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Fixed Assets in the Balance-Sheet

T. H. Sanders

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The rule for showing fixed assets in the balance-sheet at cost is sufficiently honored in the breach, as well as in the observance, to deserve an occasional re-statement. This article reviews the expressions on the subject by a number of authorities, past and present. From the former it may be demonstrated that historical authority is more strongly in favor of the rule than is sometimes supposed; while the uncertain voices of present-day writers are a perhaps natural reflection of the relatively recent past rather than of those earlier days. It is submitted that, as experience now stands, it lends an accumulation of powerful support to the cost basis and that, while business and the accounting profession should be left free in the matter, they will in most cases do well to exercise their freedom by following the rule. Granting that an arbitrary and general insistence on cost tends both to an exaggeration of the importance of the item and to a negligence of economic movements which affect it, yet insistence on such bases as current value or replacement value still further exaggerates its importance and ignores the more significant for the less significant phases.

In accounting literature much of the difficulty has arisen from the general use of the word "value" and "valuation" as applied to the amounts at which the property accounts are stated in the balance-sheet. The choice of this word is perhaps very natural, and it is the first word for the purpose which comes to the mind of any person of average intelligence who has not already given study to the subject. But, unfortunately, the word "value" carries meanings very different from original cost, and the more recent accounting literature has done little to remove this confusion. An examination of standard works is here made with a view to answering the question: Is a balance-sheet supposed to show values? The unsatisfactory status of the question will become apparent from the quotations which will be given.

There are two principal reasons why, in spite of the confusion thus engendered, the use of the word "value" has persisted. The first has already been mentioned—namely, the common use and convenience of the word for all occasions when things need to be stated in amounts of money. From this it is a too easy transition

to the position of giving, or at least pretending to give, the layman what he expects to find in the balance-sheet, namely, the present value of the assets there listed. Indeed, it is so much easier to give this delusive satisfaction to those untaught in accounting than it is to explain to them what the balance-sheet does mean that it must be confessed that the matter has been treated largely by evasion and default. Every teacher of accounting and almost every accounting practitioner knows from experience how difficult it is to deal with the question: If the balance-sheet does not show values, what does it show? This is especially true when, after a long history, the original cost of the property accounts has been modified by years of depreciation, renewals and replacements. The occasional revaluations by appraisal of the property accounts of corporations have been sufficiently numerous and prominent to add further to the misunderstandings.

The second reason for the common and persistent use of the word "value," even in cases where the intent may be perfectly clear, has been the extent to which accounting literature has borrowed terminology and ideas from economics. This occurred to some extent in the earlier English writings and has been carried further in this country, as a natural consequence of the fact that many of our accounting writers have come up through the economics departments of the universities.

One of the outstanding examples of this more or less subconscious temporizing with general impressions as to the significance of balance-sheet items is to be found in the writings of Dicksee, regarded for a generation as the foremost teacher of accounting in England, whose works have had considerable influence in this country. In his discussion of the double account system he has the following:

"The principle of the double-account system is that the capital of a company is contributed by the shareholders for the definite purpose of constructing or acquiring certain works, which—when constructed or acquired, as the case may be—are to be employed for the purpose of earning an income for such shareholders. The form of account employed is calculated to show exactly (1) what capital has been raised, (2) how much of such capital has been spent in constructing or acquiring the undertaking and (3) what amount of capital remains over for the purpose of carrying on the undertaking, and so earning income. In accounts kept upon this system, the amount of expenditure (i.e., the cost price of assets) is the amount always stated; the undertaking has to be kept in a

state of working efficiency out of revenue, but all fluctuations of value are disregarded.

"As a matter of practice, it is not unusual to find, in accounts kept upon the single-account system, that assets are stated in the balance-sheet at cost price, irrespective of their actual market value. This is, however, technically incorrect (where not actually misleading); for it is the distinctive feature of the single-account balance-sheet that all assets and liabilities should be so stated that the actual financial position may be made apparent." (*Bookkeeping for Accountant Students*, by Lawrence R. Dicksee, 1909, pp. 244–245.)

This plain assertion that the statement of assets at their original cost is a peculiar feature of the double-account form of balance-sheet and that such practice is "technically incorrect (where not actually misleading)" in the single-account balance-sheet is an extraordinary thing to find in a writer like Dicksee. As a matter of fact, the same principle applies to the statement of property accounts in both forms of balance-sheet; it is simply that the arrangement and terminology of the double-account form emphasize this principle more distinctly. Nowhere in all his writings does Dicksee suggest, as a matter of practice, that property assets should be shown at other than their cost. I was myself a student of his for three years and will venture to say that no student would have been permitted to pass in his courses who in an actual example was not perfectly clear on this point.

George O. May, writing as chairman of the special committee of the American Institute on coöperation with stock exchanges, on September 22, 1932, has the following:

"In an earlier age, when capital assets were inconsiderable and business units in general smaller and less complex than they are today, it was possible to value assets with comparative ease and accuracy and to measure the progress made from year to year by annual valuations. With the growing mechanization of industry, and with corporate organizations becoming constantly larger, more completely integrated and more complex, this has become increasingly impracticable."

Mr. May's point obviously is the present impossibility of annual appraisals, either for measuring depreciation by observation or for finding new replacement costs. But sometimes the expression that these things were possible a generation or two ago is made to serve as evidence that they were in fact generally done. The evidence is that, while there was some tendency to measure

depreciation by observed condition, there was practically no tendency toward re-valuation for the purpose of changing the basis of property amounts in the ledger or balance-sheet. At no time does any leading accounting writer lay the main emphasis on such methods; in every generation the main emphasis is upon the cost of the property assets.

In 1898, the date of publication of the first edition of Dawson's *Accountant's Compendium*, the proper basis for valuing fixed assets had evidently not become a burning question; no suggestion of any controversy of this kind appears in the meager articles on fixed capital, fixed plant, fixtures or depreciation. There is an underlying assumption that cost is the true accounting basis for all these items to the extent, apparently, of its being scarcely worth mentioning. Among "the main factors in determining the amount of depreciation" is given: "(1) The original cost of the object." Under fixed capital reference is made to "the assets representing the outlay"; under fixtures it is more definitely stated that "the cost of the fixtures would form the 'foundation value,' " most of the argument being devoted to the rates at which this "foundation value" would be written off under various leasing terms.

Going back further one comes to the well-known work of Garcke and Fells (*Factory Accounts—Their Principles and Practice*, 1889) highly regarded in its day, and still well worth reading, which says:

"The direct way of determining the depreciation or appreciation of the assets of an undertaking would, prima facie, appear to be by means of a revaluation of all the properties at periodical times. In the case of trades whose plant is of a simple kind this plan may prove practicable and would have the advantage of charging fairly the deterioration due respectively to a period of brisk trade and to a time of depression, by manifesting in the former period a greater degree of wear and tear due to a larger volume of business or to time contracts compelling a resort to overtime; while in the latter period a smaller amount would obviously be chargeable for depreciation, much of the machinery and plant having probably stood idle. But this method would in the majority of trades lead to such enormous fluctuations in the profit-and-loss account, especially if the periodical valuation was based upon the market price of the properties, and not simply upon their value as integral portions of a 'going concern,' that, except in a few trades, it would be impracticable. This would especially be the case when raw material, subject to market

fluctuations formed a large proportion of the plant and stock-in-trade. Such a method would often be a fruitful source of confusion and error. In short, to write off only such portion of the cost of the plant as represents the apparent deterioration that has taken place would be fallacious. Although machinery or plant may show no signs of diminished value or loss of earning power, yet its term of life and its value in the market must be lessened by lapse of time. A periodical survey of all buildings, plant, etc., is, however, very important, and would serve, if no other purpose, as a very valuable check upon the system of calculating depreciation that may be adopted."

The subject of discussion is, of course, depreciation as an item in the costs. But it is perfectly clear that the authors favor no basis other than cost for showing the property accounts and for computing the depreciation charge. It is interesting to find them using in 1889 the same language as Mr. May does in 1934 to demonstrate the impracticability of annual valuations.

The genial and voluble George Soulé has an illustration in his first edition of 1881, and repeated in every edition down to 1908, which is very illuminating on this matter. I have selected him for quotation for the further purpose of indicating that the cost basis for showing plant was an idea by no means confined to such metropolitan centers of accounting as London and New York; it was known and practised in other industrial centers also. The good George assures us that his working set F, The New Orleans Excelsior Cotton Factory (Soulé's *New Science and Practice of Accounts*) was modeled on an actual business in New Orleans. How then does he deal with his plant?

In a ledger account (p. 270) entitled "cotton factory" he shows the acquisition, during 1887, of three parcels of land, buildings and machinery, at a total cost of $114,814; at December 31 he closes the account by carrying down the balance under the title of "inventory." He then shows (p. 273) an "inventory book," as follows:

Cotton factory and machinery valued at cost	$114,814.00
Cotton, value of the list on hand per the following statement	8,052.16
	$122,866.16

In other words, it seems to have been the practice to "inventory" the plant and property in the same way as one inventoried

the raw materials and work in process, and indeed it was all part and parcel of the same procedure. Then the company went through the motions of "valuing" this inventory, but in the case of the plant the "valuing" consisted simply in listing it at cost. Thus the talk of those days about "valuing" the plant amounted to nothing more than going through the formality of including it in the regular inventory procedure, but there is no suggestion that this should involve anything other than listing it at cost.

In the fashion of those times, Soulé has recorded a proverb or moral observation at the foot of each page of his treatise; it is perhaps not inappropriate that his moral at the bottom of this page on inventory ran:

"Every age confutes old errors and begets new."

In 1832 Charles Babbage published his work, *On the Economy of Machinery and Manufactures.* While this book deals in a general way with the effects on business of the introduction of machinery, he has some very interesting comparisons of the costs of making certain products by hand and by machinery. In these discussions he clearly assumes, as something to be taken for granted, that machinery and equipment will be stated in the accounts at cost, and that depreciation will consist of the allocation of such costs over the life-time of the machines. One passage in which these assumptions are present is as follows:

"The time during which a machine will continue effectually to perform its work, will depend mainly upon the perfection with which it was originally constructed, upon the care taken to keep it in proper repair, particularly to correct every shake or looseness in the axes, and upon the small mass and slow velocity of its moving parts. Every thing approaching to a blow, all sudden change of direction, is injurious. Engines for producing power, such as wind-mills, water-mills, and steam-engines, usually last a long time. [The return which ought to be produced by a fixed steam-engine employed as a moving power, is frequently estimated at ten per cent. on its cost. (Babbage's note).] But machinery for producing any commodity in great demand, seldom actually wears out; new improvements, by which the same operations can be executed either more quickly or better, generally superseding it long before that period arrives: indeed, to make such an improved machine profitable, it is usually reckoned that in five years it ought to have paid itself, and in ten to be superseded by a better.

"A cotton manufacturer," says one of the witnesses before a committee of the house of commons, 'who left Manchester seven

years ago, would be driven out of the market by the men who are now living in it, provided his knowledge had not kept pace with those who have been, during that time, constantly profiting by the progressive improvements that have taken place in that period.'

"The effect of improvements in machinery seems, incidentally, to increase production, through a cause which may be thus explained. A manufacturer making the usual profit upon his capital, invested in looms or other machines in perfect condition, the market price of making each of which is a hundred pounds, invents some improvement. But this is of such a nature, that it can not be adapted to his present engines. He finds upon calculation, that at the rate at which he can dispose of his manufactured produce, each new engine would repay the cost of its making, together with the ordinary profit of capital, in three years: he also concludes from his experience of the trade, that the improvement he is about to make, will not be generally adopted by other manufacturers before that time. On these considerations, it is clearly his interest to sell his present engines, even at half-price, and construct new ones on the improved principle. But the purchaser who gives only fifty pounds for the old engines, has not so large a fixed capital invested in his factory, as the person from whom he purchased them; and as he produces the same quantity of the manufactured article, his profits will be larger. Hence, the price of the commodity will fall, not only in consequence of the cheaper production by the new machinery, but also by the more profitable working of the old, when sold at a reduced price. This change, however, can be only transient; for a time will arrive when the old machinery, although in good repair, must become worthless. The improvement which took place not long ago in frames for making patent-net was so great, that a machine, in good repair, which had cost 1200£, sold a few years after for 60£. During the great speculations in that trade, the improvements succeeded each other so rapidly, that machines which had never been finished were abandoned in the hands of their makers, because new improvements had superseded their utility." (*On the Economy of Machinery and Manufactures*, by Charles Babbage; London, England, 1832; pp. 231–233.)

Those who have thought that obsolescence was an exclusively modern experience will be impressed with the foregoing quotation; its greater significance for the present purpose is that it conveys very clearly the reasons why it is important to show the original cost of machinery and equipment in the books. Babbage is concerned about recovering the investment in these machines through the sale of their products and with the urgency of doing so before the machines have to be discarded for any reason whatever. He talks about these matters with as much pith and

point as if he were a real business man, instead of the professor at Cambridge that he was.

Among these earlier writers on accounting matters I fail to find any discordant note on this subject; the only difficulty in adducing a complete proof comes from their habit of so taking the matter for granted that they make very little specific statement on the point. To get a different view it is necessary to leave the literature of accounting and enter that of engineering. A paper, given before the engineers' society (*Inventory Valuation of Machinery Plant*, by Overlin Smith. Transactions of the American Society of Mechanical Engineers, Vol. VII, Meeting of May, 1886, p. 433) strenuously advocates the recording of "true value," "correct valuation," and "real value," regrets that "the keeping of cost and valuation accounts in connection with machinery has never been brought into so perfect a system as has ordinary commercial book-keeping" and argues that the basis for getting these is reproduction cost less observed depreciation, with some deduction for obsolescence, if any. Nowhere in the paper does the writer indicate the uses to which he would put these values; probably his "inventory" total would be his balance-sheet figure for plant; but he seems to be more concerned with "cost," and probably intends that the differences in value from year to year are to be included in cost.

The nature and origin of this exception serve only to emphasize the rule that among accounting writers, concerned with presenting a sound balance-sheet, the usual basis for plant amounts is, and always has been, the cost of the property; even in a simpler age, when annual appraisals might have been feasible, they were not in fact very much practised. When they were, it was usually for the purpose of determining the rate at which the original cost of the asset should be written off.

But not all the engineers were of Oberlin Smith's mind on the subject. Only two years earlier, in 1884, Ewing Matheson published his book entitled *Depreciation of Factories*, to the first edition of which the following was inserted as prefaces:

"In the financial administration of a factory or other industrial undertaking, the accounts which relate to disbursements and receipts are so obviously necessary to the continuous working of the undertaking as to be rarely neglected, and if errors or omissions occur they quickly compel attention. But the capital accounts are not always deemed to be of such pressing importance; and variations in the value of plant, arising from the

wear and tear or other causes, may be left unnoted. The increasing extent of factories, the subdivision of capital by means of joint-stock companies, and the conflicting interests that arise in regard to preference shares and borrowed capital, enhance greatly the importance of correct systems of account. Qualified book-keepers should be employed to arrange and check factory accounts, and the profession of accountant and auditor is rising in importance accordingly. But while accountants may properly deal with facts and figures presented to them, and may fairly allot to capital and revenue actual expenditure or estimated depreciation, they must always be dependent for the accuracy of these data on those technically acquainted with the operations of manufacture. It is endeavored in the present short treatise to point out the leading circumstances that must be considered in 'writing off' for depreciation, and to tabulate in a simple manner the annual changes that occur in capital value.

"In the valuation of a factory for any purpose whatever, the past 'depreciations' and additions have to be considered; and the possible modifications which may be necessary are dealt with in the later chapters."

In the earlier paragraph Matheson is clearly speaking of "variations in the value of plant" primarily with respect to depreciation. His book is in fact divided into two parts, the first consisting of seven chapters on depreciation, which for him means writing off the cost; and the second consisting of seven chapters on valuation, which means appraisal of the plant for purchase, sale or similar purposes. This arrangement seems to indicate in his mind a complete separation between these two questions. Writing as an engineer and appraiser, he discusses the valuation of factory properties for various purposes, but nowhere suggests that these should be used as the basis for revaluing the assets of a going concern in its books and balance-sheet.

Having reviewed the writers of earlier days and having there found no support, at least among the accounting writers, for showing anything in the nature of current or appraised values for fixed assets, let us turn to some of the representative present-day writers and see how they express the matter. I shall not quote from these writings without observing that I myself have written in similar terms, and every one of the authors quoted will no doubt retort, at least mentally, that he knew all along that standard practice was to state property assets at cost, and that he has no confusion in his mind on the subject. This I very readily believe—the purpose of this article is to advocate that we should all be even more careful in choosing our words. Experiences lead

me to believe that a good deal of damage has been done by the uncertainty which appears, and that still further damage will ensue unless the matter is cleared up. The question is still: Is the balance-sheet supposed to show values? An answer is required, which will be satisfying not only to accountants but also to engineers, lawyers and others not necessarily trained in accounting.

Montgomery (*Auditing—Theory and Practice*, fifth edition, 1934, p. 249) deals with the matter thus:

"When, however, the period to be covered is not more than one year, a serious question arises of how far the book valuations may be accepted as a basis for actual values, assuming that the concern is to be valued as a going business, and that cost, less proper depreciation, is the result desired. The auditor may as well accept the position here, as with inventories, that he is expected to report the facts about the plant account. When he cannot obtain accurate information with respect to plant values, he should state in his report that real estate, machinery, and similar assets are stated at book valuations. The balance-sheet statement of these assets should be qualified accordingly. He should, however, attempt to ascertain whether these book valuations honestly reflect present conditions. His services are of little real value if such items are grossly overstated or if a net worth is shown which could be corrected by an intelligent use of evidence readily available.

"When appraisals are made in which appreciation is included, there is no objection to setting up appraised values in balance sheets, provided the valuation is qualified by an explanation and provided the excess of the appraisal above book value is credited to special or capital surplus and is not merged in earned surplus."

Dickinson (*Accounting Practice and Procedure*, 1920, pp. 75–6) assumes the cost basis in the following terms:

"These subheadings are sufficient to give a clear description of the nature of all expenditures upon fixed assets for the purposes of a balance-sheet, although in the books of account themselves considerably more detail will be found necessary.

"In the correct determination of the amounts to be carried under any of these headings, it is necessary to insure that the expenditures included are such as may be properly treated as additions to the assets; that none are included which should properly be deemed renewals or replacements of existing facilities, and that full provision has been made for all expenditures necessary to prevent or make good depreciation due to wear and tear, obsolescence or other causes."

but then goes on (page 80):

"It is necessary to recognize that there are causes at work, particularly in young and growing communities, which may

render a statement prepared on the basis of cost of capital assets misleading and even prejudicial to the proper interests of present owners. Over a period of years changes in value due to rise or fall in prices may be sufficiently permanent to render it unfair to one business to maintain original cost values as compared with another whose assets have been created at widely varying costs. Moreover, even where constructed works may have fallen in value owing to depreciation or obsolescence which has not been provided for, there may be an offsetting increase in the values of land and its subsoil or other natural products due to the development of the community and consequent largely increased demand. It is true that from the point of view of earnings such increment can not be taken as in any way a proper offset to losses due to wear and tear, depreciation or obsolescence; but this does not alter the fact that in spite of an insufficient provision for depreciation on some assets, there may be an actual increase on the total value of all assets. In fact, there are well-known cases in which by far the larger part of the ultimate profits of a corporation over a long series of years has been due not to the results of its activities but to the large unearned increment on its capital assets. This condition must be recognized and is frequently met by means of careful appraisals of all properties, the resulting increase (or possibly decrease) being taken up as a special credit or debit to profit-and-loss account (or surplus) and shown as entirely distinct from the operating results."

Paton writes (*The Accounting Review*, June 1931, "Economic Theory in Relation to Accounting Valuations," W. A. Paton, p. 94):

"The main point to be recognized in this connection is the fact that the economist does not mean by effective cost the mere number of money units in the original charge. The effective cost of a standard piece of equipment on the date of purchase is the purchase price, which, let us say, is $1,000 (ignoring installation charges). The effective cost value a year later (ignoring the question of depreciation) is the cost of a new unit of the same type, assuming there has been no change in standards, and this may be $1,200. That is, the economist holds that the cost which is effective in the price-making process is the potential cost or cost of replacement.

"In other words, those who argue for periodic revisions of costs of fixed assets such as buildings and equipment can find considerable support for their position in orthodox economic reasoning. If it is true that the costs which are effective economically, the costs which influence the price of the product, are not the historical costs in dollars but such costs revised to date, these revised costs are the ones which are vital to the operating management and hence are worthy of some consideration by the accountant."

This contention will find general acceptance so far as it relates to price determination; Paton himself adds the necessary qualifications. One may, however, question whether the "consideration by the accountant" which he desires should go so far as actually to put on the books and show in the balance-sheet the "periodic revisions of costs."

Hatfield (*Accounting—Its Principles and Problems*, Henry Rand Hatfield, 1927, p. 25) addresses himself directly to the question in hand in the following terms:

"The question of accuracy in the balance-sheet involves a matter of fundamental theoretical importance which has perhaps received too little discussion and has never been satisfactorily settled. Accuracy may, indeed, be demanded but what constitutes accuracy depends on the purpose of the balance-sheet. A statement is accurate if it correctly presents a record of past transactions as truly as if it records present values. It has generally been accepted by accountants as a truism, indeed exalted by them into a 'principle of accounting' that the balance-sheet professes to set forth present values. But this concept is by no means fully realized; it is in accounting very frequently set aside. In the next chapter are discussed certain conventionally accepted rules regarding the valuation of various kinds of assets. In some of these the implication is strong that, at least in some instances, no attempt is made to prepare a statement of present values, but rather to represent the facts as they occurred in the past. The double-account balance-sheet is even more clearly, so far as the capital account is concerned, a history of previous transactions and in no sense a statement of present values. It is just as accurate to state what a given piece of property cost twenty years ago as to give its present estimated value, provided, of course, that in either case it is clearly understood just what the figure given really means. The balance-sheet is assumed to state present values, but it strangely halts and stumbles toward this goal. It might, and ordinarily does in part, disregard present values and present historic costs. Which of these concepts is proper may well be considered a fundamental question, but it is one on which accounting theory is unfortunately not quite clear."

It is submitted that the sum total of these quotations from the present-day writers does not make a very clear or convincing picture. If any one will try them on a non-accountant, as I have done, he will find it very difficult to persuade him that accountants have a definite philosophy on the subject.

It is far from my intention to advocate a hard and fast rule; still less is it desirable for any law or division of the government to

attempt to lay down fixed rules. Business men who are honestly trying to carry on their business to the best advantage should be left free to deal with the problem as they see it. But after two decades of the most violent swings in price levels and business activity, it may be expected that business men, even when left in the free exercise of their own judgment, will be reluctant to enter large amounts of "value" increment in the balance-sheet figures for their fixed assets. The futility of so doing has been given a good deal of demonstration. The weight of the authority of Dickinson and Montgomery still stands in favor of allowing such procedure when circumstances justify; but circumstances will justify it in far fewer cases in the future than in the past. (An extreme inflation would, of course, play havoc for a time with this assertion, but when the excitement was over we would probably be glad to get back to a normal cost basis.) Certainly the writing up of fixed assets for the mere purpose of creating a surplus to meet a temporary exigency, such as to absorb unusual losses, does not constitute a justification. A more general adherence to the rule of fixed assets at cost (and less talk about their value) will be much to the advantage of accounting and of business.

The increments in property accounts which have at times appeared in company balance-sheets as a result of reappraisals, especially during the 1920's, have probably had their origin in two main causes: the first being the desire to create a showing which would support the balance-sheet figures for security issues; and the second being more or less an outcome of public utility rate making, in which the valuation of the assets has always played a conspicuous part. While the exuberance of human nature might prompt a write-up of the assets in times of rising prices, it alone would probably not have been sufficient to bring about that result without the presence of one or both of these two very practical considerations.

For purposes of a rate hearing by a public utility or a new security issue by either a utility or an industrial company, the present reproduction cost of the property is not only a proper but a desirable piece of evidence, but it seems probable that it will gradually be borne in upon business men that it is not good practice to enter these amounts in the books of the company. Probably, moreover, the influence of the securities and exchange commission, as evidenced in the Northern States Power Company

case (*New York Times*, November 22, 1934, p. 31) will tend against such practices.

The whole experience of the last twenty years has pretty clearly demonstrated the unwisdom of plant write-ups. To unfavorable business and financial consequences there have been added, within the last two years, most unfortunate political consequences, and revaluations of property and plant, on whatever theory of value they were conceived, have come to be too generally regarded as not very different from some species of chicanery. These wholesale condemnations are unjust, but the fact that they exist is something to be reckoned with, and, where there is no very cogent business necessity or justification for the write-up, the public view of them is an additional adverse factor. In other words, increments in property values, to be included in the balance-sheet, should ordinarily rest upon bona-fide transactions conducted at arm's length.

There are those who say that all this discussion is unnecessary, because in any case the balance-sheet amount for plant is not important. It is true that in many discussions its importance is exaggerated, and there is certainly nothing to be gained to pay for the trouble of minute digging into the old plant accounts of a company which has a long history of operations, the results of which have already been appraised in the quoted prices of the company's securities. But accountants should be careful about saying that the property amounts are of no importance, since they thereby bring their own work into danger of being misunderstood and belittled. Certainly the additions to plant are important; it is important to decide whether they are proper additions or not. And if the annual depreciation charges are important, then the base on which they are computed can not be called unimportant. When the plant amounts are written up by reappraisal, that seems to me to exaggerate their importance in a particularly unfortunate way. Perhaps we shall, as some suggest, some day have balance-sheets from which the property items are omitted, their place to be taken by a picture of the plant with smoke pouring out of the chimneys; but that stage has not been reached yet, and so long as amounts are given for these assets the duty will rest upon accountants to give them a meaning.

In short, accounting writers and practitioners ought to be prepared to combat the prevalent notion of regarding original cost as of slight moment and speaking disparagingly of it in favor of an

apparently more attractive but ill-defined conception called "value." In the simpler transactions of life everybody recognizes that profit is the difference between cost and selling price; in the more complex conditions of large-scale production the same principle still holds good, but the terms are infinitely more difficult of definition and measurement. The amounts invested in property and plant by a manufacturer are costs of production of the goods he sells; they become so through the operation of the depreciation accounts. If the business breaks even or earns a profit after providing such depreciation, to that extent the original cost of the property has been recovered in the selling price of goods sold. At any one moment the cost of the property less the amount then in the reserve for depreciation is the amount still unrecovered through operations. All these are solid and substantial facts and will be held to be of weight and moment by any business man or stockholder who knows what he is about. To substitute for these definite facts estimates such as are commonly included in appraisals is to proceed from the realm of fact to that of fancy, and to very little good purpose. For income-tax purposes and other legal considerations, original cost will continue to be a dominating influence. The plant amount is also an important element, the base on which the rate of earnings is computed, in any complete analysis. For these and other considerations the amounts of money actually put into a business and the amounts taken out will continue to be prime considerations for the accountant.

It is readily granted that there is nothing new in all this; but the tendency to compromise on the subject, in writing and in practice, has been sufficient to cloud the issue, often with unfortunate results. It would seem that the time has come for more definite and consistent words.

The editor of THE JOURNAL OF ACCOUNTANCY, in the February, 1935, issue, calls attention to some of the regulations of the securities and exchange commission in form 10 and form A-2. The use of the words "basis of determining the balance-sheet amount" does indeed indicate on the co mission's part an intention to avoid any representation that the a nounts shown are necessarily the value of the items to which they refer; they should be the amounts of those items as properly determined under approved accounting rules. This phrase is not used with reference to item 12 of the balance-sheet, "property, plant and equipment," either

on the instruction directly attached to the item or on schedule II, which is explanatory thereof. No doubt this is because the commission begins schedule II with the "balance at beginning of year as per accounts" in order to avoid lengthy and valueless analysis of old property accounts. Information as to important changes in the plant accounts within the last ten years is called for by the commission elsewhere in form 10 (question 34, supplemental financial information), and this brings to the commission the same results as it would get in response to a request for the basis of determining the amount of the property.

We can all agree that it is a long and tedious process to ıake people understand clearly and precisely what these balance-sheet amounts mean, but there is no gain in beginning that process by misleading them. In published reports the basis of the property amounts should be made clear; when this is cost it would be better not to call it value; a more general adherence to cost is desirable, and fewer excuses for appraisal figures—especially increases—will be acceptable; but the matter should be left to accountants and business nen, so that they may be free to deal with it as circumstances require.