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Adjustment of inventories

William G. LaRue

sidered partly a charge to fixed overhead and partly a charge to the fluctuating overhead. In disposing of machine depreciation on this basis, the useful life of the machine is deemed to be the total machine hours of operation, or the total units of production possible before lack of machine efficiency would require replacement. A machine rate would be composed of three factors, namely, power, repairs and maintenance, and depreciation, of which the depreciation rate would be a constant, but the amount of depreciation charged to costs would fluctuate with production. An additional amount of depreciation to protect the industry from the inevitable loss through obsolescence might well be included with the fixed overhead, after making proper charges to loss through idleness. Thus, depreciation is a constant cost, and the plant assets are conservatively valued.

Standards established for a definite period usually are not changed during that period but new standards should recognize all factors of change which have taken place and correct any faulty estimates previously established.

Adjustment of Inventories

By W. G. LaRue, Kansas City Office

PRACTICALLY every accountant has at some time or other encountered technical problems in the execution of engagements. The following has to deal with the determination of a method to be used in adjusting physical inventories of work in process, finished parts and finished goods (priced at values as shown by cost department records) to approximate cost. Preliminary to the discussion of the determination of this method, the following facts are set forth:

The client maintains a most complete and comprehensive cost accounting system. The factory burden, which includes interest on investment as one of the elements, is based on predetermined departmental machine hour rates. The overhead absorbed in production costs, based on the predetermined rate, has, over a period of years, been in excess of the actual amount of overhead.

The cost records and the general books are reconciled monthly by crediting the difference between the amount of overhead absorbed in production cost, based on the predetermined rate, and the actual amount of overhead to an account known as current variation or factory profit, which, in turn, is credited to profit and loss. The differential, represented by total of the interest and of the current variation or factory profit, is not applied in the cost records as a reduction of the total cost of the various articles of finished parts and finished goods, owing to their being too numerous and varied in character.

If all the finished parts and finished goods produced were sold, it would not be necessary to make any adjustment as the interest on investment and factory profit would then be entirely earned.

In order to eliminate the factory profit and interest, included as an element of cost, from the inventory valuations, the following method was adopted.

The ratio of the total cost of finished parts and of finished product sold, to the average inventory of work in process, finished parts, and finished goods, was determined. This ratio, when applied to the total of the amount of interest, included in cost, and of factory profit, results in the ascertainment of the amount by which the closing inventory should be reduced, in order to eliminate the interest and over-absorbed burden included therein. A practical illustration of the determination and application of the method as above outlined follows:

Inventory at beginning:		
Work in process	$55,000.00	
Finished parts	65,000.00	
Finished goods	70,000.00	$190,000.00
Cost of manufacture:		
Finished parts	$680,000.00	
Finished goods	830,000.00	1,510,000.00
Total		$1,700,000.00
Inventory at end:		
Work in process	$50,000.00	
Finished parts	70,000.00	
Finished goods	80,000.00	200,000.00
Cost of finished parts and of finished product sold		$1,500,000.00
Average inventory		$195,000.00
Ratio of cost of finished parts and of finished product sold to average inventory		13%
Credits to profit and loss:		
Interest on investment	$42,500.00	
Factory profit	17,500.00	
Total		$60,000.00
Interest on investment and factory profit included in inventories, 13% of $60,000.00, or		$7,800.00

	Per Books	Adjustment	Adjusted
Adjustment of inventories:			
Work in process	$50,000.00	$1,950.00	$48,050.00
Finished parts	70,000.00	2,730.00	67,270.00
Finished goods	80,000.00	3,120.00	76,880.00
Total	$200,000.00	$7,800.00	$192,200.00

The method as outlined has been followed for a number of years, with the ratio of adjustment remaining practically constant, proving to some extent that the method as outlined may be considered theoretically sound.

Book Reviews

SLOAN, LAURENCE C., Managing Editor, Standard Statistics Company. *Corporation Profits.* (Harper & Brothers, New York, 1929. 365 p. Price $3.50).

This reviewer confesses to having tucked away, for the purpose of future study, and never to have studied them, the series of bulletins entitled, "Beneath the Surface of Corporation Profits," upon which Mr. Sloan's book is based. This reviewer confesses also to representing himself as a certified public accountant. In reading Mr. Sloan's book, for the purpose of reviewing it, he pleads guilty to having been annoyed by the premise set forth in chapter 1, paragraph 2, to-wit: "It is about accounting, but is not a book on accounting. It examines the *results* of accounting: takes up the work of the professional accountant where he himself leaves off, seeks to determine the meaning of what his figures report, so far as possible, and seeks likewise to differentiate between meaning and confusion."

Obviously, there must be some misunderstanding with respect to the function of the professional accountant if the presumption exists that his work has been finished when he compiles and presents certain financial statements. Year in and year out, for many years, educators have been preaching the doctrine that the professional accountant must interpret as well as exhibit the results of his work. These exhortations have had their effect, and the facts are that there has been a marked increase in the amount and quality of interpretation introduced into the reports of certified public accountants. However, so far as the public is concerned, this condition is not apparent. In the case of corporations, the public sees only the reports made by officers of the corporation, included in which, usually, are the financial statements supported by the approval of certified public accountants. Whatever there may be of interpretation or comment appears to be that of company officials. Mr. Sloan, perhaps, has based the conclusions stated in his premise on the examination of published reports, and is not aware of the voluminous comments which are included in the confidential reports of the accountants to the corporations.

Now, that we have settled our score with the author, we may turn, with friendly interest, to a consideration of his book, which is, indeed, a contribution of value to accountants as well as to investors, corporation officials, and bankers. The book affords what might be termed a bird's-eye view of financial condition and results of operations of American industries. It