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Editorial

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EDITORIAL

Evils of the Lowest Price

While everyone is talking about the question of offering all government contracts to public bidding, there is a tendency to regard the award of contracts after submission of bids as a panacea for all ills. But the truth of the matter is that this supposedly desirable plan has many weak points, and it would be well to bear these in mind. It is true that in almost every call for bids there is a provision to the effect that the government may reject the lowest bid if there be any indication that the bidder may be incompetent to carry out the terms of the contract in a satisfactory manner. Nevertheless, the history of bidding shows that in most cases the lowest bidder is given the order for the work. Of course, if all bidders were equally able to perform the work and if all were equally honest, there could not be much valid objection to the acceptance of the lowest bid; but such conditions do not exist, except in rare instances. As a rule the bidder who offers to undertake a contract at the lowest price is either sacrificing all probability of profit or is ignorant of the costs which will be involved. In a recent case of which we have knowledge the bids for a certain work ranged from \$8,800. to \$16,400. There were twenty bids and most of them were made by well-known concerns which might be presumed to have a knowledge of costs. Their prices were almost all within a narrow range of the highest. The lowest bid was accepted. Now, it follows as a logical consequence that either the higher bidders were expecting to make an unholy profit or the lower bidders did not know what they were about. In all probability the highest bidders were too high, but it is inconceivable that all of them were misled in their estimation of costs. If these bidders were reasonably accurate in their estimates, the lowest bidders, even if their overhead expenses were less, could not possibly have produced the articles concerned without a loss—a substantial loss. This is unfair in every way, because it means that either the lowest bidder must honestly carry out his contract and assume the burden of loss or he will be tempted to adopt means to reduce costs at the expense of the government. As a general rule, it may be safely considered that established firms of high standing would not bid at all, knowing that there would be keen competition, unless

they felt that they could undertake the work and procure for themselves a fair profit. They would not waste time in bidding prices which would entail outrageous profits, because they would know that there would be many lower bids.

Ability More Important than Price The whole question of bidding has been misrepresented because of a natural and perhaps laudable desire to obtain prices which would prevent any excess profits. Many private enterprises call for bids for work of various sorts, but it is not the custom to accept bids solely because of low rates. The private concern understands something of the costs involved, is willing to permit the contractor to obtain a reasonable profit and, therefore, accepts the bid which seems to offer not only a moderate price but good assurance of satisfactory work. Every accountant knows how foolish is the plan of calling for bids for professional work. The same fallacies are inherent in all bidding. One party or the other is almost certain to lose, and business conducted at a loss to either participant is not good business. It sets a premium upon inefficient work and upon devious methods of evading obligation. In such matters as that of air mail transportation, how absurd it would be to accept bids from concerns which were not equipped to render efficient service. Perhaps in the past excessive profits were made by contractors, but the work was certainly well done. The loss of life was happily small and the public had learned to have confidence in the delivery of letters sent through the air. If some small and ambitious contractors had been awarded the contracts at a much less price it does not seem probable that the air mail would have developed with such enormous rapidity. We are not concerned with allegations of collusion in the award of contracts. The point in which all accountants are interested is the soundness or unsoundness of the principle of competitive bidding.

Fear of Political Influence It would be ideal if the award of all government work could be entirely divorced from politics. If we had a sort of commission government, nationally, consisting of men in whom we had complete faith, they would be able to buy in the best market at a fair price and the whole country would be benefited thereby. The trouble with the propaganda in favor of competi-

tive bidding is that it presents only one side of the question. It would be much better if we had men in authority in whom the country would have sufficient confidence to permit them to buy where, when and how they thought best. In one of the great European cities there is a commission of three men who have no official title or authority. They act in an advisory capacity and yet in effect they have the power to permit and to forbid purchase. They are men who represent the highest standards of business and professional morality. If the city wishes to obtain a new building or other municipal asset, bids may be invited, but the triumvirate is not solely governed by the prices quoted. If even the city council, swayed partly by politics, wishes to embark upon some new and expensive venture, these three men can approve or reject, and their word prevails. As a consequence this great city has been well governed, its affairs have been honestly administered and there has been practically no waste of the public's money. Nearly every guilder has bought a guilder's worth. What has been done in Amsterdam could be done in all our cities and states and even in the nation itself. But we are so hampered by fear of political crookedness that we overlook the potentialities of administering the government business in a business-like way.

**Opportunity and
Responsibility**

The semi-annual meeting of the council of the American Institute of Accountants was held April 9th, and approximately forty members of council and chairmen of committees were present. The tone of the meeting was worthy of general consideration. There was manifest a distinct appreciation of the important developments which are taking place daily in the practice of the profession. Perhaps the most notable aspect of speeches was the emphasis laid upon the paramount necessity of making the most of the opportunities which are before the profession. It was the unanimous feeling that accountancy has today before it an open gate through which it may enter into a region of far greater usefulness than ever before. It was highly significant that the members of council and others present were imbued with a serious willingness to accept additional burdens which are about to be assumed. There is no doubt whatever that a number of factors will work together to increase the prestige and the accomplishments of professional accountancy if accountants themselves do not fail to grasp the

true significance of the present time. If they fail, the future of the profession will be dark indeed, and we shall be confronted by a bureaucratic control of accounting without the protection of professional independence. The innumerable codes which have been adopted or are under consideration for the regulation of business and industry, the new laws which are being passed with startling rapidity for the control of activities which have always been considered purely individual in the past, the various implications and results of the so-called "new deal," whether it continue or not—all these are of vital consequence to business generally and to accountancy perhaps as much as to any other department of modern life. Fortunately the profession has now advanced to a point at which it is competent to render the service to the public which it is being asked to render. Had the extraordinary demand of today occurred twenty-five years ago the profession would probably have been unable to cope with it. But accountancy has grown in spite of depression. The equipment of its personnel is infinitely more than it was, and if accountancy does not become what its protagonists hope, it will be solely due to error or omission on the part of its practitioners.

**Investment Bankers'
Code**

One of the most gratifying accomplishments of the national recovery administration is the code of fair competition for investment bankers approved on March 23rd of this year. This code was under discussion for a long time. It was recognized by investment bankers themselves that the time had come when there must be substantial improvement in the conduct of that vitally important business. The American Institute of Accountants through an appointed committee was called into consultation by the investment bankers, and recommendations of far-reaching nature were offered by the accountants. In the code, as finally promulgated, there is evidence of the advice and suggestions made by the Institute's representatives. There had been so much misunderstanding of the true financial condition of corporations whose securities were offered for public sale that it was imperative that there should be rules and regulations which would make it reasonably sure that the statements presented in support of attempted flotation of securities should be so clear that even an uninformed potential investor might be able to obtain knowledge upon which to base his determination to

buy or not to buy the offered securities. In article IV, section I, appear certain rules which reflect the best thought of professional accountancy. Such complex questions as degree of ownership, profit or loss of a non-recurring nature, valuation of assets and liabilities of foreign subsidiaries and others are admirably handled. We select the following paragraphs for purposes of illustration:

“(b) Annual financial statements.—To cause for each fiscal year to be prepared by independent public or certified accountants, an income statement, surplus statement and summary of changes in reserves for such fiscal year, and a balance-sheet as of the end of such year of the issuer as a separate corporate entity and of each corporation in which it holds, directly or indirectly, a majority of the voting stock together with such further information as may be necessary to disclose all intercompany holdings and transactions; or, in lieu thereof, eliminating all intercompany transactions, a similar set of consolidated financial statements of the issuer, and any or all of its subsidiaries accompanied by financial statements of the issuer as a separate entity and of any subsidiary not consolidated.

“If any such consolidated statements exclude any subsidiary, (1) the caption shall indicate the degree of consolidation; (2) the income statement shall show, either in a footnote or otherwise, the issuer's proportion of the difference between current earnings or losses and the dividends of such unconsolidated subsidiary for the period accounted for in such income statement; and (3) the balance-sheet shall show, in a footnote or otherwise, the extent to which the equity of the issuer in such subsidiary has been increased or diminished since the date of acquisition as a result of profits, losses and distributions.

“Such statements shall show the existence of any default in interest or in sinking-fund or amortization payments and any arrears of any cumulative dividends of the issuer or of any subsidiary whether consolidated or unconsolidated.

“In case there are any substantial items of profit or loss of a non-recurring nature, such as those arising from the disposal of capital assets, they shall be expressly enumerated. If, for any reason, the examination of the accounts of any subsidiary shall have been made as of a date different from that of the issuer, that fact shall be stated, either in the certificate of the accountants or otherwise, together with a statement as to the extent of their examination of the interim transactions. In so far as practicable the examination of the accounts of each subsidiary shall be made by or under the supervision of the same accountants who examined the accounts of the issuer, but if the accounts of any subsidiary included in any consolidated statement are examined by public or certified accountants other than the accountants who

examined the accounts of the issuer, such fact shall be noted in the certificate of the latter. If a consolidated balance-sheet includes assets and liabilities of foreign subsidiaries, the percentage of total assets and liabilities included which represent the aggregate assets and liabilities of all such foreign subsidiaries shall be noted on the balance-sheet. The accountant's certificates shall state the basis on which the accounts of foreign subsidiaries are included in the consolidation and there shall be set forth in the certificate or in an appended certificate any substantial differences in accounting practice employed by the foreign subsidiary or subsidiaries in so far as such differences shall be known to the certifying accountant.

"Every balance-sheet prepared in accordance with the above shall disclose the basis used to compute the figures at which the principal asset items are carried thereon. Where any liability of the issuer is secured on any assets of the issuer, the balance-sheet shall show that such liability is secured, and if the security consists in whole or in part of current assets it shall show such fact and the general nature of such current assets. Any contingent liabilities, not expressly shown on the balance-sheet, shall be shown in a footnote in so far as good accounting practice may require."

"(d) Stock dividends.—Not itself, and not to permit any subsidiary, directly or indirectly controlled, to take up as income stock dividends received at an amount greater than that charged against earnings, earned surplus, or both of them, by the company paying such stock dividend."

"(e) Surplus of subsidiaries.—Not to treat earned surplus of a subsidiary created prior to acquisition of such subsidiary as a part of earned consolidated surplus of the issuer and of its subsidiaries, and not to credit any dividends declared out of such surplus of the subsidiary to the income account of the issuer or of any other subsidiary."

"(g) Accounting changes.—Not to make any material change in depreciation rates or policies or in accounting principles or in their application without describing such change in the next succeeding published balance-sheet."

Effective Efforts of Accountants

The effective aid given by accountants in preparing the investment bankers' code is an earnest of what can be done in many other departments of financial and industrial activity. If every code were equally explicit in the very important matter of accounting records and statements it would do much to usher in the better day which is the hope of the national recovery administration. There is, of course a wide difference of opinion as to the whole scheme of controlled industry. It may succeed,

and it is at least equally liable to fail; but, at any rate, the codes adopted or even only discussed afford a chance for coöperation and their results will probably endure for some time to come. The difficulty is that many codes which have been adopted glance only casually at the accounting problems. Such codes, we believe, are destined to accomplish nothing permanently helpful. The work done by representatives of the American Institute of Accountants in the case of the investment bankers' code deserves the highest commendation of the entire financial world.

The Shannon Bill An eminently desirable bill (H. R. 6038) introduced in the national house of representatives during the first session of the present congress is still in the hands of a committee, and it seems improbable at the date of writing these notes that the bill will be reported before adjournment. The bill, however, is remarkable in many ways and it is earnestly to be hoped that sooner or later something of the kind will become law. It is rumored that this bill has the support of the administration; consequently there may be some hope that ultimately it will be enacted. It provides for the establishment and maintenance of a standard system of cost accounting and cost reports for all the executive departments of the United States. The bill is practically unique inasmuch as it calls for the introduction of sound accounting principles where such principles are most sadly needed. There has always been much criticism of the conduct of governmental departments, and it has been alleged that the country really does not know the cost of operating the great business which we vaguely call "the government." In these days of seeking after reformation, it is an encouraging sign that such a bill as that introduced by Mr. Shannon should have been introduced at all. It is evident that the bill was drafted by someone who understood the vital principles of cost accounts. The section describing what must be included in overhead expense is especially noteworthy. It reads as follows:

"(a) Expenditures applicable to and necessary in connection with any work or operation undertaken or any article or thing produced, and not properly chargeable to 'direct labor,' 'direct material,' or 'direct expenses,' and which are allocable to two or more simultaneous or successive projects within an accounting period, including supervision, indirect labor (such as factory

trucking, cleaning, inspection and other labor, the cost of which is not included in other overhead items); supplies (such as oils, waste, cleaning, hardening, tempering, and grinding supplies); fuel used, other than in the production of light, heat, and power; small tools (such as drills, files, reamers and saw blades); water; repairs to buildings, machinery and equipment; insurance; depreciation and obsolescence of plant and equipment; light, heat, and power, including fuel and power-house wages; engineering plans and drawings; factory management and general plant expense (such as telephone, stationery, purchasing department, cost and time-keeping departments, safety work, fire prevention, sanitary supplies); and property taxes: provided, that the foregoing enumeration of specific items and advisory illustrations shall not be held to exclude such other items as are properly chargeable to overhead expense in accordance with prevailing and generally accepted accounting practice in private industry."

**Overhead Expense
Defined**

Then follows a definition of administrative expense, and provision is made for the fair distribution of expense involved on two or more simultaneous projects. At various points throughout the bill it is provided that computations shall be made in accordance with bases commonly accepted and followed in private industry. For example, section three provides as follows:

"Every executive department, independent establishment, office, and bureau of the United States or under their respective direction and control, shall promptly prepare upon the completion of a project and keep a report of cost in accordance with the uniform cost accounting system herein required, which shall clearly show the charges made for each of such items of cost, and if such cost includes the amounts for overhead expenses allocable to more than one project, shall set forth the basis on which allocation was made. Whenever and wherever any item or items of cost customarily incurred by private industry (such as insurance, compensation to employees for accidents and diseases arising out of industrial employment, taxes, licences, performance bonds and penalties), are not included in cost as herein required to be determined and reported because no expenditure therefor was made, such item or items shall be fully and clearly disclosed in each such report of cost."

**To Permit Just
Comparison**

This bill if enacted will permit a proper comparison of the costs of production with the costs which would be incurred by private bidders. We hope sincerely that the administration

will lend its weight to the support of the Shannon measure. There has been far too much ignorance of production costs in all departments of the government and, as a consequence, private enterprise has been severely handicapped by governmental competition. There is no reason at all why costs which must be incurred by every contractor whether private or governmental should not be taken into consideration in the allocation of work. If this principle had been followed in the past it is certain that many private companies which have been excluded from activity on governmental contracts would have been awarded the work. The government, naturally, occupies a singularly fortunate position, because there has been no analysis of government costs worthy of the name; whereas private enterprise has been subject to the laws of sound economics. We are told that it is the intention of the government that private enterprise shall be stimulated in every reasonable way, and yet for many years there has been a lack of knowledge of governmental costs which has adversely affected the interests of many bidders. Furthermore, if the costs are concealed as they have often been, there is no way of knowing what it is actually costing the government to produce any work which may be in hand. Probably if the true costs were known it would be found that the government has been paying to its various agencies prices for work which are far higher than they would have been if the work had been given to private enterprise. And if the accounts of the government had been kept upon a proper basis it would have been possible to allot governmental contracts where they could be most competently and cheaply carried out. From every point of view it is much to be desired that reform in the accounting of government departments be expedited. Certainly every accountant in the country would welcome the introduction of accounting methods in the government, and business as a whole would be greatly benefited.