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Whose Balance-sheet Is It?

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: The leading editorial in the February issue quotes William W. Werntz, chief accountant of the Securities and Exchange Commission, who questions the habitual use of the standard short form of auditor's certificate.

Mr. Werntz might also have been quoted on the subject, Whose balance-sheet is it? unless that question is presumed to have been settled for all time at the San Francisco meeting. In the *Papers on Auditing Procedure*, recently published by the Institute, some interesting facts are recorded.

It appears that Mr. Stempf of New York not only supported his committee's point of view, but also selected his opponent in the discussion. Herbert W. McIntosh, the western representative of an eastern accounting firm, says in his opening paragraph:

> "Mr. Stempf has asked me to discuss the question, Whose balance-sheet is it? from the standpoint of its being the public accountant's, although my views are that it is the client's balance-sheet."

Thus peace and harmony prevailed.

But although the question may have been settled to the satisfaction of the Institute management, there still remains to be considered the judgment of the general public. Possibly Mr. Werntz expresses that point of view when he says:

> "Quite obviously, also, an accountant can and sometimes does prepare statements for a business that represent principally his own judgment, and not that of the management."

Such outside points of view, uninfluenced by fraternal considerations, are important, because in the long run the responsibility of the public accountant will be fixed by the general public, possibly through legislation, administrative or court decisions, regardless of any pronouncements those in the profession may make.

Another interesting point of view is that of banker W. H. Thomson, who says:

> "Too many of the considerations and decisions of your Institute have been based on the treatment that should be given to audits of extremely large concerns. This is no doubt due to the fact that your Institute is dominated to a large extent by eastern thought."

The representative of a large eastern accounting firm was recently asked how he began an audit. He replied: "We generally begin with the balance-sheet." To an old-fashioned accountant, this might seem like putting the cart before the horse. It suggests the following questions:

1. Does the accounting profession no longer favor the old method of going first to the general ledger, obtaining a trial balance before closing, then analyzing and verifying until the meaning and integrity of every account is clear to the auditor?
2. Does the accounting profession favor discarding the work sheet, which provided for extension of the auditor's adjustments, and the segregation of results into income and balance-sheet groups from which statements were compiled by the auditor for inclusion in his report?
3. Does the accounting profession no longer undertake to do synthetic or constructive work in preparing an audit report, but instead favor confining its procedure to reviewing statements prepared by a client's employees?

These questions are pertinent in view of statements which appear in the Securities and Exchange Commission's accounting series release No. 13, dated February 20, 1940.

I should like to hear from independent accountants on these questions, particularly those not connected with firms the business of which is largely confined to reviewing statements of listed concerns.

Yours truly,

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General Tax Formula

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: Having just worked out by algebra a case of federal income tax, state income tax, and bonus where each is arrived at after deducting the other two and where excess-profits tax did not have to be considered, I tried to find a general formula which would save a great deal of multiplication and division. Below is the result than which nothing could be simpler. It may be of no general interest but you may have it for what it is worth.

Symbols

P = Profit before deducting any of the three
F = Federal income tax
f = Rate of same (per unit)
S = State income tax
s = Rate of same
B = Bonus
b = Rate of same

First find bonus:

$$B = P\,\frac{((b-bf)\,(1-sf)-bs\,(1-f)^2)}{((1-bf)\,(1-sf)-bs\,(1-f)^2)}$$

(Notice that numerator and denominator differ only in the first term)

$$S=(P-B)\left(\frac{s-sf}{1-sf}\right)$$

$$F=(P-B-S)f$$

CAUTION.—Note that the rates are *per unit.* That is, if the rates are: federal 15 per cent, state 2 per cent and bonus 10 per cent: $f = .15$, $s = .02$, $b = .1$.

Yours truly,
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Puzzling Incident

Editor, THE JOURNAL OF ACCOUNTANCY:

DEAR SIR: An amusing story of the pricking of a large bubble of suspected public misdealing, appearing in the columns of a midwestern capital paper, has come to my attention. It happened a couple of years ago, but it's still worth repeating.

It seems that a city out in the state bought the local water works, whereat certain people were greatly exercised in their minds, and in digging around for dirt, they found that $1,275,000 of bonds were issued in the deal, but that only $1,125,000 in cash was accounted for. WHO GOT THE DIFFERENCE???

Much ink slinging ensued in the public press, and finally "investigators" found the whole story in the files of a bank. The answer was simply that the investment bankers had agreed to furnish $1,125,000 on a 4½ per cent yield basis, the bankers to set the coupon rate. They decided on a 3 ¾ per cent coupon rate, which automatically (as well as "mathematically," as the news story had it) hoisted the "face value" of the bonds to $1,275,000. Quoting from the news report:

"This transposition of bond total and interest rates has proved the most puzzling of any of the puzzling incidents that attended the acquisition of the water works. Few citizens, critical or otherwise, ever went to the trouble to ascertain that the cost to the water consumers of issuing and servicing $1,275,000 of 3 ¾ per cent bonds is no more than the cost of issuing and servicing $1,125,000 of 4½ per cent bonds."

Nothing Machiavellian here. But the funniest part of the story comes when it turns out that since the information from the bank's files was not contained in a public record, "the state board of accounts, jurisdiction of which is limited to investigation of official records, is still in a quandary as to how to make a report on this transaction after several months of investigation."

Is one unjust to ascribe some of this muddle to the bogeyman PAR, and to the very orthodox (yes, indeed) procedure of grabbing hold of part of the bond document and saying, "Here's what we owe," and losing sight of other equally important parts of the same document which are equally "owed" — the present worth of *all* these future owings ("face" and "coupons" to the one-track mind) being what we really owe *now?*

Another query: Is this story really amusing?

Yours truly,
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