

12-1915

Correspondence: Treatment of Bank Account

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Recommended Citation

Martin, Selden O. and Sunley, W. T. Jr. (1915) "Correspondence: Treatment of Bank Account," *Journal of Accountancy*. Vol. 20: Iss. 6, Article 9.

Available at: <https://egrove.olemiss.edu/jofa/vol20/iss6/9>

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Correspondence

Treatment of Bank Account

Editor, The Journal of Accountancy:

Sir: A letter in the November number of THE JOURNAL OF ACCOUNTANCY quotes the following paragraph from a letter of mine to a wholesaler of groceries:

" . . . we think that since bills are not legally paid until the bank on which cheques are drawn has canceled them, you would be more exact if you allowed for your outstanding cheques on your cash book, even if, for some practical reasons, it might be more convenient to deduct the outstanding cheques from your bank balance."

Though this paragraph was in reply to a specific request from him, it was incidental to the main part of my letter, which related to the Harvard system of accounts for retail grocers.

The bureau of business research has never regarded accounting as its chief work, and has never thought itself to be an accounting authority. The bureau's main object is the collection of information about business. In this collection it has found necessary the introduction of uniform systems of accounts. These systems, apparently becoming standard in the trades to which they refer—shoe and grocery, have been approved by the accounting profession and favorably commented upon in your JOURNAL. The bureau's long-standing policy has been not to trouble itself with accounting questions unconnected with the use of its systems, and it certainly has no intention of arguing any point on which a majority of accountants are agreed. Consequently, I hope the fact will be accepted that the offending paragraph was a personal expression incidental in a letter about another matter. Inspection would hardly pronounce the paragraph polemical, and it certainly had no intention of advocating a reduction of accounts payable by outstanding cheques with bank balance unchanged, as at least one accountant seems to have understood it. Against a practice so obviously incorrect explicit warning did not seem to be required.

Furthermore, in justice to the courses in accounting in the graduate school of business administration of Harvard university, I am glad to say that they are in no way responsible for the paragraph; and that such accounting practice has never been taught in them.

Yours very truly,

SELDEN O. MARTIN,

Director, Bureau of Business Research.

Cambridge, Massachusetts, November 18, 1915.

Editor, The Journal of Accountancy:

Sir: Mr. LeMaster's letter in the November JOURNAL relative to outstanding cheques is very interesting. The writer offers the following ideas, trusting they may assist in stimulating further discussion.

The Journal of Accountancy

Theoretically, an amount equal to the amount of the outstanding cheques would be withdrawn from the general bank account and deposited in a separate fund. This would be shown on the balance sheet as "fund reserved for outstanding cheques" and a corresponding liability, "outstanding cheques," set up. This seems to the writer to express the actual condition on the balance sheet date. It would be incorrect to deduct the amount of the outstanding cheques from the total monthly disbursements. The company has issued these cheques, the transactions have been recorded and the effect should be set up on the balance sheet. These outstanding cheques are not accounts payable, but orders on the bank not yet paid.

Practically, the balance sheet is not usually completed until ten, fifteen and sometimes thirty days after the end of the month. Consequently the fund reserved for outstanding cheques is most probably paid out by the bank and the corresponding liability liquidated before the balance sheet is completed. So, for the sake of brevity and condensation, the fund and its corresponding liability are usually omitted, on the presumption that the bank and the creditor will complete the transaction which the company has already recorded as complete on its books.

That this presumption may prove incorrect is a contingency that the auditor must not overlook.

In this connection an experience, which came to the writer's attention, may be of interest. A corporation's books were examined by an auditor representing a bonding house. The corporation made a practice of drawing cheques for all accounts as soon as due and held them until there were sufficient funds in the bank to meet the cheques. The result on the balance sheet, which the auditor ordinarily would have submitted, is obvious. No past due accounts would be shown and the large bank overdraft would seem to indicate either unusual confidence in the corporation by the bank (which, incidentally, would lend it nothing) or the corporation's ability to borrow readily.

In Mr. LeMaster's letter we notice the statement in Mr. Martin's reply:

"We think that since bills are not legally paid until the bank on which cheques are drawn has canceled them . . ."

In most cases this is so but the accountant must not overlook the few exceptions. A certified cheque, when this form of payment is specified by the drawee, is legal payment by the drawer before the bank has canceled it. A cheque, the payment of which is delayed by the negligence of the drawee, constitutes legal payment by the drawer. These two exceptions are of importance in case of the bank's becoming insolvent.

Another exception which has no practical bearing on the question might be mentioned. A cheque issued by A is finally returned to A in payment of the account of a third party and may never be canceled by the bank and yet constitute legal payment of the debt for which it was issued.

Yours truly,

W. T. SUNLEY, JR.

Detroit, Michigan, November 15, 1915.