Journal of Accountancy

Volume 29 | Issue 2 | Article 4

2-1920

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A prominent man in the textile industry while discussing the development of the use of standard accounting methods asked: "Why should we capitalize all additions to plant and equipment? We have always charged them to expenses in order that the book values of the property might be conservatively stated." The idea is typical of many old and successful textile firms, that is, to use arbitrary accounting methods to establish hidden reserves in their financial statements.

The real objection to the use of such methods is not due to the purpose intended to be accomplished, but to the manner in which it is carried out. Perhaps the best answer would be a plea for the use of uniform accounting in the industry.

The use of uniform or standard accounting methods has been developed greatly during the last few years. Their advantages have been conceded in the case of accounting for public institutions, and they have been successfully used by all public utility industries. Several semi-public and private industries have more recently adopted generally uniform methods. The federal government, through its recent requirements for taxation, to some extent, has standardized accounting in all industries.

The textile industry, embracing the manufacture of cotton, woolen, worsted and kindred goods, is one of the oldest and largest of our industries. Many of the firms have been using about the same general accounting systems for a generation or more without embodying modern standard principles. As they have been successful financially and are large and powerful, it might be more difficult to convince these members of the industry that standard and uniform accounting methods for the industry would be a great improvement.

Uniform accounting for the industry might be limited to uniformity as to the accounting principles used and the requirement of certain results to be obtained through a uniform general

* A thesis presented at the November, 1919, examinations of the American Institute of Accountants.

classification of accounts and not necessarily be extended to any prescribed system or methods. The results required would be uniform financial statements which might follow the lines suggested by the federal trade commission as standard forms for general use. Simple uniform cost accounting systems could be adopted by the different branches of the industry which might be perfected by combining the best ideas in the industry and allow for extension according to the details desired.

The general advantages to be derived from uniform accounting by the textile industry may be grouped under three general divisions: (1) more general use of standard accounting principles and methods; (2) benefits from trustworthy comparisons; (3) general use as a basis for determining selling prices.

As the uniform accounting would embody the best accounting in the industry it would improve the methods of any firms which still used the old so-called conservative but inaccurate and misleading accounting methods. Uniform accounting means the use of standard accounting methods such as will show the true profits, expenses and financial condition.

If it were desired to reserve part of the profits to take care of unforeseen but possible losses, this would be done with the full knowledge of the directors and with a complete record thereof. The accounts kept to show the cost of the plant, for example, would show it correctly and be available for other uses, such as making the correct annual provision for depreciation; using the true invested capital in computing excess profits taxes; adjustment of losses from fires; in case of sales of the property; or showing more correctly the actual surplus of the company in case of sales of the capital stock.

The arbitrary methods common among many textile firms have resulted at times in concealing profits and understating the assets. Plant values have been reduced arbitrarily and concealed in reductions of the profits. Profits have been understated by including the cost of additions to the plant in the repairs, labor and materials expenses. Inventories of the product have been undervalued, causing misstatements of the profits.

These arbitrary charges to profits have occurred irregularly and only in years when good profits have been shown. In other years perhaps the proper provision for depreciation was not made. The result might be that over a period of years good profits would appear to have been earned consistently each year. In this way the extent of the effect of the fluctuating conditions in the industry might have been concealed from the directors as well as the stockholders.

It is important, for example, that the directors be fully informed as to the effects of fluctuations in prices of the raw materials used. The importance of the policy of keeping purchases of raw materials covered by sales orders of the finished product will then be understood.

There was a common method, used by the cotton mills in New England, of understating the cost value of inventories of work in process. The materials in process of manufacture were valued at an amount far below the cost of the raw material, not to mention the labor and overhead costs. There was no system in the method except to make the value low for conservative purposes in financial statements. Usually the method was applied more or less to the finished product, resulting in understating its value also.

The common argument in the industry in defense of the method has been that if the plant were to shut down at any time the work in process would be worth only a scrap value. If the scrap value basis had been used consistently there would have been more merit in the argument. The values, however, varied from year to year without relation to the scrap values and when the method was applied to the finished product there was not the same justification for it.

It is impossible to find the profits on an accurate cost basis by using this method of valuing inventories. If it is desired to create a reserve out of profits, one may be established after the correct profits for the period have been shown.

A standard cost or market value basis of valuing inventories is now demanded for the purpose of determining the profits for taxation under the federal income and excess profits taxes. It should be noted that the additional value of the inventories on this basis increases the invested capital and therefore decreases the excess profits taxes to be paid. The requirements of the federal government through the income and excess profits taxes have made it necessary for the executives at least to take into consideration the results of these arbitrary methods. While many have believed it the easiest course to change their methods, they have done so as though compelled by the tax authorities. If they realized, however, the full significance of the indirect effect of their methods on their business they would have changed more willingly.

Capital stock is often held by trustees for the benefit of widows and children. They are entitled to know the exact condition of the business in order to determine whether to hold the stock or to sell it and replace it with an investment in a more stable industry, or perhaps to change from common stock to preferred stock or bonds of the same company.

If, in enlarging the business, additional capital were desired the bankers would require financial statements of the business covering several years. They would want to know the true financial position and the correct results of the business each year. The bankers, while appreciating the company's explanation that its reports were conservative for one reason or another, would put more faith in the reports themselves and not have to rely so much on the character of the officers making them or on accountants if the reports were free from concealed arbitrary methods and were prepared on recognized, sound accounting principles.

Many textile firms have modern accounting systems and know their value. These firms, therefore, would be the quickest to see the additional advantages from uniform accounting methods in the industry. Everyone knows the value of the standard form of railroad reports for comparative and other purposes to the officers, investors and public. The principle of the standard form has many well-known advantages. The application to any particular industry or group will vary only in the extent of the details. The volume of details required in railroading, of course, would not apply to the textile industry.

The Harvard graduate school of business administration has undertaken to develop the use of uniform accounting in the retail shoe business. It is intended, also, as an example to other industries to show the advantages to be derived from the adoption of standard methods in general. Large numbers of firms have adopted it and furnish their statements periodically, from which average statistics are prepared for their information and use.

In the interest of uniformity in balance-sheets and income statements, principally for industrials, the federal reserve board has published a pamphlet intended to standardize the form and preparation of these statements. This uniform standard of financial statements might be adopted as a general standard by any industry. The federal trade commission has seen the wisdom of recommending a simple and general cost accounting system for manufacturers in order to benefit those having only imperfect systems and by spreading this information generally to improve and more or less to standardize accounting methods. Another pamphlet was issued outlining a simple set of accounts for retail merchants.

One of the branches of the textile industry adopted a uniform cost accounting system within the past few years in an effort to educate the members of the trade to know their costs. A firm of accountants collaborated with members of the association and a simple uniform system was perfected which was adopted formally by the association and is used by a large number in the business.

When the form is accepted as a standard in the industry there will be a better general understanding and appreciation of financial and statistical statements. When it is known that certain firms' statements are inaccurate for one reason or another or are made up on an antiquated basis giving little opportunity for intelligent comparisons, the comparative value of the accounting statements of the industry is lost. A standard form would be simple to learn and understand; investors, bankers and officers would be more interested thereby; and the statements would be of much greater value to all.

Standard or accepted forms of statements would be useful for comparative purposes by officers. Different departments or mills in which they are interested might be put on an accurate comparative and competitive basis with each other. The causes of the weakness or strength in each might be graphically and quickly brought to the attention of the executives. A continuous record of the changes from period to period in these vital points of the business would give the proper guidance to executive judgment in operating the business. This, however, cannot be realized, unless the accounts and statistics are prepared on the same general basis and in the same form.

Comparisons are often made without preparing the accounts in this way and erroneous conclusions are necessarily reached. For example, waste from raw material, which is an important item in textile manufacturing, may be recorded in the accounts as an income or sale; it may be credited to the cost of the raw material when charged to process; it may be carried at the selling prices or at arbitrary percentages of cost prices. Loss on seconds may be shown separately, and on the basis of costs or on arbitrary basis are not to be shown separately. Labor may be carried in one account or may be subdivided into repairs and general mill overhead expenses, etc. Coal used may be charged on the actual weights or on arbitrary estimated weights with comparatively large adjustments when the stock on hand is verified. There may be differences as to where the line between plant replacements and repairs is drawn, leading to important differences in the amount shown as repairs expense. The mill overhead may be apportioned over the departments in one case and may be carried in lump sums in another or it may be apportioned on an incorrect basis. There are numerous ways in which differences in the preparation of statistics in the same business may be entirely misleading for comparisons.

In the case of comparisons between the results of different lines of business within the textile industry, only certain points of similarity are open to a beneficial comparison. However, from the financial point of view, valuable comparisons may be made as tending to show the trend of change between the kinds of business. The general percentage of profits on sales and on the capital as compared with previous periods is useful to the financial interests. Comparisons of the increase in volume of sales and increase in capital required are useful for different kinds of business to indicate where developments and enlarged operations should be undertaken.

Let us suppose that the same executives managing different lines of business in the textile industry have the accounts of these plants thoroughly examined and comparisons made. The comparative costs per unit for direct labor, material and overhead for the different plants at the same date would not have much value. There might, however, be some value in statistics showing the comparative fluctuations from period to period as indicating the tendencies of changes. For example, it would be valuable to the executives to know the comparative increases or decreases in the various items of cost in the different lines of business, such as labor and materials, and also the comparative fluctuations in the margin of profits.

While one plant might have reported fair profits and perhaps in some respects have been arbitrarily conservative, yet with its reports completely prepared on the basis adopted by the others it might be found that this plant was not making a proper return on its investment. It is difficult to overestimate the value to the executives if this were found during a period when selling prices in general were advancing and might be fixed at any level within reason.

An example of the use of uniform accounting was seen in the federal trade commission's general investigation of cotton mill costs for the purpose of fixing maximum prices during the war. Costs and other data were prepared under a generally uniform system from the accounts and records of numerous mills. These were compared and averages were worked out. From this information maximum prices could be established intelligently at levels which would result in good profits to all.

Similar methods were used by the United States navy during the war in determining settlements for special articles furnished when prices could not be fixed in advance of production. The costs and other data were assembled under a generally uniform system. The results of similar firms were compared. These results could be used in making settlements which allowed good profits. Without this uniform system the purpose of the plan could not have been carried out.

The fundamental principle of the cost-plus contract is that to the measure of profit is to be added reimbursement for costs determined on standard cost accounting principles. The emergency contracts used by the government departments called for the use of accepted cost accounting principles applied uniformly in making settlements under the contracts.

It is evident that there are well defined and accepted general and cost accounting principles. If in the application of these principles to the industry the accounts are prepared under a uniform general classification, the results may be used for comparisons, which will form a sound basis for executive judgment in controlling the business.

Selling price levels can also be fixed by executives with approximate knowledge of the profit to be derived from their mills. If costs prepared by different mills are used as the basis for selling prices, the methods of preparing the costs should be uniform, or the executives will be relying on certain profits as being earned when in reality some mills may be losing money.

There are probably few cost accounting systems in use in the textile industry in general. In some instances, it may be considered that the business is simple and that costs may be readily ascertained by the use of estimates. This is perhaps true in a few cases but it would be easier to adopt a uniform system which has been accepted in general. In other cases of more complicated manufacturing, the actual costs are not known.

Both inadequate costs systems and lack of uniformity in calculating costs have been the cause of ruinous price-cutting. The industry should not be at the mercy of firms which do not know their own costs.

It would be the purpose of uniform cost accounting in the industry to prevent cut-throat competition. With the use of uniform cost accounting, there would be general appreciation of actual costs. If any companies chose to use price-cutting methods, they would fall with full knowledge of their costs and expectation of their doom.

It has been held that general trade organizations for the control and fixing of prices in an industry are illegal. If an association were conducted with the purpose of promoting better general knowledge of accurate costs as a basis for selling prices, the undertaking would have legal sanction as well as merit from a practical and business point of view. It would be to the best interests of the industry to establish the custom of basing selling prices on actual cost, plus a certain return on the investment.

Mill cost generally means the cost of the finished product in the mill. In addition the executive must consider the general administrative and selling expenses, plus the profit, in determining minimum selling prices. The general overhead is almost uniformly expressed in the form of a percentage of the expenses to the mill cost, usually taking into consideration the volume of business for the period. There are also general principles to be observed in application of the profit allowance to costs for determining the minimum selling price basis.

For example, suppose a twenty per cent return per annum be considered a necessary average margin of profit in the textile industry. As a general proposition, the average total assets used in the business, less the non-interest-bearing liabilities, represent the capital entitled to its return. The volume of business at the mill cost plus general overhead expenses constitutes the turnover, which may be expressed in its percentage to the capital. If the turnover be at the rate of once a year on the capital, the rate (twenty per cent) which is to be earned on the capital, may be applied to the cost, plus the general overhead, for the profit allowance. If the turnover be twice a year, one-half the rate of profit or ten per cent may be applied to the cost and yield the same rate or twenty per cent per annum on the capital.

The necessary return on the capital may be calculated more closely by including in the profit allowance only the specified rate of return on any capital in the form of interest bearing indebtedness or preferred stock. The result would be that with a smaller total profit allowance the same rate of twenty per cent might still be earned on the common stock. If the product is divided into different classes which utilize entirely disproportionate amounts of capital, the latter should be sub-divided between the departments in determining the capital on which the return is to be completed.

The value of uniform accounting to the textile industry in educating its members to know their costs and necessary margin of profit in order to prevent unintelligent competition alone would be sufficient to make it desirable. The other advantages, however, are equally important in providing accurate comparative statistics for the guidance of executive judgment, in improving certain antiquated methods used and in increasing intelligent use of financial reports by bankers and investors which would serve to put the industry in its proper light.