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Changes in the bankruptcy law

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automatic. It frequently is a laborious task to reduce to market an inventory taken at cost, inasmuch as the Treasury Department has ruled that blanket depreciation rates are not permissible, but that each item must be considered separately.

The scheme is valuable in showing up stock shortages. Further, it really provides a book inventory, and thus enables the preparation of accurate monthly statements without the necessity of taking a physical inventory. In fact, a number of concerns using the retail method have adopted the practice of taking a physical inventory only as a means of disclosing stock shortages, and have found it satisfactory for this purpose to dispense with a general simultaneous physical count of all departments, and to inventory each department when convenient, such as at the time when its stock is at its lowest point.

Another advantage is stated to be that the method trains buyers to think in terms of retail prices, and provides information through the book inventory feature which is valuable in stock planning.

A number of difficulties also have been encountered in the operation of the method. In the first place, it is essentially an averaging method, and is subject to all the disadvantages of averages. It assumes that the percentages of high mark-up goods and low mark-up goods in the closing inventory are practically the same as in the total merchandise handled during the period. This difficulty frequently may be obviated by careful departmentization of the goods.

Another difficulty lies in the treatment of purchases of merchandise for special sales at which the goods are all disposed of at low mark-ups. It is believed that this situation is best met by keeping such merchandise separate from regular goods, and excluding it from all computations under the retail method of inventory.

The system requires considerable clerical work, particularly in keeping records of additional mark-ups, mark-downs, and cancellations thereof. However, studies made by the Harvard Bureau of Business Research indicate that these items are vital factors in retail stores, and that accurate data regarding them should be made available in any case.

The treatment of cash discounts and freight in connection with the retail method of inventory presents some problems when these items are not treated as other income and deductions from income, but they are not insurmountable.

The National Retail Dry Goods Association has recommended that stock turnover figures be calculated on retail prices, for the sake of uniformity.

The use of the retail method of inventory has been largely confined to department and specialty stores up to the present time, and to other retail establishments whose situation is essentially the same. Obviously, it has limitations. In most small establishments, the results secured in order to maintain the system fully would not be worth the efforts expended. And unless the method is followed in all respects, its usefulness is greatly diminished. In establishments dealing in low-priced staple commodities, with a wide range of prices and a rapid turnover, the method is less needed. Its greatest value seems to be in the department store field, where goods are thoroughly classified, and problems of season and style are an element.

Changes in the Bankruptcy Law

ALL of us are familiar with tales of fires of mysterious origin, followed by sensational fire sales and collection of large sums of insurance. It is known that in many cases such conflagrations, although apparently arising from unavoidable causes, have been started with the express purpose of taking advantage of the possibilities of fire sales and of perpetrating insurance frauds.

It sometimes has been possible also to secure a considerable amount of ill-gotten

gain through carefully planned fraudulent bankruptcies. Instances of this sort are plentiful. Investigators cite a case in which a wholesale merchant failed in a southern state, with assets of $28,737 and liabilities of $61,000. During the bankruptcy proceedings a composition offer of 25 cents on the dollar was made and was being seriously considered when investigators from the Investigation and Prosecution Department of the National Association of Credit Men were called in. Newly painted boards in the warehouse led to a stock of merchandise valued at $4,200, concealed between the ceiling and the roof. New flooring in the garage used by the merchant led to a buried lot of checks, invoices, and papers which proved to be the records of the business, although the merchant claimed that he had kept no books. One of the checks was in payment of rent on property in another city, and additional merchandise valued at more than $20,000 was found there. The total concealed merchandise recovered was valued at $32,000, which, added to the visible assets listed by the bankrupt, increased the amount available to almost $61,000, making him nearly solvent. He was indicted, tried, convicted, and sentenced to two years in the Atlanta penitentiary. Other instances of similar occurrences undoubtedly exist in which the would-be bankrupt was more successful in his nefarious schemes and consequently was able to perform the proverbially impossible feat of "eating his cake and having it too."

However, unfortunate though it may be, bankruptcy frequently results from entirely legitimate causes. Among these are failure of debtors, over-expansion, insufficient capital, adverse market conditions, etc. In such cases it is desirable that legal means be available to protect the interests of creditors of the bankrupt and to enable honest debtors to rehabilitate and reestablish themselves in business and in society. A bankruptcy law, in effect, is a provision made by society to care for its business failures.

The purposes of bankruptcy legislation are two-fold. In the first place, it should provide the machinery for a just and equitable distribution of a bankrupt's property among his creditors, without undue preference, whether they be located near or far and whether they be large or small. In the second place, it should provide that a bankrupt be released or discharged from the unpaid balance of his obligations, provided he has acted in strict good faith with his creditors. In other words, a bankruptcy law should facilitate the marshalling and conserving of assets for creditors and should relieve the honest bankrupt from permanent disability to transact business because of the unfortunate condition in which he finds himself. It should not be unduly complex in its operation.

National bankruptcy laws were enacted in the United States in 1800, in 1841, in 1867, and in 1898, each one, with the exception of the last, being repealed after a short trial. The law of 1898 was passed largely through the efforts of the credit men of the country and, with various amendments, is in effect at the present time.

It recently has been recognized generally that there were a number of defects in the law, which required remedy. It was found that loopholes in the act rendered it susceptible of misuse by the unscrupulous in the perpetration of fraudulent bankruptcies. The National Association of Credit Men, which always has been active in attempting to uncover and prosecute fraudulent bankrupts, deemed the situation serious, and launched a campaign to raise a million dollars to be used for this purpose. The campaign resulted in the accumulation of a fund of a million and a half dollars. A Credit Protection Department of the Association was organized and is now engaged on a large scale in investigating and prosecuting cases of fraudulent bankruptcy. Published records of the activities of the Association show that it has had marked success.

However, such activities are costly.

Investigation charges incurred in six cases, picked at random, averaged about $600 for each case. Evidently, certain changes were desirable in the National Bankruptcy Act. The defects complained of were several. The law was not sufficiently strict to prevent collusion between the bankrupt and his creditors or the officials appointed to administer his estate. It was found that a dishonest business man owing many debts might himself arrange bankruptcy proceedings in order to free himself of his debts without parting with all of the assets to purchase which he had created the debts. He might stage the whole affair himself through dummy creditors, sometimes created through fictitious debts; or he might have the assistance of friends who often obtain from creditors assignment of their claims. It was easy to obtain fraudulent compositions, effected with the connivance and aid of creditors who were friends of the bankrupt. Discharges in bankruptcy were too easy to obtain. Until the bankrupt secures a discharge he cannot engage again in business, or accumulate property. Thus, refusing a discharge is one form of punishment which may be inflicted on a dishonest bankrupt, but complaint was made that it was seldom invoked, even in flagrant cases. The law contained insufficient criminal provisions and penalties, and because of lack of prosecution of apparent offenders, it was difficult to secure convictions. It was comparatively easy for creditors to secure unlawful preferences. Frequently, there was considerable delay in settling estates of bankrupts, and often it was easy to evade the statute, largely because of a multiplicity of legal technicalities.

In order to correct these evils, the recent session of Congress enacted a number of amendments to the National Bankruptcy Act. The amendments were approved by President Coolidge on May 27. They are to become effective three months after approval, or on August 27, 1926. The amendments do not affect the theory of the bankruptcy law, but are designed to strengthen the weaknesses which have become apparent through the operation of the law. The more important provisions of the amendatory act may be described briefly.

The law adds new acts of bankruptcy and strengthens the definitions of present acts of bankruptcy. Bankruptcy proceedings now may be instituted if a debtor has "suffered, or permitted, while insolvent, any creditor to obtain through legal proceedings any levy, attachment, judgment, or other lien, and not having vacated or discharged the same within thirty days from the date such levy, attachment, judgment, or other lien was obtained." The purpose of adding this act of bankruptcy is to afford a remedy to creditors, when by collusion or otherwise, a creditor obtains through legal proceedings, a lien on his debtor's property, and the same is allowed to remain without sale or other disposition for more than four months until it ripens into a valid preference. The amendment will permit the filing of a petition in bankruptcy for the purpose of dissolving such a lien if it has not been vacated or discharged within thirty days from the date it attaches.

An act of bankruptcy now is committed if a receiver or trustee is appointed while a debtor is insolvent. Formerly such appointment was an act of bankruptcy only if applied for by the debtor or made *because of* insolvency. Debtors desirous of keeping out of the bankruptcy court could have someone else apply, alleging any other ground than insolvency.

The new law makes it more difficult for dishonest bankrupts to obtain discharges. It limits discharges to one in six years, whether voluntary or involuntary. The time limit previously applied only to voluntary proceedings. In cases where the objector shows that there is reason for belief that the bankrupt has committed certain acts which would prevent his discharge, the burden of proving that he has not committed the same now is upon the bankrupt.

The possible term of imprisonment for various offenses against the bankruptcy act,

including concealment of assets, has been increased from two to five years. Several new punishable offenses have been added, such as the destruction or concealment of records, concealment of property by an officer or agent of the bankrupt, concealment of property from a receiver, as well as from a trustee, and withholding of records from a receiver or a trustee. The act further extends from one to three years the time in which prosecution of offenses may be made. Receivers and custodians (as well as trustees, as provided in the former act), are among those punishable for embezzlement from bankrupt estates.

Now it is obligatory for referees to report to United States attorneys all violations of the bankruptcy act that come to their notice.

The amendments to the law curtail the payment of certain taxes from estates, and give priority to the payment of wages over the payment of taxes for the first time in bankruptcy legislation. They make provision for the payment of expenses of those creditors who successfully oppose the confirmation of compositions. They make communications between creditors, and between creditors and referees and trustees, privileged and not subject to action for slander or libel, if made in good faith.

The new law prevents delays in adjudication and in settlement of estates, caused by the offering of settlements in composition. It provides that action upon a petition for adjudication shall not be delayed when an offer of composition is filed, except at the discretion of the court. Under the old law the filing of an offer of composition effected an automatic stay upon the petition for adjudication. The time limit for proving claims has been reduced from one year to six months after adjudication.

In addition to the amendments to the National Bankruptcy Act, seven additional rules and an amendment of one rule have been promulgated by the United States Supreme Court and added to the General Orders in Bankruptcy, which have the full force of law. These changes are designed to correct particular weaknesses in the operation of the bankruptcy act and to expedite procedure under the law.

The American Institute of Accountants, through its Bureau of Public Affairs has prepared a Letter-Bulletin on "Bankruptcy Problems" dealing with the recent changes in the law and the evils which the amendments are designed to correct. Accountants may assist in remedying bankruptcy conditions by presenting information to the business public regarding bankruptcy evils when occasion presents itself, and by making their services available in investigating and administering bankrupt estates.

News Items

Mr. Kracke, who has been engaged in organizing our practice in Germany since the opening of the Berlin office, arrived in New York on July 19, on the S.S. *Leviathan*, for a vacation in this country.

Colonel Carter recently has received the C. P. A. certificate of the State of Michigan, and Mr. Wildman has acquired the Tennessee certificate.

We have pleasure in announcing that Messrs. C. N. Bullock and C. J. Drake have been appointed managers of our Detroit office. Mr. Bullock's appointment is effective as of June 1 and Mr. Drake's as of July 1.

Mr. W. L. Cranford, for a number of years a member of the staff of our New York 39th Street and Buffalo offices, has resigned to become comptroller of the Dunlop Tire & Rubber Corporation of America. We accept Mr. Cranford's resignation with regret, and wish him success in his new position.

Mr. Clifford B. Armstrong, of the Detroit staff, is to be congratulated on his success in passing the June C. P. A. examinations of the State of Michigan.

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