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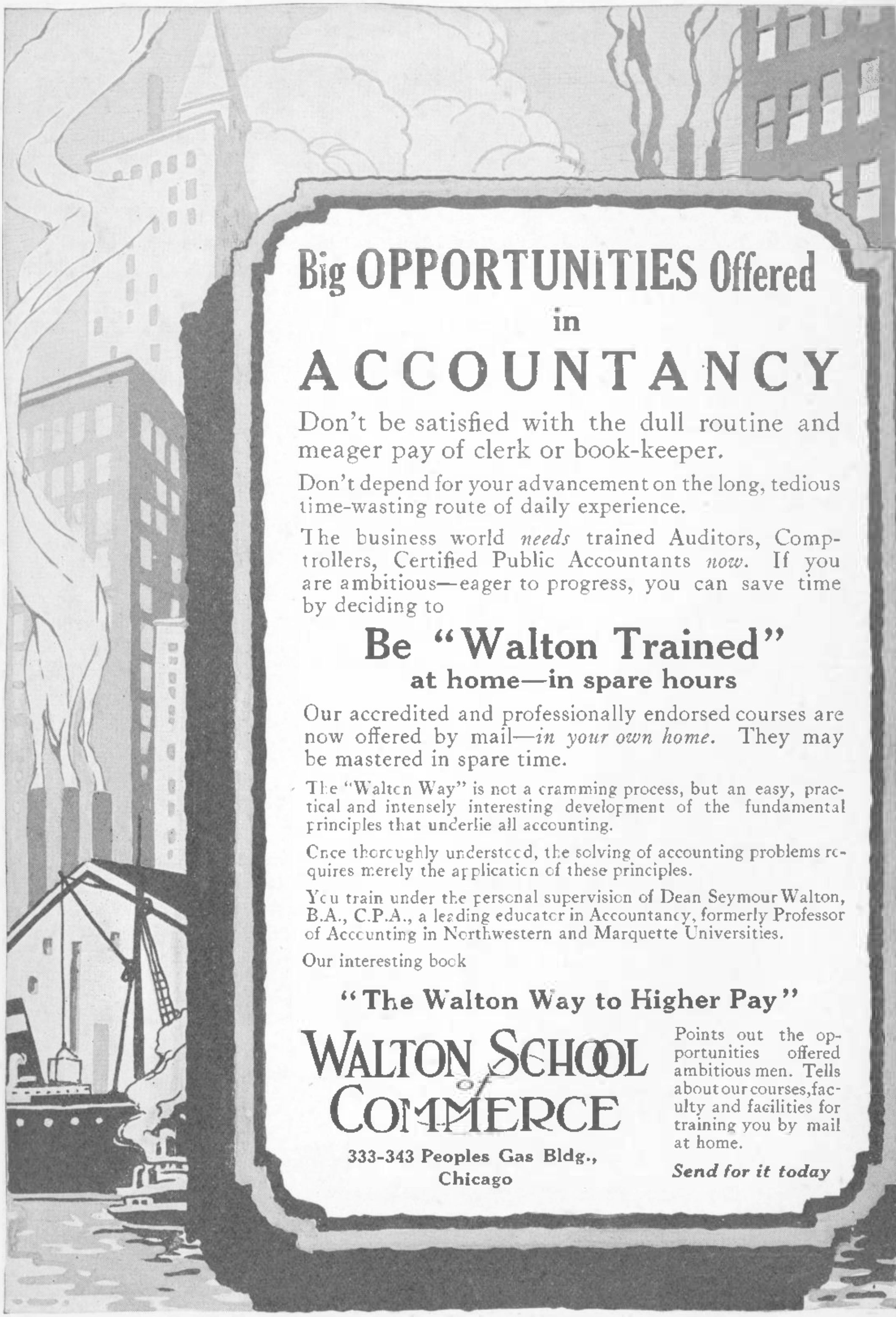
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THE JOURNAL OF ACCOUNTANCY

CONTENTS FOR NOVEMBER, 1916

THE JOURNAL OF ACCOUNTANCY is the organ of the professional accountants of the United States. In its articles and editorial columns it treats, from the accountant's point of view, of business problems and conditions.

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The Federal Reserve Act*

By Charles S. Hamlin†

We all appreciate the tremendous prosperity of the United States at the present day. It would take a body of accountants to submit the figures of our marvelous development if we were to contrast, for example, the year 1912 with the present day.

The national wealth, I suppose, has increased some forty billions of dollars. The deposits of the banks have increased six or seven billions of dollars; clearings have increased marvelously. The money in circulation in the United States has increased some seven hundred millions of dollars. Since the first of 1914, the net imports of gold into the United States have been over four hundred and sixty millions of dollars.

Such prosperity we never have had before in the whole history of the United States of America, and that prosperity is built upon a sound foundation. But in the middle of this great prosperity, it seems to me that we should take account of the future. We should be conservative. Conservatism is the rule for the present day and there is no other time to preach conservatism and care as well as when we are in the midst of prosperity.

The federal reserve system is simple. You know, we have about 7,500 national banks. The country is divided into twelve districts and the national banks in each of those districts organize another bank, called the federal reserve bank. The stockholders are all the national banks and such state banks as have entered the system or as may enter in the future. The capital paid in

*An address delivered at the banquet of the Institute of Accountants in the United States of America, New York, September 21, 1916.

†Of the Federal Reserve Board.

to these twelve federal reserve banks is about fifty-five millions of dollars, and the member banks—the national and the few state banks that have joined—contribute part of their reserves to these twelve banks. There is now deposited in the twelve federal reserve banks over five hundred millions of reserve money of the member banks. As I have said, the paid-in capital is some fifty-five millions, and altogether the federal reserve system has resources of about six hundred millions of dollars.

These banks discount the paper of the member banks. A member bank whose reserves may be getting down to the legal limit can take the paper that it has discounted to the federal reserve bank and turn that paper into gold or a credit, as the bank may desire; so that there is no longer any worry or danger when the member banks see their reserves gradually decline. That has been one of the troubles in the panics that we have had in the United States. The reserves of the banks got down to the danger-line; they could not legally impair those reserves; and they had to borrow as well as they could, one from the other.

Under the federal reserve system, part of the reserves of every member bank is stored in the federal reserve bank. A bank may put in a million dollars and, in time of necessity, it may take out ten or fifteen or any number of millions of dollars. We believe this consolidation of reserves has placed our banking system in an absolutely sound, impregnable position, and that we never again will see a wide, devastating panic such as we saw in 1907.

These federal reserve banks in discounting paper, of course, make money under that process as an individual bank would do. They can go, under certain conditions, into the open market and buy bills of exchange and acceptances. They can invest in government bonds and municipal warrants, and out of their earnings they pay accumulative dividends of six per cent. to the member banks. Over that they are allowed to accumulate a reasonable surplus; but every dollar over the six per cent. earned and a reasonable surplus is taken by the United States government in the form of a franchise tax, so that there is no reason to seek undue profit on the part of the federal reserve banks. Their duty is to hold the reserves of the country and help the member banks in times of stress.

Some criticism was made at the outset because the federal reserve banks at first earned no dividends. The system has not yet been in operation two years, and I believe you will all appreciate that few of the prosperous banks of today have ever been able, in the short period of two years, to make handsome dividends and lay up a surplus for the future. But the reserve banks have been steadily increasing their earnings, and today a majority of the banks are earning at the rate of over six per cent. and only two banks have a rate of earnings under five per cent.

Of course, these banks could easily earn all their expenses and dividends if they wanted to do so. They could go out in the open market and compete with the other banks; but that is not the function of a reserve bank. Its function is to hold the reserves of all the banks and its duty is to help the banks. Out of the reserves it makes its revenues.

On the enormous excess reserves held by the federal reserve banks only a limited demand has been made, except perhaps by the three southern banks; but when those reserves become normal, as they will, and when going to the federal reserve bank for rediscount is a normal part of the business of the banks, then you will find that these banks will easily earn their expenses and their dividends, and the government probably will derive a large revenue from their operation.

Under the operation of the system, barely two years old, you have seen the discount rates fixed by the various federal reserve banks of the country. You have seen those discount rates slowly falling, affecting rates throughout the United States. The purchase by the federal reserve banks of municipal warrants has given the towns and the cities of this country money at lower rates than they have ever been able to obtain before. Over a large portion of the country—certainly in all the large cities—the effect of the federal reserve system has been materially to lower the rates at which business men can obtain the accommodation upon which the life of their business depends. I think it can safely be said that never again will a business man who deserves credit have to be turned down by any bank which is a member of the federal reserve system—and if the federal reserve act accomplished nothing more than that, it would be a triumphant success.

It is not such a far cry to go back to the year 1914, in the summer when the terrible European war suddenly began. You will remember the conditions in this country. The exports of gold, the rising exchange—everything pointed to a panic to which the panic of 1907 could not have served respectably as an understudy; but out of that condition came the prosperity that we see today.

How did we emerge from that threatened panic?

When the federal reserve board was appointed in August, 1914—the banks, you remember, were not open until November—the first task imposed upon the board was to devise some means of paying our enormous indebtedness to Europe, estimated at some five or six hundred millions of dollars, all payable in gold, if the honor and good faith of the United States were to be maintained. We decided to call on the banks of the United States in the reserve cities to put up a fund of a hundred millions of dollars and put it at the disposal of the federal reserve board. We issued that call and as soon as the post or the telegraph could bear the news back to us, we found that the banks had responded with patriotism and had given us a hundred and ten millions of dollars in gold. That patriotic act of the banks of the United States turned the tide. It was a notice to all the world that every obligation of the people of the United States payable in gold would be faithfully paid in that metal; and although that fund of one hundred and ten millions of dollars was raised by our board, only ten millions had to be sent out of the United States. The psychological effect turned the tide, and soon you saw the flood of prosperity, which even yet has not reached its maximum.

What was the source of the confidence of the people?

They knew that the federal reserve act was law—although the banks were not open until November of 1914. They knew that the moment those banks opened their doors, the required reserves of the national banks of the United States would be materially lowered under the federal reserve act and a sum of five or six hundred millions of released reserves would be available for increased credit. They knew also that the moment the banks were open, provision had been made for an elastic currency known as federal reserve notes and that those notes could be issued and that there was no further danger of any currency panic in the United States. Those things generated confidence, and on that confidence this development that we have seen has been builded. That confidence will never be lost by the people of the United States.

Some say that the panic of 1914 was stopped by the issue of the so-called Aldrich-Freeland notes, under the Aldrich-Freeland act of 1908. Some say that the federal reserve act had nothing to do with that. The Aldrich-Freeland act was passed in 1908. We did issue, in the summer of 1914, some three hundred millions of dollars of that Aldrich-Freeland currency; but the point I want you to remember is this: that currency was not issued under the original Aldrich-Freeland act. That act put so many restrictions upon the issue of notes that it would not have been possible to meet a panic successfully by notes issued under that act as originally framed. It provided that no bank could get any Aldrich-Freeland notes unless it had outstanding national bank notes secured by bonds up to forty per cent. of its capital—and that threw out a great many banks at the start. It had all sorts of limitations as to the amount of notes that could be issued. There never could be an issue greater than the capital and surplus of the bank. The amount which could be given to each state was simply in proportion, in the first instance at least, to the capital and surplus of the national banks of the state. Further than that, there was a terrific tax imposed on those notes, beginning at five per cent. and increasing one per cent. each month until the maximum of ten per cent. was attained.

That act could be used after a panic had struck us to help gather together the wreckage, but it never could have been used to prevent a panic.

The federal reserve act amended the Aldrich-Freeland act and, as amended, that act became part of the federal reserve act. It lowered the rate of taxation from five to ten per cent. to three to six per cent., making it practicable to issue notes. It removed the limitation imposed upon the amount of notes. It provided that notes could be issued up to one hundred and twenty-five per cent. of the capital and surplus of the issuing banks, and in that way it made the act practicable.

It had to be used because, as I have said, the banks could not have been opened in time. But the feeling of confidence was not due to the Aldrich-Freeland notes. It was due to the knowledge that the federal reserve act was on the statute books; that within a month or six weeks the banks would open; that, when they opened, the national banks would have six hundred millions of released reserves as a basis of credit; and that there would be an elastic currency sufficient to supply the needs of the country.

I believe that under the federal reserve system we never again shall have a universal collapse of credit such as we had in 1907. That does not mean that individual banks may not come to grief. A bank president may have a financial "joy ride." Bank directors may forget their duties to their stockholders. They may be reckless and imprudent, and if they are they will reap the consequences in the future as in the past. But I say with confidence that we never again can have a universal collapse of credit. The federal reserve system prevents. We never again can have a currency panic such as we have had in the past. The elastic currency notes, the federal reserve notes, will obviate any such trouble as that. I believe that this country at last rests upon an absolutely sound, firm banking foundation and that the great prosperity which we are going through today is the forerunner of even greater prosperity.

Some of our friends wanted to have one central bank for the whole United States. They were enamored of the so-called Aldrich bill. You will remember the Aldrich monetary commission which went all over the world. Those gentlemen did a wonderful piece of work. They studied the financial and banking systems of the world. They gathered together a financial library —the like of which does not exist elsewhere in the world today— and on that material they framed a banking act. It was well framed; it represented the highest scientific skill.

The bill provided for one central bank in the United States at Washington, with branches scattered over the country. That system undoubtedly would have worked, but there was one fault. There was little if any public control over the banking system. It was practically dominated by the banks of the country, and the people felt that, with the enormous centralization of banking power, inevitably there would be trouble between the interests of the people and the interests of the banks. The plan was based on the theory that banking is a private and not a public business.

The fundamental idea of the federal reserve act is that banking is not merely a private business, but one of public interest and that the public have a right fairly to regulate the banking concerns of this great country. With that end in view, the federal reserve board was created—an independent board sitting at Washington. The board appointed three out of the nine directors of every one of the twelve federal reserve banks. The board has control over the discount rates fixed by the banks and general regulatory control. The twelve banks are absolutely democratic, independent banks; but they are coördinated in one system through the power of the federal reserve board. There are twelve great banks responsive to the needs of the country, regulated by the federal reserve board, instead of one great bank in Washington with all banking power centralized there.

Those who wanted one bank for the whole United States used to say: "Foreign nations have central banks. England has a great bank, France—all the great nations have these central banks. Why not have one central bank for the United States?"

A central bank in Europe and a central bank covering the whole United States are very different propositions. For example, take one of the twelve federal reserve banks—that at Chicago. The district covered represents a population of over twelve million people—more than the population of Norway, Sweden and Switzerland combined. That is quite a central bank in itself.

If you consider area, the federal reserve bank of San Francisco has an area so large that you could put into it all of Great Britain, France, the entire continental German empire and Italy, and then you would have area left over larger than all New England, except Maine. I think you will realize the tremendous possibilities of that great bank. As I have said, there are twelve banks, and I believe that those twelve banks, representing various districts and interests, coördinated under the federal reserve board, constitute a better system than one board of directors in Washington managing all the banking capital of the United States, with all the banking power concentrated in that district.

There are many interesting problems that I should like to talk about to you. Recently the federal reserve board established a new system for the clearing of the cheques in business transactions, and I have no doubt that many public accountants sooner or later will have the pleasing task of determining the cost of collection of cheques in various banks throughout the United States.

You know, of course, the intricacies of the clearing system. I had certain instances presented to me when I was studying the question of cheques. A man in the south would draw his cheque and send it to somebody in the north. That person in the north would put it in the bank. To trace the journeys of that cheque to the bank on which it was drawn would make you dizzy. It would go zigzag from one city to another, all in the effort to find some bank that would cash it without exchange. I found many instances in which a cheque would go through the city on which it was drawn before it finally got home.

I believe that the collection system inaugurated by the board is a movement toward efficiency in business, and, as a movement toward efficiency, it is bound in the long run to succeed. Banks are not compelled to deposit cheques in the federal reserve banks for collection, but, if they do, the banks on which they are drawn must pay them to their own federal reserve banks without deduction for exchange.

Many banks believe that they make a great deal of money by deducting exchange from their cheques. They make sometimes thousands of dollars and they say that that is pure profit; but they don't analyze the profit. One banker told me once: "I made six thousand dollars in money I received in exchange for deductions from my own cheques, and you are going to take that away." "Was that pure profit?" I asked. "Yes," he said, "I got every dollar of it."

I told him that he reasoned about the way I reckon the profit on my little farm in Massachusetts. I put down every dollar that I get from the sale of anything on that farm as pure profit and it makes a very handsome showing, unless some accountant comes along to analyze those profits. Then the handsome profits quickly turn into a considerable deficit.

Such, I suspect, would be the case with some of these banks if they would analyze the cost to themselves of keeping enormous balances in order to get their cheques parred by other banks. It is estimated that by the clearing system, as it was before our new regulation went into effect, five or six hundred millions of balances were kept idle which otherwise could have been lent to the merchants of the United States.

Some of the smaller banks may be injured a little at first by the new system, but that injury will be swallowed up by the benefit to the whole community. They will not be ruined. Merchants who keep twenty accounts in twenty cities can bring their accounts to the home city, because their cheques will be parred throughout the United States.

The fear of many of the banks will be quickly dissipated by the increased lending power they will obtain in the ability to take in their balances carried in the other banks; and the people in the whole country will receive a great benefit.

Fundamentals of Investment Securities Accounting

By Ernest H. Griswold, C.P.A.

The inadequacy of the accounting of the majority of firms dealing in investment securities was never more clearly shown than at the opening of the present European war.

Most firms dealing in securities were obliged to cut the cost of operation. Lack of statistics of operating cost led to a promiscuous cut in the salary list. Employees were dismissed or placed upon part pay until the point was reached where either the organization must be broken, perhaps to be rebuilt after a long period, or some other way of cutting expense must be found.

Some chose the easier way and disrupted their forces. Others called for details of expenditures and, after looking at a list which suggested no remedy, ordered the mass to be classified into intelligible data. The executives of these firms after studying the new data showed surprise at certain items and demanded the reason for not having been furnished with such material before this time. The answer was easy. Never before had it been demanded. So long as gross profit was large enough to cover expenses and leave a good round sum for disbursement to the stockholders or members of the firm, no need of such accounting statistics had been felt.

Some firms learned their lesson well, and realizing the limitations of their own clerical staffs called in public accountants for a general renovation of their systems. These firms are today enjoying a valuable classification of their operating cost and gross revenue. Others, with the return of an active market, have forgotten their troubles and are proceeding in the old way and will again be taken unprepared at the next crisis.

The accounting of the majority of the present day banking and investment securities houses is in a stage of development comparable with the accounting of the manufacturing concerns of ten and twenty years ago.

It has been well said that if the accounts of a manufacturing concern were carried out in no more detail as to fundamentals than are the accounts of a security house, the manufacturing plant would soon be closed.

The executive of the investment house will laugh and say that there is no parallel—that such a business as his does not need the intricate accounting system of the manufacturer with his cost sheets, his machine hour or man hour rates, etc. He will add, however, that he appreciates the value of such things in their proper place, and would hesitate to underwrite an issue of bonds or stocks for a manufacturing company not having these modern methods of cost finding and details of revenue—but of course in his line he can usually tell the profit on a deal before it is begun.

The manufacturer once said the same thing about his own business; but experience has taught him that he was wrong. The experience of finding out that he had been selling below cost, the competition of his neighbor who had cut an expense before he himself knew that it existed—these things showed him that the old slipshod method of accounting was only for the unwise and the unsuccessful.

The question may well be asked as to why the security selling houses have not kept pace with the improvements in accounting methods and use of statistics. The answer is threefold:

First: Profits in good times have been so large that the shortcomings of poor times have been passed over.

Second: The average executive in this business has blamed hard times for the failures and has taken as a matter of course the results of a boom when even a "wild cat" security floated toward par.

Third: The day of intensive financing with a large unit profit on a comparatively small volume is over and in its place has come extensive financing with small unit profit on a large volume. The fact that the statistics of the former phase are not good statistics for the latter phase is now being realized.

The security house executive divides expense into salaries and general expense and thinks of gross profit as profits less losses. If net profit is low he looks at expense and gross profit. He frowns on salaries and thinks general expense too high. He may pass it over as he thinks of future sales whose profits will surely increase the net. This, as must be mentioned again, is the pit into which the average man in such a business falls—thinking of the business only in the light of what he considers profits, the difference between first cost and the selling price of securities.

Perhaps not seeing any way of cutting the salary list he looks over the detail of general expense, which will probably be classified into such items as rent, light, postage, advertising, stationery, printing, traveling, entertaining, telephone and telegraph and miscellaneous. Where shall the cut come in this list? He may have details of each of these items furnished him and may find that printing is more than it should be because some one made a mistake in the form for the last general circular, which necessitated a new printing. The telephone bill may be larger than usual because of needless long distance conversations. Entertaining may contain questionable items. The engraved stationery has been used for inter-office correspondence. The recurrence of these wastes may be guarded against, but it will be mere surface glossing. The indices which will show where the policy of the business is weak or strong are missing.

The gross profit is next scrutinized. From a detailed list it is seen that there are profits on certain securities and losses on others. There is a profit or loss on interest. This executive may know why each security sold for a profit or at a loss, but he is gazing at a number of points. The whole is not apparent to him.

An accounting system built upon fundamentals would show for any period among other facts:

I. *Relative to profit or loss:*

(a) Total par value of securities sold;

(b) Total profit;

(c) Total profit per $1,000 par of securities sold;

(d) The par value of securities sold at a profit, at a loss and at cost;

(e) The amount of profit and amount of loss;

(f) The amount of profit and amount of loss per $1,000 par sold.

(g) The following data on each class of security sold, i. e., corporation and public utility, railroads and municipal. This classification may be divided still further into securities sold which have been purchased from issuer and securities sold which have been taken in trade.

1. Total par, total profit and profit per $1,000 par sold.
2. Par value sold at a profit, at a loss and at cost.
3. The amount of profit and amount of loss.
4. The amount of profit and amount of loss per $1,000 par sold.

(h) Interest earned, interest expense and profit or loss on interest per $1,000 par sold.

II. *Relative to expense:*

(a) Total expense and expense per $1,000 par of securities sold;

(b) Classification of expenses into general, selling, buying, accounting, executive, etc., with supporting data;

(c) The following data on each class of security, i. e., corporation and public utility, railroads and municipal. This classification may be divided still further into securities purchased from issuer and those taken in trade.

1. Total par purchased and total expense of purchase and expense per $1,000 par of purchase — this expense of purchase based upon proper distribution of overhead and directly applicable expense.
2. First cost, i. e., price paid to vendor.

The above are the salient features of the results of such an accounting system. The supporting detail and other classifications would be equally illuminating.

It requires no great stretch of the imagination to see the benefits which would arise from this perspective of the past and the consequent sure understanding of reasons of future policy.

How many security houses know the unit cost, the unit profit or loss? How many know that the expense of buying certain securities has taken all the profit away before they are sold, or that the cost of selling certain issues added to the loss on securities taken in trade has turned the difference between the first cost and the selling price into a loss? How many know the amount of securities sold at first cost?

The relation of interest to securities is seldom fully realized. For instance, the difference between the first cost and the selling price may be less for a municipal security than for a public utility security; but, beside costing less for buying and selling expense, a less amount of collateral is needed for loans when municipal securities are used—consequently less capital is needed and interest charges are less.

It is not denied that the banker and the security house executive know these things in an indefinite way; but indefiniteness in the business world today is no longer safe. As has been mentioned before, the bane of the executive has been the habit of looking at points and thinking only of the difference between the first cost and selling price.

The manufacturer knows his unit buying cost and his unit selling expense as well as his totals and is making daily use of this knowledge. The investment security houses need these facts today, and some have them.

The gross profit per unit sold on investment securities is growing less and the cost of operating is increasing every year. It is, therefore, essential that policies be shaped toward the selling of securities which will yield the greatest net per $1,000 par sold, after buying, carrying and selling expenses have been taken into consideration, other things being equal. Many will maintain that the fluctuations of the money market will upset all the policies based upon statistics that accounting departments can produce; but it is contended that the money market usually affects the investment security only in long swings, and that proper indices of the business warn of the approach of changes long before such changes are perceptible from quotations.

The counting house of the days gone by was the haven of the oldest customs. Our modern banking houses inherit this inertia and their accounting will change slowly, but the change is bound to come.

Dividends and the New Income Tax Law

By W. F. Weiss, C.P.A.

The federal income tax law, as amended September 8, 1916, effective September 9, 1916, provides that dividends shall be included in the net income of taxable persons. It is to be inferred that they are now to be stated in the annual return, which requires setting forth specifically the gross amount of income from all separate sources, as in another section of the act specific provision is made that, for the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation or trustee which is taxable upon its net income. Under the old law of October 3, 1913, dividends were not required to be entered on the annual return unless the income of the taxpayer, inclusive of dividends, amounted to $20,000 or more.

In defining dividends, the new law now provides that

> The term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association or insurance company, out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association or insurance company; which stock dividend shall be considered income to the amount of its cash value.

A review of this definition presents various important new issues and questions.

Treasury decision 2163 (Feb. 18, 1915) held under the old law that cash dividends constituted taxable income for the year in which they were received, without regard to the period in which the profits or surplus was earned, and stock dividends issued as a bona fide and permanent increase of the capital stock were held to represent capital. Treasury decision 2274 (December 22, 1915) superseding and revoking T. D. 2163, ruled in respect of cash dividends the same as T. D. 2163 but held stock dividends paid from net earnings or established surplus to be the equivalent of cash and to constitute taxable income under the same conditions as cash dividends. Under the provision of the new law, quoted above, dividends are now held to be distributions made or to be made in cash or in stock, *out of earnings or profits accrued since March 1, 1913, only.*

To facilitate the proper administration of this provision of the new law, it therefore now becomes a matter of importance for corporations, when declaring dividends, to determine and indicate the period of the accumulation of the free surplus from which the dividends are declared, and further to advise the stockholders of such determination by specific notice or statement. Such notice, it is to be observed, becomes a matter of necessary information for the stockholders, as they will not be taxable for income from dividends when declared and payable out of surplus accumulations from profits prior to March 1, 1913, and dependent upon the intent and substance of the action of the directors when declaring dividends, as manifested by their resolution, they may not become taxable for dividends until the free surplus accumulation to March 1, 1913, has been exhausted, as in their discretion payments of all accumulations are permitted, irrespective of when earned.

While this procedure will apply primarily to corporations with surplus accumulations of a number of years and antedating March 1, 1913, and may become unnecessary after surplus accumulations to March 1, 1913, have been exhausted, it will in fact prove desirable practice for all corporations, which the accountant can at all times conscientiously recommend. Aside from its importance for income tax purposes, the determination and indication by the directors of the period of the accumulation of the surplus, from which dividends and especially extraordinary dividends and stock dividends are declared, will prove desirable information for executors and trustees. In testamentary or trust provisions making separate disposition of principal and income, knowledge of the periods of the surplus accumulation from which dividends are declared will facilitate apportionment and may prevent disagreements.

In respect of stock dividends, the provisions of the new law appear to be singularly perplexing. It holds stock dividends to mean any distribution made or ordered to be made out of earnings or profits accrued since March 1, 1913, and payable in stock, which stock dividend shall be considered income to the amount of its cash value. With this enactment that stock dividends shall be considered income, and in view of decisions by the courts of appeal of various states and the United States supreme court, holding stock dividends to be either partly or entirely principal, the important question arises: What is to be the taxpayer's position under this new law, which appears to be in direct conflict with the prevailing decisions of courts of last resort? The question of stock dividends (and in some instances also extraordinary cash dividends) constituting principal or income has been the subject of much litigation, and, in fact, the impression can hardly be avoided that litigation continued and increased, owing to what seemed to be a hopeless conflict of authority for many years. A condensed recital of some of the decisions will prove interesting and instructive at this time, and afford appreciation of the obvious conflict with them in the new law.

Federal Court Decisions

In the case of *Gibbons vs. Mahon* (136 U. S. 549) the question involved was whether 280 new shares of stock in the Washington Gas Light Co. (the testatrix's share of a 100 per cent stock dividend) were to be treated as dividends to the principal to which the plaintiff, the life-tenant, was entitled under the will, or were to be treated as an increase of the capital of the trust fund. The court below (the supreme court of the District of Columbia) held that the new shares must be treated as capital and the United States supreme court gave the opinion that the decision of the lower court was correct. In the course of the opinion the court held further that

> When a distribution of earnings is made by a corporation among its stockholders, the question whether such distribution is an apportionment of additional stock representing capital, or a division of profits and income, depends upon the substance and intent of the action of the corporation, as manifested by its vote or resolution; and ordinarily a dividend declared in stock is to be deemed capital and a dividend in money is to be deemed income of each share.
>
> OPINION: A stock dividend really takes nothing from the property of the corporation and adds nothing to the interests of the shareholders. Its property is not diminished and their interests are not increased. After such a dividend, as before, the corporation has the title in all the corporate property; the aggregate interests therein of all the shareholders are represented by the whole number of shares; and the proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones,

This decision rendered by Judge Gray in the United States supreme court in the above case of *Gibbons vs. Mahon* appears to have been followed without variance by the United States courts since it was rendered, as evidenced by the decisions in some of the leading cases, viz.: *Coltrane vs. Blake* (113 Federal 785), *Mercer vs. Buchanan* (132 Federal 507), *Wilson vs. Amer. Ice Co.* (206 Federal 738), *Union Pacific R. R. Co. vs. Frank* (226 Federal 921).

The last mentioned case was decided in 1915 and appears to be the last published decision in point. Rendered by the federal courts these decisions attain special significance in their relation to the provisions in respect of stock dividends in the federal income tax law.

State Court Decisions

In the state of New York until December, 1913, all regular or extraordinary dividends payable out of the surplus of a corporation—whether in cash or stock and irrespective of the time when such surplus was earned and in the absence of testamentary or other written instructions to the contrary—were generally held to belong to the beneficiary of the life estate as income—*Matter of Kernochan* (104 N. Y. 618), *Monson vs. The New York Security & Trust Co.*, (140 N. Y. 498), *McLough vs. Hunt*, (154 N. Y. 179), *Lowery vs. Farmers' Loan & Trust Co.*, (172 N. Y. 137), *Robertson vs. deBrulatour*, (188 N. Y. 301).

In 1911 in the case of *Thayer vs. Burr* (201 N. Y. 155) and in 1912, in the *Matter of Harteau* (204 N. Y. 292) the court of appeals first began to give recognition in cases of extraordinary dividends to the necessity of an apportionment in order to preserve the principal of a trust estate. Among the assets of the Harteau estate were 160 shares of the capital stock of the Metropolitan Plate Glass Insurance Co. The authorized capital of this corporation at the time of the testator's death was $100,000. In 1902 the directors determined to increase it to $200,000 and to this end they declared a cash dividend of 100 per cent. payable out of the company's surplus on February 15, 1902. Stockholders were accorded the privilege of subscribing at par for the additional stock to the extent of 100 per cent. of their respective holdings, and Mr. Harteau's executors availed themselves of this privilege in behalf of this estate and applied the $16,000 which they received by way of dividends to the acquisition of 160 shares of the new stock. They subsequently sold these 160 additional shares at a price which yielded the estate the sum of $19,912.80.

One of the questions which came up for consideration upon the appeal to the court of appeals of New York was: Was the sum received by the executors and trustees for the additional stock purchased with the surplus dividend of the Metropolitan Plate Glass Insurance Co. to be regarded as capital or income?

Judge Willard Bartlett, in writing the opinion concurred in by all the court, said: "The question whether the surplus dividend is to be deemed capital or income depends upon the time of the acquisition of the surplus which was divided."

An indication of apparent further recognition on the part of our courts came in the decision of Judge Woodward in the *Matter of Affleck* (155 App. Div. 339, Feb., 1913) as follows:

A testator gave the residue of his estate to his widow and a nephew, in trust, to collect and pay the income to the widow during her life and the remainder to other persons including the nephew. Among the assets of the trust estate were certain shares of capital stock. Later the corporation which issued the stock apportioned its surplus among its stockholders by the issuance of additional stock of which the trustees received their proportion. The executor of the widow's will upon an accounting by the nephew, the surviving trustee, claimed the additional stock as income of the trust estate.

Judge Woodward says in that part of his opinion material to this question: "A considerable portion of the briefs of counsel herein is devoted to the vexed question whether the 54 shares of additional stock (issued in the apportionment of surplus) belong to the life-tenant as income or to the remaindermen as principal."

He referred to the case of *McLough vs. Hunt* (154 N. Y. 179) wherein the referee awarded a stock dividend to the life-tenant as income, which was affirmed at general term (92 Hun, 607) and by the court of appeals on a full review of authorities; also to the case of *Lowery vs. Farmers' Loan & Trust Co.* (172 N. Y. 137) wherein the appellate division (56 A. D. 408) held that a stock dividend belonged to the life-tenant, and, further holding, in effect, that such a dividend must in principle be considered the same as a dividend in money, awarded the stock to the life-tenant. This was affirmed by the court of appeals and on the same principle. He referred also to the case of *Robertson vs. deBrulatour* (188 N. Y. 301, April, 1907) where one company declared and paid a cash dividend out of surplus earnings and another company cash and stock dividends. The appellate division, held (111 A.D. 882), that all these dividends should go to the life-tenant as income or profits. The court of appeals affirmed this decision.

In view of the foregoing authorities the court felt constrained in the very recent case of *Matter of Osborne* (153 A. D. 312) to hold that stock issued by a corporation upon capitalization of its surplus earnings belonged to the life-tenant, although a part of the surplus accrued before the creation of the trust. However he expressed the opinion in that case that, "If this were on open question I should be inclined to hold that the interest of the testator in so much of the surplus earnings as had accrued up to the time of his death constitutes, as between the life-tenant and the remainderman, not income or profits but a part of the principal or trust estate itself: that a corresponding interest in the surplus earnings which thereafter accrued is income or profits."

Subsequently, however, the court of appeals modified this decision, and in December, 1913, handed down the decision in the *Matter of Osborne* (209 N. Y. 450) the facts in which are as follows:

The testator who died in 1908 gave under his will the residue of his property to his executor in trust to pay the income thereof to his wife during her life and after her death the principal to be divided as provided in the will. At the time of his death the testator owned 3,000 shares of the capital stock of the Singer Manufacturing Co. The corporation at the time of the death of the testator was capitalized at $30,000,000 and had a surplus of about $37,000,000. In March, 1910, the executor had sold 80 shares of the testator's holdings in this company. In June, 1910, the surplus of the company had increased to about $51,500,000, and at that time the stockholders voted an increase in the capital of the company to $60,000,000 and declared a 100 per cent. stock dividend, delivering to the executor his proportionate share thereof, i. e., 2,920 shares of the additional capital stock. The question presented to the court was whether the widow, the life beneficiary of the residuary trust, was entitled to the whole of the stock dividend as income or whether it should be apportioned between the life beneficiary as income and the trust fund as capital. The court in an opinion delivered by Judge Chase, after reviewing all the authorities on this question, particularly those already mentioned, stated (pages 474, 475):

It is conceded that the capital of the corporation cannot be divided among life beneficiaries. It is not alone the capital of the corporation that should be preserved, but the capital of the trust fund, whether invested by the trustee in stocks of corporations at a premium or acquired from a testator or maker of a trust. The surplus of the corporation existing at the formation of the trust or when the stock is purchased represents a part of the capital of the estate as fully as does the capital of the corporation. The division by corporations of their surplus, accumulated through a long period of years in very large amounts, is now comparatively common. . . . If such dividends of the corporation payable out of the surplus earnings whenever accumulated must be paid to the life beneficiaries of the trust unless special provision to the contrary is made in the will or instrument creating the trust, it will make the retention or purchase of stocks by a trustee in corporations having a large surplus a matter of questionable propriety. It must also be remembered that if all such dividends are adjudged to constitute income as a matter of law, then their retention in the trust even by direction of the testator or maker of the trust would in many instances amount to an unlawful accumulation of income. . . .

The distinction between ordinary and extraordinary dividend is necessary to make a workable rule and at the same time preserve the integrity of the trust fund. The integrity of the trust fund and rights of the life beneficiary under the trust should each be considered, determined and preserved by a court of equity. So far as the courts in this state have made statements to the contrary, it has been in opinions where such statements have been unnecessary to the determination of the case then under consideration and such statements are disproved. It should be held:

(1) Ordinary dividends, regardless of the time when the surplus out of which they are payable was accumulated, should be paid to the life beneficiary of the trust.

(2) Extraordinary dividends, payable from the accumulated earnings of the company, whether payable in cash or stock, belong to the life beneficiary unless they entrench in whole or in part upon the capital of the trust fund as received from the testator or maker of the trust or are invested in stock, in which case such extraordinary dividends should be returned to the trust fund or apportioned between the trust fund and the life beneficiary in such a way as to preserve the integrity of the trust fund. . . .

This case is one that requires an apportionment of the dividends. There is no dispute about the portion thereof that was earned prior to the creation of the trust, and the decree of the surrogate and order of the appellate division should be modified so as to award the proper portion of the stock dividend to the respondent, directing that the remainder thereof be retained as a part of the capital of the trust fund, and as thus modified the order and decree should be affirmed.

The court later defined very concisely and accurately the method of apportionment.

> The proposition decided by us in this case is that in all cases of extraordinary dividends, either of money or stock, sufficient of the dividend must be retained in the corpus of the trust to maintain that corpus unimpaired and the remainder thereof must be awarded to the life beneficiary.

This is without question the present law as held by the courts of New York. In July, 1914, Judge Hiscock, in deciding a case involving a similar question of facts (*Equitable Life Assurance Society vs. Union Pacific R. R. Co.,* 212 N. Y. 371), quotes Judge Chase's opinion in the Osborne case as controlling.

Judge Scott of the appellate division, first department, in the *Matter of Magrue* (December, 1915) likewise cites Judge Chase's opinion in the Osborne matter with approval and says that *where a stock dividend represented in part the capital of a corporation or profits realized before the death of the testator, that part belonged to capital, but so much as represented profits or earnings after the death of the testator represented income and should go to the cestui que trust.*

The foregoing decisions relate to the questions of principal and income as between the life beneficiary and remainderman in instruments of trust. The later, and at present controlling, decisions in New York, it will be noted, hold in favor of apportionment, or in effect that the disposition of extraordinary or stock dividends depends upon the time when the surplus out of which they are declared was earned and accumulated, and that so much of such dividends as represents surplus earned before the death of the testator constitutes capital, and that part representing profits or earnings after the death of the testator constitutes income. In the Osborne case, cited herein, a concise and accurate method of apportionment is later defined. In *Earps Appeal* (28 Pa. St. 368) a different but also very comprehensive method of apportionment is given. Such apportionment in an executor's and a trustee's accounts involves no problems.

A different condition, however, presents itself now in the provisions of the new law applying to all taxable persons, which radically decrees that stock dividends, distributed out of earnings or profits accrued since March 1, 1913, shall be considered income to the amount of their cash value. At this date the tax upon income became constitutionally effective. However, the adoption of any date in the distinction of capital and income is liable to be arbitrary if it fails to recognize the period of accumulation of surplus or the date of acquisition of the principal, the income from which is taxable.

It is to be noted that the decisions cited herein apply to estate and trust holdings and give important recognition to the date of accumulation of the surplus as well as to the date of acquisition of the capital at or after the testator's death, which becomes a matter of record.

The new law applies to all taxable persons, but, while it may be next to impossible to keep control of the dates of acquisition of stocks in the general routine of stock transactions and apportionment therefore cannot be made effective as between former and subsequent holders, the principles laid down in the various court decisions do not appear to be affected thereby.

Whenever stock dividends are considered taxable income the market value of stocks in corporations with large surplus are bound to be adversely affected and investments in them may become matters of questionable judgment.

On the other hand, if stock dividends are treated as capital, as the courts hold them to be, any actual income which may be derived from them is bound to produce eventually its share of taxation for the government, first, on the cash dividends received on account of them, and, finally, on any profit that may be realized on a sale of the stock at a price higher than the cost of acquisition.

The law holding stock dividends to be income may place the executor or trustee of an estate receiving a stock dividend in this seemingly anomalous position, that the court of appeals and the federal courts have adjudged this stock dividend capital and he must account for it, and hold and defend it as capital, and at the same time a life beneficiary, entitled to the income of the estate under a will, may make claim upon him for the stock dividend as income, backed by the new law.

Goodwill may be concluded to be capitalized and become the subject of a stock dividend—this would not be a dividend out of earnings or profits. On this subject the department held under the old law in a ruling of May 3, 1915, that the conversion of goodwill into any form of asset other than cash or its equivalent does not constitute income.

The new law holds that a stock dividend shall be considered income to the amount of its cash value, but it is silent upon what is meant by cash value. The viewpoint of the corporation and that of the stockholder may differ on that subject. Market value or the par value at which the stock dividend would be entered upon the books may have been meant. In a ruling of March 24, 1916, under the old law, the department held, in reply to an inquiry as to the proper valuation in an annual return of stock received as a dividend, which had a market value of $500 a share: "If for each $100 distributed as a dividend from net earnings the corporation issues one share of stock of the par value of $100, the amount to be returned for each share for surtax purposes is $100."

No doubt later rulings will bring enlightenment as to what is meant by the cash value of the stock dividend.

We thus find the enactment of a new law which in one of its provisions holds that stock dividends shall be that which courts of appeal and the federal courts have expressly and concisely ruled they are not. The cash value provision in the new law appears immaterial to the fundamental principle involved. Corporations as well as individual taxpayers thus find themselves under the necessity of employing counsel, and individual or co-operative and joint action on the part of those affected may be presumed to result in order to test the constitutionality of the enactment or to obtain such interpretations as would appear not to be in conflict with leading decisions of the courts.

Industrial Accounting

VI.

By F. J. Knoeppel, C.P.A.

Total operation cost combines the cost of three separate though related factors:

1. Production
2. Inefficiency
3. Lack of economy

Total service cost factors were dealt with in September, and the manner of accounting for excess cost was quite fully considered. An analysis portraying the cost of all causes responsible for excess cost is of greater importance and value when applied to productive operations than when applied to service activities, although a thorough analysis of both is needed to provide a complete review of actual conditions.

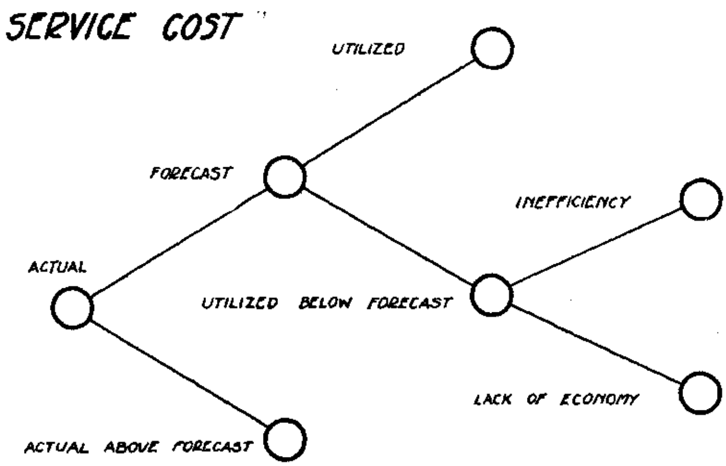
Service cost is somewhat more involved than operation cost, due to the inclusion of an additional element of cost—forecast. The peculiarities attaching to these two classes of cost will be seen in the diagram on page 354.

Operation costs naturally cover, under actual cost, the utilized cost of services; so that service costs are, in a sense, reflected through operation costs. The four divisions of operation cost given in the diagram (A, S, I, W) are very important and will be referred to repeatedly in this article.

A study of the "graph" on plate III will be of value in considering the method of determining the cost of causes responsible for excess operation cost. Consider the chart as presenting a monthly or periodic cost under any supposed operation; the shaded spaces representing utilized or standard cost, the black spaces wasted expense or lack of economy, and the white space lying between the shaded and black spaces as expense or costs due to inefficiencies.

Then consider:

A = Actual cost.
S = Standard cost.
I = Inefficiency cost.
W = Waste cost.


SERVICE COST
UTILIZED
FORECAST
INEFFICIENCY
ACTUAL
UTILIZED BELOW FORECAST
LACK OF ECONOMY
ACTUAL ABOVE FORECAST

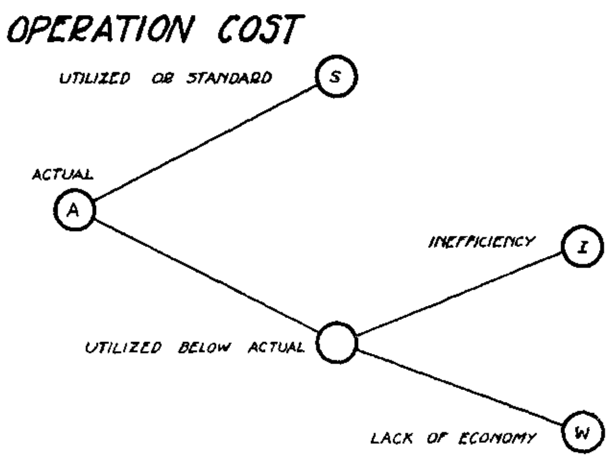

OPERATION COST
UTILIZED OR STANDARD
S
ACTUAL
A
INEFFICIENCY
I
UTILIZED BELOW ACTUAL
LACK OF ECONOMY
W

PLATE III

By examining the cost components on plate III we find that:

$$A = (S + I + W),$$
$$(A - S) = (I + W),$$
$$(A - S - I) = W,$$

The divisions a, b to k represent elements of operation cost: as a, labor; b, perishable tools, etc., each service activity being treated also as a separate element.

It will be noticed that element a (labor) does not exhibit "waste cost." This is quite natural, as all labor must be accounted for either as standard or inefficient.

How can we determine this charted division of actual cost? By ascertaining from the proper records the values of A (actual), S (standard) and I (inefficiency) cost, and by determining W (waste) in accordance with the formula just given, i. e., $(A - S - I) = W$.

A, actual cost, is exhibited through group I.

S, standard cost, is based upon actual departmental accomplishment at established standard cost rates. It is at this point that the importance of carrying the value of 3, e, group A to group I, instead of the value of 3, a, and 3, b, should be apparent. It insures an equitable basis for judging efficiency and determining the cost of inefficiencies.

I, inefficiency cost, can be ascertained from shop service cards, etc.

Actual and standard cost has previously been covered so that we are now concerned solely with inefficiency cost.

First let us consider to what these inefficiencies may be attributed. All causes may be treated under two broad divisions:

1. Due to the workmen
2. Due to the management

Inefficiency is failure to attain possible standards. When such failure upon the part of a workman is beyond his control he must not in any manner suffer a decrease in his bonus earnings. Any failure to measure up to the standards set should be investigated and recorded.

Two most important records now quite generally used under scientific management and efficiency methods are the allowance and service cards.

The allowance card usually provides for:

(1) Date
(2) Man number
(3) Name
(4) Department
*(5) Operation
(6) Allowed time
  (a) To
  (b) From
  *(c) Net (a—b)
(7) Rate
*(8) Amount
*(9) Reason
*(10) Fault
*(11) Charges

The service card usually provides for:

(1) Date
(2) Workmen
(3) Time actual
  (a) Quit
  (b) Started
  (c) Elapsed (a—b)
  *(d) Allowance
  (e) Rated (c—d)
(4) Rate
(5) Labor cost
  (a) Rated (3e × 4)
  *(b) Allowed (3d × 4)
(6) Output
(7) Standard rate
*(8) Excess cost
*(9) Fault or cause of excess cost
*(10) Charge excess cost to
*(11) Fault or cause for allowance
*(12) Charge allowance to

*Data to be tabulated for ascertaining cost of various causes responsible for excess operating cost as shown on groups I and J.

An allowance may be given to a workman either because of enforced idleness due to

Waiting for materials,
Waiting for crane,
Repairing of belts,
Breakdown of machines,
Extra machine changes, etc., etc., etc.

or, because of inefficient conditions surrounding the work, over which the workman has no control, as:

Incorrect drawings
Imperfect instructions
Improper tools
Faulty materials
Etc., etc.

When an allowance attaches to a specific order (covering actual time spent not originally provided for) it should be entered directly upon a service card. When covering idle time an allowance card should be used.

Most of the entries necessary on these cards can be made with the use of symbols. Wherever efficiency methods have been properly introduced and developed the service, allowance, replacement cards, etc., will make it a simple matter to determine and prove the actual cost of managerial shortcomings and failings. As the aggregate labor cost value on all such cards for an entire shop, during a given period, should equal the amount of the payroll, the labor cost of such inefficiencies is readily obtained by a tabulation of all service and allowance cards.

The natural method of arriving at such a division of labor cost would be to sort all service and allowance cards by operations and causes, and total the labor cost separately for each cause and operation. Tabulating machines, consisting of sorters and counters, are admirably suited for economically securing such data.

Having ascertained the basic value of the various causes responsible for inefficiency, we must apply the rates of the various cost elements involved to determine the loss in overhead or burden. This is simple multiplication, involving no great detail.

To illustrate, consider the following hypothesis: Operation A has seven elements of overhead.

Element	1,	rated	at	4.	cents	per	hour,	or	8%
"	2,	"	"	3.	"	"	"	"	6%
"	3,	"	"	0.5	"	"	"	"	1%
"	4,	"	"	2.5	"	"	"	"	5%
"	5,	"	"	6.	"	"	"	"	12%
"	6,	"	"	11.5	"	"	"	"	23%
"	7,	"	"	5.	"	"	"	"	10%
	Total,	"	"	32.5	"	"	"	"	65%

Three causes of inefficiency exist, viz.:

Cause A, with a basis labor cost of	$142
" B, " " " " " "	49
" C, " " " " " "	291
	$482

(Obviously idle time, waiting for crane, etc., does not involve the loss of as many overhead elements as faulty work or additional work, due to hard castings, etc. Consequently it would be improper to charge all causes with all elements. The elements involved under each separate cause must be established.)

Cause A involves elements 1, 3, 4, 7.
Cause B " " 1, 2, 3, 4, 5.
Cause C " " 3, 5, 6, 7.
The result of which is:

OPERATION A

Cause A ($142.)		*Cause B* ($49.)		*Cause C* ($291.)	
1— 8%=	11.36	1— 8%=	3.92	3— 1%=	2.91
3— 1%=	1.42	2— 6%=	2.94	5—12%=	34.92
4— 5%=	7.10	3— 1%=	.49	6—23%=	66.93
7—10%=	14.20	4— 5%=	2.45	7—10%=	29.10
		5—12%=	5.88		
24%=	$34.08	32%=	$15.68	46%=	$133.86

This accounts for excess cost by elements:

1,	2,	3,	4,	5,	6,	7,
11.36		1.42	7.10			14.20
3.92	2.94	.49	2.45	5.88		
		2.91		34.92	66.93	29.10
15.28	2.94	4.82	9.55	40.80	66.93	43.30

TOTAL, $183.62

Group I, classification 7, exhibits the excess actual operating overhead cost. Expressed in the terms of the formulas at the opening of this article, it represents (A—S) or (I+W). The values given above: $15.28 for element 1, etc., represent I. W still remains to be found by (A—S—I)=W.

Assuming that, under element 1:

A=45.00
S=26.50
I=15.28
then W=(A—S—I)=$3.22

A moment's reflection upon the value of the analysis of cost, as outlined in this article, should render it apparent that results obtained in departments or throughout a factory should not be viewed upon the expressed ratio of working time to standard time alone. True net operating efficiency is due to conservation of assets as well as to utilization of energy, and its correct expression calls for a portrayal of cost (economy) efficiency as well as production (energy) efficiency.

Proper determination of efficiency will be covered next month.

Salmon Industry Accounting

By E. J. Miner, C.P.A.

The fish industry of the Pacific coast and Alaska is a business of no mean proportions and merits the application of the best commercial and accounting methods The year-book of the *Pacific Fisherman* (magazine) states that for 1915 the chief fish output was as follows:

Canned salmon	7,639,592 cases
Mild cured salmon	13,306 tierces
Frozen fish	29,372,738 pounds
Halibut (fresh)	66,269,655 pounds

The aggregate value of the above was nearly $47,000,000. The figures quoted do not include the salted and smoked fish, which also amount to a considerable item. The year's output was not above normal.

There are in operation several hundred canneries, salteries, and freezing and mild cure plants along the coasts of California, Oregon, Washington, British Columbia and Alaska.

Without going into details, the accounting methods herein described embody the essential features of the system of a company operating three salmon canneries, a mild cured fish plant, a frozen fish plant, its own vessels, a fresh fish department and a mercantile store, in different localities, and directing the business from its home office.

The main books of account carried at the home office include a controlling account for each plant and the fresh fish department. Each of the departments keeps books covering the operations in detail and furnishes the home office a monthly trial balance. The home office compares the trial balances with the corresponding controlling accounts and summarizes them as to resources and liabilities for balance sheet purposes as hereafter described.

The home office books contain all the property accounts. New construction and new equipment purchase accounts are carried in the plant books but are transferred each month to the home office account.

Each season a new set of books is opened for each plant. The opening entries therein are the same as the closing transfers to the home office account in the previous year's books, with the exception of any changes which occur during the few months the plant books are not in use.

The business is a seasonal one. In the spring the plants undergo a period of repairs and preliminary work, following which they enter into the producing campaign, and in the fall they close until the next spring

The canned salmon, mild cured salmon and frozen fish product are sold through brokers; consequently the selling expenses on those classes of output are reduced to storage, insurance, brokerage, discount and allowances and freight (most of the sales being f. o. b. destination). The fresh fish department maintains its own selling organization.

The fiscal year ends and the books are closed at December 31st, at which date the plants are closed and the inventories of raw materials are at their lowest. The plants usually cease operating, however, in September or October, and as soon as possible thereafter inventories are taken of materials and supplies on hand, and the cost of production is ascertained.

Monthly Financial Statements

Monthly financial statements are prepared from the home office books. The balance sheet differs somewhat from the ordinary form in the following respects:

(1) The November and December statements must include reserve accounts to cover November and December overhead expenses.

(2) The statements from January to October include among assets "deferred operating expenses." This item represents all labor, material and supplies and the proportion of home office expenses entering into the current season's operating expenses, as shown by the trial balances of the plant books.

When the plant books are closed in the fall the operating expenses are transferred to accounts representing the cost of the output as hereafter described. Thereupon "deferred operating expenses" disappears from the monthly balance sheet until the next January, and the inventory (at cost) of fresh and frozen fish, cured fish and canned salmon is stated instead. For convenience in financial forecasts, separate balance sheets are also made including the inventory of finished product at net market value, i. e., market value, less brokerage, freight, government taxes, insurance, etc.

Exhibit 1 is a form of balance sheet.

Exhibit 2 is a form of monthly profit and loss account.

Exhibit 3 is the schedule of ledger accounts carried on the home office books.

Separate ledger accounts are carried covering each year's pack for inventories, sales and cost of sales.

Sales from the new year's pack sometimes commence in August or September and, as the cost and inventory of that pack cannot be set up in the books until October or November, separate sales accounts are carried. As soon as the cost is ascertained the inventory accounts are established and the necessary book entries made covering the cost of sales.

No profit on the current year's output is taken into consideration in drawing up monthly balance sheets until the cost has been determined. The item "deferred operating expenses" represents the total operating expenses less the amount of sales of the pack resulting from those expenses.

Costs

In order to understand better the process of costing, a brief description of the accounting system follows:

During February, March and April the purchasing department at the home office buys the material and supplies to meet the year's requirements. Payment for those purchases is made by the home office. Invoices in duplicate are required, the original being filed at the home office as a voucher, and the duplicate, accompanied by a debit memo. being sent to the plant to which it appertains. The home office credits vouchers payable and charges the controlling account of the plant. The plant credits home office account and distributes the charges over the various accounts affected.

Contract Labor

The greater part of the labor at the salmon canneries is performed under contract. The contracts are made early in the year and provide, among other things, that the company shall pay a fixed amount per case of salmon packed for a minimum number of cases, whether or not that quantity is actually packed.

Floating Equipment—Large

Besides operating numerous launches and scows at the plants the company owns large vessels. Those vessels carry the workmen and supplies to the salmon canneries in the spring and return in the fall with the workmen and the pack of canned salmon.

A columnar ledger account is carried in the home office ledger for the operating expenses of each vessel. The columns are headed:

Total
Labor
Supplies
Repairs labor
Repairs material
Sundry expenses

The first half of the year's expenses are transferred to: (1) the cannery supplies accounts and (2) contract labor expense (covering transportation of the cannery crew). The latter half of the year's expenses are transferred to: (1) the cost of canned salmon and (2) contract labor expense.

The transfers are made by means of home office debit memoranda sent to the plants.

Cost of Fish Traps, Trap Fish, Cans and Fish.

Prior to manufacturing operations, and in addition to repairs and renewals, each cannery is confronted with the cost of constructing fish traps and making cans. The frozen fish and mild cure plants purchase all their fish from independent fishermen.

A schedule of the accounts carried at a salmon cannery is set forth in exhibit 4.

Fish Traps

The salmon canneries not only purchase fish but also catch fish in traps. As the traps are expensive they form an important factor in the final cost. The traps are constructed each spring and dismantled each fall.

A construction and operation account is carried for each trap to which is charged:

Surveying
Licence
Piles

Pile driver operating expenses and
and repairs (proportion)
Lumber
Chains and cable
Wire web
Cotton web
Labor
Board of men
Launch and scow operating expenses
and repairs (proportion)
Operating labor and expenses

At the close of the season each trap is credited with:

Piles at depreciated value
Wire web at depreciated value
Cotton web at depreciated value
Chains and cable at depreciated value
Lumber at depreciated value

and charged with:

Pile puller—operating expenses
Launch and scow—operating expenses
Labor
Board of men

The final balance of the account represents the net cost of constructing and operating each trap and is closed into trap fish account.

It sometimes occurs that a heavy tide or storm will carry a trap away and the company is put to the necessity of rebuilding it.

Trap Fish

A trap fish account is set up to represent the cost of all fish caught in traps. At the close of the season it is debited with the cost of each trap as shown by the construction and operation accounts. On the credit side a record is kept of the number of various classes of salmon taken by each trap. The cost of each class of trap salmon is obtained by pro-rating the total cost of the traps over the different classes according to the numbers caught. After the cost of each class of trap salmon has thus been ascertained the trap fish account is closed by being accordingly transferred to the cost of fish account.

Cost of Fish

The cost of fish account is carried on a columnar ledger sheet providing for the different classes of salmon, namely, king, red, medium red, pink and chum. It includes the fish purchased from month to month from fishermen, and at the close of the season it is charged with the trap fish account as above described. It shows the cost of each grade of fish and the total cost of all grades.

Cost of Cans

Immediately prior to the packing season each cannery makes its tin cans. The cost of the cans is readily obtained. Several sizes are made. The chief factor is tin plate. A purchase and inventory account is carried covering tin plate and as different sizes thereof are purchased, corresponding to the sizes of cans made, the final inventory discloses the amount consumed in each size of cans. The other can making expenses such as labor, solder, power, zinc and acid, repairs and supplies, etc., are spread over the different sizes of cans in proportion to the quantities made. The greater part of the can making labor consists of contract labor covering the entire season and is apportioned between the can making and cannery operating.

A columnar ledger account is carried covering cost of cans, with columns for:

1. Total
2. 1# talls
3. 1# flats
4. ½# flats
5. Special sizes

The total of each column represents the cost of each size of cans. By dividing the costs with the total number of cans made the unit cost is ascertained. The unit is 1,000 cans.

As soon as the can making period is over and the inventories of tin plate, solder, etc., have been taken, the following accounts are transferred to the cost of cans account:

1. Can factory labor
2. Contract labor—proportion of
3. Tin plate, including freight
4. Solder, including freight

5. Fuel
6. Electric power
7. Coal oil
8. Zinc and acid
9. Repairs and supplies
10. Depreciation on machinery
11. Rent of machinery

Upon completion of the packing season, the inventory of cans remaining on hand is credited to cost of cans. The balance of the latter account, representing the value of cans consumed, is transferred to cost of canned salmon.

If cans are transferred from one plant to another, transfer entries between the two plants are made based on cost.

If cans are sold, sales of cans is credited at selling price, and a corresponding entry at cost price is made, cost of cans being credited and sales of cans being debited.

Canned Salmon Costs

The unit is a case of 48 cans.

After the inventories of materials and supplies remaining at the plants have been entered, a columnar ledger account is opened in the plant books, under the heading cost of canned salmon, with columns for:

1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum
7. Tips and tails

This account is charged with:

1. Cost of fish
2. Cost of cans
3. Labels
4. Boxes
5. General operating expenses
6. Freight outward

The transfer of cost of fish and cost of cans accounts to the cost of canned salmon account has been described above. The cost of cans is distributed according to the number of cases of each grade of fish packed.

Labels and Boxes

The labels and boxes charges are determined through the purchase and inventory accounts. The boxes are bought in the form of shooks and are merely nailed together at the plants.

General Operating

The general operating expenses represent the total cannery operating expenses, such as cannery labor, power, repairs and renewals, launch and scow labor and expenses, miscellaneous supplies, depreciation, etc. The total of those expenses is distributed over the several grades of product according to the number of cases packed.

Freight

The freight on materials and supplies is distributed (1) according to freight bills and (2) according to the first half year's operating expenses of the large vessels, thereby causing the ledger accounts to show the various commodities at laid down cost.

The freight on canned salmon from the canneries to the warehouses is charged to the cost of canned salmon.

Closing Books

The only accounts remaining upon the plant books after closing the operating accounts are cost of canned salmon, cash, inventory accounts of materials and supplies, home office and personal accounts. All these accounts are next transferred to the home office account. Corresponding entries are made in the home office books.

The home office credits the plants with the cost of their output. A columnar ledger sheet is used for the product of all the canneries, which corresponds to the totals of the cost of canned salmon accounts carried in the cannery books.

A statement is made covering the cost of the manufacture of canned salmon in which the general operating expenses are segregated. Exhibit 5 shows the form in detail. The statement arrives at a unit cost for each plant and a composite or average cost.

Frozen and Mild Cured Salmon—Cost

The freezing plant and mild cure plant buy all the fish which they pack, thereby eliminating the cost of fish trap construction and operation. The cost of can manufacture is also excluded. The frozen fish are packed in boxes and the mild cured fish in tierces. The unit is a pound.

Two grades of salmon are frozen. The cost consists simply of the purchase price of the fish, plus the freezing expenses, which are apportioned according to the quantities frozen. The fish are frozen whole.

Practically only one grade of salmon is mild cured (packed in brine in tierces) although various portions of the fish are cured. The ordinary tierce contains sides, or halved salmon. A limited number of barrels of bellies and tips and tails are also packed. The cost consists merely of the purchase price of the fish, plus the mild curing expenses.

Fresh Fish Department

The fresh fish department purchases its entire stock from fishermen. Monthly inventories are taken, thereby permitting monthly financial statements to be drawn up. These are submitted to the home office, where they are combined with the figures appertaining to the other departments and included in the general balance sheet and profit and loss account.

Exhibit 6 gives a schedule of operating accounts carried in the books of the fresh fish department.

Store

A small store is maintained at one of the canneries, chiefly for the convenience of the cannery crew. The profits are nominal. No profits on the store sales are taken into consideration in the monthly statements. An inventory of the merchandise is taken when the cannery supplies are inventoried, and the store books are then closed for the year. In the general balance sheet the inventory of merchandise is included in "inventory of materials and supplies."

Peculiarities in Costs

The cost of fish purchased from fishermen varies according to the grades of fish, while the cost of the fish caught in the traps is the same, regardless of grade.

Each cannery packs several grades of salmon which command different market prices. Other than the varying costs of fish purchased by each cannery, however, the cost of catching and packing fish which bring larger market returns is practically the same as the cost of packing the cheaper grade.

It sometimes occurs that the minimum number of cases stated in the labor contract is not packed, in which event the company pays on the basis of the minimum. This increases the unit cost of labor.

The run and consequent catch of salmon vary each year. Therefore, whatever the operating expenses may be, the output will vary as to grades of salmon and the quantities packed. The costs are correspondingly affected.

For the above reasons a comparative statement covering the costs during a period of four or five years is interesting.

There is a marked disparity between the accounting systems employed by the various companies in the fish industry in the northwest, although there are many advantages to be obtained by the use of a uniform system which would enable the various companies to make comparisons and valuable deductions. Details could be worked out covering the results from the use of certain machines, weight of tin plate and various other items entering into the business, which could be used for comparative purposes and which would result in a benefit to the whole industry.

EXHIBIT I

BALANCE SHEET..............191..

ASSETS:	
Cash on hand and balances at banks	xxx
Accounts receivable	xxx
Notes receivable	xxx
Inventory of fresh and frozen fish, cured fish and canned salmon	xxx
Total current assets	xxx
Plant: machinery, real estate, etc. (at depreciated value)	xxx
Floating property (at depreciated value)	xxx
Furniture and fixtures (at depreciated value)	xxx
Unexpired insurance	xxx
Unexpired rents and machinery	xxx
Inventory of materials and supplies	xxx
*Deferred operating expenses for..........season	xxx
Total assets	xxx

*Deferred operating expenses for ——— season appears in the statements from January to October only.

LIABILITIES:	
Payroll	xxx
Accounts payable	xxx
Notes payable	xxx
Total current liabilities	xxx
Reserve for accrued interest	xxx
Reserve for accrued taxes	xxx
†Reserve for overhead expenses	xxx
CAPITAL AND SURPLUS:	
Capital stock	xxx
Surplus	xxx
Total liabilities and capital	xxx

EXHIBIT II

PROFIT AND LOSS ACCOUNT

Month ending............191..

	Total	Canned salmon	Pickled fish	Frozen fish	Fresh fish
Sales—net	000	000	000	000	000
Cost of sales	000	000	000	000	000
Gross profit	000	000	000	000	000
Deduct:					
Brokerage	000	000	000	000	None
Storage	000	000	000	000	000
Insurance	000	000	000	000	000
Selling expenses—fresh fish	000	None	None	None	000
Net profit	000	000	000	000	000

NOTE: The sales-net represent the sales less discounts and allowances and freight.

The cost of sales is based upon the composite cost of the total output.

No profit is taken on the current season's pack of canned salmon, frozen or mild cured fish until the cost thereof has been ascertained. The costs are determined in October or November.

†Reserve for overhead expenses appears in the statements for November and December only.

EXHIBIT III

SCHEDULE OF HOME OFFICE GENERAL LEDGER ACCOUNTS

LIABILITIES:

Accounts payable (controlling account)
Vouchers payable
Notes payable

CAPITAL:

Capital stock
Surplus

RESERVES:

Reserve for bad and doubtful accounts
Reserve for depreciation (columnar ledger sheet showing):

1. Total
2. Buildings
3. Machinery
4. Floating property—large
5. Floating property—small
6. Furniture and fixtures

Reserve for overhead office expense

ASSETS:

Cash
Accounts receivable (controlling account)
Inventory of canned salmon (one account for each year's pack) (columnar ledger sheet showing):

1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum

Inventory of cured fish (one account for each year's pack) (columnar ledger sheet showing):

1. Total
2. Bellies
3. Sides
4. Tips and tails

Inventory of frozen fish (one account for each year's pack) (columnar ledger sheet showing):

1. Total
2. Silversides
3. Steelheads

Pig tin
Labels
Freight claims
Real estate
Plant (separate columnar ledger sheet for each plant showing):

1. Total
2. Buildings
3. Machinery and equipment

Floating property—large (separate account for each vessel)
Floating equipment—small (one ledger account covers all small floating property)
Oil drums
Furniture and fixtures at home office
New construction (separate account for each new project until completed, at which time the account is transferred to the proper property account)
Cannery controlling accounts (separate account for each cannery)
Mild cured fish plant controlling account
Frozen fish plant controlling account
Fresh fish department controlling account
Store controlling account
Plant drafts (separate account for drafts of each plant)
Plant drafts unpaid (separate account for unpaid drafts of each plant)

EXPENSES:

Large floating property operating account (columnar sheet showing):

1. Total
2. Labor
3. Supplies
4. Repairs labor
5. Repairs material
6. Sundry expenses

(Separate accounts for each vessel.) (The small floating property operating accounts are carried in the plant books.)

General expenses (columnar ledger sheet covering):

1. Total
2. Salaries
3. Rent
4. Office expenses and supplies

Taxes
Traveling expenses
Interest paid
Insurance on fish
Insurance on plants

Brokerage on canned salmon (columnar sheet showing):

1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum

Brokerage on cured fish (columnar sheet showing):

1. Total
2. Sides
3. Bellies
4. Tips and tails

Brokerage on frozen fish (columnar sheet showing):

1. Total
2. Silversides
3. Steelheads

SALES AND GROSS PROFIT:

Sales of canned salmon (columnar ledger sheet showing):

1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum

Cost of canned salmon sold (columnar ledger sheet showing):

1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum

Sales cured salmon (columnar ledger sheet showing):

1. Total
2. Sides
3. Bellies
4. Tips and tails

Cost of pickled salmon (columnar ledger sheet showing):

1. Total
2. Sides
3. Bellies
4. Tips and tails

Sales of frozen fish
Cost of frozen fish sold
Interest received

EXHIBIT IV

SCHEDULE OF LEDGER ACCOUNTS

(Salmon cannery)

Cash—carried in the cashbook
Boxes
Can factory—labor
Can factory—repairs and supplies
Cost of cans (columnar sheet showing):
1. Total
2. 1# talls
3. 1# flats
4. ½# flats
5. Special sizes

Cost of fish (columnar sheet showing):
1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum

Cost of canned salmon (columnar sheet showing):
1. Total
2. King
3. Red
4. Medium red
5. Pink
6. Chum
7. Tips and tails

Cannery labor
Cannery office salary and expenses
Cannery repairs (columnar sheet showing):
1. Total
2. Machinery and equipment
3. Buildings
4. Docks

Cannery operating expenses and supplies
Coal oil
Contract labor—expense
Contract labor
Cookhouse—sales
Cookhouse—expenses
Depreciation—can factory
Depreciation—cannery
Electric power
Fish gear

Fuel
Home office controlling account
Insurance
Labels
Lacquer and benzine
Launch operating expense (account for each launch)
Launch and scow labor
Launch repairs
Lumber
Miscellaneous supplies
Nails
Piling
Pile driver expense (columnar sheet showing):

1. Total
2. Labor
3. Repairs
4. Expenses and supplies

Pile puller expense (columnar sheet showing):

1. Total
2. Labor
3. Repairs
4. Expenses and supplies

Proportion of home office expenses
Rent of machinery—can factory
Rent of machinery—cannery
Salt
Scows operating expenses (columnar sheet showing):

1. Total
2. Repairs
3. Expenses and supplies

Solder
Superintendent's salary
Tin plate
Tin chips
Trap construction and operating expenses (columnar sheet showing):

1. Total
2. Labor construction
3. Materials construction
4. Operating labor and expenses

Trap fish
Wire webbing
Zinc and acid
Personal accounts

NOTE: Monthly trial balances are sent to the home office. For statement purposes the home office treats all the accounts as assets or liabilities. From January to October inclusive, the operating accounts are treated as "deferred operating expenses," and in November and December they are transferred to the inventory accounts.

EXHIBIT V

STATEMENT OF COST OF CANNED SALMON

	Total		King		Red		Medium Red		Pink		Chum		Tips and Tails	
	Total cost	Per case	Total cost	Per case	Total cost	Per case	Total cost	Per case	Total cost	Per case	Total cost	Per case	Total cost	Per case
Fish	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Cans	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Labels	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Boxes	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Nails	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Contract labor	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Cannery labor	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Superintendent's salary	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Office salaries and expenses	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Repairs and supplies	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Operating expenses and supplies	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Fuel	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Salt	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Lacquer and benzine	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Launch operating expenses	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Scows operating expenses	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Proportion of home office expenses	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Government taxes	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Depreciation	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Freight	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Total	x	x	x	x	x	x	x	x	x	x	x	x	x	x

NOTE: At the close of each year this statement is made up (1) for each cannery and (2) combining all canneries. The inventory accounts carried in the general ledger are based upon the composite cost.

EXHIBIT VI

SCHEDULE OF LEDGER ACCOUNTS
FRESH FISH DEPARTMENT

ASSETS:

Petty cash
Bank
Accounts receivable—controlling account
Notes receivable
Fresh fish—purchase and inventory
Salt and smoked fish—purchase and inventory
Oysters—purchase and inventory
Other sea food—purchase and inventory
Boxes, etc.
Supplies

LIABILITIES:

Accounts payable—controlling account
Payroll
Home office—controlling account

RESERVES:

Bad and doubtful accounts
Shrinkage in inventories
Taxes

EXPENSES:

Salaries—salesmen
Rent
Advertising
Proportion of head office expenses
Printing and stationery
Postage
Traveling expense
Commissions
Interest
Insurance
Telephone and telegraph
Taxes
Mercantile agencies and clubs
Legal expense
Licences
Light, heat and power
Ammonia and calcium
Ice
Refrigeration
Salt
Water
Labor
Stable expense
Teaming—hired
Repairs
Depreciation
Claims and allowances
Returned goods
Bad and doubtful accounts
Shrinkage in inventories

INCOME:

City sales
Country sales
Cash sales
Interest received

Logic of Municipal Fund Accounts

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.

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EDITORIAL

Status of State Societies

Since the transfer of membership in the American Association of Public Accountants to the Institute of Accountants in the United States of America considerable attention has been given to the possible effect upon state societies. In the American Association there were at the time of transfer twenty-six constituent societies, most of which were active in accountancy matters in their respective states. By virtue of membership in the state society an accountant was enabled to become a member of the American Association of Public Accountants, if he fulfilled the requirements of practice, had other necessary qualifications and possessed a C.P.A. certificate of a state whose standard was acceptable to the association.

No doubt many of the members of state societies affiliated with the local bodies in order to become eligible to membership in the national organization, but by far the greater number believed that there was also another purpose in state society membership. To these members the change in organization will appear as something not vitally affecting the purposes of the local societies. They will still feel that the welfare of the profession in their vicinity is dependent upon co-operative effort by accountants residing or practising therein, and, while proud of their membership in the Institute of Accountants, they will feel that they have not only a duty but a privilege in the opportunity to continue on terms of society fellowship with their neighbors in the profession.

Owing to the fact that the payment of dues to the institute is now direct and not through the state societies, most of these organizations will find it possible to make a large reduction in the amount of dues or subscriptions of their members. This fact may lead to an increased membership in the local societies and by virtue of the more independent character of the state societies it may be that membership will appeal to some men who have not felt much interest in national affairs and have therefore refrained from becoming associated with an organization which was an integral part of the national body.

Whatever may be the feeling of members it is to be hoped that all who are now members of state societies will retain that membership and lend their influence to the strengthening and encouragement of accountancy in the districts in which they reside. Experience of the past twenty years has shown the liability of legislators to be carried to absurd lengths in their efforts to regulate professional work. Some of the laws which have been enacted, of course, are good, but it may safely be affirmed that there are so few laws which are both adequate in form and adequately administered that there can be no cause to feel confidence in the legislative future in the states. Accordingly it will be necessary for accountants to keep a close watch upon the activities of legislators and be ready to prevent by every proper means the enactment of injurious legislation or what might be termed the amendment downward of existing laws. There is a large field here for active interest and beneficent work. It rests with the state societies to see that conditions are not rendered worse than they are at present and to seize every opportunity to raise standards.

The usefulness of the state society has not passed, as some accountants seem to feel. On the contrary, while there is apt to be a slight divergence of interest or activity between the national and the state bodies, there is continuing need for the existence of strong, representative organizations of accountants in every state.

Board of Examiners

The board of examiners of the Institute of Accountants at its preliminary meeting on September 21st adjourned to meet in New York on November 10th. At that time the questions of rules, regulations, forms of application and conduct of examinations are to be discussed and in all probability the board will be able at that meeting to prepare for the holding of examinations some time in the early part of 1917.

Applications for membership in the Institute of Accountants have been arriving in gratifying numbers and there is every reason to believe that the work of the board of examiners will be onerous. No doubt members of the board realize the importance of the work which is placed upon their shoulders. They have it in their power to raise the standards and at the same time to increase the membership of the institute and we are confident that these two important duties of the board will receive the earnest thought of every member.

A Touching Appeal

Pray heed the plight of an audit company in Chicago. The following cry was addressed to a tailor.

Dear Sir:

There are several men in the employ of this company who require a number of suits a year, and while our business is primarily auditing and systematizing, we have another department for monthly audits and weekly bookkeeping work.

This weekly service is for the benefit of concerns who do not have enough work to justify having a permanent bookkeeper, but who insist on having their books kept accurately and who require the information about their business which only a properly kept set of books can furnish. The charge is $20.00 to $30.00 a month, sometimes a little less, depending on the amount of work to be done. The charge for the monthly audits runs from $7.50 to $25.00 per month.

We wish to make arrangements with a tailor whereby we can exchange our services for clothing to be made to order for either ourselves or some of our men, and we beg to ask whether you would be interested in making an arrangement of this kind with us. We would not expect you to pay any actual cash: purely an exchange, nor would we expect you to deliver any clothing until such time as we have a credit on your books for services already performed.

An early reply will be appreciated.

The urgency of the case, as seen in the concluding paragraph of the appeal, is pathetic.

Some Mississippi Values

They have a pretty idea of values in Mississippi. The ——— county board of supervisors has refused to pay an account presented by an auditor for auditing the books of the county officers. The bill was for more than $5,000.00 and was based upon a charge of $10.00 a day. Acting upon an opinion rendered by the attorney-general of Mississippi the supervisors decided that the bill should not be paid. The attorney-general had held that an accountant's services are worth $7.00 a day—no more.

Several interesting questions arise. For example, what was the trouble in the books which made it necessary for such a great amount of time and labor to be expended upon the audit? And then, what induced the attorney-general of Mississippi to estimate the value of an accountant's services at $7.00 a day? We trust that the two questions have no connection.

Income Tax Department

EDITED BY JOHN B. NIVEN, C.P.A.

The following rulings have been given since those appearing in the October issue of THE JOURNAL OF ACCOUNTANCY:

T. D. 2366, in which the terms of decision of the United States district court of Colorado in a case under the original corporation excise tax law is published. The decision recognizes the right of the collector to make a second assessment notwithstanding the expiration of two years from the date when the return was filed by the taxpayer.

T. D. 2367, dealing with the administration of the new federal income tax law approved September 8, 1916. The act contains provision that the administration of the law will be according to the forms and regulations to be prescribed by the commissioner of internal revenue, with the approval of the secretary of the treasury; and under this treasury decision the treasury department indicates that, pending the adoption and promulgation of special regulations, those at present in force should be extended and made applicable to the new act so far as not inconsistent with its provisions. As many of the rulings and regulations are clearly inconsistent with the provisions of the new law, considerable changes and additions will be necessary before these rulings and regulations can be made to cover properly the new condition. The new regulations, however, should be issued as soon as possible to enable those interested to make a careful study of their terms before the time arrives for the filing of the next annual return so as if possible to prevent the great confusion which arose at the time when the first return under the 1913 law was due to be filed because regulations were published in the last few days available for filing.

T. D. 2374, which provides a form and makes provision in connection with the normal tax payable by non-resident aliens and claims for exemption from withholding at the source of such tax.

T. D. 2375, which gives the terms of the amendment to section 3225, *Revised Statutes,* which is contained in the act of September 8, 1916.

T. D. 2377, which authorizes the use of ownership certificates by non-resident alien firms or organizations on form 1001, revised, up to January 1, 1917. This form was framed for use when the income of such firms and organizations was entirely exempt from the withholding provisions of the law, and their use is still permitted if the words "not exempt" are stamped in large type across the face of the certificates before presentation.

TREASURY RULINGS

(T. D. 2366, September 12, 1916.)

Special excise tax on corporations—Decision of court.

1. SECOND ASSESSMENT.

The commissioner had power to make a second assessment after expiration of two years from filing return by plaintiff.

2. BURDEN OF PROOF SECTION 3225, REVISED STATUTES.

The return made by the plaintiff having understated the amount for which it was subject to taxation, although made in good faith and without any intention to escape lawful tax, plaintiff cannot recover in view of section 3225, *Revised Statutes.*

The appended decision of the United States district court for the district of Colorado in the case of *Camp Bird (Ltd.) v. F. W. Howbert, collector of internal revenue,* is published for the information of internal revenue officers and others concerned.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF COLORADO.

Camp Bird (Ltd.) v. Howbert, collector of internal revenue.

CONCLUSIONS OF LAW.

1. The court is of the opinion that under this act the plea of the plaintiff that the commissioner had no power to make this second assessment after the expiration of two years from the filing of the return by the plaintiff is not good, in view of the decision of the United States circuit court of appeals for the eighth circuit in the *National Bank of Commerce v. Allen* (223 Fed., 472).

2. In the opinion of the court, under the contract of purchase from Mr. Walsh, the sum of $2,000,000 mentioned in these contracts to be paid to Mr. Walsh, in addition to the cash payments made, did not vest in him any right of ownership to any part of the mine, but was merely an indebtedness for deferred purchase money, secured by an equitable lien of one-quarter of the net proceeds of ore mined in certain parts of the mine.

3. The payments of the tax not having been made by the plaintiff within the time required by law, it cannot in any event recover the amounts thus paid, which were 1 per cent. per month from the time the payment was due under the law until it actually paid it.

4. If the plaintiff is entitled to recover the sums of money as hereinbefore found by the court, it is also entitled to recover interest thereon from the day of payment until judgment at the rate of 8 per cent. per annum, that being the statutory rate under the laws of the state of Colorado, where the mine is situated and where the tax was paid.

5. In the opinion of the court the return made by plaintiff, having understated the amount for which it was subject to taxation, although made in good faith and without any intention to wrong or defraud the

government or to escape any lawful tax for which it may be liable under the law, the plaintiff cannot, in view of section 3225 of the *United States Revised Statutes*, recover under this action.

(T. D. 2367, September 14, 1916.)
Income tax.

Income-tax regulations for the administration of the income-tax law, where not inconsistent with the act of September 8, 1916, extended.

Pending the adoption and promulgation of special regulations under the act of September 8, 1916, income-tax regulations in force September 8, 1916, are hereby extended and made applicable to the act of September 8, 1916, so far as not inconsistent with the provisions of that statute.

(T. D. 2374, September 28, 1916)

Provision for nonresident alien corporations, etc., to claim exemption from withholding normal income tax at source of income in the United States under the act of September 8, 1916.

Under the act of September 8, 1916, the normal income tax is to be withheld at sources of income in the United States from the income of nonresident alien firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies "not engaged in business or trade within the United States and not having any office or place of business therein."

The income of such nonresident alien corporations, etc., which is subject to the withholding provisions of the law is that derived from "interest on bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations and insurance companies," regardless of amount.

And likewise the withholding provisions of the law "shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein," regardless of amount.

Including and from and after September 9, 1916, and to and including December 31, 1916, the normal income tax will be withheld from such income at the rate of 1 per cent. on the amount thereof. Including and from and after January 1, 1917, the normal income tax will be withheld from such income at the rate of 2 per cent. on the amount thereof.

To enable debtor corporations, etc., in the United States to distinguish between nonresident alien corporations, etc., which have and those which do not have *"any office or place of business"* in the United States and also to enable such nonresident alien corporations, etc., as have an "office or place of business" in the United States, to claim exemption from withholding of the normal income tax at the source on their income from sources within the United States, as specified by the statute, a certificate will be provided in the following form:

Form

TREASURY DEPARTMENT
INTERNAL REVENUE—INCOME TAX

OWNERSHIP AND EXEMPTION CERTIFICATE—NON-RESIDENT ALIEN FIRM, ORGANIZATION, ETC.

(For use of nonresident alien firms, corporations, etc., having an "office or place of business" in the United States to claim exemption from withholding normal income tax by debtor corporations in the United States.)

....
(Give name of debtor.)

....
(Character of income; if bonds, give name of issue and interest rate.)

....................191...... Amount of coupon or registered interest, $..........
(Date of maturity of interest.)

...................................., 191...... Amount of dividend, $..........
(Date of declaration of dividend.)

I hereby declare that the firm or organization named below (of which I am a member or officer) is the owner of the bonds or stock from which the above described income was derived, and that said firm or organization has an office or place of business in the United States, and that under the provisions of the income tax law said income is not subject to having the income tax withheld at the source of the income, and that all the information given herein is true and correct.

Date, ..., 191...... ....
(Name of firm, organization, etc.)

By..
(Signature of person duly authorized to sign and his official position.)

Address: ....
(Full post-office address in United States of firm, etc.)

The certificate herein provided for shall be printed on yellow paper, and shall be in size 8 by 3½ inches, and shall be printed to read from left to right along the 8-inch dimension.

The paper upon which the certificate is to be printed shall correspond in weight and texture to white writing paper 21 by 32, and about 40 pounds to the ream of 500 sheets.

Individuals or organizations desiring to print their own certificates may do so, but certificates so printed must conform in size and be printed in similar type and upon the same color, shade, and weight of paper as used by the government.

Until such certificate shall be printed and distributed, nonresident alien corporations, etc., having an "office or place of business" in the United States will use income tax certificates 1001, revised, and 1063. The address given on such certificates shall be that of the "office or place of business" in the United States of such nonresident alien corporation, etc. There shall be stamped in bold type on the face of these certificates in the blank space below the date line on the certificates "Nonresident alien corporations, etc., having an office or place of business in the United States."

The normal income tax on the character of income herein specified and payable to nonresident firms, copartnerships, corporations, etc., will be deducted, withheld, and paid to the proper officer of the United States government authorized to receive it, unless the corporation, etc., entitled to the payment shall file a certificate (under penalty for false claim) in form as herein provided, and only those nonresident firms, corporations, etc., which have an "office or place of business" in the United States can use the certificate herein provided to be used. The corporations, etc., which are permitted to use the certificate herein provided are required to make and render a certificate of income to the collector of internal revenue for the district in which they have their office or place of business, as provided by the act of September 8, 1916.

(T. D. 2375, September 30, 1916)

Amendment to section 3225, *Revised Statutes, by the act of September* 8, 1916.

Burden of proof in suits to recover taxes under second assessment. Section 3225, *Revised Statutes,* does not apply to statements or returns regarding depreciation of oil or gas wells and mines.

SIR: Referring to your letter of the 18th instant, in regard to the decision in the case of *Camp Bird (Ltd.)* vs. *Howbert,* relative to burden of proof under section 3225, *Revised Statutes,* published in T. D. 2366, your attention is called to an amendment made to section 3225, by the act of September 8, 1916, section 14, subsection (d), as follows:

. . . But this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines.

(T. D. 2377, October 4, 1916)

Authorization of acceptance by debtor corporations and withholding agents of ownership certificates (form 1001, revised) prior to January 1, 1917, when executed by nonresident alien firms and organizations and stamped "not exempt."

Where income-tax ownership certificates (form 1001, revised) have been executed by nonresident alien firms or organizations "not engaged in business or trade within the United States and not having any office or place of business therein" to accompany coupons detached from bonds or other obligations of domestic corporations they may be accepted by debtor corporations and withholding agents prior to January 1, 1917, if the words "not exempt" are stamped in large type across the face of certificates before presentation; and debtor corporations and withholding agents will be held liable under T. D. 2374 for the normal tax provided to be withheld by the act of September 8, 1916.

Students' Department

EDITED BY SEYMOUR WALTON, C.P.A.

MECHANICAL APPLIANCES

The introduction of machinery into the manufacturing of products began at least 350 years ago. In the reign of Edward VI (1547-1553) a statute was passed by parliament to prohibit the use of gig-mills in England, showing that at that time inventors had begun to devise labor-saving machinery. The introduction of any attempt to substitute machinery for manual labor was bitterly opposed by the labor element and by many economists who contended that the saving of labor would result in the throwing out of employment of so many workmen that thousands of them would be made a charge upon the public as paupers. Less than one hundred years ago the introduction of machinery into the textile factories in England caused riots of so serious a nature that they could not be stopped until a number of the ringleaders were hanged.

Laboring men and economists finally learned that the introduction of labor-saving machinery eventually caused an increase in the demand for labor, instead of a decrease, and the opposition to such machinery has consequently been abandoned.

It is only within a few years that attempts have been made to introduce machinery into office work. As was the case with laboring men at first, there is a prejudice against these innovations in the minds of many business men and especially in the minds of many accountants. The first machine to be introduced was the typewriter; but it was many years before business men of the old school could be induced to use it for any but routine correspondence. All special and important letters had to be written by hand in order to emphasize their special character. The universal use of the typewriter is due to the many advantages of its work over handwriting in legibility and rapidity, and also to the fact that one or more carbon copies can be made and the laborious and unsatisfactory copying of letters in the old-fashioned press can be avoided. In spite of the fact that much labor has been saved by its use, it has not reduced but has very largely increased the number of those who are engaged in the work of writing letters.

Accountants should always be on the alert to adopt any new device that will be of service in their own work or that will expedite or otherwise assist the office work of their clients. As they have accepted the typewriter as a machine fitted to be universally adopted, they should be willing to investigate all other machines that are claimed to be able to do better work or to do the same work more rapidly than is possible with the human mind and hand. They must approach the subject with an open mind and not condemn any project because they have an idea that it will not work. Their idea may not have any better foundation than did that of the eminent English philosopher who conclusively demonstrated that no steamship could carry coal enough to take her under her own steam from Liverpool to New York. In these days of wireless telegraphy it will not do to say that anything is impossible simply because it is beyond our ordinary experience or our capacity for understanding it.

The next step in the application of machinery to office work was the invention of the adding machine. The first one invented was a crude machine of sliding bars, which was accurate but took too much time to operate. The keyboard machine is familiar to all office men now and is both accurate and rapid. In spite of the saving of mental labor, there are still many persons who prefer the drudgery of monotonous additions rather than escaping it by using mechanical appliances. In addition to simple additions, machines will subtract, multiply and divide, so that all arithmetical operations that can possibly be necessary in an office may be performed on them with unfailing accuracy and great rapidity.

A combination of both these machines is effected by the addition of an adding attachment to a typewriter or of printing keys to an adding machine. With this combined machine, it is possible to make out invoices for goods sold, calculate all the extensions and extend the total of the bill. If the goods are billed at list prices the trade discount can be deducted and the net amounts added up. When figures are written which do not enter into the addition, a stop-key prevents the adding attachment from taking them up. If the invoice is made in duplicate, the original is sent to the customer and the duplicate filed in a post-binder from which postings can be made to the ledger, the binder acting as a sales register. If a detailed amount is desired on the ledger, it can be written at the same time that the invoice is made by putting the loose-leaf ledger page in the machine when the invoice is being written. This means that in one operation the invoice is made out, the sales register written up and the ledger posted, with no chance for error unless one is made on the invoice itself. By having two balance columns in the ledger and by inserting the old balance in one column before the total of the invoice is entered, the new balance will be calculated and extended in the second balance column at the same time that the total of the invoice is entered. The same method is used when the detail is not entered in the ledger, only the total invoice being posted. There is no necessity for the detail in the ledger, unless it is desired to have an easily accessible record of the classes of goods usually bought by the customer.

The billing system uses the typewriter adding machine so as to avoid posting to the ledger account of a customer any detail whatever, there being only one debit for merchandise bought and one credit for merchandise returned each month in each customer's account. This system is especially adapted to department store work in which it is necessary to keep a record of a very large number of items. The billhead is made in duplicate on one sheet of paper folded to bring the duplicate exactly under the original. The customers are divided alphabetically into as many classes as there are billing machine operators. The auditing department sorts the charge sales tickets according to these classes and furnishes the operator in each class with the total sales for that class for the day. The tickets are arranged in alphabetical order. On the first day of the month a billhead must be headed with the name and address of each customer who bought goods that day, but on any subsequent day billheads are headed only for those customers who had bought nothing earlier in the month. The operator then records on each customer's bill the details of the purchases in black ink and extends the total into the debit column of the bill, and at the same time records the total in a second section of the machine which adds these totals to get the grand total for the day. If this grand total agrees with the figures furnished by the auditing department, the entire work of the day is absolutely proved, except that charges may have been made to the wrong parties. This mistake is not likely to occur if the operator is careful to compare both the names and addresses on the sales tickets with those on the bills. The credit tickets for returned goods are then entered on the bills in red ink and their total compared with the figures from the auditing department. As the bills are kept in regular order throughout the month, the purchases of each day are added to them by slipping the bills into the machine at the exact place necessary, as shown by appropriate guides.

At the end of the month each customer's bill is added and the total inserted for both the black and the red columns, and the total of all the debit columns is found by the adding machine and compared with the total debits for the month, the credits being balanced in the same way. As each day's work has been balanced during the month, the totals must balance, if the work has been accurately done. If not, the error is easily found. When this is done, the bills are given to the bookkeeper, who makes any cash entries that are necessary, has the original sent to the customer and posts the total of the debit and credit on each bill to the account of the customer from the duplicate, which is then filed away as part of the ledger. In this way every customer receives an itemized bill, an exact copy of which becomes part of the permanent records, and the entire bookkeeping work is little more than is needed to make out the bills themselves.

A machine that saves a large amount of time, and therefore of money, in connection with the correspondence in an office, is the dictaphone, which does away with the necessity for dictating to a stenographer. This is really a phonograph, but one that is specially constructed so as to take a perfectly clear impression of the speaking voice at the ordinary conversational pitch and will not record any other sounds, so that a person can talk into it in an ordinary tone, in a room full of all kinds of noise, and the wax cylinder will record only the voice of the speaker. One advantage of its use is that a person can dictate to it at any time, and does not have to wait until he can call a stenographer, or he can use it at night when no stenographer is available. A still more important advantage is that no time is wasted by the stenographer in taking notes in shorthand. When a stenographer takes the shorthand notes and then transcribes them on the typewriter, the letter is really written twice. The dictaphone does away with one of these copies by making a mechanical record on a wax cylinder. This cylinder is placed in a phonograph which speaks into tubes inserted in the ears of the operator, who is thus shut off from all other sounds in the room, and writes the letter as it is spoken by the machine. The same cylinder can be used many times, as the minute scratches on it can be shaved off by a machine provided for that purpose. Another advantage is that a typewriter operator does not have to be a stenographer to use the machine.

One of the most disagreeable tasks in an office that sends out many letters is the sealing of envelopes and the affixing of postage stamps. When done by hand it is apt to be badly done, many letters being imperfectly sealed and many stamps so poorly moistened that they come off before reaching the post office. Both these operations can now be done by a machine into which the open envelopes are fed at one end, to emerge at the other end properly sealed and stamped. The time consumed in both operations is less than that required to seal the letters by hand. This is an important consideration, even if the saving of labor is not an object, because it allows of the earlier dispatch of letters, a point to which too little attention is paid. When letters reach the post office at the close of the day, they form part of a great flood of mail which cannot be handled as promptly by the mailing clerks as could have been the case earlier. Another important point is the prevention of the theft of stamps, as the stamps are put inside a locked compartment, from which they can be taken only by being affixed to envelopes.

If a concern sends out a large number of circulars to a regular list of customers every week or month, they should have, in addition to the sealing and stamping machine, an addressograph which prints the names and addresses as fast as the envelopes can be fed into it. If the circular is to go unsealed at the one cent rate, a special envelope should be used, the end flap of which is merely turned in, leaving the top flap to be folded down and pasted by the machine. It is much easier to slip the circular into such an envelope than into one the flap of which has to be turned in by hand.

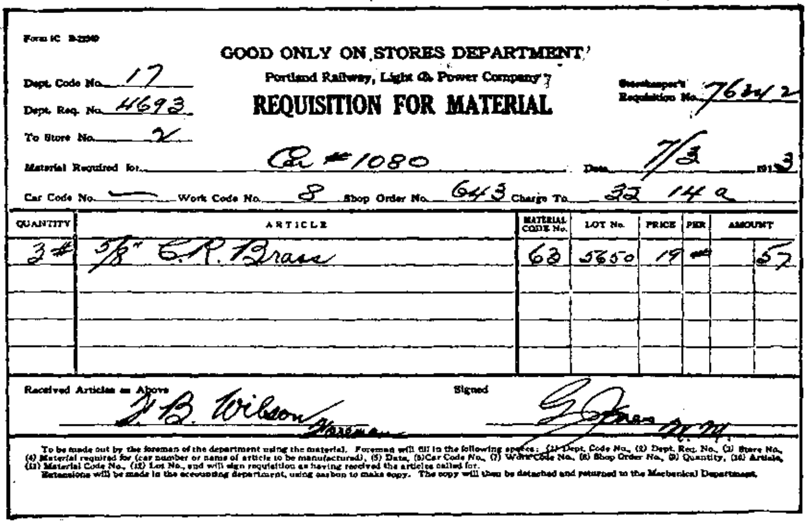
As a labor-saving device, although not a machine in the office, may be mentioned the "window" envelope, which has a transparent space on its face through which the name and address already written on the enclosure may be read, thus saving the time and labor involved in addressing the envelope. The best variety of these window envelopes is the one that forms the window by rendering part of the envelope itself transparent, instead of having a separate piece of transparent paper pasted over a hole in the envelope.

Of machines for the manifolding of documents there is an almost endless variety, some using a waxed stencil and others actual type. They are of great use to those who send out many copies of reports or letters to trade, etc., and they will often save not a little printing expense.

Of all the machines designed to expedite office work, the most marvellous is the tabulating machine or, rather, group of machines. Its object is to analyze the statistics of a business down to the minutest detail desirable, in such a way that any information in regard to any item or set of items may be obtained in a few minutes. These details recorded by hand in a set of statistical books would require so many separate columns and so much labor that many of them would be omitted and only the most important of them recorded. With a tabulating machine all the details are available, even those which, at the time of making the record, it was not thought probable would ever be needed for reference.

The foundation of the tabulating system is a card on which the information is recorded. Each card has room for 45 letters or figures on each line and for 10 to 12 lines. The cards are printed with appropriate headings at the top of the columns into which the figures are divided by perpendicular lines. Each column is given the number of spaces which will accommodate any but extraordinary quantities or amounts. If in any given case a figure is greater than one card can record, two cards are used, each recording half of the given quantity. The record is made on each card by punching out the figures which correspond with the information in respect to the particular items designated by the headings of the divisions of the card. This is done by means of a punching machine operated by hand or by electricity obtained from an ordinary light socket. Several cards may be punched at once, saving time when dating the cards for any given day.

An illustration will make the method clear. In the example given all the essential information contained in the requisition for material is reproduced on the punched card. The first column records the day as 3; the next the month as 7; then the department as 17; the car number as 1080; the kind of work as 8 (which is a code figure standing for a classification which the puncher obtains from a prepared list); the shop order as 643, the fact that it is a known amount by the A; the account to be charged as 32 (another code figure, with subdivision 14-1, to represent a); the quantity as 3 even; the unit as 18 (a code figure representing whatever basis of quantity is used, such as pounds); the character of the material as 63 (a code figure); and the amount as 57 cents. The last column is intended for the number representing the clerk who punched the card.



GOOD ONLY ON STORES DEPARTMENT

Portland Railway, Light & Power Company

REQUISITION FOR MATERIAL

Dept. Code No. 17

Dept. Req. No. 4693

To Store No. 2

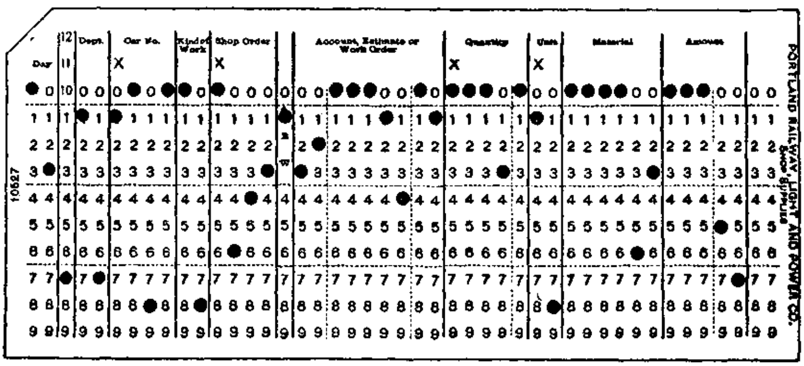
Storekeeper's Requisition No. 76242

Material Required for Car #1080 Date 7/3 1913

Car Code No. — Work Code No. 8 Shop Order No. 643 Charge To 32 14 a

QUANTITY	ARTICLE	MATERIAL CODE No.	LOT No.	PRICE	PER	AMOUNT
3#	5/8" C.R. Brass	62	5650	19	#	57

Received Articles as Above J. B. Wilson Signed



The information is punched on the cards from the original written document and filed in cabinets until needed. When it is desired to ascertain any particular fact or several facts at the same time, say the number of working hours of a certain machine for a month or a year and the amount charged to job orders for its work, the cards for that period are run through a sorter, in which the cards pass through a set of steel brushes. By setting the sorter to correspond with the holes representing the number of the machine on the card, the brushes which will touch those holes will have an electric current run through them which will cause the sorter to act only when the proper machine number appears on the card. All the cards bearing this number will be thrown out and laid in a pile. These cards are then run through the tabulating machine itself, set to record hours worked and amount charged. In an incredibly short space of time the machine will add and indicate the total of the amounts desired. The sorting machine will sort 15,000 and the tabulating machine will record 9,000 cards an hour.

By a proper setting of the sorting machine any subdivision of a class can be tabulated. For instance, if a savings bank wished to know how many of its depositors were white, unmarried women of American birth, the sorting machine would be set so that contact would occur and the circuit would be completed only when cards came through that were punched for women. These would be thrown out, to be run through again to sort out the single women, and so on until the cards containing all the information would be obtained. Life insurance companies have found that these machines have given them far more information than they have ever had before about their policyholders, especially in regard to the causes of death in various classes of persons.

Not only is information much more quickly obtained by the use of a tabulating machine; it can also be gained relative to a much larger classification of any desired items. Instead of being contented with a general classification, it is now possible to make as many subdivisions of the classes as is desirable. If all the information will not go on one card, two or more may be used. An ordinary clerk can punch 250 in an hour, so the expense is not great. One user of the machine estimates that it costs him about twice as much as did his old method of recording his factory statistics, but that he gets ten times the information.

In spite of the traditional conservatism of the English, Lawrence R. Dicksee, F.C.A., is outspoken in his praise of tabulating machines. In an address before the Chartered Accountant Student Society of London, he said: " . . . the great feature of the whole system—apart from the mere matter of speed—is, of course, that one is no longer limited to double-entry in connection with the record of transactions. From the same cards (representing original entries) we may build up records of all sorts and descriptions, representing, so to speak, different facets of our business operations, some of which may be embodied in the books of account ordinarily so called, and some of which may go to build up statistics for the use of directors or managers, upon a scale which has hitherto been regarded as impossible—with the enormous advantage that the statistics will be available practically hour by hour, instead of—as is usually the case—weeks (or perhaps even months) after the event."

Preferred Stock Retired at a Premium

Editor, Students' Department:

Sir: This company has outstanding preferred stock, which was issued at par, a certain amount of which is to be retired each quarter at $105.00 per share.

It has been the writer's contention, in which other accountants have agreed, that the premium of $5.00 per share on such stock as is retired during any quarter is to be charged to the operations for that quarter, inasmuch as the loss is actually sustained in that particular quarter.

I will appreciate it if you will advise me whether or not this is correct.

Yours truly,

Louisville, Kentucky. G. O. B.

The premium paid on the redemption of preferred stock is not a charge against operations for two reasons:

First, nothing is a charge against the operating profits of any year except those things which are necessary to the carrying on of the business. Therefore, interest paid on bonds or any other borrowed money, cash discount and bad debts are not operating expenses, because they are not absolutely necessary to the conduct of a business, but are due to lack of capital or bad judgment. Still less is the premium on the preferred stock, which is merely a question of financing and not at all of operating.

Second, the fact that the loss of the premium is paid in any given year does not mean that it is "actually sustained" in that year. It is a loss that has been accumulating during all the years that the stock has been outstanding. You might as logically say that if you owed a note of $10,000 at 6 per cent. interest, on which for some reason no interest had been paid for five years, and that you then paid $3,000, you should charge the whole $3,000 as a financial expense of the fifth year.

The proper charge of the premium is direct to surplus. It does not affect in any way whatever the operating or the financial expense of the year in which it is paid.

Sales for Future Delivery

Editor, Students' Department:

Sir: A manufacturing concern finds at the close of its fiscal year that it has unfilled orders from customers to the extent of $50,000, which in accordance with contracts it is entitled to draw for at sight, although the goods covered will not go forward to the buyers until ordered out in the following year. It is impracticable to set aside the goods involved, as additional costs will accrue, such as labeling, casing and miscellaneous warehouse expense, and, furthermore, the orders are subject to changes and cancellations.

How should this transaction be handled on the books of the selling company and how should it appear on the annual balance sheet?

R. S. W.

Honolulu, Hawaii.

Sales for future delivery are not sales that can be counted upon until the period in which delivery is made. In the meantime, they must be carried in the inventory at cost, but, since the expense of selling them has already been incurred, a reasonable amount may be added to their value or carried as a deferred asset to cover this selling cost, as it is not fair to the current period to make it stand the cost of selling goods on which the profit will accrue to the next period.

This is the general principle, but it is especially applicable to your particular case because the orders are subject to changes and cancellations.

In the meantime if any drafts are paid against the goods by customers in spite of the fact that no goods have been shipped, the credit for them should not be to accounts receivable, but to advances on future deliveries.

This subject is completely covered by Montgomery.

RECEIVERSHIP PROBLEM

You have been appointed a receiver in bankruptcy and desire to know the approximate percentage which unsecured creditors will receive on their claims. The following balance sheet is provided:

Assets

Tugboat—Jennie	25,000.00	
" Clara	50,000.00	
" Mabel	40,000.00	
Equipment—Jennie	4,000.00	
" Clara	9,000.00	
" Mabel	7,000.00	
Stock in Merchants Fruit S. S. Co.	40,000.00	
Cash in hand	800.00	
Accounts receivable, towing	1,500.00	
Loan to Merchants Fruit S. S. Co.	10,000.00	
Unexpired insurance	300.00	
Total assets		$187,600.00

Liabilities

Repair liens, tug Jennie	6,482.00	
" " tug Mabel	13,474.00	
Wages accrued	644.00	
Notes payable	91,500.00	
Interest accrued on notes payable	1,000.00	
Reserve for depreciation, tugs	34,500.00	
Proprietor	40,000.00	
Total liabilities		$187,600.00

The following appraisals have been made: tug Jennie $15,000.00, tug Clara $35,000.00, tug Mabel $25,000.00; equipment: Jennie $1,000.00, Clara $2,500.00, Mabel $1,800.00; accounts receivable $1,200.00 good and $300.00 bad. The cash in hand contains an I O U of the proprietor for $500.00. Of the notes payable, $70,000.00 is secured by 400 shares of Merchants Fruit Steamship Company stock, par value $100.00 per share, and a mortgage lien encumbering the tug Clara and her equipment. The cash surrender value of the unexpired insurance is $100.00. The balance sheet of the Merchants Fruit Steamship Company shows assets of $100,000.00, liabilities of $50,000.00 and capital stock $50,000.00. The assets of the Merchants Fruit Steamship Company are appraised at $60,000.00.

Prepare statement of affairs and explain the deficiency in technical form.

Solution.

Since there is a reserve for depreciation of tugs, amounting to $34,500.00, this reserve must be closed out to the various tug accounts in order to determine their net carrying value. The book values of the tugs are as follows:

Jennie	$25,000.00
Clara	50,000.00
Mabel	40,000.00
Total	$115,000.00

The total reserve is exactly 30 per cent. of the cost of the tugs, and in the absence of any specific data as to comparative age, construction, etc., it must be assumed that the depreciation applies proportionately to the cost. Adjustment is made by the following journal entry:

Reserve for depreciation, tugs	34,500.00	
Tug Jennie		7,500.00
" Clara		15,000.00
" Mabel		12,000.00

To determine the net carrying value of the three tugs:

The net carrying value appearing in the nominal value column of the statement of affairs is:

	Cost	Depreciation	Net carrying value
Jennie	$25,000.00	$7,500.00	$17,500.00
Clara	50,000.00	15,000.00	35,000.00
Mabel	40,000.00	12,000.00	28,000.00
	$115,000.00	$34,500.00	$80,500.00

PROPRIETOR'S NAME

STATEMENT OF AFFAIRS

Date

Assets

Book value			Expected to Realize	Shrinkage
	Fixed assets:			
$17,500.00	Tug boat Jennie, appraised value,	$15,000.00		$2,500.00
	Deduct repair liens, contra,	6,482.00	$8,518.00	
4,000.00	Equipment—Jennie		1,000.00	3,000.00

35,000.00	Tug boat Clara,			
	appraised value,	35,000.00		
9,000.00	Equipment—Clara,			
	appraised value,	2,500.00		6,500.00
	Total	37,500.00		
	Deducted, contra,	37,500.00		
28,000.00	Tug boat Mabel,			
	appraised value,	25,000.00		3,000.00
	Deduct repair liens,			
	contra,	13,474.00	11,526.00	
7,000.00	Equipment—Mabel,		1,800.00	5,200.00
	Investments:			
40,000.00	Stock in Merchants Fruit S. S. Co.			
	Estimated value 20%	8,000.00		32,000.00
	Deducted, contra,	8,000.00		
	Current assets:			
800.00	Cash	800.00		
	Less proprietor's I O U			
	in cash	500.00	300.00	500.00
1,500.00	Accounts receivable:			
	Good	1,200.00	1,200.00	
	Bad	300.00		300.00
		1,500.00		
10,000.00	Loan to Merchants Fruit			
	S. S. Co.		10,000.00	
	Deferred charges:			
300.00	Unexpired insurance			300.00
	Total free assets		34,344.00	$53,300.00
	Deduct wages—preferred claim		644.00	
	Net free assets		33,700	
	Deficiency to creditors		13,300	
			$47,000.00	
	Deficiency to proprietor		53,300.00	
$153,100.00			$53,300.00	

Liabilities

Book value				Expected to Rank
	Preferred liabilities:			
$644.00	Wages accrued—deducted contra			
	Fully secured liabilities:			
6,482.00	Repair liens—tug Jennie—deducted contra			
13,474.00	Repair liens—tug Mabel—deducted contra			
	Partly secured liabilities:			
70,000.00	Notes payable		70,000.00	
	Secured by 400 shares Merchants Fruit S. S. Co. stock, par value $40,000.00, probable realizable value,	8,000.00		
	Mortgage—tug Clara—equipment	37,500.00	45,500.00	$24,500.00
	Unsecured liabilities:			
21,500.00	Notes payable			21,500.00
1,000.00	Interest accrued on notes payable			1,000.00
	Total unsecured liabilities—estimated payment 71.9%			$47,000.00
	Deficiency to creditors—down			13,300.00
40,000.00	Proprietor's capital			40,000.00
$153,100.00				$53,300.00

Deficiency account

Shrinkage in realization of assets:		Proprietor's capital	$40,000.00
Tug boat Jennie	2,500	Deficiency to creditors per statement of affairs	13,300.00
Equipment—Jennie	3,000.00		
Equipment— tug boat Clara	6,500.00		
Tug boat Mabel	3,000.00		
Equipment—Mabel	5,200.00		
Stock, Merchants Fruit S. S. Co.	32,000.00		
Cash	500.00		
Accounts receivable	300.00		
Unexpired insurance	300.00		
	$53,300.00		$53,300.00

Although the insurance has a cash surrender value of $100.00, this cannot be realized at present because the insurance cannot be canceled.

The realizable value of the loan to Merchants Fruit Steamship Company and the stock of the company held by the bankrupt are determined as follows:

Merchants Fruit Steamship Company

Assets, realizable value	$60,000.00
Liabilities	50,000.00
Balance to pay stockholders	$10,000.00

Ignoring expenses of realization, the company will be able to pay its liabilities, including the $10,000.00 loan, in full and to liquidate its stock at 20 per cent. of its face.

Par value of stock held	$40,000.00
Realizable value—20 per cent.	8,000.00

Anonymous Letters

In spite of several notices in this department that anonymous communications will not be considered, they continue to be received. Names and addresses will not be published if their omission is requested, but they should be given as an evidence of good faith. A more important reason is that many of the requests for information are not of a nature justifying their answer in these columns, especially when the subject has already been discussed in previous articles. In such cases a personal letter is written to the inquirer, if his name and address are given, but this is not possible if the letter is signed J. L. C. and the only address given is the name of a city in Kentucky, as in one case in point.

Incompetent Examiners

That it is high time that the practising accountants should exercise some control over the appointment of examiners to pass on the qualifications of applicants for the C.P.A. certificate is shown by the following extract from a letter received by me from a resident of a state that shall be nameless.

"One of the questions in the examination was in regard to bonds, and there was the question of a discount of $100,000 on bonds running 50 years. In my answer I stated that $2,000 should be charged off each year of the life of the bonds. A short time thereafter the chairman of the board of examiners stated to me that the idea was all wrong; that the entire $100,000 was a loss at the time the bonds were sold at a discount, and that it all should be treated as a loss then. I quoted some authorities to him. His reply was that he did not care what any one else said; his idea was as above and he would not change it."

Truly, "a Daniel come to judgment!"

Book Review

RETAIL SELLING, by JAMES W. FISK. *Harper Brothers,* New York, 1916. $1.00 net.

Retail Selling is a piece of constructive work and should have wide distribution. It is not only of interest to merchants but to every buyer and salesman as well. It deals with selling of service as well as merchandise and is full of valuable information. It outlines the best methods and is a long step toward ways of satisfactory distribution.

There has been too little educational influence brought to bear on retail selling. Mr. Fisk is an evident master of his subject with broad views well set on solid foundations. Football, baseball and other sports have their coaches and trainers, but retail distribution has been allowed "just to grow" in a more or less haphazard fashion.

Beginning with the wants of the consumer, Mr. Fisk draws his line to the manufacturer and back to the customer through the various departments of the business with its many selling service features involved until the circle to the consumer is completed. In other words, the satisfaction of the consumer is recognized as the alpha and omega of all truly profitable retail selling. All departments of the business must be duly arranged with that end in view.

Layout of store; mutual education; advertising; decoration; discipline; knowledge of goods; increase of business; promotion of goodwill, and suggestions which make for efficient co-operation are features of the book. The author shows that many in the retail business because of lack of knowledge strike on the reefs. He has charted the rocks of failure and outlined the channels of success. H. C. M.

Minnesota Society of Public Accountants

The trustees of the Minnesota Society of Public Accountants have elected Edwin J. Bishop, C.P.A., to fill the vacancy on the board caused by the death of Ralph D. Webb, C.P.A. James S. Matteson, C.P.A., has been elected president and Edwin J. Bishop, C.P.A., vice-president.

Minnesota State Board of Accountancy

The governor of Minnesota has appointed Julius J. Anderson, C.P.A., of Minneapolis, to fill the vacancy on the board of accountancy caused by the death of Ralph D. Webb, C.P.A.

Henry Daspit, C.P.A.

We regret to announce the death of Henry Daspit, C.P.A., of New Orleans, Louisiana. Mr. Daspit was a prominent member of the accounting profession in his native state and served several years as president of the Society of Louisiana Certified Public Accountants, which was a constituent society of the American Association of Public Accountants. He took a prominent interest in the C.P.A. movement in Louisiana and was much interested in the development of accountancy throughout the country. Mr. Daspit died on September 10, 1916, after a protracted illness.

Haskins and Sells announce the acquisition and consolidation with their own of the accounting practice of Frederick F. Hahn, heretofore conducted in the name of Frederick F. Hahn and Company. Mr. Hahn remains as manager of the firm's office in Haas building, Los Angeles.

Ernst and Ernst announce the opening of an office in the Dime Bank building, Detroit, Michigan.

Clinton W. Bennett announces the opening of an office for the practice of accountancy at 289 Main street, Springfield, Massachusetts.

F. J. Knoeppel and Company announce the removal of their offices from Milwaukee, Wisconsin, to 870 People's Gas building, Chicago.

Clinton H. Montgomery, C.P.A., announces the opening of an office in the Fourth National Bank building, Wichita, Kansas.

The Institute of Accountants
in the United States of America

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1916-1917

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President	W. Sanders Davies, 103 Park Avenue, New York
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*A vacancy exists in the one year term owing to the death of Ralph D. Webb of Minnesota.

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Arthur Young	Illinois

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J. D. M. Crockett...................Missouri

*A vacancy exists in the Committee on Professional Ethics owing to the death of Ralph D. Webb of Minnesota.

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Statement of the Ownership, Management, Circulation, Etc., Required by the Act of Congress of August 24th, 1912

of *The Journal of Accountancy*, published *Monthly* at *New York, N. Y.*, for *October* 1, 1916.

State of *New York*, } ss.
County of *New York*,

Before me, a *Notary Public* in and for the State and County aforesaid, personally appeared *Philip J. Warner*, who, having been duly sworn according to law, deposes and says that he is the *Secretary of The Ronald Press Company, Pub. of The Journal of Accountancy*, and that the following is, to the best of his knowledge and belief, a true statement of the ownership, management, etc., of the aforesaid publication for the date shown in the above caption, required by the Act of August 24, 1912, embodied in section 443, Postal Laws and Regulations, to wit:

1. That the names and addresses of the publisher, editor, managing editor, and business managers are:

Publisher, *The Ronald Press Company* — *20 Vesey St., New York, N. Y.*
Editor, *A. P. Richardson* — *55 Liberty St., New York, N. Y.*
Managing Editor, *None* Business Managers, *None*

2. That the owners are (Give names and addresses of individual owners, or, if a corporation, give its name and the names and addresses of stockholders owning or holding 1 per cent. or more of the total amount of stock.): "The Institute of Accountants in the United States of America," a corporation formed under sub-chapter III of the laws of the District of Columbia; no stockholders; membership approx. 1,235. Principal office, 55 Liberty Street, New York, N. Y. Officers: President, W. Sanders Davies, 103 Park Ave., New York City; Vice-Pres., Harvey S. Chase, 85 State Street, Boston, Mass.; Carl H. Nau, American Trust Bldg., Cleveland, Ohio; Treas., Adam A. Ross, Morris Bldg., Philadelphia, Pa.; Secretary, A. P. Richardson, 55 Liberty St., New York City.

3. That the known bondholders, mortgagees, and other security holders owning or holding 1 per cent. or more of total amount of bonds, mortgages, or other securities are: *None*.

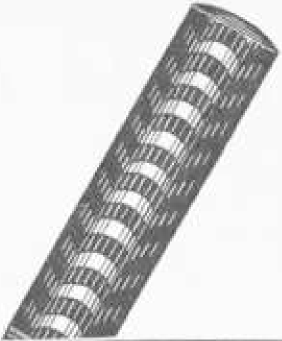
4. That the two paragraphs next above, giving the names of the owners, stockholders, and security holders, if any, contain not only the list of stockholders and security holders as they appear upon the books of the company, but also, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting, is given; also that the said two paragraphs contain statements embracing affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner; and this affiant has no reason to believe that any other person, association, or corporation has any interest direct or indirect in the said stock, bonds, or other securities than as so stated by him.

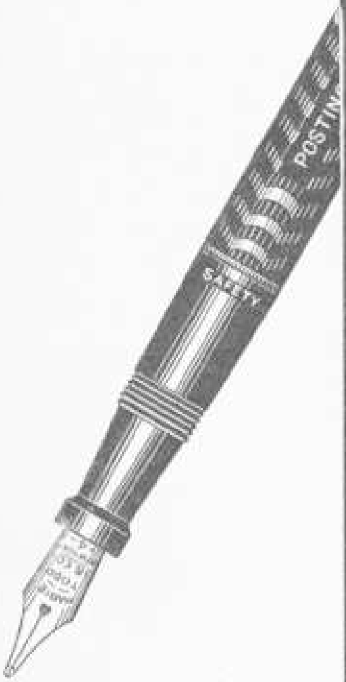
PHILIP J. WARNER.

Sworn to and subscribed before me this 9th day of October, 1916.

E. H. WYATT,
Notary Public, Westchester County, Cert. filed in N. Y. County No. 225.
(My commission expires *March* 30, 1917.)

[Seal]

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