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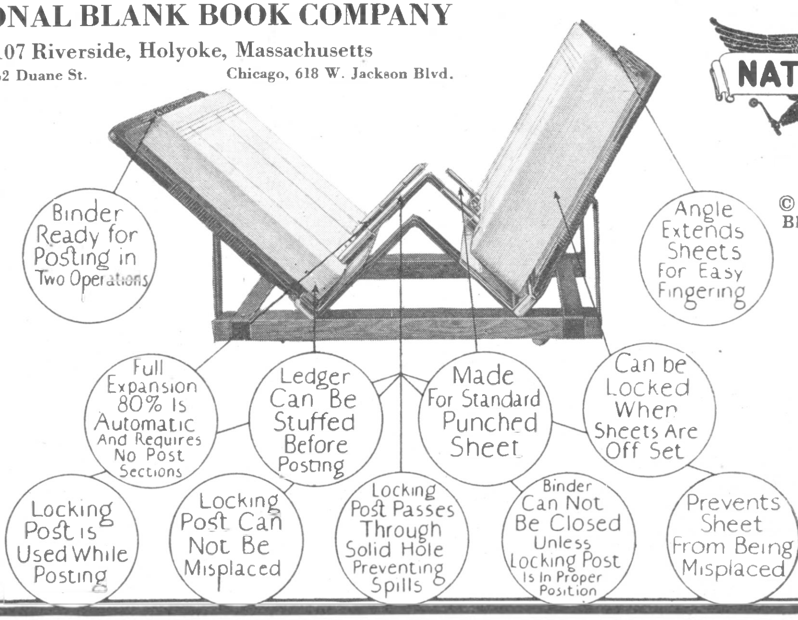

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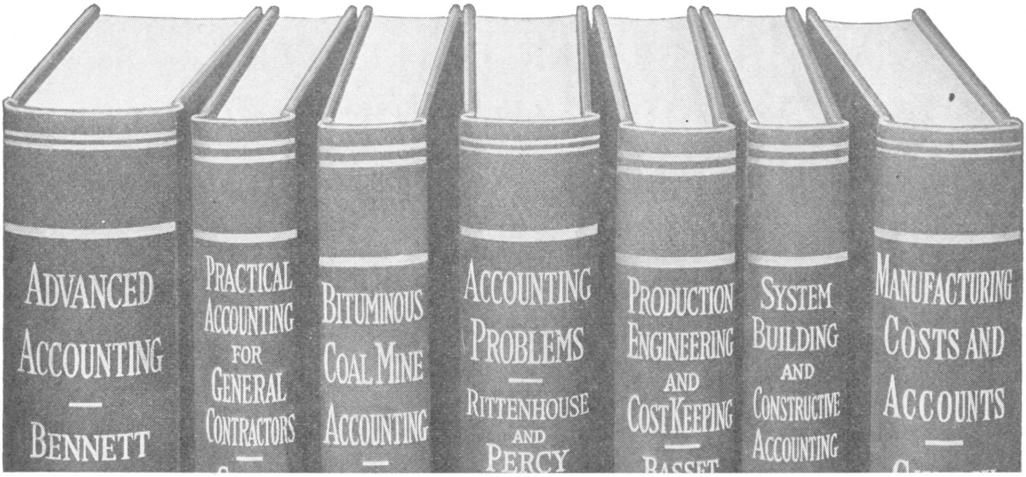

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The JOURNAL *of* ACCOUNTANCY

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Vol. 35 JUNE, 1923 No. 6

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

Examination in Auditing

MAY 16, 1923, 9 A. M. to 12.30 P. M.

Answer all questions.

No. 1 (8 points):

(a) What is meant by a deferred charge to operation? Name three examples, and state how each is proved correct in an audit.

(b) What is the difference between a liquidated and a contingent liability in the accounting sense of the terms? Give an example of each.

No. 2 (8 points):

In what ways may actual examination of insurance policies, life and fire, be useful to the auditor in the course of his work?

No. 3 (10 points):

An auditor verified in 1921 the existence of a mortgage of $10,000 by inspecting the public records. In 1922 he found that $5,000 had been paid on account of this mortgage, evidenced by a receipt from the mortgagee. Thereupon without further action he certified a balance-sheet showing this mortgage indebtedness as $5,000. Was his course correct or not? Explain.

No. 4 (8 points):

How would you audit and verify the notes and bills payable of a corporation?

No. 5 (8 points):

What would you consider a satisfactory voucher for

(a) Pay-roll in a large manufacturing business;
(b) Purchase of a stock-exchange security;
(c) Investment in a mortgage?

No. 6 (8 points):

Describe fully (or illustrate in skeleton form with proper captions if preferred) a working balance-sheet.

No. 7 (8 points):

A died in 1916 leaving certain shares of stock to his widow, B, who in 1922 gave the stock to her son, C, who immediately sold it. In his federal income-tax return C claimed as a loss the difference between the sale price and the market value on the date on which he received the stock from his mother. Was he right or wrong? Why?

No. 8 (8 points):

What federal income-tax returns are required in the case of a partnership? What returns are required when a new partner is admitted during the taxable year?

No. 9 (8 points):

What is a stock dividend? From what sources may it arise? Does the declaration of such a dividend imply that the previous surplus of the corporation has been unreasonably large and not necessary to the business? Explain.

No. 10 (8 points):

In auditing the accounts of a private firm in which there are several partners, to what points should the auditor look in order to be assured that the partners' accounts are correctly stated in the balance-sheet?

No. 11 (10 points):

A partner in a stock-brokerage firm, not active in the management, suspects his firm of conducting a bucket-shop. He secures the following balance-sheet from the firm's books, and he asks your advice. He has previously made an examination of customers' accounts and found all accounts, both long and short, amply margined at 20%. The market has been rising steadily for nearly a year. What would be your advice, and why?

BALANCE-SHEET ITEMS

Cash	$ 400,000.00
Due from customers, long	2,500,000.00
Due from brokers for stock borrowed	25,000.00
Securities on hand	75,000.00
Firm trading accounts, long	450,000.00
Due to customers, short	375,000.00
Due to brokers for stock on loan	150,000.00
Firm trading accounts, short	2,850,000.00
Capital, surplus and profit and loss	75,000.00

No. 12 (8 points):

You have been retained by a manufacturing corporation as a consulting accountant and are requested to advise the officers what steps to take in order to determine the cause of an apparent deficiency in the inventory of factory material and work in process.

What would you suggest?

Examination in Accounting Theory and Practice

PART I.

MAY 16, 1923, 1 P. M. to 6 P. M.

Answer all the following questions.

No. 1 (33 points):

Your firm audits, annually, the books of the Non-Bessemer Iron Mining Company.

The following cost sheet and condensed profit-and-loss statement are the result of your audit:

COST SHEET FOR YEAR 1922
(900,000 tons mined)

	Labor	Supplies and expense	Total	Cost per ton
1. Mining	$ 615,000	$ 164,000	$ 779,000	.866
2. Timbering	108,000	72,000	180,000	.200
3. Underground tramming and hoisting	108,000	900	108,900	.121
4. Pumping	45,000	7,200	52,200	.058
5. Mine captains, foremen and shift bosses	27,000		27,000	.030
6. Crushing and stockpile	54,000	8,100	62,100	.069

	Labor	Supplies and expense	Total	Cost per ton
7. Power, light, heat and water	9,000	198,000	207,000	.230
8. Loading from stockpile ...	18,000	7,200	25,200	.028
9. Superintendence and mine office	36,000	3,600	39,600	.044
10. General maintenance	45,000	162,000	207,000	.230
	$1,065,000	$ 623,000	$1,688,000	1.876
11. Fixed charges and general expense			472,000	.524
12. Total cost			$2,160,000	2.400

CONDENSED PROFIT-AND-LOSS STATEMENT
FOR THE YEAR 1922

Total sales ....800,000 tons @ $4.80..		$3,840,000
Cost of ore sold ....800,000 tons @ 2.40..		1,920,000
Gross profit		$1,920,000
Deduct:		
Cost beyond the mine	$1,280,000	
Royalties	480,000	
Administrative expense	60,000	1,820,000
Net profit ....800,000 tons @ .125..		$ 100,000

From a cursory review of the foregoing, it is apparent that several of the items of cost per ton are unusually high and the net profit per ton is correspondingly low. Therefore it is decided that an investigation shall be made to ascertain the correctness or otherwise of the tonnage mined.

The following information relative to operation is obtained, and you are directed by your principals properly to apportion the costs in accordance therewith; show the true net profit on the ore sold; prepare a revised cost sheet showing costs for both broken and hoisted ores and a revised condensed statement of profit and loss.

The usual mining procedure is breaking away the ore, tramming (loading on cars and hauling to the shaft), hoisting to surface, crushing and loading on stockpile.

The practical miner calls ore "mined" only when it reaches the stockpile. Your investigation discloses the fact that while 900,000 tons reached the stockpile, and this tonnage was the basis for the per-ton cost on the cost sheet, an additional quantity of 125,000 tons was completely mined to the tramming stage. This broken ore, because of its high analysis of iron content, has a better market value than the ordinary ore and will be left as it is until it can be stockpiled by itself. This condition may be considered as analogous to that of goods in process in a manufacturing concern.

Note that the hoisted ore should not be charged for the expense incurred in producing the broken ore.

No. 2 (30 points):

The following is a brief summary of the balance-sheets of three companies at a given date:

	A	B	C
Total assets	$1,500,000	$2,000,000	$3,500,000
Total liabilities	$ 250,000	$ 750,000	$1,100,000
Capital stock (shares of $100 each)	1,000,000	750,000	2,000,000
Surplus	250,000	500,000	400,000
	$1,500,000	$2,000,000	$3,500,000

Each corporation owned part of the capital stock of the others carried on their respective books as follows:

	Capital stock in A	B	C
A owned		15%	15%
Carried at		$ 100,000	$ 300,000
B owned	15%		10%
Carried at	$ 150,000		175,000
C owned	5%	5%	
Carried at	50,000	60,000	

The three companies agreed to consolidate and each to accept its pro rata share in the capital stock of a new corporation (D) having 1,000,000 shares of no par value.

What percentage of the shares of corporation D will the stockholders of A, B and C respectively receive and what will be the total equity or paid-in value of the consolidated capital?

No. 3 (15 points):

The M and N Coal Corporation is formed with a paid-up capital of $6,000,000 (60,000 shares, par value $100) and a resolution is passed authorizing the purchase of the outstanding capital stock of the K O Company.

The balance-sheet of the K O Company, at the date of acquisition is as follows:

Assets	
Current	$1,750,000
Fixed	4,500,000
Deferred	250,000
	$6,500,000

Liabilities

Current	$ 500,000
Funded debt	1,000,000
Capital stock	2,000,000
Surplus	3,000,000
	$6,500,000

Six million dollars was paid for the total capital stock of the K O Company which, after acquisition, was canceled.

Prepare the opening entries, spreading the assets and liabilities of the old company on the books of the new company.

No. 4 (15 points):

You are requested to audit the books of the A Company, engaged in the business of buying second mortgages, at the end of a period of six months and you find the following conditions relative to the mortgages purchased during the period:

Mortgages purchased, all dated July first and set up at face value, classified as follows:

1-year term	$25,000
2-year term	25,000
3-year term	25,000
	$75,000

The costs to the company for these three classes of mortgages were respectively:

1-year term	$22,500
2-year term	21,250
3-year term	20,000
	$63,750

The mortgages are repayable in equal semi-annual instalments.

The discount has been credited direct to profit and loss.

Would you prepare your statement to conform to the books or would you make adjustments? If the latter, indicate their nature and give reasons therefor.

No. 5 (7 points):

Express, briefly, your views on the subject of accounting relative to unpaid cumulative preferred dividends.

Examination in Commercial Law

MAY 17, 1923, 9 A. M. to 12.30 P. M.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

No. 1 (10 points):

In what particulars is the following paper not in the usual form?

Boston, Mass.
I, Thomas H. Green, promise to pay to James Malone or order Two Hundred Dollars. Value received.
(Signed) THOMAS H. GREEN.

No. 2 (10 points):

Andrew J. Morse drew a cheque on the A. B. Bank to the order of Samuel Winter in payment for goods purchased. Winter held the cheque more than three months before presenting it for payment. During that time the A. B. Bank failed. Morse had, however, withdrawn his deposits before the failure. Was Morse released from liability on the cheque?

No. 3 (10 points):

What are personal defenses to a negotiable instrument and in what circumstances may they be invoked? Name some personal defenses.

No. 4 (10 points):

What is (1) a collateral note, (2) a judgment note?

CONTRACTS

Answer two of the following three questions:

No. 5 (10 points):

Jones acted as a broker in the sale of Smith's home, and Smith agreed to pay him a commission of five per cent. The state of New York requires all real-estate brokers to be licensed and to pay a license fee. Jones had no such license. Smith refused to pay Jones his commission, and Jones sued. Could he recover?

No. 6 (10 points):

State what contracts in general may be assigned and what may not.

No. 7 (10 points):

A made a written contract with B to purchase B's dry-goods store, A paying B $2,000 at the time when possession was given and agreeing to pay the balance of $2,500 on or before January 1, 1923. On January 3, 1923, the balance due being unpaid, A secured B's agreement to postpone the payment until April 1, 1923. On March 5, 1923, B sued A for the balance due. Could he recover?

PARTNERSHIP

Answer one of the following two questions:

No. 8 (10 points):

A, B and C are engaged as partners in the lumber business. A dies and bequeaths his entire estate to his son, X. X desires to come into the firm in his father's place. What are X's rights?

No. 9 (10 points):

Martin and McBride were copartners in a certain business. Martin sued McBride for supplies furnished to the latter by the former for the operation of an independent business carried on by McBride, entirely independent of the partnership. Could Martin recover?

CORPORATIONS

Answer two of the following three questions:

No. 10 (10 points):

Explain the principal advantages of doing business as a corporation rather than as a copartnership or as an individual.

No. 11 (10 points):

The X Y Corporation is engaged in the grocery business in the city of Harrisburg, Pennsylvania. Its directors, by a resolution duly adopted, authorized the officers to enter into a copartnership agreement with W, the object being to operate a grocery store in Philadelphia, W to supervise the running of the store and to furnish some capital, the corporation to furnish the balance of the necessary capital and to attend to the buying of all stock. The agreement was adopted. Was it a valid agreement?

No. 12 (10 points):

A corporation which was in financial difficulties determined to cease business. It proceeded to sell certain assets, the proceeds of which were distributed pro rata among the stockholders as a dividend in liquidation. Later, on the petition of the creditors, the corporation was declared bankrupt, and the trustee in bankruptcy brought suit against the stockholders to recover the amounts distributed to them. Were the trustee's suits successful?

FEDERAL INCOME TAX

Answer both the following questions:

No. 13 (10 points):

Define the terms "capital assets" and "capital gain" as defined by the present income-tax law.

No. 14 (10 points):

How is "capital gain", mentioned in the preceding question, taxed under the present income-tax law?

Examination in Accounting Theory and Practice

PART II.

MAY 17, 1923, 1 P. M. to 6 P. M.

Answer questions 1, 2, 3, 4 and either 5 or 6.

No. 1 (35 points):

The X Machine Company received its charter and commenced business on January 2, 1922. The production of machines started July 1, 1922.

The business consists of the manufacture and sale of a standard machine, 200 of which have been sold to date at a uniform price of $500 each, through agents who receive a commission of 15%, payable 1/3 on receipt of order, 1/3 on shipment of goods and 1/3 on payment of bill.

The general manager and the sales manager have individual agreements with the company by which the former is to receive a commission of 10% and the latter a commission of 6% on net profits after provision for federal taxes.

There are issued 100,000 shares no-par-value common stock for "services" but no value is shown on the books of the company nor in the minutes.

Trial balances are given as of January 2, June 30 and December 31, 1922, prior to closing.

Prepare a balance-sheet as at December 31, 1922, and profit-and-loss statement for the year making all necessary adjustments, capitalizing such items of expense as appear to you applicable to development and setting up a reserve for federal taxes computed on the basis of 12½% of net profit with the statutory deduction of $2,000.

TRIAL BALANCES (BEFORE CLOSING)

Debits

	1922		
	Jan. 2	June 30	Dec. 31
Cash	$ 50,000	$ 33,468	$ 22,646
Accounts receivable (trade)			26,500
Prepaid insurance		1,125	1,427
Tools		4,287	6,511
Machinery and equipment		23,411	34,768
Office furniture and fixtures		1,400	1,450
Patents applied for		1,127	1,327
Organization expense		2,371	2,371
Labor			9,675
Purchases			26,506
Administrative and office salaries		2,420	4,650
Rent of factory		1,000	3,000
Agents' commissions		750	15,000
Royalties			1,030
Telephone and telegraph		147	387
Postage		37	86
Light, heat and power		125	580
Insurance		50	350
Automobile expense		147	330
Engineering salaries		1,367	2,850
Magazine advertising		1,500	1,825
Entertainment		119	287
Office stationery and supplies		377	622
Traveling		227	527
Miscellaneous expense		115	388
Returned sales			1,000
Depreciation			2,137
	$ 50,000	$ 75,570	$168,230

Credits

Capital stock preferred	$ 50,000	$ 62,500	$ 86,000
Accounts payable (trade)		12,425	13,145
Notes payable (banks)			7,500
Interest earned		145	365
Discount on purchases			288
Sale of scrap			120
Sales			52,500
Accounts payable, agents		500	6,175
Capital stock, common (100,000 shares)			
Reserve for depreciation			2,137
	$ 50,000	$ 75,570	$168,230

The inventory at December 31, 1922, was valued at $13,290.

No. 2 (30 points):

A and B are equal heirs in an estate of $100,000 consisting entirely of real-estate mortgages.

B resides in the city in which two of these mortgages are placed—one, a 6% first mortgage of $1,600, dated January 31st; the other a second mortgage, payable $25 monthly with interest at 6% on the decreasing balance. The balance of the second mortgage at March 31st, after payment of the $25 then due, was $700. These two mortgages are handled by B. All the rest are in another city in which A resides and are under his control.

One mortgage of $2,500 falls due and will be paid, with six months' interest at 6%, on April 30th, and B proposes that, in part settlement, he take over the two which are in his hands. A agrees to this.

Prepare statements of financial condition at April 30th before collections mentioned above are made, journal and cashbook entries reflecting the transactions and final statements for both A and B, each of whom keeps his books on the same basis.

No. 3 (9 points):

A corporation spends $500,000 on an advertising campaign during the first six months of the year 1922 and expects to begin to secure benefits therefrom on and after July 1, 1922, and for three succeeding years. How would you handle this expenditure on the published balance-sheet and profit-and-loss account issued to stockholders? How would you handle it on the income-tax return for 1922?

No. 4 (8 points):

What would be the effect on unit costs of a change in the calendar providing for a year of thirteen months of twenty-eight days each instead of twelve months as at present?

No. 5 (18 points):

The annual sinking-fund deposit, with interest at 6% per annum, necessary to accumulate $500,000 over a period of 80 years is $286.27. The amount of an annuity of one dollar at 6% at the end of various periods is as follows: 20 years, $36.78559120; 40 years, $154.76196562; 60 years, $533.12818089; 80 years, $1,746.59989137. Show, by means of a table, how a sinking-fund-method reserve for amortization of a franchise, which cost $500,000 and has 80 years to run, would compare with a reserve for the same purpose derived by the straight-line method.

ACTUARIAL

No. 6 (18 points):

(a) What terminable annuity, payable quarterly for ten years, would be required to repay a loan of $32,840.00, the nominal rate of interest being 4 per cent. per annum?

(b) What would be the required amount to set aside annually providing for a sinking fund to repay loan, as above, at the end of ten years instead of repaying it quarterly?

Given $(1.01)^{40} = 1.4889$.

Mechanical Difficulties in Consolidating Accounts

By Maurice E. Peloubet

In one important respect the lawyer has a decided advantage over the accountant. Almost every case of moment in which the lawyer is involved is a matter of public record, classified and ready for reference. There is not much important legal work done which is not, sooner or later, reported and published. The lawyer has, therefore, an opportunity to compare his methods with those of other lawyers, to see whether methods or grounds of argument similar to his own have been successful or otherwise and to save himself and his client unnecessary labor and expense by eliminating redundancies or expanding obscure portions of his presentation of his case; in other words, to benefit by the experience of his fellow lawyers through published reports of their actual methods and proceedings. This intra-professional contact, while not, of course, entirely lacking in the accounting profession, is, however, comparatively restricted. A principal reason for this is probably that the confidential relation with the client will not permit the actual details of any engagement to be published, while there is not, as in the law, any tribunal which enforces publicity of details.

An accounting literature has therefore grown up devoted largely to abstractions—to systems, principles and theories rather than, as in the case of law, to reports, in which the theories and abstractions are illustrated and vitalized by their application to actual parties and concrete facts. Whatever is published on accountancy is classified and indexed according to the very best methods by the American Institute of Accountants and other agencies. However, useful as the material already published is, it seems certain that a vast amount of information as to methods and practices, of the utmost value to the profession at large must be at present immured in the minds and files of practising accountants, waiting to be separated from the irrelevant and confidential detail which surrounds it so that it may be given to the profession at large. A case in point is what might be called the mechanism of the consolidated balance-sheet and income account.

The principles according to which a consolidated balance-sheet should be drawn up have been often enunciated and illustrated by writers of varying degrees of authority and lucidity. Although the ground has not been fully covered and certain controversial points have not been decided, yet there is sufficient information at hand for the practitioner or student to establish a reasonable theoretical basis for consolidating the accounts of several affiliated or controlled companies and to support his basis by citations from recognized authorities. However, if his problem be in any way a large one, he is still in somewhat of a quandary.

If he has attended or taken courses in any accounting school known to the writer or studied the solutions to various problems involving consolidated accounts, he will probably adopt what may, for convenience, be called the horizontal method of preparing his combined balance-sheet and income account—that is, he will set out his trial balances side by side, account titles vertically and company's names horizontally with columns for adjustments, eliminations and totals. It is the writer's belief that this method is, in all but the simplest cases, undesirable and is, in any case where a large number of companies is to be combined or numerous or complex adjustments are to be made, virtually impracticable because of merely mechanical difficulties. In fact, the mechanical difficulties of this method are so great that one of its advocates is constrained to recommend the parent or holding company to take up profits of subsidiaries as earned on the books of the parent or holding company, to facilitate the combination of the accounts. Apart from its doubtful legality, this method would produce greater complications than it avoids. It is interesting, however, as an illustration of the repercussion of defective mechanical methods on the theoretical basis of combined accounts.

Another method, not, so far as the writer is aware, advocated to any great extent by the various writers on the subject, but in some use by accountants, is what might be called the "agglomerative" or "agglutinative" method. By this means each item is extracted from the trial balance of the individual company and transferred to a schedule bearing as a title some balance-sheet or income-account heading such as "plant and equipment" or "income from trade investments." When all the individual trial balances are exhausted the schedules are totaled and after entering the various eliminations and adjustments thereon the totals are combined to form the consolidated accounts. This method is undoubtedly practicable. It works and can be indefinitely extended. To that extent it fulfills the requirements of a good mechanical method.

Let us assume that an accountant, having access to current accounting literature but without practical experience with consolidated accounts of any magnitude, is called upon to prepare the accounts of a parent company owning, say, twenty subsidiaries. His first idea is naturally to prepare the accounts by the method he sees most frequently recommended, the horizontal. To begin with, he has to prepare a statement which must provide for at least twenty-four horizontal columns of figures in addition to room for account names and schedule numbers. Furthermore, he must either make all his entries to one account on one line or must guess how many lines to leave between the accounts for possible adjusting or eliminating entries. Assuming that he guesses correctly, he must then make his adjusting or eliminating entries, which will be most difficult to check, as with twenty companies there could easily be need for a hundred entries, all of which will have been made in one or two vertical columns. Even if identified by letters or ringed numbers, proof of individual entries is difficult and proof in total laborious. When all adjustments and eliminations are finally made the resultant, although it appears in the columns headed "balance-sheet" and "income account," can hardly be said to be more than a variety of combined final trial balance and must be still further condensed and rearranged to form a properly drawn-up balance-sheet and income account.

The foregoing illustrates the weaknesses of the horizontal method when applied to what may be termed ideal conditions. Let us assume conditions that approximate those which occur in actual practice. For instance, our practitioner has received supposedly final trial balances from his field men for all companies, say on the fifteenth of February. By the seventeenth the trial balances are entered on the schedule making up the combined accounts and the eliminating and adjusting entries are drafted and partly posted. On the eighteenth the morning's mail includes:

1. A revised trial balance from Company D, our practitioner's men having discovered a serious error in the inventory basis after sending in the trial balance.

2. A ruling from the treasury department, which makes advisable a reconsideration of certain points of depreciation policy.

3. A telegram from the president of the parent company saying that he has not been able to arrange for the settlement of a certain claim against the corporation but that the company will have to pay damages of about $20,000.00. When the accountant first brought up the matter of this claim the president of the company was confident it could be settled and the accounts were made up on that basis, not to be published, of course, until the settlement had been confirmed.

While going through this interesting if not particularly enlivening correspondence, one of the juniors comes in and points out that in companies H, K and L accrued interest has been calculated on a basis different from that used for the rest of the companies and that companies O and P, foreign branches not audited by our practitioner, in respect of which his certificate is qualified, have not taken up accrued interest at all and appear to have taken their inventory on a basis entirely different from that used by the rest of the constituent companies. He immediately cables companies O and P for the required information and directs that the accrued interest be recalculated for companies H, K and L. Journal entries for items 1, 2 and 3 of the morning's mail are made.

The next thing is to apply all this new and belated information. Our practitioner has not yet gone over the combined trial balances. He was, of course, aware that the various companies did not all call the same things by the same names. He had not, however, realized by how many different names they could call the same thing. His combined schedule stretched horizontally 24 columns and vertically more than one hundred and fifty lines. It measured about a yard square. Every line in the adjustment and elimination column was neatly filled. He looked at the additional entries now to be made and thought of those still to come when his cables were answered. "This scheme is impossible. It won't work," he said after deep and thoughtful consideration. He instructed one of his assistants to prepare a sheet for each balance-sheet and income-account item and told him to extract everything from the trial balances that went under each particular heading. The process was substantially posting a ledger, wherein the captions of the combined accounts took the place of account titles, the trial balance drawn therefrom being the consolidated accounts. The combined balance-sheet and income account for the twenty companies was finally drawn up, but only after a long search for errors when it did not balance as at first taken off. It took a considerable time to make up, as only two men could work at it at one time. The principal did not feel very sure about the correctness of distribution of the trial-balance items under their proper combined balance-sheet and income-account headings and found it a laborious and tedious process to trace back the items from the schedules. One account in particular, called "investments" on the books of the parent company, was in his mind. This account covered Liberty bonds, investments in owned companies, investments in companies where there was not sufficient ownership to warrant consolidation, stock-exchange securities and stock taken for debt in some defunct enterprises to be written off at the date of the balance-sheet.

In order to verify the disposition of this account he had to consult the following schedules:

Trade investments.
Accounts receivable and cash.
Marketable securities.
Eliminations.
Bad debts.

He discovered the stock to be written off had been included in trade investments. If he had not known the peculiarities of this particular account the error would have been undetected. He did not know how many small errors of distribution he had not caught, as it was physically impossible for him to go over all his assistant's work.

As for eliminations—he was sure he had eliminated capital stock and investments correctly because he had the capital stock figures by which to check. He was not so sure of inter-company receivables and payables because he could not check his assistant's analysis of all the accounts receivable. This was finally compromised by eliminating the smaller of any two intercompany accounts which disagreed, as it was too late to get the information required to bring them into agreement.

The balance-sheet was finally signed at the last minute, the practitioner feeling that it was substantially right but far from being a good workmanlike, ship-shape piece of work. He felt there were no very big errors of grouping or elimination but could not say how many small ones there were.

When he came to agree the combined accounts with the books he found it very difficult to distinguish between entries posted to the schedules from trial balances from adjusting entries to be placed on the company's books and from entries made only for the purposes of the combined accounts, with corresponding difficulty in making up journal entries to be placed on the company's books. Transfers between schedules for different distributions from those at first made were particularly annoying as these were not entries at all and necessitated looking through all the schedules to find the corresponding item. The work was done in too much of a hurry to permit elaborate indexing. Building up these accounts is to some extent like the erection of a building, except that it cannot be foretold exactly what shape it will take or how large the different parts of the structure will be. It appears, therefore, that what our practitioner requires is a method which combines flexibility, continuity of structure and visibility of components.

First, flexibility, because it should be equally applicable to a combination of two companies or a hundred.

Second, continuity of structure, for it should be possible to make adjustments to an unlimited extent before and after repeated incomplete or part closings without necessitating any rewriting and without breaking up the continuity of and interrelation of the accounts themselves or of the adjusting entries.

Third, visibility of components, which will make possible simple and effective analysis and synthesis of any combined balance-sheet or income-account item, or, from the point of view of the individual company, the quick and accurate determination of the final resting-place in the combined accounts of any individual trial-balance item.

Fourth, a steady advance towards the final combined accounts, that is, each entry or distribution should be made with a definite relation to the final accounts, its bearing on the final accounts to be evident and the results to be susceptible to sectional proof.

Subsidiary benefits which accompany the foregoing features are:

A number of men may work on the combined accounts at one time.

As soon as the last adjustment is made the final figures are ready as they are in balance up to the last adjustment, having been proved company by company and entry by entry as the work was done and schedules for the combined accounts are, from one point of view, unnecessary or, from another, already prepared, as the columns for the various balance-sheet and income-account headings are complete lists of the items contained in the amounts taken into the combined accounts.

The method offered as combining all the foregoing desirable qualities and doing away with the awkward and impractical features of the other two methods is not original with the writer. It has been brought to its present form through change and experiment covering a number of years and has been applied to accounts both of the utmost simplicity and of very great complexity. It is highly probable that some similar method, in a state of greater or perhaps less refinement and development is already in use in some accountants' offices. However, so far as the writer is aware, there is not, in the literature of accounting available to the practitioner in search of a method of preparing a consolidated balance-sheet and income account for a company controlling or owning a large number of subsidiaries, say from ten to twenty upwards, any detailed description of a practical plan which will completely fulfill his requirements.

The "synopto-synthetic" or "vertical" method, which appears to meet the foregoing requirements, is, briefly, to enter and distribute each trial balance as shown in examples for company A and X and combine them as shown in the example "combined balance-sheet" and "combined income account."

Let us see to what extent this method fulfills the requirements.

In the first place, it is flexible. No difficulty would be experienced in combining a hundred trial balances, as it would simply mean a summary of one hundred lines, or two or three sheets carried forward.

Adjustments are made by entering all the debits and credits of one entry on one line under their appropriate balance-sheet or income-account headings, not accounts. The accounts affected should be indicated in the explanation or on a schedule so that the entry may later be properly made on the books but the first purpose of the adjustment is not to adjust the books but to forward the preparation of the combined accounts and is therefore distributed to its correct balance-sheet or income-account heading. The cause and effect of each adjustment is thus apparent on its face.

As a general, although not invariable, rule, adjustments affecting one company only should be made on that company's accounts, while adjustments affecting several companies, such as elimination of investments in subsidiary companies, elimination of intercompany sales or profits and similar entries can usually be made most conveniently on the summary sheet.

If, however, it is discovered that an adjustment is to be made after the totals of the individual companies' accounts have been carried forward to the summary, no difficulty is caused. An adjustment may be made, of course, indicating the company to which it is applicable, on the summary sheet, whether or not it has been totaled or ruled off. The words "per report" or "per published accounts" indicate that the combined accounts have been completed and approved. At no time before this should the summary be ruled off, although it may be totaled as frequently as need be.

Let us assume that the accounts of our practitioner have been carried to the point indicated by "Totals at 17th February on the combined balance-sheet and income account." By that time he has before him in the combined statements:

A combined balance-sheet and income account complete up to that time.

A summary by companies of the components of each balance-sheet or income-account item.

A summary of each and of all adjusting journal entries affecting the combined accounts.

On the individual companies he has:

The trial balances at beginning and end per books.

The distribution over the balance-sheet and income-account items of each book account.

The adjustments to be made on each company, their cause and effect.

The totals of each balance-sheet or income-account item as carried forward to the combined accounts.

The composition of each balance-sheet or profit-and-loss item carried forward to the combined accounts.

In place of transcribing trial balances to a combined schedule, as is necessary in the horizontal method, or of posting from the trial balances, as is necessary in the agglomerative method, the trial balance is copied once and for all on the composition of accounts for each company and extended under the appropriate balance-sheet and income-account headings. This, it will be observed, can and, in most cases, should be done by the man doing the actual audit work. For example, in our twenty-company combination if there were three teams of two men each for companies A to F, G to L and M, N, Q, R and S, respectively, the accounts would be sent in properly distributed and with the necessary adjustments made thereon as completed by the different teams. Assuming 15th January for a starting date, the accounts would come in, say, in this order:

		1st team	2nd team	3rd team
20th January	Company	A	G	M
25th January	Company	B	H	N
30th January	Company	C	I	Q
4th February	Company	D	J	R
9th February	Company	E	K	S
14th February	Company	F	L	

All this time men in the office would be working on the X company's accounts and as soon as any subsidiary company's accounts came in these could be examined by the principal who could give them sufficient time to satisfy himself of their correctness and the propriety of any adjustments and could direct that they be completed and entered on the combined composition of accounts. As far as the combined balance-sheet is concerned they are completed. Intercompany accounts could be matched up company by company while there was still time to run down differences, summary schedules for a combined report could be partly prepared and notes could be made for final eliminating entries.

From the foregoing it will be seen that under the horizontal and agglomerative methods two or three men only can work at the final combining of the accounts and that only after all trial balances are ready, while with the vertical method as many men as are desired up to two or three per company may be employed on the actual combining of the accounts. In our present suppositious case we have six field men, two men in the office and two men on the X company's accounts, a total of ten men besides the principal working at once on the actual combination of the figures. The distribution of labor and clearness of result are more important than the saving of labor, but even in this respect there is a considerable advantage in the synopto-synthetic as opposed to the horizontal or agglomerative method, in that in the vertical method a trial balance is written once only, whereas under the horizontal it must be copied; and under the vertical method an item is described once, whereas under the agglomerative method the description as well as the amount of the item must be transferred to the balance-sheet or income-account schedule if hopeless confusion is not to result.

The solution of the difficulties caused by our practitioner's belated information is shown in the example of the combined composition of accounts from "Totals as at 17th February" downward.

There is no doubt in the writer's mind as to the practical success of this method for combining any accounts provided the following simple rules are observed:

One line to one entry.

No notes or explanations apart from account titles, schedule numbers and journal-entry explanations to be made on compositions of accounts.

Account affected always to be indicated in journal entries, or if no account affected, as in distribution entries, that should be shown.

All entries on combined composition of accounts must show company's name if an individual company is affected.

Every balance-sheet and income account to have a heading. If there are too many for the number of columns on a sheet of analysis paper, cut off the last column of the first sheet and start backward on the second sheet, for example:

	Headings									
1st Sheet	1	2	3	4	5	6	7	8	9	Cut off

	Headings				
2nd Sheet	14	13	12	11	10

There is no reason to be alarmed by a large number of headings. A certain waste of paper will result, but a great amount of time will be saved. It is the writer's belief that balance-sheets should be as condensed as possible but where this is impossible or undesirable the synopto-synthetic method still offers the best solution, the only difficulty being following one line a long distance.

In a short article the uses and possibilities of the synopto-synthetic method can only be suggested and outlined. It is the writer's belief, however, that there is no situation in combined or consolidated accounts that cannot be dealt with by this method clearly, concisely and with the minimum of labor and complication. The use of the synopto-synthetic method is by no means restricted to consolidated accounts. It can with great advantage be used in place of the "working sheet," "six-column statement," "eight-column statement," etc.—all on the "horizontal" plan—described by many writers, and is principally recommended by the ease and certainty of distribution and adjustment. Its advantages, however, become more apparent with the increased volume, complexity and diffuseness of the accounts to be treated and it is for this reason that consolidated accounts have been selected to illustrate its use.

X (PARENT) CO. COMBINED

BALANCE-SHEET 31 DECEMBER, 1922

	Land	Plant and Equipment	Reserve for Depreciation	Trade Investments	Inventories	Accounts Receivable	Cash & Cash Assets	Capital Stock	7% Mortgage Bonds	Accounts Payable	Income Year 1922	Surplus 31 Dec. 1921	Dividends	Contra
Company A	3000	30500	4320		2820	9735	3170	10000		4780	2625	10000	2500	20000
B	1000	35000	6000		20000	7500	2500	25000		9500	9500	10000		6000
C	500	10000	2000		4000	2500	1000	5000		500	1500	2000		7000
D		10000	2500		1000	1000	500	5000		3750	750	1000		1000
E	1000	11000	3000		7000	4000	4000	10000		1000	2000	2000		9000
F		10000	1500		2000	1000	500	5000		3500	1500	1000		1000
G		12000	2000		8000	5000	4000	15000		1500	3500	4000		3000
H		9000	3000		8000	1000	500	10000		500	1000	2000		2000
I		9000	1500		7000	3500	200	10000		950	1250	2000		4000
J		25000	2500		3000	1000	500	15000		1000	3000	13000	10000	5000
K	1200	32000	4000		1000	3500	300	20000		1800	4200	3000		5000
L		34000	5000		4000	3000	150	25000		2000	5150	4000	5000	5000
M		22000	4000		2000	1000	500	10000		2400	1100	2000		6000
N		10000	3000		1000	500	250	5000		1500	750	500		1000
O		18000	2000		4000	3000	500	15000		500	3000	4000		7000
P		19000	1500		2000	2000	1000	15000		500	2500	2000	2500	5000
Q	2500	48000	7000		3000	1000	500	25000		300	3700	10000		9000
R		22000	1000		1000	1000	500	15000		500	1500	1500		5000
S	2000	14000	2000		2000	2000	500	10000		500	1200	1800		5000
X (Parent)	20000	143250	49700	267500	116320	19425	39720	250000	235000	35855	70330	96330	25000	106000
	31200	523750	107520	267500	199140	72660	60790	500000	235000	72835	112555	172130	45000	
To eliminate Capital Stock of Subsidiary Companies owned by X (Parent) Co.				250000				250000						
To eliminate dividends received on the above											20000		20000	
To eliminate Inter-company Accounts						6500				6500				
To eliminate Inter-company profits in Inventories					9000						9000			
Totals as at 17th February	31200	523750	107520	17500	190140	66160	60790	250000	235000	66335	83555	172130	25000	
Adjustment of Inventory Co. D					300						300			
Adjustment of Depreciation Co. B			2600								2600			
Adjustment of Depreciation Co. X			8100								8100			
Claim Liability Co. X										20000	20000			
Adjustment of Accrued Interest Co. H						100					100			
Adjustment of Accrued Interest Co. K						125					125			
Adjustment of Accrued Interest Co. L										200	200			
Interest Accrual Co. O						125					125			
Interest Accrual Co. P						200					200			
Adjustment of Inventory Co. O					800						800			
Adjustment of Inventory Co. P					900						900			
Per Report	31200	523750	96820	17500	192140	66510	60790	250000	235000	86535	76405	172130	25000	

X (PARENT) CO. COMBINED
INCOME ACCOUNT YEAR 1922

	Sales	Inventories 31 Dec. 1921	Labor	Raw Materials	Factory Overhead including depreciation	Inventories 31 Dec. 1922	Administrative Expenses & Taxes	Interest Paid	Rents & Royalties	Income from Investments and Interest received	Balance
Company A	36009	2290	9000	13005	3400	2820	8634	32		157	2625
B	180000	21000	44000	69000	41000	20000	25000		9500		9500
C	30000	5000	11500	7900	5200	4000	2900				1500
D	20000	1500	5000	6000	5000	1000	2750	1500			750
E	60000	6500	15000	22000	16000	7000	5500				2000
F	28000	2100	12000	8000	5000	2000	1400				1500
G	72000	9000	30000	26000	9000	8000	2500				3500
H	79000	7000	28000	39000	7000	8000	6000			1000	1000
I	64000	6000	27000	29000	5000	7000	2750				1250
J	35000	4000	10000	19000	4000	3000	1000		3000		3000
K	24000	2000	8000	9000	1000	1000	1800			1000	4200
L	38000	3500	14000	11000	4000	4000	3350	1000			5150
M	26000	2500	8000	10000	5000	2000	1400				1100
N	19000	1600	6000	7000	2000	1000	2650				750
O	72000	3500	27000	35000	11000	4000	2500				3000
P	42000	2800	10000	16000	9000	2000	3700				2500
Q	60000	3100	28000	24000	3000	3000	1200				3700
R	28000	900	10000	6000	5000	1000	5600				1500
S	49000	3000	22000	18000	4000	2000	2800				1200
X (Parent)	715905	120900	212500	207465	179790	116320	58515	16800	1320	32855	70330
	1677914	208190	537000	582370	324390	199140	142049	19332	13820	35012	112555
To eliminate dividends paid by subsidiary companies to X (Parent) Company										20000	20000
To eliminate inter-company profits in inventories						9000					9000
To eliminate inter-company Sales	96000			96000							
Totals as at 17th February	1581914	208190	537000	486370	324390	190140	142049	19332	13820	15012	83555
Adjustment of Inventory Co. D						300					300
Adjustment of Depreciation Co. B					26000						2600
Adjustment of Depreciation Co. X					8100						8100
Claim Liability Co. X							20000				20000
Adjustment of Accrued Interest Co. H										100	100
Adjustment of Accrued Interest Co. K										125	125
Adjustment of Accrued Interest Co. L								200			200
Interest Accrual Co. O										125	125
Accrual Interest Co. P										200	200
Adjustment of Inventory Co. O						800					800
Adjustment of Inventory Co. P						900					900
Per Report	1581914	208190	537000	486370	313690	192140	162049	19532	13820	15362	76405

X (PARENT) CO.

BALANCE-SHEET 31 DECEMBER, 1922

Account Titles	Schedule No.	Trial Balance per Books 31 Dec. 1921	Trial Balance per Books 31 Dec. 1922	Land	Plant & Equipment	Reserve for Depreciation	Trade Investments	Inventories	Accounts Receivable	Cash & Cash Assets	Capital Stock	7% Mortgage Bonds	Accounts Payable	Income Year 1922	Surplus 31 Dec. 1921	Dividends	Contra
Plant Ledger		75500	87300		137000	*49700*											
Real Estate		10000	12000	12000													
Factory Site, No. 5 Plant			7500	7500													
Preliminary Expense, No. 7 Plant			1250	500	750												
Accounts Receivable Ledger		115230	116320						10500	450			*630*				106000
Vouchers Payable		*32500*	*25900*						1100				*27000*				
Investment Ledger		257000	275000				267500		2500	5000							
William H. Scroggs		9000	7320					7320									
Raw Material		36900	45000					45000									
Notes Receivable—Cotton Crepe Co.		17000															
Wisconsin Oil Co.		7000	9000				9000										
Alfred Jones, Secretary			320							320							
Storekeeper, No. 9 Mill		500	500							500							
"Revivifying Process"		500	1500		1000			500									
Experimental Department		6000	7500		4000			1000	2000	500							
Research Department		2500	3000		500				2250	250							
Triple X Selling Co.		2700	3200						3000	200							
Finished Goods, Product A		22000	15000					15000									
Finished Goods, Product B		22000	20000					20000									
Finished Goods, Product C		14000	22500					22500									
Finished Goods, Product D		16000	20000					20000									
Profit and Loss		*54330*	*104480*											*104480*			
Surplus		*67000*	*96330*												*96330*		
Dividends		25000	25000													25000	
Capital Stock Authorized		*300000*	*300000*								*300000*						
Capital Stock Unissued		50000	50000								50000						
7% Bonds Authorized		*350000*	*350000*									*350000*					
7% Bonds Unissued		75000	75000									75000					
7% Bonds Purchased		20000	40000									40000					
Cash		20000	32500							32500							
Per Books				20000	143250	*49700*	276500	131320	21350	39720	*250000*	*235000*	*27630*	*104480*	*96330*	25000	106000
Wisconsin Oil Co. Stock written off							*9000*							9000			
Additional Reserve for Bad Debts									*2000*					2000			
Reduce Inventories to Market								*15000*						15000			
Interest Accrued on Overdue Accounts									75					*75*			
Six Months Interest on $235,000 7% Bonds													*8225*	8225			
Carried to Combined Accounts				20000	143250	*49700*	267500	116320	19425	39720	*250000*	*235000*	*35855*	*70330*	*96330*	25000	106000

X (PARENT) CO.

INCOME ACCOUNT YEAR 1922

	Schedule No.	Per Books Year 1921	Per Books Year 1922	Sales	Inventories 31 Dec. 1921	Labor	Raw Materials	Factory Overhead including depreciation	Inventories 31 Dec. 1922	Administrative Expense & Taxes	Interest Paid	Rents & Royalties	Income from Investments & Interest Received	Balance
Sales, Product A		142560	190962	190962										
" " B		136810	168700	168700										
" " C		140700	185750	185750										
" " D		117040	170493	170493										
Manufacturing Account		450500	586500		120900	212500	207465	176955	131320					
Insurance		2610	2835					2835						
Officers' Salaries		20000	25000							25000				
Office Salaries		8750	10250							10250				
General Expense		7450	9320							9320				
Taxes		2650	3045							3045				
Interest on Bonds		18550	8575								8575			
Rent—Jonesville Houses		300	420									420		
Revivifying Royalties		280	900									900		
Income from Investments		26500	32000										32000	
Interest on Overdue Accounts		650	780										780	
Balance		54330	104480											104480
Per Books				715905	120900	212500	207465	179790	131320	47615	8575	1320	32780	104480
Wisconsin Oil Co. Stock Written Off										9000				9000
Additional Reserve for Bad Debts										2000				2000
Reduce Inventories to Market									15000					15000
Interest Accrued on Overdue Accounts													75	75
Six Months' Interest on $235,000 7% Bonds											8225			8225
Carried to Combined Accounts				715905	120900	212500	207465	179790	116320	58615	16800	1320	32855	70330

A COMPANY

BALANCE-SHEET 31 DECEMBER, 1922

Account Titles	Schedule No.	Trial Balance per Books 31 Dec. 1921	Trial Balance per Books 31 Dec. 1922	Land	Plant & Equipment	Reserve for Depreciation	Trade Investments	Inventories	Accounts Receiveable	Cash & Cash Assets	Capital Stock	7% Mortgage Bonds	Accounts Payable	Income Year 1922	Surplus 31 Dec. 1921	Dividends	Contra.
Land & Buildings		10000	10000	2000	8000												
Machinery		15000	17500		17500												
Accounts Receivable																	
Ledger		8350	9760						10310	170			*720*				
C. A. Creavey		750	500					500									
Liberty Bonds		6000	3000				3000										
Development																	
No. 2 Account		8000	8620	1000	5000			2620									
Sinker Shaft Mine		250	500				500										
Surplus		*6630*	*10000*												*10000*		
Reserve for																	
Depreciation		*3800*	*4320*			*4320*											
Accounts Payable		*23800*	*24060*										*4060*				*20000*
Capital Stock		*10000*	*10000*								*10000*						
Dividends			2500													2500	
Balance		*4120*	*4000*											*4000*			
Per Books				3000	30500	*4320*	3500	3120	10310	170	*10000*		*4780*	*4000*	*10000*	2500	*20000*
To correct error in distribution							*3000*			3000							
To write off worthless investment							*500*							500			
To write off bad accounts									*600*					600			
Interest accrued on Liberty Bonds									25					*25*			
To reduce inventories to market								*300*						300			
Carried to Combined Accounts				3000	30500	*4320*		2820	9735	3170	*10000*		*4780*	*2625*	*10000*	2500	*20000*

A COMPANY

INCOME ACCOUNT YEAR 1922

	Schedule No.	Per Books Year 1921	Per Books Year 1922	Sales	Iven-tories 31 Dec. 1921	Labor	Raw Mate-rials	Factory Over-head including depreci-ation	Inven-tories 31 Dec. 1922	Admin-istrative Expense & Taxes	Interest Paid	Rents & Royal-ties	Income from In-vest-ments & Inter-est Re-ceived	Balance
Sales		*35147*	*36009*	*36009*										
Factory Expense		11648	12175		2290		13005		*3120*					
Depreciation		2610	2700					2700						
Insurance		425	425					425						
Pay Roll		14800	15000			9000				6000				
General and Office Expenses		1125	1100					275		825				
Taxes		598	612							612				
Legal Expense			50							50				
Bad Debts		70	47							47				
Interest		*249*	*100*								32			
Balance		4120	4000										*132*	
														4000
Per Books				*36009*	2290	9000	13005	3400	*3120*	7534	32		*132*	4000
Worthless Investment (Sinker Shaft Mine) written off.										500				*500*
To write off bad accounts										600				*600*
Interest accrued on Liberty Bonds													*25*	25
To reduce inventories to market									300					*300*
Carried to Combined Accounts				*36009*	2290	9000	13005	3400	*2820*	8534	32		*157*	2625

Receipt of Certificates of Capital Stock as Taxable Income

By Oscar B. Thayer

Prior to the passage of the revenue act of 1921, the bureau of internal revenue has uniformly held that when a taxpayer transfers property to a corporation and receives certificates of the capital stock as evidence thereof, such a transaction constitutes a sale or exchange of property, from which gain or loss to the taxpayer may arise.

0.1033 (20-20-938) Cum. Bulletin No. 2, p. 146.
A. R. R. 173 (28-20-1050) Cum. Bulletin No. 3, p. 58.
A. R. M. 94 (47-20-1310) Cum. Bulletin No. 3, p. 114.

This is true whether the property conveyed to the corporation for its stock is physical property or is stock of another corporation.

A.R. R. 289 (44-20-1274) Cum. Bulletin No. 3, p. 57.
O. D. 783 (5-21-1414) Cum. Bulletin No. 4, p. 45.

It will be noted from the citations made that this is true whether the proportionate interest or control thus acquired by the taxpayer in the corporation is the same or an interest other than the interest which he had in the property before such transfer to the corporation.

In the revenue act of 1921, the above position of the bureau has been materially modified. Still, under this act, the receipt of certificates of its capital stock from the corporation itself may be taxable to the recipient thereof if such stock so received has a readily realizable market value and if such recipient after his transfer of property to the corporation for its capital stock is not in control of the corporation, that is, if he does not then own

> "at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." Revenue act of 1921, sec. 202 (c) 3.

The reason which prompted congress to designate 80 per cent. of the voting stock and at least 80 per cent. of the total number of shares of all other classes of stock as constituting control of such corporation is not apparent to the writer. A stockholder owning 51 per cent. of the voting stock and at least 51 per cent. of the total number of all other classes of stock ought to be able to exercise just as much control as if he had 80 per cent. If control is a proper basis to use in determining taxable income, it would seem that all individuals acquiring interest in corporations of 51 per cent. to 79 per cent., inclusive, as a result of certain transactions with such corporation have just as much ground to be relieved from taxation thereon as stockholders acquiring interests of 80 per cent. or more. The writer firmly believes, and it is his purpose in this article to show that, under the present revenue act and under the prior revenue acts, when a corporation issues certificates of its capital stock for cash or for other property, including stock of other corporations, no taxable income arises to the recipient thereof.

In analyzing any transaction to determine whether such transaction is taxable or non-taxable, it is essential to know what income is as set forth in the sixteenth amendment, and to apply this conception of income to given transactions,

"according to truth and substance, without regard to form."

Eisner vs. Macomber, 252 U. S. at page 206.

Fortunately the supreme court of the United States has defined income as used in the sixteenth amendment. It is as follows:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case (pp. 183, 185).
>
> "Brief as it is, it indicates the characteristic and distinguishing attributes of income essential for a correct solution of the present controversy. The government although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived from capital'—'the gain derived from capital,'* etc. Here we have the essential matters: *not a gain accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being 'derived,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal—that is income derived from property. Nothing else answers the description." *Eisner vs. Macomber,* 252 U. S. at page 207.

It is plainly evident, from the above citation, that to have income something must be received by the taxpayer which represents a gain which has been severed from his capital *however invested or employed* and has been turned over to him for his *separate* use, benefit and disposal, thereby constituting property, all or any portion of which he may sell or dispose of in any manner conceivable without parting with any of his interest or equity in the capital or investment from which such gain or property was derived.

Since the definition of income as given by the supreme court must be applied to that which is received by the taxpayer, the subject under discussion in this article must necessarily be confined to an analysis of the nature and character of that which the corporation has issued to the taxpayer, namely, certificates of its capital stock, rather than to a consideration of that which the taxpayer has disposed of. It can be seen at once, that whether the taxpayer paid cash to the corporation for its capital stock or transferred property including stock of another corporation has nothing to do with the question. The tax if levied at all is to be levied upon that which was received *from the corporation* and not upon that which was given *to the corporation.*

If any income arises to an individual when he transfers certain property to a corporation for its capital stock, it must be because a sale has been consummated or because there has been an exchange of property. If it is a sale, is the corporation the vendor and are the certificates of capital stock issued by the corporation the subject matter of sale? If so, the corporation should be required to pay income taxes whenever it issues or "sells" its capital stock. No corporation has ever been required to pay an income tax on the proceeds, cash or other property arising from the sale of its capital stock. The regulations provide, and rightly, that no income arises to the corporation even if such stock is sold at a premium and no deductible loss from gross income will be allowed if such stock is sold at a discount. (Regulation No. 33, art. 97, also regulation No. 62, art. 543.)

It would seem, therefore, that while the bureau uses the expression "sale of capital stock" it really does not consider the issuance of capital stock as a sale. It necessarily must follow, therefore, that the recipient of such capital stock is not the vendee or purchaser thereof.

A corporation issues its capital stock in order to acquire capital, that is, cash, property or other means as the financial basis for the prosecution of the business of the corporation as provided in its charter. The capital thus acquired by the corporation is not

"according to truth and substance, without regard to form"

"sold" to the corporation by its stockholders. It is *contributed, dedicated.* Note the use of these words in the following citation:

> "Capital is a term which, as applied to private corporations as ordinarily constituted, is used with widely varying signification. In one sense—the strict sense—it is employed to designate specifically the fund, property or other means *contributed* or agreed to be *contributed* by the share owners as the financial basis for the prosecution of the business of the corporation; such *contribution* being made either directly through stock subscriptions or indirectly through the declaration of stock dividends. As then used, the term signifies those resources whose dedication to the use of the corporation is made the foundation for the issuance of certificates of 'capital stock,' and which, as the result of the *dedication* becomes irrevocably devoted to the satisfaction of all the obligations of the corporation." *Words and Phrases,* second series, vol. 1, p. 561.

One has only to read the definition of sale to realize that it does not apply to a transaction whereby property is conveyed to a corporation for certificates of its stock.

> "A 'sale' is a contract by which property is transferred from the seller to the buyer for a fixed price in money paid or agreed to be paid by the buyer." *De Bary vs. Dunn,* 172 Fed. 940. *Words and Phrases,* second series vol. 4, p. 436.

or

> "Sale: the exchange or disposal of a commodity, right, property or whatever may be the subject of bargain, for a price agreed on and generally payable in money, as distinguished from barter; a transfer of *all* right and property in a thing for a price to be paid in money." *Century Dictionary.*

When property is conveyed to a corporation for its stock, the corporation does not agree *to pay* the recipient of such stock, or his assign, a fixed price in money; neither has the corporation acquired an absolute right in the property so conveyed to the corporation.

Suppose that two individuals each owning a one-half interest in a tract of land convey it to a corporation. One receives cash, an account receivable or a note for his interest; the other receives certificates of stock of the corporation. It is apparent that the individuals do not have the same character of interest in the corporation. One individual or his assign will soon have no interest whatever in the corporation. The other individual or his assign will have an interest in the corporation during its entire corporate life, and throughout such period he will have certain rights, benefits and privileges which are not shared by the individual who had the same interest that he had in the tract of land.

It should be apparent that the individual who did not receive certificates of stock of the corporation has made *a sale,* while the individual who did receive certificates of stock made *an investment.*

> "'Stock' of a corporation is capital, and the stock certificate only evidences that the holder *has invested* his means as a part of the capital." *Words and Phrases,* second series, vol. 4, p. 695.

and the supreme court of the United States has held,

> "Certainly the interest of the stockholder is a capital interest, and his certificates of stock are but the evidence of it." *Eisner vs. Macomber,* 252 U. S. at page 208.

It is true that taxable income may arise in the sale of a capital interest or investment in a corporation, but taxable income cannot arise from a transaction with a corporation which results in an investment *in the corporation.* If it did, the original stockholder would become taxable both when he acquired his capital interest in the corporation and also when he disposed of it.

It may be said that there is no difference in principle between a transaction whereby property is transferred to a corporation for certificates of its capital stock and a transaction whereby property is transferred to a corporation for cash and the cash thus received is used to purchase stock of the corporation. A similar argument was advanced in comparing stock dividends, with cash dividends and the money thus received being used to purchase additional stock. The supreme court answered this contention in the following language:

> "It is said there is no difference in principle between a simple stock dividend and a case where stockholders use

> money received as cash dividends to purchase additional stock contemporaneously issued by the corporation. But an actual cash dividend with a real option to the stockholder either to keep the money for his own or to reinvest it in new shares would be as far removed as possible from a true stock dividend, such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal." *Eisner vs. Macomber,* 252, U. S. at page 215.

In A. R. R. 173 (28-20-1050) Cum. Bulletin No. 3, p. 58, it is said:

> "It has been the consistent position of the bureau that, when property is exchanged for stock in a corporation formed to take over such property, the difference between the value of the stock received and the cost or value on March 1, 1913, of the property exchanged is taxable gain or loss, as the case may be."

The bureau considers this transaction as an *exchange of property,* but a brief analysis of the transaction will clearly indicate that it is not an exchange of property. The parties to the transaction under consideration are a corporation on the one hand and an individual on the other hand. To constitute an exchange of property each party thereto must be both giver and receiver of property, both must be vendor and vendee, and both must have either a taxable gain or loss. But, as stated heretofore in this article, the bureau has never made any attempt to tax the corporation on the proceeds which it has received as a result of issuing its stock. It has confined its activities solely to taxing or attempting to tax the individual. And what has the individual received *from the corporation* but certificates of its stock? A stock certificate is merely a receipt of the corporation.

> "It is a written acknowledgment by the corporation of the interest of the stockholder in the corporate property and franchise; it operates *to transfer nothing* from the corporation to the stockholder, but merely affords to the latter evidence of his right." Cook, *Corporations,* seventh ed., vol. 1, p. 64.

That the individual receives nothing from the corporation and that the transaction is not a mutual giving of one property for another property may be seen thus. To constitute an exchange of property each party to the transaction must have property to exchange. This property must be assets of the respective owner. Assume an individual having oil leases of a value of $100,000.00 which he wishes to transfer to a corporation for 1,000 shares of its stock, par value $100.00 each. There is no doubt that the leases are an asset of the individual with a value of $100,000.00. If an exchange of property is to be consummated and the individual is to receive something from the corporation for his leases to be conveyed thereto, it must follow that the stock to be issued by the corporation to the individual must be property or assets of the corporation with a value of $100,000.00 not only *after* it has been received by the individual, but also *before* it has been issued; but

> "the unissued stock, no matter whether it be the whole capital stock, or only a reserved part thereof, represents nothing whatever beyond the potential right of issue. It has no intrinsic value. It is merely the right—granted by the state—to issue stock to the prescribed amount.
>
> "This being so, the unissued stock cannot in any way be regarded as an asset of the corporation. . . . To regard it as an asset would be as illogical as to consider the right to admit new partners in a firm as assets of the partnership." Conyngton, *Corporate Organization,* page 89.

and on page 110:

> "For $20.00 the state of Arizona will charter a corporation and authorize it to issue stock to the face value of $25,000,000.00 or more. Such a company on organization would have an over-plentiful supply of unissued stock but no assets whatever. The absurdity of regarding unissued stock as an asset is obvious."

In the case above it was assumed that leases were assigned to a corporation for its stock. Instead of leases, let it be assumed that the property was in the form of stock valued at $100,000.00 and this stock is assigned to the corporation for its capital stock, that is, for its unissued stock. It can be seen at once that this transaction does not constitute an exchange of property. Behind the stock of the individual are assets valued at $100,000.00, while behind the stock that the corporation is going to issue therefor there are no assets; it has no value prior to its issue and never will have any value until something of value is contributed or dedicated to the corporation and the certificates are issued therefor as evidence of such contribution, donation or dedication.

A certificate of stock is not the stock itself but is merely the evidence of the ownership of the stock, and the *certificate of stock* is all the issuing corporation parts with when it issues it for cash or other property. When it is said that wheat is worth $2.25 a bushel, what is meant is that a bushel basket full of wheat is worth $2.25, and not an empty one. Likewise when it is said that a given stock has a readily realizable market value, what is meant is that the already-issued stock has such value, and it does not include the *unissued* stock of such corporation.

It should also be kept in mind that all stock bought and sold on the exchange is fully paid and non-assessable; that is, it is stock which has been issued by the corporation and is not unissued stock which the corporation may issue. Furthermore a corporation can never sell its capital stock. It can only issue certificates of its stock to persons who have contributed to or invested property in the corporation to be used for corporate purposes. The capital stock is individual property of the several stockholders and can be sold only by them.

Since a corporation gives no property, no assets, nothing except a certificate of stock to an individual who contributes cash or property, including stock of other companies, to such corporation, it is evident that the individual receives nothing, and therefore according to the definition of income quoted from *Eisner vs. Macomber,* the recipient of such stock has no taxable income. The practice of the bureau of taxing such original stock issues under acts prior to 1921, therefore, is wrong in principle, and that part of section 202 (c) 3 of the revenue act of 1921 which provides for the taxation of stock having a readily realizable market value and being less than 80 per centum of the voting stock and less than 80 per centum of the total number of shares of all other classes of stock of the corporation is unconstitutional. No income is realized when property is assigned or contributed to a corporation for its stock until such stock is sold. The transaction whereby property is thus invested in a corporation is not different in principle from a transaction whereby property is turned over to a partnership at its organization.

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A. P. RICHARDSON, *Editor*

EDITORIAL

Railroad Valuation

It was not to have been expected that the question of the valuation of railroad property could remain undisturbed at a time when so many noble friends of the people are bent on demonstrating their fiscal inefficiency. For two or three years there has been a lull in the campaign against the nation's chief industry, but now the time seems to have come when something must be done to prevent the return of normal prosperity to our transportation companies. Nobody has ever yet been able to establish an absolute basis for valuation of railroad property, and it is probable that no one ever will find the perfect measure of value. The interstate commerce commission has issued a number of tentative valuations and has asked for expressions of opinion from the railroads concerned. Some cases have been argued, and many of them are virtually settled. Whether the amounts assigned to the several roads are right or wrong to a fraction of a dollar is not an important matter. The great point is to have a decision so that our sorely tried transportation industry may be able to proceed with something like an assurance of freedom from perpetual interference. We can think of only one thing worse than government ownership of roads, and that is congressional interest in the matter. The truth is that many of the railroads of the United States for years were conducted solely for the benefit of a few rather unscrupulous or absolutely crooked capitalists. The public *was* damned. But that is all ancient history. Abuses which were unpardonable have been largely overcome, and for many years the roads have been run chiefly in the interest of the general public. Ask any holder of securities his opinion. The investor has certainly not reaped a fortune. When, after the utterly mad scheme of government ownership had driven the public into a frenzy of despair, the roads were returned to their legitimate owners in a generally depleted and, in some cases, almost ruined condition, there was no special lure for the political agitator to attack an industry which seemed to be on its last wheels. But during 1922 there was a change, and some of the roads actually earned a fair return from operation. So some of our gallant senators and congressmen have suddenly been aroused to the fact, and a great demand is about to be made for revaluation. This would mean an upsetting of what little stability has been recovered and a speedy return to the chaos of 1918 and 1919—unless of course the public make known its will to its representatives and insist that business, particularly that of transportation, be allowed to continue unmolested by ambitious busy-bodies.

Good Business

What a comfort and blessing it is to find an officer of the United States government, or of any other government for that matter, competent to perform the duties imposed upon him. We do not say that it is a rarity, but it may not be exaggerating to describe such a condition as unusual. This thought is induced by figures lately published by the United States treasury; and it seems just to attribute the wonderfully satisfactory results to the able administration of Secretary Mellon. The country should not be reluctant to give praise where praise is due. According to the figures recently issued, the short-term debt of the United States, amounting to approximately five billion dollars, will have been retired within the next five years by payments from surplus revenues. At this rate, the entire national debt could be retired in less than twenty-five years. This estimate does not take into consideration the possible payments of foreign debts to the United States. The extinguishment is to be made solely, according to present estimates, from surplus revenues of the United States government itself. Great Britain has made a wonderful recovery, and in many ways has astonished the world by the speed with which both finance and industry have returned to almost normal conditions. But as an example of sheer financial excellence of administration, there seems to be no rival to the record established by the United States treasury. To accountants the facts are peculiarly eloquent. The ordinary layman may not fully understand the difficulties which have confronted the treasury, but everyone concerned with finance and accounts will be able to comprehend, at any rate in part, the magnitude of the treasury's accomplishment.

British Financial Policies

The British policy as enunciated by the chancellor of the exchequer, Stanley Baldwin, is to utilize a portion of the national surplus in reduction of the rate of taxation, thus spreading over a greater number of years the actual extinguishment of the debt, with the result that posterity will be called upon to pay its fair share for the safety and liberty received as the heritage from this generation. The British are ever more far-seeing politically than most other countries. They build not only for the immediate future but also for the distant, and consequently the chancellor's policy appeals strongly to the ordinary taxpayer in the United Kingdom. Americans, on the other hand, having an unpleasant duty before them, are apt to prefer to have done with it as soon as possible. Consequently, there will be a large section of public opinion here in favor of a continuance of the present high rates of taxation, so that the most burdensome portion of the public debt may be wiped out at the earliest possible moment. Of course, every country must have a public debt to be financially sound—that seems to be an axiom of political economy — but with debts mounting in the billions, the first and paramount task for every debt-burdened country is to reduce the load to an amount easily to be carried.

Distributing the Blame

The Better Business Bureau of the Advertising Club of Los Angeles, California, has recently been instrumental in securing a judgment against a firm of accountants describing themselves as certified public accountants, although holding no certificate from the state board of accountancy. The firm was originally requested to abstain from use of the designation "certified public accountants," and publishers of the telephone directories and the daily papers were requested to refuse the firm's advertising when containing the designation. Both these requests were refused, and the matter was taken into court. After a judgment for the complainant, the matter was appealed to the superior court of Los Angeles county, which affirmed the decision of the lower court. Publishers accepting advertising of this firm have been notified that they will be arrested if they accept its advertising containing the words "certified public accountants" unless the firm shall have obtained proper certification from the state board of accountancy. This is a most excellent corollary to the main proposition. It is not a new thing to forbid the illegal use of the designation "certified public accountant," but the accepting of misleading advertising is an offense secondary in importance only to the main evil, and we rejoice to find that publications are to be held liable for assisting in the act of misrepresentation. There seems to be nothing in the world to prevent an accounting firm, not members of the Institute, from advertising its accounting abilities or supposed abilities, but the official designation granted by a state should not be used unless proper authority has been granted. If newspapers, directories, magazines, etc., are held to a strict responsibility for truth of advertising, it will be a great help toward the establishment of complete veracity in professional and mercantile publicity. We cordially congratulate the Better Business Bureau upon its accomplishment.

C. P. A. Practice in New York

The secretary of the New York State Society of Certified Public Accountants has addressed to practising accountants in the state of New York a circular containing a digest of court opinions recently rendered in regard to the use of the designation "certified public accountant" in that state. The crux of the matter is contained in a decision of the court of special sessions in a case in which the defendant was charged with unlawfully assuming the title of certified public accountant. The court based its opinion largely upon a decision of the appellate division of the supreme court of New York in the case of the *People versus the National Association of Certified Public Accountants,* in the course of which the court said:

> "Public accountancy is a well recognized profession, the practice of which in the state of New York is not made dependent upon the issuance of any license; nor is any special qualification required by law so to do. The matter of the accountant's proficiency rests entirely with the judgment of those who engage or hire his services. But the legislature of this state has enacted an amendment to the general business law that a certified public account-

ant before practising in the state of New York as a public expert accountant, or assuming the title as such, shall receive from the board of regents of the university of the state a certification of his right to engage in such practice as a certified public accountant, entitling him to be known as such."

The court further quoted with approval the following from the opinion of the appellate division above mentioned:

"It is entirely clear from sections 80, 81 of the general business law above quoted, that no person may hold himself out as a certified public accountant or use the abbreviation 'C. P. A.' or any other word, letters or figures, to indicate that the person using the same is a certified public accountant, except upon the authorization of the regents of the university of the state of New York."

The court of special sessions further said:

"The fact that the degree of certified public accountant has been conferred on the defendant by the association of which he is a member does not, in my opinion, entitle him to hold himself out to the world as a public expert accountant in the state of New York. The use of such a degree, lawfully obtained from any board or other institution outside of this state is prohibited, unless the requirements of our general business law, supra, have been fulfilled. The appending of the name of the association, institution, board or state, after the degree so used or employed by any person does not take him out of the prohibition of the statute under consideration.

"As I view it, the statute affecting certified public accountants in this state was enacted not alone to prevent fraud but as well to assure to the public that persons practising public accountancy as experts, certified as such, have met our standard as to qualifications and tests, fixed by law, or in accordance with the rules and regulations authorized thereunder. To rule otherwise under these circumstances would mean that other states, boards, associations and institutes could prescribe a course of study, determine their own test of proficiency of the applicant and then issue a degree to him as a certified public accountant, which, according to the claim of the defendant, would entitle the recipient thereof to come into this state and practise expert public accountancy. I cannot agree with this view, which has been urged upon us for our consideration."

The digest prepared by the counsel for the New York State Society contains the following paragraph:

"The decision of the court of special sessions interprets the law of this state to forbid the use of the abbreviation

> 'C. P. A.' by any persons other than those holding a certificate issued by the regents of the university. Certified public accountants who are certified by other states or any agency other than the board of regents are not permitted in the state of New York, under the provisions of the business law, to use and assume the title 'C. P. A.' They violate the law, according to the decision of the Marlowe case, as much by qualifying the abbreviation to show the source of their certificate as they do in using the abbreviation without qualification. The decision is in line with that of the appellate division above mentioned, and clearly formulates the law."

So far as it goes this decision is to be welcomed in that it brings nearer the time of a definite interpretation of C. P. A. legislation as a whole. Every accountant desires a settlement of this much disputed question. As pointed out in our editorial comment in the March issue of THE JOURNAL OF ACCOUNTANCY, legal opinions differ as to the restrictive effect of C. P. A. laws in the case of those who are certified under some properly constituted state board of accountancy. Whichever way the matter is to be finally settled we trust that the settlement will come reasonably soon. In the interest of accountancy generally it is hoped that appeal will be taken to the highest possible tribunal and that there will be no further cause for dissatisfaction on the part of those who take the narrower or of those who take the broader view. As in tax matters, the great point is a decision which will stand.

Accountants and Mechanical Appliances

Several letters have recently been received raising a question as to the attitude of professional accountants toward the use of mechanical appliances of labor-saving purpose. The allegation has been made that accountants frown upon the use of anything that reduces labor and thereby is supposed to reduce the time consumed on any undertaking upon which a per-diem charge is made. When the first of these assertions was made it seemed too obviously absurd to merit comment, but it now appears that there are some business men who entertain a real doubt as to the opinion of the accounting profession on the subject of labor-saving devices. In order to obtain an independent and unprejudiced statement of the case we addressed letters of inquiry to prominent accountants in all sections of the country and have received replies from all to whom inquiry was addressed. In all cases they express hearty accord with the principle of labor and time saving and indicate their interest in the rapid development of invention leading to reduction of expenditure in time and effort. As a sample of the responses received we quote the following statement from a prominent accountant in the west which expresses in condensed form the substance of the opinion of all others from whom comment was received:

> "Replying to your communication wherein you request an expression of opinion as to the attitude of accountants in regard to mechanical appliances, especially those which result in labor saving, please be advised that not only is it the practice of accountants in this organization, but it is also the practice of all leading accountants in the west, to cause to be introduced wherever practicable any machine which will produce results more economically than such results can be produced without them. Indeed, without effort I could name scores of enterprises which upon our suggestion have introduced bookkeeping machines, computing machines, addressing machines, and so on throughout the entire gamut of mechanical contrivances. In my judgment it would be as ridiculous to attempt to do without modern mechanical appliances in offices as it would be to do away with the telephone and telegraph."

Meeting of Accountants in Paris

In response to a frequently expressed desire that English-speaking accountants practising in Paris should have opportunity to meet in an informal way with the object of exchanging views on matters of common interest, a meeting was held in the Hotel Meurice, on April 19th. Representatives of all the American and British firms practising in Paris were invited to attend, and there was general satisfaction at the response. It was decided that luncheon meetings should be held quarterly in the months of March, June, September and December of each year. The next meeting is to be held June 27th. The chairman of the initial meeting was J. Balfour Horne, and the chairman elected for the June meeting is Edmund Heisch. A committee consisting of Messrs. Horne, Heisch, W. E. Seatree, A. Lovibond and Oscar Fawcett (the last-named as secretary) was appointed to make necessary arrangements and to prepare a programme for the meeting. This gathering of accountants in Paris is somewhat after the manner of the regional meetings of members of the American Institute held in various parts of the United States. The great force of the meetings is their informality. There are no fixed officers and no rules which cannot be altered by the meeting in session. The idea has gained popularity in America and will probably be equally successful abroad. The benefit of rubbing shoulders with one's professional brethren is being increasingly recognized.

Prize Competition

Since announcement of the prize competition offered by the American Institute of Accountants Foundation in March last many inquiries have been received in regard to the rules governing the contest. Inquiries have come from various parts of the United States, Canada and Great Britain. The chief point upon which information seems to be desired is the length of the theses which will be acceptable. To this inquiry the foundation has answered that no limit has been fixed—the committee prefers to leave to the individual contestant the determination of the extent to which his comment shall go. It is obvious, however, that as between two theses of otherwise equal merit preference will be given to the more concisely and lucidly expressed. The attention of readers is drawn to the fact that papers must be submitted not later than October 1, 1923, and we suggest that the matter be not left until the last moment. Advertisement of the competition appears elsewhere in this issue of THE JOURNAL OF ACCOUNTANCY.

Anonymous Communications

During the past few weeks THE JOURNAL OF ACCOUNTANCY has received a number of anonymous communications, some of them dealing with matters of interest and importance. Others make allegations which would receive consideration had the writers indicated their identity. It is necessary again to point out to our readers that this magazine ignores anonymous communications. Letters sent in for publication may be signed by a pseudonym, but must be accompanied by full name and address.

Income-tax Department

EDITED BY STEPHEN G. RUSK

How the shipbuilders responded to the call for ocean-going tonnage to overcome the great destruction that took place during the war is reflected in the tentative ratios of post-war replacement value as compared to pre-war costs as of June 30, 1916, on domestic ocean-going ships.

In treasury decision number 3467, appertaining to "Ratios for determining amortization allowances on domestic steel vessels" ocean-going passenger steam vessels are estimated to have a post-war value of 120% of the cost per dead-weight ton at June 30, 1916. Ocean-going cargo-carrying steam vessels, other than tank steamers, are estimated to have a post-war value of 40% of the said pre-war cost and tank steamers 90% of the pre-war cost. As explained in treasury decision 3333, issued under date of May 19, 1922, these published ratios are only tentative and are affected by particular conditions surrounding any given case. A casual consideration of the matter would cause one to wonder why the post-war value of passenger steamers is so much greater than that of cargo-carrying steamers. It would seem that there would have been a horizontal reduction in value of ocean-going steamers of all kinds.

Congress in its expiring moments, March 4th of this year, amended subdivisions (c) and (e) of section 202 of the revenue act of 1921, and as a result articles 1566 and 1568 have been amended in treasury decision 3468. The subdivisions of the law mentioned above treat of the determination of taxable gain or loss in cases of exchange of property, real, personal or mixed, for other property of a like kind. Subdivision (c-1) is amended by the addition of the following language:

> "* * * in the case of property held for investment not including stock, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest."

The apparent effect of the above-quoted language when considered with the language of subdivision (c) is to exclude from the realm of unrealized gain or loss the several kinds of assets mentioned therein. The amendment to subdivision (e) treats of exchange of property for other property having no readily realizable market value together with money or other property which has a readily realizable market value; and it sets forth the manner in which taxable gain shall be determined by the substitution of more concise language for that which was formerly comprised in the section of the law.

TREASURY RULINGS
(T. D. 3467—April 20, 1923)

Ratios for determining amortization allowances on domestic steel vessels.

Pursuant to article 184 of regulations No. 62, the commissioner has determined and publishes the following ratios for use by taxpayers in computing claims for tentative allowances for amortization on steel vessels of domestic corporations or of resident individuals or partnerships:

(1) On ocean-going passenger steam vessels, certificated as such, replacement cost as referred to in said article 184, shall be 120 per cent. of cost per dead-weight ton of steamers of similar type, size, and speed as of or about June 30, 1916.

(2) On ocean-going cargo-carrying steam vessels, exclusive of tank steamers, 40 per cent. of the cost per dead-weight ton of steamers of similar type, size, and speed as of or about June 30, 1916, shall be accepted as residual value of the vessel whether in use or not unless actually abandoned, in which case sale or salvage value shall be substituted in lieu of the above-mentioned allowance: *provided further,* that the residual value of a steam vessel, not permanently discarded, shall in no case be less than $56 per dead-weight ton.

(3) On tank steamers replacement cost shall be computed at 90 per cent. of the cost per dead-weight ton of steamers of similar type, size, and speed as of or about June 30, 1916.

T. D. 3333 is hereby amended so as not to apply to vessels above described or to foreign-owned vessels provided for by T. D. 3448.

(T. D. 3468—April 21, 1923)

Exchanges of property

Articles 1566 and 1568 of regulations No. 62 amended

Subdivisions (c) and (e) of section 202 of the revenue act of 1921 were amended, to take effect January 1, 1923, by an act approved March 4, 1923 (Pub. No. 545), to read as follows (the part added by the amendment is underscored [italic], and the part eliminated by the amendment is stricken through):

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale, *and in the case of property held for investment not including stock, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest*), is exchanged for property of a like kind or use.

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation (however effected); or

(3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interests in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

(e) Where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess; but when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, ~~the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess,~~ *the amount of the gain resulting from such exchange shall be computed in accordance with subdivisions (a) and (b) of this section, but in no such case shall the taxable gain exceed the amount of the money and the fair market value of such other property received in exchange.*

Consequently, paragraph (a) of article 1566 and article 1568 of regulations No. 62 are amended, effective January 1, 1923, to read as follows:

Art. 1566. * * * (a) Where property held for investment (not including stock, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged for other property of a like kind, or where property held for productive use in trade or business is exchanged for other property of a like use. The words "like kind" are defined as having reference to the nature or character of the property and not its grade or quality. Under this paragraph no gain or loss is realized by one other than a dealer from the exchange of real estate for other real estate. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class, as real estate for personal property. The fact that any real estate involved in an exchange is improved or unimproved makes no difference, for such fact relates only to the grade or quality of the property and not to its kind or class. There is excluded from the provisions of this paragraph stock-in-trade or other property held primarily for sale. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

* * * * * * *

Art. 1568. *Exchanges of property for other property and money.*—Where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis described in articles 1561, 1562, and 1563 of the property exchanged, and if in excess of such basis shall be taxable to the extent of the excess; but when property is exchanged for property specified in paragraphs (a), (b), and (c) of article 1566 as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the amount of the gain resulting from such exchange shall be computed in accordance with article 1565, but in no case shall the taxable gain resulting from such exchange exceed the amount of the money and the fair market value of such other property received in exchange. The amount of the money and the fair market value of such other property received in exchange which is in excess of the taxable gain under the above should be applied against and reduce the basis for ascertaining the gain or loss from the subsequent sale of the property specified in paragraphs (a), (b), and (c) of article 1566 as received in exchange.

Examples.—(1) A exchanged certain property which he had purchased subsequent to March 1, 1913, for $5,000, for real estate having no readily realizable market value and $2,000 in cash. No gain or loss is realized from such exchange. However, if A subsequently sells the real estate, the difference between the amount realized therefor and $3,000, the basis of the property exchanged reduced by the amount of cash received in the exchange, is taxable gain or deductible loss, as the case may be. See also article 1564.

(2) A exchanged certain property which he had purchased subsequent to March 1, 1913, for $14,000, for stock having no readily realizable market value and bonds having a readily realizable market value of $16,000. A realized a taxable gain of $2,000, the amount by which the fair market value of the bonds exceeds the cost of the property exchanged. The entire amount received from the subsequent sale of the stock received in the exchange constitutes taxable income. See also article 1564.

(3) A, in connection with the reorganization of a corporation, received in place of stock purchased by him subsequent to March 1, 1913, for $9,000, stock of a fair market value of $8,000 in a corporation a party to the reorganization, together with cash in the amount of $4,000. A realized from the exchange a taxable gain of $3,000, the amount by which the sum of the cash and the fair market value of the stock received exceeds the cost of the property exchanged. If A subsequently sells the stock, the difference between the amount received therefor and $8,000, the $8,000 representing the basis of the old stock, $9,000, reduced by $1,000, the amount of cash received in the exchange which was in excess of the taxable gain, constitutes taxable gain or deductible loss, as the case may be. See also article 1566.

(4) A transferred to a corporation all of the outstanding stock of which was owned by him, property purchased by him subsequent to March 1, 1913, for $40,000, in exchange for stock of the corporation of a fair market value of $50,000, together with Liberty bonds of a fair market value of $10,000. A realized from the exchange a taxable gain of $10,000, the amount of the fair market value of the Liberty bonds received in the exchange. The actual gain from the exchange was $20,000, the excess of the sum of the fair market value of the Liberty bonds and the fair market value of the stock received in exchange over the cost of the property exchanged, but since the fair market value of "such other property received in exchange" is only $10,000, the limitation that the amount of the taxable gain derived shall not exceed the amount of the money or the fair market value of such other property received in exchange must be applied. Consequently, the taxable gain is limited to $10,000. Upon the subsequent sale of the stock the difference between the amount received therefor and $40,000, the cost of the property exchanged, constitutes taxable income or deductible loss, as the case may be.

It is assumed in the above examples that the property exchanged was not of a kind properly to be included in inventory. If the property exchanged was acquired prior to March 1, 1913, or by gift, devise, bequest, or inheritance, see articles 1561, 1562, and 1563.

The amount of taxable gain or deductible loss, if any, resulting from exchanges effected prior to January 1, 1923, should be determined under the statutes and regulations in effect prior to the amendments; exchanges effected subsequent to January 1, 1923, are controlled by the statute and regulations, as amended.

Connecticut Society of Certified Public Accountants

At the annual meeting of the Connecticut Society of Certified Public Accountants held at New Haven April 11, 1923, the following officers were elected: President, Milon M. Stone; vice-president, Leon E. Vannais; treasurer, Frederick W. Child; secretary, Maurice L. Blanchard; auditor, George W. Meder.

Students' Department

EDITED BY H. A. FINNEY

The following problem has been submitted to this department with a request for solution:

The Queen Paper Company operated a mill and also a rented store separate and apart from its mill. The mill was destroyed by fire December 7, 1917, and was not rebuilt after the fire, the company continuing its store business as a jobbing business. Its offices were at all times at its store.

The balance-sheets of the Queen Paper Company for five years, at December 31st, were as follows:

	Assets	Liabilities
December 31, 1916		
Current assets	$280,315.31	
Mill inventories	33,654.23	
Store inventories	249,082.72	
Real estate and equipment	48,583.86	
Store and office fixtures	4,047.47	
Current liabilities		$128,989.16
Capital stock		64,400.00
Surplus		422,294.43
Totals	$615,683.59	$615,683.59
December 31, 1917		
Current assets	$196,331.43	
Mill inventories	8,907.63	
Store inventories	274,012.85	
Real estate and equipment	60,063.28	
Current liabilities		$ 48,867.08
Capital stock		64,400.00
Surplus		426,048.11
Totals	$539,315.19	$539,315.19
December 31, 1918		
Current assets	$317,250.42	
Store inventories	248,841.75	
Current liabilities		$ 53,019.67
Capital stock		64,400.00
Surplus		448,672.50
	$566,092.17	$566,092.17
December 31, 1919		
Current assets	$487,429.53	
Store inventories	253,467.23	
Store and office fixtures	4,047.47	
Current liabilities		$113,706.65
Capital stock		64,400.00
Surplus		566,837.58
	$744,944.23	$744,944.23

December 31, 1920		
Current assets	$529,620.79	
Store inventories	298,139.31	
Store and office fixtures	4,103.79	
Current liabilities		$107,683.94
Capital stock		299,875.00
Surplus		424,304.95
	$831,863.89	$831,863.89

Because of adjustments approved by the government (during 1921) for the years 1916 to 1920, inclusive, the company employed you during the year 1921 to bring the adjustments on the books.

The adjustmehts are as follows:

1916

(1) The store inventories for December 31, 1916, are to be increased by $71,728.84.

1917

(2) The store inventories for December 31, 1917, are to be increased by $86,187.71.

(3) Store and office fixtures to the amount of $4,047.47 were written off during 1917 without any reason for so doing.

(4) The mill was destroyed by fire and the real estate and four workmen's cottages not destroyed were accepted at a valuation of $14,100.00.

(5) It was accepted that at the time of the fire the real estate, workmen's cottages, mill and equipment were worth $154,787.49, although carried on the books for $60,063.28.

(6) At the time of the fire there became due from insurance companies $84,373.70 for loss of buildings and equipment which was not set up on the books until 1918, when the money was received from the insurance companies.

(7) The government allowed a deduction for the loss against 1917 income because of the fire loss which occurred in 1917.

(8) During 1917 there was due $1,434.58 tax (on 1916 income) in addition to the amount originally paid, which is to be set up on the books. This was considered by the government in making a refund during 1921 for period 1916 to 1920, inclusive.

1918

(9) During 1918 (as stated in 6), $84,373.70 was received from insurance companies. This was credited by the bookkeeper to the real-estate-and-equipment account.

(10) The balance of the real-estate-and-equipment account was then closed by the bookkeeper into surplus.

(11) The store inventories for December 31, 1918, are to be increased by $76,013.19.

(12) During 1918 there was an overpayment of tax to the federal government (on 1917 income) of $34,290.65, claim for refund of this amount being allowed by the government during 1921.

(13) $404.75 depreciation on store and office fixtures is allowed for 1918, by which amount the account is to be reduced.

(14) During 1919 the bookkeeper did restore $4,047.47, which he had charged off during 1917, for store and office fixtures.

(15) The store inventories for December 31, 1919, are to be increased by $69,759.04.

(16) During 1919 there was an overpayment of tax to the federal government (on 1918 income) of $3,510.34, claim for refund of this amount being allowed by the government during 1921.

(17) $364.27 depreciation on store and office fixtures is allowed for the year 1919 to be credited to the account.

1920

(18) The store inventories for December 31, 1920, are to be increased by $97,139.64.

(19) During 1920 depreciation to the amount of $455.98 was written off the store-and-office-fixtures account by the bookkeeper, but only $353.07 is to be deducted for depreciation.

(20) During 1920 there was an overpayment of tax to the federal government (on 1919 income) of $8,853.62, claim for refund of this amount being allowed by the government during 1921.

(21) During 1920 the sum of $9,100.08 was paid to the government and charged against surplus as additional tax on 1917 income, assessment therefor having been levied by the government, but this amount is allowed by way of refund during 1921.

During 1921 the company received the sum of $54,320.11 from the government, being refunds for overpayment of taxes on income for the years 1917 to 1919 inclusive, less additional tax assessed on 1916 income.

Prepare adjusting journal entries and corrected balance-sheets and a statement of the adjustments (only) to surplus and a report for the client.

Further, the officers of the company request a separate statement showing how much the profits of the company were increased for each year, 1916 to 1919, inclusive, by reason of the increase of inventories.

SOLUTION

One question to be faced at the outset is the treatment of federal taxes. Was a liability for estimated taxes set up at the end of each year? If so, any additional payments in the subsequent year over and above the estimate should be charged to surplus and credited to a liability account as of the end of the year for which the tax was assessed. If the tax was charged to surplus in the year of payment, an adjustment as of the preceding December 31st would put into the balance-sheet only the liability for the additional assessment and not for the total assessment. As there seems to be no information to show which method was followed, the solution is based on the assumption that taxes were put on the books in the year of payment. The balance-sheets, after making the adjustments, are therefore subject to the qualification that they do not show the tax liability.

The adjustments in the following working papers are numbered to conform with the numbers in the problem. Some of the adjustments affect several balance-sheets; some affect only one.

Working Papers Adjusting Balance-sheets

	Balance-sheets per problem		Adjustments Dr.	Adjustments Cr.	Adjusted balance-sheets	
December 31, 1916						
Current assets	$280,315.31				$280,315.31	
Mill inventories	33,654.23				33,654.23	
Store inventories	249,082.72		$ 71,728.84 (1)		320,811.56	
Real estate and equipment.....	48,583.86				48,583.86	
Store and office fixtures	4,047.47				4,047.47	
Current liabilities		$128,989.16				$128,989.16
Capital stock		64,400.00				64,400.00
Surplus		422,294.43		$ 71,728.84 (1)		494,023.27
	$615,683.59	$615,683.59	$ 71,728.84	71,728.84	$687,412.43	$687,412.43
December 31, 1917						
Current assets	$196,331.43				$196,331.43	
Mill inventories	8,907.63				8,907.63	
Store inventories	274,012.85		$ 86,187.71 (2)		360,200.56	
Real estate and equipment ...	60,063.28			45,963.28 (4, 5, 6)	14,100.00	
Capital stock		$ 64,400.00				$ 64,400.00
Current liabilities		48,867.08				48,867.08
Surplus		426,048.11	1,434.58 (8)	86,187.71 (2) 4,047.47 (3) 38,410.42 (4, 5, 6)		553,259.13
Store and office fixtures			4,047.47 (3)		4,047.47	
Due from insurance companies			84,373.70 (4, 5, 6)		84,373.70	
Additional tax liability on 1916 income				1,434.58 (8)		1,434.58
	$539,315.19	$539,315.19	$176,043.46	$176,043.46	$667,960.79	$667,960.79
December 31, 1918						
Current assets	$317,250.42				$317,250.42	
Store inventories	248,841.75		$ 76,013.19 (11)		$324,854.94	
Current liabilities		$ 53,019.67				$ 53,019.67
Capital stock		64,400.00				64,400.00
Surplus		448,672.50	1,434.58 (8) 404.75 (13)	$ 4,047.47 (3) 14,100.00 (9, 10) 76,013.19 (11) 34,290.65 (12)		575,284.48
Store and office fixtures			4,047.47 (3)	404.75 (13)	3,642.72	
Additional tax liability—1916.				1,434.58 (8)		1,434.58
Real estate and equipment			14,100.00 (9, 10)		14,100.00	
Claim for tax refund, 1917...			34,290.65 (12)		34,290.65	
	$566,092.17	$566,092.17	$130,290.64	$130,290.64	$694,138.73	$694,138.73

Working Papers Adjusting Balance-sheets

	Balance-sheets per problem		Adjustments Dr.	Adjustments Cr.	Adjusted balance-sheets	
December 31, 1919:						
Current assets	$487,429.53				$487,429.53	
Store inventories	253,467.23		$ 69,759.04 (15)		$323,226.27	
Store and office fixtures	4,047.47			$364.27 (17) 404.75 (13)	3,278.45	
Current liabilities		$113,706.65				$113,706.65
Capital stock		64,400.00				64,400.00
Surplus		566,837.58	$ 1,434.58 (8) 404.75 (13) 364.27 (17)	14,100.00 (9, 10) 34,290.65 (12) 69,759.04 (15) 3,510.34 (16)		686,294.01
Additional tax liability—1916.				1,434.58 (8)		1,434.58
Real estate and equipment			14,100.00 (9, 10)		14,100.00	
Claim for tax refund—1917..			34,290.65 (12)		34,290.65	
Claim for tax refund—1918...			3,510.34 (16)		3,510.34	
	$744,944.23	$744,944.23	$123,863.63	$123,863.63	$865,835.24	$865,835.24
December 31, 1920						
Current assets	$529,620.79				$529,620.79	
Store inventories	298,139.31		$ 97,130.64 (18) 102.91 (19)		395,269.95	
Store and office fixtures	4,103.79			404.75 (13) 364.27 (17)	3,437.68	
Current liabilities		$107,683.94				$107,683.94
Capital stock		299,875.00				299,875.00
Surplus		424,304.95	$ 1,434.58 (8) 404.75 (13) 364.27 (17)	14,100.00 (9, 10) 34,290.65 (12) 3,510.34 (16) 97,130.64 (18) 102.91 (19) 8,853.62 (20) 9,100.08 (21)		589,189.59
Additional tax liability—1916.				1,434.58 (8)		1,434.58
Real estate and equipment....			$ 14,100.00 (9, 10)		14,100.00	
Claim for tax refund—1917..			34,290.65 (12)		34,290.65	
Claim for tax refund—1918..			3,510.34 (16)		3,510.34	
Claim for tax refund—1919..			8,853.62 (20)		8,853.62	
Claim for refund 1917 additional assessment			9,100.08 (21)		9,100.08	
	$831,863.89	$831,863.89	$169,291.84	$169,291.84	$998,183.11	$998,183.11

Explanations of Adjustments

(1) Understatement of 1916 closing inventory affects only 1916 surplus.

(2) Understatement of 1917 inventory affects only 1917 surplus.

(3) Store and office fixtures put back in assets, and surplus for 1917 and 1918 correspondingly increased.

(4, 5, 6) The real estate and equipment was carried at.... $60,063.28
Value of real estate and cottages not destroyed .. 14,100.00

The real estate and equipment was carried at....	$60,063.28
Value of real estate and cottages not destroyed ..	14,100.00
Amount written off	45,963.28
Amount due from insurance companies (charged to asset)	$84,373.70
Amount credited to asset account with property..	45,963.28
Credit to surplus	38,410.42

(7) No adjustment.

(8) See stated assumption at beginning of solution.

(9, 10) Apparently the real-estate-and-equipment account should have been left with a balance of $14,100.00, the value of the property not destroyed. This amount is therefore put into the real-estate-and-surplus accounts of 1918, 1919 and 1920.

(11) Understatement of 1918 inventory affects only 1918 surplus.

(12) Claim for refund, 1917, put into assets and surplus of 1918, 1919 and 1920 balance-sheets.

(13) Depreciation on furniture for 1918 affects assets and surplus in 1918, 1919 and 1920 balance-sheets.

(14) No adjustment.

(15) Increase of inventory affects inventory and surplus accounts of 1919 only.

(16) Overpayment of 1918 taxes in 1919 produces an asset and an addition to surplus in 1919 and 1920 balance-sheet.

(17) Depreciation for 1919 affects asset and surplus accounts of 1919 and 1920.

(18) Increase of inventory affects 1920 inventory and surplus accounts.

(19)

Depreciation credited to asset	$455.98
Credit should have been	353.07
Debit asset, credit surplus to correct	102.91

(20) Claim for refund added to assets and surplus.

(21) Same as (20).

The problem is not clear as to whether the books are to be adjusted as of the end of each year or only as of the end of 1920. An attempt to adjust the books as of each year would require entries which would probably be more confusing than clarifying, and so it is assumed that entries adjusting the books as of December 31, 1920, will be sufficient. This can be done by the following entry:

Store inventories	$ 97,130.64	
Claim for tax refund	54,320.11	
Real estate and equipment	14,100.00	
Store and office fixtures		$ 666.11
Surplus		164,884.64
This entry should be followed by a complete explanation, showing all the figures in the working papers adjusting the balance-sheet of Dec. 31, 1920.		

STATEMENT OF ADJUSTMENT OF PROFITS ON ACCOUNT OF UNDERSTATEMENT OF INVENTORIES

	1916	1917	1918	1919	1920
Opening inventory understated		$71,728.84	$86,187.71	$76,013.19	$69,759.04
Closing inventory understated	$71,728.84	86,187.71	76,013.19	69,759.04	97,130.64
Addition or deduction*	$71,728.84	$14,458.87	$10,174.52*	$ 6,254.15*	$27,371.60

Taxes and Bonuses

In the December, 1922, issue this *Department* devoted some space to a discussion of the propriety of deducting income taxes from profits in determining the basis on which employes' bonuses were computed. The editor expressed the opinion that it seemed logical to deduct such taxes in finding the profits subject to the bonus but, realizing that court decisions would govern, requested readers to furnish citations of any decisions bearing on the subject. The following letter was received in response to that request:

Editor, Students' Department:

Sir: Referring to the note entitled "Federal Taxes and Employes' Bonus," in which you invite information with respect to legal rulings and court decisions on this point—"Either the income tax is an expense or it is a division of profits. If it is an expense it is deductible in determining the net profit; if it is a division of profits it is not deductible. Which is it?"

In the course of the review of a case involving the charges of a water company for services, the United States supreme court (*Galveston Elec. Co. v. City of Galveston,* 42 Sup. Ct. Rep. 352) considered among other matters the status of federal corporation income taxes as a deduction in ascertaining net income for the purpose of determining whether the rates attacked were confiscatory.

The district court had excluded such taxes, although they had been allowed as a deduction by the master. The language of the court on this point is in full as follows:

"The remaining item as to which the master and the court differed relates to the income tax. The company assigns as error that the master allowed, but the court disallowed, as a part of the operating expenses for the year ending June 30, 1920, the sum of $16,254 paid by the company during that year for federal income taxes. The tax referred to is presumably that imposed by the act of February 24, 1919, C. 18, secs. 230-238, 40 Stat. 1057, 1075-1080, which for any year after 1918 is 10 per cent. of the net income. In calculating whether the five-cent fare will yield a proper return, it is necessary to deduct from gross revenue the expenses and charges; and all taxes which would be payable if a fair return were earned are appropriate deductions. There is no difference in this respect between state and federal taxes or between income taxes and others. But the fact that it is the federal corporate income tax for which deduction is made must be taken into consideration in determining what rate of return shall be deemed fair. For under section 216 the stockholder does not include in the income on which the normal federal tax is payable dividends received from the corporation. This tax exemption is, therefore, in effect, part of the return on the investment."

It will be observed that the court specifically classifies taxes as operating expenses and holds that in this respect federal taxes are not different from state taxes. It further holds that while these taxes are a proper deduction in determining the question of a fair return upon the value of the property devoted by the corporation to the public service, the fact that the stockholders are not required to include their dividends in computing taxable income for the purpose of the normal federal income tax should be taken into consideration. No method is suggested as to how this may be done and it would appear a matter of extreme difficulty in the case of a corporation with numerous stockholders.

The holding would seem not to affect the determination of net income for capitalization in reaching assessments in tax cases, as in such cases the inquiry is as to the fair reasonable value of the property, indicated by the earning power, as shown by actual operating results, and no question arises as to whether or not a given earning power indicates confiscation. The definite characterization of federal income taxes as well as all other taxes paid by the corporation as a deduction from gross earnings in reaching net earnings is a distinct recognition of a claim uniformly insisted upon by the corporatons in tax cases, but which has at times been rejected by commissions and courts, upon the notion, often obscurely expressed, that these charges, which are specifically imposed upon the corporation and paid by it, are not in reality expenses, although obviously reducing the sum left the corporation for distribution or for retention in the business.

In a recent case before the United States district court, southern district of New York (May 23, 1922, *N. Y. Tel. Co. v. Public Service Commission et al.*), an injunction was sought to prevent the application of reduced rates for telephone service ordered by the public service commission. One of the contentions of defendants was that the United States income tax should not be considered a deduction in determining net earnings. The court dismissed this contention in the following brief but conclusive statement:

"We note as matters debated at bar the following: (A) the deductibility from gross income of the so-called United States income tax is established by *Galveston Elec. Co. v. Galveston* (U. S. S. C., April 10, 1922)."

This feature of the case is thereafter in the opinion treated as disposed of.

Under date of December 28, 1922, the supreme court of Ohio in an opinion in the case of the *Ohio Bell Telephone Company v. Public Utilities Com.* held that "in determining whether rates chargeable by a utility yield reasonable compensation for service rendered and are just and reasonable under section 614-23, general code of Ohio, the federal income tax should be included as part of its operating expenses, to be deducted from gross revenues in ascertaining net income."

The theories as expressed in the letters of Chas. F. Seeger, like those of Messrs. Seligman, Kemper, Simpson, Nicholson, et al., are theoretically sound, but they fall down when tried before our higher courts.

The term "net profit" when used without qualification, means what is left for the stockholders from the operation of a business, and it is therefore logical to deduct all taxes whether based on income, sales, value of capital stock, etc., in determining net profit.

Trusting that this letter may be of some interest to you, I am,

Yours truly,

Philadelphia, Pennsylvania. S. S. KALISHER.

The article already referred to in the December issue contained a letter from Charles F. Seeger in which he cited a British decision published in Montgomery's *Income Tax Procedure, 1918,* page 302, as illustrating "the point that income taxes are not an expense." The editor quoted and commented upon this decision as follows:

"The paragraph in Montgomery's *Income Tax Procedure, 1918,* page 302, is the following:

> 'A decision under the British income act illustrates the point that income taxes are not of the nature of expenses:
>
> 'A gas company was prohibited by its special act from paying dividends to its shareholders above a fixed rate per annum. The company claimed to deduct the amount of the income tax from its gross profits before paying any dividend and then to pay the dividend in full to the shareholders. Held that the company was not entitled to do so, and that in arriving at the rate of dividend, the profits ought to be calculated as inclusive, and not exclusive, of the amount payable in respect of income tax.'

"To be quite honest about it, the editor of this department does not know what this decision means. But it does not seem possible that it means a requirement for the corporation to pay a dividend equal to the full amount of the profits before deducting the tax, because if the company started the year with no surplus, the payment of such a dividend would certainly leave it with a deficit at the end of the year."

This confession brought forth the following explanation from a gentleman who consents to its publication but requests the omission of his name:

"Under the British law the company must deduct at the source the individual's tax on dividends. Thus, a dividend is to be paid, say 5 per cent. on £100-0-0, or £5; the company must deduct 6 shillings in the pound and pay it to the government, paying the other 14 shillings to the stockholder:

Dividend = £5-0-0	
Pay to government	£1-10-0
Pay to stockholder	3-10-0

"The company wanted to charge the £1-10-0 to its expenses and pay the stockholder £5-10-0; the dividend was limited by law to a fixed rate—say 5 per cent.—and the company wanted to pay the 5 per cent. free of tax. It was allowed to pay 5 per cent., out of which the tax to the individual was collected at the source. It wasn't a tax question directly but a question as to the amount of dividend permitted."

JOINT-VENTURE PROFITS

The December issue also contained letters from readers taking exception to the editor's solution of a joint-venture problem. Unequal capital contributions had been made by two participants, and no agreement was stated as to the sharing of profits. A third participant entered, paying the other two individually for the privilege and receiving a capital credit by transfer from the accounts of the two original participants. The payment made was greater than the capital credit received, and the question was how to divide the payment. The editor held that the two original participants should be paid for the capital transferred and that the excess should be divided between them equally.

The criticism of this solution raised two questions:

(1) In the absence of a stated agreement, are joint-venture operating profits divided equally, as would be the case in a partnership?

(2) Does a different rule govern the distribution of profits arising from the sale of a capital interest?

Correspondence was invited on these points, citations of the law being especially requested. The following, among other letters, was received:

Editor, Students' Department:

SIR: Relative to the discussion of the joint-venture problem in your department of the December issue, I do not believe that the contentions advanced against your original solution have any merit. In the *Cyclopedia of Law and Procedure,* vol. 23, page 459, it is stated of joint adventures that, "in the absence of express agreement the law implies an equal division of profits without regard to any inequalities of contribution." Numerous cases are cited to support this statement, to which reference work I will refer the inquirer rather than fill your columns with a list of citations.

That would seem conclusive on one point at issue. The legal distinction between partnerships and joint adventures is drawn at some length several pages preceding the quotation, with the usual list of authorities. Without quoting at length, the rule seems to place the case in point definitely within the classification of a joint adventure.

The question of a differentiation between ordinary profits and profit from the disposal of a share in the venture remains. The *Cyclopedia* is silent on this point, the presumption being, therefore, that no such distinction exists. The equal distribution of losses, even when involving a levy on one sharer of the venture because of unequal contribution to repay the other is affirmed, however, and, while not entirely to the point, would tend to confirm the view that unequal contributions are to be regarded as advances.

In these circumstances the profit arising from sale of an interest in the venture may be treated in either of two ways, in both of which, however, the solution would be similar to your first. In the first place, the original venture may be considered as terminated with the introduction of a third contributor and a new adventure initiated in which the affairs of the first are introduced in statu quo. This method would leave the bonus on the one-third interest as the sole profit of the venture, subject to equal distribution.

Your own suggestion with regard to a nunc pro tunc profit distribution involves the question of whether, considered as a single venture, there is any profit to distribute. If so, is not C, now holding a third interest in the venture, entitled to a share? That is, of course, an absurdity. But consider the analogous situation in a partnership—if the contribution of an entering partner were considered as involving partnership instead of individual profit or loss, you would have a similar state of affairs.

In reality, therefore, is not the transaction one between the individual contributors and the profit involved that of a sale of part of the original interests? If this is so, all that remains is to determine their original interest, and it is to support this solution that I introduced authority tending to show excess of contribution as an advance to the venture rather than as unequal capital interest. What would be the procedure in a partnership? Would not an identical state of facts existing in a partnership be held to constitute an equal interest in spite of the disproportion of investment? An interest in the venture represents an investment of values, but more than that it represents a right to participate in profits. C did not invest $10,000.00 in $6,666.67 of goods but in that amount of goods and an expectation of profits therefrom. Since the law assumes that under the original agreement A and B were to share profits equally, each must have surrendered an equal share of his interest in the profits to C in return for his $10,000.00. This makes the transaction an individual taking of profits and withdrawal of excess contributions.

Yours truly,

Seattle, Washington. EDWIN E. ADAMS.

THIS IS NOT AN INSTITUTE EXAMINATION PROBLEM

A reader submitted the following problem with a statement that it was given last November in a state C. P. A. examination, worded somewhat differently.

On January 1, 1919, a savings bank made a loan of $5,000 for a term of five years, to be paid back in 60 equal monthly payments. The bank purported to lend money at 6 per cent. Sixty secured notes of $108.33 were taken. On January 1, 1921, there are on hand 36 of these notes. At what value should they be shown on the balance-sheet of that date? What is the effective rate of interest received by the bank?

Unless the problem, as given in the examination, made different requirements or stated additional information, it is an ideal illustration of an utterly unreasonable examination problem. No one can be expected to arrive at even an approximate solution of the effective rate portion of the problem without access to a comprehensive compound interest and annuity table, and to determine the exact effective rate requires a table of logarithms also. Even if the examiners furnished each applicant with these two tables, and if the applicants knew how to use them (as they should), the solution would require an unconscionable amount of time.

To determine the approximate effective rate:

If monthly payments of $108.33 pay off a present value of $5,000.00 and interest at an unknown rate, then a present value or indebtedness of $1.00 could be paid off by monthly payments of $108.33 ÷ 5,000, or $.021666.

Looking in a table headed "Annuity which $1 will buy," we find, on the 60 period line:

At 1%	.0222444
At ½%	.0193328
½% Differences	.0029116

Annuity which $1 will buy at the unknown rate	$.0216660
Annuity which $1 will buy at ½% per period ..	.0193328
Difference	.0023332

Then by interpolation, the effective rate (approximate) per month is: ½% + (23332/29116 of ½%) = .5% + .4% = .9%, or 10.8% a year.

To test the accuracy of this effective rate logarithms may be used and the following computations made:

$1.009^{60} = 1.7119$ amount of 1 for 60 periods at .9%.

$1 \div 1.7119 = .58414$ present value of 1 due 60 periods hence.

$1 - .58414 = .41586$ compound discount.

$.41586 \div .009 = 46.207$ present value of annuity of 1.

$\$5,000.00 \div 46.207 = \$108.21$ the monthly payment.

As this payment is smaller than the actual payment, it is evident that the effective rate is larger than .9%. Further computations may be made, which require the use of logarithms and are somewhat too complicated to show here, which will determine .904% as the correct rate per month.

To determine the value at which the notes should be carried at January 1, 1921, a computation must be made as follows:

Original debt		$5,000.00
Note paid	$108.33	
Less interest: .904% of $5,000.00	45.20	63.13
Balance		$4,936.87

After carrying this process through twenty-four similar steps, the value of the thirty-six notes on hand at January 1, 1921, will be determined.

The editor hopes that everyone who took the examination containing this problem passed.

SALE OF SUBSIDIARY STOCK BY HOLDING COMPANY

Editor, Students' Department:

SIR: Will you kindly advise through your columns the correct accounting method of handling the sale of a small portion of a majority interest in a subsidiary?

As a typical case, assume Company A owns 90% of the stock of Company B, amounting to 900 shares, which it acquired January 1, 1920, for $162,000.00. The book value of Company B's stock on the date of acquisition is $175,000.00, so in a consolidated balance-sheet the goodwill would be shown as $4,500.00. On June 30, 1920, 100 shares are sold for $200.00 each or $20,000.00, and from January 1, 1920, to June 30, 1920, Company B had made a net profit of $25,000.00. What figure would be used on the records of Company A as cost of the stock in Company B that was sold? Would it be $162,000.00 divided by 9, or $18,000.00; or would it be $162,000.00 plus $22,500.00 divided by 9, or $20,500.00? Assume in this case that it is the intention of Company A to carry the investment account in the approved manner, that is, charging it with subsidiary profits and crediting it with dividends.

Would it make any difference if this method was not used and the investment account was carried at cost? It would seem that as there can only be one correct profit, the result should be the same irrespective of the manner of reaching it. Would there be any difference if Company A had owned the B Company stock for several years and during that time profits had been charged to investment as earned and dividends credited as paid?

Detroit, Michigan. A. H. K.

Since the holding company sold 100 shares out of 900 owned, the investment account should be credited with one-ninth of its balance. Thus the amount of the credit would depend upon how the holding company had carried the investment account. If subsidiary profits have been charged to the account, the credit to the investment account will be larger than if the investment has been carried at cost. And consequently the credit to profit-and-loss or surplus for the profit on the sale will depend upon which method is followed. The net result, so far as total profit or loss on the income from the stock and from the sale of a portion thereof is concerned, will be the same in both cases.

For instance, if the holding company has taken up the subsidiary's profit for the six months since purchase, it will have taken up nine-tenths of $25,000.00, or $20,500.00. One-ninth of this $20,500.00, or $2,500.00, is income on the stock sold. When the stock is sold for $20,000.00 the account will be credited with one-ninth of the carrying value, or $162,000.00 plus $20,500.00 divided by 9, or $20,500.00, and there will be an apparent loss of $500.00 on the sale. Then the income for six months, $2,500.00, minus the loss of $500.00, leaves a net income for six months on this stock of $2,000.00.

On the other hand, if the stock has been carried at cost, $162,000.00, the investment account will be credited with $18,000.00, and there will be a $2,000.00 credit for profit on the sale. The results are the same, except that by the second method no distinction is made in the accounts between income during ownership and profit on sale.

The rule would be the same if the stock had been held for several years. Credit the investment account with cost if the stock is carried at cost, or credit the investment account with book value at the time of sale if subsidiary profits, losses and dividends have been taken up in the approved manner.

It is announced that the firm of Searle, Oakey & Miller has been formed to succeed Searle, Nicholson, Oakey & Lill. The general partners are H. F. Searle, Francis Oakey and Guy P. Miller. Thomas R. Lill is a special partner. The offices of the firm continue at 25 Broad street, New York, and the First National Bank building, Bridgeport, Connecticut.

Fred T. Nicholson, formerly of Searle, Nicholson, Oakey & Lill, announces that he will continue in practice with offices at 71 Broadway, New York.

Smart, Gore & Co. and Hyslop & McCallum announce the amalgamation of their New York practices under the firm name of Smart, Gore & Co., with offices at 42 Broadway, New York.

J. Lynde-Lockwood announces the opening of an office at Edificio La Mutua No. 501, Mexico, D. F.

Klein, Hinds & Finke announce the removal of their New York offices to 19 West 44th street.

Charles Banks & Co. announce the opening of an office at 105 west Monroe street, Chicago, Illinois.

Cecil D. Giles and Richard E. Niederwiesen announce the dissolution of partnership. C. D. Giles will continue practice under the firm name of C. D. Giles & Co., with offices at 55 John street, New York. Richard E. Niederwiesen will continue practice under the firm name of R. E. Niederwiesen & Co. at 149 Broadway, New York.

Farquhar J. MacRae & Co. announce the removal of their office to 68 William street, New York, and the opening of an office in the Bond building, Washington, D. C.

Joseph Sobel and Irving H. Avin announce the formation of a partnership under the firm name of Sobel & Avin, with offices at 233 Broadway, New York.

John F. Mahoney and Edmund F. Bowen announce the formation of a partnership, under the firm name of Mahoney & Bowen, with offices at 154 Nassau street, New York.

Touche, Niven & Co. announce the removal of their office to 80 Maiden lane, New York.

Edmund Walker & Co. announce the removal of their offices to Park-Lexington building, New York.

C. G. Robinson & Co. announce the removal of their Atlanta office to Citizens & Southern Bank building.

Flink & Krohn announce the removal of their offices to 31 Clinton street, Newark, New Jersey.

Mattison & Davey announce the opening of offices at 229 Kennedy building, Tulsa, Oklahoma, and at 712 Southern building, Washington, D. C.

William J. Struss & Co. announce the removal of their offices to 130 William street, New York.

J. W. Kera & Co. announce the removal of their offices to 1140 Broadway, New York.

Emanuel Rothman and Maurice N. Newman announce the opening of joint offices at 720 Haas building, Los Angeles, California.

Max Meyer announces the removal of his office to 220 Broadway, New York.

L. C. Matthews announces the opening of an office at 1607 Citizens & Southern Bank building, Atlanta, Georgia.

Terminology Department

CONDUCTED BY THE SPECIAL COMMITTEE ON ACCOUNTING TERMINOLOGY OF THE AMERICAN INSTITUTE OF ACOUNTANTS

The committee on terminology presents in this issue of THE JOURNAL OF ACCOUNTANCY tentative definitions of *assets* and some of the more important derivatives thereof; also a list of the various kinds of assets which the committee has compiled to date:

ASSETS:

The entire property of all kinds of an individual, corporation, association or estate available for or subject to the payment of debts.

In law the word frequently has a restricted meaning, especially in respect to bankruptcy, receiverships, and the administration of estates, and indicates the fund out of which debts can be paid.

Conventionally, debit balances subject to final disposition, such as deferred charges, discount on capital stock, prepayments and other suspense items, are classified as assets at closing periods even though the stated values rarely represent the realizable values available for or subject to the payment of debts.

For balancing purposes "deficit" is not infrequently included in the total assets; the committee believes, however, that this practice is not only misleading but incorrect, and strongly recommends an intermediate footing before stating the deficit.

The word "assets" is derived from the French "assez," meaning "sufficient," and originally signified a sufficiency of property to pay the decedent's debts.

ADMISSIBLE ASSETS:

Assets which may be included, by virtue of recent federal revenue acts, in the computation of invested capital for profits-tax purposes.

CAPITAL ASSETS:

Assets of a permanent nature or intended for long-continued use or possession, which are employed in or necessary for the conduct of an undertaking and reflect the investment of capital for the purpose of producing revenue. Specifically:

(a) Tangible assets, e.g., land, buildings, plant and equipment.

(b) Intangible assets, e.g., patent rights, franchises, rights of way, goodwill.

(c) Investments in other companies made for purposes of control.

Expenditures which tend to enhance the value of property or its efficiency may be charged as capital assets, or, to adopt a narrow view, only those expenditures may be capitalized which tend to increase revenue or diminish expenses.

CONTINGENT ASSETS:

Assets, the value or existence of which depends upon the occurrence or non-occurrence of a certain event or upon the performance or non-performance of a certain act.

CURRENT ASSETS:

Cash, receivables from outsiders, and inventories of stock-in-trade which in the regular course of business *will* be readily and quickly realized, together with such additional assets as *may* readily be converted into cash without impairing the business or enterprise, e.g., marketable securities other than those held for purposes of control, notes or accounts receivable from officers, stockholders or employees.

There are other terms of similar meaning, though not strictly synonymous with current assets, e.g., "quick assets" is most commonly used in banking circles and includes those current assets which *can* and *will* be quickly converted; "circulating assets" is commonly used by economists to denote those current assets which arise from trading or business operations; "floating assets" is an English term synonymous with circulating assets; and "liquid" or "cash assets" are those assets of any kind which may readily be converted into cash.

In some public utility accounting classifications the term "floating capital" is used in place of "current assets."

DEFERRED ASSETS:

(a) That portion of expense items which is applicable to the period subsequent to the closing date.

As used in this sense a more desirable term would be "deferred charges" or "deferred expenses," inasmuch as the charge to operations is the thing deferred and not the asset value.

(b) In some public utility accounting classifications the term is used in a different sense as descriptive of funds set aside or held in trust, e.g., insurance, provident, fidelity and indemnity funds; advance payments on contracts, etc. When "deferred assets" is used in this sense, the additional term "unadjusted debits" is used as descriptive of that portion of expense items applicable to a subsequent period as defined under (a).

(c) Of rare occurrence is the incidence of "deferred assets" as properly denoting assets, the realization of which is long postponed, e.g., the capitalization of rentals by virtue of a provision in a leasehold whereby said rentals may, at the option of the lessee, be applied on account of purchase price.

DOUBTFUL ASSETS:

Assets the value or collectibility of which is uncertain.

FICTITIOUS ASSETS:

Assets which do not represent real value or assets which cannot be realized.

The term, strictly speaking, is descriptive of book assets the value or ownership of which is based upon false premises; it is frequently used, however, synonymously with nominal assets and without suggestion of fraud, to denote assets which exist in name only or have a negligible value.

FIXED ASSETS:

This term is synonymous with capital assets in undertakings in which capital is employed for the purpose of producing revenue, but it may also refer to tangible assets in undertakings in which there is no proprietary accountability, e.g., hospitals, religious and charitable organizations, educational institutions.

The term "fixed" denotes a fixity of purpose or intent to continue use or possession, and does not refer to the immobility of an asset, the latter being the distinctive characteristic of "fixtures."

INADMISSIBLE ASSETS:

Assets which must be excluded, by virtue of recent federal revenue acts, in the computation of invested capital for profits-tax purposes.

PHYSICAL ASSETS:

Assets which have a physical existence, e.g., real estate, buildings, machinery and equipment.

PLEDGED ASSETS:

Assets physically placed in trust (e.g., securities) or mortgaged (e.g., land, buildings, plant) to secure an obligation or for other purposes.

Synonyms: mortgaged assets, hypothecated assets.

QUICK ASSETS:

Cash, and other current assets which, in the ordinary course of business, will be readily and quickly realized—a somewhat more restricted term than current assets, and used most commonly in banking circles.

TANGIBLE ASSETS:

INTANGIBLE ASSETS:

The committee feels that on account of the changed meaning of these terms the most acceptable definitions are those given in the revenue act of 1921 (substituting "tangible assets" in place of "tangible property," as quoted), viz.:

> "The term 'tangible property' means stocks, bonds, notes and other evidences of indebtedness, bills and accounts receivable, leaseholds and other property other than intangible property."
>
> "The term 'intangible property' means patents, copyrights, secret processes and formulæ, goodwill, trade-marks, trade-brands, franchises and other like property."

Among those assets not specifically mentioned in the law, but considered as tangible assets (by exclusion from "intangible property") are cash, inventories of stock-in-trade and all kinds of physical property.

Originally the term "tangible property" referred to assets which had a physical existence or were susceptible to the touch, e.g., real estate, buildings or machinery, and in that sense broadly corresponded to the legal phrase "chose in possession," as distinct from "intangible assets," which broadly corresponded to the legal phrase "chose in action."

UNPLEDGED ASSETS:

Assets which have not been hypothecated and are held in actual or constructive possession.

Synonyms: free assets, unmortgaged assets.

WASTING ASSETS:

Material assets (e.g., mines, timber lands, quarries), which diminish in value by reason of and commensurately with the removal of their product, or immaterial assets (e.g., franchises, patents) which theoretically diminish in value by reason of and commensurately with effluxion of time.

Synonym: diminishing assets.

WORKING ASSETS:

A term adopted as descriptive of assets intermediate in character between capital and current; specifically, assets which are consumed in the activities carried on without themselves forming an integral part of the product, e.g., supplies used in operations.

ASSETS:

accrued	fixed	net quick	secret
active	floating	net slow	shifting
actual	free	nominal	slow
admissible	good	non-ledger	special
available	gross	non-liquid	specific
capital	hidden	non-productive	specified
cash	hypothecated	obsolete	speculative
changeable	immaterial	obsolescent	sundry
circulating	impersonal	other	surplus
contingent	inadmissible	passive	tangible
converted	indeterminable	permanent	temporary
convertible	inflated	personal	trade
current	intangible	physical	unencumbered
dead	ledger	pledged	unmortgaged
deferred	legal	productive	unpledged
deflated	liquid	quick	unrealizable
depleted	liquidated	real	unrealized
depreciated	live	realizable	unsecured
diminishing	material	realized	wasting
doubtful	miscellaneous	receivable	working
encumbered	mortgaged	reserved	
equitable	net	saleable	
fictitious	net current	secured	

Communications may be addressed to any one of the undersigned.

EDWARD H. MOERAN, *chairman*,
120 Broadway, New York.

WALTER MUCKLOW,
420 Hill building, Jacksonville, Florida.

J. HUGH JACKSON,
56 Pine street, New York.

CARESTON D. FAIRWEATHER

Careston D. Fairweather, member of the American Institute of Accountants, certified public accountant of Minnesota, died April 29, 1923. Mr. Fairweather was a partner of the firm of David Elder & Co., New York, and a member of the Institute of Accountants and Actuaries in Glasgow.

Book Reviews

APPLIED BUSINESS FINANCE, by EDMOND EARLE LINCOLN. *A. W. Shaw Co.*, Chicago. Cloth, 772 pages.

This is a typical text-book for students, written in dogmatic style, with the usual earmarks including the use of italics for emphasis. It teems with statistics on financial data, no less than 78 tables being included covering a wide field of research, and there are also reproductions of 22 financial forms. The subject matter is divided into 25 chapters which are epitomized in a table of contents and there is also an alphabetical index more than seven pages in extent.

The scope of the book is quite amazing and the usual problems met with in financial undertakings are solved so dexterously and the pitfalls so clearly pointed out that one wonders how mistakes could possibly be made by anyone who had the foresight to invest in *Applied Business Finance*. There are rules for buying, selling, expanding, retrenching, economizing and other current activities, rules for acquiring capital and more rules for hanging on to it after you have acquired it, and, for those who have failed to observe the rules, the national bankruptcy act is explained in the final chapter.

Some of the sine-qua-nons of financial success are deliciously terse, e.g., "Begin humbly and cautiously"; "Go slowly and grow slowly"; "Know the facts"; "Don't guess"; "Put service before profits"; "Stay on the job"; "Buy light and for cash." In reference to the latter the author quotes the following (page 760): "There will be no scarcity of wine to him who hath the wherewithal to pay for it." After you have supplied the missing word in the admonition, a favorite indoor sport for students, the quotation becomes relevant.

The chapter which should be of special interest to accountants is the one on financial statements containing a pro-forma balance-sheet with comments on the various items comprised therein, prefaced with the statement that "It is wholly beyond the province of this book to give any detailed discussion of accounting methods and auditing procedure." It would have been better had the author omitted the chapter entirely, as his comments are too pessimistic and leave a bad impression by reason of the prominence given to ambiguities, sharp practice and fraud, e.g., "The item of *patents, trade-marks, goodwill,* and other *intangibles* may mean much or nothing"; "The value of goodwill * * * is subject to serious impairment at all times"; "Sometimes the item (investments) is largely padding"; "Sometimes treasury stock is included in the assets merely to pad the balance-sheet"; "Advances may mean almost anything"; "It is important to know whether so-called 'cash items' have been included for padding purposes"; "This item (notes and bills receivable) is usually anything but liquid"; "The number of opportunities for misrepresentation of its (inventory's) value are practically limitless"; "Frequently statements are dated at a time when the company's condition appears most favorable"; "There is a natural tendency on the part of human beings to minimize their liabilities and magnify their assets." The author might well have referred the student to the code of criminal procedure for enlightenment as to the varying degrees of rascality.

There is an attempt on page 313 to determine the book value of the bonds and stock set forth in the pro-forma balance-sheet and the conclusions are quite startling, e.g., each $1,000 bond is found to have a book value of $11,000 or $10,000 if "questionable items" are deducted; the apparent meaning is that the stated value of the security for the bonds, represented by the fixed assets, is 10 or 11 times the par value of the bonds, depending upon the exclusion or inclusion of intangibles. The author in this same chapter makes the following statements with reference to public accountants:

On page 290.

> "Some audits are real, so that the statements presented indicate closely the actual condition. Other audits are merely pro-forma, and are carried out perfunctorily, or the accountant may merely find what the concern wishes him to find and may permit his name to be used as a rubber stamp for a proper consideration."

On page 326, with reference to statements submitted to bankers "outside of New York City and a few financial centers":

> "The audited statement was a rarity, and it was estimated that as late as 1917 not more than 10% of the statements certified by public accountants were really audited statements. Rather, the accountants were following the practice merely of appending their signatures to the figures furnished by the company itself or of finding for the company the statement of conditions which they wished to disclose."

Statements such as those above quoted, particularly the latter, which is a more direct accusation, can only redound to the discredit of the author and tend to diminish one's faith in his ability to reach unbiased conclusions in accordance with the facts, a rather important attribute to possess in writing a book such as the one under review.

The author is obviously an economist and statistician, but not an accountant, and I am wondering whether the above may not be an unintentional distortion of the following, to be found on page 6 of *"Approved Methods for the Preparation of Balance-sheet Statements,"* which appeared originally in the *Federal Reserve Bulletin* for April, 1917:

> "Under present practice probably more than 90% of the statements certified by public accountants are what are called balance-sheet audits."

To be just, let us assume that I am right in my conjecture and that we have found merely another exemplification of the time-worn adage "Let the shoemaker stick to his last."

EDWARD H. MOERAN.

ENGINEERING ECONOMICS. FIRST PRINCIPLES, by JOHN CHARLES LOUNSBURY FISH. *McGraw-Hill Book Company,* New York. Cloth, 311 pp.

A book on the economic factors of engineering for the engineer, student and practitioner. Although in some respects it is a second edition of Professor Fish's former book of the same title, development of the investment and other factors practically compelled a rewriting to such an extent that it amounts to a new book on a rather fascinating subject. Engineers who are past masters in the technical part of their profession and yet find themselves after years of hard and faithful work occupying a modest and subordinate place in it may sometimes wonder enviously that others with no better technical ability attain world-wide reputation. Perhaps the answer may be found in this book. For study of the careers of these leaders surely proves that it is not alone the ability to plan and build structures that has given them prestige but the power to prove to investors the value of the service to be rendered by such building—in other words, the economics involved.

There are of course economic factors in the technology of engineering itself, such as costs of materials, labor, etc., but what Professor Fish aims at is the explanation of those economic factors which bring the engineer in touch with elements outside of his profession as it is generally conceived and with those which are of equal importance to the success of the enterprise as a whole. Why should an engineer know something about business organizations, finances, accounting? Because "the business unit is practically the only available medium or agency through which the engineer can convert his professional knowledge into public benefit" (p. 4). Why, again, should an engineer be expected to have a firm grasp of the principles of investment? Because "the fundamental problem of engineering economics is the problem of investment and may be stated thus: 'Given two or more opportunities for the employment of capital, to determine which is the most desirable.' * * * The problem of investment is thus one continually presented to the engineer. It is by analyzing this problem that the principles of engineering economics are to be discovered" (p. 5). And it is the development of this thesis that makes the book what I have called fascinating. Despite some pages of equations and formulæ rather formidable to a non-engineering mind like mine the term is not too strong.

The first four chapters give the general principles of investment and what might seem a very elementary explanation of the factors of simple and compound interest. Further chapters deal with practical analysis of first cost and operating expenses, procedure in estimating and like matters related to the technical end of engineering. Then we have a feature which should be all the more valuable to the ambitious engineer in that it is not usually a part of his preliminary training—a description of the types of business units organized to handle engineering propositions. It not infrequently happens that in order to carry through an enterprise successfully, especially if it be a comparatively small one, the engineer must be prepared to act as promotor and financier as well as to build and operate the plant. Two chapters cover the general principles of bookkeeping, rather sketchily to be sure, but enough to enable the engineer to understand the connection between the work and the records thereof. A highly technical chapter on valuation follows, and the volume closes with a few practical hints on how to write an intelligent *and* intelligible report.

The text is illustrated throughout by good graphic charts and figures helpful in visualizing logical procedure; and there are appendices containing formulæ and tables which should be valuable to the practitioner, especially "Table K—Structure Life Tables." For the student there is a compendious bibliography (though the author handsomely says "It is not expected that the student will look into every book in the list—far from it"!), and there is a series of questions and problems based on the chapters of the book.

Accountants will hardly agree with the professor's implication that it is not necessary to scrutinize closely the liabilities shown in the balance-sheet of "John Doe, contractor," because "liabilities at any date are exactly knowable" (p. 133). They may be "knowable"—the real question is whether they are shown in their true character or not. Furthermore, the question of contingent liability looms large in a contracting business.

W. H. Lawton.

COST ACCOUNTING PROCEDURE, by William B. Castenholz, *La Salle Extension University,* Chicago, Ill.

Opposite the title page of *Cost Accounting Procedure* appears a statement that it is one of the texts forming the basic material for an accountancy course. Looked at from that standpoint, the book is on the whole admirably adapted to its purpose. It covers clearly and in most cases concisely the rudiments of cost accounting and it presents a convenient arrangement of material and a clear explanation of the various steps, with most excellent charts. It should be a good basis for study by students and for classroom or correspondence lectures. Useful as the book may be for schools, it does not, in the opinion of the reviewer, contribute anything to the general knowledge of cost accounting, and such would not have been expected of it if it had not been for the first sentence in the author's preface. Practising cost accountants or members of the accounting profession who have made any study of costs will hardly find in the book any new ideas, but they might well recommend it to students and beginners who wish to obtain a knowledge of cost-accounting theory and the operation of such theory under more or less typical conditions.

The author's idea of a burden charge on material as well as a burden on labor is sound, but the details as explained seem unnecessarily cumbersome. The stores-ledger procedure as outlined with the suggestion that prices be carried to six decimal places hardly seems practical. The whole description of stores accounting, although orthodox, is very detailed and cumbersome, and for actual practice many shortcuts should have been suggested. In the discussion of depreciation the author practically disregards the very important question of obsolescence, for he merely mentions it at the end of the discussion without indicating its importance. In discussing normal machine operation and the causes of operating at less than normal, the author does not mention the very important factor of poor planning of work. In his chart of accounts there are serious questions whether capital stock subscriptions are current assets, whether the reserve accounts are stated in their logical order, and whether surplus reserves should not be included under the heading net worth. Although it may be necessary, in order to make the procedure entirely clear, to classify the factory expense accounts in such great detail, the author should state in the text that in actual practice many of these items can be combined to save clerical work and yet lose no information of value. His use of one-twelfth of the yearly charge as a monthly charge without any comment as to the inaccuracy of such a plan is hardly consistent with his calculation in other places of costs to hundredths of a cent. A comparison of the working days in the months of January, February and March would indicate that the division of the annual total by 12 is only a very rough approximation.

In chapter 13, entitled "Interest on plant investment," the author follows the well-known procedure in argument of setting up a straw man of his own and proceeding to pull him to pieces. The argument is in many places so exaggerated as to defeat its own purpose, and it will fail to carry conviction to anyone who looks at it in an open-minded way. The length to which the author goes in his argument is clearly indicated on page 212, where he speaks of the interest rate being "even a minus quantity." The same author who objects so much to charging interest into cost speaks approvingly of the plan on page 255 of including in production cost a portion of financing expense. Such a suggestion will hardly appeal either to the proponents or the opponents of interest charged to cost. The treatment of wages systems in chapter 16 has little or nothing to do with the subject of cost-accounting procedure. Although it is generally good, it hardly belongs in this book.

Chapter 17, on the whole, is good, but it is marred by some rather loose economic reasoning at the end. For example, the author urges permanent financing through the sale of more capital stock in the case of a company that cannot even earn interest on borrowed money. If it cannot earn interest, how can it be expected to earn a return in the form of dividends on the new capital stock; and, if not, how can it expect to sell the stock? In the last sentence of the chapter the author attributes much of the acute business depression in recent years to the efforts of manufacturers and merchants to recover both unused capacity costs and business losses from the public and the resulting refusal of the public to buy. This idea is partly sound, but the author fails to state that in the long run the cost of unused capacity must be recovered in the selling price of the product over a full business cycle of several years if capital is to have a fair return and necessary new capital is to be attracted to the industry.

The best individual contributions in the whole book are the charts liberally used with the discussion to summarize the text of each chapter, and full credit should be given to Ennes C. Rayson, who is stated to have prepared the charts. On the whole, the book is not one that will advance the science of cost accounting, but it does well serve its purpose as a text.

C. Oliver Wellington.

PRACTICAL FEDERAL INCOME-TAX PROCEDURE, 1923, by James V. Giblin. *Seaver-Howland Press,* Boston.

One is usually wary of publishers' encomiums on their own publications, but for once I can heartily endorse what the publishers say of Mr. Giblin's book in the foreword—

> Giblin's *Practical Federal Income Tax Procedure for 1923* strips the subject of its involved technical phraseology and gives in clear-cut English the necessary instructions as to filling out correctly all important returns.

It does just that. As a manual for the student or for intensive training of juniors it is excellent. The explanations of each item and the illustrations in facsimile of each form, individual, fiduciary, etc., are followed by practice questions for drill. Type and general make-up are a delight to the eye, and though its size, 11 x 9, makes it essentially a desk-book, being but a scant half-inch in thickness, it can easily be carried in a brief-case.

Its chief flaw is in the corporation return chapters which the new 1923 form makes partly obsolete. It is a pity the publication was not delayed a bit longer, though even at that one wonders why it was thought necessary to include the chapters on the excess-profits tax in the 1923 edition.

W. H. Lawton.

INVESTED CAPITAL ACCOUNTING, by James W. Beers, *Accountants' Publishing Company,* Washington, D. C. Cloth, 307 pages.

Mr. Beers is instinctively a teacher and, having joined the staff of the income-tax unit of the bureau of internal revenue, he quite naturally found himself, in due course, at the head of the training section. In the course of his work he issued a series of pamphlets on the subject of *Invested Capital and Excess Profits* and the book is a rewritten and enlarged edition.

The writing is in simple, rather breezy style and the points are driven home in clear understandable language. The first six chapters are devoted to corporation tax law; the remainder of the book to a consideration of the provisions of the 1918 income-tax law relating to invested capital. Few difficult problems are presented or explained but the usual difficulties of the layman in understanding the make-up of invested capital are satisfactorily cleared away. In the chapter on tangible and intangible property the author regrets the selection of these terms and suggests "tangible value property" and "intangible value property," citing in support the necessity of treating intangible assets, when acquired for cash, as tangible assets. The chapter on admissible and inadmissible assets constitutes a clear statement of the application of the law, but the author offers no solution for that portion of article 817 of regulations 45 reading:

> "Where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income . . . the corresponding part of the capital invested in such assets shall be deemed an admissible asset."

The following quotation on this subject is a fair sample of his commonsense attitude:

> "Further, the writer does not believe you will ever have occasion to make use of this portion of the law. At any rate, you will have no need to until such time as some corporation is found that is honest enough to tell us that it borrowed certain money with which to purchase an inadmissible. We know of no other way of finding out that there was 'interest incurred or continued to purchase or carry' an inadmissible. You can't 'tag' a dollar."

The author states that the book is published for the exclusive use of the employes of the income-tax unit. Coming from a member of the unit, the chapter on memorandum 106 is somewhat of a surprise as it is a complete and intelligent defense of the commissioner's attitude in restricting the action of the examining officers in reducing surplus by mathematical depreciation for past years unless it can be shown by affirmative evidence that insufficient depreciation has, in fact, been deducted. "To put it in a nut-shell, surplus as revealed by the books of account must be assumed to be correct in so far as depreciation or depletion is concerned unless the party, be it a taxpayer or the government, can show by 'affirmative evidence' that it is not correct. No arbitrary or dogmatic assertion that it is not correct, by either party, is to be accepted." Recent experience in the unit leaves the impression that Mr. Beers's sound conclusions on this question have not yet been wholly accepted in the unit and it is to be hoped that the book may be available not only to the employes of the unit but to the field officers who (at least in the past) seem to take a fiendish delight in causing the taxpayer an unconscionable amount of trouble in regard to this question of accrued depreciation.

Mr. Beers announces that the book is published without profit, one thousand copies having been subscribed for at cost by government employes before publication, and we have his word for it that this fact marks the publication as "a remarkable event in the world of books."

Donald Arthur.

SUCCESS THROUGH VOCATIONAL GUIDANCE, by James McKinney and A. M. Simons, American Technical Society, Chicago. 274 pages.

Success through Vocational Guidance forms part of a so-called vocational service. As the title implies, it is an attempt at occupation analysis.

Seventeen chapters and a rather long introduction comprise the material of the book. In the introduction the authors endeavor to show the need of carefully choosing one's life work and to emphasize that intelligence and planning are essential. Typical kinds of jobs are discussed and analyzed to point out that in every industry there are some functions to be performed by unskilled or manual workers, others require semi-skilled and clerical workers, where wages are higher and conditions of labor better, still others require the services of skilled craftsmen, and highest up is the employment requiring managerial or professional skill. It is the last function alone which, in the opinion of the authors, necessitates special effort and study in addition to what one may learn by experience on the job. Interesting charts are given to show the earning capacity and education of our people. Only 33 out of every 100 students who enter the grade schools of the United States complete the eighth grade and only three out of every 1,000 are graduated from college. The per capita earnings are equally startling.

The authors next discuss the personal assets of the individual and their relation to probable success. The need for leadership is emphasized, and in so far as the volume will tend to produce thoughtful consideration along these lines it has a mission. The remaining fifteen chapters take up the so-called learned professions of law, medicine and dentistry, engineering, commerce, accounting, advertising, manufacturing, banking, transportation, the building trades, hotel and restaurant keeping, mining, forestry, civil service, social service and agriculture. A formidable array, to be sure! But we very much doubt the ability of the authors to give advice on all these callings. We feel unqualified to pass judgment on many of them and shall comment only on the profession of accounting. Several statements interest us. For example, "Bookkeeping is the lowest semi-skilled profession in a line of promotion, the top step of which is certified public accountant. Bookkeepers follow precedent, work according to prescribed rules, do the same things over and over, and have therefore become the classical illustration of hopeless stagnation." We have known a goodly number of bookkeepers, and very few of them do we consider "hopelessly stagnated"—perhaps we have not a true appreciation of the hopelessness of these co-workers! Again, "While there is no sharp distinction between the two positions, the name auditor is usually applied to a person who possesses less than the skill required for a full-fledged accountant." Further, "The training for an accountant cannot be obtained in an ordinary lifetime on the job"—only by a "thorough study of accountancy" may one attain unto it! These statements and others in chapter VI on accounting lead one to believe that the authors know little about the real science of accountancy—they have no conception of the work which private and public accountants throughout America are performing every day or of the relation of these men to the industry of the nation.

Perhaps they know something about other professions—let us hope so, at any rate.

J. Hugh Jackson.

Society of Public Accountants of Nebraska

A meeting of the public accountants of Nebraska was held in the Hotel Fontenelle, Omaha, Tuesday, April 24, 1923, at 8.00 p. m., for the purpose of organizing a society of public accountants. Henry C. Moeller presided and in his opening remarks stated that the objects of the society were to unite in an organization the public accountants practising in the state of Nebraska and those who may hereafter enter into the profession; to establish a higher standard of efficiency; to impress upon the business community the importance, utility and necessity of the public accountant in the industrial and financial development of the state; to cultivate a spirit of cooperation among its members; to promote generally the interest of the profession; and to assist in carrying out the provisions of the certified public accountant law.

The society was organized and constitution and by-laws were adopted. The following directors were appointed: Henry C. Moeller, president; E. C. Babcock, vice-president; William Bryden, secretary; Dana Cole, treasurer; and Louis Gregerson.

The society is divided into active and associate membership. Active members consist of those who have been in continuous practice on their own account for at least two years preceding the filing of application or have obtained and hold a C.P.A. certificate issued by the state of Nebraska or have been employees in continuous employment with a firm of accountants for at least two years, and are now members of such accounting firm. Associate members consist of public accountants in public practice on their own account for less than two years or those who have been in the continuous employment of an active member for at least six months immediately preceding the filing of application. The society is governed by a board of five directors, all of whom must be active members and at least three shall be certified public accountants.

New York State Society of Certified Public Accountants

At the annual meeting of the New York State Society of Certified Public Accountants, May 14, 1923, the following were elected as officers for the ensuing year:

Robert H. Montgomery, president; Charles S. McCulloh, first vice-president; Joseph J. Klein, second vice-president; James F. Farrell, secretary; Willis S. Whittlesey, treasurer.

The following were elected as members of the board of directors for a period of two years: Luther K. Watkins, Henry E. Mendes, George V. McLaughlin, John T. Madden, Samuel D. Leidesdorf and Charles Hecht.

Pennsylvania Institute of Certified Public Accountants

At the annual meeting of the Pennsylvania Institute of Certified Public Accountants the following officers were elected for the ensuing year: President, John R. Lynn; vice-president, Henry C. Magee; secretary, R. J. Bennett; treasurer, William R. Main. The council members are now as follows: William J. Wilson, Joseph M. Pugh, Horace P. Griffith, G. R. Keast, Charles S. Rockey and officers of the institute.

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Compiled in the Library of the American Institute of Accountants

[Photostatic reproductions (white printing on a black background) of most of the articles listed in THE JOURNAL OF ACCOUNTANCY or *Accountants' Index* may be obtained from the library of the American Institute of Accountants, 135 Cedar Street, New York, at a rate of 25 cents a page (8½ in. x 11 in.) or 30 cents a page (11½ in. x 14 in.) plus postage. Members and associates of the American Institute of Accountants are entitled to a discount of 20 per cent. Identify the article by author, title, name of periodical in which it appeared, date of publication and paging. Payment must accompany all orders.]

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