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honesty, integrity, and the intelligent application of technical skill. The possibility of success of any professional firm, like that of any business house, is measured by the superiority of its product.

Some of the Questions

NOTWITHSTANDING any belief which may exist to the contrary, the life of the public accountant is not free of technical perplexities. Many of the intricacies which puzzle the mind of the layman are matters of almost perfunctory routine to the accountant. But every now and then questions arise which tax the capabilities of anyone who attempts to uphold technical integrity. The solution often, while beset with danger of attack from sticklers for purity of technique, is found in broad, practical treatment, the essence of which is fairness to all concerned.

An example which will serve to illustrate has to do with the accounts of a parent and a subsidiary company. A certain company, having put several hundred thousand dollars into experimentation and development of an automobile accessory, decided at length to form a new subsidiary corporation and turn over to the latter all the physical assets, designs, and experience acquired, to the end that the newly organized corporation might carry on the work of manufacturing the product. Along with the other acquisitions the subsidiary inherited from its predecessor the investment in experimentation and development, together with a certain theoretical good-will. Preferred stock of the subsidiary was sold to outsiders for the purpose of acquiring some new working capital, and along with every two shares of the preferred stock went as a bonus one share of common stock having no par value. Common stock sufficient to give control was issued to the predecessor company, the tangible assets and liabilities, including the liability to the predecessor company for the excess of theoretical value received over the capital value of common stock issued, were properly set up, a certain value per share was placed on the shares having no par value, and the experimental expense and purported good-will were charged to an account called cost of development.

In the books of the parent company there appeared as an asset a charge against the subsidiary, representing the difference between the combined net tangible asset valuation plus experimentation and good-will, and the value at which the common capital stock without par value of the subsidiary had been accepted. It was understood that this asset of the parent company would be realized from time to time as the subsidiary should make profits and have surplus funds available with which to make payment on the indebtedness. Presumably the legal relations between the two corporate entities made this an asset, questionable only as to value, the value being dependent only on the ability of the subsidiary to make payment in full.

The question which arises is as to the propriety of raising these accounts which may possibly be claimed to show a fictitious position. At least, they contribute to a favorable showing with respect to the parent company. That company is saved the embarrassment of making a large charge against surplus on account of experimental expense, which obviously would have been the only alternative had the new company not been formed, since there would be no excuse for deferring

this expense with the operating activity transferred to a new company. And if the expense is properly deferrable, it must of necessity follow the future operations. The subsidiary, through capitalizing good-will and experimentation expense taken over, is obliged to take up a liability somewhat contingent in its nature, but having all the ear-marks of a real liability.

It may appear that while balance sheets of the separate companies would show the conditions in a favorable light, although perhaps somewhat misleading, consolidation of the figures for the two companies would eliminate this condition. This, however, is not true to any practical extent. The amount due from the subsidiary would, of course, wash against the amount due to the parent company, but there would still remain in the consolidated figures a substitute for capitalized experimentation and development expense in the form of a contingent receivable, with a corresponding questionable showing of consolidated surplus. Strict technical procedure might appear to call for the washing out of the fictitious value, both from the deferred asset account and from the surplus. On the other hand, there is no apparent reason why expense, if a bona-fide factor in laying the foundation for a sound, profitable business, may not be spread over a reasonable number of years and considered a good asset by the parent company in this case, if it has an enforcible claim against the subsidiary. Some objection to this may be expected from preferred stockholders of the subsidiary if the company adopts the policy of appropriating all profits until such time as this good sized expense account has been amortized and the corresponding obligation liquidated. But, again, it is not incumbent upon the subsidiary corporation that all future profits shall be devoted to this purpose. The chief objection to the whole matter lies in the fact that a surplus account is shown by the parent which has a contingent basis of value. The surplus in this case was derived from anything but profits, and it seems to be extremely doubtful if any dividends might legally be declared until further profits have been earned.

The practical way out of the difficulty, from an accounting point of view, seems to rest in permitting the experimentation expense and good-will to stand as shown by the books, describing it clearly on the balance sheet to show precisely what it represents, and qualifying the surplus so that there may be no doubt about its origin and questionable substance; also to show by proper description the basis of the accounts receivable and payable between the companies, to which the experimentation expense gave rise. Justice to the public, bankers, stockholders, company officials, and public accountants on whom the responsibility for a true statement rests, seems to leave no alternative but a clear statement of the facts.

Another question concerns an open account receivable from a majority-owned subsidiary; in particular, whether or not it is proper in setting up the balance sheet of the holding company to include the amount due from the subsidiary among the current assets. Generally speaking, the test of liquidity is the length of time within which the account will be reduced to cash. Those who check credits are likely to look askance at amounts due from related companies, particularly when such amounts appear in the current position. It is conceivable that banks may question items of this kind when they appear to represent the financing of underlying or related companies, but it does not seem just that an item should be excluded from current position simply because it is due from some company in the family. The true test of an account in this class is whether or not it represents advances

which later may be capitalized and thereby frozen, or is a bona-fide account current between the companies which is being liquidated currently.

In the case in question it was necessary to apply not only the test mentioned but to go beyond, into relations existing between the two companies and the current position of the subsidiary. Upon investigation it was found that the holding company was in effect a financial agent for the subsidiary, making collections for the latter and supplying funds for operations as needed. This obviously places the holding company in the position of regulating the account in question, and since the current position of the subsidiary was entirely satisfactory, there was little doubt left that the account in question might be properly regarded as a current asset.

Many similar questions arise in the practice of a public accountant. They may not be answered by an empirical formula. Each requires careful study, thoughtful reflection, and consideration of all the facts, before any solution fairly satisfactory may be reached. Public accounting becomes more and more a study of each individual case.

Treasury Stock in Relation to Stated Capital

TREASURY stock, if it needs to be defined, is the stock of a corporation which has once been issued for value and subsequently reacquired by the same corporation. Stated capital is a somewhat more mystical term, meaning different things in different states, and to the average person somewhat obscure. It is a term which has been introduced in recent years in connection with corporations having capital stock without par value, and, generally speaking, has not received the important consideration which it merits. The corporation law of the State of New York, as to corporations having shares without par value, makes alternate provision for stated capital. Depending on the certificate of incorporation, the stated capital must be an aggregate made up either of the total preference to which all issued and outstanding preferred stock is entitled, plus all outstanding common stock at not less than $5.00 per share, plus any additional amounts which the directors shall have from time to time transferred to the sum of the two previous amounts; or the aggregate of the amounts received by the corporation for stock having no par value, plus all outstanding shares having a par value, plus any additional amounts which the directors may have transferred to the sum of the two previous amounts. It thus appears that in the event of failure on the part of directors to take formal cognizance of the matter and fix the stated capital, the provisions of the certificate of incorporation provide the formula and the amount becomes automatically determined by the facts of capital stock transactions.

In other words, where, under the first provision of the law, there is preferred capital stock having a par value and common capital stock without par but with a stated value per share not less than $5.00, the stated capital becomes the sum of the preferred capital stock outstanding at the par value per share, plus the common capital stock outstanding at the stated value per share. Under the second provision the amount of stated capital is determined by taking the number of shares of preferred stock outstanding at the par value per share, plus whatever was received as consideration for the issu-