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J. S. Seidman

Thomas York

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CORRESPONDENCE

Whose Are the Financial Statements?

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: Recent experiences have clearly brought home the fact that there are two concepts underlying the work of accountants that the public has difficulty in grasping. One is that the financial statements are representations of the client, not the accountant. The other is that accountants merely express an opinion—expert to be sure—rather than ascertain inexorable facts. As to the first item, there seems to be confusion even within the ranks of accountants.

Since these matters are basic in the organic structure of the profession and since it is clear that there has been much too much of a gap between the public's impression of what an accountant does and stands for in comparison with the accountant's knowledge of the nature and scope of his work, every step that can hope to have the effect of narrowing the band of difference is appealing, whether it deals with minutiae or reaches to the foundations. Toward that end, the following may provoke consideration:

(1) If accountants' stationery were used only to embody the accountant's opinion and comments and not for the accompanying financial statements, it would enhance the psychological mechanism that would establish the cleavage between the representation by the client and the rôle of the accountant.

To the layman, including the client, the accountant's opinion and the financial statements are like Siamese twins. They look alike and are physically conjoined. Since the opinion is that of the accountant, the natural and inexorable conclusion to the outsider is that the statements are the accountant's. That type of inevitable reasoning could be halted and the actual relationship better established and publicized if the financial statements were on the client's stationery or on nobody's stationery, and the accountant put on his own stationery only the part where he really begins to speak. The mechanics of identifying the opinion with the statements need create no pause.

The viewpoint here expressed is already exemplified in the general run of report to stockholders. That, of course, is in its external aspects a company product. The embodiment of the accountant's opinion with reference to the financial statements is clearly as a supplement to those statements and not as an inherent presentation by the accountant. A similar background houses an S.E.C. filing. The extension of this procedure to all cases where an accountant passes judgment on financial statements will help calm the troubled waters.

(2) The layman believes that financial statements, after review by accountants, present the absolute, indisputable, and final answer. Undoubtedly, the roots of this belief are watered by observation of accountants at work and through the setup of financial statements. In the one instance, he has undoubtedly seen accountants spend hours and hours to develop an accrual or a deferment down to the last penny. In the financial statements, he sees separate classifications or reference to insignificant amounts, and this opens laymen's vistas of accuracy down to these small amounts.

To look upon financial statements broadly as reflections of expert judgment, and on the other hand to wallow in fractions and hairsplitting is like mating centrifugal and centripetal forces. That convenient combination is one that we can reasonably expect from laymen only under extraordinary amiability and indulgence. Should we not rather publicize the predicate of judgment at every opportunity by steering clear of the imputations that lurk in these narrow channels for hairline precision?

Nothing here said is to be regarded as in any way flirting with a slip-shod or curve-rounding approach. All that is intended is that we avoid losing ourselves in frills and fancies of classification and computation that have no substantial significance.

(3) The profession had an excellent op-

portunity to drive home the "judgment" idea when it reconsidered the title or heading for the embodiment of the conclusion of the accountant with reference to financial statements. The word "report" was selected. The word "opinion" would have clinched the idea for the public.

The tremendous growth of the profession within and without has in the past afforded limited opportunity for inventory taking in terms of public relations. That dislocations exist, recent events have abundantly demonstrated. There need be no uneasiness that we will get them straightened out in forthright fashion. Perhaps the bits here enumerated may aid in the process.

Yours truly,

J. S. SEIDMAN

New York, N. Y.

Treatment of Bond Discount

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: The choice of method in the balance-sheet treatment of bond discount, from the point of view of the issuing company, is invariably considered, it seems, to be between two alternatives, each of which has its advocates among accountants. One is to handle the discount as an item on the asset side of the balance-sheet, and the other as a deduction from the face amount of the bonds on the liability side. But there is still another method of handling bond discount, which appears to be deserving of consideration by accountants. It is a variation of the second of the two afore-mentioned methods, and its use may possibly serve to overcome the objections which some accountants see in showing bond discount on the liability side of the balance-sheet.

From the viewpoint of this third method, the total interest paid on bonds issued at a discount consists of two parts, differing from each other merely in the time of payment: (1) the instalment payments at the coupon rate, and (2) the lump-sum payment at the maturity of the bonds, which is equal to the original or gross discount. In any account-keeping on the basis of the accrual system, the second element of interest, or lump-sum payment, must, of course, be prorated over the years comprising the life of the bonds, if the annual profit-and-loss showing is not to be distorted. These annual charges to income in advance of the lump-sum payment when the bonds mature and are paid, represent a type of expense which under the so-called accrual system of accounting is charged against the revenue of each of a succession of years by way of anticipating a certain and inevitable expenditure of funds upon the expiration of those years, which expenditure can on no account be capitalized. Viewing the entry from the credit side, the portion of the interest which is not due and payable until the principal of the bonds is paid should be accrued cumulatively as a liability over the entire life of the bonds, in conformity with the same principle by which interest due and payable in instalments is accrued when the balance-sheet date falls between two successive instalment interest dates. Is it not quite evident then that the total cumulative amount accrued at the close of each successive year during the life of the bonds should be shown on the balance-sheet as a separate liability item, and not be buried by crediting it to the bond discount account, as it is at present where the practice is followed of showing bond discount on the liability side? In the same balance-sheet in which this accrued liability is displayed, the bond discount should be allowed to remain fixed and unvarying at its original amount, and be shown as a deduction from the face amount of the bonds. A standing record of the actual principal of the loan evidenced by the bonds will thus be maintained.

In the case of a bond premium it is the principal, rather than the interest, which falls into two divisions because of the difference in the time of payment: (1) the face amount payable at the maturity date of the bonds and (2) the premium which is amortized or paid in semiannual or other instalments over the life of the bonds. The total amount paid in discharge of the obligation on the coupons of a particular date is comprised of three elements—interest on the face amount of the bonds, interest on the premium as amortized to that date, and an instalment of the premium. The actual liability at any balance-sheet date on account of the principal of bonds issued at a premium is, therefore, the sum of two amounts—the face amount and the remaining or unamortized portion of the premium; and it might not inappropriately be shown as such in the balance-sheet.

Yours truly,

THOMAS YORK

New York, N. Y.