Accounting Questions: Real estate on Proprietorship Balance-Sheet; Accounting for Underwriting and Registration Expenses

American Institute of Accountants. Bureau of Information

Accounting Questions

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REAL ESTATE ON PROPRIETORSHIP BALANCE-SHEET

Question: An individual conducting a business as a sole proprietorship owns considerable real estate not connected with his business. The title to this real property is held with his wife as "tenants by the entirety." How should the real estate be shown on his balance-sheet?

If this item is shown on the balance-sheet under the caption "Investments," with appropriate comment regarding title, or as a footnote, it seems to me that an overstatement of assets might possibly be construed, as the property is not available to the common creditors of his business and his wife has as much interest in it as he has.

On the other hand, it would not appear to be equitable to omit such property from the balance-sheet.

A further thought on the matter is that of making a joint balance-sheet. The wife has no assets other than the real estate held with her husband. Such a statement may be considered by interested parties as a partnership, which is not permissible under the District of Columbia code.

Answer No. 1: The balance-sheet of an individual may be prepared to display all his assets, liabilities, and net worth, or only the items connected with his business. In a balance-sheet of his business it would not be necessary to include the real estate, even in a footnote, as it is not connected with the business. In a balance-sheet of all his assets and liabilities, it might be advisable to include this real estate among the assets with a full description of his equity in it and the total value shown in the balance-sheet caption, but with no amount shown in the amount column.

Answer No. 2: Strictly speaking, the proprietorship has no separate interest in the real estate which could be realized for the benefit of creditors, but I am of the opinion that the item should be stated in the balance-sheet under an appropriate heading, with an explanatory footnote stating the condition of title and how the husband's interest in same has been valued. This value might be determined on a life expectancy or other suitable basis.

In any event, if the condition of title and other factors are fully explained in the balance-sheet, there can be no misrepresentation to creditors or others. It would naturally be preferable, from the standpoint of creditors, for the husband and wife to prepare a partnership financial statement.

ACCOUNTING FOR UNDERWRITING AND REGISTRATION EXPENSES

Question: The X Company is a New York corporation. Its authorized capital stock consists of 20,000 shares first preferred of no par value, entitled on liquidation to $50 per share, none of which has been issued, and 100,000 shares of common stock $10 par value, all of which have been issued. The company has an earned surplus of $500,000 and a paid-in surplus of $500,000.

The corporation proposes to issue the entire 20,000 shares of preferred stock for $1,100,000. The stock will be given a stated value of $50 per share, so that $1,000,000 will be considered the book value of the preferred stock and $100,000 excess will be credited to paid-in surplus account.

It is expected that the cost of underwriting the issue, legal and other professional services in connection with same, and registration with the Securities and Exchange Commission will amount to $75,000. The company proposes to charge this amount to paid-in surplus as an offset against the $100,000 credit.

Would this be considered good accounting practice, and if not, would it be preferable to charge it directly to current operations, rather than earned surplus?

Answer No. 1: The amount of expenses in connection with the underwriting, registration, etc., of the securities is fundamentally an item in the nature of a deferred charge to be written off on some basis over a period of time. From the standpoint of conservatism, however, many corporations have followed the principle of writing such expenses off at the time of its occurrence. If written off periodically, it would seem that the yearly charge would be a charge against operations. It might be argued, therefore, if written off at one time, the total amount should be charged against earned surplus. This method would no doubt be a conservative way of writing off such expenses.

Many instances, however, may be cited where expenses of this character have been charged against paid-in surplus as an offset against the excess of the proceeds from the sale of securities over the par or stated value thereof, which excess was credited to paid-in surplus.

In view of this latter tendency, we are of the opinion that such expenses are properly chargeable against paid-in surplus, although a more conservative method would be to charge such amount to earned surplus.

Answer No. 2: We see no objection to charging this expense, $75,000 against paid-in surplus, especially as the premium on the issue, which will go to increase the paid-in surplus, is in excess of this expense. However, the procedure followed should be disclosed on the balance-sheet or on any statement issued in connection therewith.

Answer No. 3: In our opinion, the cost of issuing new capital stock for cash or an equivalent consideration is a capital expenditure, and is not a proper charge either to current operations or to earned surplus. In the absence of a capital or paid-in surplus, it may be proper to charge such expenditures against an existing earned surplus, but in such cases the propriety of the treatment arises from its necessity and the result of such treatment is, in effect, an appropriation of earned surplus to the capital-stock account.

Where, however, as in the case presented, there is not only a paid-in surplus, but a paid-in surplus arising directly out of the proceeds of the sale of the capital stock in connection with the issuance of which the expenditures in question were incurred, there is no doubt, in our opinion, that the charging of the costs of the capital-stock issue to the paid-in surplus, created by the receipt of consideration for the capital stock issued in excess of its par or stated value, is the only proper procedure.