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Students' Department

Seymour Walton

H. A. Finney

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Students' Department

EDITED BY SEYMOUR WALTON

(ASSISTED BY H. A. FINNEY)

CHARGE AND DISCHARGE

Editor, Students' Department:

SIR: Will you kindly settle the following question for me:

Can the phrase "charge and discharge" be used in referring to book entries in a synonymous sense to debit and credit?

In making up some statements to be journalized I used the word charge in place of debit and discharge in that of credit. Another one of the office force ridiculed me for this, saying that neither bookkeeping nor accounting, either literally or theoretically, admits the use of "charge and discharge" in place of debit and credit. As I do not know, I cannot argue with him. I will appreciate it greatly if you will render an opinion as to whether I am right or not.

Yours truly,
G. Q. D'A.

As far as we know the terms charge and discharge are used only in the statements of executors and others handling trust funds. The executor charges himself with an asset when he assumes responsibility for it, and he discharges himself when he parts with the asset and thus relinquishes responsibility.

It will be noted that the executor charges and discharges himself, not the asset. The only way in which these terms would be applicable to a bookkeeper of commercial accounts would be for him to consider himself the trustee of the business, responsible at least for their correctness. He could then say that he charged himself with all the debits and discharged himself when they were disposed of. But if he called all credits discharges, he would be in a bad fix when it came to an item which originated as a credit. When he entered a note payable, he would be discharging himself from a responsibility that he never had.

The terms debit and credit fill all the requirements, and it seems foolish to substitute for them terms that are very far from being improvements, to say the least.

CAPITAL STOCK TEMPORARILY IN ABEYANCE

Editor, Students' Department:

SIR: I enclose herewith a copy of a trial balance, and would appreciate if you can give me some information relative to one or two items about which there has been discussion.

This company was incorporated with a capital of $500,000.00, and $272,190.00 is held in escrow by the commission in this state, until the company pays a dividend of 6% on the balance of its stock. Of the escrow stock $125,000.00 would be given to the patentee and inventor, and $147,190.00 is held in trust for the old stockholders. How would you treat these entries on the balance-sheet? I have just submitted a balance-sheet, leaving off

the escrow stock, as I consider it of no value until the company pays a dividend, as arranged when it was organized.

CONDENSED TRIAL BALANCE
December 31, 1919

Cash	$68,403.52	
Liberty bonds and war savings stamps	4,272.23	
Bills receivable	300.00	
Sundry employees	80.45	
Factory lease	100.00	
Rough castings and raw material	10,386.24	
Finished parts	17,162.65	
Stationery, electros, etc.	1,068.77	
Fuel	365.70	
Machinery and equipment	7,089.73	
Office furniture	923.85	
Prepaid insurance	819.90	
General expense	63,685.27	
Experimental and development	11,311.19	
Subscriptions to capital stock	44,996.39	
Unissued capital	10,960.00	
N. Smith, personal stock	125,000.00	
N. Smith, stock in trust	147,190.00	
Accounts payable	....	13,717.47
Discount and interest	....	392.42
Capital stock authorized	....	500,000.00
(Debits really add $514,115.89)	$514,109.89	$514,109.89

Trusting you can give me this information, I am

Yours truly,

Detroit, Michigan. J. H.

There is no reason why any stock should be left off the balance-sheet because it happens to be held in escrow, but this condition should be recognized in any financial statement.

The proper way to exhibit the stock on the balance-sheet is as follows:

Capital stock, authorized	$500,000.00		
Less unissued	10,960.00		
In escrow for patents	125,000.00		
In trust for old stockholders	147,190.00	$283,150.00	
Total subscribed		$216,850.00	
Less subscriptions unpaid		44,996.39	
Net stock paid in			$171,853.61

This shows the entire situation exactly as it is. If no mention is made of the $272,190.00 of escrow stock, it might be inferred that no such stock existed and that the directors have that much unscribed stock that they could sell for cash. The real situation is far from being as favorable as that.

Incidentally we note that the debit side of the trial balance adds up $6.00 more than the total given. When figures are copied they should always be added to prove. Ordinary proof-reading is not enough.

Writing Up Land Value

Editor, Students' Department:

Sir: I would like to ask your assistance in regard to the real estate account on the books of our company, the details of which are as follows:

At the time of incorporation in 1880 the land was only considered good for grazing and valued at something like $5,00 an acre, and there were somewhere around 100,000 acres taken in at the figure of $5.00 an acre and stock was issued. Since this land has proven a rich farming land and has advanced in price to $150.00 an acre at the present time, the company has sold enough of the land at the price of $150.00 an acre for the real estate account to show a credit of $50,000.00. The entire amount of the sale has been credited to real estate and no part carried to profit and loss. The old records are such that it is almost impossible to ascertain exact cost of this land per acre, as there have been some drainage ditches put in and enclosed in a wire fence and cross fenced. There would not be any difficulty in establishing the fair market value on March 1, 1913, at $100.00 an acre.

Would you advise setting up on the books the fair market value of March 1, 1913, and crediting surplus or setting up a charge to real estate and credit of profit and loss to offset this credit balance?

What effect will this have on the income and war profits tax?

Yours truly,
C. J. M.

It is generally considered that it is wrong to write up the value of an asset solely on account of an increase in its market price.

A. Lowes Dickinson modifies this idea, and takes the ground that "over a period of years changes in values may be sufficiently permanent to render it unfair to one business to maintain original cost values as compared with another whose assets have been created at widely varying costs." He is in favor of allowing a reasonable increase in value where there is every reason to believe that it is permanent, especially where sales of part of the assets have fixed the price of the whole lot.

In the case in point justification for the write-up may be found in the fact that the supposed character of the land has changed. It was bought as grazing land and has since turned out to be rich farming land. The increase in value does not arise solely from a better demand for grazing land, but is caused by the discovery that it is intrinsically more valuable.

In writing up the value, the offsetting credit should be to surplus direct, as it is not the profit of any one year.

As to the income tax, the difference between the selling price and the value at March 1, 1913, is taxable income of the year when the sale was made.

Padding Invested Capital

Editor, Students' Department:

Sir: I do not know whether subscribers are privileged to ask you for solutions to accounting questions which they run up against or not, but I am taking a chance, and would surely appreciate an opinion on the following:

A corporation was organized in 1900. The plants, equipment, materials, patterns, patent rights, etc., of several concerns were taken over. All the capital stock was issued for these items. Capital accounts were set up and the total of them agreed with capital stock account. Very little was charged off for depreciation in the early years, but in 1907 an appraisal company

made an inventory of the plant and equipment and the accounts were adjusted accordingly.

In 1919 public accountants were called in for the purpose of examining the books with a view to making up the income-tax return. They started in at 1907 and added to the capital accounts items which had been charged to expense accounts in error and corrected the accounts up to March 1, 1913. Now (here is the part that bothers me) they add to the capital account 20% of the total administration expenses—these include officers' salaries, office expenses (except selling), interest, taxes, insurance, etc.—from the start of the company (1900) through March 1, 1913. The accountants' explanation is that a certain proportion of the administration expense applies to capital items, inasmuch as part of the officers and engineers' time is taken up in planning improvements, etc. In the above case the 20% of the administration expense almost equaled the total amount of additions made to capital account from the start of the company to March 1, 1913. It is the writer's opinion that if any time should be added for overhead, as the above might be called, it should be a certain percentage of the value of the addition, or, in other words, a percentage such as that on which an architect's fee is based. Reserves for depreciation were set up from 1907 onward, and, of course, the addition of the 20% administration allowed a bigger depreciation charge for the taxable year. I don't know whether the above idea will pass revenue muster or not, but what I'm concerned to know is: is it good accounting procedure? I might add that the accountants deemed it unwise to continue the policy after March 1, 1913.

Yours truly,

A. R. C.

No one can give an authoritative answer about a subject of which he does not know all the details. From what facts are given in the letter it would look very much as if the accountants were taking extreme measures to increase the invested capital with a view to the effect on the excess profits taxes.

If very extensive additions and improvements are being carried out, and a certain amount of time is actually given to the work by officers and clerks of the concern, it is usually considered legitimate to charge a fair proportion of their salaries as a capital expenditure; but the federal reserve bulletin on *Approved Methods for the Preparation of Balance-sheet Statements* advises against capitalizing such expenditures. It hardly seems possible that this proportion should be as high as 20% for nearly or quite twelve years. Still less is it probable that the same proportion would hold for office expenses, interest, taxes, insurance, etc.

However, we would not say that it was impossible. The company may have been doing an abnormal amount of developing and comparatively little production during its first twelve years. It would require a review of all the conditions to enable one to form an opinion that would be of any value. Without that, all that can be said is that it looks suspicious.

Commission on Sale of Capital Stock

Editor, Students' Department:

Sir: The writer would like you to explain the following queries:

A new gas company is selling stock for $100 a share, this being its par value. The salesman gets a commission of 5% for his sales. How would you make the proper entries? Another salesman wants stock instead of

commission at the same rate as above. What entries would you make for this?

In a case where stock is sold on the instalment plan how would you treat the expense of collecting the instalments? How would you treat forfeited instalment subscriptions when the firm is permitted to retain payments already made?

Trusting to be favored with a prompt reply in regard to the above requests, I wish to remain

Yours truly,
S. J. V.

The entry to be made for the sale of stock depends on the entries that have gone before. If no capital stock entries had been made, these would be in order:

Subscriber	xx	
Capital stock		xx
For ——— shares of stock.		
Commissions	xx	
To salesman		xx
Paid John Doe on ——— shares at $5.00.		

Of course, cash paid by subscribers or to salesmen would go through the cashbook.

A salesman buying stock would be treated like any other subscriber, except that the payment of his subscription would be shown by a charge to his account instead of by an entry in the cashbook. However, he might be given a cheque for his commissions, and then he could pay for his stock in cash.

Specific expenses collecting instalments may be charged to organization expense, with legal and other expenses incident to starting the concern.

If instalments are forfeited the entry would be:

Capital stock (or unsubscribed stock)	$1,000.00	
Subscriber	....	$900.00
Forfeited stock	....	100.00
For stock forfeited by ———.		

Eventually commissions would be charged to organization expense, and forfeited stock should be credited to the same account. This account should be written off in as few years as possible, out of profits.

Profit on Returned Purchases

Editor, Students' Department:

Sir: I note that you answer accounting problems, and as a little controversy has arisen in our store between the accounting and sales departments, I am writing you for an authoritative opinion. We closed out an important line of merchandise, and the manufacturers thereof agreed to take it back at the prevailing cost price, which in some cases is higher than what was actually paid for it. The amount involved is about $2,500.00, and the question is if this should be credited to purchase account or sales.

Yours truly,
F. J. M.

We do not see that a slight difference in price alters the status of goods returned to the purchaser. The sales department did not sell them, and they certainly do not belong in the category of sales. There seems to be no disposition that can be made of them except to treat them like any other returned purchases—credit them to purchase account, at cost, and credit the excess over cost to profit on returned goods.

Fire Losses

Editor, Students' Department:

Sir: In case of fire losses, when the property involved is carried in the investment or property account at its original cost, but is insured for its replacement value and the amount of insurance recovered exceeds the charge to investment, how should this excess be shown in the accounts?

If it was customary to charge off the net loss through an expense account, would it be good practice to credit the same account in case the recovery exceeded the original cost?

J. A. D.

The fact that errors have been made in the past by charging fire losses to an expense account does not justify the credit to expense of an unexpected profit from a fire. All adjustments of fire losses must be made through the surplus account, since they are not part of the normal operations of the business, but are accidental and extraneous.

If fire losses are so frequent as to be considered more or less a normal expense, provision against them should be made by an additional annual charge to insurance and a credit to reserve against fires. All settlements then would be through the reserve account. In this way losses will be equalized, instead of being heavy charges some years and very light or none in other years.

Controlling Account for Freight on Delivered Goods

Editor, Students' Department:

Sir: I would be pleased to have some information as to how I can control the freight account as accounts receivable and payable are controlled. I am able to control and identify all of my accounts with this exception.

Our method is to estimate the freight and place it in an estimated freight column of ledger sheet, posting direct from copy of invoice. Then when the expense bill is sent in by customer the exact freight is placed in an amount freight returned column. We have a freight dr. & cr. account in cash journal. We have no car book, and I am at a loss as to how I can control this freight without a car book. For instance, my freight account shows a credit of about $20,000.00 representing freight that we owe to our customers, awaiting the return of their expense bills for freight credit, and is an account payable, in one sense of the word. I have never been able to take a trial balance and show to within a thousand or more dollars to whom this is due—in other words, to identify the freight with the customer's name and have it come anywhere near a balance.

I will appreciate any information that you can give me or any advice as to where I can get a book which would deal with freight handling. I have quite a little accounting library but have nothing that gives me the information I need in this case.

Yours truly,
M. J. E.

It is necessary to assume some conditions that the letter does not specify. It is presumed that goods are sold f. o. b. destination, and that the freight is not prepaid but is paid by the customer, who returns the freight voucher for which he receives credit to apply as part payment for the goods. If that is the situation the freight is a charge against sales, when finally determined, and a credit to the customer.

If it were possible to prepay the freight there would be nothing to do except to charge delivered freight. Since it is not possible, it becomes necessary to institute clearing accounts in order to record the liability for the freight. First, this entry should be made:

Estimated freight	$100.00	
Reserve for freight	....	$100.00
To cover freight on invoice 5612.		

When freight bill is received from customer, this entry:

Prepaid freight	$95.00	
Reserve for freight	5.00	
Estimated freight	....	$100.00

Then:

Reserve for freight	$95.00	
Customer	....	95.00

This finally lands the actual freight in prepaid freight and the customer account and ends this transaction.

The controlling account may be kept in a register of prepaid freight ruled in columns thus:

PREPAID FREIGHT REGISTER

				Disposition		
Date	Invoice No.	Name	Estimate	Prepaid Freight	Reserve	Date

The undisposed-of amounts must be equal to the balance of estimated freight and also of reserve for freight on the general ledger, which are the controlling accounts, while the register is the subsidiary record. These should be balanced at least once a month.

Of course, the journal entries can be kept in columns and only the totals posted to the controlling accounts monthly.

The management will have to decide what to do with the old accounts that are out of balance. The new accounts can be started at once and should be kept in balance.

Valuations by Appraisal Company

Editor, Students' Department:

Sir: The writer is confronted by a problem in accounting as stated below:

A corporation carries on its books capital asset accounts of land, buildings, machinery and fixtures, office furniture and fixtures and small tools.

The properties represented by these accounts have been appraised by an appraisal company as of December 31, 1919, and the values as shown by this

appraisal considerably exceed the values as shown by the book accounts. How should these excess amounts be written on the books of the corporation so that the books will at all times disclose the correct cost value of the property and the appraised value as of above-mentioned date?

The writer has worked out his own solution of the problem and presents it herewith:

Debit

Appraisal adjustment as of December 31, 1919

Land	....
Buildings	....
Machinery and fixtures	....
Office furniture and fixtures	....
Small tools	....
Total	....

Credit

Appraisal adjustment surplus

Land	....
Buildings	....
Machinery and fixtures	....
Office furniture and fixtures	....
Small tools	....
Total	....

Will you kindly advise me whether in your opinion this solution is correct and greatly oblige

Yours truly,

Chicago. T. H. L.

The procedure to be followed when an appraisal company values fixed assets at higher figures than the net carrying value depends on conditions not disclosed in the letter,

It may be that too much depreciation has been charged off in the past. If that is the case, the adjusting entry should be a debit to reserve for depreciation and a credit to surplus. This is because surplus has been unduly diminished by excessive charges through depreciation account in the past.

If the management is satisfied that the present carrying value is large enough, nothing need be put on the books, but the appraised value may be shown on the balance-sheet in a parenthesis. In any event the appraised value would be the basis for the settlement of a fire loss.

If the appraisal is to be put on the books, depreciation reserve should be charged and appraisal adjustment reserve credited. The word surplus ought not to be used unless the increased value is accepted as the real value, in which case the credit would be to the regular surplus, as has already been said.

Cash Discount on Capital Purchases

Editor, Students' Department:

Sir: Will you please discuss the proper handling of cash discounts on capital purchases? Should they be treated as deductions from the purchase price or as "non-operating income"?

Your early reply will be very much appreciated.

Yours truly,

J. A. O.

Cash discount on capital purchases is unquestionably a deduction from the purchase price, whatever view is taken of the discount on revenue expenditures.

It is impossible to make a profit by purchasing anything. It is necessary to make sales in order to realize profits. Even in the case of merchandise purchases, the cash discount is not a profit until the goods are sold. In the meantime it is an unrealized element of a profit to be eventually realized when sales are made. Since capital purchases are not to be sold there will never be any way by which a profit can be realized from them directly. The assets themselves do not produce a profit, but the use of them does.

Present Worth of an Annuity

Editor, Students' Department:

SIR: Will you kindly advise me in relation to the following problem and show how it is worked out?

If a principal of $1.00 will amount to $3.386354 in 25 years at 5% per annum, what would be the present worth of an annuity of $1,250.00 for 30 years at the same rate?

Thanking you in advance, I am

Yours truly,
L. B.

To find the present worth of an annuity at 5% for 30 years it is first necessary to ascertain the figure to which $1 at compound interest for that time and rate will amount. The question gives that value for 25 years only. To find the value at 30 years either multiply successively by 1.05 for 5 years or multiply by 1.276282, which is 1 at 5% compound interest for 5 years, as shown by a table. This will give 4.3219412 as the accumulation of $1 at 5% for 30 years.

Next find the present value of $1 due in 30 years by dividing 1 by 4.3219412. This will give .2313775.

Deducting this last amount from 1 gives .7686225 as the compound discount on $1 due in 30 years.

Dividing the compound discount by .05, the rate of interest, gives the present value of an annuity of $1 for 30 years as $15.37245.

Multiplying this by 1250 gives $19,215.56 as the present value of an annuity of $1,250 for 30 years at 5%.

To prove, start with 19,215.56, add interest and deduct 1250, then add interest on the remainder, deduct 1250, and so on for 30 times.

A quicker and easier way to find the desired amount is to find the present value of each yearly instalment of $1,250. This is done by dividing $1,250 by 1.05; then dividing the quotient by 1.05, and so on with each successive quotient. The total of the 30 quotients will be the amount required.

Thus 1,250. ÷ 1.05 = 1,190.48
1,190.40 ÷ 1.05 = 1,133.71
1,133.71 ÷ 1.05 = 1,079.72 and so on.

Treasury Stock—Dividends on No-Par Stock

Editor, Students' Department:

Sir: May I ask your opinion on the following?

The company which employs me as bookkeeper has had in its employ until a few weeks ago a man who, at the time of coming with this company, had the reputation of being exceptionally fine in his work. He failed, however, to come up to the expectation. He owned 75 shares of stock in the company, and agreed to resign provided the stock was taken off his hands. This the directors agreed to do, paying part in cash, the balance in notes, permitting the stock certificates to be used as collateral at the bank where the first party has note discounted, and allowing him a profit of $250.00, which makes the purchase price still less than par.

The first party purchased his entire holding on the market, the company being under no obligation to purchase stock or protect first party whatever.

(a) Has the board of directors the right to issue company notes for the purchase of stock from dissatisfied stockholders or even use the company's money for that purpose, without the stockholders' consent? This is very doubtful in my mind. The transaction, however, has already been completed.

I am handling this stock in a stock and bond account, rather than as a reduction of the capital stock account, inasmuch as the certificate has never been returned and will not be until all notes are paid.

My reason for handling it in this manner is that by reducing the capital stock account, and not having certificate to cancel, the general ledger and stock book would not agree, the stock ledger showing 75 more shares outstanding than the general ledger.

This certificate still stands on stock book in name of first party.

Am I right?

In further explanation it appears to be the desire of the directors to sell the stock rather than to retire it.

(b) One other question: the company has outstanding $50,000 preferred stock which contains a clause that after 8% per annum on preferred and 10% per annum of common has been paid, each class of stock shall share alike in the profits. Each stock has a par of $100 a share. The larger part of the common stock is held by a few men—one man and his family having control—who want the present common stock exchanged for a like number of common without par.

Is this a proper step to take when considering the preferred stock clause mentioned above?

Preferred has no voting power and the company reserves the right to retire it at $110.

How shall the preferred stockholder determine when 10% has been paid on common, if it has no par?

Wheeling, W. Va. W. H. H.

(a) The law of the state in which the company was incorporated will determine the right of a corporation to buy in its own stock. Assuming that such a step is legal, the directors do not have to consult the stockholders, but can act on their own judgment.

It was an error to charge this stock to a general stocks and bonds account. Discrimination must always be made between the outside and inside affairs of a corporation. Thus, if an outsider were lent money in order to employ otherwise idle funds, the note would be charged to notes receivable, but if any officer or employee borrows from the company or overdraws his personal account, the amount must show as due from officers

and employees. When the stock was bought it should have been charged to treasury stock. The balance-sheet which includes it in stocks and bonds account is a false statement, since it conceals the fact that the capital stock has been reduced, temporarily at least, by 75 shares. It would not be charged to capital stock, because the directors intend to sell it.

The fact that the stock is held as collateral by a bank does not affect the question. The use of the stock as collateral for the company's own notes, however, shows great ignorance on the part both of the bank and of the officers of the company. In the hands of a stockholder the stock has value as security to the bank for that stockholder's note, but when the bank holds the note of the company itself, the stock is absolutely worthless as security. In case the company should be thrown into the hands of a receiver, the note, with all the other obligations of the company, would have to be paid before anything could be paid on the stock, and if the liabilities were not paid in full, the stock would not receive anything. Therefore, either the note would have been paid in full or there would be no value in the stock when it was reached in liquidation.

It may be urged that the possession of the stock would give the bank an opportunity to realize promptly on the loan, but before the bank can have acquired the right to sell the stock, it must have put the company in default for the payment of its note. It does not require any argument to show that there is little or no value in the stock of a company that was unable to pay its note when due, and the bank would find that it really possessed no security whatever by holding the stock.

However, taking the situation as it is, there is nothing to prevent treasury stock from being used as collateral by the company itself. The ownership of the stock rests in the record on the stock ledger, not in the certificate, which is virtually only a receipt. It is not even necessary that any certificate should be issued.

It is altogether different with bonds in the treasury. They can be used as collateral for the company's own note, because they are secured by a mortgage on the fixed assets, and therefore must be paid out of the proceeds of these assets, and thus have a higher rank than an unsecured note. In other words, they have an intrinsic value which the stock does not possess.

(b) Although the common stock has no fixed par value, it has a recognized book value at all times. If all the requirements of the preferred stock have been covered, the common stock owns all the rest of the net worth. To determine its value find the net worth of the company by deducting from the total assets all the outside liabilities. From this net worth deduct the amount of the preferred stock and any accrued dividends unpaid. The remainder will be the value of the common stock. This amount is divided by the number of shares of outsatanding common to find the present value of each share of common. Let us assume that the total issue of common stock is 1,000 shares; that at the beginning of the year there are 925 outstanding (75 being in the treasury); and that the net worth belonging to it is $62,437.50, or so near it as to justify us in calling each share of common stock worth $67.50. If during the year the company should make a little

more than $15,865.63, and it was decided to pay all of it in dividends, the division would be as follows:

Preferred dividend at 8%	$4,000.00
Common dividend, 10% on $62,437.50	6,243.75
Extra preferred dividend at 5%	2,500.00
Extra common dividend at 5%	3,121.88
Total	$15,865.63

If the common stock has a book value lower than $100.00 the common stockholders lose by exchanging it for stock of no par value. When the stock was rated at $100 per share it was entitled to $10.00 per share before dividing further profits with the preferred, whereas it would now receive only 10% of its book value, this being in the above example only $6.75. Of course, if the stock has a book value greater than $100.00 the holders would make a corresponding gain. In any event, there is no difficulty in ascertaining when the common stock has been paid 10%.

Pro-rating Rent

Editor, Students' Department:

SIR: As a subscriber to THE JOURNAL OF ACCOUNTANCY, the present is to ask your opinion on the solution of the following problem:

A concern wishes to hire the ground floor of a building, eventually to use it for its own business. At present, however, there are four stores under lease, as follows:

	Square feet	Lease expires
Store A	870	May 1, 1920
B	1,330	" 1, 1921
C	1,360	Sept. 1. 1922
D	850	Nov. 1, 1925

The owner of the building offers the floor, subject to these leases, for $35,000 a year from May 1, 1920, the rent increasing so that the new tenant will pay on November 1, 1925, $45,000 a year. The problem is: What will the rent be from May 1, 1921, and September 1, 1922, the known rents being $35,000 from May 1, 1920, and $45,000 from November 1, 1925? Two accountants were asked to make up the rent figures and did not agree, but the lease was made at these rentals:

$35,000 to May 1, 1921.
38,100 " 1, 1921, to September 1, 1922.
42,500 to September 1, 1922, to November 1, 1925.
45,000 after November 1, 1925.

It is maintained the rentals should have been

$35,000 to May 1, 1921.
40,000 " 1, 1921, to September 1, 1922.
43,100 to September 1, 1922, to November 1, 1925.
45,000 after November 1, 1925.

Inasmuch as on May 1, 1921, 50% of the floor was available for the new tenant to use or re-rent and increase rentals. Therefore, 50% of the difference between $35,000 and $45,000 should be added here and 81% on September 1, 1922, as that amount of space would be under control of the new owner at that time; therefore the rent should be $8,100 more than on May

1, 1920—$43,100 as above. The maximum rent is to begin to run November 1, 1925, when the new tenant comes into possession of the whole floor. I know that the question of intent enters into this proposition to some extent, as witness the figures used in the lease, but inasmuch as the rent would have been $45,000 a year from May 1, 1920, had the whole floor been vacant at that time, it seems as though the second figures would have been correct to make the rent due correspond with the value of the premises as they become vacant. Under the second rent the owner would have been about $3,500 better off by the time the $45,000 rent started. Of course this matter is not related to accountancy, but I felt that your experience along mathematical lines would warrant your rendering an expert opinion.

Very truly yours,
J. F. G.

This letter cannot be answered with any certainty, because there is not enough information contained in it and too much must be taken for granted.

It says "the rent would have been $45,000 a year from May 1, 1920, had the whole floor been vacant at that time." This is by no means certain. It is true more often than not, in the case of a long lease, that the rent is lower the first five years than afterwards.

It is necessary to assume that all the floor space was of equal value, which is next to an impossibility. On May 1, 1921, possession will be gained of half the space, but it may be by far the poorer half.

The only way to fix rental values is to find out what the space is worth to the tenant and for what the landlord will let it, all the facts being taken into consideration. When these two agree, the rent is fixed and no theories as to whether it is right or wrong are worth the time it takes to state them.

However, as a purely theoretical proposition, it must be assumed that all the space has the same value. The increase in space from May 1, 1920, is 3,540 square feet and in price $10,000.00. This is at the rate of $2.825 a square foot. When 1,330 feet are released May 1, 1921, the rent should increase 1,330 times $2.825, or $3,757.25, and so on. Thus the rent would be at an annual rate of

To May 1, 1921	$35,000.00
September 1, 1922, add 1,330 feet, $3,757.25	38,757.25
November 1, 1925, add 1,360 feet, $3,818.00	42,575.25
After November 1, 1925, add 850 feet, $2,401.25	44,976.50

the small difference to be adjusted. This is very close to the figures actually accepted.