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Correspondence

Adjustment of Fire Losses

Editor, The Journal of Accountancy:

Sir: The writer, who is an adjuster of fire losses, has read with much interest the articles of Mr. H. C. Bentley running in your magazine. The departments of accounting touched by the adjuster are not extensive, but within their limits there is a variation of method and lack of standards which is deplorable. No one will more highly approve of the effort Mr. Bentley is making than the representatives of the fire insurance companies on whom devolves the work of auditing the claims of the insuring public.

Referring particularly to page 399 of the June number, under heading *Cost of Goods Sold,* Mr. Bentley has the following sentence:

> "An inventory which has been written down to market value knocks the computation of goods subsequently sold into a cocked hat, so to speak."

In the adjustment of losses or stocks of merchandise this very feature of inventories taken at figures other than original invoice price, or original invoice price, freight added, or original invoice price less cash discount, or original invoice price, less cash discount, freight added, or cash is constantly causing troubles and wrangles, being invariably a source of friction in a class of adjustments which should be simply problems of accounting with only one solution.

Note the position in which a merchant finds himself in the following circumstances. His first inventory is made on one of the above mentioned bases. His second is written down to a depreciated figure, or to show the then market value, which has declined. No notation is made on the inventory showing that it has been written down, or the amount by which it has been written down. Some six months later he is burned out.

The only evidence of his profits will be the showing of his books between the inventory dates. With his last inventory made on a written down and uncertain basis it will be impossible to ascertain the cost of goods sold. In other words, it will be impossible to separate the profit made in the sales from the loss occasioned by the lower market or the effects of depreciation. The only obtainable profit will be the gross profit of his business. Reducing this profit to a percentage of the sales made during that period, and then deducting the same percentage from his sales between date of last inventory and date of fire, the resulting figure will not represent the true cost of the goods sold. It will yield a figure which is not only the cost of the goods sold, but cost *plus* loss by depreciation. Subtracting this figure from aggregate of inventory and purchases, the remainder will show stock on hand at time of fire considerably less than actual stock. The adjuster representing the insurance company will then properly demand a deduction from this figure of such depreciation as is to be expected in such stocks. If the inventory cannot be checked back to invoices to prove its writing down, the merchant will either be compelled to yield the depreciation or face the uncertainty of an appraisal, as no adjuster feels justified in accepting as depreciated or written down an inventory which bears no original entry nor notation of such depression. As there are numbers of articles which are inventoried in such a way as to make impossible a checking back to invoices, the danger of the written down inventory is apparent.

The writer had occasion recently to compare the book showing of stock in one of our large department stores with actual stock taken under direction of adjusters at invoice price. After reducing the actual inventory showing to cost by applying average freight and cash discount, and depreciating this figure ten per cent, there was still considerably more stock on hand than was shown by the books. Had the firm burned out so as to require an adjustment from the books alone, their inventories would have furnished no evidence as to the amount of depreciation. Ten per cent would have been a fair depreciation, and this firm would have lost some $12,000 by reason of bad accounting methods.

The accountant supervising mercantile operations where the stocks are liable to destruction by fire should never forget that his client any day may be called upon to witness the loss of his entire physical assets and face the future with nothing but a set of books and a batch of policies. Then, if ever, he is in need of accurate records, the bases of which are his inventories. If these have been properly taken, and his records of purchases and sales preserved, his adjustment nine times out of ten will move smoothly to a prompt and equitable settlement. But if the inventories have been taken on a reduced basis, and there is no way of producing from the books evidence of the reduction, he will probably carry to his grave the conviction that company adjusters are hired simply to cut down claims to the last possible dollar.

While the writer has seen nothing in Mr. Bentley's articles referring to the calculation of stock on hand in case of fire, yet the direction for making inventories as outlined by Mr. Bentley on page 334 of the May number contains an instruction which, if carried out, would eliminate any possible contention on this score. That instruction is as follows:

> "Goods which are shop-worn, or otherwise damaged, or the value of which has materially decreased because of change in styles, or because of their being out of season, *should be inventoried at both cost and depreciated value.*"

The adjusters of the country will heartily welcome Mr. Bentley's suggested standard in this matter.

I suggest the term *Invoice Price* in preference to *Invoice Cost*, as cost and price are not synonymous. The application of cash discount and inward freight to invoice price produces cost.

Yours very truly,

PRENTISS B. REED.

Birmingham, Ala., July 1, 1912.

When the Year Ends on Sunday

Editor, The Journal of Accountancy:

Sir: In reply to the letter of *Semper Vigilans* appearing in the June issue I would like to say that I consider that he is correct in stating that a fiscal year should consist of the entire year even though the last day happens to be Sunday. Hence the balance sheet submitted in the May number should have been dated December 31, 1911. I computed accruals to and including December 31, but dated the balance sheet as of December 30, 1911. Following *Vigilans'* suggestion I made the profit and loss statement and supporting schedules cover a full year ending December 31, 1911.

Yours truly,

H. C. Bentley.

Standardization of Accounting Forms

Editor, The Journal of Accountancy:

Sir: I have been reading with much interest the series of articles by Mr. Bentley on the *Standardization of Accounting Forms and Methods* which you are publishing and would be glad if he would explain what appears to be an inconsistency in the June installment. In this number as well as in his *Science of Accounts* he says that unless a proper proportion of freight and hauling inward is added to the invoice cost of goods on hand both at the beginning and close of the period, freight and hauling inward may as well be closed as an operating expense. This seems to admit of no argument but would not the same theory apply to purchasing department expenses and warehouse expenses which he includes in exhibit B, schedule 1? Would it not be simpler and equally satisfactory to eliminate all these items from the cost of goods sold, thus making this caption represent nothing but the net invoice cost of the turnover?

Very truly yours,

J. A. Councilor.

Fort Yates, N. D., July 5, 1912.

Editor, The Journal of Accountancy:

Sir: I have read with great pleasure Mr. Bentley's articles on *Standardization of Accounting Forms and Methods,* and will say that this is certainly a great step in the right direction. I wish to call your attention, however, to the article which appeared in the June, 1912, issue.

Under heading of exhibit B, schedule 1, Mr. Bentley shows all the different expenses incurred in procuring the raw material. The cost of goods on hand at end of period however is shown at its prime cost, *i. e.*, what the firm paid to the different firms from which the goods were bought. My opinion, however, is that these goods on hand should bear an equal proportion of the expenses to those which were in the manufacturing processes.

I would like to hear Mr. Bentley's ideas on this point—which appears to be all important in preparing the profit and loss statement, as the addition to the goods on hand would certainly increase the profits carried to surplus account.

Yours truly,

F. J. VANDER HOEVEN.

Chicago, July 9, 1912.

Editor, Journal of Accountancy:

Sir: In the fifth article on *Standardization of Accounting Forms and Methods,* on page 28 of your issue of July, 1912, Mr. Bentley discusses the subject of cash discounts as follows:

> "How in the name of common sense an accountant can consider cash discounts on purchases as a deduction from gross purchases when computing net profit is more than the writer can comprehend."

As an accountant who has recommended to clients this deduction of cash discounts from purchases, I feel that the other side of the case from that taken by Mr. Bentley should be stated.

In many lines of business, and notably in the case of dry goods, the cash discounts run as high as 10%. One of the large department stores in Boston shows a gain from cash discounts during the year greater than the net profit from the business. If, in the loss and gain statement of this company, the cash discounts were shown as "other income," the results from the general trading would show a loss which would emphatically not show the true results of the trading, as the heads of the departments in purchasing, and in placing the sales prices on merchandise, take into consideration the cash discounts. Every discount is taken as a matter of course, and it is never regarded merely as an extra source of income. The logical conclusion seems to be that cash discounts should be deducted from the cost of the merchandise.

I think all accountants will agree with me that accounts should be carried on the books to give information to the men in control of the business. Comparing two departments operated under the plan suggested by Mr. Bentley, the department which dealt in merchandise on which there was but a small cash discount might show a fair profit, while another, for example the dress goods department, showed a loss, which loss was of course more than counterbalanced by the cash discounts taken, but credited in the general account of cash discounts instead of to the dress goods department. The question which should, and I believe does, interest the managers of a business, is not what they have gained in cash discounts during the year, but what they have lost from discounts which they might have taken. If the amount lost in discounts is large, the net gain from borrowing money to take cash discounts will be readily seen.

As a converse to deducting the cash discounts from purchases, we must necessarily deduct cash discounts allowed customers on sales. The same reasoning supports both procedures. The subject of cash discounts is treated at length in Chapter 21 of Professor W. M. Cole's work on *Accounts, Their Construction and Interpretation,* and I recommend that Mr. Bentley and other accountants who hold his views refer to this chapter.

Very truly yours,

C. OLIVER WELLINGTON.

Boston, July 23, 1912.

An Appreciation of the New York C. P. A. Examinations

Editor, Journal of Accountancy:

Sir: As a candidate who took the June examination for certified public accountant in the state of New York, and before knowing the result, I desire to express my appreciation of the character of the questions in all of the four subjects. I believe I am a practical accountant, for I first entered the office of a chartered accountant in London nearly twenty-four years ago, and have had a varied experience in American offices for twenty years. Circumstances have prevented my trying for the C. P. A. degree until this year, but I have watched the examination questions in many states, and particularly New York, for many years. I have heard the examinations in the past criticised as being "theoretical," "academic," and no real "test of a practical man." Surely this criticism cannot fairly hold against the recent examination. Whether I, personally, have been successful or not, I submit that the questions were eminently practical, covering a wide and proper range in all four subjects, —a fair and excellent test of a man's right to practise as a C. P. A., and comparing well with the best examination ever held for certified public accountants in the United States or for chartered accountants in Great Britain—and I have read the questions set at the majority of them from the beginning of examinations to date.

The refreshing feature of the examination is the evident purpose of the board of examiners to maintain, and to hold candidates to, standards. Practical accountants have preached for years of the necessity for standardizing nomenclature, classifications and forms, etc., yet when the Inter-State Commerce Commission comes out as an authorized supreme court of last resort, possessing all the final authority of law, and imposes upon the profession a classification of accounts for steam roads, for instance, some of these same accountants "howl" because said classification does not meet their narrow views in some particular. Likewise with the Public Service Commission and its accounting rules for various public utilities. These men overlook the fact that these governmental bodies have honestly sought and obtained the opinions of the very best practical men in the offices of railroads and other enterprises concerned.

Question No. 7 in the theory paper, "How does the Inter-State Commerce Commission require reserves to be presented in the balance sheets of common carriers?" and question No. 14 in the same paper are surely eminently practical questions, and aim to test a knowledge of standards having the sanction of law—an authority higher than the opinion of any accountant. The relation of question No. 7 in theory to question No. 1 in practical accounting,—*i. e.* the preparation of a balance sheet to meet the requirements of the Inter-State Commerce Commission, is evident. Question No. 1 in the theory paper, "Reduce the single entry system to a few accounting equations that will embody all its basic principles," has a very direct relation to the principles involved in question No. 3 in the practical paper. I venture to say that very few practical accountants recognize that there are any basic principles in single entry book-keeping, but the insurance department of the state of New York recognizes it in requiring the preparation of form No. 1 of the annual report of life insurance companies, "Proof of ledger assets"—upon which form of statement question No. 3 in the practical paper is evidently based. The writer of a recent book on the *Science of Accounts* will probably be shocked at the board's recognition of "unscientific" standards set by the New York state insurance department. Question No. 3 of the theory paper, which gave me an opportunity to deny the many extravagant claims made for the voucher record was most acceptable. How many victims of "systems" installed by "practical" accountants are today sighing for a creditors' ledger? The relation of question No. 9 in theory to question No. 2 in practical is evident. Both are eminently practical questions met with by every experienced accountant and involving points upon which any man entitled to a C. P. A. appendage should be informed.

The paper on auditing, in my opinion, marks a great step forward in coming closer to the every-day work of the public accountant. The academic youngster undoubtedly fell short on question No. 1. A correct answer required actual knowledge—not the guess-work by which questions in examinations some years back might have been correctly answered. The questions searching the auditor's knowledge in dealing with defalcations (No. 2 and No. 12) are, I believe, quite a departure from the style of auditing questions heretofore set. Question No. 3 required an answer which, to be correct, would make the "comments" on audits of some practising accountants with reference to the steps taken to verify an inventory look elementary. Likewise question No. 6, which I believe is unique. How often do practical accountants take steps in an audit to safeguard a client regarding the fire insurance carried on a stock of merchandise? Twenty, fifteen, or even only ten years ago, the auditors I knew would say such a matter was beyond their province. What? Beyond the province of a practical accountant? The New York state board of examiners evidently doesn't recognize the narrow limitation of the responsibilities of the profession.

I do not desire to trespass unduly on your space, but, in conclusion, would briefly refer to the paper on commercial law. The paper was, in my opinion, admirable and in line with the others referred to above. It covered the accounting field, embracing the law of contract, negotiable instruments, marine and fire insurance, partnership corporations, agency, etc.

The profession is to be congratulated on the evident care which was taken by the examiners to make an examination in every respect worthy of its highest aims.

Yours truly,

FRED'K GEO. COLLEY.

New York, July 15th, 1912.

Announcements

E. A. Ashdown, C.P.A., and A. S. Fedde, C.P.A., announce the consolidation of their accounting practice under the firm name of Ashdown, Fedde and Company. The offices of the firm are in the National Bank of Commerce Building, 31 Nassau Street, New York City.

John H. Baker, C.P.A., formerly accountant and auditor of the Colorado Title and Trust Company, announces the opening of offices on May 1st, last, at 415 Exchange National Bank Building, Colorada Springs, for the independent practice of public accounting.

New York State Society of Certified Public Accountants

The New York State Society of Certified Public Accountants has elected the following delegates and alternates to represent the society at the annual convention of the American Association of Public Accountants:

Delegates	*Alternates*
W. F. Weiss, chairman	James T. Anyon
Alexander Aderer	David E. Boyce
Frank Broaker	Hervey S. Champlin
Leonard H. Conant	Howard B. Cook
Henry R. M. Cook	W. J. Gunnell
Leon O. Fisher	Alexander Hunter
Charles Hecht	Maurice S. Kuhns
Frederick H. Hurdman	Charles A. Mackenzie
Richard T. Lingley	John Moull
Charles S. Ludlam	Charles A. Nicklas
Charles S. McWhorter	Henry A. Niles
Duncan MacInnes	Homer S. Pace
Perley Morse	Alfred Rose
J. Lee Nicholson	Dan Sachs
Warrel S. Pangborn	Harry T. Searle
S. D. Patterson	Dana F. Stark
John R. Sparrow	A. S. Vaughan
Elijah W. Sells	W. A. Watson
Arthur W. Teele	Norman E. Webster
William H. West	James F. White
John R. Wildman	A. F. Wicks