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Book Reviews

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PRINCIPLES OF ACCOUNTING, by ERIC L. KOHLER and PAUL L. MORRISON. *A. W. Shaw Co.*, Chicago and New York. 446 pages.

When professors in a school of accounting are also members of a firm of practising public accountants we may expect at their hands a book that combines theory and practice in eminently workable proportions. Such is the case in the present instance, and the book they offer as a text covering the first year of accounting as taught at the Northwestern University school of commerce is all it should be. The mechanics of accounting are clearly taught by precept, illustration and practice, while the theory involved in each step is brought out at the time when it is most likely to stick in the student's mind. He is literally told what to do, how to do it, and why he does it.

The scope of *Principles of Accounting* is best stated in the following excerpts from the preface (p. iv):

> "In the first six chapters the fundamental theory of debit and credit journalizing, posting, taking the trial balance and preparing the six-column statement are developed, using the simplest possible journal and ledger. The next section of five chapters brings out the usual possibilities of divided books of original and final entry, controlling accounts and columnar journals being introduced immediately. The voucher system is outlined in chapter X. . . . The next six chapters describe the adjustments leading up to and following the financial statements, with constant reminders to the student that the adjustments are as easily expressed on working papers as on the books, especially in the preparation of monthly statements." (A most practical idea, that!) "A fourth section of six chapters is devoted to the various phases of corporate accounting procedure. . . . The last section of five chapters is one of analysis and interpretation. The significance of assets and liabilities, and their relationships to each other, is dwelt upon at length. Reference is made to the limitations of the accounting record as well as to its possibilities."

The final chapter of the last section deals with the analysis of the financial statements, and might be termed a sort of liaison chapter connecting the first year with the following years' courses. As the authors state it is "necessarily incomplete," and I doubt if the average first-year student would make much out of it though it might serve to whet his appetite for more.

Nevertheless there are some matters of procedure and principle which seem open to criticism or at least to difference of opinion. It may seem hypercritical to take exception to the classification of accounts on page 63, but really when accountants discuss procedure they must use language which is mutually understood. When we speak of an account with a credit balance, we are thinking of its appearance on the balance-sheet. It is quite true that the balance of the cash account, for example, is entered on the credit side in the ledger, but we invariably speak of it as a debit balance, i. e., the balance of debits over credits. And so with other accounts. From the bookkeeping point of view it may seem paradoxical to call it so, but custom is custom, and it is a serious mistake to defy it. Consider for a moment the probable damage to a candidate's mark if a C. P. A. examiner should find in answer to the question "What does a credit balance in the cash account indicate?" the statement "It shows the amount of cash on hand or in bank," when the obvious (to the examiner) answer is that it indicates errors in posting, or that the bank account has been overdrawn.

On page 233 the authors treat the donation of a factory site as earned surplus in a way that practically makes it an item of extraneous income which is passed through profit-and-loss to earned surplus. In a footnote this is defended on the ground that it is a closed transaction. I am unable to agree with this. Earned surplus is supposed to be (as the authors correctly state on page 232) "only unwithdrawn operating profits," with its implication that it is available for dividends. Now, the donation of a factory site is certainly not an operating profit, nor is it available for dividends in the ordinary sense since it is impossible to distribute a factory site unless it is sold, or its value may be passed on to the stockholders as a stock dividend. Whether it is a closed transaction or not is irrelevant since it is not an earned profit. Of course it is a closed transaction if the title is absolute, but it sometimes happens that such a donation is subject to reversion of the property in case it is not used for the purpose for which it was donated. In this case it is actually a contingent liability, or at best an item of suspense to be carried indefinitely. I think the customary treatment of it as a capital surplus, clearly so stated on the balance-sheet, is the correct one, though it is proper to merge it into the capital by a stock dividend where the title is absolute. But it is not earned surplus and should not be included therein if for no other reason than the likelihood that it would give rise to continual bickerings with stockholders who would not understand why so large an amount of "surplus" is not distributed to them. Also there is to be considered the nuisance of explanations to income-tax authorities seeking to enforce the penalty for having an excessive surplus.

There is a further error in the footnote referred to in stating that the expenses of moving an established plant to the donated site would be a proper offsetting expense to the profit realized. On the contrary, such portion of the expense as may be incurred in scrapping the old plant should be allocated to the scrap value realized therefrom, and the portion properly due to setting up the plant on the new site is a capital expenditure.

The term "liquidating dividend" has a definite technical meaning in business and financial circles, and while the authors' definition on page 241 is literally correct, it is nevertheless misleading. In its accepted sense a liquidating dividend is one declared by a concern which is going out of business, winding up its affairs and distributing its assets among its stockholders or partners. It is not properly used to describe the distribution of a part of its assets in a going concern where such assets are no longer needed in the business, and a better term for it is an "extra" or a "special" dividend, its particular source being stated in the directors' resolution. It is not only incorrect to call it a liquidating dividend, but it might have a disastrous effect. Fancy the result in the stock market of a "flash" over the ticker that "The X Corporation has this day declared a liquidating dividend"!

The statement of page 334 that "contingent liabilities on the balance-sheet are best shown under a separate caption standing between current liabilities and net worth," is somewhat obscure, but from further explanation on page 335 I gather that they are to be shown "in short" but not extended to the final column. This is not at all in conformity with general practice and in my opinion is bad. If the contingencies are grave enough to warrant special disclosure on the balance-sheet, they should be shown in the form of reserves, thus clearly affecting the net worth; if not, then the usual practice of a footnote is the better one. The average reader of the suggested form would be led to think the net worth is stated after allowing for the unextended contingencies, whereas a properly stated footnote would make it clear that the net worth figure is subject to the contingencies stated.

W. H. LAWTON.

AUDITORS' CERTIFICATES, by DAVID HIMMELBLAU. *The Ronald Press Company*, New York.

"The purpose of this volume is to bring together in convenient form the available material relating to auditors' certificates."

The above sentence is the opening phrase of the preface of *Auditors' Certificates:* but it is too modest by far, for in addition to ninety-two certificates taken from practice, it contains definitions, a clear, concise analysis of what auditors' certificates should be, and many quotations from well known authorities on the subject, such as Sir A. Lowes Dickinson, H. L. H. Hill, H. B. Fernald and extracts from THE JOURNAL OF ACCOUNTANCY and from reports of the special committees of the Institute and of the Robert Morris Associates.

In these days of high prices, it is unusual to find a technical book of merit which can be bought for $2.50: it is remarkable that a book of such great value as is this one is sold for so small a sum. The fact becomes more noticeable as one reads the book and finds that the ninety-two certificates which form the skeleton, the framework, of the book, are originals actually used by a number of the leading accountants in many lands and must have cost the numerous clients many thousands of dollars, of pounds sterling, of francs, of marks, of yen and of rupees. Many of these certificates bear the names of the firms by which they were issued and some twenty-three such names appear.

I do not find the classic certificate which read

> "We have examined the accounts of Jonadab Finch and find them to be correct.
>
> Josiah Hastings His-X-mark
> Abijah Elliott His-X-mark"

A certificate which, if historical, is, I believe, no longer typical.

The volume contains ten chapters, the first of which is introductory and aptly quotes at length from the report of the committee of the Robert Morris Associates, a body which, working with the special committee of the Institute, probably has accomplished more than any other agency to bring the accountant and the banker together and to teach them to speak a common tongue.

In chapter II thirty-five certificates used in annual audits are quoted with comments on such matters as qualifying statements, inventories, etc. Chapter III occupies two pages only. In it the author defines certificates and classifies them by their form. The next chapter gives Professor Himmelblau's opinions, comments and analyses relating to unqualified certificates, while the following one treats of qualified certificates in the same manner.

Chapter VI describes English certificates and quotes at length from comments by Sir A. Lowes Dickinson and H. L. H. Hill. The next two chapters contain thirty certificates on statements prepared to show the effect of "financing" and appropriate quotations from the JOURNAL and from reports of the committees above mentioned, although the author gives his own analysis of the various forms of "financing" described in the certificates. Chapter IX on "faulty certificates" is one of the most valuable portions of the book. In it the author describes under eight heads various shortcomings in the examples quoted. The concluding chapter is a summary of the basic points —so good that I wish it could here be quoted. This is followed by a number of English and other foreign certificates and an index.

The foreign certificates have less practical interest for the American auditor, as the laws and customs of other lands differ sufficiently from ours to call for different treatment and different verbiage. The certificates taken from English practice illustrate clearly some of these differences. They show that the client has complied with the law in supplying to the auditor all the information he requested and they bring out clearly a point which might well be given heavier emphasis than it receives. The English certificates are usually brief. Their whole value lies in the broad statement that in the opinion of the auditor the facts are correctly stated. The preparation of statements may be, to some extent at least, mechanical—the product of a clerical worker, but the task of formulating and stating a correct, considered opinion is essentially a professional matter.

Professor Himmelblau is professor of accounting at Northwestern university and is also a consulting accountant—a combination which, it would seem, enables him to enjoy the somewhat unusual pleasure of practising what he preaches. Throughout the book there is a pleasant absence of both pedantry and egoism: it might be called a compendium or anthology of auditors' certificates, with comments by the editor. It gives the words used by many accountants, many being recognized leaders in the profession, and illumines them with the results of the author's dual experience. This is the only proper method of approach to the subject, for no one man can set a standard or fixed rule in these matters for the profession. He can show what has been done; he can give praise to the good points, blame to the bad ones and call attention to the omissions.

In the course of writing this review, the book has been read several times —to my pleasure and profit—and surprise is felt at the fact that no mention is made of two of the most important contributions which have been made to the literature on this subject. The first is that basic pamphlet *Approved Methods for the Preparation of Balance-sheet Statements* which has done so much to stabilize the balance-sheet audit and deals specifically with some of the essentials of certificates. The second is a recent contribution by Professor J. Hugh Jackson, entitled "Audit Certificates and Reports" which appeared last September in *The Accounting Review*, and, prior to *Auditors Certificates* formed perhaps the most comprehensive statement on the subject. It is comforting to find that each of these authorities is in agreement with Professor Himmelblau.

WALTER MUCKLOW.