Woman C.P.A.

Volume 16 | Issue 4 Article 3

6-1954

Deferred Charges -- What They Are and How Handled

Julia Kaufman

DEFERRED CHARGES—WHAT THEY ARE AND HOW HANDLED

By JULIA KAUFMAN, Cleveland Chapter ASWA

Defer—To put off, postpone, delay
Charge—To place to one's account

Here we have the definition of the two parts making up the title of one section of the Balance Sheet. In whole then, we can say we postpone or delay charging up certain items. There is no fixed method or rule for the entire group, but perhaps that is what makes this particular section of the Balance Sheet so interesting.

Patents

Patents when obtained by the Inventor include all experimental expense, cost of working models and cost of obtaining the patent, such as attorney fees, drawing and filing costs. Up to this point no problem has presented itself. Suppose, however, there is an infringement suit. The results of the suit determine the worth of the Patent. If the suit is lost, the entire cost of the suit and Patent is charged off to Surplus. This deduction is allowable for Income Tax Purposes even though we make the charge to Surplus rather than an operating account. Why use the Surplus Account instead of a Profit & Loss Account? Most business firms are interested in knowing and showing the results of their regular business operations. In this way the picture is not distorted by an extraneous item. If, on the other hand, the suit is successful the cost of the suit may be included in the Patent Account and charged off over the life of the Patent, which is 17 years.

Patents when purchased present fewer problems. Here the cost can only be the purchase price. If a Patent is purchased after it was first obtained by the Inventor, the cost would then be written off over the remaining life of the Patent.

There are other factors than the 17 year life of a Patent to be considered in deciding upon the period over which a patent is charged off to operating expense accounts.

A fad item is one needing special consideration. It is desirable to write off the Patent during the probable continuance of the fad. In the past, the Internal Revenue Department took the attitude that only 1/17th of the cost of the Patent could be charged off each year until such time as it was a known fact that the patented item had no further use, then the balance of the Patent could be charged off. Recently they have ruled that, if it is known the Patented item will have a life of less than 17 years, the Patent may be written off over the known life of the article in question.

Improvements are always being made and, consequently, many Patents are superceded. This element makes it advisable to write off the Patent in a shorter time than the 17 year life when the new Patent is obtained by someone other than the owner of the superceded Patent. When a new or additional Patent is obtained so closely related to the first one as to extend the basic Patent, by the same person or firm owning the first or basic Patent, the unamortized balance of the original Patent may be carried forward and written off over the life of the new one.

Copyrights

The life of a Copyright is 28 years and can be renewed for another 28 years. It is a rare publication that would have an active market for so long a period. The history of the World War, or a Faction, would be a good illustration. Common practice therefore is to write off the cost of the Copyright against the income from the first edition. A text book on the other hand may have many printings before being revised and a new copyright issued. Bear in mind, therefore, that the nature of the publication would determine whether the cost would be written off over a short period of time or a longer one. The cost of the Copyright itself is nominal, but the author may have many expenses he would take into consideration as Copyright Cost.

Franchises

Franchises are never set up on the books unless there has been direct or indirect payment. The general rule of thumb seems to be that they are perpetual and no provision is to be made for writing off their cost. If, however, they are issued for a definite period of time the cost should be written off during that period. If they are revocable at the option of the governmental body granting them, it would then be ad-

(Continued on page 13)

"The purpose shall be in accordance with the policy and program of the ASWA, to learn about the opportunities in accounting, to cultivate the qualities essential to a good accountant, to have actual experience in observing accountants in practice, and to foster the development of student leadership."

At this organizational meeting, students elect their officers and decide on meeting times, dues, etc. They meet once monthly in the school commercial classrooms, some during, others outside of school hours.

Volunteer speakers from Muskegon Chapter ASWA are called on by the ASWA "sponsor" to develop accounting topics and lead discussions at these monthly meetings. These speakers bring out problems of credit and the male accountant's viewpoint by reading papers prepared by the co-operating local chapters of the National Association of Credit Men and the National Association of Cost Accountants.

To achieve the purpose of having actual experience in observing accountants in practice we have been most fortunate in obtaining the cooperation of the National Association of Cost Accountants. This group currently is supporting, as a project of its educational program, a series of plant visitations by our FAA chapters.

Because of the embryonic stage of FAA, so much room is left to develop that we cannot see the end in sight. FAA has met with such success in our community, that we would like to see other ASWA chapters inaugurate the same project in their cities. The satisfaction and happiness resulting from the association of such receptive minds cannot be measured.

(Continued from page 7)

visable to charge off their cost rapidly.

Leaseholds

Let's look first at the definition of lease. "A contract by which the owner of real estate, without giving up his ownership rights to it, hands it over to another person for a period of time for a designated rent." A leasehold is such a contract or estate for years. If the contract calls for regular periodic payments it is treated just as though no contract were entered into and the monthly or annual expense is recorded as due and disbursed. Many such leasehold contracts, however, call for an advance payment of the entire rental. When advance payments are made covering a number of years the advance payment is computed as the Present Value of the periodical rentals taking into consideration the current interest rate. Theoretically, then, interest must also be considered in writing off the Leasehold Account. The original entry for the year would be:

Rent (for the first year's expense)
Leasehold or Prepaid Rent (for the balance of the contract)
    Cash (for the total amount paid)

Thereafter we would make the following annual entry:

Rent (for the year in question)
    Interest Income
    Leasehold or Prepaid Rent

The amount of Interest Income would gradually decrease and the credit to the Leasehold Account would increase each year. However, recording of implicit interest income is not the customary accounting practice and the usual procedure is to make the rental charge only in the amount of the leasehold credit. Because of the involved calculations, many choose to use the straight line method in accounting for advance rental payments.

Improvements to leased property should be amortized over the life of the lease. Buildings constructed on leased land are handled in the same manner. If the contract calls for a payment by the owner of the land at the expiration of the lease, this amount should be taken into consideration when determining the total to be charged off during the life of the lease.

Trademarks

Usually, trademarks have a relatively small original cost and the method of amortization used is not too important. A service for registration of trademarks is provided by the United States and such registration is accepted as evidence of prior use. A claimant who has not registered his trademark accepts the burden of proof in a legal suit to establish prior use. The certificate of registration is good for twenty years and is renewable.

Organization Cost

This account is charged with all the original items of expense of incorporation such as the promoter's fees and the original franchise. There are two generally accepted procedures for treatment of Organization Cost or Expense. Since these items are of benefit to the entire life of the company rather than just the first year, we cannot charge them off to expense the first year, and therefore must capitalize them or set them up as Deferred Charges. One procedure is to allow this account to remain on the books as a Deferred Charge or a fixed asset for the life of the Corporation, writing it off only upon the dissolution of the Corporation. On the Balance Sheet it can also be shown as a reduction to the Net Worth rather than as an Asset. The Treasury Department has followed this theory

(Continued on page 15)

(Continued from page 13)

in the past. There is some probability that contemplated changes in the Income Tax Law may permit Organization Expense to be written off.

The second accounting procedure is to write this account off over a period of two to five years even though the deduction in valuation is not allowable for tax purposes. This procedure can affect the stockholders to some extent in that Surplus available for dividends is reduced by the charge to the Profit and Loss statements. However, either method appears satisfactory.

A little more determination, a little more pluck, a little more work—that's luck.

* * *

Every minute you are angry you lose sixty seconds of happiness.

* * *

No price is too high to pay for a good reputation.

* * *

Nature gives us talent but it is for man to make it work.

* * *

Moderation is the pleasure of the wise.

CHAPTER PRESIDENTS YEAR 1953-1954

Atlanta—Dorothy E. Gunn
1117 Amsterdam Avenue, N.E., Atlanta, Georgia

Baltimore—Elizabeth S. Rodkey
3307 Benson Avenue, Baltimore 27, Maryland

Buffalo—Sophia E. Friedman
53 Fox Street, Buffalo 12, New York

Chicago—Mrs. Theresa-Jane Lindstrom
4829 West Race Avenue, Chicago 44, Illinois

Cincinnati—Mary E. Burnet, C.P.A.
6019 Oakwood Avenue, Cincinnati 24, Ohio

Cleveland—Mrs. Helen Spoerke
12802 North Road, Cleveland 11, Ohio

Columbus—Mrs. Marie Conard
2792 North Bay Drive, Columbus, Ohio

Dayton—Peggy Root, C.P.A.
315½ Lexington Avenue, Dayton 7, Ohio

Denver—Helen V. Kennard
1165 Krameria Street, Denver 20, Colorado

Des Moines—Helen Stearns
111 51st Street, Des Moines 12, Iowa

Detroit—Jean A. Currey, C.P.A.
Price Waterhouse & Co., 1946 Penobscot Building, Detroit 26, Michigan

District of Columbia—Mary F. Hall
3820 Florence Drive, Alexandria, Virginia

Grand Rapids—Mrs. Lenore G. Breen
411 Scribner Avenue, N. W., Grand Rapids, Michigan

Holland—Irma Hoeland
Duffy Manufacturing Co., 70 River Avenue, Holland, Michigan

Houston—Etta Jane Butler, C.P.A.
P. O. Box 16, Houston 1, Texas

Indianapolis—Mrs. May T. Hazel
920 North Jefferson Avenue, Indianapolis 1, Indiana

Kansas City—Grace M. Berkley
Missouri Abstract & Title Insurance Co., 925 Walnut Street, Kansas City, Missouri

Lansing—Ida M. Smith
Lansing Ice & Fuel Co., 911 Center Street, Lansing, Michigan

Long Beach—Virginia M. Youngquist
3515 Lemon Avenue, Long Beach 7, California

Los Angeles—Mildred M. Swem
1264 Country Club Drive, Burbank, California

Louisville—Mrs. Florence G. Jackman
2915 Arden Road, Louisville 5, Kentucky

Muskegon—Ruth Eckman
1756 Buys Road, Rt. 2, Muskegon, Michigan

New York—Elizabeth Bonney, C.P.A.
317 East 18th Street, New York 3, N. Y.

Oakland—Mrs. Alice B. Davis
5607 Picardy Drive, Oakland, California

Philadelphia—Martha Reese
5802 Catharine Street, Philadelphia 43, Pennsylvania

Pittsburgh—Margaret G. Smith
223 Michigan Street, Pittsburgh 10, Pennsylvania

Portland—Mrs. Marjorie M. Becker
7612 S. E. 32nd Avenue, Portland, Oregon

Richmond—Genevieve Moore
315 North Cleveland Street, Richmond 21, Virginia

Sacramento—Mrs. Queene B. Leithead
1408 P Street, Sacramento, California

Saginaw—Mrs. Shirley B. Schleimer, C.P.A.
Wagar, Lunt & Oehring, 402 Second National Bank Building, Saginaw, Michigan

San Diego—Violet M. Lince
1248 Union Street, San Diego, California

San Francisco—Mrs. Ethel Hayes
396 East Blithedale, Mill Valley, California

Seattle—Genevieve A. Michel, C.P.A.
2329 East Ward Street, Seattle 2, Washington

Spokane—Mrs. Annis E. Snow
Box 1058, Spokane 1, Washington

Syracuse—Edith V. Kenan
340 Midland Avenue, Syracuse 4, New York

Terre Haute—Mabel E. Milam
731 South 7th Street, Terre Haute, Indiana

Toledo—Mrs. Mildred E. Koch
2540 Parkview Avenue, Toledo 6, Ohio