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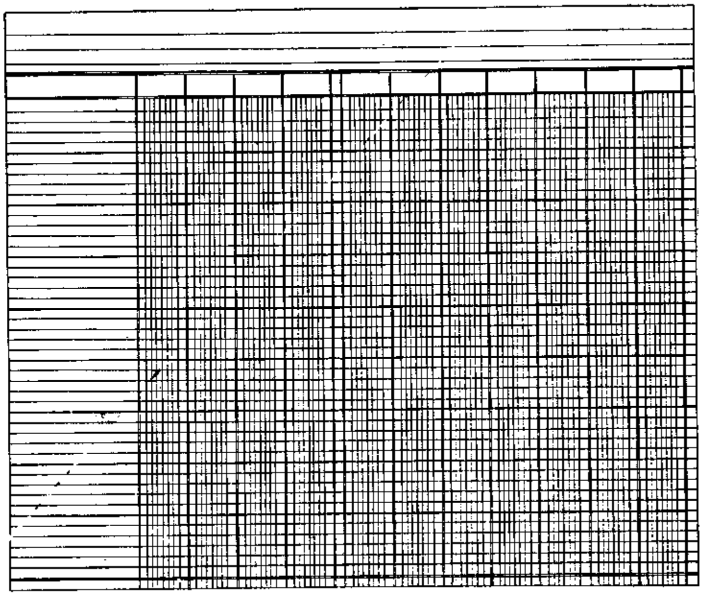

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THE JOURNAL OF ACCOUNTANCY

CONTENTS FOR OCTOBER, 1914

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.

The editor will be glad to receive and to consider for publication articles from well-informed persons, and will welcome especially contributions from public accountants. The manuscripts of articles not available for publication will be returned on request.

THE RONALD PRESS COMPANY

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The Journal of Accountancy

Official Organ of the American
Association of Public Accountants

Vol. 18 OCTOBER, 1914 No. 4

Report of the President*

We have had what might be termed a quiet year, but it has not been a period of inaction.

The secretary's report is comprehensive and, with the reports of the several committees, covers the work accomplished during the year. I again commend to you our executive secretary whose service during the year has been devoted, whose efforts to further our interests have been untiring and whose experience has now become an asset which increases in value each year. I shall, therefore, omit the usual references to the specific activities therein reported upon, because I feel that those who are interested will wish to read complete reports rather than synopses—and I have no message for those who are not interested in our work.

We have a magnificent organization and our prestige is steadily growing. Most of the credit for this enviable position is due to the committeemen who labor unceasingly throughout the year to further the best interests and sustain the high ideals of the profession.

We are indeed fortunate that the busiest and most successful practitioners, those who are supposed to have the least leisure time, are the ones whom I have found most willing to undertake work which requires time and energy.

I find it difficult, personally, to comment intelligently on the trend of public opinion and legislation as it relates to accountancy. A few months ago I was informed by one of the most influential

* Read before the American Association of Public Accountants, September 15, 1914.

members of congress that the government did not require the services of public accountants; and the trend of legislation rather bears out his statement. We see great commissions organized and great governmental departments manned by inexperienced, incompetent and underpaid officials and clerks. The results of their labors go to congressmen whose inexperience sometimes is more apparent than that of those who do the work; and naturally deficiencies are not discovered. We are spending scores of millions of dollars in investigations and investigations of investigations, which go on, like the brook, forever; and the country does not get the worth of its money. What is the remedy? I will tell you. It lies in the successful organization of a political party having for its platform efficiency and economy, and the punishment of those who secure high office under false pretences. When I say punishment, I mean imprisonment, not merely removal from office. The party now in power was elected on a platform of retrenchment and economy. When has a congress been more wasteful and extravagant? When did the Republican party ever economize? When was the pork barrel larger and juicier than when the present Progressive party head was president of the United States?

Surely we need an awakening of the people to the application of business methods to government. I wish about a dozen accountants would run for congress and that all of them would be elected.

We must, of course, so plan for the future that our progress will be uninterrupted. At the risk of repeating what I said last year, I wish to emphasize the importance of carrying on a campaign having for its object the spreading of accountancy engagements over the entire year in order to relieve the congestion during a few months. The rendering of high class service is vital to our success, but it will become impossible to continue to furnish such service if engagements during the first few months of the year multiply out of proportion to the remainder of the year. The most practicable remedy is to continue our efforts towards permitting individuals to make their income tax returns as of some date other than 31st December until we succeed.

Another plan—which I admit has some elements of danger in it—would be to acquaint the business public with the fact that public accountants are in a position to work to better advantage.

say, from April to November than from December to March. Such a campaign would have to be waged by the American Association or state societies: it could not be done by individuals.

It may not be feasible, but I would like to have the point discussed by a committee to be appointed for the purpose.

There has been a decided improvement in sentiment among bankers in favor of requiring certified balance sheets from borrowers or prospective borrowers. The action of the officials appointed and to be appointed under the new currency law will undoubtedly have some influence over future requirements.

The advantages to a banker of true financial statements are so obvious that one would think no arguments were necessary, and yet I affirm after due consideration that the majority of unaudited financial statements in the hands of bankers and now used as a basis of credit are erroneous.

In spite of a long series of failures disclosing these conditions, and particularly one large failure of national interest, it may be said that the custom of requiring audited statements from borrowers is not yet general.

I suggest that the committee on credit information be made a standing committee, and that its activities be increased.

If I were to show the foregoing statement to bankers, I know that most of them would say, "Are you sure that your profession is equipped as to numbers and ability to take the responsibility, moral and legal, of standing between borrowers and ourselves? Do you realize that we do not want to have a balance sheet copied from the borrowers' books? We do not want a statement of assets valued by the borrowers with a comment by you that you are not valuers and that you assume no responsibility for values. We do want someone of skill and courage who will not be afraid to restate a balance sheet, who will apply his experience to the valuations and who will give us a report on a borrower's financial position which will be helpful and dependable as a basis for credit action."

I will not consume the time here which I would take in answering the foregoing, but I do say to you in all seriousness that the bankers *have* in great numbers asked all of those questions and more, and they are now waiting for our answers.

We have a great profession, one which requires big men with big brains. We can, if we will, win greater respect from and higher standing in the community than any other class, but we must be eternally vigilant and jealously guard our highest ideals.

I thank you for your consideration and help during my term of office. I am proud to have held high office in an organization whose accomplishments already have been phenomenal and which promises to become one of the dominant forces of this the greatest country in the world.

ROBERT H. MONTGOMERY, *President.*

New York, September 1, 1914.

Accounting Conditions and Prospects*

By Charles G. DuBois,

Comptroller of American Telephone and Telegraph Company.

Though the art of keeping accounts is very old, accounting as a science is young—indeed, very young, for its rise to the proportions of a science is intimately connected with the development of our modern intricate industries.

The purpose of this paper is to bring forward for consideration the present-day application of the science in this country and to offer some suggestions as to its future development.

I think we may safely say that this science of accounting has now reached a point where, by its careful use, the financial transactions of any given institution may be classified and summarized and the financial situation of that institution may be clearly revealed.

During the past twenty years the legal recognition by most of the states of accounting as a profession, whose qualified public practitioners should be distinguishable from the unqualified, has not only improved the status of public accountants generally but has also assisted in developing the need for better accounting work generally and has thus, though indirectly, contributed much toward a scientific development of the subject.

But there are two other important contributions to the development of scientific accounting which should be here noted. The first of these comes through the increasing application of scientific methods to business affairs by business men and their demand for what we call "administrative accounting" as an adjunct to their business methods. This demand has been met generally by self-trained accountants, who have gradually fitted themselves to meet these requirements.

* An address before the American Association of Public Accountants, September 15, 1914.

The second contribution comes through the increasing governmental regulation of industries, which is developing some accounting principles necessary for that policy and is establishing official rules in that connection.

The fact that these contributions to the science come through distinguishable groups of men suggests that one way to examine the present status of the science in America is through some study of its representatives and exponents; that is, those who are commonly known as accountants.

And, first, what do we mean by the term "accountant"? Whatever dignity or technical requirements we may think ought to attach to the term, we must admit that sensible men generally will apply it to all those who have a general knowledge of the principles of accounting and can apply those principles in connection with actual affairs.

I have made an effort to ascertain how many persons there are in this country who would probably answer to this definition.

The census bureau, in its *Occupation Statistics for 1910,* does not provide a separate classification for accountants, for which, in view of the difficulties at present surrounding the definition, it can hardly be criticised. Accountants are included with bookkeepers and cashiers; the total number being 486,700. This is interesting but not of much help in our present inquiry.

But using various sources of information, the following figures may be taken on the whole to represent a reasonable guess:

Corporation accountants—		
Public service corporations	3,400	
Private corporations	5,000	8,400
Public accountants		3,000
Government accountants		1,100
Teachers of accounting		100
Total		12,600

Making allowance for probable errors in these figures, and assuming some over-lapping, I think we may safely say that there are 10,000 to 15,000 persons in this country who may fairly be called accountants.

Let us next take up these various classes or groups of accountants and consider the work each does or can do to the best advantage.

CORPORATION ACCOUNTANTS.

Take first the class whose number and qualifications are most difficult to ascertain or analyze but to which I have ventured to apply the term "corporation accountants." In numbers they undoubtedly exceed any other class of accountants. In qualifications they vary perhaps more widely than any other.

In a small business the figures prepared by a competent bookkeeper, interpreted by the manager with his personal knowledge of individual transactions, are usually sufficient, and in many cases are doubtless put in excellent accounting form though neither the bookkeeper nor the manager can be classed as an accountant.

But when any corporation reaches the point where detailed classified information is expected from its accounts the accounting work and responsibility is usually separated and a specialist on the subject takes charge of it. In some corporations he is still a subordinate of the treasurer but in the more modern practice he is given an independent status with the title usually of auditor, general auditor or comptroller.

The work of these officials has expanded in scope and importance with such rapidity in the past few years that in the largest corporations they now have several or even many highly trained accounting assistants.

While from the nature of their work these corporation accountants are primarily specialists in accounts, yet I have found many of them who by study and interest in the general subject have become qualified to make audits or establish accounting systems for unrelated industries.

Special administrative accounting is, of course, of supreme importance to the corporation manager, and the skillful corporation accountant must be a master of two subjects, the particular business and the science of accounts. Otherwise, he cannot devise such classification of details as will serve administrative needs and at the same time harmonize with technical balance sheet and income accounting.

The responsibility resting on the chief accounting officers of corporations is constantly increasing. Not only are the demands for administrative accounting more and more exacting as business methods become more scientific but the increasing degree to which governmental regulation is carried throws on the accounting officer the burden of responsibility for his corporation in conforming to intricate official rules.

As illustrating this point I quote from the opinion of the Interstate Commerce Commission, number 933, as follows:

> The formative period to which we have referred must now be considered as having come to an end so far as all the important principles and requirements of our regulations are concerned, and we shall hereafter expect a more exact observance of the prescribed accounting systems by the carriers and their officials. Accounting officers understand the true functions of accounts and realize their importance in determining the correct economic condition of the transportation properties with which they are affiliated. Their instincts and training are such as naturally to lead them to keep their accounts as they should be kept. They would not have the confidence of their superior officers if this were not the case. But in many instances the accounting officers of carriers have not been left free to follow their natural inclinations in this regard. Irrespective, however, of the influences brought to bear upon an accounting officer to turn him from his true course as an accountant and from his duty, under the law, of keeping the accounts in accordance with the system prescribed by the Commission, it is nevertheless his hand, or the hand of some one immediately under his authority, that makes the wrongful record, and it is the accountant, therefore, to whom the Commission must look in the first instance for the proper carrying out of its rules and regulations. Under our regulations and prescribed form the oath of the accounting officer must be attached to the annual report of the carrier to the Commission, together with that of the executive; and, from the necessities of the case, it is the accounting officer who is immediately responsible and whom the Commission will first hold responsible when it becomes necessary to invoke the penalties of law; but we shall not hesitate to call to account with even greater severity anyone above the accounting officer in authority who may share in the responsibility for any violations of the accounting rules and regulations which have been prescribed for the use of the carriers that are subject to the act.

Corporation accountants have come from various kinds of work. Some were bookkeepers who developed as the business grew. Many were young men of liberal education who started in business as clerks. Some were drawn from the ranks of the public accountants and a few came from other occupations.

Nearly all have had to acquire their technical accounting experience while at the same time learning the purpose and methods of the particular industry by which they were employed. It may be asked why they do not take the training prescribed for the certified public accountant, so as to establish their accounting status. Doubtless the controlling reason is that the requirements of most state laws include a certain period of employment in the offices of public accountants, and this means giving up a permanent position for the sake of a certificate which to employers has little meaning as determining qualifications for specialized accounting work.

While it must not be forgotten that any highly developed corporation has its own peculiar accounting problems, the successful solution of which calls for continued experience in that particular corporation, yet one can hardly escape the conclusion that the various corporations engaged in a given industry have so many accounting problems in common that some systematic exchange of views would be of great value to them all.

Just as the steam railroads of the country have their association of accountants (an example which other public utilities are beginning to follow), so we may expect to see, perhaps in the near future, various trade accounting associations dealing with and expressing authoritative opinions on the accounting problems peculiar to all the principal industries.

PUBLIC ACCOUNTANTS.

The future development of the public accountant's work has naturally received your consideration in many ways, but it is not you alone who are deeply interested in it.

Every accountant in this country is concerned in the status of our certified public accountants, because in the public view the reputation and standing of accountancy as a profession is at present chiefly in their keeping. I think this ought not to be so permanently, but I recognize that it is the existing condition.

The rapid and continued progress you are making in numbers and standing is sufficient indication of the need for your services. The efforts of this association, which I have watched with interest since its beginning—to set higher professional standards and to get recognition by deserving it—merit the attention and sympathy of all business men.

But I doubt if sufficient thought is given to the proper field for the public accountant's work—in a word, to its specialization. Now I am going to describe frankly what I think the field (or specialty if you like) of the public accountant ought to be, that is, the work he should do better than any one else, and I am going to tell, with equal frankness, what I think he is mistaken in trying to do.

In the first place, it is clear that any business concern, whose business is not large enough or not intricate enough to justify the permanent employment of a qualified accountant, may need the occasional services of a public accountant for systematizing its books and its clerical methods or for any other similar purpose.

Next, any corporation whose securities are to any considerable degree owned by others than the immediate managers, should have its accounts checked and certified by auditors who should be employed by and should report to—not the managers or directors—but to the security holders themselves or a committee of them.

Finally, in business difficulties, in reorganizations involving changes in ownership or management or generally in cases involving the rights of different parties in interest there should be work for the public accountant.

I do not mean to imply that public accountants should limit themselves to these three lines of work nor that they should invariably be employed for these; but these roughly describe the general field in which I think the economic opportunities for public accountants lie. This field, indeed, is so broad that we may expect an increasing degree of specialization in various parts of it.

The work that I think the public accountant is mistaken in trying to cover has been perhaps suggested in what was said as to corporation accountants.

The development of accounting systems, with whatever auxiliary accounting may be appropriate to the particular business, and the clerical routines necessary in connection therewith are so closely related to the character and organization of any business that the first essential is knowledge of that business. Expertness on the business is needed first and accounting expertness is secondary to that, and for the success of such work permanent responsibility must be joined to expertness.

Concerns of sufficient size to do so will permanently employ men who are, or who can become, experts both on the business and on its accounting and can take the responsibility connected therewith. To such concerns the services of public accountants for these purposes are not only inadequate but are superfluous and a waste of money. And yet large corporations are constantly being solicited by public accountants to be allowed to revise their accounting systems, frequently with much glittering argument as to scientific management, efficiency engineering and the like.

I think the public accountant loses the respect of corporation managers for the work that he can do to advantage by soliciting work that from the nature of the case can only be developed and handled successfully by permanent employees responsible for results.

If my view of the division of labor as between corporation accountants and public accountants is economically sound it will doubtless be recognized by public accountants that a part of attaining high professional standards sometimes consists in honestly recommending to their clients a course which means less employment for the public practitioner. Other professions, notably medicine and law, meet exactly this condition and accountancy cannot maintain a high professional status without solving such problems on the same plane.

GOVERNMENT ACCOUNTANTS.

A separate class includes all accountants who are, in various capacities, employed in the public service, federal, state or municipal, and this class naturally comprises four groups.

1) Accounting officers of states and cities.
2) Federal accounting officers.
3) Bank examiners, state and federal.
4) Commission accountants.

1) The first group has an organization known as the National Association of Comptrollers and Accounting Officers to which accounting and fiscal officers of cities, counties and states

are eligible. It is a comparatively young association, having been organized in 1907. Its membership was last reported as 125 and growing. Of the need for revising and improving municipal accounting throughout the country we are all well aware, and the increasing interest and intelligence that is being given to municipal affairs generally justify a hope that as a part of this movement the accounting will receive more scientific attention.

2) The federal treasury is said to handle more money than any one other institution on earth. Its accuracy in the care of money is admirable, but to accountants its methods of classification and its forms of statement seem open to criticism and bound, in the course of time, to be revised.

There are believed to be already many competent accountants in the various departments of our national government, and the increasing agitation for more modern accounting methods in the government's affairs may be expected to lead to a greater demand for competent men in this line.

3) Bank examiners, both state and federal, should be and in most cases, I believe, are competent accountants in their special line of work.

4) But the group of government accountants, to whose work I would especially invite attention, comprises those connected with the commissions which regulate railways and other public utilities.

The laws under which our federal and state governments exercise a regulatory control over railways and other public utilities include, as a necessary part of that control, the power to examine all books and papers and the power to prescribe accounting rules.

The federal trade commission bill, now pending, assumes for the government a similar accounting authority over all interstate trade.

Already the accounting methods of banks, insurance companies, steam railroads, telephones and telegraphs, electric railways, express, electric light, gas and water companies are for the most part definitely prescribed by federal and state officials, and, in my judgment, it is only a question of time when the accounting methods for all other business enterprises will be similarly under official direction. This will come about not only through governmental regulation of business practice, but also through the operation of the income tax and other methods of taxation.

This condition and tendency need only be pointed out to show the significance of the accounting work that is being done by these government accountants.

As for their qualifications as accountants it should be noted that most of those employed by the Interstate Commerce Commission must pass rigid civil service examinations, in which I am informed only about 10% of the applicants succeed, and, further, they must have several years' experience in practical accounting work.

The accountants in the corresponding positions under state commissions do not have to pass prescribed examinations in any cases of which I have knowledge, and though they are likely to be political appointments the commissions do in fact generally get as competent men as the salaries authorized by law will command.

Irrespective of the qualifications of these men, their power over the accounting of this country, though exercised subordinately through the commissions by which they are employed, is now very great and is increasing. It must be remembered that the rules they prescribe have the force of law and the precedents they establish are coming more and more to influence the accounting in all industries.

TEACHERS OF ACCOUNTING.

Among the hopeful signs of the improving status of accounting as a profession, the progress toward higher education in accounting easily takes first place.

I do firmly believe that the future leaders of our profession will be men who have begun with a broad cultural education and have next taken a thorough post-graduate training in the theory and methods of commerce and finance, specializing meanwhile on accounting.

Accounting education should be thorough on principles, and illustrations of those principles should be chiefly by analysis of actual transactions. At the same time the imagination should be stimulated to search the possibilities of the future, for we may assume that financial and accounting methods will change as much in the next twenty years as they have in the past two decades.

This kind of education should be followed by a choice of one of the four general fields of accounting I have described, and then the man's life work has begun. Specialization in technique is then safe, assuming, of course, that the man does not thereby narrow his horizon; but from this most fatal of all errors his preliminary liberal education and the continuing association with cultivated men of other vocations must be depended on to save him.

For the development of such men up to their working days we must depend more and more on professional teachers, exactly as the legal and other professions are doing. In fact, I think we shall find accounting education will develop somewhat as legal education has. For some few men the study and teaching of principles, together with the other advantages of the scholar's life, will always have more attractions than the practice of a profession.

The responsibility of accountants in practice to keep closely in touch with the developments in accounting education during this, its pioneer and formative period, has been well recognized by your association, but there ought to be a more general realization of its importance. The future of accountancy rests chiefly on the scheme of education for the accountants who will come after us.

Few accountants in practice will have either the leisure or the training to make important contributions to the literature of accounting, though encouragement in this direction is worth the serious consideration of all accounting organizations. In collecting an accounting library during the past few years I have been surprised at the dearth of really good books on the subject. But this condition is already improving and, as the opportunities for higher accounting education increase, we may reasonably expect our professional literature to advance. What I feel that we particularly need is authoritative literature dealing primarily with principles, but thoroughly outlining the processes or reasons by which such principles have become established and codifying such authorities as may be found on the application of the principles.

We would all appreciate such books, but in educational work they are a necessity and the teachers of accounting may be expected to meet the deficiency.

ACCOUNTING SPECIALIZATION.

This rough grouping of present accounting work shows that specialization in accounts has made considerable progress, and that it has been a natural evolution without special direction or stimulus. That this tendency will continue much further is suggested by the conditions now existing in more highly developed professions, as medicine, law and engineering.

In small towns and rural communities generally a doctor of medicine must attend to any kind of a case. Nervous prostration, scarlet fever and surgical operations are all part of the day's work.

The country lawyer will draw up a will or defend a murder case with equal facility.

The country engineer, often not recognized as such even by himself, will successfully survey a field, build a bridge, or lay out a water system.

But, as we get to larger and larger centers of population, there is more work and the problems are more complicated, so that this condition gives way to an increasing degree of specialization.

Now accounting in any scientific sense is chiefly concentrated in large cities since the transactions, though they may take place in the country—as for instance, the construction of a railroad—are entered on books at some central office.

It seems apparent that accounting, by reason of this centralization, lends itself readily to an increasing degree of specialization. From the technical standpoint also we may see this same tendency.

The classification of transactions naturally becomes more complicated as the transactions increase in variety. As they increase in volume the knowledge of them necessary to a business administrator does and must come through compilations of figures about them. If a man buys and sells 100 head of cattle in a year he is content to know from his books what he paid for the whole number and for what he sold them. But if he buys and sells 100,000 head of cattle he will almost inevitably classify them and will presumably seek to learn his profit on the various classes. Illustrations of this point will occur to any one. The general rule may be deduced that increase in volume tends to differentiation of classes and, hence, to increasing complexity of accounts.

It seems to me that it is the part of all professional accountants to clearly recognize this tendency toward specialization and to foster its development along sound economic lines.

In large corporations specialization may be expected to proceed from skill in the industry to skill in parts of the industry (such as departments) or to accounting subjects as applied to the whole industry, as property accounts, revenue accounting, cost accounting and the like. In public accounting work perhaps it may be found advantageous to specialize along the same lines as industries or by kinds of accounting work or according to the purposes for which an examination is to be made. Possibly some degree of specialization in public accounting work is already followed, but to the observer it seems as if public accountants generally are seeking all classes of accounting work without much regard to the specialized training needed to handle them.

We need not here concern ourselves with the arguments for or against specialization. It must be recognized as necessary in any profession under the present-day pressure for increased efficiency amid more and more complicated conditions. Of course, this specialization has its dangers and disadvantages. These we must grapple with just as the other and older professions do.

THE STATUS OF ACCOUNTANTS.

But the criticisms of present accounting work are not directed at its over-specialization—rather the reverse, I think, if they be carefully analyzed.

The most common criticism is that accountants do not sufficiently grasp the operating viewpoint of the business they are dealing with and that the effect of this is to make their studies and reports lacking in practical helpfulness. Again, this ignorance leads the accountant who attempts to devise methods into schemes that are not adapted to the organization or purpose of the concern. This general line of criticism is usually directed especially at the public accountants, but neither corporation nor government accountants escape it.

Another criticism is that in his passion for precision in his statements, the accountant often obscures the main issues by unimportant detail. All have seen the type of report that supplies a mass of tables, but does not clearly indicate whether the concern has or has not actually earned the dividends paid. From mischance as well as culpable negligence no profession can entirely free itself, but accounting ought to stand highest of all in public estimation in this respect since it deals more largely than others with matters of definite record.

It should chasten us all to read the following excerpt from the *New York Times Annalist* of July 27:

> One of the most difficult things decently to explain in finance is that on one day a corporation should appear to be solvent, from the figures certified by a reputable firm of expert accountants, and hopelessly insolvent the next, on a new set of figures prepared, perhaps, by the same experts. To this the accountant will reply that he certifies not to the solvency of a corporation, but to the arithmetical correctness of its figures—that they add and divide and subtract, and all come out even. But if that is all an accountant's certification is worth, why, how much is it worth to the investor, who, as a rule, is innocent of the technical refinements of accounting and regards a profit and loss surplus as a tangible asset because it is counted that way?

On vital issues that affect accounting, such as the valuation of properties, the method by which depreciation should be calculated, the distribution of overhead expenses, the development of unit costs, the significance of operating statistics and so on, it must, I think, be admitted that most of the discussion and progressive work to-day is among engineers, economists and operating men, rather than accountants.

Take, for instance, the *American Economic Review* for June, 1914, which classifies significant articles appearing in periodicals. Under the heading "accounting" thirty-four articles are referred to, of which eight appeared in accounting journals and thirteen in engineering periodicals, the remainder being chiefly in trade journals. Apparently, the engineers are taking more interest in accounting than the accountants! Of five hundred and one other articles on economic and business subjects two are ascribed to accounting periodicals. Of course, there is nothing conclusive in this illustration, yet I think we must admit that, while we are holding back, the engineers and the economists are exchanging ideas, forming opinions, and developing a scientific procedure with which we should be intimately concerne.

Now, the status of accountants and the value of their work are directly limited by these shortcomings. The business world realizes its need of better accounting work. It is developing more scientific methods of production and distribution. It has been struggling for some years to adjust itself to domestic political exigencies and during the past few weeks to a complete upheaval in international trade relations. In these extraordinary situations the accountant should be the premier business economist on whom the business world could safely lean, but—to put it bluntly—he has not taken advantage of his opportunity to qualify himself for the great things.

But it is not only in the great crises that his opportunity lies.

Observe the tendency toward higher ethical standards in business affairs which history shows us has been a part of the growth of civilization, but which has received in our time an unusual impetus. We all hope that the present movement for higher business standards will result in a firmer and safer foundation for our entire business structure. Its process, however, is full of confusion, wherein there is so much calling of hard names, so much virtuous denunciation of other people's acts and motives, and so much hasty legislation that the plain citizen may well wonder whether real progress is being made or only a temporary upsetting of business conditions, which will, after much hardship, pass away, leaving our standards of business morality about what they were before.

In this situation an undue emphasis has been laid on the spectacular, partly because it attracts popular attention and partly because it does not require a thorough mastery of facts. Slipshod investigation and superficial thinking are concealed behind a mass of passionate or accusatory language embellished with, but not supported by, statistics. I conceive it to be the duty of all sensible men and especially of accountants to deal patiently and thoroughly with facts of each case, seeing to it that they are stated clearly, stripped of irrelevant details, and to judge as to the propriety of the transactions or the motives of those responsible for them in a spirit of tolerance for past standards, but with constructive advice toward a better future.

THE UNITY OF THE PROFESSION.

May we not then fairly assume that the time is ripe for a new and a broader conception of the part that accounting and accountants should fill in the business world?

We shall not gain that conception nor fill that part so long as the various classes of accountants I have indicated work by themselves, largely unassociated and unrelated and with limited individual acquaintance. No one class, no matter how competent it may be, can cover the field. In no one class to-day can the development of accounting as a science be centered in this country. Each class has its part and the individuals of each class must specialize to an increasing degree in order to do the best work. This is reasonable and is the experience of other professions.

But I plead for the unity of the accountancy profession as a whole. If, as I believe, there are more than ten thousand accountants in this country, there ought to be a way provided by which they can stand together in a forward movement to develop the science of accounting and to improve its application.

Other professions, no older and no more important than ours, have successful organizations for similar purposes. Thus, for instance, the American Institute of Electrical Engineers, with over seven thousand six hundred members, represents every specialized branch of that profession. Other cases will occur to you all.

When the need for unity and solidarity of the accounting profession gains general acceptance the measures by which it can be attained will be speedily found. The one indispensable condition is a recognition of the need for unity, rising above all selfish or class considerations, to the one end that the science of accounting may be made more useful to the business world.

Some Scientific and Educational Problems of the Accountancy Profession*

By John C. Duncan.

In the past ten years the speaker has had many conversations with practising accountants as to the professional value of a university education. He has not found one who does not confess the desirability of a college course. He has yet to find a practitioner who believes that it is possible for any university to give one in accountancy anything more than a most general preparation for actual practice. More than one practitioner and members of examining boards have told the speaker that the best that any university course can do is to give the student a theoretical training which he must unlearn in the office before he is any good.

If it is true, why should the student learn that kind of theory? Many people apply the word theory to everything that is impractical. That is a wrong concept of theory. There can be no such thing as theoretically right and practically wrong, although we may have a thing theoretically wrong and practically right. Theory tries to explain known or supposed facts. If a supposed fact is not true, then the theory is false, no matter how plausible it may sound. If the explanation of a fact is incorrect the theory is wrong and does not affect the fact. In short theory must never be separated from facts, otherwise it becomes speculation. The real fault that lies at the bottom of our educational structure is not that we have too much theory, but we have too little recorded practice on which to construct sound theory.

The progress of a profession is dependent upon three things:

1. The education of its incoming practitioners.
2. Its scientific developments.
3. Its power to render material service to the community.

Twenty years have produced a marvelous development in the field of professional accountancy. Judged by its service contributions to the community, there is now no question whatever as to its professional right of being ranked with law, medicine and engineering.

No profession can afford to stand still. The apprentices and

* An address delivered before the American Association of Public Accountants, September 16, 1914.

clerks of the next generation must be able to do the work that tested the skill and ingenuity of the leaders of the present. Old problems must be settled in order to make way for the consideration of new ones. The methods of our predecessors must be taught to our successors or progress will be painfully slow. Such is the rule of all sciences. The schoolboy of to-day in a few hours learns to make the oxygen that was first produced only after years of labor on the part of one of the keenest minds of his generation.

In all lines of activities every generation is indebted to the organized knowledge of the past. It owes to the future the work of organizing its contribution so that the light can be passed on. This is what we call science. According to the *New International Dictionary* science is knowledge classified and made available in work, life or the search for truth.

In all lines of applied activity art precedes science. There was no science of war until Alexander the Great showed what could be done with armed men. The sciences of grammar and rhetoric were centuries in following languages. There were no sciences of chemistry, physics or engineering until little over a century ago; yet people worked with elements and forces since the beginning of time.

It is therefore only natural that in accountancy the art should precede the science. It is equally true that the science and educational methods must develop with the progress of art or professional chaos will result. Science and education are inextricably involved; neither can advance without the help of the other.

If we look at the field of professional activity now covered by the auditor and accountant, we find that he renders the following services:

1. He ascertains the financial conditions and earnings of enterprises for proprietors, executives, bankers and investors.

2. He discloses frauds and mismanagement.

3. He assists in bankruptcy proceedings, estate settlements, and reorganizations of various kinds.

4. He organizes accounts and installs accounting systems for all kinds of bodies.

5. He conducts investigations for intending purchasers and for governmental bodies.

6. He acts in a consultatory capacity with respect to the business policy of his client, both as to internal and external matters.

In order to focus our interests on the scientific and educational problems of accountancy, attention is respectfully called to a diagram.

[At this point was introduced a chart in the form of a Greek temple, the foundations of which were established on strata of rock, representing the general cultural courses common to all liberal educational schemes—history, literature, rhetoric, composition, sociology, political science, mathematics, chemistry, biology, music, drawing and all other subjects. The foundation of the temple represented the technical economics, commercial law, bookkeeping, public finance, mathematics and other technical courses in the economics field. The body of the temple was shown as if it were eventually to be supported by four massive columns. Each column represented a basic division of the science of accountancy. The first of these columns represented descriptive and analytical technique. The descriptive and analytical technique is that phase of accounting with which most people are familiar under the name theory of accounting. This column was represented as in place but as having on it a few irregularities in its lines, which could be readily dressed off by means of a chisel in the hands of a skilled workman. The second column represented a perfect shaft of stone and represented the science of auditing. The third column was indicated in dotted outline and the support that it was to give to the temple was supplied by heavy timbers and other massive, temporary supporting material. This third column represented the field of administrative criticism—the field in which the public accountant is being constantly called upon for services, and which is an essential division of the science of accountancy. It was represented in this temporary way because, although the profession is actually doing service in this line, and may, therefore, be represented as an actual part of the temple, no effort has been made to reduce this work to any laws or principles, so it can hardly be represented as a column already in place. The fourth column was also represented by temporary structural work. The fourth division represented constructive technique. Constructive technique is the division of accountancy which includes the work of designing and installing accounting systems for various kinds of enterprises. This division is also one that has not been reduced to laws and principles and is regarded by most people as a division of work that cannot be taught but must be acquired only through actual office experience. The roof of the temple was made to represent special courses in accountancy, like government, railroad, executorship, institutional, bankruptcy and others. All of these lines of work have their fundamental rooted in the four divisions built. In fact, one cannot take up any one of those special courses with any benefit to himself without having a complete understanding of the underlying principles, as indicated by the four columns.]

The diagram is designed to represent the existing relationship between the educational practice and educational needs for the accountancy profession.

There are four main divisions:

1. The foundation ground.
2. The foundation.
3. The main structure.
4. The roof.

THE FOUNDATION GROUND.

Everyone recognizes the value of broad training for all lines of activity. The speaker does not for one moment imagine that the prospective candidate for any profession should study all of those general courses. To do so would consume a lifetime. The candidate, however, should have an acquaintance with enough topics to be able to take an intelligent interest in the affairs of the world.

THE FOUNDATION.

Scientific accountancy must be built on the basic studies, book-keeping, economics, mathematics and law. The subjects cited in this section of the diagram should be presented to the student in a technical manner, rather than in accordance with the philosophical or historical plan. For example, in the average course in money and banking a student is taught a great deal about the banking history and the effect of legislation on the banking and business interests of the community. This is the historical and descriptive treatment. What is needed from the accountancy point of view is to teach along these lines:—The duties and responsibilities of each officer; how does the bank establish its relationship with the public; how does it build up business and save expenses; how should its accounting system be organized and so forth. This latter method is what we mean by a technical presentation.

THE MAIN STRUCTURE.

Analytical Technique. Accountancy experience so far has been organized into two divisions. The analytical technique of accountancy to-day is like a strong pillar, but its terminological weaknesses and lack of standardization destroy much of the clearness of its scientific outline. Like Michelangelo's block of marble it contains a beautiful and symmetrical work of art, but to set it forth in its true form it needs the finishing touches of a master hand.

Auditing. The auditing division of the general science of accountancy is without question the most completely organized part of the field. It is represented by a beautiful and complete column, not because the subject matter is complete, but because the technical methods have been crystallized into a science that will permit a growth harmonious with the development of new material.

To the left the reader will observe there are two timber cribs, over which are superimposed in dotted outline two columns. The crib next to the auditing column represents the division of administrative criticism. Every day the accountant is asked to suggest changes in organization and to recommend how expenses may be reduced. So far there has been no serious attempt to organize this work scientifically.

The one on the outside represents constructive accounting technique. In this is comprehended the art of drawing up accounting forms to save clerical work, the art of preparing forms and blank book material for the printer and bookmaker. It includes classifications of accounts, the work of drawing up instructions for the bookkeeper preparatory to the installation and operation of a proposed accounting system and all work of similar character. Practising accountants and teachers have ignored this great class of work in its scientific aspects, yet it must be done in every office.

Both of these two divisions are represented by cribs rather than columns, because the work of both of these sections is performed daily, although the experience has not been crystallized into science or organized into rules and principles. Everything that is done is of a temporary character, and leaves unfinished sections in the science just as builders sometimes erect temporary cribs or scaffolds in order to continue the superstructure while the permanent columns are being brought from a distance.

THE ROOF.

The roof represents the special divisions of work into which the accountant is called, executorship, bankruptcy, public service, railroad, governmental work and a host of others. Successfully to prosecute work in any one of these upper divisions one must have the fundamental technical training that is represented by the entire four columns, in addition to the special knowledge of the individual peculiarities of the business. Let us center our attention on the main structure and begin with the first column to the right, analytical technique.

Analytical technique. In this division poor terminology is the most severe handicap. Perhaps one-half of our present disputes as to the cost of production, balance sheet terms and the like are due not so much to looseness of thought as to looseness of expression.

It is not the speaker's object to make a brief in favor of the meaning of any term at this time. The point he does wish to make is that since the development of every science is dependent upon clear-cut terminology, then every science has the inherent right to give existing words technical meanings. A science has even the right to invent new words and new terms when the occasion arrives.

Salt to the ordinary person is a table relish, the chemical sodium chloride. To the chemist it is always a combination of an acid with a base. It may be any one of several thousand unions of acids and bases, but it is always the resulting product of an acid and a base.

Liability in its ordinary sense is an outstanding obligation or debt. Why has the science of accountancy not the right to have liability always mean accounts which represent outstanding obligations and ownership? We need a name for each side of that instrument called the balance sheet. Why has accountancy not the right to call one side assets and the other side liabilities, and then expect everyone who consults a balance sheet to know for what each term stands?

When the physicist began to investigate the laws of energy he invented words and terms on every side and made no apologies for them. How far would physics and electricity have advanced if the exponents of those sciences had refrained from originating and using words like erg, dyne, coulomb, ohm, volt, hysteresis and a host of others because the meanings of the terms would not be self-evident to the ordinary person?

Where would those sciences be now if they engaged in a war of words as to the meanings of terms according to their general acceptation?

If the business man or layman cannot learn the technical meanings of terms like assets and liabilities when used in accountancy, he is certainly different from the layman in every other science. We all realize that the idea of independence can be carried too far. Neither accountancy nor any other science should overload itself with unnecessary or incomprehensible verbiage. It should, however, stand on its dignity and demand the same mental effort that every one accepts without question in relation to the other scientific terminology.

So long as the American business man displays his present facility in acquiring the language of golf, the lingo of baseball, polo talk, football slang, prize-fighting patois and yachting dialect, I cannot believe he will not learn all the conventional terms accounting shall ever have to invent.

A second fault in this division is our lack of standardization. Words and expressions do not always mean the same things. For example, there is an instrument that the speaker will call the income and expense statement. He has seen that same instrument called income account, income and expense account, cost and income account, income and profit account, profit and loss account, and loss and gain account. No doubt you can add others. Such a condition should not exist. Every instrument and every definite thought should have a term to express the idea. Every one of the above terms should mean something definite and one should not be used interchangeably with the other. Moreover, all forms of instruments should be standardized, and the conditions under which each form should be used should be clearly specified.

Compared with other sciences accountancy is laboring under a severe and unnecessary handicap in relation to terminology and standardization. This body has in its power a means of removing this obstacle by continuing the work of the committee on terminology. This committee should be given authority to assign specific names to definite terms, and then have this general body take action on the committee report. This action may be entirely favorable or otherwise, but after it shall have been taken all accountants in their practice and writing should use the words and terms defined in accordance with this body's action.

In the field of analytical technique there has been produced an abundance of both descriptive and analytical literature of a high order. Much of its value, however, has been neutralized because of the confusion in terminology and lack of standardization. In passing, however, the writer cannot refrain from commending the work of Seymour Walton and of the contributions to the problem department of THE JOURNAL OF ACCOUNTANCY.

Auditing. The auditing shaft deserves only words of praise. In this division the accountancy profession has worked out its most perfect and complete contribution to the science of affairs. In his work, *Auditing,* R. H. Montgomery has given to the world a technical treatise on auditing methods which will have a high place in the literature for all time.

Administrative Criticism. To-day the accountant is called upon to advise the business man as to changes in business policy. Whereas formerly he was asked merely to make up schedules of assets and liabilities in cases of insolvency, he is now asked to explain why the insolvency occurred. In the past he was called in after bankruptcy; he is now retained to suggest means of preventing failure. His assistance was once sought to make proper provisions for depreciation and suggest means of distributing profits already made; he is now asked to tell the management how to increase income and reduce costs and losses.

Several months ago while conversing with a member of the American Association of Public Accountants, the speaker remarked that for the wealth of experience accountancy has had in the past five years along these lines, accountancy literature has produced few scientific articles on questions of the following nature:

1. The relative proportions that should exist between the various real accounts in various kinds of enterprise.

2. The relations that should exist between inventories, purchases and sales for different kinds of enterprises and different sizes of business.

His reply was: "Such things can be learned only by practical experience and cannot be reduced to a science."

Many people believe and believe conscientiously that the only way by which one can acquire even fundamentals of either of these two divisions is through the painful labor of personal experience.

The writer admits that experience may be the best teacher, but we shall all have to admit that experience is a very wasteful pedagogue. Moreover, the speaker even challenges the generally accepted impression that these things cannot be taught. He admits that up to date they may not have been taught, but we shall all have to admit that at one time man could not fly. Moreover, there were many people, and highly trained people, who believed it was conclusively proven that man never could fly.

We all admit that there are things which a person must learn from experience, but is not the value of your personal experience due to the fact that you, either consciously or unconsciously, from it evolve principles for future guidance? The value of wide experience lies in the fact that it enables one to formulate his principles from varying conditions of practice. The act of formulating experience into principles is the process of developing a science.

If several people combine their experiences for the purpose of formulating principles and publish their results, would you not derive a real benefit from their experience? Could you not apply these principles to your practice if similar conditions should confront you? It took over fifty years' experience of trained engineers to develop the commercially efficient gas engine. An ordinarily trained engineering student learns the principles of gas engine design, and designs one in six months by applying a few hours a day to the task. Instances can be multiplied indefinitely.

If we say that the results of experience in this division of administrative criticism cannot be reduced to laws and principles we are saying there is no science in business. That is not true.

When the speaker suggested the two topics mentioned he did not intend that their treatment by several authors—let alone one—would be sufficient to permit us to establish a complete science in this division of accountancy. But he is absolutely sure that if the practising accountants devote some of their time and energy in writing articles along those lines, they themselves will be surprised at the outcome.

As a step toward the substituting for the unsightly cribbage of individual experience the harmonious shaft of the science of administrative criticism, the writer ventures to suggest that we have a whole series of articles on topics like the following:

1. The relative proportions that should exist between the various real accounts in various kinds of enterprises under varying conditions.

2. The relation that should exist between inventories, purchases and sales for different kinds of enterprises and different sizes of business.

3. The relations that should exist between material, labor, and overhead costs of different mercantile and manufacturing lines.

4. Among the overhead charges what are safe proportions that rent, heat, light and power should bear to each other and to material, wages, interest, depreciation and the like?

5. What is the safe proportion that should exist between direct and indirect labor in different kinds of business?

6. How much should it cost to operate the accounting departments of different kinds of enterprises?

7. What is the best form of organization of the accounting department in different lines of activity?

8. What are the proper methods of classification accounts for different kinds of business?

These subjects are only suggestions. Once the work is started it will expand indefinitely.

Constructive technique. The young assistant's deficiencies along the lines of administrative criticism are rarely noticeable, because he must wait and work for years before his advice is sought in such matters. By the time his opinions are sought he has absorbed a great deal of information through experience. His incapacity in constructive technique is noticeable at once. Outside the routine job of checking figures about the first task he has assigned to him in the office is that of drawing up forms and working up the mechanical details of a report.

None but a sufferer can appreciate the exasperation of finding an office force incapable of performing work of this kind. The speaker has deep feeling on this point. He is talking from experience, both as employee and as employer.

The speaker will relate how he came into contact with this educational problem and how he has attempted to solve it.

His interests were always along the lines of accounting and business administration. While he was in college he took courses in chemistry and engineering in addition to all the work offered in accountancy. After graduating from the university he found that, although more interested in the business field, he was more efficient as an engineer.

Two cases will serve to illustrate this point. The inventor of a certain technical process had tried unsuccessfully to get his plans and specifications drawn up in such a manner that his attorney could secure the protecting patents from the United States government. The speaker was able to solve the difficulties in less than a day. Some time later he had occasion to design the accounting system of a small non-trading organization. It took him two weeks to do a job on which now he would be ashamed to spend more than six or seven hours. In the summer of 1907 he secured a position in the office of one of the largest and most important accounting firms in New York. In less than a month it dawned on him what was the matter with his business and accounting education. In his engineering courses he had been taught how to draw up plans of plants and how to design machinery. He was familiarized with the use of engineering instruments, his mathematics, physics, and chemistry were taught in such a manner that he could use them in the constructive phases of engineering. How different his accounting training! He was drilled in making all kinds of journal entries, he drew up balance sheets, income and expense accounts and statements of affairs from all kinds of data. He was given lectures on the general peculiarities of the accounts of different kinds of organizations like railroads, breweries, department stores, etc.; but never did he make a single form nor outline an accounting system for anything.

Is it any wonder that our juniors and assistants need office experience before they can be of any use? But is their lack of usefulness due to the fact that they have to unlearn their college theory? Is it not due to the fact that the youngster has not had any training at all in one entire field of the science, and in order to hide his ignorance he talks learnedly of theories and principles that have no application to the points at issue? His real trouble is not that he knows too much, but that he knows how to do too little.

How have the accounting and teaching forces sought to remedy these deficiencies? A practitioner gives one of his juniors the task of designing the forms of a department store accounting system. He soon finds the young man has not the slightest conception of how to proceed with the task. At the first opportunity this practising accountant suggests a course on department store accounts at the local school or university. The head of the school seeks someone who knows something about department store accounts. He may find the head accountant of a department store available, or he may find a practising accountant, or the task may be turned over to some young instructor with the command, "Teach department store accounting." Whoever gets the job the results are about the same. The student is given a series of lectures on the peculiarities of department store accountancy. These lectures are accompanied or followed by a series of department store accounting problems. The problems are analytical, very much along the lines that the student has had before in some other general accounting courses. Possibly six months from then another practitioner finds his assistant cannot design the forms for the accounts of a brewery. A course in brewery accounting is suggested as one of the big needs of the accounting profession. Again the instructor hies himself to the task of finding out the peculiarities of brewery accounts. Again there is a lecture course supported by a few more ingenious problems in analysis, this time with a brewery flavor. Illustrations may be repeated indefinitely.

We do not want more of these specific courses so much as we need to have the other side of our accounting training developed. Five years ago the speaker decided that such methods never would train a man in the principles of constructive technique in accountancy. He reasoned that if engineering colleges train students to design engines, dynamos, motor and water turbines; if medical schools train young men to cure diseases, prevent diseases, amputate limbs; if schools of architecture train young men to design buildings; then it ought to be possible to train young men to draw up forms, to design and to install accounting systems for all kinds of purposes. Moreover, since all of these other professions make a scientific study of their technique, we must do the same to realize their results in our profession.

In 1908 the speaker accepted the position of assistant professor of accountancy at the University of Illinois and was assigned the task of developing the courses in accountancy. He started out with the ideal in mind of developing the work of accountancy in such a way that the student would be able to do in that branch what the engineering graduate can do in his. For three years he had to wrestle with a number of serious problems that made it impossible to put his ideas into immediate operation.

In the first place he had two problems on hand. To realize his ideal he must teach the ordinary descriptive and analytical courses in accountancy, and also develop this technical constructive work. The two tasks present entirely different teaching problems. The technical constructive work is not a substitute method for the descriptive analytical courses and auditing. It is an added division of scientific material.

A descriptive subject can be taught by lectures, lessons in text books and by outside collateral reading assignments. Much of this kind of work is done outside of class hours, and the student's diligence and grasp of the subject is ascertained by frequent brief quizzes. The amount of class time need be comparatively small.

In analytical subjects the student is given a set of figures or conditions to criticize. He takes these figures home and reports the results of his work in class. His grasp of the subject is likewise ascertained by frequent short tests.

To train in professional technique is an entirely different problem. In the first place the student must be given a man-size task. Then he must be required to do it in a workman-like manner. The working assignments of necessity must be longer. The benefit derived in working out the exercises lies in being trained in methods of working. These courses clearly require much more class-room supervision than do the descriptive and analytical courses. Since these courses must be designed to teach a man how to work, the author called them laboratory courses.

At the university of Cincinnati, where he is now located, these courses are divorced absolutely from the descriptive and analytical ones and are designated "accountancy laboratory." The speaker wishes to make an observation at this point. One is not giving instruction in constructive technique by taking long periods of time for class work, and then teaching bookkeeping or having the men solve analytical problems under supervision. This laboratory method involves a teaching concept different from that of description and analysis. In these laboratory courses at the university of Cincinnati, the student receives training and does work as follows:

1. The student is given lectures on the qualities and mill sizes of paper. He is shown how to observe economy in adapting the quality of the paper to the importance of records. He is also shown the importance of cutting his forms to sizes that will not waste paper, that will leave sufficient binder room, that the books and papers drawn up will enter safes and filing cabinets, card index drawers and the like.

2. He is familiarized with printing and ruling conventionalities. He is shown how to draw up the forms and write out instructions to the printers without having to go through the necessity of doing a lot of expensive detailed office work that is of no assistance to the printer.

3. He is required to draw up forms and columns in such a way that they will make the mechanical work in bookkeeping as simple, clear and inexpensive as possible.

4. The student is shown how an accounting system is outlined by a superior and the detailed work designated and assigned to others.

5. He is required from this type of information to draw up the general plan of the accounting system and work out the classification of the accounts.

6. He is required to draw up the instructions for the bookkeeper to follow in order to carry out the accounting system that is installed.

The work is carried on by a series of graded exercises. First there are simple exercises in the proper methods of ruling forms. Then there is a series of organization charts to show the relationship between the accounting department and other divisions of the organization, and the relationship among the books of accounts to various departments and to the general ledger. Following these exercises is a series of definite problems in which the student designs, in all the details, the complete accounting systems for several small concerns. In these problems he first prepares the general accounting plans for the approval of the proprietor or executive officers. He works out the complete classification of the accounts as in actual office practice. He then prepares the material for the printer and binder. He writes out the instructions for the bookkeeper as to how all the accounts are to be operated.

This after ten years of observation, study and experience is the speaker's contribution to the method of teaching constructive accounting technique. While he has hopes and ambitions of rendering a real service to the accountancy profession the speaker has no thought that as yet anything more than a start has been accomplished. If this paper will arouse discussion and center the attention of you experienced practitioners, a new force will be brought into service on some of these vital points. We need have no fear of the ultimate outcome of the scientific position and educational process of the profession.

The most important scientific educational problems that now confront the profession lie along the line of three of the four fundamental divisions. In the first place our terminological problems should be settled. In the second place we need the division of administrative criticism developed into a science. And, thirdly, the science of constructive technique must be developed and perfected.

The accountancy profession has made an important place for itself in the business world. Those who are most vitally interested in its future position must seriously take up the problem of scientific and educational development along broad and far-seeing lines. No longer can accountancy be advanced scientifically, educationally or professionally by the fostering of disconnected courses, however well taught.

The whole organic scheme of the accountancy science and profession must be subjected to the broadest and keenest analysis and its continued growth must be fostered from the standpoint of constructive engineers.

The speaker is grateful to the officers and members of the American Association of Public Accountants for affording him the opportunity of presenting this paper, and for the considerate hearing they have given him. The honor and privilege is highly appreciated and he wishes to thank you all for the favors you have shown.

The National Finances*

By Harvey S. Chase, C. P. A.

About a year ago, namely, September 15, 1913, the writer submitted to the secretary of the treasury a report in two parts concerning the accounting conditions in the office of the treasurer of the United States at Washington. Part I of this report was printed in full in the *Congressional Record* of July 11, 1914. In this portion of the report it was stated:

In the multitude and magnitude of its transactions, the office of the treasurer of the United States is probably the greatest financial office in the world.

The total of the entries passing through its books approximates six billion dollars annually. It maintains accounts in sixteen hundred national banks. It furnishes the funds and keeps the accounts of nearly three thousand government disbursing officers. It acts as agent for seventy-five hundred banks in the redemption of their bank-note circulation, and it handles for the post office department the deposits of surplus money order funds from fifty thousand postmasters. It receives every business day from twenty-five to forty thousand cheques, and it must keep the continually changing records of nearly two billions of paper currency secured by gold and silver in its vaults. In the performance of these and other highly responsible duties the services of over six hundred and forty people are required in the Washington office alone. It is apparent that properly to record the great amount of business which passes through the treasurer's office, with its extraordinary maze of entries, transfers, issues, redemptions, exchanges, etc., not only is unusual skill required from the bookkeepers and accountants, but the system of accounting should be so complete and effective in all its parts that it will thoroughly control the millions of items passing through the books each year and at every moment properly safeguard the vast sums for which the treasurer is responsible under the law.

When the new method of paying government creditors was inaugurated, February 1, 1913, which carried with it the transfer to Washington of the accounts of nearly all the disbursing officers of the government, the office was soon overwhelmed by the volume of business which fell upon it, and for the handling of which it had not had sufficient time for preparation.

Extraordinary efforts were made to recover from the disorder into which the accounts were thrown by reason of this change of method, but the work of the office is still, at the end of seven months, in such a condition as seriously to retard the work of the auditing officers of the government, to impair the efficiency of the force handling the accounts, to make evident the inability of the office to furnish properly the information

* An address before the American Association of Public Accountants at Washington, D. C., September 16, 1914.

desired by the government debtors and creditors, and even to jeopardize the safety of the public funds.

With the work on national-bank accounts two and one-half months behindhand, with a week or more accumulation of uncleared cheques constantly on hand, with disbursing officers' accounts unbalanced and unstated for months, with controlling accounts ignored by reason of the pressure of details, and with the task of bringing order out of the confusion which now exists deemed hopeless by the clerks engaged upon the work, it is manifest that the efficiency of the staff is seriously affected, and that the condition calls for immediate and effective remedies.

The reference to the change in methods of paying government creditors inaugurated by Secretary of the Treasury MacVeagh on February 1, 1913, requires considerable amplication in order to be understood. Prior to that date it had been the custom for the current debts of the government to be paid from the local accounts of "disbursing officers," who were treasury agents appointed for that purpose and scattered all over the country—indeed, all over the world, when the requirements of the navy and of foreign relations are considered. These disbursing officers received from the treasurer of the United States directly, or through the sub-treasuries, advances of money drawn on "accountable-warrants," as they are called. These accountable-warrants were invented subsequent to the original establishment of our government, after it had proved impracticable to do the government's business on the theory that all claims should be audited by the treasury before they were paid. The idea of audit-before-payment is a good one theoretically and one with which all accountants are familiar. The magnitude of the operations of the government and the deliberation of the processes of audit and of record are such, however, that delays in payment of legitimate claims would have been so serious under the audit-before-payment system that the plan was necessarily abandoned in favor of the more rapid and effective method of advancing money to disbursing officers "on the spot" as it were, who could promptly determine whether or not a claim should be paid and, if satisfied that it was legal and accurate, could pay it at once and send it in for the more formal and detailed "audit" at the treasury later. This is the way that the very great majority of the government's expenditures are now provided for.

There was no change in this general system on February 1, 1913. The change which was made related to the method of keeping the accounts of the disbursing officers and to the deposit of moneys in the national banks. The change was inaugurated for the excellent purpose of preventing the continual and useless shipment of money or credits from the banks to the treasury and *vice versa.* The new plan was this:—Each disbursing officer continued to receive accountable-warrants, made on requisitions by him, representing advances of money to him for payment of legal claims against the government, including salaries, pay rolls, supplies, contracts, etc., etc. Instead, however, of depositing these accountable-warrants to his own credit at a national bank, his account at the treasury was credited with them and his cheques in payment of claims were drawn *against the treasury* instead of *against bank accounts* as heretofore. Meanwhile, collections of money for the government by fiscal officers were deposited in these banks to the credit of the treasury and from this money (or from deposits made directly from Washington) the banks honored the cheques of the disbursing officers drawn against the treasury, but locally deposited by the payees. Whereas formerly all receipts were remitted to the treasury (or sub-treasuries) and all payments were sent out from the treasury, necessitating the transferring of money or credits both ways, now by the new system only the *excess* of receipts over payments was shipped to the treasury by the banks, or the excess of payments over receipts was shipped by the treasury to the banks.

Unfortunately the time allowed by Mr. MacVeagh for the introduction of the new system was not long enough for sufficient preparation and the new method broke down almost hopelessly in practice, as our report exhibited. The scheme was devised by treasury officials and was, and is, an improvement over previous methods. I am glad to say that during the past year effectual methods have been introduced and the accounts brought up to date so that there should be no serious danger hereafter from the conditions mentioned in our report of a year ago. Part II of that report, which has not been published, contained detailed recommendations, forms, new methods and new machinery for remedying the serious condition exhibited in the published portion of the report (part I).

THE DAILY STATEMENT OF THE UNITED STATES TREASURY.

The operations of the treasury center in and are reflected by a daily publication of the treasury which is a four page sheet—

copies of which have been distributed to you—entitled the *Daily Statement of the United States Treasury.*

I have before me copies of this statement as it was published prior to July 1, 1913, and as it has been published since that date—in a new and greatly improved form. The tabulations in this statement are intended to mirror the daily transactions of the treasury and it will be advisable, therefore, to give careful attention to them.

I will now refer to the issue of June 30, 1914, which you have before you.

You will note in the first place that the first page of the statement sets forth the "cash assets and liabilities." These cash assets represent the money and credits actually in the treasury offices and in national bank depositaries of the United States government at the close of the business day, so far as reports have reached Washington during the following business day up to about 2 o'clock p. m. when the statement goes to press.

On the statement before us, June 30, 1914, it will be seen that in the "general fund" the total cash assets in treasury offices amount to one hundred and seventy-five millions of dollars, while the available deposits in the national banks and in the Philippine treasury amount to about one hundred and six millions more—the grand total of the "general fund" being $280,741,962. Against these assets in the "general fund" there were liabilities—a large part of which consisted of moneys which had been advanced by the treasury to disbursing officers—amounting to about one hundred and thirty-five millions of dollars, leaving a net balance in the "general fund" available for general purposes of the government, under present laws, $145,835,502, as of the close of business on that day. In addition to this great sum there were still huger sums in gold and silver coin and bullion in the vaults of the treasury and sub-treasuries, against which gold and silver certificates are outstanding. The total gold and silver in the "currency trust funds" on that day amounted to $1,574,263,869, with an equivalent amount of currency certificates and treasury notes of 1890 outstanding.

Further than this there are outstanding $346,681,016 of United States notes (greenbacks)—a fixed amount under the law, which requires that when any of these greenbacks are redeemed by the treasury they shall be re-issued immediately. Against this three hundred and forty-six millions of notes (greenbacks) there is held in the treasury a specific "gold reserve fund" of one hundred and fifty millions in gold coin and bullion. This fund is theoretically for the purpose of paying in gold any of the greenbacks which are presented to the treasury for redemption. It is particularly provided under the law that this gold reserve shall be kept at the amount of one hundred and fifty millions of actual gold and, to do this, authorization is given to sell United States bonds for gold whenever necessary (*i. e.* when the reserve falls below one hundred millions) in order to replenish the gold reserve fund.

You will note immediately an interesting question which arises as to whether or not it is correct to exhibit the gold reserve assets, of one hundred and fifty millions, on the left hand side of the account, but not to exhibit the total amount of the outstanding United States notes (greenbacks), of three hundred and forty-six millions, on the other side. You will see that the statements sets forth on the liability side an item "gold reserve" which is one hundred and fifty millions, exactly balancing the account "gold coin and bullion" on the other side of the account. Many of you will be inclined to question this arrangement and to assert that the total amount of the notes, three hundred and forty-six millions, should be set up as an actual liability. Upon further consideration, however, and with an understanding of the requirements of the law, you will, I think, agree with me, that this amount of three hundred and forty-six millions should *not* be set up as a liability against these assets, but should merely be explained as is done in the note which you see on the right hand side of the account.

As it fell to me, when at work in the treasury last year, to lay out the new form for the *Daily Statement,* I am responsible primarily for this arrangement—which was of course duly accepted and authorized by the secretary of the treasury. The reasons for not exhibiting the United States notes as liabilities against the cash assets are these:

Under the provisions of the law it is required that, in order to preserve the value of these notes at all times on a gold basis, this reserve fund of one hundred and fifty millions shall be set aside. This reserve fund is, however, not the only asset against these notes. All the assets of the United States government may be said to be resources to preserve the gold value of these notes, excepting of course the coin and bullion especially set apart to protect the outstanding gold and silver certificates. Furthermore, the law states that these notes shall not be finally redeemed but shall—as fast as taken in by the United States in exchange for gold, or otherwise—be re-issued by the treasury and kept continually outstanding at the amount of $346,681,016. Again, as I have already stated, power is granted by the law to sell bonds for gold, and with the proceeds of these bonds, to provide for the preservation of the gold value of the notes (greenbacks). Therefore, it will be clear to you, I think, that the liability of the greenbacks is not simply a liability, against the cash assets of the government (shown on this sheet), but is a liability which has as an asset the governmental power to issue bonds and to provide gold thereby. It is evident, therefore, that the liability on these notes is practically the same as that of United States bonds—which I infer none of us would consider as liabilities against current assets; except so far, of course, as such bonds have matured and have not been paid by the government. Is it not evident, then, that the total amount of these notes should *not* appear as a liability against the assets of the gold fund?

If now you will compare the old form of the statement with the new form you will note, I believe, various marked improvements from an accounting standpoint. In the first place, the old form consisted of sub-totals of assets with sub-totals of liabilities deducted therefrom; resulting in what was called the "working balance in treasury offices" while separately there was set up the "balance in banks and treasury of Philippine Islands"—these two, together with "subsidiary silver coin, etc.", making what was called the "total balance in the general fund." By the new form you will note that the assets are set up on the left hand side of the statement while the liabilities are on the right hand side, in balance sheet form. Moreover, at the foot of the sheet the grand total of cash assets in the treasury, amounting to over two billions of dollars, is set forth. This statement gives a much better idea of the actual resources of the United States treasury than could be obtained from an ordinary survey of the old form.

During the careful study which was given by us to the items making up the totals of the *Daily Statement,* which extended over the summer of 1913, reasons were found for changing the designations and accounting classifications of some of the current liabilities. Certain liabilities now set forth had never before been included in the statement—one of such items being the "redemption fund for national banks" which on the June 30, 1914, statement amounted to over fifteen millions of dollars. This question was also a most interesting one from an accounting standpoint and was decided on its merits in the opposite direction from the question of the greenbacks. It was included as a liability for the reason that this money had actually come in from the banks and was included in the cash and other assets on the other side of the account; therefore, it is evident that it should be set up as a liability, despite the fact that, by the act of July 14, 1890, congress declared this "redemption fund for national bank notes" should be specifically included in the list of "United States debts bearing no interest." It is evident, however, that to include it in this way would cause the item to be set up in duplicate on the general balance sheet, namely, once as a liability *inside* the general fund, and once as a liability *outside* the general fund, under the heading "debt bearing no interest." In order to overcome this difficulty—occasioned by the difference in viewpoint of the law passed by congress, as against proper accounting requirements—a new table was set up in the monthly *Statement of Public Debt* in which the two-fold appearance of this item as a liability of the government was corrected and the true *net debt* of the government properly exhibited.

I will now distribute copies of the *Statement of the Public Debt* for June 30, 1914. This item, "national bank notes: redemption fund" is marked with a red arrow.

The reasons for the change in the form of the *Daily Statement* are exceedingly interesting to accountants but would be too long a story to attempt to state here. One of the elements may be explained at some length, however, as illustrating a danger which is common in many kinds of the financial accounting of governments, whether of municipalities, or of states, or of the nation itself. This element is the tendency among government officials—which of course is a necessary tendency—to follow official instructions to a degree which is often exaggerated and which may become subversive of correct accounting and of accurate statements. It is probably true, that each of you who has had to do with governmental accounts is aware of this tendency and of its unfortunate results at times.

The old form of the *Daily Statement* with its "working balance in treasury offices" had in it a feature which sometimes became difficult and even dangerous. This "working balance" was looked upon by those both inside and outside the treasury as the barometer of the condition of the treasury and any sudden change in it or any continuous diminution of it over a relatively short period was construed by those outside the treasury as a disturbing factor and as an indication that the government finances were in an unsatisfactory condition. It will be evident to you as you study the arrangement of the old form that any considerable transfer of funds from the "treasury offices" to the "national bank depositaries" would immediately affect the "working balance in treasury offices" although it might not at all affect the final figures, namely, the "total balance in the general fund." In connection with this it was a fact some years ago that the amount of deposits in national banks considerably exceeded the amount of bonds held by the treasury to secure the deposits of government money in those banks—the total of such bonds being set forth on the interior page of the statement. Adverse comment having been aroused, the criticism was made that the statement on its face showed an excess of government deposits in banks over and above the bonds of the banks in the treasury. This outside criticism caused a treasury official to instruct those who had charge of the tabulations in the *Daily Statement* "not to let such a condition occur again." These instructions were, no doubt, proper instructions and might have been carried out theoretically in any one of three different ways. First, the government deposits in banks might have been reduced until equal to or less than the amount of bonds deposited against them. Second, the banks might have been requested to increase their deposits of bonds in the treasury until they equalled and protected the total deposits of government money in the banks. Third, the actual figures coming in from the daily reports might be manipulated so as to conceal the fact that the deposits actually exceeded the amount of bonds. In the case now under discussion it actually occurred that the third method was chosen and the figures were manipulated and for a considerable period the *Daily Statement* reflected inaccurately the facts in regard to the deposits of government moneys in national banks and in relation to the amount of bonds held by the treasury against these moneys. This manipulation of the figures apparently decreased the total deposits in national banks on the statement and correspondingly increased the "working balance in treasury offices." These changes of the figures, while commonly about three millions, sometimes amounted to over fifteen millions of dollars. A portion of this transfer from one total to another on the *Statement*—although not in the books—may be accounted for quite properly as estimated moneys in transit from banks to treasury offices. During a considerable period, after the instructions above stated had been given, some three millions of the total moneys reported by the banks were considered as if in transit every day. To be specific, this amount was entered on the *Statement* as if it had been received by the treasury offices and was included in the item "gold certificates" on hand. This was not far off from the amount actually in transit daily and no objection would have been raised if this item had been explained by a foot note or otherwise.

When, however,—owing to the large collections which came to the banks through the corporation tax law, and also through the congestion which occurred in the treasurer's office owing to the change in method of paying government creditors—these figures ran up to seven, eight, ten, thirteen and even fifteen millions of dollars, it was evident that this method of preparing the *Statement* was radically wrong. After careful consideration of this method it became evident that the principal reason, or excuse, for attempting such an inaccurate presentation of the facts was the purpose of protecting the so-called "working balance in treasury offices" as it appeared day by day on the *Statement*—the intention being that no alarming shrinkage should appear therein. It was further evident to us that the proper way to avoid this tendency and to destroy any possible excuse for such manipulation of the figures was to combine the "treasury balance" in the *Statement* with the "national-bank depositaries balance" and in place of these two to set up one total for the whole and this is now done in the new *Daily Statement.* As soon as this combination took place, the so-called "working balance" disappeared entirely from the *Statement* and therefore no further necessity could be alleged for improperly transferring amounts from one portion of the *Statement* to another.

Furthermore, it was merely common sense to change the *Statement* in this particular inasmuch as government moneys on deposit in national banks are just as available for paying the debts of the government as the money in the treasury offices. Indeed, one might say that the bank deposits are even more available, because the great bulk of payments made by the government is made from these deposits in the national banks. It will be evident to you, therefore, that in these particulars at least, the new form of the *Daily Statement* is far superior to the old form.

Turning to the interior pages of the *Statement* you will see that the daily receipts and payments of the "general fund" are set forth on page 2. You can easily imagine how extensive must be the government's system of accounting in order to provide such large totals every day with all items verified, balanced, and proved beyond question, mathematically.

There are other questions which would appear from further study of this *Daily Statement* which I should be glad to refer to, except for the reason that if I did so this address would require altogether too much time. I wish, however, to bring to your attention two matters on the fourth page, the first being "pay-warrants drawn," which are arranged for comparison with corresponding dates of the previous fiscal year. The other matter on that page is entitled "paper currency statement," at the top of the page. This statement, I am inclined to believe, is fairly open to serious criticism. In the first place you will note that, contrary to the usage on other pages of the *Statement*, assets are set up on the right and liabilities on the left hand side, which is the reverse of the usual accounting practice in America. This method of setting the assets on the right is common in Great Britain, as we know, but it is out of place it seems to me, in a statement issued by the United States treasury. Furthermore, no details are given showing how the amount of "paper currency" is made up. One would have to know of his own knowledge that it consists of gold certificates, plus United States notes (greenbacks), and "treasury notes of 1890," if he wished to verify the total against the sum of the items on previous pages of the publication. In order to make this criticism effective, I will submit to you a new form in which, as it seems to me, this "paper currency statement" should be published and I will be glad to listen to any comments or answer any questions.

NEW FORM PROPOSED BY MR. CHASE

(Figures of June 9, 1914)

PAPER CURRENCY STATEMENT

Resources		Liabilities	
Gold Certificates			
Gold in currency trust funds......	$1,122,097,869.00	Gold certificates outstanding	$1,122,097,869.00
United States Notes and Treasury Notes			
Gold in gold reserve fund	$150,000,000.00	United States notes outstanding	$346,681,016.00
Gold and gold certificates in general fund	68,406,474.22	Treasury notes of 1890	2,452,000.00
Silver dollars of 1890	2,452,000.00		
	$220,858,474.22		$349,133,016.00
Silver Certificates			
Silver dollars.......	$481,400,000.00	Silver certificates outstanding	$481,400,000.00
National-Bank Notes			
Held in treasury as security:		National bank notes: outstanding	$751,034,211.50
United States bonds	$740,731,160.00		
National bank notes: Redemption fund.	15,857,121.00		
	$756,588,281.00		$751,034,211.50

THE GENERAL ACCOUNTS OF THE GOVERNMENT AS A WHOLE.

In an organization as vast as that of the United States government, accountants naturally would expect to find an exemplary accounting system culminating in a general ledger, or series of general ledgers, in which would be recorded summaries of the assets and the liabilities of the government, both "current" and "fixed." We should also expect to find summaries of the total revenues of the government—at least of the *cash* revenues—and also of the expenditures.

As a matter of fact there is a "general ledger" in the "bookkeeping and warrants" division of the treasury department which is intended to provide mathematical proofs by trial balances over the double-entry portion of this accounting, but this "general ledger" is such in name only and, aside from this proof of accuracy in mathematics, is of very little, if any, value to the government. The trial balances, or "balance-sheets" drawn from such trial balances, are not published in the government's financial reports and if published they would be of no use to legislators, or to the intelligent citizen, or even to public accountants.

The insufficiency of this general ledger has been recognized by government bookkeepers for a considerable period and various plans have been formulated for improving and extending it until it should truly represent and correctly exhibit the important "controlling accounts" of the government as a whole.

During the years that the writer was a member of President Taft's "commission on economy and efficiency," he endeavored to make a comprehensive study of the accounting methods in the treasury in order to outline the necessary steps which should be taken and preparations which must be made to provide bookkeeping machinery which would necessarily result in true "controlling accounts" in a real "general ledger." The difficulties in the way of the installation of such accounts are many. Some of them arise because of present provisions of the law; others through long-established customs which, in government practice, are not easily changed. Such an installation, however, would be practicable in due time and it should go without saying that, to us as accountants, there can be but one conclusion in regard to such a matter, namely, that such an installation should be begun promptly. To accomplish this in a permanent manner, in such form that it could not be overturned or seriously changed by an incoming administration, would require legislation by congress. Old laws must be amended and new laws must be passed before modern and effective accounting machinery and methods can be firmly established.

THE METHODS OF AUDIT.

In this connection we must consider also the *auditing function* of the government, which to-day is carried on in the treasury department under the control of the secretary. The powers and duties of the secretary of the treasury in these days, especially since new requirements relating to the federal reserve board have been added, are scarcely less than overwhelming in their number and magnitude. It is not too much to say that—no matter how able an individual may be personally, or how complete his financial experience otherwise may have been—no man, except after years of training in the department, can fully perform the functions demanded of the secretary of the treasury. Pressure is so great and interference by relatively outside matters is so frequent and sudden demands, made by wholly new requirements upon the time of the secretary and his assistants, are so subversive of efficiency, that it is no wonder if secretaries break down under the strain or, if they are wiser, that they should protect themselves by doing only what is relatively practicable and by letting the remainder of business—be it routine or be it new matter—await a leisure which is hoped for but which never arrives.

Cabinet officers of the government have not the resource of hard-driven executives in commercial affairs. They cannot appoint able assistants when the necessity becomes acute, except after appropriations have been made by congress for such a purpose. It is well known, in this connection, that it is especially difficult to induce congress to vote appropriations for salaries commensurate with the ability of men who have had the training and experience needed to fill effectively the highest positions in the service. Congress will often pass appropriations for clerkships, sometimes in excess of the economical needs of the government, but will decline to provide for highly competent men, and thereby spend much more money annually than would be expended if a few higher salaries were provided for such competent men whose expert services are really needed. However, this is a condition of governmental affairs which may be criticised but which will not be changed probably except very slowly. We must make the best of it as it is.

Now as to auditing. The whole audit force of the government is under the control of the secretary of the treasury under the law. The secretary is also the head of the collecting and disbursing divisions of the government, although the immediate officer in charge of cash transactions is the treasurer of the United States, who is in reality the government's *cashier,* responsible under surety bonds for the accuracy of the inflow and outflow of cash. To a public accountant it is an anomaly to see the head of a fiscal office at once his own collector, disburser and auditor. It does not seem fitting or safe, at first sight, that these distinct functions—of *accounting for cash* and of *auditing* *these accounts* should be under the control of the same individual. It appears, therefore, to us that some day this anomaly will be corrected—although it has not worked badly in practice—and the audit functions will be separated from the accounting functions. The former will then be provided for in a new and better way, and this brings us to one of the conclusions to which those who have carefully studied our treasury conditions have come, namely, that there should be a new office or bureau—perhaps a separate "establishment"—reporting directly to the president and to congress, which would have the duties pertaining to a "central auditing and summarising bureau."

Such an office would supervise the audits of the treasury and of the other departments; would summarise the audited accounts and would bring them under control for the "general government ledger" to which I have referred previously. Its head would be, probably, an accounting officer—the comptroller of accounts, perhaps—not the comptroller of the treasury who renders legal and technical decisions, nor yet the comptroller of the currency, who as you know supervises the national banks. Such an office would also prepare the "national budget" for the president to submit to congress annually in December with his financial message, and this budget would then be published from two distinct viewpoints which, in common with others, I have urged as fundamentally necessary in our government's finance. These two viewpoints are, respectively, the *inside* viewpoint—that of congress and the executive departments—and the *outside* viewpoint, that of the financier, the business man, the journalist, and the intelligent citizen. The first of these viewpoints would require the arrangement of "estimates of appropriations" in classifications pertaining to *units of organization,* namely, departments, bureaus, divisions, offices, and establishments of the government, *i. e.,* the units which are to expend these appropriated moneys.

The second viewpoint would require that there should be an arrangement of the estimates according to the *purposes of expenditure* (functions of government) irrespective of the units of organization which are to spend the money. In a recent publication upon this subject, I said:

"Suppose that the president is about to submit to congress and to the public his annual message at the beginning of the session. He has, we will say, adopted the budget idea and has prepared a message supported by tables of figures based upon estimates of proposed expenditures and estimates of expected revenues furnished to him by his cabinet officers and the heads of the government establishments. These estimates have been prepared in two ways. First, in the ordinary way, as required by present legislation. Secondly, in a new way, arranged in logical order and intelligible sequence, grouped by purposes or functions of government, and segregated by character of expenditure—whether for current expenses or for capital outlays, and for subdivisions of each. The revenues, too, have been carefully calculated and compared with other years, due allowances have been made, non-revenue receipts have been eliminated, trust funds and trust income separated, all remaining revenue concisely classified, and the available total determined. The president, with the advice of his cabinet—and probably with the assistance of a central administrative accounting bureau—has prepared these estimates of revenue and of expenditure in budgetary form. He has struck a balance. He has accepted the anticipated result, whether it be a surplus of revenue, or a deficit. If the latter, he has considered methods of providing for the deficit. With these data before him, he constructs a budget as follows:—He sets up the revenues by classes with explanations and a final total. He tabulates the proposed expenditures, classified as exhibited below.* He first deducts from the total estimated revenue, the 'fixed charges' which must be met without question—such as interest on the public debt; definite debt redemptions; revenues required for trust-fund liabilities or other special funds; pension requirements; recurrent allowances for upkeep and maintenance of public buildings, grounds, parks, and the public domain generally. Having totalled these and deducted the total from the expected revenue, he next exhibits the necessary, perhaps unavoidable, expenditure for military and naval purposes; for continuation of engineering projects of great importance, and for similar requirements. The total of these is again subtracted from the remaining revenue and an amount of revenue is left which is available for less mandatory purposes.

"Concerning the expenditure of this portion of the revenue there may be considerable question and discussion. Whether,

* See *A Financial Plan, or Budget*, in The Journal of Accountancy for June, 1914.

for instance, less shall be spent for stimulation of agriculture, with more for promotion of commerce or *vice versa;* whether less should be provided for the function of education and more for public health; whether or not labor and the laboring classes need additional promotion, and whether defectives and dependents should be more liberally provided for. The wards of the nation, Indians and others, would be discussed and their necessities considered; our foreign relations, embassies and commercial attaches would have due attention; all the various functions and activities would have each its needful consideration from the general standpoint of its relative importance to all other expenditures and to the available revenue.

"Such an analysis of the finances of the government, of the purposes and character of expenditure, and of the relations of the latter to the expected revenue would present a picture of supreme importance to every intelligent citizen in the country and one of the greatest moment in the efficient handling of financial problems by congress. It goes without saying that such an exhibit by the president at the opening of congress would be intensely stimulating; would awaken nation-wide interest; would provoke discussion and criticism; would flood the mail boxes of congressmen with urgent appeals to increase here and to cut down there, and would open the eyes of the members themselves as to what could be done and what could not be done in the way of modification and change without upsetting the balanced relations of revenue and expenditure *in toto*."

(NEW FORM)

DAILY STATEMENT OF THE UNITED STATES TREASURY

AT CLOSE OF BUSINESS JUNE 30, 1914.

CASH ASSETS AND LIABILITIES.

GENERAL FUND.

ASSETS.	
CASH:	
In Treasury Offices—	
Gold coin	$45,381,760.92
Gold certificates	45,520,740.00
Standard silver dollars	4,670,087.00
Silver certificates	11,387,624.00
United States notes	7,841,373.00
Treasury notes of 1890	11,942.00
Certified checks on banks	422,502.53
National-bank notes	32,586,262.46
NOTE.—This includes $26,260,644.46 which the Treasury has redeemed and for which it will receive payment from the national banks.	
Subsidiary silver coin	22,052,187.82
Fractional currency	226.22
Minor coin	2,123,564.80
Silver bullion (avail for subsidiary coinage)	2,853,784.76
	$174,852,055.51
In National-bank Depositaries—	
To credit of Treasurer United States*	93,388,665.72
To credit of postmasters, judicial officers, etc.	6,566,058.85
In Treasury Philippines—	
To credit of Treasurer United States	2,998,175.29
To credit of disbursing officers	2,937,006.96
Total	$280,741,962.33

LIABILITIES.	
CURRENT LIABILITIES:	
In Treasury Offices—	
Disbursing officers balances	$51,858,439.31
Outstanding warrants	993,941.45
Outstanding Treasurer's checks	3,336,884.18
Outstanding interest checks	272,349.37
Post Office Department balances	9,915,466.70
Postal Savings balances	1,547,406.18
Judicial officers' balances, etc.	7,625,867.34
National-bank notes: Redemption fund†	15,142,888.50
National-bank 5 per cent fund	25,874,236.19
Assets of failed national banks	1,834,705.96
Miscellaneous (exchanges, etc.)	5,475,176.39
Total	$123,877,361.57
Subtract: Checks not cleared	883,154.62
	$122,994,206.95
In National-bank Depositaries—	
Judicial officers' balances, etc.	6,566,058.85
Outstanding warrants	894,159.48
In Treasury Philippines—	
Disbursing officers' balances	2,937,006.96
Outstanding warrants	1,515,027.99
	$134,906,460.23
Net balance in general fund	145,835,502.10
Total	$280,741,962.33

THE CURRENCY TRUST FUNDS, THE GENERAL FUND, AND THE GOLD RESERVE FUND.

ASSETS.		LIABILITIES.	
CURRENCY TRUST FUNDS:		OUTSTANDING CERTIFICATES:	
Gold coin	$838,855,683.00	Gold certificates outstanding	$1,080,974,869.00
Gold bullion	242,119,186.00	Silver certificates outstanding	490,850,000.00
Total gold	$1,080,974,869.00	Treasury notes outstanding	2,439,000.00
Silver dollars	490,850,000.00		
Silver dollars of 1890	2,439,000.00		
Total currency trust funds	$1,574,263,869.00	Total outstanding certificates	$1,574,263,869.00
GENERAL FUND:		GENERAL FUND LIABILITIES AND BALANCE:	
Total cash assets, as above.	280,741,962.33	Total liabilities, as above.	134,906,460.23
		Balance in general fund as above	$145,835,502.10
GOLD RESERVE FUND:		GOLD RESERVE	150,000,000.00
Gold coin	100,000,000.00	NOTE. — Reserved against $346,681,016 of U. S. notes and $2,439,000 of Treasury notes of 1890.	
Gold bullion	50,000,000.00		
		Total net balances	$295,835,502.10
Grand total cash assets in Treasury	$2,005,005,831.33		$2,005,005,831.33

* The large excess of bank balances is due to heavy collections of income and corporation taxes deposited late in the afternoon, and will be transferred on the succeeding day.

† The act of July 14, 1890, provides that deposits made by national banks to redeem circulating notes shall be covered into the Treasury as miscellaneous receipts and that the Treasury shall redeem from the general cash the circulating notes which come into its possession subject to redemption.

(OLD FORM)

Statement of the United States Treasury

AT CLOSE OF BUSINESS JUNE 30, 1913.

RESERVE FUND.

Gold held for redemption of	$346,681,016 of United States notes....	Coin...$100,000,000	
	$2,660,000 of Treasury notes of 1890.	Bullion 50,000,000	
			$150,000,000

TRUST FUNDS.

Held for the redemption of the notes and certificates for which they are respectively pledged.

Gold { Coin $887,471,847				
Gold { Bullion 199,255,322				
	$1,086,727,169	Gold certificates outstanding.	$1,086,727,169
Silver dollars..................	483,550,000	Silver certificates outstanding.	483,550,000
Silver dollars of 1890.........	2,660,000	Treasury notes outstanding..	2,660,000
	$1,572,937,169		$1,572,937,169

GENERAL FUND.

In Treasury Offices—			
Gold coin..................................		$23,084,092.92	
Gold certificates............................		78,194,420.00	
Standard silver dollars.....................		9,991,659.00	
Silver certificates...........................		13,360,808.00	
United States notes........................		8,757,310.00	
Treasury notes of 1890....................		3,219.00	
National-bank notes		16,302,025.21	
Certified checks on banks.................		62,200.77	
			$149,755,734.90
Deduct current liabilities—			
National-bank 5 per cent fund	$26,593,959.99		
Less notes in process of redemption	26,593,959.99		
		....	
Outstanding warrants and Treasurer's checks		14,730,825.06	
Balances to the credit of disbursing officers		77,053,640.15	
Post Office Department balances..........		10,883,411.02	
Miscellaneous items (assets of banks in liquidation, etc.).........................		4,564,518.53	
		107,232,394.76	
Less items in transit, or in Treasury not cleared (estimated).....................		23,000,000.00	
			84,232,394.76
Working balance in Treasury Offices............................			$65,523,340.1[illegible]

In National Bank Depositaries—			
To credit of the Treasurer of the United States*	97,160,472.33		
To credit of postmasters, judicial officers, etc.	5,588,827.18		
	102,749,299.51		
Less items in transit, or in Treasury not cleared (estimated)	23,000,000.00	79,749,299.51	
In Treasury of the Philippine Islands—			
To credit of the Treasurer of the United States	1,037,510.48		
To credit of United States disbursing officers	3,186,102.50	4,223,612.98	
		83,972,912.49	
Deduct current liabilities—			
Outstanding warrants	916,077.15		
Balances to the credit of disbursing officers	8,774,929.68	9,691,006.83	
Balance in Banks and in Treasury of Philippine Islands			74,281,905.66
In Treasury Offices—			
Silver bullion (at cost)		2,054,492.54	
Subsidiary silver coin		20,765,510.86	
Fractional currency		276.37	
Minor coin		2,006,469.38	
Awaiting reimbursement: Interest on public debt paid		71,694.57	24,898,443.72
Total Balance in General Fund†			164,703,689.52

* The large excess of bank balances is due to very heavy deposits on account of corporation taxes and other exceptional revenue on the last day of the fiscal year.

† Under the act of July 14, 1890, the deposits made by national banks to retire circulation are paid into the General Fund of the Treasury as a "miscellaneous receipt." Therefore, the bank notes subject to retirement, when presented, are redeemed from the General Fund. The net amount of such deposits included in the General Fund on this day is $22,092,806.00.

The Journal of Accountancy

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A. P. Richardson, Editor   Jos. French Johnson, Consulting Editor

EDITORIAL

Burden of Prosperity

There has been much talk of the wave of prosperity which will sweep over the new world when the storms of the old have subsided. It will be a kind of tidal wave following the earthquake.

Nearly everyone admits that when the purchasing power of Europe begins to be restored the demand for American products, both raw materials and manufactured articles, will be greater than it has ever been in the past. The commercial output of Germany will be inconsiderable for several years to come. France will be severely crippled. England, although not so greatly influenced by the war as her continental neighbors, will nevertheless be compelled to look abroad for many of those things which heretofore she has produced within her own boundaries.

Whatever be the outcome of the war one thing is certain, namely, that it is to the western hemisphere that Europe must look for its supplies. Demand for food products will be at its most acute stage immediately after the war when the embargo on contraband is removed; and it will decrease slowly until the fields of Europe are brought again under the plow and harrow. The demand for manufactured articles will begin with the termination of the war and increase steadily for some years until the depletion caused by military operations has been made good. How much further the market for our products will extend no one can say. It is to be hoped that America will hold the trade which she will acquire when the war is ended, but in any event the one certainty remains, that for some years at least America is sure to be taxed to her utmost to provide those things for which a war-worn world will call.

All this is practically self-evident; but there is another and a deeper significance in the outlook which does not seem to have attracted sufficient attention. This is the responsibility which will rest upon the country to see that it is not ruined by the prosperity which is coming. When the resumption of activity begins there will be an era when every manufacturer, every producer and everyone concerned with exportation will find it a comparatively simple matter to make more money than he has ever made before. As a consequence there will be a strong temptation to indulge in overconfidence and to embark upon undertakings which will have no legitimate foundation. It threatens to become a time of wild-cat propositions, a time closely resembling the period of the "South Sea Bubble" when everything was profitable and investment and speculation ran riot.

In view of these things it seems to us that an enormous burden—one hardly to be borne—will rest upon the members of the accounting profession. It will be to the public accountants that the public will look for frank, unprejudiced statements of affairs—not to the grandiloquent prospectuses with which the investing public will be assailed. It may be thought that as people nowadays are better acquainted with business conditions, and as they remember the frequent losses which have been made in speculation, they will become more cautious and exercise greater discernment, but experience in speculation is never much of a teacher and there will always be an abundance of investors for every investment in a time of national prosperity.

Here lies the opportunity for accountants to demonstrate conclusively their importance to the body commercial and financial. If the profession strictly adheres to its high standards of integrity, refuses to certify to any statement which may mislead the most gullible investor, lets it clearly be known that nothing can deviate its members from the straight and narrow path of rectitude—if the profession does these things it will not be wasted effort. It will be another illustration of the axiom concerning the political merits of honesty.

In all the fields of business endeavor there will be work for the public accountant. Bankers will be much inclined to extend credits. If disaster is to be avoided they must listen to the voice of the public accountant and insist upon full examination of conditions by impartial investigators rather than depend upon the optimistic reports of intending borrowers. In a score of other ways a burden of responsibility will be thrown upon the public accountant.

The profession is small in numbers but fortunately is imbued with high ideals. If there be men in practice who are amenable to ulterior influences, they are certainly few and it should not be difficult to remove them from the ranks of membership in the various state societies or in the national body. It is more important than ever before that the American Association of Public Accountants should exercise the most rigid discipline and demand absolute integrity and scrupulous regard for verity among the entire membership.

The burden will rest upon every member—not upon a few merely. There will be a time of unparalleled activity and almost constant demand for the services of accountants.

Were it not for the record of the profession and the general excellence of its present personnel we should fear for the future. As it is we trust that this great and growing profession will satisfactorily endure the crucial test to which in common with the business of the country it will be put.

The Convention Habit

It has frequently been remarked that the same men attend the American Association meetings year after year. Each year new faces appear but thereafter the novelty ceases for the newcomers readily fall into stride beside the older friends and soon become known as regular attendants. It matters little, apparently, where the convention be held. In California or Massachusetts or Illinois we find the same men, hear the same familiar voices and receive the same kindly greetings.

There is a lesson in all this if one look for it. Why is it that the fact of attending one convention almost inevitably leads to attendance at the convention following? Why do men leave their practice and travel the length of the land for a meeting lasting only three or four days? The answer is simple. It is to be found in the well-founded belief that by this yearly assembling, by the renewal of professional acquaintance and friendship, by the interchange of experiences and opinions, it is possible to derive a direct personal benefit whose value is considerable.

The social features of the meetings are delightful and it is good to meet with the welcome of friends, but the great merit in convention is the bringing together of the members of the profession and the development of a corporate entity which without personal touch would never be achieved. It is somewhat remarkable that in the American Association of Public Accountants the convention idea should so prevail. Many people are apt to point to the jealousies which exist between different sections of the country and doubt the unity of effort which is needful in a national organization; but the truth is that from a membership widely scattered the average attendance is about fifteen per cent of the active practitioners—a record which few similarly constituted organizations can equal.

As time goes on more men will acquire the convention habit. It is a splendid habit to cultivate and we wish it well. It makes for the strengthening of the association and of all its members.

American Association of Public Accountants

Annual Meeting

The annual meeting of the American Association of Public Accountants was held at the New Willard Hotel, Washington, D. C., September 14th to 17th, inclusive.

The total number of registrations was one hundred and thirteen—the small representation being largely due to the uncertainty of business conditions.

The meeting was a distinct success in everything except attendance and the thanks of the association were heartily accorded to those members of the Maryland and Virginia societies upon whom had been thrown the work of preparing for and conducting the affairs of the convention.

On Monday, September 14th, the regular annual meeting of trustees was held. Reports were submitted by officers, state societies and committees and ordered printed in the year book.

The following new members were elected on the recommendation of the committee on membership:

California State Society of Certified Public Accountants

Fellows:

James Leonard Davis, C. P. A.
R. W. E. Cole, C. P. A.

Colorado Society of Certified Public Accountants

Fellows:

Elwood Fink, C. P. A.
H. J. Falk, C. P. A.

Georgia Society of Certified Public Accountants

Fellows:

Edward Osborne Whealler, C. P. A.
Edward Richardson, C. P. A.
Aldon Fenton Thompson, C. P. A.
Dameron Black, C. P. A.

Associate:

James L. Respess, C. P. A.

Illinois Society of Certified Public Accountants

Fellows:

C. M. DeLany, C. P. A.
D. Himmelblau, C. P. A.
John Medlock, C. P. A.
Charles R. Whitworth, C. P. A.
William B. Campbell, C. P. A.
W. P. Kelly, C. P. A.
J. Gordon Steele, C. P. A.
J. Angus Steven, C. P A.

Society of Louisiana Certified Public Accountants
Fellow:
David H. Deas, C. P. A.

Certified Public Accountants of Massachusetts, Inc.
Fellow:
William C. Canning, C. P. A.

Minnesota Society of Public Accountants
Fellows: (advanced from associates)
James S. Matteson, C. P A.
Clare L. Rotzel, C. P. A.

Missouri Society of Certified Public Accountants
Fellows:
Arthur F. Brodie, C. P. A.
Charles B. Couchman, C. P. A.

Society of Certified Public Accountants of the State of New Jersey
Fellow: (From associate)
Arthur Wright, C. P. A.

New York State Society of Certified Public Accountants
Fellows:
Armand L. Bruneau, C. P. A.
Joseph M. Conklin, C. P. A.
F. William Deike, C. P. A.
Christian Djorup, C. P. A.
James F. Farrell, C. P. A.
Morton Foster, C. P. A.
Adolph Fuchs, C. P. A.
Lewis C. Fuller, C. P. A.
J. E. Graef, C. P. A.
A. M. Hauser, C. P. A.
P. Hergert, C. P. A.
H. A. Horne, C. P. A.
Charles A. Klein, C. P. A.
James J. Newman, C. P. A.
Norman C. Newman, C. P. A.
John Noone, C. P. A.
Carlos F. Noyes, C. P. A.
Albert M. Perkins, C. P. A.
Louis E. Stander, C. P. A.
William Topper, C. P. A.
Henry W. Wechsler, C. P. A.
H. A. Wythes, C. P. A.

Ohio Society of Certified Public Accountants

Fellows:

J. D. Cloud, C. P. A.
F. W. Hart, C. P. A.
A. L. Peters, C. P. A.

Associate:

R. J. Beaman, C. P. A.

Pennsylvania Institute of Certified Public Accountants

Fellows:

William J. Blair, C. P. A.
Thomas M. Miller, C. P. A.

Rhode Island Society of Certified Public Accountants

Fellow:

William H. Scott, C. P. A.

Associate

Lewis C. Fisher, C. P. A.

Tennessee Society of Certified Public Accountants

Fellows:

O. P. Cobb, C. P. A.
T. E. Cress, C. P. A.

Virginia Society of Public Accountants, Inc.

Associates:

Frederick B. Hill, C. P. A.
Robert J. Walker, C. P. A.

Washington Society of Certified Public Accountants

Fellow:

George W. Temple, C. P. A.

The Association of Certified Public Accountants of Montana

The resignation of the Montana State Society of Public Accountants was accepted and a new organization, the Association of Certified Public Accountants of Montana, was elected, the members of which were formerly members of the old society:

Fellows:

Donald Arthur, C. P. A. (president)
J. C. Phillips, C. P. A.
W. D. Mangam, C. P. A.
George Raban, C. P. A.
W. B. Finlay, C. P. A.
E. M. Crumrine, C. P. A.
A. G. Badger, C. P. A.
John Crawford, C. P. A.
Arthur J. Andrews, C. P. A.
J. Lee Rice, C. P. A.

The report of the trustees for presentation to the association showed that the total membership of the association excluding duplications is one thousand and seventy-four.

The treasurer's report showed a balance on hand on September 11th of $6,528.97 compared with $4,223.25 at the beginning of the last fiscal year.

The report of the budget committee showed estimated revenues $10,540.00, expenses $9,926.09.

On Monday afternoon a reception was held by the ladies of the entertainment committee. Madame Carrie Bridewell very generously sang for the visitors and made the reception one of the most notable events of the convention.

On Tuesday morning the meeting was called to order at 9:30 and Secretary Redfield of the department of commerce welcomed the delegates in a speech of great ability and exceptional interest. The reply to the address was delivered by the retiring president, R. H. Montgomery.

The committee on credentials reported the delegates whose credentials were in order and the convention proceeded to business.

Two amendments to the constitution and by-laws were adopted without discussion. These amendments are as follows:

CONSTITUTION—ARTICLE II, SECTION 7

Strike out the third and fourth lines, ending with the word "trustees," and substitute "the secretary thereof shall report such member to the secretary of this association, provided such member shall possess the qualifications necessary for his admission as a fellow to this association, but not otherwise, unless such member shall himself request that he be admitted as an associate; and upon his election by the board of trustees such member"

BY-LAWS—ARTICLE V, SECTION 4

Make the present section 4 paragraph (*a*) and add paragraph (*b*) as follows:

"No dues shall be required to be paid by any state or district society for those of its members who may not be entitled to become society fellows of this association, unless at their own request they shall become associates of this association."

After luncheon the delegates and visitors were taken in sight-seeing cars through Georgetown, Fort Meyer and Arlington, returning to Washington at 4 o'clock to hear a paper on *Accounting Conditions and Prospects* delivered by Charles G. Du Bois, comptroller of the American Telephone and Telegraph Company. Discussion of this paper was led by Carl H. Nau of Cleveland.

After the discussion Elliot H. Goodwin, secretary of the Chamber of Commerce of the United States of America, spoke on the subject of the national chamber and its importance to American business interests.

In the evening an informal discussion on income tax questions took place. Mr. S. H. Boyd of the treasury department presented the government's views in regard to questions raised.

On Wednesday the convention reassembled in business session at 9:30 a. m. After some discussion it was resolved that the next meeting of the American Association should be held in Seattle, Washington, at the invitation of the Washington Society of Certified Public Accountants.

The meeting then proceeded to the election of officers and the following were unanimously elected: President, J. Porter Joplin, Illinois; treasurer, Carl H. Nau, Ohio; trustees for three years: R. H. Montgomery, Pennsylvania; E. W. Sells, New York; W. F. Weiss, New York; auditors, W. R. Mackenzie, Oregon, and E. G. Shorrock, Washington.

In the afternoon the delegates and visitors visited Alexandria and Mt. Vernon, Virginia.

At 8 p. m. Professor John C. Duncan, of the college of commerce, university of Cincinnati, read a paper on *Some Scientific and Educational Problems of the Accountancy Profession.* The discussion was led by John B. Geijsbeek, of Colorado. Later in the evening Harvey S. Chase, of Massachusetts, read a paper on *National Finances.* Both papers were followed by interesting discussions.

Thursday morning the final business session took place and the new officers were installed. At 11 o'clock, the incoming board of trustees met and elected A. P. Richardson secretary and the following members of the executive committee: W. Sanders Davies, R. H. Montgomery, E. W. Sells, E. L. Suffern and W. F. Weiss.

At 2:15 the delegates and visitors were received by President Wilson in the East Room of the White House.

After the White House reception the party left for Annapolis in special cars. Various points of historic interest were visited and the grounds and buildings of the naval academy were open to the delegates. At 7 o'clock an informal dinner was held at Carvel Hall, Annapolis. This was a departure from the usual banquet but was generally approved by all those who were present. There were no formal speeches but remarks were made by the toastmaster, R. H. Montgomery; the new president, J. Porter Joplin; Captain Fullam, U. S. N., and W. P. Hilton, representing the entertainment committee.

Income Tax Department

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

In elucidation of T. D. 2005 published in last month's JOURNAL wherein the treasury department gave its interpretation of what should be deducted for loss in a return of income for income tax purposes, a separate explanatory letter has been addressed to the collectors and internal revenue agents on the subject in which the department expressly extends the principle applied in arriving at losses, enunciated in T. D. 2005, to profits arising from the same source. This letter has not yet been issued in the official weekly publication of the department, but a copy of it has been obtained and is reproduced this month in THE JOURNAL along with the official rulings.

It is gathered from the rulings and the letter just mentioned that the department will not allow as a deduction any amount under the heading of depreciation, except only a reasonable allowance in respect of depreciation on buildings, fixtures and other physical assets. In the case of all other assets, including unimproved real estate, bonds, stocks and like securities, the department apparently in no circumstances will allow such a deduction to be entered in the return; and even the fact that the amount has been charged to income on the books of the individual or corporation will not affect the situation. The asset must have been actually disposed of before the depreciation or appreciation in value—determinable only upon the basis of the difference between the cost and the selling price—can appear in the income tax return as a profit or loss as the case may be.

It may be that this method will be satisfactory where there is a short interval of time between the purchase and the sale of the assets; but where the assets are held for extended periods the proposed method is not likely to work without some difficulties especially in those instances where the practice obtains of adjusting the values on the books from time to time to bring them into conformity with the market prices.

That, however, is not the most serious aspect of the question. The department expressly rules that, where the property was acquired prior to March 1, 1913, in the case of individuals and prior to January 1, 1909, in the case of corporations, the difference between the cost and selling price will be prorated over the whole period during which the property was held and the proportion applicable to the entire taxable period will be taken into account in the annual return of income for the year in which the property is realized. Such a method would certainly be a rough and ready one of arriving at a figure to represent the profit or loss on the property since the commencement of the taxable period, but in no circumstances, except by a happy chance, could it be said that the figure thus arrived at even approximated the true amount of such profit and loss. Some legal authorities maintain that the law could not be made retrospective and that it is illegal to tax the income of an individual prior to October 3, 1913, the date when the act was promulgated; but, whether there are any grounds for such a contention or no, it is conceded by all that the law does not authorize the taxation of income, so far as individuals are concerned, prior to March 1, 1913, or, so far as corporations are concerned, prior to January 1, 1909. Under the method which has just been referred to, the taxpayer will in many cases be paying a tax on profit made prior to the taxable period. For instance, in the case of property purchased by an individual during the panic of 1907 on the basis of the prices then prevailing, the value of which might have practically doubled at March 1, 1913, if the property were to be disposed of at the present time there is no doubt that, while the price obtainable might be considerably in excess of the cost in 1907, it would be less than the price which would have been received had the sale taken place in March, 1913. Still, with an obvious depreciation in the asset since the commencement of the taxable period, the taxpayer would, under the department's ruling, have to pay tax on an alleged profit since that date. Many similar cases could be cited to prove that in following out the ruling, taxpayers would be forced to pay taxes for which there was apparently no legislative sanction.

Generally, and particularly as regards bonds, stocks and like securities, it is comparatively easy to fix the value as at March 1, 1913 and where that is possible it is obvious that that value should be the basis for determining the profit or loss for income tax purposes. In instances where it is impossible to arrive at the value as at March 1, 1913, it may be that a fixed rate for determining the profit or loss will be satisfactory in many cases; but to apply such a method to all cases would be a rough and ready treatment of the matter and would tend to show a lack of that administrative consideration with regard to detail which we are entitled to expect. It is beyond doubt unnecessary, and its legality may be open to question.

The difficulty which would confront the department in applying this ruling to profits or losses on securities received by persons making returns, in reorganizations effected prior to March 1, 1913, as compared with the facility which would result from the use of market values at that date, will at once be apparent.

The subject-matters of the various rulings which are also printed this month are as follows:

T. D. 2011 deals with commissions on renewal premiums on insurance, and states that such commissions are income if received subsequent to March 1, 1913, even though the premiums were on business written prior to that date.

T. D. 2012 extends to non-resident aliens the use of exemption certificate 1063 for claiming exemption on dividends payable in United States from stock of foreign corporations.

T. D. 2013 provides for the return of income of a non-resident alien and the payments of the tax, normal and additional, being made by the person, firm, company or other body in the United States having control of his income from a trade or profession or otherwise.

T. D. 2015 contains the intimation that in cases where, through ignorance or misunderstanding, penalties have been incurred because of failure to make returns within the prescribed period, the department will accept offers in compromise of the penalty as follows: $5.00 from individuals and $10.00 from corporations organized for profit. Where the corporation is not organized for profit, it has until December 31, 1914, to file without penalty.

T. D. 2016 prescribes the rules and regulations, signed by the secretary of the treasury and approved by the president, upon which the returns under the income tax law will be open to inspection. In pursuance of the powers devolving upon him by the law the regulations are published in the form of an executive order by the president.

As regards the returns of individuals, they are not available for inspection at all except to the proper officers and employees of the treasury department.

The returns of corporations are not quite so inaccessible. In the case of corporations whose stock is offered for general public sale, the returns are open to the inspection of any person upon application to the secretary of the treasury. In other cases the returns are only open to stockholders after proper application to the treasury, which has to be accompanied by a certificate by the president and secretary of the corporation that the applicant is a *bona fide* stockholder or failing such a certificate by other satisfactory evidence.

Besides regulations for the production of the returns of both individuals and corporations in legal proceedings, there is a provision for access to the returns, or to abstracts thereof, to be granted to the proper officer of a state which imposes a general income tax. This provision applies to the returns of corporations only.

T. D. 2017 advises that interest and dividends received by non-resident aliens from domestic corporations are not subject to tax whether the bonds and stock be physically located within or without the United States.

Treasury Rulings

Mimeograph letter to collectors of internal revenue and internal revenue agents, of date August 14, 1914.

Referring to treasury decision No. 2005, it will be observed that losses due to fluctuations during a taxable year in the value of capital assets, even though evidenced by book entries, do not constitute such losses "actually sustained" as, within the meaning of the law (Section 2 act of October 3, 1913), may be allowably deducted form gross income. Losses are not actually sustained until, as a result of a completed, a closed transaction, such losses have been definitely ascertained and the amount they represent has irredeemably disappeared from the assets of the individual or corporation.

Likewise and conversely any appreciation in the value of assets due to appraisal or adjustment and taken up on the books of the individual or corporation is held not to be income within the meaning of the law until such appreciation, as a result of a completed, a closed transaction, has been converted into cash or its equivalent, that is, has been realized as an addition to and a part of the tangible assets of the individual or corporation. A book entry reflecting only an enhanced value of assets during the year evidences an increase in the net worth of the corporation or individual for that year, an increase which, under adverse conditions, may disappear the next year. An increase in value thus evidenced is intangible, unstable and is not such income as the federal income tax law contemplates shall be returned for purposes of the tax.

Returnable and taxable income is that actually realized during the year, that is, that which is evidenced by the receipt of cash or its equivalent. Until any appreciation taken up on the books has been so realized, it will not be required to be returned as income. Hence, in the preparation of returns and in the examination of books for the purpose of verifying the same, mere book entries of appreciation in value of capital assets will be disregarded.

It should be understood, however, that in the event of the sale of the assets the increase in whose value has been taken up on the books, the profit or income to be returned as a result of the sale will be determined upon the basis of the difference between the cost and the selling price of the assets; that is to say, in the case of a sale, book values will be ignored save and except as such book values represent the actual cost of the properties.

The instructions hereinbefore given will not in any way affect the "reasonable allowance for depreciation, if any," which the law authorizes as a deduction from gross income, provided that in computing such "reasonable allowance for depreciation," any portion of the book value representing the value of "goodwill" shall be eliminated from the calculation, an allowable depreciation deduction being an amount properly written off and charged against income to measure the loss due to wear and tear, exhaustion and obsolescence of physical property.

Any rulings previously made by this office and in conflict with the holdings hereinbefore made are superseded by this letter, but any returns, adjustments, or assessments made in accordance with previous rulings will in no wise be affected by the foregoing instructions.

(T. D. 2011, July 28, 1914)

Taxability of commissions on renewal premiums on insurance.

Commissions on renewal premiums for insurance are income when received and income for the period in which received. Therefore, commissions on renewal premiums received between March 1 and December

31, 1913, are taxable income for that period and should be included in returns of income for 1913.

Where commissions on renewal premiums received by individuals between March 1 and December 31, 1913 (including commissions on renewal premiums on business written prior to March 1, 1913, and payable and paid subsequent to that date) were not included in returns of income of such individuals for 1913, they should file amended returns and include in such amended returns the amount of said commissions on renewal premiums.

Where returns of annual net income were not made by individuals in receipt of commissions on renewal premiums because of insufficient income to require a return of income, and such showing of insufficient income was caused by the exclusion from the return of said commissions on renewal premiums, such individuals should make and file returns of income and include therein the commissions received by them on renewal premiums within the period from March 1 to December 31, 1913.

(T. D. 2012, July 30, 1914)

Extending exemption certificate No. 1063, as prescribed in T. D. 1998, to nonresident alien individuals.

Exemption certificate 1063, as provided in T. D. 1998, is hereby extended to and made applicable to the use of persons who are non-resident aliens in claiming exemption from income tax on dividends payable in the United States from stock of foreign corporations.

(T. D. 2013, August 12, 1914)

Nonresident aliens—Amendment of article 8 of regulations 33, providing for the collection of tax on income of nonresident aliens derived from trades or professions in the United States.

Article 8, income tax regulations 33, is hereby amended by adding thereto the following:

The person, firm, company, copartnership, corporation, joint-stock company or association, and insurance company in the United States—citizen or resident alien—in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income, of whatever kind, to a nonresident alien, under any contract or otherwise, and which payment shall represent income of a nonresident alien from the exercise of any trade or profession within the United States, shall make return for such nonresident alien on form 1040 and shall pay any and all tax—normal and additional tax—chargeable upon the said income of such nonresident alien.

So that article 8 as amended shall read:

ART. 8. The income of nonresident aliens subject to the normal tax of 1 per cent shall consist of the total gains, profits, and income derived from all property owned and from every business, trade, or profession carried on within the United States (to be designated as gross income), less deductions (1 to 8, inclusive) specifically enumerated in paragraph B of the act (see art. 6), in so far as said deductions relate to said gains, profits, etc.

The specific exemption in paragraph C of the act cannot be allowed as a deduction in computing the normal tax of nonresident aliens.

Nonresident aliens are subject to additional or surtax the same as prescribed in the case of citizens of the United States or persons residing in the United States.

The responsible heads, agents, or representatives of said nonresident aliens who are in charge of the property owned or business carried on shall make full and complete return of said income and shall pay the tax as provided herein.

The person, firm, company, copartnership, corporation, joint-stock company or association, and insurance company in the United States—citizen or resident alien—in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income, of whatever kind, to a nonresident alien, under any contract or otherwise, and which payment shall represent income of a nonresident alien from the exercises of any trade or profession within the United States, shall make return for such nonresident alien on form 1040 and shall pay any and all tax—normal and additional tax—chargeable upon the said income of such nonresident alien.

(T. D. 2015, August 13, 1914)

Compromises—Minimum amounts which will be accepted.

The fact has been developed that a great number of individuals and corporations failed to make returns of annual net income for the income tax, either through ignorance of the requirements of the law or through a misunderstanding of its requirements, and it has been determined by the treasury department to accept offers in compromise of the specific penalty for failure to file returns within the period prescribed by law in a minimum sum, as follows: $5 from individuals, $10 from corporations which are organized for profit.

In the cases of all corporations not organized for profit, the specific penalty will not be asserted this year, provided the required return has been or shall be filed before December 31, 1914. The United States district attorney should be requested not to institute proceedings in such cases.

The foregoing applies only to those cases where there was no intent to evade the law or escape taxation.

In all cases, however, wherein a return is not made until the liability to make a return is discovered by investigation of collectors of internal revenue or revenue agents, the above schedule will not necessarily apply, but each individual case will be decided upon its own merits and the amount of the offer in compromise which may be favorably considered will be determined accordingly.

(T. D. 2016, August 18, 1914)

Inspection of income tax returns—Executive order—Regulations.

The following executive order, together with regulations signed by the secretary and approved by the president, relative to the publicity feature of section 2 of the act of October 3, 1913, imposing an income tax, is hereby published for your information.

EXECUTIVE ORDER

Pursuant to the provisions of section 2 of the tariff act of October 3, 1913, said section providing for an income tax, and which contains in paragraph G, sub-paragraph (*d*) the following provision,

> When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the commissioner of internal revenue and shall constitute public records and be open to inspection as such: *provided*, that any and all such returns shall be open to inspection only upon the order of the president, under rules and regulations to be prescribed by the secretary of the treasury and approved by the president: *provided further*, that the proper officers of any state imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to any abstract thereof, showing the name and income of each such corporation, joint stock company, association or insurance company, at such times and in such manner as the secretary of the treasury may prescribe,

it is hereby ordered, that all such returns shall be subject to inspection in accordance and upon compliance with rules and regulations prescribed by the secretary of the treasury and approved by the president, bearing even date herewith.

WOODROW WILSON.

THE WHITE HOUSE, *July 28, 1914*.

REGULATIONS GOVERNING THE INSPECTION OF RETURNS OF CORPORATIONS, JOINT-STOCK COMPANIES, ASSOCIATIONS, OR INSURANCE COMPANIES, MADE IN COMPLIANCE WITH THE REQUIREMENTS OF SECTION 2 OF THE ACT OF

OCTOBER 3, 1913. RETURNS OF INDIVIDUALS ARE NOT OPEN TO THE INSPECTION OF ANYONE EXCEPT THE PROPER OFFICERS AND EMPLOYEES OF THE TREASURY DEPARTMENT.

TREASURY DEPARTMENT,
Washington, D. C., July 28, 1914.

Inspection of returns.

By section 2 of the act of October 3, 1913, congress imposed a tax upon the entire net income arising or accruing from all sources to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, and upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere, and upon every corporation, joint-stock company or association, and every insurance company, with certain exceptions, engaged in business in the United States, and prescribed the method of handling the returns of annual net income filed in compliance with said law, as follows:

(*d*) When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the commissioner of internal revenue and shall constitute public records and be open to inspection as such: *provided,* that any and all such returns shall be open to inspection only upon the order of the president, under rules and regulations to be prescribed by the secretary of the treasury and approved by the president: *provided further,* that the proper officers of any state imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint stock company or association or insurance company, at such times and in such manner as the secretary of the treasury may prescribe.

For the purpose of making effective the legislative intent thus expressed the president has ordered that such returns shall be open to inspection under the following rules and regulations. The word "corporation," when used alone herein, shall be construed to refer to corporations, joint stock companies or associations, and insurance companies.

1. The return of every individual, and of every corporation, joint stock company or association, and every insurance company, whether foreign or domestic, shall be open to the inspection of the proper officers and employees of the treasury department. Returns of individuals shall not be subject to inspection by anyone except the proper officers and employees of the treasury department.

2. Where access to any return of any corporation is desired by an officer or employee of any other department of the government, an application for permission to inspect such return, setting out the reasons therefor, shall be made in writing, signed by the head of the executive department or other government establishment in which such officer or

employee is employed, and transmitted to the secretary of the treasury. If the return of a corporation is desired to be used in any legal proceedings other than those to which the United States is a party, or to be used in any manner by which any information contained in the return could be made public, the application for permission to inspect such return or to furnish a certified copy thereof shall be referred to the attorney general, and if recommended by him transmitted to the secretary of the treasury.

3. All returns, whether of persons or of corporations, joint stock companies or associations, or insurance companies, may be furnished, upon approval of the secretary of the treasury, for use, either in the original or by certified copies thereof, in any legal proceedings before any United States grand jury or in the trial of any cause to which both the United States and the person or corporation or association rendering the return are parties either as plaintiff or defendant, and in the prosecution or defense or trial of which action, or proceeding before a grand jury, such return would constitute material evidence, but in any case arising in the collection of the income tax, the commissioner of internal revenue may furnish for use to the proper officer either the original or certified copies of returns without the approval of the secretary of the treasury. In all cases where the use of the original return is necessary, it shall be placed in evidence by the commissioner of internal revenue or by some officer of the bureau of internal revenue designated by him for that purpose, and after such original return has been placed in evidence it shall be returned to the files in the office of the commissioner of internal revenue at Washington, D. C.

4. The secretary of the treasury, at his discretion, upon application to him made, setting forth what constitutes a proper showing of cause, may permit inspection of the return of any corporation, by any *bona fide* stockholder in such corporation. The person desiring to inspect such return shall make application in writing to the secretary of the treasury, setting forth the reasons why he should be permitted to make such inspection, and shall attach to his application a certificate, signed by the president, or other principal officer, of such corporation, countersigned by the secretary, under the corporate seal of the company, that he is a *bona fide* stockholder in said company. (Where this certificate cannot be secured, other evidence will be considered by the secretary of the treasury to determine the fact whether or not the applicant is a *bona fide* stockholder and, therefore, entitled to inspect the return made by such company.) Upon receipt of such application the corporation whose return it is desired to inspect shall be notified of the facts and shall be given opportunity to state whether any legitimate reason exists for refusing permission to inspect its returns of annual net income by the stockholder applying for permission to make such inspection. The privilege of inspecting the return of any corporation is personal to the stockholders, and the permission granted by the secretary to a stockholder to make such inspection cannot be delegated to any other person.

5. The returns of the following corporations shall be open to the inspection of any person upon written application to the secretary of the treasury, which application shall set forth briefly and succinctly all facts necessary to enable the secretary to act upon the request:

(*a*) The returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally.

(*b*) All corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public sale.

Returns can be inspected only in the office of the commissioner of internal revenue, in Washington, D. C. In no case shall any collector, or any other internal revenue officer outside of the treasury department in Washington, permit to be inspected any return or furnish any information whatsoever relative to any return or any information secured by him in his official capacity relating to such return, except in answer to a proper subpoena, in a case to which the United States is a party.

6. Returns of individuals shall not be open to the inspection of any person other than the proper officers and employees of the treasury department or person rendering the same, and are under no conditions to be made public, except where such publicity shall result through the use of such returns in any legal proceedings in which the United States is a party.

7. Upon request of the governor of a state imposing a general income tax, the proper officer of such state, to be designated by name and official position by the governor of such state in his application to the secretary of the treasury, may have access to the returns or to abstracts thereof showing the name and income of each corporation, joint stock company or association, or insurance company, at such times and in such manner as the secretary of the treasury may prescribe. Such application shall be made in writing, addressed to the secretary of the treasury and shall show (first) that the state, whose governor makes the request, imposes a general income tax; (second) the name and address of each corporation, etc., to which access is desired; (third) why permission to inspect the returns of the corporations, etc., named in the request is desired, and (fourth) what officer or officers are designated to make the desired inspection, giving their names and official designations. Such request must be signed by the governor of the state and sealed with the seal thereof, and shall be transmitted to the secretary of the treasury for his consideration and action thereon.

No provision is made in the law for furnishing a copy of any return to any person or corporation, and no copy of any return will be furnished to any other than the person or corporation making the return, or their duly constituted attorney, except as hereinbefore authorized.

The provisions herein contained shall be effective on and after the 1st day of September, 1914.

W. G. McAdoo,
Secretary of the Treasury.

Approved:
Woodrow Wilson,
The White House, July 28, 1914.

(T. D. 2017, August 25, 1914)

Nontaxability of interest from bonds and dividends on stock of domestic corporations owned by nonresident aliens.

Interest on bonds of domestic corporations and dividends on stock of domestic corporations owned by nonresident aliens, and whether such bonds and stock be physically located within or without the United States, are not subject to the income tax.

Students' Department

EDITED BY SEYMOUR WALTON, C. P. A.

SALE OF DEPRECIATED ASSETS

The following question in regard to depreciation has been submitted:

A boiler which cost $10,000.00 and against which depreciation had been set up for three years at the rate of 10 per cent per annum on the diminishing value, was sold for $3,000.00, to be replaced by another boiler, which cost $16,000.00. A dispute arose as to the proper entries to be made.

The bookkeeper said: "In the first instance, I would debit original purchase $10,000.00. Each year would credit agreed amount of depreciation. If on purchase of new boiler the old one was sold for $3,000.00, this would be credited to original purchase, together with depreciation at 10 per cent, $2,710.00, leaving a balance of $4,290.00. Now I contend it is wrong to write this amount of $4,290.00 off to profit and loss account (taking into consideration the fact that it might have a further seven years in which to live), and debiting cost of new purchase, *viz.,* $16,000.00 and allowing that to stand as cost of boiler. The balance of $4,290.00 I would add to cost of new boiler, making total of $20,290.00, and thus have an opportunity to spread loss of succeeding years in depreciation, and not burden one year's sales with the loss. The reason interest is mentioned is that same should be charged, then an amount set aside to provide a sinking fund for new boiler, machinery, etc. It has to be borne in mind that this investment is entitled to its interest in the same manner as if the money were otherwise invested.

"After viewing the above matter, I am still of the opinion that on purchase of a new boiler the method adopted by some firms of writing off the balance of unused boiler (after allowing for depreciation) to profit and loss account, and charging boiler account with the cost of the new purchase, and allowing that to stand as the actual cost of the boiler, is not a good one."

The bookkeeper adds: "A visiting auditor here a little while ago concurred with the above opinion." He does not say whether he was a professional accountant or not. Let us hope that he was not.

The office manager absolutely disagreed with this view of the matter, contending that no amount should be carried over to the cost of the new boiler to cover the loss on the old one, and that the loss should be written off to profit and loss at once, since the return from the new boiler will amply compensate in a short time for the amount that has been lost. His argument is that "there are so many new things coming along these days that it is impossible safely to regulate the life of any part."

There are several minor points to be noted in the bookkeeper's statement. One is his giving a life of only seven years to the old boiler on the basis of a depreciation of 10 per cent per annum. He overlooks the fact that the depreciation is calculated on the diminishing value, as is shown by the amount for three years being $2,710 and not $3,000. This would make its carrying value on the books $3,486.78 at the end of the tenth year, and $1,215.76 at the end of the twentieth. As a theoretical case, based on the estimated depreciation and not on the probable facts, the further life of the boiler is more than seventeen years, instead of seven.

Another point is his statement that "this investment is entitled to its interest in just the same manner as if the money were otherwise invested." This fallacy was exposed some time ago by a number of eminent accountants in The Journal of Accountancy. The money was not put into the boiler for the sake of earning interest, but because it was expected that its use would result in the making of a profit for the business. The measure of the value of a piece of machinery to a business is not the amount of interest it will earn. It is determined by its ability to produce a certain thing, (perhaps more than one) cheaper or to better advantage than it can be bought for outside. For instance, many piano factories buy their backs ready made, because experience has shown them that they can buy them more cheaply than they can make them. To convince them that they should install machinery with which to make their own backs, it would be necessary to demonstrate to them the possibility of saving money on the cost of that part of their pianos. It would be no argument to show them that they would make ordinary interest on the cost of the machinery.

The principal objection to figuring interest on the cost of machinery and other fixed assets as a manufacturing expense is that it is only a partial treatment of the case. In many instances it takes several months to finish an article, while in others, as in piano manufacturing, a large amount of money is tied up in parts made and held until needed. If interest is to be calculated on the money permanently locked up in machinery, it should also be calculated on the money temporarily invested in the raw material and labor until the finished product is ready for sale, on the finished product until it is sold, and on the accounts receivable until they are paid.

The third point is his use of the term, "sinking fund." He implies that an amount of actual money should be set aside to accumulate at interest for the purchase of a new boiler. It is hardly to be supposed that any concern would take money out of its business to be invested at ordinary interest for any such purpose, but if it did, the fund would not be a sinking fund. It would be a replacement fund. A sinking fund is always established for the redemption of some direct obligation which must be paid in the future. It is established to protect the holders of the obligation. A question asked in the Illinois C. P. A. examination, "What three purposes can you name for the establishment of a sinking fund," merely served to show that the examiners themselves did not understand the proper meaning of the term.

The main question at issue is the disposition to be made of the balance of \$4,290 remaining in the old boiler account after the depreciation of \$2,710 and the \$3,000 cash have been credited to it. The bookkeeper is unquestionably wrong in claiming that it should be left in boiler account and the \$16,000 cost of the new boiler added to it, so as to make a balance of \$20,290 represent an actual asset of only \$16,000. It is absolutely false accounting to carry an asset on the books for more than it is worth.

On the other hand the bookkeeper is right in saying that it should not be charged to profit and loss at once, and the office manager is wrong in advocating that course. If it is to be charged off at once at all, it should be charged to surplus as an extraordinary loss. It is important that profit and loss should be confined to its legitimate function of showing the results of current operations of a normal character. Any extraordinary or accidental gains or losses should be reflected directly in the surplus account after the results of the normal operations have been transferred to it. The fact that the inadequacy of the old boiler became apparent at the end of the third year does not make the loss consequent upon its sale a loss of that year.

It is curious that the bookkeeper should have a vague idea of the right to carry the old boiler on the books for the time being, without advancing any argument for it, and that the office manager should deny the right and yet furnish the argument which justifies it, when he says "the return from the new boiler will amply compensate in a short time for the amount that has been lost."

It is manifest that the old boiler is not discarded because it is worn out. It must be in very good condition to command a price of \$3,000 as second hand material. If it had been entirely worthless, its residual balance would have to be charged to surplus as a mistake in originally purchasing an article of very inferior quality. The price it realized and the fact that it was replaced by a very much larger boiler prove conclusively that it was disposed of because of such enlargements of the factory as to make it inadequate to supply the power that had become necessary. The new boiler is installed because it will, in connection with the increased factory equipment, so increase the profits as to justify the increased cost of the fixed assets, and also to repay the loss consequent upon the discarding of the old boiler. Since the increase in profits during a certain number of future years will be greater than the residual balance of the old boiler, it is eminently proper that the loss on the old boiler, the replacement of which made those profits possible, should be borne by those profits as they accrue in the future, and should not be charged against the past years, which cannot benefit by the change. Therefore, instead of charging the loss of \$4,290 either to profit and loss or to surplus, it should be carried as a deferred asset to be charged off as rapidly as the increase in profits will allow. It is not necessary to credit the account with all the profits due to the increase in boiler capacity, but the allowance should be more liberal than the ordinary rate of depreciation on a boiler in active use. If it is not desirable to carry the account as old boiler account, it can be charged to re-organization of factory, or some similar account.

Professor M. E. Cooley, quoted without comment by Mr. R. H. Montgomery, whose book *Auditing* is the last word in American accounting, gives inadequacy as a cause of depreciation. The term depreciation should be confined to its proper meaning as the inevitable deterioration of a fixed asset consequent upon its use or upon the action of the forces of nature causing its decay or other disintegration. Inadequacy is not inevitable, and it does not imply deterioration. It is not caused by any fault in the asset that must be discarded. It must necessarily be caused by such an expansion of business as will call for larger and more effective apparatus. As the profits arising from the increased business will inure to the future years, they can properly be given the duty of caring for the loss through inadequacy instead of having it loaded on to the years during which the asset was adequate, by having an extra amount added to the depreciation charge to provide against possible inadequacy. It is generally safe to say that the period that receives the benefit should stand the expense that made the benefit possible.

Capital

Although the editor of The Journal of Accountancy says in the note appended to Mr. Van Cleve's letter in the August number that it does not seem to call for any further reply, I wish to call attention to one point in it which throws light on the whole subject. Mr. Van Cleve's error is one that is very prevalent, not only among accountants, but also among economists, and unfortunately also among some who aspire to call themselves statesmen, at least to the extent of aspiring to the presidency of the United States. It is the failure to distinguish between a certain thing and something which merely represents that thing.

Mr. Van Cleve says: "I did not know that any one had ever attempted to draw a distinction between net asset and net worth or net capital. I supposed that the terms were synonymous."

Again, in the same number of The Journal, Mr. A. Fischer quoting Mr. Carl H. Nau's statement that in a sole proprietorship the excess of assets over liabilities, which is net worth, is carried in one account called "net worth," goes on to say, "Is not the sole proprietor's investment carried in one account called 'capital account,' preceded by the sole proprietor's name, as 'John Doe, capital account,' and does not the net worth usually consist of more than one element, the original investment or capital, plus the profit?"

In both these cases, there seems to be a failure properly to distinguish between net assets and net worth, unless Mr. Fischer's question is purely one as to terminology. Net worth or net capital is the amount invested in the business by the proprietor, either originally or plus the profits. Net assets are the various things in which the net worth is permanently or temporarily tied up. Net worth is always exactly equal to net assets. They are the same in amount but not in character. Net worth is a credit balance denoting the proprietor's interest, the net capital. Net assets is a debit balance representing the net capital and accounting for it.

A concrete illustration is always easier to understand than abstract reasoning. Suppose a company with $100,000.00 capital and $25,000.00 surplus. The net worth of the proprietor, in this case certain stockholders, is $125,000.00, the net capital of the company. Over against and representing this net capital there must be net assets of exactly $125,000.00. The net capital or net worth equals the net assets, but it is not the net assets themselves. If it is, let us go a step further. The company issues $50,000.00 bonds at par and with the proceeds buys a plant worth $50,000.00. The plant represents the bonds that paid for it and accounts for them, but no one would say that the plant and the bonds are the same thing. And yet they must be, if net capital and the net assets into which it has gone are the same thing.

As to Mr. Fischer's charge that I have personified the business, I do not care one jot. It does not affect the argument. Until some one categorically answers the following, there is no use in making mere statements that I am wrong. It is mere beating about the bush and is not argument.

There cannot be a debit without a corresponding credit, nor an asset without a corresponding liability.

If A invests money in the business of A & Co., A on his private books debits A & Co. At the same time A & Co. credit A in his capital account.

On A's private books he carries the account of A & Co. as an asset. On A & Co.'s books A's credit account must be a liability of A & Co. to A. If not, *what is it?* Answer that, if you please, before you go any further.

I do not care whether you commit the apparently heinous crime of personifying the business and say that the business owes A the money, or whether you say that the proprietor as a business man owes himself as a capitalist. You can choose either horn of the dilemma that you wish. All I insist on is that the amount is a liability to A as an individual.

In a double entry ledger every account must be either an asset or a liability to the amount of its balance. The nominal accounts are only temporary assets and liabilities, but in a balance sheet, every account is either a real asset or a real liability, including the capital account.

This confusion between capital and the net assets that represent capital leads often to curious misconceptions, which are rather difficult to explain away. For instance, if a man starts the year by paying into the business $5,000.00 in cash, and at the end of the year has $6,000.00 in net assets, it is not an infrequent thing for beginners to say that he has a capital of $6,000.00, as shown by his net assets, and that he also has the original capital of $5,000.00.

Some of our so-called statesmen have been unable to distinguish between a standard and a thing which represents the standard, a very similar confusion to the one under consideration. During the free-silver discussion a number of years ago, it was frequently stated that there were many kinds of standard yards, some of wood, some of steel, and some of cloth, as in a tape measure. The truth is that there is only one standard yard and that is made of neither wood, steel, nor cloth. It is not a tangible thing at all, it is merely a distance between two points, the amount of space that separates them. This distance may be filled up, as with wood in the storekeeper's yard stick, or it may be empty, as in the case of the tops of two unconnected posts that are thirty-six inches apart. The piece of wood or steel or cloth is not itself a yard, it is the representative or expression of a yard. The standard yard is always the same; the representative of it may vary on account of moisture, or heat, or by stretching. While it is possible to have many different representatives of the standard, it is impossible to have more than one standard itself.

It is the same with money. The standard is a certain purchasing power. Neither the gold nor silver dollar is itself the standard, but both are representatives of the standard. As the wooden and steel and cloth representatives of a standard yard are sufficiently stable to fulfill all the usual functions of a proper representative, they can be used indiscriminately for all ordinary commercial purposes. As long as gold and silver were, in a similar way, equally stable in their relations to each other, they could also be used indifferently as proper representatives of the standard of purchasing power. But when their mutual relation was materially disturbed, they could not both be used, and it was necessary to choose one or the other, not as the standard itself, but as the one which would most nearly, and with least variability, act as a recognized representative of the standard.

Of course, the confusion in all these cases is caused by the use of conversational language. We speak of a gold dollar as the standard of value, when we mean that it is the recognized representative of the purchasing power of a dollar. We speak of a man's net assets as being his capital, when we mean that he has a certain credit on the books which is exactly represented by certain net debits, or net assets. The ordinary expressions are good enough for ordinary, every day usages. It is only when we attempt to analyze them that it is necessary to be more particular in our use of terms.

The following letter shows the necessity of two parties to a controversy getting together in a proper understanding of their viewpoints, before they attempt to contradict each other's opinions. More than half the time it will be found that the only difference arises from the fact that they are looking at things from different standpoints.

"Referring to revenue accounts, will you kindly advise the writer if it is proper to consider finished goods of a small manufacturing company where no cost records are kept to include same in the trading statement as a credit and not put same in the manufacturing account; or is it proper to put same in the manufacturing account, showing same on the credit side?

"The writer believes putting same in the trading statement, bringing down the profits to the profit and loss account, the trading statement will show a fictitious profit.

"This question has been discussed with several people and there have been two sides taken, some saying it is correct to incorporate this in the manufacturing statement, while others contend that inasmuch as the goods are finished the item should be placed in the trading statement.

"I notice in a solution of a revenue problem that same is included in the manufacturing statement, deducting the finished goods and raw materials on hand from the materials purchased, thus showing the supposed cost of the goods manufactured for the period. I contend this is correct but in view of the fact that others have questioned this and have advanced arguments showing they are correct, I would thank you very kindly for your expressions in the matter."

In reply, we first call attention to the necessity of distinguishing between a statement and an account. An account consists of the entries on the ledger, as they are posted from the original books. A statement consists of these same figures marshalled in an entirely different order, the object being to exhibit the processes and results in a manner that will be more intelligent to the ordinary director or stockholder, because each phase of the business can be developed and ticketed, as it were. In a statement deductions from debits may be made by subtraction; in a ledger account they must appear as credit items, which is always confusing.

When a revenue account is divided into three ledger accounts of manufacturing, selling, and profit and loss, only those items belonging strictly to each department are included in each account. The term "selling" is used in preference to the vaguer term "trading." The result is that the manufacturing account shows only the cost of the goods made during the period. This is all that interests the manager of the manufacturing department. It is not affected by the amount of finished goods on hand at the beginning, because they were made in the previous period, nor by the finished goods on hand at the end, because they are merely that portion of the goods made that happened not to have been sold. Therefore the inventories of finished goods have no place in the manufacturing account.

The directors, as managers of the whole business, wish to know not only the cost of the goods made, but also the cost of those sold, in order that they may compare the cost with the amount realized as shown by the net sales. This is contained in the selling account when that account is charged with the cost of the goods made and with the inventory of the finished goods on hand at the beginning and is credited with the inventory of finished goods on hand at the end. If a balance is brought down at this point, it will show the cost of the goods sold, but this balance is seldom or never expressed. The information is there but it is lost sight of in the other details of the selling account. In the revenue statement, each of these desired items of information is brought out by a series of additions and deductions which show exactly how each balance is arrived at in a much clearer way to the average business man than in the balanced ledger accounts. A very much condensed example will show the difference. Of course, the various items composing manufacturing and other expense would be detailed, both on the ledger and in the statement. For the sake of simplicity, goods in process are combined with the material in the inventories.

LEDGER ACCOUNTS

Manufacturing

Inventory, material Jan'y. 1	$ 36,000.00	Inventory, material Dec. 31	$ 35,000.00
Purchases	218,000.00	Manufacturing cost	407,000.00
Labor and expense	188,000.00		
	$442,000.00		$442,000.00

Selling

Manufacturing cost	$407,000.00	Inventory finished goods, December 31	$ 38,000.00
Inventory finished goods, Jan'y 1	27,000.00	Net sales	530,000.00
Selling expense	49,000.00		
Profit on sales	85,000.00		
	$568,000.00		$568,000.00

Profit and Loss

Administrative expense	$ 34,000.00	Profit on sales	$ 85,000.00
Interest	4,000.00	Discount taken	9,000.00
Discount given	5,000.00		
Bad debts	7,000.00		
Net profit for year	44,000.00		
	$ 94,000.00		$ 94,000.00

REVENUE STATEMENT

Net sales		$530,000.00
Cost of manufacture:		
Inventory material Jan'y 1	$ 36,000.00	
Purchases	218,000.00	
	$254,000.00	
Less, inventory material Dec. 31	35,000.00	
Cost of material used	$219,000.00	
Manufacturing labor and expense	188,000.00	

Cost of goods made	$407,000.00	
Inventory finished goods January 1	27,000.00	
	$434,000.00	
Less inventory finished goods, Dec. 31	38,000.00	
Cost of goods sold		396,000.00
Gross profit on sales		$134,000.00
Less selling expense		49,000.00
Net profit on sales		$ 85,000.00
Less administrative expense		34,000.00
Net profit on operations		$ 51,000.00
Less net deductions from income:		
Interest, discount given, and bad debts	$ 16,000.00	
Discount taken	9,000.00	7,000.00
Net profit of the business for year		$ 44,000.00

The distinction is made between net profit from operations and net profit of the business, because the last items of interest, discount and bad debts are not necessary elements of the conduct of the business, being dependent to a large extent on the amount of capital available and on the character of the management. They would not be taken into consideration in determining the relative value of two manufacturing concerns.

The revenue statement explains why some say that the inventory of finished goods belongs in the manufacturing section. On the ledger it clearly belongs in the selling or trading account, but in the statement it assists in forming a link between the manufacturing and selling, so as to bring out the cost of the goods sold. Like any other link, it may be said to belong to either side or to neither.

The probability is that the difference of opinion referred to in the letter arose from the fact that one party was thinking of the ledger accounts, and the other of a revenue statement.

There has been recently published an answer to problem 11 of the Illinois examination of May, 1913, which illustrates very forcibly the necessity for a better understanding by candidates at the examinations of the kind of answers required by the examiners. The solution as published requires considerably more time than the one we suggest and yet does not bring out any more clearly any accounting principle. The question is whether it is necessary to calculate the actual days or whether one and one-half months may not be considered to be one-sixth of nine months. In order to calculate the actual days the published solution is obliged to make the rather improbable assumption that the quarry was worked Sundays and holidays, including in the latter Independence Day and Labor Day. Since no year is given, it is impossible to tell how many Sundays occurred in either period.

Similar points are very apt to come up in the examinations and it does not seem at all unfair to ask the various examining boards for a ruling on them.

Problem

A is the owner and operator of a stone quarry which, owing to weather conditions, cannot be operated between December 1 and February 28. B caused damage to the quarry which delayed the commencement of operations until April 15th, from which date the quarry was worked until November 30th and produced 71,000 cu. yds. at a quarry cost of 29c per cu. yd. The product was all sold at 77c per cu. yd. Overhead expense for the year, $10,000. B repaired the quarry at his own expense. You are required by the lawyer for "A" to indicate the measure of consequential damage as a basis for action. In your answer illustrate your method.

Answer

In solving this problem it has been assumed:

(1) That the overhead expense of $10,000 is fixed and is not affected by the production or the length of the operating period (because it is stated to be "for the year").

(2) That the quarry cost of 29c a yard includes the value of the stone before quarrying and does not include any of the overhead expense.

(3) That the same daily production and cost and selling price would have been maintained if the quarry had been operated for the full season from March 1 to November 30.

(4) That the working days include Sundays and holidays.

Based on these assumptions the problem would be solved as follows:

(1) The loss of production would have been—

$$\frac{\text{Production days lost}}{\text{actual production days}} \times \text{actual production}$$

or

46/229 x 71,000, which equals 14,262 cu. yards

(2) The financial loss would be—

profit per cubic yard x loss of production

or

48c x 14,262 cu. yds. which equals $6,845.76

Comments

The problem says "delayed the commencement of operations until April 15th, from which date the quarry was worked, etc." If operations were commenced on April 15th, as the wording would clearly indicate, the lost time included 31 days in March and 14 in April or 45 days, instead of 46, as given. The fraction would then be 45/230, or 9/46, instead of 46/229. However, this is a matter rather of arithmetic than of accounting principle, and it is generally understood that arithmetical errors are not as important as errors of principle.

In calculating the financial loss, the considering of the shut-down time as 1/5 of the operating time makes the solution an easy and rapid task, as shown by our first suggested answer.

Suggested Solution

The gross profit was 48c per cubic yard.

Gross profit on 71,000 yards actually quarried, at 48c	$34,080.00
One-fifth of this would have been made in addition if the quarry had been operated full time	6,816.00

Since the quarry was operated 7½ months at a gross profit of $34,080.00, the profit per month was $4,544.00. As it was shut down 1½ months the loss was 1½ times the monthly profit.

Another Method

The operating season of the quarry was normally nine months. B's action caused it to be shut down one month and one-half, or one-sixth of its season. If the production in five-sixths of the season was 71,000 yards, the production, if the quarry had been operated the full season, would have been one-fifth more, or 14,200 yards additional, a total output for the full season of 85,200 yards.

If the quarry had been operated the full season the output of 85,200 yards sold at 77c would have realized			$65,604.00
The quarry cost of 85,200 yards at 29c would have been		$24,708.00	
The overhead cost was		10,000.00	34,708.00
The net profit would have been			$30,896.00
By being shut down part of the time,			
71,000 yards sold at 77c realized		$54,670.00	
Quarry cost at 29c was	$20,590.00		
Overhead cost was	10,000.00	30,590.00	
Net profit actually made was			24,080.00
Difference, being loss by shut-down			$ 6,816.00

The latter method has the advantage of showing clearly that the loss was one-fifth of the gross profit on the yards actually quarried and not of the net profit after the overhead expense had been taken out. The overhead expense, being for the year, is clearly not proportionate to the output, but is a fixed amount.

The following are two practical accounting problems given in the Illinois examination in May, 1914.

The A. B. C. Estate Company was formed on January 1, 1912, and the following is the trial balance as at December 31, 1913, before closing the income and expenditure accounts for current year:

THE A. B. C. ESTATE COMPANY

TRIAL BALANCE—DECEMBER 31, 1913

		Dr.	Cr.
Capital stock authorized and issued			$140,000.00
Bonds issued:			
120,000 20-year 5% bonds issued January 1, 1912 at a discount of 5%			120,000.00
Discount on bonds issued		$ 6,000.00	
Property (Jan. 1, 1913)		250,280.50	
Capital stock in treasury		12,000.00	
Calls unpaid		500.00	
Additions to property 1913:			
Sinking artesian well		5,000.00	
A. B. C. Estate Co.:			
Bonds purchased 1912 (and cancelled)	$6,000.00	5,850.00	
Bonds purchased 1913	6,000.00	5,750.00	
Rents collected			24,500.00
Fire insurance paid for year ending June 30, 1914		300.00	
Agents' fees and expenses		2,850.00	
General office expenses		1,050.00	
Cash at bankers and on hand		1,389.50	
Secretary's salary and commission		2,380.00	
Income and expenditure account 1912			14,250.00
Interest on bonds (paid annually)		5,400.00	
		$298,750.00	$298,750.00

The rent collections include rents paid in advance, $750.00, and there are sundry rents outstanding not taken up on the books, amounting to $2,650.00, of which it is estimated $15.00 will not be collected.

No provision has been made in the year's accounts for depreciation of the buildings, included in the property account, the original cost of which was $120,000.00 In the year 1912 the amount written off was based on an estimated life of 20 years.

Prepare balance sheet as at December 31, 1913, and income and expenditure account for the year ended that date, after making the necessary adjustments.

SOLUTION

Evidently the books have been closed for the year 1912, without taking into consideration any allowance for the pro rata of discount on bonds, or for any adjustment on the bonds bought in at a discount. The bonds bought in 1913, at least, must have been bought flat, as there is no charge for any accrued interest on them. The debit balance of interest on bonds is just five per cent on the $108,000.00 of bonds outstanding. Although not payable until the next day, the cheque has evidently been drawn for this interest and deposited with the bank that pays the coupons.

The proportion of discount to be charged off each year is taken at one-twentieth, without attempting to amortize it. This would be $300.00 for the first year and $285.00 for the second, since 5 per cent of the bonds had been redeemed. It is assumed that the bonds were bought at the end of each year. The discount on bonds is bond interest paid in advance, therefore an entry should be made:

Bond interest for 1912	$ 300.00	
" " " 1913	285.00	
To discount on bonds		$ 585.00

As the bonds purchased were redeemed and cancelled and not put into a sinking fund, they should be charged off against the bond account at par, and discount on bonds should be credited, not with the discount actually received, but with the proper proportion of the original discount. As the discount on the bonds sold in 1912 has already been credited with one-twentieth and on those sold in 1913 with two-twentieths, the amounts to be credited now will be $285.00 and $270.00 respectively, a total of $555.00. As the discount at which they were bought was only $400.00, the difference of $155.00 must be charged to surplus. The entry would be:

Bonds	$12,000.00	
Surplus for loss on discount	155.00	
To A. B. C. Estate		$11,600.00
Discount on bonds 1912		285.00
" " " 1913		270.00

Crediting the discount on bonds account with these items, totalling $1,140.00, will leave a balance in that account of $4,860.00, which is 90 per cent of the 5 per cent discount on $108,000.00 bonds outstanding, which is correct, as 10 per cent of the life of the bonds has elapsed.

The property account should be divided into two accounts, so as to keep track of the buildings for both depreciation and insurance purposes. Evidently the depreciation for 1912 was written off from the face of the account. Taking this as being $6,000 (without attempting to amortize it) this amount is added back to the account and a corresponding reserve for depreciation set up.

To the rents collected, $24,500.00, should be added $2,650.00 which should be charged to tenants, against which a reserve for bad debts should be set up of $15.00. Of the resultant balance in rent account $750.00 must be carried forward as rents paid in advance, as it is not an earning of the present year.

With these explanations, the following tables are self-evident:

Income and Expenditure, Year of 1913

Insurance ....$	150.00	Rents collected ....$	23,750.00
Agents' fees and expense	2,850.00	" due $2,650.00	
General office expense ..	1,050.00	Less reserve .. 15.00	2,635.00
Secretary, salary and commissions	2,380.00		
Reserve, dep'n bldgs. ...	6,000.00		
Interest on bonds paid .	5,400.00		
" bonds discount 1913	285.00		
Balance to surplus	8,270.00		
	$ 26,385.00		$ 26,385.00

Surplus

Bond interest, discount 1912 ....$	300.00	Balance January 1 .....$	14,250.00
Bond discount loss	155.00	Profit of year	8,270.00
Balance December 31 ..	22,065.00		
	$ 22,520.00		$ 22,520.00

Balance Sheet, December 31, 1913

Assets			*Liabilities*		
Land $136,280.50			Capital stock ....$		140,000.00
Additions	5,000.00	$141,280.50	Less in treasury ..$12,000.00		
Buildings ...$120,000.00			Call unpaid .	500.00	12,500.00
Reserve	12,000.00	108,000.00			$127,500.00
Discount on bonds		4,860.00	Bonds outstanding		108,000.00
Unexpired insurance ...		150.00	Rents paid in advance ..		750.00
Tenants $2,650.00			Surplus		22,065.00
Less reserve	15.00	2,635.00			
Cash at bank and on hand		1,389.50			
		$258,315.00			$258,315.00

This is an excellent problem, exemplifying especially the principles involved in the treatment of discount on bonds issued. There is absolutely no criticism to be made on it as a fair and clearly stated proposition. There is, however, a very serious criticism to be made as to the time allowed for its solution in the examination. It is given a credit of 20 points out of 100 for the session. Even if the session is extended to three and one-half hours, the time allotted to this problem would be only forty-two minutes. There may be young men who can give all the points involved due consideration, grasp all the principles, make the calculations, prepare the tables, prove the work, and write all the explanations, all in a clear and legible manner, inside of the forty-two minutes. If so, they are certainly exceptionally quick both in comprehension and in execution, and richly deserve to succeed. But experience shows that it is not the brilliant exceptions in a class that usually attain the most solid success. The quiet, cautious students, who take time to think things out, and who make sure that they are right before they go ahead, are the ones that can be depended on to be right much oftener than those that rush through a problem at the pace that is demanded by the examiners. Rapidity in either comprehension or execution is a very valuable quality to possess, but it is the least valuable characteristic of a trained accountant. The ability to think clearly, to reason correctly, and to state conclusions convincingly does not depend upon rapidity of thought or action. But however great the ability possessed by a candidate, he has no chance whatever, unless he possesses also the necessary speed. He has no time to think, because he knows that there are four more problems still to be mastered and he realizes that he cannot afford to waste time on one alone.

It is more than probable that any practising accountant would consider a client very unreasonable who would present him with a mass of rather complicated figures, and would hold a stop-watch over him, demanding that he be ready in forty-two minutes with an absolutely correct set of statements properly arranged and thoroughly explained. Is it any more reasonable to expect such a feat from one who is not yet an experienced accountant, but who is only asking for the opportunity of being put in the way of becoming one? A man's knowledge of accounting principles, (or the lack of it) can be better shown by three examples of deliberate work than by five that have to be hurried through.

May, 1914, Practical Part I

A cloak manufacturing concern, turning out but one grade of cloaks, claimed to have been robbed on the night of April 16 and forthwith filed a claim under a burglary insurance policy it was carrying.

The proof of the loss filed by the assured contained two items, *viz:* 300 cloaks valued at $12,000.00 and 1,000 yards of silk stated to be worth $1,500.00.

The insurance company being notified of the loss immediately ordered an inventory to be taken, which was done on the morning of the 17th, and disclosed the following:

1,250 cloaks
6,250 yards of cloth
2,500 yards of silk

On the same day you were called in by the insurance company to examine the books for the purpose of proving or disproving the claim, when the following information was obtained:

FIRST: That a complete inventory had been taken on January 1, 1913, of the cloaks, cloth and silk on hand at that date, the inventory sheets of which had subsequently been lost or destroyed. However, the books showed that the total valuation was $32,675.00 and the firm's representatives assured you that this was correct and that the inventory had been properly valued at cost prices which had not fluctuated since.

SECOND: That the cloth and silk purchases subsequent to January, 1913, had amounted to 18,750 yards of cloth and 5,000 yards of silk at average prices of 50c and $1.00 per yard of each fabric respectively.

THIRD: That 3,000 cloaks had been manufactured during the same period which had consumed 20,000 yards of cloth and 5,000 yards of silk, while 4,500 cloaks had been sold.

You were further informed that the manufacturing cost was as follows:

Material	$5.00 per garment
Labor and other expenses	3.50 per garment
Total	$8.50 per garment

Give the gist of your report to your client; and state what, if any, different case you could have made out for the firm had you been employed by it instead of by the insurance company.

SOLUTION

There are two ways in which it can be shown that the claim for loss is excessive, one by values and the other by quantities. The insurance company would not need an accountant to tell it that 300 cloaks at $8.50 amounted to only $2,550.00, and 1,000 yards of silk at $1.00 to $1,000.00, which would be the basis of the claim, unless the goods were insured at selling price.

By the value method, the inventory January 1, plus the purchases and manufacturing cost, minus the cost of the goods sold should give the inventory on hand at date of burglary.

Inventory January 1	$32,675.00	
Purchases cloth, 18,750 yds. @ 50c	9,375.00	
" silk, 5,000 yds. @ $1.00	5,000.00	
Labor, etc. 3,000 cloaks @ $3.50	10,500.00	$57,550.00
4,500 cloaks sold cost @ $8.50		38,250.00
Inventory that should be on hand		$19,300.00
Inventory actually on hand:		
1,250 cloaks @ $8.50	$10,625.00	
6,250 yds. cloth @ 50c	3,125.00	
2,500 yds. silk @ $1.00	2,500.00	16,250.00
Amount missing		$ 3,050.00
Firm claims stolen:		
300 cloaks @ $8.50	$ 2,550.00	
1,000 yds. silk @ $1.00	1,000.00	3,550.00
Excess of claim over actual loss		$ 500.00

The material cost as given is shown to be correct at $5.00, since the material that went into the 3,000 cloaks made cost $15,000.00 The cost of labor, etc. must be taken as given, since there are no data in regard to it.

By the quantity method, we work backward to the inventory of January 1, instead of forward from it. The quantity of each article accounted for by being sold or consumed, on hand, or stolen as claimed, less the quantity purchased or made, should give the respective quantities on hand January 1. Any discrepancies between the value of these quantities and the inventory as shown by the books must be accounted for by an error in some of the figures. Since the figures of the inventory of January 1, of the articles sold or consumed, of those on hand, and of the purchases, are not disputed, the error must be in the amounts claimed to have been stolen.

Cloaks sold	4,500		
On hand	1,250		
Claimed stolen	300	6,050	
Manufactured		3,000	
Inventory January 1 @ $8.50		3,050	$25,925.00
Cloth, consumed yards	20,000		
On hand	6,250	26,250	
Purchased		18,750	
Inventory January 1 @ 50c		7,500	3,750.00
Silk consumed, yards	5,000		
On hand	2,500		
Claimed stolen	1,000	8,500	
Purchased		5,000	
Inventory January 1 @ $1.00		3,500	3,500.00
Total inventory on this basis			$33,175.00
Actual inventory			32,675.00
Discrepancy			$ 500.00

Note: Of course, only one method need be given in an answer in a C. P. A. examination. Either answer ought to be worked out easily within the time limit. The problem is an excellent one to bring out the ability of the student to prove a loss of this kind or one by fire, or to attack the correctness of a previous inventory which had been suspiciously lost.

I do not see that any different case can be made out for the firm. The facts are the same whether they are ascertained for one side or the other. Whether the goods stolen are to be valued at cost or at an advance covering loss of prospective profit is something with which the accountant would have nothing to do.

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A JOURNAL IMPOSTER

A man giving the name of Hood has been canvassing in Albany, Rome, New York and Brooklon, offering a Journal at $1.50, together with *Modern Methods*, *Bookkeeping Today* and five books on accountancy. It is needless to say he is an imposter. Journal readers are asked to warn others who may be approached with a similar offer.

(Continued on page VIII)