Journal of Accountancy

Volume 37 | Issue 4

4-1924

Journal of accountancy, April 1924, Vol. 37 issue 4 [whole issue from bound volume]

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An Historical Defense of Bookkeeping*

By Henry Rand Hatfield

I am sure that all of us who teach accounting in the universities suffer from the implied contempt of our colleagues, who look upon accounting as an intruder, a Saul among the prophets, a pariah whose very presence detracts somewhat from the sanctity of the academic halls. It is true that we ourselves speak of the science of accounts, or of the art of accounting, even of the philosophy of accounts. But accounting is, alas, only a pseudoscience unrecognized by J. McKeen Cattell; its products are displayed neither in the salon nor in the national academy; one finds it discussed by neither realist, idealist nor phenomenalist. The humanists look down upon us as beings who dabble in the sordid figures of dollars and cents instead of toying with infinities and searching for the elusive soul of things; the scientists and technologists despise us as able only to record rather than to perform deeds.

We suffer perhaps in silence, even, as Carlyle says, "consum-ing our own choler as some chimneys consume their own smoke," perhaps in public denying that we suffer at all, but here—in a meeting not of accountants, but of university instructors in accounting—we can admit among ourselves that at times this academic attitude does get under our skins.

The contempt for accounting is not limited to university circles, but is well-nigh universal. It is evidenced by ignorance of the subject, by condescension toward its devotees, by their exclusion from polite literature.

And how abysmal that ignorance! I give two instances. The university speaker who said, "If you do so and so your ledger
[speaking figuratively, of course] will show a debit balance.” Would he have spoken of an equation with unequal numbers? And the distinguished writer in the October Atlantic, thesaurus of culture, supposedly barred to academic solecisms, who says, “In most sections of America the fact that a man or woman has been divorced * * * is something to be set down * * * on the debit side of the account,” ignorant that likely as not a debit (as for instance in the bank account) means the imputation of additional value—which I take it is quite contrary to what Mrs. Gerould intended.

But the contempt for accounting is even more clearly shown by a constantly repeated phrase, a phrase which of all phrases is to me the most exacerbating—because of the combination of ignorance and supercilious condescension. This phrase, which I could quote from uncounted sources, is: “That is a mere bookkeeping entry.” One might as well say, “That is a mere algebraic equation,” or, “That is a mere statement of discovered fact,” or, “That is the formulation of a mere axiom.” Mere truth, mere fact, mere sanctity, mere virtue. Do you wonder that I lose my temper every time I see the phrase? Of course one may make a misstatement in bookkeeping, just as one may lie either in Greek or in German: But that merits some adjective more invidious than “mere.”

And remember how accounting has been slighted in literature. The public eye has generally, both in history and in fiction, been turned on the man on horseback, but nevertheless at times there comes upon the stage a more prosaic figure. Great masterpieces have grouped themselves about a scholar as Faust, about a carpenter as Adam Bede, about a manufacturer as in Les Miserables, about a sailor as Robinson Crusoe, about courtesans, thieves and beggars beyond recital. Even a horse and a dog have been made the heroes in Black Beauty and in Rab and His Friends. But never, so far as I recollect, has a bookkeeper been made the hero of novel, play or poem. The bookkeeper is not even honored by being made a noteworthy villain.

Long ago Sir Roger de Coverley assumed that “little that is truly noble can be expected from one who is ever poring on his cashbook or balancing his accounts.” Literature has maintained this attitude ever since, and the bookkeeper has reached his apogee in the gentle and pathetic figure of Tim Clerkenwell. Compare
An Historical Defense of Bookkeeping

him for a moment with the military hero. The latter appears mounted on a horse, leading, to the music of bugle and drum, his martial columns in charges against the foe, brandishing a reeking sword, and wearing on his brow the victor's wreath of laurel. The bookkeeper too is mounted, but on a quadrupedal stool, he too marshals columns, but of figures to the accompaniment of a clicking Burroughs, his charges are those on the debit side of the ledger, his brow is encircled but by a green eye shade, he brandishes only the humble rival of the sword, guiltless doubtless of his country's blood, and incarnadined only with Carter's cardinal ink.

But it is not good for a man's soul always to suffer under the inferiority complex. Let us no longer bear in humility the lash of contumely. Let us face our contemners, be they classicists, philosophers or scientists.

"No matter if he is a houn',
They gotta quit kicking my dog aroun'."

Let us boldly raise the question whether accounting, the late claimant for recognition as a profession, is not entitled to some respect, or must it consort with crystal-gazing, sociology, chiropRACTICE, pedagogy and palm-reading.

Three elements, if not conclusively proving, at least presumptively establish, respectability. These are, first, parentage and lineage; second, the company one keeps; and, third, the services which one renders the community. Let us examine accounting in these aspects.

Without raising the question as to accounting in antiquity, we look upon the Franciscan monk Paciolo as the father of modern accounting, as his Summa, published in 1494, which was the first printed work dealing with algebra, also contained the first text on bookkeeping, a slender tractate entitled De Computis et Scripturis.

Not much can be said of Paciolo,* aside from his writings, but his academic credentials are flawless. He was an important if not a great mathematician. His first appointment to teach in a university was at Perugia. In less than a year his request for an increase of salary was granted. The reason stated in the official records has a singularly modern sound. It reads: "because he has already taught for two months and has shown himself to be a man

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of highest learning, and because it appears that he manifestly can not live on such a meagre stipend.” Again in less than six months he was promoted, this time with a more permanent tenure as well as increase of salary. Soon afterward he left the university, probably devoting himself to the study of philosophy and theology. He returned to Perugia in 1487, and while he had previously signed himself “Brother Luke,” in his later writings he was wont to describe himself as a “humble professor of sacred theology.” He held many other university positions, at various times teaching at Naples, at Pisa, at Florence and at Bologna. He ended his career with his highest honor, for in 1514 Pope Leo X appointed him professor of mathematics in the Sapienza at Rome, a position in the “university of the highest standing in all Christendom.”

In 1496 he was called to Milan by the reigning duke, Ludovico il Moro, whose court was a center of light and learning, and to be established there was a signal honor. Adams in China, Hollander in Porto Rico, Bogart in Persia, Paciolo in Milan—all indications of deserved recognition of professorial eminence—all doubtless to be kept in mind for at least 427 years.

At Milan, Paciolo was brought into contact with many prominent persons, the most significant being Leonardo da Vinci, perhaps the most eminent man of his day. Between the two there grew up an intimate friendship. Da Vinci himself tells that he hastened to buy a copy of Paciolo’s Summa as it came off the press, and he collaborated with Paciolo on a later book, the Divina Proportione, for which Paciolo furnished the text and Da Vinci the illustrations. Honor indeed for a university professor! Would not the most eminent mathematician of today rejoice if the greatest man of his time, say Roosevelt or Henry Ford, had hastened to buy one of his treatises (even though it contained the adventitious attraction of some chapters on bookkeeping)? Would not even one so eminent as William James have been flattered if in his psychology the somatic reactions of the emotions could have been illustrated by the master hand of the creator of Mutt and Jeff?

I need not outline to you the nature of Paciolo’s treatise, with which you are familiar, at least through Geijsbeek’s somewhat paraphrastic translation. Have any of you not read this you will be interested in it, not merely as a piece of technical literature,
but because of its quaintness of expression, its naïve attention to
detail, its exuberance of piety, its flavor of mediaevalism.

It is seldom the case that a first book on a subject has so
dominated its literature as was the case with Paciolo's *De Com-
putis et Scripturis*. It is nearly true to say that for a hundred
years the texts appearing in England, France, Germany, Italy and
the low countries were “at the best revisions of Paciolo, at the
worst servile transcriptions without even the courtesy of referring
to the original author.” But further than that many little matters
of bookkeeping technique were followed for at least four centuries,
merely because they were inculcated by Paciolo, persisting like
buttons on our coat sleeves, long after their significance had dis-
appeared. I need not mention these to you, but may I refer to a
peculiar instance relating rather to a matter of general form?

Whether it was because of his churchly connections or because
it conformed to the customs of his day, Paciolo’s book is replete
with gems of moral and religious advice. I know not how it may
be in the higher branches, such as sociology or Americanization—
but in the elementary text-books, such as algebra or chemistry,
we do not today find the thread of the discourse interrupted by
bits of proverbial philosophy or moral exhortation. But in book-
keeping this has continued down until today. I might cite instances
from many of the high school texts used today, from practically
all used so lately as ten years ago. But let me take a single
extreme example. Soule’s book is still in vogue in this country.
At the foot of nearly every one of his 749 pages, he has a line
quite in keeping with Paciolo. The statement in the earlier writer,
“Who does nothing makes no mistakes, who makes not mistakes
learns nothing,” is matched by Soule’s “Our greatest glory is not
in never falling but in rising every time we fall.” “It costs more
to make a good merchant than to make a doctor of laws,” is
matched with “Experience is not a free school, we all pay for our
tuition.” But even a fifteenth-century monk can not rise quite to
the level of the twentieth-century practical American who tells
us “The only amaranthine flower on earth is virtue, the only last-
ing treasure truth.” Bookkeeping was spread throughout the
world by a series of plagiarisms and imitations of Paciolo. The
habit of imitation became so fixed that in bookkeeping it has per-
sisted throughout the centuries, and even the foibles of Brother
Luke are reproduced in the treatises of today.
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Let those who vaunt the superior merits of other disciplines remember that this first presentation made by Paciolo was not crude and incorrect but contains the essentials of bookkeeping as we know it today, despite the fact that it was written at a time when chemistry partook of the vagaries of alchemy, biology was a weird collection of errors, and medicine had more in common with the medicine man than it has even today. It may be well to see how this discipline—I do not venture to call it science—compares in its antiquity with the more arrogant natural sciences. In neither case do I go back to the feeble beginnings and adumbrations of learning but compare the position of bookkeeping, as it was first formulated in print by a university professor, with the formulation of natural sciences—not by some dim groper in far-off antiquity—but by the first vice-president of Harvard College. A comparison, thus made, is, I am sure, more than generous to the natural sciences, despite their illiberal attitude toward the social sciences with which, in general, they admit of no kinship.

Charles Morton, who, like Paciolo, was at once distinguished teacher and cleric, was brought to Harvard from England almost two hundred years after Paciolo had formulated bookkeeping. If not professor, he was at least made vice-president, and his work on science was used as a text-book in the college.*

But he explained the problem of the migration of birds by saying that each autumn they flew to the moon, 200,000 miles distant, a two months’ journey, and in his text-book, earthquakes are explained as follows: “They come from choking up of wind below, fermenting, bursting out, causing trembling and strokes.” Or dropping into verse:

“In subterranean caverns winds do frolic
When Mother Earth is troubled with the colic.”

How marked a contrast to the teachings of the geologist at the University of California. It is told that when he appeared in court as an expert witness, the opposing lawyer foolishly attempting to ridicule his pretension of knowledge, said: “And do you pretend to know what is going on in the bowels of the earth?” To this the geologist replied: “I do not know that the earth has any bowels.”

Only two hundred years ago science—in the leading American college—was a futile and ludicrous display of ignorance. More

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*The authority for the following statements is found in Meriwether, Our Continental Curriculum, pp. 188, ff.

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than four hundred years ago, in the the very first book published on the subject, bookkeeping was outlined in a form which still prevails around the entire world. Can not bookkeeping claim an honorable and ancient lineage? Is it indeed an upstart as compared with geology, and chemistry, and landscape gardening, and social psychology, and business English, and olericulture, and oto-rhino-laryngology, and other cherished subjects of the university curriculum? Founded, like San Francisco, by a follower of St. Francis of Assisi, cradled in mathematics with algebra as a twin, established under the ægis of a great university—surely this is an origin sufficiently academic to give respectability to this our “houn’ dog.” Perhaps I should adopt the language appropriate to the kennel and speak of bookkeeping as having been sired four hundred years ago by a monk, and today damned by thousands of university students, and yet, despite certain questions which the frivolous might raise to a celibate paternity and the extremely puzzling biological enigma of such a multiple maternity, bookkeeping is thoroughly respectable.

But many a house founded by a great man has degenerated and the descendants have been of quite inferior clay. Has the later entourage of bookkeeping been made up of a fair number of respectable persons?

The second book on bookkeeping was also written by a man of distinction, Grammateus or Schreiber. He, like Paciolo, combined algebra and bookkeeping, and his book, dated 1518, was the first work published in Germany dealing with either of these subjects. On the authority of Cantor, he stands, as a mathematician, unquestionably in the front rank of his time.

Almost immediately following Grammateus was Jerome Cardan, that picturesque scapegrace and brilliant scholar, astrologer, physician, scientist, mathematician, professor of medicine first at Pavia, later at Bologna. He, too, wrote a book combining algebra and bookkeeping. This work, says Richard Garnett, marks an era in the history of mathematics, being the first in which the principle of cubic equations was fully explained. Everett says it is one of the most valuable contributions to the literature of algebra. As a physician he was so eminent that he was called to Scotland, no mean journey in those days, to attend an archbishop; he was famous enough as an astrologer to visit the court of Edward VI to cast the king’s nativity. But his chief claim to dis-
tinction is his general scientific attitude, so far in advance of his
times. Says Garnett: "Alike intellectually and morally, Cardan
is one of the most interesting personages connected with the
revival of science in Europe. He possessed the true scientific
spirit in perfection. As a mathematician he effected most im-
portant advances, and to complete the catalogue of his accomplish-
ments he is no contemptible poet." And to add picturesqueness
to his career he became involved in difficulties, was addicted to
gaming, imprisoned for debt, banished from Milan, was later
deposed from his professorship, imprisoned, released, prohibited
from further teaching, but spent his latter years in Rome as a
prisoner of the pope.

Out of the first six writers three are thus seen to be men of
enminent distinction—in fields other than that of bookkeeping, as
judged by persons who are not themselves particularly interested
in bookkeeping. Surely the early days—if not the unknown origin
of bookkeeping—are sufficiently respectable so that we need not
be ashamed.

Extending somewhat the field of survey we find that Brown
lists only 150 names of writers on bookkeeping before 1800. But
even the reduced list of those who have reputations in fields other
than bookkeeping is too long to repeat in detail. These are not a
group of narrow specialists. One finds there authorities on
algebra (as is to be expected), on navigation, on optics, a com-
mmissioner to settle the foreign exchange, the author of the French
code of 1763 (who not only had this great code named after him,
the Code Savary, but is perhaps even more distinguished by hav-
ing had seventeen children who also bore his name), astronomers,
a French grammarian, an authority on gunpowder and the his-
torian of the Baptist church. To find these names in the Encyclo-
pædia Britannica one does not look under accounting or book-
keeping—these articles are scant and unsatisfactory and both
contain misstatements concerning the history of the subject—but
under the following rubrics: algebra, camera obscura, deaf and
dumb, earth figure, fortification and siege craft, gravitation, infini-
tesimal calculus, insurance, logarithms, mathematical tables, Napier,
and navigation.

Perhaps I may be pardoned if I mention more specifically
three of the names. There is Simon Stevin. Cantor styles him a
Dutch mathematician, but says his claims to fame are varied. He
invented a horseless carriage which worked, he was first to solve some problems regarding polyhedra, he proved the law of equilibrium on an inclined plane, he discovered the hydrostatic paradox, he explained the tides by the moon, he devised new forms of fortification, was many times public officer, a soldier and statesman, and the first to introduce decimals. Yet he thought it well worth while, in 1602, to write an extended treatise on bookkeeping for the express purpose of training his royal pupil, the prince of Orange.

There was Charles Hutton, a colliery boy, who became teacher of mathematics at eighteen and later professor at the royal academy at Woolwich, fellow and foreign secretary of the Royal Society (three others in the brief list were also fellows of that distinguished body), perhaps most famous for his computation of the density of the earth, an achievement recognized by Laplace and said by various competent critics to show ingenious and important methods, which can hardly be improved upon, author too of a work on conic sections said by Montucla to be a model of precision and clarity, receiver of the Copley medal for his paper on gunpowder, and doctor of laws of Edinburgh. And yet this man, who could weigh the earth as in a balance, condescended to write a text-book on bookkeeping, a subject which many think worthy the attention only of writing masters and proprietors of business colleges.

There was Robert Hamilton, who after some years’ experience as a banker, betook himself to teaching, and was professor first of natural philosophy and later of mathematics at Aberdeen; famed, however, more as an economist, for it was he who exposed the economic fallacies of Pitt’s policy of the sinking fund. Yet this man, banker, merchant, mathematician, capable of confuting England’s master statesman, thought it not beneath his dignity also to write on bookkeeping.

I have limited this survey to writers before 1800. I will mention only two persons since then. Augustus De Morgan, whose eminence needs no description, was so far interested in bookkeeping that one of the best elementary books ever written on the subject acknowledges that it is based on the suggestions of De Morgan. And finally Arthur Cayley, who thirty years ago turned aside from his duties as professor of mathematics at Cambridge long enough to write a most excellent work, entitled The Principles of Double-entry Bookkeeping.
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I have cited illustrious men who have written on bookkeeping rather than illustrious writers on bookkeeping. I did this merely to establish the argument that bookkeeping is a subject worthy the attention of men of ability—not to be relegated to the ordinary business college.

But not all who have attempted to write on the subject have succeeded. He may, like Grammateus, stand high as a mathematician, and yet, as a writer on bookkeeping “deserve no praise beyond that of being the first German who ventured to write on that difficult subject,” producing a book, which Row Fogo says is “so confused that it is extremely improbable that he himself knew much about what he was attempting to teach.” He may, like Cardan, show originality and genius in science, yet as a writer on bookkeeping be worse than banal. He may, like Collins, hold an honorable position in the Royal Society, yet produce a work on bookkeeping which receives no particular mention by the historian of the subject. He may, like Hamilton, deserve the encomium of McCullough, that he succeeded in the impossible task of opening the mind of the British public on an economic question, and yet have the Encyclopædia Britannica say that his work on bookkeeping is now forgotten. A man of distinction may write on bookkeeping; his work in that line is not necessarily distinguished. Would it be fair to say that it takes a peculiar genius to make a success in that subject?

The third presumptive evidence of respectability is that one performs some important service in the world. Can this be said of accounting? Perhaps this can best be answered by showing that bookkeeping appeared, not as a chance phenomenon, but distinctly in response to a world need. This is true not only of the days of Paciolo, but, as I hope to show, of that more important, almost present-day, revival.

It is not without significance that bookkeeping appeared at the end of the fifteenth century, nor that its birthplace was in the Italian republics. We all know of the marvelous awakening of that period, and particularly of the sudden expansion of commerce. Sieveking, one of the few historians who has paid attention to the subject, says that bookkeeping arose as a direct result of the establishment of partnerships on a large scale, a feature of the expanding commerce.

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An Historical Defense of Bookkeeping

But bookkeeping dozed for several centuries, and it was not until just about four hundred years after Paciolo's book, that a startling awakening took place. New works in unheard-of abundance and of a new quality began to appear, and again the universities seriously undertook instruction in a subject which had fallen into academic disrepute.

Why this new prominence in a subject taught before 1500? The answer is so obvious that I offend by explanation. The end of the nineteenth, even more than the end of the fifteenth century, was marked by a most extraordinary expansion of business. Then was the period of the organization of the great corporations (ordinarily called trusts), a phenomenon common to America, England and Germany. Then came that new appearance, the billion-dollar corporation, and just then—not a curious coincidence but a necessary response—accountants woke up. Garcke and Fells started the list of works on cost-accounts, Pixley first and then Dicksee began their voluminous writings dealing with the more refined problems of corporation accounts, England chartered the Institute of Chartered Accountants, New York set the example, since followed by every American state, of granting the title of "certified public accountant," the adding machine was invented, logarithms were placed beside the ledger, books were written, conventions were held, accounting was.

In part the new significance of accounting is due to subdivision of ownership and the severance of ownership and control so characteristic of the corporate form of business organization. If the substitution of a small partnership for the individual trader called for improvement in bookkeeping methods, how much more was improvement needed when the partnership was displaced by the corporation with its owners numbered by the tens of thousands.

But still more significant has been the great investment of fixed capital characteristic of modern production and made possible by the organization of corporations. The use of fixed capital on a large scale increases incalculably the difficulty of determining the profits earned in any given year. Paciolo made no serious effort to do this. Business in his day was a congeries of disconnected ventures. A ship went here, a caravan there, a joint venture was undertaken with Messer Juan Antonio in French wool, and a flyer was taken in ginger michini. As these ventures fell in,
The profit gained in the completed transaction was ascertained, somewhat roughly, it is true, but fairly satisfactorily. But no attempt was made to deal with unfinished operations.

But today business is a continuum. Machinery serves for many years, the factory building stands for a generation, the railroad is built to last forever. The industrial process is made up of a never-ending stream of raw materials, goods in process and finished commodities. Expenses are incurred in common and not like the expenses of a caravan solely in connection with one parcel of goods. But man is strangely agricultural in his tradition, even though society has become industrial. Time was when the recurring cycle of the year was of immense significance to him, for seed-time and harvest each came in connection with the course of the earth around the sun. And man still thinks that he must reckon results in terms of the accidental period involved in such a circuit. We demand to know how much a concern makes in a year. We must know, because the reciprocal rights of preferred and common stockholders may be altogether changed, depending on whether profit is to be attributed to the month of December or to the following January. We must know in order to satisfy the demands of the income-tax collector. And so accountants are asked to perform the hopeless task of taking this economic continuum, of chopping it up into arbitrary and meaningless lengths called a year and apportioning to each such year a proper part of the cost of a building which will last fifty years, of a machine which will be used for twenty years, of a blast furnace which will last ten, and of a stock of coal bought in December which will all be consumed before spring again appears.

Progress in the science seems slow. There stand out, however, two contributions of present-day accountants, one of practical, the other of theoretical importance. The first, made by America, consists of innumerable little devices for saving work in the handling of great masses of figures. Cumbersome and needless forms, surviving as tradition from the past centuries in England, and still more on the continent, have been discarded in America and new forms have been introduced by which results can be obtained with less labor. The other contribution has been the attempt to ascertain the exact cost of producing objects or parts of objects or for carrying on processes in continuous manufacture. Manufacturers now must know not only what it costs to make a
machine but what is the cost of each separate wheel, pinion and screw in that machine; what is the cost not merely of a yard of cloth, but of carding, of roving, of spinning, of weaving, of dyeing, of finishing, of selling that yard of cloth. This has been the characteristic scientific contribution of recent years.

Progress is being made. What better evidence is there than that even lawyers and courts are coming to appreciate that there are such things as accounting principles? No longer is it possible for the supreme court of the United States to declare that “the public * * * rarely ever take into account the depreciation of the building in which the business is carried on.”* Never again, I believe, will the supreme court of California repeat the statement regarding depreciation:** “The theory is . . . . that a sum should be set aside to be handed to the stockholders upon the sad occasion of the company’s demise, as an alleviating salve to their sorrow, but such a thing is all wrong. The theory can not be tolerated for a moment that such a fund is to be stowed away to make glad the hearts of the stockholders.”

I have tried to remove the stigma attached to accounting by showing that in its origin it is respectable, nay even academic; that despite its present disrepute it has from time to time attracted the attention of men of unquestioned intellectual attainment; that it justifies itself in that it has arisen to meet a social need. Its functions are to locate responsibility, to prevent fraud, to guide industry, to determine equities, to solve the all-essential conundrum of business: “What are my profits?”; to facilitate the government in its fiscal operations, to guide the business manager in the attempt to secure efficiency. Are not these efforts worthy of any man's attention? And so I close this paper with quotation from men whom all must respect: Scott, the romanticist, declared the profession of accounting “respectable”; Goethe, the universal genius, speaks of bookkeeping as “one of the fairest inventions of the human mind,” and Cayley, scientist beyond question, even more significantly declared “Bookkeeping is one of the two perfect sciences.” With these I rest the defense of my houn’ dog.

*Eyster v. Centennial Board of Finance, 94 U. S. 503.

**San Diego Water Co. v. San Diego, 118 Cal. 556.
Defalcations

By F. W. Lafrentz

The modern banking, manufacturing and distributing systems have been matters of slow growth. As late as the beginning of the nineteenth century the unit of organization in each line was very small. The agent abroad, when one was needed, was apt to be a man conducting his own business independently and compensated by a commission which was—in the case of a sales agent—frequently on a del credere basis. Those houses which made a business of acting as agents had many of them been long established. Their continuity was maintained for generations, and the relationship of agent for any house once established was rarely disturbed. Banks operated through correspondent banks rather than through branches, and banks were much more interested in exchange and collections than in deposits and discounts. Under this system of organization the personnel of any particular house was not large and each individual was known personally to the master. The master generally had a strong personal interest in each member of the staff, studied him, used him, and advanced him as much as possible, for advancement for any member of the staff meant increased business and increased profit for the master. Cash and securities were to a large extent under the sole control of the master or, at most, of a single confidential clerk. The business was supervised by the master in person and good or bad conduct met with prompt reward or punishment. Each man engaged in the business was an apprentice, a fellow-craft, or a master—and master meant master. When a workman had progressed to the point where he was entitled to be known as a master workman he started his own business. This was true whether the business was that of manufacturing, distributing or banking. The apprentice was one who was studying the business and in the meantime furnishing as much and as valuable service to the master as was consistent with that purpose. He usually lived in the master's household and was considered one of his family, was compensated by board and lodging, and at the end of his apprenticeship was furnished with certain clothing, his kit of
tools or other equipment, a small sum of money and a certificate
that he had completed his apprenticeship. Ordinarily he was then
registered with the guild as a fellowcraft or journeyman, and
traveled seeking employment where he could find it. He was
rarely content to settle down for any length of time, for by travel
and service under several masters he hoped to secure a thorough
knowledge of the trade or business and to fit himself to become
a master workman. When that time came, he either started a new
business in a small way on his own account or was accepted
as a partner in an established business. In time, if successful, he
retired to make way for the next generation.

All were in close touch with each other. The chances of
defalcation were reduced to the minimum. Each was more or
less interested in the other, and industrial difficulties were rare.
Dishonesty in a trusted employee, while not unknown, was rare
and apt to be soon discovered. When discovered, punishment was
sure and swift, and in most cases during the middle ages it was
death. With the development of modern machinery and of the
modern business organization, all this changed. Economic con-
ditions in most lines would not permit a small organization to
compete successfully. Large capital became necessary—larger than
could be found in the hands of single individuals. As a multitude
of owners did not make an effective executive, the corporation
developed. This produced a new class of people who were inter-
jected between the owners and the workers, and they then took the
place to a certain extent of the masters. They have been developed
to a very high degree of efficiency and are known as executives.
The motives governing them, however, were not at all times the
same as those governing the masters. When master and owner were
synonymous and the personnel was small, any neglect of the per-
sonnel was reflected in the results of the business, with the result
that either the individual who was a misfit was dropped or the
master took upon himself the task of changing him so as to make
him fit. So long as the organization of business was made up of
small units, the dropping of an individual by one master did him
but little harm for there were many other masters, and he would,
quite likely, fit in somewhere else. The executives operating large
units found themselves under the primary necessity of producing
dividends or of showing good cause for not doing so, as owners
had no object in investing capital in a business except to realize
dividends either at once or prospectively. Unless executives could produce these they were useless and were dismissed from the service. As always happens, a primary necessity is met, and executives did produce dividends, but in many cases without reference to the effect of overwork or of unsatisfactory or unsafe working conditions upon the employees. So long as this continued unrestrained, it provoked rebellion, dishonesty, disloyalty and what not on the part of the employees, for abuse is always compensated in that manner. They knew they were being imposed upon, and knew further that when—through disease or industrial or other accident—they became unfit, they would most likely be thrown aside to sink or swim. In case of premature death their families were frequently left in want. The condition this produced in England has been well set forth by Charles Kingsley in some of his stories. Fortunately all this has changed in the course of time; owners and executives have learned that they are their brother’s keeper. They have also learned that it is not only inhumane but economic waste to neglect employees. They have learned that one who works with his hands or with his brain will produce more in eight hours a day than he will in ten or twelve, and will retain his health and efficiency longer.

Everywhere we find trained personnel managers, welfare workers, employees’ committees and many other means for giving voice to the needs and wishes of the employees and bringing them to the notice of the executive and when necessary to the notice of the owner, thus bringing employer and employee into closer connection. Every competent executive feels that his object in life is, not merely to use the people employed under his direction to the best advantage of the owner, but so to use them as to protect them against their frailties, to develop them to the best of his ability and, should the relationship of employment at any time cease, to send them away better equipped to live their lives than they were when they came under his direction. This is the inspiration of the capable executive, for he knows that his work is of a class inferior to none in its importance and in the value of its results to the human material which comes under his direction.

Owners and executives should do everything in their power to create conditions which will discourage any kind of dishonesty and will lead to prompt discovery of any such act which may occur. This lesson has been very well learned, and business
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organizations of the better class have been arranging so as to reduce to as near a vanishing point as possible the opportunity for undetected dishonesty.

Obviously there will remain some opportunity for dishonesty, and sometimes the necessarily small compensation paid those of limited capacity adds to the temptation. The comradeship resulting from common employment makes immediate supervising employees and associates trustful; the ordinary precautions are often neglected. When dishonesty occurs, not only does the owner suffer, but the dishonest employee has lost his character and has thus lost his opportunity for a successful life and drops to the class of drifters, of no value to himself nor to the community. The wrong thus done the employee we should feel is even more serious than the harm done the owner whose property has been diverted.

However, after all is said and done, the one thing that impresses me in my experience as a surety man is the high average of honesty on the part of men of all stations, and the thing that impresses me next is that a large number of defalcations which occur would never occur if proper accounting systems were used and regular audits maintained. A few instances which have come to my attention recently will, I am sure, interest the readers of this article, and bear out what has just been said.

A young woman in the employ of a telegraph company caused a loss of about $450 in the following circumstances: In one office she concealed cash receipts and finally overpaid herself on account of salary thirty dollars. Being transferred to another office, she concealed cash receipts in several instances and kept money received for transfer by telegraph. On being discovered and dismissed, she calmly proceeded to another city, took another name, and was employed by the same employer at two different places, and stole in a very short time over $3,000 more, apparently using similar methods. The auditing department of the company ultimately traced the transactions resulting in the loss, of course.

A woman serving as assistant bookkeeper for a coal company was found short in her accounts about $80,000. She expended the money in the purchase of securities, of jewelry and of an automobile. The salvage recovery was very considerable in the circumstances. The methods employed by this person to secure the funds of her employer were bold but simple. She drew
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cheques to the order of fictitious persons for fictitious bills for supplies, presenting the cheques so drawn to the bookkeeper who presented them to the treasurer, with his approval. The treasurer affixed his signature and returned them to the defaulter to be forwarded to the payees. She then forged the endorsements thereon and collected them either through her own bank account, or placed them in the cash drawer of the employer, withdrawing an equal amount in cash in lieu thereof. There were approximately 250 separate items of theft in this case, and although cheques bore the endorsement of the defaulter, as she deposited them to her own credit, the defalcation was not discovered for over a year. How a defalcation of this amount, made up of so many items, could have accumulated before discovery thereof is a mystery. The bank that accepted them for deposit was certainly negligent, and whoever was charged with the reconciliation of the bank account of the company certainly failed to scrutinize them, for it seems to me that the most elementary examination should have revealed the defalcation.

A certain man was agent for four coal companies and vice-president of a bank. These companies were large. For some months at least, this person was kiting cheques between the several companies. He deposited their cheques to his own credit. Then, as vice-president of the bank he made false returns of the bank balances, until he succeeded in converting to his own use upwards of $107,000. Then discovery came. In the meantime the bulk of the proceeds had been dissipated, and the loss to his employers was far in excess of the suretyship carried. Even a casual inspection of the canceled cheques returned to any one of the coal companies should have led to discovery of the defalcation. But the auditing departments failed to function properly.

The president of a bank in one of the Rocky Mountain states also headed a real-estate company which he controlled. This real-estate company needed funds for development, so for a period of more than a year, using his own bank and another, he filched $55,000, covering his tracks by committing forgery and by false entries in the books of the bank.

In the state of Indiana a successful business man commanding the respect of all who knew him, as the crowning event of his life organized a national bank, a savings bank and a trust company. Upon his retirement his sons and son-in-law succeeded to
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the management of these three institutions. Becoming interested in oil promotions they found themselves in need of funds and proceeded to make improper loans to themselves, concealing these loans from the directors and the bank examiners by transferring them from one institution to another as necessity demanded. As the loans could not be realized ultimately the banks were forced to close their doors. Not until then was the true condition disclosed.

In a western state a father, mother and son operated a bank. The son proved unfaithful to his trust. The bank failed because of certain manipulations of his which resulted in a loss of about $70,000 to the institution. The case is still under investigation, and the real facts in the case have not as yet been ascertained.

The cashier of a bank in northeastern Pennsylvania became party to the kiting of a cheque by a depositor in the year 1919. Additional cheques were kited by the same person thereafter, and in October, 1923, a loss amounting to upwards of $97,000 was created. The suretyship bond was only $10,000, and the heavy unsecured loss to the bank caused its failure. How these frauds went undetected for so long a time when so much manipulation had to be resorted to is beyond me.

In the latter part of last year a young woman in the employ of a small bank drew a cheque for $2,800, signing the name of a depositor in the bank there, and making it payable to a fictitious person. She then introduced herself at another bank, opened an account there and deposited this cheque to her credit. By drawing three cheques against it she exhausted the amount. The fraudulent cheque passed through the exchanges and was paid. Having successfully gone through with this transaction, she indulged in similar ones during the succeeding months, until the depositor sought information regarding entries against his balance, no vouchers covering them having come to him. Inasmuch as the evidence had been destroyed, it was most difficult to get at the bottom of the matter. Ultimately, clever detective work disclosed the identity of the culprit, the young woman confessed and her friends made good the loss. In observing this case one wonders: first, how a forgery could so easily pass the teller of the bank on which the cheque was drawn; and, second, how the young woman could succeed so readily in opening a bank account at another bank without proper introduction and identification.
Because we served notice on an employee of one of the largest banking institutions of the northwest of our intention to retire from our suretyship in his behalf, he resigned his position, went on a hunting trip, and returned to his domicile. In the interim a defalcation in excess of $150,000, for which he appeared to be responsible, was discovered. We were notified in due course and as the loss was so very large, the president of the bank came to see me personally about it. I asked him if he felt certain that all of the loss was created during the currency of our bond, which was about two years. He was positive that such was the case, for he felt that it would be impossible for anyone in his institution to cover a shortage for any considerable period of time. I advised him to state the amount of loss as of the date of discovery and with this prima facie proof in hand caused an examination to be made of the books and accounts. We succeeded in finding about $75,000 of the total to have been occasioned prior to the date of our obligation of suretyship. That much could be traced to the satisfaction of the claimant bank. No doubt the sum was larger than that, but vouchers had been returned, statements and other evidence destroyed for one reason or another, and we were obliged to let it go at that in face of the assertion of the culprit that he had taken a thousand dollars a month for more than twelve years. He was in charge of foreign accounts and manipulated them with ease.

These instances might be added to indefinitely, for never in our history have so many defalcations come to our notice as during the last few years. And some of them are really staggering. I call to mind, as I am bringing this article to a close, the failure of four national banks within the last two years, due to the dishonesty of one or more of their officers. In one case the sum total embezzled was $500,000; in another it was $600,000; in another it was $800,000; and in another it was $1,600,000. In the last instance the president of the bank took in addition all readily convertible securities contained in the safety deposit boxes rented by the bank to customers. He obtained access to these by means of duplicate keys.

Almost every loss resulting from dishonesty on the part of the principal on fidelity bonds brought to my attention is the result of some omission in accounting supervision which is perfectly apparent after the loss occurs. Of course no system, how-
Defalcations

ever perfect, is an absolute shield against a designing defaulter. There is always a weak spot somewhere, but a proper system of accounts usually makes attempts of the kind easy of detection. Public accountants ought to be employed not only to install accounting systems adaptable to the particular businesses, which insure the introduction at the same time of proper safeguards, but also to audit the accounts regularly, for they, from the nature of their calling, are taught to take nothing for granted and to insist on receiving information regarding that which is obscure or out of the ordinary.
Restrictive Legislation in New York

A REVIEW OF THE C.P.A. BILL RECENTLY INTRODUCED IN THE NEW YORK LEGISLATURE

By Homer S. Pace

Accountancy may soon move forward to a new status—to a status in which practice, in the interest of the public, is forbidden except to accredited practitioners. For twenty-five years or more accountancy has had, in New York, official recognition of a limited kind. Similar recognition has been accorded in the other states and in the District of Columbia. The practising accountants of the country, during this probationary period, have amply justified this recognition by their services to the public. We have come now to a time when the public interests and the state of the profession, in the judgment of many accountants, justify full professional recognition and standing. They believe that the present conditions, under which any person, regardless of qualifications, may hold himself out to the public as qualified to audit accounts and certify statements, are unfortunate and inimical to the interests of the public and of accredited accountants. Therefore, the New York State Society of Certified Public Accountants has introduced in the New York legislature a bill which, if enacted into law, will create new standards of practice and regulation.

The first legislation in this country with respect to the practice of accountancy, as is well known, was enacted by the state of New York in 1896. The statute, which was very brief, provided for the recognition of practitioners by the issuance of the certificate of certified public accountants by the regents of the university, and it conferred power upon the regents to conduct examinations and to provide regulations for the issuance of the certificate. The original law has been slightly modified, but even as amended it does not provide regulation that is satisfactory from the viewpoint of the public, the regents and the accredited accountants. Notwithstanding this fact, high standards of preliminary and professional education have been maintained for a quarter of a century and more, and the enforcement of the law has, in the main, been satisfactory. The defects have been more in the matter of the statute itself than in enforcement.
From the time of the passage of the original law in 1896 until the present time 1,365 certified public accountants have received their certificates from the state of New York. These certificates have been issued, with the exception of a relatively small number issued under an original waiver clause, to candidates who have met the high academic and professional requirements early established by the regents. Many of the accountants to whom certificates were granted have died, others have removed to distant parts of the country, and still others are engaged in occupations other than the public practice of accountancy. The exact number of certified public accountants authorized under the laws of New York who are in public practice in that state is not definitely known. It is evident, however, that the number in actual practice is considerably less than the total number of those to whom certificates have been granted.

During the years in which the law has been in force in New York many accountants who have not been accredited, either by New York or by other states, have developed accountancy practices in New York. Still other accountants, accredited by other states or countries, have come to New York and engaged in practice. Many of the latter, until recently, used the title "certified public accountant" or "C.P.A.,” indicating the origin of their certificates. Others have used such credentials without disclosing their origin. A comparatively recent decision restricts the use of the title "certified public accountant,” or the abbreviation “C.P.A.” to those persons who hold certificates of certified public accountant issued by the state of New York.

Similar conditions have developed in other states. The result of these conditions is that, among the large number of accountants holding themselves out to the public as qualified practitioners, there are many who have made no adequate preparation for the work, and there are others who are competent to perform the work but have not, for one reason or another, qualified for the certificate of certified public accountant under the New York statute. No effective control is obtained over the certification of statements with respect to financial conditions and results, and the public, which can not be expected to be fully informed with respect to the various distinctions that have grown up, is more or less confused in the matter of determining who is and who is not a qualified and accredited practitioner. Many individuals and
concerns, it is true, are able to make their selection of an accountant upon a proper basis—they determine, in a particular instance, whether the individual holds the certified public accountant certificate or is a member of the Institute. The public at large, however, is not fully informed. As an example of this lack of understanding the New York Times, in a recent editorial, referred to the public accountant as a "chartered accountant," the writer evidently being under the impression that the term "chartered accountant" was the accepted and official description of the accountant practising in New York.

For several years the unfortunate aspects of these conditions have been apparent and the legislation committee of the New York Society of Certified Public Accountants has from time to time attempted to obtain legislation that would provide for the recognition in New York of all reputable and qualified accountants in practice. Many differences of opinion have arisen in the discussions that have taken place. The problem, however, has been defined and gradually a consensus of opinion has been obtained as to its solution. Several bills have been introduced in the state legislature without the approval of the society or the regents, and these bills have been defeated. The society has now finally perfected a draft of a bill the provisions of which have been approved by representatives of the division of the state education department which, under the supervision of the regents, directs the enforcement of the laws with respect to the conduct of the professions. The bill also has the approval of the New York State Society of Certified Public Accountants, of many accountants who are not qualified under the New York law and of many business men. The outstanding features of this bill, in its present form, will now be discussed.

The bill provides for the restriction of the public practice of accountancy, in New York, to accountants who hold the certified public accountant certificate of the state of New York and have taken out a license, issued on a yearly basis, to engage in practice. The restriction is based on a definition of public practice which has been formulated by the committee expressly for this legislation, as follows:

"A person engages in the public practice of accountancy within the meaning and intent of this article who, holding himself or herself out to the public as a qualified practitioner of account-
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ancy offers for compensation to perform, or who does perform, on behalf of clients, a service that requires the audit or verification of financial transactions and accounting records; the preparation, verification and certification of financial, accounting and related statements for publication or credit purposes; or who in general and as an incident to such work renders professional assistance, in any or all matters of principle and detail relating to accounting procedure and the recording, presentation, and certification of financial facts."

Any unauthorized person who holds himself out to the public as competent and willing to perform the work of a public accountant as defined above will be subject to practically the same penalties as would be a person who undertakes to practise medicine or dentistry without authorization by the state. The society has been advised by counsel that the state may constitutionally regulate, under its police powers, the practice of accountancy in this manner. Similar regulation is found in the engineering bill, which has been in effect for a year or more, under which the practice of mechanical engineering, civil engineering and surveying is restricted under severe penalties to engineers and surveyors who are licensed.

The bill gives the regents authority to issue the certificate of certified public accountant, without examination, to accredited practitioners of other states whose qualifications are satisfactory to the regents; to accountants engaged in practice in the state of New York at the time the act becomes effective, who have been engaged in practice for three years or more and whose qualifications are satisfactory to the regents; and also to accountants who are engaged in practice in New York on a staff of an accountant or firm of accountants and, for a period of three years or more, have been in responsible charge of accounting engagements.

Under the foregoing provisions it is expected that certificates will be issued, without examination, to a large number of qualified and reputable practitioners without examination. In this way the number of certified public accountants will be largely increased. No one can accurately estimate the number, but it is within the possibilities that the number of accountants thus accredited may reach 2,000 or 2,500. The importance, from the practitioner's viewpoint, of a professional body as large as this can be judged by a comparison with the number of dentists, approximately 5,000,
who are now engaged in practice in the state of New York. This large number will overcome to some extent the common objection that the number of practitioners is too small to warrant the giving of restrictive privileges—that the accountants are a mere handful of practitioners who practise largely through employees.

Many additional provisions that seem necessary under the peculiar conditions of accountancy practice are included in the bill. For example, practitioners in other states and jurisdictions are to be permitted to handle engagements in the state of New York which arise as an incident to their practice in other states. Thus, if a public accountant in Pennsylvania should find it necessary to audit the accounts of a branch of a concern that was being audited in Pennsylvania, or to undertake any other temporary work in New York, he would be permitted, under this provision, to do the work. It would be obviously unwise and impracticable to enact a law that would prevent the free performance of the accountant’s duties in this manner. Such an accountant, however, would not be permitted to hold himself out to the public in New York as an accredited practitioner, and his engagements within the state must not constitute continuous practice.

The bill contains a provision permitting the use of any firm name or style, duly registered under the laws of the state. This clause would permit the use of a name or style that contains names of accountants who are deceased or of those who are not accredited under the state law. The law requires, however, that there must be at least one local partner who is a New York certified public accountant, that all local partners must hold certificates under the New York law, and that each other firm member must be an accredited accountant in the state or country of his domicile.

Provision is made for an annual registration fee of $2. In each year, in December, the accountant who wishes to engage in practice, whether as an individual or as a member of a firm, must take out a license. The bill provides for the distribution of a list of practising accountants to the individuals authorized to practise and to certain state and county officers. An accurate list of all those persons who engage in practice will thus be obtained yearly, and the license to practise can be withheld from any person whose acts are questioned. Provision is also made for the revocation, in certain circumstances, of the certified public accountant certificate.
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It should be understood that the bill as drafted may be subject to substantial revision before it becomes a law. If enacted in accordance with the present provisions, as outlined above, and if the essential provisions are upheld by the courts, the law will have a far-reaching effect and will establish accountancy on a plane almost identical with that of the older professions. In the course of time, if the law is enacted and proves successful, it is likely that similar legislation will be passed in other states.

Many conservative accountants have hesitated to advise restrictive legislation, and even yet there are many difficult problems that have not been completely solved. However, the present conditions of practice in New York, as far as regulation is concerned, are undesirable; the public is not properly protected; and there seems to be a demand for the better control of the presentation and dissemination of financial facts and information.

In view of all these conditions, the members of the New York society, upon whom the principal burden of shaping this legislation falls, are definitely committed to a programme which seeks the establishment of accountancy practice on a fully regulated and professional basis. They have approached the matter in the liberal spirit of providing means by which the way will be made easy for reputable practitioners to qualify and to join their ranks. This step has not been an easy one to take in view of the fact that the majority of the present practitioners have specifically, and in many cases laboriously, met every academic, professional and experience requirement that has been set by the regents. They are now willing, however, under proper restrictions, to increase their number without examination. This privilege, however, will be limited to a period of six months following the passage of the act, after which no one will be able to obtain the certificate in New York except by the ordinary method of conforming to the academic and professional qualifications heretofore established, or by the recognition by the regents of a certificate obtained from another state.

The certified public accountants of New York are thus undertaking, in a broad and liberal spirit, constructive work based upon long and thorough consideration of all the problems involved. The results of their efforts will be followed with great interest by accountants throughout this country, and throughout other countries as well. A new era in accountancy is dawning—the era of a Greater Accountancy.
When Does a Tax Accrue?

By Edward McCarthy

The question of when a tax accrues is important, not only for the purpose of determining when it should be deducted from taxable income, but also for the purpose of determining invested capital under federal income-tax laws for those years in which the profits taxes apply. The statutory invested capital of a corporation is affected by the payment of dividends within the first sixty days of the taxable year under the revenue acts of 1918 and 1921, and it may also be affected under those acts by the payment of dividends after the first sixty days and under the revenue act of 1917 by the payment of dividends at any time during the taxable year when the amount distributed is in excess of the available current earnings at the date of payment. Article 857 of regulations 45 provides that, for the purpose of ascertaining the amount of current earnings available for distribution, accrued federal income and profits taxes for the taxable year shall first be deducted.

In computing the amount available for dividends under article 857 of regulations 45, the usual practice of the income-tax unit has been to deduct the income and profits tax on the entire year's income and then to pro-rate the balance in determining the amount available at a particular date. This method is varied when the taxpayer can show that the earnings at the dividend date were in fact greater than the year's income pro-rated. (A. R. R. 2839, Bul. II-16-1003).

It was pointed out in Kixmiller & Baar's Consolidated U. S. Income Tax Laws (C. C. H.), p. 906, that the practice of pro-rating the current income and profits tax over a period prior to the passage of the law under which the tax is assessed is open to question. It does not appear, however, that these adjustments of invested capital have been contested in the courts, although they have been contested in the bureau. The practice of the income-tax unit was upheld by the advisory tax board in T. B. R. 54, 1 C. B. 298. In that case a dividend was paid in March, 1917, and the board sustained the unit in "accruing" at March, 1917, taxes that were assessed under a law passed five months later.
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In A. R. R. 2839 (supra), the committee on appeals and review, in referring to the provision in article 857 for accruing taxes on the current year's income, said: "It was admitted at the oral hearing that until this article was changed the unit's action in following it was correct." But did the unit really follow the letter of the regulations? The first question is, not whether article 857 is wrong in providing for the deduction of accrued taxes, but, What are accrued taxes, and When does a tax accrue?

Webster's Dictionary defines the word "accrue" as:

"To come by way of increase; to arise or spring as a growth or result; to be added as increase, profit or damage, especially as produce of money lent."

In 1 Cyc., p. 503, it is:

"To arise; to grow to or to be added to; to occur. In the past tense the word 'accrued' is used in the sense of due and payable; vested; existed."

In 1 C. J., p. 733—

"In the participial form 'accruing' means, resulting, arising; augmenting; becoming due and payable; inchoate, in process of maturing; that which will or may at a future time ripen into a vested right, an available demand or an existing chose in action."

In the case of U. S. vs. Woodward, 256 U. S. 632; 545 U. S. Tax Cases 58; T. D. 3195, 4 C. B. 153; the supreme court said, in deciding whether the federal estate tax could be allowed as a deduction in the 1918 federal income-tax return of the estate:

"Here the estate tax not only 'accrued,' which means became due, during the taxable year 1918, but it was paid," etc.

But to say that an accrued item is a due-and-payable item would probably fail to meet with approval in the accounting profession. It is possible that the word is used by accountants more often in referring to an item which is not due and payable. And this meaning has also been given to it by the courts. (1 C. J. 734) "Accrued" and "accruing" have been variously defined for the purpose of giving effect to various meanings intended by the use of the words in statutes, contracts, etc. It may be safe, however, to say that an accruing liability or expense is one which is arising, growing or coming into existence; and that an accrued liability or expense may be fully accrued, that is, one which has ceased to grow, but is not due, or it may be only partly accrued and still increasing. And it would seem that an accrual must be
predicated upon some definite condition or event from which the accrual commences; as interest runs from the date at which the debt is created or the date at which an obligation is specified to bear interest; rent accrues from the commencement of the term or rental period; and salaries and wages accrue when the services are rendered. Even in the definition from Cyc., in which "accruing" is said to mean "inchoate * * * that which may at a future time ripen into a vested right," the verb "may ripen" is used, not because there is any doubt about whether the right has commenced to accrue, but because the uncertainty lies in the possibility that a subsequent event may happen to prevent the right from vesting. "Inchoate" is defined in Black's Law Dictionary as "imperfect; unfinished; begun but not completed." There can be little doubt that, in the common every-day use of the word, an accrual, whether of income or expense, conveys the idea of a right or obligation arising out of and resulting from a fact or condition which went before. The idea that "accruing an expense" means to pro-rate it retrospectively, does not seem to be supported by authority.

An "accrual" of taxes may be set up before the levy or annual assessment is made; but the justification for calling this an accrual is that the tax is a regular periodic tax, which is reasonably certain, and the amount or rate of the levy can be estimated with reasonable accuracy on the basis of past levies. It appears, however, that some accountants object to calling this an accrual; they say it is a reserve, rather than an accrual. Suppose there is less certainty about the amount of the tax that may have to be paid, and a greater amount is set up than would be warranted solely on the basis of past experience—then there would seem to be less doubt that the amount set up was a reserve for taxes, and not accrued taxes. Or suppose an accountant had been called in on April 30, 1917, to make an audit for a corporation. He presents to the directors a balance-sheet showing a reserve for federal income taxes equal to 50 per cent. of the earnings for the preceding four months and makes this explanation: "Gentlemen, you know we declared war last month. That means the government must have a great deal of money. I foresee that in October of this year congress will repeal the excess-profits-tax law, passed about two months ago, and will enact a new law taxing the incomes of corporations for the entire year as high as 50 and
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60 per cent. You must be prepared to meet these taxes. I have, therefore, set up a reserve equal to 50 per cent. of your net income.

Would anyone say this was an "accrual"—that these taxes were "accrued taxes"? Such a reserve for taxes would no more be "accrued taxes" than a reserve for unknown disasters impending would be "accrued losses."

But the law is retroactive, it is said. So it is; so also are the state income-tax laws hereinafter cited. A retroactive law attaches new legal consequences to precedent facts. It does not change the facts. To conceive of effect as preceding cause does violence to the first principle of logic.

There is a manifest inconsistency on the part of the bureau in allowing federal income and profits taxes to be included in invested capital for a part of the following year, under T. D. 2791, and, on the other hand, holding that this fund is not available for the payment of dividends in the current year. The advisory tax board questioned the soundness of T. D. 2791, in T. B. R. 17, 1 C. B. 294. But it may well be asked if T. D. 2791 is not more sound than the accrued-tax provision of article 857. Why should not federal income and profits taxes be treated as dividends are treated under article 858—that is, as affecting invested capital only when they are due and payable and not even then if the earnings of the year in which the tax is payable are sufficient to pay it? The tax comes out of the earnings or surplus of the corporation; it has been called "Uncle Sam's dividend"; in the words of T. B. R. 17 (supra) "it is a sharing of the government in the income of the taxpayer for the taxable year." In a well reasoned article by Charles F. Seeger, appearing in a recent issue of The Journal of Accountancy, the conclusion was reached that income taxes are a distribution of profits and not expense.

The conclusion reached in T. B. R. 17 (supra) was that article 845 of regulations 45 should not be modified. Article 845 was later modified, however, by T. D. 2931—article 845-(a). This conclusion of the advisory tax board was based on the proposition that "the amount of these taxes for any year cannot, therefore, after conclusion of such year, be considered as a part of surplus, but is rather in the nature of a liability." In support of this proposition a "single illustration" is used to show that the taxes
are "chargeable" against the income upon which they are computed. But the tax board's illustration is beside the point. The question, under either article 845 or article 857, is not what income the taxes are "chargeable" against, but when they are chargeable. In other words, when does a tax accrue?

The bureau of internal revenue has repeatedly held that a tax is not a liability and cannot accrue before the passage of the law under which it is assessed. In those cases involving the accuracy of state income taxes, the bureau has refused to allow as a deduction the state income taxes under a law passed after the close of the taxpayer's federal taxable year. O. D. 505, 2 C. B. 121, N. Y. income tax; I. T. 1498, 1-2 C. B. 95, S. C. income tax; O. D. 1118, 5 C. B. 133, Wisconsin additional surtax; O. D. 387, 2 C. B. 116, Wisconsin bonus tax.

The Wisconsin bonus-tax law was passed in 1919, imposing a tax on 1918 income. A federal taxpayer sought to deduct the amount of this tax in a return for the year 1918 as a tax accrued in 1918. The bureau of internal revenue refused to allow the deduction. The case was carried to court. The district court gave a decision for the government. Appeal was taken to the circuit court of appeals (Ed. Schuster & Co. vs. Williams, Collector, 283 Fed. 115; 545 U. S. Tax Cases 974; T. D. 3330, I-1 C. B. 133) and that court held that the tax did not accrue in 1918, saying "it did not accrue until it became a liability," and citing the case of U. S. vs. Woodward (supra).

It is interesting to note that, in an Iowa case (Overland Sioux City Co. vs. Clemens, 179 N. W. 954; 545 U. S. Tax Cases 387) the opinion of the state court concerning the retroactive effect of the federal income-tax law is in harmony with the opinion of the federal court in the Schuster case (supra), concerning the retroactive effect of a state income-tax law. In the Iowa case the corporation paid a dividend July 1, 1917, out of its earnings for the preceding six months, leaving a surplus balance which was not sufficient to meet the payment of federal income and excess-profits taxes assessed under the revenue act of October 3, 1917, on net income of the six months ending June 30, 1917. Immediately after the dividend was declared and paid the stock of the corporation was sold by Clemens to another. Recovery was sought against Clemens on the theory that the tax was a liability as of June 30, 1917; that the profits and surplus were overstated
in the books; and that the dividend was paid in ignorance of the tax and under mistake. This is just such a case as the advisory tax board had in mind when T. B. R. 17 (supra) was issued. Here is what the Iowa court said:

"But was the dividend or any part of it illegal? No one will so pretend unless it was rendered so by the act of October 3, 1917. That act did not undertake to undo anything which had gone before. * * * It did not require the payment of the excess profits tax exacted from any specified fund or the income of any particular period. * * * Counsel have argued as though the tax must have been paid from the earnings of the company prior to July 1, 1917.

"The act contains no such requirement, and as the tax was not payable until nearly a year later, there would be no ground for such an inference. * * * For all that appears the company's earning capacity may have continued as before and have been ample out of which to discharge the tax long before it became payable. * * * As indicated, the act was not retrospective, save as including the income of the calendar year prior to October 3 with that portion following, in making up the net income on which the taxes would be levied and collected, and cannot be considered to have affected in any manner the legality of the dividend or sale of stock."

Our question, When does a tax accrue?, has therefore been answered for us by the courts and by the bureau of internal revenue itself, and it seems clear that the income-tax unit should change its practice in applying article 857, and equally clear that it can do so and still keep strictly within the letter of the regulations.

How about the regulations? If federal income and profits taxes are the government's share of the profits, why not treat them the same as dividends—the stockholders' share of the profits?

For the purpose of collecting the tax, of course, the government is a creditor, and the tax, a liability, or, as has been said, "both are of a higher nature." But for the purpose of determining the income, the government is a partner sharing in the profits, and the government's share of the profits is not allowed as a deduction from income. Why, then, should not invested capital be determined on the same theory? So long as a corporation is able to meet its federal tax payments when they fall due, why should it not be allowed to use its current earnings as it sees fit? Congress undoubtedly intended that it should be allowed to do so. The provision for paying the 1917 tax June 15, instead of when

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the return was filed, and the provision in the 1918 law for paying the tax in four instalments are obviously not designed for the convenience of the government, but for the convenience of the taxpayer. It is manifest that the purpose of the law is to allow the tax to be paid out of the earnings of the year in which the tax payments are due. If this were not so, why should not the entire tax be paid when the return is filed? The provision of article 857 which "deems" current earnings to be applied first to the payment of the tax computed on the same current earnings seems, therefore, to be in conflict with the plain purpose of the statute.

There is really nothing in the law even to suggest the purely theoretical set-up of "tentative tax accrual" required by article 857. The law simply provides that "invested capital for any period shall be the average invested capital"; and, while it excludes from invested capital earnings of the current year it contains nothing authorizing the commissioner to regulate the disposition of those current earnings. Certainly there is nothing in the law from which could be inferred a requirement that a corporation shall take a part of every dollar earned during the year and lock it up in a strong box against the day of the tax-gatherer's visit.
ELIJAH WATT SELLS

[After the time for closing the forms for the April issue of The Journal of Accountancy word has come of the death of Elijah Watt Sells, past president of the American Association of Public Accountants (the body which preceded the American Institute of Accountants), one of the great leaders of the accountancy profession and a splendid friend of all those who made for the advancement of the profession in America. The exigencies of printing do not permit more than a brief note in this issue of the magazine, but we have asked J. E. Sterrett, another past president and a close friend of Mr. Sells, to prepare a brief reference to the sad event.—Editor, The Journal of Accountancy.]

Elijah Watt Sells is dead. These words carry a message of sorrow to every member of the accounting profession and to an unusually wide circle of friends outside of it—for one of the high gifts of this man was his capacity for winning and holding discriminating friends. Born in Muscatine, Iowa, on March 1, 1858, he died at his home in New York March 19, 1924. He was one of the pioneers and a stalwart leader in his profession. To its service he gave gladly and wisely of himself and all that he had. It is too soon and the emotions are too deeply stirred by his passing to attempt a statement of his aims and accomplishments; the hour is one in which the heart speaks in loving tones and in unison with the reverberating chords of memory. A friend has gone, a genial, kindly friend, an earnest man of large vision, diligent, considerate, a seeker after justice, ready in praise, cautious in censure, always gracious.

Thus was he known through the years that have gone and thus will he be remembered and cherished through the years that are to come.

J. E. Sterrett.
Some months ago the American Institute of Accountants' Foundation offered a number of prizes for the best papers to be submitted upon the following subject: The Principles Which Should Govern the Determination of Capital and the Amounts Available for Distribution of Dividends in the Case of Corporations, with Special Reference to the System of Capital Stocks without a Par Value. The competition was widely advertised and has received much favorable comment in the press of this country and of Great Britain. The subject is one upon which little has been written and many accountants, lawyers and others concerned with it have been grooping more or less in the dark in a search for the true effect and the proper treatment of the question. It was with this thought in mind that the Foundation made the offer, rendered possible by the generosity of a prominent member of the profession. The time for acceptance of competitive essays closed October 1, 1923. Since that date the theses submitted have been under consideration and the jury has now completed its labors. In the last issue of this magazine we announced that the winner of the first prize was S. Gundelfinger. Since the first prize was allotted the jury has made a further report in which it is announced that only one other prize is to be given and that is to go to the member of the American Institute of Accountants whose essay was considered best among those submitted by members. The winner of this prize is Charles B. Couchman, New York. We are permitted to publish the following text of the jury's report which is to be presented to the Institute:

February 14, 1924.

To the American Institute of Accountants:

We have examined the papers submitted to us in connection with the competition for the prize offered by your Institute for the best paper on the subject of

The principles which should govern the determination of capital and the amounts available for distribution of dividends in the case of corporations, with special reference to the system of capital stocks without a par value.

We recommend that the prize be awarded to the paper submitted under the name of Francis Parker Elliott.

We do not find that any of the papers are of exceptional merit and think that the paper which we have selected as the winning paper does not merit more than the minimum prize which you offered, namely, $1,000. Nor do we find that any of the other papers submitted deal with any phase of the question in so meritorious a way as to call for the awarding of subsidiary prizes which we were authorized under the offer to award.

We have felt that it was desirable to make the general awards without any indications whether the papers were submitted by members of the
Institute or by others, and we are not in a position therefore at this time to make any award of the prize for the best paper submitted by a member of the Institute.

Attached hereto is a list of the papers submitted in the competition as reported to us by the secretary of the Institute.

JULIUS H. BARNES
WESLEY C. MITCHELL
FREDERICK STRAUSS
(By Albert Strauss)
GEORGE O. MAY

Jurors.

Mr. Nicholas Kelley, who was appointed as a substitute for Mr. Albert Rathbone owing to the latter's absence from the United States was himself called abroad, before the report was ready for signature, but had approved the findings before sailing.

March 1, 1924.

To the American Institute of Accountants:

Supplementing our report of February 14th, we have been furnished with a list, a copy of which is attached hereto, of the competitors in your prize competition who are members of your Institute, and recommend that the first prize be awarded to the author of the paper submitted under the nom de plume of "7654321."

JULIUS H. BARNES
WESLEY C. MITCHELL
FREDERICK STRAUSS
(By Albert Strauss)
GEORGE O. MAY

Jurors.

The theses were submitted under the following noms de plume: Atticus, Pierre Briand, Pleno Jure, L'Tojays, Maple, 7654321, James W. Conner, Areleph, No Par, Ballantine, January, Edmond Burke, John Trevelyon, Chatora, Dominoca, Campbell Argyle, W. Rard, Ita Lex Scripta, L. X. L., Neellie, George Emerson, Frederick Ashman, Arthur A. Lee, David Gray, John D. Carpenter, Caution, Durisdeear, Lilrose, Nerraw W. Yelssin, Phillip Sandler, Golf, Lesaler, Capro, Krawener, Semper Paratus, Alnewmal, Totis Veribus, Robert Lester, Le Juste Milieu, Dexileos, Bowline, Danica, Douglas Lincoln, Delta, Everett, Ray, Francis Parker Elliott. This list is published here for the information of competitors.

The opinion expressed by the jury that the theses submitted did not sufficiently cover the subject will probably induce the Foundation to adopt some other measure for bringing out a more or less complete and authoritative pronouncement on the subject at issue. It is felt that in view of the great importance of the subject it is most desirable that there should be made available
for general use a text which can be regarded as representing the best thought of the accountant and the lawyer as to all the important phases of the question. We hope that the purposes which the Foundation has in mind will be carried into effect and that in addition to the winning theses, which will be published in The Journal of Accountancy, much further treatment of the subject will appear in the near future.

Restrictive Legislation

Elsewhere in this issue of The Journal of Accountancy we publish a statement prepared by Homer S. Pace at our request relative to the bill which has been introduced in the legislature at Albany, dealing with the practice of public accountancy in the state of New York. Other bills have been introduced bearing upon the same subject but the bill which is discussed by Mr. Pace is one that has been approved by representatives of the state educational department and is supported by the New York State Society of Certified Public Accountants, acting on legal advice that such a measure would be constitutional. We are confident that all readers of The Journal of Accountancy throughout the country will be much interested in this attempt to enact legislation, which if effective will limit the practice of accountancy to those who are registered and approved by the state authorities. From the beginning it has been felt that there were constitutional and various other objections to the limitation of practice as an accountant. Many opinions have been given both for and against the idea that state legislatures have the right to limit practice in this way. Accountancy is a vocation whose operations have a vital effect upon civic and commercial health and it may therefore be argued that the practice should be restricted quite as narrowly as is the practice of law. On the other hand we believe that there is no law inhibiting the giving of legal advice for a fee. The regulation of legal practice concerns the right to appear before courts but does not extend to the giving of advice. It is quite possible and altogether desirable that the practice of accountancy before such bodies as the bureau of internal revenue should be subject to consent of the bureau or other administrative body, but many people believe that any attempt to prevent the rendering of accounting service in the capacity of financial advisor or auditor is not a subject falling
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within the jurisdiction of the state or within the police powers. One or two of the British colonies have successfully established the restrictive right and public accountancy is entirely under control of the colonial governments or their appointed agents. Attempts have been made in several of the United States to effect a similar restriction, but so far without satisfactory results. It is quite certain that something should be done to protect the public from the operations of unqualified or unscrupulous practitioners, and the only question which is arguable is the possibility under the constitution of enforcing restriction. At any rate the effort now being made in New York is one which will be watched with the utmost interest and if successful the example will doubtless be followed by every state in the union. New York was the first state to have certified public accountant legislation and in a period of twenty-five years the movement has spread throughout the land; therefore it is not unlikely that any further satisfactory development of regulation will also be adopted in every other state. In the case of this particular bill it may be said that while the phraseology and probable effect of such a law are not all that heart could wish they represent something in the nature of a compromise. If effort is to be made to restrict accounting practice it should be done with the advice and approval of the board of regents and of the New York State Society of Certified Public Accountants rather than by individual and possibly misdirected personal effort.

And in Kentucky

In Kentucky a bill has been introduced to the following effect:

No public accountant or firm of public accountants shall be employed by the commonwealth of Kentucky or by any branch or department of the state government or by any commission or committee thereof or by any county within the commonwealth of Kentucky or by any fiscal court, commission, board or officer thereof for the purpose of auditing, investigating or otherwise working upon any official business for the commonwealth of Kentucky or any county thereof, unless such public accountant or firm of public accountants shall have been, previous to his or their employment, duly licensed to practise accountancy by the state board of accountancy, provided, however, that nothing herein shall affect contracts of employment on state or county business at the time of the passage of this act.

This is another expression of the effort to establish restrictive legislation. In the case of Kentucky the situation differs somewhat from that of New York as there has been much criticism of
the administration of the law and several practising accountants
there have not sought certification by the C. P. A. board. Such a
measure as that quoted should be adopted only in states in which
there is general agreement among the accountants in regard to
the excellence of administration of the law.

The Journal of Accountancy

The 1923 Utah state legislature passed a
law making it the duty of elective boards
in that state controlling counties, cities,
towns or school districts, to have an audit
made, at least biennially, of the accounts and records of all officers
having the collection, management or disbursement of public
funds. This law was to become effective beginning with the
calendar year 1922. The audit or investigation is in each case to
be "by or under the immediate direction and supervision of a
competent accountant." The audit must be begun within twelve
months of the close of the period to be covered by it. Reports
shall be rendered, and copies of these must be filed with the state
auditor; also, in the case of schools, a copy must be filed with the
state superintendent of public instruction.

As might be expected, however, the law has met with certain
difficulties in its administration. The most important point has
seemed to relate to determining who, under the provisions of the
statute, is a "competent accountant." In some cases the so-called
report has been submitted to the state auditor signed by members
of the city council; these gentlemen gave no figures or other
data, but merely asserted that the various funds had been audited
by the committee and, in the opinion of its members, found
correct. Still worse, from a certain city there has been filed with
the state auditor a copy of a report to the city council of an
audit conducted by the city recorder. It is highly improbable that
the lawmakers contemplated that a city recorder should pass on
his own accounts, although, because the city council objected to the
additional expense of having the accounts audited by a certified
public accountant, it was necessary for him to do so.

However, in commenting editorially upon the situation, the
Salt Lake Tribune recently said:

"It is to be noted as a most encouraging sign of the times
that the subdivisions of the state that are complying with the
greatest alacrity, not only with the spirit of the law, but also
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with its most strict interpretation, are the school districts of Utah. The school boards in Utah have control of greater public expenditures than any other group of officials. They are to be congratulated not only on the fact that they are having these examinations of their accounts made by competent accountants, and in most cases by legally certified public accountants, but also on the fact that the reports, on the whole, are disclosing such evident care in the handling of public money and such apparent intent to manage to the best advantage the large funds placed in their trust."

Attempts to Set Aside C. P. A. Laws

One of the most popular expressions of discontent with the regulation of the profession in this country is the attempt made to overthrow C. P. A. legislation. Many states in the past have been afflicted by efforts to overthrow legislation or to obtain court decisions declaring unconstitutional the laws referring to the certification of public accountants. These efforts are invariably unavailing but they have the merit of persistence. During the past winter there have been several instances in which persons having a grievance or, as they themselves would doubtless say, seeking the amelioration of intolerable conditions have endeavored to set aside the law. A recent experience of this kind is reported from the state of Texas. As this magazine goes to press we receive word from a member of the state board there that the court of appeals has upheld the constitutionality of the Texas law. In Alabama as our readers have already been informed the law has been upheld. There may have been other attempts to overthrow C. P. A. legislation which have not been brought to our attention, but they have certainly not been successful or their success would have been bruited far and wide. As a whole C. P. A. legislation stands firmly established and its beneficence is generally recognized. The pity of it is that persons who are unable to qualify for registration in any of the states should be permitted to express their dissatisfaction, take up the time of legislatures and involve the expense of defense when there is no good ground for complaint. If those who cannot qualify under C. P. A. laws and feel that their success depends upon the possession of a C. P. A. certificate will give the matter careful thought it may occur to them that perhaps in the choice of a profession they have erred.

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Although the provisions of the federal income-tax regulations and the procedure in the preparation of returns have been simplified as compared with the war period there yet remains much for the accountant engaged in tax practice to do. He needs not only to understand the provisions of the law, and to be familiar with the more or less constant changes in the rulings and regulations of the internal-revenue department, but he should see that his clients, the taxpayers, understand and use proper methods of accounting and that they make correct returns of income in the first instance. This means, obviously, that the more or less profitable litigation work (often much more profitable to that type of practitioner who seeks the "velvet" of the war-time tax claims than it has any right to be) will gradually disappear. Even so, the worthy accountant who enables his clients to avoid trouble by making correct returns in the beginning will continue in business at a reasonable profit long after the other type of so-called accountant has ceased to do business. That the delay involved in the settlement of war-time income-tax cases has been the cause of great annoyance to taxpayers cannot be doubted. The vastness of this problem to the treasury department is perhaps little appreciated. Thus we are informed that during the government's fiscal year ended June 30, 1923, additional taxes amounting to more than $460,000,000 were assessed. During this same period more than 88,000 claims were adjusted. These made necessary the refund, credit or abatement of more than $440,000,000. Furthermore, we are informed that of these enormous amounts of additional taxes annually assessed more than sixty per cent. of such assessments are made in error. In many cases this results from incomplete tax returns or because in other ways inadequate information is furnished by taxpayers, but the responsibility for these errors rests largely upon congress, which has never provided adequate administrative machinery for the enforcement of the tax laws.

It is a spectacle to make angels weep which Washington presents today. Probably every sound man of business, whatever his party affiliation or predilection may be, will admit that we have a secretary of the treasury who actually
understands his duties and who knows as few men know the intricacies of national and international finance. This could not be said of every secretary of the treasury who has graced the office, but providentially we have today the right man in the place. At the other end of Pennsylvania avenue we have a congress which all the newspapers of the country have been vainly seeking the language adequately to describe. The warmest friend of congress, if any friends remain, would hesitate to affirm that as a body the house of representatives or even the senate has any real reason to pride itself upon financial insight. The president of the United States has recommended the adoption of much needed amendment of our federal tax laws. The detail of the plan has been worked out with infinite care and wisdom by the secretary of the treasury. On Capitol hill the many financial geniuses are now engaged in exposing to the country their absolute ignorance of the fundamentals of fiscal affairs and they have taken the plan of tax amendment, altered it, amended it, emasculated it, made it altogether disreputable in appearance, and now in the face of a growing volume of protest by the country are unwilling to adopt this thing which they have fathered. Meanwhile the long-suffering public pays its taxes for March 15th and has no idea what it will have to pay on June 15th. Business is hampered, stability is impossible and the wheels of progress are clogged. The old saying that the ideal form of government was a benevolent autocracy in these circumstances seems to have some weight. There seems to be no real reason why we should hesitate to recognize Soviet Russia. One legislative chaos should not frown upon another.
Income-tax Department

Edited by Stephen G. Rusk

From the voluminous mass of income-tax rulings and decisions that are published each month an attempt has been made to sort out those that seemed of greatest importance to the greatest number. The commenting upon all of them or the publication of all these rulings in their entirety has never been contemplated because of the obvious impossibility of so doing. Even those that have seemed to contain matter of outstanding importance have at times piled up because of lack of space for their publication and have, therefore, appeared at later dates than they otherwise would have been printed. The Journal of Accountancy goes to press about the fifteenth of the month and is mailed the first of the following month. These conditions render it necessary to review and publish decisions and rulings that seem old when they are read by the subscribers, and this fact has been commented on by some of our readers. There have been times when the comments and opinions expressed in these columns have been misleading to our readers, because subsequent to their expression a later ruling has been made diametrically opposed to the one upon which comment was made.

An example of this is furnished by comments and opinion appearing in the February issue of this periodical on treasury decision 3521, containing a court decision upon the subject of "return of income for period of less than 12 months—section 226 (c)—returns of income of decedent and of his estate for year in which he dies." The ruling contained in treasury decision 3521 was reversed by the United States circuit court of appeals, second circuit, on December 10, 1923; this later ruling was embodied in treasury decision 3547, issued by the treasury department February 7, 1924, and appears in the government's publication, Treasury Decisions, dated February 14th, a copy of which was received about February 20th, and is published herein.

Realizing that comments upon and publication of a treasury decision that has been reversed by the time this publication is delivered to its readers is likely to be misleading and is not good service, an endeavor will be made, henceforth, to correct this defect. Beginning, therefore, with this issue the columns appertaining to income tax will contain brief summaries of the latest decisions available, as well as the important decisions that are derived in the usual manner from the government publications.

An opinion was recently expressed that engagements coming to accountants for federal income-tax matters will decrease materially within the next three or four years and that the subject will become less important to accountants because of the decreasing engagements. There is probably some truth in this opinion, but when one remembers that at the present time there are some forty thousand of the more important tax returns for the year 1918 to be examined by the bureau of internal revenue, five years after these returns were made; that there is a greater number to be examined for each year since; that there seems to be no decrease in
decisions upon the several revenue acts under which these returns were made, it would seem that accountants will find plenty to do for years to come in handling federal income-tax matters, and it will undoubtedly be found desirable to keep informed upon this subject.

SUMMARY OF RECENT RULINGS

Department Circular No. 230 prohibits former employees of the treasury department from appearing before it as counsel, attorney or agent for prosecuting any claim against the United States, or in any manner, or by any means to aid in such prosecution, within two years after they have ceased to be such employees.

Treasury Decision No. 3451 extends the time to June 15, 1924, for filing information returns as to dividends paid in 1923.

Court Decision in case of Cadwalader, et al., v. Edward L. Sturgess, collector, denies injunction against collection of tax after expiration of period of statute of limitations where assessment was made prior to close of such period.

Court Decision in case of United States v. Bresin and Schaefer, bankrupts, rules that one year limitation for filing claims against a bankrupt does not apply to a claim of the United States and that such claims against the individual partners can be satisfied out of partnership assets where individual's assets are insufficient but where partnership assets and salaries left in the business are sufficient.

Court Decision in case of New Creek Company v. Lederer, collector, rules that entire proceeds, including royalties to a lessor, derived from the mining of coal, constitutes gross income;

That a mining corporation which in consideration of certain royalties, grants the right to extract ore from its land is not entitled as an inherent right to any deduction from gross income for depletion, and the right to such deduction depends upon the statutory provisions of the taxing act.

The revenue act of 1916 as amended provides a reasonable allowance for depletion and delegates to the secretary of the treasury the power to prescribe the amount by appropriate regulations. The allowance for depletion provided by articles 171 and 172 of regulations No. 33 is reasonable.

The subjects comprehended in the foregoing summary of recent rulings will be treated at length when the treasury decisions are received.

In these days when the government is seriously considering making tax returns subject to inspection by certain congressional committees as well as duly constituted officers of the several state governments, it is interesting to learn through treasury decision 3546, that:

"The government has the right to require the employees or agents of a bank who know facts as to deposits or investments or any dealings of parties who owe income taxes, to testify to the entries made on the books of the bank relating to such transactions."

In the February issue of The Journal of Accountancy treasury decision No. 3521 was published. This decision embodied a court decision by Judge Goddard of the United States district court, southern district of New York, in which it was held by the court that

"when a taxpayer dies during his taxable year, the return of his income and the return of the income of his estate for the said year are returns for a period of less than 12 months within the meaning of section 226 (c) of the revenue act of 1921, and the respective incomes must be placed upon an annual basis, as required thereby."

This decision has been overruled by the United States court of appeals, second district, and the later decision is embodied in treasury decision 3547, published herein.

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The latter court rules that:

"the tax upon the income of a decedent to the date of death and the tax upon the income of an estate during the period of settlement should be computed under the general provisions relating to returns for a period of twelve months and not under section 226 (c), revenue act of 1921, which applies to returns for a period of less than one year."

Judge Goddard in reading section 226 concluded that paragraph (c) thereof applied to cases independent of those referred to in paragraphs (a) and (b), whereas Judge Manton held that section 226 was interdependent and that paragraph (c) thereof amplifies and explains the previous paragraphs of the said section, and does not apply to returns of income of a decedent and of his estate.

TREASURY RULINGS
(T. D. 3545—February 7, 1924)

Estate tax—Revenue act of 1918—Decision of court.

1. Gross estate—Trust to take effect at death.
   Where the creator of a trust reserves the income for life, the value of property passing under the instrument is part of the gross estate of the creator within the wording of section 402 (c), revenue act of 1918.

2. Same—Consideration.
   A release of dower incidental to the creation of a trust under the terms of which the wife is to get one-sixth of the corpus and undistributed income does not constitute a bona fide sale for a fair consideration in money or money's worth within the meaning of section 402 (c), revenue act of 1918.

The following decision of the United States district court for the eastern district of Missouri, in the case of Mercantile Trust Co., guardian of the estate of Tevis Reyburn and Florence K. Schill v. Arnold J. Hellmich, is published for the information of internal revenue officers and others concerned.

DISTRICT COURT OF THE UNITED STATES, EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI. No. 6451.


MEMORANDUM OPINION OF THE COURT.

FARIS, judge: This case was submitted to the court a few days since on a demurrer to the petition. The petition itself does not fully set forth the trust agreement which forms the bone of contention. If the petition stood absolutely alone, without the briefs of counsel in the case, it is highly probable, as a strictly technical matter, that the demurrer ought to be overruled merely because the facts upon which the demurrer is bottomed do not appear in the petition. Both sides, however, in their briefs have referred to the terms of the trust agreement. Both sides, both in their arguments and their briefs, have seen fit to bottom the field of contention absolutely upon the terms of that trust agreement. I think, then, that I am warranted in considering the terms of that agreement, which were set out fully in the brief of the defendant, and which is referred to in the brief of the plaintiffs; in short, both sides consider the matter as turning upon the terms of the trust agreement, and seem to concede the power of this court regardless of the precise language of the petition itself, to determine the matter upon a full consideration of the question of ultimate liability.

On the 24th of June, 1912, one Amedee V. Reyburn, Jr., joined with his wife, Florence, and who now seems to be Florence K. Schill, in a certain trust agreement by which the settler of that trust, the said Reyburn, conveyed
to the plaintiff, Mercantile Trust Co., in trust, all of his property. Under the terms of that trust agreement, which took largely, if not wholly, the form of the instrument commonly called a "spendthrift trust," Reyburn was to be paid the sum of $750 per month out of the net income for the term of his natural life. If there were income over $750 per month such income could, in the discretion of the trustee, Mercantile Trust Co., be paid to the settler, or to any other person whom he might select.

At the death of the settler Reyburn the trust created in the Mercantile Trust Co. ceased, or it was so provided in the trust agreement, and thereupon one-sixth of the corpus and undistributed income of the trust estate, it was provided, should go to and vest in Florence Kelley Reyburn, now, as stated, Florence Kelley Schill.

There was a proviso to this provision, however, to the effect—

That if, after the date of this instrument and during the life of said Amedee V. Reyburn, Jr., there shall not have been paid by the said trustee, to or for the use of said Florence Kelley Reyburn, annually, a sum equal to at least one-sixth of the annual net income distributed by the trustee each year, then and in that event, instead of only the foregoing one-sixth of the corpus and undistributed income, one-fourth of the corpus and undistributed income of said trust estate shall go to and vest in and be paid and delivered to Florence Kelley Reyburn, absolutely and in fee simple, if she be then living.

It was provided further that all the balance and residue of the estate, save and except that just referred to, should, upon the death of Amedee V. Reyburn, Jr., vest in the legal heirs of said settler, and that each stirpes should share equally.

The settler died about the year 1920 leaving, it seems, only one granddaughter surviving him, who seems to be Tevis Reyburn, for whom the Mercantile Trust Co. is guardian, and for whom the Mercantile Trust Co. suits here.

I think there can be no question that, so far as regards the property held by the Mercantile Trust Co. for Tevis Reyburn, that the tax paid, a recovery of which is here sought, was correctly paid, and can not be recovered. But little contention seems to be made touching that proposition. Clearly, the property which came to Tevis Reyburn came to her only upon the death of the settler. If this be true, then there can be no question that the Mercantile Trust Co. was entitled to pay to the defendant here the inheritance tax sought here to be recovered back, so far as concerns such part of that payment as was due from Tevis Reyburn.

The statute on which the tax in this case was imposed and paid first provides for the levying of a certain percentage of tax in favor of the United States, upon the net estate of every decedent dying after the passage of the act. This provision is found in section 401 of the act of 1918 (40 Stat. 1057).

Section 402, subdivision (c), provides for the levy of this tax—

To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of, or intended to take effect in possession or enjoyment at or after his death, whether such transfer or trust is made or created before or after the passage of this act, except in case of a bona fide sale for a fair consideration in money or money's worth.

As stated, upon the facts presented in this controversy, there is absolutely no question that so much of this estate as has come to Tevis Reyburn, and which was taxed, was liable to this tax, for, clearly, the estate came to her only after the death of the settler. So much seems to be conceded, but the contention is made in behalf of Florence Kelley Schill that she ought to recover back the amount paid to defendant by her because there was a bona fide sale for a fair consideration, in money or money's worth,
to her. This proposition is bottomed upon the theory that when Florence Kelley Schill, as the wife of the settler, joined in the trust agreement she inevitably conveyed away from herself all dower rights in the property, and in effect she took, by the provisions of that trust agreement, upon the death of her husband, the settler, other property, namely, a one-sixth interest in the estate, which was less than the statutory one-third, and that therefore the conveyance of her dower was in fact a bona fide sale to the trustee in trust for a fair consideration, in money or money's worth, and that therefore she falls within the exception of the statute named.

I think, however, that a fair reading of the trust agreement shows conclusively that Florence Kelley Schill benefited by the trust agreement; that she was helped and not hurt by the making of it. In short, that she took more, perforce its terms, than she would have taken had she not made it and relied upon the provisions made for her by the Missouri statutes touching dower. That, however, will not necessarily settle the case. A further consideration comes in, and that is whether such a sale, such a conveyance of dower (which, it will be noted, happened only incidentally in this case), falls within the purview of that bona fide sale for a fair consideration in money mentioned in the exception contained in the statute. I am of the opinion that it does not. Florence Kelley Schill, while joining in the trust agreement with the settler, necessarily conveyed her dower interest, but such a conveyance, in my view, does not constitute a bona fide sale for a fair consideration in money. The language "fair consideration in money" has been construed by various courts of the United States. The definition of the term, in my opinion, does not include a situation similar to that here presented.

I think the demurrer ought to be sustained, and so it will be ordered.

(T. D. 3546—February 7, 1924)

* * *

General administrative provisions—Revenue act of 1921—Decision of court.

1. EXAMINATION OF BOOKS AND RECORDS.

The government has the right to require the employees or agents of a bank who know facts as to deposits or investments or any dealings of parties who owe income taxes to testify to the entries made on the books of the bank relating to such transactions.

2. SAME—CONSTITUTIONAL RIGHTS—SEARCHES AND SEIZURES.

The fourth amendment to the constitution, which prohibits unreasonable searches and seizures, does not authorize a third person who has books and papers which may be relevant to federal tax liability to refuse to produce such books or papers and testify as to the facts.

The following decision of the United States district court for the southern district of Alabama in the case of United States v. First National Bank of Mobile is published for the information of internal-revenue officers and others concerned.

United States District Court for the Southern District of Alabama.

United States v. First National Bank of Mobile.

Ervin, district judge: This is a petition filed under section 1310 of the revenue act of 1921, volume 48, part 1, of the public laws of 1921-22, page 312, asking the assistance of the court to require the First National Bank to furnish information as to the transactions had by William J. Hanlon and his wife, Annie E. Hanlon, with the bank involving deposits of money and investments by said Hanlon and his wife.

Section 1308 provides:

That the commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, * * * to examine any books, papers, records, or memoranda bearing upon the matters required to
be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons. (Italics mine.)

Section 1310 (a) provides:

That if any person is summoned under this act to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

Section 1300 provides:

And every person liable to any tax imposed by this act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the commissioner, with the approval of the secretary, may from time to time prescribe.

The petition sets out that the said Hanlon and his wife have not made full, true, and correct statements of their respective incomes of the years 1918, 1919, 1920, 1921, and 1922, and that the ledgers and other books of the bank containing the accounts of the said Hanlons will be of material assistance to the United States in arriving at the true and correct incomes of said individuals of the respective years. That summons to appear and testify and produce the books had been served on D. F. Bester, Jr., as president of the bank and that the said bank and its officers had failed to appear at the time and place designated in the summons and they now refuse to appear and permit the duly authorized agents of the internal revenue of the United States to have access in any manner to the records and accounts of said bank and prays for the assistance of the court to require the bank officers and employees to testify and the bank to produce its books and accounts.

Said bank refuses to testify and produce the books and contends that they are protected by the fourth amendment to the constitution from doing so. As I understand the fourth amendment, it protects the parties to criminal prosecution against unreasonable searches and seizures of their papers, and I do not understand this to authorize a third party who has books and papers which may be relevant to the inquiry, to refuse to produce such books and papers because of this amendment.

This is not a question of a search and seizure of a party's books and papers but of whether a witness who has information as to a party's dealings may be required to testify to those facts and produce book entries as to such entries in connection with and supporting such testimony.

The bank further contends that there is no specific showing of any deposits or investments by the Hanlons or to the materiality of the books and entries in the bank accounts against said Hanlon. It is true that such entries as may be found in the bank's books without more are inadmissible against Hanlon and wife as showing any income received by them, but the bank not only refuses to produce the books but refuses to have its president testify as to the facts.

Many cases have been read to me where evidence had been sought under subpoena ducem tecum and objection has been made that no showing of the materiality and relevancy of this evidence had been made. In the present matter, however, it appears clear to me that if Hanlon and wife are shown by the testimony of the agents and employees of the bank to have deposited funds in the bank at various dates and to have made investments in securities that the entries in the books in connection with the testimony of the officers and agents of the bank as to transactions will be both material and relevant against Hanlon and his wife to show moneys or income which
they had received. It is not necessary to say that many accounts in the bank are accounts of parties who handle money for other parties and don't show any individual receipt of income in such cases of fiduciary funds. These transactions, of course, like those of use of funds coming in fiduciary relation can be explained, but until explained they tend to show income received. Nor is it any excuse for refusing to testify and give the facts to say that moneys which pass through a man's bank account are not always income received by him. This may be conceded, and yet it is evidence from which income can be inferred and does tend to show income. Like other transactions, however, it may be explained by Hanlon and wife.

It is monstrous, it seems to me, to say that because sometimes money which is deposited in banks doesn't show income and because the bank desires to protect the dealings of its customers from unauthorized investigation by third parties that the government could not inquire as to the moneys of its citizens who owe income taxes and trace these moneys through its various agencies, such as national banks, in order to ascertain the correct income tax that is owing by the citizen that is owing by the citizen.

For these reasons I am of the opinion that the government has the right to require any of the employees or agents of a bank who know facts as to deposits or investments or any dealings of parties who owe income taxes to testify to the entries made on the books of the bank as to such transactions so the government may be correctly informed as far as possible of the income which has been received by its citizens.

An order will therefore be issued ordering the bank to furnish the information desired.

(T. D. 3547—February 7, 1924)

Income tax—Revenue act of 1921—Decision of court.

INCOME OF DECEDE NT—INCOME OF ESTATE—RETURNS—COMPUTATION.

The tax upon the income of a decedent to the date of death and the tax upon the income of an estate during the period of settlement should be computed under the general provisions relating to returns for a period of twelve months and not under section 226 (c), revenue act of 1921, which applies to returns for a period of less than one year.

The following decision of the United States circuit court of appeals for the second circuit, in the case of Bankers Trust Co. et al., executors of Glackner v. Bowers, collector, is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT. No. 173. OCTOBER TERM, 1923.

(Argued November 12, 1923. Decided December 10, 1923.)

Bankers Trust Co. and Frederick H. Pearce, as executors of the last will and testament of John Glackner, deceased, complainants-appellants, v. Frank K. Bowers, as collector of internal revenue for the second district of New York, defendant-appellee.

Appeal from the District Court of the United States for the Southern District of New York.

Before ROGERS, MANTON, and MAYER, Circuit Judges.


Joseph M. Hatfield, Esq., counsel for appellants.

Victor House, Esq., Assistant United States Attorney, counsel for appellee.

William R. Conklin, Esq., as counsel for parties similarly situated.
Manton, circuit judge: We shall refer to the parties as below, plaintiffs and defendant.

The plaintiffs have appealed from a judgment at law. Their remedy on appeal is by writ of error, and we shall treat their appeal as a writ of error pursuant to the act of September 6, 1916 (chap. 448, sec. 4, 39 Stat. 727), ignoring the mistake and regarding the action taken as appropriate so as to bring the cause here for review.

John Glackner died April 4, 1921, leaving a will which was duly admitted to probate and the plaintiffs qualified as his executors. On March 15 1922, they filed two income-tax returns. One reported the net income of decedent during the calendar year of 1921 and the other the net income received by the plaintiffs as executors during the same calendar year. The first cause of action set forth in the complaint is for a tax paid upon the basis of the return filed for the decedent. It alleges that the correct tax liability of the decedent for the calendar year 1921 was $260.44 and that the defendant demanded and was paid on account of this tax $1,560.04; that $1,290.60 of said tax was paid under protest and duress and a claim for the refund thereof was subsequently rejected by the commissioner of internal revenue. The second cause of action sets forth a tax paid upon a basis of the return reporting the net income received by the executors in 1921. The correct tax is alleged as $2,050.27, whereas there was demanded and paid $2,633.85; of this amount $583.58 was paid under protest and a claim for refund was denied by the commissioner of internal revenue. The tax collected and paid was computed by the internal revenue commissioner under a construction of section 226 (c) of the revenue act of 1921. On motion made by the defendant that the complaint did not state a cause of action, the complaint was dismissed, the court delivering an opinion which supported the claim of the government as to the amount of the taxes. The question raised on this review is whether the taxes in question should have been determined in the manner described in section 226 (c) of the revenue act of 1921 or by other provisions of the act referred to herein. Section 226 reads as follows:

(a) That if a taxpayer, with the approval of the commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) In all cases where a separate return is made for a part of a taxable year the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included.

(c) In the case of a return for a period of less than 1 year the net income shall be placed on an annual basis by multiplying the amount thereof by 12 and dividing by the number of months included in such period; and the tax shall be such part of a tax computed on such annual basis as the number of months in such period is of 12 months.

Subdivision (c) of section 226 applied only to computing tax in case of a return for a period of less than 1 year, and the district court has held that returns necessary to be filed by the plaintiffs were returns for a period of less than a year and that the tax liability was properly determined applying the statutory formula of (1) multiplying the net income by 12;
(2) dividing the product so obtained by the number of months and fraction thereof in the period covered by the return; (3) computing the normal and surtax on the quotient; and (4) dividing the total tax so computed by 12 and multiplying this quotient by the number of months and fraction thereof in the period covered by the return.

The statute and regulations of the department, apart from section 226 (c), contain a complete scheme for the filing of income-tax returns of decedents and their estates. We must accept the fact that income-tax statutes are designed and intended to reach actual income received by the taxpayer. Section 213 (a) defining gross income points this out in providing:

Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Section 212 defines net income as meaning the gross income as defined in section 213 less the deductions allowed by section 214 and subdivision (b) thereof provides that the net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer. Actual income was to be taxed—not constructive or hypothetical. The plaintiffs argue that the return was not a return for a period of less than one year within section 226 (a) and that the tax should be computed by the ordinary method prescribed for the computation of income tax. The plaintiffs base this writ of error upon the nonapplicability of section 226 and urge that if it applies it is unconstitutional for the reason that in operation it would tax as income that does not constitute income within the sixteenth amendment of the constitution and therefore violates the provisions of article 1, section 2, clause 3, and article 1, section 9, clause 4, of the constitution; also if so construed, it would violate the fifth amendment of the constitution. In the view we take, it will be unnecessary to consider the constitutional questions presented. This, for the reason that section 2, subdivision (c) provides solely for the placing of income on an annual basis and for computation of the tax thereon in the case of a return for a period of less than one year where the change is made voluntarily by the taxpayer or pursuant to an order of the commissioner. The fundamental scheme of title 2 of the revenue act is for a tax upon the net income of the taxpayer during an accounting period of 12 successive months. This general accounting period seems to be a predetermined measure to be applied to a taxpayer as income and is not affected by his death or change of status within the period. The tax is imposed upon the entire net income for such period and the return of such income constitutes his return for the period of 12 full months, even though he may have lived only a portion thereof. The exception to this is where a voluntary change is made in the accounting period by the
taxpayer or where it becomes involuntary in so far as the taxpayer is concerned by the commissioner's declaring the taxable period terminated under section 250 (g). Sections 210 and 211 impose a normal tax and surtax for each taxable year upon net income of the individual. A taxable year, a term applied to the general accounting period, is by section 200 defined as follows:

(1) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1921, shall be the calendar year 1921 or any fiscal year ending during the calendar year 1921.

The basis for computing the net income of individuals is found in section 212 and provides:

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(c) If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

Thus it will be observed that except where a voluntary change is made, the accounting period is 12 months which becomes the taxable year. And, so that the commissioner of internal revenue may have the necessary information for determining the tax liability upon this basis, returns are to be filed under section 223 (1) by individuals having a net income for the taxable year equal to or in excess of specific sums; (2) by partnerships for each taxable year; and (3) by fiduciaries for individuals, estates, or trusts having income equal to or in excess of specified sums for the taxable year. The time of filing is given by section 227 as:

(a) That returns (except in the case of nonresident aliens) shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of March. In the case of a nonresident alien, individual returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then the return shall be made on or before the 15th day of June.

No time other than the close of the calendar or fiscal year is fixed. By section 225 "any fiduciary required to make a return under this act shall be subject to all the provisions of the act which apply to individuals." Section 219 entitled "Estates and Trusts," does not require filing returns for less than one year and subdivision (a) thereof provides that taxes imposed by section 210 and section 211 apply to income of estates and trusts. It reads:

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;
(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;
(3) Income held for future distribution under the terms of the will or trust; and
(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

By subdivision (b) "The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212."

The executors here have made a return of income received and paid taxes for the estate "during the period of administration or settlement" and by subdivision (c), "the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216."

We therefore observe that section 219 (b) expressly required that the net income shall be computed in the same manner and on the same basis as provided in section 212 and that section 212 provides for an accounting of twelve full months. The only exception being in the case alone where "the net income shall, with the approval of the commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226."

The plaintiffs allege their accounts as executors were kept on the calendar-year basis, and upon this basis they are taxable pursuant to section 219. We find nothing in the act making returns filed for decedents or estates exceptions to the general rule. The plaintiffs in their returns for the decedent and his estate did not elect to change the accounting period nor is there any attempt to defeat the collection of the tax which might invoke either of the sections above referred to. Therefore, not falling within either of the exceptions above, they would be improperly considered if returned for less than a year. The time of receipt of income or the ability to receive income has no bearing upon the accounting period. A taxpayer may receive his income for the year on the first day of the year. He may become a nonresident alien during the year without property in or income from any source in the United States. As an alien, he may have come to this country during the first taxable year and he may have attained his majority or become incompetent during the year. When during the year his status changes and he becomes a taxpayer, or ceases to be one, is immaterial. If he received taxable income during any part of that year and kept his books on a calendar-year basis, a return is required of all such income derived from or received within the twelve months of such calendar year and the return is for a period of twelve months. Here the plaintiffs reported all the taxable income received by the decedent during the calendar year 1921. And in their return, they reported all the taxable income received by the estate of the decedent during the same calendar year 1921. The estate and deceased were separate entities, each having a separate accounting. Because their books were kept for the calendar year 1921, it required them to return for that year. It was possible for the estate to have kept its books on a fiscal-year basis. A different period might then have been called for. The return filed for the decedent was one of the returns required to be filed by the fiduciaries and for "an individual" having a net income for the taxable year of "$1,000 or over" under section 225, and the estate return was required for "every estate or trust the net income of which for the taxable year is $1,000 or over" under the same section.

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The decedent and his estate have long been regarded as separate taxable entities. In Mandell v. Pierce (16 Fed. Cas. 516, case No. 99008), arising under the act of June 30, 1864 (13 Stat. L. ch. 173), an executor sought to recover a tax collected on the income received by the decedent from January 1, 1865, to July 2, 1865, the date of his death. The plaintiff argued that the income tax was imposed on an annual income and the act required no return to be filed by an executor where the deceased died before the time appointed for the filing of the return. In sustaining the tax, the court said it was imposed upon the income received within the income-year and that the income received by the decedent within the income-year constituted "annual gains, profits, and income" within the meaning of the act, holding that "gains, profits, and income received within the income-year are taxable for the income of the income-year as such, and the income of the period which would have constituted the income of the income-year, if there had not been a change in the decedent's status, shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the period for which such survivor makes return of income.

This section indicates it was not the intention of Congress that the date of death be the last day of the period for which the decedent's return is filed. If Congress wanted to include within section 226 (c) decedent's and other estates, it might have done so in appropriate language.

Reading section 226 as a whole, it is clear that the purpose was to present a single unified plan for computing tax liability of a taxpayer who voluntarily changed his accounting period. Subdivision (a) provides for making of separate returns covering a period of less than 12 months in case of a taxpayer who, with the consent of the commissioner, changes his accounting period, and this is the only provision providing for a change of accounting period except section 250 (g). Subdivision (b) merely provides that in all cases where separate returns are made for part of the taxable year, the return shall include the taxpayer's income during the period covered by the separate return and that the tax rate of the calendar year in which the period falls is applicable. The use of the phrase "all cases" undoubtedly applies to cases where separate returns are required under subdivision (a). Having provided the periods to be covered by returns in the case of a change in voluntary periods and in income to be accounted for in returns and the tax rate applicable thereto, subdivision (c) provides for the computation of the tax on an annual basis. The returns required under subdivision (a) are returns for a period of less than one year, and it is clear from the context that subdivision (c) was intended to apply to such returns alone. There was nothing in subdivision (c) which would indicate a purpose to create a new and extensive class of returns such as those in the instant case, for a period of less than one year. We regard subdivision (b) and (c) as interrelated. Subdivision (b) assumes that the period covered by the return will fall within a single calendar year, for it provides that tax shall be paid at the rate for the calendar year in which such period is included.
In case of a voluntary change of the accounting period, the period of less than one year will necessarily fall within a single calendar year in the case of a taxpayer who renders returns on a fiscal-year basis. However, the period from the beginning of the fiscal year to the date of his death may very well fall within two calendar years. So it is with executors who may keep their books on a fiscal-year basis, in which case the period from the date of the decedent’s death to the end of the fiscal year may fall within two calendar years. If Congress had considered returns for decedents and for their estates to constitute “a separate return * * * for a part of a taxable year,” subdivision (b) would have made provision for the application of the rates of taxes for the calendar year in which the periods covered by the returns were included. The revenue act nowhere contains a provision or computation of a tax in the case of a return for a period commencing in one calendar year and terminating the following calendar year other than at the close of a fiscal year. It is only in section 205 in which provision is made for a tax where a tax shall be computed in case of fiscal years beginning in 1920 and ending in 1921 or beginning in 1921 and ending in 1922, but there fiscal years only are covered. Therefore, subdivision (c), which provides for the method of computing the tax applying the rates provided in subdivision (b), could not apply to returns for decedents or their estates. Again, subdivision (c) in providing for the placing of a net income on an annual basis refers solely to the number of months included in such period. This language is entirely inappropriate where death occurs on any date during the month and no provision is made for computation which would include a period covering a fraction of a month. The language used is entirely appropriate in cases of returns filed under subdivision (a) for a month, for such returns would not include a fraction of a month.

In interpreting a statute, the construction placed thereon should avoid unjust consequences unless the language compels such a result and a construction should be had with reference both to the history of the legislation and to other sections of the law with which it is in pari materia—Gutschalk v. Peck (261 Fed. 212). The congressional reports and the legislative history of section 226 are of interest. Under the act of 1918, section 226, a taxpayer, with the approval of the commissioner, was permitted to change his accounting period, which adjustment necessitated a return for a period for less than one year. The filing of a return for a shorter period resulted in a subsequent saving in surtaxes and made a change in the accounting periods of decided advantage to the taxpayer. This result was unfair to the taxpayers who did not change their accounting periods or who could not show a basis therefor, as well as unfair to the government. It was remedied by the present act (sec. 226-c) as finally enacted. The purpose of the proposed amendment was stated in the report of the committee on ways and means accompanying H. R. 8245:

Section 232: Under existing law the taxpayer may improperly reduce his surtax by changing his fiscal year, thus splitting his annual income into two parts. This section proposes to prevent such evasion by providing that in the case of a return for a period of less than one year the net income shall be placed on an annual basis and the surtax properly computed thereon in accordance with the number of months in such period.

In the original house bill the subdivisions of section 226 were not separately numbered or lettered, and the insertion by the Senate of the distinguishing letters (a), (b), and (c) was described in the statement attached to the conference report as “a clerical change.” It is apparent that this was done solely for convenience and not with the intention of separating subdivision (c) from its context. In the house bill section 226 (d) began with the words “in all of the above cases.” This was changed by the Senate amendment No. 346 to read “in all cases where a separate return is made for a part of a taxable year.” This amendment
was adopted in conference and states: "Amendment No. 346: This amend-
ment is a clerical change; and the house recedes."

In the 1918 act, the title of section 226 was "Returns when accounting
period changed." This bill was changed in the original house amend-
ment and in the title as reported by the senate finance committee by
amendment proposed on the floor of the senate and adopted without debate,
the title of the section was changed to "Return for a period of less than
twelve months" (61 Congressional Record, 7917-18). The amended title
was printed in the draft of the bill accompanying the conference report.
The conference report refers to the senate amendment No. 345 (reënact-
ing section 226 (a) with the amended title) as follows:

This amendment is a clerical change made necessary by the repeal
and reënactment of the revenue act of 1918 instead of its amendment
in specified particulars, as explained in connection with amendment
No. 3; and the house recedes.

There is nothing of the legislative history of section 226 which indi-
cates a contrary interpretation than that which we have given it, and the
conference report argues forcibly that congress had in mind returns
expressly referred to in subdivision (a) when it enacted subdivision (c)
thereof. The interpretation of statutes levying taxes must not extend
beyond their provisions by implication, nor must they be interpreted
beyond the clear import of the language used. In case of doubt, they are
interpreted strongly against the government and in favor of the taxpayer.
—United States v. Wigglesworth (2 Story, 369); American Net & Twine
Co. v. Worthington (141 U. S. 468); Bensiger v. United States (192 U. S.
38); Gould v. Gould (245 U. S. 151); Smieinka v. First Trust & Savings
Bank (257 U. S. 602). The taxpayer may change his accounting period
under section 226 as he will and may stand the disadvantage of the tax.
Inequity would flow in following the formula proposed for taxation under
section 226 (a), if applied to a decedent and his estate, particularly if the
practice was indulged in of using the month and a fraction of a month in
calculating the income. Where a construction of a statute will occasion
great inconvenience or produce inequality or injustice, that view is to be
vetoed if another and more reasonable interpretation is present in the
statute.—Knowlton v. Moore (178 U. S. 41); Bate Refrigerating Co. v.
Schleberger (157 U. S. 87).

We think the complaint sufficiently alleges a cause of action for the
recovery of the tax in question and that it was error to grant the motion
for judgment.

Judgment reversed.

Edwin J. Bishop

Edwin J. Bishop, member of the American Institute of Accountants,
certified public accountant of Minnesota and member of the firm of
Bishop, Brissman & Co., died at St. Luke's Hospital, St. Paul, Minnesota,
February 14, 1924. Mr. Bishop had been in the accounting field for many
years and was a sincere believer in the highest ideals of his profession.
He was highly esteemed by those with whom he came in contact and had
done much for the advancement of the profession in the Northwest.

W. T. Woodbridge

W. T. Woodbridge, member American Institute of Accountants, mem-
ber of the firm of W. T. Woodbridge & Co., died at the Presbyterian
Hospital, Santurce, P. R., February 7, 1924.
Students' Department

EDITED BY H. A. FINNEY

Solutions of the following problems have been requested:

Part 1 of Problem

A partnership was entered into between A and B on January 1, 1910, with a capital of $45,000, of which A contributed two-thirds and B contributed one-third.

The agreement between the partners provides that in lieu of a salary B as manager of the business shall be entitled to 20 per cent. of the profit arising in the usual course of business; that the partners shall be entitled to interest at the rate of 6 per cent. on their respective capital investments at the first of each year, and that the profits remaining after deducting the aforementioned items shall be divided equally between the partners; but that any profit or loss resulting from the sale of the business as a whole shall be divided in proportion to the capital investments at the time of sale.

The partnership had been in existence for three years, and during that time the accounts were kept by single entry, but fairly accurate records were kept of sales and expenses, so as to arrive at the approximate profits. The profits as determined for each year were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>A (Profits)</th>
<th>B (Profits)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910</td>
<td>$9,000.00</td>
<td></td>
</tr>
<tr>
<td>1911</td>
<td></td>
<td>$15,000.00</td>
</tr>
<tr>
<td>1912</td>
<td></td>
<td>$21,000.00</td>
</tr>
</tbody>
</table>

This data was used to determine the commissions to be allowed B, interest on capitals, and profits of partners; also to arrive at the respective capitals of the partners at the first of each year.

The credits and debits to the partners' accounts as shown by the books were as follows:

<table>
<thead>
<tr>
<th>Credits:</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910 Commissions</td>
<td>$1,800.00</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>$1,800.00</td>
<td>900.00</td>
</tr>
<tr>
<td>Profits</td>
<td>2,250.00</td>
<td>2,250.00</td>
</tr>
<tr>
<td>1911 Commissions</td>
<td></td>
<td>3,000.00</td>
</tr>
<tr>
<td>Interest</td>
<td>1,923.00</td>
<td>1,077.00</td>
</tr>
<tr>
<td>Profits</td>
<td>4,500.00</td>
<td>4,500.00</td>
</tr>
<tr>
<td>1912 Commissions</td>
<td></td>
<td>4,200.00</td>
</tr>
<tr>
<td>Interest</td>
<td>2,128.00</td>
<td>1,412.00</td>
</tr>
<tr>
<td>Profits</td>
<td>6,630.00</td>
<td>6,630.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debits:</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910 Withdrawals</td>
<td>2,000.00</td>
<td>2,000.00</td>
</tr>
<tr>
<td>1911 &quot;</td>
<td>3,000.00</td>
<td>3,000.00</td>
</tr>
<tr>
<td>1912 &quot;</td>
<td>4,000.00</td>
<td>4,000.00</td>
</tr>
</tbody>
</table>

The partners intend to incorporate, but before doing so they desire a revision of their accounts, as they have doubts regarding the adequacy of their system to give accurate results. After consultation with you, an accurate inventory is taken and a statement is prepared under your direction, setting forth all known assets and liabilities as of December 31, 1912.

The statement so prepared shows:

**Assets:**

- Cash $2,000.00
- Accounts receivable 41,650.00
- Inventories 54,350.00

**Liabilities:**

- Notes payable $5,000.00
- Accounts payable 14,500.00
- Accrued rents and taxes 1,500.00

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Given the preceding data, you are required to show:

(1) The net profits for each year, how obtained, and the distribution of same between the partners.
(2) Adjusting entries to correct the partners' accounts to December 31, 1912.
(3) Revised accounts of partners, showing credits and charges for each year, and capital of each partner at the beginning of the respective years.
(4) Of the $2,000 cash on hand, distribute $1,109.02 to A and $890.98 to B; then show the adjustments of the accounts of A and B after the sale of the business.
(5) Show the amount of the preferred stock of the corporation that the several partners are entitled to receive after making an equal distribution of the common stock owned by the partnership.

Note: As it is deemed impractical to go into a detailed examination of the accounts for the three years past, you are to apportion to the several years any increase or decrease in the aggregate profits for the three years on a percentage basis.

In making the adjustments bear in mind that no change is to be made in the system of accounting of the partnership.

**Part 2 of Problem**

The corporation A and B was organized for the purpose of taking over the business of A and B. Its charter authorizes the company to issue 1,000 shares of common stock of the par value of $100 per share, and 1,000 shares of 7 per cent. cumulative preferred stock of the par value of $100 per share, interest payable July 1st and January 1st of each year.

The board of directors agreed with A and B to take over their assets, exclusive of the cash on hand, and assume the liabilities of the partnership, and that the property acquired should be valued at $100,000. It was further agreed that the consideration to be given to A and B should consist of 750 shares of the common stock and 250 shares of the preferred stock of the company. The mutual agreement was put into effect as of January 1, 1913.

On April 1, 1913, the company sold 200 shares of its preferred stock at the flat rate of $105 per share, and on June 1, 1913, 100 shares of preferred stock were sold at $103.50 per share and accrued interest.

You are required to submit journal entries:

1. To record the transaction with A and B.
2. To record the sales of preferred stock.

**Solution:**

**A and B**

**Profit-and-Loss Statement**

For the three years ended December 31, 1912

(Single-entry method)

**Net worth, December 31, 1912:**

**Assets:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$2,000.00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>41,650.00</td>
</tr>
<tr>
<td>Inventories</td>
<td>54,350.00</td>
</tr>
</tbody>
</table>

**Liabilities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes payable</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>14,500.00</td>
</tr>
<tr>
<td>Accrued rents and taxes</td>
<td>1,500.00</td>
</tr>
</tbody>
</table>
Deduct net worth, January 1, 1910:

<table>
<thead>
<tr>
<th></th>
<th>A's investment</th>
<th>B's investment</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910</td>
<td>$30,000.00</td>
<td>$15,000.00</td>
<td>$45,000.00</td>
</tr>
<tr>
<td>Increase in net worth</td>
<td></td>
<td></td>
<td>32,000.00</td>
</tr>
</tbody>
</table>

Add drawings:

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910</td>
<td>$2,000.00</td>
<td>$2,000.00</td>
<td>$4,000.00</td>
</tr>
<tr>
<td>1911</td>
<td>$3,000.00</td>
<td>$3,000.00</td>
<td>$6,000.00</td>
</tr>
<tr>
<td>1912</td>
<td>$4,000.00</td>
<td>$4,000.00</td>
<td>$8,000.00</td>
</tr>
<tr>
<td></td>
<td>$9,000.00</td>
<td>$9,000.00</td>
<td>$18,000.00</td>
</tr>
</tbody>
</table>

Net profit for the three years $50,000.00

Statement of Adjusted Profits by Years

<table>
<thead>
<tr>
<th></th>
<th>As originally estimated</th>
<th>Add 1/9</th>
<th>Profits as adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910</td>
<td>$9,000.00</td>
<td>$1,000.00</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>1911</td>
<td>$15,000.00</td>
<td>1,666.67</td>
<td>16,666.67</td>
</tr>
<tr>
<td>1912</td>
<td>$21,000.00</td>
<td>2,333.33</td>
<td>23,333.33</td>
</tr>
<tr>
<td>Total</td>
<td>$45,000.00</td>
<td>$5,000.00</td>
<td>$50,000.00</td>
</tr>
</tbody>
</table>

A AND B

Statement of Partners' Accounts
For the three years ended December 31, 1912
(Giving effect to distribution of true profits)

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>$30,000.00</td>
<td>$15,000.00</td>
<td>$45,000.00</td>
</tr>
<tr>
<td>Commission—20% of $10,000.00</td>
<td>2,000.00</td>
<td>2,000.00</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>1,800.00</td>
<td>900.00</td>
<td>2,700.00</td>
</tr>
<tr>
<td>Balance of profits</td>
<td>2,650.00</td>
<td>2,650.00</td>
<td>5,300.00</td>
</tr>
<tr>
<td>Total</td>
<td>34,450.00</td>
<td>20,550.00</td>
<td>55,000.00</td>
</tr>
<tr>
<td>Drawings</td>
<td>2,000.00</td>
<td>2,000.00</td>
<td>4,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1910</td>
<td>32,450.00</td>
<td>18,550.00</td>
<td>51,000.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>1911:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission—20% of $16,666.67</td>
<td>3,333.33</td>
<td>3,333.33</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>1,947.00</td>
<td>1,113.00</td>
<td>3,060.00</td>
</tr>
<tr>
<td>Balance of profits</td>
<td>5,136.67</td>
<td>5,136.67</td>
<td>10,273.34</td>
</tr>
<tr>
<td>Total</td>
<td>39,533.67</td>
<td>28,133.00</td>
<td>67,666.67</td>
</tr>
<tr>
<td>Drawings</td>
<td>3,000.00</td>
<td>3,000.00</td>
<td>6,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1911</td>
<td>36,533.67</td>
<td>25,133.00</td>
<td>61,666.67</td>
</tr>
</tbody>
</table>

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Students' Department

1912:

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission—20% of $23,333.33</td>
<td>4,666.67</td>
<td></td>
<td>4,666.67</td>
</tr>
<tr>
<td>Interest</td>
<td>2,192.02</td>
<td>1,507.98</td>
<td>3,700.00</td>
</tr>
<tr>
<td>Balance of profits</td>
<td>7,483.33</td>
<td>7,483.33</td>
<td>14,966.66</td>
</tr>
<tr>
<td></td>
<td>46,209.02</td>
<td>38,790.98</td>
<td>85,000.00</td>
</tr>
<tr>
<td>Less drawings</td>
<td>4,000.00</td>
<td>4,000.00</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1912</td>
<td>$42,209.02</td>
<td>$34,790.98</td>
<td>$77,000.00</td>
</tr>
</tbody>
</table>

In order to determine the adjusting entries, it is necessary to ascertain the credit balances in the respective capitals resulting from the distribution of the estimated profits.

A and B

Statement of Partners' Accounts
(As kept)
For the three years ended December 31, 1912

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>$30,000.00</td>
<td>$15,000.00</td>
<td>$45,000.00</td>
</tr>
<tr>
<td>Commission</td>
<td>1,800.00</td>
<td>1,800.00</td>
<td>1,800.00</td>
</tr>
<tr>
<td>Interest</td>
<td>2,250.00</td>
<td>2,250.00</td>
<td>2,250.00</td>
</tr>
<tr>
<td></td>
<td>34,050.00</td>
<td>19,950.00</td>
<td>54,000.00</td>
</tr>
<tr>
<td>Drawings</td>
<td>2,000.00</td>
<td>2,000.00</td>
<td>4,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1910</td>
<td>32,050.00</td>
<td>17,950.00</td>
<td>50,000.00</td>
</tr>
<tr>
<td>1911:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td>3,000.00</td>
<td>3,000.00</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Interest</td>
<td>1,923.00</td>
<td>1,077.00</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Balance of profits</td>
<td>4,500.00</td>
<td>4,500.00</td>
<td>9,000.00</td>
</tr>
<tr>
<td></td>
<td>38,473.00</td>
<td>26,527.00</td>
<td>65,000.00</td>
</tr>
<tr>
<td>Drawings</td>
<td>3,000.00</td>
<td>3,000.00</td>
<td>6,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1911</td>
<td>35,473.00</td>
<td>23,527.00</td>
<td>59,000.00</td>
</tr>
<tr>
<td>1912:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td>4,200.00</td>
<td>4,200.00</td>
<td>4,200.00</td>
</tr>
<tr>
<td>Interest</td>
<td>2,128.00</td>
<td>1,412.00</td>
<td>3,540.00</td>
</tr>
<tr>
<td>Balance of profits</td>
<td>6,630.00</td>
<td>6,630.00</td>
<td>13,260.00</td>
</tr>
<tr>
<td></td>
<td>44,231.00</td>
<td>35,769.00</td>
<td>80,000.00</td>
</tr>
<tr>
<td>Drawings</td>
<td>4,000.00</td>
<td>4,000.00</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Balances, December 31, 1912</td>
<td>$40,231.00</td>
<td>$31,769.00</td>
<td>$72,000.00</td>
</tr>
</tbody>
</table>

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As no change is to be made in the partnership system of accounts, the single-entry system will be retained, and the adjusting entries will be made in the daybook, as follows:

A capital ............ (Cr.) $ 1,978.02
To adjust A's account to $42,209.02
from 40,231.00
Increase .......................... $ 1,978.02

B capital ............ (Cr.) 3,021.98
To adjust B's account to $34,790.98
from 31,769.00
Increase .......................... $ 3,021.98

The distribution of the cash, as indicated, will reduce A's capital to $41,100.00, and will reduce B's capital to $33,900.00, thus bringing the capitals into the ratio of 54.8 and 45.2, in which ratio any profits on the sale of the business to the corporation will be divided.

In order to solve part (5) of the first problem, it is necessary to refer to the second problem for the information as to the payment made by the corporation to the partnership.

**Statement of Liquidation**

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitals before sale (as above)</td>
<td>$41,100.00</td>
<td>$33,900.00</td>
<td>$75,000.00</td>
</tr>
<tr>
<td>The business is sold for $100,000, thus making a profit of $25,000.00, which is divided as follows:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A—54.8% of $25,000.00</td>
<td>13,700.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B—45.2% of $25,000.00</td>
<td></td>
<td>11,300.00</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>25,000.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>Together</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$54,800.00</td>
<td>45,200.00</td>
<td>100,000.00</td>
</tr>
<tr>
<td>Distribution of common stock</td>
<td>37,500.00</td>
<td>37,500.00</td>
<td>75,000.00</td>
</tr>
<tr>
<td>Balances, payable in preferred stock</td>
<td>$17,300.00</td>
<td>$ 7,700.00</td>
<td>$25,000.00</td>
</tr>
</tbody>
</table>

There are some rather unusual conditions in this problem. In the first place, the division of the profit on the sale of the business in the ratio of the capitals at the time of the sale is unusual and of doubtful equity. The price received for the goodwill is a realization of an immediate profit presumably based on the earning power of the business. If A and B remained partners, instead of becoming stockholders, they would continue to divide their profits in the partnership profit-and-loss ratio, and the earning power of the business would benefit them in their profit-and-loss ratio. The agreement for the distribution of the profit on the sale of the business in the capital ratio, causes them to benefit from the earning power in the capital ratio.

In the second place, it is preferable to take preferred stock for the assets, other than goodwill, and common stock for the goodwill. By
making the preferred stock preferred as to assets, the partners would be safeguarded as to their rights in the assets in the event of liquidation.

**Entries on the Corporation's Books**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions to common stock</td>
<td>75,000.00</td>
</tr>
<tr>
<td>Unsubscribed common stock</td>
<td>25,000.00</td>
</tr>
<tr>
<td>Capital stock common</td>
<td>100,000.00</td>
</tr>
<tr>
<td>To record the authorized issue of common stock, and the portion thereof subscribed for by the partnership.</td>
<td></td>
</tr>
<tr>
<td>Subscriptions to preferred stock</td>
<td>25,000.00</td>
</tr>
<tr>
<td>Unsubscribed preferred stock</td>
<td>75,000.00</td>
</tr>
<tr>
<td>Capital stock preferred</td>
<td>100,000.00</td>
</tr>
<tr>
<td>To record the authorized issue of preferred stock, and the portion thereof subscribed for by the partnership.</td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>41,650.00</td>
</tr>
<tr>
<td>Inventories</td>
<td>54,350.00</td>
</tr>
<tr>
<td>Goodwill</td>
<td>25,000.00</td>
</tr>
<tr>
<td>Notes payable</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>14,500.00</td>
</tr>
<tr>
<td>Accrued rents and taxes</td>
<td>1,500.00</td>
</tr>
<tr>
<td>A and B, vendors</td>
<td>100,000.00</td>
</tr>
<tr>
<td>To record the purchase of the assets of the partnership of A and B, the assumption of their liabilities, and the liability of the corporation for the net assets acquired, payable in stock.</td>
<td></td>
</tr>
<tr>
<td>A and B, vendors</td>
<td>100,000.00</td>
</tr>
<tr>
<td>Subscriptions to common stock</td>
<td>75,000.00</td>
</tr>
<tr>
<td>Subscriptions to preferred stock</td>
<td>25,000.00</td>
</tr>
<tr>
<td>To record the offset of our liability to the partnership for net assets, against their liability to us on account of subscriptions.</td>
<td></td>
</tr>
</tbody>
</table>

The problem states that the preferred stock bears interest. This is a misstatement. Bonds bear interest, but stocks pay dividends. The stock sold on June 1 was sold at $103.50 and accrued dividends, not at $103.50 and accrued interest.

While some accountants might record the issue of the preferred stock in a manner to show the amount of the payment for accrued dividends, it does not seem necessary to do so. It is advisable to have purchasers of preferred stock at dates between dividend days pay for the accrued dividends, so that they will not receive an advantage over other preferred stockholders. But it does not seem necessary to divide the sale price into three parts: par, accrued dividends, and premium. Let us assume that the accrued dividends paid for were credited to some account such as accrued dividends paid for. At the dividend date the entire dividend would have to be charged to surplus and credited to dividends payable. The payment of the dividend would be recorded by a charge to dividends payable, thus closing that account. The accrued dividends paid for account
would remain open. It could be closed to surplus or capital surplus. Why not, therefore, credit it to surplus, or capital surplus, or premium on stock in the first place?

Cash ........................................... $21,000.00
Unsubscribed preferred stock ............... $20,000.00
Capital surplus ................................ 1,000.00

To record the sale of 200 shares of preferred stock on April 1, 1913, at 105.

Cash ........................................... 10,641.67
Unsubscribed preferred stock ............... 10,000.00
Capital surplus ................................ 641.67

To record the sale of preferred stock for:
Par ........................................... 10,000.00
Premium ....................................... 350.00
Accrued dividends—5/12 of $700 ... 291.67

Total ........................................... 10,641.67

Problem:
From the following data prepare a tabulation to show the sources of all funds produced and the distribution thereof:

<table>
<thead>
<tr>
<th>Item</th>
<th>Dec. 31, 1920</th>
<th>Dec. 31, 1921</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$1,000</td>
<td>$800</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>5,000</td>
<td>4,500</td>
</tr>
<tr>
<td>Notes receivable</td>
<td>600</td>
<td>500</td>
</tr>
<tr>
<td>Inventories</td>
<td>8,000</td>
<td>8,500</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>400</td>
<td>360</td>
</tr>
<tr>
<td>Building</td>
<td>8,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Land</td>
<td>2,000</td>
<td>2,500</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>300</td>
<td>200</td>
</tr>
<tr>
<td>Discount on stock</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>$25,300</td>
<td>$26,560</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item</th>
<th>Dec. 31, 1920</th>
<th>Dec. 31, 1921</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>$1,700</td>
<td>$200</td>
</tr>
<tr>
<td>Bonds payable</td>
<td>2,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Premium on bonds</td>
<td>200</td>
<td>180</td>
</tr>
<tr>
<td>Allowance for depreciation—building</td>
<td>800</td>
<td>1,050</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Capital stock</td>
<td>15,000</td>
<td>17,000</td>
</tr>
<tr>
<td>Surplus</td>
<td>5,500</td>
<td>5,030</td>
</tr>
<tr>
<td></td>
<td>$25,300</td>
<td>$26,560</td>
</tr>
</tbody>
</table>

Depreciation written off against furniture and equipment, $40.
Concrete floor put in part of building and charged to depreciation allowance, $200.
Land written up, $500.
All bonds have a ten-year life. $1,000 sold December, 1921, at face value.
Stock sold for cash, 1921, $1,800. No dividends were declared in 1921.

Note: A mere comparative balance-sheet showing increases and decreases of totals is not sufficient. The cause of all increases and decreases in funds is required.
### Working Capital—Year's Excess

<table>
<thead>
<tr>
<th>Item</th>
<th>December 31, 1920</th>
<th>December 31, 1921</th>
<th>Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,000</td>
<td>1,200</td>
<td>200</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,000</td>
<td>5,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>8,000</td>
<td>8,500</td>
<td>500</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,000</td>
<td>3,600</td>
<td>400</td>
</tr>
<tr>
<td>Building</td>
<td>2,000</td>
<td>2,500</td>
<td>500</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>300</td>
<td>200</td>
<td>100</td>
</tr>
<tr>
<td>Discount on stock</td>
<td>200</td>
<td>200</td>
<td>00</td>
</tr>
<tr>
<td>Total Working Capital</td>
<td>25,300</td>
<td>26,560</td>
<td>1,260</td>
</tr>
</tbody>
</table>

### Surplus

<table>
<thead>
<tr>
<th>Item</th>
<th>December 31, 1920</th>
<th>December 31, 1921</th>
<th>Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,000</td>
<td>1,000</td>
<td>00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,000</td>
<td>1,500</td>
<td>500</td>
</tr>
<tr>
<td>Inventories</td>
<td>8,000</td>
<td>8,000</td>
<td>00</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,000</td>
<td>4,000</td>
<td>00</td>
</tr>
<tr>
<td>Building</td>
<td>2,000</td>
<td>2,000</td>
<td>00</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>300</td>
<td>300</td>
<td>00</td>
</tr>
<tr>
<td>Discount on stock</td>
<td>200</td>
<td>200</td>
<td>00</td>
</tr>
<tr>
<td>Total Surplus</td>
<td>5,500</td>
<td>5,030</td>
<td>470</td>
</tr>
</tbody>
</table>

### Net Loss from Operations

<table>
<thead>
<tr>
<th>Item</th>
<th>December 31, 1920</th>
<th>December 31, 1921</th>
<th>Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,000</td>
<td>1,000</td>
<td>00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,000</td>
<td>1,500</td>
<td>500</td>
</tr>
<tr>
<td>Inventories</td>
<td>8,000</td>
<td>8,000</td>
<td>00</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,000</td>
<td>4,000</td>
<td>00</td>
</tr>
<tr>
<td>Building</td>
<td>2,000</td>
<td>2,000</td>
<td>00</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>300</td>
<td>300</td>
<td>00</td>
</tr>
<tr>
<td>Discount on stock</td>
<td>200</td>
<td>200</td>
<td>00</td>
</tr>
<tr>
<td>Total Net Loss</td>
<td>5,500</td>
<td>5,030</td>
<td>470</td>
</tr>
</tbody>
</table>

### Increase in Working Capital

<table>
<thead>
<tr>
<th>Item</th>
<th>December 31, 1920</th>
<th>December 31, 1921</th>
<th>Increase/Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,000</td>
<td>1,000</td>
<td>00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,000</td>
<td>1,500</td>
<td>500</td>
</tr>
<tr>
<td>Inventories</td>
<td>8,000</td>
<td>8,000</td>
<td>00</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,000</td>
<td>4,000</td>
<td>00</td>
</tr>
<tr>
<td>Building</td>
<td>2,000</td>
<td>2,000</td>
<td>00</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>300</td>
<td>300</td>
<td>00</td>
</tr>
<tr>
<td>Discount on stock</td>
<td>200</td>
<td>200</td>
<td>00</td>
</tr>
<tr>
<td>Total Increase in Working Capital</td>
<td>5,500</td>
<td>5,030</td>
<td>470</td>
</tr>
</tbody>
</table>
The Journal of Accountancy

The foregoing working papers serve as a convenient means of determining the increases and decreases in the accounts, and of making adjustments to eliminate items which had no effect upon the funds. Following is an explanation of the various adjusting entries:

(a) Transfers the depreciation on furniture and equipment from the asset line to the group of items relating to net profit. The decrease of $40 in the furniture and equipment does not represent a provision of funds, and the $40 charge against operations reduced the profits without requiring an expenditure of funds. The adjusting entry eliminates the $40 from both accounts which were affected by the provision of depreciation.

(b) The laying of the concrete floor required an expenditure of funds; the charge to the reserve is transferred to the building account, thus producing a total increase of $1,200 in the building account, which represents the sum of the two expenditures made on the buildings, one of which was charged to the building account, and the other of which was charged to the reserve account.

(c) The $500 write-up of the land account increased that account and the surplus account without having any effect on the funds. Therefore the entry is reversed.

(d) The $20 written off from the premium-on-bonds account, reduced the book loss, but it had no effect upon the funds. Hence that entry also is reversed.

(e) The allowance-for-depreciation-of-buildings account shows a net increase of $250 after having charged the account with the $200 expenditure for the concrete floor. Hence the account must have been credited with depreciation of $450. As this affected the profits without affecting the funds, the amount is transferred from the depreciation line to the profits section.

(f) The $2,000 of capital stock was sold at a discount of $200. To determine the net amount of funds provided by the sale of stock, the $200 discount is transferred from the discount line to the stock line.

(g) The surplus account shows a decrease of $470 for the year, but this is after having credited the account with $500 in writing up the land. Hence the operating loss must have been $970, and this amount is transferred from the surplus line to the profits section.

NAME OF COMPANY

STATEMENT OF APPLICATION OF FUNDS
For the year ended December 31, 1921

Funds Provided:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>By an additional issue of bonds, at par</td>
<td>$1,000.00</td>
</tr>
<tr>
<td>By an additional issue of $2,000 par value of stock at 90</td>
<td>1,800.00</td>
</tr>
<tr>
<td>Total</td>
<td>2,800.00</td>
</tr>
</tbody>
</table>
Students' Department

Less funds lost in operations:
Net loss per books ........................................ $970.00
Less net adjustment for items affecting the profits
without affecting the funds:
Depreciation of furniture and equipment $ 40.00
Depreciation of buildings ......................... 450.00
Total .................................................... 490.00
Less bond premium credited to income .. 20.00
470.00

Net funds provided during the year .................. $2,300.00

Funds Applied:
To additions and improvements to building ............ $1,200.00
To increase in working capital and deferred charges (per
schedule) .............................................. 1,100.00
Total funds applied ................................... $2,300.00

Name of Company
Schedule of Working Capital and Deferred Charges
December 31, 1920 and 1921

Current Assets:
Dec. 31, Dec. 31, Working capital
1920 1921 Decrease Increase
Cash .................................................... $ 1,000 $ 800 $ 200
Accounts receivable—less reserve ... 4,900 4,400 500
Notes receivable ........................................ 600 500 100
Inventories ............................................ 8,000 8,500 $ 500
Total current assets ......................... $14,500 $14,200

Current Liabilities:
Accounts payable .................................... $ 1,700 $ 200 1,500

Working capital .................................. $12,800 $14,000
Increase in working capital ................. 1,200
$ 2,000 $ 2,000

Deferred Charges:
Prepaid insurance, December 31, 1920 .......... $ 300
Prepaid insurance, December 31, 1921 .......... 200
Decrease ............................................. $ 100

Summary
Increase in working capital .................... $ 1,200
Decrease in deferred charges .................. 100
Net increase in working capital and deferred charges .... $ 1,100

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Holding-company Accounting

SIR: I would greatly appreciate your opinion on the following questions: H Company, with a stock of no par value, acquires through exchange of its stock the entire $100,000 capital stock of O Company. At the time of the acquisition, the O Company had an earned surplus of $100,000, and has since earned another $100,000. It then declares a cash dividend of $200,000.

(1) What account should the holding company credit this dividend to? Is all of this dividend available as free surplus to the holding company to be used for disbursement as earned dividends to its stockholders if it so desires?

(2) Can dividends be declared out of paid-in or capital surplus when such surplus shall originate from paying in property or cash in excess of the par value of the stock issued therefor?

(3) Must a holding company confine itself to declaring cash dividends out of surplus originated from earnings of subsidiaries earned since consolidation and received as cash or stock dividends from such subsidiaries?

Yours truly,

New York.

J. J. L.

The consensus of opinion seems to be that no par value capital stock should be put on the books at the amount received for it. In this case it would seem that the book value of the net assets of the subsidiary, as shown by its capital stock and surplus accounts, would be the best measure of the value of the property acquired for the no-par-value stock. As the subsidiary had a capital stock account of $100,000 and a surplus of $100,000 at the date of the acquisition of its stock by the holding company, the stock appears to have been worth $200,000, and the entry recording the purchase would be:

Investment in O Company stock ............................................. $200,000
Capital stock ................................................................. $200,000

To record the acquisition of the O Company stock at book value, represented on the O Company's books by their
Capital stock account ................................. $100,000
Surplus account ...................... 100,000

Total ................................................................. $200,000

The subsidiary's earnings after the date of acquisition would be taken up on the holding company's books by the following entry:

Investment in O Company stock .................. $100,000
Surplus ................................................................. $100,000

To take up our earnings from the ownership of the O Company stock.

The declaration and payment of the dividend by the subsidiary does not constitute an earning to the holding company, but merely a conversion of a portion of its permanent investment into cash. The value of the investment in stock is decreased exactly as much as the cash is increased.
Hence there is no profit to the holding company, and the entry on the holding company's books when the cash is received should be:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$200,000</td>
</tr>
<tr>
<td>Investment in O Company stock</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

To record the receipt of a dividend from the subsidiary.

(1) It is my opinion that a holding company can consider as surplus only the earnings made by the subsidiary after the date of the acquisition of its stock by the holding company. Hence, in this case, the holding company could pay a dividend of only $100,000. This statement is subject to the qualification, however, that some accountants believe that a company issuing no-par-value stock for more than the minimum price fixed by the statute are permitted to pay back to the stockholders as dividends the entire excess of the capital over the amount of the statutory minimum capital.

The fact that a holding company should compute its earnings on the basis of the profits of the subsidiary, earned after the date of the acquisition of the stock, and not on the basis of the dividends received from the subsidiary, may be shown by assuming that at the very date when the holding company acquired the subsidiary stock the subsidiary paid a dividend of $100,000 from the surplus on its books at that date, all of which was, of course, earned by the subsidiary prior to the date of the holding company's purchase. The holding company certainly would not be justified in considering such a dividend as income from which it could pay dividends, and I do not see that the holding company could consider as income the dividends paid from previously acquired surplus even though the subsidiary waits for some time before paying the dividends. In other words, the holding company's income consists of the earnings of the subsidiary after the date of acquisition, and does not consist of the dividends which the subsidiary chooses to pay.

(2) If the paid-in surplus is valid (that is, if the asset values are not inflated), the weight of opinion seems to be that there is no legal restriction against paying dividends therefrom. For instance, if $125,000 was received in cash for stock of a par value of $100,000, the premium of $25,000 would be available for dividends. And the same rule would apply if assets other than cash were paid in, provided that the assets were valued fairly. As stated above, some accountants believe that no-par-value stock can be given an arbitrary par of the amount fixed by the statute as a minimum payment per share, and that all assets received for the stock in excess of this minimum may be returned as dividends. So far as I know, there are no court decisions indicating either the correctness or error of this view.

(3) This question was answered in (1) above.

**LONG-END INTEREST**

*Editor, Students' Department:*

Sir: Kindly explain the meaning of the term "long-end interest."

Yours truly,

A. Sr. G.

Hartford, Conn.

Let us assume that I borrow $500 from you, agreeing to pay $25 per month, with long-end interest at 6 per cent. The interest is to be deducted
from the $25 payment, and the balance is to be applied on the principal. The debt would be reduced as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original principal</td>
<td>$500.00</td>
</tr>
<tr>
<td>First payment</td>
<td>$25.00</td>
</tr>
<tr>
<td>Less one month's interest on $500</td>
<td>2.50</td>
</tr>
<tr>
<td></td>
<td>22.50</td>
</tr>
<tr>
<td>Unpaid balance of principal</td>
<td>477.50</td>
</tr>
<tr>
<td>Second payment</td>
<td>25.00</td>
</tr>
<tr>
<td>Less one month's interest on $477.50</td>
<td>2.39</td>
</tr>
<tr>
<td></td>
<td>22.61</td>
</tr>
</tbody>
</table>

Unpaid balance of principal .......................... 454.89

On the other hand, suppose that I agree to pay $25 per month, plus interest on the $25 being paid. Then the principal would be reduced $25 each month, and the total monthly payments would be:

First month—$25.00 plus one month's interest on $25.00, or $.13, or a total of $25.13.

Second month—$25.00 plus two months' interest on $25.00, or $.25, or a total of $25.25.

This is short-end interest.

**Preferred Stock Sinking Fund**

*Editor, Students' Department:*

Sir: One of the provisions of the articles of incorporation of the company with which I am connected, calls for:

"A sinking fund to be created to redeem preferred stock, and an account 'preferred stock-sinking fund' credited...with a sum equal to 3 per cent. of the aggregate of all preferred stock issued, if sufficient surplus profits remain after providing for accrued dividends on preferred.... The funds in preferred stock-sinking fund are to be applied to acquisition of preferred stock, etc., etc."

Is there not some confusion here, regarding the purpose of a sinking fund? It seems to me that the account to be created is a reserve for redemption of preferred stock, as a sinking fund would naturally be a debit entry.

By what entries could the funds in a preferred stock-sinking fund (a credit balance) be applied to the acquisition of preferred stock? Yours very truly,

New York.

X. Y. Z.

Your letter furnishes an excellent illustration of the frequent confusion of funds and reserves, and the resulting incorrect use of terms.

The preferred stock-sinking-fund account should be created by setting aside cash in the fund, debiting the sinking-fund account and crediting cash. When stock is purchased and canceled, debit the capital-stock account and credit the sinking-fund account.

The provision requiring the creation of a so-called sinking-fund account out of profits indicates the intention of requiring a reduction of the surplus available for dividends. But a fund account should not be used to show an appropriation of surplus, because fund accounts should have debit balances. Surplus appears in an account with a credit balance, and it must appear
in an account with a credit balance even after it has been appropriated and made unavailable for dividends. The title, surplus reserved for retirement of preferred stock, would be more suitable. This account would be credited with 3 per cent. of the stock issued, assuming the adequacy of the profits, and it would not be debited when the stock is retired. Hence this account will eventually have a credit balance equal to the par value of the preferred stock issued and retired, but it will amount to that figure only when all of the stock has been retired, or at least only when provision has been made for its retirement.

The question of what to do with the account after the stock has been retired, is one to be answered by the directors. As long as there is any preferred stock outstanding, its holders have the right to insist that the reserve account shall be kept intact and not charged with any dividends, as the payment of such dividends might so impair the company's financial position as to reduce its earnings and render it unable to pay off the remaining preferred stock. But as soon as the last preferred stock has been retired, the former holders have no right to say what the company shall do with its surplus. Hence the directors may return the appropriated surplus to the regular surplus account, using it for dividends if they wish to do so. They probably would not wish to do so, because the purpose of issuing the preferred stock with the sinking-fund provision was to obtain the capital from outsiders, while retaining the right to pay off these outsiders as equivalent amounts of capital could be retained from profits. If the directors, after the retirement of the preferred stock, were to pay a dividend equal to the retained profits, the company would undo all the work of financing.

Lybrand, Ross Bros. & Montgomery announce the consolidation of the practice heretofore conducted by Klink, Bean & Co. in San Francisco and Los Angeles with their own. Offices will be continued in these cities and Klink, Bean & Black will continue their association with the practice of accounting at both offices. George R. Keast, formerly resident partner of Lybrand, Ross Bros. & Montgomery, Pittsburgh, will act as resident partner in California.

W. T. Woodbridge & Co., San Juan, Porto Rico, announce the consolidation of their practice with that of their New York associates, Robert G. Sparrow & Co., New York. Offices will continue to be maintained in New York and San Juan under the firm name of Robert G. Sparrow & Co.

J. B. Scholefield announces the formation of a partnership with Seymour Wells, practising under the firm name of Scholefield, Wells, & Co., with offices at 923-3 Kearns building, Salt Lake City, Utah.

Philip J. Mayer announces the opening of an office at 20 Vesey street, New York.
Book Reviews

1924 MANUAL INCOME-TAX PROCEDURE FOR 1923 RETURNS, by William B. Castenholz. LaSalle Extension University, Chicago.

Three reasons are given by the publishers of this manual as to why it has an outstanding appeal. They are as follows: "The subject is clearly presented; the contents are of last-minute scope; the price is low."

No difficulty is confronted in affirming that this work can be so appraised, but it does not appear quite as clearly that these characteristics necessarily cause a book to have an outstanding appeal, as there are other books on this subject for which the same rather modest claim would be justifiable. Mr. Castenholz's contribution to the literature upon the subject of federal income taxes apparently was written primarily for students, but because of the simple and direct language used it will be of undoubted value to many of that vast body of individuals known as "taxpayers." In the development of the subject the author has followed closely the arrangement used in the government regulations, and it is interspersed with explanatory matter, forms and solutions of problems. The work does not deal in detail with "unusual features of the law, such as its application to non-resident aliens, foreign corporations, oil and gas companies and insurance companies." Several pages are devoted to the subject of tax-saving possibilities which may prove of considerable value to its readers.

Stephen G. Rusk.


These are days in which many books are published giving the secret of success. The matter has been approached from almost every conceivable angle, and it really does not seem that much can remain to be said. Making Business Advancement Sure is one of the latest of these publications, and it contains many excellent points told in a rather original way. It is written in a style which will doubtless appeal to the young man and woman for whom it is intended. And what it says is true.

A. P. R.

COST ACCOUNTING FOR LOGGING OPERATIONS, by G. A. Ware. News Print Service Bureau, New York. 50 pages.

This pamphlet is designed primarily for the use of paper manufacturers who carry on logging operations to procure the wood necessary for the operation of their pulp mills.

With but little adaptation the accounts could be used to record the logging operations incidental to lumber manufacture.

The chart of the system and the suggested forms of cost and other statements are clear and the purposes of the various accounts are well explained, leaving little to the imagination. No mention is, however, made of the relationship of the cost accounts to the general accounts, and while
Book Reviews

the purpose of the pamphlet is specific, its usefulness for general purposes would have been greatly enhanced had this relationship been shown. There is frequently much confusion in this connection in the minds of executives of logging companies and their office staffs.

While the pamphlet does not add much to the knowledge of public accountants familiar with logging operations, it should be useful to public accountants not so informed, and to the accounting officers of the industry.

J. D. Currie.


Thirty years of actual experience in banking work and twelve years' experience as a writer and lecturer enable the author to handle his subject in a masterly way. Each transaction and department of a commercial bank is explained and discussed in a clear and interesting way. Bank accounting and auditing are very fully covered in chapters seventeen and eighteen. To those who desire an intimate knowledge of the internal workings of a bank the books are highly commended.

D. D. F. Mackenzie.


In the preface to Problems in Industrial Accounting, Dr. Sanders has made mention of a variation in the aim of different authors of cost accounting text-books, stating that some emphasize the technique of the subject and others lay more stress on the underlying principles. The writers of both types, however, have had one similarity in that they have uniformly found it difficult to present this branch of accounting in its natural vigor as a real and living thing.

On first thought it would seem strange that a topic of such vital interest in its everyday application to business should become unattractive to the student, and undoubtedly there are certain limitations to work of this character and a certain difficulty in visualizing the manifold operation as readily as the simple one, as well as the ever-present difficulty of making any statistical matter other than dry. It would seem, however, that Dr. Sanders has succeeded in presenting the matter in this book in a very attractive manner and had successfully taken away much of the statistical effect.

It is easy to see that the student who will study this book can grasp from its pages a realistic idea of the operation which is presented and which means to the business man what chemical analysis means to the scientist. Burden application is no longer just a name, but becomes a matter of "lean months" in the case of the Lotus Bottling Company, becomes a matter of the World Furniture Company's "right to live," and
so on. Everyone will admit that these are real problems in actual business and we all know how beneficial it is to present the matter so definitely to the student.

This effect has been obtained in a number of ways. The division of the book into a statement of theory in the first section and a second section devoted entirely to problems has a very clear and decided effect. The basic principles are in this manner brought out in relief and the consideration of special cases avoids distracting and lengthy harangues on general topics.

There may be a certain impression of "light touch" which one receives from reading some parts of the book, in which the writer avoids going into minute detail; but, as he makes each example cover a specific item and focuses all attention at that point, it gives the student a very clear idea of a specific point which is being discussed.

The problems are remarkable for their variety and the fact that they are up-to-date adds greatly to the interest of the student. He must feel, after having given this book a careful examination, that he is asked to work at the problems from the viewpoint of the executive and not from that of the clerk, which is in itself worthy of much commendation.

HERBERT F. FRENCH.


This is a text-book on business training for junior high schools or for the early years of a four-year high school course. Part I is an admirable exposition of business procedure that one should know about in everyday life whether one is engaged in business or a profession. Many adults as well as children could profit by a study of it. In fact, Part I by itself would make a valuable manual for those not familiar with the most elementary business practices and customs. It may not be amiss to suggest that a chapter on building and loan associations would be a useful addition.

Part II begins with some very sound advice to the youngsters in the matter of choosing a vocation (which they will probably not heed!), and goes on to give practical training in the lower clerical positions, what the author calls "pre-vocational training." As concerns the formation of habits of system and orderliness it could not be better, but an old fogy may be pardoned for thinking the time could be better devoted to more English composition and history.

The nub of the matter is that comparatively few boys and girls complete the high school course (four-year) mainly because of a desire to "be independent." The junior high school course is intended to give them at least a smattering of training to meet the demands of short-sighted business men. That educators should lend their-assistance to this course seems a pity.

W. H. LAWTON.
Announcements

Herman R. Ginsburg, Henry G. Berkowitz, Benjamin L. Landsberg and David Gerber announce the formation of the Accounting Service & Audit Co., with offices at 110 East Lexington street, Baltimore, Maryland.

Anton Gerharz announces that M. J. Roddy has become associated with him. The practice will be continued under the firm name of Gerharz, Roddy & Co., with offices at 215 Securities building, Billings, Montana.

Walter Hood and Addison G. Strong announce that William A. Doyle and Edward H. Lamont have been admitted to the firm of Hood & Strong, with offices at 260 California street, San Francisco, California.

T. O. Williams, chartered accountant, has been elected Lord Mayor of the city of Birmingham, England. This is the first time that an accountant has occupied that office in Birmingham.

John H. Reid and Henry Knust announce the opening of offices, practising under the firm name of Reid & Knust at 125 Trumbull street, Hartford, Connecticut.

Stockton Bates & Sons announce the removal of their offices to 802 Bailey building, 1218 Chestnut street, Philadelphia, Pennsylvania.

Ericksen & Lusk announce the removal of their offices to 905-7 Chicago Temple building, 77 West Washington street, Chicago, Illinois.

Earl S. Clark & Co. announce the removal of their Providence office to the Hospital Trust building, 15 Westminster street.

McKee, Minteer & Co. announce the removal of their offices to 904 Grand Avenue Temple, Kansas City, Missouri.

Samuel I. Bendet announces the removal of his office to the Chamber of Commerce building, Newark, New Jersey.

Howard C. Nern announces the opening of offices in the Gibbons building, Parkersburg, West Virginia.

William Castenholz & Co. announce the removal of their offices to 79 West Monroe street, Chicago, Illinois.
Current Literature

[Photostatic reproductions (white printing on a black background) of most of the articles listed in The Journal of Accountancy or Accountants' Index may be obtained from the library of the American Institute of Accountants, 155 Cedar Street, New York, at the rate of 25 cents a page (8½ in. x 11 in.), and 35 cents a page (11½ in. x 14 in.), plus postage. Members and Associates of the American Institute of Accountants are entitled to a discount of 20 per cent. Identify the article by author, title, name of periodical in which it appeared, date of publication, and paging. Payment must accompany all orders.]

ACCOUNTANCY


England


History


New Zealand

Protecting the Word "Accountant." Accounting, Commerce and Insurance, December, 1923, p. 242-3.

United States


ACCOUNTANTS


ACCOUNTANTS' SOCIETIES

What Advantage is Gained by Studying to Qualify for Membership of One of the Recognized Accountancy Institutes? Australasian Accountant and Secretary, February, 1924, p. 35.

ACCOUNTING


ACCOUNTS


BANKS AND BANKING

Costs


BIBLIOGRAPHIES, INDEXES, CATALOGUES, ETC.


BOOKKEEPING


BROKERS

Auditing

BUDGETS

COKE
Bryce, W. D. Coal Mining Costs and Costing for Coke and By-product Plants: cont. COST ACCOUNTANT, February, 1924, p. 304-10.

CONSOLIDATIONS

CONTRACTORS

CORPORATIONS

COST AND FACTORY ACCOUNTING

Cycles

DAIRYING

DEFERRED CHARGES
Deferred Charges to Operations. COMMONWEALTH JOURNAL OF ACCOUNTANCY, January, 1924, p. 113.

DEPRECIATION, DEPLETION AND OBSOLESCENCE

Ties
EDUCATION

ELECTRIC LIGHT AND POWER COMPANIES
Accounting
Second Group Meeting National Accounting Section. NATIONAL ELECTRIC LIGHT ASSOCIATION BULLETIN, January, 1924, p. 57-8.

Accounting, Uniform Classification

EXAMINATIONS
Australia

Institute of Cost and Works Accountants

New Zealand

Scotland
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