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By B. F. Butterfield

The object of this article is to unite, under scientific principles common to all accounting, the appropriation accounts of cities and the accounts of commercial organizations. The writer has found no work in which accounts of both classes are logically joined to a common scientific skeleton, so to speak. The most advanced authors have failed to explain appropriation accounts from a scientific point of view, but have treated them as floating by themselves, not forming part of the general accounts. In the attempt to provide practical text books, intelligible to persons not accountants, the theoretical field has been left by master writers to later and perhaps less qualified hands.

Until very recently the accounts of most cities were simply elaborations of the administrators' own accounts. Men entrusted with public money credited it to what they regarded as liability accounts on their books, and charged these accounts with payments as they made them. This was the origin of appropriation accounts. It was as if a commercial house had no accounts except the accounts kept with it by its employes. Cities did not have accounts of their own in any true sense of the word. The books were in reality those of the administrators, intended only to show that their indebtedness to the cities had been duly discharged by paying out for the proper purposes the funds received in trust. The cities were in fact treated as opposite parties to a contract, which supposedly should keep other books of their own, charging and crediting their administrators, and keeping account of their assets, liabilities, revenues and costs. But in reality no such books were kept, because there were no officers designated to keep them.

With the multiplying of municipal activities arose the necessity for thorough, scientific accounting. It became a pressing need to introduce the real and nominal accounts as they exist in commercial double entry bookkeeping. Here occurs a difficulty which has served more than is generally supposed to prevent cities from adopting double entry bookkeeping. The difficulty is simply this: double entry bookkeeping treats the real and nominal accounts not as parallel, collateral and corroborative of one another, but as opposite to one another, mutually cancelling each other. It thus has no place for the appropriation accounts so indispensable to municipal accounting. Here is a point where double entry bookkeeping entirely ignores the needs of our great and growing cities, complacently failing to meet one of the tests of twentieth-century usefulness.

The analysis of commercial accounting begins with the fact that at first accounts were kept only with persons. The sides of these accounts, by what seems a mischievous accident, were styled "debit" and "credit," and these names were later given to the sides of all kinds of accounts, although entirely meaningless except as applied to personal accounts. The real distinction between the two sides of a personal account is that in the left-hand column are entered those items which considered by themselves denote the existence of capital belonging to the proprietor keeping the books, while in the right-hand column are entered those items which considered by themselves signify the lack of such capital. In other words, a proprietor, reading over his personal account balances, thinks "favorable to me" of every left-hand balance and "adverse to me" of every right-hand balance. Using this latter distinction as the true one, the same distinction can be made as regards property and impersonal liability accounts, without straining the meaning of words or resorting to analogy.

A ledger containing all assets and liabilities would be out of balance by the amount of capital. A statement made from it would not be a balance sheet, and, as capital is not a liability, if capital account were entered on such a statement to save the reader the trouble of subtracting the liabilities from the assets (which is the only true reason for entering it), such capital account ought logically to be entered in red ink, after the formal manner of bringing down the balance of an account that is not closed.

A revenue and expenditure ledger is simply a second classification of the proprietor's capital, according to the sources which have increased or tended to dissipate it. Such a ledger would naturally begin with the capital account, or as it should be styled, "capital brought forward from previous fiscal period." Additional accounts would tabulate all the gains and losses; and the ledger would at all times fail to balance by the same amount as the ledger of real accounts, that is the present net worth as shown by the books. It is quite natural to make this nominal ledger comparative by epochs of time by periodically making adjustments to show accrued charges and transferring all balances to "capital brought forward from previous fiscal period," whereupon a new fiscal period is begun. And in making the transfer any grouping could be followed, in order to classify the period's gain or loss, just as in making a statement of assets and liabilities these are conveniently grouped.

At the risk of being accused of predicating large dogmas upon little knowledge, the writer contends that the nominal ledger should logically carry the favorable entries, that is, the income accounts, on the left-hand side, and vice-versa. The present practice utterly reverses all the nominal accounts, for the avowed purpose of mixing the two ledgers together in such a way as to get the useless answer of zero. It is as if a party of engineers, levelling by two separate lines from one point to a second, to ascertain the elevation of the latter, should systematically pretend that all the elevations along the second line of levels were the corresponding elevations below sea level, for the dubious purpose of arriving at two elevations for the second point, which added together should equal zero. For the only intentional end served by so mixing the ledgers is a trial balance which means nothing to anyone until, like the old-fashioned merchandise account, it has been split into its two divisions. As a result, in accounting, we confuse losses with assets, and the capital account itself appears among the liabilities and is by most bookkeepers imagined to be one of them. Worst of all, it is hopelessly confusing to the business man to see the "favorable" balances now on one side and now on the other side of his books. Even an accountant can do nothing with a trial balance when, as is generally the case, the titles of many accounts do not show whether they are real or nominal. As a proof of journalization and posting the trial balance is no better than two separate lists of accounts from different ledgers, showing them out of balance by the same amount on the same side. Even now, subsidiary ledgers show a balance on the same side as the controlling account, and this is esteemed as good a proof as a trial balance.

The present practice was at one time enforced by the fact that bookkeepers mixed every real account with its corresponding nominal account. Not only "merchandise" account was thus mixed, but, for instance, "real estate" account contained in one and the same account the asset value of real estate owned, less taxes and repairs, plus rent received, and so on. Obviously separate ledgers could not have been kept, if such accounts were to continue. But now that mixed accounts are in disuse, nothing compels the continuance of the present system, which appears to the writer to be the product of bookkeepers simply, not of accountants.

If, now, we insist that the two foregoing classifications of net worth are opposed to each other, are opposites, and mutually cancel each other, as the present style of bookkeeping indicates (without deceiving accountants), then our circle of accounts is complete, and we can have no other classifications of accounts. But if we acknowledge that the real and nominal accounts are two separate, parallel, collateral classifications of present net worth, both showing a preponderance on the same side of the books in our mind's eye, then we have opened a way for the establishment of a third, a fourth, and subsequent classification of net worth, all mutually corroborative, all failing to balance by the same amount, on the same side of the books.

For instance, one such ledger might contain the partners' investment accounts, with gains and losses posted daily, without preventing the keeping of nominal accounts. Another such ledger would contain the realization and liquidation account, if needed.

But the object of this article is to take up the question of fund or appropriation accounts. This is the most important third classification.

Although, because generally mistaken for liabilities, appropriation accounts are commonly kept with right-hand or "credit" balances, the writer believes that since appropriations are simply the same capital previously classified into assets and into sources of gain, etc., now classified over again according to the purposes to which it is dedicated, appropriation accounts should have left-hand balances. Unless offset by some other account, an appropriation balance is favorable, showing that there is available capital for the purpose indicated, and consequently it is as logically a left-hand balance as is a bank deposit, which, indeed, it may be. For, to make the meaning quite clear, let us suppose that a certain city possesses $300,000 net worth, of which $100,000 was obtained from a property tax, deposited in the First National bank, and devoted to general expense purposes; another $100,000 was the proceeds of a poll tax, deposited in the Second National bank, and devoted to the support of the school system; the third $100,000 was the total of licences collected, deposited in the Third National bank, and devoted to the sinking fund. Needless to say, the ledger of real accounts would carry accounts with the three banks; the nominal account ledger would carry accounts with the three fiscal levies; and the appropriation ledger would have accounts with the three appropriations. In every ledger the balance would be favorable, and there would be no logical reason for not showing all the balances on the same side of the accounts. Inspection will show the reader that by arbitrarily reversing any one of the ledgers it could be forced into a trial balance with either of the other two.

Overdrawn appropriations would naturally appear on the right-hand or adverse side of the books, and unused appropriations granted in excess of present resources would be offset by adverse accounts showing the deficit to be made up by taxation or otherwise. Any resources not available for the particular purposes enumerated among the appropriations, or available but not intended to be dissipated, would be classified as reserves, having favorable balances. In commercial accounting, the reserves, erroneously made to show on some balance sheets as reduction of capital, and which under double entry cannot be set up until the nominal accounts are closed, really appertain to the third ledger.

Recent writers on municipal accounting, having balanced the real accounts against the nominal, have introduced a second, disconnected trial balance in which appropriations and reserves are balanced against accounts of a fourth series, the appropriations being stated with right-hand balances. The writer has not seen any scientific distinction drawn between the two distinct kinds of accounts appearing on this second or "fund" trial balance, nor any fundamental relationship traced between the two trial balances.

The accounts of the fourth series recapitulate the asset accounts, directly diminishing each by the amount of the analogous liability, and fluctuate as either the assets or the liabilities fluctuate.

As soon as a purchase order is issued against any appropriation, the money is transferred from the appropriation account to an account styled "reserve for orders." The writer construes a reserve as a part of net worth, not of liabilities, and believes that unless reserve for orders is diminished when goods are delivered rather than when ultimately paid for, the reserve for orders becomes an unscientific mixed account, appertaining partly to the third classification of accounts and partly to the fourth.

Real accounts show capital in the present tense, outlining that of which it now consists; nominal accounts supply a past tense, showing how present capital was acquired; and appropriation and reserve accounts furnish a future tense, signifying the purposes to be carried out by the use of present capital. Thus, the introduction of appropriation accounts enables the administrators to face forward in their accounts, instead of backward. To use a metaphor, they are enabled to ride upon the front end of the train, watching the approaching landscape, rather than upon the rear end, gazing upon the receding scenes already past. Or, in still other words, appropriation accounts enable the administrators to keep account with their plans, not merely with their past achievements.