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## Checking lap-overs

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telling the client what the figures mean in addition to supplying figures which are correct. The figures are presumed to be correct. To interpret them, within reason,

will go a long way in the crusade which is so badly needed, namely, to make accounting data serve as a basis for administrative judgment.

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## Checking Lap-overs

**W**HILE all of our practice offices are cognizant of the fact that we have had a number of quite extensive engagements from railroad companies during the past two years, many are not aware that most of these engagements arose through the taking over of the important transportation systems by the Government in December, 1917, and consisted of checking "lap-overs."

It will be recalled that without previous notice, President Wilson, by a proclamation dated December 26, 1917, took possession of all important transportation systems on December 28, 1917, and directed that their control and operation be exercised by William G. McAdoo, who was appointed Director-General of Railroads. While possession of the railroads was assumed on December 28, 1917, the proclamation stated that for accounting purposes possession and control would date from midnight of December 31, 1917.

While the President had power under the Act of Congress approved August 29, 1916, to take possession of the railroads, he had no authority to enter into agreements with the companies for compensation for the use of their properties until granted such authority by the Act of Congress approved on March 21, 1918, nearly three months after the roads had been taken over. It took nearly six months longer for the representatives of the Government and of the railroad companies to agree upon standard clauses for use in the contracts between the Government and the railroad companies, with the result

that few contracts were signed before the year 1919, and, in fact, some contracts have not yet been signed.

A few days after his appointment as Director-General of Railroads (on December 30, 1917, to be exact) Mr. McAdoo issued an order reading as follows:

"Until otherwise directed, no changes in the present methods of accounting as prescribed by the Interstate Commerce Commission will be required. The accounts of your respective companies shall be closed as of December 31, 1917, and opened as of January 1, 1918, in the same manner as they have heretofore been handled at the close of one fiscal period and the beginning of another, and in the same manner that you should have handled your account had the Government not taken possession and control."

No other general orders relating to methods of accounting were given until April 3, 1918, when General Order No. 17 was issued. This order provided, among other things, that each carrier subject to Federal control should open new and separate books of account (designated as "Federal Books"), such as cash books, general and subsidiary ledgers and journals, and all supporting and subsidiary books and records incident thereto, upon which should be recorded transactions which arose under and were incident to Federal control on and after January 1, 1918.

This same order provided that all transactions which arose after the closing of the

books as of December 31, 1917, relating to operations (involving revenues, expenses, taxes, rentals, etc.) should be entered in the Federal books and included in the operating results of the carriers regardless of the date thereof. Further, that such of these transactions as were clearly applicable to the period prior to January 1, 1918, termed "lap-overs," should be set up in separate accounts and subsequently charged or credited to the respective railroad companies.

For example, a settlement, made after December 31, 1917, of a personal injury claim, the injury incident to which was sustained prior to such date, would be included in the operating results of the railroad for the month in which settled. It would then be charged back by the Railroad Administration to the company and taken up by the latter as an operating expense applicable to the period prior to December 31, 1917, thus constituting a "lap-over" debit.

This Order No. 17 was so general in its scope that it was susceptible of misinterpretation by accounting officers and others. As a consequence, the Accounting Committee of the Division of Public Service and Accounting issued under date of May 22, 1918, a bulletin containing interpretations of accounting principles prescribed in General Order No. 17, and this was followed throughout the remainder of the year 1918, and in the year 1919, by other bulletins and circulars of the Division of Accounting, all relating to matters of accounting between the Government and the carriers.

In view of these circumstances, it is not to be wondered at that the accounts of the carriers were thrown into a chaotic state.

The unavoidable delay in issuing definite instruction for keeping the accounts after December 31, 1917, and the necessity for scrutinizing all transactions relating to

operations in order to pick out the lap-over items, threw an immense burden upon the accounting departments of the carriers, which had already been depleted by the war. Labor was scarce and competent help impossible to secure, so in order to keep up the current work and open new books and records and revise the accounts for several months it was necessary in nearly every instance to require a large part of the accounting force to do night work for many months. In some instances, clerks were used in the preparation of lap-over statements who had not the slightest conception of what they were expected to do, and in other instances clerks were used who, either through lack of interest or as a result of overwork, did their work in a careless manner.

In almost every instance where we have been engaged to check the lap-over statements, so many errors were found (a considerable proportion of which involved comparatively large amounts), that it was necessary for the accounting departments to make a complete revision of their statements. In those cases in which the work of preparing lap-over statements had been so carelessly performed as to preclude the use of test-checks, an enormous amount of work was involved in checking the statements, as it was necessary among other things (particularly in the early months of Government control), to examine the abstracts pertaining to every way-bill and every correction and the details of every claim and voucher.

Owing to many differences of opinion among accounting officers as to what did or did not constitute lap-over items, it was found necessary during the progress of each such engagement from a large carrier to prepare a memorandum showing the manner in which each kind of transaction encountered during the checking of the statements was treated, in order that similar treatment might be made in respect of

corresponding items at the termination of government control. In this case neither the Government nor the railroad company

would be made to suffer to any extent by changes in personnel or methods during the period of Government control.

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## The Tax Situation

**P**RIOR to the enactment of the Revenue Act of October 3, 1917, the Federal income tax was not, owing to the low tax rates, of vital importance to the financial community. The provisions of previous laws and the Regulations issued by the Treasury Department interpreting such laws, were comparatively simple and no great difficulty was encountered in preparing the returns. Advice in connection with any involved question was obtained by corporations from counsel. These points arose principally in connection with estates. The entire situation was radically changed upon the enactment of the Revenue Act of 1917, this Act and the subsequent Act of 1918 being looked upon by many as impossible of interpretation and practical application except by accountants, or those with a knowledge of accounting, who have specialized in this work. This is due largely to the involved provisions relating to the determination of net profits and invested capital.

Anticipating requests from clients and the public in general for advice in connection with tax returns and the preparation thereof, the firm, immediately after the enactment of the 1917 Act, organized an Executive Tax Department. Mr. George M. Dallas was given charge of this department, the personnel of which comprises accountants who had made and who have continued to make a thorough study of Federal, State, and foreign taxes. A similar department has been organized at each of our practice offices, under the supervision and direction of the Executive Tax Department, the purpose being to render competent assistance to our clients through-

out the country in the solution of their tax problems. The personnel of the tax organization at the practice offices has been specially trained through tax courses and correspondence conducted by the Executive Tax Department. Information bearing on taxes is collected from all sources by the Executive Tax Department and distributed to our practice offices with advice as to the use to be made of it. Difficult questions are submitted by all practice offices to this department for discussion and advice. This department maintains constant contact with the officials of the Bureau of Internal Revenue at Washington.

Mr. Dallas is quoted on the subject of legislative tendencies as follows: "It is not anticipated that any new tax legislation will be enacted by Congress to become effective prior to January 1, 1921, hence Federal tax returns for the calendar year 1920 and for fiscal years ending in the calendar year 1920, must be prepared in accordance with the provisions of the Revenue Act of 1918. Thus it is essential that those responsible for the preparation of Federal returns be thoroughly familiar with this Revenue Act.

"Many severe criticisms have been made of the Excess and War Profits sections of the Revenue Act of 1918. Such criticisms are due primarily to the difficulty encountered in the preparation of the returns owing to lack of comprehensive knowledge of the practical application of the provisions of the Act, and the high percentage of net profits exacted by the Federal Government. It must be conceded, however, by those who have made a conscientious study of the Act, that it is the most scien-