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# An Accounting Perspective of Society

BY EDMOND GATTONE

In the present era of world-wide economic distress and the consequent experimentation to rehabilitate and coördinate the forces of production and consumption, it becomes of paramount importance that the nature and relationship of such basic concepts as wealth, savings, profits and income be clearly defined and understood. Here, I believe, the accountant has a fertile field for research and constructive thought. As the science of accountancy has correlated to a degree of exactitude the property, income, expenses, obligations and ownership of an individual business or chain of affiliated businesses, so it would seem that this same science could be extended to show with mathematical clarity the balanced relationship in a society of its wealth, distribution of wealth, social institutions and economic activity. Today, of course, relatively meager and inadequate sources of statistical information would make the practical execution of such a plan virtually impossible. Nevertheless, I believe a theoretical discussion of procedure would be justified if for no other purpose than to demonstrate the potential application of accounting methods as an aid to the solution of social and economic problems.

This discussion will of necessity be based on a hypothetical case. Because of the extensive scope of such an analysis, the limitations of space will permit the assumption of relatively few facts and a very broad and general classification of social institutions and economic activity.

We shall commence with a society having a total population of 1,000 persons. This society has been organized into a political community or state. The functional agencies of the state will be known as the government. As the economy of the social system is essentially laissez-faire, or individualistic, the activities of the government do not transgress the field of private initiative, but are confined to such constituent functions as national defense, administration of justice, regulation of property rights, coinage of money, etc.

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The economic activity of the society may be summarized into three very broad classifications as follows:

1. Production.
2. Distribution.
3. Banking and credit.

Production consists of all processes combining human labor with technological skill and equipment and designed to transform natural resources either directly or indirectly into consumable goods and services. In this sense production includes all phases of agricultural and industrial activity such as farming, animal raising, mineral extraction, forestry, manufactures, power generation, building construction, transportation of raw materials and goods in process, etc. All production activities of the society are vested in private ownership and for the sake of simplification will be grouped into a single business unit known as "production industries."

The functions performed by those enterprises handling, buying and selling, marketing and merchandising the finished goods turned out by the production industries are defined as distribution. As here used, distribution includes the operations of wholesalers, retailers, commission merchants, etc., and the storage and transportation of finished goods. The ownership and management of distribution facilities are vested in private interests and for the purpose of simplifying the discussion all distribution activities in the society will be grouped into a single business unit known as "distribution enterprises."

To fill the need for elastic credit, essential to a highly organized system of exchange, and to serve as a depository for surplus funds, a banking institution has been organized. Pertinent facts relating to the economic conditions of the society at the beginning of our period of review, say, January 1, 1926, are as follows:

*Exhibit 1*

The government  
Balance-sheet, January 1, 1926

<i>Assets</i>	
Gold bullion held in trust against gold certificates—contra . . . . .	\$ 40,000
Bank deposit . . . . .	2,000
Foreign government loans . . . . .	10,000
Gold certificates held in trust to redeem bank notes—contra . . . . .	600
3½% government bonds held in trust to secure bank notes—contra . . . . .	12,000
Public improvements and properties—250 units . . . . .	250,000
Total . . . . .	<u>\$314,600</u>

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*Liabilities*

Gold certificates outstanding secured by gold bullion—contra . . . . .	\$ 40,000
Greenback currency outstanding . . . . .	23,000
Public debt—evidenced by 3½% interest-bearing bonds . . . . .	155,850
Liability for gold certificates held in trust to redeem bank notes— contra . . . . .	600
Liability for 3½% government bonds held in trust to secure bank notes—contra . . . . .	12,000
Surplus . . . . .	83,150
Total . . . . .	\$314,600

Exhibit 1 sets forth the financial condition of the government as at January 1, 1926, and the status of its trust funds as of that date. All gold bullion in the society has been deposited in trust with the government treasurer and gold certificates (a kind of money or currency) have been issued against such deposits. The gold certificates are redeemable on demand in gold specie. The status of the gold bullion trust is depicted by the following items in exhibit 1:

*Asset:*

Gold bullion held in trust against gold certificates—contra . . . . .	\$40,000
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*Liability:*

Gold certificates outstanding secured by gold bullion—contra . . . . .	\$40,000
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The banking institution is empowered to issue bank notes (another kind of money or currency) on condition that an equal face amount of government bonds, together with gold certificates equal to 5 per cent. thereof, be deposited as security for such issue with the government treasurer. The status of the trust securing the bank circulation is described as follows in exhibit 1:

*Assets:*

Gold certificates held in trust to redeem bank notes—contra . . . . .	\$ 600
3½% government bonds held in trust to secure bank notes— contra . . . . .	12,000

*Liabilities:*

Liability for gold certificates held in trust to redeem bank notes— contra . . . . .	\$ 600
Liability for 3½% government bonds held in trust to secure bank notes—contra . . . . .	12,000

A third kind of money in circulation in the society consists of greenbacks or legal tender notes issued by the government. This greenback currency, although not secured by a specific fund, is protected by the general taxing powers of the government.

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The liability of the government for this greenback issue is denoted in exhibit 1 as follows:

Greenback currency outstanding . . . . . \$23,000

In order to finance the construction and acquisition of public improvements and properties deemed necessary to efficient governmental administration and the public welfare, the government has floated long-term interest bearing bonds. The total amount of this bonded indebtedness is shown in exhibit 1, as follows:

Public debt—evidenced by 3½% interest-bearing bonds . . . . . \$155,850

The quantitative inventory of public improvements and properties has been designated in exhibit 1 as “250 units,” the cost value of which is \$1,000 per unit, or \$250,000.

To meet the emergencies arising in a past warfare, loans to the amount of \$10,000 were granted to allied foreign governments. These loans bear interest at the rate of 5 per cent. per annum, payable in gold.

The \$2,000 current operating fund of the government, as is indicated by exhibit 1, has been deposited with the banking institution.

The excess of the government’s assets over its liabilities amounts to \$83,150 and has been denoted as surplus in exhibit 1. Each member of the society has an equal, nontransferable, beneficial interest in the government’s surplus. The ownership of this beneficial interest, although real, is not evidenced by an instrument or certificate in writing, as is usually the case with other classes of property rights.

*Exhibit 2*

The bank  
Balance-sheet, January 1, 1926

<i>Assets</i>	
Gold certificates in vault . . . . .	\$ 39,400
Loans . . . . .	60,000
Gold certificates deposited in redemption fund with government treasurer . . . . .	600
3½% government bonds deposited with government treasurer to secure note circulation . . . . .	12,000
Total . . . . .	\$112,000

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<i>Liabilities</i>	
Deposits.....	\$ 74,000
Circulation.....	12,000
Capital stock.....	20,000
Surplus.....	6,000
	<hr/>
Total.....	\$112,000

Exhibit 2 is a statement of resources and liabilities of the banking institution as at January 1, 1926. The law of the society has prescribed gold certificates as the legal reserve for the bank and such reserve is not to be less than 10 per cent. of the outstanding deposit liability. In exhibit 2 it will be noted that gold certificates in the vault as at January 1, 1926, aggregated \$39,400, as against deposits of \$74,000, or a reserve ratio of 53.24 per cent.

As already mentioned, the circulation of bank notes must be secured by an equal amount of government bonds, together with a 5 per cent. redemption fund deposited with the government treasurer. The status of the bank's circulation, together with the trust funds set aside as security therefor, is described as follows, in exhibit 2:

*Assets:*

Gold certificates deposited in redemption fund with government treasurer.....	\$ 600
3½% government bonds deposited with government treasurer to secure note circulation.....	12,000

*Liabilities:*

Circulation.....	\$12,000
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It will be noted from exhibit 2 that the loans of the banking institution aggregated \$60,000 on January 1, 1926. As an increase in loans is offset by a corresponding increase in deposits, or a withdrawal of cash, the over-extension of bank credit is held in check by the minimum legal reserve requirement.

The capital stock of the bank is privately owned and the stockholders' equity, which is represented by capital stock and surplus aggregating together \$26,000, serves as a margin of safety to depositors.

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*Exhibit 3*

Production industries balance-sheet, January 1, 1926

<i>Assets</i>	
Bank deposits . . . . .	\$ 30,000
Production equipment and properties—800 units . . . . .	800,000
Natural resources—750,000 units . . . . .	750,000
<hr/>	
Total . . . . .	\$1,580,000
<i>Liabilities</i>	
Notes payable—bank . . . . .	\$ 50,000
6% bonds payable . . . . .	150,000
Capital stock . . . . .	1,380,000
<hr/>	
Total . . . . .	\$1,580,000

Exhibit 3 sets forth the financial condition of the production industries as at January 1, 1926. All natural resources of the society such as land, mineral deposits, forest reserves, water power, etc., are privately owned by the production industries. The quantitative inventory of these resources has been designated in exhibit 3 as 750,000 units, the value of which is \$1 per unit or \$750,000.

All tools, technological equipment, and building structures used in production activities are also owned by the production industries and, as will be noted in exhibit 3, aggregate 800 units valued at \$1,000 per unit, or \$800,000.

Partly to finance the acquisition of natural resources and the construction of plant and equipment, bonds to the amount of \$150,000 have been floated. The balance of the financing has been completed through the sale of capital stock, which aggregated \$1,380,000.

Although the working capital of the production industries amounts to \$30,000 and has been supplied through the medium of bank credit, the relative bank obligation aggregates \$50,000 and constitutes a floating debt to the extent of \$20,000.

*Exhibit 4*

Distribution enterprises balance-sheet, January 1, 1926

<i>Assets</i>	
Bank deposits . . . . .	\$ 8,000
Consumable goods—150,000 units . . . . .	150,000
Distribution facilities—225 units . . . . .	225,000
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Total . . . . .	\$383,000

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*Liabilities*

Notes payable—bank.....	\$ 10,000
Capital stock.....	373,000
	<hr/>
Total.....	\$383,000

The finished goods and services turned out by the production industries are marketed or distributed to the persons comprising the society by the distribution enterprises. To perform the functions of distribution certain facilities are necessary, such as sales buildings, display counters, showrooms, warehouses, delivery vehicles, etc. These distribution facilities as set forth by exhibit 4 aggregate 225 units valued at \$1,000 per unit or \$225,000.

The merchandise inventory carried by the distribution enterprises consists of goods wholly processed and ready for human consumption. It will be noted from exhibit 4 that the consumable goods on hand at January 1, 1926, amounted to 150,000 units valued at \$1 per unit or \$150,000.

Aside from the fact that a portion of the working capital has been procured through bank credit, the distribution enterprises have been financed solely through the medium of capital stock, all of which is privately owned.

THE POPULATION

As has been previously mentioned, the population of the society consists of 1,000 persons. For the sake of simplification, the economic class structure of the population may be divided into two very broad groups as follows:

	Number
Investor class.....	100
Worker class.....	900
	<hr/>
Total.....	1,000

The investor class comprises persons who have supplied the necessary capital to operate the private enterprises and therefore are vested with the legal ownership, control and management of such enterprises. Whether the investors accumulated their capital through the medium of honest savings, speculative profits or other methods is not material in this discussion.

The worker class is composed of all persons engaged in skilled or unskilled occupations, whose primary source of income is derived from wages or salaries earned from such occupations.



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The employment of the worker class is distributed as follows in the society:

	Number employed
The government.....	26
The bank.....	3
Production industries.....	820
Distribution enterprises.....	51
Total.....	900

Exhibit 5 is a balance-sheet of January 1, 1926, of the investor class. This balance-sheet was constructed by combining or consolidating the balance-sheets of all the persons comprising that class. Exhibit 6 is a balance-sheet of January 1, 1926, of the worker class and was also prepared by combining or consolidating the balance-sheets of all the workers in the society.

*Exhibit 5*

Investor class—100 persons  
Balance-sheet, January 1, 1926

<i>Assets</i>		
Bank deposits.....	\$ 2,000	
Greenback currency.....	3,000	
Stocks owned at book values:		
Bank.....	\$ 26,000	
Production industries.....	1,380,000	
Distribution enterprises.....	373,000	1,779,000
Production industries 6% bonds at par.....		150,000
Total.....		\$1,934,000
<i>Liabilities</i>		
Net worth.....		\$1,934,000

As will be noted from exhibit 5, the investor class owns all the outstanding capital stock of the production industries, the distribution enterprises and the bank. Through the medium of this stock ownership this class is vested with direct control of the production, distribution and credit facilities within the society, subject of course to certain prescribed governmental regulations.

All the outstanding bonds of the production industries are also owned by the investor class. It might be observed that a

relatively small proportion of the resources of the investor class is kept in liquid form, i.e., in the form of cash and bank deposits.

*Exhibit 6*

Worker class—900 persons  
Balance-sheet, January 1, 1926

<i>Assets</i>	
Bank deposits . . . . .	\$ 32,000
Greenback currency . . . . .	20,000
Bank notes . . . . .	12,000
3½% government bonds . . . . .	143,850
Total . . . . .	<u>\$207,850</u>
<i>Liabilities</i>	
Net worth . . . . .	\$207,850

From exhibit 6 it will be noticed that the resources of the worker class are highly liquid, consisting of bank notes, greenback currency, bank deposits and government bonds. The exigencies of day-to-day existence do not permit this class, with its relatively limited surplus, to risk the hazards of more speculative investments.

#### SOCIAL WEALTH

In considering wealth in a social sense it is important to distinguish between the physical objects of wealth and the superstructure of claims existing against such objects of wealth. Claims for wealth bear a dual position, being at once an asset to the claimant and a liability to the obligor. When both the claimant and the obligor are members of the same society, then the claim asset of one is offset by the claim liability of the other and, in a social sense, no wealth or obligation exists. However, should the claimant and the obligor be members of different societies, then the claim is at once wealth to one society and an obligation to the other.

Exhibit 7 is a summary of balance-sheets showing the manner of combining and consolidating the wealth of all the institutions and persons comprising the society on January 1, 1926. All claims for wealth wherein both the claimant and the obligor are members of the society have been eliminated in the column headed, "Intra-society eliminations." It will be noted that such items as bank deposits, loans, gold certificates, bank notes, greenback currency, trust accounts, bonds and stocks constitute

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Exhibit 7

The society balance-sheets, January 1, 1926

	The government	The bank	Production industries	Population		Distribution enterprises	Intra-society eliminations	Social balance-sheet
				Investor class	Worker class			
<i>Assets</i>								
Gold bullion.....	\$ 40,000							\$ 40,000
Deposits in bank.....	2,000	\$ 39,400	\$ 30,000	\$ 2,000	\$ 32,000	\$ 8,000	\$ 74,000 (A)	
Gold certificates.....		600					39,400 (B)	
Gold certificates—redemption fund.....	600						600 (C)	
Gold certificates in trust.....				3,000	20,000		600 (B)	
Greenback currency.....							23,000 (D)	
Bank notes.....					12,000		12,000 (E)	
Government bonds.....		12,000			143,850		143,850 (F)	
Government bonds—with treasurer.....	12,000						12,000 (G)	
Government bonds—in trust.....	10,000						12,000 (F)	
Loans.....		60,000					60,000 (H)	
Foreign government loans.....				150,000			150,000 (I)	10,000
Production industries—6% bonds.....				1,779,000			1,779,000 (J)	
Stocks at book values.....			150,000					150,000
Consumable goods—150,000 units.....			225,000					225,000
Distribution facilities—225 units.....								
Production equipment and properties—800 units.....	250,000		800,000					800,000
Public improvements and properties—250 units.....			750,000					750,000
Natural resources—750,000 units.....								
Totals.....	\$314,600	\$112,000	\$1,580,000	\$1,934,000	\$207,850	\$383,000	\$2,306,450	\$2,225,000
<i>Liabilities</i>								
Gold certificates outstanding.....	\$ 40,000							\$ 40,000 (B)
Greenback currency outstanding.....	23,000							23,000 (D)
Circulation.....		\$ 12,000	\$ 50,000			\$ 10,000		12,000 (E)
Notes payable—bank.....		74,000						60,000 (H)
Deposits.....								74,000 (A)
Liability for gold certificates in trust.....	600							600 (C)
Liability for government bonds in trust.....	12,000		150,000					12,000 (G)
6% bonds payable—production industries.....	155,850							150,000 (I)
Public debt.....		20,000	1,380,000			373,000		155,850 (F)
Capital stock.....	83,150	6,000		\$1,934,000	\$207,850			\$ 83,150
Surplus.....								6,000 (J)
Net worth.....				\$1,934,000	\$207,850			2,141,850
Totals.....	\$314,600	\$112,000	\$1,580,000	\$1,934,000	\$207,850	\$383,000	\$2,306,450	\$2,225,000

mere offsetting claims for wealth and form no part of the social wealth. However, in the case of foreign government loans, as the obligor (a foreign government) is not a member of the society under review, such loans are a part of the social wealth. As shown by exhibit 7 in the column headed, "Social wealth," the balance of the items constituting the actual wealth of the society are the natural resources, public improvements, production equipment, distribution facilities, inventories of consumable goods and gold bullion.

DISTRIBUTION OF WEALTH

Having determined what constitutes social wealth, we may next consider its distribution among the persons in the society and the particular claims for wealth evidencing and affecting this distribution. In the society under review, both persons and institutions are owners of claims for wealth. Obviously, however, the claims for wealth owned by persons determine the distribution of social wealth and not the claims for wealth owned by institutions. Hence, each person's share in the social wealth is measured and evidenced by the amount of his bank deposits, currency, bank notes, bonds and shares of stock.

*Exhibit 8*

Social balance-sheet, January 1, 1926  
Social wealth

Gold bullion . . . . .	\$	40,000
Foreign government loans . . . . .		10,000
Consumable goods—150,000 units . . . . .		150,000
Distribution facilities—225 units . . . . .		225,000
Production equipment and properties—800 units . . . . .		800,000
Public improvements and properties—250 units . . . . .		250,000
Natural resources—750,000 units . . . . .		750,000
Total . . . . .		\$2,225,000

Distribution of wealth

Ownership of worker class (900 persons) evidenced by:		
Bank deposits . . . . .	\$	32,000
Greenback currency . . . . .		20,000
Bank notes . . . . .		12,000
Government bonds at par . . . . .		143,850
900/1000ths of government surplus . . . . .		74,835
		\$ 282,685

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Ownership of investor class (100 persons) evidenced by:

Bank deposits . . . . .	\$ 2,000	
Greenback currency . . . . .	3,000	
Stocks at book values . . . . .	1,779,000	
Production industries 6% bonds at par . . . . .	150,000	
100/1000ths of government surplus . . . . .	8,315	<u>\$1,942,315</u>
Total . . . . .		<u>\$2,225,000</u>

Exhibit 8 has been designated a "social balance-sheet" and purports to show the actual wealth of the society, its distribution and the claims for wealth affecting this distribution. It is important to notice that to account for all wealth the beneficial interest in the government's surplus, shared equally by all, has been included among the claims for wealth. As an estimate of the value of this item would serve no practical purpose, it is generally ignored in the preparation of a person's balance-sheet.

It will be noted from exhibit 8 that of the total social wealth valued at \$2,225,000, \$282,685, or 12.7 per cent., is owned by the worker class and \$1,942,315, or 87.3 per cent., is owned by the investor class. The aggregate value of the bank deposits, bank notes, greenback currency, bonds, stocks and government surplus, owned by all the persons in the society is equal to the aggregate value of the social wealth.

### ECONOMIC ACTIVITY

The next phase of discussion concerning the society will deal with its economic activity during the calendar year 1926 and the effect of this activity on the social wealth of the close of the year. Pertinent facts concerning activities during 1926 may be reviewed in the following order:

#### THE GOVERNMENT

The sources of governmental revenues are twofold, consisting of taxes levied on domestic industries and enterprises and interest collected on loans granted to foreign governments. Disbursements are appropriated for departmental salaries and wages, interest on the public debt and the construction of public improvements. The government balanced its budget for the year 1926, as will be observed from the following:

#### Budget—for the year 1926

*Receipts:*

Taxes . . . . .	\$45,954.75
Interest on foreign loans . . . . .	500.00
Total . . . . .	<u>\$46,454.75</u>

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*Expenditures:*

Departmental salaries and wages . . . . .	\$39,000.00
Interest on the public debt . . . . .	5,454.75
Public improvements—2 units . . . . .	2,000.00
	\$46,454.75
Total . . . . .	\$46,454.75

As will be recalled, the number of governmental employees is 26 and the average annual salary of each employee amounts to \$1,500, or \$39,000 in the aggregate. Interest on the public debt is paid at the rate of 3½ per cent. per annum.

During the year the government awarded contracts to the production industries for the construction of two units of public improvements at a total contract price of \$2,000.

A statement of the government's income and expense for the year 1926 is as follows:

*Exhibit 9*

The government  
Summary of income, year 1926

Income:	
Taxes . . . . .	\$45,954.75
Interest on foreign loans . . . . .	500.00
	\$46,454.75
Expenses:	
Departmental salaries and wages . . . . .	\$39,000.00
Interest on the public debt . . . . .	5,454.75
	44,454.75
Net income . . . . .	\$ 2,000.00

It will be noted that the government enjoyed a net income of \$2,000 during the year, which increased the surplus from \$83,150 at the beginning of the year to \$85,150 at the end.

THE BANK

Practically all business transactions of institutions, as well as of persons in the society were consummated through the mechanism of banking facilities, i.e., by the deposit and drawing of cheques. At the close of the year 1926 the bank's resources showed an increase of \$222,500, which consisted of the following:

Increase in gold certificates in vault . . . . .	\$ 2,500
Increase in loans . . . . .	220,000
	\$222,500
Total . . . . .	\$222,500

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The increase in gold certificates is accounted for by the transfer of gold bullion into the society from foreign countries in settlement of the following items:

Interest on foreign government loans.....	\$ 600
Net excess of exports over imports.....	2,000
	\$2,600
Total.....	\$2,600

Upon receipt of the gold bullion, the government treasurer issued \$500 gold certificates to the government and \$2,000 gold certificates to the distribution enterprises. These certificates were accordingly deposited in the bank.

To finance purchases of consumable goods made by the distribution enterprises from the production industries, bank loans to the distribution enterprises were increased by \$220,000 during the year.

A statement of the bank's income and expense for the year 1926 follows:

*Exhibit 10*

The bank  
Summary of income, year 1926

Income:	
Interest on loans.....	\$11,900
Interest on government bonds.....	420
Foreign exchange service charges.....	300
	\$12,620
Expense:	
Salaries and wages.....	4,500
	\$ 8,120
Net income.....	\$ 8,120
Dividends paid to stockholders.....	3,000
	\$ 5,120
Undivided profits.....	\$ 5,120

Three employees are engaged by the bank at an annual salary cost of \$1,500 for each employee, or \$4,500 in the aggregate. Interest was not paid on deposits because all deposits are payable on demand.

It will be noted that the bank's income was derived from interest on loans and government bonds and charges made for foreign exchange services. Of the net income of \$8,120, \$3,000 was paid to stockholders as a dividend and the balance was carried as undivided profits.

PRODUCTION INDUSTRIES

The activities of the production industries may be divided into two basic operations as follows:

1. Direct production of consumable goods and services.
2. Indirect production, i.e., the construction of capital equipment, tools, improvements, etc.

During 1926 the production industries gave employment to 820 persons at an average salary or wage cost of \$1,500 per annum, or \$1,230,000 for the total number employed. This total wage or labor cost may be allocated to direct and indirect production as follows:

Labor costs applicable to direct production of consumable goods..	\$ 964,230
Labor costs applicable to construction of improvements, facilities and equipment.....	265,770
	<hr/>
Total.....	\$1,230,000

During the year the production industries extended their own plant and equipment by 250 units and, under duly awarded contracts, constructed two units of public improvements for the government and twenty units of distribution facilities for the distribution enterprises. Total labor costs for construction during the year may be divided among these three classes of extensions as follows:

	Labor costs
Production equipment—250 units.....	\$249,600
Public improvements—2 units.....	1,470
Distribution facilities—2 units.....	14,700
	<hr/>
Total.....	\$265,770

To finance the construction of its 250 units of production equipment, the production industries floated \$250,000 par value 6 per cent. bonds. These bonds were subscribed by the worker class.

The total cost of the 250 units of production equipment consists of the following elements:

Labor.....	\$249,600
Depletion of natural resources.....	400
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	\$250,000



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Statement of operations of the production industries covering the year 1926 follows:

*Exhibit 11*

Production industries				
Summary of operations, year 1926				
	Construction government— 2 units	Contracts distribution enterprises— 20 units	Consumable goods— 1,288,000 units	Total
Sales . . . . .	\$2,000.00	\$20,000.00	\$1,288,000.00	\$1,310,000.00
Cost of sales:				
Labor . . . . .	1,470.00	14,700.00	964,230.00	980,400.00
Depletion . . . . .	.90	9.00	590.10	600.00
Depreciation . . . . .	72.00	720.00	47,208.00	48,000.00
Taxes . . . . .	371.43	3,714.37	20,676.70	24,762.50
Less, consumable goods in process	. . . . .	. . . . .	(25,000.00)	(25,000.00)
<b>Total cost of sales . . . . .</b>	<b>\$1,914.33</b>	<b>\$19,143.37</b>	<b>\$1,007,704.80</b>	<b>\$1,028,762.50</b>
Gross profit on sales . . . . .	\$85.67	\$ 856.63	\$ 280,295.20	\$ 281,237.50
Interest expense:				
Notes payable . . . . .				\$ 3,500.00
Bonds payable . . . . .				17,125.00
<b>Total interest expense . . . . .</b>				<b>\$ 20,625.00</b>
Net profit for year . . . . .				\$ 260,612.50
Dividends paid to stockholders . . . . .				230,000.00
<b>Undivided profits . . . . .</b>				<b>\$ 30,612.50</b>

It will be observed from exhibit 11 that the major portion of gross profits earned by the production industries was derived from the production and sale of 1,288,000 units of consumable goods. These goods were sold directly to the distribution enterprises and not to consumers. The entire selling price was collected for all but \$50,000 of consumable goods sold. This uncollected amount was charged to an open account to the distribution enterprises.

A net profit of \$260,612.50 was earned during 1926, from which \$230,000 dividends were distributed to stockholders, leaving \$30,612.50 undivided profits in the industries.

DISTRIBUTION ENTERPRISES

All consumable goods and services produced within, exported from or imported into the society are marketed to consumers by the distribution enterprises. It will be observed from exhibit

12 that the 1,636,000 units of consumable goods available for sale or consumption during 1926 were disposed of as follows:

	Units
Sold to domestic population (workers and investors).....	1,024,000
Exported.....	160,000
Unsold (closing inventory).....	452,000
	<hr/>
Total.....	1,636,000

During the year the distribution enterprises exported 160,000 units of domestic goods at an aggregate selling price of \$200,000 and imported 198,000 units of foreign goods at an aggregate cost of \$198,000. As will be recalled, the net trade balance of \$2,000 was settled by the transfer of gold bullion into the society.

At the close of 1926 the distribution enterprises had increased their inventories of domestic and imported goods by 302,000 units. The purchase of this increased inventory was financed by bank borrowings and through open credit extended by the production industries.

In conjunction with increased trade activities, the distribution enterprises expanded their distribution facilities by twenty units. These additional units were constructed by the production industries at a total contract price of \$20,000.

The total number of persons employed by the distribution enterprises was 51 and the average salary for each employee amounted to \$1,500 per annum, or \$76,500 in all.

It will be noted from exhibit 12 appearing on following page that the distribution enterprises enjoyed a net profit of \$176,807.75 for 1926 and paid \$140,000 dividends to stockholders. The balance of earnings, amounting to \$36,807.75, was retained in the enterprises as undivided profits.

#### THE POPULATION

The money income of the population under review was derived from the following sources:

1. Wages and salaries.
2. Interest on bonds.
3. Dividends in stocks.

It is important to distinguish the money income from the real income inuring to the members of society. The real income consists of the total units of consumable goods and services actually

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Exhibit 12

Distribution enterprises—Summary of operations, year 1926

	Domestic goods		Imported goods		Total	
	Units	Money value	Units	Money value	Units	Money value
<b>Gross sales:</b>						
Worker class	720,000	\$ 900,000	None	None	720,000	\$ 900,000.00
Investor class	208,000	260,000	96,000	\$120,000	304,000	380,000.00
Exports	160,000	200,000	None	None	160,000	200,000.00
<b>Total</b>	<u>1,088,000</u>	<u>\$1,360,000</u>	<u>96,000</u>	<u>\$120,000</u>	<u>1,184,000</u>	<u>\$1,480,000.00</u>
<b>Cost of goods sold:</b>						
Beginning inventory	150,000	\$ 150,000	None	None	150,000	\$ 150,000.00
Purchases	1,288,000	1,288,000	198,000	\$198,000	1,486,000	1,486,000.00
<b>Total goods available for sale</b>	<u>1,438,000</u>	<u>\$1,438,000</u>	<u>198,000</u>	<u>\$198,000</u>	<u>1,636,000</u>	<u>\$1,636,000.00</u>
Less, ending inventory	350,000	350,000	102,000	102,000	452,000	452,000.00
<b>Total cost of goods sold</b>	<u>1,088,000</u>	<u>\$1,088,000</u>	<u>96,000</u>	<u>\$ 96,000</u>	<u>1,184,000</u>	<u>\$1,184,000.00</u>
<b>Gross profit on sales</b>		<u>\$ 272,000</u>		<u>\$ 24,000</u>		<u>\$ 296,000.00</u>
<b>Expenses:</b>						
Wages						\$ 76,500.00
Depreciation						13,500.00
Taxes						21,192.25
Foreign exchange service						300.00
Interest on notes payable						8,400.00
<b>Total expenses</b>						<u>\$ 119,892.25</u>
<b>Net profit for year</b>						<u>\$ 176,107.75</u>
<b>Dividends paid to stockholders</b>						<u>140,000.00</u>
<b>Undivided profits</b>						<u>\$ 36,107.75</u>

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consumed during a given period. The amount of this real income for a society is measured by the cost of living of all the people comprising its population. To increase this real income either immediately or in future periods should be the ultimate objective of all economic activity and legislation regulating economic affairs.

*Exhibit 13*

Investor class—100 persons Summary of income, year 1926		
<b>Income:</b>		
Dividends on stocks.....	\$ 373,000.00	
Interest on production industries—6% bonds	9,000.00	
Total.....		\$ 382,000.00
<b>Cost of living:</b>		
Domestic goods consumed—208,000 units..	\$ 260,000.00	
Imported goods consumed—96,000 units...	120,000.00	
Total.....		380,000.00
Direct savings.....		\$ 2,000.00
<b>Indirect savings:</b>		
Increase in book value of stocks owned:		
Production industries—undivided profits.	\$ 30,612.50	
Distribution enterprises—undivided profits.....	36,107.75	
The bank—undivided profits.....	5,120.00	71,840.25
Total savings.....		\$ 73,840.25

*Exhibit 14*

Worker class—100 persons Summary of income, year 1926		
<b>Income:</b>		
Wages and salaries.....	\$1,350,000.00	
Interest on bonds.....	13,159.75	\$1,363,159.75
<b>Cost of living:</b>		
Domestic goods consumed—720,000 units..		900,000.00
Total savings (direct).....		\$ 463,159.75

Exhibits 13 and 14 set forth the money income, real income, and savings for 1926 of the investor class and the worker class respectively. From these exhibits it will be observed that the direct savings of the population consist of money income received

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Exhibit 15

Society balance-sheets, December 31, 1926

	The government	The bank	Production industries	Distribution enterprises	Population		Intra-Society eliminations	Social balance-sheet
					Investor class	Worker class		
<i>Assets</i>								
Gold bullion.....	\$ 2,000	\$ 41,900	\$ 34,612.50	\$ 5,607.75	\$ 4,000.00	\$ 245,159.75	\$ 291,380.00 (A)	\$ 42,500
Deposits in bank.....	600	600					41,900.00 (B)	
Gold certificates.....							600.00 (C)	
Gold certificates—redemption fund.....							600.00 (D)	
Gold certificates in trust.....							23,000.00 (E)	
Greenback currency.....					3,000.00		12,000.00 (F)	
Bank Notes.....							143,850.00 (G)	
Government bonds.....							12,000.00 (H)	
Government bonds—with treasurer.....							50,000.00 (I)	
Government bonds—in trust.....							280,000.00 (J)	
Accounts receivable.....		280,000	50,000.00				400,000.00 (K)	10,000
Loans.....							1,850,840.25 (L)	
Foreign government loans.....								
Production industries—6% bonds.....					150,000.00	250,000.00		
Stocks at book values.....					1,850,840.25			
Consumable goods (domestic)—350,000 units.....				350,000.00				350,000
Consumable goods (imported)—102,000 units.....				102,000.00				102,000
Goods in process—100,000 units.....			25,000.00					25,000
Distribution facilities—245 units.....				245,000.00				245,000
Production equipment and properties—1,050 units.....			1,050,000.00					1,050,000
Public improvements and properties—252 units.....	252,000							252,000
Natural resources—750,000 units.....			750,000.00					750,000
<b>Totals.....</b>	<b>\$319,100</b>	<b>\$334,500</b>	<b>\$1,909,612.50</b>	<b>\$702,607.75</b>	<b>\$2,007,840.25</b>	<b>\$671,009.75</b>	<b>\$3,118,170.25</b>	<b>\$2,826,500</b>
<i>Liabilities</i>								
Gold certificates outstanding.....	\$ 42,500						\$ 42,500.00 (B)	
Greenback currency outstanding.....	23,000						23,000.00 (D)	
Circulation.....		\$ 12,000					12,000.00 (E)	
Notes payable—bank.....			\$ 50,000.00	\$ 230,000.00			280,000.00 (I)	
Deposits.....		291,380					291,380.00 (A)	
Accounts payable.....				50,000.00			50,000.00 (H)	
Liability for gold certificates in trust.....	600						600.00 (C)	
Liability for government bonds in trust.....	12,000						12,000.00 (G)	
6% bonds payable—production industries.....	155,850		400,000.00				400,000.00 (F)	
Public debt.....							155,850.00 (J)	
Reserve for depreciation.....			48,000.00					48,000.00 (K)
Reserve for depletion.....			1,000.00	13,500.00				1,000
Capital stock.....	85,150	20,000	1,380,000.00	373,000.00				85,150
Surplus.....		6,000						6,000.00 (L)
Undivided profits.....		5,120	30,612.50	36,107.75				71,840.25 (K)
Net worth.....					\$2,007,840.25	\$671,009.75		2,678,850
<b>Totals.....</b>	<b>\$319,100</b>	<b>\$334,500</b>	<b>\$1,909,612.50</b>	<b>\$702,607.75</b>	<b>\$2,007,840.25</b>	<b>\$671,009.75</b>	<b>\$3,118,170.25</b>	<b>\$2,826,500</b>

during a given period and not converted into real income during that period. Undivided profits of corporations during a given period and enhancing the book values of their outstanding stocks constitute indirect savings to the owners of these stocks, as is shown by exhibit 13.

The total savings of the worker class, amounting to \$463,159.75 for the year, were invested as follows:

Deposited in bank.....	\$213,159.75
Invested in production industries 6% bonds.....	250,000.00
	\$463,159.75
Total.....	\$463,159.75

The savings of the investor class were principally of an indirect nature; however, the total savings of this class amounting to \$73,840.25 for the year, are accounted for as follows:

Deposited in bank.....	\$ 2,000.00
Increase in book value of stocks owned (undivided profits).....	71,840.25
	\$ 73,840.25
Total.....	\$ 73,840.25

EFFECT OF ACTIVITY

Exhibit 15 sets forth the closing balance-sheets as of December 31, 1926, of all the institutions and classes of population in the society and the resulting social wealth after eliminating intra-society items. On comparing this exhibit with exhibit 7, it will be observed that the total social wealth has increased during 1926 by \$539,000 (after allowance for depreciation and depletion). The nature, source, and ownership of this increased wealth may be set forth as follows:

*Exhibit 16*

Summary of increased social wealth, year 1926  
Nature of increased wealth

Gold bullion.....	\$ 2,500
Consumable goods (domestic)—200,000 units.....	200,000
Consumable goods (imported)—102,000 units.....	102,000
Goods in process—100,000 units.....	25,000
Distribution facilities—20 units.....	20,000
Production equipment and properties—250 units.....	250,000
Public improvements and properties—2 units.....	2,000
	\$601,500
Total.....	\$601,500
Less, reserves for depreciation and depletion.....	62,500
Net increase in social wealth.....	\$539,000

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Source and ownership of increased wealth

Ownership of worker class (900 persons) derived from:

Direct savings:

Increase in bank deposits.....	\$213,159.75	
Increased holdings of production industries 6% bonds.....	250,000.00	\$463,159.75

Indirect savings:

900/1000ths of increase in government surplus	1,800.00	
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Ownership of investor class (100 persons) derived from:

Direct savings:

Increase in bank deposits.....	2,000.00	
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Indirect savings:

Increase in book value of stocks owned (un- divided profits).....	\$71,840.25	
100/1000ths of increase in government surplus	200.00	72,040.25

Total.....		\$539,000.00
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It will be noted from exhibit 16 that the actual physical increases in wealth consist of additional quantities of gold bullion, consumable goods, goods in process, distribution facilities, production equipment and public improvements (less reserves for depreciation and depletion). The sources of this increased wealth arose from direct savings of the population, undivided corporate profits (indirect savings) and an increase in the government's surplus (indirect savings). Of the total increase in wealth, \$464,959.75 inured to the worker class and \$74,040.25 to the investor class.

Let us now examine more closely the items constituting the increased social wealth, for the purpose of ascertaining to what extent the society is building its prosperity on a sound basis. The first item of increased wealth set forth in exhibit 16 is "gold bullion \$2,500." It will be recalled that this increase in gold arose as a result of the following:

Settlement of a favorable trade balance.....	\$2,000	
Collection of interest on foreign government loans.....	500	
Total.....		\$2,500

As the supply of gold in the world is limited, it can not be expected that foreign societies will be able to effect gold settlements on their debts for an indefinite time. Consequently in order to be assured of a continued prosperity based on foreign trade and for-

eign loans, the society should look forward to receiving settlements of net balances in forms of wealth other than gold which it can not duplicate within its own political boundaries.

The next three items of increased social wealth consist of consumable goods—domestic, imported, and goods in process—all of which have an aggregate money value of \$327,000. In general, it may be stated that the accumulation of consumable-goods inventories is a hazard to the continued economic well-being of a society. Under a competitive-price system the dangers of drastic price reductions to dispose of surplus inventories and the concomitant evils of curtailed production are too well known to require comment. In such circumstances it would be far better for business to earn smaller profits and for persons to accumulate less savings in order to effect the consumption of consumable goods than to risk disruption of the entire economic machinery. Consumption is real income in the final analysis and is the end toward which all economic activity should be directed. The accumulation of consumable-goods inventories or the curtailment of production is justified only when complete satiety of economic wants is enjoyed by everyone in a society.

Production equipment and distribution facilities were increased during 1926 by 270 additional units, which have been valued at \$270,000. If this expansion of equipment and facilities was made to provide for wants of the population not capable of being satisfied with existing facilities, then the expansion has been a healthy one and the prosperity has been built on a sound base; however, if existing equipment was adequate to meet these wants, then the expansion has been wasteful and the prosperity is illusory. Future returns on this class of equipment and facilities will not be sufficient to justify the capital investment.

Public improvements, which have been increased by two units at a total cost of \$2,000, are basically sound in the economic growth of society provided these improvements contribute materially to the efficiency of governmental administration. However, should the improvements add little to governmental efficiency or to the betterment of the public welfare, then this class of expenditures hardly seems justified.

From the foregoing discussion it will be seen that the direct savings, undivided profits and governmental surplus accumulated during a given period have a physical counterpart in various units of wealth created during that period. Although these units



of wealth are valued in monetary terms at the direct cost of production or acquisition, plus gross profits realized on subsequent transfers or sales, this monetary valuation is not necessarily indicative of the future returns that will be earned on each wealth unit. Future monetary returns depend upon the nature of the units of wealth created; hence an over-valuation of wealth units results in an over-statement of savings, undivided profits and governmental surplus and conveys a false notion as to the extent of the economic progress made during a period of activity.

In general, the economic activity of society during a given period may be reduced to the following objectives:

1. The production of goods and services to meet the requirements of current consumption.
2. The creation of additional units of capital wealth to offset depreciation and depletion charges on existing wealth and to provide for the expanding wants of the population.

The accomplishment of these objectives may be considered as a postulate of prosperity, for, without the attainment of both, the social and economic machinery of society can not function smoothly. For example, where the foreign trade balance is even and all activity is devoted to the direct production of consumable goods and services, and the total domestic output and current imports are sold to the population at an aggregate sales price equivalent to the aggregate money income of the population, business and industry will find a deficit for the period, due to book charges for depreciation and depletion. If, to offset depreciation and depletion charges, the domestic output and current imports are sold at an aggregate price greater than the current money income of the population, then the result will be merely a transfer of wealth from one group of the population to another group and will in no way counterbalance both the decrease in social wealth and the corresponding impoverishment of that group within the population spending beyond its current money income. Thus we see that the economic program of a laissez-faire society must not only make provision for the current wants of the population, but must include a well-directed plan for building and expansion in order to afford the necessary channel for the direct savings of the people and the accumulated profits of businesses which together form the driving force for continued activity.