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Editorial

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The JOURNAL of ACCOUNTANCY

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A. P. RICHARDSON, *Editor*

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EDITORIAL

Social Legislation as a Whole

We have received several letters from correspondents drawing attention to what they believe was an error in editorial comment which appeared in THE JOURNAL OF ACCOUNTANCY for July, 1936. Perhaps the misunderstanding can be best explained by one of the letters, which reads in part as follows:

"Your editorial in the July, 1936, issue of THE JOURNAL is a very candid and much needed exposition of some of the fallacies of the theories behind the social security act and some of the special inequities of that particular act.

"There was, however, one item on which I believe you have been misinformed. The tax levied under title IX of the social security act, presumably for unemployment insurance benefits, is assessed upon employers of eight or more persons. The tax under title VIII, however, which presumably is for old age annuity benefits, is not restricted to concerns where eight or more are employed, but is applicable to all employers and employees no matter what number engaged, except certain specified individuals such as those engaged in agricultural labor, domestic service, those employing themselves, etc.

"I use 'presumably' above because the act does not specifically tie in the taxes with the benefits, probably in an effort to escape having the law declared unconstitutional.

"It is true that the only payroll tax applicable to 1936 is that under title IX and that this is paid by employers only. In 1937, however, the payroll tax under title VIII will also go into effect and this will apply to all employees of whatever number, with the

exceptions above noted. The tax under title IX, presumably for unemployment insurance, will also remain in effect for 1937 and both will increase from year to year."

We admit freely that our comments were susceptible to misinterpretation, but, as a matter of fact, while the language in the editorial may have been somewhat ambiguous, it is practically impossible to separate the social security sections from the sections of the new laws providing for old age annuity benefits. The two things are really part of a general scheme, and, while there is technically a distinction between the provisions for so-called security and those for the provision of old age benefits, nevertheless it is all part of one Utopian notion, and if one falls before the decision of the supreme court the other will probably be equally affected.

**Both Parts of Plan
Are Undesirable**

We are not unaware of the technical differences, but in the July issue we were not attempting to analyze specific details. It was rather the general scheme that we were considering and what was said continues to be our opinion of the fallacy and the probable unconstitutionality of both measures. In a time when efforts are being made to overturn the whole structure of American government it is no easy task to designate this or that particular factor of the whole which is good or bad. It may be that we shall have some plan ultimately declared constitutional which will provide resources from which old age benefits can be paid to worthy applicants; but we decline to believe that America has so changed its whole outlook upon the problems of life that it will condone pure socialistic adventure which lays a premium upon idleness and thriftlessness and augments the paternalistic powers of the federal government. Two months have passed since the comments which are the present subject of discussion appeared in print. In that time one would have supposed that it would have been possible to discern the meaning of the social security act and its fellow, but the confusion which arose upon enactment of these measures continues unrelieved. Nobody knows today any better than anybody knew two months ago the exact implications of these extraordinary laws. They are the cause of an infinite amount of uncertainty and a welter of detail in accounting, which are placing a burden upon the staff of

every corporation. The laws are effective chiefly in their political connotation.

**The Political Side
of the Question**

Legislators who were directly responsible for these laws are using them as an illustration of their perfervid desire to distribute the wealth of the nation even to those who have done nothing to help in the creation of that wealth. There are, unfortunately, many voters in this blessed land of ours who take political utterances at their face value and cast up their eyes in sanctimonious reverence for the great and the good, the beneficent and the humanitarian members of congress, who at the behest of the administration enacted these seemingly worthy laws. There is, however, we believe, a much better understanding of the truth of the matter today than there was a few months ago. The necessity for extravagant expenditures in the relief of the unemployed is being discovered to be largely chimerical. We are beginning to learn that the numbers of unemployed have been grossly exaggerated for political reasons and that there is work for thousands of men and women who have been describing themselves as the innocent victims of depression. The man who honestly desires work and is not too nice in his willingness to accept honest labor can generally find something to do. In the August issue of this magazine we drew attention to what is happening in New Jersey where extravagance and waste in relief seems largely a thing of the past. Since those notes were written there has been a further increase of legitimate employment and a concomitant decrease in the demand for uncompensated relief. Throughout the country the preachers of the gospel of ubiquitous need are finding that their hearers begin to question and after that to doubt and finally to repudiate the allegations of the extent of need which have been so useful a weapon in the hands of our socialistic experimenters. As we have said many times, in discussing the whole question of unemployment and relief, we do not wish to appear brutal or even unsympathetic with those who deserve sympathy, but it is the truth that there is nothing like the amount of inescapable unemployment which some of our demagogues would have us believe to exist. We do not like the social security act and we do not find ourselves in complete harmony with the principles underlying the old age pension law. No country, so far as our research reveals, ever continued to prosper when crazy socialism was

allowed to take the place of the sound philosophy of hard work for able men and women.

Institute's Annual Meeting

The attention of readers is directed to the importance of attending the annual meeting of the American Institute of Accountants which is to be held at Dallas, Texas, October 19th-22nd. This meeting will be more important than most such events because it is expected that the effort to effect a merger of the Institute and the American Society of Certified Public Accountants will reach its final stages and in all probability will succeed. This is a busy year in the state of Texas, which is celebrating its centennial and, as a consequence, there is great demand for hotel and other accommodation. Everyone who is interested in accountancy is urged to attend the meeting in Dallas and it is important that reservations of rooms should be made at the earliest possible moment. The greater part of the meeting will be open to all accountants whether members of the Institute or not. Persons who desire to make reservations should address their requests to the Institute.

Reserves for Unknown-able Taxes

It is reported that the securities and exchange commission has been somewhat confused as to what practice should be followed in the treatment of federal income taxes in profit-and-loss statements for periods of less than a full year filed with the registration of securities. Some accountants it appears have omitted any provision for income tax and have explained in footnotes that no provision has been made because of the difficulty of estimating the income tax under the federal income-tax laws. Others have followed the profit-and-loss statement with footnotes to the effect that the figures represented only the total of normal income tax payable under the laws of 1936 based upon the amount of the taxable income of the period and that, in addition, the companies may be liable for surtaxes on undistributed profits applicable to the period, depending upon the policy of the company in declaring dividends. Some have estimated the approximate maximum of such surtaxes provided no further dividends should be paid during the year. Still others have included an amount for income taxes without footnotes but with the word "estimated" inserted parenthetically after the designation.

**A Suggested Method
of Accounting**

It is not at all astonishing to find that accountants differ widely in their interpretation of what would be regarded as the best practice. The whole device of the taxation of undistributed profits is a novelty—and a very dubious one at that—and accounting principles which would take care of freak legislation have never been established. We have, however, been privileged to see a very able letter dealing with this question and we take the liberty of quoting the following:

“The established practice prior to the passage of the revenue act of 1936, in the presentation of financial statements for an interim period, has been to provide out of income for federal income taxes. This practice should be continued with regard to normal income tax, capital stock and excess-profits taxes, and, in the case of personal holding companies, to the surtax, if any, on such companies. However, the surtax on undistributed net income, which was imposed for the first time by the revenue act of 1936, seems to require different treatment.

“This surtax is in a different category because it may be entirely avoided by the payment of dividends before the end of the taxable year. As no one or more individuals can commit a board of directors at an interim date as to what its dividend policy is going to be for the rest of the year, the amount of the undistributed-profits taxes, if any, can not be determined at any interim date.

“As this condition will apply in the great majority of cases, the best practice would be to state in a footnote on the profit-and-loss statement that no provision has been made for undistributed-profits tax and to show what the tax would be if the undistributed net income is finally determined to be subject to such surtax. The following language is suggested:

“‘No provision has been made for federal surtax upon ‘undistributed net income’ of the company for the six months ended June 30, 1936, inasmuch as the amount of such income subject to surtax is not determinable until December 31, 1936, and is dependent upon the action of the company’s board of directors with respect to the payment of dividends on or before December 31, 1936. In the event that the ‘undistributed net income’ at June 30, 1936, is determined to be subject to surtax, such tax would amount to approximately \$’

“While it is desirable that interim income accounts should bear all appropriate deductions including taxes, the justification for the suggested treatment lies in the revenue act itself in that the imposition of the tax is subject to contingencies which can not be resolved until the end of the taxable year.

“In cases where the registrant has made provision for such undistributed-profits tax, either on the theory that the dividend policy is well established and will not be changed or because it is

felt that the dividend policy for the rest of the year is known, the provision for the undistributed-profits tax should be charged to income rather than surplus account. The importance of this tax, however, is likely to distort comparisons of net income from year to year, and we therefore recommend that in the income statement all deductions for normal and excess-profits taxes be made in arriving at 'net income before deducting federal tax on undistributed profits'; that in the next line, as a separate item, deduction should be made for such tax, thereby arriving at 'net income'."

**A Troublesome and
Futile Tax**

This seems to be another example of the fruits of ill-considered legislation. It is bad enough to pay exorbitant taxes, which all of us are paying, but the evil is made infinitely worse when it is impossible to know what the taxes will be. Some one has said that accountants should be the last people in the world to cry out against complicated and incomprehensible legislation, because every vague law means more consternation in the minds of business men and it might logically be supposed that the work of the accountants would be correspondingly magnified. It is doubtful, however, if accountants welcome any such addition to their labors, when even they can not determine the meaning of a law and are at a loss to guess its effect. Business has been undergoing a series of silly impositions and, while it may be true that the work of the accountant has been increased, it is certainly not true that the happiness of the accountant has been promoted correspondingly. The tax upon undivided profits, if the supreme court should by any stretch of imagination hold it constitutional, must always be a bug-bear to everyone who has to do with its computation or its payment. We have previously pointed out some of the innumerable weaknesses of this attempt to destroy business, and now it appears that the security and exchange commission itself is sadly bewildered. When a law can not be intelligently administered and when it is despised by every man of business it seems to the ordinary mortal that, even if constitutional, it should be rescinded—and that we hope and believe is what will happen before many months have passed.

**Percentages of Failure
in Examination**

Recent issues of *The Accountant*, London, have contained reports of the Institute of Chartered Accountants in England and Wales dealing with results in examinations for

admission to the Institute. For example the examination committee reported the following results of examinations in May 1936:

| | Passed | Failed | Total |
|-----------------------|--------|--------|-------|
| Primary | 81 | 101 | 182 |
| Intermediate. | 365 | 384 | 749 |
| Final | 306 | 300 | 606 |

These figures are of considerable interest to examiners and candidates throughout the United States, because it is evident that the percentage of success in England is higher than in any state in the United States. It is also interesting to note that the percentage of success increases steadily as the students advance through the three stages of their examination, until in the final examination more than half succeed. It appears, therefore, that as the weeding-out process continues the number of students possessing the requisite preparation and knowledge increases. Here in America the situation is entirely different. We have no apprenticeship system and in all probability we never shall have it. It is contrary to American notions to expect any man, however young and inexperienced, to work for five years and to receive practically no compensation or indeed to pay a premium for permission to work. One can not imagine a young American who could be so diverted from calm and comfortable assurance of his innate and incomparable value that he would feel justified in contributing gratis his vast wisdom to the welfare and progress of an accounting firm. In Great Britain and largely throughout the British dominions the accountant serves an average of five years without anything but nominal compensation so far as money is concerned. He does receive compensation, however, in the knowledge which he acquires and in the preparation which is given him for his life work. Here accounting staffs are recruited from men who have had no experience whatever; most of them in these days are college graduates and therefore have the ability to study and to learn, but they lack technical qualifications and equipment. Yet they expect to receive and do receive a living wage from the time they enter the accountant's office. The firms encourage them in every reasonable way to fit themselves for their professional careers, they are aided in preparation for examination and credit is given them usually in a tangible form when they have acquired the designation "certified public accountant."

Reasons for Failure

The average number of successes in any state examination is far lower than it would be under the apprenticeship system, because in most states the men are allowed to sit at the examinations whether they have any knowledge and experience or not. Sometimes the examination is taken merely for the sake of experience and without any reasonable hope of success. We have heard of states in which whole classes of accounting students have taken the examinations for no purpose whatever other than the desire to know what examinations are like. Naturally nearly all such candidates fail. In other cases men from other walks of life go into accountancy because of a natural love for it or because of a belief that they will derive greater compensation. They are not adept in examination work and their chances of success are rather small. Some of them may have had no experience whatever in accounting offices, and in such cases it is absurd to expect that they will succeed in any examination in which the questions are practical and based upon actual problems which have arisen in practice. It is not fair, therefore, to assume merely because American successes are less than British that the quality of the candidates is lower here. As a matter of fact that is not the truth. The failure of so large a percentage to pass is due rather to insufficient preparation and incomplete field experience.

**Specific Causes
of Failure**

A special report of the examiners of the English institute on the November, 1935, intermediate and final examinations appeared in *The Accountant* of May 16th. The report consisted of comments upon the results of examinations and reasons for failure were summarized as follows:

- “(1) Many candidates show by their answers that they have not read the questions carefully.
- “(2) Many candidates do not express themselves clearly and concisely.
- “(3) Answers to questions involving figures are frequently not set out in a clear and practical form.
- “(4) Many answers are not suitably divided into paragraphs.
- “(5) References are frequently made to irrelevant legal cases.
- “(6) Some candidates appear to overlook the fact that neatness, correct spelling and legible handwriting are important factors.
- “(7) Many candidates give estimates in cases where accurate calculations are obviously required.”

Editorial

These reasons for failure apply with equal force in America, but we have here other causes of failure which must exist also in Great Britain. Many candidates select the easiest problems to answer first and consequently leave themselves short of time in which to answer the problems which require the most effort and carry the greatest weight. Many candidates are so distressed by nervousness that they do not recognize problems with which they may be perfectly familiar. The only cause of failure which we believe to be peculiar to America is lack of preparation and insufficient experience. But that gets back to the original proposition that where there is no apprenticeship system there is always a danger that candidates will go to the examination room foredoomed to failure.