a technical program of audit, but to generally point out, and make the building and loan public familiar with what is expected of the examining committee. This audit, which is made independently, helps safeguard the interest of the subscribers, presents a picture of the condition of the association, and reflects the true financial position of the association at the end of its fiscal year.

The mortgage loans of a building and loan association constitute its principal asset, and, under the laws of this State, these investments must be first liens on real estate. The law, however, permits the association to include in its investments purchase money mortgages taken back by the association upon the sale of real estate owned. The acquisition of such

mortgages becomes necessary in some instances in order to aid the association in disposing of the property.

The examination of the mortgage loans must be thorough and detailed. The committee must appreciate the fact that an improper examination of the bonds and mortgages might result disastrously and will, of course, reflect in a great measure on the ability of the committee. Care should therefore be exercised in the performance of the work.

An examination should be made of the applications for loans to determine whether the appraisals thereon have warranted the passing of these loans, and to see that the applications have been properly signed. The minutes should be examined to ascertain whether the loans have been authorized by the Board of Directors.

In this State, all mortgage loans must be first liens of real estate, must not exceed 80% of the appraised value of improved real estate, must not be more than 50% of the appraised value of vacant land, and must not exceed 65% of the appraised value of improved real estate on what is commonly known as "split mortgage loans," that is, where the amortization of the mortgage loan is less than the standard payments made usually.

There is, of course, a limitation on mortgage loans, and the examiners are advised to make certain that Section 27 of the Act is not violated. This act provides that:

"No association having mortgage loans outstanding in excess of the sum of one hundred thousand dollars, shall lend on mortgage on any property an amount in excess of ten per centum of its total mortgage loans outstanding, and associations having mortgage loans outstanding of one hundred thousand dollars or less shall not lend on any property more than ten thousand dollars."

The bonds and mortgages must be examined to see that the bonds have been properly signed, that the mortgages have been properly executed and are on file with the association or are being recorded at the County Clerk's office, and that the bond is for double the amount of the mortgage. The mortgage should be further examined to determine that such details as the date thereof, date of recording, terms, amount, location of property, etc., are set out accurately. The certificates of title should be examined to determine whether

the attorney has certified the mortgages to be first liens on the property, and that the proper assignments are on file.

The certificate of stock should be in the name of the owner of the property, and the examiner should determine whether it has been properly assigned to the association to cover the loan. Insurance policies should be examined to determine whether the insurance covering the loan is adequate, whether the policies contain the standard mortgage clause in favor of the association, and whether the location is the same as shown on the mortgage loan.

It is important to determine, from an examination of the minutes of the association, whether any side collateral submitted by the borrowers, is on file and has met all the requirements as indicated in the minutes of the association.

All mortgage loans made during the period under review should be examined to ascertain whether the deductions made for bonuses and interest are adequate and are properly authorized.

It is important to ascertain whether the proper amount has been paid to the association for mortgages paid off during the year being examined.

The examiners should determine whether the filing methods used by the association meet with the present modern requirements. If the system is not adequate, they should recommend a flat filing system for the securities, making it convenient for ready reference and for examination.

In the examination of the securities, a record should be prepared listing all missing papers relating thereto, and the officials be given an opportunity to produce them. In the event such papers are not presented at the conclusion of the audit, mention should be made in the written report to the Board of Directors.

Share loans represent loans made by an association to subscribers on the pledge of their shares as collateral. The Building and Loan permits a member to borrow from the association up to ninety per cent of the withdrawal value of the shares so pledged.

The examining committee, in auditing the share loans, should verify all the promissory notes on file with the association, by actual inspection. Each note should be examined to

determine that it has been properly prepared and executed and that there is a sufficiency of payments by the member on the shares pledged to warrant the loan. The note should contain a proper assignment of the certificate of shares pledged. The aggregate amount of the notes on file with the association should agree with the amount appearing on the balance sheet of the association at the end of its fiscal year.

In certain cases payments are made periodically on account of the notes held by the association. These payments should be checked to determine that they have been properly credited to the respective accounts. These payments are usually entered on the reverse side of the note, indicating the exact status of the account. Some secretaries do not make this notation of the payments and confusion often results when trying to determine the immediate standing of the subscribers' accounts.

The examining committee should attempt to verify the authenticity of the notes and should see that all signatures on the notes are witnessed. A complete confirmation of the notes should be made by mailing verification notices to the note holders. The result of this verification will give the examining committee a complete and independent confirmation of the share loans. If there are any errors in the notes they should be pointed out specifically in the auditors' report.

An examination of the roll book is made to determine whether interest has been paid on share loans in force, and if the payments are not made, to ascertain that the arrearages, correctly computed, are set up in the annual statement. A schedule of loans should be prepared showing the book number, name, number of shares and the amount of the loan.

The real estate owned by the association should be verified by an examination of the deeds to the property. In the case of real estate acquired under foreclosure, the committee must ascertain that the cost at acquisition is properly set out, that all expenditures in connection therewith have been charged to the real estate account and not to the operation of the buildings. Where charges appear which represent capital expenditures, incidental to the foreclosures of real estate, they should be charged to the cost of real estate acquired. The importance of properly seg-

regating and allocating these disbursements cannot be over-emphasized, since the profits of the association are affected and consequently increase or decrease the distribution to shareholders, depending on how the expenditure is treated. The capitalization of items chargeable to operations results in an over-statement of profits which benefits shareholders withdrawing in the current period; and when items which should be capitalized are charged to operation of real estate, the result is that profits are under-stated and works to the detriment of shareholders withdrawing in the current period.

The examiners should determine that there are no incumbrances on the real estate acquired by the association, with the exception of those appearing on the books thereof. The committee should consult with the counsel to secure such details as may be necessary in the proper recording of the real estate accounts on the books of the association.

An examination should be made of the operations of the real estate acquired, to determine that all expenditures were properly disbursed and had been authorized by the real estate committee, and that the income has been accurately recorded and accounted for.

The insurance should be examined to determine that the amount is adequate and that there is proper liability insurance. The account reflecting the cost of the property acquired by the association for its own meeting place should be checked to determine that the cost thereof is within the limits as provided by the law.

All cash transactions should be scrutinized for the period under review. The examiners should trace the deposits made, from the bank statements to the cash book of the association, thereby determining that all the cash deposited has been accounted for in the books of the association and that there are no receipts as shown on the books which have not been deposited. The amounts on deposit with the banks should be verified by direct communication. If there is any cash on hand, the cash should be counted, and if an imprest fund is maintained by an association, this fund should be audited to determine that the expenditures made by the office are proper. Where an association has already accumulated and set up a Liquid Reserve Fund, as required by law, the amount on deposit, in the savings

or other department of a bank, should be verified by an inspection of the pass book and by direct communication with the depository. The committee must understand that withdrawals from this fund can be made only on the same authority and signatures as the ordinary disbursements are made.

All the disbursements made for the period under examination should be checked with the cancelled vouchers to determine that the disbursements are properly distributed to the proper accounts. Care should be exercised to ascertain that no disbursements were made without proper authorization by the Board of Directors or officers, as required.

All amounts paid for shares withdrawn for the period under review should be verified by direct communication, and the computation should be made to determine that the profits paid thereon are correct.

In the verification of withdrawn shares, care should be exercised that the certificates are on file and have been cancelled. If a certificate is not on file and the shares have been withdrawn, a bond of double the amount of the share paid out should be with the papers. This bond should be issued by a bonding company that meets with the approval of the Commissioner of Banking and Insurance and if a personal bond has been submitted in lieu thereof, the minutes of the association should properly reflect that the Board of Directors saw fit to accept a personal bond instead of one issued by a responsible bonding company.

In the examination of the disbursements, the endorsements and signatures should be scrutinized and the distribution verified. Instances arise where officers or directors of an association who advanced money for the account of certain members and were never reimbursed therefor, withdrew the funds and, although the checks were made payable to the members, endorsed the checks and deposited them to their own accounts. This condition, if tolerated, may lead to manipulations. Checks improperly endorsed, therefore, should be pointed out in detail to the Board of Directors.

Since the passage of the amendment to the Building and Loan Association Act, making it mandatory for an association to establish a "Liquid Reserve Fund," some associations have been fulfilling this requirement by accumulating a reserve fund in the form of se-



curities such as meet with the approval of the Department of Banking and Insurance for this specific fund. The examining committee should determine whether such securities in which the association has invested, are legal investments for building and loan associations. These securities should be examined by actual inspection, and a schedule prepared listing them in the report to the Board of Directors showing cost and market valuations at the end of the audit period.

The accounts of all other assets of the association, such as furniture and fixtures, supplies and stationery, should also be checked as to the amounts at which they are being carried on the books as assets. The items themselves, such as safes, typewriters, desks, etc., making up the furniture and fixtures account, should be inspected in addition to inspecting invoices therefor, and approximating their value and comparing the total with the books will reveal any material discrepancy which may require explanation. Certain fixtures might have been disposed of and might not have been taken off the books, which would not be disclosed by merely examining the account. A detailed list of all items of furniture and equipment owned should be kept. In the case of stationery, pass books and supplies, the common practice is to write all such expenditures off as current expenses. Where, however, the expenditures are quite large and large supplies are on hand, it is permissible to carry the inventory of such supplies as an asset. An actual inspection of the supplies will disclose whether the amount carried as an asset is correct.

This concludes the verification of the assets of an association and we next proceed in the verification of the liabilities of the association.

The principal liability, in amount, of a building and loan association, is the liability for dues paid to it by shareholders on installment shares, and its liability for paid-up shares issued and outstanding. In addition to examining the stock certificate books and ledger accounts, the outstanding certificates and amounts paid in should be confirmed by direct communication with the shareholders.

The verification notices should be mailed out with a return envelope enclosed. The address on the return envelope should be that of the examining committee or its accredited representatives. The subscriber, in returning

the verification, notes that the account is either correct or that a difference exists between his records and those of the secretary. If a difference exists, the account should be promptly and satisfactorily adjusted. As this is one of the most important features in the examination of the accounts, serving the dual purpose of verification and adjustment, considerable care is therefore necessary.

The notices, when received, must be carefully sorted and checked, as the answers have brought to light errors of omission by the secretary, incorrect recording of payments to accounts, and lapsing of funds from one month to another, which in certain cases have been found to be the result of peculations by the secretary. Instances have been noted where money, paid to directors for the accounts of their friends, was not turned over to the association. These notices have therefore been invaluable to the auditors in immediately bringing any irregularities to the attention of the Board. Notations calling for changes in address are usually made on the notices, and have helped the secretary materially in keeping his address file up to date.

Upon the completion of the verification of accounts, a special schedule should be prepared and submitted in the auditors' report, which sets out the differences that exist between the subscribers' and the associations' records. These differences should be immediately reconciled, so that the members of the Board of Directors may know that they have been properly adjusted.

In some associations large arrearages on the books have prompted the auditors to suggest more frequent periodical verifications of accounts under the supervision of the examining committee. This procedure checks the books of the association periodically and reconciles the accounts, if any differences exist. The psychological effect on the shareholder is excellent, of course, as it informs him whether the records of the association are correct and in good order, and is indicative of general good management.

The committee should determine that the law has been complied with in the issuing of paid-up shares. The Building and Loan Act provides, under Section 74, that: "No member shall hold paid-up shares in any association of a value in excess of two per cent of the liability of such association for dues on

installment shares, and in no case shall a member hold paid-up shares in any such association of a value in excess of twenty-five thousand dollars."

Notes payable of an association should be confirmed by direct communication with the bankers or with the note holders and consideration should be given to Section 20 of the Building and Loan Act, which, among other things, provides that the total amount of money borrowed shall at no time exceed thirty per cent of the amount then actually paid into such association as dues on installment shares, and every such association shall at all times reserve, unused, of such borrowing capacity, an amount equal to five per cent of its liability to members for payments made to it by them, such reserve capacity to be availed of only for paying for shares withdrawn or matured. No mortgage loan shall be made by any such association as long as such reserve borrowing capacity remains impaired.

The examiners should carefully examine the lapsed share account, which is similar to a dormant savings account in a bank, and is one which can easily be manipulated. This account is usually verified by mailing an auditors' notice, but receipt of replies thereto is

usually negligible. Payments made thereon should be investigated and thoroughly examined to determine that the monies have been actually paid to the proper persons.

The mortgages payable on the books of the association should be confirmed by direct communication requesting a certificate from the mortgagee substantiating the amount, the interest dates and the last date to which interest was paid for comparison with the books to determine that the amount has been properly set out on the books of the association.

The balances due on mortgage loans granted should be properly verified as to amount and the reason for withholding these payments. In most cases where money is withheld, the mortgage is granted on a certain stipulation, recorded in the minutes, which calls for the performance by the borrower of additional work necessary to complete a building or to bring it up to a certain standard before the full and final payment will be made. The auditors should make an examination of the minutes for the authorization of these payments and to ascertain that the obligation required has been fulfilled.

*(Concluded in June Issue.)*

## Questions and Answers Department

EDITOR, W. T. SUNLEY, C.P.A., Educational Director  
International Accountants Society, Inc.

The following question has been submitted:

*Question:*

May a parent company enter in its accounts its proportionate share of the profits of a subsidiary company and credit such amount to parent's earned surplus? If so, is such surplus available for dividend distribution?

*Answer:*

In a consolidated balance sheet (which is, after all, the true balance sheet of the parent company) the proportionate share of the subsidiary's profits become a part of the earned surplus of the consolidation, (which is the parent company). Since this is so, it is quite consistent to enter such profits in the accounts of the parent company; but they should be

credited to a separate account entitled "Earned Surplus, Earnings of Subsidiaries," in order that a statement of the source of the surplus may be evident without the necessity of analyzing the Earned Surplus Account. Where statements of the individual corporations are to be submitted in addition to the consolidated statement the account "Earned Surplus, Earnings of Subsidiaries" may be eliminated from the parent corporation's individual statement by deducting the balance from the balance of the account representing the investment in the subsidiaries. It scarcely seems necessary to add that whatever method is used should be the same for *all* subsidiaries.

In respect to dividends, the best practice

is that cash dividends should not be paid by the parent company from surplus earnings of a subsidiary until at least an equal amount of cash has been received as a dividend from the subsidiary. If the parent has a preponderance of cash and wishes to use the Earned Surplus arising from a subsidiary's earnings for dividends, the parent can, of course, loan sufficient money to the subsidiary to permit the latter to pay a cash dividend to the parent.

*Solution to Problem 7 from the Service of Examination Questions prepared by The American Society of Certified Public Accountants for May, 1930:*

In answer to a request we are presenting a solution to the Maud N. Manufacturing Company problem which appears on pages 306 and 307 of THE CERTIFIED PUBLIC ACCOUNTANT for October, 1930.

It is an interesting problem because it brings out the various items affected by any adjustment of overhead distribution.

From the statement of this problem, it is very apparent that the cost of sales, cost of machinery manufactured, and the closing inventories of work in process and finished stock are incorrectly stated. The reason for these mis-statements is the over-absorption into the costs of factory overhead.

A logical solution of the problem consists of:

1. Determining the correct percentage of factory overhead to be applied to the costs.
2. Preparing memorandum journal entries to show the effects of the adjustments on the accounts.

3. Applying these effects to the trial balance figures and the inventory data.

As the overstatement of the closing inventories of work in process and finished stock had the effect of understating the cost of sales, the adjustment decreasing the inventories is applied to the Cost of Sales Account thereby increasing that account. This is accomplished in entry (1).

Entry (2) reduces the Machinery and Equipment Account by the amount of the excess overhead included in the charge for the machinery manufactured, and likewise corrects the Factory Overhead Absorbed Account.

The problem states that "the depreciation provision must be corrected." As this depreciation is included in the factory overhead, which has been taken into the cost of sales, the adjustment must correct this later account. See entry (3).

At this point it will be seen that the amount of factory overhead absorbed into the cost of sales still exceeds the actual overhead by \$6,168.33. This situation is corrected by entry (4).

After applying the entries outlined above to the figures stated in the problem, it is clear that the provision for federal income tax should be adjusted to 11% of the corrected profits. A quick side calculation will show the correct income tax to be \$10,008.16. Entry (5) effects the adjustment to the proper accounts.

As stated in the third step, the effects of all the adjusting entries can now be applied "to the trial balance figures and the inventory data" and the required statements can be prepared. An elaborate working sheet is neither necessary nor desirable.

#### MAUD N. MANUFACTURING COMPANY

##### Adjusting Journal Entries, December 31, 1929

(1) Cost of Sales .....	\$1,401.00	
Work in Process (Factory overhead) .....		\$ 819.00
Finished Stock (Factory overhead) .....		582.00

To adjust overstatement of inventories at December 31, 1929 on account of using incorrect percentage in applying the overhead to costs:

	Work in Process	Finished Stock
Overhead as stated .....	\$25,116.00	\$17,848.00
89% of Direct Labor ....	24,297.00	17,266.00
	<hr/>	<hr/>
Adjustment .....	\$ 819.00	\$ 582.00
	=====	=====

(2) Factory Overhead Absorbed .....	114.02	
Machinery and Equipment .....		114.02
To adjust cost of machinery manufactured:		
Overhead applied .....	\$ 3,496.63	
89% of Direct Labor (\$3,800.68) .....	3,382.61	
Adjustment .....	<u>\$ 114.02</u>	
	=====	
(3) Reserve for Depreciation .....	5.70	
Cost of Sales .....		5.70
To adjust charge for over-depreciation		
on machinery manufactured:		
5% of .....	\$114.02	
(4) Factory Overhead Absorbed .....	6,168.33	
Cost of Sales .....		6,168.33
To correct Cost of Sales to reflect actual		
factory overhead included in costs:		
Overhead absorbed per trial balance .....	\$192,832.40	
Less—Adjustment for machinery... ..	114.02	
	<u>\$192,718.38</u>	
Actual overhead per trial balance.. ..	186,550.05	
Adjustment .....	<u>\$ 6,168.33</u>	
	=====	
(5) Accounts Payable and Accrued .....	166.02	
Provision for Federal Income Tax .....		166.02
To adjust provision for Federal		
Income Tax as follows:		
Tax as per trial balance .....	\$ 10,174.18	
11% of corrected profits (\$90,983.26) .....	10,008.16	
	<u>\$ 166.02</u>	
	=====	

## MAUD N. MANUFACTURING COMPANY

Balance Sheet, December 31, 1929

## ASSETS

## Current Assets:

Cash in First State Bank .....	\$ 7,209.15	
Customers' Accounts .....	84,600.31	
Inventories:		
Raw Material .....	\$10,080.48	
Work in Process .....	91,201.02	
Finished Stock .....	65,516.50	166,798.00
	<u>                    </u>	<u>                    </u>
Total Current Assets .....		\$258,607.46

## Fixed Assets:

Machinery and Equipment .....	\$375,007.09	
Less — Reserve for Depreciation .....	100,235.26	274,771.83
	<u>                    </u>	<u>                    </u>

## Deferred Charges:

Unexpired Insurance Premiums .....		1,234.45
		<u>                    </u>

Total Assets .....		<u>\$534,613.74</u>
		=====

LIABILITIES			
Current Liabilities:			
Accounts Payable and Accrued .....			\$ 64,067.23
NET WORTH			
Capital Stock:			
No-par-value Common Capital Stock authorized and outstanding (20,000 shares)			\$256,488.90
Earned Surplus:			
Balance, January 1, 1929.....	\$133,082.51		
Net Profit for Year (after providing for Federal Income Tax) .....	80,975.10	214,057.61	
Total Net Worth .....			470,546.51
Total Liabilities and Net Worth..			\$534,613.74
			=====

## MAUD N. MANUFACTURING COMPANY

Profit and Loss Statement for the Year Ending December 31, 1929

Sales .....			\$974,016.22
Cost of Sales (from Statement of Cost of Manufacture and Sales) .....			774,342.28
Gross Profit on Sales .....			\$199,673.94
Salesmen's Commissions .....			85,314.48
Net Profit on Sales .....			\$114,359.46
General and Administrative Expense:			
Officer's Salary .....	\$20,000.00		
Office Rent and Expense .....	3,376.20	23,376.20	
			\$ 90,983.26
Provision for Federal Income Tax .....			10,008.16
Net Profit for Year .....			\$ 80,975.10
			=====

## MAUD N. MANUFACTURING COMPANY

Statement of Cost of Manufacture and Sales  
for the Year Ending December 31, 1929

Inventory, Finished Stock — January 1 .....			\$157,766.33
Manufacturing Costs:			
Work in Process—January 1 .....		\$ 98,932.48	
Raw Material:			
Inventory—January 1 .....	\$ 17,200.50		
Purchases .....	281,734.10		
		\$298,934.60	
Less—Inventory—December 31...	10,080.48		
		\$288,854.12	
Direct Labor .....		209,600.44	
Factory Overhead .....		186,544.35	
		\$684,998.91	

Brought Forward .....	\$684,998.91	\$98,932.48	\$157,766.33
Less—Cost of Machinery Manufactured.	10,637.92	674,360.99	
		<u>\$773,293.47</u>	
Less—Work in Process—December 31		91,201.02	
Cost of Manufacture .....			<u>682,092.45</u>
			<u>\$839,858.78</u>
Less—Inventory, Finished Stock—December 31			65,516.50
Cost of Sales .....			<u>\$774,342.28</u>
			=====

MAUD N. MANUFACTURING COMPANY  
Schedule Showing Analysis of Cost of Sales  
for the Year Ending December 31, 1929

	Material	Direct Labor	Factory Overhead	Totals
In Process, January 1, 1929.....	\$ 41,236.48	\$ 30,050.00	\$ 27,646.00	\$ 98,932.48
Put in Process .....	288,854.12	209,600.44	186,544.35	684,998.91
	<u>\$330,090.60</u>	<u>\$239,650.44</u>	<u>\$214,190.35</u>	<u>\$783,931.39</u>
In Process, December 31, 1929 ..	39,604.02	27,300.00	24,297.00	91,201.02
	<u>\$290,486.58</u>	<u>\$212,350.44</u>	<u>\$189,893.35</u>	<u>\$692,730.37</u>
Less—Cost of Machinery Manufactured .....	3,454.63	3,800.68	3,382.61	10,637.92
	<u>\$287,031.95</u>	<u>\$208,549.76</u>	<u>\$186,510.74</u>	<u>\$682,092.45</u>
Finished Stock, January 1, 1929..	62,438.33	49,650.00	45,678.00	157,766.33
	<u>\$349,470.28</u>	<u>\$258,199.76</u>	<u>\$232,188.74</u>	<u>\$839,858.78</u>
Finished Stock, December 31, 1929	28,850.50	19,400.00	17,266.00	65,516.50
	<u>\$320,619.78</u>	<u>\$238,799.76</u>	<u>\$214,922.74</u>	<u>\$774,342.28</u>
	=====	=====	=====	=====

MAUD N. MANUFACTURING COMPANY  
Calculation of Correct Overhead Percentage  
for the Year Ending December 31, 1929

Total Factory Overhead —	\$186,550.05
Total Direct Labor —	\$209,600.44
	= 89%

MAUD N. MANUFACTURING COMPANY  
Calculation of Correct Federal Income Tax  
for the Year Ending December 31, 1929

Cost of Sales (per trial balance) .....	\$779,115.31
Adjustments:	
Add—Entry (1) .....	1,401.00
	<u>\$780,516.31</u>
Deduct—Entry (3) .....	\$ 5.70
Entry (4) .....	6,168.33
	<u>6,174.03</u>
Corrected Cost of Sales .....	<u>\$774,342.28</u>

## Expenses:

Salesmen's Commissions .....	\$85,314.48	
Officer's Salary .....	20,000.00	
Office Rent and Expense .....	3,376.20	108,690.68
Total Costs and Expenses .....		\$883,032.96
Sales .....		974,016.22
Net Profit prior to providing for Federal Income Taxes.....	\$ 90,983.26	=====
Tax: 11% of \$90,983.26 .....	\$10,008.16	=====

## Auditors' Certificates

(12)

*(Continued from page 269)*

certify that the foregoing statements are in accordance with the Treasurer's books, and the reports received from the Company's Office.

AUDITORS.

(10)

We have examined the accounts and records of x x x for the period, November 2, 1929 to November 1, 1930, and certify that the above Balance Sheet and Income and Surplus Account consolidating all 100% owned United States and Canadian companies are in accordance therewith and, in our opinion, are drawn up to exhibit correctly the position of the company as at November 1, 1930 and the result of its operations for the year. The inventories of product, merchandise, and supplies have been valued at cost or market, whichever was lower, or at market where costs were not ascertainable.

(Signed)

(date) *Certified Public Accountants.*

(11)

We have examined into the affairs of x x x x and of its Subsidiary Companies and have verified the Assets and Liabilities shown above and the relative Surplus and Income accounts. The Net Income is after deducting all Development expenditure of the year, Depreciation of Coal and Timber Lands and Depreciation of Plants and Equipment. We hereby certify that this Balance Sheet shows the financial condition at 31st December, 1930, of the companies as an aggregate whole and that the accompanying Surplus and Income accounts for the year ended that date are correct as stated.

(date) *Certified Public Accountants.*

Having made a general audit of the books and accounts of the x x x and its Subsidiaries as of December 31, 1930, we certify that the foregoing Balance Sheet and related Trading and Profit and Loss account are true Exhibits of the accounts and, in our opinion, correctly set forth the financial condition of said Companies as of December 31, 1930, and the results from operation for the year then ending.

THE AUDIT COMPANY OF  
(Signed) *President.*

(date)

(13)

To Committee:

We report to the Members of the x x x x x that we have examined the above Balance Sheet with the Books of the Company and have obtained all the information and explanations we have required. No provision has been made for depreciation on the Company's Fleet and Properties for the year. A substantial part of a bad debt incurred during the year has been charged against a Taxation Reserve no longer required. No provision has been made in the Accounts for the Directors' Fees for the half-year to 31st December, 1930. Subject to the foregoing, we are of opinion that such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the State of the Company's affairs as at 31st December, 1930, according to the best of our information and the explanations given to us and as shown by the Books of the Company.

*Chartered Accountants.**(The discussion will appear in the June issue.)*

# Managerial Control of Sales Products and Markets<sup>\*</sup>

IT is a managerial function to define the requirements of an individual business and to create accounting, research and statistical divisions to meet these requirements, having in mind the necessity for operating and for financial information, and the necessity for forecasting and for historical data.

With modern day mass production methods, the competitive struggle is a battle for volume rather than large profit per unit. To achieve this it is necessary to have a thorough knowledge of markets—which consists of those people who deeply influence the demand—the ultimate consumer—those who destroy the exchangeable value of goods instead of those who merely add time, utility, and place to them. Management will find that their knowledge of the market for their products involves a knowledge of their potential value and volume and the expense involved in covering them. A knowledge must be had of the potential profits as compared with the volume of sales to be obtained, as against the required investment in plant, accounts receivable, inventories, etc.

Any plan of control must compare the consumer and producer characteristics and demand under the following general classifications:

- (a) Territorial Determination—Where can the products be sold?
- (b) Potential and Quota Determination—How much can be sold?
- (c) Channels of Distribution.
- (d) Competition.

## TERRITORIAL DETERMINATION

Consumer: The demand ordinarily follows population; trading areas may be determined by topography, ease of communication, available transportation. It may be independent of political boundaries. Consideration must be given to changing habits due to the influence of good roads, automobiles, moving pictures, the intelligence had by the radio,

etc. Some distinction must also be made between wholesaler and consumer trading areas.

Producer: Industrial markets will be found highly concentrated:

75% will be found in	Pct. of Counties
Manufacturing Plants . . .	12.8
Wage Earners . . . . .	6.8
Wages . . . . .	4.7
Cost of Materials, etc . .	4.9
Values — Total . . . . .	4.5
Values — Added . . . . .	4.5
Power . . . . .	11.1

It may be better to sell to few rather than to many customers.

## POTENTIAL AND QUOTA DETERMINATION

The characteristics of the demand must be studied: How much, where, when? A study of the consuming possibilities of the market must be made in an endeavor to determine the present consumption by the total per capita—by cities and towns—or on the basis of some other consuming unit.

Statistics of production by the various companies in a field may be had through trade associations, governmental reports, or by special studies. To find the market, it is necessary to know to whom the appeal must be made. It must be determined whether the demand for the product is had through style, or, in case of territories, through transportation costs which are less than those of competitors—through climatic conditions. The field for the product might also be limited somewhat by the financial strength of the producing company. The necessity for investment in accounts receivable, that of raw materials, finished products, while awaiting the turnover.

It must also be determined before a sales quota can be established through the character of the product and the demand as to what creates the consuming impulse for the product. Is the product one for which the demand is had in buying season? In other words, through seasonal purchases. Is it one for

<sup>\*</sup>Excerpts from an address given by T. M. McNiece before the New York Chapter, National Association of Cost Accountants.



which the demand can be gauged through building records—through the records of weddings, births, fire losses, etc. A determination of the potential demand will measure the entire market—and thus enable you to budget production for the individual share of the market which your plant should have.

So that with a knowledge of the total of any market consumption for a product and the quota consumption for the individual plant established, it is possible to ascertain the sales progress in any territory.

In the establishment of the potential market demand, it is necessary to have a knowledge of the causes which control the business or economic cycle so that the manufacturer will not be prone to expand in the hope of added profit during the boom portion of the cycle, but will keep his business on an even keel so that contraction or liquidation of stock can be readily had in the depression part of the cycle.

To quote from a recent publication of the Department of Commerce: "How to Use Cost Business Statistics." "A brick manufacturer saw from the chart of his association statistics that over-production took place in this industry when orders and shipments slackened, thus increasing stock. On the other hand, the manufacturers under-produced when orders increased by filling orders from stock. The result was an accumulation of stock produced at relatively high costs which were a financial strain on idle capital and eventually resulted in liquidation at lower prices. This firm instead of stocking while prices were falling, stocked ahead as soon as demand appeared to increase, which saved them carrying idle stock over depression and enabled them to produce stock at the lowest costs when better workmen were available. Through this method and slight price cuts whenever total stocks in the industry mounted this manufacturer's business was always in liquid condition gaining interest earnings from investments, and profits from low cost stocks, making his capital work both ways. Moreover, when stocks were liquidated, securities purchased were usually at a low price and interest rates high, while in starting to stock goods, when business was beginning to advance, securities would be high owing to low interest rates and a profit could be obtained in liquidating them to accumulate stock."

Knowledge must also be had as to whether the market is growing or shrinking. A rapid increase in demand means an undeveloped market and larger sales quotas may be established than in a shrinking market. The financial condition of your competitors must also be known for if, for instance, the present consumption is 100,000 units, and the manufacturer's production is 10,000 units, he must get 10% of the total market demand in order to operate his plant at capacity. To ignore the methods of your competitors—their resources—length of time they have been in business—is to fight in the dark. Knowledge must be had as to the relative strength of your competitors, the percentage of business secured by each. Suppose one gets the major portion of a total business, to rectify the remaining minute portion, it may be better policy to go after the business of the smaller more inefficient manufacturers than the larger ones.

#### CHANNELS OF DISTRIBUTION

Consumer: To market the product direct to the consumer would require a much larger number of salesmen than if the product were placed through the wholesalers, and to market it through retail stores would require a much larger sales force than to market it through chain stores.

In this connection, a knowledge of your competitors' methods would be of value, for in order to obtain your percentage of the total demand for the product, it may be necessary for you to adopt some quicker method of distribution than he has adopted. If the product which you are marketing requires further manufacturing before reaching the ultimate consumer, your market will be found with the intermediate producer or through wholesalers who supply their wants.

Any marketing campaign should be preceded by a carefully prepared budget of estimated receipts and expenditures. As an example, the following items should be included:

1. Tabulation of complete expense balanced against returns from 90% of proposed first year's output.
2. Detail of manufacturing expense.
3. Detail of sales organization expense.
4. Detail of advertising expense.

*(Continued on page 306)*

# Depressions, Management and Shareholders

By BORIS BAIEVSKY, C.P.A., Washington, D.C.

THE recurring depressions are getting deeper each time. The growing industrialization is generally recognized as one of the outstanding causes of depressions, but that increasingly poor business management is a factor of equally if not of greater importance as a cause of depressions, is perceived rather dimly as yet.

Unfavorable economic and human factors work toward the lowering of business management, because ownership and management are growing farther apart, and furthermore, the detrimental consequences are accentuated by opposing trends; namely, while demands upon the management are getting more complex and its duties more exacting, the selection of the management is becoming more and more a matter of chance.

The dominating form of business of today is a corporation. In general, the procedure is something like this—a new corporation is formed by a group of men and is headed by persons well known in the business world who become the corporation's board of directors. Often they are on many other boards and do not have time or the desire to work on each and every corporation on the boards of which they serve. Even if they would, these directors cannot be equally well informed of the work of the multifarious corporations that they take part in.

For the same reason, the board of directors which elects officers does not exercise proper supervision over the officers of the corporation who manage the affairs of the company.

The real owners of the business, the shareholders, who are most vitally interested in the success of the corporation, hardly can exercise any influence over their investment; they are scattered over the country or even over the world and are not in a position to attend the meetings.

In order to have a quorum on these meetings the management asks the shareholders to mail the proxies to the management. The shareholders do not know whether the matters to be decided at these meetings are for

their benefit or detriment but what can they do? To refuse the mailing of their proxies may mean the blocking of the conduct of the business of the corporation, so they have to send the proxies to the management. In this way the management and a few shareholders, without considering the real owners—the shareholders as a whole—manage the corporation as their private affairs, and at times, for their own ends.

The financial statements, in too many cases, are meager. Not always are these statements certified, so even, the information that is given is open to doubt as to its correctness and truthfulness.

The shareholders are left in the dark; the management does not take them into its confidence. Should some of the shareholders ask questions to amplify the annual report and statements, such questions may be brushed aside.

The management, knowing the impotence of the owners—the shareholders, feels secure in its position, whether they are good executives or poor, mostly poor, as shown by the conditions of the majority of corporations during the last two years, and still these executives remain in the saddle to the detriment of the shareholders whose investment and income are melting away to the vanishing point.

Not only is such a state of affairs a direct loss to the individual shareholders, but the result of inefficient corporation management is a national loss that affects everyone whether he is a stockholder in such poorly managed corporation or not, and the nation, meaning you, your friends, your neighbors, your community, etc., has to foot the bill; every failure of a corporation has its repercussions on sound and well managed corporations who have to suffer from the mismanagement of corporations entrusted into wrong hands.

Failure of a corporation means the throwing out of employment of a number of people, thus reducing the purchasing power of that group, reacting unfavorably on the community where these unemployed live; such

failures usually react on *their* creditors, sometimes causing the failure of other corporations, thus spreading the above-mentioned consequences in ever wider and wider circles; the failure also reacts on the banks, on their credit, and on everybody who has to come to the banks to secure credit for the conduct of business.

Who are the chief executives in a number of old established corporations? In many cases, they received their training in the "horse-and-buggy" period. Since that time we have had the advent of automobiles, radio, aviation, numerous inventions, the effects of the World War, which affected everyone and everything.

Business methods had to be changed accordingly. But the type of executives referred to above did not grow with the changed conditions; all they can see is external changes, while the underlying causes and the entirely new forces and relationships are beyond their comprehension. They are on the top—whether they got there rightly or not, and now they are a dead weight on the affairs of the corporations of which they are heads. They do not understand the new world and resist the inevitable changes. Humanly enough, they select their associates and subordinates among persons of the same type so the workings of such an organization notwithstanding its many seemingly new gadgets are thoroughly antiquated in spirit and system.

#### PERSONNEL

One of the outstanding shortcomings of the present-day management is the lack of comprehension and control of the human factor of the corporation, namely, its personnel.

Any person who has something that fills a human need, be it goods or services, may find financial backing. But enterprises that turn out a most wanted article and have ample capital, may be ruined by inefficient management and personnel. After all, it is the human element, the personnel, that does the work and produces profit. The earning power of an enterprise depends on its management and personnel. The same physical plant may produce large profits under a good management, and then show "red figures" when that management is replaced by a poor one. The organization, that is the men and women who

make up that organization, is the most vital factor of any enterprise; these men and women are responsible for the success or failure of the business. However, this fact is hardly given recognition, except in talks and writings, but not in application.

In factory work, where unit costs have to be worked out, the high cost of turnover of the operatives and of the indiscriminate "hiring" and "firing" was directly reflected in the cost sheets. Therefore, this fact was recognized, proper conclusions were made, and steps were taken to remedy such situation.

But how do things stand in the main office, where the mainsprings of the business are located? There the human factor is given little thought, if any.

All items of the corporation's assets are minutely watched and accounted for, but the most important asset of any corporation, its personnel, is entirely left out of consideration by the higher executives. Some executives do not even recognize the need of giving their attention to this vital matter or if they grudgingly admit that the personnel should be given attention, they take only half-hearted measures for controlling it. Certain vague policies are adopted, and an employment department is set up—for clerks and minor executive positions only—and the employment manager is left to shift for himself.

In accordance with the attitude of the management toward the personnel question, the position of such an employment manager is a minor one—his opinions are considered of small importance, his authority and the field of his activities are limited. This is at the best, while in the majority of cases the management is not even dimly aware that such a personnel question exists, with all the disastrous results of chance hiring of employees, their only qualifications being to fit in in accordance with the notions of such executives that only "experience" counts; experience acquired under supervision of a man who got it in the same way. That is a practice which might have worked well one or two generations back. Such methods and practices as are being handed down, become more and more out of date and are soon obsolete. If a man with modern training happens to get into such an organization, he is looked down upon as a "theorist" — "impractical," and he has to do as the others, or get out.

Thus, notwithstanding many innovations in such organizations that on the surface claim to be modern and up-to-date, the substance of the management is far from that and is truly backward. The organization is spiritless; the executives work in a routine way, though claiming adaptations of modern ideas, while the file and rank of the personnel play the part of cogs in a machine; this means working without interest or initiative, with consequent inferior performance.

The cost of training such employees is high because the superiors, the teachers, do not know much and when they do know the "how" of doing their work, they cannot impart their knowledge to the employees who, in their turn, are not over zealous to learn. It is a long and costly way, and then, after a time, for one reason or another, the employees leave, being either "fired" or on their own initiative, tempted to try a new place in the hope that it may turn out better—and the same training process starts all over again, with the same wasteful results.

As an example of the aforementioned vague policies of the management, if these may be dignified by such a name, is an order to the employment department to consider applicants not over a certain age, setting such an age limit at about forty years, or even lower, thirty-five years. Can anything be more uneconomic? Age is an individual matter—one may be old at thirty, if he doesn't develop his abilities, and another is young at seventy if he retains the interest in life and his work and is moving with the time and not against the tide of progress.

With the right kind of a man, any and every kind of experience helps in training him to do better work, and as the time goes on his usefulness and value increases in the same business, and so does his adaptability to new lines or new work.

While the person is young, many interests may interfere with his business work, but after one grows older his business becomes more and more his dominant interest and he gives to it the best that is in him, whatever position he may occupy, provided, of course, that he feels that he is treated not as a piece of machinery, but as a human being; just, not arbitrarily, at the whim of his superior; given an opportunity to exercise an authority within proper limits, to apply his own ideas, and

bearing full responsibility for the results; and having an assurance that his work will be duly recognized. Under such conditions, the old-age limit certainly will not be thirty-five or forty years, but nearly twice as high, the same as that of executives, who are made of the same clay as the employees are. If it is true that the average quitting age of employees is only fifty-five years, while executives are not retired till they reach seventy or seventy-five years, it would mean that the present-day management wastes from 20 to 25 most useful years of its personnel, that is, nearly half of the most valuable asset of any corporation.

People, the same as machinery, get out of order, deteriorate; but unlike machines, whose production capacity can be calculated, the abilities of human beings for work and development cannot be accurately forecasted. Given the right conditions, a human being may develop remarkable powers within an amazingly short time and retain them nearly to his last breath. Anyone can recall such cases within his own experience.

That is the reason why employees—I say "employees" because they are part and parcel of the management, should be properly selected, trained for their particular work, and and also to do that work as members of a team; their performances and capabilities should be recorded, and an inventory taken of the personnel just as of any other tangible asset. Upon the results of such an inventory it will be possible to make the necessary adjustments, eliminating "dead wood" and fitting each member of the organization in a place where he can produce the maximum results. Such a situation will afford an opportunity to stimulate the work of older and most valuable members and make it last a longer period, cashing in on their accumulated experience, and, also, to recognize the special abilities of the younger members of the organization.

You may ask "But after all, just how can an executive be measured and how can one find out whether he is up to the mark or not?" The answer is not difficult.

#### ORGANIZATION

Take a look at an appraisal of his associates and subordinates. The grade and quality of subordinates denotes the calibre of the

executive, of course, provided this executive has the authority to choose his employees.

The function of an executive is to select the right man for the right place; give that man full authority to do the work and hold him responsible for the results to be secured at proper costs.

The executive plans for the organization, coordinates the work of his associates and controls their work, but the daily work of each department, from the largest to the smallest one, is done by the chiefs of these departments who must work out their own problems. If the executive is what that name implies, he will find the right associates for the work who in their turn will select proper men, and so down the line.

Next, observe the attitude of the employees. Are they alert—know their “stuff”—and show interest in their work; or are they just bored and trying to “pass the buck”? Is the work done systematically and with the resulting speed and accuracy? Or are the employees running from one place to another asking questions, without any one knowing exactly where to find the information, and how to find it; does the work of the organization show team work, or are each department and each employee working for themselves?

Next, examine the policies. Does the management look only to the present glory, satisfied to just go on, or does it look ahead searching for increased uses of its products, new uses for it, improving its qualities, form, substance, appearance, or creating new products, in order to meet the changing conditions, not only to hold its place in line but to surge ahead, to get its due share of the consumers' dollar and of its special line of business, in proportion to the organization's capacity. Do these activities form an integral part of the organization, for instance in the form of research departments, laboratories, and the like, or is it just satisfied to point to the volume of sales that hold out, without bothering much to investigate how long such sale will continue in the future?

In other words, investigate if there is an organization with all that this word implies. Just having capable and alert men is not enough—they can succeed only in case they work toward a common goal in perfect teamwork.

This means that all of the plans have to be

worked out in detail, from the top down the line, to the smallest unit and the lowest member in the organization. Each member of the organization has to produce certain results, in quantity and quality, at a certain cost, and at a definite time, each doing his special work with one guiding idea; namely, to gain the common goal—net profits, not profits for his department, but for the enterprise as a whole.

#### SYSTEM AND CONTROL

However, to select the personnel and outline a plan is not enough. The executive has to see that his plan is carried out, and on schedule too, so it is necessary to have not only a plan, what to do, but a system, how to do it, and also suitable tools to enable the executive to control the work of the organization.

Figures and reports may be distorted either through ignorance or willfulness, to show better results and thus cover poor management or to manipulate the market by either showing conditions better than they are (if the aim is to “unload”) or worse than they actually are (if the goal is to “freeze out” the stockholders). Whatever the reason, these reports and figures are of no use if they do not represent the actual conditions. They may mislead the management into decisions which are not warranted by the actual state of affairs, and may work to the detriment of shareholders, who on the face value of incorrect or untrue financial statements may be induced to sell their holdings at a price below their true value or to buy new or additional stock at a price far in excess of its intrinsic value.

#### AUDITS BY C.P.A.'s

A procedure which may guard against such happenings is to have the book of accounts audited by qualified and disinterested persons who will not certify such financial statements unless they are correct and true.

In order to get such a protection to the fullest degree possible, this certificate should be issued by persons who are qualified for this work and are to be trusted. The shareholders have no way of knowing whether the auditor who certifies the financial statements is up to the requirements. However, when he sees that after the name of such an auditor stand the letters “C.P.A.” (Certified

Public Accountant), he may feel reasonably assured as to these two points because this means that a State authority vouches for a certain minimum of technical fitness of such a person for this particular work, requiring him to pass a rigid examination, and also for his integrity; otherwise his certificate would have been revoked. Thus, financial statements certified by C.P.A.'s give the shareholder an assurance that the statements of conditions and activities of the corporation are, at least, as good or bad as they are stated, giving a fair basis for any decisions or actions.

A management sure of its efficiency and integrity can only gain from such an audit by disinterested and qualified persons; the only ones who may object to such a course, are executives who are afraid that such an auditor would uncover their inefficient management or manipulation.

But how about the cost of such audits? As in any other business outlay, it doesn't matter how much or how little one pays, but whether the expenditure is justified by the results obtained.

The New York Stock Exchange states that it makes every effort to have the activities of all corporations that are listed on its Board clearly reflected in their reports, and that it has given much consideration to the question of making a requirement of audits by outside accountants. Although such a regulation is not in force as yet, a number of well known corporations have, voluntarily, their annual financial statements certified by C.P.A.'s. Obviously these corporations consider that the expense for such an audit *is* worth the results.

For any enterprise that is properly organized, the cost of an independent audit is comparatively small. If the corporation is not properly organized, the more reason there is to engage an outside auditor because such a course may bring out the losses due to the lack of proper organization, and suggest means for the devising and installing of a clear-cut system; that is, not a "ready-to-wear" system, but one designed to meet the requirements of this particular business, that takes into consideration all factors—business activity, personnel, financial resources, etc.

It is the only way to get proper records and reports that will enable executives to do their work, that is, to control their subordinates, their performance, and do it currently at the

time when this work is being carried on, observing the deviations from the plan, investigating the causes of such unfavorable deviations at once, and enabling them to devise remedies before the detrimental conditions gain headway, or, in case of a performance more favorable than planned, to take full advantage of such conditions.

It may sound elementary but, unfortunately, too many executives even of large enterprises fail to comprehend the necessity of a plan and its requisite; namely, a properly designed set of records that form a system. These are necessary not only for control purposes, but also for formulating policies and planning future operations. Such executives still look upon a professional accountant as a necessary evil without realizing that decisions, as in the past, based on a hunch or inspiration might have been quite proper in days gone by; but at present the stakes are too great and therefore to act upon guesswork is positively unforgivable when there are well-known ways and means to act upon a firm basis of facts and trends that are presented in illuminating form, facilitating the grasping of their significance, saving the time of the executive from the study of details and calling his attention to the important matters to which he must give his immediate attention.

However, under the present form of business organization, a management of the type referred to above remains at the helm, and there is no machinery for its removal.

#### A NEW WAY FOR SHAREHOLDERS TO MANAGE THEIR INVESTMENTS

What is the remedy? Do the shareholders have to attend all the meetings or does it mean that the corporate form of doing business has outlived its usefulness? Certainly, no.

Even should the shareholders come to the meetings, they would be unable to take a firm hold on the affairs of the corporation, because not all of them are trained to read financial statements and, in particular, to interpret them correctly, and they are even less qualified than the board of directors to pass an opinion on actions of the management or to recommend policies, choose a new management, etc.

*(Continued on page 289)*

# Early Accounting Bibliography

IN connection with the annual meeting of the American Association of University Instructors in Accounting, held in Washington, D. C., last December, the Library of Congress prepared an interesting exhibit of its references to early accounting. We list the documents below:

<i>Title and Description</i>	<i>Author or Editor</i>	<i>Date</i>
Sumerian administrative documents.....	David Vilhelm Myhrman (1866)	3945 B.C.
Babylonian cuneiform tablets .....	C. J. Gadd (1929) .....	2474 B.C.
Mathematical, metrological and chronological cuneiform tablets...	H. V. Hilprecht .....	2200-1350 B.C.
Babylonian legal and business documents .....	Hermann Ranke (1906) .....	1977 B.C.
Code of laws of Hammurapi .....	Robert William Rogers .....	1950 B.C.
The Rhind mathematical papyrus .....	{ Arnold Buffum Chase } { Henry Parker Manning } .....	1650 B.C.
Early ledger account .....	Albert T. Clay .....	1322 B.C.
Business documents of Murashu sons of Nippur .....	Hermann Vollrat Hilprecht .....	464-424 B.C.
Legal and commercial transactions of Murashu sons of Nippur.....	Albert T. Clay .....	424-404 B.C.
Egyptian Business documents from the Thebaid .....	{ A. H. Gardiner, H. F. H. Thompson, J. G. Milne }	
Business documents from Egypt under the Ptolemies .....	F. Ll. Griffith	
Accounts relating to the cost of building the Erectheum .....	{ G. P. Stevens, L. D. Caskey, H. N. Fowler, J. M. Paton, }	409-8 B.C.
Receipt roll of the English Exchequer .....	W. A. S. Hewins .....	1185
Charters of Endowment, Inventories and account rolls of Priory of Finchale (England) .....	Surtees Society publications...	14th Cent.
Facsimile of first page of Pacioli's "Summa de Arithmetica" in history of accounting and accountants .....	Richard Brown (1856) .....	1494
Original translation of Pacioli's treatise on double-entry bookkeeping, Pietro Crivelli .....		1494
Facsimile of title page of Domenico Manzoni's book on bookkeeping, Wilmer L. Green (1930) .....		1534
Treatise .....	Giacomo Manenti .....	16th Cent.
Treatise .....	Giovanni Mariani .....	16th Cent.
A Spanish account in "The Merchants Avizo" .....	John Brown .....	1589
"The Accountant" by Rembrandt Biographical introduction by .....	Adolf Rosenberg (1907) .....	17th Cent.
Reproduction title page of "The Merchant's Mirrour or Directions for the Perfect Ordering and Keeping of his Accounts, Framed by Way of Debitor and Creditor after the (so-termed) Italian Manner, Debitor and Creditor .....	Richard Dafforne .....	1660 edition
A platform, guide, mate, for purchasers, builders, measurers. In three books .....	Thomas Wilsford .....	1659
Practical Treatise of Arithmetick .....	William Leybourn .....	1668
Debtor and Creditor made easie: or, A short instruction for the attaining the right to use of accounts; with Advice to the women and maidens of London .....	Thomas York .....	1687
Arithmetick surveighed and reviewed: in four books.....	Stephen Monteage .....	1682
The Household Account Book of Sarah Fell of Swarthmore Hall..	Samuel Jeake .....	1696
Treatise on Bookkeeping: Der wehrt geschatzte handelsamnn .....	Norman Penney .....	1714
The Gentleman Accountant .....	Joachim Rademann .....	1714
Arithmetica infinita; or The accurate accomptant's best companion contriv'd and calculated by .....	{ A Person of Honor } { (Roger North supposed author.) }	1715
The compleat compting-house; an essay on bookkeeping by William Webster added to 5th edition .....	Reverend George Brown .....	1718
The exact dealer's daily companion .....	John Vernon .....	1719
The merchant's magazine; or Trades-man's treasury .....	N. H., merchant .....	1721
Le livre des comptes-faits, ov Tarif general des monnoyes.....	E. Hatton, gent. ....	1726
The American Accountant .....	Francois Bertrand de Barreme .....	1723
A new and complete system of bookkeeping by an improved method of double entry .....	Benjamin Workman .....	1789
An introduction to merchandize .....	William Mitchell .....	1796
A Selection of Some Modern Works on Accounting .....	Robert Hamilton .....	1797
	{ John R. Wildman, F. H. Elwell, R. B. Kester, H. A. Finney, J. L. Dohr }	1910-1930

<i>Title and Description</i>	<i>Author or Editor</i>	<i>Date</i>
Accounts for the Maintenance of His Majesty's Military Establishment in North America. (One page original manuscript) .....		1773
George Washington — examples of his school copy work in compound interest. (Original manuscript) .....		1750-1772
George Washington Account book. (Original manuscript) .....		1821-1822
Edgar Allan Poe — bills for his schooling. (Original manuscript) .....		1835
Edgar Allan Poe — tailor's bill. (Original manuscript) .....		

## Depressions, Management and Shareholders

(Continued from page 287)

This function should be delegated by the owners to experts, as everything else in our age of specialists, who are qualified to perform this particular task and who will devote their full time to this work.

It may be arranged somehow along the following lines: A group of qualified men of known integrity, may announce that they will undertake to perform this task for the benefit of shareholders of various corporations.

When a shareholder gets an announcement of a forthcoming corporation meeting, he may send a proxy to that group of men, including a remittance of, say, one cent per share, with a minimum of say, one dollar.

The group, receiving the proxies, will attend the meeting. They will get the financial statements and other reports, and study them before the meeting, thus putting them in a position to interpret intelligently the information given in such statements. If the statements are not sufficiently clear, they will ask the management to elucidate them, asking for the necessary details. They will inquire into phases which are not reflected in the financial statements and other reports, and unless they get a satisfactory answer the management will be advised as to better ways and means or the management, if it is not up to the mark, may be replaced by better men. Such a "group" may work toward evolving uniform records that will make statements and the result of business and management comparable, thus leading toward the establishment of standard performance by management in various lines, because gradually such a "group" undoubtedly will represent more than one corporation in any line of business.

The very fact that the affairs of a corporation will be looked into by qualified persons, will exert a good management to even better

results, and also will help such a management by getting support from such a group representing the shareholders, while a poor management will be brought to light and removed before it could do too great a damage. This, quicker than anything else, will make the management realize that the real owners are the shareholders, not the management, and should the latter fail to do its duty, out it will go, just as any employee who falls down on his job.

The logical nucleus of such a group would be certified public accountants assisted by economists, statisticians, engineers, lawyers, and other experts in accordance with requirements of a particular case.

Why C.P.A.'s? For a number of reasons. Because it is their professional work to verify and to interpret financial statements; also they are independent and disinterested persons who have an opportunity for comparison afforded by their work in various enterprises; thus they may bring the benefit of their training and varied experience to their clients, the shareholders.

Once established, this "group" may have its representatives in strategic business centers, these representatives specializing in particular lines, or even, particular enterprises, thus getting a firm and comprehensive hold on the business of the corporation, the meetings of which they are to attend.

In the headquarters, information coming from its representatives and other sources will be studied by lines and industries, on the background of general business trends and developments, enabling it to call to the attention of its local representative who is to attend the meeting, specific phases that require special attention, or to make specific recommendations, etc.

Ultimately, this "group" may develop an organization that may evolve and fulfill the functions of a National Economic Council, thus eliminating the necessity of government legislation along these lines.



## TALKING SHOP

A Department Conducted by L. GLUICK, C. P. A.

On April 22 Leonard Levine spoke for thirteen and one-half minutes from station WMCA on the subject of "Federal Taxation, Present and Pending." On April 30 the conductor of this department spoke from the municipal station WNYC on the subject of "Retail Realty—Where Shall I Put My Store?"

At the meeting of the Eastern Commercial Teachers Association, held at the Hotel Pennsylvania, New York, during Easter Week, the most popular exhibit was the collections of Messrs. Montgomery, Myer and Herskowitz. Dr. Myer gave his illustrated lecture to a large and enthusiastic audience. Indianapolis committee take note.

Those who read President Miller's editorial in the March issue, and "Our Canadian Friends" on page 187 of the same, and the article on page 67 in February, will find a recent Virginia case most interesting. It is entitled *Masch vs. Schneer et. al.* and the jury gave the plaintiff accountant about fifty per cent of his bill, after listening to a formidable array of "expert" witnesses. The defendant has appealed.

### THIS MONTH'S LAUGHS

from the Cincinnati *Enquirer*: "At least a small income isn't taxed," said the Cheerful Guy. "No," growled the gloomy one, "but it taxes a wife's patience, and that's worse for the husband."

\* \* \*

*Auntie Blossom*: "Walt! Such explosive language—and right before Skeezix!"

*Walt*: "Well, if a tire can blow out I guess I can too."

*Skeezix*: "Uncle Walt, what does tax exempt mean?"

*Walt*: "Well, if anything is tax-exempt you don't have to worry about any tax in connection with it."

*Skeezix*: "Then why don't you get some tacks-exempt tires?"—*Gasoline Alley*.

On April 11 the New York State Society held a meeting devoted to insurance. On the 14th, the New York *Evening Post* reported the sale of several large group policies. Is this cause and effect?

### EMBARRASSING MOMENTS

The following communication has given us the idea that there may be many other members with something on their minds that they would like to tell about. The editor of this department, for his own protection, must know the identity of all contributors, but no names, or even initials, will be printed, if so requested. So step up and tell your troubles; "Confession is good for the soul."

"I am auditor for a club. I make a quarterly audit. At the end of each fiscal year I make a report, which I am obliged to get up and read at the annual meeting. Imagine my chagrin when the Secretary got up and took exception to my report, claiming one item was wrong, and proving it! The loss of the client would have been of no importance; the club pays me a pitiful audit fee. But the loss of prestige among the members, some of whom are business clients, worried me. The explanation was simple when I got to the ledger.

"I was at the Memphis convention when the audit for the quarter ending September 30 came due. An assistant who had worked with me on this engagement many times was left to do it alone that time; and he failed to detect an error in expense distribution. Whether or not I should have caught his mistake is debatable; if a principle has to reaudit his junior's work, what good is there in having the junior at all? But there is no question as to the responsibility. I am the goat. However, I intend to go to Indianapolis anyhow."

And speaking of goats and conventions; the best part of those meetings we have attended is the midnite stag of The Order of Twelve. "Ask Oldtimer; he knows!"

J. H. Amick got a partial victory for a Michigan Cemetery Corporation (25 BTA 544). M. P. Rosenthaler of the same State got a clean verdict for his client (25 BTA 562). C. R. Dawson's case (25 BTA 666) is interesting as showing how difficult it was to get a good hotel for Macon, Ga. The decision must have been a heartbreaker for him and his client. We hope he wins an appeal.

Visitors to pre-Hoover Washington could not help but notice the old eyesore, Center Market, at 7th and B Streets. It was quite a local institution. Even old inhabitants knew little of its history. Now that it is gone, you can read how it started and finished in the case at 25 BTA 576. Aside from the human interest it seems to us to be a leading case to cite whenever condemnation proceedings figure in a tax return.

Amos 'n' Andy fans should find the Prophylactic Tooth Brush case in 25 BTA 676 of immense interest. We never suspected the intricacy of tooth brush making. Nor did we know that "position" could be used as a verb.

Frankly we fail to see the basis of the four-man dissent in the case of Burdette (25 BTA 692). Why is the disagreeing opinion not published? The opinion of Lansdon strikes us as eminently just. On the other hand, there seems to be merit in a five-man dissent in the case of Hancock (25 BTA 607); this also was not published, merely noted. How come?

Our 1932 convention is to be held in Indianapolis, Ind., which is the national headquarters of the American Legion. Star and Sinbad will be there. Will you?

Max Blumenreich was elected first president of the newly-formed Iota chapter of Delta Mu Delta of Brooklyn. H. B. Eversole, of the faculty of commerce, University of Iowa, in addition to being certified in three states has the degrees of B.S. and M.S.

from the University of Illinois, where he was elected to Beta Sigma Gamma in 1922. T. B. Maxfield whose certificate is from Ohio, but is now resident in Syracuse, N. Y., graduated from the University of Wisconsin as a mechanical engineer in 1922, and was elected to Tau Beta Pi and Pi Tau Sigma, which we gather are the Phi Beta Kappa of Mechanical Engineering. Which proves, if anything, that engineering training is a suitable foundation for almost any kind of work.

#### THE SHOP TALKERS

"I suppose," said Blank, "that already, with commencements a month and more away, we are about to be bombarded with letters from bright students seeking opportunity."

"And have more than ever to reject," said Oldtimer. "I feel genuinely sorry for them."

"And to think," said Blank, "that when I told my economics prof. that I intended to take up public accounting, he congratulated me on my foresight in entering an uncrowded profession. That was before the war, of course," he added as Junior gave him a quizzical look.

"The only solution nowadays," said the Kid, "is to hire only the honor men; the Dee Em Dees and Phi Betes."

"Not so good," said Oldtimer. "The presumption in their favor is much overworked. Just because a man gets good marks in school is no proof that he will be a good worker."

"Seems to me," said Dash, "that I heard the personnel man for the biggest certified firm say that while they had a few honor students on the staff, that they had learned to look with suspicion on *magna cum laude* men. They had too great a tendency to be theorists, useless for field work."

"Yes," said Oldtimer, "that is likely to be the case, but not necessarily. In fact, I know one highly successful New York firm which hires only Dee Em Dee men, and one out West which specializes on Beta Sigma Gamma. Nevertheless I prefer a mixed staff."

"But not too mixed," said the Kid. "That only leads to jealousies."

"In the final analysis," said Sinbad, "the question of honors is secondary. When I joined the Navy an old Chief Warrant gave us 'boots' a short talk, to about this effect: The Navy only showed up a man. If he was

going to be a bum, he'd get there faster; and if he had good stuff in him, the Navy would bring it out and build it up. I saw it work in the Navy; and the same thing holds true with education. If a man has brains, college will help; but if he lacks them, ten universities will do no good."

"Now just whom have you in mind?" queried Junior.

"Your dad for one," answered Sinbad. "He never went to college, yet he is our oracle. And the other case is a man in my class at the University. He made a creditable record, but got nowhere near the Dee Em Dee grade. He had to take the C.P.A. exams three times before he passed. But everyone of you would recognize his name if I mentioned it, for today he is known internationally."

"Don't think the Navy has a monopoly on character influence," said Star. "The Army does the same thing. But let me tell you of a man I know. He had been a *cum laude* graduate of New England University (Junior became very self-conscious) and on the strength of that got a job on the same staff to which I belonged. Nice chap, but no mixer. Strong on theory; weak on adding. One senior after another turned him back to the chief-of-staff. Nothing wrong; worked hard; always respectful; but he didn't seem to belong—."

"Well, one fine day the senior in charge of one job failed to appear and this fellow just went ahead and did it solo; and he did it so well that it seemed to show up the absent senior. The poor junior was more unpopular than ever, and the C. of S. recommended his discharge in the interests of harmony. But the big boss demurred. He liked the man's initiative in having taken charge. So he fished around till he found a good spot for him, work in which he could work alone, at his own pace. And today he's a senior partner in the firm, a veritable genius at his own specialty, and reasonably popular."

"Which proves what?" said Blank.

"That if a man makes a good record at school, he will usually do likewise afterwards, given half a chance. The poor students usually are poor workers; or at best stay in subordinate positions, doing good routine work."

"Yes," said Sinbad, "like that man I was

telling you about. Long afterwards I found out about his college course. He had to work all day, and commute. He just could not devote to his study the time that would have brought him honor grades. Released from the load, his ability had a chance to show its worth."

"Last month," said Dash, "I heard a lecture by Dean Winternitz of Yale. He made some very disparaging remarks about Phi Beta Kappa men."

"I'll bet a dollar," said Junior, "he missed election to it himself and is just jealous."

"I won't take you," responded Dash, "because I am sure you are wrong. And anyhow, neither of us could prove our point. Some of the worst cracks at honorary societies I ever heard, came from members."

"As for example," replied Dash.

"One of my clients," replied Dash, "has as his secretary a graduate of Goucher College. The last time I was there she showed me a most interesting article by the president of her Alma Mater. It dealt with just this topic."

"Okay," said the Kid, "but nevertheless, by and large, I'll prefer to take a chance on honor men. They may be flops, but so may the ordinary men."

"Like girls at a prom," said Junior. "The pretty faces catch the eye, and get the most dances. They may be dumb and dance poorly but they get the call over the plain-faced girl with brains."

"An apt comparison," said Oldtimer, "but basically, it's just the old, old adage that 'you can't tell a book by its cover'."

"I agree within limits," said Dash. "But if making good college records does not aid a graduate in obtaining employment, what incentive will there be to study more than just enough to get by?"

"That's a fine point," said Blank, "and I agree. But in the long run, the real true student will study regardless of honors or degrees. And the mere mug-hunters will soon be found out or shown up."

"All right," said Oldtimer. "Each man must be judged by himself, for all his qualities, not just mere ability to recite his lessons well. That's just a form of mental regurgitation."

"I hope the poor fellows get jobs anyhow," said Blank. "Good or bad, they need them."

## C. P. A. Examination Questions

Maryland, November 23, 24, 25, 1931.

### Theory of Accounts

November 23, 1931.

Time Allowed: 9 A. M. to 12 M.

Answer All Questions Fully.

*Do not repeat the questions, but write your answers fully, designating the questions by number. The intelligence indicated by your answers and the neatness and general appearance of your papers will be considered in marking, as well as technical accuracy.*

(1). (10 Points.)

- (a) Explain and compare the cash basis and the accrual basis of accounting.
- (b) State and discuss the factors which you would consider in deciding which basis should be adopted for a given business.

(2). (15 Points.)

Journalize, with explanations, each of the transactions described below, viz:

(a) A sole proprietor, for a fee of \$500 paid him in cash, guarantees payment in six months of the promissory note of John Jones for \$10,000 payable to bearer with interest at 6%.

(b) A corporation has outstanding \$1,000,000 of 5% first mortgage bonds, \$500,000 of 6% first preferred stock, and \$400,000 of 8% second cumulative preferred stock. Its surplus as of January 1st, 1930, was \$40,000, and its earnings for the year 1930 before bond interest were \$25,000. On January 2nd, 1931, it pays a year's interest on the bonds and a year's dividend on the first preferred stock, and passes the dividend on the second preferred stock.

(c) A corporation has \$1,000,000 6% gold debentures outstanding which had been issued at par and mature December 31st, 1930. It has also a sinking fund reserve of \$965,000, sinking fund securities which cost \$900,000, and sinking fund cash of \$172,000. On December 31st, 1930, the Corporation sells the sinking fund securities for \$925,000 cash, pays the installment of interest for the six months ending December 31st, 1930, and pays off the entire bond issue.

(3). (10 Points.)

(a) Describe fully the interest which each member of a general partnership has in the real estate owned by the firm.

(b) Assuming that the surviving partners continue the firm business for two years after the death of one partner without any settlement or agreement with his executor, what are the respective rights and obligations of the surviving partners and the executor at winding up in respect of transactions occurring (1) before the death of the partner, and (2) during the two years' subsequent operation?

## (4). (15 Points.)

Thomas Testator died in Baltimore, leaving the following relatives, viz: John and Robert, children of his deceased brother Henry; his surviving sister, Mary, and her son James; William, Thomas and Chester, children of his deceased brother George, and Ruth and Letitia, infant children of George's deceased daughter Anne. By his will, duly admitted to probate, he devised and bequeathed his entire estate, after payment of debts and expenses, to "my brothers and sisters and their descendants living at my death, per stirpes and not per capita," and appointed Mary as his executrix without bond. His estate consisted of cash \$50,000, securities valued at \$150,000, life insurance of \$10,000 payable to his sister Mary, a note for \$5,000 drawn to his order by his deceased brother George, and life insurance of \$20,000 payable to his estate. The life insurance was collected, but not the note signed by George. Funeral expenses, debts and cost of administration (including taxes) amounted to \$25,000. The securities were not sold.

Draw up the executrix's administration and distribution account.

## (5). (15 Points.)

- (a) Explain, compare and illustrate the following, viz:
- (1) Fixed cost and indirect cost.
  - (2) Variable cost and overhead expense.
  - (3) Loading and budgeting.
  - (4) Piece work and spoilage.
  - (5) Composite depreciation and obsolescence.
- (b) Explain and distinguish between a job-order system and a process system of cost accounting, with illustrations, and indicate the circumstances in which and the extent to which both could be used in the same business?

## (6). (10 Points.)

Give your opinion, with reasons, with reference to each of the following procedures, viz:

- (a) Writing off goodwill by charging it against a surplus arising from the appraisal of the Corporation's fixed assets.
- (b) Including as earned surplus premium from the sale of par value preferred stock.
- (c) Showing trade discount, freight out, and cash discount as deductions from gross sales.
- (d) Including in current assets a 40% stock interest in another corporation with which the owning corporation has close business relations—the stock being listed and actively traded in on the market.

## (7). (10 Points.)

- (a) Explain in detail the exact nature of and procedure involved in a short sale of stock and its subsequent covering.
- (b) Give the entries that should be made in connection therewith on the books of the broker.

## (8). (15 Points.)

The following transactions occurred in the business of Peter Proprietor during the month of December, 1930:

Sales were \$50,000, of which \$30,000 were for cash, and \$20,000 were on credit to the Acme Corporation, from which on December 15, 1930, a 90-day trade acceptance

for \$5,000 was received. The trade acceptance was immediately discounted at the First National Bank. Merchandise purchases were \$40,000, of which \$15,000 were paid for in cash, and \$25,000 were on 60 days credit from Robert Morris and Company.

The following articles were bought for cash: Office furniture, \$1,000; delivery truck, \$1,200; two typewriters at \$100 each; store fixtures, \$1,600. Other payments were as follows: Salaries, \$500.00; repairs, \$250.00; heat and light, \$200.00; telephone, \$50.00; rent, \$1,000.00; miscellaneous, \$600.00.

Peter Proprietor's investment as of December 1, 1930, was \$60,000, all cash. During the month he withdrew \$1,000.00 cash, and contributed new merchandise worth \$5,000.00. On December 26th, 1930, a fire occurred in his store which destroyed merchandise which cost \$500.00 and was not insured. On December 31st, 1930, his inventory of merchandise was \$12,500.

- (a) Show the above transactions properly recorded on single entry books.
- (b) Prepare a statement of assets and liabilities and a statement of profit and loss.
- (c) Draft journal entries to open a set of double entry books on January 1, 1931.

## Commercial Law

November 23, 1931.

Time Allowed: 1:30 P. M. to 4:30 P. M.

Answer All Questions Fully.

(1)

- (a) Define and discuss "consideration" as an element of a contract? Are there any circumstances under which a contract is valid without legal consideration?
- (b) State the elements necessary to make note negotiable.
- (c) What are the usual and essential differences between preferred and common stock?

(2)

A and B formed a partnership for the conduct of a machinery and supply business. They agreed between themselves not to sell tractors to the Amtorg Trading Corporation because they deemed the credit risk too hazardous. While A is out of town, B makes a large sale of tractors to the Amtorg Trading Corporation. A returns and immediately repudiates the sale. Is there a valid contract between the partners and the Amtorg for the delivery of the tractors?

(3)

A minor, who looks mature, purchases a stock of merchandise from an adult, who first inquires whether the minor is of age. The minor represents that he is 22 years old. The sale is then made. The adult sues the minor for the price and the minor makes his minority a defense to the suit.

Answer the following questions, giving reasons:

- (a) Is the minor estopped to set up this defense?
- (b) If the minor is not so estopped and wins the suit, can the adult sue him for damages in a tort action for deceit?
- (c) Is a minor allowed to defend on the ground of minority where he can not restore what he has received?

(4)

Dr. Quack, a resident of Maryland, consulted a lawyer about a bill for \$500.00, covering an operation performed on a patient four years previously. The doctor showed his lawyer a letter written to him two years after the operation was performed and the bill was sent out, in which the patient states that it was his desire to settle the outstanding account, but in which he makes no promise to do so. Dr. Quack asks the lawyer whether or not his claim against the patient is outlawed by the Statute of Limitations. What should the lawyer advise? Discuss fully.

(5)

What is meant by the terms:

(a) Novation.

(b) Accord and satisfaction.

Discuss fully.

(6)

(a) State the general principles which govern declaration of dividends by a corporation organized under the laws of Maryland.

(b) Is a declaration of dividends (otherwise valid) valid if made by

(1) President of the corporation?

(2) The directors of the corporation?

(3) The stockholders of the corporation?

(c) Can a dividend which has been declared and set aside be rescinded? Explain.

(d) If a dividend is properly declared, and following this the corporation becomes insolvent, can the stockholders entitled to the dividend recover the amount of the dividend in full, or do they prove as general creditors of the corporation? Why?

(7)

(a) D, who is insolvent, pays the full amount of his debt to his friend A, who has knowledge of D's financial condition. D also pays in full the amount which he owes his friend B, who receives the payment without knowing anything about D's financial condition. Two months after the first of these two payments D is adjudicated a bankrupt under the Federal Bankruptcy Act, and the trustee in bankruptcy for D seeks to set aside both payments. Will the trustee be successful in either or both cases? Give reasons.

(b) Name four acts of bankruptcy under the Federal Bankruptcy Act.

(8)

(a) Oriole Manufacturing Corporation, a Maryland corporation, has issued and outstanding the following stock:

1,500 shares of preferred stock,

850 shares of Class A common stock,

150 shares of Class B common stock.

Under the charter of the Corporation, exclusive voting rights are vested in the Class B common stock. A proposition is made by the Blackbird Corporation to purchase all of the assets of the Oriole Corporation, which the Directors of the Oriole Corporation are anxious to accept. State the corporate proceedings necessary to authorize a sale of all of the assets of the Oriole Corporation to the Blackbird Corporation.

(b) Suppose all of the necessary corporate proceedings are taken to authorize the sale, but that X, the holder of 50 shares of Class A common stock of the Corporation, objects to the sale, but is unable to sell his stock in the open market. Is there any way in which X can liquidate his stock? Explain.

(9)

A is the holder in due course of B's promissory note in the principal sum of \$1,000.00, dated January 1, 1929, and due September 1, 1931, the note being negotiable in all respects. A, before leaving for Europe, delivers the note to C, to be presented for payment at maturity. On September 5, 1931, C secures a loan for \$500.00 from his bank, and pledges A's note as security. The bank takes A's note without knowledge of any of the surrounding circumstances. A returns from Europe and sues to recover note from the bank. Should A be allowed to recover? Discuss the legal principles involved.

(10)

A, a director of a corporation which had become financially involved, promises B that if B will extend credit to the corporation up to a stated amount for a certain time, he, A, "will see that B is paid." B agrees to and does extend the credit. The agreement between A and B is oral. The corporation fails to pay the account and B sues A. A contends (1) that the "statute of frauds" furnishes him a technical defense, and (2) there is no consideration. Discuss both contentions.

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## Auditing

November 24, 1931.

Time Allowed: 9 A. M. to 12 M.

Answer All Questions Fully.

(1). (10 Points.)

Discuss the various methods of handling returnable containers in different businesses. What is the duty of the auditor in each case?

(2). (15 Points.)

In an audit of a department store it develops that there is a considerable difference between physical and book inventories in some departments.

What could cause such a difference?

Prepare a schedule showing the computation of an inventory by the retail method using your own figures and giving consideration to opening inventory, purchases, sales, mark-downs, additional mark-ups and transfers from other departments. Show clearly how percentage of mark-up in final inventory is determined.

(3). (10 Points.)

How should the following items appear on the balance sheet:

Liability as accommodation endorser on note.

Cumulative preferred dividends unpaid.

Prepaid balances by customers on unfilled contracts.

Collateral belonging to firm and hypothecated with bank as security for loan.

Legal actions pending against firm.

(4). (15 Points.)

Can surplus available for cash dividends be created in other ways except through profits earned from operations? Explain fully.



(5). (15 Points.)

In connection with proposed financing, define and differentiate annual profits available for bond interest; for preferred dividends; for common dividends. Discuss fully.

(6). (15 Points.)

Discuss the advantages and disadvantages of no par stock.

(7). (20 Points.)

A corporation issued January 1, 1929, 20-year mortgage bonds in the amount of \$200,000 which were sold at 95. It is provided that \$10,000 shall be redeemed and cancelled annually at a price not greater than 105 and a reserve for premium was set up monthly on the books. 20 bonds have been accordingly redeemed at 105.

On July 1, 1931, due to the depression in security values, they bought \$45,000 of their bonds at 80 borrowing \$30,000 at their bank and hypothecating the bonds purchased as security therefor; their expressed intention is not to resell the bonds but use them for redemption under the provisions of the indenture.

How should all bond transactions appear on their books and on the balance sheet as at July 1, 1931?

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## Economics

November 24, 1931.

Time Allowed: 1:30 P. M. to 4:30 P. M.

Answer All Questions Fully.

1. The economic system of this country is spoken of as one of "free private enterprise." What is meant by this? Under this system, what are the forces that determine how much of each type of goods is produced? What are the forces that protect the consumer against extortionate prices or inferior quality of goods? Explain your answers fully.
2. What are the more important advantages and disadvantages of large scale production. Explain why they are not the same for all types of industry. In what way does the extent of the market affect the possibilities of large scale production? How do the high protective tariffs of small European states affect the possibility of large scale production in those states? Is the same effect produced by a high protective tariff in the United States? Explain fully.
3. How do you account for the growth of the corporate form of business organization in this country in recent years?  
A corporation needs \$5,000,000 to enlarge its plant. It is necessary to decide whether the money can best be raised by issuing bonds, preferred stock, or common stock. Point out the conditions under which each of these methods would be most desirable.
4. Can the following statements be reconciled? "Price is determined by supply and demand." "Supply and demand are determined by price." Explain. What is meant by elasticity of demand? Explain its importance in connection with prices.
5. What are the functions that money performs in our economic system? What is meant by the gold standard? By the bimetallic standard? What factors would you say are responsible for a reviving interest in a bimetallic standard? Give the reasons for your answer.

- 6. What changes in our banking system were brought about through the establishment of the Federal Reserve System? Why have we had so many bank failures recently in spite of the Federal Reserve System?
- 7. It has been proposed that, as a means of bringing back prosperity the Federal Government should float a bond issue of from \$3,000,000,000 to \$5,000,000,000 for the purpose of financing a program of public construction. What arguments might be advanced for and against this proposal?
- 8. Discuss the economic effect of a fall in the general level of prices upon the following: the debtor, the creditor, the man working on a fixed salary, the owner of a business, the holder of a deposit in a savings bank, the beneficiary of a life insurance policy.

Practical Accounting

November 25, 1931.

Time Allowed: 9 A. M. to 1 P. M. Answer All Questions Fully.

No. 1. (20 Points.)

The cash book of the Millenburg Corporation showed the following transactions for the period from July 1 to 10, 1930:

RECEIPTS.

	Total	Checks	Currency
Balance, July 1, .....	\$4,217.10		
July 1, .....	1,028.40	\$ 750.00	\$ 278.40
2, .....	727.04	431.62	295.42
3, .....	306.07	275.00	31.07
4, .....	815.61	545.19	270.42
5, .....	1,523.21	1,216.00	307.21
6, .....	1,006.00	610.00	396.00
7, .....	1,275.36	1,112.00	163.36
8, .....	1,455.47	1,044.21	411.26
9, .....	931.63	787.86	143.77
10, .....	1,349.98	1,140.01	209.97

DISBURSEMENTS.

July 1, .....	\$ 376.22	\$ 326.00	\$ 50.22
2, .....	816.40	675.31	141.09
3, .....	506.00	452.00	54.00
4, .....	571.80	363.06	208.74
5, .....	1,210.09	1,210.09	...
6, .....	1,105.00	998.85	106.15
7, .....	847.14	800.00	47.14
8, .....	1,062.96	1,050.00	12.96
9, .....	1,257.00	987.70	269.30
10, .....	910.10	865.54	44.56

A bank statement obtained showed the following:

Balance, July 1, .....	\$4,018.86
	=====

	Deposits	Withdrawals
July 1, .....	\$ 672.05	\$ 302.00
2, .....	1,000.00	824.09
3, .....	482.12	756.00
4, .....	275.00	321.11
5, .....	605.19	785.00
6, .....	1,526.75	1,264.01
7, .....	860.06	1,224.40
8, .....	1,217.50	701.00
9, .....	1,400.00	1,050.00
10, .....	827.56	947.64

The composition of the cash balance at the beginning of business July 1, 1930, was as follows:

On deposit, .....	\$3,380.06
Check on hand, .....	372.05
Currency on hand, .....	464.99
Total, .....	<u>\$4,217.10</u> <u>=====</u>

It is the practice of the company to deposit all checks the day after receipt, together with such currency as they felt was not immediately needed.

Prepare statements showing currency on hand on the end of each day from July 1 to 10, inclusive, reconciliation of bank balance, and the composition of cash book balance at the latter date.

No. 2. (30 Points.)

The Artex Company acquired 22,500 shares of common capital stock of The Burnam Corporation as of December 31, 1926, at a cost of \$2,000,000.00. On June 30, 1928, it acquired 4,000 shares of the common capital stock of The Plymouth Machine Company at \$200.00 a share. The balance sheets of the two companies at the dates of acquisition of their stocks were as follows:

THE BURNAM CORPORATION.

(December 31, 1926.)

ASSETS.

Cash, .....	\$ 300,000.00
Customers' Notes and Accounts, .....	700,000.00
Inventories, .....	800,000.00
Land, .....	125,000.00
Buildings, .....	500,000.00
Machinery and Equipment, .....	750,000.00
Prepaid Expenses, .....	25,000.00
Total, .....	<u>\$3,200,000.00</u> <u>=====</u>

LIABILITIES.

Notes and Accounts Payable, .....	\$ 200,000.00
Federal Income Taxes Payable, .....	30,500.00
Accrued Interest, .....	3,000.00
Other Accrued Expenses, .....	1,500.00
Reserve for Depreciation, .....	200,000.00
Reserve for Doubtful Accounts, .....	15,000.00

Capital Stock:	
Preferred—4,500 shares (par value \$100.00) . . .	450,000.00
Common—30,000 shares (no par value), . . . . .	1,500,000.00
Surplus, . . . . .	800,000.00
	<hr/>
Total, . . . . .	\$3,200,000.00
	=====

## THE PLYMOUTH MACHINE COMPANY.

(June 30, 1928.)

## ASSETS.

Cash, . . . . .	\$ 150,000.00
Customers' Notes and Accounts, . . . . .	300,000.00
Inventories, . . . . .	450,000.00
Land, . . . . .	50,000.00
Buildings, . . . . .	200,000.00
Machinery and Equipment, . . . . .	370,000.00
Discount on First Mortgage Bonds, . . . . .	26,443.00
Prepaid Expenses, . . . . .	15,000.00
	<hr/>
Total, . . . . .	\$1,561.443.00
	=====

## LIABILITIES.

Notes and Accounts Payable, . . . . .	\$ 150,000.00
Federal Income Taxes Payable, . . . . .	15,000.00
Accrued Interest:	
On First Mortgage Bonds, . . . . .	9,208.00
On Notes Payable, . . . . .	1,235.00
Other Accrued Expenses, . . . . .	1,000.00
Fifteen-year 6½% First Mortgage Bonds due 1940, ..	425,000.00
Reserve for Depreciation, . . . . .	100,000.00
Reserve for Uncollectible Accounts, . . . . .	10,000.00
Capital Stock:	
Preferred—2,000 shares (par value \$50.00 each),	100,000.00
Common—5,000 shares (par value \$100.00 each),	500,000.00
Surplus, . . . . .	250,000.00
	<hr/>
Total, . . . . .	\$1,561.443.00
	=====

On February 1, 1931, The Artex Company purchased \$50,000.00 par value of the First Mortgage Bonds of The Plymouth Machine Company at 80, and on July 1, 1931, it made another purchase of \$25,000.00 of these bonds at 75. A total of \$500,000.00 of these bonds were originally issued as of March 1, 1925, and sold to bankers at 92, interest payable semi-annually on March 1 and September 1.

The balance sheets of the three companies at September 30, 1931, were as follows:

	Artex Company	Burnam Corporation	Plymouth Machine Company
ASSETS.			
Cash, . . . . .	\$ 1,000,000.00	\$ 182,800.00	\$ 100,000.00
Customers' Notes and Accounts, ..	2,500,000.00	700,000.00	200,000.00
Inventories, . . . . .	3,000,000.00	834,400.00	450,000.00
Advances to Subsidiaries, . . . . .	500,000.00	.....	.....

## Investments:

\$75,000 par value of Plymouth Machine Co. bonds, . . . .	58,750.00	.....	.....
Capital Stocks of Subsidiaries..	2,800,000.00	.....	.....
Land, .....	400,000.00	125,000.00	65,000.00
Buildings, .....	1,500,000.00	750,000.00	200,000.00
Machinery and Equipment, .....	3,000,000.00	1,025,000.00	484,000.00
Discount on First Mortgage Bonds, .....	.....	.....	15,711.00
Prepaid Expenses, .....	30,000.00	20,000.00	10,485.00
Total, .....	\$14,788,750.00	\$ 3,637,200.00	\$ 1,525,196.00

## LIABILITIES.

Notes and Accounts Payable, . . . .	\$ 2,500,000.00	\$ 50,000.00	\$ 100,000.00
Federal Income Tax Payable, . . . .	25,000.00	10,000.00	.....
Accrued Interest:			
On First Mortgage Bonds, . . . .	.....	.....	1,896.00
On Notes Payable, .....	23,750.00	1,000.00	300.00
Other Accrued Expenses, .....	40,000.00	1,200.00	500.00
Due to The Artex Company, . . . .	.....	250,000.00	250,000.00
Fifteen-year 6½% First Mortgage Bonds, .....	.....	.....	350,000.00
Reserve for Depreciation, .....	1,500,000.00	450,000.00	160,000.00
Reserve for Uncollectible Accounts, .....	200,000.00	25,000.00	12,500.00
Capital Stock:			
Preferred, .....	.....	450,000.00	100,000.00
Common .....	7,500,000.00	1,500,000.00	500,000.00
Surplus, .....	3,000,000.00	900,000.00	50,000.00
Total, .....	\$14,788,750.00	\$ 3,637,200.00	\$ 1,525,196.00

There were 75,000 shares of capital stock of The Artex Company outstanding at September 30, 1931. There had been no change in the outstanding stocks of the other two companies during the previous five years.

Dividends on the preferred stocks of the subsidiaries were cumulative in both cases at the rate of 7% per annum. In the case of The Burnam Corporation they were payable quarterly on the first days of February, May, August, and November, and had been paid regularly since organization of the Company. Preferred dividends of The Plymouth Machine Company were payable semi-annually on March 1 and September 1, and the last dividend paid was for the six months ended March 1, 1930. Prior to that time they had never been in arrears.

The Artex Company takes up interest income on Plymouth Company bonds only when received.

Prepare a consolidated balance sheet as of September 30, 1931, showing the figures for the companies separately with eliminations and consolidation.

No good-will is to be shown on the consolidated balance sheet.

November 25, 1931.

Time Allowed: 1:30 P. M. to 5:30 P. M.

Answer All Questions Fully.

## No. 3. (25 Points.)

On July 1, 1929, Mr. J. C. Elder purchased the leasehold interest in a piece of property located in Baltimore for the sum of \$20,000.00. The property was held under the usual form of ninety-nine year lease prevailing extensively in Baltimore and was redeemable at any time at the option of the leaseholder for an amount equivalent to the annual ground rent capitalized at 6%. The property was improved by five dwellings and annual ground rent was \$375.00, payable in semi-annual instalments on May and November 1. The amount paid by Mr. Elder in connection with the acquisition of the property was as follows:

Purchase price, .....	\$20,000.00	
Legal fees for title search, .....	400.00	
Recording deed, .....	5.00	
		<u>\$20,405.00</u>
Less:		
Accrued ground rent—2 months, .....	\$ 62.50	
One-half of taxes for year 1929 that had not been paid by previous owner, .....	325.00	387.50
		<u>387.50</u>
Amount paid, .....		<u>\$20,017.50</u> =====

Subsequent to purchase Mr. Elder paid a total amount of \$500.00 to the tenants in the houses as a consideration for their vacating at once.

On August 1, 1929, Mr. Elder and certain associates organized the Vantos Company with an authorized capital stock of 2,000 shares, par value \$100.00 each, all of which stock was subscribed for at par. Mr. Elder's subscription of \$50,000.00 was settled by conveying the property previously acquired by him to the company at its total cost to him and giving his check for \$29,482.50. The remainder of the subscriptions were paid in cash.

The corporation then contracted for the erection of a factory building on the site at a cost of \$100,000.00, and paid \$1,000.00 for the razing of the dwellings and clearing of the site. It realized \$150.00 from the sale of old materials in the razed dwellings.

The factory building was completed and delivered to the company by the contractors on April 30, 1930, and final payment made on contract price at that time. Equipment was then purchased at a cost of \$30,000.00, and installation thereof was complete and operations started on July 1, 1930.

In addition to the items mentioned above the following expenditures were made prior to July 1, 1930:

Office Rent—10 Months, .....	\$ 1,500.00
Legal Services:	
Re. Organization of Company, .....	500.00
Re. Building Contract, .....	250.00
Bonus Tax and Charter Filing Fee, .....	30.00
Services of Architect for Plans of Building and Supervision, .....	2,500.00
"Extras" Paid to Building Contractor, .....	3,000.00
Superintendent's Salary—April 1 to July 1, 1930 (3 months) .....	1,000.00
Labor—Installing Equipment, .....	1,500.00
Clerical Salaries, .....	1,000.00
Telephone, Postage, and Other Office Expenses, .....	500.00

Property Taxes:	
Year 1929, .....	650.00
Year 1930, .....	500.00
Ground Rent Due November 1, 1929, and May 1, 1930, ..	375.00
Ground Rent Redeemed on May 1, 1930, .....	6,250.00
Total, .....	<u>\$19,555.00</u>
	=====

The officers who were also stockholders waived all salaries prior to the starting of operations.

The superintendent was engaged to operate the plant. He reported for duty on April 1, 1930, so as to supervise the placing of the plant in condition to operate.

The bank allowed interest on balances to July 1, 1930, in the total amount of \$1,500.00.

Prepare a statement as of July 1, 1930, grouping the various charges and credits given above for balance-sheet purposes, and state your reasons fully for the various classifications.

#### No. 4. (25 Points.)

You are engaged to prepare the Federal income tax return of The Bryant Corporation for the calendar year 1930. A trial balance of the general ledger at December 31, 1930, after applying all adjustments to be made at end of year, but before closing profit and loss accounts, was as follows:

	Debits.	Credits.
Cash, .....	\$ 200,000.00	
Notes Receivable, .....	50,000.00	
Accounts Receivable, .....	600,000.00	
Inventories:		
Finished Goods, .....	400,000.00	
Work in Process, .....	200,000.00	
Raw Materials, .....	150,000.00	
Factory Supplies, .....	25,000.00	
Investments, .....	40,000.00	
Good-will, .....	90,000.00	
Factory Land, .....	35,000.00	
Factory Buildings, .....	300,000.00	
Machinery and Equipment, .....	400,000.00	
Office Furniture and Equipment, .....	10,000.00	
Improvements to Branch Offices (Leased), ....	7,500.00	
Prepaid Insurance, .....	8,300.00	
Sundry Prepaid Items, .....	5,000.00	
Notes Payable, .....		\$ 105,000.00
Accounts Payable, .....		85,500.00
Accrued Interest, .....		1,200.00
Accrued Payroll, .....		5,000.00
Sundry Accrued Items, .....		1,500.00
Reserve for Federal Income Tax, .....		890.00
Reserves for Depreciation:		
Factory Buildings, .....		100,000.00
Machinery and Equipment, .....		250,000.00
Office Furniture and Equipment, .....		5,000.00
Reserve for Bad Debts, .....		10,000.00
Reserve for Contingencies, .....		50,000.00

Capital Stock:		
Preferred, .....		420,000.00
Common, .....		1,000,000.00
Profit and Loss, .....	388,300.00	
Surplus, .....		500,000.00
Sales, .....		3,500,000.00
Raw Materials, .....	1,200,000.00	
Factory Labor, .....	1,350,000.00	
Factory Supplies, .....	110,000.00	
Salesmen's Salaries and Expenses, .....	300,000.00	
Branch Office Expenses, .....	40,000.00	
Miscellaneous Selling Expenses, .....	15,000.00	
Officers' Salaries, .....	60,000.00	
Office Salaries, .....	40,000.00	
Miscellaneous Office Supplies and Expenses, ...	10,000.00	
Miscellaneous General Expenses, .....	5,000.00	
Income from Investments, .....		1,710.00
Interest on Notes Payable, .....	4,500.00	
Interest on Notes Receivable and Bank Balances,		6,500.00
Miscellaneous Income (Sale of Scrap Materials) .....		1,300.00
Total, .....	\$6,043.600.00	\$6,043.600.00

The details of the investments at December 31, 1930, and the income received therefrom during the year were as follows:

	Book Value.	Income Received.
Bonds:		
State of Maryland, .....	\$15,000.00	\$ 600.00
Symes Manufacturing Co., .....	10,000.00	450.00
Stocks:		
The Sterco Company (Preferred)—90 shares	9,000.00	540.00
Arnold & Co., Inc. (Common)—240 Shares.	6,000.00	120.00
	<u>\$40,000.00</u>	<u>\$1,710.00</u>

The good-will was acquired for cash, \$150,000.00, in the year 1920, and under resolution of the Board of Directors four per cent. thereof has been written off each year beginning with 1921.

The balance in the reserve for Federal income tax represents an amount set up in March, 1930, for such taxes for the year 1929, less the actual amount of taxes paid.

An analysis of the reserve for bad debts shows the following:

Balance Dec. 31, 1929, .....	\$12,500.00
Additional Provision for Bad Accounts (Dec. 31, 1930), ..	17,500.00
Total, .....	<u>\$30,000.00</u>
Less Accounts Charged Off During the Year as Uncollectible	20,000.00
Balance, Dec. 31, 1930, .....	<u>\$10,000.00</u> =====

An analysis of the entries in the profit and loss account during the year shows the following:



	Debits.	Credits.
Preferred Stock Dividends, .....	\$ 31,500.00	
Common Stock Dividends, .....	60,000.00	
Discount on Preferred Stock Purchased and Retired, .....		\$10,000.00
Adjusting Book Value of Investments to Market Values, .....	5,000.00	
Amortization of Good-will, .....	6,000.00	
Depreciation:		
Factory Buildings, .....	7,500.00	
Machinery and Equipment, .....	33,500.00	
Office Furniture and Equipment, .....	800.00	
Amortization of Improvements to Leased Property, .....	1,000.00	
Provision for Bad Debts, .....	17,500.00	
Provision for Contingencies, .....	10,000.00	
Decrease in Inventories of Finished Goods and Work in Process, .....	200,000.00	
Provision for Federal Income Tax for the Year 1929, .....	25,000.00	
Loss from Sale of Machine, .....	500.00	
	<u>\$398,300.00</u>	<u>\$10,000.00</u>
	=====	=====

There were no entries in the surplus account during the year.

Decreases in inventories of raw materials and factory supplies were credited to the purchase accounts.

The rates of depreciation and of amortization of improvements to leased property are those used in preceding years and approved by the Bureau of Internal Revenue. The latter has been credited direct to the asset account.

The directors have authorized transfers to the reserve for contingencies from time to time to be held for extraordinary expenses but there have never been any charges against it. The amount appropriated this year was stated by the directors to be "the profits made in purchasing and retiring preferred stock."

Prepare a statement showing taxable net income of the company for the year and a reconciliation thereof with the earnings as shown by the books.

## Managerial Control

(Continued from page 282)

5. Detail of expected volume of sales with basis of estimation.
6. Detail of possible lesser volume and greater volume of sales, with accompanying scales of graduated expense and returns.
7. Details of administrative financing of the proposition.

The exact cost should be known of every phase of salesmen's activities—every form of advertising—cost of individual advertisements or pieces of advertising matter—

the cost of sales and advertising administration—total marketing subdivided as far as may be desired—the sales attributable to the different methods of sales administration and stimulation records of consumption of the product by the ultimate consumer by town and county—in short, every kind of record that may enable the manager of the business to know exactly where the business stands. It should be known to stimulate the business and the cost of stimulation and the results obtained.

Business must be conducted on the basis of known facts. With all this knowledge, it may be impossible to forecast the consumer attitude.

# The Certified Public Accountant\*

By LYLE W. HINES, C.P.A., St. Paul, Minn.

FROM frequent inquiries received by the State Board of Accountancy, it is evident that there is quite a widespread interest in its activities and a desire for knowledge as to exactly how a candidate may become a certified accountant. I shall endeavor this evening to cover briefly the more frequently recurring questions, those which should prove of more general interest.

To provide a partial understanding of the profession of accounting let me present a few pertinent factors relative to professions in general.

History tells us that all civilized nations of the past have recognized professional classes similar to those existing today. As persons of similar makeup and qualifications offered their skill and knowledge to the general public, they gradually began to be regarded as a class and recognized officially by law or unofficially by the public as professional groups.

There are two underlying fundamentals justifying a professional class. First, the development of public opinion which as the result of contact recognizes such class distinction; second, the services of the group must be necessary in the life of the community. Thus through the recognition of a class distinction and the necessity of the type of service rendered by the group, a profession is created by public acknowledgment through the action of the public.

Since acknowledgment and necessity form the corner stones upon which a profession is based, it must keep these factors continually in mind if it is to continue.

The services rendered must be of special value so as to prove their necessity to the public interest. The honesty and integrity of the members of the group must be unquestionable. The public must understand in what way the profession is able to serve. The services rendered must merit the approval of the public through performance with entire satisfaction.

Professional groups having been formed through public acknowledgment, it became desirable that statutes be enacted recognizing them as such and defining who are included therein.

The profession of accountancy is, as compared with the other professions, relatively new, yet it is recognized and established by law in all states of the Union.

In our State, the statute regulating the practice of accountancy by certified public accountants was passed by the legislature in 1909. This act creating the State Board of Accountancy prescribed its powers and duties and provided for examinations and issuing of certificates to those properly qualified and providing penalties for those violating the act.

The Minnesota State Board of Accountancy is composed of three practicing certified public accountants appointed by the governor of the State for a period of three years. The board is charged with the enforcement of the standard of special education, the science and art of accounting, the standard of moral character and general public experience as prescribed by the statute.

To become a certified public accountant in the State of Minnesota, a person must be a citizen of the United States, or have declared his intention of becoming a citizen, over 21 years of age, and must successfully pass an examination in accounting, auditing, commercial law and such other subjects as the Board may deem advisable. The prospective candidate must have been employed for a period of at least three years as an assistant in the office of a public accountant, or practicing as a public accountant on his own account.

Examinations for certified public accountants are given twice each year about the middle of May and November. The examinations cover a period of three days, the first day of which is oral.

Upon fulfillment of the preliminary requisites and passing the examination, the candidate is issued a certificate by the Board entitling him to practice as a certified public accountant. No others may so style them-

\*One of three radio addresses given over Station KSTP, under auspices of the Minnesota Society of Certified Public Accountants.

selves. Certificates may be issued to holders of certificates of other states obtained upon examination where equal standards are in effect. No partnership may practice as certified public accountants in the State of Minnesota, and no corporation shall assume such title or the abbreviation C.P.A., or other words, letters, or abbreviations tending to indicate that such corporation is a certified public accountant.

The Board is charged with the regulation of the profession in the State and may revoke any certificate for bad moral character, dishonesty, conviction of crime, incompetency or unprofessional conduct. Notices of any complaint must be served upon the certificate holder who is charged with the violation and a hearing held before the State Board of Accountancy.

A marked increase in the interest of young men in the profession has been indicated in the past few years. During the year 1931 the State Board held two examinations at which times fifty-six candidates were examined and certificates were issued to twenty of them giving them the right to practice as certified public accountants under the law. The Board has attempted to develop and maintain high standards of professional conduct and has made every effort to improve the relationship between the public and the profession.

Inquiry is frequently received as to the method of qualifying for the examination, how one may learn the fundamentals of accounting. Nearly all colleges and universities today give thorough courses in accounting. To those who have been deprived of a college education, a knowledge of the fundamentals may be secured through any one of a number of reliable schools teaching accounting through correspondence. Knowledge of theory gained in school is not of itself sufficient to qualify one to practice as an accountant, but is sufficient to gain admission to the staff of a practicing accountant. This, with the three years' experience and a high school education or its equivalent will qualify a candidate for examination.

I am personally of the opinion that the educational qualifications as provided in the statute are the very minimum that can be desired and that the accountant of the future who has had a college education will make

progress with considerably less difficulty than the man who has received a high school education only.

In addition to a study of the technique of auditing and accounting, an accountant should obtain a broad general education, becoming conversant with economics, banking, public finance and commercial law, which subjects are directly beneficial to his practice. Familiarity with the cultural subjects will be advantageous to the accountant who wishes advancement in his chosen field.

I think a word might be pertinent as to the type of individual fitted for the practice of accountancy. First of all he should be healthy. The work is sometimes tedious and confining and is not suitable for persons of nervous temperament or who have no reserve of stamina on which to draw. He should have a pleasing personality because his success is going to depend, to a large extent, upon his ability to make a favorable impression on those with whom he comes in contact. He should have character because he will be charged at all times with the necessity of presenting all of the facts and in frequent instances presentation of the facts will react against his own selfish interests. He must have an analytical mind. The accountant is a business analyst and must be able to secure facts, to analyze them and to assist in the formation of policies based upon his analyses.

Under the conditions existing today, it is desirable that he have some means of financial support during the period of development. Positions upon the staffs of practicing accountants are not easily available to young men and frequently it happens that a young man must make a connection of two or three months a year for two or three years before being permanently employed on a staff.

The certified public accountant who serves you has a definite and fixed responsibility touching upon his ability, education and his standing as a professional man. The Minnesota State Board of Accountancy is constantly endeavoring to increase the professional standards of those under its jurisdiction. We invite your suggestions and criticisms in order that we may carry on the work of this Board in a manner which will be in the best interest of the public and the C.P.A.'s.

## STATE SOCIETY NEWS

### CONNECTICUT

The Connecticut Society of Certified Public Accountants has just issued three pamphlets. One is 5½ x 8, Directory of Members and Constitution and By-Laws. Another of the same size contains a Directory of Members and Code of Ethics. Each lists the officers and committees of the society. The third is just a handy pocket size, 3½ x 5½, and contains merely the Constitution and By-Laws.

\* \* \*

### INDIANA

The latest bulletin of the Indiana Association of Certified Public Accountants is in the form of a brochure headed "Is Your Accounting 'Certified' Under the Laws of Indiana?"

It is our opinion that this is the best pronouncement yet made by the Indiana Association which has been a leader in group publicity.

Harry Boggs, president of the Board of the Indiana Association, resigned the presidency of the Board in March, but retained his membership thereon. Earl E. Thomas, of Evansville, vice-president, was elected to fill the unexpired term of Mr. Boggs. Wm. M. Madden, of Indianapolis, a director, was elected vice-president to succeed Mr. Thomas.

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### MASSACHUSETTS

The March meeting of the Massachusetts Society of Certified Public Accountants was held at the Parker House, Boston, with an attendance of seventy-five. At that meeting it was noted that James D. Glunts, Hollis H. Sawyer, and Raymond D. Willard had been appointed as a Special Committee on Arbitration. A Nominating Committee was elected to present nominees for the several officers to be elected at the annual meeting. The speaker of the evening was John C. Hull, Director of the Securities Division of the Department of Public Utilities, who was accompanied by Frank F. Jenks and Richard A. Knowles, C.P.A., who are associated with Mr. Hull in the Department. The Massachusetts *News Bulletin*, No. 7, contained the following notice of his address:

"Mr. Hull described the history of Blue Sky legislation stating that it was now twenty-one years old and was instituted originally in the State of Kansas and that at the present time Nevada was the only State without Blue Sky legislation. He continued that there were four different types of Blue Sky laws, and that in Massachusetts it was required that notification be given the Blue Sky Division before securities were offered for sale and that all security salesmen are required to be registered. He stated that, after the Commission had been notified as to the securities to be offered for sale, selling might proceed providing there was no objection from the Commission. He stated that there was no Federal law against sales of securities except as such a transaction might be connected with using the mails to defraud. Mr. Hull mentioned that a uniform Blue Sky law had been formulated, and that it had been adopted by Florida and Oklahoma, and it seemed to him desirable that the remaining states should also be on the same basis."

Following his address questions were asked by the members and graciously answered by Mr. Hull.

Announcement was made that the Executive Committee of the society was to meet with the State Board of Registration of Certified Public Accountants for the purpose of discussing matters of mutual interest.

The April meeting was in the form of a joint meeting of the Massachusetts Society and the Boston Chapter of the National Association of Cost Accountants. Professor Roy B. Kester, of Columbia University, spoke on "Composition and Interpretation of the Balance Sheet."

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### MICHIGAN

Members of the Michigan Association of Certified Public Accountants were guests of the Detroit Chapter of the National Association of Cost Accountants at a meeting held in the Crystal Ballroom of the Masonic Tem-

ple, Thursday, April 21.

The speaker of the evening was Wm. F. Sims, Manager of the Research Division of Felt and Tarrant, Chicago. The discussion was led by Lewis D. Crusoe, Controller of the Fisher Body Corporation, a national director of the Cost Accountants.

The *Detroit Free Press* for April 11, carried the following on its financial page:

"The changes now being made by General Motors Corporation in its internal operating methods, involving the Buick, Olds Motor, Pontiac and Chevrolet companies, are an indication of what is going on within hundreds of industrial and commercial organizations in Michigan, according to Francis E. Ross, of Ann Arbor, president of the Michigan Association of Certified Public Accountants. The changes, he points out, are calculated to enable the companies to meet changed economic conditions efficiently and profitably.

Analyses of operating methods, made possible by accounting figures brought out by certified public accountants in their audits of these companies, says Mr. Ross, have revealed the necessity, under present conditions, of watching carefully the items of expense that grow up needlessly in times of great prosperity. In hundreds of commercial houses and industrial plants these needless items are being weeded out, with the help of the certified accountants, and in nearly every instance important savings are being effected—savings which have a healthy effect upon net earnings records.

But, as in the case of General Motors, a large number of companies are not only weeding out needless expense items, but also are making sweeping changes that cut down on labor requirements, eliminate duplications in accounting work, and reduce actual costs in every department of activity. The participation of the certified public accountant in these efforts to reduce overhead and increase profits is necessarily extensive, Mr. Ross points out, and it is on this basis that wide-awake concerns are utilizing more than ever before the services of certified public accountants."

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#### MINNESOTA

The April meeting of the Minnesota Society of Certified Public Accountants was to have been addressed by Professor W. A. Paton, of the University of Michigan. On ac-

count of illness, which prevented his attendance, the program was supplied by Professor George Filipetti and Dr. Marion Trabue of the Employment Stabilization Research Institute of the University of Minnesota.

The speakers presented results of their industrial research work based on accounting data. Their research work has covered the years 1926 to 1930, inclusive, and concerns operating in the cities of Minneapolis, St. Paul and Duluth. While not completed, they were able to indicate some general broad trends which had been developed. This is a phase of work in which the various State Societies and university schools of business administration can cooperate to their mutual advancement.

\* \* \*

#### NEBRASKA

The regular monthly meeting of the Nebraska Society of Certified Public Accountants for April was held at the Chamber of Commerce, Omaha.

The subject discussed was "Professional Training Courses in Accountancy," the leaders being Dean F. E. Walsh, of Creighton University, and Professor O. R. Martin of the University of Nebraska. Their addresses were followed by questions and a round table discussion.

The monthly meetings alternate between Omaha and Lincoln. The May meeting will be held at Lincoln on the 14th.

\* \* \*

#### NEW JERSEY

At a meeting of the Society of Certified Public Accountants of the State of New Jersey, held on Monday evening, April 4th, 1932, several interesting addresses were given.

The speaker of the evening was ex-Congressman Franklin W. Fort, who spoke on the Reconstruction Finance Corporation. Mr. Fort gave briefly a history of conditions which led to the organization by the Government of this new financial institution, and also the purposes it is expected to achieve.

An address was given by Henry S. Puder, C.P.A., on "The Accountant's Service to the Banker." He spoke in much detail of the research he had been doing to ascertain what the banker really desires and expects from an accountant's report, and urged a greater cooperation between the accountant, client, and the banker.

The final address was given by Rev. Wil-

liam Hiram Foulkes on "The Message of George Washington for America Today."

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#### NEW YORK

The regular monthly meeting of the New York State Society of Certified Public Accountants was held on Monday evening, April 11, 1932, at the Hotel Waldorf-Astoria.

The general subject selected for the meeting was "Insurance — Facts Accountants Should Know," with three guest speakers and a member of the society presenting interesting talks. Andrew Wilson, Jr., Vice-President of the Bank of Manhattan Trust Company, New York City, spoke on "Business Life Insurance Trusts." Charles G. Taylor, Jr., Third Vice-President of the Metropolitan Life Insurance Company, New York City, discussed "Modern Life Insurance Trends." Laurence E. Falls, Vice-President of The American Insurance Company, Newark, New Jersey, had for his subject "Property Insurance in Connection with the Conservation of Capital." Charles E. Mather, C.P.A., of Staggs, Mather & Hough, discussed "Insurance in its Relation to the Work of the Accountant."

\* \* \*

#### NORTH CAROLINA

The Spring meeting of the North Carolina Association of Certified Public Accountants will be held at the Green Park Hotel, Blowing Rock, Thursday, Friday, and Saturday, May 26, 27 and 28.

It is reported that the hotel is next adjacent to the teeing-off green, so that there will be no excuse for even the lazy members to avoid golfing privileges.

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#### OHIO

The Spring meeting of the Ohio Society of Certified Public Accountants will be held jointly with the College of Commerce, Ohio State University, and the Columbus Chapter of the National Association of Cost Accountants, at Columbus, Ohio, on Friday and Saturday, May 20 and 21, 1932.

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#### PENNSYLVANIA

The annual meeting of the Pennsylvania Institute of Certified Public Accountants will be held in June at Bedford Springs, Pa.

The Philadelphia chapter of the Pennsylvania Institute of Certified Public Accountants had as its March speaker O. Howard

Wolf, manager to the Philadelphia Loan Agency, the Philadelphia representative of the Reconstruction Finance Corporation. Mr. Wolf described the operations of the Finance Corporation and submitted himself to questioning with regard thereto.

The April meeting was addressed by Mr. Clyde Sheaffer, Chief of the Bureau of Corporations, Department of Revenue for the State of Pennsylvania. He presented the recently prescribed regulations governing the recognition of attorneys, agents and others representing claimants before the State Department of Revenue which became effective April 15.

(Comment: These types of meetings are one of the best ways in which the profession can be brought to the attention of those who should know about the services which certified public accountants can render.)

A meeting of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants was held at the Keystone Athletic Club on April 6, 1932 at 6:30 p. m., in joint session with the Pittsburgh Chapter of the National Association of Cost Accountants.

Because of the elaborate program arranged by Hymen Schlesinger, chairman of the Meetings Committee, no business session was held.

During the dinner very enjoyable entertainment was provided by a quartet of which James M. Cumming, member of the Pittsburgh Chapter, was a member.

The principal speaker of the evening was Honorable Willis C. Hawley, ranking Republican member of the Ways and Means Committee of the House of Representatives, who gave a most interesting and instructive address on the subject of "Pending Tax Legislation." He outlined the general principles of taxation, stating the various proposals that had been considered by the committee in drafting the present tax bill and outlined the various provisions of the bill as finally adopted by the House. Representative Hawley said the national budget should be balanced, and the country's credit maintained at a high standard.

President Vansickle, of the Cost Accountants, then introduced Dr. Marion O'K. McKay, who discussed the general tax principles involved in the pending tax legislation.

J. M. Cumming led the discussion that followed with particular reference to accounting and technical questions.

## PORTO RICO

At the annual meeting of the Porto Rico Institute of Accountants, held February 21, 1932, at the Hotel Palace, San Juan, Porto Rico, the following officers were elected for the year 1932: President, William A. Waymouth; Vice-President, R. Rodriguez Sanchez; Treasurer, Santos G. Ramirez; Secretary, Juan C. Villarini; Directors, Jose P. Gorbea, J. E. Soltero, and J. E. Rosario.

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## RHODE ISLAND

The annual meeting of the Rhode Island Society of Certified Public Accountants was held at the Narragansett Hotel, Providence, Rhode Island, on Monday, April 8, 1932.

Officers for the year were elected as follows: President, George B. Clegg, Jr.; Vice-President, Thomas V. Barb; Secretary-Treasurer, William B. M. Miller; Directors, Ernest H. Davison and C. Watson Scott.

\* \* \*

## SOUTH CAROLINA

The present officary of the South Carolina Association of Certified Public Accountants is as follows: President, L. C. Dodge, Spartanburg; Vice-President, B. C. Wallace, Greenwood; Secretary-Treasurer, George M. Thayer, Columbia.

\* \* \*

## VIRGINIA

The Spring Jubilee of the Virginia Society of Public Accountants will be held at the Cavalier Hotel, Virginia Beach, Friday and Saturday, May 27 and 28. The advance notice reads:

"Dear Pal:

Horace Greeley's famous ole-tyme saying was 'Go West, Young Man, Go West', but we're changing it to a modernistic trend and are telling you that the 'big swing' is on deck for one grand and glorious ballyhoo . . .

## 'WAY DOWN EAST'

at the Cavalier Hotel, Virginia Beach (down where the Atlantic meets the Chesapeake).

So pack up your duds, gas up your chariot, and be with us on the week-end of *Friday and Saturday, May 27th and 28th.*

Don't fail to circle those two days with a *red* pencil, ole top . . . we're counting on you for a grand, uproarious, good-fellowship jamboree of fun, fun and more fun.

More news in a few days or so . . .

*Spring Meeting Committee."*

## WASHINGTON

The March issue of *The C.P.A.*, official organ of the Spokane Chapter of the Washington Society of Certified Public Accountants, builds its main article around the conclusion reached by the United States Department of Commerce, following an investigation of the causes of failure and bankruptcy, that only one out of four bankrupts has kept a really adequate set of books.

Another short article brings out clearly the fact that the purpose of a bank is not to lend money to supply a deficiency in permanent capital but rather to finance exigencies arising from seasonal or temporary circumstances.

In the April number of *The C.P.A.*, issued by the Spokane Chapter of the Washington Society of Certified Public Accountants, the subject matter presented is entitled, "Is Your Accounting System a Help or a Hindrance to Your Business?"

\* \* \*

## WISCONSIN

A special meeting of the Wisconsin Society of Certified Public Accountants was held on Wednesday evening, April 6, at the City Club, Milwaukee.

Interesting addresses were delivered by Mr. Keith Clarke, representative for Prentice-Hall, Inc., and Mr. Fortney H. Stark, Executive Secretary of the Milwaukee Real Estate Board.

## State Board News

## OKLAHOMA

Announcement is made of the appointment of Dwight Williams, of Oklahoma City, as the fifth member of the Oklahoma State Board of Accountancy. The Board has organized with Homer C. Hammonds, of Oklahoma City, Chairman; W. I. Nicholson, Jr., of Tulsa, as Secretary, and W. J. Law, of Ardmore; Chas. A. Wright, Muskogee, and Dwight Williams, of Oklahoma City, as members.

## PENNSYLVANIA

Harold S. Irwin, of Carlisle, has been appointed the second attorney member of the Pennsylvania State Board for the Examination of Public Accountants, to succeed John McI. Smith.

## NOTES

H. A. Roney, Treasurer of The American Society, is Chairman of the Finance Committee of Murat Temple (Masonic) Indianapolis. He is also a member of the Temple association directorate.

The March issue of *Corporate Practice Review* contains an exceedingly interesting article by Herrmann Herskowitz, C.P.A., on "Archaic Laws and Divergent Policies."

The officers and faculty of Pace Institute are holding a series of informal and intimate dinners at which current problems of education are discussed.

At the April 20 dinner Homer St. Clair Pace spoke on "Observations of the Economic Readjustment now in progress with Special Reference to Education and Vocational Advice."

Inquiries have come concerning the report on Causes of Business Failures and Bankruptcies of Individuals in New Jersey in 1929-'30, to which reference was made in a recent issue. This can be obtained for ten cents from the Superintendent of Documents, Government Printing Office, Washington, D. C.

In addressing a joint Convention of the Northwestern and the Iowa Hotel Associations, at Des Moines, Iowa, October, last, Edward C. Romine, C.P.A., listed fifty-six varieties of methods by which hotel expenses might be cut, with the added statement that it was only a starter.

In a radio address given over the Columbia Broadcasting System in January, Julius Klein, Assistant Secretary of Commerce, said among other things: "Far too many casualties in the business world, when called upon to explain their maladies, cite generalities such as unseasonal weather, chain store competition, door bell ringing, peddlers, meddlesome bureaucrats, politicians, or plagues of grasshoppers."

"To get the facts as to these ailments we must turn to that truly pathetic clinic of sick business, the bankruptcy court.

"In an effort to render helpful assistance, let us be guided by definitely established, pre-

cise conditions as revealed in clinical analysis and not by vague surmises or casual assumptions, much less by emotional demonstrations. We have had entirely too much of those in our so-called business thinking these days.

"We, in the Commerce Department, are interested purely in the business or economic aspects of the problem as contrasted with the legal ones which naturally lie quite beyond our jurisdiction.

"I understand that a bill for the consideration of Congress has been drafted by the Attorney General and that the proposals are designed to give additional protection to creditors, to help them collect more than the eight cents on the dollar which is all that they average under the present law. It is expected that the proposed legislation will substantially improve the bankruptcy situation from a legal point of view.

"I am sure that it will surprise you, as it did me, to learn that the depression has not materially increased the number of firms and individuals who have failed in business. That number has been growing more or less steadily during good periods as well as bad ones. In fact, there were actually fewer failures in the fiscal year 1930-31 than there were in the much better period, 1929-30. The increase in the number of bankrupts during 1927 and 1928 was 11% as compared with but a little over 6% in 1930 over 1929. . . . These figures have to do with the number of failures. When it comes to losses of creditors through such failure during the depression, this figure has naturally been increasing considerably."

In a recent issue of *Money and Commerce*, Pittsburgh, J. M. Cumming, Chairman of the Committee on Legislation of the Pennsylvania Institute of Certified Public Accountants, presented an interesting article on "Capital Gains and Losses."

The March issue of *Credit and Financial Management*, the official publication of the National Association of Credit Men, contains an interesting article on "Buying for a Bust," by R. A. Colliton, Director of the Credit Interchange Bureaus of the N.A.C.M.

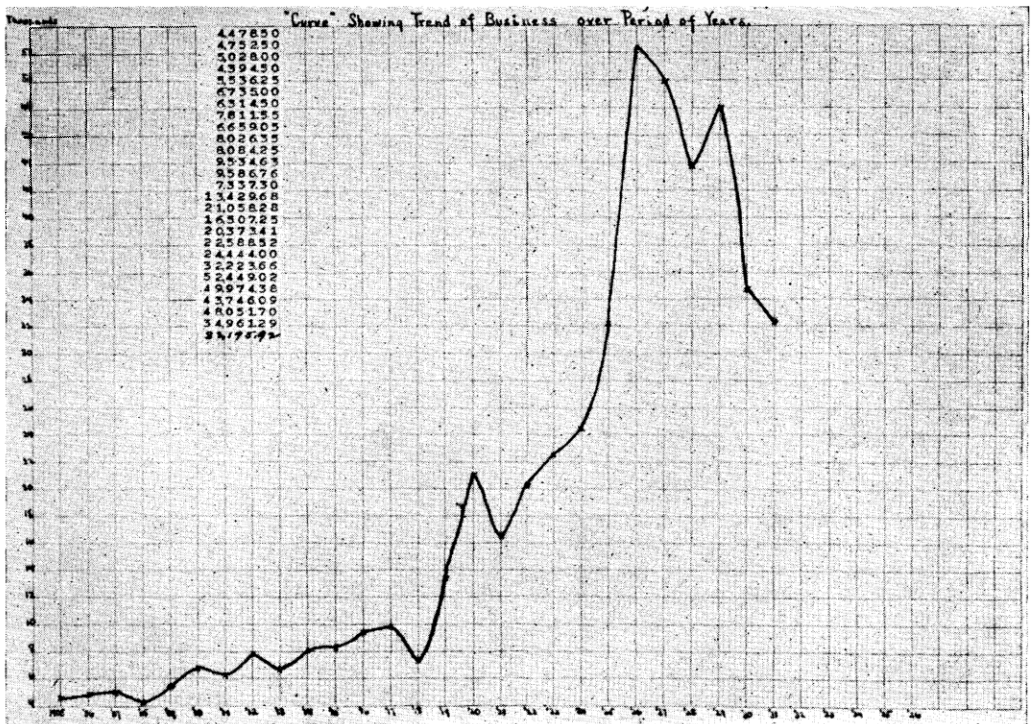
In answering the question as to how "buying-for-a-bust" fraud can be avoided, the author, while recognizing the part which



ratings and financial statements play in all credit grantings, reached the conclusion that "last, and most important, any worth while effort to defeat 'buying-for-a-bust' fraud must be based on coöperation. But it must be effective coöperation. And there is only one kind of coöperation which can be effective. That which will bring together all of the creditors of an individual customer regardless of the location of the customer, location of the creditors, or the lines of business in which either or both may be engaged."

One of the most interesting charts which we have noted relates to the income of an abstract company over a period of a quarter

of a century. This abstract company cares for the needs in a county of approximately 60,000 people, with one city of 25,000, another of 12,000, five prosperous villages and a good quality of farm land. The income of an abstract office is dependent on sales of real estate requiring abstracts brought down to date. So far as changes in local business or industrial conditions during the period in question is concerned, there was nothing to produce the marked rises or drops save as local conditions were affected by general conditions. Yet it will be seen that real estate transfers, as reflected in a county which did not have an industrial development, felt the general effects of the varying business conditions.



Ellsworth C. Alvord, speaking before the April meeting of the Washington Trade Executives, and discussing the financial situation of the Government, among other comments, said:

"As I see it, the real issue is: Is an adequate reduction in Federal expenditures preferable to a corresponding increase in taxation? It seems to me idle for persons

to assert that expenditures cannot be reduced. I have little sympathy for those who plead that decreased expenditures will "cripple," or require a "moratorium on the administration of justice." I do not believe that our Government was crippled, or that moratoriums existed back in 1928. And yet if we reduce our expenditures merely to the 1928 total, we effect a sav-

ing of approximately \$600,000,000. Faced with loss of income, business balances its budget by a reduction in expenditures—cold-bloodedly perhaps, but nevertheless real. You and I meet loss of income with curtailment of expenditures. The Government is in no different position. Whether effected by economies, Government reorganizations, elimination of non-essential functions, postponements of desirable but not immediately necessary appropriations, or otherwise, a reduction of Federal expenditures is essential—and I would place the reduction in excess of the \$200,000,000 mark. It is my opinion that a reduction in Federal expenditures of \$500,000,000 will occasion less hardship upon the public generally, and upon taxpayers particularly, than an added tax burden of \$200,000,000."

## How Our Departments Have Grown

"One civil servant who hadn't much to do, Asked for an assistant, and then there were two.

Two civil servants kept the job alive,

Three more were appointed and then there were five.

Five civil servants pushing at a pen—

They made them a department, and then there were ten.

Ten civil servants—one would think 'twas plenty—

But, being a department, soon there were twenty.

Twenty civil servants—an' the taxpayer grew shirty.

But taxpayers don't matter, and soon there were thirty.

Thirty civil servants, but the Minister grew haughty.

His department wasn't big enough, and then there were forty.

Forty civil servants—for reasons full and weighty—

The Minister, who needed votes, increased it up to eighty.

Thus the game goes on and on, it's really rather fun,

Making a hundred joblets grow where formerly was one."

—*Rhodesia Railway Review*.

## The American Society on the Air

Down in Louisiana Darby Sere interests himself in professional matters relating to accounting in a variety of ways. Last year he was president of the Society of Louisiana Certified Public Accountants, and this year is a director of that society. Last year he was State Representative for Louisiana of The American Society, and this year he is Chairman of the Committee on State Legislation in The American Society. He is also interested in the advancement of accountancy education, especially as connected with the College of Commerce and Finance of Loyola University. The latest evidence of this interest is an announcement by President Miller, under date of April 6, reading: "Through the courtesy of Mr. Darby Sere, C.P.A., Loyola University has offered the use of Radio Station WWL, every Monday night for seven consecutive weeks for a fifteen minute broadcast, under the auspices of The American Society of Certified Public Accountants. The plan is to discuss Classification of Accountancy Services as recommended by The Society."

A complete program, chosen from members of Loyola faculty, follows:

Monday, April 25, 6:30 p.m. Introduction  
—Henry J. Miller, C.P.A.

Monday, May 2, 6:30 p.m. "Detailed and Test Audits," Darby Sere, C.P.A.

Monday, May 9, 6:30 p.m. "Review Audits and Examinations of Financial Condition," Thomas A. Williams, C.P.A.

Monday, May 16, 6:30 p.m. "Reviews of Operations and Audits of Specific Accounts," John A. Peyroux, C.P.A.

Monday, May 23, 6:30 p.m. "Investigations and Tax Services," Henry J. Miller, C.P.A.

Monday, May 30, 6:30 p.m. "System Services and Budgetary Services," Louis H. Pilie, C.P.A.

Monday, June 6, 6:30 p.m. "Opinions, Preparation of Statements from Books Without Audit, and Miscellaneous Services," August A. Wegmann, C.P.A.

## State Practice Recognition

AFTER April 15, 1932, no attorney, certified public accountant or other agent can represent a client before the Department of Revenue of the State of Pennsylvania unless enrolled with the Department. This is in accord with regulations governing the recognition of attorneys, agents and other persons representing claimants before the Department approved on March 15 by Secretary of Revenue Clyde L. King.

However, any individual claimant, taxpayer, or member of a firm or officer or authorized regular employee of an individual, firm or corporation may appear solely for himself or such individual, firm or corporation without being enrolled upon presenting adequate identification to the Department. Applicants for enrollment must be residents of Pennsylvania. Special permits will be granted on request to practitioners residing in other states.

A set of standards has been adopted for the conduct of those appearing before the Department. This was done, Secretary King said, because the Department found it necessary to take steps to improve ethical standards in practice before it. The protection of the taxpayer and the protection of ethical attorneys and accountants demanded this action, he said. The regulations also will serve to expedite public business.

Enrollment is not restricted to licensed attorneys and certified public accountants. All applicants for enrollment must show that they possess a good character and reputation, and a familiarity with the laws covering taxes and other subjects which they propose to present to the Department. Those not attorneys or accountants must show evidence of ability to understand tax questions or such matters as they will bring before the Department. A bad reputation as to integrity or professional conduct may be regarded as sufficient cause for rejection of the applicant.

Among the causes for disbarment are: soliciting business from claimants who are already represented by attorneys or accountants; making false answers to questions in the application for enrollment; conviction of perjury or of a crime involving dishonesty in money matters; disbarment of an attorney

by a court of record; disbarment or cancellation of a certificate of an accountant by a legally constituted board; making a false statement for any firm, person or corporation and certifying that such statement is correct, and any other conduct which is unethical as viewed by the standards of the American Bar Association or the Pennsylvania Institute of Public Accountants.

Other causes for disbarment include use of printed matter on letterheads, cards, or other advertising matter indicating previous connection with the Department of Revenue; representation, orally, in printing or in writing, of acquaintance with officials or employees of the Department; use of any title or name which might imply connection with the Department. This last includes use of such designations as "Pennsylvania Tax Expert," "Pennsylvania Tax Bureau," "Pennsylvania Tax Counsellor," "Pennsylvania Tax Counsel."

Applications for enrollment and all disbarment proceedings will be handled by a Committee on Enrollment and Disbarment. The committee's recommendations will be submitted to the Secretary of Revenue for his approval.

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## American Trade Association Executives Award

The American Trade Association Executives' annual award this year was made to the Paint and Varnish Association. The jury's reasons for making the award were stated as follows:

"First, on the record, they carried through a program which was comprehensive, well coordinated and effective in the interest both of the public and of the industry. Second, the voluntary agreement under which they set up and successfully operated an Unfair Competition Bureau is a conspicuous tribute to their courage and initiative. This bureau, established in 1929, has now had a good test, and on the record has been remarkably successful. It represents an outstanding attempt at self-discipline, and as such affords striking evidence of industry's ability to regulate itself in its own and the public interest. In its provisions first for non-governmental

arbitration and finally, if that fails, for submission to the Federal Trade Commission, it is sound in conception and effective in practice. Here is an industry which is organized on the principle that its own interests are best served by protecting the public against the unfair and unethical practices of the few. Such enlightened and courageous action deserves recognition."

### From a Genuine Letter from an Old-Fashioned Father to His Son

December 14th, 1931.

DEAR SON:

Your letter greatly interested me. I can see what a tough time you fellows are having. The only consolation I can offer you is the thought that you would be worse off in jail or amongst the Japanese in the Manchurian trenches, or in the hospital with broken leg, or standing in a bread line, or having to make a speech or sing a song in public when you have nothing to say and can't sing. Oh, there are a thousand ways in which we might be worse off.

Just the same we are surely going through the most perilous times. But the world has gone through worse and the sun has come out again and life has gone on. Did you ever read about the black death or the hundred years' war in Europe?

I remember once when your grandfather Tibbals lost four hundred dollars in a bad loan. It meant a lot in those days. Somebody was pestering him with lamentations. He said "you haven't heard *me* squeal, have you?" Fine old fellow. Well, son, I figure it this way—you and I have enough to eat and a house to live in. There are a hundred million other people in this country. Of course, most of them are awfully stupid and are just going round in silly circles and hollering and there does not appear to be any Moses to lead us to the promised land. But we don't need any other land and the promises are inherent in the situation and do not depend on *politicians* or *bankers*. These hundred millions are going and wearing out clothes and needing houses and automobiles and everything else. Also, we have plenty of resources by which these things are going to be supplied and the "captains of industry" have just enough intelligence and initiative

to keep up the supply. So we shall go on living and making and buying and selling so that soon we shall either find things adjusted or we shall be adjusted to things as they are. I don't suppose I shall ever get back the money I merrily "invested" in 1929. Anyway I am happy and intend to stay so as long as possible.

The worst feature of the situation to my mind is the fact that Congress is "setting." They won't hatch anything. If they would only sit and go to sleep then there would be hope in that. About the most foolish thing I know is picking on Hoover. Why should he be expected to devise some miraculous scheme by which prosperity might be brought back over night? If he had such a device it would be worked. God himself might propound such a plan but if he were either a Republican or Democrat the other side would viciously oppose him. No—things must be worked out of themselves and they will. Probably many heads will fall and not the right ones. That is how it goes. When the people are in this state of mind they just hit the biggest heads whether those of friend or foes. Then they calm down, clear up the mess and go to work.

From the *Wall Street Journal* of January 5th, 1932.

### Infectious Gaiety

By MAURICE C. MOORE

"A HUMDRUM job, that man has—yet he he is always keen, always high-spirited: what you'd call an infectious gaiety!"

I overheard two fellows saying that about a third man.

It seemed to puzzle them, how this third man could keep his edge and happiness, doing work that would bore *them*.

But each to his taste and task; perhaps this man's work was not boring *him*.

That, however, does not necessarily follow, for I have known several cheerful and even quite riotously merry folk whose lot in life certainly, if I am any judge, palled upon them.

There is this. Dull work is not nearly the deadly thing it may seem. The discipline of it, forcing you away from the fullstretch constructive effort that of course you like best, can be surprisingly restorative. Your

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Leading accountants and financial executives everywhere are accepting this new edition, as they did the previous (1923) volume, as part of their everyday working equipment. A letter from Lybrand, Ross Bros. & Montgomery, who have bought 650 copies, says:

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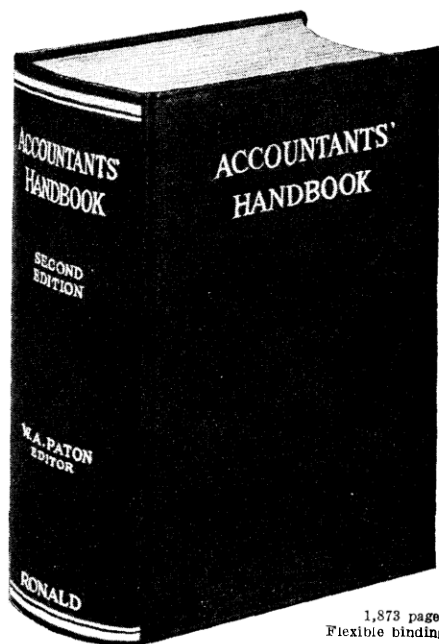
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powers have not been taxed by it so much, and afterwards you make the welcome discovery that you are fitter and fresher. One may cheerfully face a stretch of routine in that mood. And also, of course, there is the following satisfaction of something attempted something done; the feeling of pleasure that comes when you have stuck at toil in which you are not specially interested is considerable.

But anyhow, whatever we may be doing, why *not* that "infectious gaiety"?

Tolstoy, the great Russian novelist, once wrote to Bernard Shaw, as great a man (I think a greater, if we understand him aright) and complained that he, Shaw, "treated life as a joke." To which Shaw replied: "Admitted; and my idea is to make it a *good* joke." This retort would be a bad joke to Tolstoy, who obviously found life itself the worst kind of joke. I go all the way with Shaw. Why gloom? Tolstoy no doubt painted a true picture of his environment and of life as he saw it. But we want to improve the picture. Then how? Let us sparkle in the mind, let us get "the healing gift of laughter," let's grasp at some of the immense amount of fun that's to be had, and we are re-born and become giants in strength through shedding defeatist thoughts. Shaw's my man!

If things are wrong, let's think the right things in their place.

It is the quick way to get them right.

More practical wisdom in a laugh than in a cry.

Hope makes the happy mind. And hope isn't an act of faith that may turn out to be delusion. It's an anticipation of what can *be* if you hope, but will never be if you don't. For hope means that high-spirited action which alone makes the good things come to pass.

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## Bankers Group Meeting

The general subject for discussion before a meeting of Group Four, Pennsylvania Bankers Association, held at Williamsport, was "The Tendencies of Unit and Chain Banks."

A few quotations from addresses and articles referred to in the addresses follow:

Reference was made to the testimony of Mr. Trafford, Vice-Chairman of the First Na-

tional Bank of Boston. When asked the question "Is it your thought that the effect of branch banking on a large scale would be to produce a race for the purchase of banks with the result of embarking upon perhaps a feverish speculation in the stock of those banks?" he replied "Yes. I think they are all right on the line ready to go. I do not know how many would go. I think it would have that effect. I do not think it would do much good."

John W. Pole, Comptroller of the Currency, was quoted as believing: "I have, therefore, predicated my recommendations for trade area branch banking upon the theory that it is necessary to disregard State boundary lines with respect to the trade areas of many cities just as it was necessary to disregard State boundary lines in many cases when the Federal Reserve districts were established."

A. H. Wiggin, Chairman of the Governing Board of the Chase National Bank, New York City, was quoted as saying: "Our own preference would be not to see any extension of branch banking. If the branch banking were limited to trade areas or to Federal Reserve districts, it would cause, in the New York district, a competition in the buying of other banks in other cities which we would dislike to see."

E. E. Wakefield, Vice-President of the First Bank Shares Corporation, Minneapolis, was quoted: "We have learned by our experiences of the last three years how much more effective branch banking would be than group banking."

Melvin A. Traylor, Chairman of the Board of Directors, First National Bank of Chicago, was quoted as saying: "I regret that I cannot agree with some of my very good friends who have suggested a national system of banks, one system for the banking facilities of the country. I believe that such a proposal is fraught with more hazard to our political and economic life than any suggestion seriously proposed in my lifetime. I believe in the independent unit system of banking which this country has always enjoyed. I believe the thing we have to fear most of all is the extent to which in supposed emergencies, we modify that system. \* \* \* It is about time that the states assert some of their protective sovereign rights in this banking situation."

## ANNOUNCEMENTS

S. C. Kossoy, C.P.A., announces the removal of his offices to 11 West 42nd Street, New York City.

Cornell and Company, Certified Public Accountants, announce the removal of their offices to suite 1501-13 Fidelity Bank Building, Kansas City, Mo.

J. W. North and Co., Certified Public Accountants, are now located at 105 West Monroe Street, Chicago, Illinois.

James L. Andrews, C.P.A., is now located at 22 East 40th Street, New York City.

Swanson Ogilvie Company announce the removal of their offices to suite 1809-13 Midland Building, 176 West Adams Street, Chicago, Illinois.

Samuel Klein & Co., Certified Public Accountants, announce the removal of their offices to Military Park Building, 60 Park Avenue, Newark, N. J.

Samuel Tarter, C.P.A., announces the removal of his office to 1457 Broadway, New York City.

Earl G. Teeter & Co., Certified Public Accountants, announce the removal of their office to 1621 Bankers Building, 105 West Adams Street, Chicago, Illinois.

William B. Weinberger, C.P.A., announces the removal of his office to 450 Seventh Avenue, Nelson Tower Building at 34th Street, New York City.

Announcement is made of the retirement from public practice of Arthur L. Perry, C.P.A., and the dissolution of the firm of Davis, Perry & Company, Certified Public Accountants.

Carrol F. Davis, C.P.A., and Philip M. Osborne, C.P.A., both formerly of the firm of Davis, Perry & Company, and Harlan Johnson, C.P.A., formerly of the firm of J. S. Wilson, Jr., & Company, announce the formation of the firm of Harlan Johnson,

Davis & Osborne, Certified Public Accountants, with offices in the Calvert Building, Baltimore, Md.

Carbis A. Walker & Associates announce the admittance of Stratton Coyner, C.P.A., and attorney-at-law, as a senior member of the firm, effective February 1, 1932, and the change of the firm name to Walker, Coyner & Associates. The offices are now located at 838 Nissen Building, Winston-Salem, N. C.

Harold B. Barnett, C.P.A., announces the removal of his offices to 8 East 41st Street, New York City.

Haskins & Sells announce the removal of their uptown office from 75 East 45th Street to 22 East 40th Street, New York City.

James W. Walsh, C.P.A., of the Associated Audit Co., announces the removal of their offices to 2 Rector Street, New York City.

E. H. Griswold & Company, Certified Public Accountants, announce the removal of their offices to the First National Bank Building, 1 Federal Street, Boston, Mass.

S. A. Glick & Company, Certified Public Accountants, announce the removal of their offices to 38 Park Row, New York City.

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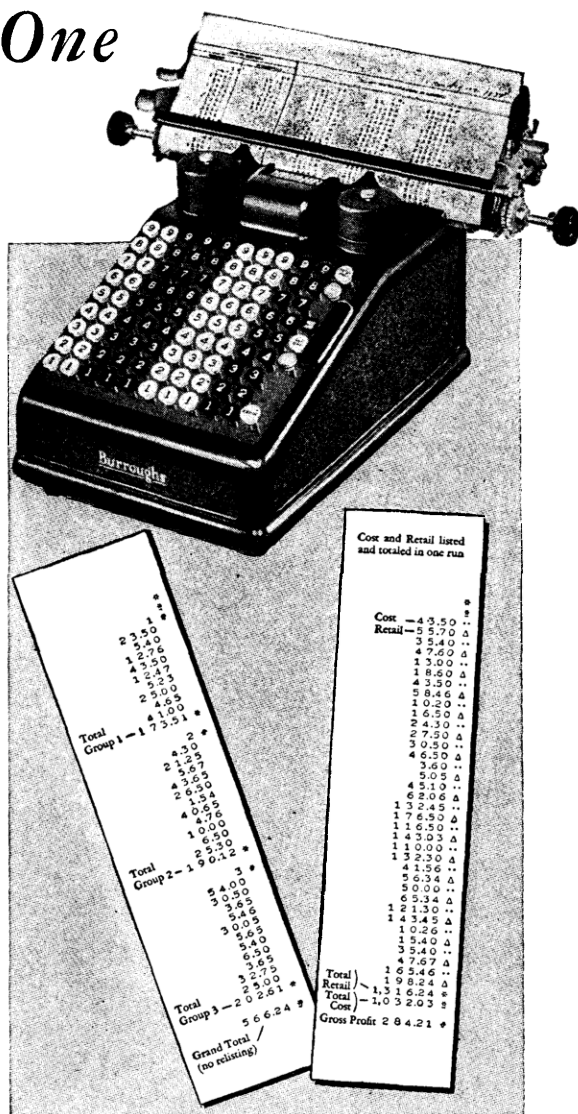
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*The*

June, 1932

# CERTIFIED PUBLIC ACCOUNTANT

Official Organ of The American Society of Certified Public Accountants

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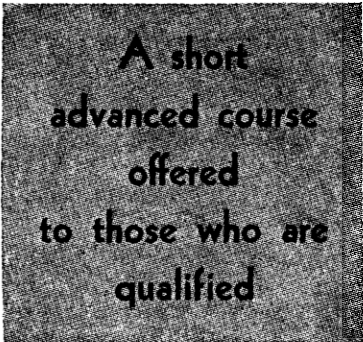
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**WHEN ANSWERING ADVERTISEMENTS MENTION THE CERTIFIED PUBLIC ACCOUNTANT**

Clients provide the fees that are our sustenance. We owe them honest service, we owe them a confidential relationship. They employ us, however, not only because of our *Certified* skill, but especially also, because we are recognized by the Public, as dedicated to *Public Service*. If we fail in our duty to a client we err and are punished — sometimes by loss of the client's business. If we fail in our duty to the Public we commit an unforgivable fault, and cannot escape its consequences.

We may try to explain or try to hide, try to blame others or try to excuse, but we cannot still the accusing voice. If we murder *Truth to the Public*, some day out of a clear sky will come the question, "Where is thy brother?" The world will hear it, for a thousand echoing tongues will spread the fearful question. The *Public* we are pledged to serve will exact an auditing, directly through law or indirectly through lessened patronage. No matter how shrewd our legal counsel, no matter how learned he is in intricate law, no matter how ambiguous or mystifying the phrases we use to slaughter Truth, no matter to whom, where, or when, we direct our report, no matter what words we employ to limit liability and responsibility, no matter if trapped and bewildered by our own perfidy, we cannot hope to seek refuge behind the retort of the first murderer—"Am I my brother's keeper?"

## Government Budgeting

In industrial budgeting the estimate of sales necessarily forms the base on which the manufacturing program and estimate of expenditures is erected. The primary purpose in government budgeting should be to determine the revenue requirements, the logic of which is to reverse the industrial process by an estimate of the expenditures as the base for the revenue superstructure. This simple logic seems not to have been impressd on the minds of a majority of the legislative representatives of the people, and apparently will not be until the people have more forcefully or more effectively expressed themselves.

In times like these, when the people are being forced into drastic economies, there would seem to be no sound reason why a like practice should not be followed in all forms of government—national, State, county, or municipal; no sound reason why government expenditures should not be limited to actual necessities. But who has heard vociferous crying from the housetops: "*Taxes must not be imposed on the people to cover any avoidable expenditure*"?

Proposals are being made such as that the federal government borrow from the people a huge sum of money to be used in government enterprises or for loans to private enterprises that will assure a return sufficient for interest and amortization. The anomaly is that there should be one proposal to tax the people to the uttermost limit and another that they should constitute the federal government an agent for the investment of their surplus (?) funds in such enterprises. Can there be doubt that, if taxes were kept down to the irreducible minimum, the funds resultantly left in the hands of the people would not, from

the confidence established, find utilization in expanding private enterprises and thereby relieve the depression and afford the employment so sorely needed.

Representations frequently have been made that the certified public accountant owes a duty to the public interest. It would seem that present conditions afford them the best opportunity yet encountered to engage in a constructively educational work that would give to such representation a real meaning. Will they do it?

## *Our Apologies*

On page 308 of the May issue, in the radio address given by Lyle W. Hines on "The Certified Public Accountant," the omission of two lines in the make-up presented an entirely erroneous statement. The sentence read "No partnership may practice as Certified Public Accountants in the State of Minnesota \* \* \*." The omitted words were "unless all members thereof shall have received certificates as Certified Public Accountants." The sentence should have read "No partnership may practice as certified public accountants unless all members thereof shall have received certificates as certified public accountants in the State of Minnesota \* \* \*."

In view of the fact that no law in any State precludes the practice by partnerships, the misstatement due to the omission was obviously patent to all readers, but it has afforded the Editor an opportunity of knowing that a considerable number of the readers are carefully checking up on the various statements made.

Some individualists have inquired as to whether a uniform law which put partnerships and corporations both out of the accounting picture would not be a good thing. This shows an interest in accounting legislation beyond that which some of us believed actually existed.

## *Public Capital vs. Private Capital*

Newspapers have carried much information concerning the debates in both Senate and House regarding the budget, taxation, retrenchment, etc. A comment made by Sir Ernest Benn in an address on "Public Economy," delivered to the Incorporated Accountants' London and Districts Society, is indicative of the fact that these difficulties are not confined to the United States. One paragraph of his address was:

"My proposition, in a sentence, is this: That the worst possible place for money is the public purse. You will notice, indeed, that when money gets into the public purse, it positively changes its character. I give you this curious comparison that may interest you: Private capital is that part of the income of the past which has been saved; public capital is that part of the income of the future which can be mortgaged. From which it follows that the more private capital, the cheaper it becomes, and the more public capital the more expensive it gets."

# The Certified Public Accountant

DEVOTED TO THE INTERESTS OF THE C. P. A., HIS CLIENT, AND THE PUBLIC WELFARE

VOLUME XII

JUNE, 1932

NUMBER 6

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*Editor:* DURAND W. SPRINGER. All communications should be addressed to the editor. Published monthly by The Accountants Publishing Company, National Press Building, Washington, D. C. *Publication office:* 1406 East Franklin Street, Richmond, Va. *Subscription price:* A year of 12 issues, \$2.00; twenty cents a copy. Entered as second-class matter, January, 1932, at the post office at Richmond, Virginia, under the act of March, 1879.

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*"A man's value lies in his ability to think  
individually and act collectively."*

—ELBERT HUBBARD.

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## The President's Page

### "Am I My Brother's Keeper?"

HENRY J. MILLER, C.P.A.

The letters C.P.A. represent three words which, together, indicate our profession. Each, individually, expresses some part of our duties or qualifications. They are not all of equal importance. *Accountant* is merely a general name for the service we perform. *Certified* indicates that we have acquired a standard skill, and have been approved by proper authority of a sovereign State. *Public* is the most important word in the title. It is more than a mere name. It is more than an indication of fitness. It proclaims us as servants of the Public. It invests us with the responsibilities of Public trust.

We experience some degree of pardonable pride and satisfaction when we are first Certified by a State Examining Board. It is pleasant to acquire the stamp of proficiency. In the happiness of our success we oftentimes give little thought to the seriousness of the obligation represented by the second word of our designation, although our relationship to the *Public* is what elevates the profession to its high plane. To serve our fellow man in matters of accountancy is a noble trust. It is one that cannot lightly be regarded, and calls for the exercise of both technical skill and moral character.

Our greatest concern as certified public accountants should be to maintain unblemished the public trust reposed in us. No temptation can be great enough to warrant betrayal of our fellow man by failure to reflect honestly, skillfully, and clearly the *whole Truth*. When Cain replied, "Am I my brother's keeper?" he evaded and sought to shirk responsibility. Certified public accountants are not literally keepers of their brothers, but since of their own free will they have elected to serve them in matters of accountancy, they have definite responsibilities which they cannot evade. Cain could not escape the penalty of his act. Neither can the Certified Public Accountant escape his sins against the confidence of the Public, by attempted evasion of responsibility.

## Excerpts from Annual Address<sup>\*</sup>

By ARTHUR H. CARTER, C.P.A., New York City

"The following remarks are an expression of my own personal opinion in regard to various matters and may in no way be considered views of the Society.

"The cumulative effect of the foreign and domestic stress and strain in business and financial affairs during the past year has placed the accounting profession in the limelight as a real constructive public institution, known to exist by many, but too little appreciated until failure to utilize its agencies has demonstrated the necessity therefor.

"In an endeavor to restore public confidence, bankers, investors, financial writers, and statistical services are clamoring today as never before for facts relating to business.

"It is almost unbelievable that in this day and age the glamour of any individual, or any group of individuals, could so sway the judgment of prudent business men and the investing public as to lead them to accept any financial statement without an independent audit.

"The prosperity of our country depends largely upon the good will and confidence of the public, because upon that good will depends the sale of goods to the consumer and the purchase of securities by investors. Public and private corporations are beginning to understand that the confidence of the public is one of the least expensive and at the same time most valuable and essential of all factors of success.

"The C.P.A. occupies an ever-increasingly important place in the business structure of today. He has the opportunity to assume an even stronger position in the affairs of commerce than he has in the past, for it may be fairly stated that accounting, with all its ramifications, holds within itself the control of every business enterprise.

"Every project is predicated upon and expressed by some accounting formula.

<sup>\*</sup>The following quotations, having more than a local Society interest, are taken from the annual address of President Carter before the New York State Society.

### CAUSES OF BUSINESS FAILURES

"The United States Department of Commerce, after investigation of the causes of business failures in the State of New Jersey in 1929-30 stated that failures in business seemed to indicate that business methods and practices should be given first place as the cause of failure.

"Of 400 businesses for which information was secured on this point, 96, or 23%, kept no accounts at all; 120, or 29.4%, kept accounts inadequate for the purpose of showing the condition of their business; and 192, or 47.1%, kept accounts which might be described as adequate.

"The lack of records is frequently accounted for by owners on the ground that the business is small, or they are too busy, or cannot afford to hire qualified bookkeepers or accountants.

"Is this not an opportunity for the Department of Commerce to champion the cause of accountancy and urge that all business organizations avail themselves as far as possible of the services of C.P.A.'s in the conduct of their business to the end that this increasing number of business failures, due to such bad methods and practices, may be minimized.

"In comparison with present activities it would seem entirely appropriate that this subject be given a major place in the constructive program of that department.

"Experience of the last twenty years has impressed upon management of corporations the necessity for accurate published statements of financial condition and earnings of those enterprises, the securities of which are so widely held. It is my opinion that, more than at any time during the last twenty years, absolute frankness is required in dealing with the public, since full disclosure of true conditions will be brought to light today as never before.

"Distortion of financial statements by covering up facts will not hasten the return of better business conditions.

"Over-optimism reflected in financial statements is just as dangerous as undue pessimism

— a sound middle course based upon true conditions is logical and should prove effective.

"I believe that the leaders of our country are the leaders in these policies which I have indicated.

"No doubt in the years to come we shall see an even greater effort on the part of such leaders to keep the public frankly informed regarding the securities in which they have invested, and in doing so must utilize the services of the independent accountant.

"I believe that accountants as a group represent the highest standard of conservative thinking, and if their influence is properly applied they will make a great contribution in meeting today's troublesome situation.

#### RELATION OF THE C.P.A. TO GOOD GOVERNMENT

"While the value of the C.P.A. has been more and more recognized by business leaders during the last twenty years, Federal, State, municipal, and other public officials are beginning now to realize the value and importance of accountancy in the administration of public affairs. In my opinion it is impractical, illogical, and unnecessary for the government or taxpayers to depend entirely upon official agencies for the proper audit control of public funds. I do not suggest that the official, commonly termed 'Comptroller', charged with responsibility for audit and control of expenditures of public funds should not have a staff of qualified accountants to make the many necessary special investigations, but I do contend that the accountancy profession of this State is now adequately equipped to render independent service to the State, municipal, and other governmental bodies superior to any service which may be rendered by an organization maintained by the State.

"In this connection, the special message of the Governor of this State to the legislature, which was published in the *New York Times* of February 25, 1932, indicates the consciousness of public officials of the necessity of proper audit control of government finances.

"The comptroller of the State of New York requested fifty additional auditors but only ten were included in the governor's budget. In supporting his plea for these additional auditors he pointed out that the force at the present time was so small that it was impos-

sible to check local government accounts on an average of more than once in twelve years and referred to two recent defalcations, one by a city and the other by a county official. He contended that the additional auditors would save ten times their salary every year in the form of safeguarding public funds. This definite and conspicuous approval of auditing on the part of the chief executive of this State leads me to believe that we may expect an even more definite demand for independent audits from taxpayers whose burden is made heavier by improper control of public finances.

#### MUNICIPALITIES SHOULD BE AUDITED

"The group of bonds known as 'municipals' has always been assigned a high place in the group of 'legals' suitable for the investments of savings banks, insurance companies, and trust funds.

"This high rating of 'municipals' has been based upon safety of income with which to meet the interest charges and not upon the assets behind the bonds—in fact, the last thing the buyers of these bonds have given any thought to has been the theoretical 'book value'.

"In these days and in these times municipalities are encountering great difficulty in balancing their budgets, and they will encounter greater difficulties during the next few years unless radical steps are taken to reduce departmental expenditures to a point equal to or less than income.

"Bond houses, investment bankers, and others who have in the past underwritten securities are now, and will in the future become more and more insistent upon independent audits of those organizations whose securities they underwrite and offer to the public.

"Why should municipalities be exempt from this requirement?

"Such organizations as the Investment Bankers Association, the Bond Club of New York, and others would take a constructive step in the interest of protecting their own good names and the funds of their clients and investors generally if they insisted upon independent audits of municipalities, whose securities the members underwrite and in turn sell to investors.

"Statistics are not available but I hazard a guess that the firms of investment bankers represented by the two associations mentioned



control, directly or indirectly, 90% of the business in municipal bonds.

"If these two associations led the way and demanded independent audits, it would correct many situations which now exist and forestall legislation which it is not unreasonable to expect may be enacted.

"Certainly, most citizens of every county and city of the State of New York are aware of the necessity for independent audit of their own business affairs and I do not believe they would have any hesitancy in approving expenditures from the funds of the community to which they have contributed in an amount necessary to cover a proper independent audit of the accounts and affairs of their government.

#### BANKS AND TRUST COMPANIES

"I also believe that the Certified Public Accountants of this State are particularly well equipped to serve the officers and directors of our banking institutions who are charged with responsibility for the protection of the depositors' money — a service which is necessary if they are to carry out properly their responsibilities under the provisions of the banking law of the State. The value of such services is no doubt appreciated more by directors at the present time than ever before because of their personal financial responsibility under the law. I am hopeful that they will take advantage of the facilities at their disposal more generally in the future than they have in the past for the protection of their official responsibility by employing independent auditors. The examinations provided by the Superintendent of Banks of the State cannot adequately replace the full responsibility of the directors for the integrity of their institutions.

"What applies to bank directors applies with equal or greater force to directors of industrial, public utility, and other corporations with large numbers of stockholders.

"Large corporations maintain their own legal, patent, engineering, advertising, sales and other staffs, but on all fundamental problems, outside independent experts are always called upon for advice and guidance.

"And by the same token the time is not far distant when the C.P.A. will be employed by the board of directors as an outside independent adviser to its members on accounting and related matters.

"Particularly is this necessary in many cases where a director in a corporation is also a director in ten, fifteen, or twenty other large corporations and by the very nature of the demands upon his time, cannot be expected to have an intimate working knowledge of the financial affairs of all of these companies.

"Many directors are only beginning to realize the responsibilities of their positions.

#### SOMETHING THE STOCK EXCHANGES COULD DO

"The stock exchanges of the country have made commendable progress in improving requirements for listing securities, insisting that corporations publish balance sheet and income accounts which will properly disclose the accounting policies and give a true picture of the financial position and operations of the companies.

"Further improvement in this direction will, in my opinion, be made in the near future, as it is evident that officials of exchanges realize that the investing public is entitled to full disclosure of financial facts related to the securities they hold.

"When the requirements demand that all such statements shall be independently audited I feel that the confidence of the investors will be strengthened."

The following editorial appeared in the New York *Herald Tribune* for May 11th:

"It is not often that the words of those invaluable but self-effacing guardians of financial truth, the certified public accountants, reach public print. Their opinions deserve wider publicity, especially when what they have to say is as sensible and constructive as was the speech of Colonel Arthur H. Carter before the thirty-fifth annual meeting of the New York State Society of C.P.A.'s. More light, said Colonel Carter, will result in more confidence; the good will of the investing public can be bought at the small price of full disclosure of the essential facts of the corporations in which it invests. More and more do the country's stock exchanges realize that the public is entitled to complete knowledge about securities and insist that the companies whose stocks they list should publish accurate and revealing balance sheets and income statements.

*(Continued on page 374)*

# Audit Procedure in the Examination of N. J. Building and Loan Associations<sup>\*</sup>

By L. M. STERNRICH, C.P.A., Newark, N. J.

An important part of the examination is the verification of the profit and loss statement. The distribution of profits to shareholders should be studied to determine whether the apportionment has been accurately made and whether the method employed is the proper method for the association as set forth in its by-laws. The methods frequently employed in this State are what are known as the "Partnership Plan" and the "Dexter Plan." Of the two methods the Partnership Plan is the more popular and the one generally followed by building and loan associations.

Under the "Dexter Plan," previously apportioned profits are considered as capital and past distribution as definitely belonging to the respective series to which the profits have been allocated. Profits once distributed become capital and, added to the amounts paid in, form the basis of the distribution of current profits. Previous distributions which become capital remain undisturbed. Current profits are distributed based on the amounts contributed from year to year plus accretions of profits from year to year, in the same manner as interest is compounded by computing interest with principal and interest.

Under the "Partnership Plan," the profits are distributed on the theory that all profits constitute a common pool for all series alike. Previously distributed profits are pooled with current profits and redistributed on the resultant new basis annually. This method is similar to calculating interest on a certain invested sum over a period of years at simple interest.

The auditor should recommend and explain the method of profit distribution which should be adopted by the Board of Directors.

The building and loan public is now becoming interested in a different method of profit distribution of building and loan associations. At the suggestion of numerous building and loan shareholders, a careful

study has been made with the result that<sup>1</sup> have come to the definite conclusion that a more equitable plan of apportionment of profits is the one which is seldom used in this State, namely the commonly called "Dexter Plan," or compound interest plan.

Methods of distribution of profits did not concern the officers of building and loan associations, because, in the past years premium income was large, foreclosures of mortgages were rare, losses were nominal, reserves for contingencies were not set up and profits were not affected. The profits were then distributed by the secretaries of associations in the method commonly used—the simple interest or partnership plan.

We have now gone through a serious period of depression which has affected our building and loan associations. Real estate depreciated considerably in value, associations foreclosed mortgages, losses have been sustained, reserves for possible losses have been set up. Associations that failed to provide the required reserves were compelled to do so by the State Department which sponsored a bill in the recent Legislature which passed, among other laws, several amendments to the Building and Loan Act, making it mandatory for building and loan associations to create reserves for contingent losses on mortgage loans. In setting up the reserves, they were to be charged against the current periods, when the earnings of associations were small because few loans were made, and consequently there was little premium income. The shareholder in the older series then realized that his investment in the building and loan association had *not materially increased* in value in the past fiscal year and that the new shareholder was making *more money at the expense of the older shareholder*. To enlighten building and loan officials who have come to the conclusion that there must be something wrong in the method of distributing the profits of their association, I outline what, in my opinion, is the most equitable plan of

<sup>\*</sup>This article, the first part of which appeared in the May issue, was originally prepared in serial form for the *Newark Sunday Call*.

distribution of profits for building and loan associations. This is known as the "Dexter" or "Compound Interest Plan." In order to clearly set out the differences in profit distributions, the method now commonly used, known as the "Partnership" or the "Simple Interest Plan" will be compared with the Dexter Plan.

Under the "Partnership Plan" the profits are distributed on the theory that all profits constitute a common pool for all series alike. The profits are merged and redistributed on a new basis annually. This theory, of course, was to the serious disadvantage of any group of series of shares wherein the profits are irregular each year, as the old series gain at the expense of the new series if the rate of profit increases, and lose if the rate declines.

The "Dexter Plan" considers previously apportioned profits as capital, and treats past distribution as definitely belonging to the respective series. As a result, the shares which remain in the association for some time are not disturbed, distribution is made annually only of the current profits earned, the capital remains intact, current earnings are added, and in this manner older shares are not penalized in the event the profits fluctuate from year to year.

The advantages of the "Dexter Plan" and the disadvantages of the "Partnership Plan" are pointed out here for the purpose of conveying the merits of the former system.

The advantages of the "Dexter Plan" are enumerated as follows:

1. All profits and losses during the year are settled during the year and do not come up each year for distribution.

2. New series during the fiscal year have no bad years to average up with losses that may have been sustained in prior years; they are concerned only with profits of the current year.

3. The officers are kept accurately informed of the true earnings of their association. If profits of the past years averaged 6% and the current year 2%, inquiry will be made and the difference in profits can be easily determined.

4. Distribution is in proportion to the value of shares existing at the time and is computed on the basis of a single share fully paid to date. It is made according to actual value as distinguished from the withdrawal value.

5. "Dexter Plan" being more equitable, shareholders participate on the basis of their investment plus accretions.

6. Distribution of profits is made on the basis that all shareholders will hold their shares to maturity.

Under the "Partnership Plan":

1. The establishing of a reserve works a hardship to the older shareholders, as they are penalized first by faulty distribution and then by the setting out of a reserve which should be a current deduction, and as reserves are compulsory under the law, it is obvious that this plan will not meet with the modern tendencies of present building and loan accounting.

2. Delays the maturity of the older series.

3. The operations of the current year are merged in the surplus and the current earnings are concealed in the general surplus.

#### DISTRIBUTION OF PROFITS—"DEXTER PLAN"

The following represents certain rules that govern the method of distributing profits under the "Dexter Plan":

1. Arrive at increase in surplus by taking the total profits as shown by the report and deducting the profits of the report of the preceding year.

2. Arrive at profits for distribution by adding to above figure the profits paid and profits withheld on withdrawn shares during the period.

3. Arrive at the capital, for the current year, by multiplying the value of each share in each series as indicated in the last report by the number of shares in force in the series, and add the equalized dues for the current year. This represents the total capital for the current fiscal year.

4. Arrive at the percentage of net profits for the current year by dividing the net profits by the total capital for the current year.

5. Arrive at the total capital of one share in each series by adding to the value of each share, as indicated in the last preceding statement, the equalized dues for the current year.

6. Arrive at the net profits of each share by multiplying the total capital per share for the current year by the per cent of profit for the current year.

The following will illustrate the simple manner in which profits are actually dis-

tributed under the "Dexter Plan":

	1.00	"	4	"
\$1.00 for 12 months	1.00	"	3	"
1.00 " 11 "	1.00	"	2	"
1.00 " 10 "	1.00	"	1	"
1.00 " 9 "				
1.00 " 8 "	\$12.00		78 months	
1.00 " 7 "	Divide \$12.00 into 78 average months			
1.00 " 6 "	equals \$6.50, which represents the equalized			
1.00 " 5 "	dues for computation purposes.			

#### FIRST YEAR

\$247.38 Profit	Dues	Profits	Total
300 shares at \$12 per share .....	\$3,600.00		
300 shares at \$ .82 per share .....		\$246.00	\$3,846.00
Undivided Profits .....		1.38	1.38
	<u>\$3,600.00</u>	<u>\$247.38</u>	<u>\$3,847.38</u>
	=====	=====	=====

#### SECOND YEAR

\$695.38 Profit	
Total Profit at end of Second Year .....	\$695.38
Less: Profits First Year .....	246.00
	<u>\$449.38</u>
	=====

#### CAPITAL ACCOUNT

300 Shares — 1 year at \$12.82 .....	\$3,846.00
300 Shares — 2 years .....	
600 Shares at \$6.50 per share equalized dues .....	3,900.00
	<u>\$7,746.00</u>
	=====

Total Capital Participating in Current Year's Profits .....

#### DISTRIBUTION OF PROFITS

\$449.38 Profits for the Second Year .....	\$7,746.00	=	5.80%
	1st Year		2nd Year
Value of Share, Last Report .....	\$12.82		
Equalized Dues for Current Year .....	6.50		\$6.50
	<u>\$19.32</u>		<u>\$6.50</u>
	=====		=====

1st year —  $\$19.32 \times 5.80\% = \$1.12$   
 2nd year —  $6.50 \times 5.80\% = .37$

#### VALUE OF SHARES

	1st Year	2nd Year
Value at Last Report .....	\$12.82	
Profit Current Year .....	1.12	\$ .37
Dues for Current Year .....	12.00	12.00
	<u>\$25.94</u>	<u>\$12.37</u>
	24.00	12.00
	<u>\$ 1.94</u>	<u>\$ .37</u>
	=====	=====

## GENERAL STATEMENT — FOR TWO YEARS

	Dues	Profits	Total
300 Shares 1 Year \$24.00 .....	\$ 7,200.00		
300 Shares 1 Year 1.94 .....		\$582.00	\$ 7,782.00
300 Shares 2 Years 12.00 .....	3,600.00		
300 Shares 2 Years .37 .....		111.00	3,714.00
	<u>\$10,800.00</u>	<u>\$693.00</u>	<u>\$11,496.00</u>
Undivided Profits .....		2.38	2.38
	<u>\$10,800.00</u>	<u>\$695.38</u>	<u>\$11,498.38</u>
	=====	=====	=====

## THIRD YEAR

Total Profits at End of Third Year .....	\$1,541.38
Less: Profits Distributed at End of Second Year .....	693.00
	<u>          </u>
Balance, Net for Year .....	\$ 848.38
	=====

## CAPITAL ACCOUNT

300 Shares 1st Year at \$25.94 .....	\$ 7,782.00
300 Shares 2nd Year at 12.37 .....	3,711.00
300 Shares 3rd Year at .....	
900 Shares at \$6.50 Per Share Equalized Dues .....	5,850.00
	<u>          </u>
Total Capital .....	\$17,343.00
	=====

\$848.38 Profits for year—\$17,343 = 4.89%.

	1st Year	2nd Year	3rd Year
Value of Share Last Report .....	\$25.94	\$12.37	
Equalized Dues for Current Year .....	6.50	6.50	\$6.50
	<u>          </u>	<u>          </u>	<u>          </u>
Total Capital .....	\$32.44	\$18.87	\$6.50
Multiplied by per cent of Profit .....	4.89%	4.89%	4.89%
	<u>          </u>	<u>          </u>	<u>          </u>
Profit Per Shares .....	\$ 1.59	.92	.31
	=====	=====	=====

## VALUE OF SHARES

	1st Year	2nd Year	3rd Year
Value at Last Report .....	\$25.94	\$12.37	
Profit — Current Year .....	1.59	.92	\$ .31
Dues for Current Year .....	12.00	12.00	12.00
	<u>          </u>	<u>          </u>	<u>          </u>
Present Value .....	\$39.53	\$25.29	\$12.31
Total Dues Paid Per Share .....	36.00	24.00	12.00
	<u>          </u>	<u>          </u>	<u>          </u>
Total Profits .....	\$ 3.53	\$ 1.29	\$ .31
	=====	=====	=====

GENERAL STATEMENT				Dues	Profit	Total
(1)	300 Shares 1st Year	\$36.00 .....		\$10,800.00		
	300 Shares 1st Year	3.53 .....			\$1,059.00	\$11,859.00
(2)	300 Shares 2nd Year	24.00 .....		7,200.00		
	300 Shares 2nd Year	1.29 .....			387.00	7,587.00
(3)	300 Shares 3rd Year	12.00 .....		3,600.00		
	300 Shares 3rd Year	.31 .....			93.00	3,693.00
				<u>\$21,600.00</u>	<u>\$1,539.00</u>	<u>\$23,139.00</u>
Undivided Profits .....					2.38	2.38
				<u>\$21,600.00</u>	<u>\$1,541.38</u>	<u>\$23,141.38</u>
				=====	=====	=====

This plan has been outlined for a period of three years and is to be followed to maturity.

The plans of profit apportionment are presented for comparison.

COMPARISON OF ANNUAL ACCRETION OF PROFITS					
Year	Months	Annual Accretion		Difference	
	Paid In	Dexter	Partnership	Increase	Decrease
11th	132	\$13.28	\$11.11	\$2.17	
10th	120	11.56	10.06	1.50	
9th	108	9.95	9.00	.95	
8th	96	8.46	7.96	.50	
7th	84	7.06	6.90	.16	
6th	72	5.76	5.84		\$ .08
5th	60	4.55	4.79		.24
4th	48	3.42	3.73		.31
3rd	36	2.37	2.68		.31
2nd	24	1.39	1.63		.24
1st	12	.48	.57		.09
		<u>\$68.28</u>	<u>\$64.27</u>	<u>\$5.28</u>	<u>\$1.27</u>
			4.01		4.01
		<u>\$68.28</u>	<u>\$68.28</u>	<u>\$5.28</u>	<u>\$5.28</u>
		=====	=====	=====	=====

COMPARISON OF PROFIT AND BOOK VALUE PER SHARE					
Year	Dexter	Partnership	Dexter	Partnership	Difference
11th	\$68.28	\$64.27	\$200.28	\$196.27	+ \$4.01
10th	55.00	53.16	175.00	173.16	+ 1.34
9th	43.44	43.10	151.44	151.10	+ .34
8th	33.49	34.10	129.49	130.10	— .61
7th	25.03	26.14	109.03	110.14	— 1.11
6th	17.97	19.24	89.97	91.24	— 1.27
5th	12.21	13.40	72.21	73.40	— 1.19
4th	7.66	8.61	55.66	56.61	— .95
3rd	4.24	4.88	40.24	40.88	— .64
2nd	1.87	2.20	25.87	26.20	— .33
1st	.48	.57	12.48	12.57	— .09
		<u>\$269.67</u>	<u>\$269.67</u>	<u>\$1,061.67</u>	<u>\$1,061.67</u>
		=====	=====	=====	=====

It should be noted that the foregoing was prepared for the purpose of having the shares mature in 132 months.

The above comparison clearly conveys that the "Partnership Plan" favors the newer series at the expense of the older series; and is obviously unfair because the older series produced the profits. This naturally has caused the building and loan public to give consideration to the more equitable plan of distribution, and as a result serious thought has been given towards the adoption of the Dexter Plan method.

Notice that under the "Dexter Plan" the shares *actually* mature in 132 months; the value of the shares was \$200.28 compared to \$196.27 under the Partnership Plan. Notice the difference in the earlier series for the first eight years where the value of the shares under the Partnership Plan is favored in amounts ranging from \$.09 to \$1.27. The profits after the eighth year are more equitable and are equalized to the point that at maturity of 132 months, which is being used as the focal point, the Dexter Plan is \$4.01 ahead of the Partnership Plan.

The industrial depression which has gripped the country has reduced, and in many cases has cut off considerably, the purchasing power of the merchant, wage earner and business man, who are the home owners and the tenants, making it difficult, and in many cases impossible, to meet their rents or their interest and mortgage payments. This has resulted in vacated houses which affected the return on real estate and the profits to be derived by investing in it, and in abandoned houses which the associations were compelled to take over. These factors and their many ramifications demoralize the real estate market to such an extent that the associations find themselves the owners of many properties for which there is no market. In order, therefore, to provide for such periods as these and to forestall sustaining any possible serious loss in any one period on the disposal of real estate, which might wipe out the entire profits and surplus of an association, the practice of setting up reserves was instituted to adequately take care of any contingencies which might arise. The establishment of these reserves has been made compulsory by certain legislation which was urged upon the legislature in the form of several amendments sponsored by the Depart-

ment of Banking and Insurance. The examiners must take cognizance of the laws relating to the reserves and become familiar with them so that they may determine that the reserves have been properly set out.

One of the important reserves that must be provided is the one as described under Section 69 of the Building and Loan Act, stating that every association should set apart a reserve fund, out of the net profits each year, before any dividends are declared or any division or apportionment of profits is made, two per cent of said net profits. The association, however, may set aside additional profits as it sees fit, provided that this reserve fund shall at no time exceed fifteen per cent of the total assets of the association. This reserve was written into the law to provide a reserve for contingencies. However, to prevent the excessive reduction in distributable profits which might work to the detriment of the stockholders, this fund is limited to fifteen per cent of the total assets of the association. This reserve might be set aside before any dividends are declared or any division or apportionment of profits is made. It is an excellent provision and it is commendable that the legislature has written this in the law.

A second reserve which is required by the law and complements the reserve just described is provided for associations which hold real estate. This is defined in the Building and Loan Act as a "Real Estate Reserve," which must be established where the two per cent reserve is less than ten per cent of the cost of any real estate acquired by any such association. Under its terms, the association must set up a special real estate reserve in an amount equal to the difference between the amount of such aforesaid reserve of two per cent, and ten per cent of the cost of any such real estate, which real estate reserve account must remain unimpaired until the association disposes of the real estate, at which time the loss on such real estate, if any, should be charged to the real estate reserve account. The necessary reserve held for any property which has been disposed of may be taken into profits and distributed.

The third reserve required, defined by the law as the "Liquid Investment Fund," provides for the liquidity of certain assets which can be immediately turned into cash to meet any payments which may be immediately re-

quired on withdrawals. These funds may be invested in securities in which savings banks of this State are authorized by law to invest, demand or time deposits and certificates of deposit. This fund should be in the name of such association and should be designated "Liquid Investment Fund." This fund, the establishment of which is mandatory, must be created when all demands for withdrawals have been met and before any new mortgage loans are granted, and must be equivalent to not less than 10% of the average annual cash payments made in three preceding fiscal years by an association to shareholders, for:

- (a) Shares withdrawn
- (b) Shares matured
- (c) Stock loans on shares.

Statistics recently issued indicate that nearly ten million dollars was invested by associations in the Liquid Investment Fund at December 31, 1930. This has pleased the banking interests in that most of this money has been kept on deposit in their savings departments. It has helped the association to remain liquid, in that it was able to meet unusually large withdrawals when necessary. It has tended to stabilize the building and loan situation and has helped to place the associations in a sounder financial position.

It is, therefore, important in the examination of an association, that these reserves be properly set out on the books. The associations that have been conservative in the past and have provided these reserves to meet any contingencies that may arise, are those in which the people will continue to invest their funds.

The depression has brought great hardships on building and loan associations as on other institutions, financial, commercial and industrial, which they were unprepared to meet, and it also has had a certain salutary effect upon them which, though not immediate, will be of great benefit in the future, since it has caused the establishment of various safeguards. Building and loan associations are very fortunate, at least more so than industrial and commercial establishments, in having a supervising governmental body which not only examines and guides associations, but also fosters legislative action resulting in laws which make compulsory certain beneficiary measures necessary to the proper, expedient and efficient consummation of the affairs and

administration of the funds of the building and loan associations.

Reserves are desirable, in that they place the association on a sounder, more conservative basis, a particularly necessary feature of a financial institution.

In an attempt to evade the purpose of the reserves, real estate companies are formed by officers and directors who do not deem it desirable to show real estate owned on their financial statement. They, therefore attempt to eliminate real estate owned from their books and to evade the setting out of these reserves by forming holding companies which would acquire real estate taken over under foreclosure. The directors would in some cases assume no financial responsibility, other than to make a nominal contribution to the capital stock of the holding company, which would execute a bond and mortgage to the association and make convenient financial arrangements to pay such sums to the association as the income from these properties warrants. The result, of course, is that the annual report of the association does not show the real estate owned, and consequently evades the provisions requiring the establishment of the reserves under the Building and Loan Act. Though expedient, and probably legal, this method is rather questionable, at least from a moral viewpoint, and may be regarded as a subterfuge for hiding the true financial condition of the association from the investing public. The public is well aware that the present real estate depression has brought about foreclosures on realty and that associations, no matter how careful they may have been in their appraisals in the past, have had to acquire some real estate, the absence of which on the balance sheet of the association is bound to excite inquiry.

When the holding company acquires real estate and it makes the necessary initial payments under the preliminary arrangements between it and the association, there is, in my opinion, nothing in the technical interpretation of the law, making it mandatory for the association to set up a real estate reserve, since the real estate does not appear on the books, title having been transferred to the holding company. The association's distributed profits, therefore, may be fictitious to the extent that the profits include an amount which would otherwise have been set aside as



a reserve, and any payments made on withdrawn shares on the basis of these profits are incorrect, since the association has no assurance that the properties will not have to be taken back again in the future. The great danger lies in that the holding company may lose money on the operation of the real estate, and that these losses may accumulate to the end that the properties would have to be turned back to the association; whereas, were the properties owned by the association, a reserve would have been set aside each year to provide for shrinkage in value.

The directors of a building and loan association have a responsibility to the public and any violation of that trust, though unintentional, would reflect upon their integrity. Generally, the directors are realizing the fallacy of forming holding companies. It is the auditors' duty, in my opinion, to bring this to their attention. There is, however, no objection to holding companies, if they have been formed for the purpose of guaranteeing the mortgage loans to the building and loan association, and if they have their directors and officers individually sign the bonds and continue the proper payments and amortization of principal.

It is the examiners' duty, therefore, to determine the existence of such holding companies and to bring this information out in the report to the directors. The auditors should be permitted to examine the transactions of these holding companies and to fully report thereon to the board of directors. In connection therewith, it is my opinion that the Department of Banking and Insurance should have the power by law to investigate holding companies formed for the purposes enumerated, and the right to review their transactions. They would then have the necessary jurisdiction over the holding companies and would put the Bureau in a singular position of authority, to advise and correct conditions that they may consider faulty.

An important feature of the audit is the verification of the transaction conducted by the trustee. A statement should be prepared setting out the receipts and disbursements and should be submitted in the auditors' report to the board of directors. This examination involves the reconciliation of the trustee's cash balance with that shown by the bank, and the confirmation of the bank balance by

direct communication; the tracing into the trustee's records and cash account of all checks representing payments on mortgage loans, by a transcript prepared from the association's books; and the auditing of checks drawn on the cash account to determine that the funds have been properly disbursed.

The audit should include the examination of the stock certificate books. A receipt should be on file for all certificates issued, and all certificates cancelled should be properly filed and checked against the shareholders' register to determine that they are all accounted for. Notation should be made of all missing certificates that have not been signed for by the persons taking them, and verification should be made by direct communication of the fact that they are held by the persons designated.

The bonds covering officers, clerks, and other employees of the association should be examined to determine that they are adequate and that they meet the requirements of the Department of Banking and Insurance.

The burglary and compensation insurance policies should be examined to determine whether they are adequate for their purposes.

The minutes of the association should be reviewed to determine that all loans have been properly authorized and that the important matters concerning the association's policy have been properly noted.

The examiners should determine that the officers and directors are shareholders of record and that the directors have complied with the constitution and by-laws of the association.

The footings of monthly receipts and disbursements with their summaries should be checked and cross-footed. Interest calculations should be proved. Accruals should be checked and it should be determined that these details are properly set out on the books of the association.

Throughout the audit those entrusted with carrying the examination to completion should note, and observe matters of routine and policy, the records used, and the manner of recording transactions, so that all these matters may be given consideration for the purpose of recommending constructive changes and improvements.

When all of the details covered in this article have been completed, the examining committee or those conducting the audit

*(Continued on page 348)*

# Indianapolis

## "The Hub of Hoosier Hospitality"

INDIANAPOLIS, capital of the Hoosier State, which has contributed so much to the manufacturing, scientific and cultural achievements of America, will open its doors to visitors in attendance at the convention of The American Society of Certified Public Accountants, which will be held there on September 26, 27, 28 and 29, and will welcome the opportunity of extending to these visitors the hospitality for which the city so long has been justly famous.

There are many reasons why convention delegates should be especially interested in a visit to Indianapolis. Indianapolis is a most beautiful city in which to spend four or five days at a convention gathering. The city's clubs, parks, and boulevards are not to be excelled in any city of comparable size in the United States. Added to this beauty is the natural conveniences of location, inasmuch as Indianapolis is the most accessible city in the United States. A network of railroads and highways leading into the city make it possible for visitors from every corner of the nation to reach the metropolis with the least possible delay and expense.

Indianapolis is situated only sixty miles from the center of population of the United States. More than two million people live within two hours' ride of Indianapolis, and

more than sixty million more can reach the city over night. There is a daily transient population in the city of 20,000 people. To take care of this large influx of visitors, the railroads have provided through Pullman service from practically every railroad terminal of any size in the United States. Seventeen steam lines with 167 passenger trains daily, a network of electric interurban lines and more than a score of bus lines converge here. Indianapolis acts as a hub to a number of the larger trunk lines including the C. I. & L., Big Four-New York Central, Pennsylvania, B and O, Illinois Central and the Nickel Plate Railroads.

Indianapolis is easily as accessible by automobile as by train. It is the intersection of two transcontinental motoring routes of the United States arterial highways systems and the converging points of a number of hard-surfaced national and State roads. The State of Indiana, as a whole, has long been known for her wonderful highway system, and has acquired the title of "The Tourists' Paradise" on this account. The transcontinental routes are the National Old Trails Road from Washington, D. C., to Los Angeles, and the Pike's Peak Ocean to Ocean Trail from New York and Philadelphia to San Francisco. From the standpoint of distribution of population, it is safe to say that all roads lead to Indianapolis.

The city of Indianapolis proper is said by experts to be one of the best planned cities in the world. In addition to the downtown section, there are miles of beautiful boulevards lined with magnificent homes and parks, which lead to every point of interest in the city.



THE CLAYPOOL — OUR HEADQUARTERS

Indianapolis will overlook no opportunity to entertain the accountants, to provide them with every known convention facility and is striving to make its service and its facilities as pleasing and convenient for its visitors as possible.

# Presenting Analyzed Surplus in Corporate Records

By H. B. EVERSOLE, C.P.A., Iowa City, Iowa

SOMETIME ago an article appeared in the financial section of a metropolitan newspaper to the effect that certain brokers were suggesting a write-down of the fixed assets of a steel producing company. The purpose of the suggested write-down would be to reduce depreciation charges in order to eliminate net losses, thus improving the appearance of the earnings statement in general. The write-down would be charged to Surplus.

This company had been financed to a considerable extent by reinvestment of earnings. The earnings to a large degree had been locked up in fixed assets. In proposing the write-down, the brokers seem to have assumed that the surplus of the company resided in the fixed assets.

Some months earlier the same company was sharply criticized by political and labor leaders when it announced salary and wage cuts. The critics made considerable noise over the fact that the company had a large surplus. In general, the impression created was that the surplus resided in the cash and quick assets, which would go to stockholders as dividends.

The obvious conclusion from the above instances is that the surplus item of the company meant different things to different people. The balance sheet had failed to present a clear and unambiguous picture.

In view of the present social aspects of large corporations, it seems a logical time to start a crusade which has as its objective the carrying of analyzed surplus in the published reports of corporations. So long as surplus remains a term which can be defined according to the concepts of any individual, corporate balance sheets will remain more or less unintelligible to all parties concerned.

Too many accountants to date have been indifferent to the problem of accounting for surplus. It is true that an attempt has been made to develop a surplus classification and terminology, but no concerted effort has been put forth to have it adopted in practice. Furthermore, in defining surplus there has

been too much of a tendency to conform to legal and economic definitions, rather than to develop definitions out of corporate financial and managerial problems that arise.

Most accountants and accounting textbook writers subscribe to the general legal conception that surplus denotes an excess in the aggregate value of all assets of a corporation over the sum of its entire liabilities, including capital stock. (Edwards v. Douglas, 269 U. S. 204, 46 S. Ct. 85, 70. L. Ed. 235). The viewpoint embraces the philosophy that surplus resides in all the assets and that it cannot be traced into any of them. Fine as this may be in law and in economics, it falls far short of the needs of the manager and the investor.

The writer believes that the surplus account can be analyzed and that it should be. He further believes that the accounts can be kept in a manner which will show how each surplus item arose, its present status, and its location. The subject is obviously too great to cover in a short article, but an attempt will be made to touch the major points.

Surplus, for the purpose of this article, will be considered as made up of two parts:

1. *Capital Surplus*, a generic term covering all forms of unearned surplus.

2. *Earned Surplus*, a term reserved exclusively for actual profits which have been re-invested in the business either permanently or temporarily, or both.

Capital Surplus seldom presents a managerial problem after it is once set up, because few corporations declare dividends out of Capital Surplus. For the same reason, Capital Surplus is of little interest to the investor. Even so it seems desirable to present it accurately analyzed in the accounts.

By a proper selection of account titles, Capital Surplus can be accounted for in such a way that the source and present status will be clearly indicated. To illustrate, we may have such items as:

1. Surplus arising from revaluation (appreciation) of fixed assets.

2. Surplus arising from donations of specific assets.
3. Surplus paid in.
4. Surplus arising from so-called negative good will in the preparation of consolidated balance sheets.

Each of these items can be labelled in a manner to prevent any misunderstanding as to its nature. Since most accountants agree that different kinds of Capital Surplus should be clearly indicated, the subject will be summarily dismissed on the assumption that no case need be made for it.

Accounting for Earned Surplus presents a different problem. It seems to be an almost universal conception that Earned Surplus represents past earnings reinvested in the business and that the status and present location of these earnings is undeterminable. The writer believes that this conception is erroneous, and that it is inimical to sound management. Earned Surplus can be analyzed and can be traced into specific assets or groups of assets. It is a relatively simple matter to set up the analysis on the ledger. The only real obstacle in the way is the generally accepted philosophy holding that it can not be done.

To reduce the proposition to the simplest terms, assume a corporation which has been in operation a single year. Further assume that the corporation had no surplus at the beginning of the year; that profits earned during the year are \$10,000; that no dividends have been paid; that no long-term obligations have been retired; that there has been no increase in fixed assets. The \$10,000 surplus unquestionably resides in the working capital and is located among the current assets. The profits have not been spent. They are not permanently locked up in investments. The surplus thus created is properly available for dividends and may be called free. It represents the maximum measure of current dividends to the investor. To borrow a term from governmental accounting, the surplus is expendable.

Suppose now that the \$10,000 realized out of earnings is spent on an addition to the plant. In such a case, the surplus funds become definitely invested and are in no sense free and available for dividends. Unless the capitalized investment is permanently financed in the future by borrowings, the funds thus locked up will be returned to working capital

only at the same rate as the depreciation charged off on the asset. To show the \$10,000 simply as Earned Surplus in this instance is to make a statement which is true but misleading. Such a surplus is not a measure of current dividend-paying ability. At the best, it indicates the maximum dividends available over a long period of time. In governmental accounting terminology it would be properly labelled "Expended Surplus."

The carrying of Analyzed Earned Surplus in the accounts of a new corporation is simple and presents no real difficulties if adopted at the very outset of the corporate life. It may be taken care of through the following accounts and procedure:

1. *Earned Surplus Available for Dividends.* This account will be credited with the earnings of the business. It will be debited for the amount of dividends declared; with all appropriations made for reserves; with amounts credited to expended surplus; for operating losses.

When funds are released from fixed investments by permanent financing, the account will be credited, the corresponding debit being carried to the Expended Surplus Account. When working capital is used to retire long-term liabilities, the proceeds from which were invested in fixed assets, the account should be debited and Expended Surplus credited. The account will also be credited with the amount of the periodic depreciation charges on the fixed assets.

2. *Earned Surplus Expended on (or Invested in) Fixed Assets.* This account will be credited with all working capital funds which have been definitely placed in permanent assets. It will be debited for the amount of the funds released by permanent financing. It will also be debited for the amount of the periodic depreciation charges,\* the credit being passed to Earned Surplus Available for Dividends. If earnings residing in working capital should be used to retire bonds or other long-term items which were originally issued to cover fixed asset costs, a reduction of Earned Surplus Available for Dividends occurs. Accordingly, that account should be debited and Earned Surplus Expended on Fixed Assets should be credited. The amount of the debit

\*This debit is not to be confused with the profit and loss debit for depreciation, although the amounts involved will always be identical.

and credit will be the value of the asset depreciated to the date of the cancellation of the obligations. This credit will then be restored to free surplus at the rate of the depreciation charges on the assets.

In those cases in which funded debt is retired by means of a sinking fund, a different treatment will be needed. When the debt is retired and the fund closed out, the following entries should be made:

(1)

Debit — Funded Debt.

Credit — Sinking Fund Asset Account.

To record the retirement of the funded debt.

(2)

Debit — Sinking Fund Reserve.

Credit — Earned Surplus Expended on Fixed Assets.

To indicate that the reserved surplus has been invested in fixed assets.

If working capital is set aside and Surplus reserved to meet serial bond retirement needs, a similar treatment will be required.

If the fixed assets financed through re-invested earnings are numerous, the surplus account may be operated as a control and a subsidiary account provided for each individual investment.

3. *Earned Surplus Invested in Deferred Charges.* This account may be necessary in some instances where the deferred charges are of considerable size and unlikely to be written off except over a long time. The account should be credited with the amount of working capital invested in the fixed charges, the debit being passed to Earned Surplus Available for Dividends.

Prepaid Expenses which will be utilized in current operations are considered here as working capital items. Such expenses are truly Deferred Charges to Operations in the sense that they will flow into the working capital inventories. Furthermore, they represent investments of working capital which are temporary and in no sense permanent.

Deferred Charges such as organization expenses, bond discounts, etc., should logically be considered Deferred Charges to Net Worth. In the accounting treatment, these items are considered as non-operating and do not flow into the current assets normally. They represent permanent or long-time investments.

Underabsorbed burden presents a special

problem. If the amount is small, it may be considered a working capital item on the assumption that it will be charged to operations in the near future. In depression periods, underabsorbed burden tends to reach proportions that prohibit its being charged to operations. If it is deferred, it should be classified as a Deferred Charge and not as a Prepaid Expense because it is really a Deferred Charge to Net Worth.

While this proposal may appear a bit fantastic at first glance, in reality it is nothing of the sort. If properly carried out, it answers the question "Where are the profits that were reinvested in the business?" The value of such information to the management and to the investor is tremendous.

It is true that the same information can be supplied through the so-called Statement of Application of Funds. Such statements are seldom, if ever, available in connection with published corporate reports. The probability is that they will not be available. It seems logical, therefore, to show Analyzed Surplus in the balance sheet.

The technique discussed above has been confined to a new corporation. It is admitted that the problem of placing Analyzed Surplus on the books of an old corporation is difficult, but not impossible where the records have been prepared honestly and where they have been kept consistently. The most accurate procedure is a statistical one in the main. It consists in essence of the preparation of a Statement of New Resources and Their Application since the beginning of the business. This will show the total funds coming into the business; the fixed investments and permanent expenditures; the funds on hand in working capital. The working capital balance may be used for the present balance of Earned Surplus Available for Dividends. The remainder of Surplus may then be regarded as expended. Obviously, this does not give accurate results, but it does afford a plan on which future transactions may be based. Thereafter, analysis can be carried on as a routine.

The viewpoints presented in this paper are not entirely new, but they certainly are not in general usage. It is believed that corporate reports and accounts would be of more use to all parties concerned if the procedure recommended were adopted. It is true that

under this plan there would be some increase in the keeping of detailed records, but the value received from the information provided would more than offset the extra cost. It is also true that some overlap in the allocation

would be inevitable. That is nothing unusual in accounting, however.

In these days of fading assets and shrinking surpluses, the investor and the manager need x-ray pictures instead of posed portraits.

## Professional Etiquette

**T**HE *Accountant in Australia*, official organ of the Institute of Chartered Accountants in Australia, presented the following leading editorial in its January, 1932, issue. It is reprinted as probably representing the viewpoint of the profession in that country:

"Many accountants in Australia, practising in one State only, are represented in other states by agents or correspondents. Such an arrangement is of benefit both to the accountants concerned and to their clients, in that the accountancy work of firms operating in more than one State may be carried out by accountants who are in close touch and co-operation with each other, whilst at the same time duplication of the overhead expenses of the accountants is avoided. The observance of a rigid code of etiquette between accountants acting as agents or correspondents with each other in this way is of fundamental importance. Unless accountants can be assured that those selected by them to perform work for their clients in other states will scrupulously avoid taking advantage of opportunities afforded to supplant the introducer in his home city, they will naturally hesitate to take the risk of introduction and will prefer to perform the work themselves. That would operate either to the disadvantage of accountants through increased expenses, or of the client through unnecessarily large fees.

A recent incident has been brought under notice, in which it would appear that a firm of accountants was guilty of a breach of professional etiquette in replacing as head office auditors another firm, by which it had been recommended for the office of branch auditors, and against which there had not been any complaint. Briefly, the facts are that a firm in the State where the head office books were kept was asked some years ago to recommend auditors of the accounts in another State, and they duly recommended their correspondents, who were appointed branch auditors. Later the correspondents opened an office in the

city of the head office of the company, and about two years later they were appointed auditors of the accounts in both cities, thus superseding the firm by which they had been introduced in the first place. There was no question of the client's dissatisfaction with the work that had been done by the retiring auditors, who received a letter from the company notifying them of the change that had been made, and expressing appreciation of their past services. It should also be mentioned that the correspondents wrote to the firm of accountants a day or two before the appointment was made, stating that they had been asked to undertake the work for the head office by a director-shareholder of the company resident in the branch office city, who controlled the voting power of a majority of shares, and who was a personal friend of a member of the correspondents' firm. This letter was received by the firm of accountants on the morning of the day on which the appointment of auditors was made. The facts were reported to the Council of the Institute, though no charge of professional misconduct was laid, and it was suggested that the Council might approve a definite principle for the protection and guidance of members in similar circumstances. The Council, on consideration of the matter, resolved:

"That a member who has been employed by another member as Agent or Correspondent shall not accept any appointment from the client introduced in any State other than the State in which he is or was employed as Agent, without the written consent of the member who employed him as Agent or Correspondent."

It was also decided that an Agency agreement should be prepared, and that the conditions of such agreement should be held to apply to members in all such cases.

## Why Should a Printer Operate a Cost System?\*

By WILLARD B. OLIVER, Vice-President, First National Bank of Scranton, Pennsylvania

I HAVE three excuses for talking to a Typothetae group: First, my father is the oldest printer in point of service in my home town.

Second, my own experience as a newspaper man. You see, while introduced to you as a banker, I am only a little over 50 per cent banker, fourteen years of my business career having been spent in newspaper offices and sixteen years as a banker. During my early days on the newspapers things were not quite so specialized as at present. I have solicited advertising and job work, set heads, read proof, handled one end of a bull ladle in a stereotyping room, and even on one occasion, when circulation manager of a Scranton paper, went into the pressroom after all the mechanics had left and ran off a few additional copies of the paper—slow motion, of course.

Third, I am at present financially interested in a firm which manufactures auxiliary printing machinery.

You have asked me to talk on "Why Should a Printer Operate a Cost System?" You might just as well ask, "Why should a printer operate a print shop?" I take it, the primary reason is for *profits*.

You certainly owe it to yourself and to those dependent upon you to make a living, or a little better than a living, out of your business. And how can you make profits unless you know how to figure your costs with reasonable accuracy, and then quote a price for your work sufficiently in excess of your costs to earn a little profit for yourself?

Cost of paper, labor and other direct costs are easily figured, or can be reasonably accurately estimated; but the other items—depreciation, overhead, obsolescence, repairs, loss from uncollected accounts, wastage, solicitation, advertising, accounting, taxes, rents, light, heat, etc.—must be provided for and

must be collected from the sales price of your merchandise somewhere, or else at the end of each business period you are going to need a new bottle of red ink.

And don't forget that these overhead items change in their ratio to direct costs with every fluctuation in your volume—a point that must be understood, especially in times like these when, as a rule, the volume is reduced; and the sad part of this absolutely economic fact is that costs tend to rise at times when it is almost impossible to increase selling prices in proportion.

Another factor now enters which has been the beginning of the end of many enterprises, not only in your line but every other manufacturing line. In order to overcome overhead, more and more work is taken at short prices, and bids, first by one and then by another, are cut so that no one can make a profit. The worst sufferer of all, of course, is the man who, not knowing his costs, cuts not only to the quick but to the artery—and his life blood, profits, ebbs away.

What I said regarding changes in costs, rising and falling with volume, is a somewhat controversial and debatable matter, good cost accountants differing in their analysis and method of handling. But I am speaking from my experience and my point of view as a banker, and I feel that I am right in making this point. Each of you of course must work out the answer as best you can from your own methods and experience. You know, and I know, that if your volume is cut by even a small percentage your profits tend to disappear rapidly because of the higher percentage on your sales required to absorb your more or less unchanging overhead.

Therefore, you must know your costs—and it is essential that your system not only be accurate and up to date, but kept accurate under varying conditions in your trade. The headquarters of your association has made a thorough going study of this subject, but more about this feature later.

\*Address delivered at convention Third District Typothetae Federation, and reprinted by permission of the *Typothetae Bulletin*.

Whatever system you adopt, see that it fits your own particular needs and conditions. Do not allow a system to be installed that was figured out for some similar business but which is not thoroughly adapted to yours. Do not allow your business to be fitted to a system, but see that the system is built to fit your business.

The ability to work out and install a cost system presupposes a knowledge of accounting principles and some knowledge of the technique of bookkeeping. To interpret your costs and financial statements of other kinds properly, one must know something of how the figures are assembled and be familiar with profit and loss and other subsidiary and complementary statements. Such interpretation requires the ability to visualize a business and realize how the routine transactions are translated into figures, first on the regular books of account, and then summarized into the final figures.

A good many years ago I heard one of the best merchandise and advertising men of his day say that in the association of which he was a member it was too often the practice of the speaker to prepare a talk, carefully eliminate all the points which might be of value to the other fellow, and deliver only platitudes and discuss matters which all his listeners understood. I don't think this is the general rule today. I know that in our banking and credit associations it is not, and that the free and candid exchange of ideas among bankers and credit men has immeasurably strengthened the whole credit fabric.

If bankers can work together for their own common good, why can't printers or men engaged in any other line do the same? Why can not bankers and printers exchange ideas if they have anything in common, or if the one has given some phase of business study which might be of value to the other? On account of my newspaper experience I have a speaking acquaintance with some of your terms, technical words and problems.

Need I further stress the necessity of good cost keeping? Is there any man here who wants to do a job at a loss? Even though at the end of a year you show a profit on your business as a whole, you should ask yourself if that is a good reason why you should not know where your profits are coming from, and if you know whether all jobs are profitable or if you are carrying some business at

a loss, off-setting this loss by profits on other business.

Do you know the printer who makes prices on the spur of the moment? John Jones comes in, wants a reprint job out immediately, gives you a piece of copy. Mr. Printer takes it, turns it over in his hand, gives the paper a jerk or two to test quality and says, "I'll do this job for \$10.00." "Go ahead," says Jones, disappearing through the door, "but the paper has got to be better than on the last job, and I want them padded in pads of fifty and must have them tomorrow." Maybe those last few remarks turn a profit into a loss.

I am loan officer of my bank, and it is part of my duty to check over carefully the applications for credit we receive and then keep in touch with the financial condition of our various borrowers or prospective borrowers. The basis for credit granting is more and more based on an analysis of borrowers' statements, and it is my privilege to check and analyze the statements of over a thousand concerns annually.

It probably will not surprise you greatly to know that the accounting methods of many business men are far from good, and that dozens actually do not know their own financial position. The larger and better houses, of course, have accurate accounting and cost systems, but both large and small are in direct competition, and the lack of accounting in the one may directly affect the profits of both, as the prices of the man who knows his costs may be affected by prices of a concern that does not know its costs. How any concern can do business without, to me, the absolutely essential factor of knowing where they are at, is not a conundrum, it is a tragedy, because I know that too many of those who do not know their costs and financial position fall by the wayside.

I was greatly pleased to discover recently that the master printers' international organization has worked out a standard cost system for your line of business, and, going further, they have done considerable laboratory work on statements and statement analysis, getting out a series of composite figures showing the average financial position of some 400 printers or firms in allied lines. It is worth the time of every one of you to get these figures and set your own along side of them to see how yours compare with the average; in fact,



I find that your international office will make these comparisons for you.

Quite a few years ago I heard one of the country's outstanding credit authorities make this statement: "You can always trade a dollar for a brick, but rarely can you trade the brick back for your dollar." Beware of unwarranted expansion in bricks and mortar, or any "dead assets," as we bankers call them, because if unwisely purchased they do not reduce but rather increase your costs.

The Robert Morris Associates, a national group of banking credit men, was organized about fifteen or sixteen years ago, and I have been a member most of that time, missing few of their semi-annual meetings, as I know of no better way of keeping in touch with what other men in my own line are doing. True, in any group of this kind, listening to addresses covering trade subjects, there is considerable repetition, and we hear iterated and reiterated over and over again things that we already know, but here and there a thought or idea comes out that makes all such meetings very much worth while.

I well remember an idea brought out at our meeting last fall, one that had never occurred to me but which since that meeting has had considerable publicity and discussion. You know it to be a fact that meeting with the other fellow has value; he probably has solved the selfsame problem that you are facing now. While experience is a great teacher, it is a slow teacher. Did you ever realize that frequently we know some fact but somebody else must tell us the fact in words before we actually realize that we have known it all along? The telling galvanizes the fact in our own minds so that we can make some use of the knowledge.

Do you think any man makes a success of his business in a large way without a knowledge of his costs, or without some idea of the costs of his competitors, without a knowledge of good accounting, or without keeping in touch with progressive policies in his own line of business through his technical associations and a study of his trade papers?

Your own association has gone very deeply into this subject of costs and analysis of costs. I have before me a pamphlet, called "Ratios for Printing Management," which was developed from actual balance sheets and operating statements compiled by the Department

of Finance and Accounting of your international association, which is as good a treatise and statement analysis as it has been my pleasure to read in a long time. When I started to read this pamphlet a few evenings ago it occurred to me that it had been written by a good friend of mine, Alexander Wall, secretary of our own Bankers Association, and later along, in the back, I found that Mr. Wall had actually collaborated in working out the selected credit ratio data. My time is too short to go over the various items, percentages, ratios, etc., as given in this booklet, but it should be worth the time of any master printer to not only read it over but study it carefully and then compare figures in his own plant with the figures given. It seems to be true in the printing business, as it is in most others, that only a small percentage of the whole is operated at a reasonable profit. Listen to this—the figures so compiled in your own association are the only statistics that I will quote as I have always had a feeling that statistics are better read than listened to: Of 400 statements analyzed, sixty-three per cent made a profit of more than six per cent, thirty-seven per cent failed to earn even a banking return of six per cent on their investment, and the average profit for the whole 400 was 12.99 per cent.

Your head office has sent me four studies of four separate printing concerns, and here are a few figures which should be of interest to you:

No. 1—Sold \$466,000 of merchandise, had a plant of \$215,000, and made a net profit of \$41,000, or 12.05 per cent of net worth.

No. 2—Sold \$1,628,000, had a plant of \$993,000, and made a profit of \$97,000, or 8.52 per cent of net worth.

No. 3—Sold \$164,000, had a plant of \$134,000, and made a loss of \$6,400, or 7.8 per cent *loss* against net worth.

No. 4—Sold \$19,000, had a plant of \$19,000, and lost \$2,000, or 40 per cent *loss* of net worth.

These figures vary widely, may or may not be typical, but they indicate the value of working out your own figures, or having them worked out for you, and then comparing them with the composite figures of your trade as a whole, to satisfy yourself as to whether you are average, above the average, or below the average.

I close with these brief sentence remarks:  
Your machinery and other dead assets must earn their depreciation *and a profit*.

Don't fool yourself on your costs. Don't figure that you are earning more than you are, finding out on closing your books that your expected profits have vanished into thin air. You all know the man who is making \$100 daily but only \$5,000 yearly.

Attend your group meetings. Rub shoulders

and match wits with the other men in your own line.

Install a good general accounting system.

Analyze your own business regularly, and don't turn a blind eye to your own figures, especially if they are not what they should be. Lastly, use all the good old-fashioned common sense that you are possessed of in working out the problems that daily confront you.

## Professional Ethics

By KINGSLEY TUFTS, C.P.A., Los Angeles, Cal.

THE word "ethics" has a much broader significance than is accorded it by the majority of individuals who use the word. Ethics in its broader sense has to do with those principles of social living which underlie the common effort of men to get on with one another. To be ethical may mean only to act in the most expedient manner with reference to self, if that is the general policy; while, if the general policy is to act each in the interest of the other any departure from this *modus operandi* may be judged despicable.

Out of the social contacts of individuals have evolved certain modes of conduct, many of which are prescribed by law for the protection of property and other rights, and many of which are simply embodied in the *consensus gentium*. There is a certain distinction to be noted with regard to what is considered proper conduct in business practice, and, for example, in domestic relations. Certainly the conduct required in the home and that required in the office are to be judged by different criteria to determine their propriety.

Those principles of conduct which in the experience of men have been found to facilitate transactions wherein there is a consideration having a monetary value, a need for secrecy, and a difference of interest may be considered under the general classification of professional ethics.

There is no distinction to be drawn between what is "professionally ethical" for various groups of individuals organized as professions. We are agreed that any modes of conduct to be acceptable must contribute to the

general welfare as well as redound to the credit of the profession. Kant considered no maxim of conduct acceptable unless it could with safety be made a universal rule, and this may have its application in helping us to determine what professional maxims or rules of conduct should be prescribed in a given profession. For example, to violate a client's confidence in secret matters, to adulterate a consideration bargained for, or to support an interest against the law or public welfare is accorded to be "unethical." This is true because if this type of conduct were made a universal practice the result would be social confusion.

A concise criterion to consider when determining what decision should be made regarding a problem of professional conduct is simply: What effect would my conduct in this matter have if universally applied to all matters of like nature? The conclusion drawn will either be followed or rejected, and the validity of the individual's reasoning and his subsequent actions will determine whether the mode of conduct pursued is one favorable or unfavorable to the interests of his profession or his community.

The body of these individual conclusions and their results, arising out of many distinct instances, when grouped according to identity of subject matter, become the bases for rules of professional conduct. And from this proposition we observe that a system of rules such as this, is, by its nature, subject to constant change and within the power of every individual to influence.

## TALKING SHOP

A Department Conducted by L. GLUICK, C.P.A.

There were two high spots of human interest at the May 9 meeting of the New York State Society. The first was when President Carter read the Treasurer's report with the auditors' report thereon, revealing that a reserve for delinquent dues had been set up over the Treasurer's protests on the auditors' insistence. The other came at the end of Henry Fernald's talk, when he quoted at length from Gibbon's *Decline and Fall of the Roman Empire*. Augustus had the same trouble with his Senate about sales taxes and other similar items that Hoover is having with our Senate. Nineteen hundred years seemed to vanish; but for the difference in names, one would have thought it was a present-day report. The audience enjoyed both of the very human incidents.

We had a good laugh recently from meeting a C.P.A. whose initials are D. N. After making the usual remark about "Oh, you're the man who writes about Oldtimer" he went on to tell us how he disagreed with us on some points. So far, fine! We disagree with some of the things we publish ourselves. If the point is worthy, we don't let our sentiments interfere with broadcasting it. But then, D. N. added, "Of course, I know how it is, you've just got to fill up space." That's where we got our haha! The chief difficulties we have had since the Shop opened was not running over the allotted space. Maybe we could have used better material in the space. That's a matter of judgment. But "just to fill up space!" Why, Mr. Springer cuts out most of the neat paragraph headings we put on our stuff to get room for it. And at that, a lot is crowded out permanently.

Cleveland, Ohio, has a little magazine entitled *Parade* modeled on the *New Yorker*. From the April issue we quote the following:

"The shortage in the Treasurer's office is not only one of audit, but one of intelligence.

"County Treasurer Collister has hired ex-

finance director, Rusk. His salary has not been decided. Maybe he can be paid out of the reward for finding the missing money."

### EMBARRASSING MOMENTS

"I am, in addition to being a practicing accountant, a teacher of the subject in night classes. The mid-year examinations coming at the peak of my public practice, I had to hire a senior student to mark the papers for me, and in due course gave him a check in payment for his services. Imagine my plight when he brought the check back to me for signature! I, who always insisted on precision in all class work, being careless enough to issue a check unsigned. I suppose others have done it, but it is twice as bad when a mere student has the laugh on you."

Right! And here comes the next man to the mourners' bench: "I never was much of a card player; and poker was my choice when I did play. But a few years ago the bridge craze got me and I tried to learn to play. Never have I seen or participated in a more contentious game. This new contract fad must be the cause of more wars than the League of Nations has to worry about. Anyhow, one night I lost my bid by failing to keep track of all the fifty-two cards, and my partner remarked 'You a C.P.A., and you can't count up to thirteen!' And that is when I quit the game for good and ever."

A man after our own heart. And now listen to the next penitent get something off his mind next month.

### B. T. A. NOTES

All of the following page citations are in 25 B.T.A.

Henry Fernald won a substantial rule 50 decision in the matter of Paine (p. 764). W. J. Hollings did not do quite so well in the California case of Buck (p. 780), but still a rule 50 is better than nothing. F. C. Rohwerder had two rule 50 cases (p. 840 and p. 928), which establishes a record for

one number of the B.T.A. reports.

The Boca Ceiga case (p. 941) requires comment on several points. The first is a question. If cases arising out of a boom and collapse in a single State, Florida, in 1926, are still coming up in 1932, how long will it be before our present unpleasantnesses are liquidated in the tax courts? Next, why is the name of the "accountant who audited petitioner's books" not mentioned? Was it Edward McGrath who split the verdict? If not, who? Finally, in case you need it, this is a good case to show realtors who keep only "a day book and ledger" by single entry. Full accrual double entry books would have won the case entirely.

If George Witter's client (Brant, p. 805) had died in Michigan instead of California, he would have won his case. Too bad!

The twin cases of the Oten Biscuit Companies cover pages 870 to 897, quite the longest in a long while, and very interesting. Learn how crackers are made and sold, by reading them. Any time you have a client who is recalcitrant about having the necessary accounts kept to distribute expenses accurately, show him what it cost the Roessler & Harslacher Co. (p. 915 ff) to estimate. The Board insists on "an apportionment as accurate as reasonably may be under the circumstances."

#### ABOUT BOOKS

We acknowledge receipt of a slim book entitled *Chapters in Business and Finance*, published by the Bank of Manhattan Trust Company. The chapters are by Secretary of the Treasury Ogden L. Mills; R. M. Haig, of the National Tax Association; G. T. Stephenson, of the American Bankers Association, and Newcomb Carlton, of the Western Union Telegraph Co. The last is the best, but they are all good.

The Limited Editions Club has permitted us to examine another slim book entitled *Reform of the Paper Currency*, by W. A. Dwiggins. The reform advocated is in design, not amount; the author is an artist. He recognizes that existing patterns make counterfeiting difficult; the ones he suggests do not seem to meet the test; and to our unartistic soul, seem no improvement. But his proposed postage stamps strike us as both practical and pleasing. The price of the book

(\$5.84) indicates that some cost accountant was at last permitted to have his way.

Maybe you don't think we got a kick out of seeing that Oldtimer Thornton, reviewing the new *Handbook* for our esteemed contemporary the *Journal of Accountancy*, decried the omission of the Economics section even more loudly than we had done. The publishers might ignore what a Kid like us says; but now it is squarely up to them to remedy the defect.

And now, as we go to press, we are just about finishing *The Epic of America*, by J. T. Adams. It was published first last September; it has been among the six best sellers in the non-fiction class ever since. Read any part of it and you will know why.

#### THE SHOP TALKERS

The following comes from *As We Were Saying* by the late Charles D. Warner:

"The secret of the failure of so many dinners is that the conversation is not general. To listen with a show of intelligence is a great accomplishment. It is not absolutely essential that there should be a great talker or a number of good talkers at a dinner, if all are good listeners. For success does not depend upon the talk being brilliant, but upon its being general. There is a notion that the art of conversation, the ability to talk well, has gone out. That is a great mistake. Opportunity is all that is needed."

This Shop gives you the opportunity. It is up to you to grasp it. Oldtimer and Company welcome you.

"Kid, you look pleased," said Oldtimer.

"I am," replied the Kid. "For the first time I beat the New York State Tax Commission. Only twenty-five dollars, but it tickles me."

"I don't blame you," said Oldtimer. "That's a tough outfit to beat."

"Give us the details," said Blank. "They might come in handy for us."

"I doubt it," said the Kid. "It was like many other cases. Amounts involved too small to warrant the expense of going to Albany. It's absolute injustice to make city taxpayers go there for a beating. I wrote a couple of letters, not much different than in other corporation cases, and this time they clicked.

I don't know why and I don't care."

"Congratulations, anyhow," said Blank. "But now, can anyone here tell me anything about a man named Rover?"

"C.P.A.?" queried the Kid.

"Yes," responded Blank.

"I think I do know him," continued the Kid. "Medium size, dark hair, clean shaven, slow talker."

"That's the man," said Blank. "Tell me what you know."

"Not much, except that he is honest and well-named," said the Kid. "I believe he's been on the payroll of more firms than any man in the profession. Seems to have a bad case of wanderlust. Now why are you so interested in him?"

"Because I'm thinking of taking in an associate — not a partner yet — and he seems quite the best man under consideration. But, naturally, I must check up on him."

"Right," said Oldtimer. "But whether you take him or some one else, I'm mighty glad to know you are taking a prospective partner. What made you do it?"

"Well," replied Blank. "Business has been so bad that I could not continue the overhead of my office. My staff is cut to two boys and a girl, and she isn't busy half the time, but I must have her there if it's only to answer the 'phone. So I figured if I could get a congenial and honest man to help me share the expenses, I'd be ahead. It was Rover who wanted to know if a partnership was possible."

"I think your reasons are not too good," replied Oldtimer. "But no matter what they are, anything that will result in your having a partner is good. There is no man whom I pity more than the so-called independent — free lance — accountant. It always reminds me of the man in the Bible who bought his freedom at a great price. The disadvantages of being alone are so much more than the imagined benefits."

"It says in the Bible also," broke in Dash, "that it is not good for man to live alone."

"That's different," said Oldtimer. "It refers to marriage. Let us stick to our own *business*. I can tell you any number of cases where single practitioners lost out, and don't know but one who has succeeded, and he is not in such good shape lately, at that."

"Okeh," said the Kid. "I think I have

time to listen to about three cases before I start home to Jersey."

"You can go now, as far as I'm concerned," said Blank. "If Oldtimer wants to talk for two hours, to help me with my problem, I'll listen. I can get a train to Long Island any time. That's the beauty of not living in a foreign country."

"That's an old crack that never was a joke," said the Kid, but Oldtimer went on placidly between puffs of a good cigar.

"The latest case to reach my attention has brought six C.P.A.'s previously in two firms, and one independent, together into one suite of coöperative offices. It was economic pressure, like Blank's, which started it, but already it has worked wonders. The collective experiences and libraries of all six are at the disposal of all. A client's problem, which had been bothering *A* for months, was solved by *E* in one long conference. An out-of-town job that *B* had been neglecting to the point of losing, is now being punctually cared for by *D*, who, being single, can travel at will. *C* has a client who is more or less of a nuisance in the matter of calling up for immediate information which he insists must be authoritative. *C* had to play with him, because he was his biggest client. Now, with six C.P.A.'s in the organization, one of them is always in the office, prepared to speak for any of them on most matters.

"You all know just what kind of things come up that way. Mine is a big firm and we feel that our growth is due largely to our ability to give the clients service when they want it. Not but that the personal element does figure largely, but as one client told me once: 'I could afford a car—naming a super-expensive foreign make—as far as first cost and upkeep go. But even that car is subject to break-down or accident, and if I'm touring in most parts of this country, it would take days or weeks to get spare parts, even if a mechanic capable of installing them were available. But I can drive any one of a half dozen domestic makes, not quite so swank, but just as fast, and no matter where I might be wrecked, I could get expert service and parts in not over twelve hours.'

"But, of course, the biggest advantage is in case of death. Youngsters don't think of that factor, but about the time men reach your age, Blank, they realize that they are

*(Continued on page 360)*

# The Wisdom Born of Experience

By ROBERT ATKINS, C.P.A., New York City

IN the late summer of 1929 a firm of accountants made an investigation of a corporation engaged in the sale of securities, principally those of public utility companies, in which it had either majority, or very substantial, holdings.

The purpose of this examination was to inform the Insurance Commissioner of one of the states as to the condition of the company at the latest date obtainable in order that he could intelligently pass upon an application which had been made to him to sell the company's preferred stock in his State. The fact that the bulk of the company's holdings were the securities of subsidiaries was known to him, prior to the preparation of the report referred to, and he had expressed an opinion that this fact in itself did not make for a strong situation and that he could not admit the stock to be sold in his State.

The report which was rendered showed conditions unchanged in this respect, the main question relating to the valuations to be placed upon its holdings of these securities. From an inspection of the audit reports and other data, from which the information was to be obtained, it was evident that the only satisfactory way to submit such information to the Commissioner would be to make plain to him the basis of the opinions which were expressed. With this in mind, the report was qualified to such an extent as this was considered necessary, and the basis of every opinion as to the value of securities owned was stated, in order that the Commissioner might determine for himself whether or not the conclusions were justified from the facts upon which they were shown to have been based.

Notwithstanding the equity value of the stock offered for sale, the information contained in the report was not such as would justify its sale in the State in which the Commissioner resided. As a matter of record, consent to sell the stock was not given.

The negotiations for this engagement were made by mail and the prospective client (and a former client, by the way) specified a sum which it desired the cost of the proposed investigation should not exceed, and the con-

tract was made with the understanding that the fee should not exceed that sum. While one would ordinarily think of this as a perfectly proper thing to do, the fact that the client had named a limit for the work was construed by the prosecution as evidencing a willingness on the part of the accountant to give not only an equivalent measure of service but that the report to be rendered would be in a form acceptable to it. The fact that the clients' reports were the only ones which were available for parts of the period covered by the investigation gave some color to this conclusion.

The introduction to the report, except that the years are not the ones for which the examination was made, was substantially in the following form: "I have examined the reports of the public accountants who audited the accounts and records of the company for the years 1901, 1902, 1903 and 1905, and those of the company's accountants for the year 1904, and for the six months ended June 30, 1905, and have prepared, etc." The fact that an audit report of a firm of public accountants had been made for the year 1904 was concealed from the examiner, and with good reason, as was subsequently learned, the results shown thereby having been unfavorable and differing materially from the report of the Company's accountants.

A matter of utmost importance to the accountant-examiner in such cases is the good faith of his client. In this case the good faith was fairly to be assumed because of former relations and, so far as was known, there were no criticisms of the management at that time. While the determination of the client's good faith places an added responsibility on the accountant, if he is unable to satisfy himself on this point he had better omit the firm from his list of clients.

About two months after the report was rendered the company went into the hands of receivers and at a later date the heads of the concern were charged with having used the mails to defraud, and have since been convicted.

The report which was rendered differed from the one issued by the company as at

the latest date, the principal item of difference making a distinctly less favorable showing. Although the changes which were made in the final statement were all unfavorable to the company the prosecution did not give any favorable consideration thereto. From more than two days spent on the witness stand, explaining in considerable detail how the work was done, and why the opinions which were expressed were given in so much detail, the opinion is ventured that the only safe policy for an accountant under conditions such as were present in this case would be to decline the job.

While the generally optimistic conditions which were present in the summer of 1929 probably did not justify the statements made for the stocks of many companies whose securities were offered for sale then, it is not improbable that not a few firms made representations similar to those made for this company. This, of course, has no bearing upon the misrepresentations which appear to have been made in this case, although there are few businesses today that do not look altogether different to those responsible for their functioning when compared with the way they looked to their sponsors in 1929.

At the trial of the two defendants it was learned that only those persons who actually perform certain portions of the work on an investigation can testify regarding it. The rule differs from that applying to cases relating to audits, in which the accountant-in-charge is permitted to testify as to the work done under his direction. The disadvantages of this rule, when applied to an investigation, are obvious and work a distinct hardship, inasmuch as former members of the accountant's staff who performed portions of the work may not be available, or cannot be located for summons to testify at the trial.

The position of the accountant-witness in cases such as this one, is an unenviable one. Every effort is made by the prosecution to discredit the report and even the utmost in qualification is interpreted adversely.

It should be remembered that the preliminary negotiations stated the specific purpose for which the report was wanted and that it was compiled with that object in view. There was, therefore, not the same need for extreme caution as there would have been if the report was to have been used for other purposes.

From the experience gained in this case, it is the writer's opinion that special investigations of this sort should only be undertaken on a per diem basis. Then, in the event that the client should become involved financially, the accountant will be able to state that he did not agree to do anything for a stated sum, named in advance of the performance of the work.

Incidentally, this case furnishes a strong argument in favor of less complicated procedure in our criminal courts. This trial, and the time taken by the jury to reach a verdict, took nearly eleven weeks, and while the results seem to justify it, it would seem that the jurors were penalized to an unwarranted extent.

It will be found desirable to have every special investigation undertaken with as few assistants as can conclude the work in the time within which it must be finished in order that the accountant's office may be in a position to satisfactorily protect his own, and his client's interests, if called upon to do so.

## Audit Procedure

*(Continued from page 334)*

should be prepared to render to the association a report covering the examination. This report should inform the directors as to the exact condition of the affairs of the association, should point out any information that might be valuable to the directorate and which would not ordinarily be disclosed, and should contain all details of any adjustments necessary to bring the books into proper balance in accordance with the examining committee's report. The report should be written in a direct, comprehensive manner. It should contain the complete story of the entire examination with comments on specific items in the submitted Balance Sheet, which reflects the association's financial condition, and in the necessary supporting schedules, pointing out the information that is pertinent and valuable.

Three copies of the report should be submitted; one of which should be mailed to the Commissioner of Banking and Insurance not later than sixty days after the close of the fiscal year of the association; one copy to the secretary, and one copy to the committee.

# Questions and Answers Department

EDITOR, W. T. SUNLEY, C.P.A., Educational Director  
International Accountants Society, Inc.

Last month we published a solution to a problem involving the correction of overhead expense. Here is another interesting problem in the same subject. It was given in the Service of Examination Questions prepared by The American Society of Certified Public Accountants for May, 1931, and appeared on pages 240 and 241 of the August, 1931 issue.

## Comment:

Upon reading the problem it is evident that the amount of overhead applied in the accounts has not been given. This amount can be determined by reversing the usual process of calculating the cost of sales. The method is shown in the "Statement showing Determination of Overhead Absorbed and Adjustment to Actual Overhead." In preparing this statement when the line described as "Overhead Absorbed" is reached, a side calculation may be made to determine the difference between the Total Overhead Absorbed and the Total Actual Overhead, as follows:

Actual Overhead .....	\$ 278,245.00
Overhead Absorbed .....	252,950.00
Difference .....	<u>\$ 25,295.00</u>

It is apparent at once that in order to correct the overhead to actual, it is necessary to add 10% to the overhead absorbed. This may be done as shown on the last two lines of the statement.

After adjusting the overhead absorbed the next step is to correct the overhead in the inventories. The correction of the opening inventories is given in totals only. The difference may be spread over the departments on the same basis as the original distribution, thus:

Overhead in inventory of	
Work in Process .....	\$ 19,125.00
Corrected to .....	17,690.63
Difference .....	<u>\$ 1,434.37</u>

Distributed as follows:

Department A 5100/19125 ..	\$ 382.50
Department B 3500/19125 ..	262.50
Department C 2800/19125 ..	210.00
Department D 7725/19125 ..	579.37
Total .....	<u>\$ 1,434.37</u>

The overhead in the inventory of finished goods 1/1/30 may be adjusted in the same way:

Overhead in inventory of	
1-1-30 .....	\$60,700.00
Corrected to .....	56,147.50
Difference .....	<u>\$ 4,552.50</u>

Distributed as follows:

Department A 10200/60700 ..	\$ 765.00
Department B 7625/60700 ..	571.88
Department C 5900/60700 ..	442.50
Department D 36975/60700 ..	2,773.12
Total .....	<u>\$ 4,552.50</u>

The overhead in the inventory of Work in Process 12/31/30 is adjusted by adding 10% to bring the overhead to actual.

The overhead in the finished goods inventory 12/31/30 may be adjusted in two sections:

Goods manufactured during 1930.  
Goods which were on hand 1/1/30.

The overhead in the finished goods inventory of 12/31/30 representing the goods carried over from the opening inventory may be adjusted by dividing the adjustment of overhead between the goods on hand 12/31/30 and those sold during 1930, on the basis of the original overhead distribution, thus:



Department A 1650/10200 of	
\$765.00 .....	\$ 123.75
Department C 800/5900 of	
\$442.50 .....	60.00
Department D 1875/36975 of	
\$2,773.12 .....	140.62
Total Adjustment .....	\$ 324.37
	=====

The overhead in finished goods inventory of 12/31/30 manufactured during 1930 (before adjustment) is determined by deducting from the amounts given in the problem, one-half of the valuation of the finished goods of 1/1/30 which were not sold during 1930. The resultant figures are adjusted to actual overhead by adding 10%.

By adding the overhead of the finished goods which remained from the opening inventory to the overhead of the finished goods which were manufactured during 1930, but not sold during 1930, we obtain the total ad-

justed overhead for the finished goods inventory of 12/31/30, before charging off the allowance for obsolescence of the goods carried over from the opening inventory. This allowance is 50%, and may be deducted to show the final adjusted inventory.

The next step is the adjustment of the overhead in the departmental transfers. Assuming that these transfers represent 1930 manufacture, the overhead may be adjusted by adding 10% as shown in "Statement showing Adjustment of Overhead in Departmental Transfers."

The last statement to be prepared is the adjusted overhead in Cost of Sales. With the adjusted figures for the overhead in the Work in Process inventories and for the Overhead Absorbed, the calculation of the Cost of Sales is not complicated, although it should be observed that it is necessary to use the closing inventory of finished goods before charging off the obsolescence, since this charge off is *not* a part of the cost of the goods sold.

#### PALACE SPECIALTIES COMPANY

Statement showing Determination of Overhead Absorbed and Adjustments to Actual Overhead for the year ending December 31, 1930.

	DEPARTMENT				
	A	B	C	D	Total
Cost of Sales .....	\$70,050.00	\$45,207.50	\$33,295.00	\$ 91,747.50	\$240,300.00
Finished Goods 12-31-30 ..	12,000.00	8,625.00	8,300.00	40,350.00	69,275.00
	<u>\$82,050.00</u>	<u>\$53,832.50</u>	<u>\$41,595.00</u>	<u>\$132,097.50</u>	<u>\$309,575.00</u>
Finished Goods 1-1-30 ..	10,200.00	7,625.00	5,900.00	36,975.00	60,700.00
	<u>\$71,850.00</u>	<u>\$46,207.50</u>	<u>\$35,695.00</u>	<u>\$ 95,122.50</u>	<u>\$248,875.00</u>
Departmental Transfers ..		2,707.50*	1,095.00*	3,802.50	
Work in Process 12-31-30	7,050.00	4,125.00	3,100.00	8,925.00	23,200.00
	<u>\$78,900.00</u>	<u>\$47,625.00</u>	<u>\$37,700.00</u>	<u>\$107,850.00</u>	<u>\$272,075.00</u>
Work in Process 1-1-30 ..	5,100.00	3,500.00	2,800.00	7,725.00	19,125.00
	<u>\$73,800.00</u>	<u>\$44,125.00</u>	<u>\$34,900.00</u>	<u>\$100,125.00</u>	<u>\$252,950.00</u>
Overhead Absorbed .....	\$73,800.00	\$44,125.00	\$34,900.00	\$100,125.00	\$252,950.00
Adjustment to Actual .....	7,380.00	4,412.50	3,490.00	10,012.50	25,295.00
	<u>\$81,180.00</u>	<u>\$48,537.50</u>	<u>\$38,390.00</u>	<u>\$110,137.50</u>	<u>\$278,245.00</u>
Actual Overhead .....	=====	=====	=====	=====	=====

\*Deductions.

## PALACE SPECIALTIES COMPANY

Recomputation of Overhead in Inventories at beginning and end of 1930.

Overhead in Inventory of Work in Process 1-1-30.

	DEPARTMENT				
	A	B	C	D	Total
Before Adjustment .....	\$ 5,100.00	\$ 3,500.00	\$ 2,800.00	\$ 7,725.00	\$ 19,125.00
Adjustment .....	382.50	262.50	210.00	579.37	1,434.37
After Adjustment .....	<u>\$ 4,717.50</u>	<u>\$ 3,237.50</u>	<u>\$ 2,590.00</u>	<u>\$ 7,145.63</u>	<u>\$ 17,690.63</u>
	=====	=====	=====	=====	=====

Overhead in Inventory of Finished Goods 1-1-30.

	DEPARTMENT				
	A	B	C	D	Total
Before Adjustment .....	\$10,200.00	\$ 7,625.00	\$ 5,900.00	\$ 36,975.00	\$ 60,700.00
Adjustment .....	765.00	571.88	442.50	2,773.12	4,552.50
After Adjustment .....	<u>\$ 9,435.00</u>	<u>\$ 7,053.12</u>	<u>\$ 5,457.50</u>	<u>\$ 34,201.88</u>	<u>\$ 56,147.50</u>
	=====	=====	=====	=====	=====

Overhead in Inventory of Work in Process 12-31-30

	DEPARTMENT				
	A	B	C	D	Total
Before Adjustment .....	\$ 7,050.00	\$ 4,125.00	\$ 3,100.00	\$ 8,925.00	\$ 23,200.00
Adjustment .....	705.00	412.50	310.00	892.50	2,320.00
After Adjustment .....	<u>\$ 7,755.00</u>	<u>\$ 4,537.50</u>	<u>\$ 3,410.00</u>	<u>\$ 9,817.50</u>	<u>\$ 25,520.00</u>
	=====	=====	=====	=====	=====

## PALACE SPECIALTIES COMPANY

Statement showing Adjustment of Overhead in Departmental Transfers during the year ending 12-31-30.

	DEPARTMENT				
	A	B	C	D	Total
Before Adjustment .....		\$ 2,707.50	\$ 1,095.00	\$ 3,802.50*	
Adjustment .....		270.75	109.50	380.25*	
After Adjustment .....		<u>\$ 2,978.25</u>	<u>\$ 1,204.50</u>	<u>\$ 4,182.75*</u>	
	=====	=====	=====	=====	=====

Overhead in Inventory of Finished Goods 12-31-30

	DEPARTMENT				
	A	B	C	D	Total
From Inventory of 1-1-30:					
Before Adjustment ...	\$ 1,650.00		\$ 800.00	\$ 1,875.00	\$ 4,325.00
Adjustment .....	123.75		60.00	140.62	324.37
After Adjustment ...	<u>\$ 1,526.25</u>		<u>\$ 740.00</u>	<u>\$ 1,734.38</u>	<u>\$ 4,000.63</u>
	=====	=====	=====	=====	=====

## Manufacturing during 1930:

Before Adjustment ..	\$12,000.00	\$ 8,625.00	\$ 8,300.00	\$ 40,350.00	\$ 69,275.00
Less: From Inventory of 1-1-30 .....	825.00		400.00	937.50	2,162.50
	<u>\$11,175.00</u>	<u>\$ 8,625.00</u>	<u>\$ 7,900.00</u>	<u>\$ 39,412.50</u>	<u>\$ 67,112.50</u>
Adjustment .....	1,117.50	862.50	790.00	3,941.25	6,711.25
	<u>\$12,292.50</u>	<u>\$ 9,487.50</u>	<u>\$ 8,690.00</u>	<u>\$ 43,353.75</u>	<u>\$ 73,823.75</u>
	=====	=====	=====	=====	=====
Total Inventory before charging off Obsolescence ...	\$13,818.75	\$ 9,487.50	\$ 9,430.00	\$ 45,088.13	\$ 77,824.38
Obsolescence—one-half of goods carried over from opening inventory .....	763.12		370.00	867.19	2,000.31
	<u>\$13,055.63</u>	<u>\$ 9,487.50</u>	<u>\$ 9,060.00</u>	<u>\$ 44,220.94</u>	<u>\$ 75,824.07</u>
Final Adjusted Inventory	\$13,055.63	\$ 9,487.50	\$ 9,060.00	\$ 44,220.94	\$ 75,824.07

## PALACE SPECIALTIES COMPANY

Recomputation of Overhead in Cost of Sales for the year ending 12-31-30.

	DEPARTMENT				
	A	B	C	D	Total
Work in Process 1-1-30 ..	\$ 4,717.50	\$ 3,237.50	\$ 2,590.00	\$ 7,145.63	\$ 17,690.63
Actual Overhead Absorbed	81,180.00	48,537.50	38,390.00	110,137.50	278,245.00
	<u>\$85,897.50</u>	<u>\$51,775.00</u>	<u>\$40,980.00</u>	<u>\$117,283.13</u>	<u>\$295,935.63</u>
Work in Process 12-31-30	7,755.00	4,537.50	3,410.00	9,817.50	25,520.00
	<u>\$87,577.50</u>	<u>\$57,268.87</u>	<u>\$44,232.00</u>	<u>\$137,484.76</u>	<u>\$326,563.13</u>
Cost of Goods Manufactured ....	\$78,142.50	\$47,237.50	\$37,570.00	\$107,465.63	\$270,415.63
Departmental Transfers ..		2,978.25	1,204.50	4,182.75*	
	<u>\$78,142.50</u>	<u>\$50,215.75</u>	<u>\$38,774.50</u>	<u>\$103,282.88</u>	<u>\$270,415.63</u>
Finished Goods 1-1-30 ..	9,435.00	7,053.12	5,457.50	34,201.88	56,147.50
	<u>\$87,577.50</u>	<u>\$57,268.87</u>	<u>\$44,232.00</u>	<u>\$137,484.76</u>	<u>\$326,563.13</u>
†Finished Goods 12-31-30 before charging off Obsolescence .	13,818.75	9,487.50	9,430.00	45,088.13	77,824.38
	<u>\$73,758.75</u>	<u>\$47,781.37</u>	<u>\$34,802.00</u>	<u>\$ 92,396.63</u>	<u>\$248,738.75</u>
Cost of Sales .....	=====	=====	=====	=====	=====

\*Deduction.

†The obsolescence should be charged to a separate expense account and not to Cost of Sales. After the Cost of Sales has been determined an additional entry should be made charging the expense account and crediting Finished Goods Inventory, 12/31/30. This entry would include, of course, obsolescence, one-half of the value of the material and labor in the finished goods carried over from the opening inventory in addition to the overhead.

In this solution only the overhead is shown since the problem called for only the overhead adjustments.

# Modernizing Depreciation

By HOMER A. DUNN, C.P.A., New York City

Editor's Note: The editor of the *Bulletin* of the Minnesota Society of Certified Public Accountants, Herman C. J. Peisch, is chairman of the Advisory Committee of The American Society by virtue of being its junior past-president. One of his associates in that committee is Homer A. Dunn, of course another past-president. It appears that Herman had supplied Homer, as a gift subscription, with all copies of the *Bulletin*, beginning with No. 1 of Vol. I, and that when Herman thought Homer had partaken sufficiently of the "free viands," he assumed to treat him as a toast-master would treat an honorary guest at a banquet and called on him for a "few words"—literally for an article for his *Bulletin*. Herman hasn't informed us of the target score which he gave the marksman, but he has consented to its reproduction in this magazine:

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It is much easier to use you as a target for my verbal "shootin' iron" than it would be to write in the abstract; so I'll give you the privilege of scoring my distance from the bull's-eye.

In these days of distress and the call for a large measure of abdominal investiture there is much discussion over various kinds of economic and accounting reformation, and Depreciation falls with the category of items.

Laying aside the lexicons, for they are all deficient on accounting terminology, isn't Depreciation, in its genesis, the difference between cost and ultimate salvage, if any; otherwise the whole of the cost at the time of necessary discarding from use, leaving obsolescence out of consideration? In common usage, however, it is accepted as including the factor of distribution, or spread. It is in that distribution, or spread, that we encounter an economic theory or an accounting practice. Since it is not given to the human mind to forecast the future accurately in respect of the results of wear and tear or decadence, resort must be had to some kind of an estimate. The most common practice has been to estimate the time period of probable usefulness and the salvage, and to distribute the economic burden on the basis of the lapse of time. But when and where there are no

earnings or profits out of which to absorb such distribution, or spread, people are beginning to take notice of the fact that the result of the ordinary treatment is to increase the deficit for the period, and some, if not many minds are wondering if something cannot be done about it. Well, here and there, in just a few spots, something has been done about it—not recently, but for several years past. In those spots there has been one more factor of estimate included, and why not have two as well as one if the product over a period of years will be the same, but with a more logical accounting throughout the interim? It is not necessary to suggest to you that the other factor of estimate is the one which measures the use to be derived out of the property during the period of estimated life, which may be in machine hours, horse-power, kilowatt hours, flour tons, coal tons, nautical miles, locomotive miles, car miles, or any other proper unit of measurement—and I mean on the basis of probable, rather than theoretical, use. If any such factor is used in measuring the spread of depreciation, what happens? The graphic line of that particular thing becomes more consistent with the graphic line of direct production cost, direct operating cost, or the earnings or revenue, and when the operations are at 125% of normal and earnings, profits, or revenue are high the depreciation charge is something quite different from the charge when at only 25% of capacity, as some now are. Don't forget, Mr. Editor, that if the estimate of the use naturally to be derived is as good as the estimate of life, you will have substantially the same accumulation of depreciation reserve at the end of the period as you would by using elapsed time as the basis. Please advise your C.P.A. friends that here is an avenue through which to serve not only some of their clients, but the investing public as well, and suggest to them that where opportunity offers they insist on being supplied with an estimate of not only the useful life but of the quantitative factor that will be contained in that useful life, so that the spread of depreciation may be worked out on the basis of the latter and the accounting made accordingly."

# State Income Taxation\*

By SIDNEY E. HOOVER, C.P.A., Portland, Oregon

STATE taxation of income, both corporate and personal, appears to be enjoying a growing popularity and, in recent years, taxation of income has been used to supplement or relieve other forms of direct taxation. Such income taxation when efficiently administered conforms closely to the principle of ability to pay and to a great extent is designed to relieve the tax burden of real property. This is particularly the case in Oregon where the laws covering taxation of intangible income and personal income are stated to be for the relief of the tax burden on real property, recognizing that a more diversified form of taxation is necessary in circumventing the inequities of real property taxation.

At the present time eleven states have adopted the principle of taxing corporate income from manufacturing and trading business, either directly, or as a measure of a franchise or excise tax, while seventeen states now have laws providing for direct taxation of personal incomes. During the last few years many states having such laws have increased the rate of taxation, but at the present time the State of Oregon has effectively the first honors in this respect.

In general, corporate income taxes are levied upon two different principles, either as a direct tax of general income or as a franchise or excise tax for the privilege of doing business within a State. In the latter case the measure of the tax may be the income of the corporation, but the subject of the tax is the right to carry on business within the jurisdiction of the taxing State. However, in a recent decision of the United States Supreme Court in connection with the Massachusetts Franchise Tax it was ruled that a franchise tax, measured by corporate income, was effectively a tax on income and, as the result of this decision, it appears that the two types differ only on matters of minor importance. When the tax is levied on the corporate income it is illogical to extend the tax to income from dividends already taxed as general

income and in those states taxing income, this is not done. However, under the principle of State franchise or excise taxation this thought does not apply as the corporate tax is levied as a privilege tax, the measure of which is the income of the corporation. At least three states have an excise tax which includes dividends in the measure of the tax, namely, New York, Massachusetts and Oregon.

It is recognized that states have the power to tax the entire net income of domestic companies while foreign corporations doing business with the taxing State may only be taxed upon the basis of segregated or allocated income. While the State has the right, it is expedient in the case of domestic corporations to enforce a tax upon the basis of the business done within the taxing State, as otherwise, the domestic company doing only part of its business within the State might be tempted to incorporate in some other State affording a more lenient tax burden and then enter the taxing State as a foreign corporation.

The whole problem of business carried on within and without the State is of primary importance, either as affecting taxable income or as the measure upon which a corporation or individual may be taxable.

In the State of Oregon and many other states, the income arising within the State may be determined upon a so-called segregation basis which requires a reasonably exact accounting of the result of all activities both within and without the State. When this information is not obtainable in a satisfactory manner, the State will require an apportionment of income by an allocation method best suited to the company's activities. The use of a general allocation or factor method is suggested in those states not actually requiring the use of standard factors. The power of the State to determine the measure of allocation is practically unencumbered by constitutional limitations. When the measure of allocation is intended to reach and reasonably reaches only profits earned within the taxing State, it appears that the courts will sustain the method or at least will place the burden

\*Paper read before the Northwest Convention of Certified Public Accountants.

of proving injustice upon the complaining corporation.

While states have the power to tax domestic corporations organized under their respective laws, in practically any manner or on any basis, they are restricted in the application of their tax laws as affecting corporations not incorporated within the taxing State. Such foreign corporations may be taxed only on such portion of their income as may be earned or allocated to the taxing State by the measure of property owned or business done within the taxing State. Moreover, if the only business done by a foreign corporation within the taxing State is the taking of orders for merchandise manufactured outside the taxing State, and the delivery of such goods directly from outside sources, it is deemed by the courts to be engaged exclusively in interstate commerce which, under constitutional limitations, is not taxable by the individual states.

With particular reference to the corporation excise, the intangibles income and the personal income tax laws of the State of Oregon, it may be well to first briefly summarize the historical features of such taxation.

An income tax on domestic corporations and Oregon residents was effective for the year 1923, but the law was repealed by the people in 1924.

In 1929, an intangibles income tax was enacted which taxed the intangibles income of individuals but not of corporations. This law was held by the Supreme Court of Oregon to be unconstitutional for the reason that there was unreasonable discrimination between individuals and corporations which denied to individuals the equal protection of the laws in conflict with the provisions of the fourteenth amendment to the Federal constitution. It is expected that the taxes paid to the State will be refunded eventually after the legislature has authorized the refund and appropriated funds for that purpose. However, in the place of the unconstitutional law we now have the intangibles income tax passed in 1931 which is effective with respect to income received from intangibles during the calendar year 1930.

In the year 1929, the legislature also passed a personal income tax law which was held in abeyance by a referendum petition to the people at an election in November 1930, at which time the law was enacted. Under an

opinion from the Attorney General of Oregon, the State Tax Commission held that the tax under this law is collectible in 1931 upon incomes for the year 1930.

The third tax law enacted in 1929 was the Corporation Excise Tax which relates entirely to domestic and foreign companies doing business in this State. This is an excise or franchise tax for the privilege of doing business within this State and the measure of the tax is the net income attributable to a company's activities within the State of Oregon.

I shall now speak on what appear to be the more important features of our three income tax laws in the hope that some of the thoughts may give rise to general discussion.

The various laws set forth certain factors of income which are held as not taxable, but in addition thereto, I would like to mention the following:

A company incorporated in another State cannot be made subject to tax when engaged only in interstate commerce within the taxing State. Congress alone has the power to regulate interstate commerce and under no formula can a State tax things wholly beyond its jurisdiction. For example, when agents of a foreign corporation limit their activities to soliciting orders for goods later to be shipped into the State, the corporation is protected by the commerce clause of the Federal constitution. It is also the case that business obtained by a foreign corporation by mail soliciting or through a commission broker, is interstate commerce and not taxable by the State in which the business is obtained. An Oregon court decision stipulates, that a foreign corporation whose agents in the State solicited orders which were subject to approval at head office, for goods to be delivered from a stock on hand in the State, was not doing business within Oregon and therefore not taxable.

The State may not tax the means by which the Federal Government acquires property. A Mississippi court decided that under an excise for the privilege of selling gasoline, a tax could not be collected by a State in respect of gasoline sold to the Federal Government for use in the Coast Guard Fleet and the Veterans' Hospital.

It appears, mostly by inference from legal decisions, that royalties for the use of patents or trademarks are not taxable by states as such

may be considered instrumentalities of the Federal Government, analogous to Federal securities which are not to be included in the measure of a tax according to a recent decision of the United States Supreme Court.

Some very difficult questions arise in connection with the allocation of income within and without the State as affecting the calculation of excise taxes of both domestic and foreign corporations. Regulations covering our excise law provide that net income may be determined from the taxpayers' records, if such are properly kept in a manner correctly reflecting income within the State. This is called the segregation method. While it is necessary to show the prescribed factor method of allocation of income, the taxpayer may submit the segregation method or some other formula where such would more reasonably apportion the net income attributable to the business done within the State. As an indication of the procedure which may be followed under various circumstances, it is enlightening to consider the trend of legal decisions with respect to income tax laws of other states which are similar to ours.

In the case of the Standard Oil Company of Indiana versus Wisconsin Tax Commission it was held that it was possible to ascertain the income derived from business transactions by the application of proper accounting methods. The conditions were as follows: The oil company maintained tank farms from which deliveries were made in the State and adjoining states. Practically no manufacturing was done within the State and the oil received in the State was charged at the market price of the products, plus a proper proportion of expense and was credited with the gross amount received from sales within the State.

Under the decision rendered in the Underwood Typewriter Company case in Connecticut, the company was taxed under the allocation factor method upon the basis of 47% of its total net income, whereas only 3% of its net income was derived from business done within the State. The factory was located in Connecticut with branches in other states and the main office in New York City. In making this decision the court said in part "The profits of the corporation were largely by a series of transactions beginning with manufacture in Connecticut, and ending with sales in other states. The legislature, in attempting to put upon this business its fair

share of the burden of taxation, was faced with the impossibility of allocating specifically, the profits earned by the processes conducted within its borders."

While the various legal decisions appear conflicting, it is reasonable to suppose that if the taxpayer's books are so maintained as to set forth in good faith the income and expenses properly attributable to business done within and without the State, great weight must be attached to the taxpayer's segregation. However, in the State of Oregon, when a segregation method is used, there must be no arbitrary allocation of income or expenses. As the tax is measured by income, and as the courts have repeatedly held that income does not arise solely from the sale of goods when two or more steps are involved in producing and marketing a product, the taxing authorities are inclined to hold that the taxpayers are not justified in making an apportionment of income solely on the basis of sales. However, it is apparent that the State Tax Commission desires to be fair and reasonable in such controversial matters as the insistence upon a rigorous allocation would possibly be harmful to Oregon enterprises. Under a too burdensome application of the law, many corporations in a position to do so, would weigh the advantage of changing their principal place of business to another State.

To many people it was a surprise to find that dividends received are fully taxable under the intangibles law. It was expected that some provision would be made for the exemption of dividends received from Oregon corporations and, following the procedure of the Federal Government and some other states, it was thought that distributions from income earned prior to January 1, 1930, would be non-taxable. Under the Corporation Excise law as amended, provision was made for the exclusion of dividends received by a corporation, from the earnings of another corporation, to the extent of the income taxed to the corporation paying the dividend. However, as dividends are taxed as intangibles when received by a corporation or by an individual, the intangibles law would appear to govern the taxable status of the dividends, and this law makes no provision for any kind of dividend exemption. It is believed, that this was an oversight in framing the Intangibles Tax Act, and it may be that the exemption features of the Excise law will receive

consideration in the administration of our taxes.

With reference to some features affecting individual taxpayers under the intangibles law, the question of the situs of intangibles is of considerable importance for purposes of taxation. In general, the domicile of the owner is the determining factor and it makes no difference whether the bonds or certificates of stock or other evidences of ownership are lodged in this State or elsewhere. It is often well to ask, where can income from intangibles be reached by State taxation and the answer to this question will usually determine the situs for tax purposes. The State by levying a tax which it has power to enforce, fixes the situs of the thing taxed, within the State. For example, a State may not tax a non-resident on the ownership of stock of a foreign corporation, though the certificate may be located in the State. The mere impounding of the certificate will not prevent the owner from selling the stock and as the State has no means of enforcing the tax, the courts hold that the situs of the stock for purposes of taxation is not in the State. But, the State of the domicile of the owner, having jurisdiction of his person by reason of his residence within the State, may force him to pay a tax on the income. However, if bonds, notes, mortgages, etc., are held within this State in connection with the business of a foreign corporation or non-resident individual, the income thereon would be taxable by this State as having a business situs within the jurisdiction of Oregon. It appears therefore that intangible income may be taxed in more than one State, and the doctrine that intangibles follow the person would appear to mean that they can be taxed at the domicile of the owner, not that they cannot be taxed elsewhere.

It should be noted that banks and financial corporations are not taxable under the Intangibles Act on the net income included in the measure of the Excise Tax. However, the situs of intangibles is important here as fixing the income within or without the State. When banks and financial corporations maintain offices or branches in more than one State, it is frequently the practice to allocate portions of their capital to the different branches and to allow each to maintain an independent portfolio of investments. Securities so held acquire a "business situs" in the State where they are lodged and become taxable there.

Income from real property located outside of the State is not taxable to an Oregon resident, but there appears to be some question as to the taxable status of profits from sales of such property. It is understood, that the Oregon tax authorities consider the profit taxable in this State, but it is noted that some other states require the levy of a tax on sales within their jurisdiction, and it would appear that there is a question of the power of Oregon to enforce collection of a tax on such outside profits.

The exemption of income from real estate also holds in connection with the receipt of distributions from income of trusts located outside the State, to the extent that such distributions are made from real estate income. However, income from trust intangibles is taxable to an Oregon resident when received. The converse is also true, that distributions from an Oregon trust to a beneficiary outside this State are taxable in Oregon to the extent of the real estate income, but intangible income may be distributed without tax to the beneficiary. However, if the income is accumulated in trust, a tax is payable by the trustee without regard to the residence of the beneficiaries.

In view of the fact that dividends received by corporations are taxable, the practice of the State Tax Commission in allowing consolidation of income for tax purposes is of increased importance. The excise law provides that the tax commission may require consolidated returns when it is believed that the true income is not reflected by separate returns of affiliated companies, where 95% or more of the voting stock of one corporation is owned by another corporation or the same interests. There does not appear to be any right to file consolidated returns as the measure relates to possible evasion of the law. However, it may be that consolidated returns will be accepted if actual control is exercised under a high percentage of stock ownership and the interlocking nature of the business is such as to distort the income of the companies upon a separate basis.

There are many other important provisions in our three income laws which have not been mentioned. As we are to hear from visitors from other states and Canada, it was considered best to bring out some of the more uncertain or general features so as to make a discussion of interest to all.



# Current Thoughts on Auditors' Certificates\*

By DAVID HIMMELBLAU, C.P.A., Chicago, Illinois

## DISCUSSION

*Mr. William B. Isenberg:* Number six in your mimeograph copy states: "We have examined your accounts and hereby certify that, in our opinion,—". Wouldn't that, after all, be the best form of certificate, without attempting to describe the nature of the examination or the scope? The understanding between the accountant and the public would be that where a reputable firm states it believes this statement to be correct, that is sufficient. The subscribing accountant would then be able—would then be obligated, in making his engagement with a client, to see to it that sufficient scope was given to enable him to stake his reputation upon the fact that a correct statement was being issued. In some cases this might only mean a test audit or in some cases it might mean that certain assets would have to be appraised or revalued or other steps taken to assure himself that when he says, in this very general language, that "we have examined the accounts and certify that in our opinion they are correct," that that represents just one hundred per cent of what it says.

*Mr. Himmelblau:* Personally, I don't see how that is possible, because no auditor will assume the responsibility for any statement being 100% correct. When an argument comes up the auditor relies on the fact that he made a certain engagement with a client. The person reading that certificate doesn't know what that was. How would the reader ever find out what it was, unless indicated?

*Mr. Isenberg:* I mean that the accountant would be under the necessity of either refusing an engagement or of telling the client that under the limited scope, which, of course, means a limited fee, he will not be able to issue a certified statement.

*Mr. Himmelblau:* Might as well close your office right away if you are going to do that. It can't be done. No, you cannot do that for the simple reason that you will take the engagement under any basis rather than let your competitor have it.

*Mr. Isenberg:* The only point I raise is that you should mention what your limitation is.

*Mr. Laux:* What is your reaction towards the practice, when we have monthly service jobs, of issuing a statement on our stationery but with no certificate? We simply say: "Mr. John Jones: We are handing you herewith the financial statement covering the operation of your business for the month of so and so" followed by the balance sheet of that date.

*Mr. Himmelblau:* Personally I think the auditors should have the privilege and the right of issuing any statement, complete or incomplete, as long as they specify what it is. In other words, if all you did was to prepare the statements then the wisest thing to do is to insert in a paragraph of the letter the fact you didn't make an audit. If you made a partial audit say what you did. If the reader doesn't want it—if he doesn't like it, if it is not adequate for his purpose, he will send it back and you have another job. You can't complain about that. It is the only club that you have over the client.

Apropos to that point, I remember a statement we made up for a client for his own use. About a year and a half afterwards we heard about that statement from the vice-president of one of the large banks in the Loop. He started asking a lot of questions about it. Finally I asked him what his point was. He said they had made a loan on that basis as he thought because there was an auditor's name on it that an audit had been made. I told him to read it over. It said explicitly "without any audit" but he hadn't read it. If you are going to limit your work to unqualified audits, you will have to decline a lot of work that can be done with value to the client and some financial value to yourself. The

\*The address on this subject, given by Mr. Himmelblau, before the Seventh Annual Michigan Accountants' Conference, appeared in the May issue, together with thirteen suggested certificate forms. The discussion was as follows.

whole problem, as I see it, is how to specify what was done so that nobody will be misled.

*Mr. Payne:* If you have a classification to follow, what would you suggest should be done in educating the client? Should you put the classification in on a white sheet of the report, or endeavor to educate by word of mouth, or what is the best procedure?

*Mr. Himmelblau:* Before you undertake a piece of work I assume you will have a letter confirming the assignment. It would be a very simple matter to incorporate in that letter or attach to the letter a copy of the classification indicating just what you are going to do for them. Some firms are doing that now. Some of you now place at the bottom of your reports the statement that no copy or any extracts can be made therefrom without your consent, because some people will copy the portion they want and leave out the part they don't like. If the National Association of Credit Men, Robert Morris Associates, the Federal Reserve and other similar groups had a voice in saying what should be the classification and the wording of certificates, the agreement reached would have the prestige of the other organizations as well as the accountants, and the client would have a very difficult time trying to get away from it.

*Mr. Ross:* There are two questions I would like to ask Mr. Himmelblau with regard to these audit certificates in the printed form: First question is whether or not the use of the word "examine" instead of "audit" creates any different legal responsibility, and the second question is whether or not a statement which does not say that it certifies is a certificate?

*Mr. Himmelblau:* The word "examine" has been brought in with the idea of trying to get away from what I mentioned earlier—the misuse of the word "audit." The word "audit" has been misused to the point where many people want to scrap the term. Whether this will accomplish that end I don't know. People have the impression that whatever is audited is absolutely right; it is a one hundred per cent audit. We know that there are very few of those audits being made at the present time because no one is willing to pay for them. I see no real difference—examination and audit are the same.

Whether you say you certify or don't say

you certify seems to me simply a matter of terminology. If you sign your name you take just as much responsibility as if you specified on what basis you are making your signature.

We did have a period of time when all the auditor did was simply sign his name at the bottom of the statement. Sometimes he said "correct" and sometimes he didn't—just signed his name. The responsibility under those conditions, to my mind, is just as great as if you write a short certificate or a long-winded certificate. I think the only way to minimize your responsibility is to indicate on what it is based.

If you indicate that you only made a limited examination, and whatever is wrong could not have been discovered in that limited examination, you have no responsibility whatsoever. You have disclosed the basis of your certificate.

*Mr. Laux:* In certificate No. 7 we say "We certify to so and so and so" but in certificate No. 10 we go to particular effort here to tell them about the inventory. Please explain why that is necessary or why we shouldn't do that in all certificates?

*Mr. Himmelblau:* I would say in certificate No. 10 the reference to inventories is redundant. It ought not to be there. That was started when inventory mark-downs were serious problems. If you will remember I stated in my remarks that all our qualifications should be on the balance sheet. The proper place to put that information is on the balance sheets and not in the certificate.

*Mr. Laux:* How will you show it in the balance sheet?

*Mr. Himmelblau:* Right after the inventories you state the basis of valuation.

*Mr. Laux:* In the body of the balance sheet?

*Mr. Himmelblau:* Yes, right after the word "inventory." That is where it belongs. Whoever looks at the statement wants to know how the inventory was valued. You should answer the question there. The properties are appraised. You put it on the balance sheet—appraised by Jones & Company as of a certain date. The basis of valuation should be on the balance sheet and if you do that then you can leave such matters out of the certificate, making it easy for the reader. I have seen certificates comment on so many points that you couldn't spot the qualifications

unless with your pencil you marked them one, two, three, four and figured out which ones were surplusage and which were qualifications neatly buried.

No. 7 is much shorter and gives all the information the reader wants to know. The only objection is, "what kind of audit did they make?" You know they didn't make a detailed audit. As an accountant you know some of these things but the average reader doesn't know and that is my objection. They should say "we have made a test audit" or "made an examination of your accounts"—if you don't like the word "test." One committee suggested the word "standard." That sounds much better to me, but it was criticized because it would convey the idea that a test audit was the standard audit. I don't care what you use. I am merely arguing about certain fundamentals.

*Mr. Laux:* I think that is fine so far as the inventories are concerned. Now we go down to, say, investments, the company has made. What are you going to do with those in that case?

*Mr. Himmelblau:* The same thing. If you haven't enough Federal tax liability, do the same thing. Qualify it under current liabilities where it belongs, not in the certificate.

*Mr. Laux:* Don't you think we would have a rather complicated balance sheet? We would have to get a couple of sheets of paper to put it on.

*Mr. Himmelblau:* No.

*Question:* I have seen within a month, a very fine balance sheet that covered four sheets and it was handled in exactly that way and looked upon by the bankers and financial houses as being just such a thing as they really needed. I don't think the size of a balance sheet makes any difference.

*Mr. Laux:* That is what I am trying to bring out. Most everyone seems to think you have to keep the balance sheet on a double sheet of paper.

*Mr. Himmelblau:* I agree with you. I don't like four sheets but if you need it, well, use four. It would be an unusual balance sheet that had so many qualifications on it. If I had such a balance sheet I would be scared to death to write the certificate without having every one of those qualifications on the balance sheet. I would be afraid the client would do what some others have done,

that is, separate the balance sheet from the certificate and submit the balance sheet alone. When asked "Who made it up?", they answer, "Jones & Company," and the man that reads it hasn't the faintest idea what the qualifications are.

*Mr. Laux:* The reason I am talking so much about this is that I have a particular balance sheet in mind and if I put all that you said to do on the balance sheet I would have three sheets.

*Mr. Himmelblau:* Do you know what will happen if you insist on placing all qualifications on the balance sheet? The client will accept some of your adjustments thus eliminating many of those points.

### Talking Shop

*(Continued from page 346)*

subject to it, and should seek to protect their dependents. What is the value of the goodwill of a single practitioner?"

"Not much," said Dash.

"You're right," continued Oldtimer. "At the best, some friend or employee will pay the widow a fair sum for the files. But that is no guaranty that the clients will go to the purchaser, especially if he be a stranger or outsider. More often they follow the employee, who is under no legal obligation to pay a cent for the goodwill. We had a case up before the ethics committee about four years ago, where we persuaded the man to pay a few hundred dollars to the estate, but it was a moral obligation entirely. Immediately following his employer's death, he had taken desk space in a law office, mailed simple announcements to everyone he knew, including, of course, the clients where he had worked, and 90% of them naturally gave him their patronage. A practice that had netted the dead man better than \$10,000.00 a year went to the young man for nothing.

"The widow appealed to us, with the result that the man bought the files for a nominal sum. Now, if that man had had a partner, or better still, had admitted the employee to partnership as soon as he got his certificate, the contract could have covered the disposition of the goodwill and everything."

"Yes," said Blank, "but how does that cover coöperation, or associates not partners?"

"Easy," said the Kid, "the coöperative office is the trial marriage of business."

# C. P. A. Examination Questions\*

May, 1932

## Auditing

### Question 1:

A, B, and C are the officers and directors and the owners of 55% of the outstanding capital stock of the Cyril Building Corporation, the remaining stockholders being inactive in the company's affairs. In September, 1931, A, B, and C employed an individual to purchase corporate obligations (first-mortgage bonds) in the amount of \$70,000.00, maturing October 15, 1931, at as great a discount as the bondholders could be induced to accept. Cash loans equal to the par value of the maturing bonds were made by the corporation to the three individuals in order that the purchases might be made; and at maturity the bonds, which had been purchased at an average price of 60, were formally redeemed by the corporation and the loans to the individuals canceled.

What would be your attitude, as auditor, as to these transactions in the preparation of a certified balance sheet of the Cyril Building Corporation at December 31, 1931? You were appointed auditor by the stockholders at a special meeting held on May 2, 1932.

### Question 2:

During the course of an audit as at December 31, 1931, you find that your client in 1925 purchased two acres of land adjacent to its present plant for future expansion, subject to a first mortgage, the maturity of which was May 10, 1929. The mortgage has not been refinanced but has been extended for one year at each May 10th since 1929, the date of the annual 6% interest payment. The bank which owns the mortgage informs you that, subject to the usual interest payment at May 10, 1932, it will grant the customary one-year extension of the mortgage to May 10, 1933. Your client is in good financial position. How will you show the mortgage liability on the balance sheet?

### Question 3:

In preparing the December 31, 1931, balance sheet of an advertising agency, you find that invoices totaling \$12,000.00, dated during December, for advertising space in various magazines issued during that month, which in ac-

\*The Service of Examination Questions conducted by The American Society furnishes practically twice as many questions in Theory, Auditing, Commercial Law, and Economics and Public Finance as could be used by any State Board for a four-hour examination period, and twice as many problems in Practical Accounting as would be required for two examination periods of four to five hours each. A Board using the service makes its own selections and adds any special questions or problems which it desires. The questions in Auditing and Economics follow.

cordance with established custom were rebilled to the advertiser's clients as of January 3, 1932, have not been recorded on the books of the advertising agency, and your client refuses to take them up as his liability until 1932. What effect will this have on the certificate which you will attach to the balance sheet?

**Question 4:**

The Boyles Corporation, for which you have been auditor since its organization in 1926, manufactures and sells direct to consumers a health appliance in one size and style. In 1931, sales volume was less and unit manufacturing costs and expenses higher than in 1930. Outline the type of data you would include in your annual report for the year 1931, under your comments on the operating results.

**Question 5:**

In an organization which you are now auditing and which pays certain officers a bonus based on net profits, what accounts should be given particular attention to prevent manipulation of the current year's earnings? State six methods by which these accounts might be altered so as to affect net profits.

**Question 6:**

You are called upon by Mr. John A. Wall, President of the Wall Paper Company, to furnish him with a brief memorandum setting forth the advantages of an annual audit of the company's accounts. He explains that while he feels disposed to employ your services, several members of his board of directors have stated that the customary annual audit, in this year of depression, might well be dispensed with as an unnecessary luxury.

Prepare a brief letter which he may pass on to his board of directors.

**Question 7:**

(a) What is the scope of a balance-sheet audit?

(b) Prepare an index of the working-papers of an imaginary balance-sheet audit.

**Question 8:**

Upon commencing an audit of the books of the Z Hospital you discover that the entries in the general journal have no explanations attached to them. What procedure would you adopt to verify them?

**Question 9:**

Your client, the Ajax Television Company, over a period of five years has adopted the practice of capitalizing all experimental and development expense, together with operating losses, the account therefore now exceeding in amount one-third of the asset total. The president states that until successful television apparatus has been perfected and profits therefrom can be shown, the practice will be continued. What would be your attitude toward the inclusion of such an account in the balance sheet of the company which you are called upon to certify?

Question 10:

Explain fully what is meant by the phrase "auditing accounts by comparison and inspection."

Question 11:

What items other than customers' accounts are often found in a receivable ledger? How would you dispose of them for balance-sheet purposes?

Question 12:

What is meant by aging accounts receivable, and what process would you follow in verifying the aging prepared by the company's bookkeeper?

Question 13:

During 1931 you find that certain minority stock interests held for many years as investments by the Z Company were exchanged for real estate bonds, several of which were in default before the end of the year. The par value of the bonds is, however, greatly in excess of the cost of the stocks exchanged, and the excess has been credited to capital surplus account. What principles should govern in determining the income or loss (a) for Federal income tax purposes, and (b) for the purposes of preparing a balance sheet and statement of profit and loss which you may certify to without qualification?

Question 14:

Criticize the following audit certificate:

To the President:

At your request, we hereby certify to you that we have audited the books of your company, the Apex Manufacturing Industries, Inc., and that the attached balance sheet at December 31, 1931, is in conformity therewith. We further certify to you that all ascertained liabilities have been given expression to therein.

GOOD AND TORO,  
*Certified Public Auditors.*

Question 15:

In your audit of the books of the Gable Sales Company, dealer in automobiles, you find on hand 14 used cars, acquired in trades, having a total book value of \$4,800.00. The book value represents the trade-in values at which the used cars were acquired. The cost up to the end of the fiscal period of putting the 14 cars in salable condition was \$643.19, which has been charged to expense, and in addition, it is estimated that approximately \$550.00 will be required to complete the overhauling before they can be sold. Not more than \$3,500.00 is, however, expected from the ultimate sale of these cars and you are informed that the experience of the dealer has been fairly uniform in this respect. A commission of a flat 10% is allowed salesmen on all used-car sales.

How would you express these items in your report to the company?

**Question 16:**

An investment trust company of the management type maintains the following surplus accounts:

(1) Capital surplus; in this account are credited and debited gains and losses arising from the valuation of securities on hand at market prices at December 31 of each year. On December 31, 1931, the debit balance in this account was \$42,346,655.18.

(2) Surplus from realized security gains; to this account are transferred gains or losses previously credited or debited to capital surplus with respect to investments sold, together with any further gain or loss resulting from movements of market values since the next previous December 31. On December 31, 1931, the debit balance in this account was \$5,368,775.54.

(3) Earned surplus; to this account are credited interest and dividends received less administrative expenses and interest paid. The account is debited with cash dividends paid on preferred and common stocks and in 1931 it was credited with the sum of \$49,500,000.00 which arose from the reduction in the declared value of the common stock outstanding from \$27.50 a share to a par value of \$5.00 a share. The credit balance of this account at December 31, 1931, was \$48,689,230.69.

In the minutes of a special meeting of the stockholders on December 12, 1931, you find that the reduction in value of the common stock was approved and that the credit to earned surplus was authorized, against which, according to the resolution, "any debit balances of other surplus accounts shall be carried."

In preparing a balance sheet of the company at December 31, 1931, how would you display the item of surplus?

**Question 17:**

Name and discuss briefly six expenses which may not be deducted from the income of a corporation in the preparation of its Federal income tax return.

**Question 18:**

Prepare a liability certificate suitable for the signature of the officers of a company you are auditing.

**Question 19:**

Prepare an audit program to cover the current liabilities of a manufacturing company with which you are acquainted.

**Question 20:**

During the course of your audit of the accounts of the Y Company, you discover an account, detailed below, covering merchandise shipped to customers on consignment.

Particulars	Dr.	Cr.
Balance, January 1, 1931 at billing prices to customers (factory cost \$14,214.96) .....	\$ 18,834.12	
Shipments to customers at billing prices (factory cost \$93,531.63); offsetting credit to sales .....	127,386.91	
Cash received from customers as indicated by following account-sales rendered:		
Sales (factory cost \$88,326.53) .....	\$139,426.91	
Less:		
20% commission .....	\$27,885.38	
Freight, storage, and other charges...	1,263.81      29,149.19	\$110,277.72
Defective merchandise returned by customers, credited to this account at billing price and charged to defective merchandise (an expense) account. Factory cost of these returns was \$4,383.66, and the merchandise had no scrap value .....		5,568.11
Totals .....	\$146,221.03	\$115,845.83
Debit balance per books at December 31, 1931 .....		30,375.20
Totals .....	\$146,221.03	\$146,221.03

Prepare journal entries adjusting the above-mentioned account and state how you would treat the balance on the financial statements of the company at December 31, 1931.

## Economics and Public Finance

Question 1. Explain the theory on which the Reconstruction Finance Corporation was established. Outline what you believe will be its temporary as well as ultimate effect on economic conditions.

Question 2. Much has been and is now being written about the ill effects of short sales. Explain the difference in economic results between short sales and regular margin purchases as distinguished from outright purchases.

Question 3. One of the propositions before Congress is to cash the soldier bonus claims by means of issuing in the neighborhood of \$2,000,000,000 of paper promises of the Government in the form of money. What would be the economic effects of such a procedure?

Question 4. Give reasons both for and against the issuance of tax exempt bonds.

Question 5. Melvin A. Traylor, President of the First National Bank of Chicago, brought out in a recent address the fact that at the present time the total governmental tax levies require the payment of the income from one full day's work a week on the part of every man, woman and child in the United



States. The public payroll has grown within a few years from one in every twenty-two people to one in every eleven. If you were a member of Congress or a member of the Legislature or a member of the Commot Council, how would you suggest that this governmental load could and should be lessened?

Question 6. What are the factors affecting the market value of securities?

Question 7. There are two theories as to how business may be best restored. One is based on the theory that governments (national, State or local) should set an example by spending more on public works, even to the extent of borrowing and thus increasing the public debt. The other is based on the theory that governments should set an example by reducing their present expenditures in order that the tax burden should be lessened. Give your views both pro and con on either of these two theories (not on both).

Question 8. List by groups the various ways in which the local (township or city), State and national governments are engaging in business, as distinguished from governmental, activities.

Question 9. Explain the economic differences resulting from wage scale cuts, part time work schedules at present rates or compulsory furloughs without pay.

Question 10. During the recent and not fully completed warlike exchanges between China and Japan a considerable number of prominent persons recommended that the United States boycott Japanese goods as a means of expressing its antagonism to Japan's policy. Explain why you would have favored or opposed that suggestion.

Question 11. Define inflation, rent, profits, legal tender, distribution.

Question 12. Continued unsettled industrial conditions have changed in the minds of many people the viewpoint on the prohibition problem from a moral question to an economic question. Based entirely on economic conditions, would the return of a legally recognized liquor traffic be good or bad, and why?

Question 13. Distinguish between luxuries and necessities, stocks and bonds, patents and copyrights, checks and money, partnerships and corporations.

Question 14. In your judgment, has the development of branch banking been helpful to the general economic condition of the country? Give reasons for your opinion.

Question 15. Name, without explaining, what you believe to be the factors which in the first instance caused the present industrial break and in a second group name the factors which have tended to retard a return to a more nearly balanced economic condition.

## Presidential Short Stops

**P**RESIDENT MILLER left New Orleans early Saturday morning, April 30, for Mobile, Alabama, where he was joined by Nelson E. Taylor, Director of the Seventh District. At noon the accountants of Mobile had a luncheon meeting at the Battle House, arrangements for which had been made by Walter K. Smith, member of the Council of the Alabama Society and State Representative of The American Society.

Director Taylor explained the workings of the Mississippi regulatory law, which is somewhat different from that of any other State, and discussed the benefits which had come to the profession in Mississippi as a result of their State organization.

President Miller stressed the value of chapters as being practically the only way in which the necessary local group relationships could be established with others who were interested in somewhat the same problems as the public accountant.

Miller and Taylor travelled across Florida Sunday, reaching Jacksonville in the evening, where they stayed for three hours prior to starting for Miami, and during that time they were entertained by Messrs. James and Smoak.

Monday, May 2, was spent at Miami. The luncheon meeting, under the direction of Harry Goldstein, president of the local chapter, was well attended. Director Taylor compared the C.P.A. organizations in this country to the Mississippi River, which, starting as a small stream in the Northwest, because of the addition of various other streams, develops into the tremendously powerful river found at New Orleans. He compared the small rivulets and streams to the individual C.P.A.'s, merging into the larger rivers as individuals establish chapters and State societies, finally forming the Mississippi River with all of its power, representing The American Society, the national organization of certified public accountants. He warned the practitioners against the danger that results when part of the river draws away from the main body, breaking through the levees and spreading destruction, feeling that in this country where the C.P.A. is the accepted legal terminology by which the professional practitioner should be known, it is dangerous to undertake

in any way to deviate from the natural development of the profession through chapters, State associations and the national organization of certified public accountants.

President Miller discussed general professional conditions, and the work of The American Society, dwelling on the report of the Committee on Classification of Accountancy Services and the Service of Examination Questions which The Society inaugurated, also touching on various coöperative movements with bankers, lawyers, credit men and others.

Tuesday morning a couple of hours was spent at Tampa for an informal conference with the Tampa chapter, arranged by J. D. A. Holley, its president. It is hoped that interest in the chapter was stimulated.

Tuesday evening was spent at Jacksonville. Much the same subjects were discussed as at the other places. Messrs. James, president of the Florida Institute, and Walter Mucklow, State Representative of The American Society, were in charge of the meeting.

Savannah, Georgia, was visited on Wednesday. Thomas O'Brien and S. T. Lee, president and secretary of the Georgia Society, were in charge of the arrangements. An evening meeting was held and the time was devoted to a general and informal discussion of accounting problems.

Thursday morning a stop was made at Charleston, South Carolina. Arrangements for this meeting had been made by Martin T. Powers, State Representative of The American Society, none of the State Society officials living at Charleston. An evening meeting was held, attended by most of the Charleston accountants. Informal discussions of the question-box variety occupied the entire time.

Friday morning the trip was made to Columbia, South Carolina, where a luncheon meeting was held, arrangements for which had been made by George M. Thayer, secretary-treasurer of the South Carolina Association. While the accounting groups at both Charleston and Columbia are not large, they are sufficiently numerous so that with unified efforts they should be able to keep accountancy in that State to the front.

At Columbia Director Taylor left to meet with the Atlanta accountants Saturday noon,

and President Miller went on to Charlotte, North Carolina.

Saturday noon a luncheon meeting was held at Charlotte, presided over by George H. Emery, president of the North Carolina Association of Certified Public Accountants. Informal discussion of matters of general interest occupied the allotted time, following which a business meeting of the Charlotte members was held for the purpose of discussing the proposal of the Mecklenburg Civic Affairs Association looking toward an investigation of the governmental features of the City of Charlotte with a view to recommending changes in the system which should result in reducing the cost of government. The group agreed that the proposal was well worth while and expressed a willingness to assist in any way possible. Later in the afternoon Messrs. Hutchinson, Emery and Miller had a golf threesome, but no reports have been received as to the score.

Monday, May 9, was spent at Richmond, Virginia. At one o'clock a luncheon was held to which some of the accountants from outside cities were present, including A. V. Sheffield, of Norfolk, president of the Virginia Society of Public Accountants. Following President Miller's talk and general questions, about a dozen of the members remained for a more detailed discussion of one or two local problems.

The Secretary found it convenient to be in Richmond that day in connection with some printing matters, and was present at the luncheon and following conference. Later in the day the President and Secretary came on to Washington.

Tuesday the President and Secretary devoted the day to working on plans for the annual meeting to be held in Indianapolis the last week in September. During the day Forrest Mathis, president of the Texas Society of Certified Public Accountants, and A. C. Upleger, former president of The American Society, visited the office, having been drawn to Washington by the dedication of the Masonic Memorial Temple at Alexandria.

The Maryland Association of Certified Public Accountants was holding a monthly meeting that evening with William S. Gordy, Controller of the State of Maryland, as the chief speaker in accordance with a program arranged last fall. A party from Washington

went over for the meeting, including President Miller, former presidents Upleger and Councilor, Forrest Mathis, president of the Texas Society; Gordon Buchanan, of the District Board of Accountancy, as well as State Representative in The American Society, and the Secretary. Each of the visitors was introduced. Mathis referred to the value of State societies, Upleger told a story, Councilor and Buchanan made their bows, and President Miller spoke for twenty minutes on the present status of the profession. The controller gave an exceedingly clear statement of the financial processes of the State government and the checks from an accounting angle with which they were surrounded. After the program was completed, a business meeting was held, and the Secretary was asked several questions concerning matters in which the Maryland men were especially interested.

Wednesday the certified men of the District of Columbia had a luncheon at the National Press Club with President Miller as the only speaker, although Charles D. Hamel, first-chairman of the United States Board of Tax Appeals, was present, and was introduced. The attendance was the best which had been had at any meeting of the District Institute this year.

During the day the President and Secretary completed the meeting plans ready for presentation to the Indiana Association later in the week.

Thursday, West Virginia was visited, a stop being made at Charleston, where the State Board was giving an examination. At the luncheon meeting the candidates were invited to be present.

Louisville, Kentucky was the Friday stop. In the afternoon, under the guidance of immediate past-president of the Kentucky Society, William Cotton, the President of The American Society watched the races. However, he reported that it being Friday the 13th he considered that discretion was the better part of valor so far as any attempt on his part to even guess as to which of the horses might turn out to be winners.

The dinner meeting was held at the Seelbach Hotel, presided over by O. S. Meldrum, president of the Kentucky Society. President Miller devoted the major portion of his time to the discussion of regulatory legislation, following which an informal general discus-

sion was entered into, largely based on questions propounded from the floor.

Saturday, May 14, and a goodly portion of Sunday, was spent at Indianapolis. This was the annual meeting of the Indiana Association. The local State business was largely completed at the morning session. At the luncheon held at the Hotel Severin President Miller devoted considerable time to a discussion of the question of regulatory legislation. Much time was spent with the local convention committee, the chairman of which is Marshall G. Knox, and the details of the annual meeting were practically agreed upon. The Claypool Hotel will be headquarters, and President Miller reports that the arrangements indicate extremely satisfactory local conditions. Mrs. Knox will act as Chairman of the Ladies' Entertainment Committee. Plans are materializing very rapidly.

Monday noon, President Miller lunched at the Hamilton Club with the State Representatives and officers located in Chicago. George W. Rossetter was necessarily out of the city in connection with the meeting of the United States Chamber of Commerce at San Francisco, California.

Tuesday, President Miller was at Milwaukee, where, at a luncheon, he was the guest of the Wisconsin Society of Certified Public Accountants, at which William Charles, the president, presided. Most of the President's remarks related to legislation, as Wisconsin is discussing that very important subject.

A night and day jump brought Miller to Pittsburgh for the annual meeting of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants, held at the Keystone Club that evening. Late in the afternoon a round of golf was had, arranged by Ernest Crowther, president of the Pennsylvania Institute and Director of The American Society, which just enabled the group to reach the dinner at 6:30. Aside from the election of officers the time was devoted to the remarks of President Miller, with discussion following.

Thursday morning, the President reached Detroit, contacted with the Secretary, who was present in connection with the May examination given by the Michigan State Board. During the morning Tom Evans and others gave him a view of Detroit's Belle Isle. In the afternoon he visited the State examina-

tion for a little while and then the President and Secretary completed the outline for the Indianapolis meeting.

The Michigan Association had a dinner at the Yacht Club, following which President Miller spoke on "Present Day Accounting Conditions." The meeting had the largest attendance of the year thus far, which might be accounted for in part, at least, by the clever advance announcement prepared by M. A. Yockey, chairman of the entertainment committee. The message brought by President Miller was appreciated.

Friday and Saturday were spent at Columbus, Ohio, where the annual spring meeting of the Ohio Society was held. A. C. Upleger, past-president of The American Society, was at the meeting on Friday, which opened with a luncheon at the Fort Hayes Hotel. In the afternoon the guests had the choice between golf, a baseball game or inspecting the Ralston Steel Car Company plant. Miller and Upleger chose the golf, Upleger winning the prize for the lowest gross score and Miller winning a prize for the least number of putts.

The evening session was a combined meeting of the Ohio Society and the Columbus Chapter of the National Association of Cost Accountants. The speaker was Professor Ralph C. Davis, of Ohio State University, who presented a paper on "Trends in Progressive Management."

The Saturday meetings were held at Ohio State University. In the morning Dean Walter C. Weidler welcomed the group. The discussion which followed related to credit problems, the meeting being held jointly by the Ohio Society and the Credit Association of Central Ohio. The accountants asked questions of the credit men and the credit men asked questions of the accountants. The leaders of the credit men were E. W. Hillman, Director of The Credit Association of Central Ohio, Treasurer, Federal Glass Company, and Albert E. Binder, member of Robert Morris Associates, Manager and Examiner of The Columbus Clearing House Association.

Luncheon was served in the Faculty Club in the Administration Building, in which building the afternoon session convened. Professor Jacob B. Taylor, Chairman of Accounting Department, Ohio State University, reviewed the book by A. P. Richardson on "The Ethics of a Profession," during which he

quoted from the editorial in the May number of THE CERTIFIED PUBLIC ACCOUNTANT by President Miller, indicating that the ideas therein expressed represented his views.

H. J. Kraus, member of the Tax Commission of Ohio, explained "Ohio Tax Returns from the Administrative Point of View," and answered questions put to him with regard thereto.

President Miller, in his talk, used the points brought out by the other speakers during the convention as text for presenting his views.

Saturday evening Berle E. Graham, president of the Ohio Society, took Miller with him to Cincinnati from which city he took a night train for New Orleans.

During a period of twenty-three days he had met the accountants in nineteen cities representing sixteen states, the largest number of visits made on any single trip by any president of The American Society since the first year.

### Director's Trip

The report on the visit of President Miller to many states carries with it the fact that Director Nelson E. Taylor, of the Seventh District, was with him in connection with seven meetings, representing the stops President Miller made in the Seventh District.

Leaving Columbia, South Carolina, the last joint stop, Director Taylor was with the Atlanta accountants on Saturday, May 7. N. E. Cann, the Internal Revenue Agent in charge at Atlanta, has been acting chairman of the Atlanta chapter since the chairman moved to California. Cann is both an attorney and a C.P.A., as is Taylor, consequently they were able to discuss relative relationships between lawyers and accountants with the Federal Government much more intelligently than the average lawyer or the average accountant, each of whom personally knows but one side of the story. Cann reported that the Treasury Department was especially well pleased with the cooperation which the accountants had given it. This fact was reflected somewhat later when the Savannah Chapter passed a resolution asking the Georgia Senators and Congressmen to oppose any legislation which would result in lessening the personnel of the Treasury Department as far as Georgia was concerned. Both Cann and Taylor agreed that the accountants had not

yet acquired the group consciousness which the lawyers had and that this fact was very much to their disadvantage. They both recognized that the work of the accountant had a tendency to make him an individualist. His work was largely done separate and apart from contact with other accountants, whereas lawyers met in their regular practice other members of their profession who were opposing their ideas and there was developed the capacity to measure the strength and ability of one individual as against the strength and ability of another individual to a much greater degree in law than in accounting. However, both agreed that the accountant should, not only for his own benefit but for the benefit of his client whom he represents and the public which must depend upon the accuracy of his work, do everything within his power to more definitely establish the group consciousness which recognizes a necessity for working with one's fellow.

A luncheon meeting had been arranged at the Atlanta Athletic Club at which, informally, various problems affecting the profession were discussed.

Saturday afternoon Taylor was taken out to see Stone Mountain, after which he completed his trip by turning homeward to Greenwood, Mississippi.

## State Board News

### DISTRICT OF COLUMBIA

Announcement is made of the reappointment of Wayne Kendrick to the Board of Accountancy of the District of Columbia.

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### RHODE ISLAND

Thomas C. Lomasney, of Pawtucket, has been appointed to the Rhode Island State Board of Accountancy to succeed Ralph R. Bradley. The Board has organized with Ernest L. Goodman as Chairman, Carl W. Christiansen as Secretary, and Thomas C. Lomasney as Treasurer.

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### SOUTH DAKOTA

Walter P. Mollers, C.P.A., of Rapid City, has been appointed to the South Dakota Board of Accountancy to succeed the late C. C. Crandall.

## STATE SOCIETY NEWS

### COLORADO

At a meeting of the Colorado Society of Certified Public Accountants, held on April 14, 1932, the society was addressed by Messrs. Peter Holme and T. E. Howard on the subject of "State Income Tax."

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### CONNECTICUT

The Annual Meeting of the Connecticut Society of Certified Public Accountants was held on April 27, 1932, at the Elks' Club, New Haven.

The meeting was in two sessions, the first beginning at 4 p.m. to 6:30. After dinner the evening session started at 8 p.m. Among the activities reported by the society was the addition of eight new members. During the year the society took out membership in the Connecticut State Chamber of Commerce with the right to elect one of its members to the Board of Governors.

The following officers were elected: President, Walter A. Musgrave; Vice-President, John S. Roth; Secretary, Lewis Sagal; Treasurer, Harry Jacobs; Auditor, Russell C. Everett. Charles F. Coates and Seth Hadfield were reelected to the Board of Governors for a period of three years.

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### DISTRICT OF COLUMBIA

The District of Columbia Institute had as a luncheon guest at the Thursday, May 26, meeting, Mr. C. H. Pope, president of the District of Columbia Bankers Association. Mr. Pope gave an interesting presentation of the activities involved in attempting to work out a better fiscal relationship between the City of Washington and the District of Columbia, and emphasized the necessity for accountants to actively interest themselves in civic affairs.

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### GEORGIA

On Thursday afternoon, May 12, 1932, the Savannah Chapter of the Georgia Society of Certified Public Accountants held their annual meeting and elected the following officers for the fiscal year 1933: Chairman, Syd-

ney T. Lee; First Vice-Chairman, Henry F. Meyer; Second Vice-Chairman, John T. McIver; Secretary-Treasurer, Harry R. Friedman.

Newly-elected officers of the Atlanta Chapter of the Georgia Society of Certified Public Accountants are: Chairman, U. A. Morton; First Vice-Chairman, M. F. Pixton; Second Vice-Chairman, L. F. Bennett; Secretary, L. E. Campbell; Treasurer, T. F. Avery.

The annual meeting of the Georgia Society of Certified Public Accountants was held at the Hotel Tybee, Savannah Beach, on May 27 and 28.

Officers elected for the ensuing year were: President, W. J. Carter, Atlanta; First Vice-President, U. A. Morton, Atlanta; Second Vice-President, S. T. Lee, Savannah; Secretary, T. S. Respass, Atlanta; Treasurer, Victor Markwalter, Augusta. Directors elected for one year: H. H. Hunt and U. A. Morton, Atlanta, and R. L. Holland, Savannah. To serve for two years: C. W. Saussy and G. L. C. Hunter, Savannah, and N. D. Cann and H. H. Gardner, of Atlanta.

Reports of the meeting showed the Society to be in a healthy condition. The main social feature was the dinner the first evening, presided over by T. A. O'Brien, of Savannah, retiring president. During the day John L. Carey, Secretary of the American Institute of Accountants, and Elmer Hatter, of Baltimore, Chairman of the Institute's Board of Examiners, gave addresses. The Secretary of The American Society was unable to accept an invitation to be present.

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### IDAHO

The Idaho Association of Certified Public Accountants has changed the official name of the organization to The Idaho Society of Certified Public Accountants.

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### INDIANA

At the annual meeting of the Indiana Association of Certified Public Accountants held at the Hotel Severin, Indianapolis, on May 14, the following officers were elected: President, Earl E. Thomas, Evansville; Vice-Presi-

dent, Harry Boggs, of Indianapolis; Secretary, H. A. Roney, Indianapolis; Treasurer, Arthur R. Chapman, Indianapolis; Auditor, Howard W. Painter, Indianapolis. Directors elected for one year: Earl E. Thomas, of Evansville; J. R. Wharton, of South Bend, and Harry Boggs and H. A. Roney, of Indianapolis. Those elected for two years were: Arthur R. Chapman, Troy G. Thurston and Birney D. Spradling, all of Indianapolis.

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#### MASSACHUSETTS

The Massachusetts Society of Certified Public Accountants, Inc., and Boston Chapter of the National Association of Cost Accountants held a joint meeting at the Chamber of Commerce on Thursday, April 21, 1932. The dinner preceding the meeting was attended by 200 members and guests, and those coming in later increased the total to over 400.

Professor Roy B. Kester, of Columbia University, was the speaker of the evening, and had for his subject "Composition and Interpretation of the Balance Sheet."

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#### MICHIGAN

The regular monthly meeting of the Michigan Association of Certified Public Accountants which would have occurred on May 12, was postponed to the 19th in order that Henry J. Miller, President of The American Society, might be present. An account of the meeting is given in the report of President Miller's trip.

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#### MINNESOTA

The Minnesota Society of Certified Public Accountants held its regular May meeting in the Sun Room of the Curtiss Hotel, Minneapolis, the speaker being Wm. A. Paton, Professor of Accounting at the University of Michigan. His subject was "The Lower Price Level as it Affects Accountancy."

In addition to the speaker, the guests of the evening were members of the Minnesota Association of Public Accountants, members of the Minnesota University Chapter of Beta Alpha Psi, and the candidates who had taken the State Board Examination the three preceding days.

From the May Bulletin of the Minnesota Society we quote:

"Hardly an hour passes that someone doesn't tell us of the evils of price-cutting,

and that accountants are being forced by business to bid one against the other. Who is to blame, the client who wants the lowest price he can get, or the accountant who, grasping at straws, feels that any sort of work, even done at a loss, is better than an idle staff? The State Societies are taking a lively interest in the subject, but for the most part their chief remedy is to point out that such practices are detrimental both to the client and the accountant. We cannot hope to build by tearing down."

The Minnesota Society, through its president and secretary, offered the services of a special committee to the Committee on Revision of the Corporate Code of the Minnesota State Bar Association. To this tender the chairman of the Bar Committee replied acknowledging its receipt and saying, "Our first work has to do with the law relating to general business corporations. When we reach the subject of capitalization and payment of dividends, and related matters, I believe that the accountants could be of some real assistance to us. I think that will be some time in the middle of the summer."

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#### NEW JERSEY

The Thirty-fifth Annual Meeting of the Society of Certified Public Accountants of the State of New Jersey was held at the Downtown Club in Newark, on Monday, May 23.

Richard C. Plumer, Assistant Attorney-General of the State of New Jersey, spoke on "Security Fraud Legislation." Eugene W. Farrell, Business Manager of the *Newark Evening News*, addressed the Society on "Courage."

Annual reports were read by the officers and chairman of each committee.

The following officers were unanimously elected: President, Henry B. Fernald; First Vice-President, Philip S. Suffern; Second Vice-President, Julius E. Flink; Secretary, Theodore Krohn; Treasurer, W. Melville Coursen.

Auditors for two years: Samuel I. Bendet, and Douglas D. Besore; Trustees: James J. Hastings, and John A. Conlin.

Henry B. Fernald, president, conducted the meeting. This was the first meeting in which all the presidents for the past twelve years were present: Charles E. Mather, 1920-1922; Jas. F. Welch, 1922-1925; Jas. F. Hughes, 1925-1927; Maurice E. Peloubet, 1927-1929;

William C. Heaton, 1929-1931. Associate member, Charles E. Pollard, of the Attorney-General's office, of the State of New Jersey, was present. Accountants from all parts of the State attended.

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#### NEW YORK

The thirty-fifth Annual Meeting of the New York State Society of Certified Public Accountants was held May 9, 1932, at the Waldorf-Astoria Hotel, New York, for the purpose of electing officers and directors for 1932-33. The committee on nominations consisted of Walter A. M. Cooper, Peter A. Eckes, James Hall, Louis Kadison, Samuel Mandel, Winfield McKeon, Morris C. Troper, Charles L. Hughes, Secretary, and Emanuel Engel, Chairman.

The following directors were elected to serve two years: Eric A. Camman, Winfield McKeon, Philip S. Suffern, Morley S. Wolfe, Maurice E. Peloubet. Directors elected to serve one year follow: Harold B. Hart, Vivian Harcourt, Bertram Goldsmith, Philip N. Miller. In this group of directors to serve one year the latter three men are additions to the Board in accordance with the By-Laws amended in January increasing the Board from twelve to fifteen members.

The officers who were reelected for a term of one year, are: President, Arthur H. Carter; First Vice-President, Walter A. Staub; Second Vice-President, Martin Kortjohn; Secretary, Fred L. Main; Treasurer, Prior Sinclair.

The new Board of Directors consists of the officers and directors elected at this meeting, as listed above, and the following directors who continue in office for unexpired terms: Emanuel Engel, A. S. Fedde, Wm. J. Forster, Frederick H. Hurdman, Charles E. Mather, Morris C. Troper.

This will be Col. Carter's third successive term as President. In view of the many important projects of the society initiated during the past year and others which are contemplated, the nominating committee after fullest deliberation and consideration prevailed upon the officers to accept nomination for another year.

The secretary reported that there is now a total of 1,763 members compared with 1,580 a year ago, and 1,392 two years ago.

The annual reports of officers, Board of

Directors, and sixty-four standing and special committees indicated that the society has closed the most active year in its existence.

\* \* \*

#### OHIO

The Columbus Chapter of the Ohio Society of Certified Public Accountants had an extremely interesting meeting at the Deshler Wallick Hotel on the evening of May 6, following a dinner.

Professor Charles H. Chase, of Ohio State University, spoke on the subject "Prosperity Making by Aid of a System of Trade Credit Exchange and Clearing Association." Professor Chase maintained that it is possible to practically create prosperity at will. He furthermore maintained that prosperity may be maintained if appropriate mechanisms are set up for performing the functions by which it is creatable.

\* \* \*

Reference is made to the annual spring meeting of the Ohio Society of Certified Public Accountants in the report of President Miller's trip. In addition to the items there mentioned, it is noted that following the address by Mr. Kraus, a member of the Tax Commission of Ohio, the usual condition prevailed under which there was considerable argument as to the points treated by him. A committee consisting of Messrs. Graham and Willig, of Cincinnati; Flanders and Warren, of Cleveland; Wall and Kirschner, of Columbus; Battelle and Cassell, of Dayton; Arft and Nelson, of Toledo, was appointed to meet with the State Tax Commission for a further discussion of the Tax Commission's rulings.

\* \* \*

#### PENNSYLVANIA

The eleventh annual meeting of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants was held at the Keystone Athletic Club on May 18, 1932, at 6:30 p.m.

Henry J. Miller, of New Orleans, La., President of The American Society of Certified Public Accountants, was the guest of honor of the evening.

Reports of officers and committees were heard and other matters of business transacted. The following resolution was unanimously passed:

"WHEREAS, our fellow member Frank Wilbur Main, C.P.A., recently retired from the State Board for the Examination of Public



Accountants with which body he had been identified for many years, and

"WHEREAS, the said Frank Wilbur Main, C.P.A., labored unceasingly in these years of service to raise and to preserve the standards of our profession,

"NOW THEREFORE BE IT RESOLVED, that the best thanks of the Pittsburgh Chapter of the Pennsylvania Institute of Certified Public Accountants be and are hereby extended to Frank Wilbur Main, C.P.A., for his most excellent service and unselfish devotion to the interests of the profession of the Certified Public Accountant throughout the Commonwealth of Pennsylvania. AND be it further resolved that the Secretary be directed to spread a copy of these resolutions on the minutes of this Chapter."

Officers were elected as follows: Chairman, William F. Marsh; Vice-Chairman, Edwin S. Reno; Secretary, Ira G. Flocken; Treasurer, Harry Coon; Auditor, Harvey L. Maury. Executive Committee: Arthur Medlock and M. D. Bachrach for a term of two years, and James J. Mulvihill for one year.

Chairman Adrian Sanderbeck presented the newly-elected officers, who responded with brief remarks, and then introduced President Miller, who addressed the meeting on the development of the profession of public accounting.

\* \* \*

#### SOUTH DAKOTA

The South Dakota Society of Certified Public Accountants issued Bulletin No. 1, under date of May 20, 1932. It was a four-page letter-sized mimeographed document, extremely creditable to a State Society of a State that has issued only ten C.P.A. certificates in its history and has only eight resident C.P.A.'s at the present time. Other State societies should take notice of this accomplishment.

The society has also decided to issue an educational folder to be sent to State, county and city officials and trade and business associations, leaving to the individual members the duty of sending them to individual business concerns.

A special meeting of the South Dakota Society of Certified Public Accountants was held at Watertown on Sunday, May 8, at which every South Dakota C.P.A. residing in the State was present.

Discussion centered on an education pro-

gram to be launched for the purpose of acquainting the public with the value of C.P.A. certificates and the service of certified public accountants and also for the encouragement of public officials and others to give proper recognition of South Dakota C.P.A.'s in connection with work during the coming year as a matter of relief in distress times. Policies and interpretations of the new South Dakota accountancy law were informally discussed with members of the Board of Accountancy present, and a formal resolution for action by the Board in specific matters was adopted and submitted.

Officers elected for the ensuing year were: President, H. H. Hobbs, of Yankton; Vice-President, Geo. A. Anderson, of Aberdeen; Secretary-Treasurer, C. O. Quickstad, of Watertown.

\* \* \*

#### WISCONSIN

A meeting of the Wisconsin Society of Certified Public Accountants was held on the evening of May 9, 1932, at the Hotel Schroeder, Milwaukee, at which members of the Public Accountants Association of Wisconsin were guests.

Joseph C. Brauer, president of the association, spoke on the public accounting situation in Wisconsin, and Roger Sherman Hoar, attorney with Bucyrus-Erie Company, addressed the meeting on "Unemployment Insurance," as recently enacted into the Wisconsin statutes.

#### Annual Address

(Continued from page 326)

"There is much room for improvement in this direction, according to Colonel Carter, who looks forward to a time when all corporations shall before listing on the Stock Exchange be required to submit to an independent audit—in other words, to a time when every big-league financial game shall be played according to rules interpreted by a trained and impartial umpire. The investor on the whole does not understand the rules, and understands even less the vital function of those discreet and skeptical umpires—the public accountants, who owe it to themselves and to the public to explain a good deal louder and oftener the duties, responsibilities and importance of one of the least recognized professions."

## NOTES

The first editorial in the January issue of the *Indian Accountant* discussed their professional accountancy law and rules as follows:

"1931 will be remembered as a fateful year as our slow moving Government brought into existence a structure for the establishment of the Indian Accountancy Board. The draft rules have been thrashed out thread bare and we expect that in 1932 the Indian Accountancy Board will come into existence as a vital organization to control the profession in the country. Frankly speaking the draft rules are not such which will give any tangible responsibility to the profession as you will observe from the criticism from a professional accountant appearing in this issue. We believe in evolution and not in revolution and therefore the present Accountancy Board however defective it may emerge from the present consideration of the criticism of the draft rules is a nucleus for a future Institute of Chartered Accountants. Such institutes are not created only by the grant of Royal Charters by His Majesty the King-Emperor, but they are also incorporated under the special statutes of the Legislature as in Canada. If it is found that the rules finally promulgated by the Government are not suitable for the requirement of the daily advancing profession, any member of the legislature shall be at liberty to move a private Bill in accordance with the legislative procedure to achieve the object. We wish the situation may not reach to such an impasse and the year 1932 may prove another lucky one."

Samuel F. Racine, C.P.A., gave the following interview in the *North Pacific Banker* for February:

"The recent trial and conviction of an officer and director of the Puget Sound Savings & Loan Association, is indicative of a rapidly increasing tendency of the public to look more closely into the attitude of directors and trustees towards the companies they represent and should cause many a corporate officer to pause a moment and to reconsider that responsibility that he holds to his shareholders.

"The American public is notorious for its failure to attend corporate meetings and to take a part in the guidance of its companies. This is probably due to the fact that so many

corporate meetings are unquestionably in the control of a few majority stockholders and because the majority stockholders pay no heed to the wishes of the minority.

"The above case is almost paralleled by a case recently decided in England where an English peer, Lord Kylsant, managing the Royal Mail Steam Packet Company, permitted reports to be published which did not disclose all of the facts to the shareholders. It seems that this company during the war years had accumulated quite a large amount of profits but had suppressed these profits so that they were not apparent on any of the reports, and during subsequent years the directors had drawn upon these secret reserves for the purpose of maintaining their dividend rates, with the result that stockholders were never fully informed as to the financial position of the company, and the managing officer of the company was charged with having issued false reports. Mr. Justice Wright in his charges to the jury emphasized the fact that, no doubt, in some cases secret reserves might be proper but that all too often they were used to cover up negligence, irregularities or even bad faith. He stated that the directors sometimes forget that they owe the shareholders full information subject to reasonable commercial necessity. After a trial covering a considerable period Lord Kylsant was convicted for having issued false reports to his stockholders and was sentenced to twelve months imprisonment.

"When we stop to consider how many corporate officers there are who sign reports without having them verified by certified accountants, who sign stock certificates in blank and checks and other documents at any time just because the documents are placed before them by trusted employees, yet who never check up to determine whether the trusted employees really can be trusted, who seldom attend the trustees' meetings or who serve merely as dummy trustees for the benefit of other persons, we wonder how it is that so few corporate officers are brought up before the courts. Certainly, many of them have been negligent and have failed to take at least some of the steps necessary to carry out the reasonable requirements of their trusteeships."

Howard L. Chambers, C.P.A., of South Bend, Indiana, has been appointed one of twenty-three members of the Citizens Advisory Committee for the purpose of determining a basis of cutting expenses of the City of South Bend. Mr. Chambers was made chairman of the sub-committee on Park Department.

Robert Atkins, C.P.A., was the author of an article published in the May 18 issue of *New York University Alumnus* entitled "Quick Administration of Justice Needed."

The National Economic League recently sent an inquiry to its members asking them to record their opinions as to the relative importance of paramount problems of the present economic depression.

This list had been selected by a special committee of the League, composed largely of economists and financial experts. Economy and Efficiency in Government, National, State and City, was declared by the membership to be first in importance, although it had been listed as (9) in the committee vote. Taxation Reduction was determined by the membership to be second in importance, although it had been listed by the committee as (28). Reparations and International Debts, which were listed as first in importance by the special committee was ranked as the third problem by the entire membership and Banking, Credit and Finance, listed by the committee as second in importance was given fourth place in the membership vote. Reduction and Limitation of Armaments or Disarmament was listed by both committee and membership as fifth in importance.

Of the first ten problems listed by the special committee, five of them were listed in the first ten in the membership vote.

Perry M. MacCutcheon, C.P.A., of Charleston, West Virginia, has announced as candidate for nomination to the office of State Auditor in the Republican primaries in West Virginia.

George H. Adams, C.P.A., of Charlotte, North Carolina, is a candidate in the Democratic primaries for the office of State Auditor of the State of North Carolina.

It is noted that in the summer session of Columbia University two addresses each are to be given as a symposium in the law and practice of taxation. The lecture on July 12 will be on "Accounting and the Concept of Income," given by Colonel Robert H. Montgomery.

We have received a copy of the second issue of the *Australian Bankruptcy Trustees Bulletin*. It is expected that this publication will greatly assist in standardizing practices under the Bankruptcy Act and Rules by disseminating matters of interest in connection therewith, being utilized generally as a medium of coöperation by registered trustees. Its leading editorial "visualizes the day when there will be an Australian Bankruptcy Trustees Association with a branch in each State of the commonwealth.

The Institute for Government Research of the Brookings Institution devoted the time from June, 1931, until October in a survey in the organization and administration of State and County Government in Mississippi. This study was made at the instance of the Research Commission of the State of Mississippi, created by the Legislature in 1930.

In the letter of transmittal, W. F. Wiloughby, the director, said, "In preparing this report it has been our purpose to present a long-time program for the improvement of government in Mississippi. Nevertheless we have been extremely conscious of the acute financial problem now confronting the State and threatening to continue for the next two or three years. We have touched upon other aspects of this problem in our report and have made some suggestions relating to sources from which increased revenues may be obtained, but it has not seemed advisable to formulate at this time a definite program to meet the present emergency."

H. P. Seidemann, C.P.A., acted as accountant consultant in the survey.

The report is presented in 142 pages, and if the State of Mississippi follows its suggestions as rapidly as possible, it will arrive at a point where the State's financial condition can be as exactly determined as is that of any business corporation which has a modern organization, both accounting and advisory.

Mayor William A. Anderson, of Minneapolis, recently appointed an Advisory Committee of sixty-one members on the subject of Public Utilities and Their Relationship to City Development. Herman C. J. Peisch, past president of The American Society, was named a member thereof. Later the selection of an Executive Committee was delegated to a committee of six, of which Mr. Peisch was a member. The Executive Committee of seventeen, of which Mr. Peisch is also a member, will direct the study, which in the last analysis is really intended to have as its major job attempting to settle the question as to whether municipal ownership and operation of the Minneapolis Gas Light Company property is wise.

In recent times at informal conferences with State Board members one has frequently heard the statement that candidates for C.P.A. certificates did not appear to be as well prepared as formerly. Evidently the depression, while affording the candidate an extra amount of time for study, has had a tendency to affect his general attitude not only in the field of accountancy but in other professional examinations. The *Law Student*, Brooklyn, N.Y., in its May issue, gives a record of bar examination statistics covering all states in the Union, save one whose statistics were not available, for the 1931, and 1932 thus far reported, examinations indicating that of the total examined by law boards 53.4% failed. In four states there was a perfect record, all passing. In three states the percentage of failures was 75% or better, the highest State recording 84.1/3% of failures.

It is evident that the precaution indicated in the story, recorded in the same issue of the magazine, had not been taken by all of the candidates:

"The professor was delivering the last lecture of the term. He told the students with much emphasis that he expected them to devote all of their time to preparing for the final examination.

"The examination papers are now in the hands of the printer", he concluded, "Now, is there any question you would like answered?"

"Silence prevailed for a moment, then a voice piped up:

"Who is the printer?"

## Depression\*

V. H. HOWIE, C.P.A., Bellingham, Wash.

Its just a condition where our minds have sunk  
That turns life's gold to a lot of junk;  
That makes all friends appear untrue  
And the rose of happiness turn to blue.

The evil thoughts it brings to mind  
And the words we speak, so very unkind;  
The thoughts we think and the things we say  
You'd think depression had come to stay.

For shame on you and for shame on me,  
If we'd open our eyes we would surely see  
That this good old world is still the place  
To live our lives to the end of the race.

The sun still shines and gives us light,  
And the moon comes up to rule the night.  
The flowers bloom and the birds still sing—  
For about depression they care not a thing.

If you're down in the dumps and feeling blue,  
Take a look at the sunset — God's painting  
for you.

Or glance at the water, the hill or the trees  
That God put on earth for you to please.

Just talk to your friends, you'll find them  
still true;

Or speak to your wife—she still loves you.  
And your sons and daughters—what will  
they think

If they see your courage slowly sink?

Come on, perk up, throw out your chin,  
Look the world in the face and give us a grin.  
Depressions have come and depressions have  
gone,

So laugh and fight on with a smile and a song.

For God's in his heaven—be sure of that,  
And is holding the wheel to steer us back  
To the path of joy and song and love  
Till we reach our home with Him above.

\*Thoughts suggested by reading article, "I Am Still Rich," page 258, May issue.

# Review Audits and Examinations of Financial Condition\*

THOMAS A. WILLIAMS, C.P.A., New Orleans, Louisiana

BY properly classifying the services that public accountants are qualified to render, both the accountant and the client have a definite understanding as to the scope of the examination to be made before any work is undertaken, and subsequent readers can intelligently decide how much reliance can be placed upon certified statements according to the use they intend to make of them.

The American Society of Certified Public Accountants at its annual meeting at Memphis, Tenn., on October 6, 1931, approved and endorsed the principle of classification of accountancy services. It is the purpose of this talk to deal with the approved classification of two types of services—(1) Review Audits and (2) Examination of Financial Condition.

A Review Audit, which is usual in financings, has been stated to be "of the type in which the results of the service are for the benefit of a party whose interest lies in having an opinion from the accountant that the net assets at a given date and the net profits for a given period ended on that date are at least as great in amount as represented."

It is not necessary to establish in this type of service the fact that all of the assets which should be on hand are on hand, or that all of the income which should have been received has been received.

In verifying the results of operations reliance is placed more upon tests of the accounts by analytical review, comparison and investigation, than by a detailed verification of the actual transactions.

Examinations of financial condition, is that service whereby one undertakes to reach conclusions and express an opinion concerning the stated financial condition of an enterprise and comprehends verification as of a given date of assets, liabilities and capital, and an analysis of surplus, including as an incident thereto, such examination of the operations

as may be necessary to give credence to the stated financial condition.

The verification procedure is restricted to accounts representing financial condition at a given date, and to the verification of operating transactions which occur at or about the balance-sheet date. The accountant only undertakes to render an opinion as to whether the net assets are as great as the amounts represented.

These types of service must not be confused with what are variously called general, complete or detailed audits, as they do not contemplate the same kind of systematic verification of transactions. They may not be relied upon to disclose any understatement of assets which may have been concealed in the operating accounts, nor any fraud upon the part of the owners or employees, so that the discovery of unrevealed losses may be dependent upon future developments.

Unfortunately, very few people understand that public accountants perform several distinct types of service, and that these types must be differentiated. However, it is dangerous for one who does not comprehend the method of presentation to draw conclusions therefrom, and the uninformed lay reader should no more attempt this than he should try to interpret a legal document or a medical text without skilled professional advice.

Public accountants do not pretend that restricted types of examinations are a completely satisfactory procedure, and in many cases would rather have bankers and others extending credit demand a more complete audit. The chief virtues of these types of examinations are economy of cost and the saving of effort which makes it possible to deliver a certified financial statement with the maximum of promptness from the given date.

Before placing his trust in a financial statement the reader must satisfy himself of the standing of the firm of certified public accountants and the qualifications of its members as to education and experience. It is highly desirable that the firm members have a reputation for exercising technical skill,

\*Talk over radio station WWL, New Orleans, La., May 9, 1932, under auspices of The American Society of Certified Public Accountants, courtesy Loyola University.

vigilance and discretion to a reasonable degree compatible with their professional responsibilities.

While a financial statement is a presentation of facts in that it reflects at a given date the existing assets and liabilities of a business and their value, yet in another sense it is an opinion in that the judgment of the one preparing it is necessary to determine (1) whether all the essential facts are shown and correctly stated (2) the basis upon which values shown are predicated. The opinion reflected in the financial statement therefore is dependable only to the extent that the integrity and competency of the individual who prepared it is proven.

In a recent case the New York Circuit Court of Appeals decided that a public accountant's liability for negligence is bounded by the contract between himself and his client. This but emphasizes that third persons using an audit report or certified financial statement should make certain of the professional standing of the practitioner whose certificate is appended. The fact that the name of an individual accountant or member of a firm of public accountants appears upon the roster of the State Society or that of The American Society of Certified Public Accountants, can generally be depended upon as an assurance of probity and competence.

The lay reader of a certified balance sheet should remember that he has responsibilities as well as the certified public accountant who prepared the statement, and that it is incumbent upon him to give full consideration to the accountant's representations and the qualifications in the certificate.

Take the question of reflecting asset values for instance, which should be those attributable to a going concern. It is not unusual to find disagreement between reputable accountants as to the basis to be used and to find three or four bases used in the same statement. The lay reader should carefully scrutinize the statements, certificate and auditor's qualifications so as to ascertain whether the fixed or capital assets are carried at depreciated cost, or at appraised values; whether the inventory is at the lower of cost or market or at retail prices; whether securities or other investments are carried at their cost or the market values. The improper valuing of some assets at market prices instead of cost may write into the surplus account unrealized

profit that may evaporate should it be later necessary for the credulous lender to turn the assets into cash. Cash dividends paid out of such unrealized profits would also endanger an investment in or a loan to the business.

The inventory item on a financial statement is often a substantial portion of the liquid assets and for that reason it is significantly important to the investor or lender. The present practice is so unsettled as to the public accountant's responsibility in verifying, identifying and valuing this item that the layman should make diligent inquiry as to the procedure used. It is often only possible for the accountant to test the existence, ownership and method of taking the inventory, especially when his examination is conducted after the lapse of considerable time since the inventory was taken. It has been said that the experience and practice of accountancy does not embrace a direct dealing with nor an intimate knowledge of the physical items which may be made the subject matter of the records verified and that the certificate of an industrial engineer qualified in the particular industry should be had in addition to that of the accountant.

The accountant's description of and comments upon the accounts receivable items should also be closely read so that information may be obtained as to their validity, age and source. Hypothecation is often indicative of a heavy drain on the earnings due to heavy interest charges for borrowed money.

It must be understood that it is impossible for the public accountant to determine ownership of every asset as a result of his personal verification as he must, to a great extent, rely upon confirmation of his inquiries. Also in fact valuation in restricted audits he has to rely upon a method of admitted limitations, that of test verification. The test method saves time and if followed with judgment, initiative and discretion, it is practicable and reasonably effective. The public accountant using this method must have faith in the integrity of the management and personnel and must therefore presuppose that the accounts to be examined present a *prima facie* statement of facts; that there is a good system of accounts in use and adaptable to the needs of the particular business; that some form of internal control is in effect. As this is the only practical way of conducting a restricted audit engagement, the public accountant must neces-

sarily be a skillful and trained investigator.

The financial statement should be properly supported by appropriate schedules and necessary explanatory remarks. Besides the verification, analysis of and presentation of financial transactions, the public accountant's function is to intelligently interpret the results so as to make their significance reasonably plain to the untrained reader.

Readers of certified statements of financial condition, it must be admitted, would be better informed if these statements were all drawn up in accordance with an established custom and usage. While accountancy is not an exact science and the public practitioner should be allowed sufficient latitude and initiative to express his individual powers of interpretative analysis and to give reasonable play to constructive imagination, yet there is a growing need for more standardization in the preparation and presentment of financial statements.

While, because of the formative stage of the profession in this country, much remains to be done yet some progress has been made. The committee of The American Society of Certified Public Accountants has done splendid work in preparing and recommending a plan for standard classification and certification of accountancy services, which plan has in part received the official sanction of The Society. Various trade associations within specific industries have recognized the need for standard classification of statements, as to form and accounts, notable examples being the National Association of Ice Manufacturers, the National Wholesale Druggist Association, the Controllers' Congress of the National Retail Dry Goods Association and many others.

Business has as a whole also recognized this need. Gerard Swope, president of the General Electric Co., has incorporated into his announced plan for the regulation and conduct of American business an essential requirement that all but closed corporations publish quarterly and annually, balance sheets and statements of profit and loss, both patterned after uniform models and based on uniform classification of accounts. It is hoped that this will aid stockholders in understanding financial condition and operating results.

The accountancy profession should strive to perfect standardization as to (1) forms and classification of statements, (2) content and

terminology, (3) valuation, (4) audit and verification.

It is highly important to the accountancy profession that it continue to build up for itself a technical terminology so that the meaning of the terms used will be clear to everyone. A science without such a terminology is in the unfortunate position of not being able to communicate technical information among even its own practitioners with any reasonable degree of certainty that it will be distinctly understood.

Business is a science. The members of the accounting profession are continually striving to perfect themselves in the principles of that science, which are the objects of their study. All their technical training and experience is directed to this distinct field of investigation.

Business today is halting and stumbling in a maze of uncertainty. There is too much guessing as to the causes of the industrial breakdown. The business man and the investing public need the experienced counsel and training of the certified public accountant as never before.

In the complexity and magnitude of modern business transactions it stands to reason that distinct methods must be followed in public accountancy practice to meet different conditions, and that on occasion there must be taken into consideration the judgment of those charged with the responsibility of managing an enterprise, especially as to the need for economy of time and money.

In conducting these restricted examinations the competent public accountant uses analytical classification in his form of presentation, and also interpretative comment, to convey to you, who use his certificate or report, his opinion of what the true condition is, which is as much as human fallibility will permit. But, he has in mind, and you must also, the purpose of his examination—to meet the distinct existing business need.

Therefore, in closing, I warn you, if you are not adept in the science of business and accounting, do not depend upon your own understanding of what you read in certified statements to form your judgment and decide your course of action in business ventures. Call to your aid and counsel the certified public accountant who prepared the statement, or some other properly fitted by training and ability.

## ANNOUNCEMENTS

Smyth & Perkins, Certified Public Accountants, announce the dissolution of their partnership as of May 1, 1932.

James F. Smyth, C.P.A., will continue in individual practice at Crocker First National Bank Building, 1 Montgomery Street, San Francisco, California.

Ross L. Perkins, C.P.A., will continue in individual practice at 111 Sutter Street, San Francisco, California.

Haskins & Sells announce the removal of their Newark office from the Federal Trust Building to the National Newark Building, Newark, New Jersey.

Samuel Lippman, C.P.A., announces the removal of his offices to 8 West 40th Street, Suite 911-12, New York City.

C. J. O'Donoghue, C.P.A., announces the removal of his office to Stone & Webster Building, 90 Broad Street, New York City.

Haskins & Sells announce the removal of their San Francisco office from the Crocker Building to the Alexander Building, San Francisco, California.

Austin L. Beaujon, C.P.A., announces the removal of his offices to 205 East 42nd Street, New York City.

Acker, Bacas & McGirl announce the removal of their offices to 205 East 42nd Street, New York City.

Byrnes & Baker, Certified Public Accountants, announce the removal of their office to the eighteenth floor of 19 Rector Street, New York City.

Edward W. Smith, C.P.A., and James A. Harden, C.P.A., announce the formation of a partnership for the general practice of accounting under the firm name of Andrews, Harden & Company, with offices in the Jackson Building, Birmingham, Alabama.

Griffith & Company, Certified Public Accountants, have recently moved their offices to the Girard Trust Company Building, Philadelphia, Pa.

Z. E. Matthews, C.P.A., announces the opening of an office for the practice of accountancy at 334 Boush Street, Norfolk, Va.

H. M. Webster & Company, Certified Public Accountants, and Webster, Atz & Co., Inc., Management Engineers, announce the establishment of an office at 744 Old Aetna Life Building, 650 Main Street, Hartford, Connecticut, under the management of Mr. Raymond B. Johnson.

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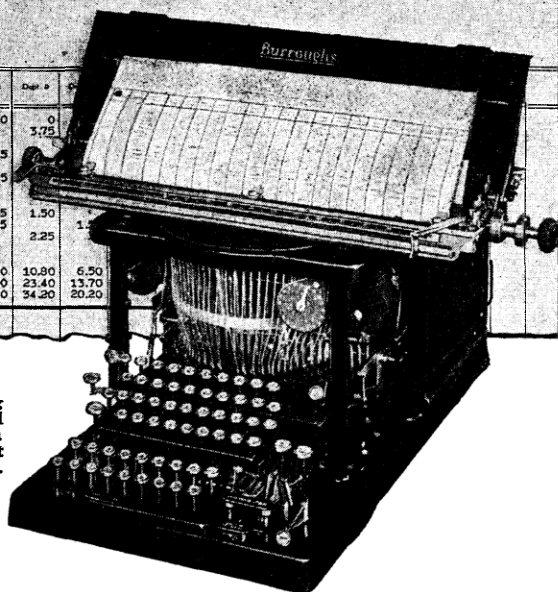
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566	11.25cr	3.25	1.25	4.60	2.50			1.75			3.75	
567	23.50cr					2.20			1.75			
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