Journal of Accountancy

Volume 63 | Issue 6 Article 8

6-1937

Accounting Questions

American Institute of Accountants. Bureau of Information

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[The questions and answers which appear in this section of THE JOURNAL OF ACCOUNTANCY have been received from the bureau of information conducted by the American Institute of Accountants. The questions have been asked and answered by members of the American Institute of Accountants who are practising accountants and are published here for general information. The executive committee of the American Institute of Accountants, in authorizing the publication of this matter, distinctly disclaims any responsibility for the views expressed. The answers given by those who reply are purely personal opinions. They are not in any sense an expression of the Institute nor of any committee of the Institute, but they are of value because they indicate the opinions held by competent members of the profession. The fact that many differences of opinion are expressed indicates the personal nature of the answers. The questions and answers selected for publication are those believed to be of general interest.—EDITOR.]

SALES COMMISSIONS ON ANNUAL REPORT OF INVESTMENT TRUST

Question: An investment trust sells its stock, the price of which is based on three factors:

1. The par value—plus
2. An additional amount to be credited to paid in surplus—plus
3. A sales commission of 9 per cent. based on the sum of (1) and (2).

This commission is immediately disbursed and becomes an item possibly not to be included in the statement of the company.

Could you advise what would be the proper method of handling this commission on the annual report of the company to the S.E.C. and others?

Answer No. 1: There is some argument in favor of charging such commissions to organization expenses or some similar account. In that event, provision should be made for charging off such expenditures over a period of years, the basis thereof to be stated in at least the report to the Securities and Exchange Commission. However, we would prefer to see such expenditures written off during the current fiscal year. In that event, if the amount is relatively large, or material, it should be shown as a separate item.

Answer No. 2: Disclosure of the circumstances should be made in the annual report as well as in any report to the S.E.C. Without advancing any opinion as to how the S.E.C. would feel these transactions should be reflected in the accounts, we should say that the entire amount received should be credited to capital-stock account for the par value and the balance to the capital-surplus account. The board of directors in its minutes should direct that commission paid be charged against capital surplus. The report should then show: "Capital surplus (less commissions paid for sale of stock $........) $........"

Or, simply the net amount might be stated on the balance-sheet provided the report carries an accompanying statement of capital surplus showing the deductions for commissions as well as any other adjustments which might have been made during the period reported on.

VALUATION OF STOCK ISSUED TO CORPORATION OFFICERS AS BONUSES

Question: Statement of facts:

1. On an original issue of no-par common stock, the directors of a corporation declared a stated value of $5.00 per share, the excess of the issuing price over the stated value being credited to capital surplus.
2. The corporation subsequently acquired some of its outstanding no-par common stock in the open market, at a price in excess of the stated value. The excess of the purchase price over the stated value was charged against surplus, the treasury stock thereafter being carried on the books at stated value.
3. The corporation subsequently entered into agreements with certain of its officers, whereby those officers were to receive as additional compensation each year, a certain number of shares of no-par common treasury stock for each $1,000.00 of net profits. The corporation agreed not to reduce the number of shares of stock then in the treasury, except in payment of such additional compensation. The agreements also provided that if the corporation was unable to re-issue the stock without registration, such compensation would be payable at the rate of $10.00 per share. (However, the corporation can re-issue the stock without registration.) The stock was to be delivered to the officers within 90 days after the close of the fiscal year.

In setting up the liability at the end of the year for the additional compensation payable in stock, what value per share should be used in determining such liability?

1. Cost at which the stock was repurchased, or
2. Stated value of $5.00 per share, or
3. "Cash" value of $10.00 per share, or
4. Market value at date of balance-sheet?

Should the same value per share which is used for setting up the bonus liability also be used in charging the bonus to profit and loss?

Answer No. 1: It is our opinion that the liability on account of stock to be issued to the officers of a company as additional compensation should (assuming that the market value of the stock is greater than the stated value), be set up on the balance-sheet at the fair market price prevailing at the date thereof. The same value per share used in setting up the bonus liability should also be used in charging the bonus to profit and loss.

It would also seem wise to include a footnote on the balance-sheet stating that the bonus liability would be liquidated by payment in stock.

Answer No. 2: The question resolves itself into the determination of the correct amount to be charged against the profit-and-loss account.

The additional compensation payable to the officers would appear to be represented by the "value" of the treasury stock deliverable to them. If there is a market value which can be presumed to represent the actual value of the treasury stock, it would seem that this market value is the amount that should be used to determine the amount chargeable against the profit-and-loss account.

The amount so charged should be credited as follows:

1. To "liability-payable in treasury stock" at the amount of the stated value which is the amount at which the treasury stock is carried on the books. On issue of the stock the liability will be charged and the treasury stock credited.
2. The excess of the amount charged to profit and loss over the stated value should be credited:
   (a) To the extent of the difference between the stated value and the cost, to that surplus account to which the excess of cost over the stated value was previously charged.
   (b) The excess (if any) of the market value over the cost should be credited to earned surplus account.

In view of the fact that the corporation can reissue the treasury stock without registering, the alternative value of $10.00 per share would appear to be inapplicable.

The question as to the right of the directors to so use the treasury stock is a legal one and should be referred to the company's lawyers.

TREATMENT OF PREMIUM ON GENERAL LIABILITY POLICY

Question: One of our clients has contracted for a general liability policy which provides that they are to pay 50 per cent. of the premium in advance, 30 per cent. at the end of the first year, and the remaining 20 per cent. at the end of the second year.

They have been charging to operations one-third of the total premium each year. The officers of the company contend that the amount of the premiums not yet due should not be carried as a liability since the policy provides that it may be cancelled at any time by the assured at the customary "short rate."

The "short rate" on this particular policy at the end of the first year is 37.0 per cent. and at the end of the second year is 68.5 per cent.

We feel that this policy should be handled just like any other three-year policy in which the entire premium is paid in advance and feel that the unpaid premiums should be reported as liabilities, those coming due within one year in the current section and those due after one year under a separate caption. What is the customary method of handling this type of policy?

Answer No. 1: Under the conditions stated, it is our opinion that the amount of the unpaid portion of the premium need not be shown as a liability on the grounds that no liability exists under a contract which can be cancelled without obligating the company to make payment of an amount of premium in addition to that already paid in advance.

Answer No. 2: Replying to your question as to the setup of three-year policies payable on the installment system, we concur with the accountant's view that the entire premium should be treated as a liability, since the company has taken advantage of the reduced three-year rate, which it would not get unless they paid the entire amount, and would so handle the matter where the amount was of sufficient importance to warrant it.

USE OF WEEKS AS FISCAL PERIOD AS COMPARED WITH CALENDAR YEAR

Question: Please submit to the proper committee, for their opinion, the following questions:

1. Advantages or otherwise, of using a given number of weeks for a fiscal period as compared with the calendar year;
2. Is the former system used for sales and manufacturing production purposes only?
3. Do chain and departmental stores favor to any great extent the former system?

Answer:

1. The advantage "of using a given number of weeks for a fiscal period as compared with the calendar year" is that it does away with the nuisance of split weeks. If, however, the question has in mind not simply closing the books at the end of the week nearest the close of the calendar year but the adoption for accounting purposes of a 13 month year, i. e., 13 months each of 4 weeks, then there is the further advantage of having even periods, thus facilitating more exact comparisons.

The disadvantage is that there is an additional set of statements to be prepared—13 instead of 12, while adjustments would, of course, be necessary in the preparation of statements for calendar periods.

2. If the system is adopted, it is used throughout the accounting and not merely for sales and manufacturing production purposes.

3. Though not so extensively used by chain and department stores as to be the recognized procedure, the appreciable number of such stores that has adopted the accounting in question attests to its practicability and convenience.