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Accounting Questions

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INSTALMENT PURCHASE OF REAL ESTATE

Question: Will you send me some information with reference to the correct way to record on a balance-sheet real estate being purchased under an instalment contract. Which of the following three ways should it be reported:

(a) The net amount paid as an equity;

(b) The gross purchase price on the asset side of the balance-sheet, less the unpaid balance of the contract with the balance extended as equity owned;

(c) The purchase price of the real estate shown on the asset side as real estate being purchased under contract, and on the liability side the balance of the contract shown as an instalment real estate contract payable?

Answer: Such transactions as are referred to fall into one of two classes:

1. Those in which the obligation is assumed by the purchaser.
2. Those in which the contract gives the purchaser merely the right to buy the property, but he does not enter into an obligation to complete the transaction.

In class 1 there is a definite liability and, in my opinion, the proper way to enter such transactions is to show the purchase price among the assets and to set up the unpaid portion as a liability which is reduced as each payment is made. It sometimes happens that this liability is in the form of periodic instalments. In that case a portion of it might fall under "current liabilities" and a portion under "deferred liabilities."

As to class 2, the purchaser has no liability and I think the best way to show the transaction is to place the amounts paid among the assets. This may be done in one of two ways, as indicated by your correspondent under (a) and (b). These two methods give the same result but 2 gives full information and I therefore think it is to be preferred to 1.

BEDAUX POINT SYSTEM

Question: A client of ours has raised a question with regard to using the Bedaux wage-payment plan as a method of distributing manufacturing overhead.

A company manufacturing food products consisting of 1,200 standard items has been operating a standard cost system for a period of years. It is now installing the Bedaux wage-payment plan. This plan as a measurement of labor "is based on the principle that all human effort may be measured in terms of a common unit, that unit being made up of a combination of work and rest. The Bedaux unit, or B, is a fraction of a minute of work plus a fraction of a minute of rest, always aggregating unity, but varying in proportion according to the nature of the strain."

In the Bedaux plan the "B" is a basic element of control. All details of the system are computed, classified and spoken of in the terms of "B's".

To what extent can the Bedaux wage-payment plan be coördinated with the standard cost system?

Can the "B's produced" be used as a method of distributing departmental manufacturing overhead?

Would you recommend building up labor and overhead cost around "B's" and training your cost department to think in terms of "B's"?

Answer: The answer to the question as to what extent the Bedaux wage-payment plan can be coördinated with the standard cost system is materially affected by the definition given to a standard cost system. Some standard cost methods are based on the results of past experience for normal production activities; while in other instances standard costs are prepared to reflect the possible ideal rather than the actual past accomplishment. If experience standards are used, we believe the Bedaux wage-payment plan can be coordinated with the standard cost system. However, if expected or ideal accomplishment is the basis of the standards it seems impracticable to attempt to coördinate the Bedaux plan with such a standard cost system, because under the Bedaux plan the point value of each operation is usually based on past performance rather than on the theoretically possible production, and it would, therefore, be necessary to compile other standard costs on the latter basis.

Where standards are based on past experience, the operation of a standard cost system with respect to labor requires:

1. The establishment of unit standard labor costs for each of the standard items.
2. The accumulation of a standard value of production, by the application of the standard unit costs to the quantities produced.
3. The determination of actual cost of production from payroll distributions.
4. The computation of the labor variance or difference between the standard value of production and actual cost.

The expected production of "B's" seems a practical basis for establishing standard unit labor costs because the "B's" acquire monetary values. The second, third and fourth steps in standard cost procedure, stated above, present no special problem.

The effect of distributing overhead upon the basis of the "B's" produced is similar to the result obtained where a direct-labor-dollar method is used for straight piece-work wage payments. Most elements of overhead benefit direct manufacturing operations in direct proportion to the time the facilities are in use; hence overhead distributions based on units produced may not give proper weight to this time element. Production increases should ordinarily result in lower overhead charges per unit and conversely curtailed production tends to increase unit overhead costs.

It not infrequently happens that overhead distributions based on production ("B's" produced) are sufficiently accurate for practical purposes, due to the fact that the relative output of various production centers remains fairly constant. Distribution on such a basis would be very simple from a clerical standpoint. Determination as to whether it would be accurate enough must depend on a study of the facts in each case.

The Bedaux wage-payment plan is a useful and practical application of wage incentives, but it is not a substitute for sound factory accounting. The records of business are written in terms of dollars and cents. The true measure of performance of a workman or of the executive is the relation existing between a fairly established standard and actual results, both expressed in a language understood not only by cost clerks, but by department heads, company officers and the public.

We are of the opinion that while the "B" may be a useful symbol as an expression of the amount of work assigned to 1/60 of an hour, or one minute, and serves as an intermediate measure of performance for purposes of payroll computation and related production statistics, it has no place in the accounting records, which must be so kept as to be understandable by those not versed in the technicalities of the Bedaux plan.

To summarize briefly, we believe it is practicable to coördinate the Bedaux wage-payment plan with the standard cost system when standards reflect past experience, and that "B's" may be used as a method of overhead distribution if such a basis is suitable for the operations of the business under consideration. However, we would not recommend that labor and overhead costs be built up around the "B's" or that the cost department be trained to think in terms of "B's".

DISCOUNT AND PREMIUM ON CORPORATION BONDS

Question: In a recent audit, the enclosed problem presented itself. Having followed numerous opinions expressed by you through The Journal, we would be interested in knowing just how you would have handled the situations surrounding the purchase of the bonds.

Company A has outstanding bonds 5% of $200,000. These are 30-year bonds maturing in 1937 and are not callable. Records unavailable and current balance-sheet shows no unamortized debt, discount and expense.

Company B 5% bonds outstanding of $700,000. These are 40-year bonds maturing in 1950 and are not callable. Original discount and expense $100,000.

A and B merge. Consolidated corporation is known as company B. Company B assumes all liabilities of company A.

Company B executes a first and refunding mortgage and issues 5½% bonds maturing in 1957 for the purpose of "(a) paying or refunding or to be exchanged for bonds heretofore issued by company A and by company B and/or for bonds of any other series that shall have been issued in pursuance of this indenture; (b) to provide capital for enlarging, etc.; (c) to pay obligations heretofore contracted, etc.; (d) to acquire and/or develop additional plant capacity."

At the time of the issuance of the first and refunding bonds, the unamortized balance of discount and expense on the old bonds was $75,000.

Of the new bonds $800,000 were sold for cash at 98, $650,000 were exchanged for old bonds of company B and $195,000 were exchanged for old bonds of company A, leaving $50,000 of old company B bonds and $5,000 of company A outstanding.

Provisions of the new mortgage are that all reacquired bonds of previous issues are to be held as collateral on the new mortgage.

In acquiring some of the old bonds a premium was paid, in no specific amount, but just the amount necessary to effect the acquisition. This premium amounted to $12,000.

In setting up the modified balance-sheet what disposition should be made of:

(a) The unamortized balance of discount and expense on bonds which have been reacquired.

(b) The premium paid at acquisition of $12,000.

The fourth paragraph of your letter states that:

> "A and B merge. Consolidated corporation is known as company B. Company B assumes all liabilities of company A."

If A and B merged, there was no consolidation and no new company was formed. We assume, therefore, that instead of the word "consolidated" it was intended to use the word "merged" in the second sentence of the foregoing paragraph.

After all of the new 5½% bonds have been issued, company B will have on its books a balance of $75,000 of unamortized discount and expenses applicable to the $700,000 of old 5% bonds. Since only $50,000, or 1/14 of the old bonds remain outstanding, only 1/14 of the foregoing sum, or approximately $5,357, should be carried as an asset on the balance-sheet. The remainder should be charged off against surplus. The premium of $12,000 paid on acquisition of the old bonds should likewise be charged to surplus. However, there is some justification for the view that the balance of the old discount-and-expense account—$69,643—as well as the $12,000 premium should be amortized over the life of the new bonds issued in exchange. The first treatment is more conservative and, on that account, preferable.

The problem does not state specifically whether the new bonds were exchanged for the old on a par-for-par basis but, since $800,000 of the new bonds were sold for cash at 98, it has been assumed that the exchange was on a par basis, and that the difference between 98 and 100 represented financing expenses.

Answer: It is our opinion that the unamortized balance of discount and expense on bonds which have been reacquired should be deferred on the "modified" balance-sheet and written off over the remaining life of these bonds. We are also of the opinion that the premium paid in acquiring some of the old bonds should be deferred and written off over the life of the new issue, this premium representing a part of the cost of issuing the new bonds.