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Students' Department

H. A. Finney

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Students' Department

EDITED BY H. A. FINNEY

ANALYSIS OF THE PROFIT-AND-LOSS STATEMENT

Auditors' reports usually contain a statement of some kind comparing the profit-and-loss statement of the year under audit with the statement of the preceding year. A common form of statement is illustrated below in condensed form.

COMPARATIVE PROFIT-AND-LOSS STATEMENT

	—Year 1920—		—Year 1921—	
	Dollars	%	Dollars	%
Net sales	\$280,000.00	100.00	\$225,000.00	100.00
Less cost of goods sold	210,000.00	75.00	185,000.00	82.22
Gross profit on sales	70,000.00	25.00	40,000.00	17.78
Less selling expenses	21,000.00	7.50	18,000.00	8.00
Net profit on sales	49,000.00	17.50	22,000.00	9.78
Less general expenses	28,000.00	10.00	20,000.00	8.89
Net profit on operations	\$21,000.00	7.50	\$2,000.00	.89

Statements are also prepared showing the increase or decrease in each item and the rate of increase or decrease.

COMPARATIVE STATEMENT OF PROFIT AND LOSS

	Year 1920	Year 1921	Increase or Decrease*
Net sales	\$280,000.00	\$225,000.00	\$55,000.00* 19.64%
Less cost of goods sold ...	210,000.00	185,000.00	25,000.00* 11.90
Gross profit on sales	70,000.00	40,000.00	30,000.00* 42.86
Less selling expenses	21,000.00	18,000.00	3,000.00* 14.29
Net profit on sales	49,000.00	22,000.00	27,000.00* 55.10
Less general expenses	28,000.00	20,000.00	8,000.00* 28.57
Net profit on operations ..	\$21,000.00	\$ 2,000.00	\$19,000.00* 90.46

The increases and decreases are misleading if they are assumed to have a direct effect on the profits. The decreased sales, for example, do not decrease the profits to the extent of \$55,000, because there should be a corresponding decrease in the cost of goods sold. On the other hand, the \$25,000 decrease in cost of goods sold is not a very significant figure. The important point is: How much should the cost of sales have decreased to correspond with the \$55,000 reduction in sales? These facts may be brought out somewhat more clearly by a statement in the following form. The 1921 figures "on the same basis as 1920" are computed by multiplying the 1921 sales by the cost and expense rates applicable to 1920.

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	— Year 1920 —		— Year 1921 —		
	Dollars	%	Actual	On same basis as 1920	Increase Decr.*
Net sales	\$280,000	100.00	\$225,000	\$225,000	
Less cost of goods sold	210,000	75.00	185,000	168,750	\$16,250
Gross profit on sales	70,000	25.00	40,000	56,250	
Less selling expenses	21,000	7.50	18,000	16,875	1,125
Net profit on sales	49,000	17.50	22,000	39,375	
Less general expenses	28,000	10.00	20,000	22,500	2,500*
Net profit on operations ..	\$21,000	7.50	\$ 2,000	\$16,875	

This statement ignores the fact that there may have been a change in the selling prices in 1921. It would be necessary to take this fact into consideration, particularly in determining what the cost of goods sold should have been in 1921, if there had been no changes in cost of sales. Giving consideration to a change in selling prices would affect the statement as follows:

Assuming a 10% reduction in selling prices, the goods sold in 1921 would have been priced at 1920 figures at $\$225,000 \div 90\% = \$250,000$.

	— Year 1920 —		— Year 1921 —		
	Dollars	%	Actual	On same basis as 1920	Increase Decr.*
Net sales	\$280,000	100.00	\$225,000	\$250,000	\$25,000*
Less cost of goods sold ...	210,000	75.00	185,000	187,500	2,500*
Gross profit on sales	70,000	25.00	40,000	62,500	22,500*
Less selling expenses	21,000	7.50	18,000	18,750	750*
Net profit on sales	49,000	17.50	22,000	43,750	21,750*
Less general expenses	28,000	10.00	20,000	25,000	5,000*
Net profit on operations	\$21,000	7.50	\$ 2,000	\$18,750	\$16,750*

Per cent. decrease in selling prices: $\$25,000 \div \$250,000 = 10\%$

Per cent. decrease in cost of sales: $\$2,500 \div \$187,500 = 1\frac{1}{3}\%$

Causes of Changes in Net Profit.

Net operating profits vary from year to year because of changes in:

- Selling prices,
- Quantity of goods sold,
- Cost of goods sold,
- Selling expenses,
- General expenses.

In explaining the methods which may be followed in preparing a statement accounting for the changes in profits caused by variations in the items just enumerated, the discussion of the effect of changes in

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selling prices will be postponed until all the other items have been considered.

Quantity of Goods Sold.

The quantity of goods sold has a direct bearing on the gross profit. To illustrate the method of showing the effect upon profits of a variation in this item, the figures in the 1921 statement will be changed so as to eliminate variations in all other items.

	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of goods sold	210,000.00	168,750.00
	70,000.00	56,250.00
Gross profit on sales	21,000.00	21,000.00
Less selling expenses	49,000.00	35,250.00
Net profit on sales	28,000.00	28,000.00
Less general expenses	\$21,000.00	\$7,250.00
Net profit on operations	\$21,000.00	\$7,250.00

The actual statement for 1921 is changed, in the foregoing statement, as follows:

In 1920 the cost of goods sold was 75% of the sales; there was no change in selling prices in 1921, and if the cost of goods sold had not changed the cost of sales would have been 75% of \$225,000, or \$168,750. The selling and general expenses are also changed to make them agree with the 1920 figures. In this statement for 1921, therefore, the quantity of goods sold is the only item showing a variation from the 1920 figures. The rate of gross profit was the same in 1921 as in 1920. Hence the reduced profit is entirely due to decreased sales, and the amount of the reduction in profit is 25% (gross profit rate) of \$55,000, the decrease in sales.

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1921	\$ 21,000.00
Net profit—1920	7,250.00
	\$ 13,750.00
Reduction in net profit	\$ 13,750.00

Accounted for as follows:

Reduced sales:

Sales—1920	\$280,000.00
Sales—1921	225,000.00
	55,000.00
Reduction in sales	25%
Multiply by rate of gross profit	\$ 13,750.00
Gross profit lost on decreased sales	\$ 13,750.00

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Variation in Cost of Goods Sold.

The figures for 1921 will now be re-stated, using the true cost of goods sold, \$185,000. We now have two variations: a decrease in the quantity of sales and an increase in the cost of goods sold. Selling and general expenses are kept the same.

	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of goods sold	210,000.00	185,000.00
	70,000.00	40,000.00
Gross profit on sales	70,000.00	40,000.00
Less selling expenses	21,000.00	21,000.00
	49,000.00	19,000.00
Net profit on sales	49,000.00	19,000.00
Less general expenses	28,000.00	28,000.00
	\$21,000.00	\$9,000.00*
Net profit or loss* on operations	\$21,000.00	\$9,000.00*

As the quantity of goods sold and the cost of goods sold have both varied, our statement accounting for the reduction in profits must show the effect of these two variations, as follows:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920		\$ 21,000.00
Net loss—1921		9,000.00
		\$ 30,000.00
Total reduction in profits		\$ 30,000.00
Accounted for as follows:		
Reduction in sales:		
Sales—1920	\$280,000.00	
Sales—1921	225,000.00	
	55,000.00	\$ 13,750.00
Gross profit lost: 25% of	55,000.00	\$ 13,750.00
Increase in cost of sales:		
Cost of sales—1921	\$185,000.00	
If there had been no increase in costs, the goods sold in 1921 would have cost 75% of \$225,000, or	168,750.00	
	16,250.00	16,250.00
Increase		16,250.00
Total reduction in profit		\$ 30,000.00

Variation in Expenses.

The original statement for 1921 will now be used, thus involving changes in four items: quantity of sales, cost of sales, selling expenses and general expenses.

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	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of sales	210,000.00	185,000.00
	70,000.00	40,000.00
Gross profit on sales	70,000.00	40,000.00
Less selling expenses	21,000.00	18,000.00
	49,000.00	22,000.00
Net profit on sales	49,000.00	22,000.00
Less general expenses	28,000.00	20,000.00
	\$21,000.00	\$2,000.00
Net profit on operations	\$21,000.00	\$2,000.00

Our statement accounting for the change in net profit will now include four items and will take the following form:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00	
Net profit—1921	2,000.00	
	\$ 19,000.00	
Reduction in net profit		\$ 19,000.00

Accounted for as follows:

Reduction in sales:

Sales—1920	\$280,000.00	
Sales—1921	225,000.00	
	55,000.00	

Gross profit lost—25% of	55,000.00	\$ 13,750.00

Increase in cost of sales:

Cost of sales—1921	\$185,000.00	
At 75% of sales, cost would have been	168,750.00	16,250.00

\$ 30,000.00

Decrease in selling expenses:

1920	\$21,000.00	
1921	18,000.00	3,000.00

Decrease in general expenses:

1920	28,000.00	
1921	20,000.00	8,000.00
		11,000.00

Reduction in net profit		\$ 19,000.00

Summary.

The preceding statements were based on the assumption that the cost of goods sold, and hence the gross profit on sales, should continue to be the same percentage of sales from year to year. On this assumption the statement accounting for the variation in profits shows the changes in profits due to

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Change in sales: difference in sales multiplied by rate of gross profit of preceding year.

Change in cost of sales: difference between actual cost in second year and the amount the goods would have cost at the rates prevailing in the preceding year.

Change in selling expense: difference between actual figures for the two years.

Change in general expense: difference between actual figures for the two years.

Selling Expenses Proportionate to Sales.

The management may believe that it is advisable and possible to keep the selling expenses, as well as the cost of goods sold, proportionate to sales. If this result is accomplished, the net profit on sales in the second year will be the same per cent. of sales as in the first year and any change in the amount of sales will result in a corresponding change in the net profit on sales. It is doubtful whether selling expenses can be kept proportionate to sales in many businesses, but if it is desired to show to what extent the selling expenses have varied from a uniform percentage of sales, the statement accounting for changes in profits may be prepared as follows:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00	
Net profit—1921	2,000.00	
Reduction in net profit	\$ 19,000.00	
Accounted for as follows:		
Reduction in sales:		
Sales—1920	\$280,000.00	
Sales—1921	225,000.00	
Net profit on sales lost: 17½% of	55,000.00	\$ 9,625.00
Increase in cost of sales:		
Cost of sales—1921	\$185,000.00	
At 75% of sales, cost would have been	168,750.00	16,250.00
Increase in selling expenses (in proportion to sales):		
Selling expenses—1921	18,000.00	
At 7½% of sales, selling expenses would have been	16,875.00	1,125.00
		\$ 27,000.00
Decrease in general expenses:		
1920	28,000.00	
1921	20,000.00	8,000.00
Reduction in net profit	\$ 19,000.00	

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General Expenses Proportionate to Sales.

While it is difficult to keep the selling expenses in a uniform ratio to sales, it is even more difficult to keep the general expenses proportionate to sales, because the general expenses consist largely of fixed charges. If it were possible to keep the cost of sales, the selling expenses and the general expenses in a uniform ratio to sales year after year, the net profit on operations would remain a uniform percentage of sales; and any variation in sales would cause a corresponding variation in the net profit on operations.

To show how far the management has failed to keep these several elements in a uniform ratio to sales, the statement may be prepared as follows:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$	21,000.00
Net profit—1921		2,000.00
		2,000.00
Reduction in net profit	\$	19,000.00

Accounted for as follows:

Reduction in sales:

Sales—1920	\$280,000.00	
Sales—1921	225,000.00	
	55,000.00	

Net profit on operations—lost: 7½% of	55,000.00	\$ 4,125.00
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Increase in cost of sales:

Cost of sales—1921	\$185,000.00	
At 75% of sales, cost would have been	168,750.00	16,250.00
	16,250.00	

Increase in selling expenses (in proportion to sales):

Selling expenses—1921	18,000.00	
At 7½% of sales, selling expenses would have been	16,875.00	1,125.00
	1,125.00	
		\$ 21,500.00

Decrease in general expenses (in proportion to sales):

At 10% of sales (as in 1920) general expenses would have been	22,500.00	
General expenses—1921	20,000.00	2,500.00
	2,500.00	

Reduction in net profit	\$	19,000.00
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Variation in Selling Prices.

To illustrate the method of showing the effect on profits of a reduction in selling prices, the statement for 1921 will be re-drawn on the assumption that selling prices were reduced 10%, while the quantity of sales, the cost of sales and the expenses remained the same as in 1920.

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	1920	1921
Net sales	\$280,000.00	\$252,000.00
Less cost of goods sold	210,000.00	210,000.00
	70,000.00	42,000.00
Gross profit on sales	70,000.00	42,000.00
Less selling expenses	21,000.00	21,000.00
	49,000.00	21,000.00
Net profit on sales	49,000.00	21,000.00
Less general expenses	28,000.00	28,000.00
	\$21,000.00	\$7,000.00*
Net profit or loss* on operations	\$21,000.00	\$7,000.00*

Since the same quantity of goods was sold in 1921 as in 1920, and since costs and expenses remained the same as in 1920, the entire change in profits was caused by decreased selling prices.

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net loss—1921	7,000.00
	\$28,000.00
Reduction in net profit	\$28,000.00
Accounted for as follows:	
Reduction in selling prices:	
Sales of 1921 at 1920 prices: $\$252,000 \div 90\% =$	\$280,000.00
Actual 1921 sales	252,000.00
	\$ 28,000.00
Reduction in net profits	\$ 28,000.00

Variation in Selling Prices and Quantity of Sales.

The 1921 statement will now be changed as follows:

Sales will be reduced from \$280,000 to \$225,000, the total decrease from the 1920 sales being the result of a 10% reduction in selling prices and a decrease in the quantity of goods sold:

$\$225,000 \div 90\% = \$250,000$, the price at which the 1921 sales would have sold at 1920 prices.

$\$280,000 - \$250,000 = \$30,000$, decrease in sales (at 1920 prices).

Since it is assumed that the goods cost the same in 1921 as in 1920, the cost of goods sold is shown at 75% of \$250,000, or \$187,500.

	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of goods sold	210,000.00	187,500.00
	70,000.00	37,500.00
Gross profit on sales	70,000.00	37,500.00
Less selling expenses	21,000.00	21,000.00
	49,000.00	16,500.00
Net profit on sales	49,000.00	16,500.00
Less general expenses	28,000.00	28,000.00
	\$21,000.00	\$11,500.00*
Net profit or loss* on operations	\$21,000.00	\$11,500.00*

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The following statement shows how the profits of 1921 were reduced by decreased selling prices and decreased quantity of sales.

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net loss—1921	11,500.00
	\$ 32,500.00

Accounted for as follows:

Reduction in quantity of sales:

Sales—1920	\$280,000.00
Sales of 1921 at 1920 prices:	
$\$225,000 \div 90\% =$	250,000.00

Reduction in sales	30,000.00
Multiply by 1920 rate of gross profit	25%

Reduction in gross profit from decreased sales \$ 7,500.00

Reduction in selling prices:

1921 sales at 1920 prices	250,000.00
1921 sales at actual prices	225,000.00

Reduction in gross profit from decreased selling prices 25,000.00

Total reduction in net profit

	\$ 32,500.00
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Variations in Selling Prices, Quantity of Sales and Cost of Goods Sold.

To show the effect of changes in selling prices, quantity of sales and cost of goods sold, the last illustration will be changed by reducing the cost of sales from \$187,500 to \$185,000.

	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of goods sold	210,000.00	185,000.00
Gross profit on sales	70,000.00	40,000.00
Less selling expenses	21,000.00	21,000.00
Net profit on sales	49,000.00	19,000.00
Less general expenses	28,000.00	28,000.00
Net profit or loss* on operations	\$21,000.00	\$9,000.00*

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net loss—1921	9,000.00
	\$ 30,000.00

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Accounted for as follows:

Reduction in quantity of sales:

Sales—1920	\$280,000.00	
Sales—1921 at 1920 prices:		
\$225,000 ÷ 90% =	250,000.00	
Reduction in sales	30,000.00	
Multiply by 1920 rate of gross profit	25%	
Reduction in gross profit from decreased sales		\$ 7,500.00

Reduction in selling prices:

1921 sales at 1920 prices	250,000.00	
1921 sales at actual prices	225,000.00	
Reduction in gross profit from decreased selling prices		25,000.00
Total		\$ 32,500.00

Decreased cost of sales:

If there had been no change in costs, the goods sold in 1921 would have cost:

1921 sales at 1920 prices.....	\$250,000.00	
Multiply by	75%	
	187,500.00	
Actual cost	185,000.00	
Increase in gross profit from decreased costs		2,500.00

Total reduction in net profit \$ 30,000.00

Variations in Selling Prices, Quantity of Sales, Cost of Sales, Selling and General Expenses.

To illustrate the method of showing how profits are affected by all of the changes enumerated, we shall now return to the original statements:

	1920	1921
Net sales	\$280,000.00	\$225,000.00
Less cost of goods sold	210,000.00	185,000.00
Gross profit on sales	70,000.00	40,000.00
Less selling expenses	21,000.00	18,000.00
Net profit on sales	49,000.00	22,000.00
Less general expenses	28,000.00	20,000.00
Net profit on operations	\$21,000.00	\$2,000.00

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STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00		
Net profit—1921	2,000.00		
Reduction in net profit	\$ 19,000.00		
Accounted for as follows:			
Reduction in quantity of sales:			
Sales—1920	\$280,000.00		
Sales—1921, at 1920 prices	250,000.00		
Reduction in sales	30,000.00		
Multiply by 1920 rate of gross profit	25%		
Reduction in gross profit from decreased sales		\$ 7,500.00	
Reduction in selling prices:			
1921 sales at 1920 prices	\$250,000.00		
1921 sales at actual prices	225,000.00		
Reduction in gross profit from decreased selling prices		25,000.00	
Total		\$ 32,500.00	
Increased cost of sales:			
If there had been no increase in costs, the goods sold in 1921 would have cost:			
1921 sales at 1920 prices.....	\$250,000.00		
Multiply by	75%		
Cost on 1920 basis	187,500.00		
Actual cost of 1921 sales	185,000.00	2,500.00	
Reduction in selling expenses:			
1920	21,000.00		
1921	18,000.00	3,000.00	
Reduction in general expenses:			
1920	28,000.00		
1921	20,000.00	8,000.00	13,500.00
Reduction in net profit			\$ 19,000.00

Selling Expenses Proportionate to Quantity of Goods Sold.

The statement may be altered to show how far the management has failed to keep the selling expenses proportionate to sales. If it is desired to bring out this fact, the statement may be prepared in the following manner.

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STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00	
Net profit—1921	2,000.00	
Reduction in net profit	<u>\$ 19,000.00</u>	
Accounted for as follows:		
Reduction in quantity of sales:		
Sales—1920	\$280,000.00	
Sales—1921, at 1920 prices	250,000.00	
	<u>35,000.00</u>	
Multiply by 1920 rate of net profit on sales	17½%	
	<u> </u>	
Reduction in net profit on sales, from decreased sales		\$5,250.00
Reduction in selling prices:		
1921 sales at 1920 prices	\$250,000.00	
1921 sales at actual prices	225,000.00	
	<u>25,000.00</u>	
Reduction in net profit on sales, from decreased selling prices		25,000.00
Total		<u>\$ 30,250.00</u>
Reduction in cost of sales:		
Cost of sales at 1920 figures would have been	\$187,500.00	
Cost of sales—1921—actual	185,000.00	
	<u>2,500.00</u>	
Increase in net profit on sales, from decreased cost of sales		2,500.00
Reduction in selling expenses (in proportion to quantity of goods sold):		
If the selling expenses had been kept in the same proportion to the quantity of goods sold as in 1920, the selling expenses of 1921 would have been 7½% of \$250,000 = 18,750.00		
Selling expenses—actual	18,000.00	
	<u>750.00</u>	
Decrease		750.00
Reduction in general expenses:		
1920	28,000.00	
1921	20,000.00	
	<u>8,000.00</u>	
Decrease		11,250.00
Reduction in net profit		<u><u>\$19,000.00</u></u>

General Expenses Proportionate to Quantity of Goods Sold.

The statement may also be prepared in such a way as to show to what extent the general expenses have varied from a uniform ratio to sales.

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STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT		
Net profit—1920	\$ 21,000.00	
Net profit—1921	2,000.00	
		\$ 19,000.00
Reduction in net profit		
\$ 19,000.00		
Accounted for as follows:		
Reduction in quantity of sales:		
Sales—1920	\$280,000.00	
Sales—1921 at 1920 prices	250,000.00	
		30,000.00
Reduction in sales	30,000.00	
Multiply by 1920 rate of net profit on operations	7½%	
		\$2,250.00
Reduction in net operating profit from decreased sales		\$2,250.00
Reduction in selling prices:		
1921 sales at 1920 prices	\$250,000.00	
1921 sales at actual prices	225,000.00	
		25,000.00
Reduction in net operating profit from decreased selling prices		25,000.00
		27,250.00
Total		27,250.00
Reduction in cost of sales:		
Cost of sales at 1920 figures would have been	\$187,500.00	
Cost of sales—1921—actual	185,000.00	
		2,500.00
Increase in net operating profit from decrease in cost of sales		2,500.00
Reduction in selling expenses (in proportion to quantity of sales):		
If the selling expenses had been kept in the same proportion to quantity of goods sold as in 1920, the selling expenses of 1921 would have been: 7½% of \$250,000 = 18,750.00		
Selling expenses—actual ..	18,000.00	
		750.00
Decrease	750.00	
Reduction in general expenses (in proportion to quantity of sales):		
If the general expenses had been kept in the same proportion to the quantity of goods sold as in 1920, the general expenses of 1921 would have been: 10% of \$250,000 = 25,000.00		
General expenses—actual	20,000.00	
		5,000.00
Decrease	5,000.00	8,250.00
		\$ 19,000.00
Reduction in net profit		\$ 19,000.00

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Rates of Change in Selling Prices Unknown.

While the statements on the preceding pages furnish valuable information, they cannot be prepared in the form shown without definite knowledge of the rate of change in selling prices. This information is usually not obtainable; hence it is impossible to show the effect upon the profits of the changes in selling prices as well as in the cost of the goods sold.

In such circumstances it may be assumed that any reduction in selling prices should be accompanied by a corresponding reduction in cost of sales. That is, if the goods sold cost 75% of the selling price in 1921, a reduction in the selling price should be accompanied by a sufficient reduction in costs so that the cost of sales will continue to be 75% of the selling price, and the gross profit will remain 25% of the sales. On this assumption the statement may be prepared as follows:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net profit—1921	2,000.00
	\$ 19,000.00

Accounted for as follows:

Decrease in sales:

Sales—1920	\$280,000.00
Sales—1921	225,000.00

Decrease	55,000.00
Multiply by rate of gross profit in 1920	25%

Gross profit lost on decreased sales	\$13,750.00
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Increased cost of sales—in proportion to sales:

Cost of sales—1921	185,000.00
If the cost had been kept at 75% of the sales the cost would have been 75% of \$225,000	168,750.00

Total decrease in gross profit	30,000.00
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Decrease in selling expenses:

1920	\$ 21,000.00		
1921	18,000.00	3,000.00	

Decrease in general expenses:

1920	28,000.00		
1921	20,000.00	8,000.00	11,000.00

Reduction in net profit	\$ 19,000.00
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Students' Department

Perhaps a more logical way of approaching the problem, particularly in a trading business where costs cannot be controlled, is to ascertain what the selling prices should have been to maintain the same rate of gross profit as in prior years. This fact may be brought out as follows:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net profit—1921	2,000.00

Reduction in net profit	\$ 19,000.00

Accounted for as follows:

From insufficient mark-up:

In 1920 the rate of gross profit was 25%;
hence the rate of mark-up was 33⅓%.

The cost of goods sold in 1921 was \$185,000.

At a mark-up of 33⅓% the sales for 1921
should have been 133⅓% of \$185,000, or \$246,666.67

The sales for 1921 were 225,000.00

Profit lost from insufficient mark-up \$21,666.67

From reduced sales:

Sales—1920 280,000.00

Sales—1921—adjusted to 33⅓% mark-up 246,666.67

25% of 33,333.33 8,333.33

Total 30,000.00

Decrease in selling expense 3,000.00

Decrease in general expense 8,000.00 11,000.00

Reduction in net profit \$ 19,000.00

Difference in Rate of Gross Profit.

If it is desired to show the effect of a change in the rate of gross profit, without analyzing the causes of the change in gross profit to show how much of the change is due to a reduction in selling prices and how much to a variation in cost of goods sold, the statement may be prepared in the following manner:

STATEMENT ACCOUNTING FOR REDUCTION IN NET PROFIT

Net profit—1920	\$ 21,000.00
Net profit—1921	2,000.00

Reduction in net profit	\$ 19,000.00

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Accounted for as follows:

The gross profit in 1920 on \$280,000 of sales was		\$70,000.00
The rate of gross profit in 1920 was 25%, while in 1921 it was only 17.77+%. Therefore, if the sales in 1921 had been	\$280,000.00	
the cost of goods sold would have been 82.22+% of \$280,000, or	230,222.22	
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and the gross profit would have been 17.77+% of \$280,000, or		49,777.78
Therefore, even if the sales had been kept up to the 1920 figure there would have been a loss of gross profit amounting to		20,222.22
There was a further reduction in gross profit due to the fact that the sales of 1921 did not reach the 1920 figure of	\$280,000.00	
The sales were only	225,000.00	
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and the company lost 17.77+% on this decrease of	55,000.00	9,777.78
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Total		\$ 30,000.00
Against this decrease in gross profit there are offsets due to the reduction in expenses:		
Selling expenses:		
1920	\$ 21,000.00	
1921	18,000.00	3,000.00
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General expenses:		
1920	28,000.00	
1921	20,000.00	8,000.00
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Reduction in net profit		\$ 19,000.00
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Presentation to Edward E. Gore

Edward E. Gore, member of council, American Institute of Accountants, was guest of honor at a banquet at the Blackstone Hotel, Chicago, on April 27th. The banquet was given by the Illinois Society of Certified Public Accountants in recognition of the honor conferred upon Mr. Gore in his election as president of the Chicago Association of Commerce, and also in recognition of his services to the accounting profession. A solid silver tea and coffee set was presented by the society. Among the speakers were George W. Rossetter, chairman; Ernest Reckitt, Harry A. Wheeler, vice-president of the Union Trust Co.; Joseph H. Defrees, president, United States Chamber of Commerce; R. E. Heilman, dean of the school of commerce, Northwestern University.