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## Cuba's financial situation [News items]

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## Cuba's Financial Situation

By C. M. CLARK, Acting Manager, Havana Office

GENERAL post-war conditions augmented by the reaction from an unbridled speculation in sugar and an almost total prostration of the Port of Havana have brought upon Cuba its financial crisis. Delayed by the moratorium but not averted, the latest development has been the closing of the doors of what had been Cuba's most important banking institution. Much greater panic would, doubtless, have resulted had it not been for the American and Canadian banks with the reserves of their parent organizations behind them.

Dating as far back as the year 1918, the Port of Havana has been subjected to serious strikes interfering with the delivery of goods. During the closing months of the war, it became extremely difficult for merchants in Havana to obtain any goods. Orders were not being filled and those goods which did arrive were so involved in the dock congestion as to be almost unobtainable. One of the customs regulations of the Port refused the clearance of a shipment except in total. If part of a shipment were missing, nothing could be cleared. Strenuous objection to this practice did finally bring about the establishment of the "quedan," which is a deposit or guarantee covering all possible charges against the missing portion of the shipment. Even this to-day is applicable only to certain classes of merchandise.

Havana merchants placed large orders in the hope that some of the goods would get through. In some instances goods were ordered shipped to Matanzas to be brought to Havana by truck. Price meant little so long as the goods were to be had.

Then there came the time when the overstocking of merchandise, particularly in the United States, was realized, and

Cuban orders, shipment of which the merchants little expected, were filled promptly.

In the summer of 1920, the Port of Havana was completely paralyzed with ship after ship lying at anchor waiting to discharge its cargo. What little work the dock laborers did was handicapped by customs regulations. Goods were transferred to wharves and lighters until such capacity was exhausted. Any breakage in shipments in the transfer meant refusal of clearance.

Millions of dollars' worth of goods were thus piled up in the Havana congestion when the storm began to break in the fall of 1920. Merchants who had obtained letters of credit at banks became powerless to take up their shipping documents and banks found themselves with shipments to be disposed of. Sight drafts with shipping documents attached were not accepted and accumulated in large numbers awaiting advice from shippers.

A campaign started by the Rotary Club of Havana when its members donned overalls and went to the docks to work was finally successful in centering opinion upon the dock congestion. A commission was sent from the United States to assist. A new régime was established and merchants were told that they must remove their goods immediately upon notice. An old abandoned cemetery and other vacant properties were obtained and enclosed, and non-perishable goods uncalled for by consignees were deposited there and stored under tarpaulins or such other protection as could be erected.

The docks were cleared but the credit situation will take many months to work itself out. Vast quantities of merchandise are now on hand in Cuba bought at tremendously high prices and surcharged with

excessive handling costs. Necessarily much of this must be sold in a market where falling prices appear to be the prospect. Rice importers and dry-goods merchants have extremely aggravated situations to deal with.

That part of the banking business which centers upon the commodity credit has been severely strained. The financial outlook of the merchants themselves is not a favorable one. They have maintained their high prices, believing that a refusal to import new goods would compel the people to buy those on hand at old prices. The anticipated sales have not been made and the merchants are facing the prospect of competition with goods purchased in the readjusted markets of the rest of the world. In some cases they are now turning to their creditors in the United States and Europe to share their losses with them by a cancellation of part of their debts, explaining that more will be received in that way than if the Cuban house is forced to suspend payment of liabilities, which is a Cuban procedure in insolvency.

Another factor having its effect upon the merchandise credit, although only to a limited extent, is the Cuban insurance company. Not required by law to maintain reserves to cover liabilities to policyholders, any such action has been voluntary. Rumors are therefore easy of circulation and only a complete investigation of some of the companies attacked could establish their solvency. Perhaps the present situation will cause the enactment of adequate insurance laws and provide for their enforcement. At present most of the marine and fire risks are carried by foreign companies.

With all the difficulties of trading, the uncertain value of merchandise credits, and the question of shipping documents as security, the failure of the Banco Nacional de Cuba might not have occurred had it not been for the wild speculation in sugar.

There are those who pay to the former president of the Banco Nacional the honor of saying that had he not been absent because of critical illness in his family he could have held the situation in check.

Normally selling at from  $3\frac{1}{4}$  to 4 cents per pound, sugar was forced up until the price of  $23\frac{1}{2}$  cents was reached in June, 1920. Belief was common among some that the price would go to 30 cents or higher. Vast loans were obtained from the banks for purchase of sugar properties and the growing of cane, for the purchase and development of mills, for the financing of expenditures incident to delivery and sale of sugar. In addition to the loans for development, there was the speculation in sugar itself.

In recalling this sugar bubble that grew and burst, one must remember that the instincts of chance are much more general among the Latin-Americans and whetted just a little bit more keenly than the present day Anglo-Saxon community contemplates. Like some other governments Cuba conducts every ten days a national lottery and every Cuban has his expectation that he is going to win one of the big prizes on some chance he takes. Cuba also permits the operation of a public roulette wheel.

The bankers had an exceptional opportunity while it lasted. Interest rates mounted higher and higher. Time loans up into the millions were negotiated at 13 per cent. compounded monthly. As the price of sugar advanced, loans were increased accordingly. Lacking laws regulating reserve funds, stockholders' liability, or even stockholders' contribution of cash, there was a great temptation for banks to take long chances and to make big loans where interest returns were large.

But the price of sugar, reaching its crest in June, 1920, began to fall. The high initial price and the effect of the rate of foreign exchange produced a fabulous price for sugar in Europe and that market be-

came practically closed. Banks with sugar hypothecations called upon their borrowers to cover wherever possible. Where nothing else could be obtained, the banks had to be satisfied with the pledge of future crops contained in their contracts of hypothecation. The price continued to fall and has now reached  $4\frac{1}{8}$  cents.

The crash with the banks came on October 8, 1920, when a large check was presented to the Banco Internacional, which acknowledged its inability to pay and suspended payment. The following morning there were runs on the Banco Español de la Isla de Cuba and the Banco Nacional de Cuba. The short business day of Saturday was in the favor of the banks, and on Sunday, October 10, President Menocal declared a moratorium under which the banks need pay immediately only 10 per cent. of their liability to depositors.

For a day or two some banks did not observe the moratorium. Then an agreement was worked out by the banks to stand together and not allow the withdrawal of funds beyond the ten per cent. limit. Deposits made after the moratorium were subject to withdrawal in full at any time.

El Banco Internacional and El Banco Español de la Isla de Cuba came forward with offers to their depositors of managers' certificates or bonds covering the amounts of their deposits. Some depositors, believing that they would obtain more by accepting the certificates and allowing the banks to continue, did so. The success of such a scheme will depend upon a sufficient number of depositors accepting the certificates to relieve the immediate embarrassment of the situation, and then the obtaining of sufficient new deposits and new business to relieve the top-heavy capital condition created by the interest-bearing certificates.

A proposal strongly urged by many was that the Banco Nacional be authorized to

issue paper money and thus supply the currency necessary for the liquidation of the moratorium liabilities. Another plan was for the establishment of a clearing house with power to issue certificates which should pass as currency. It was with great difficulty that the issue of fiat money was avoided. Even now it is constantly suggested.

Just before the expiration of the moratorium, a law was passed known as the Torriente Law, providing for the liquidation of moratorium debts. Taking effect January 27, 1921, it provided that commercial debts should be paid 15 per cent. within 15 days, 25 per cent. within 45 days, 25 per cent. within 75 days, and the remainder, or 35 per cent., within 105 days. Bank balances as of the date of the moratorium were subject to withdrawal 15 per cent. in 15 days, 15 per cent. in 45 days, 20 per cent. in 75 days, 25 per cent. in 105 days, and 25 per cent. in 135 days.

The hope behind the Torriente Law was that the sales of the current crop of sugar would produce funds for the gradual liquidation of the moratorium obligations. A disquieting feature, however, was the presence in Cuba of large amounts of the previous crop still on hand. General estimates were made that the whole current crop would have to be sold at from five to six cents to provide any possibility of liquidation. Subsequent estimates have set the figure necessary to clear the situation as low as  $4\frac{1}{4}$  cents.

*(To be concluded)*

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We note with pleasure that Mr. E. A. Kracke, Manager of the Chicago Office, has recently obtained the C. P. A. certificate of Illinois; also that Mr. T. U. Conner, of the Atlanta Office, has obtained the C. P. A. certificate of the State of New York.

tions with high salaried legal departments which do not commit such blunders. The woods are full of them, however, who pay little attention to corporate matters and it is up to the public accountant to bring their ignorance and carelessness to light.

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### Cuba's Financial Situation—(Concluded)

By C. M. CLARK, Acting Manager, Havana Office

A SUGAR BOARD was created to maintain the price of sugar and control sales. The most powerful means which the Board could have had to control the situation, it did not possess, namely, the ability to finance the mills and the crop. The price has been maintained to a certain extent but sales have been limited. Considerable activity was evidenced during the latter part of April in transferring sugar to the United States in order to have it landed there before the Fordney tariff provisions should become effective, but such transfers were not necessarily sales.

Little difficulty was experienced by the banks in February. The Torriente Law required only a payment of 15 per cent. of moratorium balances and 10 per cent. had already been paid. The middle of March was passed without trouble although the pinch for money was beginning to be felt. The planters needed money, the mills needed money, in fact throughout the interior of the island it was difficult, almost impossible, to get money.

On behalf of the Banco Nacional, a commission was sent to the United States to secure the necessary funds for the middle of April moratorium payment. On April 9 the bank announced its inability to secure the necessary funds and did not open its doors for business.

Acting in good faith with the post moratorium depositors, the bank issued to them drafts on the Royal Bank of Canada for their balances. Its affairs were then turned over to a liquidating commission.

Directly following the closing of the Banco Nacional vehement attacks were made upon the American and Canadian banks, particularly upon the Royal Bank of Canada. The consequent run upon that bank was met only by telegraphic instructions to remain open until midnight if necessary to pay depositors. Rumor that the foreign banks would not stand behind their Cuban branches was thus successfully met.

During the week of April 11, a loan, said to be \$20,000,000, was obtained by a combination of financial interests, and a corporation was formed to finance the mills and the sugar crop. This organization has been credited with the ability to raise whatever funds are necessary for its purposes. It is backed by the interests of the Guaranty Trust Company of New York, the Royal Bank of Canada, and The National City Bank of New York.

The situation as this article is written has eased considerably but the next strain will probably occur as the date for the middle of May moratorium payment approaches. The political situation has been cleared by the recognition by the United States of Dr. Alfredo Zayas as the duly elected President of Cuba to take office on May 20, 1921, and by the withdrawal of General José Miguel Gomez from the political field.

There is a great deal of hoarding of money. Importation and sale of small family safes is extensive. A practice which dates back to the time when merchants throughout the island had more confidence

in the people who sold them merchandise than in the banks shows evidence of being revived. Deposits with the merchants of Havana are being made by their customers, to be disposed of in accordance with instructions. Such deposits, however, cannot bear interest or else the Havana merchant would subject himself to the banker's tax. How long these practices will continue, and whether there will be the burglaries that usually ensue, only time will tell.

For a clear understanding of the effect upon the Island of Cuba of the closing of the Banco Nacional, it must be mentioned that this bank with its principal office in Havana, maintained 135 branches throughout the island. El Banco Español de la Isla de Cuba with its principal office in Havana also operates many branches.

Confidence between the American and Canadian banks on the one hand and the people of Cuba on the other is a little too far strained to permit a ready solution of the problem by American financing. The newspapers of Cuba have little understood that a policy of conservatism on their part would do much to help the situation. They have made bitter attacks upon the banks with no regard for the effect of such articles in destroying confidence. The foreign banks are a little hesitant about taking deposits that will be withdrawn at the next rumor. And their loans are greatly hampered by the Cuban custom which is to loan largely on name and persuasion.

Financial statements are not usually offered, but will be supplied from the books when requested. Such statements are not to be questioned without apparent insult to the client. They must be assumed to be correct because the Cuban law places certain restrictions upon the keeping of books. To doubt the correctness of accounts is to question the integrity of the organization and the honesty of the book-

keeper, according to the Cuban attitude. That the bookkeeper may have unintentionally made some mistakes or that he may not have thoroughly understood the accounting principles necessary to record in a proper way some transactions, is given no consideration.

One of the outstanding examples of credit is revealed in the announcement in the newspapers of the meeting of the creditors of one individual who owes \$28,000,000, and whose pyramid of debt was built for the purchase of property at highly inflated values with no margin of safety. Liquidation of such liabilities, if possible at all, cannot be accomplished for years. While the assets include two sugar centrals, a refinery, some land, securities and contracts, it is difficult to see how these can keep up the interest on such heavy loans and make any substantial reduction of principal.

The situation now is one of anxious hope. The mills are grinding and there is evidence of activity which ought to produce some value for purposes of liquidation. Rumors constantly come to Havana that certain large mills have closed for want of funds. But as yet these remain unconfirmed. The end of the grinding season will, without doubt, find many heavy credits not liquidated. A system of American warehouses has been established and is being extended to take care of some of the sugar that is not sold.

Cuba may reach a situation this summer or fall where it will have to face large credits unliquidated by the present crop and with little prospect of further extensive liquidation until the grinding season of 1922. This is not necessarily pessimistic prophecy. It is an eventuality to be considered as a part of the financial outlook.

There is little doubt but that many in Cuba have learned from bitter experience that certainty should be the foundation of banking and finance in so far as certainty

is possible. And where estimates of the future must be made, such estimate should be based upon known facts as to present conditions, and as to the results of past efforts.

For some the lesson will not have been sufficiently plain and the old "rule of thumb" methods will continue. That persons will be able to build credits into the

millions of dollars without presenting certified statements, however, is hardly to be looked for again. Such credits will be established not upon one's estimate of what he has, nor upon a certification of what his books say, but upon impartial competent opinion expressed after careful investigation, and substantiated by figures verified and presented.

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### Analyzing Cost of Manufacture and Cost of Goods Sold

THE following article is from a contributor who prefers to remain anonymous. Modesty or a desire to dodge responsibility are the motives which usually prompt an author to hide behind the cloak of anonymity. In the present case we are sure it is modesty. The essay bears too well the ear-marks of an accountant who has suffered. It sounds the plaintive note of one who has been the victim of working papers found wanting in the day of judgment. It suggests not only more careful attention to the matter in practice but some hard study on the part of every accountant who doesn't know the "cost of goods sold" section of the income statement forwards, backwards, and up-side-down.

"One of the requirements of engagements involving the preparation of federal tax returns for manufacturing companies is an analysis of cost of goods sold to show materials purchased or consumed, labor, manufacturing expense—in reasonable detail, and inventories at the beginning and end.

"Judging from the incompleteness of the working papers, the importance of this analysis is underestimated by many accountants while others become confused in their efforts to obtain the desired information.

"It is not uncommon for accountants to report that this information cannot be

obtained because costs are kept by units or classes of production. In other instances where the books show estimated costs, sub-divided as between material, labor and expense, these estimated figures are reported. And we have known accountants to sub-divide the total cost of goods sold into the three elements on a percentage basis ascertained from cost reports. Some accountants who are not familiar with the tax forms, have reported that cost of goods sold could not be analyzed to show material, labor and expense, because these elements could not be segregated in the inventories at the beginning and end.

"An audit of a manufacturing company which does not embrace an examination of cost of manufacture, and cost of goods sold, whether required for tax purposes or not, overlooks what is usually one of the most important, if not the most important, items in an audit.

"It is obviously inconsistent to analyze selling and administrative expenses in great detail but to neglect to analyze much larger expenditures representing the cost of manufacture and cost of goods sold.

"The government's purpose in requiring the information called for by the tax returns is to ascertain whether the charges to cost of manufacture and cost of goods sold, are proper from a tax standpoint. It should hardly be necessary to say that