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Accounting for Receiverships*

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Under federal practice, "a receiver is an officer appointed by a court of equity to assume the custody of property pending litigation concerning the same." This definition from the chapter on "Receivers" in Roger Foster's *Federal Practice* may serve as an introduction to the consideration of the question of accounting for receivers, to indicate by its breadth the scope of receivership practice from the legal point of view and the great variety of conditions with which the accountant may be confronted in entering upon an engagement in a receivership case.

In addition to the broad class of receivership proceedings in the federal courts, which may be described as chancery receiverships, there is a more strictly defined class of statutory proceedings for the appointment of receivers, either in cases of bankruptcy or in circumstances comprehended by the laws of the various states. Legally, the nature of these statutory receiverships is sharply differentiated from that of the equity cases, and it is accordingly necessary for the accountant to recognize the distinction.

At the same time, it is not necessary to assume that the accounting procedure will resolve itself into the same interesting diversities of form as the refinements of legal practice may give to the court proceedings. The accountant may very safely follow general principles, and the cases which demand special treatment will invariably be defined with such clearness as not to involve the danger of an unsuspected difficulty.

Because of the general application of almost identical principles to accounting under the various classes of receivership (apart from any established requirements in certain states or jurisdictions as to the form of accounts to be filed in court by the receiver), the present discussion may be regarded as relating to receivers' accounts generally, but more particularly to the accounts

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of receivers appointed by the federal courts, in which class are comprised practically all cases of receiverships of railroads and most of the receiverships of important industrial companies.

It may not be out of place in a paper on this subject—though without presuming to do more than merely touch upon the technical management of a receivership as represented by the orderly progress of the court proceedings—to endeavor briefly to outline the form which the great majority of the more important receiverships assume and the features in which administration of a property by a receiver differs from management under normal conditions.

A receivership is essentially a measure for the protection of the rights of all parties in interest. The appointment of a receiver is, however, so serious an invasion or setting aside of the rights of private management of property that every possible effort will be made to avert the necessity for such action, and the court will exercise the utmost caution in granting an application. The court will not appoint a receiver without hearing the answer of the corporation, except in cases in which it appears that the property involved or the rights of the petitioner will suffer irretrievably by delay. From these conditions it results that in the great majority of cases the necessity for a receivership has been admitted by the officers and directors of the corporation before the petition is filed, and, in order the better to protect the interests of all concerned by expediting the steps initiated by the filing of the petition, the procedure has been developed of obtaining so-called "consent receiverships."

A creditor with a domicile foreign to that of the corporation appears as petitioner in a general creditors' bill filed in the United States district court for the district in which the principal operating office of the corporation is situated, alleging, among other things, the inability of the corporation to pay its current obligations as they mature and the imminent danger of injury to its property and business and praying for the appointment of a receiver. An answer is simultaneously filed by the company, admitting the allegations and joining in the request that a receiver be appointed; whereupon the court signs an order appointing a receiver or two or more joint receivers. Petitions are immediately filed in every judicial district in which property of the cor-

poration is situated for similar appointments (ancillary receiverships) in those districts. The court in which the primary or principal bill is filed assumes the administration of the entire property, through the receiver. In the event of the receivership having arisen from the imminence of default under a mortgage, the trustees of the mortgage, upon the conditions precedent to foreclosure having developed, file bills in the same courts, the suits are "joined" and the receivers already named are also appointed in the foreclosure proceedings.

This is not, of course, the invariable procedure. It is, however, one of the very usual methods followed and possesses so many advantages from the legal point of view that it may be regarded as typical. That it lends itself on occasion to newspaper attack as constituting "collusion" or "conspiracy" does not reflect in any degree upon the wisdom or entire legality of the course outlined.

Whatever the manner in which the step may be reached, however, the first matter of importance to be considered by the accountant is the order appointing the receiver, following which there will issue from time to time various other orders of the court, each of which should be carefully studied. The orders of court in any given case practically constitute the law for that case and, to a very large extent, contain the specific instructions which alone will distinguish the accounting in one receivership from that in another, or, indeed, from the accounts of the same property under ordinary management.

Certain general rules of law obtain governing those things which a receiver ordinarily should or should not do in administering a property. As a matter of practice, however, the attorney for the receiver will, if he considers the conditions to be at all exceptional, obtain instructions from the court in the form of an order with regard to many matters even of this character.

It may be advisable to digress at this point to mention the fact that in this country a receiver in the federal courts is generally understood to exercise the functions of what under English law is described as a "receiver and manager." The text-books may refer to a "passive" as distinguished from an "active" receiver. The distinction, however, lies solely in the form of the

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order appointing the receiver. The expression "receiver" as used in this paper is understood to imply an "active" receiver, corresponding to a "receiver and manager" in England.

Turning, then, specifically to the question of accounting, the subject may be considered as falling under the following heads:

- (a) The opening of the receiver's books of account;
- (b) The accounting for the administration of the property;
- (c) The forms of reports to be rendered from time to time to the court by the receiver;
- (d) The closing of the books of the receiver.

The fact must also be kept in mind that the appointment of a receiver does not operate to dissolve the corporation. It continues to exist, and in some respects remains a separate entity for accounting purposes. A fifth heading may thus be added:

- (e) The accounting records of the corporation as such.

The forms of reports to be rendered to the court largely fall to be considered in conjunction with the discussion of matters of accounting under these various heads and will in part be so treated.

THE OPENING OF THE RECEIVER'S BOOKS OF ACCOUNT.

The order appointing the receiver should be studied carefully for the designation of the property of which the receiver is to take possession. In the usual class of appointments, however, the description is very broad and comprehensive, and "the effect of the appointment is to vest in the receiver as an officer of the court a qualified title to all the property of the corporation within the jurisdiction of the court and right of possession of such property for the purpose of administration so far as the purposes of the trust require." (Thompson, on *Corporations*.) The receiver takes the property subject to existing liens.

The order of appointment almost invariably instructs the receiver to file with the court within a specified time or as soon as possible a report of the property coming into his possession, and it is customary, or the receiver may be directed, to give the court such information as may be available of the liabilities of the corporation in respect of which claims may be expected to be made against the property.

In opening the books of the receiver, however, consideration need only be given to the items of property, disregarding at the

outset the question of liabilities entirely, except to the extent of making notations of actual liens upon any of the property.

The situation calls for a balance-sheet audit, as expeditious as may be, of the corporation, as of the date of the receivership, with an adjustment of the accounts as far as may be found necessary upon the books of the corporation, and a closing as at the end of a fiscal period.

A physical inventory of merchandise should be taken as of that date, if such a course is practicable. If this would jeopardize the progress of work on hand, however, and the system of accounting comprehends a reliable book inventory, this step may be delayed for a short period and any adjustment found to be necessary applied back upon an equitable basis.

In any event, however, the status of merchandise received during the period immediately preceding and following the receivership requires to be definitely established. Whether a physical inventory is taken or not, the records must be kept open and all liabilities brought into account in the "prior" period for all goods actually received up to the date of the receivership. As to goods in transit at that time, the vendor may exercise the right of stoppage in transit. Broadly speaking, however, the receiver will only accept goods received subsequent to his appointment, even though shipped before, if he intends to use them in his management of the business, and in that event he will accept them as his own liabilities.

Contra accounts in the various ledgers should be offset where no question exists as to the right of offset. Outstanding bank cheques should be set up as liabilities and added back per contra to the bank balances. In the event of there being notes or loans payable to the banks, the latter will probably seek to apply any bank balances they may hold in reduction of the indebtedness to them. Such an offset and any of a similar character should only be recorded upon the specific instructions of the attorney for the receiver, who may find grounds for challenging the right claimed. It may be appropriate here to state that there should be no offsetting of prior liabilities against receiver's accounts.

Accrued items, both receivable and payable, should be calculated and brought into account up to the date of the receivership. Depreciation should similarly be charged off, the necessary

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reserves for bad debts and discounts created, and all other entries made in respect of the broken period corresponding to those which would be made at the close of the fiscal year.

A journal entry will be made recording the fact of the appointment of the receiver, and transferring to an account designated "John Doe, receiver," all the asset accounts representing the property of which he has taken possession, including such as may be in the hands of third persons claiming liens upon it. Against such assets there will be transferred to the credit of the receiver any reserve accounts applicable in reduction of the book values, such as reserves for depreciation, bad debts, discounts, etc., but no liability accounts of any kind will be transferred.

Treasury stock accounts should not be transferred; neither does it appear advisable to transfer accounts representing goodwill, patent rights, franchises, etc., if carried separately, other than at nominal values for purposes of record.

The receiver's books will then be opened with entries of an exactly contrary nature, charging the various asset accounts, crediting the reserves against them, and crediting the net total to an account designated "The A. B. C. Corporation, in receivership." In making these opening entries the narrative should contain proper notations of liens against the various properties, but neither these nor any other liabilities should be taken up as such on the receiver's books.

The propriety may be questioned of taking up fixed assets on the receiver's books, on the ground that the actual value is as a general rule indeterminate, and that the receiver takes possession of, but not title to, the property, which further remains subject so far to the lien of mortgages and all charges ahead of the general creditors. This appears, however, to be an unnecessarily arbitrary distinction to make, and the better practice seems to be to take such property on the receiver's books. The receiver should in any event charge depreciation on such property against his operations before determining the results of his management of the business.

A somewhat interesting variation of the orthodox method of treatment of receiver's accounts was that adopted in a certain railroad receivership. The accounts as determined at the date of the receivership were carried forward as a whole without change

on a ledger described as the "prior" ledger, while the "receiver's" ledger proper took up only the operations after the date of the receivership, together with all sums realized from the liquidation of "prior" accounts and all payments made on account of "prior" liabilities. The two last-mentioned classes of transactions were, of course, reflected in the "prior" ledger and constituted the controlling account between the two ledgers, which were operated in effect as one set of books. The advantage of this method lay in the fact that the receiver's books were kept absolutely free of adjustments or unrealized values in respect of the prior period: the disadvantage consisted in the necessity for maintaining in every case the distinction between the accounts on the two ledgers, with the controlling columns required to preserve that distinction throughout the system of accounting. The result was, however, both successful and instructive.

ACCOUNTING FOR THE ADMINISTRATION OF THE PROPERTY.

The consideration of this division of the subject may best be approached by following the line of thought developed by the preceding section.

The receiver's books are presumed to have been opened upon the basis of taking up all the assets of the corporation, less existing reserves, to reduce them to actual values, or to depreciated book values in the case of fixed assets, without recording any liabilities except in the form of memoranda of known liens upon any of such assets.

Nevertheless, the receiver will almost invariably be called upon—he will, in fact, be instructed by orders of the court—to discharge certain of the liabilities existing prior to his appointment out of the funds passing into his hands. Certain claims are preferred as a matter of law, but instructions for their payment are, as a general rule, either contained in the order appointing the receiver or in an order subsequently obtained.

Wages, taxes, trust funds and liens of which the payment is necessary for the protection of the property are examples of claims which are entitled to a preference. In the case of railroads and other quasi-public corporations, the law recognizes a preference in favor of the class of so-called "six months' claims"—that is to say, vouchers and supply accounts incurred within a limited time (not necessarily restricted to six months) in the

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operation of the property. In one case the receiver was ordered "to pay out of the funds coming into his hands . . . the current and unpaid payrolls, vouchers and supply accounts incurred in the operation of said railroad system at any time within six months prior hereto." In another case (a more recent example) the order read "to pay . . . any unpaid payrolls, vouchers and supply accounts heretofore incurred in the operation of said railroads." This rule may be broadened somewhat to cover the case of private corporations. Almost invariably, however, the attorney for the receiver will obtain an order from the court authorizing such payments.

On the books of the receiver the payments of these items should be charged to a special account designated "The A. B. C. Corporation, in receivership, preferred claims paid," or, if such claims fall within several well-defined groups covered by specific orders or sections of orders, an account may be opened for each group. Such account or accounts will eventually be applied in reduction of the account representing the net balance of assets taken possession of by the receiver, but in the meantime will be carried as a receiver's account representing a part of his accounting for funds coming into his hands.

On the books of the corporation the payment of such preferred claims will be reflected by a charge to the liability accounts and a credit to the receiver.

In order to break as little as possible the continuity of the accounts, it is proper to treat payments maturing subsequent to receivership and accrued partly on the books of the corporation and partly as expenses by the receiver (e. g., taxes) in a similar manner to the foregoing class of preferred claims, to the extent of the proportion accrued to the date of the receivership on the books of the corporation.

Allusion may be made here to the question of interest upon obligations of the corporation. Such interest continues to run, but it runs against the corporation and not against the receiver. It should accordingly be accrued as a liability in the usual manner upon the books of the corporation. The receiver will not pay such interest without an order of the court, though on the other hand it has been held in a recent case that, where failure to pay such interest constitutes default under a mortgage, the receiver

should apply to the court for instructions before permitting this to occur. In the event of payment being ordered by the court it appears preferable, again to preserve the continuity of the accounts, to charge the proportion accrued to the date of the receivership to one account, under the description of "The A. B. C. Corporation, in receivership, accrued liabilities at date of receivership paid," and the proportion accrued subsequent to that date to a separate account, "The A. B. C. Corporation, in receivership, interest paid." Both portions will be treated as payments made on account of the corporation and not as charges against the receiver's operations even as to the portion accrued during the receivership.

As to other charges which accrue regularly and mature for payment at stated intervals—as, for example, lease rentals—the position is somewhat different. It is as a general rule open to the receiver to adopt or to disaffirm such obligations. If a receiver elects to continue as tenant under a lease, the rental accruing after his appointment of necessity constitutes a charge against his operations as such, and does not fall to be treated as a payment made for account of the corporation.

Upon the appointment of a receiver the right of the officers of the corporation to salary is terminated. The receiver may, however, appoint the same individuals to act as officers under his administration at such salaries as may be agreed upon, which will, of course, constitute charges against the receiver's operations.

A receivership generally entails a certain amount of expense not normally incurred by a corporation. Such expense, including the fees of attorneys, accountants and other experts, and sums drawn on account from time to time by the receiver should be charged to a special expense account, described as "receivership expenses."

Apart from such slight variations as those indicated, the endeavor should be made in a receiver's accounts to render the results as nearly as possible uniform and comparative with the previous accounts of the corporation, in order that those interested in the reorganization of the property or the receiver himself, in attempting to dispose of the property as a going concern, may be in a position to present to prospective purchasers or finan-

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ciers accounts for a series of years in comparative form. Even in cases in which the system of accounts previously in operation is found to have been defective, it is advisable to arrive at results in such a manner that the old and the new figures can be expressed, broadly speaking, in the same terms. The failure to do this—the failure, particularly, to provide for exhibiting as great a degree of detail in the accounts as formerly—may prove embarrassing at a time when it is desired to submit to bankers for preliminary consideration, before investigation, the accounts for a number of years, embracing the receivership period and prior years.

The receiver's accounts should be closed at regular intervals upon the same dates as the accounts of the corporation were previously closed. The first closing will comprise the broken period from the date of the receivership to the end of the regular fiscal period of the corporation. In this manner, also, the orderly sequence of the accounts by fiscal years is preserved.

In certain instances, however, notably in the case of the disavowal of leases or guarantees of interest or dividends on securities of subsidiary companies, the circumstances necessitate a radical departure from previous methods of accounting. This condition frequently arises in railroad cases. The order appointing a receiver may direct him to take possession of and to manage the properties of such lessors or subsidiaries, but the fact of his doing so will not operate as an acceptance by him of the lease or of the terms of the guarantee. The federal courts have held that the receiver holds the leasehold estate "as he would hold any other personal property involved, for and as the hand of the court and not as assignee of the term." During a reasonable time, in which the receiver has to determine whether or not to accept the lease, he is regarded as having operated the property for the account of the lessor, if he elects not to adopt the lease. Accordingly, in cases in which the operations of leased property have practically, under normal conditions, been merged with the operations of the lessee, or where the property of a subsidiary wholly owned, except as to an outstanding bond or preferred stock issue guaranteed as to income, has practically been treated as part of the property of the holding company, it becomes necessary immediately to institute an accurate system of accounting

between the corporation and the lessor or affiliated company. If the receiver disavows the lease or the guarantee, the net profit for the period will be credited or the net loss charged to the other company. The court would, however, order the payment of a reasonable rental in such cases, if the nature of the property was such as to render it of particular value to the corporation but of small independent earning power. The importance of distinguishing carefully between capital expenditure on such property and improvements on property owned outright is also apparent.

In cases in which the assets are insufficient to meet the claims of all creditors in full, a question may arise as to the particular fund to which any net income realized from the operations of the receiver should apply. The principle appears to be that such net income belongs to the bondholders, at any rate from the date of the appointment of the receiver under the suit to foreclose the mortgage, and earlier if claimed by the mortgagee, except to the extent that it has been applied in payment of preferred claims. The question is largely a legal one and should be raised at an early date by the accountant, in order that the apportionment of the net income at the controlling dates may be provided for, if the necessity arises.

The principle of the marshalling of assets may be raised by general creditors against secured creditors—that is to say, the general creditors may appeal to the court to compel secured creditors first to exhaust their security before claiming against the general estate. The resulting liquidation of the property pledged will be recorded in the same manner as the application of other assets to the satisfaction of liens.

The only remaining point in connection with the current accounting to which attention requires to be called is the issue of receiver's certificates. Receiver's certificates are in the nature of certificates of indebtedness issued by the receiver by order of the court for money borrowed and secured by a lien upon the property in the possession of the receiver to the extent indicated on their face. A certificate issued without the order of the court would be a personal obligation of the receiver. The points to be considered with regard to receiver's certificates are the concern of the lawyer rather than of the accountant. As far as the

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accounting is concerned, the certificates of each series are credited, as sold, to a separate account for the series, which shows the due date and the interest rate. The order of the court defines the extent of the lien given to the certificates.

FORMS OF REPORTS TO BE RENDERED FROM TIME TO TIME TO THE COURT BY THE RECEIVER.

The receiver is almost invariably directed, in the order by which he is appointed, to cause to be prepared and to file with the court, either within a specified time or as soon as practicable, schedules of all the property, rights and assets which may come into his possession as receiver. Authority is frequently expressed, though it may always be regarded as implied, to employ such experts as may be necessary to enable this to be done.

The receiver may thereafter be directed to file reports at monthly, half-yearly or other intervals, and a master will be appointed, as a rule, to pass upon the accounts presented. Particularly in cases in which a property is being operated at a deficit, it is important that frequent reports be filed, in order that the financial situation may be brought to the attention of the court and instructions obtained in good season, before the position becomes too involved, as to the desirability of further operation. Reports should in every case be rendered at least annually.

In all these reports, the utmost importance should be attached to the narrative or comments accompanying the statements submitted. The presentation of accounts and schedules in a clear, intelligible form is in the highest degree essential, but the theory upon which the accountant should endeavor to proceed is that the accounts and schedules serve to illustrate the receiver's narrative report, and not the contrary point of view, that the narrative represents so much comment upon the statements which it accompanies.

The attorney for the receiver will undoubtedly dictate or indicate broadly the form which the narrative should assume and will, in fact, in many instances personally undertake the preparation of the report, depending upon the accountant for the figures and summaries of accounts which it comprises and for the accounts and schedules by which it is supported. It will facilitate this collaboration if the accountant will adopt a non-technical

form of language and expression, with a view to rendering the presentation of the matter as far as possible convincing and free from the necessity for further interpretation.

The receiver's first report to the court should contain, as before indicated, a statement of the properties in the hands of the court, divided very carefully as between permanent or fixed assets and current or liquid assets, analyzed according to location within the several jurisdictions in which ancillary receivership proceedings have been brought, and classified as "pledged" or "free" assets, with a statement as to the liens to which the pledged assets are subject.

It is not necessary in this report that any values should be placed upon the permanent or fixed assets. Whether such values are given or not, however, a reasonably comprehensive description of the fixed assets should be given. If a value is stated, the basis upon which it is arrived at should be shown. A distinction should be drawn between property used in and necessary for the prosecution of the business of the company and other property capable of realization without detriment to the going-concern value of the undertaking.

Investments representing the control of subsidiary companies or of properties necessary to the business of the company should be classified as fixed or permanent assets.

The schedules should naturally comprise more than mere tangible property. Leases, patent rights, rights of action and similar intangible items of value should be set forth.

Reference may be made parenthetically to the fact that a receiver may recover assets misappropriated by the stockholders of a company and cause to be returned to him capital distributed as dividends. In exceptional cases only is it likely that such a right would be sufficiently definite to be asserted at the time of the filing of the first report. It is a point to be kept in mind by the accountant, however, in scrutinizing the books of the company, and it may become his duty to suggest to the receiver that an investigation upon these lines might be productive of substantial results.

Accompanying the schedules of assets there will be given, for the further information of the court, schedules of the creditors, secured and unsecured, as far as can be determined from the

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books of the company, and any other data available to the receiver. These schedules will not constitute admissions in any sense of the validity of the claims. The liabilities will be classified as to (a) claims in respect of which a preference may be asserted; (b) secured claims, with details as to security; (c) unsecured claims; (d) contingent claims. In the case of continuing obligations, such as those under leases and guarantees, the aggregate liability should be computed to the end of the term, particularly in cases involving an early disposition of the property without reorganization. The law provides that the receiver may disaffirm any executory contracts not beneficial to the company. This will not, however, operate to prevent the other party to the contract from asserting a claim against the company (though not against the receiver) for any loss sustained by reason of such disavowal, and the liability under such contracts should be stated.

Following the first report of the property passing into the hands of the court, there will be prepared, preferably at regular intervals, a series of reports showing the progress of the receiver's administration of the property. It cannot be said that any uniformity obtains as to the form which these reports should assume. Their purpose is manifold, and to meet varying conditions different forms may be adopted. The objects to be served in the preparation of the reports are: (a) to demonstrate the extent to which the liquidation of the property taken over has proceeded; (b) to indicate the changes which have occurred in the status of the property; (c) to show the results of the operation of the property by the receiver; (d) to enable the court to appraise the value of the services of the receiver. These purposes can all to a substantial extent be accomplished by the presentation of accounts in the form known as an account charge and discharge. The receiver charges himself with:

- (1) The assets at the date of the receivership (or at the date of the last report), exclusive of permanent or fixed assets;
- (2) Additions to such assets since discovered;
- (3) Increments upon realization of such assets;
- (4) Amounts realized from the sale of permanent or fixed assets;

- (5) Amounts realized from the sale of receiver's certificates;
- (6) Increases in the amount of receiver's liabilities;
- (7) Gross income from the operation of the property.

The receiver credits himself with:

- (1) Preferred or other liabilities of the company paid;
- (2) Decreases in the assets stated as taken over at the date of the receivership;
- (3) Losses on realization of such assets;
- (4) Expenditures on permanent or fixed assets;
- (5) Receiver's certificates repaid;
- (6) Decreases in the amount of receiver's liabilities;
- (7) Interest charges paid;
- (8) Expenses of operation of the property;
- (9) Receivership expenses;
- (10) The assets at the close of the period covered by the report, exclusive of permanent or fixed assets.

In practice, this account should further be supported by:

- (a) Comparative balance-sheets of the receiver at the beginning and end of the period covered by the report;
- (b) Income and expenditure or profit and loss account for the period;
- (c) Abstract of cash transactions for the period.

This last is largely optional.

The balance-sheet may be a balance-sheet of the receiver alone, in which case payments of liabilities on account of the company will be carried as receiver's assets, or the balance-sheets of the receiver and of the company may be shown in parallel columns and consolidated.

The details should cover the changes occurring during the period since the last report, and, if desired, the cumulative figures for the entire term of the receivership to the date of the report may also be given.

A form in which the theory of the account charge and discharge is preserved, though somewhat modified, consists in a statement upon the following lines:

- (1) Profit and loss account in summarized form, showing net income accruing to the receiver (excluding receivership expenses);

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- (2) To which add:
 - (a) Reductions in assets other than cash, less increases;
 - (b) Increases in receiver's liabilities, less reductions; giving total resources to be accounted for;
- (3) Accounted for as follows:
 - (a) Liabilities of the company paid,
 - (b) Expenditures on fixed assets,
 - (c) Interest paid,
 - (d) Receiver's expenses paid,
 - (e) Addition to cash on hand.

Assuming that these reports are made at reasonably frequent intervals, it would appear that they may be in a brief summarized form. Reference to the form of accounts for fiscal periods will be made later.

It is particularly important that a receiver should be in a position to support his accounts by proper vouchers, and he may be called upon by the master, upon the demand of any party in interest, to produce vouchers for all his disbursements in excess of a nominal amount, say \$20.00.

A report which will be called for in due course during the receivership is the schedule of claims filed as the result of advertising or calling for claims. This will not be done until an order is issued, and in most cases a master is appointed by the court to receive and pass upon claims. The claims filed will be reconciled with the records of the company and differences adjusted as far as possible with the creditors. The schedules will then be filed with the master as soon as practicable, with comments upon any discrepancies as to the disposition of which it has been found impossible to agree. Such cases will be passed upon by the master.

It is advisable that the final report of the court should contain a general summary of the main features of the transactions carried out under the management of the receiver for the entire duration of his appointment. This will assist the court in determining the proper remuneration to be allowed the receiver. In comparatively small cases a percentage basis may be adopted in fixing such remuneration, five per cent of the sum of the receipts

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and disbursements being not unusual. In large matters, the basis is usually that of allowing a round sum, commensurate with the time and responsibility involved.

THE CLOSING OF THE BOOKS OF THE RECEIVER.

A receivership in the equity courts is sometimes, in the case of industrial companies, terminated abruptly by bankruptcy proceedings brought within four months of the date of the receivership. The bankruptcy law does not apply to railroads, however, the receivers of which are thus protected from this ungrateful treatment.

Should this eventuality arise, the closing of the receiver's accounts is a simple matter. It becomes necessary merely to transfer to the account of "The A. B. C. Corporation in receivership" the accounts representing all the assets taken over by the trustee in bankruptcy, together with all the operations accounts of the receiver, with a proper narrative of the facts. Assuming that the receiver had proceeded in a circumspect manner, with due authority from the court, any debts incurred by him and remaining unpaid would constitute preferred claims against the assets and, being assumed as such by the trustee in bankruptcy, would be closed out on the receiver's books to the credit of "The A. B. C. Corporation in receivership." The final accounting of the receiver would be made in a form similar to those already discussed, the account charge and discharge being unquestionably the most appropriate form in the circumstances.

In the vast majority of cases, however, receiverships are terminated (probably as to numbers of cases in the order named), (a) by reorganization after foreclosure; (b) by sale and liquidation; (c) by reorganization without foreclosure. For the purposes of this discussion the distinction between classes (a) and (b) is really less marked than the distinction between the first two classes and the last.

The last class, viz.: reorganization without foreclosure, is the simplest from the point of view of accounting. Under safeguards satisfactory to the court and with proper provision for future financing, the property is merely returned to the reorganized or recapitalized company, after the discharge of the outstanding receiver's certificates, the payment, or assumption by the com-

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pany, of the receiver's liabilities and due provision for the receiver's expenses and remuneration. The accounting procedure, as far as the receiver's books are concerned, is fairly obvious. The record of the transactions involved in the reorganization naturally appears upon the books of the company.

Turning, however, to the most numerous class of cases, viz.: those involving foreclosure and subsequent reorganization, the details are of a more interesting character.

In these circumstances the court enters a decree of foreclosure and sale and appoints a special master to conduct the sale. In most cases a plan of reorganization has been agreed upon by the holders of the bonds—under the mortgage to secure which the foreclosure proceedings have been brought—the holders of bonds and securities inferior to such issue, the unsecured creditors and the stockholders, each group acting through its protective committee. A purchasing committee, acting for all parties to the plan, accordingly bids in the property at the sale, subject to all liens prior to the issue or issues foreclosed and pays the purchase price, in whole or in part, by the deposit of bonds of the foreclosed issues.

The special master will thereupon make a report to the court of the result of the sale and a decree confirming the sale will be entered. Under this decree the receiver will be directed to deliver or transfer to the purchaser or purchasers the property sold, and the method of distribution of the proceeds will be specified. The procedure as far as the receiver's accounts are concerned depends entirely upon the exact terms of the sale. It must be remembered that the receiver is merely an officer of the court whose functions are fulfilled when the property is taken out of his hands and dealt with according to the court's decree. If, therefore, under a comprehensive plan of reorganization of a company which has emerged successfully, under the receiver's management, from insolvency into a reasonably or, it may be, very satisfactory condition, the purchaser undertakes to settle with the assenting bondholders, to provide cash for the payment of dissenting bondholders, to pay the expenses of the receivership and the remuneration of the receiver, to assume the liabilities to unsecured creditors and to afford to the old stockholders an opportunity to become interested in the reorganized company

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(generally upon payment of an assessment), it is apparent that the accounts of the receiver do not extend to the recording of the transactions involved.

In this case the accounts of the receiver will be closed as at the end of a fiscal period and a final report to the court will be made in the same form as that previously adopted, with a reference to the fact of the disposition of the property under the decrees of the court and a statement of the property so disposed of. The books will be closed merely by the transfer of the accounts, debit and credit, with a proper recital of the facts, into the account of "The A. B. C. Corporation in receivership."

Cases are frequent, however, in which the stockholders are entirely eliminated, the unsecured creditors receive a percentage of their claims and the secured creditors either realize the whole of their claims out of the proceeds of the sale of the mortgaged or pledged property, or applying such proceeds pro tanto to the payment of their claims, rank with the unsecured creditors against the general estate for any deficiency.

In this connection it may be permissible to note that the law, if invoked, will denounce the elimination or scaling down of the claims of general creditors in cases in which the stockholders of the old company are permitted to participate in the new company in any way which recognizes their old stock holdings. For this reason, therefore, the secured creditors will be unlikely to join the stockholders with them in any plan of reorganization unless the value of the property admits of the raising of sufficient cash or the creation of sufficient securities substantially to satisfy in full the claims of the unsecured creditors. This condition is an important factor in cases in which heavy claims stand out against the general estate in respect of guarantees or leases disaffirmed by the receiver and sought to be foreclosed by the sale of the property.

In all cases, however, in which the settlement of all matters arising out of the receivership is not, with the approval of the court, covered by a comprehensive plan of reorganization, the court will direct that a sufficient part of the consideration for the property sold shall be paid in cash, and not in deposited bonds,

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to provide for the payment of (a) the costs of the proceeding and the receiver's remuneration, (b) the debts of the receiver and (c) preferred claims.

In this case, as well as in the case of a receivership terminated by the unprotected sale of the assets, the accounting of the receivership will proceed to the point of recording the receipt of such proceeds and the discharge of the expenses and liabilities referred to. Where the cash proceeds are specifically applicable against individual assets, they should be so applied and any difference between book and realized values carried to "profit and loss on realization." Where the cash represents merely part payment for various parcels of property, the balance being paid by the deposit of bonds, the cash should be credited to an account designated "Receipts on account of sale of assets," and its disposition in the payment of the various classes of charges and liabilities recorded in the usual way. It appears to be unnecessary and inadvisable to record in the books of the receiver, except possibly as a memorandum, the deposit of bonds of the company against the purchase price of the property. The delivery or transfer of the property and the distribution of the proceeds among the secured and unsecured creditors remains in every case a matter of court decree which can be recorded simply by the transfer of all accounts, with a proper narrative, to the account of "The A. B. C. Corporation in receivership."

THE ACCOUNTING RECORDS OF THE CORPORATION AS SUCH.

Reference has already been made to the desirability of keeping the books of the corporation in agreement with the books of the receiver as to all matters affecting the inter-relation between the corporation and the receiver.

The books of the corporation should also record such recurring liabilities as interest, guarantees, rentals, etc., not taken up as charges by the receiver, being either extraneous to his operations as such or actually disavowed by him. In this manner the books of the corporation will continue to show the liabilities which will require to be dealt with upon a distribution of the general estate or, as to certain items (e. g., interest), in the distribution of specific portions of the estate.

The corporation may from time to time, at the end of its regular fiscal periods, issue reports to its stockholders. In the

case of railroad corporations this will almost invariably be done, but it may be omitted in receiverships of industrials. Such reports should be in the form of consolidation of the corporation and the receivership accounts, preferably, but not necessarily, stated separately in parallel columns and consolidated in a third column. In the balance-sheet, in any event, the liabilities of the corporation prior to receivership, less such as have been paid by order of the court or by the liquidation of liens, should be shown in a separate group of figures from the liabilities of the receiver, as should also the accrued liabilities previously mentioned, which are taken up by the corporation but are not recognized by the receiver. The nature of these should be explained in a footnote to the accounts. It is hardly necessary to add that the fact of the property of the corporation being in the hands of a receiver should be very clearly expressed.

Upon the termination of the receivership, the books of the corporation should be adjusted to show specifically what has taken place. The receiver should be charged and surplus credited with the amount of the profit shown by the receiver's accounts, or vice versa in the event of a loss. Additions to property, less depreciation, should be credited to the receiver and charged to the property accounts in cases in which the latter have been retained in the books of the corporation. The liabilities should be adjusted to the amounts allowed by the master appointed by the court. The realization of the property should be recorded, each parcel being credited to the account of the receiver and charged, with a narrative of the details, to an account designated "Realization of property," to which the proceeds will be credited, the difference being charged or credited to surplus. Where property is sold subject to existing liens, the accounts representing such liens will also be transferred to the credit of the "Realization of the property" account. The application of the proceeds to the payment of the various classes of liabilities, either in full or pro rata, will be recorded, the unpaid proportions, if any, being left open, meantime, on the liability accounts. In the event of a deficiency existing, the books will finally show a debit on deficit account, open credits on certain classes of liabilities and credit balances on the capital stock accounts. These will be closed one against the other.

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Where an equity remains for the stockholders, the closing entry made upon the dissolution of the corporation will record the distribution to the stockholders of the assets by which it is represented.

The case of a reorganization without foreclosure presents no difficulties. The assets and liabilities are brought back on the books of the corporation by transfer from the receiver's account, and the entries recording the provision of additional capital and the scaling down of junior securities and stocks under the plan are given effect to on the books of the corporation, which are continued as the books of the reorganized company.

A variation of some interest occurs in the case of New Jersey corporations. It is the practice, owing to certain features of the laws of that state, to appoint a receiver for the corporation in the New Jersey state courts, after a receiver has been appointed for the property of the corporation in the federal courts in some other jurisdiction. This receivership does not supersede the first, but is supplementary to it. The receiver under the state law merely takes possession of any property not in the hands of the federal receiver, receives any equity remaining for the stockholders after the discharge of the indebtedness and liquidates the company. It may even happen that the company is dissolved by the New Jersey courts before the termination of the receivership proceedings. In this case the accounting in the books of the former corporation is continued for the account of an entity described as "The stockholders of the A. B. C. Corporation, now dissolved." The situation is somewhat anomalous, but the accounting procedure need not be affected in any way.

It will be recognized that in a paper of this length it is only possible to touch very briefly upon the details of a subject of this magnitude, and it would be presumption to go too far into the questions of law involved. A more comprehensive idea of the subject from the legal point of view than can be gained from the text-books will probably be obtained from the very instructive lectures of James Byrne and Paul D. Cravath which are included in a series published by the Macmillan Company in a volume entitled *Some Legal Phases of Corporate Financing, Reorganization and Regulation*.