Accounting Questions

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ACCOUNTS OF FLOUR BROKER

Question: A corporation is in the flour business. It represents a few mills, selling on commission, and also buys and sells for its own account.

It buys a carload of flour and gives a sight draft. It can not get possession of the flour unless it pays the sight draft. In the meantime it sells this flour to customers and bills them for it, debiting accounts receivable and crediting sales. At the same time it debits purchases and credits accounts payable for the flour sold. The flour is not delivered to the customer until released by payment of this draft.

Would it be correct to make a journal entry taking out such items both from the accounts receivable and accounts payable, and to show these accounts on the balance-sheet for merchandise actually sold, released and delivered?

Answer No. 1: In my opinion it would be incorrect to make a journal entry taking out the items described both from the accounts receivable and from the accounts payable and thus eliminating the liability and assets from the balance-sheet.

In my opinion the procedure is improper because it is proposed to omit a liability which has actually been incurred and not liquidated.

Answer No. 2: We can not see any justification in making a journal entry eliminating the items described from both accounts receivable and accounts payable. There can be no question that the corporation had a liability for the goods purchased, and it would be a false balance-sheet that failed to reveal it. By the same token others had purchased these goods from the corporation, delivery to be made presumably at some future date. In spite of this deferred delivery, we see no reason why the transactions should not be included in the year's business. The fact that title has not passed from the original seller would not justify him in carrying the goods in inventory at the year-end. He, too, has made a sale and should carry it on his balance-sheet as sight draft receivable.

Care should naturally be taken by the accountant to see that none of the goods sold by the corporation had been included in the year-end inventory in cases where drafts had been met before the year-end and goods had not yet been shipped to the ultimate purchaser.

BROKER'S COMMISSIONS

Question: In an audit of a corporation, certain payments to a broker were shown on the books as charges against sales instead of commissions. This broker was also known by the accountants to have been acting in the same capacity in behalf of other concerns in the same kind of business.

In view of the round sums represented in the cheques paid to him, the officers were questioned as to the propriety of such charges and the reason for charging such items against sales instead of the ordinary commission account. The accountants were advised that such payments were entirely in order and that in view of the nature of the particular transactions involved, the company preferred to charge such commissions directly against sales.

Reports of other accountants on audits of previous years during which even larger payments were made to the same broker did not allude to such transactions.

About two years later, the accountants learned that the greater part of the payments involved were not commissions on sales but rather represented settlement of certain agreements between some of the officers and this broker for losses sustained by him through the purchase and sale of the company's stock.

The minutes of the company did not refer to such transactions.

(1) Should the accountants refer to this entire situation in their current or subsequent reports? (2) What, in general, should be the position of an accountant concerning new information that may come into his possession relating to an audit made two or three years previous? Should such information be referred to in reports on audits of a current year?

Answer: In our opinion a full disclosure of the transactions referred to should be made in the current and also subsequent reports if the practice is continued. In the account submitted to the company the amount of sales as per the books should be increased by the charges improperly made thereto and the general expenditures should be correspondingly increased. The extent to which references should be made of the charges in previous years would depend largely upon circumstances.

ACCOUNTING FOR ADVANCES TO MINES BY COAL COMPANY

Question: A New York corporation obtained the exclusive sales rights of coal mines in Pennsylvania. In order to do so this corporation made advances to the mines. In a number of instances the mines closed in debt to this corporation. The advances to the mines were greater than the agreed value of the coal received. The contract price, which was the agreed value, was less than the prices fixed by the "line circular."

The question is in what section of the report shall loss, as a result of such advances, appear? Shall it go in "bad debts arising from sales" on the income tax return, because it really is a trade loss, or "arising from trade"? Shall it appear as an item in the "purchasing account" or "purchasing expense" or "other costs" or under some other heading indicating this item as a "cost of goods sold," because it is directly connected with the purchasing end of the business? Shall it appear in the profit-and-loss section as a special loss not included in bad debts?

Answer No. 1: It is our opinion that the loss referred to in the inquiry is properly regarded as forming part of the bad debts to be charged in the profit-and-loss section.

The loss, however, clearly is not a "bad debt arising from sales" nor does it seem to us that it increases the cost of purchases or the costs incident thereto, inasmuch as failure by the mining company to meet its obligation in the agreed manner, namely, by the delivery of coal, evidently does not increase the cost of actual deliveries.

We should add that if the loss in question is at all material the item might well be shown as a separate item, thus serving a primary purpose of classification—clearness of presentation.

Answer No. 2: In the case cited I believe that the advances when written off should appear in the profit-and-loss section. It is distinctly a loss arising through the financing of a purveyor. So far as the tax return is concerned it should appear as a bad debt.