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Letter from Richard W. Spaulding, American Institute of Accountants, to Niles & Niles Re: Questionnaire Regarding Definition of Earned Surplus.

Richard W. Spaulding

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NILES & NILES
CERTIFIED PUBLIC ACCOUNTANTS
60 BROADWAY, N. Y.
53 STATE STREET, BOSTON
INTERNAL CORRESPONDENCE

R 6/18

Boston, June 16, 1928.

Miles & Niles,
60 Broadway,
New York, N. Y.

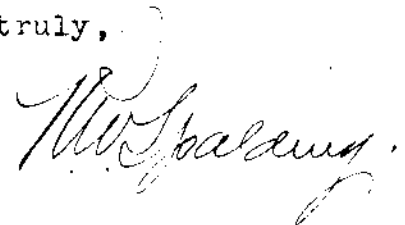
Gentlemen:

As you know, The American Institute of Accountants sent out a questionnaire regarding definition of earned surplus.

I presume that the members of the firm of Miles & Niles submitted their replies and if not too much bother to you I would like to ascertain if my answers agree with yours. I enclosed a copy of my reply.

I realize that some of the questions might be interpreted from different view points and several are open to argument. If this is going to be a bother to you please do not waste any time on it.

Yours truly,



AMERICAN INSTITUTE OF ACCOUNTANTS

QUESTIONNAIRE RE DEFINITION OF EARNED SURPLUS

(Please answer each question "yes" or "no" wherever possible.)

1. Should earned surplus be restricted to the undistributed balance of earnings arising from the operations of the present corporation?
Yes.
2. Or may earned surplus include, without qualifying comment, profits arising from the sale, in toto or in relatively large amounts, of a company's plant assets? No.
3. If a 100% owned subsidiary is dissolved and its assets and liabilities are taken over by the parent company may its earned surplus (all of which was earned subsequent to the date of acquisition of its stock by the parent company) be considered to represent earned surplus of the parent company and be included therein without qualifying comment? Yes.
4. In preparing a consolidated balance sheet of a parent company and its 100% owned subsidiary, may the surplus of the subsidiary, earned prior to the date of acquisition of its stock by the parent company, be considered to be a part of the consolidated earned surplus and be included therein without qualifying comment? No.
5. May surplus arising from the sale of a corporation's par-value stock at a premium or from the sale of stock of no par value at an amount per share in excess of its stated value be considered as earned surplus and included therein without qualifying comment? No.
6. Is an unrestricted cash donation made to a corporation by one of its principal stockholders a proper credit to earned surplus? No.
7. If a corporation realizes actual profits on the purchase and subsequent resale of its own stock for cash, may such profits properly be included in earned surplus without qualifying comment? No.
8. May earned surplus arising from recapitalization, created by writing down the par or stated value of the corporation's capital stock, be merged with the earned surplus under the title of "Surplus" on a published balance-sheet, without qualifying comment? No.
9. If deficits covered by operating losses suffered by a corporation in prior years have been wiped out by means of a recapitalization (not reorganization) may the surplus actually earned since date of recapitalization be shown, without qualification, as the earned surplus of the corporation? Yes.
10. If a corporation takes up on its books an appraisal of its fixed properties which is in excess of the former book values, should the depreciation on the new values be charged entirely against the year's operations and thence into surplus? No.

11. Or is it proper for a corporation to charge depreciation on appreciation against the capital surplus arising from appreciation and to charge against the earned surplus only the depreciation on the old book values, either by making the charge directly to capital surplus and earned surplus, respectively, in the first instance, or by charging the entire provision against earned surplus with concurrent transfers from earned surplus to capital surplus of the depreciation taken on the appreciation? Yes.
12. If the agreement covering the issue of preferred stock by a corporation provides for the setting aside annually out of earnings on March 1st of each year, of a stipulated sinking-fund provision, is it necessary to qualify the earned surplus account on a December 31st balance-sheet with respect to the provision to be made on March 1st of the succeeding year? Yes.
13. Should surplus appropriated for the retirement of preferred stock under the provisions of a preferred-stock agreement be considered as permanently appropriated until the entire issue of preferred stock has been retired? No.
14. Is the gain arising from the cancellation of an open account payable by the parent company a proper credit to earned surplus by the subsidiary? No (if account is owed parent company by subsidiary).
15. If an appraisal of fixed assets has been taken up on the books of a corporation and if the appraised values have been fully depreciated by charges to operations from year to year, is it sound accounting procedure after the full depreciation has been provided, to transfer the surplus arising from appreciation from capital surplus to earned surplus? Yes.
16. In the event a bond issue is retired is it sound accounting procedure to charge off the discount unamortized at date of retirement against a surplus arising from an appraisal of the company's fixed assets? No.
17. If, in a plan of recapitalization, a bond issue is retired and a capital surplus is created by reducing the par or stated value of a corporation's capital stock, is it sound accounting procedure for the corporation to write off the discount unamortized at date of retirement against the capital surplus created by reducing the par or stated value of the stock? No.
18. Is it sound accounting procedure to write off the unamortized discount on bonds still outstanding against capital surplus created by writing down the par or stated value of the corporation's capital stock, in order to relieve future earnings of the annual amortization charge? No.
19. In preparing a balance-sheet, is it sound accounting procedure to show losses from operations as a charge against capital surplus and to carry forward the net figure as capital surplus in stating the opening surplus on the balance-sheet prepared at the end of the succeeding year? No.

20. Would it be sound accounting procedure for a corporation to write off goodwill or other intangible assets by charging them off against a surplus arising from the appraisal of the company's fixed properties? Yes.
21. Should all dividends declared be considered to be payable out of earned surplus, unless definitely stipulated otherwise in the declaratory resolution? Yes.
22. Should dividends declared by a subsidiary out of the earnings accumulated by the subsidiary prior to the date of its acquisition by the holding company be added to the earned surplus of the holding company? No.
23. Should dividends declared, "payable out of the surplus of the corporation" without any definite designation of the surplus out of which they are payable, in excess of the balance in earned surplus be shown to produce a deficit? No.
24. Or may such dividends, if declared in excess of the balance in earned surplus, be shown on the balance-sheet as a deduction from all types of surplus combined? No.
25. If dividends are to be shown on the balance-sheet as a deduction from all types of surplus combined, should not the board of directors of the corporation take appropriate action to designate the specific surplus accounts from which the dividends are to be considered to have been payable, in order to permit of the proper segregation of the balances in the several surplus accounts as of the beginning of the following year? Yes.

Signed- Richard W. Spalding.

New York, July 12, 1928.

Niles & Niles,

53 State Street,

Boston 9, Mass.

Gentlemen:

Your letter of the 11th instant has been received. While we presume that Mr. Beaton advised you that he was leaving for Bay City, Michigan, we are enclosing herewith a copy of his letter to us of the 11th instant, advising us of that fact. Please advise if you knew he was going and, if so, why Miss Russell did not write us about the matter.

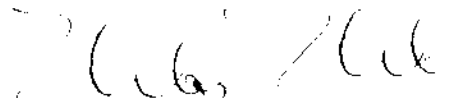
Referring to Mr. Spalding's letter of June 16th and to ours of the 18th regarding the questionnaire of the American Institute of Accountants, we have just been advised by Messrs. Horne and Wood as follows:

Mr. Horne writes: "I have not replied to the questionnaire - Many of the questions require a further statement of circumstances before a 'yes' or 'no' answer is justified."

Mr. Wood writes: "I have not replied to the questionnaire for the same reason as stated above."

We think that, in addition to the reason assigned above, both Mr. Horne and Mr. Wood were very busy and did not feel like giving the time to studying the matter before answering the questions.

Yours truly,



H.N-B
Enc. 1.

AMERICAN INSTITUTE OF ACCOUNTANTS

SPECIAL COMMITTEE ON DEFINITION OF EARNED SURPLUS

May 9, 1928.

TO THE MEMBERS AND ASSOCIATES OF THE
AMERICAN INSTITUTE OF ACCOUNTANTS:

GENTLEMEN:

The report of the special committee on the definition of earned surplus to the Council of the Institute, under date of September 10, 1927, contained the recommendation that it be empowered to prepare and submit in the near future to our members a questionnaire, designed to cover the principal questions that arise with respect to the proper accounting treatment of transactions affecting surplus accounts. It was intended that this questionnaire should constitute a preliminary step looking toward the promulgation by the Institute of an official statement with respect to approved procedures and forms of presentation of the different types of surplus.

At a meeting of the Council of the Institute held on September 19, 1927, it was resolved that the report of the special committee on the definition of earned surplus be accepted and that the recommendations which it contained be adopted.

Acting upon the authority conveyed by this resolution, your committee has proceeded with the preparation of a questionnaire containing certain questions designed to clarify many problems arising in the balance-sheet presentation of surplus, with respect to which accounting practice is by no means standardized.

The enclosed questionnaire, therefore, is submitted with the thought that a digest of the considered opinion of the membership with respect to these questions may best serve as the basis for official action by the Institute, with a view to securing a greater degree of standardization and uniformity in the treatment of these problems by the members of our profession.

May we request, therefore, that we receive your active coöperation in this undertaking and that you fill out and return the enclosed questionnaire at your earliest convenience.

Special Committee on Definition of Earned Surplus,

ARTHUR ANDERSEN, *Chairman,*
GEORGE D. BUIST,
F. A. R. MAC FADDEN.

Please address reply to
Arthur Andersen, Chairman
Special Committee
American Institute of Accountants
111 W. Monroe Street,
Chicago, Illinois.

AMERICAN INSTITUTE OF ACCOUNTANTS

Questionnaire Re Definition of Earned Surplus (Please answer each question "yes" or "no" wherever possible.)

1. Should earned surplus be restricted to the undistributed balance of earnings arising from the operations of the present corporation?.....
2. Or may earned surplus include, without qualifying comment, profits arising from the sale, in toto or in relatively large amounts, of a company's plant assets?.....
3. If a 100% owned subsidiary is dissolved and its assets and liabilities are taken over by the parent company may its earned surplus (all of which was earned subsequent to the date of acquisition of its stock by the parent company) be considered to represent earned surplus of the parent company and be included therein without qualifying comment?.....
4. In preparing a consolidated balance-sheet of a parent company and its 100% owned subsidiary, may the surplus of the subsidiary, earned prior to the date of acquisition of its stock by the parent company, be considered to be a part of the consolidated earned surplus and be included therein without qualifying comment?.....
5. May surplus arising from the sale of a corporation's par-value stock at a premium or from the sale of stock of no par value at an amount per share in excess of its stated value be considered as earned surplus and included therein without qualifying comment?.....
6. Is an unrestricted cash donation made to a corporation by one of its principal stockholders a proper credit to earned surplus?.....
7. If a corporation realizes actual profits on the purchase and subsequent resale of its own stock for cash, may such profits properly be included in earned surplus without qualifying comment?.....
8. May earned surplus arising from recapitalization, created by writing down the par or stated value of the corporation's capital stock, be merged with the earned surplus under the title of "Surplus" on a published balance-sheet, without qualifying comment?.....
9. If deficits covered by operating losses suffered by a corporation in prior years have been wiped out by means of a recapitalization (not reorganization) may the surplus actually earned since date of recapitalization be shown, without qualification, as the earned surplus of the corporation?.....
10. If a corporation takes up on its books an appraisal of its fixed properties which is in excess of the former book values, should the depreciation on the new values be charged entirely against the year's operations and thence into surplus?.....
11. Or is it proper for a corporation to charge depreciation on appreciation against the capital surplus arising from appreciation and to charge against the earned surplus only the depreciation on the old book values, either by making the charges directly to capital surplus and earned surplus, respectively, in the first instance, or by charging the entire provision against earned surplus with concurrent transfers from earned surplus to capital surplus of the depreciation taken on the appreciation?.....
12. If the agreement covering the issue of preferred stock by a corporation provides for the setting aside annually out of earnings on March 1st of each year, of a stipulated sinking-fund provision, is it necessary to qualify the earned surplus account on a December 31st balance-sheet with respect to the provision to be made on March 1st of the succeeding year?.....

13. Should surplus appropriated for the retirement of preferred stock under the provisions of a preferred-stock agreement be considered as permanently appropriated until the entire issue of preferred stock has been retired?.....
14. Is the gain arising from the cancellation of an open account payable by the parent company a proper credit to earned surplus by the subsidiary?.....
15. If an appraisal of fixed assets has been taken up on the books of a corporation and if the appraised values have been fully depreciated by charges to operations from year to year, is it sound accounting procedure after the full depreciation has been provided, to transfer the surplus arising from appreciation from capital surplus to earned surplus?.....
16. In the event a bond issue is retired is it sound accounting procedure to charge off the discount unamortized at date of retirement against a surplus arising from an appraisal of the company's fixed assets?
17. If, in a plan of recapitalization, a bond issue is retired and a capital surplus is created by reducing the par or stated value of a corporation's capital stock, is it sound accounting procedure for the corporation to write off the discount unamortized at date of retirement against the capital surplus created by reducing the par or stated value of the stock?.....
18. Is it sound accounting procedure to write off the unamortized discount on bonds still outstanding against capital surplus created by writing down the par or stated value of the corporation's capital stock, in order to relieve future earnings of the annual amortization charge?.....
19. In preparing a balance-sheet, is it sound accounting procedure to show losses from operations as a charge against capital surplus and to carry forward the net figure as capital surplus in stating the opening surplus on the balance-sheet prepared at the end of the succeeding year?.....
20. Would it be sound accounting procedure for a corporation to write off goodwill or other intangible assets by charging them off against a surplus arising from the appraisal of the company's fixed properties?
21. Should all dividends declared be considered to be payable out of earned surplus, unless definitely stipulated otherwise in the declaratory resolution?.....
22. Should dividends declared by a subsidiary out of the earnings accumulated by the subsidiary prior to the date of its acquisition by the holding company be added to the earned surplus of the holding company?
23. Should dividends declared, "payable out of the surplus of the corporation" without any definite designation of the surplus out of which they are payable, in excess of the balance in earned surplus be shown to produce a deficit?.....
24. Or may such dividends, if declared in excess of the balance in earned surplus, be shown on the balance-sheet as a deduction from all types of surplus combined?.....
25. If dividends are to be shown on the balance-sheet as a deduction from all types of surplus combined, should not the board of directors of the corporation take appropriate action to designate the specific surplus accounts from which the dividends are to be considered to have been payable, in order to permit of the proper segregation of the balances in the several surplus accounts as of the beginning of the following year?.....

Signed