

PROBLEM 7.

A city during financial stress, arranged with the bondholders that it should suspend payments to the Sinking Fund for five years and that the life of all its bonds should be extended five years. During the suspension of the sinking fund, the carrying charges of the electric light and waterworks plants were taken to be the amount of interest. Three years elapsed before this fact was revealed by a new firm of auditors. What remedial accounting action is necessary, if any, and why?

ANSWER. The fact that no sinking fund deposits are required to be made during the five years in question, does not by any means say that no depreciation should be provided. The assets are wasting in exactly the same manner, and at exactly the same rate, as if no alteration had been made in the terms under which the bonds, from the proceeds of which they were created, had been made, whilst obsolescence due to improved machinery, etc., has to be provided against, just as if the city had not been through a period of financial stress.

It would appear as though the Council should act promptly in deciding to make provision for depreciation and obsolescence on fair lines during the ensuing two years, and also to create further depreciation equalling that which should have been provided during the three previous years. This latter should be charged spread over the ensuing five years, so as not to make the burden unduly heavy in any one year.

But it may be argued that the suspension of the sinking fund was obtained solely to obviate the need for making such provision.

This is no argument at all in connection with two public utilities that should be on a paying basis.

What has doubtless happened in past years is that the provision for depreciation, made by means of charges for overhead to the utilities, has been dissipated in the general