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1923

## Why surplus is not cash [News items]

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### Recommended Citation

Haskins & Sells Bulletin, Vol. 06, no. 01 (1923 January), p. 2-3

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now prevail would be largely dissolved. Haste, waste, and anxiety would become strangely missing. The battle which rages during the first two and a half months of the calendar year would give way to a stretch of calm, peaceful, sane, efficient work, and the whole bulk of practice would be more equally distributed over the year, which in turn would mean a steadier

and more consistent staff of accountants.

Agitation of the natural business year for fiscal closings is a fitting resolve for the accountant with which to start the new year; to let no opportunity pass which will enable him to advocate it; to talk it whenever and wherever occasion is presented or may be found. Dripping water will wear away a stone.

### Why Surplus Is Not Cash

**T**HE general manager of a public utility some years ago, while claiming credit for having originated the standard classification of accounts for the utility in question, admitted in the same breath that he had never been able to understand why his company should not have in cash the amount reflected by the surplus account.

Surplus as used in accounting relates to value; excess, or free value, as it were. To assert that surplus may be found only in cash would be to claim that nothing but cash has value.

Most business enterprises require cash for purposes of convenience, since it is the one thing which passes freely among business concerns. But the original cash with which an organization begins business soon loses its identity. Some of it passes out in exchange for merchandise; some is disbursed for services and supplies; some, perhaps, for construction work, thus having been converted into fixed property.

Many transactions might take place without the creation of any surplus. Cash may be converted into other forms of assets; liabilities may be incurred and liquidated; plants built and stocks of merchandise laid in, or goods manufactured, without giving rise to a dollar's worth of surplus.

The essence of surplus is profit and the essence of profit is sales. Generally speaking, not until goods, services, or privileges

which have been acquired at one price are disposed of at higher prices is there any profit. But because all goods are not sold for cash, it necessarily follows that a part of the profit which has been added to the cost of the merchandise purchased must be found in the accounts not yet collected from customers or what are commonly known as accounts receivable. Notes may even be accepted in settlement of accounts. There is a regular cycle of cash, goods, accounts receivable, notes receivable, cash. The accounts or notes must be reduced to cash in order that the profit may be realized, but it must be appreciated that prior to this point the profit rests either in accounts or notes.

If it were possible to ear-mark on a dollar basis the units of investment in a business there would be, first, the original cash consisting entirely of dollar units. Passing into merchandise purchased for sale the units would still contain a hundred cents. As the goods were sold at a profit the units representing the accounts receivable would contain, say, a dollar and twenty cents. Some of these units remain in the accounts receivable; some pass into the class of notes; others come back into the cash.

There are now, assuming that some of the original units were left in the cash, two classes of units therein; one containing a hundred cents, or what might be called the

"A" units; a second containing one hundred and twenty cents, to be called the "B" units.

Some of the "A" units are joined with "B" units and both used to purchase more merchandise, and in the cycle of conversion the "A" units become "B" units with one addition of profit, while the former "B" units become "C" units with two additions of profit. But while the conversion was taking place, some of the "B" units were exchanged for property, and thus not only became tied up so as to be unavailable for disbursement, but lost to the merchandise group for future active work.

Having in mind that some of the units which have gotten into the fixed property are carrying profits, it is obvious that they may not be used in any distribution of profit. Recourse must be had for the distribution of profits to those units which are in the cash, since the units which are in the merchandise, accounts or notes receivable are as firmly fixed, for the time being, as those in the property. No one wants dividends in the form of property. Everyone wants cash. And this perhaps accounts for the association of profit distribution with cash.

But it is impracticable to resort to any scheme of ear-marking investment units. A sorry mixture would result from any such attempt. In lieu thereof accounts are kept which record and measure periodically the profits. Accounts are also kept for the expenses of doing business which reduce the profits. The balance representing the net profits is closed out to an accumulation account called surplus.

The units of investment are all scattered through the various assets of property, merchandise, notes and accounts receivable. They are not ear-marked; nor can they be identified. But the profit element in the units, scattered though they

are, is measured collectively by means of the surplus account.

When surplus is distributed through dividends in the form of cash, the surplus is diminished, but there is an equal diminution in the cash. Figuratively speaking, the units used for the payment of dividends are of a new type; not the investment units, but some which have been made by prying loose from them, or at least such of them as are in the cash, that part which represents the excess over one dollar, and by moulding such excess into new units.

Surplus is a matter of value, of value over and above original investment. Cash is a convenient medium for the transaction of business. Cash may or may not represent any surplus. Obviously, all surplus is not cash any more than all cash is surplus.

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Mr. R. J. Leo is a member of the House Committee of the Portland, Oregon, Chamber of Commerce, and has taken a noteworthy part in many of the activities of the Chamber. He recently served as general chairman of the Floral Show held in Portland on November 14 to 16, 1922.

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Mr. Page Lawrence addressed the Cost Accountants group of the Kansas City Chamber of Commerce on November 17, 1922, on the subject of "The Relation of Costs and Cost Accounting to the Financial Position as Expressed in the Balance Sheet."

Mr. Lawrence has also been nominated as chairman of the Program Committee for this group. About eight or ten meetings have been planned to be conducted somewhat on the lines suggested by the Fabricated Industries group of the Chamber of Commerce of the United States.