Tips for Busy Readers

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DEPRECIATION—THE TAX ORPHAN, by Earl A. Spiller, Jr. The Controller, Vol. XXX—No. 4, April, 1962. p. 158 and following.

This article explores the inequities which exist under the present tax structure, considers possible changes which have been proposed, and projects the effects of each proposal in solving or reducing the present inequities.

The concept that income does not include a return of capital has been established by Supreme Court decisions. However, the current method of allocating the historical cost of fixed assets as charges against the revenues earned during the periods such assets are in use, results in treating as income a part of the real capital invested. This, of course, is true because the current depreciation charge is expressed in dollars having lower purchasing power than the dollar units expended when the asset was originally acquired.

This method results in further inequities between firms. The company having a substantial proportion of its investment in the form of fixed assets will carry a greater proportionate burden than the firm having its major investment in inventories, where turnover is more rapid.

Two solutions have been proposed to correct the above inequities. One would provide for accelerated depreciation allowances, but would limit the amount taken over the life of the asset to original cost; the other would disregard historical cost and allow depreciation charges adjusted to reflect the effects of inflation.

The accelerated methods of providing for depreciation offer no real solution to the problem, for while such plans provide for a greater amount to be written off in the earlier years, no permanent tax saving results unless the total amount invested in such assets is being constantly increased. Savings resulting from such methods however do have some immediate benefits; such dollars are available for current investment and will tend to have a higher purchasing power than the dollar which will have to be paid in taxes at a later date.

A plan of "reinvestment depreciation" has been considered in various forms; in fact, the current program advocated by President Kennedy is based on this general idea. Precedent for such a plan has been established in the tax relief allowed the homeowner. If he sells his home at a gain, and reinvests in another home within a limited period, he is not taxed at that time on the gain resulting from the first sale. A plan of reinvestment depreciation which would permit a deduction in the year an asset is retired of the difference between actual cost and replacement cost, and would still allow for depreciation charges based on the full cost of the new asset, would seem to offer some real relief. However, such plans have been criticized as favoring the companies having ready access to capital for expansion purposes.

To allow capital gains treatment of the difference between adjusted depreciation charges and those based on original cost would offer some relief from the taxation of real capital. This would simply extend to fixed assets a plan of taxation now in effect on other capital assets. Such a plan has the advantage of being in line with an existing concept of taxation, of giving recognition to the price-level problem, and of providing for relatively easy administration.

The author feels "common dollar depreciation" would provide the most satisfactory solution to the problem. The procedures to be followed under this plan would involve aging the book cost of the assets; a fraction consisting of the current price index, over the index when the asset was originally recorded, would then be used to convert to common dollars. General purchasing power indices are suggested as being the most appropriate to be used. Adoption of such common dollar accounting would be necessary for all groups of taxpayers if tax equities were to be fully resolved; however, such a policy might involve serious administrative problems.

COST ACCOUNTING PRINCIPLES AND MANAGERIAL APPLICATIONS, by G. R. Crowningshield. Houghton Mifflin Co., Boston, Mass., 1962. 687 pp.

Recognizing that both accounting majors and those training for careers in managerial positions need to understand the basic concepts of cost accounting, the author has devoted Part I to a concise explanation of fundamental principles. The contrast in procedures to be followed under a process and a job order cost system are set forth with clear flow-charts and illustrative problems included for each.

The effects of flexible budgets, classification of costs, and volume of production in the predetermination of rates of application for overhead costs are explained to the reader much earlier than is usual in an introductory text.

How standard costs attempt to overcome the limitations which exist when records are based on actual costs, the reduction in expense which results when standard costs are recorded in the accounts, and the analysis of variances in connection with each of the three cost elements, are covered in the two chapters devoted to standard costs.

Part II is devoted to the applications which management can make of cost accounting data in decision-making. Titles such as "Distribution Cost Analysis," "Cost-Profit Volume Analysis" and the preparation of cash and capital budgets indicate that the material in this section emphasizes the uses to be made of cost accounting data. The chapter on direct costing includes a particularly good presentation of the advantages and disadvantages claimed by advocates of this method.

Part III has been included primarily for students preparing for the C.P.A. examination. Advanced problems in process costing, as well as problems connected with loss and spoilage costs are included.

While this volume has much to recommend it, I had the feeling the author had tried to serve "too many masters." I believe it is better adapted to the use of one interested in the applications of cost accounting, than to the accounting major seeking a firm foundation in the field of cost accounting.

Highlights of the Joint Annual Meeting AWSCPA—ASWA

New York City September 18-21, 1962

Sept. 18 AWSCPA and ASWA Board meetings; Sightseeing and Professional Development session with the Hon. Esther Peterson, Ass't U.S. Secretary of Labor as guest speaker. Joint business meeting.

Sept. 19 Technical session; Luncheon with Miss D. M. Vaughn, F.C.A. Edenburgh, Scotland as guest speaker. ASWA business meeting and AWSCPA dinner.

Sept. 20 AWSCPA business meeting, professional development session, chapter president's luncheon, continuation of ASWA business meeting; reception and banquet.

Sept. 21 Farewell brunch, AWSCPA and ASWA Board meetings.

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Before judgment can be made, as to which deflating index should be used in a certain case to convert a historical cost basis to its current general purchasing power equivalent, the question has to be answered whether or not pressure (of the price movements) varies extremely in the various sections of the statements. If there are no great variances as to price movements, a simple general index would give sufficient results, otherwise multiple indexes will be required.

Common Dollar Statements, an acceptable solution?

After having analyzed the difficulties in removing the effects of price level changes and the enormous clerical burden involved, the accounting profession's hesitation to make scientific adjustment procedures a permanent part of the accounting routine is readily understood.

There is no doubt that our conventional accounting procedures and conventional standards of measurement of business transactions are not able to produce results, usable without adjustments as a basis for sound managerial decisions in times of currency depreciation. It is obvious that common dollar statements, capable of full scale adjustment, would represent an acceptable solution, especially since they are now no longer considered a violation nor a departure from the "original cost convention," but an improvement in regard to the "matching concept."

The question is only, are at our present stage of money detoriation the possible refinements through the use of common dollar statements justifying the additional clerical burden involved. A too soon and to frequent application may not be justified by the results acquired since

"It is unwise to burden balance sheet practice with a complication unless an important inaccuracy exists."[16]

It is up to the accounting profession's conscience to decide whether there now exists a sufficient necessity for the adoption of common dollar statements as a permanent part of the conventional statements.

Interesting and at the same time a warning for serious reconsideration of the issue is the fact that practically all of the European countries have as of now some kind of general application of adjustment procedures, frequently government-approved.

Is the monetary detoriation in our country truly so much slighter or is our profession only lacking insight and unity?

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[16]Schmalenbach, op. cit.