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A CRITICAL ANALYSIS OF THE UNIFORM SYSTEM OF ACCOUNTING FOR MOTOR CARRIERS AS PRESCRIBED BY THE INTERSTATE COMMERCE COMMISSION

By

Carroll E. Miles

A Thesis

Submitted to

the Faculty of the Graduate School

The University of Richmond

In candidacy

for the Degree of

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TABLE OF CONTENTS

CHAPTER		PAGE
	INTRODUCTION	1
I.	CRITERIA AGAINST WHICH SYSTEM WILL BE ANALYZED	5
	Principle, Judgment and General Acceptance	5
	Communication	10
	Consistency	13
	Materiality	15
	Going Concern Concept	16
	Depreciation	17
	Accounting Cycle	18
	Disclosure	19
II.	THE SYSTEM	22
	Authority For Regulation of Commerce	23
	Authority For Prescribing Records To Be Kept	25
	Definitions	27
	Instructions	30
	Numerical Numbers Assigned To Account Titles By System	31
	Interpretations, Citator, Index and General Sections	35
III.	ANALYSIS OF AREAS OF DISAGREEMENT	37
	Areas Which Have Been Improved	42
	Areas Still In Need Of Improvement	45
	Areas Likely Never To Be Changed	66
IV.	SUMMARY	71
	BIBLIOGRAPHY	74

CHAPTER PAGE

APPENDIX A.. 76

APPENDIX B.. 80

APPENDIX C.. 83

INTRODUCTION

In the beginning of any work a general understanding of what is being attempted is of some value to everyone concerned.

The title contains the word critical. One dictionary meaning of the word, and possibly the one most generally accepted, is, "inclined to criticize, unfavorable". A second meaning has it, "exercising or involving careful judgment". A meaning will be found somewhere between the two. The end product may appear to be more compatible with the former definition. This is not the intent. This apparent paradox may be better understood, or at least clarified, with the following thoughts.

Accounting is a utilitarian science which serves many people in many ways and for many reasons. During the development of accounting, the need arose before the accounting procedure, or system if you will, was designed to fill that need. It follows that the only real criterion for judging the usefulness of an accounting system is the purpose for which it was designed. The system under discussion in this paper was designed as one tool of a body charged with the regulation of an industry. Thus the system must perform in the public arena of regulation and in the private exhibition of the competitive market place. In this light, this paper is not being critical of the system in the performance of its designed task. The mission is to "exercise careful judgment" in exposing differences between what is accepted as sound accounting in the economic market place and treatment by the regulatory tool in an attempt to justify some common ground which will allow the system to do its designed job

and also be acceptable in the market place.

The system does comply in the majority with "generally accepted accounting principles". There are areas which could stand improvement. Improvement is not impossible or unattainable since there are areas which have been improved, some rather recently.

Differences, if expounded, are criticisms. Disagreements in particular areas easily could be considered unfavorable. These two admissions make this work and the first dictionary definition almost identical. As stated before, careful judgment has been exercised to the utmost of the writer's ability in pointing out the areas. Thereby, both definitions are involved. Possibly the phrase, "constructive criticism", combined with the exercise of careful judgment is more descriptive of what it is hoped will be accomplished.

Another area which will be touched on and one which belongs in an analysis of this nature, concerns changes which would improve the system's usefulness in the purpose for which it was designed.

This analysis will be made using "generally accepted accounting principles" as its guide. This is an often used phrase which is very difficult to define. This phrase is used daily, or even more often, by almost every accountant, be he certified or not, yet very few, if any, can itemize the principles without going into great detail. Even then, there are few who will assure the completeness of their summation. It appears that principles are the products of education and general acceptance comes only with experience in application. The nonexistence of any codified statement or work which dealt specifically with this problem was

somewhat surprising. However, this is a fact admitted by the American Institute of Certified Public Accountants. Because this condition exists, the word criteria is used in Chapter I to set up guides against which to evaluate the system.

If the American Institute has not codified a statement on generally accepted accounting principles, it may be foolish to even try to formulate such principles. The chapter on basic criteria will in no way purport to cover all accounting principles. In fact, some of these criteria may be rules or procedures.

The description of the system will probably prove rather difficult to handle. There are some rather long and technical definitions and instructions which will have to be quoted. Then, too, the actual description of the accounts is voluminous and detailed. The way in which this will be treated is to list the accounts by numbers and titles for a general idea of the composition of the material and quote only those accounts which are actually used in the analysis. Some brief descriptions of the accessory sections of the system will round out this chapter.

The final chapter will point out areas where the system disagrees with the criteria. It is not held that these are all of the disagreements. They are thought to be the major ones and their improvement would go a long way toward clearing some of the misunderstood aspects of this system.

The work on points which would improve the system, in and of itself, may be off base. The contention of need for changes in certain areas may be the result of lack of complete understanding of the use of the system

in the particular area analyzed. The first thoughts on this situation were that it would weaken the thesis to include it. Upon deeper contemplation, it was concluded that the understanding, or lack of it, in such matters would strengthen the work. Even if this logic tends to turn to misunderstanding, will not the existence of it show that the system needs improving in those areas?

As a time saver, both to the reader and to the writer, some shortened forms of some rather long proper names and titles seem advisable. These appear below as their use is intended:

1. The Uniform System of Accounts for Motor Carriers of Property. Wherever possible it is the intent to refer to this work simply as the System.
2. The Interstate Commerce Commission. The Commission will be used.
3. The American Institute of Certified Public Accountants. The Institute, or the American Institute, would seem to be satisfactory.
4. Certified Public Accountants. Reference here will be certified accountants, or professional accountants.

With these ground rules, it seems in order to proceed to the next chapter.

CHAPTER I

CRITERIA AGAINST WHICH SYSTEM WILL BE ANALYZED

In the introduction it was decided that an endeavor would be made to analyze the System in the light of "generally accepted accounting principles". In this chapter the task is to define these principles of accounting which are generally accepted. This, on the surface, appears a fairly simple task. In reality, it is most difficult.

Principle, Judgment, General Acceptance

The difficulty is caused by several things, one of the most important of which is the different meanings given the word principle in everyday usage. The degree of the meaning may more aptly describe the trouble area. The dictionary definitions most closely applicable to the area are, "a fundamental truth; a primary or basic law, doctrine, or the like; a settled rule of action; a governing law of conduct".

With these definitions in mind, what is the certified public accountant referring to in his opinion letter when he says, "...in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year"? What does the author of a text with a title such as, Principles of Accounting, Fundamental, have in mind? Are they talking about the same principles? Is one more inclusive or broader than the other? These are basic questions and must be answered before the analytical criteria for this undertaking can be established.

The wording of the certified accountant's opinion letter gives one

clue to the type of principle he has in mind. According to the letter, the principles have been applied on a basis consistent with the preceding year. Consistency is a generally accepted accounting principle of long standing. Thus, the opinion use of the word principle refers to such things as materiality, consistency, conservatism, going concern concept, and the matching of revenue and expense in the determination of income. The fact that two accountants can handle an identical item in different ways and write almost identical opinions on the financial statements involved indicates that this is the type principle to which reference is made. The difference could be in application of a procedure or method, but possibly the big difference is judgment. As an example, use the principle of materiality.

Materiality is the mathematical relationship between one number and one or more other numbers. This has a place in accounting. One place where materiality comes into play is in the presentation of certain items on the income statement. There are two schools of thought concerning items which appear on the income statement. One group is of the opinion that only those items from the normal operations should be used in the computation of net income. The other thought is that every item which enters into the realization of net income should appear on the income statement.

The position of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants, as expressed in Bulletin 43, is set forth below:

> ... it is the opinion of the Committee that there

> should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption relates to items which in the aggregate are material in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period. Thus, only extraordinary items such as the following may be excluded from the determination of net income for the year and they should be excluded when their inclusion would impair the significance of net income so that misleading inferences might be drawn thereon.
>
> (a) Material charges or credits (other than ordinary adjustments of a recurring nature) specifically related to operations of prior years, such as the elimination of unused reserves provided in prior years and adjustments of income taxes of prior years;
>
> (b) Material charges as credits resulting from unusual sales of assets not acquired for resale and not of the type in which the company generally deals;
>
> (c) Material losses of a type not usually insured against, such as those resulting from wars, riots, earthquakes, and similar calamities or catastrophes except where such losses are a recurrent hazard of the business;
>
> (d) The write-off of a material amount of intangibles;
>
> (e) The write-off of material amounts of unamortized bond discount or premium and bond issue expenses at the time of the retirement or refunding of the debt before maturity.[1]

The one thing that all these items have in common is that they must be material in amount to be excluded from determination of net income. They must be material in amount in relation to the net income of the en-

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[1] Accounting Research and Terminology Bulletins, (New York: American Institute of Certified Public Accountants, Final Edition, 1961.) p. 63.

tity involved. What is material? Suppose a company has a net income of $1000.00, exclusive of one of the questionable items mentioned above. No auditor would have any trouble whatsoever making up his mind to exclude one of the items mentioned in the opinion in the amount of $500.00. Some would have a little trouble with $100.00. More would have trouble with a $95.00 item. The point to be made here is that there is no correct answer. It is a question of judgment on the part of the accountant involved. This is the reason that two accountants can handle similar items and come up with different treatments and still issue an identical opinion. This, then, also is indicative of the type of accounting principles spoken of in their opinions.

When an author uses the word principles in the title of a text, he not only includes the principles of the public accountant, but he also includes more detailed and less inclusive ones. In fact, they may not even be principles in the strict meaning of the word. The author deals with all of the principles previously associated in this chapter with the Certified Public Accountant. He also deals with this type:

> Market may be determined on one of the following bases, depending on the type of inventory involved.
>
> Purchase or replacement basis:
>
> This basis applies to purchased merchandise or materials. It has been defined by the Treasury Department for tax purposes as follows: 'upon ordinary circumstances and for normal goods in an inventory for the particular merchandise in the volume in which usually purchased by the taxpayer.' The restriction concerning quantity is important; if it were omitted, inapplicable market values might be used.
>
> 'Replacement' is probably a better work than 'purchase', as

it is broad enough to include the incidental acquisition costs, such as freight and duties, which are properly included with the purchase price in inventory computation.

Reproduction basis:

This basis applies to manufactured goods and goods in process. It is determined on the basis of market prices for materials, prevailing labor rates, and current overhead.

Realization basis:

For some items in the inventory, such as obsolete or repossessed merchandise, a purchase or reproduction market value may not be determinable, and it may be necessary to accept, as an estimate of market value, the prospective selling price minus all prospective costs to be incurred in conditioning and selling the goods, and minus a reasonable profit.[2]

The above quotation is not a principle in the accepted meaning. It is not even a rule. Consider it a description of different methods of market determination in relation to the so-called cost or market rule. There are probably those who disagree with this terminology. This is of little importance. The point is to differentiate the uses of the word principle by segments of the profession.

While the market determination methods are not principles, they are grouped with other methods, procedures, concepts, and principles in a work entitled Principles of Accounting, Intermediate. After studying one or two such texts, all material covered assumes the status of a principle.

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[2]Finney, H. A. and Miller, Herbert E., Principles of Accounting, Intermediate. (New York: Prentice-Hall, Incorporated, Fifth Edition, 1962), pp. 244-245.

In order to make the detailed analysis which is being attempted, it may be necessary to use principles, concepts, procedures, methods and rules as bases to which the System will be compared. Thus, the use of the word criteria in the title of this chapter.

As previously stated, the Institute has not set out a codified statement of generally accepted accounting principles. They have, however, made pronouncements in the form of bulletins on just about every facet of accounting. The Institute and its members, although not in complete agreement on every subject, have more stature and are held in higher esteem by the users of financial statements than any other one segment of the accounting profession. For this reason, in the areas of disagreement, the pronouncements of the Institute will be considered as the generally accepted treatment.

Thus far, the word principle has been explained in an attempt to get a feel for the word as it is used in this work. An example of judgment and its interplay with principles has been presented and the requisite for general acceptance has been stated. Of necessity, it has been rather lengthy because of the problem of communication. The foregoing discussion points out the different connotations attached to the word principle. Part of the trouble comes from the multiple meanings of many words in our language. Some of it comes from expanded meanings which attach themselves to a word through usage or inference.

Communication

The communication problem is explained mainly because accounting is, in one sense, a science of communication. It attempts to record the his-

tory of a business entity in a feasible, accurate and informative way and communicate this history to interested parties who, in some cases, are far removed from any actual contact with the entity. The great difference in the interests of these parties adds to the communication problem.

Examine some of the various groups who, for one reason or another, may have an interest in this history (or chapter of history) of an entity. The stockholders would have very definite interest in the financial statements of the business. Creditors, or potential creditors, have more than a curious interest in these vehicles of communication. Employees, labor organizations, and governmental agencies, for possibly divergent reasons and to varying degrees, have an interest in these statements. The accountant's attempt to communicate to these groups of diversified interests and backgrounds, through the summation of the numerous transactions by use of the so-called "all purpose statement", represents an undertaking of no mean proportion. The recognition of this problem by different segments of the profession, including the Institute, is shown in the following statement:

> In more recent years accountants have become concerned about the term 'surplus' as a potential source of misunderstanding by users of financial statements. In 1948 the American Accounting Association dropped the term 'surplus' from its statement of accounting concepts and standards. In 1949 the Institute's Committee on Accounting Procedure authorized the publication, as Bulletin 39, of a report of its Subcommittee on Terminology, in which the discontinuance of the use of the term 'surplus' was recommended. The subcommittee noted the misleading connotations associated with the term 'surplus', such as excess, overplus, residue, or 'that which remains when use or need is satisfied' - meanings which are

not intended in its accounting usage.[3]

This change was made due to possible misunderstanding of the users of financial statements. The Institute was not concerned over their members' understanding of the word surplus, but for the layman who relied on statements and the meaning which might be attached to the word by some of the groups discussed previously. The accountants and some texts still use "surplus" and "retained earnings" (the Institute's recommended replacement) interchangeably. They have, however, to a large extent, followed the recommendation in eliminating the term "surplus" from the financial statements. The validity of the above statement is authenticated by a statement in Accounting Trends and Techniques.

> ...There has been a steady decrease in the use of the term 'earned surplus' in describing the 'retained earnings' account in the balance sheets in the published annual reports of the 600 survey companies. In 1946 there were 501 companies that used the term 'surplus' in this connection in their balance sheets, whereas in 1960 there were only 174 survey companies that continued to use such terminology.[4]

The existence of this problem makes communication a necessary criterion to the analysis of the System. The System very likely has communication problems of its own. Apart from that fact, continued usage of some terms which are believed to be misleading, employment of terms not

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[3]Ibid., p. 123.

[4]Accounting Trends and Techniques In Published Corporate Annual Reports, (New York: American Institute of Certified Public Accountants, 15th edition, 1961), p. 12.

usually associated with accounting terminology, and specialized terms peculiar to regulatory accounting tend to add to the confusion and misunderstanding already in existence. The problem seems to be of sufficient importance to justify the inclusion of communication as a part of our criteria against which our analysis will be made.

There have been included thus far two elements, communication and judgment, which do not conform to the nature of the other criteria; that is principle, concept, rule, etc. It is felt that sufficient justification has been presented for their inclusion, thus the balance of the chapter will concern itself with naming and defining the rest of the criteria.

Consistency

This has long been recognized as one of the fundamental principles of accounting. It has been considered as such for so long that it has without a doubt become generally accepted. The certified accountant thinks enough of this principle to make a definite statement concerning it in the opinion paragraph of his certificate.

Every accountant is aware that decisions and judgments have a definite effect on the determination of net income. They are also aware that such judgments and estimates can never be eliminated from such determinations. However, it would be undesirable to have income determined by whims and subjective reasoning and even worse by changing whims and subjectivity. There are many applications of the accounting principles and at times either of two different applications may be acceptable. Consistency has to do with deciding on an application and using it from year to year.

This is not to be used as a license to be consistently wrong. As has been said before, judgment is a most valuable asset in accounting. The use of it is a necessity. Thus, consistency is not to be carried to the point which excludes change; neither are changes to be made every year. If changes of accounting application are made frequently, most certainly they will destroy comparability and may create some misunderstanding with the users of the financial statements.

The American Institute has this to say on the subject:

> 1. The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an installment of what is essentially a continuous history.
>
> 2. In any one year it is ordinarily desirable that the balance sheet, the income statements and the surplus statement be given for one or more preceding years as well as for the current year. Footnotes, explanations and accountants' qualifications which appeared on the statements for the preceding years should be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. If, because of reclassification or for other reasons, changes have occurred in the manner of or basis for presenting corresponding items for two or more periods, information should be furnished which will explain the change. This procedure is in conformity with the well recognized principle that any change in practice which affects comparability should be disclosed.[5]

Conservatism

Conservatism has long been considered a virtue by the accounting

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[5] Accounting Research and Terminology Bulletins, (New York: American Institute of Certified Public Accountants, Final Edition, 1961.), p. 15.

profession. At one time it probably had the status of a commandment. It has lost some of its lustre but still has some of its virtue left.

In the early days of accounting, statements were prepared mainly for grantors of credit. They were interested in ability of the enterprise to repay the loan and placed more emphasis on the balance sheet than on the income statement. The possibility of a liquidation naturally made them concerned with the balance sheet and the virtue of conservatism in its preparation.

The rise of the corporate form of business entity brought wide separation of ownership and management. It also brought into existence a new statement user, the investor. The investor may be in favor of conservatism to a degree, but it is doubtful that he ever seriously considers the possibility of liquidation (unplanned). If he does, he will not maintain the status of an investor very long. The new statement user has been one factor in the shift of emphasis from the balance sheet to the income statement.

Emphasis shifting from the balance sheet to the income statement detracted from the virtue of conservatism. Nevertheless, it is still a factor worthy of consideration. In areas of uncertainty, conservatism is still a virtue to be trusted but not a crutch upon which to lean.

Materiality

Previously in this chapter, materiality was used to point up the fact that judgment played an important role in accounting. The opinion of the Institute was quoted and better describes materiality than any words which might be mustered by the writer. The quote concerned what items could be excluded from determination of net income. This is not

the only place materiality acts upon accounting, nor does each item have to be material.

There is another aspect of materiality which should be brought out if it is to be fully understood. It refers to the relationship of accounts and is best explained by example. An unrecorded item for machinery repairs is more material than an unrecorded liability of the same amount for merchandise in transit. Merchandise in transit conceivably would not even change the current ratio, while the machinery repairs would change the current ratio, the profit and retained earnings. Do not be misled at this point. Merchandise is not to be considered as inventory. In an industry whose prime function is service, inventories in the usual sense are nonexistent. Parts, tires and tubes and fuel have the appearance of inventory items but are in reality prepaid expenses which do not enter into the determination of income. Examples utilizing errors are not the most desirable; hopefully, the benefits of another aspect of materiality outweigh the bad example.

Going Concern Concept

Accountants, when making valuations of inventories and other assets, must assume that the entity will continue in business. Assets are not usually as valuable in liquidation as they are to a company that is going to use them in the manufacture of products or the performance of services which will be sold at a profit. Accounting is not basically a process of valuation but one of matching costs with the income of periods benefiting from the use of the assets from which the costs arose. This matching process leads to another criterion.

Depreciation

There are several methods of computing depreciation which for various reasons have become acceptable over the years. Straightline, working-hours method, production method, and reducing charge methods are a few which are generally accepted. These methods all have points in their favor and factors which detract from their appeal. It is the responsibility of the accountant to study these methods and the particular situation he finds himself responsible for and choose the one which will best spread the cost over the useful life of the asset.

Depreciation presents a problem in choosing a dollar basis at which the asset will be recorded. Outright purchase presents no problem. Cost is the basis. When trade-ins are involved there is a decision to be made. There are three acceptable ways to handle trade-ins in determining the basis of depreciation. They are more easily explained by example.

Suppose, for example, there is an asset on the books which cost $5000.00. Up to the date of the trade-in, depreciation in the amount of $4000.00 has been allowed. This leaves a book value of $1000.00. The new asset has a price of $6000.00 and a trade-in allowance of $3000.00 is to be given. The market value of this asset in its used condition is $2000.00. At this point several questions become apparent. Is the gain or loss given recognition? If so, in what amount? At what price is the new asset recorded in the property accounts?

Theoretically, the gain or loss has to be recognized. There are several ways this may be handled. The one chosen will naturally affect the price at which the new asset is recorded. Using market value, a gain

of $1000.00 is recognized and the new asset would be recorded on the books at $5000.00 which is the market, or second-hand value of the old asset plus the additional cash expended in the acquisition of the new asset. This is probably the most correct procedure, theoretically speaking. As a practical matter this approach presents problems, mainly because the market value is not easily ascertainable. It may not even be known for certain groups of assets.

Another way of handling the situation is to use the trade-in allowance in computing the gain or loss on the retiring asset. Under these conditions the gain on the disposition of the old asset would be $2000.00. The new asset would be recorded on the books at $6000.00, representing the trade-in allowance of $3000.00 plus the cash outlay of $3000.00.

Tax treatment allows the recognition of no gain or loss on trade-in transactions. The cost of the new asset for depreciation purposes is $4000.00, computed by adding the book value of the old asset of $1000.00 to the cash disbursement of $3000.00.

It is not the purpose in this chapter to analyze the principles set forth herein, but some indication as to their acceptability is basic to the task. To state which one is the most generally accepted is impossible for the simple reason that published financial reports do not normally disclose items of such detail as this, consequently no survey as to usage is available. Depreciation methods and bases will undergo further comment in Chapter III.

Accounting Cycle

The only complete and absolutely accurate accounting for a business

entity can be accomplished only at the end of its business life. The perpetual character of modern business makes this goal an impossibility within the foreseeable future of most businesses. Nevertheless, there exists a real need for some kind of progress report before the end of the business' life. Management must know how it is doing if improvements are to be made. Investors must be able to have some facts before they can make a decision as to whether or not to invest. Credit grantors must have reasonably accurate information on which to approve or disapprove loans. To supply these needs, financial statements are usually prepared on a yearly basis. Thus, a year is the generally accepted accounting cycle. There are, of course, exceptions. In cases when the normal production cycle is longer than a year, the accounting cycle should be extended to agree with the production cycle but usually the accounting cycle will be one year.

Disclosure

Disclosure is the act of leaving no material fact out of the financial statements that will tend to make them misleading. This is almost in direct contrast with the very nature of financial statements. Summation of countless transactions into clear, concise, classified, financial statements which present capsuled information, and which allow the reader to see at a glance (relatively speaking) the financial position, is the very essence of and the reason for financial statements. Even though this is their purpose, material facts which may not even be recorded in the books of account, cannot be omitted if they tend to make the statements more understandable. It even goes a little farther than that. They

cannot be left out if their omission would keep the statements from being fully understood.

The American Institute has many pronouncements concerning disclosure, most of which are on specific items. The most concise general statement concerning disclosure appears below:

> As to the financial statements, fairness of presentation, apart from relationship to generally accepted accounting principles, requires consideration of adequacy of disclosure of material matters, whether relating to form, arrangement, and content of the financial statements with their appended notes; the terminology used; the amount of detail given; the sufficiency of explanatory or descriptive matter; the classification of items in statements; the bases of amounts set forth, for example, with respect to such assets as inventories and plants; liens on assets; preferred dividend arrearages; restrictions on dividends; contingent liabilities. This enumeration is not intended to be exhaustive but indicative of the nature of the disclosures necessary in order that the financial statement be sufficiently informative.[6]

There are many, many more principles, methods, rules, concepts, and procedures which have not been covered in our criteria. Some of the omitted ones are so basic that they may even be overlooked. The double entry system, for example, is practically a law as far as accrual accounting is concerned. It has become so commonplace that it is seldom thought of when principles are mentioned.

The criteria for the most part have been kept very general. This was necessary in order to cover inconsistencies which arose when the actual analysis was undertaken. To be more detailed in this chapter would

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[6] Generally Accepted Auditing Standards, Their Significance And Scope, (New York: American Institute of Certified Public Accountants, 1954), p. 52.

necessitate the writing of the analysis chapter first, thus detracting from the objectivity of that chapter.

The general approach also allowed the most ground to be covered in the least space. If a more detailed approach had been attempted, it might have been necessary to have a much longer criteria chapter. An approach of this nature almost certainly would have included much irrelevent material.

In summary, the criteria which are to be used are:

1. Judgment
2. Communication
3. Consistency
4. Conservatism
5. Materiality
6. Going Concern Concept
7. Bases of Depreciation
8. Accounting Cycle
9. Disclosure

CHAPTER II

THE SYSTEM

The Uniform System of Accounts is required by law. This very fact startles some people. A very general historical background of some of the laws and reasons therefore will reduce much of the uneasiness in this area.

Transportation companies in these United States are public utilities and as such their first duty is to the public. Thus, under inherent sovereign powers, a government may, when necessary for the public good, regulate the manner in which citizens shall use their own property. This brings on the age old question as to whether state sovereignty or federal sovereignty dominates. The principle that if a certain power has been delegated to the federal government by the states through the Constitution, then the state no longer has sovereign power in this field is rather generally accepted. Some real problems are disturbing the whole country today because of different interpretations of the Constitution.

When the question arose concerning interstate commerce, there were naturally problems, even lawsuits. They did not, however, approach the magnitude of the problems of today. Probably, there were many reasons for this, one being the clear, concise language in the Constitution on this subject.

That the Congress has the right to regulate interstate commerce is a generally accepted fact. This power was delegated to the federal government by the states through the Constitution in this language: "The Con-

gress shall have the power...to regulate commerce with foreign nations, and among the several states and with the Indian Tribes;...". This is commonly known as the "Commerce Clause", which is found in Article I, Section 8, Paragraph 3 of the Constitution of the United States. By whatever it is called, this language makes it fairly certain that our forefathers meant to have interstate commerce regulated by the Congress. Today it is fairly easy to see why conflicting state laws would unduly restrict interstate commerce, but to think that the founders of our country could foresee this when writing the Constitution should make us all proud of their keen minds and undying belief in democracy.

The railroad system was the first mode of transportation to be regulated. There were several reasons for the railroad regulation to come as it did. There were conflicting state laws which made interstate movement, without undue restraint, almost impossible. On the other side of the fence, the railroads were using unfair practices such as rebates, unjust discrimination, and pass privileges. Due to these prevailing factors, Congress in 1887 passed an Act to Regulate Interstate Commerce.

Do not be misled by the foregoing facts. They are not meant to imply that the railroads are the demons of the transportation industry. Every mode of transportation ran into practically the same problems as it developed.

As the different modes of transportation developed, so did the Act to Regulate Commerce develop until today we have in the Interstate Commerce Act and related acts, a rather large body of law governing transportation.

The Interstate Commerce Act, as it is known today, consists of five parts. Part I covers railroads, Part II covers motor carriers, Part III covers water carriers, Part IV concerns itself with freight fowarders, and Part V considers loan guarantees.

The Interstate Commerce Commission, the regulating body for interstate commerce, is a creature of the Interstate Commerce Act. In the early stages of development, there was some question as to whether or not such a regulatory commission was legal. In Interstate Comm. Com. v. Cincinnati N. O. & T. P. Ry. Co., 67 U. S. 477, the Supreme Court was of the opinion that the creation of the Interstate Commerce Commission was merely a delegation, by Congress, of its regulatory powers and, as such, was in accord with the Constitution.

Public utility regulation, in any form, places grave responsibility on a regulatory body. This fact is even more pronounced in the case of the Interstate Commerce Commission. In order to understand the responsibility with which this Commission is charged, it is necessary to quote the National Transportation Policy of the United States, which has become a part of the Interstate Commerce Act.

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preference or advantage, or unfair or destructive competitive practices, to cooperate with the several states and the duly authorized officials thereof; and to encourage fair wages and equitable working

> conditions; all to the end of developing, coordinating and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense.

Great responsibility is contained in this policy. Not only is the Commission charged with protecting the public, but it is charged with protecting the carriers from each other.

In order for the Commission to carry out this delegated responsibility, there must naturally be a like delegation of authority. The authority on which the Commission relies is the Act.

The Commission must also be well informed and up to date on the entire transportation industry. In so broad a field it would be virtually impossible for the Commissioners to develop this information for themselves. Since this practical impossibility exists, they must be kept informed by the industry. The Act includes provisions for the Commission to require certain reports from the carriers. In fact, the language of the law is so general that the Commission can require almost anything, in the way of records and reports, to be maintained and filed with the Commission. By way of explanation Section 220 (a) of Part II of the Interstate Commerce Act is quoted:

> The Commission is hereby authorized to require annual, periodical, or special reports from all motor carriers, brokers, lessors, and associations (as defined in the section); to prescribe the manner and form in which such reports shall be made; and to require from such carriers, brokers, lessors, and associations specific and full, true, and correct answers to all questions upon which the Commission may deem information to be necessary. Such annual reports shall give an account of the affairs of the carriers, brokers, lessors, or associations in such form and detail as may be prescribed by the Commission. The Commission may

> also require any motor carrier or broker to file with it a true copy of any contract, agreement, or arrangement between such carrier and any other carrier or person in relation to any traffic affected by the provisions of this part. The Commission shall not, however, make public any contract, agreement, or arrangement between a contract carrier by motor vehicle and a shipper, or any of the terms or conditions thereof, except as a part of the record in a formal proceeding where it considers such action consistent with the public interest: Provided that if it appears from an examination of any such contract that it fails to conform to the published schedule of the contract carrier by motor vehicle as required by section 218(a), the Commission may, in its descretion, make public such of the provisions of the contract as the Commission considers necessary to disclose such failure and the extent thereof.

The entirety of Section 220 has not been quoted here as the rest of it would add little to what has been given. From Section 220 (a) it can be seen that the Commission can require just about anything it desires in the way of records and reports.

In order to discharge the responsibility delegated it by Congress, the Commission uses this section of the Act to require motor carriers to supply the information needed to regulate this mode of transportation.

There are many reports, statistics, etc. which they require. The subject of this work is but one of many. The Uniform System of Accounts as prescribed by the Commission is a complete system of accounts and rather detailed in form. Even though this concerns accounting systems and procedures, it is issued in the form of an order.

Time, and possibly the ability of the writer, does not permit the listing of the many reasons for such a system of accounting. Since this is an analysis of the System, rather than the reasons for its existence, it is sufficient to say, in this connection, that fair regulation requires

comparisons; comparisons between carriers operating within the same mode of transportation; comparisons between different modes. Comparisons, to be worthwhile, must be of likes. Thus, in order to compare motor carriers, it is essential to have their accounting performed in a systematic manner.

At this point the authority under which Congress regulates interstate commerce has been cited; the delegation of this authority to the Commission has been discussed; and the general need of the Commission for uniform accounting and the necessary statutes to require compliance have been shown. Next comes the System itself. Before going into the accounts themselves, there are some definitions which should be understood, and these are:

1. "Accounts" means the accounts prescribed in this system of accounts.

5. "Amortization" means the gradual extinguishment of an amount in an account by prorating such amount over either a fixed period dependent on the requirements of regulatory bodies, the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefit will be realized.

7. "Book cost" means the amount at which the property is recorded on the books of the carrier without deduction of related reserves.

8. "Carrier" or "motor carrier" includes both a common carrier by motor vehicle and a contract carrier by motor vehicle, subject to the Interstate Commerce Act.

9. "Carrier operating property" means the property which is used (see definition 38) by the carrier in the conduct of its motor carrier operations or leased to others for such operations, and which has an expectation of life in service of more than one year from the date of installation. This includes land, structures, equipment and facilities necessary for such operation and service incidental thereto.

10. "Company" means any individual, firm, co-partnership, corporation, association, or joint-stock association, and includes any trustee, receiver, assignee, or personal representative thereof. (See definition 29).

11. "Commission" or "the Commission" means the Interstate Commerce Commission.

15. "Current assets" means cash as well as those assets that are readily convertible into cash or are held for current use in operations or construction; current claims against others, payment of which is reasonably assured, and other amounts accruing to the carrier which are subject to settlement within one year from the date of issue or upon demand.

16. "Current liabilities" means those obligations the amount of which is definitely determined or closely estimated which are either matured or become due within one year from date of issue or assumption or upon demand, except bonds, equipment and other long-term obligations, receivers' or trustees' certificates, which shall be classed as long-term obligations (see definition 24) regardless of the period for which they are to run.

19. "Delayed items" means items relating to transactions which occurred before the current calendar year. It includes adjustments of errors in the income, operating revenue, and operating expense accounts for prior years. (See instruction 8).

20. "Depreciation", as applied to depreciable property, means the loss in service value (see definition 35) not restored by current maintenance, incurred in connection with the consumption or prospective retirement of property in the course of service from causes against which the carrier is not protected by insurance, which are known to be in current operation. Among the causes to be given consideration are wear and tear, decay, action of the elements, obsolescence, changes in the art, inadequacy, changes in demand, and requirements of public authority.

22. "Distinct Operating Unit" means all or any portion of a route or routes covered by a certificate of convenience and necessity or a permit, including

motor vehicles and other physical property owned and used in the operation thereof.

24. "Long-term obligations" means obligations having a life of more than one year from date of creation or assumption, all unmatured bonds and receivers' or trustees' certificates, and demand obligations which by mutual agreement will not be paid within one year from date of issue.

25. "Mileage method", as applied to depreciation of vehicles, means the plan under which the service value is charged to depreciation expenses and credited to depreciation reserves at a fixed rate per mile run.

26. "Minor items", as applied to carrier operating property (see definition 9), means the associated parts or elements of which units of property (see definition 37) are composed.

27. "Net book cost", when applied to property, means the book cost (see definition 7) less related depreciation and amortization reserves.

31. "Property retired", as applied to operating property, means property which has been removed, sold, abandoned, destroyed, or which for any cause has been permanently withdrawn from service.

33. "Salvage value" means the amount received for property retired, less any expense incurred in connection with the sale or in preparing the property for sale, or, if retained, the amount at which the material recovered is chargeable to account 1180, Materials and Supplies, or other appropriate account.

34. "Service life" means the period between the date when carrier operating property (see definition 9) is placed in service and the date of its retirement. (See definition 31).

35. "Service value" means the difference between the book cost (see definition 7) and the salvage value (see definition 33) of carrier operating property.

36. "Straight-line method", as applied to depreciation accounting, means the plan under which the service

> value (see definition 35) of property is charged to depreciation expenses or other appropriate accounts and credited to the depreciation reserves through equal periodic charges as nearly as may be during its service life.[1]

These definitions are rather lengthy and detailed and were included for several reasons. Firstly, it shows the extent to which the Commission has gone to explain, in detail, exactly what is included in some of the terms used throughout the order setting up the System. Secondly, it shows that generally speaking the System is prescribed in accordance with generally accepted, sound accounting principles. Lastly, even though the latter statement is true, there are places where the System is not founded on sound accounting theory.

Instructions

Immediately following the definitions are the instructions. They are every bit as detailed as the definitions and as long, or longer. No useful purpose will be served by quoting them in their entirety. However, a general understanding of the System requires some knowledge of the instructions, at least an idea of what they cover. On the whole they are in general agreement with accepted principles. The instructions with which issue will be taken will be quoted at the place where the issue is set out. Thus, all that is needed here is some general information about the instructions.

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[1]Uniform Accounting for Motor Carriers of Property, (Washington: American Trucking Associations, 1948), pp. A-7 - A-10.

One thing that they include is the classification of carriers. A Class I carrier is one who grosses over $1,000,000 per year. Class II carriers are composed of those who gross over $200,000 but less than $1,000,000 per year. Those grossing under $200,000 per year are Class III.

The instructions also cover such things as records to be maintained, the accounting period to be established, opening entries, delayed items, clearing accounts as well as a host of other activities.

Accounts

The breakdown of accounts follows the instructions. They are numbered, titled, and each has a description of what is properly includable therein. Like so much of the System, they are very detailed and present somewhat of a problem as to how to acquaint one with them generally without being of such detail as to be monotonous. The account titles are fairly descriptive and a listing of them by number and title should suffice to acquaint the reader with the general organization. Here again, if issue is taken with a particular account, the complete description of the account will be quoted at that time. The listing of the accounts follows:

BALANCE SHEET ACCOUNTS

ASSETS

1000. Cash
1020. Working Funds
1040. Special Deposits
    1041. Interest Special Deposits
    1042. Dividend Special Deposits
    1043. Miscellaneous Special Deposits
1060. Temporary Cash Investment
1080. Notes Receivable
1100. Receivables from Affiliated Companies
    1101. Loans and Notes Receivable

1105. Interest and Dividends Receivable

1109. Accounts Receivable

1120. Accounts Receivable - Agents, Customers and Interline.

1130. Accounts Receivable - Other

1140. Subscribers to Capital Stock

1160. Interest and Dividends Receivable

1170. Prepayments

1171. Prepaid Taxes and Licenses

1172. Prepaid Insurance

1173. Prepaid Interest

1174. Prepaid Rents

1175. Prepaid Stationery and Printed Matter

1176. Prepaid Tires and Tubes.

1179. Miscellaneous Prepayments

1180. Materials and Supplies

1190. Other Current Assets

TANGIBLE PROPERTY

1200. Carrier Operating Property

1201. Land and Land Rights

1210. Structures

1220. Revenue Equipment

1230. Service Cars and Equipment

1240. Shop and Garage Equipment

1250. Furniture and Office Equipment

1260. Miscellaneous Equipment

1270. Improvements to Leasehold Property

1280. Undistributed Property

1290. Unfinished Construction

1300. Carrier Operating Property Leased to Others

1400. Non-carrier Property

INTANGIBLE PROPERTY

1500. Organization, Franchises and Permits

1501. Organization

1511. Franchises

1541. Patents

1550. Other Intangible Property

INVESTMENT SECURITIES AND ADVANCES

1600. Investments and Advances - Affiliated Companies

1650. Other Investment and Advances

1701. Sinking Funds

1751. Depreciation Funds

1781. Miscellaneous Special Funds

DEFERRED DEBITS
1880. Unamortized Debt Discount and Expense
1890. Other Deferred Debits

MISCELLANEOUS DEBIT ITEMS
1900. Discount
1910. Commission and Expense on Capital Stock
1920. Reacquired Securities
1990. Nominally Issued Securities

CURRENT LIABILITIES
2000. Notes Payable
2020. Matured Long-term Obligations
2030. Payables to Affiliated Companies
    2031. Loans and Notes Payable
    2035. Interest and Dividends Payable
    2039. Accounts Payable
2050. Accounts Payable
    2051. Accounts Payable - Officers, Stockholders and Employees
    2055. Interline Account Balances
    2059. Accounts Payable - Other
2070. Wages Payable
2090. C. O. D.'s Unremitted
2100. Dividends Declared
2120. Taxes Accrued
2150. Interest Accrued
2160. Matured Interest
2190. Other Current Liabilities

ADVANCES PAYABLE
2200. Advances Payable - Affiliated Companies
2250. Other Advances Payable

EQUIPMENT AND OTHER LONG-TERM OBLIGATIONS
2300. Equipment Obligations
2330. Bonds
2360. Other Long-Term Obligations

DEFERRED CREDITS
2400. Unamortized Premium on Debt
2450. Other Deferred Credits

RESERVES
2500. Reserves for Depreciation - Carrier Operating Property
2600. Reserve for Amortization - Carrier Operating Property

2610. Reserve for Depreciation and Amortization - Other Property
2630. Reserve for Adjustments - Investments and Advances
2650. Reserve for Uncollectable Accounts
2660. Insurance Reserve
2680. Injuries, Loss and Damage Reserve
2690. Other Reserves

CAPITAL STOCKS

2700. Preferred Capital Stock
2710. Common Capital Stock
2720. Premiums and Assessments on Capital Stock
2730. Capital Stock Subscribed

NON-CORPORATE CAPITAL

2800. Sole Proprietorship Capital
2810. Partnership Capital

UNAPPROPRIATED SURPLUS

2900. Unearned Surplus
2930. Earned Surplus

INCOME ACCOUNTS

3000. Operating Revenues
4000. Operation and Maintenance Expense
5000. Depreciation Expense
5100. Depreciation Adjustment
5150. Amortization Chargeable to Operations
5200. Operating Taxes and Licenses
5400. Lease of Distinct Operating Unit - Debit
5500. Lease of Distinct Operating Unit - Credit
6100. Income from Non-Carrier Operations - Net
6300. Interest Income
6400. Dividend Income
6500. Other Non-Operating Income
7100. Interest
7300. Amortization of Debt Discount and Expense
7400. Amortization of Premium on Debt - Credit
7500. Other Deductions
8100. Extraordinary Income Credits
8200. Extraordinary Income Charges
8400. Delayed Income Credits
8600. Delayed Income Charges
8800. Income Taxes[2]

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[2]Uniform Accounting for Motor Carriers of Property, A. T. A. Accounting Service, Washington, 1948, pp. A-31 - A-33, A-77 - A-78.

Interpretations

In sequence, after the account descriptions, there appears a section of cases or Commission interpretations. These cases are really questions as to what accounting should be performed in specific situations. The questions are followed by the Commission's answer to serve the particular situation posed by the question.

Citator

Preceding the actual cases just described, there is an "interpretation citator". This is very helpful to any bookkeeper or accountant in his everyday work with these accounts. If he thinks he knows the account number but is not absolutely sure and cannot find authority which allows the use of that account, then he turns to the citator. Through its use he is sure that he has seen every interpretation on the particular account with which he is concerned. The citator is fairly simple in design and has its own explanation of how it is to be used.

Index

Subsequent to the citator is an index, very detailed in its items, which proves useful when there is no indication as to the account in which an item is properly included. Using both the citator and the index, little difficulty should be encountered in placing an item in its proper account.

General Sections

There are also sections on compilation of statistics, suggested accounting controls, destruction of records, and records for tax purposes. These sections are general in nature and explain some aspects of the quarterly and annual reports which are filed with the Commission. In a

sense, they are guides. They are not completely authoritative, as are the rest of the sections. The sections prior to the ones mentioned here say, (more or less) "this is the way it will be done". These sections, most of them at any rate, say, "doing it this way will be helpful; or if that is impossible or impractical, try this way". Quite obviously, the section on the destruction of records does not conform to this generality. It says specific records will be kept a given number of years, which is quite definite and authoritative. The other sections discussed here are of the nature described. As with the other sections, they will be quoted, or made more specific, when and if issue is taken with any of them or anything contained therein.

This, of necessity, has been a descriptive chapter. Quotations have been used a great deal for a couple of reasons. One, the System could not have been described properly if the great detail to which it goes had not been shown. Second, paraphrasing some of these technicalities would have been dangerous in that it may not have done the area justice. For these reasons, some areas have been quoted, while others have been covered with a rather general statement as to what they contain.

While the chapter may appear rather long, in reality it is relatively short considering the amount of material contained in the System. Its goals have been realized if a very general idea of the overall organization and content of the System has been offered.

CHAPTER III

ANALYSIS OF AREAS OF DISAGREEMENT

The System is designed to promote a high degree of uniformity in the accounting for motor carrier operations. It is evidenced partially by the long and rather detailed definitions and instructions quoted in the preceding chapter. The moment one starts to define, one also excludes. Exclusions create divergencies and divergencies breed misunderstanding. This could be construed to imply that any degree of definition is bad. This is not the intent. It merely means that those responsible for defining should remain constantly aware of the possibility, particularly in accounting, that drawing the definition too fine tends to destroy the uniformity and consistency which was the original object of the definitive process.

The detailed definitions and instructions of the System exclude the judgment of the accountant at the company level. The Commission may feel that the judgment of accountants in the motor carrier industry is not of a caliber which justifies dependence. This may or may not be true. It is not the object of this work to judge the ability of the accountants. If this feeling does exist on the part of the Commission, the formulation of a system which is detailed enough to make the accountant an instrument of the Commission is not the proper solution to the problem. The Commission is charged with preserving and protecting all modes of transportation. If the accountants, as a group, have degenerated to such a degree as to create the feeling that their judgment is not sound, then other regulatory powers

should be invoked to force compliance. Since such powers do exist, it is not believed that this is the reason for the degree of detail found in the System. It is felt that the Commission has attempted to attain a high degree of uniformity and comparability so necessary to regulation. Its success in this attempt has reached the point where it tends to distort the uniformity rather than enhance it.

This is a rather general discourse on the exclusion of judgment through minute definitions. This is not to say that it is widespread in the System, or that all the exact instances where it occurs have been found. The contention is that an industry as big as motor transport, with many companies of varying sizes, no two of which are exactly alike, and problems and ways of doing business almost as numerous as the companies, cannot be expected to pour their accounting into a minutely detailed mold without destroying some of the individual facts which are so much a part of every business transaction. In destroying these facts, some of the real meaning of the transactions are lost and the possibility of distorted information being submitted to the Commission is very real and is destructive of the very uniformity and comparability so earnestly sought through the detailed definitive areas of the System.

If the System would attempt to define, and possibly classify what should be included, only to the point where a logical understanding of what is desired in a particular account or procedure, and leave the detailed inclusions and exclusions and estimations to the judgment of the accountant on the job, more reliable and comparable information would be gathered than through the use of a system which defines to the degree of

exclusion.

There is at least one specific case which could be used as an example of all that has been said above. However, it is deemed desirable to leave this for the section on the area where improvement will be desired. Reference to this exclusion of judgment idea will be made at that point.[1]

In Chapter I judgment and communication were placed among the criteria which would be used in analyzing the System. The way in which judgment is limited by the System has been explained and will be referred to again in a more specific sense.

The Communication Problem

In Chapter II some of the communication problems were discussed in a general way. The kind of thing discussed there could be found in almost any field of endeavor. In this chapter, some attention will be given to words or phrases which have been specifically defined but which, if mentioned among a group of accountants, would infer a much different meaning from the one defined in the System.

Undoubtedly, there are those who will feel that this is an unimportant matter. The writer disagrees with those who have this feeling. Anything which causes misunderstanding, or could cause misunderstanding, by those who will use the reports and records of the Commission should be eliminated, if at all possible. That people other than the Commission use its reports and records is proved by the following facts: (1) The

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[1]Cf., pp. 52-53.

reports and records of the Commission are public records. (2) The vast majority of trucking companies reporting are not publicly held and consequently do not publish financial reports. Does it not logically follow that seekers of financial information concerning trucking companies would turn to the Commission? (3) Another body which considers communication is the Institute which, through its Committee on Terminology, continually tries to discontinue the use of often misunderstood words by the profession. True, terminology and communication are not synonymous but are so interdependently a part of accounting and financial reporting that one cannot be effective without the other. Now that the importance of the criteria is justified, it would be well to seek a specific example of this discussion.

Accountants, both certified and otherwise, almost universally accept the phrase "book" value" as meaning the original or historical cost less depreciation allowed or provided. Cost is used originally because at the instant of purchase this is the best measurement of value.

Two System definitions follow:

> 7. "Book cost" means the amount at which property is recorded on the books of the carrier without deduction of related reserves.
> 27. "Net book cost", when applied to property, means the book cost (see definition 7) less related depreciation and amortization reserves.[2]

Thus, what the accounting profession calls "book value", the System

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[2] A. T. A. Accounting Service, Uniform Accounting For Motor Carriers of Property, (Washington, D. C.: American Trucking Associations, Inc.), pp. A-3 - A-9.

calls "net book cost". There is no accounting counterpart for the System's "book cost". The "book cost" of the System is likely to be taken as book value by the users of Commission records who have become accustomed to the use of the latter term. It could possibly be confusing to the professional accountant who, through long usage of and association with the book value concept, sees it and does not stop to analyze the term. He may assume it to mean the same as "book value".

Another phrase which could be confusing is "depreciation adjustment".

> The cost of a fixed asset should be written off as an expense gradually over the life of the asset. The periodical adjusting entry includes a debit to a depreciation (expense) account and a credit to an accumulated depreciation account.[3]

This is the sense in which the term is usually used. If there has been a change in expected useful life of an asset since its acquisition, the rate of depreciation should be changed. The resulting adjustment may be shown on the income statement as a below the line item, (depending on which theory of reporting extraordinary income and expense items is followed) and labeled "depreciation adjustment".

The System does not use the term in this manner. There is an account titled "Depreciation Adjustment". Generally speaking, this account includes amounts representing over or under depreciation on property which has been fully depreciated. The adjustments are made when

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[3]Finney, H. A. and Miller, Herbert E., Principles of Accounting, Intermediate. (Englewood Cliffs: Prentice-Hall, Inc., 1962.) Fifth Edition, p. 12

the property is retired. This is not the proper handling of depreciation, and that aspect will be dealt with later. The point here is that the phrase has an entirely different meaning from either one of the others mentioned and therefore causes misunderstanding to users of the statements and adds to the difficulty of communication between the two groups of accountants.

Areas Which Have Been Improved

The feasibility of dealing with areas which have already been improved and brought more into compliance with "generally accepted accounting principles" may be questioned. It is deemed important for several reasons. It shows that improvements are made from time to time. It indicates that they are evolutionary as opposed to revolutionary, and one discovers that it is not always the Commission which is resistant to change. The two items which will be discussed are interest and that portion of long term obligations due within one year. Their position or classification on the balance sheet was the nature of the change.

Interest is the charge for borrowing money. It has been described as both prepaid and deferred.

> "Interest deducted in advance is a prepaid expense."[4]

The above quote is taken out of context but it has reference to unsecured loans on which the interest has been deducted.

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[4]Holmes, Arthur W., Basic Auditing Principles, (New York: Richard D. Irwin, Inc., 1957.) p. 181.

> Interest on unsecured bank loans is usually paid in advance through discounting the notes, but interest on collateral loans is usually payable monthly or quarterly.[5]

The above quotations are used because they differentiate between prepaid and deferred interest. The first quote deals with prepaid interest. The second deals with both, but the collateral loan involves deferred interest.

Equipment obligations comprise the majority of the indebtedness of the motor carrier industry. The process has become almost routine. The money is borrowed to pay for the equipment. The charge for borrowing the money, interest, is added to the amount borrowed and the total is divided by the number of months the loan is to run. Thus, one can plainly see that interest is a part of each and every payment. It is evident, also, that this type of loan is more of a deferral than a prepayment.

For many years this type interest was described in the account as "prepaid interest" and classified on the balance sheet as a current asset. It would not be helpful to go into detail about why this should be deferred rather than prepaid since it has already (within the last year or two) been given the proper treatment. Hindsight being what it is, there is difficulty in finding a logical reason for ever having considered this as a prepayment. The only possibility being that in the very early stages

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[5]William H. Bell, M.C.S., C.P.A., and Ralph S. Johns, M.S., C.P.A., Auditing, (Englewood Cliffs, N. J.: Prentice-Hall, Inc., Third Edition, November 1952), p. 304.

of regulation, with the motor carrier industry in its infancy, the lending institutions required the interest to be deducted in advance from the face amount of the loan. Assuming this was the situation, still reservations are held about classifying this as a prepayment. Since debate of this subject appears academic at this point, it is useless to pursue it further.

Another area very similar to the one just discussed concerns that portion of long term debt due within one year. For many years no distinction was made as to debt due within one year. It was included in Account 2300, "Notes Payable", which contained the whole obligation as a long term debt. It was not until April, 1957, that the Commission issued a "Notice of Proposed Rule Making" in which it advocated classification of long term debt due within one year as a current liability. The National Accounting and Finance Council of the American Trucking Associations, Inc. opposed the change and succeeded in getting banks and some certified public accounting firms to voice their opposition to the Commission's proposal. The result was that Account 2190, "Other Current Liabilities", was re-numbered to 2180 and 2190 was assigned the title, "Equipment Obligations and Other Debt Due Within One Year". It was given a position on the balance sheet immediately following "Current Liabilities" and preceding "Advances Payable".

The two items just discussed accomplish the objectives undertaken for this section. The interest has been brought into compliance with accepted principles. The debt due within one year, while not in complete agreement, has been improved. To some it may even satisfy the principle

of disclosure but further improvement is needed in its classification.

Near the beginning of this section the statement was made that changes in the System were evolutionary as opposed to revolutionary. Possibly it would have been more accurate to say that changes are evolutionary as opposed to "status quo". The debt change was an improvement and perhaps the future will evolve further changes which will bring the desired agreement. The opposition, engineered by the trucking industry, to the Commission's proposal on debt due within one year leaves no doubt as to where the responsibility lies for the compromising nature of this change.

Areas Still In Need of Improvement

(a) Current Portion of Long Term Debt

In the preceding section, debt due within one year was discussed. It was indicated that this was still improperly classified on the balance sheet. Further discussion of this item seems a likely opening for this section.

> The term current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. As a balance-sheet category, the classification is intended to include obligations for items which have entered into the operating cycle, such as payables incurred in the acquisition of materials and supplies to be used in the production of goods or in providing service to be offered for sale; collections received in advance of the delivery of goods or performance of services; and debts which arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties, and income and other taxes. Other liabilities whose regular and ordinary liquidation is expected to occur within a relatively short

> period of time, usually twelve months, are also intended for inclusion, such as short-term debts arising from the acquisition of capital assets, serial maturities of long-term obligations, amounts required to be expended within one year under sinking fund provisions, and agency obligations arising from the collection or acceptance of cash or other assets for the account of third persons.[6]

The Institute's explanation of current liabilities above seems to leave little doubt that serial maturities, or long-term obligations are properly classifiable as current liabilities. In fact, debt due within one year on long-term equipment obligations seems entirely compatible with this concept of current liabilities. Agreement with the application of a principle tends to preclude the existence and understanding of different application of the same principle. In other words, one looks for support for his own opinion rather than examining the opposition to see whether or not it has merit.

To avoid this situation as much as possible, an examination will be made of the System's definition in an attempt to see if there are logical reasons for exclusions of this type debt from the current section of the balance sheet.

> "Current Liabilities" means those obligations, the amount of which is definitely determined or closely estimated, which are either matured or become due within one year from date of issue or assumption or upon demand.[7]

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[6] Accounting Research and Terminology Bulletins, (New York: American Institute of Certified Public Accountants.), pp. 21-22.

[7] A.T.A. Accounting Service, Uniform Accounting for Motor Carriers of Property, (Washington, D.C.: American Trucking Associations, Inc.), p. 66.

Nothing in the definition prohibits the current classification being assigned to the item under discussion. The basis for handling debt due within one year in a category all its own is certainly not found in either definition quoted.

In seeking the logic for this handling, communication was instigated with Mr. C. W. Emken, Director, Interstate Commerce Commission's Bureau of Accounts, Cost Finding and Valuation. Mr. Emken's reply, in part, is as follows:

> The debt obligations which mature serially or in installments and are payable within one year have some of the characteristics of "current liabilities" as you suggest. On the other hand, financing by carriers in connection with purchase of equipment and some other property is customarily arranged so that payments are spaced fairly even from year to year and the money for such payments is regarded by the carrier as provided for largely from current depreciation funds and not from accumulated working capital. Under the new rules, the amount of obligations maturing within one year, while not shown under current liabilities, will be separately shown in the balance sheet statement and in this way the facts are fully disclosed.

Mr. Emken is incorrect in his statement that the facts are fully disclosed. The item is set out by itself but the principle of full disclosure is best satisfied when proper classification is achieved. Special classification is likely to confuse the nonprofessionals and disclosure is not adequate until current liability is stamped on the item in the conventional manner. This treatment seems to say, "yes, these items are due within one year, but they really are not current." Certainly, such an approach is not full disclosure.

His comments that carriers regard current depreciation as the provider of funds for payments on current debt leads one to believe that they

are just that. Carrier thoughts and arguments! Not his own! His agreement that debt obligations which mature on installments and are payable within one year have some of the characteristics of "current liabilities" denotes a softened approach, a middle of the road comment in light of his ensuing explanation of what the carrier thinks.

It must be remembered that Mr. Emken's bureau scheduled the rule-making session and proposed that this item be classified as a "current liability". The carriers, through their national association, managed some sort of compromise on this issue. Thus, Mr. Emken is forced to regulate carrier accounting, using this compromise as a rule. He also must defend the rules he uses to regulate and this he has attempted to do in his reply to the query. It seems logical that the scheduling of a rule-making session and the proposal of a current classification for this item speak more clearly his and the Commission's real conviction then does his explanation of its present treatment.

The responsibility for this special treatment of installment debt seems to lie with the carriers. This being the case, examination of some of the issues presented by the carriers to compromise this proposed rule change is in order.

Mr. Emken indicates one issue. The carriers argue that current depreciation provides funds for these monthly payments. It is submitted that this statement is untrue. Depreciation does not in any sense of the word provide funds. Depreciation protects the funds provided by operations by charges to expense. If enough funds are not provided by operations, depreciation may create a loss. This argument is very nearly irrelevant

to the issue of current classification as opposed to special classification.

Opposition to current treatment is voiced also by Mr. M. C. Benton, Jr., President (in 1957) of the National Accounting and Finance Council, with this statement:

> If the I.C.C. were to adopt a rule that trucking companies' long term debts due within one year must be treated as a current liability, the entire trucking industry's credit would be seriously affected.

Mr. Benton is quoted out of context and this is very likely not the only point he has to raise in opposition. Even so, the necessity of refuting this point is important to the position taken by the writer on the issue being argued.

First reaction to this point is that if his statement is true, industry credit may rest on deceit. Rather than belabor the point, it is safe to say that the facts, even though improperly handled, do not confuse credit grantors. Banks, in particular, are aware that the working capital ratio is not what the System's prescribed balance sheet purports it to be. If the bank credit of the industry has been seriously affected, industry is unaware of it and this special type of disclosure has appeared since 1958. It appears that either it does not make any difference to the credit grantors and/or they were familiar with the old long term treatment.

It is essential to state that the comments on the statements of Mr. Emken and Mr. Benton are not intended to reflect in any way on their ability, their position, or their sincerity. Their statements present

different views on this point and were of necessity refuted.

At this juncture, it has been shown that the Commission proposed to change the classification on long term debt due within one year from long term to current. This proposal was opposed by the trucking industry. Neither position prevailed and a special classification was set up, so, hopefully, it has been shown that the current classification is the one compatible with "generally accepted accounting principles".

The carriers are really trying to protect the working capital ratio. They think that lowering this ratio will affect credit. Some of the arguments they use are proper reasons why credit institutions should not look at the balance sheet of a motor carrier in the same way they scrutinize the balance sheet of a manufacturing concern. It follows that carrier credit may be better protected by an educational program aimed at the credit institutions than by departures from "generally accepted accounting principles".

In summary of this point, the balance sheet contains this caption, "Total Current Liabilities (Exclusive of Long Term Debt Due Within One Year)". This is followed by the caption, "Long Term Debt Due Within One Year". This is much like having one's cake and eating it too. Full disclosure is not accomplished until the item is placed in the current section.

Categorical statements similar to the one just made are extremely hard to defend. The whole issue was presented in this manner because this is in strict compliance with the criteria established in Chapter I. It makes everything black or white, thereby eliminating any gray area

whatsoever. Such treatment makes for easy presentation but in and of itself may violate the principle of disclosure. It most certainly does not leave much to the judgment of the accountant.

Probably, what Mr. Emken and Mr. Benton are trying to say is that motor carriers have a different situation from most industries when it comes to paying off current debt. The usual situation is that current liabilities have to be retired by the use of current assets. This is not the general situation with motor carriers. They are allowed by the Act to extend credit but seven days. Thus, receivables are kept at a minimum and are collected very quickly when compared with other industries, making current assets relatively low. In reality, then, current liabilities are not retired from current assets but from cash generated by current operations.

Even in light of the preceding statements, the writer is not retreating from the position that installment debt due within one year should be presented in the current liability section of the balance sheet. However, it is felt that this item should be properly footnoted to disclose the existing conditions. In this manner no one should be misled and the item will also be in compliance with the generally accepted treatment.

(b) <u>Depreciation</u>

Another major point of discussion is depreciation. In the previous chapter three methods, used in arriving at the base on which the asset was to be depreciated when there was a trade-in involved, were discussed. All three ways were considered acceptable. Since usage makes something

like this generally acceptable, naturally all of them cannot be accepted to the same degree. The Internal Revenue Service recognizes the procedure which adds the cash outlay to the book value to arrive at the base for the new asset. Recognition by the tax agency may make this particular method generally accepted. In order to analyze this area one should know how the System presents this item. Presentation is made by the System in the "Interpretation" section.

> Query: What accounting should be performed in connection with the trade-in of an old unit of revenue equipment toward the acquisition of a new unit under a conditional sales agreement, based on the following date?

Book cost of old unit (excluding tires and tubes)	$5,000.00
Depreciation accrued	4,000.00
Trade-in value, old unit (including $50.00 as estimated value of tires and tubes)	500.00
Cost of new unit (including $400.00 as cost of tires and tubes and $40.00 tax on tires and tubes)	6,925.00
Notes issued, including cost of interest and finance fees	6,815.00
Interest and finance fees includes in note	390.00

Answer:

	Retirement of Old Units (See Instruction 21a)		
1890,	Other Deferred Debits	$5,000.00	
1220,	Revenue Equipment (To transfer book cost of old unit of equipment to clearing account)		$5,000.00
2520,	Reserve for Depreciation - Revenue Equipment	4,000.00	
1890,	Other Deferred Debits (To transfer accrued depreciation to clearing account)		4,000.00
1130,	Accounts Receivable, Other	500.00	
1890,	Other Deferred Debits		450.00
4160,	Tires and Tubes - Revenue Equipment (Trade-in received for old unit)		50.00

5100, Depreciation Adjustment	$ 550.00	
1890, Other Deferred Debits		$ 550.00
(To adjust balance in clearing account representing difference between book cost of old unit and total of depreciation accrual and amount received in trade)		

Acquisition of New Unit (See Instruction 19)

1220, Revenue Equipment	$6,485.00	
1176, Prepaid Tires and Tubes	440.00*	
1890, Other Deferred Debits - Interest and Fees (See Case 73)	390.00	
1130, Accounts Receivable - Other		$ 500.00
2300, Equipment Obligations		6,815.00
(Account 2190, Equipment Obligations and Other Debt Due Within One year, for portion due and payable within one year)		

*The cost of tires and tubes, including taxes, may be charged direct to account 4160, Tires and Tubes-Revenue Equipment.[8]

The quoted case merely transfers the cost and accrued depreciation to a clearing account and at the same time removes these amounts from the equipment and depreciation accounts. It takes into consideration the tires and tubes and the balance is transferred to the depreciation adjustment account. The new asset is then entered at its historical cost. Analysis at this point may seem pointless since using trade-in instead of market value was one of the accepted methods described in Chapter II. There are, however, a couple of observations which have a bearing.

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[8] Uniform Accounting For Motor Carriers of Property, (Washington, D. C.: American Trucking Associations, Inc., 1948), pp. B-27, 28.

A few statements about the three methods will refresh the mind on these points. One method used market value instead of trade-in value in figuring the gain on the disposal of the old asset. When discussing this in the criteria chapter, it was considered as the most theoretically correct method. Its impracticability of application makes this almost useless in everyday transactions. The tax method which adds the cash outlay to the book value of the old asset to arrive at base of the new asset is theoretically incorrect because it does not recognize any gain or loss whatsoever. The use of trade-in value in determination, which is what the System uses, is also theoretically incorrect because it very likely recognizes a gain which economically does not exist. When trading equipment the amount offered for the old unit depends on many factors. Two used units traded on one new unit will not bring as much per unit as if the same two units were traded on three new units. The quota the manufacturer, or his branch, has to meet may have some bearing on the amount which will be offered to complete the transaction. To whatever degree such factors affect the trade-in value, they distort the accounting usefulness of the figure involved in the transaction.

Proper understanding may be more nearly attained through an actual case. Fourteen, thirty-five foot aluminum trailers were traded on sixteen, forty-foot aluminum trailers, with sliding tandems. The old trailers were over six years old and needed skid plates and general tandem overhauls. New trailers were priced around $8500 each and a $2000 allowance was made for each used trailer. Most of these trailers were disposed of by the company which took them in trade for $1675 each. This

was accomplished after putting skid plates under them at a cost of $175. A few were disposed of at $1950, but in order to get this price, the tandems had to be overhauled, the cost of which ran to about $400. From these figures, a fairly accurate market value of between $1500 and $1550 is ascertained. Thus there is a gain of approximately $500 per trailer which exists only on paper.

Realization of such gains by the use of trade-in value in the System is of major importance because such gains affect both the income statement and the balance sheet and are never really cleared from the accounts until liquidation. Allowing for depreciation of the new asset on the basis of historical cost in a rising market may be expected to produce similar results and add to the erroneous amounts when the new assets are retired.

In this example, if there is an unrealistic gain of $500 per trailer, it would amount to $8000 on the sixteen. Gains of this nature are carried through the income statement and end up in the earned surplus. These transactions, over a period of years, result in considerable over statement of retained earnings.

Observations up to this point have concerned themselves with what, for lack of a better description, will be called "paper gains". Discussion of the entire gain (actual gain plus the "paper gain") is pertinent to the analysis in this area. It will be remembered that the old unit is retired through entries to Account 1890, Other Deferred Debits, which is also used as a clearing account. After all the necessary entries have been made in Account 1890, the remaining balance is transferred to

Account 5100, Depreciation Adjustment. This account is shown on the income statement in what accountants refer to as an above the line position. In other words, it is used to figure operating ratio. This ratio is the relationship of expenses to revenue and purportedly represents the results of operations for the year. The inclusion of gains or losses from the retirement of equipment does not fit into this classification. The retirement of old equipment and addition of new equipment is certainly necessary to the conduct of business by a motor carrier of property. These transactions even occur on a rather regular basis. Still, this does not qualify them for consideration in the determination of net income from operations, or the operating ratio. Net income from operations should reflect the profit derived from transactions involving the production of goods or services for which the entity was originally organized. A motor carrier of property was organized for the transportation of freight. Retirement and replacement of revenue equipment is necessary to the operation but gains and losses involved in the exchanges only confuse and detract from the meaningfulness of the net income from operations when they are included in its determination. These gains and losses should be below the line presentations. The System treats interest, debt discount and expense, and contributions to charitable organizations in this manner. They are not considered in computing net income from operations. Interest paid on loans for equipment is not considered, but gains and losses on exchange are.

Those who prefer the treatment given by the System probably contend

that the majority of the gains or losses so handled were created through charges to depreciation expense which affected operations. Even if this contention is correct, the charges to depreciation are on a yearly basis and the gains and losses represent a number of years. The Commission probably recommends this treatment because when they use these records it is very likely that they use ten or more years at the time. In this case, reflecting gains and losses in operations accomplishes the desired purpose because it corrects depreciation errors and over a long period the adjustments probably would fall within one of the years being examined. Even here the "paper gains" are in error.

Depreciation as treated here should be reviewed in relation to some of the principles set out in the criteria chapter. The use of trade-in value in computing the gain or loss on the retired asset is one of the acceptable ways of handling. This does not mean that it is the most desirable. It does not satisfy the principle of conservatism, even in its less potent form which arrived with the shift in emphasis from the balance sheet to the income statement. The inclusion of the "paper gains", in fact, is the direct opposite of conservatism and inclusion of any gain in computation of net income from operations is placed in the same category. Effect of this method on the income statement and balance sheet has been fully discussed and supports the incompatibility of the treatment with the principle of conservatism.

The most accurate of the three methods (use of market value) has already been discarded as useless because of the impracticability, if not impossibility, of determining market value. To be sure an illustration

was used to demonstrate the presence of an unrealistic increment in the trade-in value. The illustration purported to show a fairly accurate market value and this it does in relation to trade-in value. It may even have been accurate or actual market value. Irrespective of these facts, it must be remembered that this information was not available until several months after completion of the original transaction. If something had been received in trade on one of the second-hand trailers by the manufacturer, the market value of the first unit could not be definitely determined until the disposal of the second used unit was complete and final. There are an infinite number of things which could affect the determination of actual market value and only a few have been pointed out. They are sufficient to support, at the very least, a classification of impractical for this method.

Thus, the only method remaining to be discussed is the one which recognizes no gain or loss on transactions of the nature being discussed here. Attacks on this method are most likely to be made on the grounds of ultra conservatism, since some gain or loss is almost bound to exist. If neither of these exists, accounting utopia has been attained in the area of depreciation. The opponents of this method are absolutely correct in saying no recognition of the gain is given. Actually, they are saying that no recognition is given in a lump sum at one time. Recognition is given over the life of the new equipment in the form of lower depreciation charges, if it is a gain, and greater charges if a loss is involved. The "paper gains" mentioned so often are not recognized in this method. Tax authority acceptance is hardly a criterion by which to judge account-

ing methods, but by the same token, such acceptance should not preclude its use per se. The recognition of no gain or loss seems to do best what depreciation is designed to accomplish. Thus, while considered ultra conservative by some, it appears the least faulty of the methods available.

Choosing a method of arriving at a base for depreciating an asset certainly involves judgment. The judgment has been completely removed from the company accountant by the System. Straight line method of depreciation is required and the basis on which depreciation is to be applied is spelled out even to the journal entries required. This produces uniformity but accuracy is probably sacrificed in the process. Uniformity is good, but a re-examination of the uniform practices could possibly make it even better.

Thus far most of the objection has been about the method of selecting a base on which to compute the depreciation. The treatment of the gains or losses in the income statement certainly violated the conservative principle. To show items which apply to a period of six, seven, even ten years as components of the current year's operations is as far from conservative accounting as it could possibly get.

Such presentation is misleading and therefore violates the principle of disclosure. Gains and losses on retirement of equipment do not vaguely resemble income from, or expenses of operations. In reality these are corrections of errors in judgment over a period of years. They should appear on the income statement, if recognized, but in a clearly defined position which would eliminate any doubt as to their being a part of

operational income or expense.

(c) Ambiguous Accounts

Another area of the System which could be improved is a very general one. It is in the area of the communication criterion established earlier. Ambiguity of accounts is only part of it. Excessive detail is another part, and too little detail is also closely related to the problem. Perhaps the proper way of discussing this problem is by way of specific examples. Examination of two accounts is presented as a beginning point of explanation. The following quotation is one paragraph of Account 4680, Other General Expenses:

> (6) This account shall also include contributions for charitable, social, or community welfare purposes, except contributions to employees' welfare associations which shall be included in Account 4645, Employees' Welfare Expenses, and contributions provided for in Account 7500, Other Deductions.[9]

The following quotes two paragraphs of Account 7500, Other Deductions:

> This account shall include all deductions from gross income not provided for in any of the following accounts, such as:
>
> 5. Contributions for charitable, social, or community welfare purposes that do not have a direct or intimate relationship to the protection of the property, development of the business or welfare of the carrier's employees. (See Account 4645 - Employees' Welfare Expenses, and Account 4680 - Other General Expenses.).[10]

The two accounts described above are not ambiguous. They are almost identical. The ambiguity comes in the decision as to which account should

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[9] Ibid., p. A-99. [10] Ibid., p. A-112.

actually be charged with contributions to charitable organizations. In reality, the only difference in the accounts is that the 7500 account is a little more verbose than the 4680 account. Which account would be charged with a contribution to the Red Cross? Using the description of the accounts, the charge would be perfectly correct in either account. The intent of the System is to have pure charitable contributions in Account 7500. The intent is not spelled out and if someone were searching the System for the proper account, more than likely the one found first would be the one used.

One of these account could be eliminated. Keep in mind that the whole account is not under discussion. The two quoted sections are merely parts of the accounts. Elimination of the charitable contributions paragraph in one of these accounts would do the System no harm, in fact it would improve it.

Quoting out of context often proves misleading. In both the 4680 and the 7500 accounts, there is reference to employees' welfare expense. This may leave the impression that all welfare expenses of employees go into Account 4645. This is not the case. Each expense category has a 45 account and the welfare expenses of employees of that department are charged to the 45 account in that category. Transportation employees' welfare expenses would to Account 4245. Welfare expenses of persons who work in the traffic department would be charged to Account 4445, etc.

(d) Detail

Variation in the degree of detail in the description of different accounts tends to supply unintentional emphasis and create, in some places,

excessive work for the carrier. As example which will serve as bases for discussion, two other accounts are quoted:

> 1120- Accounts Receivable - Agents, Customers, and Interline
>
> This account shall include amounts currently due from customers for transportation and storage charges and for advances to other carriers and warehouses for the account of customers, balances due from other carriers (except affiliated companies) against each of which there is a net debit balance representing interline freight accounts; amounts due from customers and from other carriers, as rent for revenue equipment with or without drivers; also the net balances in current accounts due from agents, including drivers, other employees and representatives, charged with the collection or custody of current transportation revenues.
>
> Note A - At the end of each calendar year for the purposes of the annual report to this Commission, the carrier shall prepare an analysis of the balance in this account, segregating the items included therein to show balances due from customers, from other carriers, and from agents.[11]
>
> 2050- Accounts Payable
>
> (a) This account shall include amounts payable to others (except affiliated companies) that are subject to current settlement, for material and supplies and services received, including rents payable for the use of revenue vehicles and other property; other matured rents, amounts due to public authorities, amounts of payable judgments, current accounts with officers and employees, personal injury and property damage claims, the carrier's liability for transportation taxes and sales taxes collected from customers, for deductions from employees' wages for social security and income taxes, and other similar items;
>
> (b) This account shall also include the balances due other carriers (except affiliated companies) in favor of each of which there is a net credit balance representing interline accounts.

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[11] *Ibid.*, pp. A 35-36

(c) This account shall be subdivided as follows:
2051- Accounts Payable - Officers, Stockholders and Employees
2055- Interline Account Balances
2059- Accounts Payable - Other[12]

A person having only a little accounting knowledge, gained either from education or experience, could take these detailed descriptions and do a passable job of deciding what was includable in the accounts.

Account 1120 which contains amounts receivable from agents, customers and interline required no subdivision in the account. The necessity of keeping these items segregated is mentioned in the note. Carriers will have different requirements as to segregation, depending upon the number of customers, agents, and interlines with whom they do business. Most Class I carriers would likely have sufficient volume to necessitate subsidiary ledgers in at least two of the three groups. In this event the segregation will probably be maintained throughout the year; nevertheless, this is left to the descretion of the carrier.

In contrast, Account 2050- Accounts Payable is subdivided into three groups. Each group is inclusive enough to require maintenance of a subsidiary ledger, thereby making each sub-account a control account for all intents and purposes. It follows that the only useful purpose served by the 2050 account is to act as a control on the control Accounts 2051, 2055, and 2059. The only time it is actually used will be in reports to the Commission and the balance which will show there will be the total of the balances in the other three accounts. In view of this situation, it

[12] _Ibid._, pp. A-52, 53.

seems the maintenance of Account 2050 is merely extra work which can be eliminated without destroying any needed information. A quick adding machine tape on the balances in Accounts 2051, 2055 and 2059 will produce the same information with much less effort.

Accounts Payable could have been handled in much the same way as Accounts Receivable. It would have been simpler, more direct, and more easily understood. The descriptive narratives of Accounts Receivable most likely could be shortened without materially detracting from its meaning. Full, clear descriptions are necessary and useful. Long, detailed listings, with minute cross references, are unnecessary in light of the availability of a very detailed distribution index. Such an approach may possibly preclude needed changes which would otherwise be made. A small change might greatly improve the understanding of one account, but might possibly necessitate changes in other accounts. The very mechanics of printing, revising each account affected, and mailing may nullify the feasibility of an otherwise sound change. The changes may have to wait until they accumulate to the point where they can be economically justified. The more detailed the work the more importance this situation would assume. The more detail presented and cross referencing used, the more quickly one reaches the point that small but meaningful changes cannot be made because of the economic justification referred to above. This logic gathers support from the Accounting Interpretations section mentioned only briefly in the preceding chapter. Through interpretations presented in the form of questions and answers, change may be effected and detail kept out of the text of the accounts. Presentations

of this nature are helpful, useful and welcome, but they do not completely solve the problem because the text of the account and the interpretation case may well be in conflict.

(e) Materiality

Materiality is another area where differences of opinion are fairly common. The differences usually arise in specific instances concerning whether or not a particular amount is material or not. The System differs with the principle of materiality. In order to discuss this point it is necessary to see what instructions are given concerning this item.

> 8. Delayed Items
> Delayed items and adjustments, except adjustments pertaining to Account 2500- Reserve of Depreciation-Carrier Operating Property, arising during the current year which are applicable to prior accounting periods, shall be included in the same accounts which would have been credited or charged if the item had been taken up or adjusted in the period to which it pertained, except that when the amount of the delayed item is relatively so large that its inclusion in the appropriate account for the current year would seriously distort the revenues, expenses, or other income accounts for the year, the amount of the item shall be included in Account 8400- Delayed Income Credits, or Account 8600- Delayed Income Charges, as appropriate. The carrier shall prepare and keep in its records a statement showing the full particulars concerning each such item, including the account and year that would have been affected had the item not been delayed.[13]

It should be noted from the above that materiality is only considered when it is so large as to seriously distort revenues, expenses or other income. Its relationship to profit is not mentioned, but profit is cer-

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[13] Ibid., pp. A-14, 15.

tainly one guage as to whether an item is material or not in the principle. Conceivably, an item equal to one-half the net profit for the year would not be considered as delayed because in relation to total revenue or total expenses it is not material.

The reason for this is unknown to the writer. It is known that when the Commission uses these records, especially in a rate case, they usually review at least ten years. This being the case, the material items would likely be properly placed within one of the ten years. It seems logical to assume that this is a labor saving device which does not in any way distort the figures for Commission use, at least in the context described above.

Even though no distortion exists for the Commission, such a situation certainly leads to misunderstanding for other users of the statements. Hopefully, this does not indicate an inconsiderate attitude on the part of the Commission toward other groups of users of these public records.

AREAS LIKELY NEVER TO BE CHANGED

Unregulated business enterprises may pick the time for closing their books. The most useful fiscal year naturally is one which corresponds with a natural business cycle. Even if no natural cycle exists, the fiscal year can have any closing date desired.

A choice in this area is not available to regulated motor carriers subject to the System. Motor carriers must keep their records on a calendar year basis. Realistic comparisons so necessary to informed regulatory decision necessitate this uniformity. Such necessity precludes change, and rightly so.

The next problem area in this category is more mechanical than theoretical. It concerns the process of closing the operating accounts at year's end and transferring the results to surplus. Instruction three says, in essence, that at the end of the year the revenue and expense accounts should be closed into earned surplus. No mention is made of a profit and loss account. Absence of such accounts leaves no mechanical process for the transfer. Examination of Account 2930- Earned Surplus, shows that a host of surplus accounts are closed to this account. They present two possibilities for accounts which could serve as a closing account. The first possibility is Account 2932- Credit Balance Transferred From Income. The title suggests that the operational accounts having credit balances may be closed to this account which, in turn, is closed to the earned surplus account. Such treatment would at least provide the mechanics for effecting the transfer of the credit balance operational accounts to surplus. The suggestion, however, is just that - a suggestion by the account title. The account description states, "If the income statement for the current calendar year reflects a net credit balance, it shall be brought forward to this account." Thus, if operations show a profit the net profit is transferred to this account. From what account is it transferred? The income statement does not have an account number, nor does it appear as an account.

Only the credit balance has been discussed up to now. There is an account number, title and description which treats the net debit balance in the same manner. There is no mechanical process for closing the books outlined in the System. Are the revenue and expense accounts left

with balances and forgotten? Is the accountant left to close the books in a manner to his own liking? These questions are left unanswered by the System. It may be an insignificant matter in the eyes of the Commission. An account may be used as a closing account with the resulting balance closed to the appropriate surplus account which, in turn, is closed to Account 2930- Earned Surplus. When net results only are being transferred, it seems unnecessarily time consuming to transfer the figure to one account, say 2932, and then to 2930. Taking the result directly to earned surplus seems much more direct and attains the same result while omitting one seemingly useless step.

Thus, the System leaves the book closing technique hanging in mid-air, making it inconsistent within itself. In one instance it takes the accountant by the hand and leads him, step by step, through the entering of a transaction on the books, while it only hints at the mechanics of closing the books. No great hindrance is presented by this omission. The books certainly get closed. Because no great problems are posed and the job gets done, the likelihood of change is small.

Cargo loss and damage claims are handled in the System by charging Account 4550- Cargo Loss and Damage, for the amount of the actual damage to the cargo and Account 3100-Freight Revenue, is charged with the amount of unpaid freight charges, if any. The other major claim category is overcharge. In this instance an erroneous freight charge is assessed through error or misinterpretation of a tariff. Overcharge claims are charged to freight revenue.

The portion of Loss and Damage Claims which covers return of revenue

should also be charged to Account 4550- Loss and Damage Claims. No accounting principle is involved here. It is merely a matter of distorting the cause of the loss of revenue. In an overcharge claim, the revenue, in theory, has never been earned. In a loss and damage claim the revenue has been earned and the loss is due to whatever caused the damage, rough handling, improper packing, improper loading, or just a plain ordinary accident. The money has to be refunded, there is no doubt about that. However, the entire cost seems more appropriately charged to loss and damage, rather than charging revenue with that portion which covers return of freight charges on the damaged material. Only in this way is the carrier able to ascertain the real cost of lost and damaged freight.

This problem could have been placed in the section which needs improvement. This really needs improvement, but it is included here because it is not likely to be improved. Reduction of revenue produces the same result as increasing an expense account. This being the case, it is felt that chances of improvement are slim. In the event of a general overhaul of the System, this, along with other things mentioned in this section, hopefully will come in for consideration.

In conclusion it must be brought out again that on the whole the System does a good job of conforming to generally accepted accounting principles. Some areas of disagreement have been presented. Of those presented, some are major while others are minor. In the minor category, such as some of the terminology or communication problems, no attempt was made to include every such item encountered. It is hoped that enough have been presented to illustrate the areas which have minor weaknesses. To have

included all such descrepancies would make this work the recipient of one of its own complaints - too much detail.

CHAPTER IV

SUMMARY

This summary is presented to restate in capsule form what hopefully has been accomplished in this work.

In Chapter I, criteria were established against which the System would be analyzed. The word criteria was chosen because principle proved troublesome to define. All of the techniques used did not fit even the broadest definition of the word principle. For example, selecting a basis for depreciation is not a principle. It is a method or procedure. On the other hand, the double entry system is almost a law of accounting. Thus, a law of accounting is much less flexible than a principle, while a method or procedure may allow an item to be treated in different ways and still adhere to the principle. In order to be inclusive, the word criteria was used. The pronouncements of the Institute were selected as the ones most generally accepted.

Chapter II was included as a descriptive chapter to acquaint the reader, very generally, with the System. To some it probably seems very long and drawn out. To the non-accountant it may not even give a glimmer of what the System contains. It was designed to give those who have some background in accounting an introduction to the System and what it contains, and how it is presented.

In the analysis chapter, issue was taken with several points; some minor, some major.

It was brought out that some areas have been improved. The Commission

has tried to improve others but has been restrained in this effort by the carriers.

The System has a special balance sheet classification for that portion of long term debt due within one year. This paper considers this incorrect. The item should be presented in the current section. Any special facts or situations should be disclosed in a footnote to comply to the fullest extent with the principle of disclosure.

Issue was taken with many aspects of the System's treatment of depreciation. The use of trade-in value as the basis for determining gain or loss on the disposition of fixed assets is the least desirable of the three methods described as generally accepted. Inclusion of the gains so determined as a part of current operating income is not a practice of conservative accounting. Inclusion of the "paper gains" only compounds the error.

The System, in its use of detailed descriptions of accounts, has reduced its own effectiveness. It was pointed out that the same item could be included in either of two accounts with equal ease and correctness. Very likely misunderstanding gave birth to the "Interpretations" section of the System. The section is presented in question and answer form which indicates trouble on the part of the company accountants in understanding certain parts of the descriptive material.

Judgment is removed from the accountant at the company level. Depreciation is of necessity a process of judgment and estimation. These two aspects cannot be eliminated; nor can they be made more exact than the accountant's judgment. In prescribing the base and the method of

application, the judgment of the Commission is substituted for that of the accountant.

There are areas which will never be improved. This is necessarily so. Comparison would be almost impossible if carriers had fiscal years ending at numerous different dates. Of necessity, then, motor carriers will likely always have the calendar year as their accounting cycle. Some other areas appear unlikely of being changed unless the entire System is overhauled. It is to be hoped that this may happen in the not too distant future.

In the Appendices there appear some sample financial statements. In Appendix A an income statement and a balance sheet are shown. These statements are presented as they would have appeared in a report to the Commission prior to 1957 which means that none of the points included in this work have been changed. Appendix B concerns itself with changes which have already been made, namely, the interest on installment loans being classified as a deferred item instead of a prepayment; and the special classification of the current portion of a long term debt. Both of these changes affect only the balance sheet. This being the case, an income statement is deemed unnecessary since it would only be a repeat of the one shown in Appendix A. Appendix C contains both an income statement and a balance sheet which are presented in accordance with some of the changes suggested in this discourse.

The Appendices have been included in an attempt to set forth visually some issues previously discussed. The form used is the System's in so far as it could be followed.

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A P P E N D I C E S

APPENDIX A

SCHEDULE 2998 - INCOME STATEMENT

I CARRIER OPERATING INCOME

	Revenues:		
(3000)	Operating revenues		$50,000.00
	Expenses:		
(4000)	Operation and maintenance expenses	$41,000.00	
(5000)	Depreciation	4,500.00	
(5100)	Depreciation adjustment	(1,500.00)	
(5200)	Operating taxes and licenses	3,500.00	
	Total Expenses		47,500.00
	Net Operating Revenue		2,500.00

II OTHER ORDINARY INCOME

(6300)	Interest income		50.00
	Gross Ordinary Income		2,550.00

III DEDUCTIONS FROM ORDINARY INCOME

(7100)	Interest expense	$ 500.00	
(7500)	Other deductions	500.00	
	Total Deductions From Ordinary Income		1,000.00
	Net Income (or Loss) Transferred to Earned Surplus or Noncorporate Capital Accounts		1,550.00

Operating Ratio (Total Expenses ÷ Operating Revenue 95.00%

SCHEDULE 100 - BALANCE SHEET

ASSET SIDE

	Current Assets		
(1000)	Cash and working funds	$ 2,475.00	
(1120)	Accounts receivable	3,300.00	
(1170)	Prepayments (Note 1)	2,475.00	
(1180)	Materials and supplies	550.00	
	Total Current Assets		$ 8,800.00
	Tangible Property		
(1200)	Carrier property	40,650.00	
	Less: Reserve for depreciation	24,425.00	
	Total Tangible Property		16,225.00
	Intangible Property		
(1500)	Organization, franchises, and permits		275.00
	Investment Securities and Advances		
(1650)	Other investments and advances		2,200.00
	Total Assets		$27,500.00

SCHEDULE 101 - BALANCE SHEET

LIABILITY SIDE

	Current Liabilities		
(2050)	Accounts payable	$ 2,475.00	
(2070)	Wages payable	275.00	
(2180)	Other current liabilities	275.00	
	Total Current Liabilities		$ 3,025.00
	Equipment and Other Long Term Obligations		
(2300)	Equipment obligations (Note 2)		12,100.00
	Reserves		
(2690)	Other reserves		275.00
	Capital Stock		
(2710)	Common capital stock		1,925.00
	Unappropriated Surplus		
(2930)	Earned surplus		10,175.00
	Total Liabilities		$27,500.00

Note 1- Prepayments include $1,375.00 in interest
Note 2- Equipment Obligations include $4,675 representing the current portion of these obligations

Comments:

Operating ratio is 95.00%. The current ratio is 2.91 to 1 which is a very fine ratio, but much better than it actually is.

The notes presented at the bottom of the balance sheet are not intended as further disclosure. They would not appear on a statement submitted to the Commission prior to 1957. The same information will be presented differently in the following appendices and it was deemed advisable to note this information and thus allow the reader to follow the changes with greater ease.

APPENDIX B

SCHEDULE 100 - BALANCE SHEET

ASSET SIDE

	Current Assets		
(1000)	Cash and working funds	$ 2,475.00	
(1120)	Accounts receivable	3,300.00	
(1170)	Prepayments	1,100.00	
(1180)	Materials and supplies	550.00	
	Total Current Assets		$ 7,425.00
	Tangible Property		
(1200)	Carrier property	40,650.00	
	Less: Reserve for depreciation	24,425.00	
	Total Tangible Property		16,225.00
	Intangible Property		
(1500)	Organization, franchises, and permits		275.00
	Investments Securities and Advances		
(1650)	Other investments and advances		2,200.00
	Deferred Debits		
(1890)	Other deferred debits		1,375.00
	Total Assets		$27,500.00

SCHEDULE 101 - BALANCE SHEET

LIABILITY SIDE

	Current Liabilities		
(2050)	Accounts payable	$ 2,475.00	
(2070)	Wages payable	275.00	
(2180)	Other current liabilities	275.00	
	Total Current Liabilities		$ 3,025.00
	Long Term Debt Due Within One Year		
(2190)	Equipment obligations and other debt		4,675.00
	Long Term Debt Due After One Year		
(2300)	Equipment obligations		7,425.00
	Reserves		
(2690)	Other reserves		275.00
	Capital Stock		
(2710)	Common capital stock		1,925.00
	Unappropriated Surplus		
(2930)	Earned surplus		10,175.00
	Total Liabilities		$27,500.00

Comments:

The current ratio is 2.45 to 1. This was brought about by moving interest due on installment equipment obligations from prepaid interest to other deferred debits. This is the more proper classification and in keeping with the generally accepted treatment.

It should be noted also that the current portion of long term equipment obligations has been placed in a special category. This is an improvement of the presentation in Appendix A, but not the best one attainable.

APPENDIX C

SCHEDULE 2998 - INCOME STATEMENT

I CARRIER OPERATING INCOME

	Revenues:		
(3000)	Operating revenues		$50,000.00
	Expenses:		
(4000)	Operation and maintenance expenses	$41,000.00	
(5000)	Depreciation	4,500.00	
(5200)	Operating taxes and licenses	3,500.00	
	Total Expenses		49,000.00
	Net Operating Revenue		$ 1,000.00

II OTHER ORDINARY INCOME

(6300)	Interest income		50.00
	Gross Ordinary Income		$ 1,050.00

III DEDUCTIONS FROM ORDINARY INCOME

(7100)	Interest expense	$ 500.00	
(7500)	Other deductions	500.00	
	Total Deductions From Ordinary Income		1,000.00
	Net Ordinary Income		$ 50.00

IV EXTRAORDINARY INCOME

(8400)	Delayed income credits		$ 1,500.00
	Net Income (or Loss) Transferred to Earned Surplus		$ 1,550.00

Operating Ratio (Total Expenses ÷ Operating Revenues)	98.00%

SCHEDULE 100 - BALANCE SHEET

ASSET SIDE

	Current Assets		
(1000)	Cash and working funds	$ 2,475.00	
(1120)	Accounts receivable	3,300.00	
(1170)	Prepayments	1,100.00	
(1180)	Materials and supplies	550.00	
	Total Current Assets		$ 7,425.00
	Tangible Property		
(1200)	Carrier property	$40,650.00	
	Less: Reserve for depreciation	24,425.00	
	Total Tangible Property		16,225.00
	Intangible Property		
(1500)	Organization, franchises, and permits		275.00
	Investments, Securities and Advances		
(1650)	Other investments and advances		2,200.00
	Deferred Debits		
(1890)	Other deferred debits		1,375.00
	Total Assets		$27,500.00

SCHEDULE 101 - BALANCE SHEET

LIABILITY SIDE

	Current Liabilities		
(2050)	Accounts payable	$ 2,475.00	
(2070)	Wages payable	275.00	
(2180)	Other current liabilities	275.00	
(2190)	Equipment obligations and other debt	4,675.00	
	Total Current Liabilities		$ 7,700.00
	Long Term Debt Due After One Year		
(2300)	Equipment obligations		7,425.00
	Reserves		
(2690)	Other reserves		275.00
	Capital Stock		
(2710)	Common capital stock		1,925.00
	Unappropriated Surplus		
(2930)	Earned surplus		10,175.00
	Total Liabilities		$27,500.00

Footnote to Balance Sheet:

Current classification of equipment obligations due within one year requires consideration of several things peculiar to the trucking industry when analyzing the effect of this item on the current ratio. The service aspect of the industry, the absence of inventory of raw materials, or finished goods, and the rapid turnover of accounts receivable certainly affect such an analysis.

Comments:

The operating ratio has increased from 95.00% to 98.00%. This increase was caused by moving the depreciation adjustment from the current operating section and placing it in the extraordinary income category. This is the net result of all that has been said concerning the treatment of depreciation adjustments. It shows that the System's treatment is misleading as to the amount of income derived from operations.

The current ratio in this presentation is .96 to 1. This is the natural result of moving the current portion of installment debt from its special classification into the current section.

It is the contention of this paper that this is the favored and more generally accepted treatment of this item. The System's presentation tells the reader that it is current but does not indicate why it is specially classified. The presentation of this appendix says that this is a current item and so classifies it. Through a footnote to the balance sheet, special considerations which affect this item (regardless of its classification) are pointed out, thus more fully disclosing the true nature of this item.

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