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## Accounting Problems of the Unincorporated Investment Trust

BY GABRIEL A. D. PREINREICH

That this article was written at all is due largely to accident. In the course of a regular audit, I was requested by a client to explain the contents of a printed report on the affairs of a certain trust described as an accumulative fund. In the opinion of the client, the report contained several contradictions and utterly failed to satisfy his very natural curiosity on two points:

1. How was it possible for the fund to close its operations with a huge profit notwithstanding the fact that he had just been notified of a reduction in the value of his certificate and of the amount of his losses deductible for income-tax purposes?
2. How could he determine from the audited income account presented in the report whether the notification received was correct or not?

The trust in question is of the management type and consists merely of a fund contributed by holders of non-negotiable certificates. Control and custody is vested in a manager and a trustee respectively, the certificate holders' rights being limited to the privilege of calling for the redemption of their certificates at the end of any calendar week.

Since I was inclined to agree with the client, at least in part, it has occurred to me that a brief study of the problems confronting such trusts and an independent attempt to solve them, might be timely and lead not only to fruitful discussion but to a gradual standardization of the still somewhat untried accounting procedure used by a form of financial enterprise which is steadily gaining in public favor.

The main advantages of the unincorporated investment trust over its corporate kin consist of greater ease and flexibility in organization and management and the fact that it is not subject to federal or state income taxes in any form whatever, each certificate holder being taxed exactly in the same manner as though he had been personally engaged in buying, holding and selling securities to the extent of his participation in the total fund.

This, undoubtedly, is an advantage, which, however, is offset by certain disadvantages springing from the same source.

Corporations are not burdened with the redemption of their stock, nor do stockholders have to report income unless the corporation pays dividends. The unincorporated trust must be able to determine the exact redemption value of its certificates on each redemption date and must advise the certificate holders of their shares in as many as seven or eight different kinds of income, not only annually, but whenever they elect to retire from the trust. Certificates issued during the year must be sold at their exact value as of the date of issue and income accumulated thereon for the remainder of the year must be determined correctly to safeguard each holder's individual interests. If we add that good accounting procedure requires that the lower of cost or market be used as the basis of investment valuation, whereas admissions and redemptions are closed at market values, and if we further remember that cost for tax purposes is not always equal to cost, we have a fair picture of the difficulties besetting the bookkeeper of the unincorporated trust, from all of which his more fortunate confrère working for a corporation is happily exempt.

The principal accounting problems of the unincorporated trust may therefore be summarized as follows:

1. The exact financial condition of the trust must be known as of each date of admission or redemption.
2. Such financial condition must be stated on three different bases, namely:
  - (a) Cost as defined by income-tax regulations.
  - (b) The lower of cost or market, as defined by correct accounting procedure.
  - (c) Market.
3. Income must be segregated into the following classes:
  - (a) Profit on sale of securities.
  - (b) Capital gain on sale of securities.
  - (c) Dividends of domestic corporations.
  - (d) Dividends of foreign corporations.
  - (e) Interest on tax-exempt bonds.
  - (f) Interest on bonds (tax paid at source).
  - (g) Interest (fully taxable).
  - (h) Non-taxable income arising from differences between income-tax regulations and accounting procedure.

4. The proportionate amounts of each class of income due each shareholder must be readily available on each balance-sheet date, with due consideration for fractional periods reducing the shares of holders who:
  - (a) Joined after the beginning of the year.
  - (b) Retired before the end of the year.
  - (c) Joined after the beginning and retired before the end of the year.
5. Compensation due the management and the proportionate amounts thereof chargeable against each certificate holder must be ascertainable to the same extent as income.

At first sight, this appears to be a large order, but it may be noted that, after all, the number of general-ledger accounts required is not large. The balance-sheet will, in all probability, list the following items:

I. Assets:

1. Cash on deposit.
2. Call loans.
3. Securities long (at cost).
4. Unrealized market appreciation of securities long.
5. Accrued interest receivable.
6. Accrued preferred dividends receivable.
7. Common dividends declared.

II. Liabilities:

1. Brokers' balances.
2. Securities short at selling price.
3. Market appreciation of securities short.
4. Management compensation payable.
5. Subscriptions to certificates not issued.

III. Capital:

1. Certificates outstanding.
2. Surplus.
- 3-10. Income of current year.
11. Unrealized profits.

The foregoing list makes allowance for a broader scope of operations than will be conducted by the average investment trust. Accounts used for trading on margin may probably be

dispensed with, as well as several of the income accounts, since investments may well be limited to common stocks of domestic corporations. The list was made comprehensive to show the flexibility of the system outlined in the following paragraphs, which makes it adaptable to the needs of different classes of investors.

Since the number of accounts is small and accountings must be rendered frequently, it becomes apparent that the record best suited for the purpose is a columnar book combining the functions of cashbook, journal, general ledger and trial balance, the size of which will be reduced to the limit by avoiding the cumbersome distinction between debit and credit columns through the use of red ink for credits or some similar arrangement. For the sake of clarity the record proposed is reproduced in exhibit A in its simplest form. Examples of transactions occurring in the course of regular operations are entered and will be discussed in the order recorded.

*Opening entry Sept. 1, 19...*

Cash.....	\$1,000,000.00	
To certificates outstanding		\$1,000,000.00
Details are posted to a subsidiary certificate ledger in the usual way.		

*Purchase of securities Sept. 1:*

Securities owned.....	977,750.00	
To cash.....		977,750.00
Details are posted to the subsidiary investment ledger.		

*Interest received Sept. 30:*

Cash.....	55.62	
To interest on bank balance		55.62

*Sale of securities, Oct. 3:*

Cash.....	153,250.00	
To securities owned (cost of 1,000 U. S. Steel).....		147,750.00
Profit on sale.....		5,500.00

The capital gain column will be used in all cases where securities were held over two years. In the final or annual accounting to

*Accounting Problems of Unincorporated Investment Trust*

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certificate holders the capital gain is transferred to profit on sale for all holders whose certificates were issued less than two years before sale of the investment.

*Money lent on Call, Oct. 3:*

Call loans.....	\$150,000.00	
To cash.....		\$150,000.00

*Interest received, Oct. 31:*

Cash.....	59.80	
Call loans.....	1,050.00	
To interest.....		1,109.80

*Accruals to close books, Nov. 3:*

Accrued interest on bank balance.....	6.40	
Accrued interest on call loans	112.50	
Dividend receivable.....	10,500.00	
To interest.....		118.90
Dividends.....		10,500.00

*Management compensation, Nov. 3:*

The fee payable to the management is the only expense of the trust. It may be computed in various ways, such as:

1. Fixed amount per month.
2. Percentage of income.
3. Percentage of market appreciation of securities.
4. Percentage of net worth.

In exhibit A the fee equals  $\frac{1}{101}$  of the face value of certificates issued and  $\frac{1}{101}$  of income and unrealized market appreciation.

The former is not returnable upon redemption of the certificates; the latter, however, is charged back to the management if losses are subsequently suffered. The results of the computation may best be observed in exhibit B. Since the illustration is that of a trust in its first period of operation, the fee includes the original levy on capital. The correctness of the amount charged may be proved as follows:

*The Journal of Accountancy*

<i>A. White—December 31, 19...</i>	
Certificates outstanding.....	\$500,000.00
Profit on sale and interest.....	11,472.79
Dividends.....	5,250.00
Non-taxable income.....	2,128.32
Unrealized appreciation.....	21,052.63
	\$539,903.74
Management expense 1%.....	5,345.58
	\$534,558.16

*Unrealized market appreciation, Nov. 3:*

Only a memorandum entry is made, supported by a list of securities priced at both cost and market as of the close of the day.

*Issue of additional certificates, Nov. 4:*

The price at which new certificates must be issued is determined by dividing the total equity, including unrealized market appreciation on securities, by the number of old certificates outstanding. The total to be paid by the new entrant is then computed in the following manner:

$n_o$  = Number of old certificates outstanding.

$E_o$  = Net worth including unrealized market appreciation at the close of the day as of which new shares are to be issued.

$$\frac{E_o}{n_o} + \frac{100}{101} = \text{Cash price of 1 new certificate.}$$

Using this formula for the computation of the entry shown in exhibit A, we have

$$\frac{1,106,222.10}{10,000} + \frac{100}{101} = 111.61231$$

The issue of 500 shares is therefore recorded in detail as follows:

Cash.....	\$55,806.15
Management compensation.....	58.06
To certificates outstanding...	\$50,000.00
Surplus.....	.....
Profit on sale and interest.....	339.21
Capital gain.....	.....
Dividends.....	525.00
Non-taxable income.....	5,000.00

Postings are made to the income accounts of the general ledger and to the certificate ledger as shown in exhibit B. The posting of new contributions to income distorts the actual earnings of the trust, but it simplifies the computation of individual incomes.

For the benefit of the reader inclined to be skeptical about such an innovation it may be well to recall the case of the *cadi of Arabian Nights* who had to execute the will of a man who died leaving three sons and nineteen camels. The will provided that one half of the camels was to go to his eldest son, whereas the two others were to receive one fourth and one fifth respectively. As may be remembered, the *cadi* solved the baffling problem by directing his attendant to lead his own camel alongside the others. The division was then effected smoothly by allotting 10, 5 and 4 camels respectively, to the three heirs, and the *cadi's* camel, left over, was returned to its grazing place.

That is about what is proposed here. Further explanation and algebraic proof of the correctness of this procedure is furnished in a later paragraph. The payment made for the new entrant's proportion of the unrealized market appreciation was included in non-taxable income for reasons discussed under that caption. Just what such a contribution really represents may be determined as follows:

$$\begin{aligned} M &= \text{Unrealized market appreciation.} \\ n_o &= \text{Number of old certificates outstanding.} \\ n_e &= \text{Number of new certificates to be issued.} \\ \frac{M}{n_o} &= \text{Unrealized appreciation owned per old certificate} \\ &= \text{and therefore to be contributed by each new} \\ &= \text{certificate.} \\ \frac{n_e M}{n_o} &= \text{Total payment of new entrants for unrealized mar-} \\ &= \text{ket appreciation.} \\ \frac{M}{n_o + n_e} &= \text{Unrealized appreciation owned per certificate after} \\ &= \text{admission of new entrants.} \\ \frac{\frac{n_e M}{n_o}}{n_o + n_e} &= \frac{n_e M}{n_o(n_o + n_e)} = \text{Market appreciation realized by} \\ &= \text{each old certificate.} \end{aligned}$$

The admission of a new entrant, therefore, amounts to the sale of the security holdings to the extent of the expression  $\frac{1}{n_o} - \frac{1}{n_o + n_e}$



for cash, and to the realization of that proportion of the market appreciation.

If, therefore, the amount of  $\frac{n_e M}{n_o}$  is paid in, that amount may be properly posted to profit on sale or capital gain, since it represents appreciation converted into cash to the extent of  $\frac{n_e M}{n_o + n_e}$  and a contribution of new entrants to match that gain in the amount of  $\frac{n_e^2 M}{n_o(n_o + n_e)}$ .

$$\frac{n_e M}{n_o} = \frac{n_e M}{n_o + n_e} + \frac{n_e^2 M}{n_o(n_o + n_e)}$$

*Redemption of certificates, Dec. 9:*

The amount to be paid to certificate holders wishing to retire from the trust is similarly determined by first recording all accruals and dividing the sum of book equity and unrealized market appreciation by the number of certificates outstanding. Conversely to the issue of certificates, a redemption may be considered the purchase by the remaining certificate holders of the retiring holders' interest in securities owned. The price paid for that interest in excess of the book value is therefore an addition to cost rather than a distribution of income, since the income so distributed has not been realized as yet.

$\frac{M}{n_o}$  = Portion of market appreciation owned by each certificate.

$n_r$  = Number of certificates to be redeemed.

$\frac{n_r M}{n_o}$  = Portion of market appreciation due to retiring members.

$\frac{M}{n_o - n_r}$  = Portion of market appreciation per remaining certificate.

The amount of unrealized market appreciation purchased for cash or the additional cost of securities owned will, therefore, be

$$\frac{M}{n_o - n_r} - \frac{M}{n_o} = \frac{n_r M}{n_o(n_o - n_r)}$$

Apart from this addition to cost, each remaining certificate holder will also own a larger portion of the portfolio than before; this increase, however, is reflected by the increased number of

shares held per certificate, not by an increase in the cost price, and is offset by a corresponding decrease in cash.

The solution appears to be correct from the strictly mathematical and theoretical point of view, but it gives rise to doubt as to the conservativeness of the procedure. Suppose for instance, that equal numbers of certificates are issued and retired on the same day. The result would be to charge cost and credit profit on sale by

$$\frac{n_e M}{n_o} = \frac{n_r M}{n_o}$$

although none of the old holders is actually affected. By placing

$$n_o = n_r = n_e$$

it would be possible to imagine that all the certificates were constructively retired and immediately reissued, whereupon the unrealized market appreciation would suddenly be realized.

It may therefore be better practice to charge the portion of unrealized market appreciation to profit on sale as a distribution of profits which, it must be hoped, will ultimately be credited to that account. This procedure will meet no opposition, when the trust is of the accumulative type, paying no distributions whatever, except upon redemption of its certificates. If, however, income is regularly distributed, zealous protagonists of the propriety of increasing cost will no doubt arise. Their best argument is that the trust has no separate entity distinct from its members and that, therefore, changes in the value of individual equities are actually realized at each bona-fide issue or redemption of certificates.

NON-TAXABLE INCOME ARISING FROM DIFFERENCES BETWEEN  
INCOME TAX REGULATIONS AND ACCOUNTING PROCEDURE

The first item to be considered under this heading is the realization of market appreciation which takes place upon the issuance of additional certificates. It may be said that the case is similar to that of admitting a new partner. In accordance with established precedent, the old partners are not liable for income taxes on their proportion of the excess paid in until the assets to which the increased value attaches have been sold. The question at issue is merely: When does realization really take place? The tentative inclusion of the item in non-taxable income for the purpose of this essay should not be interpreted as a definite

answer to this question, which is really outside the scope of this discussion. Its inclusion in surplus might be just as proper, but it would complicate the technique of the annual closing. The creation of a special capital-surplus account should not be considered, since all income accounts are already distorted by the inclusion of capital items.

The excess over book value paid for redeemed shares is the second item tentatively recorded in this account, although, for purposes of the retiring member it must, of course, be transferred to taxable income (see F. Brown's account in exhibit B). So far as the remaining holders are concerned, the amounts so disbursed might be described as the exchange of realized profits for unrealized ones, and the continuous writing up of cost may well result in inflation beyond the market price prevailing at a later date.

Another discrepancy between income-tax regulations and accounting procedure will be found in the treatment of stock dividends. Without wishing to pass upon the merits of other opinions held upon this subject, the writer believes that, *Eisner v. Macomber* to the contrary notwithstanding, a stock dividend declared from surplus earned after the acquisition of the stock represents realized income at least to the extent of the recipient's proportion of the amount transferred from surplus to capital stock by the issuing company. The exception applying to the case of parent companies which record the stock of subsidiaries at their respective book values must, of course, be recognized.

The entry shown in exhibit A uses the well known illustration of the North American Company, which transfers \$10.00 a share from surplus to capital stock upon issuance of its quarterly 2.5% stock dividends. If a considerable part of the equity were invested in the stock of this company, the trust would be unable to pay distributions commensurate with earnings, unless the correctness of the income theory were recognized. That some of the dividend stock may have to be sold in order to make cash distributions possible is readily admitted, but whether such a course of action is in the best interests of the trust or not is a question of investment management rather than accounting theory.

The journal entries will be as follows:

Upon declaration:

Dividends declared . . . . .	\$250.00	
To non-taxable income . . . . .		\$250.00

Accounting Problems of Unincorporated Investment Trust

Upon receipt:	
Securities owned .....	\$250.00
To dividends declared .....	\$250.00
Upon sale:	
Cash .....	2,325.00
To securities owned .....	250.00
Profit on sale .....	99.39
Non-taxable income .....	1,975.61

The last entry is computed in accordance with income-tax regulations:

1,000 shares cost	\$91,250.00
25 " "	.....
1,025 " "	91,250.00
1 " "	89.02439
25 " "	\$2,225.61
25 " sold for	2,325.00
Taxable profit	\$99.39

The entries seem theoretically correct, whenever the common stock is diluted at a lower rate than the rate of earnings upon the entire equity of common stockholders and so long as the long-term trend of market values remains a constant multiple of annual earnings. All these factors have been present so far in the case of the North American Company. Strictly speaking, a further qualification must be made to the effect that if the stock was purchased at a higher cost than the constant multiple referred to, the excess purchase price must be amortized out of the proceeds of stock dividends sold.

If the procedure outlined is followed, careful memorandum records must be kept with respect to the difference in cost according to the books and cost for income-tax purposes. The proper proportion of this difference must be transferred from non-taxable income to profit or capital gain on sale, when part of the original stock is sold.

*Closing, Dec. 31:*

When a certificate is issued, the consideration received is entered in detail in the subsidiary certificate ledger (exhibit B). Upon redemption, the price is posted in a similar manner. The

difference between the two entries is the amount to be reported as income. At the annual closing, the balance of each income account in the general ledger is divided by the number of shares outstanding and multiplied by the individual holdings. The results so obtained are again posted to the certificate ledger, whereupon the accounts are balanced to obtain the income to be reported by those who were members of the trust at the end of the year.

Attention has already been called to the fact that the closing balances of the income accounts do not reflect the income of the trust, but, since additions and deductions arising from changes in the number of certificates outstanding were always in proportion to the respective equities, those balances divided by the number of certificates outstanding at the end of the year will equal the amount earned by a certificate for the entire year. Algebraic proof of this may be furnished as follows:

Let us assume that at some time after the beginning of the year, new certificates were issued and then, after a second period had elapsed, other certificates were redeemed. This divides the year into three periods symbolized as follows:

	Number of cert. outstanding	Income for period
First period.....	$n_o$	$i_o$
Second period.....	$n_o + n_e$	$i_e$
Third period.....	$n_o + n_e - n_r$	$i_r$

The income of a certificate held throughout the year is:

$$\frac{i_o}{n_o} + \frac{i_e}{n_o + n_e} + \frac{i_r}{n_o + n_e - n_r}$$

In actual practice, this expression would attain considerable length, since admissions and redemptions occur weekly or even daily. Let us now add the proportionate share of each entrant to the income already earned. The balance of the income account will then be:

$$i_o + \frac{n_e}{n_o} i_o + i_e - \frac{n_r}{n_o + n_e} \left( i_o + \frac{n_e}{n_o} i_o + i_e \right) + i_r$$

or simplified:

$$\left( i_o \left( 1 + \frac{n_e}{n_o} \right) + i_e \right) \left( 1 - \frac{n_r}{n_o + n_e} \right) + i_r$$

*Accounting Problems of Unincorporated Investment Trust*

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This expression, divided by  $n_o+n_e-n_r$  yields the original formula for the income of one certificate held throughout the year, thereby furnishing the proof required:

$$\frac{\left(i_o\left(1+\frac{n_e}{n_o}\right)+i_e\right)\left(1-\frac{n_r}{n_o+n_e}\right)+i_r}{n_o+n_e-n_r} = \frac{i_o}{n_o} + \frac{i_e}{n_o+n_e} + \frac{i_r}{n_o+n_e-n_r}$$

It may, therefore, be seen that by surrendering the largely imaginary advantage of having the books reflect the total income of the trust, a convenient base is derived for the quick computation of each certificate holder's individual income, without the cumbersome procedure of posting profits to every account, whenever there is a change in one or the not much less cumbersome alternative of keeping separate income accounts for each succeeding partnership, of which there may be 52 or even 300 a year.

At the end of the year, when the certificate ledger is closed, the total of the individual incomes to be reported will give the total income of the trust. The proof of this total may be obtained as follows:

Certificates outstanding at end . . . . .	\$950,000.00
Surplus after closing . . . . .	25,660.50
	\$975,660.50
Less: Certificates outstanding at beginning . . . . .	
Surplus at beginning . . . . .	
Transactions in certificates for period . . . . .	\$950,249.36
	950,249.36
Income of trust . . . . .	\$25,411.14

The trial balance of the certificate ledger showing this reconciliation is reproduced in exhibit B. In order to facilitate the procedure, it is advisable to use a separate column in the general ledger for cash transactions affecting certificates. This column will act as a controlling account for the certificate ledger throughout the year. The bank balance must, obviously, reconcile with the algebraic sum of the two cash columns.

STATEMENTS FOR CERTIFICATE HOLDERS

With the routine of bookkeeping disposed of, we may now return to the question: What information is most interesting to the certificate holder? In general, the data may be grouped under three headings:

1. Balance-sheet and supporting schedules;
2. Income account;
3. Comparative statistical data.

The information conveyed by the balance-sheet is especially needed when certificates are issued or redeemed. When we buy or sell something, we are more interested in values than at any other time during the period of ownership and it is only natural that we should like to see a bill of sale itemizing the details of the transaction. If the client mentioned earlier in this article had received a balance-sheet as of the date he acquired his certificate (on or about September 1, 1929), a comparison of the figures with the closing balance-sheet as of December 31, 1929, would have answered his query, even though the unpleasant subject was avoided in the report, which stressed the success of operations for the year 1929. We may say therefore, that no trust of the kind described is organized with due regard to the wishes of its certificate holders, if its accounting system cannot produce a balance-sheet correct to the last detail upon the shortest notice, or if it fails to furnish that information to every certificate holder at least:

1. As of the day of purchase;
2. Quarterly;
3. As of the day of redemption.

The form of record shown in exhibit A is a perpetual balance-sheet, ready to furnish the exact figures at the close of any business day. For example, a balance-sheet for the use of H. Greene, Esq., may be prepared as follows:

THE UNINCORPORATED INVESTMENT TRUST  
Comparative balance-sheet for H. Greene, Esq.

	November 3	December 8	Increase Decrease
Cash.....	\$ 25,615.42	\$ 38,638.80	\$13,023.38
Call loans.....	150,000.00	400,000.00	250,000.00
Accrued interest receivable....	1,168.90	3,656.64	2,487.74
Dividends receivable.....	10,500.00	10,500.00	.....

*Accounting Problems of Unincorporated Investment Trust*

Securities owned (at cost) . . . . .	\$830,000.00	\$682,250.00	\$147,750.00
Unrealized appreciation on securities . . . . .	100,000.00	50,000.00	50,000.00
	<u>\$1,117,284.32</u>	<u>\$1,185,045.44</u>	<u>\$ 67,761.12</u>
Less: Management fees payable . . . . .	11,062.22	1,717.16	9,345.06
	<u>\$1,106,222.10</u>	<u>\$1,183,328.28</u>	<u>\$ 77,106.18</u>
Certificates outstanding (par 100) . . . . .	\$1,000,000.00	\$1,100,000.00	\$100,000.00
Surplus: Realized . . . . .	6,222.10	33,328.28	27,106.18
Unrealized . . . . .	100,000.00	50,000.00	50,000.00
	<u>\$1,106,222.10</u>	<u>\$1,183,328.28</u>	<u>\$ 77,106.18</u>
Value of 500 Certificates . . . . .	\$ 55,311.10	\$ 53,787.65	
Management fee paid . . . . .	495.05		
Total . . . . .	<u>\$ 55,806.15</u>	<u>\$ 53,787.65</u>	<u>\$ 2,018.50</u>

It will probably be unnecessary to furnish a detailed schedule of securities owned, except upon special request.

The income account of the report referred to is fairly representative of several others. It is a copy of the old-fashioned profit-and-loss account, with all the emphasis upon the earnings of the trust and scant regard for the individual owner. In the comments upon income figures there occurs this statement:

“As subscriptions to the accumulative fund were received continuously throughout the year ended December 31, 1929, the income and unrealized profits on securities held as reported in statement 2 are not properly applicable to the face value of certificates outstanding at the end of the year. The following tabulation is therefore designed to disclose the rate per cent. per annum on the average face value of certificates outstanding during the year.”

(Table omitted)

“It should, however, be borne in mind that the rates per cent. per annum upon face value in the above tabulation relate only to a theoretical average certificate.”

That describes the matter very well. In other words, no certificate holder, even though he may have been a member of the



trust for the entire year, is in a position to find out from the audited income account how much his holdings earned, in order to verify the accuracy of the statement received from the trust to attach to his income-tax return. (N.B. The earnings of the theoretical average certificate as described would be equal to those of a certificate held throughout the year only if the income had never varied from a constant percentage of the changing equity. This, however, was obviously not the case in 1929, when huge profits were made in the first three quarters, only to be lost during the fourth.)

The income account, therefore, is of little practical value, except as a bookkeeping device for the reconciliation of surplus at the beginning and end of the year. What the certificate holder looks for in an annual report is the appreciation of a certificate held throughout the year, with at least quarterly if not monthly subdivisions, so as to permit a rough approximation of the increase in the value of his investment for the period the certificate was actually held. The next question of interest would be: What part of that appreciation is realized and how much of it represents paper profits?

As already pointed out, the amount earned by a certificate held throughout the year is obtained by dividing the footings of each income account in the general ledger by the number of certificates outstanding at the end of the year and summarizing the result. Unrealized market appreciation was recorded as a memorandum and may be similarly treated for statement purposes. The income account of 1,000 certificates held throughout the year may then be prepared in the following form:

Value of 1,000 certificates at beginning	\$100,000.00	100.00%
	<hr style="border-top: 3px double #000;"/>	<hr style="border-top: 3px double #000;"/>
<i>Income per 1,000 certificates:</i>		
Profit on sale and interest . . . . .	\$2,294.56	2.29%
Less: Management expense . . . . .	1,069.11	1.07%
	<hr style="border-top: 1px solid #000;"/>	<hr style="border-top: 1px solid #000;"/>
Income subject to normal tax . . . . .	\$1,225.45	1.22%
Capital gain . . . . .	. . . . .	. . . . .
Dividends . . . . .	1,050.00	1.05%
Non-taxable income . . . . .	425.66	.43%
	<hr style="border-top: 1px solid #000;"/>	<hr style="border-top: 1px solid #000;"/>
Total realized income . . . . .	\$2,701.11	2.70%

*Accounting Problems of Unincorporated Investment Trust*

Unrealized market appreciation . . . .	\$4,210.53	\$4.21%
Gross increase in value of 1,000 certificates . . . . .	\$6,911.64	6.91%
Less: Distributions . . . . .	. . . . .	. . . . .
Net increase in value of 1,000 cer- tificates . . . . .	\$6,911.64	6.91%
Value of 1,000 certificates at end of period . . . . .	\$106,911.64	106.91%

For the first year, percentages may be omitted, since the amounts give the same information in greater detail. In subsequent years, percentages will show appreciation during the year, whereas the amounts will continue to express the rate of increase on the par value of the certificates. The subdivision of this income account into quarterly or even monthly figures is essential, whenever the annual rate of earnings per certificate during the several months varied substantially from its average for the year.

The simplest form of the report furnished to the certificate holder for filing with his income-tax return is undoubtedly a carbon copy of his page in the certificate ledger. The total income or loss reported must agree with the net increase or decrease as shown by the comparative balance-sheet furnished at the same time. The certificate ledger best adapted for this purpose will consist of an alphabetical tray containing the individual accounts in original and duplicate. At the annual closing or upon redemption, the duplicate is detached and mailed, whereas the original is filed in an inactive binder.

## The Journal of Accountancy

*Exhibit A*  
THE UNINCORPORATED  
Combined cash book,

Cash		Call loans	Accrued interest	Dividends declared	Securities owned	Folio	Description
Certificates	General						
							Sept. 1
							A. White F. Brown J. Black
\$1,000,000.00					\$886,500.00	1	6,000 U. S. Steel
	\$977,750.00				91,250.00	2	1,000 North American
	55.62						Sept. 30
	153,250.00				147,750.00	1	Oct. 3
	150,000.00	\$150,000.00					1,000 U. S. Steel New York Trust Co.
	59.80	1,050.00					Oct. 31
			\$ 6.40				Nov. 3
			112.50				Interest bank balance
				\$10,500.00			Interest call loan
							6,000 U. S. Steel
							Market apprec. \$100,000
							Management fee
\$1,000,000.00	\$ 974,384.68	\$151,050.00	\$ 118.90	\$10,500.00	\$830,000.00		
							Nov. 4
111,612.31					147,750.00	1	H. Greene 500 sh. F. Greene 500 "
	161,300.00						1,000 U. S. Steel
	250,000.00	250,000.00					New York Trust Co.
	111.07	1,775.00	118.90				Nov. 30
			31.64				Dec. 8
			800.00				Interest on bank balance
							Interest on call loan
							Market apprec. \$50,000
							Management fee
							Management fee paid
	10,000.00						
\$1,111,612.31	\$1,074,975.51	\$402,825.00	\$831.64	\$10,500.00	\$682,250.00		
							Dec. 9
107,575.90							F. Brown 1,000 sh.
53,787.65							H. Greene 500 "
	152,825.00	152,825.00					New York Trust Co.
	11,331.64		831.64	\$10,500.00			Dec. 31
	2,325.00				250.00	2	25 Stock Div. North Am.
					250.00	2	" " " "
			57.11				Interest bank balance
			1,250.00				Interest call loan
							Market apprec. \$40,000
							Management fee
\$ 950,249.36	\$ 906,491.87	\$250,000.00	\$1,307.11		\$682,250.00		
950,249.36	950,249.36						Closing entry
	\$ 43,757.49	\$250,000.00	\$1,307.11		\$682,250.00		

## Accounting Problems of Unincorporated Investment Trust

### INVESTMENT TRUST

journal and general ledger

Folio	Certificates outstanding	Surplus	Profit on sale Interest	Capital gain on sale	Dividends	Non-taxable income	Management compensation	
							Expense	Liability
1	\$ 500,000.00							
2	100,000.00							
3	400,000.00							
			\$ 55.62					
			5,500.00					
			1,109.80					
			6.40					
			112.50					
					\$10,500.00			
							\$11,062.22	\$11,062.22
	<u>\$1,000,000.00</u>		<u>\$ 6,784.52</u>		<u>\$10,500.00</u>		<u>\$11,062.22</u>	<u>\$11,062.22</u>
4	50,000.00		339.21		525.00	\$ 5,000.00	58.06	
5	50,000.00		339.22		525.00	5,000.00	58.06	
			13,560.00					
			1,767.17					
			31.64					
			800.00					
							654.94	654.94
								10,000.00
	<u>\$1,100,000.00</u>		<u>\$23,611.56</u>		<u>\$11,550.00</u>	<u>\$10,000.00</u>	<u>\$11,833.28</u>	<u>\$ 1,717.16</u>
2	100,000.00		2,146.51		1,050.00	5,454.54	1,075.75	
4	50,000.00		1,073.25		525.00	2,727.27	637.87	
			99.39					
			67.11					
			1,250.00					
						250.00		
						1,975.61		
							63.06	63.06
	<u>\$ 950,000.00</u>		<u>\$21,798.30</u>		<u>\$ 9,975.00</u>	<u>\$ 4,043.80</u>	<u>\$10,156.60</u>	<u>\$ 1,664.10</u>
1-5		\$25,680.50	21,798.30		9,975.00	4,043.80	10,156.60	
	<u>\$ 950,000.00</u>	<u>\$25,680.50</u>						<u>\$ 1,664.10</u>

Exhibit B  
THE UNINCORPORATED INVESTMENT TRUST  
Certificate Ledger

Date	Description	Folio	Certificates outstanding	Surplus	Profit on sale Interest	Capital gain on sale	Dividends	Non-taxable income	Management expense
A. WHITE									
Sept. 1	Original issue 5,000	1	\$500,000.00	\$13,505.53	\$11,472.79		\$ 5,250.00	\$2,128.32	\$ 5,345.58
Dec. 31	Closing entry	1			\$11,472.79		\$ 5,250.00	\$2,128.32	\$ 5,345.58
Dec. 31	Income (Loss) reported								
F. BROWN									
Sept. 1	Original issue 1,000	1	\$100,000.00		\$ 2,146.51		\$ 1,050.00	\$5,454.54	\$ 1,075.75
Dec. 9	Redeemed 1,000 Transfer	1	100,000.00		5,454.54				
Dec. 31	Income (Loss) reported				\$ 7,601.05		\$ 1,050.00		\$ 1,075.75
D. BLACK									
Sept. 1	Original issue 4,000	1	\$400,000.00	\$10,804.42	\$ 9,178.23		\$ 4,200.00	\$1,702.65	\$ 4,276.46
Dec. 31	Closing entry	1			\$ 9,178.23		\$ 4,200.00	\$1,702.65	\$ 4,276.46
Dec. 31	Income (Loss) reported								
H. GREENE									
Nov. 4	Issued 500	1	\$ 50,000.00		\$ 330.21		\$ 525.00	\$5,000.00	\$ 58.06
Dec. 9	Redeemed 500	1	50,000.00		1,073.25		525.00	2,721.27	537.87
Dec. 31	Transfer				2,272.73			2,272.73	
Dec. 31	Income (Loss) reported				\$ 1,538.69				\$ 479.81
F. GREENE									
Nov. 4	Issued 500	1	\$ 50,000.00	\$ 1,350.55	\$ 339.22		\$ 525.00	\$5,000.00	\$ 58.06
Dec. 31	Closing entry				1,147.28		\$ 525.00	212.83	534.56
Dec. 31	Income (Loss) reported				\$ 808.06			\$4,787.17	\$ 476.50
TRIAL BALANCE									
Dec. 31	A. White 5,000	1	\$500,000.00	\$13,505.53	\$11,472.79		\$ 5,250.00	\$2,128.32	\$ 5,345.58
	F. Brown 1,000	2			7,601.05		1,050.00	1,075.75	1,075.75
	D. Black 4,000	3	400,000.00	10,804.42	9,178.23		4,200.00	1,702.65	4,276.46
	H. Greene 500	4	50,000.00	1,350.55	1,538.69			4,787.17	479.81
	F. Greene 500	5	\$950,000.00	\$25,660.50	808.06				476.50
			950,249.36	25,411.14	\$27,521.44		\$10,500.00	\$ 956.20	\$11,654.10
			\$ 249.36	\$ 249.36					