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In the beginning of the world's history, when man was created, all of his material wants were provided for, but, not being satisfied with that condition, and exercising all of the prerogatives of a free moral agent, he apparently started at once the plan of securing each unto himself as large a share of worldly goods as his intelligence and activities permitted. Naturally some acquired more than their needs, or a surplus, and others less, or a deficiency. This in turn reached a point where the imposing of a charge for the use of an article, by the more successful, became a factor in the tribal life. In the book *Leviticus* usury is first mentioned. The word "interest" does not occur in the references, nothing but the harsh word "usury." In that particular passage, or a later one, the inference is drawn that by command it was deemed unrighteous or unlawful to oppress any person through such an agency.

The point I wish to make is that interest (in every sense usury) is a man-made article which had been used to such a degree as to command the attention of the early biblical writers. It eventually became so thoroughly established that the common saying, "Interest shall follow as the shadow follows the substance," became a definite rule in all legal proceedings concerning transactions of a financial nature.

Thus there was created what we might term "a silent partner" operating, on the one hand, solely to the benefit of accumulated wealth, of whatever extent, and, on the other hand, to the detriment of the less fortunate.

It is impossible to determine the full effect of this factor, but one class of securities with which we are all familiar will serve to illustrate the point:

A city issues $100,000.00 worth of 30-year 6 per cent. bonds, without a sinking fund provision, for the purpose of building a school actually to cost $100,000.00. When those bonds are retired, at maturity, the school is probably out of date and of

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no value, yet what, on a cash basis, would have cost the community $100,000.00, in reality cost $280,000.00. Therefore through the medium of interest we have an actual as well as a theoretical element ever tending to give to one man a greater and to another a lesser share of the per capita wealth to which each is, by the laws of creation, entitled.

As the interest factor operates in the case of municipal or any other bonded indebtedness, it will also influence the cost of commodities to a consumer. Therefore conditions would be further aggravated if a general accounting principle were adopted whereby the manufacturing cost of an article would be increased by a charge representing interest on capital employed in the respective subdivisions of the operation.

Can we as accountants—the only profession dealing with financial conditions which has the reputation of being non-partisan—contribute to the approval of a principle which operates entirely for inequality to the end that capital interests shall be unnecessarily augmented and the less fortunate possessors of this world's goods unnecessarily burdened by a reduction of the purchasing power of their wealth?

I am not combating any gains made through the legitimate processes of trade, but I do say that it is unreasonable to saddle the cost of an article with a charge originating in a factor which operates, unheard and unseen, entirely outside of the law of supply and demand and necessary legitimate production charges.

To my mind, the plan of making interest on capital employed an element of cost is circumscribed by so many undeterminable or fluctuating conditions as to preclude its standardization. I believe in the first place that the term "interest" it wrong, whether for cost purposes the charge is made as an operating expense or, under the plan favored in Mr. Mahon's paper, such charges are deducted from the net earnings of any operation either as an entirety or departmentally. It occurs to me that instead of "interest" we should have a term properly to convey the thought that an element was being inducted into our calculations representing *a measure of reasonable expectancy for the use to the business of the capital employed.* In this it is apparent how divergent the views of different business organizations must be. One concern can set a measure of six per cent.; another four;

another twelve, and so on. If one manufacturer uses four and another seven, the cost figures of one will be of no more service to the other than if "A" uses four and "B" ignores the item altogether. Moreover "A" may use it as a direct cost; "B" may deduct it from "net earnings"—in consequence their comparison cannot possibly be of value without recalculation. Therefore the best plan will be for neither to use it.

Let us establish what is the capital of a business. Generally it is spoken of as representing the amount stated as capital stock and surplus combined. This will not suffice for the subject before us and therefore we must consider the capital as the aggregate amount of all the assets, regardless of what the source may be as represented in the actual liabilities, and any credit items appearing on the balance sheet. Granting the necessity of a charge for employed capital, it at once becomes apparent that to whatever division or department the assets are allocated, such operating accounts will be charged with a rate covering "reasonable expectancy."

Now let us consider the theoretical intent of a concern entering the business field.

A normal condition would be where the stockholders contribute an amount sufficient to provide plant, equipment, stock of merchandise and adequate working capital. Under ideal conditions no items would appear on the credit side of the balance sheet other than the amount of capital stock and any subsequent increment as represented by surplus. If this were possible in all cases, the segregation plan or any other plan of spreading an arbitrary charge on the books might be in order. But — and here any such plan fails — no human being nor any group of live, aggressive business men is content to confine an operation to the limitations of an original investment, especially if the business is successful, and most certainly not if, through error in judgment or the contributing causes of trade conditions, losses are sustained. In either case there enters the speculative feature—on the one hand further to increase the profitable condition by anticipating market fluctuations and purchasing supplies and merchandise far in advance of needs; or, on the other, the necessity of carrying losses already made in the hope that such can be recovered out of future profits.

Either phase at once produces an abnormal or subnormal condition and there are raised on the books accounts known as notes payable, accounts payable and bonded indebtedness. We can ignore the subnormal condition and deal entirely with the abnormal or "above regular."

The usual amount of merchandise purchased in advance is distributed to various departments. The respective departments by virtue of wise purchasing are enabled to show a remarkable profit and under the plan advanced at the end of a period will have deducted from profits an arbitrary rate "of reasonable expectancy." All other factors being equal, another concern less fortunate might show a loss. Now has the first concern proceeded properly from a cost standpoint? I think not. In the first place a true cost basis has been superseded by one of speculation. If the normal cost plan had been maintained the department would have been charged with the market value of the goods at the time they were consumed and, under the segregation plan, with such rate of expectancy as had been adopted. Would not the showing for that department have been vastly different than in the first case?

Allow me to digress from the subject long enough to say that the need of a definite "normal" standard for cost systems and the elimination of speculative factors in order to produce actual 100 per cent. pure operation is a matter that must eventually be regarded with most careful thought by the accounting profession.

Now to return. All the assets must be segregated to various departments. To illustrate:

Financial department	(Including credit department)	
Branch houses Group one	Jobbing house	A
	Factory	A1
	Factory	A2
	Factory	A3
Branch houses Group two	Jobbing house	B
	Factory	B1
	Factory	B2
	Factory	B3

The assets collectively are counterbalanced by the aggregate of notes payable, accounts payable, bonded debt, capital stock and surplus.

To what accounts will the "measure of reasonable expectancy" be credited when the several departments are debited? That arising from the notes payable, if the "interest paid" rate were the same as the rate for capital employed, would be offset through the interest account. (Here we have another fluctuating quantity, as only in rare cases would the two rates agree. Money at present can be had at almost any rate between 3½ and 6 per cent.—concerns borrowing at 6 per cent. and compelled to maintain minimum balances in bank would possibly pay above 7 per cent. Therefore a credit or debit balance would appear in either account.)

Accounts payable not requiring the payment of interest would not be covered by an offsetting item.

Bonded indebtedness interest would clear or else fail to adjust itself evenly, the same as notes payable interest.

Capital stock would present the same condition as accounts payable and, in addition, the credit offsetting the aggregate charge, assessed to the various departments which entered into the general operation or loss and gain, at once would become the property of the stockholders to be increased by such further dividends as might be declared. In the case of loss, however, an illegal condition could arise in that there would be no account to absorb the loss and the funds set aside on stockholders' investment, as above, might take the form of impairment of capital.

Therefore it is apparent, the foregoing plan being impracticable, that the only course left open is that termed the "segregation plan" in Mr. Mahon's paper. If any plan is ever uniformly adopted, I favor this one, principally for the reason that the charges for capital employed are not included in the cost of raw material or goods in process. In other words, values are not shown in the accounts other than cost of material plus proper manufacturing expense. If the consensus of opinion is for cost purposes to adopt a plan whereby the "reasonable expectancy" rate is made a factor of the expense, then at fiscal closings any amount accruing from this source and included in the values placed on finished or other merchandise on hand should be reversed by debiting loss and gain and erecting an offsetting reserve, which for balance sheet purposes should be deducted from the inventory values.

Every person who enters the business field, either as a partner or as a holder of any class of capital stock which does not guarantee a certain dividend, risks or ventures his contribution for better or worse. That is, out of all the opportunities which may be brought to his attention, some one presents the best assurance of a fair return on his investment as well as the safety of the principal sum. There should not be anything in the scheme which would unnecessarily increase the cost of the product and thus burden the public with an arbitrary value. In the case of larger organizations, however, regardless of what comparisons may be made between separately controlled companies in the same business, it is necessary that a plan be adopted whereby the management of each of the departments or subdivisions can have an adequate basis of comparison between department and department. Undoubtedly all of us are familiar with the controversies appearing from time to time between department heads and branch house managers relative to the actual results obtained. The segregation plan would solve this question accurately and conclusively beyond all peradventure if the "normal" condition previously mentioned were maintained. By the inclusion of the speculative feature we should have a hydra-headed affair which could produce complications and demand an intricacy in bookkeeping methods and other things far worse than any contingency which could arise from the omission of a charge to represent *a measure of reasonable expectancy for the use to the business of the capital employed.*