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CONTENTS

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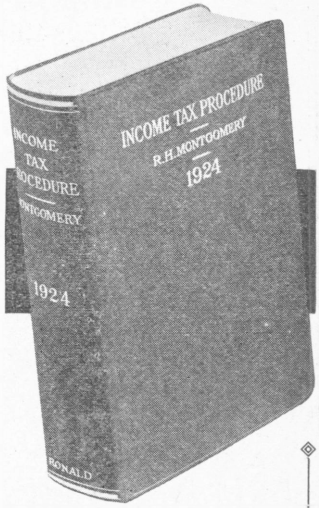

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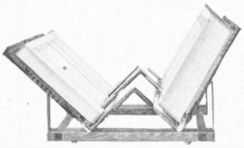

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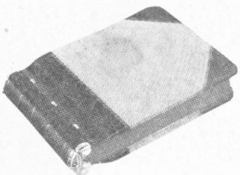

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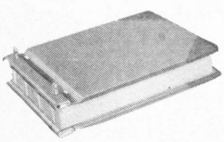

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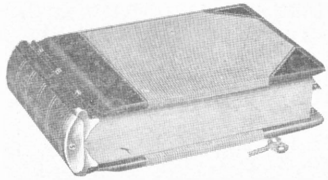

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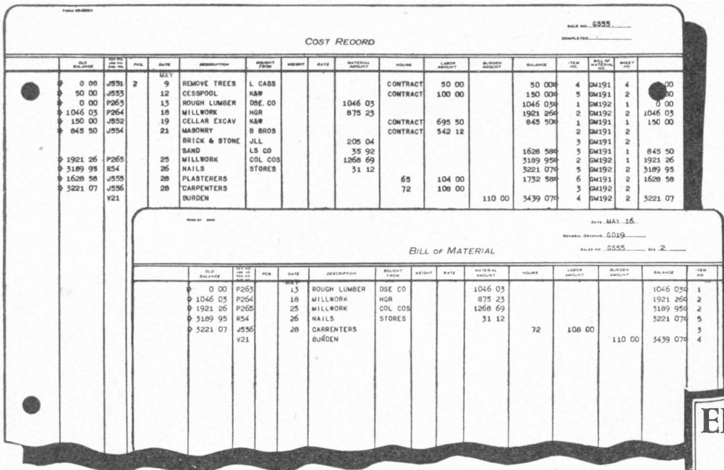

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Old Balance	Key No. Job No.	Pcs.	Date	Description	Bought From	Weight	Rate	Material Amount	Hours	Labor Amount	Burden Amount	Balance	Item No.	Bill of Material No.	Sheet No.	
0 00	J551	2	MAY 9	REMOVE TREES	L CASS				CONTRACT	50 00		50 00	4	GM191	4	00
50 00	J553		12	CESSPOOL	K&W				CONTRACT	100 00		150 00	5	GM191	2	00
0 00	P263		13	ROUGH LUMBER	DSE. CO			1046 03				1046 03	1	GM192	1	0 00
1046 03	P264		18	MILLWORK	HGR			875 23				1921 26	2	GM192	2	1046 03
150 00	J552		19	CELLAR EXCAV	K&W				CONTRACT	695 50		845 50	1	GM191	1	150 00
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				BRICK & STONE	JLL			205 04					3	GM191	2	
				SAND	LS CO			35 92				1628 58	3	GM191	1	845 50
1921 26	P265		25	MILLWORK	COL COS			1268 69				3189 95	2	GM192	1	1921 26
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3221 07	J556		28	CARPENTERS					72	108 00			3	GM192	2	
	V21			BURDEN							110 00	3439 07	4	GM192	2	3221 07

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0 00	P263		MAY 13	ROUGH LUMBER	DSE CO			1046 03				1046 03	1
1046 03	P264		18	MILLWORK	HGR			875 23				1921 26	2
1921 26	P265		25	MILLWORK	COL COS			1268 69				3189 95	2
3189 95	R54		26	NAILS	STORES			31 12				3221 07	5
3221 07	J556		28	CARRENTERS					72	108 00			3
	V21			BURDEN							110 00	3439 07	4

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The JOURNAL *of* ACCOUNTANCY

Official Organ of the AMERICAN INSTITUTE OF ACCOUNTANTS

Vol. 36 DECEMBER, 1923 No. 6

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 15, 1923, 9 A. M. to 12.30 P. M.

The candidate must answer all the following questions.

(10 points each)

No. 1. Define—

(a) a balance-sheet.
(b) a comparative balance-sheet.
(c) a consolidated balance-sheet.
(d) a double-account balance-sheet.
(e) a fund balance-sheet.

No. 2. In a detailed audit how would you verify and value the item "accounts receivable"?

No. 3. Do you consider the periodizing of the outstanding accounts-receivable balances as the best method of determining the adequacy of the reserve for bad debts? Give reasons.

No. 4. Corporation A has taken over the assets and liabilities of corporations B and C. The assets and liabilities have been merged with those of corporation A. In what circumstances may the amount of the goodwill account of corporation A be (a) decreased; (b) increased?

No. 5. You are examining the accounts of a mercantile corporation which has several selling branches but all shipments are made and all customers are billed by the main office. It is not intended that you shall visit the branches. Outline a procedure for the verification of the branch balances.

No. 6. On February 15, 1924, you are called on to audit the books of a concern for the calendar year 1923. State in detail how you will verify as of December 31st the balance-sheet items (a) cash, (b) notes receivable and (c) accounts payable?

No. 7. After all credits, exemptions and deductions A and B have net incomes of $7,500 each. All of A's income is derived from dividends on stocks of domestic corporations; B's from salary and commissions. At what rates will each be assessed under the federal income-tax law of 1921?

No. 8. A died February 14, 1923. What return or returns under the federal income-tax law of 1921 should be made by A's executor, and when?

No. 9. In 1917, A bought 100 shares of stock for $10,000. In 1922 he received an "extra dividend from profits earned prior to 1913" of $2,000. Thereupon (1922) he sold the stock for $6,000. What return of these transactions should he make for 1922?

No. 10. In certifying without qualification to a balance-sheet what responsibilities—financial, legal and moral—to your client and to the public will you consider that you have assumed?

Examination in Accounting Theory and Practice

PART I

NOVEMBER 15, 1923, 1 P. M. to 6 P. M.

The candidate must answer the first three questions and two other questions.

No. 1 (25 points):

The Newton Foundry & Machine Co. has on hand at the beginning of the month $50,000 worth of steel and, in addition, material sufficient to manufacture 100,000 lbs. of castings.

The following is a summary of transactions of the several departments of the business for April:

The foundry department manufactures castings for its own shops and also for customers. One hundred thousand pounds of castings are made during the month at a cost of 10 cents per pound; 50 per cent. of the product goes to the machine shop at 12 cents per pound; 35 per cent. goes direct to customers at 15 cents per pound; 10 per cent. is defective and 5 per cent. remains on hand at the end of the month.

The machine shop withdraws from stores steel to the value of $50,000. Productive labor on the product amounts to 100 per cent. of the cost of the material and the factory overhead to 150 per cent. of the productive labor. The finished product of the department is disposed of at cost plus 10 per cent., as follows: 60 per cent. to the assembling department; 10 per cent. to the shipping department to fill customers' orders; 15 per cent. to the storeroom; 5 per cent. is defective and 10 per cent. remains in process.

The assembling department labor and overhead amounts to 20 per cent. of the cost of the product to this department. Ninety per cent. of the product received is completed and delivered to the shipping department, crated and shipped to customers.

Allowing 5 per cent. of factory cost for shipping department expense, 10 per cent. for selling expense and 10 per cent. for profit, prepare departmental factory accounts and trading account to reflect the foregoing transactions embodying the following:

One whole shipment of merchandise was returned by a customer as not being in accordance with specification and unfit for his purpose. The billing price of this shipment was $10,164; the cost of the assembled product was $8,000.

Give summary of inventories on hand at the close of the period with comments regarding values and submit suggestions for improvement in the methods of accounting.

No. 2 (20 points):

A, B, C and D form a partnership for the purpose of executing certain contracts owned by C. A agrees to allow the partnership the use of a building owned by him, valued at $50,000, for which he is to receive a fair and adequate rental. B agrees to lend securities valued at $50,000, stipulating that he as an individual shall receive the equivalent to the income from said securities. C assigns his contracts to the copartnership, valuing them at $50,000. D agrees to contribute services based upon his knowledge of the processes of manufacture and long experience in the business, which he values at $50,000.

The books of account are opened with the following journal entry:

Buildings	$50,000	
Securities	50,000	
Contracts	50,000	
Manufacturing formulas, etc.	50,000	
To A's capital account		$50,000
B's capital account		50,000
C's capital account		50,000
D's capital account		50,000

No written agreement is drawn but it is understood and mutually agreed that profits shall be divided equally between the four partners.

A manager is appointed with a competent staff, the partners being required to devote little of their time beyond instructing the manager as to their wishes and desires.

After deducting all expenses there remains a net profit, for the period of operation, of $200,000, which is applied as follows:

A's drawing account	$20,000
B's drawing account	20,000
C's drawing account	70,000
D's drawing account	70,000
Undivided	20,000

A and B take exception to the accounts on the ground that C and D are not entitled to withdraw their capital; that they are entitled to one-fourth only of the profits; and that without the use of the property and securities furnished by them (A and B) no profit could have been made.

C and D reply that their contracts and their experience have produced the result and that A and B are getting excellent return for the loan of their properties.

After considerable discussion with no idea of a satisfactory settlement but an express desire to avoid "going to law" it is decided finally to submit the whole matter to arbitration.

You are appointed arbitrator with full powers. Your decision to be final and binding upon all parties.

Present your report and findings, giving reasons for your conclusions.

The opening journal entry must not, of course, be considered as absolute.

No. 3 (10 points):

Are there any circumstances in which depreciation may be charged against an account other than current profit and loss? If so, cite instances, giving reasons.

No. 4 (20 points):

Corporations L, M, N, O and P decide that it is to their mutual advantage to amalgamate.

The following information is on file regarding these corporations:

	Present capital stock and surplus	Average annual net earnings 10-year period	Appraised value, net assets
L	$ 5,250,000	$ 420,000	$ 4,000,000
M	2,500,000	300,000	3,000,000
N	750,000	150,000	1,200,000
O	500,000	110,000	700,000
P	1,000,000	180,000	1,500,000
	$10,000,000	$ 1,160,000	$10,400,000

The directors of the L corporation suggest that the capitalization of the new company be $16,000,000 and that each corporation receive its pro rata share in accordance with the present capitalization, L receiving $8,400,000, M $4,000,000, N $1,200,000, O $800,000 and P $1,600,000.

The plan is favored by all the companies, subject to the approval of their accountants.

On behalf of the M, N, O and P corporations you are asked to criticize the plan and report, submitting an alternate plan if you consider that proposed not equitable to any or all of the companies which you are representing.

No. 5 (25 points):

The following is a statement of the X Y Z Company, July 1, 1923:

ASSETS

Cash in banks and on hand	$ 55,000
Customers' accounts (good)	65,000
Merchandise inventory	80,000
Real estate and building	200,000
Operating equipment	20,000
	$420,000

LIABILITIES

Bills payable	$ 35,000
Accounts payable	45,000
Encumbrance on real estate and building	50,000
Reserve for building depreciation	20,000
Capital stock preferred	10,000
Capital stock common	20,000
Earned surplus	240,000
	$420,000

Jones and Smith each own $10,000 par value of the common stock. They have had a serious dispute with regard to business policy and Smith desires to withdraw from the corporation. As the corporation is a "close" one and Jones is unable to purchase Smith's stock, they consult and request that you outline a plan enabling Smith to retire and not to impair the general credit of the corporation.

Submit your plan and prepare journal entries for putting into effect, on the records of the company, the result of your suggestions.

Prepare a statement of the X Y Z Company after Smith has retired from the business on the basis suggested by you.

ACTUARIAL (OPTIONAL)

No. 6 (25 points):

The annual sinking fund has been fixed at $83,290.94 to redeem a bond issue of $1,000,000 at the end of 10 years. It is argued against this plan that the payments should be $100,000 per annum. Demonstrate which of these two amounts is the correct one, assuming the fund to be invested meantime at 4 per cent. interest, compounded annually. Show also the amount of the saving effected by the smaller sinking fund, discounted to maturity, and the amount to be returned to the borrower at the end of the period if the larger sinking fund ($100,000) were adopted.

[$1.04^{10} = 1{,}480{,}244$.]

Examination in Commercial Law

NOVEMBER 16, 1923, 9 A. M. to 12.30 P. M.

Give reasons for all answers.

(The possible credit for each question is 10 points)

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

No. 1. B signed a promissory note in blank, leaving it on his desk. During B's absence from his desk A took the note, filled it in for two hundred dollars and sold it for value to C, who knew nothing about the method by which A came into possession of the note. Could C recover on the note from B?

No. 2. Y gave X a cheque for fifteen hundred dollars in payment of a debt. The cheque was drawn on the Union Trust Company. X had the cheque certified by the Union Trust Company. On the following day, when X was about to deposit the cheque in his own bank, X learned that the Union Trust Company had failed at the opening of business that morning. X then claimed that Y must make good for the cheque. Was X correct in his contention?

No. 3. Define (a) an inland bill of exchange; (b) a foreign bill of exchange. In what circumstances does the determination as to whether a bill of exchange is inland or foreign become a vital point?

No. 4. Name three kinds of indorsement, give an example of each and explain the effect of each.

CONTRACTS

Answer two of the following three questions:

No. 5. Chandler, owner of a chain of grocery stores in Cleveland, Ohio, sold his entire business to Davison. The contract of sale contained an agreement by Chandler not to engage in the grocery business for a period of ten years. Could Davison enforce the agreement mentioned? What would have been the effect if Chandler had agreed not to engage in the grocery business in Cleveland, Ohio, and vicinity for a period of ten years?

No. 6. Under the statute of frauds, what contracts must be in writing?

No. 7. What is specific performance and when may it be granted?

PARTNERSHIP

Answer one of the following two questions.

No. 8. A and B were copartners. They dissolved the partnership, A retiring from the business and B continuing it. After the dissolution B continued to use the same offices, on the door of which A's name remained, and also continued to use the firm's stationery, of all of which A had knowledge. Many concerns not knowing of the dissolution sold goods, as they supposed, to the firm. Upon the insolvency of B they sought to hold A liable. Could they?

No. 9. Weeks and Matthews formed a copartnership for a five-year term. Soon after they began business, Matthews found that Weeks was engaging in wild speculations, was almost continually in a drunken state and was generally so conducting himself as to cause the firm to lose its good name and reputation. Had Matthews any remedy?

CORPORATION

Answer the following two questions:

No. 10. State generally the principal rights of a stockholder.

No. 11. A and B, upon the formation of a corporation, agreed to take certain shares of the corporation's stock. They paid one-fourth of the purchase price, that is, one-fourth of the par value of the stock which it was agreed should be purchased, but failed to make any further payments. The corporation, after conducting business for a time, became insolvent, and the creditors, finding that the corporation had no assets, sued A and B for the balance of the purchase price of the stock which they agreed to purchase. Did the creditors recover?

BANKRUPTCY

Answer the following question:

No. 12. What are the principal duties of a bankrupt under the bankruptcy law?

INCOME TAX

Answer the following question:

No. 13. What credits are allowed a domestic corporation against the corporation's net income before computation of the income tax?

Examination in Accounting Theory and Practice

PART II.

NOVEMBER 16, 1923, 1 P. M. to 6 P. M.

The candidate must answer all the following questions.

No. 1 (27 points):

You are instructed to prepare, for a meeting of creditors, a statement of the debts, liabilities and assets, as at July 31, 1923, of Joseph Herman—trading as the Globe Manufacturing Co.—against whom a petition in bankruptcy was presented by creditors on August 1, 1923.

The statement should show the amounts available for payment of each class of creditors.

The following data have been obtained, partly from the books and partly from information supplied by Herman, the estimates of values being as stated by the debtor.

ASSETS

Works, buildings and land, mortgaged, cost $25,000, estimated value $15,000. Unimproved land, mortgaged, cost $25,000, estimated value $27,500. Dwelling-house, cost $12,000, estimated value $14,000; first mortgage $6,000, interest accrued $150; second mortgage $4,500, at 6 per cent., granted to his wife May 1, 1923, as security for loans of $3,000 on March 1, 1923, and $1,500 on May 1, 1923.

Household furniture, claimed by wife, cost $3,000, estimated value $1,500; auto delivery truck, cost $1,200, estimated value $1,000; passenger car, cost $650, estimated value $350; stock in trade on hand, cost $85,000, estimated value $60,000; stock in trade at agents' for sale, cost $10,000, estimated value $7,500 less advances by agents of $6,000.

Cash on hand and at banks $1,250.

Protested bills and promissory notes on hand $2,500, estimated to realize $750; trade-marks and patents, book value $10,000, estimated to realize $1,000; office furniture and fittings, cost $2,200, estimated value $600; preferred stock of the Enjee tin mines, 60 shares of $100 each full paid, subject to recent assessment of $20 a share under reorganization scheme, estimated value nil; life insurance policy $5,000, surrender value $600 less advance by insurance company $500, assigned to wife March 1, 1923, on condition of her paying future premiums and premium and interest then due amounting to $125.

Disputed claim against Roberts & Co. for breach of contract to purchase goods $3,000, value nil.

Machinery and tools, cost $22,500, estimated value $15,000. Machines bought on hire-purchase system, price $6,000, estimated present value $5,000, payments already made $2,500, estimated equity $1,250.

Accounts receivable—good $18,000; doubtful $7,000, and bad $5,000, estimated to realize $22,000.

Personal property exempt by law, estimated value $200.

J. Herman receives $1,000 per annum from his mother, his father's will having provided a trust fund for three children, and the mother having the right to distribute the income at her discretion and to nominate, by her will, the children who are to receive the principal at her death.

LIABILITIES

Accommodation paper, jointly with Alfred Brown, now bankrupt, $20,000, due August 15, 1923; this bill was discounted and each of the two parties received one half of the proceeds.

Creditors for raw materials of manufacture supplied to debtor (preferential claims under the laws of the state), $15,000; other trade creditors, unsecured, $110,000; notes payable $15,000; notes receivable discounted $6,500, estimated liability $1,500; judgment creditors' claims and costs $970; loan creditor for $21,700 at 6 per cent. interest, partly secured by second mortgage on works for $10,000; interest accrued on $11,700, $410; interest accrued on mortgage of $10,000, $350; loan from wife made July 1, 1923, unsecured, $1,500.

First mortgage on works at 6 per cent., $10,000; interest due June 30, 1923, still unpaid, $350; purchase-money mortgage on unimproved land at 5 per cent., $15,000; interest unpaid since March 31, 1923.

Wages and salaries due—to twenty workmen, one week's wages, $750; to two salesmen, salaries and commissions for July, 1923, $310 and $240; to works manager, salary for July, $400.

Taxes and licences due—federal, $300; state, $1,250; municipal taxes on dwelling-house, $250.

An assessment of $2,200 on the unimproved land, for local improvements, was made three years ago; this was arranged to be paid by ten yearly instalments with interest at 7 per cent.; the interest has been paid to July 31, 1922, and $660 has been paid on account of the principal.

Estimated capital of Joseph Herman, $21,530.

No. 2 (15 points):

A client contemplates investing capital, as a special partner, in a trading business which proposes to manufacture its own products in the future instead of having them made by other concerns.

The business appears to be a profitable one and is not subject to changes of fashion.

Your client has been offered one-third of the net profits on condition that he invest $200,000 as capital and an additional $100,000 as a loan with interest at 6 per cent. per annum. These funds are at present invested to yield an average income of 5 per cent. per annum.

Each of the two working partners has $100,000 capital in the business and during the last five years each has received a salary of $5,000 and a further average profit of 10 per cent. It is proposed to continue the salaries of the two working partners and to charge these and the interest on the $100,000 loan as expense before dividing the profits.

Assuming that the additional funds would earn, at least, the former average profit, show the probable income to your client from the investment.

What advice would you give him for the protection of his interests?

No. 3 (12 points):

How would you deal with the following premium or discounts, in the first and subsequent years:

(a) An issue of preferred shares at a premium;

(b) An issue of bonds at a discount redeemable at par;

(c) An issue of bonds at a discount redeemable at a premium at a fixed date or by purchase in the open market prior to that date. If there were a saving by purchasing in the open market, how should this be treated?

(d) State your opinion as to the correctness of crediting to surplus account a premium on the issue of stock. If so credited, is the premium legally available for distribution as dividend?

No. 4 (38 points):

The Benson Company was incorporated June 1, 1922, for the purpose of building and selling dwelling-houses.

The authorized capital was as follows:

Preferred, cumulative, 7% stock;	1,500 shares of $100 each.....	$150,000
Common stock;	1,500 shares of $ 5 each.....	7,500
		$157,000

At a meeting, after incorporation, the board of directors accepted an offer by the president, in consideration of the issuance to him of $7,500 common stock, to transfer to the company all his rights in a three years' option to purchase 150 lots of unimproved land of the Graham estate at $400 a lot.

On July 1, 1922, the company bought a block of land—120 lots, each 20 by 100 feet—from the Walker estate at $1,000 a lot, the vendor agreeing to do the grading and sewering, make roads and pave sidewalks. A subsequent agreement provided, however, that in consideration of the Benson Co's undertaking this work and assuming liability for a general sewer assessment of $4,800, the vendor should allow the sum of $42,000 from the $120,000 purchase price.

On September 1, 1922, a contract was made with the Eastern Construction Co. for the building of group 1, comprising two detached houses at an estimated cost of $15,000 each and ten semi-detached houses at $12,000 — total $150,000 — all on the Walker estate.

The construction company (hereafter known as the contractor) was to receive a fixed fee of $10,000 for superintendence and management and to charge only the net cost of the labor, material and direct expense of the work, whether done by its own men or by those of sub-contractors. Payments were to be made through the contractor on monthly requisitions.

In consideration of a guarantee to bear any excess of total direct building cost over $172,000 (including the $10,000 fee, but excluding extras) the contractor was to receive 40 per cent. of any saving between the original estimate of $160,000 and the guaranteed maximum cost of $172,000.

Extras were to be charged at cost plus a varying percentage for superintendence.

Building operations—group 1—began October 1, 1922, and were completed March 31, 1923.

A contract was made by the Benson Co. direct with the Valgimigli Co., March 1, 1923, for the excavation work and concrete foundations of two additional groups of houses on the Walker estate land as follows:

Group 2: for 10 semi-detached houses, contract price..	$8,500
Group 3: for a terrace of 12 houses, contract price ...	6,800

Changes were made subsequently which increased these costs.

The total land of the Walker estate used for building operations was 45 lots as shown below:

Group 1: Riley avenue.	
For each of 2 detached houses	45 ft. frontage
For each of 10 semi-detached houses	31 ft. frontage
Group 2: Riley avenue.	
For each of 10 semi-detached houses	30 ft. frontage
Group 3: Neild avenue.	
For the terrace of 12 houses	200 ft. frontage in all

The land was to be charged against completed houses at the rate of $1,000 a lot of 20 feet frontage.

Some of the houses were sold for cash outright; others with first and second mortgages. Two were sold direct; the rest through agents. The first mortgages were transferred from the building mortgages to the purchasers of the houses; the second mortgages were first taken by the Benson Co., which afterwards sold them at a discount.

The following is a list of balances on the books of the Benson Co. at May 31, 1923:

	Dr.	Cr.
Land purchase, Walker estate, 120 lots	$120,000	
Reserve for development of above land		$ 42,000
Surveys of Walker land	650	
Removal and storage, 600 loads of top-soil	1,500	
Option on 150 lots, unimproved land, Graham estate	7,500	
Sales from sand-pit, Walker land		1,200
Sales of top-soil, 90 loads		450
Field office, cost of building	1,650	
Assessment on 120 lots, Walker land, for district sewer	4,800	
Organization expense, legal and other charges	1,620	
Retaining fee to lawyer, one year to May 31, 1923	1,000	
Legal charges for mortgages and sales of houses	450	
Real-estate taxes on 120 lots, Walker land, to May 31, 1923	2,400	
Outstanding first mortgages on houses unsold, 1 detached, $9,000; 1 semi-detached, $7,000		16,000
Commissions, etc., on building loans	4,800	
Interest, etc., on building loans	750	
General expense, June 1 to November 30, 1922	8,200	
General expense, December 1 to May 31, 1923	5,500	
Capital stock issued, preferred, 7% cumulative		125,000
Capital stock issued, common		7,500
Group 1—		
Paid to contractor, on requisitions	156,600	
Paid to contractor, fixed fee	10,000	
Paid to contractor, for extras and other fees	24,310	
(Apportion the above three items, 10% on each detached and 8% on each semi-detached house)		
Balance due to contractor for group 1		1,910
Transfer of labor and material to group 2		175
Transfer of labor and material to group 3		125
Inspection fees for houses	250	
Gifts and bonuses for houses	150	

	Dr.	Cr.
Compensation paid for cancellation of order for mill work because of changes in plans	1,500	
Hire-purchase instalments, saw-mill	150	
Fire insurance on 12 houses	90	
Coal for heating houses during construction	320	
Planting gardens and making lawns, 12 houses (Apportion according to feet frontage)	2,000	
Sales of houses—		
1 detached		28,500
9 semi-detached		191,650
Loss on sales of second mortgages—		
1 detached house	2,100	
6 semi-detached houses	10,375	
Commissions on sales of houses—		
1 detached	662	
6 semi-detached	3,200	
Grading (one-half each, groups 1 and 2)	4,500	
Sewering (one-half each, groups 1 and 2)	2,500	
Development, 75 unimproved lots, Walker land	13,400	
Architect's fees for plans, specifications and supervision—		
Group 1	4,000	
Group 2	620	
Group 3	600	
Balance due to architect		1,220
Work billed and paid, group 2	9,500	
Work billed and paid, group 3	7,200	
Valgimigli company, 10% retained		1,670
Group 2, transfer from group 1	175	
Group 3, transfer from group 1	125	
Hire-purchase payments, concrete-mixer (Used equally in groups 1, 2 and 3)	420	
Office furniture and fixtures	800	
Petty-cash balance	250	
Fire insurance, field office	15	
Notes payable		10,000
First National Bank	15,768	

From the foregoing, prepare:

(a) Statement showing the profit or loss on the operations for the period to May 31, 1923, with the average cost and gross profits on the detached and semi-detached houses sold.

(b) Balance-sheet as at June 1 (May 31), 1923, after making such adjustments, provisions for reserves, etc., as you think necessary from the details presented and from the following audit notes:

One detached and one semi-detached house of group 1 remained unsold May 31, 1923.

Plant, material and loose tools remaining on hand from group 1 operations were valued at $2,250. The original cost, $3,500, had been charged to material of group 1.

The field office was estimated to have a scrap value of $150 after three years' use.

The contractor for group 1 is to be charged $250 for use of the field office.

Of top-soil stored 510 loads were on hand May 31, 1923.

On first mortgages of $16,000 on houses unsold interest at the rate of 6 per cent. per annum had been paid to March 31, 1923.

Fifty per cent. of amount paid for hire-purchases instalments is to be written off for wear and tear.

The by-laws of the company provide for salaries as follows: The president is to receive 10 per cent. of the net profits for management; a further 10 per cent. is to be divided amongst five other directors.

No. 5 (8 points):

The vendor of a business to a corporation has taken part of the purchase price in preferred and common stock.

On account of a decline of the annual profits, the vendor makes a gift to the corporation of $100,000 preferred stock, to be sold for the benefit of the corporation.

How should this be treated on the books of the corporation? May the $100,000 be used for payment of dividends?

Some Professional Obligations

By J. Harry Covington
Former Chief Justice of the Supreme Court of the District of Columbia

I should like you to bear with me while I speak seriously for a little while. The times merit serious discussion among those people in our country whose businesses or professions are such that the intricate social and economic problems which now exist constantly confront them. It is such people who must appreciate the obligations that rest upon them and by thought and common counsel contribute toward a right solution of those problems.

There is not any question about the fact that the end of the war established a new era in the world. The outlook upon life of all classes has undergone a radical change. The battle cry of destruction to imperialism in Germany and the slogan "to make the world safe for democracy" were bound to quicken the hopes and stimulate the ambitions of countless millions in all civilized countries. And we have begun in this country generally to understand that a more socially humane democracy—and by that term I mean a better organization of society under free representative government—must rest upon a closer relationship between all classes of people. We have come to know that it is not the opulence of its palaces but the comforts of its homes that constitutes the greatness of a nation.

At the same time none of us in his right senses has become anything less than an individualist. No one who is thoughtful on the subject of what is best for a free people has abandoned the notion that the individualistic scheme of life is the only one that has made for progress in civilization from the beginning of the world down to the present time. We recognize that the ample reward for unusual genius and for extraordinary energy, possible only where there is freedom of contact and opportunity alike, constitutes the goal for that honest ambition which stimulates an aggregate citizenship so to build as to assure the permanence and progress of our Christian civilization.

With the rapid increase of our population, the constant advance of science, and the ever widening extent of our industrial organization, government becomes more and more complicated. To

*From an address delivered at the annual banquet of the American Institute of Accountants, September 19, 1923.

preserve individual liberty, and at the same time fix our standards of government so that our great masses shall be prosperous and happy, is a task of the first magnitude. The proper social and industrial relations between all our people must be comprehended in order to be dealt with intelligently. Here is the peculiar duty of the professional man, particularly the lawyer and the accountant. Broader training, and the habit of impartial judgment give him the opportunity and place upon him the obligation to point the way to sane and humane policies in the relations of business and government for the ultimate good of our country.

This is particularly true of you in the American Institute of Accountants. You come in intimate contact with the industries of the country; you earn your livelihood as the result of developing, with the complex accounting systems that are a necessity today, the standards of industry. You are professional men weighing your problems with scrupulous nicety, coming in contact with people in all employment grades of the great industries during the course of your services to them. With your keen training you see and understand that great reward for unusual ability, in a land of true opportunity, must accompany or be associated with prosperous and contented masses if there is to be that peace and contentment in the national life which is the best embodiment of self-government.

You are of the highly educated and finely trained men of the country, and you are in consequence among those who constitute her hope. While recognizing the necessity of capital and the individual chance to stand out among men through individual effort you know that the advance of civilization from the despotism which has been lately destroyed must be through the progress of the ordinary man. Our citizenship in the aggregate must be satisfied if there is to be happy augury for our future.

A great statesman said many years ago, and it is a thing that, as Americans, we can all keep in our minds and hearts, that:

> "Our country's greatness consists, not in the wealth of its inhabitants, not in the extent of its dominion, but in the fitness of its people to maintain justice, liberty and conscientious manhood through the agency of self-government."

As you are of America's cultivated and highly trained men, understanding her social and economic problems, you have a duty together with the engineers, the lawyers, the doctors and the professors, to carry the tidings of understanding to all the people. Yours must be the duty of preaching the doctrine of individualism in its most humane sense, including the basic principle that peace and not strife must exist among all our people, and that this can be when our government rests upon a great moral foundation and is guided by truly conscientious manhood.

Now, speaking to you more intimately about your own comparatively new profession, may I say that you must realize precisely what the legal profession has had long ago to understand and adhere to—that because it is a profession and occupies a definite relation and responsibility to the public its members must accept and conform to a strict code of ethics. Your responsibility is unquestionably to require the maintenance of moral standards in the professional conduct of your members. You are finely equipped public servants, and the most intricate businesses in the country must be trusted by the public in the final analysis, largely by your word concerning them. As with the lawyer you have a great professional duty to see that the opulent do not become so through fraud upon the humble. If your ethical standards are of the highest your profession is indeed one of great power for good in our country.

You of the American Institute of Accountants have a peculiar responsibility. Your membership requirements are of the strictest sort, and you cannot hope to enroll every accountant into the ranks of the Institute. However, the American Bar Association contains but a relatively small number of the lawyers of the country; the American Medical Society contains but a small fraction of the doctors of the country; but those organizations do contain those men in their respective professions who understand the depth of professional responsibility and who realize that in the outward manifestation of that professional responsibility is the only salvation for the profession to which they belong. Lawyers and doctors and accountants will, after all, be judged by the best among them. This world is not a hypocritical world; there is more good than bad. The idea that the measure is always taken of a man or a group of men from the worst among them is not true. It is a wholesome truth that men and women look up to the best. As organized society comes in contact professionally with lawyers or with doctors or with accountants

—I am speaking now peculiarly to you as accountants—it will take its measure of you as professional men by the standards that the best of you set. It therefore behooves you as a young profession, graduated from the field of business up to the higher place of professional understanding, to try always to have the finest professional standards, with the consciousness in your mind that you are thereby not merely advancing the cause of your profession, not merely creating for it a more profound respect among all classes of people, but that you are making your contribution, and a very real contribution, toward the solution of the ever-pressing social problems that are upon us by the broad example of fine ethical practices which habitually guide you.

As a parting word let me say to you that we in America have our social and industrial problems in serious form, just as they are having them in Europe. While not so acute, their right solution means nearly as much for our future as does the right solution of the immediately menacing problems abroad mean for a broken down Europe. These problems will be solved only when they are settled rightly, and they will be settled rightly and in keeping with a liberal and Christian civilization only when the educated men and women of our country firmly resolve to do their part in promoting the common cause of our people. If there is an ethical, yea religious purpose among us to make the humblest realize that happiness for all and injury to none is the purpose of our great experiment in representative self-government we shall go on in the vanguard of the world people in prosperity and happiness. As men of a profession peculiarly equipped to understand business in its relation to government and men, your duty is clear.

Accounting for Photographers

By R. F. Hampson

The majority of individuals and firms engaged in the photographic business operate portrait studios as their principal activity. Commercial and news photography, if handled at all, is generally the work of a separate and smaller department. The principal technical operations in a portrait studio may be stated briefly as follows:

Exposure of plates or films in operating room; development in dark room of the exposed plates or films; retouching the negatives; printing proofs on sensitized paper (day-light or arc-light method); additional retouching of negatives selected for order; printing and developing finished prints. Further technical detail, involving applications of the laws of optics and chemistry, will be omitted as this paper is intended to treat primarily of the work of the accounting department.

In those photographic businesses, where the annual volume of sales is not less than $25,000.00 nor more than $300,000.00, the following list of books and blanks to be used by the accounting department in recording the various transactions should prove adequate:

General ledger
Sales ledgers
  (departmentalized, if necessary)
Sales journal
Sales returns and allowances journal
Voucher register
Cash-receipts book
Cash-disbursements book
Cheque book
Petty-cash vouchers
General journal
Journal vouchers
Payroll record

A satisfactory classification of general ledger accounts, arranged in the order of their appearance on the monthly or annual statements, is shown below:

ASSETS (WITH VALUATION ACCOUNTS) AND DEFERRED CHARGES

Current:

Cash in bank
Petty-cash fund
Notes receivable
Accounts receivable
Reserve for doubtful accounts
Chemicals
Frames
Mounts
Paper
Plates

The total of the above group is the amount of the "merchandise" item on the balance-sheet.

Fixed:

Land
Building
Depreciation reserve for building
Furniture and fixtures
Depreciation reserve for furniture and fixtures
Cameras
Depreciation reserve for cameras
Lenses
Depreciation reserve for lenses

Deferred charges:

Insurance unexpired
Stationery on hand
Salaries prepaid

Current liabilities:

Accounts payable
Notes payable
Salaries accrued
Reserve for taxes

CAPITAL

If a corporation:

Capital stock, preferred
Capital stock, common
Surplus

If a partnership:

William Smith, capital
Henry Jones, capital

If a sole proprietorship:

John Doe, capital

INCOME AND EXPENSE ACCOUNTS
(departmentalized, if necessary)
LIABILITIES AND CAPITAL

Gross sales
Sales returns and allowances
Discount on purchases
Cost of sales
Advertising
Bad debts
Depreciation
Heat and light
Insurance
Interest
Postage
Salaries
Stationery and printing
Sundry expenses
Taxes
Telephone and telegraph
Profit-and-loss

With the intention of grouping relevant transactions and records under logical captions, they have been arranged under seven principal headings, as follows:

1. Purchases
2. Sales
3. Cash records
4. Payroll system
5. Provision for depreciation
6. Inventories and stock control
7. Insurance

Ordinarily, the transactions of a photographic business do not require anything in the way of accounting treatment different from that which is usual to the average medium-sized business. There are, however, a few exceptions to this statement and these are taken up under their appropriate captions below.

Purchases:

After approval of requisition from any department in need of materials or supplies a formal order should be made up in the office of the purchasing agent. This order should be prepared in triplicate, the original going to the firm from which the goods are ordered, the duplicate to the accounting department, and the triplicate should be retained for the files of the purchasing agent.

When the material is received it should be unpacked and carefully checked, the count of the contents being made by a receiving clerk who does not know the quantity called for by the order. It is believed that this method of checking is very effective in the detection of shortages, as it is necessary that the receiving clerk actually count the contents of every case received. The expiration dates of all sensitized materials, i. e., films, paper or plates, should be noted at this time and any expired goods should be promptly returned to the vendor. A chronological record should be kept of all incoming shipments, showing in separate columns the date received, name and address of shipper, detailed description of articles received, amount of freight or express paid on the shipment and any special remarks. After the checking is completed, the merchandise should be placed in the stock-room and withdrawn only on requisitions approved by some authorized employee.

The date of receipt and quantities should be entered in spaces provided therefor on the accounting department's copy of the purchase order.

The invoice, when received, should be verified by the accounting department as to quantity, price and extensions and, if found correct, approved and filed alphabetically until date of payment.

A card record of all purchases should be maintained, showing, as to each purchase, the name of the article, name and address of dealer, price per unit, discount from list price and date of purchase, these cards being filed alphabetically under the name of the articles purchased.

Sales:

Ordinarily, many orders are given orally by customers in the reception room but probably an equal or greater number is received through the mail. In either case, the order should be entered on a ticket-register machine, which furnishes three numbered copies, preferably of different colors. One copy should be attached to the proofs selected by the customer for the finished order; another copy should be temporarily filed and used in making up a daily sales report; and the third copy should be used by the accounting department as the basis of an entry in the sales journal.

The order should be made up from the data shown on the copy which is sent to the retouching department, where the negatives covering the selected proofs are withdrawn from the files for finished retouching. When the retouching has been completed, the negatives are sent to the printing department for printing and developing. The negative is then filed and the prints, when thoroughly dried, are sent to the finishing section where the backgrounds are spotted in and the necessary folders supplied. The finished order then goes to the reception-room bookkeeper, who should make out an invoice from the customer's account card, checking it against the number of photographs received from the finishing section.

If any photographs or frames are submitted on approval, they should not be entered on the books until accepted or until a reasonable time for examination by a prospective customer has elapsed. If the goods are accepted the transaction can be entered as an ordinary sale, the sales journal showing instead of a regular order number the number of the blank used when forwarding the photographs on approval. All photographs or frames out on approval should be followed by letters requesting prompt acceptance or return of the goods.

At the end of each fiscal period there should be set aside as a reserve for doubtful accounts a certain amount, e. g., one per cent. of the gross sales made during that period. A good credit manager may be able to keep this rate down to one-half of one per cent.; if it exceeds two per cent. it is usually indicative of poor credit management. Trial balances should be submitted monthly, showing the customers' accounts which are 30 days old, over 60 days old and over 90 days old.

Cash Records:

With very few exceptions, payments from customers are received personally in the reception room or through the mail. If received in the reception room, the amounts collected should be turned in once or twice daily to the cashier, who should make out a ticket in triplicate for the amount received from each customer, one copy of this ticket being given to the reception clerk as her receipt for the money, another placed on the permanent numerical file of such tickets, and the third used as the specific item for which an entry must be made in the cash-receipts book in much the same way that each cheque stub furnishes the basis for an entry in the cash-disbursements book. Remittances received through the mail would be treated substantially the same as when received in the reception room. All cash receipts should be deposited daily and, of course, the total of each group of daily entries must agree with the amount of the deposit for that date.

All cash disbursements, petty-cash items excepted, should be made by cheque. If the business is incorporated, all cheques should be signed and countersigned by two responsible, bonded executives. If it is a partnership, this function should be exercised by two of the active partners, where this is possible, and, in the case of a sole proprietorship, the signature of the owner will usually suffice. A record of the daily deposits can be kept on the cheque book stubs and this total less the accumulated total of cheques drawn gives the bank balance each day. In addition to this record, a daily report, showing bank balance at close of previous day, deposit (analyzed as to sources of receipts), disbursements (classified as to nature of payments) and bank balance at close of day, will prove very useful to the management. As soon as practicable after the close of each month, the balance shown by the pass book should be reconciled with the balance of the "cash in bank" account and a record should be kept of all outstanding cheques.

The petty-cash fund, the amount of which will depend on the needs of each business, should be treated as follows:

Each disbursement should be recorded on a small, printed and numbered ticket to which can be attached, when practicable, any supporting papers, such as express receipts, receipts from newspaper agents, cash-register receipts for small purchases, etc. When the fund is about three-fourths expended a cheque, payable to the cashier, should be drawn for the total of all tickets on hand, thereby bringing the fund up to its maximum amount. Such a cheque should be drawn on the last day of a fiscal period, regardless of the condition of the fund, in order that the amount shown on the balance-sheet may be entirely represented by cash, and all the expense items should be charged to the proper period.

Payroll System:

Any one of numerous payroll forms probably will prove satisfactory for the average photographic business, but one which permits on the same sheet an analysis of the total wages and salaries according to liability-insurance classifications will be found advantageous, when the insurance company's auditor makes his periodical visits for the purpose of determining the exact premium earned.

To minimize errors, the payroll should be prepared one day before distribution of the envelopes, where this is practicable. No changes on the payroll, i. e., additions, removals, increases or decreases, should be made except upon written instructions of the proper executive. One cheque for the total amount necessary to fill the envelopes should be drawn in favor of the cashier. An analysis of the items should be made, in order to determine the proper number of bills and coins of each denomination and this analysis given to the bank, on its blank, at the time of cashing the payroll cheque.

A receipt for his pay should be signed by each employee, and the payrolls, with these receipts attached, should be filed chronologically.

When closing the books at the end of a fiscal period accrued or prepaid salaries should be taken into account. Any unclaimed pay can be deposited in bank but liability therefor should be shown for a reasonable length of time.

Provision for Depreciation:

Depreciation should be provided for by charging off at the close of each fiscal period an estimated amount covering the physical depreciation for that period. No account is ordinarily taken of obsolescence. On furniture and fixtures, for example, if the estimated life is ten years, the full cost should be depreciated on a straight-line basis over that period, no account being taken in most cases of any possible residual value. The expense element can be brought on the books by inclusion with all of the other similar charges to one account for "depreciation," but the credit, in each case, should be to a reserve for depreciation which becomes a valuation account for its particular asset. This reserve for depreciation or valuation account should be shown on the balance-sheet as a deduction from the book value of the asset, the asset account not being changed during its life except when increased by purchases of new furniture or fixtures. In this way, the balance-sheets will exhibit the original cost, the amount of depreciation charged off and the estimated value at the close of each fiscal period.

Inventories and Stock Control:

A physical inventory of the merchandise should be taken monthly. Only that part of the merchandise which is in the stock-room should be included in the inventory, as the unused portions of packages in the hands of laboratory employees occasionally become light-struck or otherwise spoiled and their value would be doubtful. It is also important to exclude from the inventory all sensitized paper, plates or films whose expiration date is not beyond the inventory date. Depreciation of the stock may also have to be provided for if the proper temperature is not maintained in the stock-room, as the photographic paper, for example, is quickly affected by excessive heat.

The basis of valuation for the merchandise inventory should be cost or market, whichever is lower.

A graphic perpetual inventory, maintained in the office of the purchasing agent, showing as to each item of the stock, quantity on hand, quantity ordered and minimum quantity, will be found very helpful if the stock is large or varied. By means of colored map tacks, the falling of any item to its minimum can be automatically determined and the replenishment of the stock greatly facilitated. The positions of the tacks should be adjusted daily, the necessary information being obtained from the receiving records and the stock-room requisitions.

Insurance:

The following forms of insurance should be carried by every photographic business:

(a) Fire insurance on building (if owned)
(b) Fire insurance on fixtures
(c) Fire insurance on merchandise
(d) Liability insurance on automobiles (if owned)
(e) Fire, theft and damage insurance on automobiles (if owned)
(f) Employers' liability insurance, covering accidents to employees
(g) Owners, landlords and tenants' liability insurance
(h) Public liability insurance
(i) Use and occupancy insurance

When a policy is taken out, the total amount of the premium should be charged to "insurance unexpired" and this account should be credited at the end of each fiscal period with the total of the insurance-expense charges of the several policies. If the business is departmentalized, the expense of each form of insurance should be allocated to the several departments on as equitable a basis as can be devised, the total of the items thus obtained determining the total periodic charge to each department.

The amount of insurance carried in the balance-sheet as a deferred charge should represent the full amount unexpired at that date as it is not considered desirable to use the short-rate surrender value in the accounts of a going concern.

Individual surety bonds should be required of all employees handling money or in charge of valuable supplies, the premium on these bonds being paid by the employer.

In concluding this paper, the writer wishes to invite attention to the very valuable statistical information which may be obtained from records kept in accordance with the above outline. Unit costs, the percentage relations of the various expenses to net sales and the comparison of these with previous fiscal periods permit what is otherwise impossible, namely, the substitution of trustworthy conclusions for deceptive opinions.

The Practical Application of the Theory of Accounting for Supplies

By Percy W. Pogson

He would be a hardy adventurer who attempted to add to the already complete writings on the theory of accounting for what are known in manufacture as supplies or stores, and I hasten to disclaim any such intention.

I would like, however, to discuss the practical application and use of that theoretical knowledge for, to my mind, the question of the proper handling of supplies is one of the important issues before the practising accountant of today. He often finds a perplexing indifference on the part of company officials in this particular which, it is my impression, arises and exists through the tendency to consider supplies once purchased as material objects which have lost their money identity and, until issued for use in manufacture, having no further direct connection with the financial or accounting system. Here is lack of coördination in accounting. If there is to be genuine coöperation between the supply department and the general accounting office those concerned must at all times regard the item of supplies as something representing actual value, and everyone, from the chief clerk in the general office to the warehouse force and supply department manager, must think in terms of money value—not material things. Every amount charged to the supply department should be accounted for, not approximately, but accurately and to the last cent, so that the stock of supplies in the warehouses expressed in terms of money value at all times equals the exact amount shown by the controlling supply accounts in the general books.

This is not impossible, and in fact it is not even difficult . The plan today is working successfully to my own knowledge. The reason exact balancing of perpetual inventories is usually considered difficult or next to impossible is that it has seldom been done in the past.

What is the usual practice? Generally, to take physical inventories once or twice each year, whether or not cards and so-called perpetual inventories have been kept; to list the various articles on sheets; to price, extend, foot, check and re-check; to arrive at a total and finally to make an adjusting entry, arbitrarily changing the controlling accounts to equal the totals shown by the physical inventories.

Can such physical inventories be correct? Almost without exception, no. To take a physical inventory of any magnitude by count, weight or measurement, and to price and extend it and have it correct would be a fortuity. The time consumed in taking a large supply inventory will run into weeks or even months. The stock is moving continuously during the stock-taking. Generally a large part of the inventorying is done by extra men employed for that purpose who, as a rule, are unfamiliar with the stock descriptions, classifications, standards of measurement, units, etc. Incidentally, the cost of taking such an inventory is no insignificant item.

In keeping proper records of accounts receivable one or more controlling accounts are kept in the general books, supported by an unlimited number of individual accounts in separate ledgers. No accountant would think of balancing the controlling accounts with the totals of the individual ledgers, say once or twice a year, by forcing them and writing off the difference to profit and loss. Yet this is what is generally done with supplies after taking a physical inventory.

In well regulated offices, accounts receivable are balanced exactly with the controlling accounts at least once a month; cash is balanced daily. Is there, as a matter of fact, any real difference between the importance of cash which usually is largely in the form of bank balances—or accounts receivable, the next conversion of which is to cash—or supplies, which finally will be converted, through manufacture and sale, into accounts receivable and cash? All of these are items represented by money on hand due to the company, or paid out for a tangible article, and they should be accounted for scrupulously.

Can supplies be balanced exactly each month, as are accounts receivable? My experience is that they can, but there must be coöperation and coördination between the various departments concerned, combined with a perpetual inventory dealing with money values.

As to a plan of working, I can give only a very general outline in the space at my disposal. Fundamentally, the plan involves nothing more than the use of any good perpetual inventory system carried to its logical conclusion. No definite plan covering statements and forms suitable to any and all concerns could be recommended or devised. My experience is that, based upon certain set principles of control, the supporting system must be built up gradually, depending upon the particular operating conditions environing an enterprise. Broadly, the plan involves:

Purchasing records
Receiving records and stock cards
Disbursing records and requisitions
Records of adjustments and corrections
Inventory records

The purchasing records may be disposed of by stating that they must of necessity include books, documents and files necessary for reference purposes.

The receiving records are of major importance. A columnar record must be kept which shows reference to the purchase order, the date of receipt of the goods, the description and amount of the purchase, the discount if applied against supply stock, the net amount, cost of freights, handling, commissions, etc., and the net total, which total must represent the total net cost of the particular article put in stock.

There must also be shown in the receiving record a description of the number, weight or measurement of the article received, together with the unit used in keeping track of the stock, and a column for card numbers. Finally, there should be a space where a stamp can be used to show the date upon which the stock received was entered on the individual stock cards in the supply department office.

When the article is entered on the stock card the number of the card should be entered in the column provided for that purpose. Care must be taken that no item is stamped in the receiving record as a debit to a card unless the entry is actually made on the card. At the end of the month the total of the total net money column in the receiving record should exactly equal the aggregate amounts charged on the individual cards during the month, and that charged to supply account in the controlling accounts in the general office records. The totals shown in the receiving record should be distributed in an auxiliary record to the general stock classifications and the general classifications can be further distributed in auxiliary records to such sub-classifications as may be desired.

As to the cards to be kept in the supply department office, almost any standard form can be used, providing the card shows quantity, unit price and amount in debit, credit and balance.

In order to facilitate the constant checking and correcting of actual physical inventories with the quantities and amounts shown by the cards, it is a good plan, where feasible, to keep another set of cards in the warehouse showing quantity only, debit, credit and net. Where these auxiliary "quantity only" cards are kept it is possible for the warehousemen to constantly check the warehouse cards against the actual stocks during their spare time. When this is done a stamp may be used which shows the date they are checked and corrected. At the end of each day, corrected quantity cards with memoranda of corrections should be turned in to the warehouse office for comparison and correction of the quantity money cards.

In order to keep a correct perpetual inventory it is necessary to work almost constantly on a comparison of the cards with the stock. Stocks containing articles such as small tools and electrical supplies, etc., which might possibly be pilfered or used without requisition, should be gone over and compared with the cards, say once a month. Other fast moving stocks, say at least once in three months. Slow moving stocks or large articles, say two or three times a year. And stocks of any kind when entered on a replacement memorandum for reordering.

If any differences are developed they must be run down immediately, but in practice there should be no differences, for everyone should bear in mind that this is not supplies they are handling but money, which has been charged to the department and which must be accounted for in full. However, it sometimes develops that during a rush or emergency, or on night shifts, some particular article is required immediately to keep a machine or plant in operation, and it may be taken from outside stock without filing a requisition. The constant checking of the inventories will disclose any such discrepancy before the circumstances have been forgotten and generally, instead of having a shortage to write off to profit and loss, it develops that the necessary adjustment can be made by charging some department with the cost of a definite article used in operations.

All differences which cannot be charged definitely to any department should be listed on an adjustment sheet and an effort should be made at once to find out what has become of articles short. Often it will be found that where an article is short, some similar article, or the same article in a different size, is over. In this case there is no shortage, but immediately an adjustment should be made to take up any price difference.

As the various small adjustments and corrections are entered on the adjustment sheet in the supply department office, the individual items and corrections must be applied at once to the cards representing these items. At the end of the month the adjustment sheet should go to the general office with all necessary explanations on each item, and after authorization, the net of the adjustments should be charged or credited to the supply department through the controlling account and an account on the general books called Supplies "Over and Short."

In disbursing supplies, on no account may any article be released from stock without a requisition from some official or department head with authority to sign an order. Requisitions as filled should be numbered by a duplicating stamp commencing a fresh series of numbers each day, the duplicate numbers being stamped on a daily issue sheet, the latter showing briefly requisition number, ordering name, description and quantity. This sheet is used as a check against the possibility of loss of any requisition after it has once been filled at the warehouse.

Requisitions should show the signature of the official ordering, the account number to which chargeable, the article required and the quantity, for what purpose ordered, to whom delivered and by whom the order was delivered. Space should be left on the requisition blank to be filled in in the warehouse, showing stock number and quantity delivered, and in the warehouse office showing quantity, price and money value.

All requisitions should go to the warehouse office daily to be posted in a columnar record showing the various charge account numbers and total, this record to fit into the financial divisions and cost divisions of the general accounts. The requisitions should then be posted to the stock classifications and sub-classifications to correspond with the classifications kept as part of the receiving records.

The daily totals by charge accounts and classifications should be summarized daily to group results for the month, and monthly for the year. Requisitions should be posted to warehouse quantity cards and to the warehouse office quantity, price and amount cards, and filed for ready reference. At the end of the month the total for the month of the total column in the disbursing record, supported by a summary of the division of disbursements for cost and financial purposes, should go to the general office, and the controlling supply account in the general books be relieved of the value of the total supplies disbursed for the month.

As an aid in keeping track of stock and in order to lessen the chance of error upon the part of new employes and those unfamiliar with all of the various articles, it is a good plan to have every article in stock carry or be represented by a stock number, and every card a corresponding stock number. The stock number should appear on the bins, compartments or shelf divisions, as the case may be. On large articles in outside or yard stock the numbers may be lettered on with paint.

Reference should be made to this number wherever possible on requisition blanks, posting records, etc., as this tends to eliminate the chance of error and assists in the correction of errors should they occur.

In my opinion, it is better to use an average unit price in crediting the cards for articles issued instead of the plan sometimes used of first in first out, and when goods are received at a price at variance with the old stock on hand, the unit price on the card should be immediately corrected to the average.

Cards must be compared with actual stock at reasonable periods as outlined; and corrections should be made on the cards immediately any discrepancy is discovered.

The net of all corrections should be taken up through the controlling accounts by entry supported by all necessary data, at the end of each month. Inasmuch as, under this plan, all cards are at all times represented by actual physical stock on hand, an accurate inventory may quickly be determined at any time by totaling the cards. If the clerical and accounting work has been done correctly, the total of the cards will, at the end of any month, equal the totals of the controlling accounts. Under this plan a semi-annual or annual physical inventory is not necessary, as the controlling accounts represent the true value of the physical stock of supplies.

Groups of card numbers and corresponding stock numbers should represent classifications and sub-divisions of stock, and interesting comparisons of the various classes of stock may readily be furnished of inventories, purchases, disbursements and turn-overs, if an accurate working basis is once arrived at.

After the various stocks have been segregated into classifications, further divisions should be made into fast moving, slow moving, surplus and obsolete stock and when the surplus and obsolete stock have been determined, colored cards, or some such distinguishing method of identification, may be used to call attention to these items, and from these records lists of surplus and obsolete stock may be sent out if desired, offering the excess stock for sale.

Once the excess stock is reduced, if the plan of ordering based only on actual requirements is followed, there should be no further accumulation, except of small amounts from time to time as certain operations or types of machines are abandoned. If this does happen, then the supplies affected should immediately be thrown to the obsolete stock division and steps taken to realize on this obsolete stock in some manner and at some price. In any event, the obsolete material should be moved out of active stock and carried at salvage or nominal value, depending upon the possibilities of disposal.

An important help in the accounting for, as well as the successful handling of, a supply stock is the arrangement of the stock itself. It must be kept in perfect order and so arranged that comparison may be made with the cards with little effort and time. This calls for considerable ingenuity and skill in stock arrangement, classification and indexing, and necessarily one of the chief elements leading to success is a really good supply manager. No real results can be obtained and the plan as a whole carried to a successful conclusion if those in charge of supplies are not really interested in their work and coöperating to the fullest extent with the accounting department.

The success of an enterprise depends to a large degree upon continuous operations, therefore a stock must at all times be carried which will obviate the possibility of a shutdown through lack of supplies. For this reason, without accurate consumption records the tendency is to overstock. Proper consumption records not only guard against the possibility of a shortage, but at all times indicate to those interested the actual necessary stock which will give adequate protection against shortages and at the same time keep the supplies reduced to a safe operating minimum.

A record of previous years' operations on each stock should be kept in a columnar book by years, showing units used, noting any abnormal conditions arising through extra material used on special work, etc. From this record should be established a fair minimum and maximum quantity necessary for a given period, and from these results there should be determined a safe minimum and sufficient maximum stock to carry, dependent upon the proximity to markets from which supplies may be obtained. Minimum and maximum requirements should be marked on each supply stock card, and when issues reduce that particular stock to or below the minimum stock necessary, the card should immediately be compared with the actual remaining stock on hand and a replacement memorandum turned in to the supply department office, showing that the stock has been checked with the card and the amount of stock on hand, and indicating the necessary further amount required to properly restock. The replacement memorandum should at once go to those in charge of orders for purchase.

Where there is a lack of proper supply records relating to minimum and maximum requirements, and where no perpetual inventories are kept, there is generally waste and unnecessary expense—waste through the gradual accumulation of obsolete stock which must eventually be written off as a loss—loss through inventory shortages arising from pilfering or misplacement of small articles—inaccurate costs of manufacturing through direct charges to profit and loss at the end of a period represented by supplies used in operations and actually applicable to costs, but through error not charged direct to costs at the time of issue —interest charges or the equivalent on working capital tied up in excess supply stocks—expense of continued handling and re-handling excess stock and insurance and taxes on the value thereof—cost of unnecessary warehouse space, etc.—expense of taking the semi-annual or annual physical inventory.

The plan of an extra set of quantity stock cards used in the warehouse, as outlined in this article, might not be good for all companies. With a comparatively small stock the warehousemen are able to keep the stock in order and the cards checked up at such times as they are not filling requisitions. In the case of a much larger stock it might be better to appoint a supply auditor, part of whose duties would be, with such assistants as might be necessary, to keep the stock in order and the quantity money cards in the supply department office checked up with the actual stocks on hand. Even if this latter plan were used, I think it a good idea to have some sort of quantity card record at each bin, or source of distribution, as the cards tend to remind the warehousemen of the conditions of the various stocks.

The plan of actually balancing the cards against the controlling accounts may be successfully applied to almost any business. A wholesale house I happen to know of, with four distributing warehouses in different localities, carries approximately 3,000 articles in each stock. The 12,000 cards representing these articles are kept at the main office. A stock auditor checks each item in each stock monthly and the results are at once forwarded to the general office for comparison with the cards. The differences are practically nil, for the stocks are assumed to represent money values for which the warehouse managers are held responsible. Two clerks do all the posting and work in relation to the keeping of the cards and supporting records, and balance the cards monthly. The system has been in use for three years and the cards have balanced exactly to the controlling accounts at the end of each month during that period.

The inventory and receiving and disbursing records of this company are in such shape that it is possible to purchase for the future with little danger of overstocking, and each month any stock which does not appear to be moving right is drawn off and listed and such instructions are sent to the salesmen as will tend to immediately move the stock.

At the beginning of each six months' period, a ratio of gross profit and desired turnover is established and the company is able to take full financial advantage of its perfect inventory records.

In the foregoing I have purposely kept away from the technical phases of my subject. Practising accountants of today thoroughly understand the working elements involved in any inventory system, although it is my belief that most of us are not nearly so well fitted to devise the detailed operating part of a system as are those who actually work on or are in charge of it.

It is not my idea to advocate any particular system but rather to point out one of the apparent weak phases in accounting in modern business—the laxity in methods of handling supplies and materials.

It appears to me that in this matter of supplies there is a chance for real constructive work upon the part of accountants—not so much in the preparation of the forms and the working out of the technical details of supply systems as in originating and advocating constructive ideas and working gradually and persistently towards gathering up the loose ends and making a compact whole so that the clerical work is proven and true results obtained.

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A. P. RICHARDSON, *Editor*

EDITORIAL

Tax Reform

The news item of the month of greatest interest to accountants is undoubtedly the letter of Secretary of the Treasury Mellon to the Acting Chairman of the Committee on Ways and Means. The secretary makes proposals for changes in the revenue laws which, if adopted by congress, will affect accountants in two important particulars. Firstly, they will be benefitted by the reduction of taxes and especially by the reduction accorded to earned income. Professional and salaried men have had to pay heavy taxes, heavier proportionately than taxpayers deriving their income from business or from investments. They cannot incorporate, they cannot deduct depreciation or depletion upon their useful life, nor can they adjust their losses in ways that will give the greatest measure of tax benefit. They have been unable to join the swelling ranks of tax avoiders.

Secondly, accountants will hail with satisfaction such a reform in tax administration as a board of tax appeals independent of the bureau of internal revenue. Congress has hitherto shown little conception of the complex problem of tax administration and since the beginning of our war taxation it has made no serious effort to provide adequate machinery. It is the fault of congress rather than of the bureau of internal revenue that the country has suffered and is still suffering from a delay in the audit and settlement of tax cases and a loss of revenue that might have been avoided in large measure had congress been willing to think about the matter.

The secretary's proposals have been received with a chorus of approval from nearly every section of the country and it is especially gratifying to note that this approval shows little evidence of partisan politics. This is as it should be. Internal revenue is not a matter for party politics and, unlike the tariff, it has seldom been a party question. The issue is now before the country and upon it accountants have an opportunity and an obligation to make their influence felt.

An Opportunity for Accountants

One of the corollaries of success is notoriety, and a corollary of notoriety is the mail burdened with offers destined to lead the buyer into the fields of fortune. This is by way of introduction to a consideration of some openings that have recently been presented to members of the profession. For example, one of our most eminent accountants has recently received an offer to sell to him "the most up-to-date, complete and busiest blank-book manufacturing and auditing concern in ————, ideally located in its own building ————, doing the largest business of its kind, with highly satisfactory per cent. return on money invested and a net annual profit of between $8,000 and $12,000 from the auditing department alone. A real he-man's business, clean and progressive, capable of being expanded into a million-dollar concern with expenditure of little effort and time. . . . With an investment of $100,000 the concern can attain any size; its possibilities are limitless. It is really a beautiful business, and we know that if we can find the right person or persons to acquire it they would be as keenly interested and alive in owning and running it as the owner has been in establishing it."

It seems a pity to add anything to this modest and conservative estimate of what a book-manufacturing and auditing concern may do. One can imagine, however, the kind of auditing which is involved. It seems almost possible that at times the auditing staff would find itself compelled, out of sheer affection for the client, to recommend the blank books manufactured by the other half of the family. Dr. Jekyll could never quite forget, in such circumstances, the existence of Mr. Hyde.

The Unholy Alliance of Trade and Profession

There was a time, in the early history of accountancy, when some people thought that an auditor's duty was the introduction of an elaborate and always expensive system of bookkeeping, and there have been purchasers of such systems on the recommendation of so-called auditors. But it is a little astonishing and wholly discouraging to find that the idea has not yet been utterly abandoned. A very safe rule for those who engage the services of accountants in professional capacities is to have nothing whatever to do with any accountant, or person who represents himself to be an accountant, whose affiliation with any manufacturing concern whatsoever is even remotely possible. In the letter which is before us the person who would sell this precious business does not realize that there is anything amiss in the proposition; and this indicates that in that particular part of the country where the business is situated there must be a lack of knowledge of professional accountancy, at least on the part of many business men. Otherwise the vendor would have heard an echo if not the direct voice of protest against the idea of combining profession and business.

And then there is the concern which offers accountants special inducements to bring financial business its way. The following is a typical sentence from a letter insulting the profession: "If you will bring to our attention situations in which a company is in need of additional capital we shall be delighted to make arrangements with you to divide equally with you all commissions accruing from such business." One wonders what would become of the professional standing of any man who, for any inducement whatever, would seek to establish a relationship between money-lenders and borrowers in which he, as the go-between, would derive a commission. Will the people never learn that a professional man is above that sort of thing, and that the acceptance of commission or any compensation from anyone except his client is utterly contemptible? Where would be the value of professional advice if the client had the slightest reason to fear that the accountant giving the advice might have an ulterior motive, dictated by a lively expectation of commissions to be received? Accountants know, and lawyers, architects, engineers, physicians know, that there is nothing so destructive of professional standing as any doubt of the absolute integrity and disinterestedness of the practitioner. When the public has thoroughly absorbed this professional ideal it will be a happy day for all of us. On the other hand it is not only the man on the outside of accountancy who is guilty of debasing, or attempting to debase, the profession. What should be said of the man describing himself as an accountant who wanders out into fields far from his home? Not long ago we wrote of the accountant who wished to undertake social service labor. He was either a wit or witless. Now comes the man who wants to do the accounting, auditing, advising, directing and all other functions for his clients, and lest those functions should be insufficient he would add plans for enlarging capacities, standardizing manufacture, advertising, improved sales methods, and inducing people to invest their money in the companies in which he is interested as an accountant. It is all very wonderful and beautiful, from one point of view, and all very damnable from the other, and we confess our preference is for the second view.

Women in Accountancy

One of the questions most frequently asked of practising accountants concerns the opportunity which accountancy offers or fails to offer for women. The number of women engaged in preparation for the accounting field increases year by year, and there is hardly a school of accountancy in the country which does not number women among its students. The great majority of these women find their way into employment as bookkeepers or officers of corporations, but a few are earnestly imbued with an ambition to enter public accounting. This magazine is frequently requested to give advice and assistance to women who have finished accounting courses and now feel themselves competent to enter the office of a public accountant as a member of the staff. The fact that most such efforts fail utterly causes a good deal of distress and heartburning, both of which are quite justifiable. But the fact of the matter is that women are not wanted as accountants on the staff of practising public accountants. Their ability in accountancy is unquestioned. In many cases those who have completed courses of instruction and have taken examinations have passed with distinction. Probably it is safe to say that the average female student surpasses, in application and ability, the average male student. There is, of course, the traditional belief that the female mind is not so adapted to analysis as to other mental activities, but the results which attend the examination of students indicate the fallacy of this belief. As to loyalty to their employers, there is no doubt. The great increase in the number of women employed by companies of all kinds, and to some extent in managerial capacities, is a well-deserved testimony to their worth. And yet, the accountant has no room in his organization for a woman as a member of the accounting staff—and herein lies the seeming paradox.

What Militates Against Them

Yet the matter is quite simple. When a member of an accounting staff is engaged it is understood that he is to hold himself in readiness to serve whenever and wherever called upon to do so. In the wide variety of modern accounting practice a staff member may be required to go from one end of the country to another, in company with groups of staff members, working at high pressure and under living conditions not suitable for what might be termed post-graduate co-education. Then, again, there are many assignments to which staff members are sent, involving working all night long in places of difficulty and inconvenience. For example, an audit of a bank must be performed between the hours of closing and opening, particularly as to the counting of cash and securities. Large numbers of men are sent to work, but any attempt at heterogeneous personnel would hamper progress and lead to infinite embarrassment. Further, there is the utterly unwarranted objection, raised by some clients, when a woman appears as a representative of the accountant. Many of our business men are still living in the age when woman's place was never outside the home, and to such men it is not only a shock but almost an indication of disregard if a woman is sent to undertake the work of a practitioner. There are several women who are members of the American Institute of Accountants and are conducting accounting practices. The range of their activities is, however, somewhat restricted, and until the business world has advanced to a point at which the equality of the sexes is universally acknowledged, their practices will be restricted. The number of women who are certified public accountants is increasing slowly, principally in those states which have no requirement of preliminary practice before taking examination. In states like Pennsylvania, where no one is allowed to take the examination who has not had actual public experience, women find it difficult to obtain admission to the examinations. Few accountants display a willingness to employ women on their staffs, even for the purpose of giving them the experience required under the preliminary-practice clauses of law and regulation. In a word, then, the prospects for women in the field of accountancy are not brilliant. For that kind of accounting work which is involved in comptrollerships, treasurerships and the like, women have a distinct opportunity. In many such instances their abilities and characteristics render them far more suitable than a man would be likely to be. But as to the public field, it must be admitted, with regret, that the woman who succeeds is the rare exception.

A Song of Degrees

There was a time within the history of mankind, in the United States and perhaps elsewhere, when those who desired to have degrees attached to their names could do so without much difficulty. There were places where one could buy a degree in medicine or philosophy or law, and above all, in music. The writer of this note remembers well a member of a British colonial legislature who was always known as Dr. So-and-So. There was profound mystery surrounding the origin of his title, but after deep research and much cross-questioning it appeared that he was a doctor of music, granted by some hitherto unknown degree-factory in the extreme northwest of the United States. But he had no knowledge of music, except the sound of his own voice, which was more or less cacophonous. But he was a doctor of music, save the mark! We had hoped that that sort of thing was as dead as Queen Anne, but apparently it is not, for it has been reported to us, and evidence has been submitted, that an organization describing itself as a "university" is prepared to issue degrees in nearly every known science and art. The list of degrees available presented in their abbreviated form looks as though a page of a dictionary had been dropped and pied. The only letter that seems to be missing is Z. In order to obtain any of these precious degrees one must take a course in home study. Payment may be made in instalments. The courses are not described, and perhaps it is as well that it should be so. Special examinations will be held. In a word, nothing seems to have been omitted which could possibly be desired by the least industrious of aspirants for a degree. There is a serious omission, however, which was overlooked, and that is, there seems to be no provision for the issuance of C. P. A. certificates. The error must be purely typographical.

Wall Street's Fundamental Purpose

A young man who recently made his initial effort and failure in Wall Street expressed the opinion that he had been exceptionally unfortunate and seemed to feel as though the Fates had singled him out for attack. This theory was based upon the assumption that at least fifty per cent. of the people who go into Wall Street, and by that we mean those who go into speculation, for which "Wall Street" is the proverbial synonym, come out of Wall Street with more money than they had originally. The fact of the matter is widely otherwise. The percentage of men or women who can succeed in speculation is probably smaller in stock-market affairs than in horse racing, and the sooner the public learns the fact the better for all concerned. The recent epidemic of bucket shops reminded everyone of the fact, which some had been inclined to forget, that the public likes to gamble and will gamble even if loss is comparatively certain. The psychology of the thing is quite incomprehensible, and yet the procession of speculators lengthens year by year. During the past few months we have been passing through a period of market depression, or softness, which has not been explained and probably cannot be explained by any other reason than manipulation and a certain amount of timidity. Whatever the cause, the market has been little better than no market at all. Many explanations are offered, and many excellent exhortations are delivered with the purpose of preventing speculation; but the lure still draws and people go down into the Street with the idea that they can buy and sell at a profit. If the foundation upon which the stock exchange and all similar agencies are based were understood, there might be less eagerness to participate. For the word "exchange" is a misnomer. It is not a place in which exchanges take place, but it is primarily a place for the selling of securities, and when this point is grasped it will readily be seen that with selling as its chief objective, the function of exchange is secondary. There have been many pages devoted to the discussion of the iniquity of short selling and the foolishness of margin trading. Perhaps they may have some effect. But what should be understood by the public is the fundamental fact that the sale of securities is the thing for which the exchange exists. Having sold, the interest of the exchange largely ceases, and those who have bought must shift for themselves.

Difference Between Sale and Resale

Take the analogy of the ordinary town market in which meat, vegetables, etc., are offered for sale. Would anyone dream of going into such a market, purchasing a side of beef, and then moving around among the throng of purchasers in the hope of making a profit by reselling the beef? That is the kind of thing that our simple friends who enter Wall Street expect to do and are bitterly aggrieved when they find that they cannot do. The number of successful speculators is eloquent by its smallness. In most things our daily papers emphasize the unhappy events and lay no stress upon the pleasant things. Wall Street, however, aside from notorious failures, is an exception, inasmuch as we hear far more of the people who succeed than we do of the hundreds of thousands who lose by gambling. Of course each one of us has his own little system for breaking the bank, whether it be at Monte Carlo or at the corner of Broad and Wall Street, and once in a while the system seems to work. But sooner or later, if we keep returning to the tables, the wheels will go against us. The market has a useful purpose to serve so long as it is engaged in selling. Let the public grasp the fact and cease to endeavor to make a medium of exchange out of what is merely an undertaking to sell.

Income-tax Department

EDITED BY STEPHEN G. RUSK

Attention is invited to two interesting decisions published in this month's issue of THE JOURNAL OF ACCOUNTANCY. One of them, No. 3518, appertains to rental paid to a terminal company owned jointly by the railroads using it. The terminal company was organized to build, own and maintain a bridge across the Ohio River near Louisville, Kentucky. The rental charged to the railroad companies for use of this bridge was intended to be used only to pay off, over the life of a bond issue, the cost of the bridge and the cost of its upkeep and maintenance. The circuit court of appeals, sixth district, ruled that these payments of rent constituted income to the terminal corporation, and as such was taxable. While it is not stated, it is presumable that the rentals paid by the railroads would constitute allowable deductions from the taxable income of the railroad corporations, if the court's decision stands.

The commissioner has held at least in the case of Bean *v.* Hamilton, that an accountant is responsible for the correctness of the figures in an income-tax return but that the taxpayer is responsible for the data upon which the figures are compiled. In the case above cited, which case is embodied in treasury decision 3519, it is alleged that the taxpayer disclosed only a part of his income to the accountant making his return, and did not disclose to him another and larger part which would have subjected the taxpayer to an assessment of excess-profits tax. These features, with others of importance, will make a reading of this decision worth while.

TREASURY RULINGS

(T. D. 3515—September 11, 1923)

Income tax—Gross income defined—Exclusions

Article 75, Regulations 62, amended.

The federal farm loan act was amended by an act (ch. 252, 42 Stat. 1454) approved March 4, 1923, authorizing the creation of federal intermediate credit banks, and prescribing the manner in which such banks should be conducted. Section 210, Title II, of the act, as amended, makes applicable to intermediate credit banks the privilege of tax exemption accorded under section 26 of the act to federal land banks and national farm loan associations.

Accordingly, article 75 of regulations 62 is amended to read as follows:

ART. 75. *Dividends and interest from federal land banks, federal intermediate credit banks, and national farm loan associations.*—As section 26 of the federal farm loan act of July 17, 1916 (ch. 245, 39 Stat. 360), as amended by an act approved March 4, 1923 (ch. 252, 42 Stat. 1454), provides that federal land banks, federal intermediate credit banks, and national farm loan associations, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, and that first mortgages executed to federal land banks, federal intermediate credit banks, or to joint-stock land banks, and farm loan bonds, and debentures issued by intermediate credit banks, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of federal land banks, federal intermediate credit banks, and national farm loan associations, and from interest on promissory notes secured by such first mortgages, or from such farm loan bonds or debentures, is not subject to the income tax. See also section 231 (13) of the statute.

(T. D. 3516—September 12, 1923)

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

1. DEDUCTIONS—FEDERAL ESTATE TAXES—RIGHT TO DEDUCT FROM INCOME OF DECEDENT.

Where a taxpayer dies during the taxable year, a return of his income for the period in such a year during which he was alive is required showing the net income after deducting from the gross income deductions properly allowable by law. However, the occasion of an estate tax being death and it being imposed only after death, such tax would not be available to the taxpayer as a deduction during life and is accordingly not available to his personal representative when making a return, as he is required to do, of the income received by the decedent prior to date of death. As affecting a decedent, the deduction of an estate tax can not have been contemplated by the word "taxes" in section 214 (*a*) (3) of the revenue act of 1918. Such tax is from its very nature deductible only from income received after the tax has, following death, come into existence.

2. JUDGMENT OF THE LOWER COURT.

Judgment of the United States district court for the eastern district of Pennsylvania (280 Fed. 241) affirmed.

The following decision of the United States circuit court of appeals for the third circuit in the case of *Wilson Catherwood, executor of the will of Emma R. Catherwood, deceased, v. United States,* affirming the United States district court for the eastern district of Pennsylvania (280 Fed. 241), is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT. No. 2903.
OCTOBER TERM, 1922.

Wilson Catherwood, executor of the will of Emma R. Catherwood, deceased, plaintiff in error, v. United States, defendant in error.

ERROR to the district court of the United States for the eastern district of Pennsylvania.

Before BUFFINGTON, WOOLLEY, and DAVIS, circuit judges.

WOOLLEY, circuit judge: Emma R. Catherwood died August 22, 1920. On February 25, 1921, the plaintiff, her executor, in obedience to the revenue act of 1918 (40 Stat. 1057, 1096-11-1), filed a return for federal tax on her estate and paid the tax. On the same day he filed two income-tax returns. One covered income received by the decedent during the taxable year 1920 prior to her death. In computing taxable net income the executor did not deduct the estate tax he had that day paid because, under the regulations of the department of internal revenue then in force, the deduction would not have been allowed. Had the deduction been allowed and made, there would have been no taxable income for that part of the taxable year. The other return covered income of the estate received by the executor during the remainder of the taxable year. This was small and, even without deducting the estate tax, it disclosed no taxable income for that period. Therefore, if the estate tax had been deducted in the first return, there would have been no taxable income shown by the two returns for any part of the taxable year. The executor brought this action to recover the amount of income tax he had paid on income received by the decedent during the part of the taxable year she was alive, calculated without deducting the estate tax. The case was heard as though on demurrer and the court entered judgment for the defendant. (280 Fed. 241.) The plaintiff sued out this writ of error.

The question turns on the interpretation of several sections of the revenue act of 1918 and particularly on the interpretation of section 214. (40 Stat. 1058, 1082.) We shall approach this section by reviewing the preceding sections to which it relates, freely using italics to direct attention to the points under discussion.

The matter falls first under title II of the act dealing with income tax and later under title IV dealing with estate tax. Section 210, the first provision with which we are concerned, declares that "there shall be levied, collected, and paid for *each taxable year* upon the *net income* of every *individual* a normal tax at the following rates." This provision is relevant to the matter in hand in three particulars: first, it refers to the income of an individual, who in this case was Emma R. Catherwood; second, it shows that the taxable income is the *net* income; and, third, that the period for which such tax shall be levied, collected, and paid is a "taxable year." Section 200 defines "taxable year" to mean, in this instance, the calendar year. Emma R. Catherwood, dying in August, 1920, did not live throughout the calendar or taxable year of 1920. Had she lived throughout that year she would have obeyed section 210 by making a return conformable with section 212, which defines the "net income" on which the tax is levied as meaning "gross income" as defined by section 213, less the deductions allowed by section 214. This is the section, as affected by section 401, which calls for construction. It reads as follows:

SEC. 214. (a) That in computing net income there shall be allowed as deductions: * * *

(3) Taxes paid or *accrued* within the *taxable year* imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes. * * *

The estate tax, which by section 401 of the act, is "imposed upon the transfer of the net estate of every decedent dying after the passage of this act," is obviously not a tax that could have been "paid" by Emma R. Catherwood, or that could have "accrued within the taxable year" had she lived to file her own return, for such a tax can neither accrue nor be paid until death. So, had Emma R. Catherwood lived, she would not have been affected by, nor could she have deducted, an estate tax. But Emma R. Catherwood did not live throughout the taxable year. Income had been received by her during the part of the year in which she had lived and it was natural to expect that income would be received by her estate during the remainder of the year after her death. For a tax on the income she had received during the taxable year while alive she was liable. Though liable, she could not, as she was dead at the time the tax became due, make return and pay it herself. Anticipating such a case, and for the purpose of gathering a tax on all the income of a decedent for the whole of a taxable year—that which was received before death and that which was received after death—the law requires a return to be made by her personal representative for income received by herself—a fixed liability of her estate—and a return to be made by him for income received by her estate—a liability of his own. To this end the statute, by section 219, provides:

(a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate; * * *

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts.

In this connection the act, by section 225, further provides:

That every fiduciary * * * shall make under oath a return for the individual, estate, or trust for which he acts. * * * Fiduciaries required to make return under this act shall be subject to all the provisions of this act which apply to individuals.

Therefore it is, that when an executor makes a tax return of net income received either by the decedent or by himself during the administration of an estate, he, too, is allowed the deduction, named in section 214, of "taxes paid or accrued within the taxable year imposed by authority of the United States, except income, war-profits, and excess-profits taxes."

But this section conceivably allows an executor who has himself received income a deduction which it does not allow a taxable making his own return. And this is so where the death of the taxable has intervened and because, thereupon, the law has raised a new tax, payable solely from the estate of the taxable. This is the federal estate tax. (Sec. 401.) This tax is not excepted from the allowable deductions under section 214, and, if "paid or *accrued* within the taxable year," it is properly deductible from gross income received by the executor in ascertaining taxable net income. This has been definitely determined in *United States v. Woodward* (256 U. S. 632, 41 Sup. Ct. 615, 65 L. Ed. 1131). That case turned primarily on the question whether, in any event, an estate tax is a proper deduction under section 214, and on the facts of the case the supreme court held that it was a proper deduction to be made in a return by the executor of income he had received in the taxable year after the decedent's death and during the settlement of the estate. The plaintiff contends that in principle the Woodward case rules the case at bar where the deduction of the estate tax is sought to be made from income received by the decedent while living. To prevail on this contention the plaintiff must show that the supreme court, when it held that the estate tax "becomes due not at the time of the decedent's death, * * * but one year thereafter, as the statute plainly provides" (sec. 406), was wrong in construing the words "taxes * * * *accrued* within the taxable year," as used in section 214, to mean "taxes [that] became *due* during the taxable year." It is fairly debatable under the Woodward decision whether an estate tax accrues when due, or, under the decision in *Hertz v. Woodman* (218 U. S. 205), it accrues when imposed. But aside from this question we are of opinion that in construing section 214 the taxes there allowed as a deduction must be read with reference to the person affected. The first return made by the executor was, as we have shown, for income received by the decedent during her lifetime. From such income received by her during that part of the taxable year the deduction of an estate tax can not have been contemplated by the word "taxes" in section 214, because there was as affecting her, when living, no such thing as an estate tax. The occasion of an estate tax is death and it is imposed only after death. It was in this instance imposed upon the transfer of the decedent's estate and the duty of payment was imposed upon her executor. If the estate tax "accrued" when "due" in 1921, it did not accrue within the "taxable year" of 1920 and was not, in any line of reasoning, deductible in either tax return. If it "accrued" when "imposed" in 1920, then it "accrued within the taxable year" within the meaning of section 214 and was, under the decision in the Woodward case, a proper deduction to be made by the executor in ascertaining taxable net income from gross coming into his hands "during the period of administration or settlement of the estate." It so happens in this case that, because of the small gross income received by the executor during administration, the deduction thus available would be of no use. Therefore, the effort is made to shift the deduction to the executor's return on income received by the decedent during her lifetime. There would be nothing in this position were it not for the breadth of the language in section 214 wherein a deduction is allowed on "taxes paid or accrued within the taxable year," coupled with the plaintiff's claim that the estate tax, paid when "due" in 1920, actually "accrued" within the "taxable year" of 1920. The plaintiff maintains that it makes no difference in what part of the taxable year, whether before or after the decedent's death, the tax accrues. For the reasons already given we are not impressed with this contention. Assuming without deciding that the estate tax "accrued" within the "taxable year" of 1920, it does not follow that it may be deducted at pleasure from income received by different persons at different times during that year. It is, from its very nature, deductible only from income received after the tax has, following death, come into existence, not on the theory that it is payable out of a segregated part of the estate, for it is not (deduction and payment are different matters), but because the deduction, not being available to the taxable, had she lived, is not available to her personal representative when making a return for her of income she had received when living—a return clearly different from the one an executor is required to make for income received by himself during the settlement of the estate.

Finding no error, we direct that the decree below be affirmed.

(T. D. 3518—September 20, 1923)

Income tax—Revenue acts of 1913 and 1916, as amended—Decision of court.

1. INCOME, WHAT CONSTITUTES.

Payments by railroad companies, sole stockholders and tenants of a terminal company, as rentals for their proportionate user, held to be income.

A terminal company was organized by three railroad companies to acquire, own, and jointly operate a railroad bridge "for the equal benefit" of the railroad companies and "not for the purpose of making any pecuniary profit from the undertaking." The capital stock was taken by them in equal proportions. The terminal company had a large outstanding mortgage indebtedness, the payment of both principal and interest of which was guaranteed by the railroad companies. The railroad companies agreed each with the others, and with the terminal company, to contribute as rental to any deficit of the terminal company in proportion to the user by each railroad company of the terminal facilities. It was further agreed that no dividends should be declared by the terminal company, and that "all surplus and net earnings and income shall constitute a reserve fund for additions to and improvements and reconstruction of the property of the terminal company." *Held,* that such contributions by way of rental payments by the railroad companies to the terminal company to make up the annual deficit of the latter were taxable income of the terminal company under section II G (a) of the revenue act of 1913, section 10 of the revenue act of 1916, and section 4 of the revenue act of 1917.

2. The payments so made by the proprietary companies as rentals which were earnings of the latter's operation "proceed from the property" of the terminal company, and constitute a profit therefrom (equally whether or not there was a net gain or net income to it), notwithstanding the agreement that they were not to be transformed into dividends and were ultimately to be a reserve fund for additions, improvements, and reconstruction of the terminal property.

3. Decision of the district court reversed.

The attached decision of the United States circuit court of appeals for the sixth circuit in the case of *Elwood Hamilton, collector, v. Kentucky & Indiana Terminal Railroad Co.,* is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT. No. 3821.

Elwood Hamilton, late collector of internal revenue, plaintiff in error, v. Kentucky & Indiana Terminal Railroad Co., defendant in error.

ERROR to the district court of the United States for the western district of Kentucky.

[Submitted April 9, 1923. Decided May 8, 1923. 289 Fed. 20.]

Before KNAPPEN, DENISON, and DONAHUE, circuit judges.

KNAPPEN, circuit judge: Defendant in error, which we shall call the terminal company, during the years 1915, 1916 and 1917 owned and operated a bridge across the Ohio River for railroad, street-car, wagon, and foot purposes between Louisville, Ky., and New Albany, Ind. By section II A (1) [II G (a)] of the revenue act of October 3, 1913 (38 Stat. 114, 166), the terminal company was liable to a tax of 1 per cent. upon its "entire net income arising or accruing from all sources" during the year 1915; by title 1, part II, section 10, of the revenue act of September 8, 1916 (39 Stat. 756, 765), it was liable to a tax of 2 per cent. upon such income during the year 1916; and by title I, section 4, of the revenue act of October 3, 1917 (40 Stat. 300, 302), it was liable to a tax of 4 per cent. upon such income during the year 1917. Taxes assessed for each of the three years were paid under protest and suit brought for their recovery. The only question presented is whether in that suit the district court rightly rendered judgment for the terminal company, upon the ground that it had not during any of the years in question any taxable income whatever.

The terminal company was organized with a capital stock of $75,000 held (except as to a few qualifying shares) in equal proportions by three railroad companies (the Southern, the Baltimore & Ohio Southwestern, and the Chicago, Indianapolis & Louisville), which acquired the terminal properties (as stated in the plan of reorganization) "for the equal benefit" of the three companies, and "not for the purpose of making any pecuniary profit from the undertaking," but "with the view to securing to these companies terminal facilities in the city of Louisville and without any purpose of making the corporate organization a profitable one in the way of dividends upon any corporate stock to be issued by the new corporation." During the years in question the terminal company had an outstanding mortgage bond issue of more than $6,000,000, the payment of both principal and interest whereof was guaranteed by the three railroad companies to facilitate the sale. By contract between the terminal company and the three proprietary companies each of the latter was to have "full and equal rights with the others" in the terminal property, each agreeing for a period extending beyond the taxing years in question to make use of the terminal company's properties for all passenger and freight traffic within its control destined to cross the Ohio River at Louisville. Each proprietary railroad company was to be charged the same amount for switching per car, but any deficit of the terminal company was to be "made up" by the three proprietary companies in proportion to each company's use of the terminal,[1] the terminal company being required to render monthly bills to the proprietary companies for switching charges, and also monthly bills to each showing amounts due by each company under the clause we have quoted in the margin, each bill to include in its estimates one-twelfth part of the annual taxes and of the annual fixed charges.[2] Provision was also made for excluding any proprietary company which defaulted in payment of such bills from further use of the terminal company's property and from enjoyment of the terminal service. It was also provided that until otherwise expressly agreed by the proprietary companies no dividend from profits should be declared by the terminal company, but that "all surplus and net earnings and income shall constitute a reserve fund for additions to and improvements and reconstruction of the property of the terminal company."

If the payments so made by the proprietary companies are excluded from the terminal company's returns, that company not only had no income, but it suffered a substantial deficit during each of the years in question. If, however, the contributions by the proprietary companies constitute income, the terminal company had a substantial net income within the meaning of the statute for each of the three years, due to the fact that while the proprietary companies paid the bond interest in full, the terminal company was entitled in computing its net amount to deduct but a trifle more than one-

1 The contract provided that the proprietary companies "shall pay for the use of the property and facilities of the said terminal company such sums of money as shall from time to time be required, in addition to other revenues of the terminal company, to meet all expenses of operation and maintenance of the property of the terminal company and all of its obligations for taxes and interest upon its first-mortgage bonds as the same may be out-standing from time to time; the respective amounts to be paid by each company being fixed and determined" on a basis of usage of the terminal property.

2 During the year 1915 the proprietary companies, under the contract provisions referred to paid, $363,445.59; during 1916, the sum of $361,994.47; during 1917, the sum of $534,981.16.

half of the amount of the interest so paid. The terminal company raises no quesion of the validity of the income-tax provisions so limiting interest deductions. See *Anderson v. 42 Broadway Co.* (239 U. S. 69; T. D. 2261). It results that if the payment of the bond interest by the proprietary companies to the terminal company was income, the judgment below is concededly wrong and should be reversed. The case thus turns solely upon the definition of income.

In *Stratton's Independence v. Howbert* (231 U. S. 399, 415; T. D. 1913), income was defined as "the gain derived from capital, from labor, or from both combined." In *Doyle v. Mitchell* (247 U. S. 179; T. D. 2723), this definition was approved when made to include profit gained through a sale or conversion of capital assets. In *Eisner v. Macomber* (252 U. S. 189, 207; T. D. 3010), and in *United States v. Phellis* (257 U. S. 156, 168-9; T. D. 3270), (both of which were stock-dividend cases), the definition above quoted was approved, being elaborated in statement (to use the language of the Phellis case) as "a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value, proceeding from the property, severed from capital, however, invested, and coming in; that is, received or drawn by the claimant for his separate use, benefit, and disposal." The terminal company invokes these definitions, and contends that the payments made by the proprietary companies are wholly excluded therefrom. In this connection it contends that its road was not operated for profit, and invokes the broad proposition that the income-tax laws do not treat as income that which in the generally accepted sense is not income.

We think these contentions overlook the substantial situation. The payments made by the proprietary companies were part of the rentals to be paid by those companies for their use of the terminal facilities. The terminal company had a substantial gross income apart from payments made by the proprietary companies. The latter needed the terminal facilities, and were willing to pay what these facilities were worth. They found it to their interest as stockholders to own equal interests in the stock, but as proprietary companies (as distinguished from their interests as stockholders) they saw fit to contract to pay to the terminal company, which owned and operated the physical properties, whatever amount was required above receipts from other sources to meet the expenses of operation, repairs, maintenance, and conservation of property, including interest upon the corporate indebtedness. These contributions were apportioned according to the beneficial use of the terminal facilities which each of the three proprietary companies enjoyed. These payments were nothing more or less than rentals of the terminal facilities. It could not well be doubted that had they been beforehand fixed in amount they would properly be treated as income. That these amounts were uncertain until fixed by experience does not alter their essential nature. Nor is it open to reasonable doubt that had the amount of these so-called deficiency payments been derived from rentals to other than the proprietary companies they would have constituted income. Upon principle, we think these payments were true income, and they did not fail of being such from the fact that as the only (at least the chosen) means of obtaining the terminal company's facilities, and the preferred rights thereunder, the proprietary companies were required to pay more for the facilities than perhaps could be obtained for casual or less complete or less important service. Nor, in our opinion, can it properly be said that the corporation was not organized for profit. The contract provision that until otherwise expressly agreed by the proprietary companies no dividend from profits should be declared, etc., does not preclude a change of policy in that regard. Nor do we think that payments such as are here in question are outside the generally accepted definition of income. We think it clear that the payments so made by the proprietary companies as rentals did "proceed from the property" of the terminal company, were earnings of the latter's operation, and did constitute a profit therefrom (and equally whether or not there was a net gain or net income), notwithstanding, according to the then existing policy, such profits were not to be transformed into dividends but were ultimately to find their way into "additions to and improvements and reconstruction of the property of the terminal company." The contemplated "reserve fund" to result from "surplus and net earnings and income" could be nothing else than profits. The fact that a net income, in a taxable sense, resulted only because the terminal company could not deduct from the rentals received all the interest paid is unimportant, as has already appeared. That statutory "net income" was directly and immediately due to the interest payments made by the proprietary companies is not important. We are not impressed with the terminal company's contention that it acted only as distributing agent in the collection of the interest payments from the proprietary companies. The terminal company owned the terminal properties subject to the payment of the mortgages thereon. The interest money was thus paid to and used by the terminal company for meeting charges against its own property, default in whose payment might well result in the loss of the property. Had the interest payments been made by the proprietary companies directly to the bondholders or the mortgage trustee, the payments would have been none the less income of the terminal company.—*Anderson v. Morris, etc., Co.* [C. C. A.] (216 Fed. 83, 90). It has been held that interest on bonds of a lessor company and dividends to stockholders of such company, paid as part of rentals by a lessee company, are "income" of the lessor company.—*Rensselaer, etc., Co. v. Irwin* [C. C. A. 2] (249 Fed. 726); *Northern Ry. Co. v. Lowe* [C. C. A. 2] (250 Fed. 856). That dividends on stock paid by a lessee company directly to the lessor's stockholders, as part of an agreed rental, constitute "income" of the lessor corporation is held in *West End Street Railway v. Malley* [C. C. A. 1] (246 Fed. 625; T. D. 2620). Our conclusion, so far stated as on principle, that the proprietary companies' payments here involved are income within the taxing acts here in question, is fully supported by reasoned and convincing adjudications, which we are content to follow.—*Boston Terminal Co. v. Gill* [C. C. A. 1] (246 Fed. 664; T. D. 2671); *Houston Belt & Terminal Ry. Co. v. United States* [C. C. A. 5] (250 Fed. 1; T. D. 2710). The Boston Terminal case was in its facts almost identical with the instant case. The Houston Terminal case directly involved, as did the Boston Terminal case, the question of interest upon a terminal company's bonds. Every vital question here involved was presented and decided in one or both of these cases. The terminal company here makes no attempt to distinguish these cases from the instant case.

It results from these views that the judgment of the district court should be reversed, and the cause remanded with directions to take further proceedings not inconsistent with this opinion.

(T. D. 3519—September 20, 1923)

Income and profits tax—Revenue act of 1917—Decision of court.

1. Excess-profits Tax—Separate Return.

Under the excess-profits-tax provisions of the act of October 3, 1917, and the regulations thereunder, an individual who receives income from a trade or business having an invested capital is required to file a separate excess-profits-tax return in addition to his income-tax return.

2. Excess-profits-tax Return—Penalty for Failure to File.

Failure to file such a return under the conditions stated subjects the taxpayer to the penalty prescribed by section 3176, revised statutes, as amended, even though he makes an income-tax return which impliedly shows that he was not engaged in a business having an invested capital and that he did not owe any excess-profits tax upon income derived from a business having invested capital.

3. Return—Failure to File Reasonable Cause for Failure.

The fact that the taxpayer turned over to an expert accountant what he thought was all the data necessary to make out complete and accurate income and excess-profits-tax returns, and that through inadvertence he failed to give the accountant all the necessary facts, as a result of which his income was understated in his income-tax return and no excess-profits-tax return was filed does not constitute reasonable cause for failure to file an excess-profits-tax return, the facts also showing that the taxpayer executed the income-tax return without looking at it or noting the amount thereof.

4. Appeal and Error—Matters Concluded by Judgment in Trial by Court.

In an action by a taxpayer to recover a refund of a penalty of 50 per cent. imposed by the commissioner of internal revenue under section 3176, revised statutes, as amended by section 16 of the revenue act of 1916, and paid under protest, where a jury is waived, a judgment dismissing the action involves a finding of fact that the plaintiff failed to make and file a return within the time prescribed by the statute.

The attached decision of the United States circuit court of appeals for the sixth circuit in the case of *James B. Beam v. Elwood Hamilton, collector,* is published for the information of internal-revenue officers and others concerned.

United States Circuit Court of Appeals, Sixth Circuit. No. 3787.

James B. Beam, plaintiff in error, v. Elwood Hamilton, collector of internal revenue, defendant in error.

Error to the district court of the United States for the western district of Kentucky.

[Submitted April 9, 1923. Decided May 15, 1923. 289 Fed. 9.]

Before Knappen, Denison, and Donahue, circuit judges.

Knappen, circuit judge: This writ brings up for review a judgment rendered in favor of the collector in a suit by plaintiff in error to recover a penalty of 50 per cent. assessed (and paid under protest) for alleged failure to make a return under the revenue act of October 3, 1917 (40 Stat. 300). During that calendar year (and for many years before) plaintiff in error was the vice-president and general manager of a distillery, for which service he received an annual salary of $4,200. On his shares of stock therein he drew dividends of $18,000. He was also on his own account (and for several years preceding had been) engaged in the business of registered distiller and wholesale and retail liquor dealer, and as such distiller owned and operated that individual business. He made an income-tax return showing the salary and dividends referred to and several thousand dollars of other income (not connected with his personal distillery and liquor business), showing a net taxable income of $27,472.78, on which a tax of $1,360.74 was computed and paid. No return whatever was made of his income from his personal business as distiller, etc., from which he received during 1917 an income of $51,994.70. A return thereof would have made plaintiff liable to an additional income tax of $4,333.18 (a total of $5,693.92 instead of $1,360.74), and to an excess-profits tax of $21,155.47. On discovering this situation the commissioner made a new assessment of taxes on the correct basis, adding to the taxes assessed a penalty of 100 per cent. ($5,693.92) for making a false and fraudulent return, and a penalty of 50 per cent. upon the excess-profits taxes for failure to make and file an excess-profits return. The entire of the additional taxes and penalties so assessed was paid under protest. In this suit to recover both items of penalties paid, the district court (which tried the case on statutory waiver of jury, under Rev. Stat. 649, U. S. Comp. Stat. sec. 1587) concluded that the return actually made was not false and fraudulent, it appearing to have been prepared by an expert accountant, plaintiff in error claiming he had given the accountant full data for the return and that he had executed the same without "looking at it or noting the amount thereof."

The court held, however, that plaintiff was not entitled to recover the 50 per cent. penalty assessed and paid for failure to make an excess-profits return. The government has not asked review of the judgment regarding the 100 per cent. penalty. Plaintiff in error does not complain of the reassessed taxes paid. The only question here relates to the 50 per cent. penalty.

Revised Statutes 649 (U. S. Comp. Stat. sec. 1587) provides that "the finding of the court upon the facts, which may be either general or special, shall have the same effect as the verdict of a jury." Revised statutes sec. 700 (U. S. Comp. stat. sec. 1668) provides for a review of the rulings of a court in the progress of a trial if excepted to at the time and presented by bill of exceptions, and that "when the finding is special the review may extend to the determination of the sufficiency of the facts found to support the judgment." The record does not show that any request for special findings was made, nor that any finding was made except that in the judgment entry the court "found the fact to be that the said return, upon which said penalty was based, imposed and collected as stated in the pleadings, was not wilfully 'false' nor 'fraudulent,' nor was it wilfully made with intent to defeat or evade assessment of a tax." The return referred to is obviously the income-tax return actually made, on which the tax of $1,360.74 was computed and paid. The statute under which the penalty in question was assessed (Rev. St. sec. 3176, as amended Sept. 8, 1916—39 Stat. p. 775; U. S. Comp. Stat. sec. 5899) provides that "in case of *any* failure to make and file a return or list within the time prescribed by law, or by the collector, the commissioner of internal revenue shall add to the tax fifty per centum. of its amount," subject to an exception hereinafter referred to. A fraudulent failure to file return is not necessary to the imposition of that penalty; concededly, mere failure is enough. With reference to that item the judgment entry is merely "in respect to the remainder of the amount sought to be recovered by the plaintiff, viz., the further sum of $11,015.21, and interest thereon, the court is of opinion and now adjudges that plaintiff's action should be and it is dismissed." This adjudication has the force of a general verdict of a jury, and (in the absence of exception to the admission of evidence) is conclusive upon all matters of fact involved therein. See *Lehnen v. Dickson* (148 U. S. 71); *Vicksburg, etc., Ry. Co. v. Anderson, etc., Co.* (256 U. S. 408, 415); *National Surety Co. v. C. N. O. & T. P. Ry. Co.* [C. C. A. 6] (145 Fed. 34); *Mason v. Smith* [C. C. A. 6] (191 Fed. 502, 503). Our statement of facts, supra, is supported by admissions in pleadings or otherwise.

The exception in the 50 per cent. penalty provision before referred to is that "when a return is voluntarily and without notice from the collector filed after such time, and it is shown that the failure to file was due to a reasonable cause, and not to wilful neglect, no such addition shall be made to the tax." On this record plaintiff is not entitled to the benefit of this exception. The fact of voluntary return wihout notice from the collector is not found, the allegation thereof in plaintiff's petition is denied by the answer, and there is direct evidence to the contrary. Two witnesses testified without dispute, that plaintiff refused, under advice of his accountant, to sign the excess-profits-tax return prepared by the revenue officers. Presumably the extent of plaintiff's actual claim in respect to voluntary return of the excess-profits tax is that his act in furnishing the revenue officers with the details of his income from his personal business, which was incorporated into the proposed return and upon which the excess-profits tax was assessed, amounted to a making of such return by him.

The sole substantial question presented is whether the penalty provision involved extends to a failure to make a return of excess profits, or whether it is limited to failure to make *any* income-tax return.

In our opinion the 50 per cent. penalty applied to the failure to make an excess-profits-tax return. The excess-profits feature had its genesis in the United States in the act of March 3, 1917, which applied only to corporations and partnerships. The act of October 3, 1917, with which we are concerned, applied to individuals as well, and superseded the act of March 3, so covering the entire of the year 1917 (Holmes *Federal Taxes,* 1923 ed., p. 1213). In the act of October 3 a distinction between ordinary income taxes and excess-profits taxes was clearly recognized, separate and distinct provisions being made for return of the two classes of taxes. The act was divided into 13 titles, title I relating to war income taxes, title II to war excess-profits taxes, titles III to IX, inclusive, and title XI relating, respectively, to taxes on beverages, tobacco and manufactures thereof, public utilities and insurance, excise, admissions and dues, stamp taxes, estate tax, and postal rates. Title X contained administrative provisions, title XII income-tax amendments, and title XIII general provisions. Section 201, which is part of title II, imposed the excess-profits taxes in question. Section 212, also part of title II, expressly made applicable thereto all provisions of title I of the act of September 8, 1916, as amended by the revenue act here in question, relating to returns and payment of the tax therein imposed, "*including penalties,*" thus incorporating into title II of the act of October 3, 1917, the requirement of section 8 of title I of the 1916 act, which requires a "true and accurate return under oath" to be made "in such form as the commissioner of internal revenue, with the approval of the secretary of the treasury, shall prescribe;" while section 213 (also part of title II) authorized the commissioner of internal revenue, with the approval of the secretary of the treasury, to make regulations for carrying out the provisions of that title, and to require corporations, partnerships, or individuals subject to the provisions thereof "to furnish him with such facts, data, and information as in his judgment are necessary to collect the taxes imposed by *this title,*" viz., the excess-profits taxes. In 1917 the commissioner provided two separate forms for individual tax returns, No. 1040, entitled "Individual income-tax return for calendar year 1917," and No. 1101, entitled "Individual excess-profits-tax *return* for calendar year 1917." Heading A on form 1040 contained blanks for details regarding "income from salaries, wages," etc. The first paragraph of instruction No. 7 (Form 1040), entitled "excess-profits taxes," directed that "if your net income reported under A * * * exceeded $6,000 you are subject to an excess-profits tax at the rate of 8 per cent. on the amount by which the net total under A exceeds $6,000." Heading B on form 1040 relates to "income from business (including farming)." The second paragraph of instruction No. 7 on that form reads: "If your total income from all sources exceeded $6,000 *and you received any income from a trade or business with invested capital,* you should get a copy of the excess-profits-tax return (Form 1101) and calculate the amount of your tax, if any, as directed therein." On form 1101 instruction 2 reads: "Every individual *employing invested capital* in his trade or business and having a net income for 1917 of $6,000 or more *must make a return on this form;*" and instruction No. 4 on form 1101 gives the information that net income subject to excess-profits taxes falls into two classes; that the first comprises all net income derived from trade or business (including occupations and professions) having no invested capital or not more than a nominal capital, and includes incomes reported in schedule A, form 1040; that the tax on *such income* should be computed and entered on Form 1040 according to the instructions thereon; but that all other income subject to tax (with reference to instruction No. 3 above, which in terms relates to excess-profits taxes) should be entered on form 1101, and the tax computed as directed in the instructions on that form. This form 1101 contained four schedules, designated, respectively, as "net income subject to tax," "adjusted capital," "deduction," and "computation of tax," each heading containing express reference to excess-profits-tax regulations. This form 1101 was required to be sworn to as "a true and *complete return*" * * * "pursuant to the excess-profits-tax regulations."

We think the two returns, thus so clearly distinguished, in connection with the requirement of separate return on form 1101, do not lose their separability or distinct identities from the fact that the amount of the excess-profits tax is to be carried onto form 1040, under headings 34 and 35, designated respectively as "excess-profits tax at rate of 8 per cent. (see instruction No. 7, page 1)" and "excess-profits tax on income from business with invested capital, as computed on *excess-profits-tax return form 1101;*" nor from the fact that the excess-profits tax is to be deducted, in line L of form 1040, from the taxable income otherwise shown thereby.

As plaintiff's income from salaries, wages, etc., under subdivision A, form 1040, did not amount to $6,000, he was not subject to excess-profits taxes thereon. The blanks under B, however, relating to income from business having invested capital, were left unfilled (as was the blank in line L relating to deduction of excess-profits taxes), and so form 1040 failed to show any income subject to excess-profits tax. In view of the considerations we have pointed out, we are unable to agree with plaintiff's contention that because schedule B was so left blank, and plaintiff thereby (impliedly only) made a return that he was not engaged in a business with invested capital and that he did not owe any excess-profits tax, he thereby made a return within the meaning of the excess-profits title, although the return so impliedly made on form 1040 was untrue; nor with the further contention that unless the return actually made was wilfully false or fraudulent, as the court below found it was not, plaintiff can not be subject to the penalty for failure to make another return as to which the liability is not conditioned upon fraudulent action. Not only was the excess-profits tax a separate, distinct, and then novel source of revenue, but the statute and regulations, as we have above shown, in express and formal terms required separate and distinct returns thereof, and we think it clear that failure to make a separate return of excess-profits tax is none the less a failure to make the return contemplated by the statute because of the mere fact that the computations on the excess-profits return are to be carried onto form 1040; the use of that form also is necessary to a complete report. By section 213 the commissioner was undoubtedly given authority, with the approval of the secretary of the treasury, to require both returns. The document, failure to make which the statute penalizes, is not styled a "report;" the statute denominates it as a "return or list;" and form 1101 is plainly such "return or list." The statute penalizes *"any* failure to file a return or list," etc. Nor is there any inconsistency between the court's finding of lack of "wilfully false or fraudulent" action as applied to the return made on form 1040, and the conclusion of liability for failure to make an excess-profits return. While we must assume, in view of the judgment, that plaintiff thought he had acquainted the expert with his ownership of a separate distillery business, and so did not act fraudulently, the accountant testified on the trial that plaintiff "never informed" him that he (plaintiff) "was in business as a distiller on his own account." In so far as the conclusion of fact so testified to was essential to the judgment rendered, the trial court is presumed to have believed the testimony. We think the commissioner justified in holding that while the accountant was responsible for the correctness of the figures, plaintiff was responsible for the source of the same and sufficient details to insure a complete understanding of the business, and that failure to take such precaution to "discover the omission of the principal item of income" does not "constitute reasonable cause for failure to file an excess-profits-tax return, which was also due to the omission of the income in question from [plaintiff's] income-tax return." The penalty, while drastic, was intended to insure payment of public revenue. No question of its reasonableness is involved.

The judgment of the district court is affirmed.

Students' Department

EDITED BY H. A. FINNEY

THE STATEMENT OF APPLICATION OF FUNDS

It is the established practice of many public accountants to include a comparative balance-sheet in their annual reports. This comparative balance-sheet shows the assets, liabilities, and capital both at the beginning and at the end of the period under review, together with the increases and decreases in the various items. Such a statement shows the changes in the financial condition during the period, and furnishes the auditor with a basis for commenting upon the various changes in assets and liabilities.

Many accountants have felt that the comparative balance-sheet did not go far enough in organizing the material in such a way as to give a clear and comprehensive conception of the change in the financial condition caused by the profits of the period, the dividend payments, and any financing programme which may have taken place. A comparative balance-sheet merely shows the change in each balance-sheet item; it does not classify similar items in such a way as to show, for instance, the total increase or decrease in the fixed assets, and the change in the working capital. Nor does it indicate in a clear manner the means which enabled the corporation to effect the changes shown.

The statement of application of funds, often called the statement of resources and their application, has been devised in order to overcome these objections to the comparative balance-sheet. The statement of application of funds not only classifies the information which is usually shown in a comparative balance-sheet, but it also goes beyond the balance-sheet figures, and furnishes more or less detailed information as to the causes of the various changes in the assets and liabilities.

As a simple illustration, the following comparative balance-sheet is shown. This is followed by a statement of application of funds, utilizing the information shown by the comparative balance-sheet and certain other data which would have to be obtained from the books:

THE A COMPANY
Comparative Balance-sheet
Assets

	Dec. 31, 1921	Dec. 31, 1922	Decrease	Increase
Real estate	$50,000.00	$60,000.00		$10,000.00
Inventories	12,000.00	13,500.00		1,500.00
Accounts receivable	7,500.00	6,500.00	$ 1,000.00	
Cash	2,000.00	2,200.00		200.00
	$71,500.00	$82,200.00		
Net increase			10,700.00	
			$11,700.00	$11,700.00

	Liabilities			
Capital stock	$40,000.00	$45,000.00		$ 5,000.00
Surplus	27,500.00	34,200.00		6,700.00
Accounts payable	4,000.00	3,000.00	$ 1,000.00	
	$71,500.00	$82,200.00		
Net increase			10,700.00	
			$11,700.00	$11,700.00

The statement of application of funds is an attempt to classify the comparative balance-sheet information and other data in such a way as to show the sources from which additional resources were obtained for the business, and the application which was made of these additional resources. The comparative balance-sheet shows that additional funds of $5,000.00 were obtained by an issue of capital stock. It also shows that the surplus has increased $6,700.00, and the first assumption might be that the profits for the year had supplied additional resources of $6,700.00. An examination of the surplus account, however, shows that a dividend of 10% was paid on the capital stock outstanding at the beginning of the year. If this dividend had not been paid, the surplus would have increased $10,700.00; therefore any statement intended to show what resources or funds were provided during the year, ought to show that the profits provided funds of $10,700.00, and that $4,000.00 of funds were used for the payment of dividends.

The following statement of application of funds is made up from the foregoing comparative balance-sheet and the additional information as to profits and dividends:

THE A COMPANY

Statement of application of funds
for the year ended December 31, 1922

Funds provided:	
By net profits	$10,700.00
By issue of capital stock	5,000.00
Total funds provided	$15,700.00
Funds applied:	
To payment of dividends	$ 4,000.00
To increase in real estate	10,000.00
To increase in working capital (per schedule)	1,700.00
	$15,700.00

SCHEDULE OF WORKING CAPITAL

	Dec. 31, 1921	Dec. 31, 1922	Working capital Decrease	Working capital Increase
Current assets:				
Inventories	$12,000.00	$13,500.00		$ 1,500.00
Accounts receivable	7,500.00	6,500.00	$ 1,000.00	
Cash	2,000.00	2,200.00		200.00
Total current assets.	21,500.00	22,200.00		
Current liabilities:				
Accounts payable	4,000.00	3,000.00		1,000.00
Working capital	$17,500.00	$19,200.00		
Increase in working capital ..			1,700.00	
			$ 2,700.00	$ 2,700.00

Attention is directed to the method of showing the facts in connection with the working capital. The statement of application of funds shows only the net change of $1,700.00 in the working capital. This net change is supported by a separate schedule of working capital. This schedule shows the current assets at both the beginning and the end of the period; it also shows the current liabilities at both dates; and it shows the working capital of $17,500.00 at December 31, 1921, and the working capital of $19,200.00 at December 31, 1922. The two columns showing changes in working capital require some explanation. If the current assets have increased, the working capital has been correspondingly increased; hence increases in current assets are shown in the working capital increase column. But if current liabilities have decreased, the working capital has increased; hence the working capital increase column shows both increases in current assets and decreases in current liabilities. The working capital decrease column shows decreases in current assets and increases in current liabilities.

The foregoing illustration is intentionally a very simple one; but in preparing a statement of application of funds for incorporation in a report, an auditor is usually confronted by the necessity of making a great many adjustments. Under such circumstances the preparation of the statement becomes a difficult and complicated matter, and it is often helpful to organize the figures in working papers. The following illustration serves as a simple introduction to the working papers which will be used later in this article for the assembling of data in more complicated statements. These working papers are based upon the foregoing illustration.

STATEMENT OF APPLICATION OF FUNDS—WORKING PAPERS

	Dec. 31, 1921	Dec. 31, 1922	*Year's excess* Debits	*Year's excess* Credits	*Adjustments* Debit	*Adjustments* Credit	*Working capital* Increase	*Working capital* Decrease	*Funds* Applied	*Funds* Provided
Assets:										
Real estate	$50,000	$60,000	$10,000						$10,000	
Inventories	12,000	13,500	1,500				$ 1,500			
Accounts receivable	7,500	6,500		$ 1,000				$ 1,000		
Cash	2,000	2,200	200				200			
	$71,500	$82,200								
Liabilities:										
Capital stock	$40,000	$45,000		5,000						$ 5,000
Surplus	27,500	34,200		6,700	$10,700 (a)	$ 4,000 (b)				
Accounts payable	4,000	3,000	1,000				1,000			
	$71,500	$82,200								
Funds provided by profits						10,700 (a)				10,700
Dividends paid					4,000 (b)				4,000	
			$12,700	$12,700	$14,700	$14,700				
Increase in working capital								1,700	1,700	
							$ 2,700	$ 2,700	$15,700	$15,700

The working papers are prepared in the following manner:

The assets and liabilities at the two dates are entered in the first two columns. The amounts to enter in the year's excess debits and credits columns are next computed. The real estate account has increased; this increase was caused by excess debits during the year. The inventories have also increased as a result of excess debits. The accounts receivable have decreased as a result of excess credits. The capital stock increase represents excess credits; the surplus increase also represents excess credits; while the decrease in the accounts payable represents an excess debit.

Since changes in fixed assets are shown as funds applied, the $10,000.00 increase in the real estate is carried to the funds applied column, which is a debit column. The changes in inventories, accounts receivable, cash, and accounts payable, are entered in the working capital columns; the net increase of $1,700.00 is entered as a balancing figure in the working capital decrease column and is carried to the funds applied column. The increase in capital stock is carried to the funds provided column. The $6,700.00 net change in the surplus is analyzed by two adjustment entries; the first entry transfers $10,700.00 from the surplus line to the separate line called funds provided by profits; this $10,700.00 is then carried to the funds provided column. The $4,000.00 dividend is transferred from the surplus line to a separate line called dividends paid; this amount is then carried to the funds applied column.

The two adjustments in the foregoing illustration accomplish the breakdown of the $6,700.00 change in the surplus account. The following illustration is somewhat more extended, and it involves a number of adjustments. The breakdown of the $3,805.00 increase in the surplus account includes four items, and there are adjustments in several of the other accounts:

In the first place, the profits shown by the profit-and-loss statement for the year, were $10,805.00; this amount is transferred from the surplus line to the section at the bottom of the working papers, called funds provided by profits. This transfer commences the breakdown of the change in the surplus balance, and is accomplished by adjustment (a).

The next adjustment is one which almost invariably appears in statements of application of funds, and is one which must therefore be clearly understood. During the year $500.00 was charged to operations and credited to the reserve for depreciation, thus increasing the reserve. Adjustment (b) transfers this $500.00 increase in the reserve for depreciation to the section called funds provided by profits. This transfer is made because the funds provided by the profits were really larger than the profits themselves. To understand why this is, let us assume that a man is doing a cash business; he buys goods which cost $5,000.00 and sells them for $6,000.00, thus making a profit of $1,000.00. He also pays expenses of $200.00 leaving a profit balance of $800.00. Thus it appears that the profits have increased his cash $800.00. But he has a small investment in certain fixed assets which are subject to depreciation and he proceeds to make a book entry debiting profit-and-loss and crediting the reserve for depreciation $50.00. This reduces the balance of the profit-and-loss account to $750.00, but it does not reduce the cash funds provided by the profits. These funds remain at $800.00. Hence to find the funds provided by the profits, we must add the net profit per books and the depreciation provision.

Adjustment (c) is made for similar reasons. Operations were charged $1,000.00 on account of the patent expiration expense applicable to the year. While this $1,000.00 reduced the profits for the year, it did not reduce the funds brought in by the profits, and hence this $1,000.00 credit in the patent account is transferred from the patent line to the net profit line as an adjustment to determine the funds provided by the profits.

Adjustment (d) is made in order to show the net funds provided by the bond issue. The bond account shows an increase of $20,000.00 during the year, which was the par of the bonds issued. Against this there appears a bond discount account of $1,900.00. The analysis of this account, obtained from the books shows that it was charged with $2,000.00 discount on the issue of the bonds; and since the bonds were to mature in twenty years, 1/20 of the discount has been written off. Now since the bonds were issued at a 10% discount, the $20,000.00 par of bonds produced only $18,000.00 of funds. In order to show this fact in the working papers $2,000.00 of bond discount is transferred from the bond discount line to the bonds payable line reducing the $20,000.00 balance of the bonds payable to $18,000.00, the net funds provided.

Referring to the bond discount line we find that the $1,900.00 item in the year's excess debit column and the $2,000.00 credit adjustment leave a $100.00 balance in the account. This is the amount of discount written off during the year, and the amount of the charge to profit and loss. But this was merely a book entry which had no effect upon the funds. In other words this charge to profit and loss did not require an expenditure of funds nor did it reduce the amount of funds provided by the profits. Therefore adjustment (e) is made transferring the $100.00 to the funds provided by the profits section of the working papers.

An analysis of the land account shows that the $5,000.00 increase during the year was the result of an appraisal, and that an entry was made debiting the land account and crediting surplus. As this debit to land does not represent an expenditure of funds, and as the credit to surplus does not represent a provision of funds, the entry is reversed in the adjustment columns by debiting surplus and crediting the land account.

During the year a stock dividend of $8,000.00 was paid. This stock dividend involved a transfer of $8,000.00 from surplus to capital stock, increasing the balance of the latter account $8,000.00. This increase of the capital stock does not represent a provision of funds, and hence adjustment (g) is made reversing the entry recording the stock dividend. This entry eliminates the $8,000.00 change in the balance of the capital stock account because the stock dividend had no effect upon the funds.

During the year a cash dividend of $4,000.00 was paid. In order to complete the breakdown of the change in the surplus balance, and also in order to show the cash dividend as an application of funds, the $4,000.00 is transferred by adjustment (h) from the surplus line to a separate line called cash dividend.

The next step is to make the distribution in the working capital and the funds columns. The $5,000.00 change in the land account has been eliminated by an adjustment; hence it is not to be carried out to either the working capital or the funds columns. The $30,000.00 increase in the building account is carried to the funds applied column. The change in the patents account has been eliminated. The $5,000.00 decrease in the bond investment account is carried to the funds provided column. The increase in the inventory is shown as an increase in the working capital. The decrease in the accounts receivable is carried to the working capital decrease column. At this point attention is called to the treatment of the reserve for bad debts. This reserve has increased $10.00 during the year. This $10.00 might be added back to the profits in the same way that the provision for depreciation was added back. It seems preferable, however, to carry this change in the reserve into the working capital column, because the accounts receivable and the reserve for bad debts must be considered together in determining the amount of the working capital. In the schedule of working capital the accounts receivable at the beginning and at the end will be entered at the net amount after deducting the reserves at the two respective dates, and the change in the accounts receivable will be the sum of the $150.00 decrease in the account receivable and the $10.00 increase in the reserve.

The increase in the unexpired insurance is entered in the working capital column. In the statement of application of funds the change in working capital and deferred charges will be shown as a single item. The deferred charge item should be itemized below the working capital items in the schedule of working capital and deferred charges.

The change in the capital stock has been eliminated. The change in the surplus has been broken down and the several elements which caused the net change have been transferred to various places in the working papers. The change in the reserve for depreciation has been eliminated by transfer to the profits. The net amount of the bond issue, that is $20,000.00 minus $2,000.00 discount, is carried to the funds provided column. The increase in the accounts payable is carried to the working capital decrease column.

The total funds provided by the profits are now computed by adding the net profit per books and the three items which decreased the net profits but did not reduce the funds provided by the profits. The addition of these four items produces a total of $12,405.00 of funds provided by profits.

The cash dividend is carried out as an application of funds.

THE B COMPANY
Statement of Application of Funds—Working Papers

	Dec. 31, 1921	Dec. 31, 1922	*Year's excess* Debit	*Year's excess* Credit	*Adjustments* Debit	*Adjustments* Credit	*Working capital* Increase	*Working capital* Decrease	*Funds* Applied	*Funds* Provided
Assets:										
Land	$15,000	$20,000	$ 5,000			$ 5,000 (f)				
Buildings	65,000	95,000	30,000						$30,000	
Patents	17,000	16,000		$ 1,000	$ 1,000 (c)					
Investment in X Co. bonds	5,000			5,000						$ 5,000
Inventories	18,000	19,600	1,600				$ 1,600			
Accounts receivable	3,000	2,850		150				$ 150		
Cash	2,700	2,900	200				200			
Unexpired insurance ..	300	315	15				15			
Bond discount		1,900	1,900		100 (e)	2,000 (d)				
	$126,000	$158,565								
Liabilities:										
Capital stock	$ 80,000	$ 88,000		8,000	8,000 (g)					
Surplus	41,600	45,405		3,805	5,000 (f)	8,000 (g)				
					10,805 (a)	4,000 (h)				
Reserve for depreciation	1,000	1,500		500	500 (b)					
Reserve for bad debts..	150	160		10				10		
Bonds payable		20,000		20,000	2,000 (d)					18,000
Accounts payable	3,250	3,500		250				250		
	$126,000	$158,565	$38,715	$38,715						
Funds provided by profits:										
Net profit per books						10,805 (a)				
Add: Depreciation..						500 (b)				
Write-off of patents						1,000 (c)				12,405
Write-off of bond discount						100 (e)				
Cash dividend					4,000 (h)				4,000	
					$31,405	$31,405				
Increase in working capital and deferred charges								1,405	1,405	
							$ 1,815	$ 1,815	$35,405	$35,405

The following statement of application of funds, with its supporting schedule of working capital and deferred charges, was prepared from the foregoing working papers:

THE B COMPANY
Statement of application of funds
for the year ended December 31, 1922

Funds provided:		
By net profits:		
Net profits per books	$10,805	
Add: Depreciation	500	
Write-off of patents	1,000	
Write-off of bond discount	100	$12,405
By issue of bonds at 90		18,000
By sale of bonds of the X company		5,000
Total funds provided		$35,405
Funds applied:		
To increase in buildings		$30,000
To payment of cash dividend		4,000
To increase in working capital and deferred charges (per schedule)		1,405
Total funds applied		$35,405

SCHEDULE OF WORKING CAPITAL AND DEFERRED CHARGES

	Dec. 31, 1921	Dec. 31, 1922	*Working capital* Decrease	Increase
Current assets:				
Inventories	$18,000	$19,600		$ 1,600
Accounts receivable (less reserve)	2,850	2,690	$ 160	
Cash	2,700	2,900		200
Total current assets	$23,550	$25,190		
Current liabilities:				
Accounts payable	3,250	3,500	250	
Working capital	$20,300	$21,690		
Increase in working capital			1,390	
			$ 1,800	$ 1,800

DEFERRED CHARGES

	Dec. 31, 1921	Dec. 31, 1922	Decrease	Increase
Unexpired insurance	$ 300	$ 315		$ 15

SUMMARY

Increase in working capital	$ 1,390
Increase in deferred charges	15
Increase in working capital and deferred charges	$ 1,405

The possible complications which may be met in the preparation of the statement of application of funds, are almost innumerable. Depreciation may have been credited to an asset account, thus writing it down; at the same time additions may have been charged to the asset account. The net change in the balance of the asset account ought to be broken down so as to show the depreciation as an addition to the profits, and to show the addition to the property as an application of funds.

If extraordinary repairs have been charged against a depreciation reserve, the net change in the balance of the depreciation reserve will be the difference between the depreciation and the extraordinary repairs. Adjustments ought to be made in the working papers to break down the two elements of the change in the reserve, showing the depreciation as an addition to the profits, and showing the extraordinary repairs as an application of funds.

If the profit-and-loss statement shows a loss for the period, the transfer of depreciation provisions and other non-fund-requiring expenses to the profit section, may change the loss into a profit. If the adjustments are not sufficient to change the loss into a profit, the question arises as to the proper method of showing the loss in the statement of application of funds. There are two possible methods. In the first place the loss may be shown in the funds applied section on the theory that the funds provided from other sources were used in part to cover the loss. In the second place the funds provided section may be added and the loss may be deducted in order to determine the net funds provided during the period.

When the working capital has increased, the increase is shown as an application of funds. If the working capital has decreased, the decrease may be shown as one of the sources of funds, on the theory that funds were taken out of working capital in order to accomplish the various purposes shown under the funds applied heading.

Many accountants feel that if some current item has changed in a very large amount, this change ought to be set out as a separate item in the statement of application of funds. To illustrate, assume that the balance-sheet at the beginning of the year showed a large liability on bank loans; at the end of the year this liability has been paid off. Should this reduction in the current liability of bank loans be shown as a separate item in the statement of application of funds? Those who contend that it should be, argue that it is so important an item that it ought to be given a conspicuous presentation. While this may be true, it should be remembered that if the decrease in the current liability is set out separately as an application of funds, the change in this liability cannot also be shown in the schedule of working capital. If the schedule of working capital cannot show the reduction in the current liability, it cannot show the liability in the beginning of the year. Therefore the schedule of working capital would misstate the working capital at the beginning of the year and would also misstate the change in the working capital during the year. It seems doubtful whether the setting out of this item separately is sufficiently important to justify a serious misstatement in the schedule of the working capital.

The following problem from an American Institute examination is given in order to illustrate further the preparation of the working papers and the statement of application of funds:

Following are the balance-sheets of the Alhambra Trading Company at stated dates:

Assets	Dec. 31, 1920	Dec. 31, 1921
Land	$ 3,000	$ 4,000
Building	6,000	7,500
Delivery equipment	900	700
Store fixtures	1,200	1,250
Merchandise inventory	7,500	8,650
Accounts receivable	3,200	2,400
Notes receivable	800	750
Cash	675	405
	$23,275	$25,655

Liabilities		
Mortgage notes	$ 4,000	$ 3,000
Accounts payable	7,320	6,135
Reserve for depreciation—building	600	750
Capital stock	10,000	12,000
Surplus	1,355	3,770
	$23,275	$25,655

The statement of surplus appears as follows:

Balance, December 31, 1920		$ 1,355
Add: Write-up of land		1,000
Net profit for the year		2,915
Total		5,270
Deduct: Stock dividend	$ 500	
Cash dividend	1,000	1,500
Balance, December 31, 1921		$ 3,770

Depreciation was provided during the year as follows:

Building (credited to reserve)	$ 400
Delivery equipment (asset written down)	300
Store fixtures (asset written down)	200

A new roof was put on the building, and other extraordinary repairs were made at a total cost of $250.00, and charged to the reserve for depreciation. The mortgage notes are due serially, in annual amounts of $1,000.00.

Prepare a statement of resources and their application.

THE ALHAMBRA TRADING COMPANY

Statement of Application of Funds—Working Papers

	Dec. 31, 1920	Dec. 31, 1921	*Year's excess* Debits	*Year's excess* Credits	*Adjustments* Debit	*Adjustments* Credit	*Working capital* Increase	*Working capital* Decrease	*Funds* Applied	*Funds* Provided
Land	$ 3,000	$ 4,000	$ 1,000			$ 1,000 (a)				
Building	6,000	7,500	1,500						$ 1,500	
Delivery equipment ...	900	700		$ 200	$ 300 (f)				100	
Store fixtures	1,200	1,250	50		200 (g)				250	
Merchandise inventory..	7,500	8,650	1,150				$ 1,150			
Accounts receivable	3,200	2,400		800				$ 800		
Notes receivable	800	750		50				50		
Cash	675	405		270				270		
	$23,275	$25,655								
Mortgage notes	$ 4,000	$ 3,000	1,000						1,000	
Accounts payable	7,320	6,135	1,185				1,185			
Res. for dep'n—building	600	750		150	400 (e)	250 (h)				
Capital stock	10,000	12,000		2,000	500 (c)					$ 1,500
Surplus	1,355	3,770		2,415	1,000 (a)	500 (c)				
					2,915 (b)	1,000 (d)				
	$23,275	$25,655	$ 5,885	$ 5,885						
Funds provided by profits:										
Net profit per books						2,915 (b)				
Add: Depreciation, building						400 (e)				3,815
Depreciation, delivery equipment						300 (f)				
Depreciation, store fixtures						200 (g)				
Dividends paid					1,000 (d)				1,000	
New roof and extraordinary repairs					250 (h)				250	
					$ 6,565	$ 6,565				
Increase in working capital								1,215	1,215	
							$ 2,335	$ 2,335	$ 5,315	$ 5,315

THE ALHAMBRA TRADING COMPANY
Statement of application of funds
for the year ended December 31, 1921

Funds provided:			
By net profits:			
Net profits per books		$ 2,915	
Add back depreciation:			
Building	$ 400		
Delivery equipment	300		
Store fixtures	200	900	$ 3,815
By issue of stock			1,500
Total funds provided			$ 5,315
Funds applied:			
To increase in fixed assets:			
Building		$ 1,500	
Delivery equipment		100	
Store fixtures		250	
New roof and extraordinary repairs to building		250	$ 2,100
To payment of mortgage serial note			1,000
To payment of dividend			1,000
To increase in working capital (per schedule)			1,215
Total funds applied			$ 5,315

SCHEDULE OF WORKING CAPITAL

	Dec. 31, 1920	Dec. 31, 1921	*Working capital* Decrease	Increase
Current assets:				
Merchandise inventory	$ 7,500	$ 8,650		$ 1,150
Accounts receivable	3,200	2,400	$ 800	
Notes receivable	800	750	50	
Cash	675	405	270	
Total current assets	$12,175	$12,205		
Current liabilities:				
Accounts payable	$ 7,320	$ 6,135		1,185
Working capital	$ 4,855	$ 6,070		
Increase in working capital			1,215	
			$ 2,335	$ 2,335

May and Galloway, 805 W. R. Rust building, Tacoma, Washington, announce the admission to partnership of John G. Thorstenson.

Arthur A. Lechner announces the opening of an office at 110 West 40th street, New York.

American Institute of Accountants

REGIONAL MEETINGS

Dallas, Texas, October 26 and 27, 1923

A regional meeting of members of the Institute and other accountants in Arkansas, Louisiana, New Mexico, Oklahoma, Texas and Mexico, was held at the Oriental Hotel, Dallas, Texas, October 26 and 27, 1923.

The meeting was called to order at 10 A. M. An address of welcome was delivered by C. E. Calder, president, Power and Light Corporations, Dallas, and response was made by Edward E. Gore, Chicago, president of the American Institute of Accountants.

A message of greeting from Mexico was delivered by Sr. Mariano Narro. Sr. Roberta Casas Alatriste, member of the Federal Congress of Mexico, also addressed the meeting.

At the afternoon session an address was delivered on *The Junior Accountant* by E. C. Gause of Pittsburgh, followed by a paper on *Depletion of Oil and Gas Properties* by Joseph McElroy, Dallas. These addresses were followed by general discussion.

In the evening a dinner was held at the Oriental Hotel. The following speeches were made: *Accountants and Clients* by Edward E. Gore; *American Citizenship,* R. E. L. Knight; *Certified Balance-Sheet,* Nathan Adams, vice-president, American Exchange National Bank, Dallas; *Fraternal Relations,* Sr. Roberta Casas Alatriste and Sr. Mariano Narro. An attractive musical programme was provided.

On the morning of the 27th B. A. McKinney, Governor, Federal Reserve Bank, Dallas, addressed the meeting on *Relation of Auditors to Banks.* A paper on *Banks and Banking Accounts* was also read by George Armistead of Houston and followed by discussion.

At the afternoon session Dr. William F. Hauhart of Southern Methodist University, addressed the meeting. A report of the Texas Society of Certified Public Accountants was then read by Austin H. Cole, president of the society, followed by general discussion and business session.

The meeting was a notable success, being attended by approximately 200 persons.

Kansas City, Missouri, October 31, and November 1, 1923

The seventh midwest regional meeting was held at the Hotel Bellerive, Kansas City, on October 31 and November 1, 1923. About 150 persons were present.

On the first day there were several important discussions among which were the following: *Public Service of the Public Accountants,* led by J. Arthur Marvin; *Income Tax Practice—Special Advocate or Impartial Investigator?* led by Victor H. Stempf; *Accountants' Relation with Bankers,* led by E. E. Amick of the First National Bank of Kansas City, and *Relation of the Courts with Accountants and Business,* led by Elmer N. Powell, Referee in Bankruptcy of the Western District of Missouri.

In the evening an informal banquet was held at the Hotel Bellerive.

On November 1st the meeting opened at 9:30 with the following discussions: *Should Communications between Accountant and Client Be Privileged?* led by Francis R. Roberts; *The Work of the American Institute of Accountants,* led by A. P. Richardson; *What Distinguishes a Profession from a Business?* led by Loyd B. Smith.

In the evening a dinner and theatre party concluded a very successful meeting.

Akron, Ohio, November 3, 1923

A regional meeting of the American Institute of Accountants was held at the Akron City Club, Akron, November 3, 1923. Representatives from Ohio, West Virginia, Western New York, Western Pennsylvania and Eastern Michigan were present.

The meeting was called to order at 10 A. M. After a brief business session an opening address was delivered by A. P. Richardson, secretary of the American Institute of Accountants.

The following papers were read and discussed:

Progress in Audit Procedure by Hugh L. Patch of Cleveland; discussion led by Lewis Wintermute, Cleveland.

Some Problems in the Installation of Accounting Systems by William A. Ullrich of Dayton; discussion led by Walter F. Vieh, Cleveland.

Several Phases of Branch Accounting by Charles H. Brook of Akron; discussion led by Chester L. Weberg, Akron.

Growth of Professional Ethics by Carl H. Nau of Cleveland;

Federal Tax Practice by John T. Kennedy of Washington;

Accounting Terminology by Homer S. Pace, New York.

In the evening a banquet was held, the toastmaster being Homer C. Campbell. Speeches were delivered by H. E. Andress, attorney; Edward E. Gore, president of the American Institute of Accountants; C. S. Marvel, secretary and treasurer of the First Trust and Savings Bank, Akron; Homer S. Pace, Pace Institute, New York, and W. O. Rutherford, vice-president in charge of Sales of the B. F. Goodrich Company, Akron.

The meeting was attended by 150 persons.

Charles H. Steel and Calvin O. Althouse announce the formation of a partnership under the firm name of Althouse, Steel & Co., with offices at 719 Schaff building, Philadelphia, Pennsylvania.

Nau, Rusk & Swearingen announce the opening of an office at 910 Ellicott Square building, Buffalo, New York.

Paul H. Wilkes announces the opening of an office at 526 Brisbane building, Buffalo, New York.

Edwin B. Hathaway announces the opening of an office at 983 Main street, Hartford, Connecticut.

Book Reviews

THE WISCONSIN INCOME TAX LAW, INTERPRETATION, RULINGS AND COURT DECISIONS, by HENRY B. NELSON, A. B. *Trade Publishing Company,* Milwaukee.

Wisconsin is looked to to blaze the way in many matters of legislation and was one of the first states to adopt an income-tax law. Its experience upon the latter subject dates back to 1911, and it has, through the succeeding years, refined and improved upon its first attempt. Notwithstanding this experience, it still holds that a stock dividend constitutes taxable income at par value of the stock received. The surprising part of this phase of the law is that this view of stock dividends has been upheld by the supreme court of the state. How the court arrived at this conclusion and how Wisconsin met and solved its soldier's bonus problem can be found in this book by Henry B. Nelson, who, by the way, writes with the conscious authority derived from his experience as former chief auditor of the income-tax section, corporation department of the Wisconsin Tax Commission. The interpretations and rulings contained in this volume are the work of this commission and as such are written from the viewpoint of the taxing authority. The subject matter is compiled in four parts. Part one, consisting of six chapters, deals with the application of the law; Part two, with method of administration; Part three, with laws for refund and compromise; Part four, with surtax laws; Part five, with computation of surtaxes, and Part six, with synopses of court cases.

The book contains one hundred and sixty three pages of concise information and should be valuable to all who are subject to the Wisconsin income-tax laws, and to others for general information upon income-tax questions.

STEPHEN G. RUSK

Alex J. Boka announces the opening of an office under the name of Alex. J. Boka & Co., with offices at 1025 Planters building, St. Louis, Missouri.

Price, Waterhouse & Co. announce the removal of their Los Angeles office to the A. G. Bartlett building, 215 West Seventh street.

Schuessler, Keller & Company announce the opening of an office in room 716, Title Guaranty building, St. Louis, Missouri.

Horwath & Horwath announce the opening of an office in the Chicago Trust building, Chicago, Illinois.

Philip W. Johnson announces the opening of an office at 19 Congress street, Boston, Massachusetts.

Philip Sigmund Kantor announces the opening of an office at 277 Broadway, New York.

Current Literature

Compiled in the Library of the American Institute of Accountants

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