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Accounting Questions: Valuation of Securities on Financial Statements, Disclosure on Balance-Sheet of Commission of Sale of Stock, Accounting Treatment of Cartage, Cash Discount and Goods in Transit

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Accounting Questions

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VALUATION OF SECURITIES ON FINANCIAL STATEMENTS

Question: This refers to a statement by the comptroller of the currency that the government had determined to ignore for the purpose of bank statements, the quotations of the New York bond market, and to regard intrinsic values as the true basis for judging the worth of the securities held by national banks.

A number of financial institutions who are our clients have heard of this dictum and are insisting that in preparing statements of financial condition as at December 31st, we should, as auditors, ignore the then current quotations of securities and show them on such statements at their intrinsic worth. To determine intrinsic worth of securities is rather difficult for an accountant to do, and it of course means that the clients will expect them to be listed at what they think they are worth, which we are, of course, not inclined to do. This situation resolves itself into a matter of dickering with the client as to what they and we may think is the intrinsic value, a very unsatisfactory situation.

We feel rather inclined to insist upon the well recognized and sound rule heretofore followed of showing the securities at cost or market whichever is lower. The fact that conditions are somewhat abnormal does not, we think, warrant a departure from that rule. In view, however, of the statement of the comptroller of the currency, which, of course, affords an excellent precedent for our clients, we are somewhat at a loss to know what course to pursue. The matter has undoubtedly come up with other accountants and we shall be glad to have your advice as to the result.

Answer: This statement was undoubtedly based upon questions of public policy involved in the relations between the comptroller of the currency and the national banks, and between the national banks and the general public. There are in general two schools of thought on the question of public policy involved, one, that it is dangerous to give the general public the true facts for fear of increased panic and hysteria, with consequent greater injury to financial institutions and business, and, two, that it is better to state the facts, as otherwise the general public becomes suspicious that the actual facts may be worse than they really are.

We believe that accountants in general would subscribe to the second viewpoint, and if the matter were entirely in our hands we should undoubtedly insist upon a disclosure of all pertinent facts. That is undoubtedly the attitude that we should employ in preparing statements for business corporations. Our personal opinion is that we would not care to have our firm name attached to a balance-sheet of a financial institution on which the facts as to market quotations of securities were not indicated clearly in some form. If, from the standpoint of public policy, a financial institution desires to put out its statements without disclosing all pertinent facts, it obviously has the right to do so, the responsibility then being only that of the officers and directors, but we do not think any such institution can expect a public accountant to lend his name and certificate to such a statement, where facts that accountants believe are essential are omitted from the statement.

We agree with the suggestion made in the question, that it is not practical to determine "intrinsic value" of securities, and that the only well recognized measure is that of actual quotations, or bid prices on a recognized exchange.

If some public bureau or official having authority to make such a decision requires or recommends the use of some basis other than current quotations (such, for example, as market quotations for June 30, 1931), that plan may be followed, but the fact that the securities are stated on the basis of June 30, 1931, market quotations should be clearly noted on the statement.

DISCLOSURE ON BALANCE-SHEET OF COMMISSION FOR SALE OF STOCK

Question: A corporation issued 50,000 shares of non-par value stock, authorized by the directors to be sold at $5.00 per share, less a commission of 10 per cent. for selling, or a net sale price per share of $4.50. The gross sale price of all of the shares was $250,000, and the total commission $25,000, net proceeds being $225,000.

In preparing a balance-sheet for the company the accountant was requested to include therein the capital stock of the company as follows:

Capital stock:
  No par value, authorized and issued, 50,000 shares...... $225,000

without making any disclosure on the balance-sheet (certified) or in a report to the stockholders regarding the amount of the selling commission.

Is it proper for him to comply with this request?

Answer No. 1: We wish to say that it appears to have been the intent of the directors of the corporation to sell the 50,000 shares of no-par-value stock for $225,000. That amount is in fact the capital with which the corporation starts business. The very purpose of no-par-value stock is to afford a disclosure of the actual amount of capital paid in for such stock, and certainly no one can question the fact that the corporation in this case started business with a capital of $225,000 and not $250,000.

Some might argue that the gross amount of $250,000 should appear as the value of the capital stock and that the commission should be shown per contra as organization expense, to be subsequently amortized. This would unquestionably have to be done in the case of a par value stock. Ordinarily, however, in the case of no-par-value stock the board of directors have the right to sell it for a reasonable value which the board of directors may determine.

Answer No. 2: If commission is legally payable under the state, we are inclined to think that it would be proper to state the figures net.

From an accounting standpoint, however, we think it would be preferable to add the words "net cash proceeds," or other indication that some deduction had been made. It might be a good thing to point out that the stockholders must have been aware that they had paid $5.00 per share for the stock and it would prevent inquiries as to why some people had apparently received it for less.

If there are no requirements under state law to state the amount of commission allowed on the sale of shares, we would not be prepared to go so far as to say it was improper to certify the balance-sheet as required, but consider the other course better.

ACCOUNTING TREATMENT OF CARTAGE, CASH DISCOUNT AND GOODS IN TRANSIT

Question: I have always considered the answers to the following question elementary, but I now find there is some difference of opinion.

1. Do you treat cartage inward as part of the cost of goods or as an expense?
2. In certifying the value of inventory do you deduct from said value, assuming it is properly valued (at cost or market, whichever is lower) true cash discount?
3. Do you include goods in transit as part of the inventory and as part of the accounts payable or do you merely make a footnote on the balance-sheet or do you make no mention of it at all?

Answer: 1. The federal reserve board in its publication entitled *Approved Methods for the Preparation of Balance-sheet Statements,* on page 12, states: "If duties, freight, insurance, and other direct charges have been added, test them to ascertain that no error has been made. Duties and freight are legitimate additions to the cost price of goods, but no other items should be added except under unusual circumstances." This quotation is sufficient authority to support the treatment of inward freight as part of the cost of goods.

As far as practice is concerned, we so include inward freight. If the books of account treat freight as an expense, we would probably adjust to include in merchandise costs, as far as our statements are concerned, unless the item were relatively unimportant.

2. The same publication previously referred to, states on page 14: "Trade discounts should be deducted from inventory prices, but it is not customary to deduct cash discounts. However, this may be done when it is trade practice so to do."

As a matter of practice, we distinguish cash discounts from trade discounts by treating any discount of 2 per cent. or less as a cash discount. We always deduct trade discounts and, generally speaking, do not deduct cash discounts from inventories, but take care to make the requisite adjustments where accounts payable are net of cash discounts.

3. It is our practice always to include goods in transit in the inventory and in accounts payable, indicating the amount.