Journal of Accountancy

Volume 60 | Issue 1 Article 9

7-1935

Book Reviews

George P. Auld

Eric A. Camman

Harold Dudley Greeley

Book Reviews

CORPORATE PROFITS AS SHOWN BY AUDIT REPORTS, by W. A. PATON. No. 28 of the publications of the *National Bureau of Economic Research, Inc.*, New York. Cloth, 151 pages. 1935.

The subject of corporation profits is surpassed by few in general economic and social importance. Professor Paton's work on its statistical foundations is an exceptionally meritorious study that ploughs new ground and maintains the high standards set by previous publications of the National Bureau of Economic Research.

The study is based on income statements and balance-sheets of about 700 corporations for the years 1927 to 1929. The statements were prepared so as to disclose significant details, classified on a uniform basis, and the businesses analyzed were denoted under 54 separate industrial groups. The original data were compiled for the National Bureau by members of the American Institute of Accountants from audit reports, under procedure ensuring that any possible breach of professional confidence would be avoided. The publication thus marks, as is suggested in a foreword by George O. May, a significant first step in the utilization for research purposes of valuable economic data heretofore unavailable.

Professor Paton's work is executed with great competence, combining skilful analysis, discriminating definition and judicious generalization. It thus not only realizes its broad purpose of providing significant source material for students of the social sciences, but it also has much to offer of high professional value to practising accountants.

The companies were selected on the basis of exclusion of certain major types of business. Eighty per cent. of the corporations covered by the study were manufacturing or trading companies, eight per cent. were service corporations, and the remainder fell under the three general headings of extraction, construction and real estate and finance companies. No very large corporations were included. Described as a sample of small and medium-sized corporations, the average net book value of the assets of the selected companies was nevertheless $2,244,000, as contrasted with an average of $643,000 for all corporations (excluding public utilities) filing tax returns in 1928.

The book is full of meat, and no attempt to summarize its findings can do it justice. The central fact developed by the study is that over the three-year period the average annual rate of earnings on net book value of assets was 8.4 per cent. (manufacturing companies averaging 9.2 per cent. and trading concerns 6.3 per cent.). Within the major industrial groups there were wide variations in earnings rates, ranging from 2.8 per cent. on net book value of assets in lumber manufacturing to 14.9 per cent. in the processing of miscellaneous food products, and from 3.9 per cent. in the distribution of fruits, vegetables, dairy products, etc., to 8.6 per cent. earned by cotton and wool merchants.

Highly suggestive are the facts developed relating to earnings averaged for companies included within specific size-groups. The highest average earnings rate, 11.3 per cent., was attained by the 78 manufacturing companies having assets under $200,000. The group of 46 manufacturing companies with assets exceeding $5,000,000 earned an average of 8.6 per cent. and the lowest size-group average, 7.3 per cent., for manufacturing was made by the 85 companies in the group between $500,000 and $1,500,000. In the trading field the highest earnings rate averaged by any size-group was 7.2 per cent. by the 16 companies in the top group (over $5,000,000) and also by the 44 companies in the group having assets from $500,000 to $1,500,000; the lowest rate, 5.43 per cent., was made by the 61 companies in the group between $200,000 and $500,000. Differences in earnings rates are also developed on the basis of variations in types of capital structure.

Computing the earnings ratios on the basis of stockholders' equity, it is shown that the average return was 9.2 per cent., reflecting rates of 9.6 per cent. for manufacturing and 7.9 per cent. for trading companies. These rates, as Professor Paton brings out, lie between the earnings rates of all corporations for the same years, derived from treasury figures, of 7.4 per cent. for manufacturing and 5.6 per cent. for trading corporations, and the rates for 2,710 medium-sized and large corporations, 1927–1928, (Study by R. C. Epstein, Publication No. 26, National Bureau of Economic Research, as cited by Professor Paton) of 10.2 per cent. for manufacturing and 12.7 per cent. for trading companies.

The study shows that only 57 per cent. of earnings available for common stock were paid out over the period in dividends. Earned surplus accounted on the average for over 30 per cent. of total stock equity. The median figure of operating ratios (ratio of all expenses except interest and taxes to sales) was 94 per cent. for manufacturing companies and 97 per cent. for trading companies. The typical (median) ratio of current assets to current liabilities of manufacturing concerns was about 4 to 1 and of trading corporations about 3 to 1. Inventories constituted 26 per cent. of assets of manufacturing corporations and 29 per cent. of trading companies. Statistics of average rates of inventory turnover for the period are given for each of 42 industry sub-groups. Such ratios and others shown in the book are properly computed, for the broad purposes of this study, as over-all averages. For purposes of management control and of credit analysis a scheme of selection of the more successful companies included in the sample would be desirable.

In dealing with a wide variety of suggestive facts developed, Professor Paton does not attempt to go very far beyond a critical consideration of their statistical validity. He leaves it to students in other specialized fields, as must the writer of this review, to suggest the bearing of these facts on the theory of the capitalistic system and on questions of public policy. He is too conscientious a workman in his own field, however, to fail to bring out the reservations with which his study, like many other useful researches in economic statistics, must be accepted. The study was begun early in 1930, and the years selected were at the top of the boom. Its chief limitations, however, arise from the small size of the statistical sample (representing only 25/10,000ths of a total of 280,000 American corporations) and from defects, which were apparently unavoidable, in the sampling methods employed. The sample is unbalanced from the fact that companies that have their accounts audited are generally more successful than the average. The selection represents varying indeterminate fractions of the corporate clients of such members of the Institute as were able to respond to the questionnaire. However, the members were asked and presumably endeavored to make representative selections. In any event, deficiencies in the scope and manner of selection were the price that had to be paid for the advantage of securing detailed financial information of a character not elsewhere obtainable.

In denoting total assets less depreciation and other valuation reserves, which is used as one of the two alternative bases for computing profit ratios, Professor Paton employs the term "net assets" interchangeably with the more precise term "net book value of assets." Such usage is particularly awkward in this study, since the other basis of computation used is "stockholders' equity," with which, in the minds of numerous readers, the expression "net assets" will be synonymous.

Solomon Fabricant of the National Bureau staff, who contributes a summary of the results and a final chapter on "further analysis of accounting records" gives suggestive indications of the kinds of facts having social-economic importance that can be adequately developed only by studies of accountants' reports. He thus supplies a convincing reason why public accountants should give sympathetic consideration to future requests for coöperation by institutions pursuing research projects in the public interest.

GEORGE P. AULD.

COST ACCOUNTING PRINCIPLES AND PRACTICE, by JAMES L. DOHR, HOWELL A. INGHRAM and ANDREW L. LOVE. (Second revised edition.) *The Ronald Press Company*, New York, 1935. 621 pages.

Cost Accounting Principles and Practice is a good book on three counts: its style, its arrangement and its contents. The authors have succeeded in a manner that is noteworthy in the difficult task of presenting a technical subject so that the student reader is not constantly bumping into technicalities to hinder and tire him. The technicalities have been submerged. The style is remarkably lucid and the explanations given are complete. About the only difficulty that could be found with this text would be to misunderstand it. There is no trace of dogmatism, both sides of questions and the advantages and disadvantages of procedures alike being stated without undue emphasis.

The arrangement, too, is excellent. The objects and uses of cost accounting, that is to say the ends in view, are first explained, so that the student may have some understanding at the beginning what the cost accounting procedure he is going to learn in all its details later is about. Next come chapters dealing with the intermediate range, which comprises the accounts and the ledgers through which the figures are obtained for the objects and the uses which have been explained. Finally comes a description of the sources of information showing how the data arise from initial transactions. This is much better than the reverse way, namely starting the student off on a long journey picking up all the initial details which he must carry about with him until he can piece them into some intelligible pattern.

The contents are comprehensive. In addition to what might be termed the purely accounting phases of cost accounting the text gives a commendably thorough discussion of the accessory functions in manufacturing operations (regarding cost accounting as the function with which we are now principally concerned) of purchasing, the handling of production orders, stock and storesroom procedure, shipping, etc. While much of this may seem elementary—indeed is elementary—it is also fundamental and necessary to an understanding of the principal subject. Any student who reads through this book without skips or slights will have a good fundamental understanding of the general operations of a manufacturing enterprise.

There are, of course, expressions which can be questioned, which will always be so until the book which contains all the answers is written. None of these seems important enough to pick on as material for a major quarrel. To instance some, organization expenses appear strange among fixed manufacturing expenses (p. 16). It is questionable whether one of the ends achieved by cost accounting in the field of management is the prevention of unfair and ruinous competition by establishing minimum costs below which sales prices may not be quoted (p. 52). Finished stock inventory adjustments are not invariably chargeable as a distribution cost, perhaps not even usually so (pp. 11, 131, 228). Unabsorbed burden or factory service expense may not be confined to fixed expenses (p. 423 et seq.).

Such questions or matters for questioning will vary with the individual person and the circumstances. As indicated, these in no way impair the merit of the main accomplishment, a book which should leave the reader better able to discuss intelligently possible variations in practice.

ERIC A. CAMMAN.

BUSINESS LAW, by LEONARD H. AXE, *Harper & Brothers.* 664 pages. 1935.

Business Law is a textbook for college-grade courses in business law. Its author is assistant professor of business law in the University of Kansas and he disclaims any attempt to interest business men. He writes solely for the classroom. The book is chiefly one of condensed cases, with extremely brief statements of fundamental principles. In the hands of a good teacher who can amplify these statements and bring into class additional cases illustrating some of the infinite variations played by the courts on these fundamental principles, this volume should prove interesting as well as instructive to the students. It certainly is interesting for a lawyer to read the statements of fact called practice problems and to try to decide what the court's decision was in each case. The author is wise in his realization that law is not an exact science. In more than one instance he makes statements such as "under the rule that is probably most widely followed."

A useful feature of this book is the printing in full of several of the uniform statutes which have been adopted by many states. But it would have been well to warn the student that he is apt to find section numbers changed in the statute as passed by a legislature. He should not, for instance, cite section 1 of the uniform negotiable instruments law in support of an answer in a New York matter because that section has become number 20 in the New York statute. Much space is wasted by printing sections in full in the body of the chapters instead of summarizing them briefly and referring to the complete printings at the ends of the chapters. For example, on pages 505 and 506, sections 31 and 32 of the uniform partnership act are printed in full, although they are again printed in full on pages 517 and 518. In a second edition, if space were saved in this and other ways and the number of pages slightly increased, it should be possible to include important subjects now omitted.

HAROLD DUDLEY GREELEY.