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STEAMSHIP ACCOUNTING

By MARIE REYNOLDS

The Steamship industry has two main divisions—subsidized and non-subsidized. It is important that you keep in mind what each includes, so that you may more clearly understand their effect on the accounting problems of a Steamship Company.

Unsubsidized Steamship Lines include primarily, coastwise and intercoastal lines, but also some lines running to foreign ports.

The Subsidized Steamship industry is wholly composed of "off-shore" or "deep sea" lines, operating to foreign ports. After their routes are approved as essential in the foreign trade of the United States, and their contracts are approved, these lines are paid an operating-differential subsidy, to compensate them for the extra costs imposed on them by law. These extra costs include the use of American citizens in their crews, and "only articles, materials and supplies of the growth, production and manufacture of the United States—except in case of emergency—when necessary to purchase supplies or equipment in some foreign port in order to complete her voyage."

Subsidy is the grant of financial aid by a Government. It is the amount given above the charge for services, and a company receiving a subsidy must be able to guarantee regular service. Subsidies have taken various forms. At one time, it was a flat payment per annum for maintenance of certain transatlantic service, and in 1936, before the passage of the Merchant Marine Act, it was a so-called "Mail Pay" which was measured by the combination of miles covered, and the vessel speed. This far exceeded reasonable compensation for the tonnage of mail hauled. The Merchant Marine Act of 1936 was passed in order to foster the development, and encourage the maintenance of an adequate and well-balanced Merchant Fleet, including vessels of all types, to provide shipping service on all routes essential for maintaining the flow of the foreign commerce of the United States at all times. This was deemed necessary in order that we would have a Merchant Marine capable of serving as a Naval and Military Auxiliary in time of war, or National Emergency. At these times, we need safe, suitable vessels constructed in the United States and staffed with trained and efficient United States citizens.

The Steamship Company then is granted an operating-subsidy to offset the excess of costs because of the American Standard of Living over the comparative costs of foreign flag competing vessels. The Steamship Company is also granted a differential-subsidy to offset the cost of vessels built in the American Yards by American Workers. It is then, merely a subsidy to the American Workers.

These subsidized lines have certain accounting problems not shared by the non-
subsidized lines, however, all accounting problems of the non-subsidized lines are shared by the subsidized lines.

I would like to point out a few of the accounting problems of a subsidized Steamship Company. I am employed by the American President Lines, and although the problems here presented are general to all Steamship Companies, the methods of my company are the basis used. American President Lines is one of the few Steamship Companies which combines domestic business with subsidized foreign business. Today it carries intercoastal cargo and passengers, as well as foreign cargo and passengers.

Steamship accounting, like that of other industries, has the Operating Statement Accounts, and the Balance Sheet Accounts. First I will take the differences of the Operating Statements Accounts.

Accounting for vessel operations is based on the "Venture". The voyage is the accounting unit. The voyage is termed the period of time elapsing from a given port, back usually to the same port, and it ends with the discharge of the homebound cargo. For practical reasons, the end of the voyage is taken as midnight on the day on which discharge of cargo was finished, or that day on which the crew is paid off from foreign articles, whichever is later. The Operating Statement reflects only the results of the completed voyages, during the accounting period, and no allowance is made for the income or expenses of voyages commenced before or during the period, but terminated even as little as one day after the close of the period.

The basic unit of the income statement is the "voyage profit". This is net profit of a voyage after vessel and voyage expenses, but before depreciation, mortgage interest, advertising, overhead, taxes, charter hire.

Vessel expenses are the direct costs of operating the vessel and include wages, fuel, lubricants, repairs, expendable equipment, stores, water and provisions. Voyage expenses consist of stevedoring, cargo checking, loss and damage claims, port charges, vessel insurance premiums accruals, canal tolls, brokerage and other direct expenses, that are not actually a part of the operating of the vessel itself.

The Maritime Commission, through its General Order #22, has promulgated a complete system of numbered accounts to which all subsidized lines must adhere in rendering their quarterly and annual reports to the Commission. The Steamship Lines engaging in coastwise and intercoastal traffic in competition with railroad and truck lines, is under the jurisdiction of Interstate Commerce Commission, and must render accounts to them also. The Interstate Commerce Commission requires full clear accounting reports covering every phase of the intercoastal and coastwise lines.

The Pegboard form of report is convenient for voyages accounting, because it makes consistent comparison between different voyages of the same vessel or similar vessels, readily possible.

Although it sounds logical that subsidy-earned would be deducted from the specific vessel expense accounts on which the subsidy was calculated, it has been found more convenient to calculate voyage profits on actual revenue and gross expense, and then to add to the voyage profit, thus calculated, the amount of the subsidy. This shows the new amount of voyage profit after subsidy.

The chief charges against voyage profits are depreciation, general and administration expense, advertising and interest expenses and taxes. Depreciation, according to the Merchant Marine Act of 1936, is figured at 5% of cost less a small arbitrary residual value. The residual value is 2½% of the original costs. This brings the average depreciation rate to about 4½%.

General and administration expenses, and advertising and interest accounts, are similar to those accounts in other industries. The only difference might be the case of a Steamship Company having mortgages against a vessel. The interest cost of the mortgage is not included in computing the voyage profits of the vessel. This is sound, because for no reason related to earning power one vessel may be heavily mortgaged and another lightly.

Steamship Company taxes differ greatly from those of manufacturing or trading companies. Deep Sea vessels, because of their location, are not subject to property tax. The Merchant Marine Act of 1936 states that, "The earnings of any contractor receiving an operation-differential subsidy under authority of this Act which are deposited in the contractors (Capital and Special) reserve funds—except earnings withdrawn from the Special Reserve Funds and paid into the contractors general fund or distributed as dividends or bonuses—shall be exempt from all Federal Taxes." Negotiations with the Treasury Department have watered down this tax benefit to a form of tax deferment. For this reason, you may see tax charges in Steamship Company statements at times lower than you would otherwise expect.
Because our vessels enter many ports in various countries, we have considerable difficulties with income taxes in foreign countries. Perhaps the saving Grace is the fact that the American Steamship Company, doing business in a foreign country, may deduct from their United States income taxes the amount actually paid in income tax to a foreign country, providing such tax does not exceed the amount that would otherwise have been payable on the same income to the U. S.

After arriving at net income, there are still two items on a subsidized Steamship Company's Operating Statement which are peculiar to such a statement.

The first is debits and credits to the surplus on account of transactions of former years. Under the Maritime Commissions General Order No. 22 it is required that the subsidy accrued, and subsidy recapture accrued, be adjusted almost indefinitely for even small items, and therefore, surplus adjustments are prevalent in subsidized Steamship Company's reports. I might mention here that subsidy recapture is a repayment of subsidy to the Government. The Merchant Marine Act implies that if a Steamship Company can earn more than 10% per annum on its "capital necessarily employed" in the subsidized operations, the subsidy is not really needed, and one-half of any such excess must be paid back to the Government. Since the war, this repayment is deducted before the subsidy recapture is paid by the Government.

The other item found in the surplus account, is the amount carried to subsidy recapture, if the earnings from subsidized operations are more than 10% on "Capital necessarily employed"; and an amount carried into surplus from subsidy recapture liability if such earnings were less than 10% and if there is previous provision for subsidy recapture on which to draw.

Subsidy recapture is computed cumulatively and settlement occurs at the end of every ten years during the life of the operation-differential subsidy contract.

Now we come to the Balance Sheet Accounts. Because transportation generally is not provided on credit terms the accounts receivable of a Steamship Company are substantially less than that of a typical manufacturing company. They consist mostly of interline accounts, subsidy earned and Government bills of lading unaccomplished.

A subsidized operator will have a Capital Reserve Fund on the Balance Sheet. Into this fund go all earned depreciation on subsidized vessels and the proceeds of all subsidized vessels sold or lost. From this fund replacement vessels are purchased and existing vessels are reconstructed.

Another asset peculiar to the Balance Sheet of a subsidized operator is the Special Reserve Fund. This fund consists of all earnings in excess of 10% on "Capital necessarily employed" in subsidized operations. Part of such earnings are held for settlement with the Maritime Commission and the remainder of the fund is available to reimburse operation losses. Disbursements from this fund can only be made on the Maritime Commission's approval.

The capital asset usually reflects owned vessels as the major item. A conservative useful life of 20 years is used in calculating depreciation.

Unearned insurance premiums do not differ from that account on other Balance Sheets, but it is likely to be much larger in comparison. This is due to the extensive policies carried on vessels. The value of individual steamships are large and the risk of loss as well as liability, are substantial, so it is wise to be fully protected.

The liability side of the Balance Sheets will show large balances for tickets sold but not yet honored, both for voyages not yet commenced, and for those commenced but not terminated. Most freight is prepaid so there will be freight money received on voyages commenced, but not terminated. Wages and repairs are not determined until the end of the voyage, and stevedoring and other costs accrue as the voyage proceeds. The accounts often show deferred revenue in excess of vessel and voyage expenses. It is almost true to say that a large part of our net working capital is supplied by our customers.

Small inventories of stores are maintained because the vessels are generally supplied directly from the wholesale dealer. Hence, credit terms are short and payments prompt, making accounts payable small.

Now let me tell you a little about steamship accounting methods and procedures. Certain procedures typical of steamship accounting are as follows:

1. No customers accounts are kept. Instead, bill of lading and ticket stock are basis of collection of revenue. The freight cashiers and the issuers of passenger tickets are held responsible for revenue collection. This is controlled by bills of lading showing tonnage and rates, and passenger manifests showing individual ticket numbers and space assigned.

2. No ledgers for trade accounts pay-
able are kept, but the respective accounts are charged directly from a copy of the voucher check used in paying invoices.

3. Bills of Lading are analyzed to show commodity shipper, the consignee, port of loading and port of discharge, freight rate and office, and tonnage. This is done by a punched card system.

4. Every Steamship Company must deal in foreign exchange, but they have been able so far to require payment of freight and passenger revenue in U. S. Dollars, or in stable currency.

5. Home office concentration of accounting work is intense, due to the very large number of domestic and foreign branches and agents, vessel pursers, and connecting lines. Nearly all bookkeeping and auditing is performed at the home office. Needless to say, it is quite a task to fit all these reports together to provide a complete story of voyages terminated during the month. Each voyage account is composed of transactions in perhaps 15 to 30 calls at 10 to 25 different ports, in nearly as many different countries. The problem of assembling promptly the voyage revenue, expenses and other related data in a Round-World voyage of say 25 ports of call, is enough to keep any accountant on his mettle. Estimates of revenue must be furnished to the various departments within a few days after termination of the voyage, and all voyages terminated within the month, must have the revenue computed for the closing, by the middle of the following month.

6. Crew payrolls require a large staff of specially trained crew payroll accountants. These payrolls are complicated because of the additions to the basic wage. Additions include overtime, area bonuses, penalty wages, slop chest charges, and earned vacation credits, as well as the usual tax deduction and withholding. It is necessary to make almost immediate payoffs when the last port of call of a voyage is reached and the purser always needs help to complete the crew payroll.

7. Operation-differential subsidy, construction-differential subsidy, recapture of former and refund of the latter, Capital Reserve Funds, Special Reserve Funds and Construction Reserve Funds are peculiar to the Steamship industry, and all require an understanding of the Merchant Marine Act of 1936.

The Steamship industry is a service industry, and is vital to the needs of our Nation. The size, strength and soundness of the Steamship industry depends in part on the wisdom of its management, including those charged with the keeping and interpretation of its accounts.

**TAX NEWS**

**TENNIE C. LEONARD, C.P.A., Memphis, Tennessee**

**THE TAX COURT NEEDS AN ACCOUNTANT**

One source of difficulties in the practice of income taxation is the difference between the accounting concept of income and income as sometimes determined by the Commissioner of Internal Revenue. J. K. Lassner and Maurice E. Peloubet published an interesting article on that conflict in the Tax Law Review of March 1949.

As an illustration of the difference between the Commissioner's idea of what is income and what business men and accountants believe to be income, there is the Sullenger case (11 TC 1076) where the Commissioner attempted to disallow, for income tax purposes, the deduction of amounts paid for merchandise in excess of O. P. A. prices. The Tax Court in that case held that the Commissioner had exceeded his authority, that the 16th amendment to the constitution provided for the taxation of income, and income is what remains after the cost of the goods sold has been deducted from the sales price. We suggested (The Woman CPA, February 1949) that the decision in the Sullenger case might result in permitting the deduction of wages paid in contravention of wage stabilization regulation where the wages paid were a part of the cost of goods sold.

Now the Tax Court, in Weather-Seal Mfg. Co., 16 TC No. 158, denies that wages paid may be considered a part of the cost of goods sold. The Court is unable to see any distinction between the cost of goods sold, which is a deduction from gross sales before arriving at gross income, and any other expense which is a deduction by legislative grace, from gross income which is subject to taxation, if the cost or expense is compensation for personal services.

The opinion of the Tax Court, which is of more interest now that price and wage ceilings are with us again, cites in its contention that there is nothing "sacrosanct" about the cost of goods sold, the case of American Pitch Pine Export Company, Inc., 8 TCM 976, in which an incorrect inven-