PROBLEM 11

A City is carrying on Capital works to the amount of $2,000,000 which take 2 years to complete, and for which consolidated stock is offered for sale when the work is completed. During construction, Treasury bills were offered for sale for the purpose of financing the works until such time as the stock can be sold. The Bills were discounted at 94, and the discount charged to current revenue. Is this correct?

ANSWER. The first thing we gather from this question is that the bills were discounted. Therefore the amount of discount became interest on temporary borrowings until such time as the work was completed.

The question now resolves itself into arriving at a decision as to whether the cost of temporary financing during construction is a capital charge or not. If not, of course the procedure adopted in the question was correct.

It would seem that there are two condition under which temporary borrowings during construction are necessary. The first is under similar conditions to those outlined in the question, and the second in case the bond issue for the works is dated prior to construction, and sold as funds are needed, or as favourable selling conditions arise.

In the first case, as in the question, the Treasury Bill discounts appear to be an incidental to construction, and therefore might reasonably have been included in the issue of consolidated stock just as discount on the stock itself might be.

On the other hand, if the discounts on Treasury Bills were caused by the delayed sale of debentures the reverse might obtain, because the ByLaws under which the debentures were authorized, unless postdated to the date of their sale, would provide for the levying of interest and sinking fund during construction. If such were the case, the discounts would take the place of the interest coupons on the bonds to their extent, and are therefore a thoroughly justi-