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Accounting Questions: Balance-sheet for Receivership, Examination of Partnership Books, Chain-store Accounting

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Accounting Questions

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BALANCE-SHEET FOR RECEIVERSHIP

Question: A question has arisen as to the treatment of certain items in the preparation of a balance-sheet for receivership purposes.

A receiver was appointed for a textile plant as of ———, and has requested an audit at close of business that date.

Included in the assets is an item representing unamortized discount on gold notes and certain other items such as prepaid insurance.

1. Should the auditor write these items off through a surplus adjustment, or does the responsibility rest with the receiver?

Bear in mind, the receiver commences operations on the basis of the audit.

2. No appraisal has been made. Will an ordinary balance-sheet meet requirements?

The company manufactures cloth and the finishing is done by an affiliated company.

3. Is the finishing charge a manufacturing expense or a deduction from sales?
4. All production of current period is in inventory. How shall finishing charge be treated?

Answer: As to the treatment of deferred charges, it seems that the balance-sheet should show the condition of the company as such, which means that the unamortized discount on gold notes and all similar deferred charges would be included. As a second step, the receiver will probably want to have a balance-sheet in which such valueless items as unamortized discount on gold notes will be eliminated. However, there seems to be no reason why unexpired insurance should not be carried as an asset on the books of the receiver.

It would seem that the plant property could properly be carried in the balance-sheet at its value as shown by the books of the company, in the absence of an appraisal. In any case the basis of valuation of this and other assets should be shown on the balance-sheet.

Assuming that the cloth is returned to the company after finishing, the finishing charge is a part of the cost of manufacturing and thus should be included in the inventory valuation—unless the total cost thus found exceeds the market value (i.e., replacement cost). In such case the inventory value should be reduced to market.

EXAMINATION OF PARTNERSHIP BOOKS

Question: Two partners in one business show a favorable financial position, assets being ample for payment of liabilities in the ordinary course of business or even, in all probability, sufficient in case of forced liquidation. One of the partners, however, is also engaged in another separate and distinct business on his own account, and such business is in only a fair condition, so that a forced sale would result in a deficit to be collected from the partnership assets.

The question is what mention should be made in the accountant's report or certificate, upon an audit of the partnership, of the outside business of one partner.

My personal opinion was and still is that no direct mention need be made, since the mere fact that the organization is a partnership is sufficient notice to creditors that it may become involved in a partner's difficulties, so that it would be gross negligence on the creditor's part not to demand individual statements as well as that of the partnership.

Answer No. 1: In an examination of the books of a partnership the auditors usually have little opportunity to ascertain very much about the outside personal interests, and possible liability to the partnership therefrom, of the individual partners. In the case mentioned, the auditor apparently has some knowledge of one such outside interest, but specific comment on that might lead to the assumption by a reader of the report that all such outside interests had been investigated, unless it were accompanied by a statement that no other investigation was made.

Whether any comment should be made on this specific matter is dependent upon its importance and also to some extent upon the nature of the examination being made. If, for example, the auditor is making an investigation for a creditor bank, undoubtedly he should report all pertinent information acquired, irrespective of any technical limitation of his engagement. If, however, he is employed by the partnership, he is more or less bound to stay within the limitations of his engagement, but these limitations should be made completely evident to any reader of his report.

A report on an examination of a partnership should always indicate clearly that the business is not incorporated, and it is desirable to include a statement to the effect that the scope of the examination did not cover the personal outside interests or possible liabilities of the individual partners.

Answer No. 2: How to certify or report on the accounts of a partnership in view of the possibility that the firm assets may be subject to attack from creditors of an individual partner is a very pertinent question. In all ordinary cases, however, we think it should be sufficient for the accountant to make clear in his certificate or report that his examination covers only the business of the partnership. An appropriate certificate might read as follows:

> "We have made an examination of the books of account of the partnership business of ...... and report that in our opinion the accompanying statements properly set forth the financial condition and operating results of the partnership business at the date and for the period stated."

Reference to the "partnership business" should generally be a sufficient emphasis of the distinction between the partnership affairs and those of the individual partners personally.

Circumstances do alter cases, though, and this recommendation does not mean to say that we would not advise going further with a more direct qualification if the examination of the partnership were undertaken during the imminence of contingencies liable to fall from the outside upon the firm assets. We can conceive of cases where it would be justifiable to add to the reference to the examination of the accounts of the partnership business a phrase "but not those of the individual partners," and to refer to the statements as showing the financial condition and operating results of the partnership business "as such."

The same situation arises in an examination of the accounts of a sole proprietor. In such cases we follow substantially the recommendations first made.

Answer No. 3: We concur in the opinion of the member inquiring that, in general, no direct mention need be made.

The partnership assets are available in the first instance for partnership liabilities and usually an individual partner's creditors have only the right to receive what he would receive under the terms of the partnership deed. We can not see, therefore, that his possible financial embarrassment in an entirely separate business is a matter that need be incorporated in a partnership return. In fact, in most partnerships, the accountant is not in position to be able to report on the property of the partners individually.

CHAIN-STORE ACCOUNTING

Question: A chain-store company selling relatively few commodities makes a practice of charging them to the various stores at retail prices in order to exercise some degree of control over the various store managers. The wholesale and retail prices on some of the products handled vary considerably and rapidly from time to time, and adjustments on account of changes in retail prices are handled by means of the equivalent to "mark-down" sheets prepared by the various stores and approved by their managers.

Because of trade conditions, it is not practicable for the home office to make these adjustments except on the basis of information submitted by the stores. At periodical intervals the company's internal auditors visit these stores and check their inventories, cash receivables, etc., and make comparison with the control accounts carried by the general offices. In view of the fact that the store management determines the "mark-down" sheets which are submitted as the basis of relief for charges for inventory, it appears that there is an opportunity for their improper use to cover shortages in cash or merchandise.

It seems to me that the only practical method of check from the home office is through the means of the auditors' visits, who should inspect sales invoices, etc.

I am wondering, however, if there is any other method of control which might be suggested.

Answer: It appears to us that a proper approval of mark-down sheets in various stores by independent people would be a protection against improper use of mark-downs to cover these shortages. We think that besides this, a careful tabulation of gross profits earned in various departments in the various stores should show where special tests are needed, as even with products whose prices vary rapidly, the figures should be reasonably uniform in different stores.

We imagine that even a traveling auditor will find it very hard to check mark-downs which occurred prior to his visit, at least so far as retail prices are concerned, because the goods in question are probably out of the store.