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Advantages of a Natural Business Year

A. S. Fedde

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American Institute of Accountants

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135 Cedar Street, New York, N. Y.

October 27, 1933

John W. Byrne, Esq.,
Hotel Washington,
Room 331,
Washington, D. C.

← Returned not found at
this address.

Dear Mr. Byrne:

Simplicity, accuracy, and uniformity of operation are aims and hopes of all who are working under codes of the National Recovery Administration.

Two of the most troublesome features, namely, cost finding and statistics can be simplified by the adoption by all within each industry of a uniform fiscal year ending on a date coinciding with a business season's and when inventories are at a low point. We hardly think it is realized how very important this matter is to industries attempting to operate under a code.

Some of the advantages accruing from the adoption of such a fiscal period are reviewed in the attached excerpt from an article published last June in The Journal of Accountancy.

The Institute's committee, which has made a study of this subject, would be glad to advise and assist trade associations which are interested.

Yours very truly,

SPECIAL COMMITTEE ON NATURAL BUSINESS YEAR

A. S. Fedde
A. S. Fedde
Chairman.

Advantages of a Natural Fiscal Year*

By A. S. FEDDE

One result of the Federal tax laws passed in 1909 and in 1913 was to cause corporations whose accounts were on a fiscal-year basis, other than the calendar year, to change the accounting period to correspond with the calendar year, in order that the requirement of the law to report income received in the calendar year might be met without the necessity of closing the books more than once a year. After five years—1909 to 1913 inclusive—of reporting on that basis, it became possible for corporations to change back to their former fiscal periods if they wished. Section 46 of the revenue act of 1932 and the related treasury department regulation indicates how the change may be brought about by the filing of a simple form, setting forth the reasons for changing, which is followed in the ordinary course by permission granted by the commissioner of internal revenue to make the change.

A few years ago the bureau of business research of the university of Illinois made an investigation into the question of the advantages of adoption of the natural business year, the results of which were published in its *Bulletin No. 11*. It was ascertained that the advantages of adopting a natural business year far outweighed the disadvantages, but, strange to say, the most common argument put forth in opposition to its adoption was that the income-tax laws require returns to be filed as of December 31st for the calendar year. And that, after the privilege of filing returns on a fiscal year basis other than the calendar year had been in the law for more than ten years. It is evident that knowledge of the privilege must not be taken for granted.

Advantages from a more general use of the natural business year would accrue, not only to the management of the enterprise, but also to bankers and the bureau of internal revenue. However, managers of enterprises determine policies of this sort—therefore they are the ones to be directly addressed, rather than others who have a collateral interest only.

From the reports of over four hundred business executives, received in the investigation mentioned, it appeared that advantages would accrue to the management from closing at the end of a natural period because seasonal activity would be completed, there would be low stocks of goods at closing, more time would be available for

* From an article in *The Journal of Accountancy*, June, 1933. Reprinted by permission.

the firm's auditors, new contracts would be discussed between seasons and statistical data would be collected for a natural period.

There is a tremendous difference between taking an inventory in the middle of a manufacturing season, with big stocks of raw materials, work in process and finished goods accumulated for shipment, and taking an inventory when raw materials are at a low point, factory operations almost or entirely stopped and finished goods practically all shipped. The greater accuracy possible when taking inventories at a low point is apparent. Statements prepared thirty or sixty days after the close of a season will show the completion of an annual or semi-annual cycle, not an enforced stop at the peak or at an intermediate stage of operations. Bank loans would naturally appear low or cleared up, accounts receivable substantially realized and the business as a whole in its most liquid position.

Closing the books at December 31st by firms which are at that date operating in seasonal production has the effect of splitting a natural business year, thereby throwing operating results of two seasons, namely, the end of one season and the beginning of another, with varying economic conditions, into one operating statement for the calendar year.

In the survey previously mentioned it was found that of 439 prominent firms all but 123, or 28 per cent. used the calendar year, whereas, selecting the most suitable natural date, 56 per cent. would be using a date other than December 31st for closing.

If a survey were made of smaller firms, it would probably be found that more than 72 per cent. were closing their books with the calendar year. With cost keeping presumably at a less developed point in the smaller firms, their inventory costs may be less accurate. Such inaccuracies when applied to low inventories may be immaterial, but they tend to become serious when applied to inventories taken at the peak; and they would also distort operating results if the position in the season at December 31st were to change, due to weather conditions or to altered customs in the industry.