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Budgets and balance sheets: The practical application of sound accounting principles and methods to municipal book-keeping

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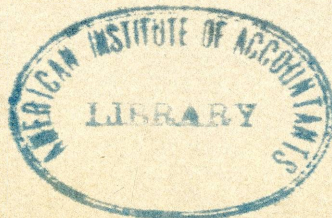
BUDGETS AND BALANCE SHEETS

THE PRACTICAL APPLICATION OF SOUND ACCOUNTING
PRINCIPLES AND METHODS TO MUNICIPAL BOOK-KEEPING

BY

HARVEY S. CHASE
Certified Public Accountant
BOSTON, MASS.

*An Address before the National Municipal League
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By **HARVEY S. CHASE**
Certified Public Accountant
Boston, Mass.

AN ADDRESS BEFORE THE NATIONAL MUNICIPAL LEAGUE AT THE
BUFFALO MEETING, NOVEMBER 14-17, 1910

If we look through the proceedings of the League for the past ten years, we shall find many papers and discussions upon questions related to municipal accounting. If these are noted carefully from year to year, it will be found that there has been a steady progression from the original and somewhat crude classification, which appears in the earlier volumes, down through the development of the past ten or twelve years, until we have to-day the standardized classifications which are applied throughout the country by the United States Census Bureau. These standards have been adopted, so far as the laws permit, by the various States which have uniform municipal accounting bureaus; these States being Ohio, Massachusetts, New York, Indiana, and various others. I bring to your attention a well-thumbed copy of the City Auditor's report for the year 1900 of the City of Newton, Mass., in which appeared for the first time in this country a "uniform" classification of municipal accounts. This document is now historic and in it the National Municipal League is given full recognition of the efforts to establish a standard, to which all the cities of the country could conform ultimately, which were then under way through the League's committee upon "Uniform Municipal Reports and Accounts." Continuing our examination of the League's proceedings, it will be noted further that most, if not all, of the papers heretofore given before the League on this subject have been devoted to the classification of appropriations and sub-appropriations authorizing municipal expenditure. I wish in the present paper to go a considerable step beyond these questions, and point out what seems to me, after long experi-

ence in municipalities in various parts of the country, to be a fundamental necessity in the installation of sound accounting systems in our municipalities, including both cities and towns. This essential feature which I wish to bring to your attention to-day is a counterpart of what is fundamental in all classes of commercial accounting, although the aim of and therefore the requirements upon commercial accounting systems differ in important particulars from those of municipal accounting. These differences have been enlarged upon many times by city comptrollers and others, and I will not attempt here to emphasize them. On the contrary, I desire in this paper to emphasize the *likeness*, in certain fundamental aims, of both municipal and commercial systems of accounting. You are familiar with the primary distinctions of commercial accounts,—“capital” and “revenue”; that is to say, between those classes of accounts which have to do with “assets and liabilities” and those classes of accounts which have to do with “income and outgo.” The one represents properties, actual cash, and securities belonging to the organization, together with the debts owed by the organization, as well as its capital stock liabilities. The other relates to earnings which have come in during a certain period or have accrued during that period, together with expenses which have been paid out during that period or have been incurred during the same period. It has been said frequently by persons actually engaged in governmental accounting that the likeness which I am endeavoring to demonstrate to you does not exist. In fact, to quote the words in a recent address by a certified public accountant familiar with ordinary methods of governmental accounting, such a relationship ought not to be considered at all! This gentleman said, “The considerations of ‘Capital’ and ‘Revenue’ which characterize the accounts of all private undertakings are conspicuously absent in the accounts of cities, and in fact in all public accounts, and accordingly neither the ‘Balance Sheet’ as commercially understood nor its inseparable companion, the ‘Profit and Loss’ account, finds any place in the reports of public finances.”

I wish to make immediate and emphatic objection to this statement. My experience among cities both large and small and in various parts of the United States during the last fifteen years has led me to certain conclusions from which I find myself unable to escape, and one of these conclusions bears very closely upon this matter of “Capital” and “Revenue” in municipal accounts. In fact, it appears to me that we do have, and must necessarily have, in city affairs the same distinctions in classes of accounts which are represented by these titles “Capital” and “Revenue” in commercial affairs. It will be found impractical to install sound accounting methods in municipalities, in my

opinion, unless these distinctions are recognized, whatever be the titles given to these different classes of accounts. The word "Capital" is not a satisfactory term to apply to municipal accounts. For this reason I have coined and used the word "Non-revenue." The term "Revenue," however, and "Revenue Account," used in very much the same sense as a "Profit and Loss" account is used in commercial affairs, is one of the most essential features of a proper installation of sound methods of accounting in cities. Of this I am fully convinced, and for this reason:—While, as the authority I have quoted says, "The question of 'Gain' or 'Profit' finds no proper place in municipal accounts," the question of *Surplus* or *Deficiency* of revenue is an exceedingly important item in such accounts. This question,—whether or not the revenue pertaining to a fiscal period is in excess of the expenditure which that revenue is supposed to meet,—is one of the fundamental questions which a proper system of accounts in a municipality should exhibit, and should exhibit so clearly as to be without question. The corollary of this statement is evident. If the current revenue has not provided for the current running expenses of the city, then borrowed money must be used to supply this deficiency, and such borrowed money can be liquidated only out of future revenues. Thereby such deficiencies of the present become unwarrantable burdens upon the tax-payers of the future. I have examined city after city in which, owing to the crude methods of accounting in vogue, the municipal officers year after year permitted the expenditures to exceed the revenues available, and thereby municipal debts have piled up. These debts, being complicated by and mixed with other debts which have been issued for public improvements and similar purposes, have been almost inextricably confused in the accounts, and it has been beyond the capacity of the officers to determine whether, or by how much, the city was running behindhand annually. In fact, as may be readily imagined, a considerable number of municipal office-holders do not sincerely desire that the public shall know how much to the bad their expenditure is carrying the city. They prefer that the finances of the city should run along as best they may until their own terms of office have expired. "After us, the deluge," is too frequently the motto of political office-holders.

Even if these officials are honest, and do desire to exhibit the actual conditions to the public, they find themselves handicapped by unsound methods of accounting based on mere cash accounts, which, under provisions of law, are the prevailing methods of accounting in municipalities to-day.

With laws and legal requirements we must of course comply, but, wherever these requirements are not in accord with sound accounting

principles, it is evident to us, as professional accountants, that in due time these laws must be changed. We should look at these matters from a point of view which will give us a broad survey of the whole field of municipal necessities. Laws are by no means perfect, and they are especially deficient along accounting lines for the reason that in general laws are drawn and are amended by members of the legal profession who, as a rule, have little knowledge of and less patience with accounting requirements. We cannot avoid recognizing the fact that, as accountants, we must insist,—always, of course, with tact and patience,—and must continuously insist that the laws shall recognize accounting requirements and that from time to time the statutes must be changed by amendment and repeal until sound accounting principles shall be matters of law as well as matters of necessary business procedure.

My experience in city after city has led me step by step to conclusions which I am endeavoring to place before you to-day, and, in order that we may start properly and that you may get a correct understanding as to what I mean by "Revenue" accounts and their application in municipal book-keeping, I will now refer to the large charts here upon the wall.

EXPLANATION OF CHARTS.

These charts have been prepared for the purpose of illustrating on a scale comparable with the revenue expenditures of a city like New York the entries necessary to establish proper methods of revenue accounting in the books. In order not to complicate the matter, which is sufficiently complicated at best, only those entries have been illustrated which are fundamentally necessary in order to establish the simplest form of a monthly balance sheet. The amounts set forth on the charts correspond closely enough to the actual expenditures of the city of New York in a recent fiscal year, but no emphasis whatever should be laid upon these figures or any of them. I wish to lay stress solely upon the form and the methods of making the entries and the corresponding ledger accounts which are thereby set up in books and which give automatically a correct balance sheet at the end of each fiscal period simply by taking off a trial balance of the general ledger.

Schedule 1 is a title-page merely.

Schedule 2 exhibits a journal entry debiting "Revenue Account 1910" and crediting "Appropriations Account 1910" with \$130,000,000.00, representing the expenditures authorized to be made from taxes and all other revenues during the fiscal year. This journal entry is given in detail under the standard classification established by the Bureau of the Census, and applied by it to the annual reports of all cities throughout the country as published in the Census bulletins. These detailed appropriations will be set up in a subsidiary ledger,—appropriation ledger; and this subsidiary ledger will be controlled by the "Appropriations 1910 Account" in the general ledger.

SCHEDULE 2.

Journal.

January 1, 1910.

Annual budget for the year 1910. Estimated by the Board of Estimate and Apportionment and passed by the Board of Aldermen. Required to pay the expenses of conducting the public business for the ensuing year.

Revenue Account 1910	\$130,000,000.00
To Appropriations 1910, viz.:	
General Government:	
Mayoralty	\$75,000.00
Board of Aldermen and City Clerk	240,000.00
Department of Finance	1,300,000.00
Etc., etc.	200,000.00
Protection of Life and Prop- erty:	
Police Department	15,000,000.00
Fire Department	7,200,000.00
Etc., etc.	2,500,000.00
Health and Sanitation:	
Department of Health	2,100,000.00
Etc., etc.	1,200,000.00
Department of Street Cleaning	6,900,000.00
Bureau of Sewers	150,000.00
Etc., etc.	500,000.00
Highways:	
Department of Bridges	600,000.00
Bureau of Highways	650,000.00
Etc., etc.	2,300,000.00
Charities and Corrections:	
Charitable Institutions	4,000,000.00
Department of Public Charities	2,400,000.00
Department of Correction	1,300,000.00
Etc., etc.	2,000,000.00
Education:	
Department of Education	30,000,000.00
College of the City of New York	500,000.00
Etc., etc.	750,000.00
Recreation:	
Department of Parks	3,000,000.00
Etc., etc.	400,000.00
Miscellaneous:	
Etc., etc.	935,000.00
Municipal Industries:	
Department of Water Sup- ply, Gas, and Electricity,	6,000,000.00
Municipal Indebtedness:	
Interest on the City Debt	23,000,000.00
Redemption of the City Debt	9,000,000.00
Instalment Payable in 1907,	5,800,000.00
	\$130,000,000.00

SCHEDULE 3.

General Ledger.

REVENUE ACCOUNT 1910.

1910 Jan. 1	To Appropriations 1910	J	130,000,000.00				
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APPROPRIATIONS, 1910.

				1910 Jan. 1	Appropriations for the year	J	130,000,000.00
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Appropriations Ledger.

(Subsidiary)

MAYORALTY (as illustration).

				1910 Jan. 1	Appropriation	J	75,000.00
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Schedule 2. Illustration of entries at beginning of the fiscal year of a municipality.

Schedule 3. The accounts in the general ledger are exhibited after the journal entry on schedule 2 has been posted. There is also given as an illustration of the subsidiary "appropriations" ledger one account—Mayoralty.

SCHEDULE 4.

Journal.

CREDIT TO REVENUE FROM TAX LEVY AND OTHER RECEIPTS TO BE COLLECTED.

Tax Levy of 1910	\$110,250,000.00	
Estimated other Revenue	30,000,000.00	
To Revenue Account 1910		\$135,000,000.00
To Reserve for Abatements (overlay)		5,250,000.00

Schedule 4 exhibits a journal entry establishing the credit to "Revenue Account 1910" and setting up on the other side as an asset the tax levy of 1910 and the "estimated other revenue" as established by the budget-making body. There is further established by credit entry a "reserve for abatements" account. A reserve account of this nature is fundamentally necessary in municipal book-keeping, in order that provision may be made for abatements of taxes and other losses of taxes which always occur in municipal finances. If such abatements and losses are not properly provided for by the tax levy itself, they must be made up by additional borrowings which must become burdens upon the revenues and tax-payers of the future.

SCHEDULE 5.
General Ledger.
 TAX LEVY OF 1910.

1910 Jan. 1	Tax Levy of 1910	J	110,250,000.00				
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ESTIMATED OTHER REVENUE 1910.

1910 Jan. 1		J	30,000,000.00				
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REVENUE ACCOUNT 1910.

1910 Jan. 1	To Appropriations 1910	J	130,000,000.00	1910 Jan. 1	Taxes Levied Estimated Other Revenue	J	105,000,000.00 30,000,000.00
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RESERVE FOR ABATEMENTS (overlay).

				1910 Jan. 1	Taxes Levied	J	5,250,000.00
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Schedule 5 shows the condition of the general ledger accounts after this journal entry. It will be noted that the "Revenue Account 1910" now stands with a credit balance of \$5,000,000.00.

SCHEDULE 6.

January 31, 1910.

MONTHLY WARRANT FOR THE EXPENDITURES OF CURRENT MONTH.

Appropriations, viz.:

General Government:

Mayoralty Appropriations	\$8,398.42
Board of Aldermen and City Clerk	19,457.39
Department of Finance	140,023.17
Etc., etc.	12,452.72

Protection of Life and Property:

Police Department	1,182,933.75
Fire Department	794,110.98
Etc., etc.	23,182.72

Health and Sanitation:

Department of Health	183,731.44
Etc., etc.	43,079.21
Department of Street Cleaning	508,499.62
Bureau of Sewers	12,402.71
Etc., etc.	9,664.37

Highways:

Department of Bridges	46,982.42
Bureau of Highways	49,484.11
Etc., etc.	17,015.48

Charities and Corrections:

Charitable Institutions	518,972.48
Department of Public Charities	287,441.82
Department of Correction	145,732.45
Etc., etc.	18,941.63

Education:

Department of Education	2,893,487.32
College of the City of New York	42,347.84
Etc., etc.	39,745.29

Recreation:

Department of Parks	306,721.42
Etc., etc.	16,237.87

Municipal Industries:

Department of Water Supply, Gas, and Electricity	482,732.14
Etc., etc.	29,205.99

Municipal Indebtedness:

Interest on the City Debt	2,434,182.18
Redemption of the City Debt	742,842.83
Instalment Payable	400,000.00
Etc., etc.	14,102.05

 \$11,424,111.82

 To Audited Vouchers Payable
 (or Warrants Registered)

\$11,424,111.82

SCHEDULE 7.
General Ledger.
APPROPRIATIONS.

1910	Warrant for January				1910	Appropriations for year				130,000,000.00
			11,424,111.82							

AUDITED VOUCHERS PAYABLE (OR WARRANTS REGISTERED).

					1910	January War- rant				11,424,111.82

Appropriations Ledger.

MAYORALTY.

1910	Warrant for January <i>Balance</i>				1910	Appropriation				75,000.00
			8,398.42							
			66,601.58							
			75,000.00							75,000.00
						Balance				66,601.58

Schedule 6 exhibits a monthly warrant for the expenditures under all of the appropriations from revenue. The total amount is charged to "Appropriations Account 1910" and credited to "Audited Vouchers Payable" or to "Warrants Registered," or whatever the title of the liability account may be.

Schedule 7 shows once more the condition of the general ledger accounts after this entry.

SCHEDULE 8.

Journal.

CASH RECEIPTS FOR MONTH.

Cash	\$18,762,491.31	
To Tax Levy 1910		\$18,762,491.31
Collections of Taxes		
<hr/>		
Cash	\$2,489,472.28	
To Estimated other Revenue		\$2,489,472.28
Collections of Other Revenue		
<hr/>		
Audited Vouchers Payable	\$9,887,065.72	
To Cash		\$9,887,065.72
Payments of Warrants, or Au- dited Bills and Pay-rolls		
<hr/>		
Reserve for Abatements (overlay)	\$896,743.21	
To Tax Levy 1910		\$896,743.21
Taxes Abated		

Schedule 8. A series of journal entries relating to cash. For simplicity these entries are made by the journal instead of being entered, as they would in practice, through the cash book directly. Cash is charged with collections on account of tax levy and is also charged with collections on account of other revenues (licenses, fees, etc., etc.). Again, for simplicity, no cash balance at the beginning of the period is set up in these accounts, although of course there would be, naturally, various classes of cash balances at the beginning of the period.

On schedule 8 also "Audited Vouchers Payable" account is charged and cash is credited with the actual payments of warrants or bills and pay-rolls made by the treasurer's or chamberlain's office during the month. Further, we suppose that various taxes have been abated, and "Reserve for Abatements" is charged, and the tax levy credited with those items which have been allowed by the proper officers in accordance with the requirements of law.

Schedule 9 sets forth the condition of the ledger accounts after these entries have been made.

SCHEDULE 9.
General Ledger.

CASH.

Receipts	18,762,491.31	Payments	9,887,065.72
"	2,489,472.28	Balance	11,364,897.87
	21,251,963.59		21,251,963.59
Balance	11,364,897.87		

VOUCHERS PAYABLE.

Cash	9,887,065.72	January War-	11,424,111.82
Balance	1,537,046.10	rant	
	11,424,111.82		11,424,111.82
		Balance	1,537,046.10

TAX LEVY 1910.

Tax Levy 1910	110,250,000.00	Cash	18,762,491.31
		Abatements	896,743.21
		Balance	90,590,765.48
	110,250,000.00		110,250,000.00
Balance	90,590,765.48		

ESTIMATED OTHER REVENUE.

	30,000,000.00	Cash	2,489,472.28
		Balance	27,510,527.72
	30,000,000.00		30,000,000.00
Balance	27,510,527.72		

RESERVE FOR ABATEMENTS (overlays).

Abatements	896,743.21	Tax Levy	5,250,000.00
Balance	4,353,256.79		
	5,250,000.00		5,250,000.00
		Balance	4,353,256.79

SCHEDULE 10.

Journal.

Revenue Account 1910	\$10,000,000.00	
To Appropriations 1910		\$10,000,000.00

Additional appropriations made subsequent to original levy. Not provided from any specific source—"Money in the Treasury not otherwise appropriated," or other phrase of this nature having been used in the order, or no phrase at all—no provision of revenue at all—frequently.

General Ledger.

REVENUE ACCOUNT 1910.

	Appropriations	130,000,000.00			105,000,000.00
	Additional Appropriations	10,000,000.00		Taxes levied	
				Estimated	
				Other Revenue	30,000,000.00
				Balance	5,000,000.00
		140,000,000.00			140,000,000.00
	Balance	5,000,000.00			

APPROPRIATIONS 1910.

	Warrant for	11,424,111.82			130,000,000.00
	January	128,575,888.18		Appropriations	
	Balance			Additional Appropriations	10,000,000.00
		140,000,000.00			140,000,000.00
				Balance	128,575,888.18

SCHEDULE 11.

TOTAL FOOTINGS OF LEDGER ACCOUNTS.

	<i>Debit.</i>	<i>Credit.</i>
Cash	\$21,251,963.59	\$9,887,065.72
Tax Levy 1910	110,250,000.00	19,659,234.52
Estimated Other Revenue	30,000,000.00	2,489,472.28
Vouchers Payable	9,887,065.72	11,424,111.82
Appropriation Balances Unex- pended	11,424,111.82	140,000,000.00
Reserve for Abatements	896,743.21	5,250,000.00
Revenue Account 1910	140,000,000.00	135,000,000.00
	\$323,709,884.34	\$323,709,884.34

TRIAL BALANCE.

Cash	\$11,364,897.87	
Tax Levy 1910	90,590,765.48	
Estimated Other Revenue	27,510,527.72	
Vouchers Payable		\$1,537,046.10
Appropriation Balances Unex- pended		128,575,888.18
Reserve for Abatements		4,353,256.79
Revenue Account 1910 (defi- ciency)	5,000,000.00	
	\$134,466,191.07	\$134,466,191.07

Schedule 10 exhibits an entry illustrating what is frequently done in municipalities throughout the country, although it is opposed to all considerations of sound accounting and should be prohibited by law. Such action is prohibited by law in various cities, and such action could not be taken in the city of New York. This is, however, the essential point which I desire to bring out, and therefore this entry has been made as set forth.

Schedule 11 exhibits the totals of the debit and the credit entries in each of the ledger accounts, and also exhibits a trial balance or balance sheet of the accounts as they stand on the general ledger after the entries above set forth have been made. The "deficiency of revenue," \$5,000,000.00, is exhibited on this trial balance.

Frequently, in cities of moderate size, and even in cities of large size, appropriations are made without proper provisions for new sources of revenues to meet the expenditures under such appropriations. We desire to make evident in these charts the necessary result of such action by city councils or other appropriating bodies. Hence this journal entry, which supposes that the appropriating body in this case has made additional appropriations to the extent of \$10,000,000.00, without providing additional revenue therefor. The journal entry would then be "Revenue Account 1910" debited with \$10,000,000.00, "Appropriations Account 1910" credited with \$10,000,000.00.

The condition of the general ledger accounts is shown lower down on Schedule 10, and it is seen that by this entry the "Revenue Account 1910," which prior to this entry had a credit balance of \$5,000,000.00, now has a debit or "deficiency" balance of \$5,000,000.00.

This is the point that I wish particularly to emphasize. It is the fact that in a very large number of our cities in all parts of the country action is frequently taken by appropriating bodies similar to that set forth above. The methods of accounting heretofore in vogue, however, do not exhibit the deficiencies of revenue thereby created. My point is that the accounts *should* exhibit such deficiencies automatically and promptly, so that proper remedial action may be taken by the municipal government and further unsound financing be avoided. The importance of this matter can scarcely be exaggerated. Such action is the reason, in my opinion, for the extension of municipal debts which has been going on in most of our cities far beyond the amount represented by public improvements or other additions to the properties (fixed assets) of the city. This deficiency of revenue demonstrates that the accounts of every municipality should be so devised that deficiencies of this nature should be shown automatically and without concealment. This is the argument which has caused me to have these charts prepared and to make this statement to you.

The importance of this matter is well shown in the City Auditor's printed statement of the city of Lynn, Mass., of which you now have copies. Turning to the first page of that statement, in the upper left-hand corner in the current assets, you will note the deficiencies of various years set forth. You will please note first that the deficiency of revenue 1908 is stated as \$78,386.21, while the deficiency of revenue 1909 is given as \$8,692.18. There is a difference between these two deficiencies of \$70,000.00, which means that \$70,000.00 less of borrowed money from long-term bonds was expended for running expenses in the year 1909 than was expended in the year 1908. The only reason why as much or more money was not expended in 1909 arises from

the fact that in the latter year these balance sheets were presented to the city council monthly, and these prospective deficiencies were clearly evident, whereas in the year 1908, before the new methods of accounting were installed, there was nothing in the monthly statements which could exhibit this important fact to the city government. Here is a saving of \$70,000.00 or more a year to future tax-payers in the city of Lynn, which would undoubtedly have been an additional burden upon them, had it not been for this monthly statement, published as now exhibited to you.

It will be noted further that the deficiency of revenue 1910 (if appropriations are fully expended) is expected to be \$9,772.21. This deficiency has been caused by bonds issued for revenue purposes shown on the opposite side of the account, amounting to \$10,000.00. The deficiency would be exactly \$10,000.00, had it not been that minor revenues have come in during the year to date, which diminish the deficiency to the amount stated in the balance sheet.

There are many other matters in this Lynn balance sheet which are interesting, and perhaps I should explain to you in the first place, turning to pages 2 and 3 of the statement, that the items set forth upon those pages are accumulated in the total set down in the lower right-hand corner in the last column but one, representing the balance of appropriations not yet expended at the date in question, September 30. The item \$353,586.73 on page 2 is made up of all the complication of accounts on that page, but it is exhibited in the balance sheet on page 1 as only *one* of the many items of liability. In addition to this item there are, as you see, a large number of other liabilities which are legal claims against the corresponding assets on the other side, and it is only when all of these liabilities are properly set up on the balance sheet in this way, contrasted with the available current assets, that we may know whether or not there are deficiencies of revenue and how much those deficiencies amount to.

I think you will see clearly, if you give careful attention to this division of the balance sheet, the fundamental nature of the methods of accounting which I have described and the insistence which professional accountants should place upon such an installation of ledger accounts as will give, without possibility of concealment, the true condition of the finances of every municipality at least as often as once a month.