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Accounting Questions: Accounting for Dues of a Club, Sales of Piece Goods and Trimmings by Clothing Manufacturer, Cash Surrender Value of Life-Insurance Policies

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Accounting Questions

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ACCOUNTING FOR THE DUES OF A CLUB

Question: The fiscal year of a club ends March 31st. Bills for dues for the ensuing fiscal year, however, are sent out March 15th and a substantial number of these bills is paid prior to March 31st. In preparing the annual balance-sheet should the amount of dues received in advance be shown under current liabilities or deferred income? So far as assets are concerned the charge for dues receivable is not made until April 1st, but cash received for dues paid in advance is deposited in the regular bank account and is included under current assets. Would the treatment on the liability side for the amount received in advance be affected by the fact that a portion of the amount received had actually been expended between the date of receipt and March 31st?

Answer No. 1: Payments made to the club during the period from March 15th to March 31st to cover dues for the year beginning April 1st seem to us to be in the nature of a liability of the club and not deferred income as of the date of the balance-sheet, March 31st. In the absence of full knowledge of the organization of the club we have assumed that were the club to liquidate on March 31st, these advance payments would rank with ordinary creditors. However, since the accounts apparently are those of a going institution, these payments will not need to be repaid but will be liquidated through services of the club during the coming year. In those circumstances we do not believe it would be correct to include them with current liabilities. We would suggest a separate caption on the balance-sheet describing the liability as "advance payment of dues for the ensuing year." The fact that part of the funds already have been expended would not influence our opinion.

Answer No. 2: I like to see accounting statements prepared on a conservative basis, but unless there is some real expectation that the club will find it necessary to refund the amounts of dues which have been paid in advance it seems to me that it would be practising over-conservatism to set up the amount of these dues in the annual balance-sheet under "current liabilities." In my opinion, it would be better practice to carry the amount as "deferred income." I do not think that the treatment on the liability side of the balance-sheet should be any different because a portion of the amount received had actually been expended between the date of receipt and March 31st.

Going somewhat beyond the specific question asked by your correspondent, I know of one case of a charitable organization which receives contributions to be used within a given year—for example, the calendar year 1934. It may receive in 1934, in addition, some contributions for account of the calendar year 1935. In preparing the balance-sheet of this organization as at December 31, 1934, the amount received in 1934 for account of the work of 1935 is stated under a deferred-income classification, and the cash is segregated so that the amount which has been received in 1934 for account of the year 1935 is stated separately. In case some of the 1935 money has actually been expended in 1934, the full amount received for account of 1935 is stated in a short column, with a deduction under an appropriate heading for the amount of 1935 cash which has been expended in 1934. Such procedure has been found to show more clearly to those not trained in accounting the fact that cash intended for use in 1935 has actually been used in 1934, than it would be shown by comparison of the cash balance with the deferred-income balance.

SALES OF PIECE GOODS AND TRIMMINGS BY CLOTHING MANUFACTURER

Question: A clothing manufacturer makes a practice of selling some of its piece goods and trimmings to other manufacturers in order to make a profit. The question is: Should the sales of such piece goods and trimmings be shown as sales, with the sales of their finished suits and be shown in the income part of the operating statement, should such sales be shown as a deduction for merchandise purchases or should the profit on such transactions be shown as other income in the operating statement?

Answer No. 1: If all the sales of miscellaneous piece goods and trimmings are sold as accommodation sales at cost and without any profit, such sales may properly be considered as a reduction of cost of sales and be shown as a deduction from purchases. As these miscellaneous sales appear not to be accommodation sales, no further consideration need be given to showing them as a reduction of purchases.

If these miscellaneous sales of piece goods and trimmings are sales at a profit or at a loss on sale of obsolete stock, they should be shown in a separate section of the operating statement, if the cost of such goods is known. Otherwise, the operating statement should show—

Sales of finished suits
Sales of miscellaneous piece goods
Sales of miscellaneous trimmings

against which the total cost of sales should be shown, when it is not possible to obtain the cost of each type of sales.

The sales of miscellaneous piece goods and trimmings should not be shown as other income, because in that case no account would be taken of the cost of such sales, which would represent a deduction from income.

Answer No. 2: The best way to disclose the result of the sales you refer to would be to show a separate item in the income account for these sales and to deduct from it specifically the cost of the goods sold, thus showing a separate income item for the result of this business. This separate item could either be added to the net profit on the ordinary sales or could be shown in other income.

CASH-SURRENDER VALUE OF LIFE-INSURANCE POLICIES

Question: Several years ago a corporation borrowed $600,000 on first mortgage gold bonds maturing serially over a period of years.

Under the trust indenture the corporation agreed to insure the lives of its president and general manager for $50,000 each. Policies were written so as to make the insurance payable to the trustee (trust company). In the event of death prior to maturity of the bonds, proceeds from the policies are to be applied to the unpaid portion of the bonds.

The two policies have been in existence about six years and their combined cash-surrender value has reached a substantial sum. The corporation pays the annual premiums, which are charged to expense.

Since the trustee, rather than the corporation, is the beneficiary, the question arises as to whether or not the cash-surrender value of the policies should be recorded as an asset in the accounts of the corporation. It has been argued that in view of the fact that the corporation is not the beneficiary the value should not be treated as one of its assets.

At this time there is no provision for the continuation or disposal of the policies at the termination of the trust indenture. At that time the policies may be discontinued by the corporation or turned over to the insured for continuation by them individually. In the latter case no consideration may be given to the corporation for the accrued cash-surrender value because of valuable services rendered the corporation by the insured. Would this be in order or subject to criticism? Would it require a directors' resolution or a vote by stockholders?

Answer No. 1: The cash-surrender value of the policies constitutes an asset of the corporation, regardless of the fact that the insurance is payable to the trustee under the mortgage bonds, as any proceeds from the policies are to be applied to the unpaid portion of the bonds. The balance-sheet of the corporation, therefore, should reflect this asset.

One method of accomplishing this would be by means of a footnote on the balance-sheet, stating the amount of the cash-surrender value at the balance-sheet date and indicating the agreement governing the disposal of the proceeds of the policies. A preferable method would be to record the cash-surrender value of the policies among the assets on the balance-sheet.

Since the ultimate disposal of the policies has not yet been decided, a reserve may be set up on the balance-sheet, offsetting the amount of the cash-surrender value of the policies, until final disposition is decided.

When the bonds are fully paid, the corporation might decide to cancel the policies, receiving the then cash-surrender value in cash. In that event, the reserve could be transferred to surplus. On the other hand, if at that time the corporation decided to turn over these policies to the insured because of valuable services rendered, both the cash-surrender value and the reserve account could be cancelled. The charge to operations because of such services would already have been accomplished during the years and would be represented by the excess of the annual premiums over the cash-surrender value.

The stockholders are entitled to know that an asset in the form of cash value on the insurance policies is accruing to the benefit of the corporation. If the corporation should turn the policies over to the officers without compensation, the stockholders should be made aware of the fact that an asset has dropped out of the corporation's balance-sheet. The method above suggested brings both of these facts to light.

Answer No. 2: Since the proceeds from the policies are to be applied to the unpaid portion of the bonds, undoubtedly the corporation benefits pecuniarily in the event of the death of one of the officers, and we see no reason whatever why the surrender value should not be placed upon the books of the corporation.

On the termination of the trust indenture the corporation is in a position to receive in cash the surrender value or at its option continue the policies on the lives of the officers insured. If they were turned over to the insured for continuation by them for their personal accounts, without requiring full surrender value to be paid, it would in our opinion be distinctly subject to criticism. Whether the authority to do so requires a directors' resolution or a vote by stockholders would depend on the laws of the state and bylaws of the company. Stockholders' authority would certainly be preferable if the president and general manager were on the board, or if the board had not full power to vote on remuneration or gratuities.