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Review of “Materials on Accounting,” By Robert Amory

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in statutory construction the courts are less free than in case-law, because, while they can alter the meaning of the prescribed words, they cannot alter the words themselves, and because their own decisions establish a tendency or direction for the statute. In constitutional interpretation on the other hand, they are more free than in dealing with statutes because, from the nature of the case, they can more easily desert their own decisions, return to the document, and even declare frankly that the words cannot be limited to the conditions known to the draftsmen. It seems that the description of our actual position under statutes is accurate, but it is not a necessary condition. There is no inherent reason why a court should not possess the freedom in dealing with statutes that it has in dealing with constitutions. Perhaps only the fact that so much of our law is case-law has prevented courts from claiming this freedom. As current trends toward legislative remedies continue, and as our case-law, from its very mass, increases the pressure for total codification, we may witness a change in statutory construction toward the methods now current in constitutional interpretation and it may be helpful to have the latter method at hand to imitate. All this, however, is not inconsistent with Professor Levi's thesis; it is only one of the numerous dark places in which it sheds useful light.

To conclude, books of general jurisprudence and of logical analysis are of value to the teaching and research functions in law, but they are hardly ever concrete enough to repay a practicing lawyer, otherwise than intellectually, for the time consumed in their study. This concise book is an exception to the rule. Its values to the teacher and student are obvious; but the practicing lawyer will find it far more valuable to him than others of its kind. He will find its description of his methods accurate in his own field, while the generalized statement and application will help him work in unfamiliar areas, by carrying over much of his experience whose applicability he might not easily recognize. The book may displease those on the other hand, who believe that the law is, or can be made, a logical and coherent system. But that is a battle which we can hope is already won.

A. C. Becht.*

MATERIALS ON ACCOUNTING. By Robert Amory. Brooklyn: The Foundations Press, Inc., 1949. Pp. xxiii, 781. Price \$7.00.

The day is definitely past when a lawyer can boast of his ignorance of accounting. Almost unheralded, a new profession has arisen, "accounting-based law." Mr. Amory has written a valuable book to acquaint readers, particularly law students, with accounting. He makes it plain that he does not purport to treat "Legal Accounting." In fact, he seems to doubt whether there is any such thing; instead he regards accounting as a *universal* language.

Students and practicing lawyers alike should prepare themselves to practice the new profession, else they may find themselves excluded more and

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more from important and lucrative sectors of the practice. It needs but a passing glance at Mr. Amory's book to realize that accounting is a prime ingredient in many major fields. Among these may be mentioned: income tax, public utility regulation, Interstate Commerce Commission regulation, Securities and Exchange Commission compliance, business counselling, including corporate finance, trust management, legal matters, concerning fidelity auditing, including detection of embezzlement and accounting malpractice suits. The foregoing list is not exhaustive and many other subjects could be mentioned where the understanding of the universal language of accounting is a *sine qua non*.

Whereas in an ordinary case book the compiler is fairly well confined to decided cases with some supplementary matter, the compiler of a case book on accounting has a much wider scope and many more sources from which to draw. Since the book under review is slanted particularly toward the legal mind, court decisions occupy a prominent place. In addition, there are some rulings by the Treasury Department, although the author takes pains to point out that this particular book is not intended primarily for the study of the income tax and, therefore, relatively few rulings of the Treasury Department relating to this subject are included. Fourteen "Accounting Series Releases" of the Securities and Exchange Commission are included, as well as a letter from the Chief Accountant of that Commission.

The author also publishes twenty-eight "Accounting Research Bulletins" of the American Institute of Accountants, together with some other data issued by the Institute.

He reprints by permission approximately a dozen of the copyrighted "cases" of the Harvard Business School. These cases are not litigated controversies but are fact situations presenting an accounting problem. In the prospectuses of corporations, especially those filed before the Securities and Exchange Commission, the author has a valuable mine of information.

Also, of course, the published statements of the corporations, which the author utilizes in great quantity, contain many valuable and timely discussions of accounting points.

There is valuable text material by the author himself, as well as a chapter on cost accounting by Perry Mason, C.P.A., Professor of Accounting, University of California.

The contents included are of considerable importance and wide scope, ranging from fundamental concepts to detailed discussions of branches of the new profession of accounting-based law. The author quotes from an Institute Research Bulletin¹ explaining the meaning of accounting "principle" and pointing out that, in discussion, the word is often invested with an aura of sanctity arising out of the more fundamental meanings of principle, thus leading many persons to attribute to the rules of conduct called accounting principles a greater force and more universal and permanent validity than most of them were ever intended to have; and there is some discussion as to whether it would not be better to call these rules of conduct

1. American Institute of Accountants, *Accounting Research Bulletin* No. 7.

“good accounting practices.” The dissemination of this information will have a tendency to offset the undue glorification of “accounting principles” with the implication that these principles are known only to a priesthood who are practicing accountancy and who state what they are *ex cathedra* and without any opportunity existing to anyone else to question the authoritativeness of the pronouncement. Therefore, the Accounting Research Bulletin is well advised in stating that care should constantly be taken to make it clear that, as applied to accounting rules of practice, an accounting principle does not connote a law of that high order from which there is no appeal and that an accounting principle is not a principle in the sense that it admits of no variation, nor in the sense that it cannot conflict with other principles. The Research Bulletin ends with the complaint that whereas principles of law frequently conflict with each other, it is surprising to find the possibility of conflict among the accounting principles giving rise to any question.

The author has his own treatment of the fundamentals of double entry bookkeeping which is a gem.² He bases it all on an equation as follows: “Assets = liabilities + net worth.” While admitting that net worth, being a composite of various standards of cost and value, is therefore an anomaly, he points out that this equation underlies all of the technique of bookkeeping.

He emphasizes that debit means an entry on the left-hand side of a ledger account, and credit means an entry on the right-hand side, and that either a debit or a credit may represent an increase or a decrease of an account, depending on whether the account is one where positive quantities are found on the left-hand side or on the right-hand side. For example, a debit to a property account would be an increase on the account, whereas a debit to the surplus account would represent a decrease of that account. If this fundamental concept could be understood by all who begin the study of double entry bookkeeping, they would be spared many perplexing moments.

In the chapter on revenue,³ our author points out that periodic net income can never be stated with absolute precision because of the impossibility of forecasting events in the future, which alone can give definite monetary expression to the continuous process that must be judged and described in mid-passage.

It is only when the enterprise is terminated and beyond the contingencies which are operative during its life that the actual amount of the revenue in any interim period can be stated with precision. Yet “accrual” accounting is a necessity.

The requirement that income must be realized before it is the basis of dividends is discussed in several decided cases.⁴ Since this may involve legal liability upon directors, it is of interest to lawyers.

A chapter is devoted to inventory methods.⁵ The method known as “last

2. Chapter 2.

3. Chapter 3.

4. *People ex rel. Farnum v. San Francisco Savings Union*, 72 Cal. 199, 13 P. 498, and *Kingston v. Home Life Insurance Company of America*, 11 Del. Ch. 258, 111 Atl. 898 (1917), *aff'd*, 11 Del. Ch. 428, 104 Atl. 25 (1918).

5. Chapter 5.

in, first out" and abbreviated "lifo" is considered at length.⁶ The experience of the Caterpillar Tractor Company is of interest.⁷ The author points out that the Caterpillar Tractor Company adopted lifo in its accounts in 1947 and thereby made the change near the top of the price cycle. This company noted in its reports that its income for the year was reduced by \$3,519,548.00 as a result of the change. Yet it elected to pay its taxes on the old or "first in, first out" method and therefore paid to the Federal Government \$2,156,897.00 more than it was required to in 1947. The company's explanatory statements setting out the reasons for this election are given by the author. These, in general, are that the lifo method has the general effect of excluding from reported profits increases in inventory costs. Since these increases are deemed to be merely the result of rising cost levels, the company points out that at such time as cost levels decline the basis used for general reporting purposes, namely lifo, will lead to the reporting of profits *greater* than the taxable profits, and the company states that at that time the proper portion of the deferred income tax which had not been allocated to operations previously would then be allocated to operations. Prior to that time the excess income taxes paid were treated as a deferred charge on the company's books.

The author makes liberal use of a statement by the United Electrical Radio and Machine Workers of America 1943 entitled "How Corporations Conceal Profits and How to Understand Your Corporation's Financial Report."⁸ The author quotes a discussion of last in, first out contained in the statement referred to, in which the statement says that every merchant tries to sell his oldest goods first, but the last in, first out method assumes that the merchant does just the opposite and sells his oldest goods last; and they make this statement also, "A corporation using lifo is debarred from taking a book inventory loss, since it takes no book inventory profit, but it may take a real one." This seems to refer to the fact that with lifo, inventory prices are in effect frozen. They cannot be written down because they have not been written up, but they can be sold down and normally are sold down in a period of declining prices. An article by Arundel Cotter in Barron's Magazine is quoted to the effect that so long as the depleted inventory is not replaced until after the start of the next accounting year an inventory loss actually realized is chargeable against profits for tax and other purposes in a period of declining prices.

The analysis of financial statements and, in particular, of consolidated statements,⁹ is quite valuable. Many publicly held corporations issue consolidated statements of their various corporations and accordingly the reader should understand the technique applicable to the consolidation.

Cost accountants will be most happy that their relatively new branch of the profession has received ample recognition in this work, which, be it remembered, is slanted to law students. It has been said that the growth of industrial America would have been impossible without the development

6. P. 127.

7. P. 183.

8. P. 186.

9. Chapter 12.

of cost accounting. It, of course, goes without saying that the National Association of Cost Accountants¹⁰ with its many chapters and its national bulletin has been the greatest single force in the spread of cost accounting knowledge. The author even includes treatment of such a highly technical point as "break-even point" which is the amount of volume necessary to defray fixed and variable costs of production so that an increase in that volume will result in a profit, and, *per contra*, a decrease in that volume will result in a loss. This may be the most important single problem confronting a business man. Since break-even points are extremely high at the present time, the spread of the knowledge of break-even point computation is probably very valuable. That this should be included in a book intended as a text book to be used in law schools is indeed a salutary thing. The author "debunks" the idea that the cost accounting procedure is primarily for the purpose of determining actual costs with a view to selling prices. This is rarely true, he says.¹¹ Selling prices are fixed on entirely different considerations. Professor Mason, who wrote the chapter on cost accounting states something which should be pondered by every manager of a business, namely that *special studies offer the most effective methods of arriving at important decisions with the use of production costs and distribution cost accounting figures and that in general accounting records are too strongly flavored with historical cost to be correctly applied to current problems.*

The foregoing statement, which is almost a direct quotation from the chapter, is emphasized because of the great tendency of the uninformed to consider the financial statements of corporations as authentic pronouncements which can be used for all purposes, including that of planning for the future. The purpose of cost accounting is stated by Professor Mason to be something else entirely, namely the measure of efficiency of operation.

No one can consider the wealth of material included by Professor Amory in the book under review without coming to the conclusion that, just as the boundary between economics and law, and the boundary between sociology and law, have become eroded and of small consequence, so the boundary between accounting and law is, as in many areas, of no consequence whatever. It is, of course, common knowledge that, in the field of taxation, for example, the accountant must be competent in the law of taxation, and the lawyer must be competent in the practice of accounting, and it is of small moment whether the practitioner arrived at his goal by one route or another. The thing which is not so well understood is that the same evolutionary process has occurred also in many other fields, and it is these fields rather than taxation which are emphasized in the book under review. May we hope that the broadening out of the application of accounting knowledge to concrete legal problems, which is exemplified in this book, will be carefully pondered by law students and practitioners, and that the subject matters of the book will become a standard part of the curriculum of the laws schools of this country.

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11. P. 757.

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