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Basic conditions of surplus are contrast; opposites, as supply and demand; more of one thing than required. Conformably, commercial surplus is more net assets than required to equal the capital stock. The surplus is the excess net assets—not the balancing figure which shows the amount by which the dollar value of net assets exceeds the face value of capital stock. On a condensed balance-sheet we have a net-assets figure, a capital-stock figure and a resultant surplus figure. The surplus exists irrespective of this figure.

Standard dictionaries define corporate surplus as excess of net assets over par of capital stock—perhaps a tinge of technical significance but meaning no more than the word does in everyday talk. There is reason in so limiting the word in balance-sheet use, for when we say the total surplus is conglomerate and attempt to divide and separate the total we not only are inconsistent but at times face complications and difficulties almost, if not quite, insuperable. The factors from which we derive surplus are assets, liabilities and capital stock. If a portion of the assets can be offset against a portion of the result of the whole the dictionary definition is wrong. To set apart a portion of surplus against some one asset implies equality, the antithesis of surplus. To keep surplus to its proper place as a balancing figure, a mathematic, is to be consistent.

Few statements of absolute fact are possible on a balance-sheet. In one figure surplus is an exact statement of fact; separated, it is almost certain not to be. United it stands, divided it falls. As Mr. Justice Holmes said in *Edwards* v. *Chile Copper Co.* (270 U. S. 452) "we can not let the fagot be destroyed by taking up each item of conduct separately and breaking the stick. The activities and situation must be judged as a whole."

A noun is the name of a thing. It is difficult to conceive of surplus as a thing of itself. It has no qualities, color, size or shape. Having surplus cash you haven't surplus, you have cash; surplus energy is not more surplus than you need but more energy. Surplus is meaningless until related to some *thing*.

The word seems by its very nature to be adjectival, or at most, a pronoun.

Many courts have found occasion to define the word, and of these definitions the pronouncement of Mr. Justice Brandeis in *Edwards* v. *Douglas* (269 U. S. 204) is perhaps the best:

> "The word 'surplus' is a term commonly employed in corporate finance and accounting to designate an account on corporate books. . . . The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be 'paid-in-surplus', as where the stock is issued at a price above par; it may be 'earned surplus', as where it was derived wholly from undistributed profits; or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property."

As to banker's surplus, in *Leather Mfrs. Nat. Bank* v. *Treat* (128 Fed. 262), the court says, "When the statute uses it it does so with reference to the particular class of bankers to which alone it is applicable, and means the fund created by corporate or quasi-public institutions as an addition to or reinforcement of the share capital."

Banks do not differentiate surplus, they segregate a portion of it. With them the word has an accepted technical meaning which does not apply in corporation accounting. The bank separates its surplus into fluid and static, holding one available for dividends and the other not. That division is purely arbitrary—in no way based upon the origin of the surplus—and is analogous to the corporation stock dividend.

The interstate commerce commission's theory seems to be that while there is only one surplus it is divisible into two general classes by more or less arbitrary appropriation. That is, the commission attaches greater importance to destination than origin; to what is done with increment rather than to how it arose.

The National Association of Railway and Utilities Commissioners, terming surplus "profit and loss", define it as "The collective title for a small group of accounts which form the connecting link between the income account and the balance-sheet. Its principal function is to explain changes in the corporate surplus or deficit during a given fiscal period as affected, first, by the net results of all the transactions reported in the income account; second, by appropriations of surplus for specific purposes made at the option of the accounting company; and third, by special and unusual transactions or adjustments such as are not regularly recorded in the income account."

Accounting authorities seem to regard as important three descriptions of surplus:

1. That measuring the amount of assets available for distribution in dividends (one authority would have the word "surplus" used only in this way).
2. That which measures the dollar value of unnamed assets assumed to be isolated to a specified use or purpose.
3. That which indicates the source or origin of extraordinary increments (regardless of whether the assets indicated are present, in original or changed form, or have long since disappeared).

As to point 1, in separating surplus to show what is available for dividends do we mean:

(a) legally,
(b) physically (dependent on availability of cash or other asset for distribution), or
(c) practically (as a matter of policy; what the directors consider wise and justified)?

No one of these has any necessary relation to the balance remaining over from earnings; not only earned but paid-in, capital surplus, etc. being legally available; physical surplus having no significance apart from available assets and the uncertainties of determining what is practically available being obviously no fit subject for certification.

Must not we, therefore, abandon the idea that earned surplus necessarily has any connection with, or bearing upon, dividends?

Earned surplus does not tell what has been earned; what has been paid in cash dividends; what has been capitalized in stock dividends; the proportion of dividends to earnings; what legally may be paid out in dividends; what practically remains subject to dividends; what the directors regard as subject to dividends. If the balance-sheet figure of earned surplus speaks at all it is of something other than these things, for certainly here it is silent.

What, then, does it say? No more than to show what earnings have not been distributed, and that only if it is clearly known what really are earnings and only if dividends paid from other sources are excluded.

If "earned" were here an informative qualifying word it would have significance, but it is a negative qualification; it shows something which has not been done, not something which will be done; it is a limitation—not an exposition—and it fails to distinguish between the different limitations on dividends. Earned surplus is left over *from* dividends; not *for* dividends. Since surplus is the whole thing no added, connected, qualifying word can enlarge it; additions must be restrictive.

Regarding point 2, differentiation to show appropriation or impounding is more feasible because based on definite and readily ascertainable grounds, as the will or inclination of the directors. Thus a banker's surplus is clear-cut and well understood. But, however assigned or earmarked, it remains genuine surplus and the utmost balance-sheet separation which logically may be given it is to group it as:

Surplus:		
Appropriated	$100	
Unappropriated	50	
		$150

preserving the integrity of the one surplus figure.

When a part of surplus is segregated in qualification of an asset it is a reduction—not a separation—of surplus. A needed reserve, of course, is not surplus at all.

Concerning point 3, separation of surplus on the balance-sheet to show *how* the assets were acquired, nothing inherent in the word warrants or justifies using it to denote source or origin; it rather denotes a present state.

If appropriate to speak of a balance-sheet, as is often done, as a picture of a situation at a given instant of time, then like all pictures it can show only present existence—never source. A photograph takes the features as they are; why or whence does not register in the camera.

If we definitely adopt this view even the simplest condensed make-up of surplus commonly shown on a balance-sheet:

Surplus:		
Balance at beginning of year	$100	
Add: net income of the year	30	
	130	
Deduct: dividends paid	20	
		$110

is illogical and out of place. As a present picture we must conclude that no such presentation of surplus is permissible, that the one total figure of surplus is the only true balance-sheet figure and with that the balance-sheet is complete. With no surplus figure at all the picture would not be disturbed except mathematically.

The source of an asset neither determines nor indicates its money value or its useful worth. If you have a worn-out motor-car that is what you have, whether purchased with your own hard-earned money or a gift from your father-in-law.

But under this view important information is excluded from the balance-sheet, and restrictive innovation in balance-sheet construction is to be well considered and adopted with caution. Yes, but, first, all this information, and more, can be submitted in a surplus-account statement supporting the balance-sheet figure, and, second, much of the information could be retained in the balance-sheet without offending the above conception. For example, if we had this situation:

Cost of plant and equipment	$1,000	
Excess of appraised value of plant and equipment over cost	100	
Cost of inventory	400	
Excess of cost of inventory over market value		$ 30
Cost of marketable securities	500	
Excess of market value of securities over cost	40	
Cash	200	
Share capital outstanding in stock certificates		1,000
Amount of cash contributed at organization		100
Premium received on capital stock sold for cash		100
Appreciation surplus		110
Total earnings, less total dividends paid		900

it would properly enough appear in the picture thus:

Plant and equipment, at cost (appraised value $1,100)	$1,000	
Inventory, at cost (replacement value $370)	400	
Marketable securities, at cost (market value $540)	500	
Cash	200	
Capital stock		$1,000
Surplus (of which $ is legally available for dividends)		1,100

This offends no balance-sheet principle; in each instance the two figures are present views but from a different angle, a photograph taken in two positions.

To tag each asset or group of assets with "acquired through operation", "contributed by stockholders", etc. would show the source, but the fact that to keep this up is clearly outside the realms of the possible only serves to show how equally difficult it is to express the same thing by figures on the liability side of the balance-sheet.

The simplest form to which corporate status can be reduced is expressed in two figures:

Net assets	$10,000
Number of capital shares outstanding	100

These consist of three main elements:

Possessions (property and rights owned)
Obligations (rights owing)
Ownership (stockholders' equity)

of which the most concrete balance-sheet expression would be:

Total assets	$15,000
Total liabilities	5,000
Proprietorship	10,000

In dividing and re-dividing these three we face the first problem of balance-sheet expression—to what extent is division informative, practicable, reasonable and logical; not how much can we find to say, but how little and say it all. Good balance-sheet construction is a matter of compression. That a balance-sheet should be made as full, clear and explicit as possible needs no argument, but how to achieve it is quite another matter. Of this one thing only are we certain, that wealth of detail is far from the correct answer.

It is first to be noted that while assets and liabilities are divisible according to their nature (character, condition, situation, relation, use, etc.) proprietorship is of one indivisible nature and can be separated only as to form; that portion which is formally fixed in representative shares and that which is not. Surplus is not a thing in the sense that ownership is; it is an arbitrary division of the latter; it may be increased or decreased at will. Ownership is fixed, alike with assets and liabilities. We can not change the true value of cash by writing it up or down, nor if we truly owe John Smith $100 do we reduce that obligation by transfer to an account of other name.

For a balance-sheet we set down on a sheet of paper words descriptive of, and figures representing, things, rights and obligations. As a fact exhibitor the sheet is then complete—it shows all the stockholders have and all they owe—but it is unsymmetrical and incomplete mathematically. We add the par value of capital stock and still it is mathematically lacking, so we add a figure and make it a *balanced* sheet. That correlative and reciprocal figure is a complement, an adjunct, and we call it surplus, with a meaning akin to the legal "surplusage" which "implies that the superfluous matter is such that its omission would not impair the true meaning nor the right of the party".

The saying "surplus can not be bought" rests squarely on the fact that it is a figure, and a figure is not a marketable product.

Surplus of the commonest origin arises from the commercial exchange of an asset from terms of cost into another in terms of greater money value.

	We have at one date	at a later date	and at a still later date
Merchandise....................	$100		
Accounts receivable..............		$150	
Cash..........................			$147
Capital stock....................	100	100	100

This is complete as to the facts—we owned merchandise, sold it, and the purchaser discounted payment—but incomplete for our purpose. By force of necessity as well as for reasons of convenience we want more; we need a balance figure to prove each step of the transaction, and it is convenient to know what the resultant balance figure represents. These are clearly two distinct things. We insert the balance figures arbitrarily and we keep a separate historical record of how the gain arose, thus:

Sales................................	$150
Cost.................................	100
	$ 50
Cash discount.........................	3
Net income...........................	$ 47

If we refuse to believe the $47 is nothing more than a balancing figure and feel it must have other significance the furthest we can get is that it is a measure of the gain. The gain itself is in cash. The balance figure is analogous to the pound weight in a scale which on the opposite side supports a pound of butter. The weight represents the butter only in terms of avoirdupois—and so the net income represents the excess of assets only in terms of dollars.

The transaction produces income and repeated incomes produce surplus. Surplus, of course, comes about in other ways too, exchange of goods for goods, assets received gratuitously, liabilities forgiven, or natural increase, but however it arises it is always the same in principle and in the last analysis an increase in net assets.

Commercial surplus, broadly speaking, is generated:

1. By forces within the organization;
   (a) through specific operation—earnings
   (b) acquired by other efforts—specific or due to the organization's progress and improvement

2. By forces without the organization;
   (a) contributed by nature—natural increase
   (b) contributed by man—assets paid-in, liabilities remitted or by general progress and improvement

Any and all such increment settles into increase in net assets.

If, then, surplus can not be anything in and of itself other than a balancing figure we must dismiss the idea that a consecutive history of transactions is or has any relation to surplus and regard such history as the story of the changes in net assets which happens, by reason of our adoption of the perfect-balance idea, to end with the surplus figure.

We can not escape the fact that the balance-sheet is an arrival, not a history, nor the other fact that the history of an enterprise is of prime interest and importance. Nor the third fact that the two are fundamentally different and not mergeable.

Surplus is a stream of transactions and occurrences sounded by the balance-sheet; their relative positions thus:

———|———

We leave Syracuse in the early morning and all day long travel leisurely along a broad smooth highway, now overhung with rocks, now arched with shading trees, past shiny little lakes, along racing brooks and at dusk come to Erie. Those are our impressions and remembrances. In balance-sheet form we were "at Syracuse in the morning, at Erie at night".

Suppose the story of a given enterprise to be this:

The organizers paid in assets for capital stock whose value exceeded par of the stock by	$100
The company prospered and earned from operation	500
This enabled it to sell further stock at a premium of	50
The company found a part of its land and buildings no longer needed for successful operation and sold them for an amount in excess of depreciated cost value of	300
It then had the plant appraised and found the book cost less than appraised cost by	25
	$975
It then retired the preferred stock at a premium of	30
	$945
Paid a stock dividend of	200
	$745
And paid cash dividends of	100
Leaving the difference between the dollar value of net assets and par of outstanding stock at the balance-sheet date	$645

Can we condense that story into two or three figures on the balance-sheet and lose nothing of it? Or shall we, by a separate surplus account, report all that happened during the year, the earnings, dividends thereon, dividends from other sources, various increments of other origin than earnings, etc? Or go even further and, on the theory that a business has only the one true period of operation—from its inception to its close—make the surplus account cover the elapsed portion of that period? For example, let us take a business having a sole unit of production such as a brewery or an oil-producing company—perhaps the latter as more becoming at present.

	From organization (Jan. 1, 1919) to Dec. 31, 1927, 9 years	Year ended Dec. 31, 1928	Total for 10 years
Barrels of oil sold	3,370	170	3,540
Sales of oil	$3,590	$180	$3,770
Cost of oil sold	1,788	101	1,889
	$1,802	$ 79	$1,881
Depreciation	337	17	354
	$1,465	$ 62	$1,527
Deduct: federal taxes (income and capital stock)	83	5	88
	$1,382	$ 57	$1,439
Deduct: interest paid	16	4	20
Net income	$1,366	$ 53	$1,419
Premium on capital stock issued for convertible bonds		100	100
Realized from sale of capital assets	50	10	60
Surplus paid in at organization	100		100
	$1,516	$163	$1,679
Dividends declared	1,200	50	1,250
Credit balance of surplus account per balance-sheet	$ 316	$113	$ 429

Is not undue significance now given to the balance-sheet and too little to the surplus and income account? Although the balance-sheet is in the foreground of financial statements it is of secondary importance to the stockholder unless it shows values from a producing, as well as a security, viewpoint; he is mainly interested in earning power and dividend probabilities. We can even imagine a stockholder's contentment with some such balance-sheet as this:

	Assets	*Liabilities*
Permanent assets, necessary working capital and management	Power to earn annually $ per share	
Cash and its equivalent not needed in the business	$1,000,000	
Stockholdings		10,000 shares

In practice surplus is differentiated on the balance-sheet:

1. In words and figures—by separating the total figure into parts and to each part attaching appropriate wording which
   (a) admits the parts are surplus—as earned paid-in, capital, appropriated, etc.
   (b) ignores that the parts are surplus—as reserves for dividends, contingencies, insurance, etc.
2. In words only—by showing only the one total figure but describing it as earned, free, corporate, etc.

Lest the reader think this question of showing surplus on the balance-sheet purely academic, consider the following terms expressive of surplus taken from a handful of 1928 reports of industrials picked at random:

Surplus
Surplus account
Profit and loss
Profit-and-loss surplus
Profit-and-loss balance, being excess of assets over liabilities
Net worth
General surplus
Accumulated surplus
Further surplus
Earned surplus
Free surplus
Surplus—appropriated
Surplus—unappropriated
Corporate surplus appropriated
Corporate surplus unappropriated
Capital surplus
Paid-in surplus
Special surplus
Property surplus
Surplus arising from appreciation of properties
Reserve for dividends
Reserve for contingencies
Insurance-account surplus

Clearly, then, it is a proper question to bring before the bar of accounting opinion for discussion. We know little of the forces which impel a people to clothe its words in that precise meaning essential to the intelligible interchange of thought and idea, but we do know, as the great Burke has said, that "Writers, especially when they act in a body and with one direction, have a great influence on the public mind."

Accountants of one mind in desiring to make the balance-sheet full, clear and explicit may yet differ as to the appropriate means to that end; different roads may conscientiously be traveled to reach a common goal, but the road must reach that goal or we wander in by-paths. A balance-sheet which does not carry the intended impression fails to register and falls short of its goal. A balance-sheet, like a quarrel, takes two to make it effective. One must give it out in form and language such as the other will take in.

As concerns the public, our financial statements are the finished product and by them are we judged. To seek uniformity, shun technicality and speak in words generally understood may be heretical doctrine for a profession, but a very young one can afford to depart, might even be commended for departing, from the ingrained practice of the older professions in that respect.