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What is Involved in the Making of a National Budget*

BY FREDERICK A. CLEVELAND

It is difficult even to suggest the importance to the American people of a budget. The fact that we have gone on for one hundred and twenty-three years without an annual statement of affairs which may be readily understood, and without a definite programme as a guide to future work, would not excite any considerable comment were it not for the disappointment which we feel with the results. We have come to realize that the energies of our greatest welfare institution, the national government, have been misdirected. Lately we have come to realize that we have departed from principles that have been considered by us as fundamental to constitutional government. Finally, the American people have decided that something must be done, and that this something must carry with it a definite governmental plan or programme which the average citizen can understand and will support. It is in this relation that the question, as to what a budget may mean, finds its broadest significance.

DEFINITION OF A BUDGET

First let us make sure that we understand each other. In this country the word budget has been very loosely used to signify at least five different ideas, viz., (1) departmental esti-

* This paper was prepared for the annual meeting of the Efficiency Society at New York, January 28, 1913. As Mr. Cleveland could not be present the paper was ordered printed as a part of the proceedings.
mates, (2) a summary of departmental estimates for expenditure and an estimate of revenues prepared by a finance officer, such as a comptroller, (3) a statement of financial conditions, operations, and estimates by the executive to the legislature, (4) bills prepared by legislative committees, (5) acts of appropriation.

I am using the term in the sense in which it is understood in England, in France, in Germany, in other countries where a true budget system obtains. For this purpose, therefore, I will define a budget to be a summary statement submitted by the responsible head of the executive branch of the government to the representative branch—a statement which reflects present business conditions and operative results; one which carries also definite recommendations with respect to the future, including a proposed method of financing estimated expenditures.

The budget as an instrument of control:

Originally a budget was adopted as a means whereby the executive might be compelled to submit to the representative body and to the country an account of revenues and expenditures before further supplies would be granted. Later the practice was expanded to include the submission of a definite plan or list of proposals for future revenues and expenditures which the head of the administration was expected to explain and defend. The fundamental constitutional purpose of a budget is to provide the means whereby officers of government may be made responsive and responsible to the electorate, and to this end the executive and the legislature are required clearly to define the issues which are to be discussed. In this particular a budget procedure is to the electorate what a judicial procedure is to a court.

The budget as a means of developing coöperation and avoiding conflict:

Without a budget the usual attitude of the legislative and executive branches toward each other is one of suspicion, hostility, and conflict of powers as between these two branches of the service. A budget as it has developed in use is an instrument of precision which enables the legislative and executive officers to coöperate in the management and control of its business. This result obtains as a result of requiring each to take his fair share of responsibility for mistakes in policy or results of mismanagement.
What is Involved in the Making of a National Budget

AN APPEAL TO BUSINESS EXPERIENCE

The best way to approach a business problem is through the experience of business men. As business men most Americans are more or less familiar with corporate organization and management. Although we have been operating without a budget there is nothing new in the principles to be discussed.

An example in corporate organization:

In thinking about national business what I would have each of you do is to picture yourself as a member of a corporation with a hundred million shareholders—a corporation which is officered by a board of five hundred trustees on one hand and by a president on the other. The question at issue is whether responsibility for the details of management should be in this unwieldy board or in the president; whether judgment about matters of current business should be exercised by committees appointed by the board or by officers responsible to the chief executive.

The issue may be better understood when it is said that this corporation transacts nearly every kind of business that is known to man. It employs 500,000 men in the regular performance of its activities; it has over 70,000 different offices; they are under the direction of 1,000 different operating chiefs who are organized under nine different executive department heads—these heads being appointed by the president. For the purpose of effectively relating the official responsibility for the management of this great corporation to the shareholders, the five hundred members of the board of trustees are elected to represent particular interests of localities, while the president, as the head of the executive branch, is elected by the shareholders at large. The volume of the business to which responsibility is to be attached may be suggested by the fact that the money transactions aggregate more than $5,000,000,000 a year or $16,000,000 each day, of which vast amount nearly $2,000,000,000 is in the nature of receipts and disbursements for the current expenditures of the government, while more than $3,000,000,000 is in the nature of trust receipts and disbursements, including currency trusts, Indian trusts, and sacred obligations of the government that have been undertaken for the welfare of those who have been specifically designated as legal beneficiaries.
In this institution of which you are a member, the legal or charter relations of the board to the executive are practically the same as in the other corporations with which you may be connected—the same as those to which business men are accustomed, except that the board is larger, the business is more complex and the shareholders are more widely scattered. There is a further difference, also, in that each shareholder has only one vote, so that each member is on a plane of equality with every other member. Under the articles of incorporation the board is required to meet once a year; it may meet more frequently on call of the president. The purpose of this meeting, as with other boards, is to determine questions of policy; that is, it is called upon to decide what the corporation shall do and how much it will authorize executive officers to spend on each undertaking.

Administrative problems to be solved:

The administrative problems are also similar to those of a private corporation doing similar business. The president as the head of the corporation is charged with the same responsibility for carrying out policies of the board as the president would be in any corporation with which you may be acquainted. He is responsible for selecting and directing the heads of departments. He is responsible for every act of every subordinate in the same manner as is the chief executive of any business organization. He is responsible not only for developing efficiency in the organization but also for the economy with which expenditures are made. There are the same responsibilities, the same technical requirements in the construction of a ship, whether built by public or private agency. Questions of management are similar whether in operating a private or a public canal, school, hospital, or other undertaking. In other words, every problem which relates to the expenditure side of the business is common to all executives. It is in the policy-determining and revenue-raising or financial side that the principal differences are to be found.

A question of board or executive control over administrative details:

The foregoing is descriptive of the plan as originally con-
What is Involved in the Making of a National Budget

cieved by those who framed the charter of this great corporation. Now let us catch a glimpse of the institution at work.

As required by charter the board of five hundred members gets together; at its annual meeting it organizes itself and in the regular course of business prescribes the ordinances and by-laws which shall govern the administrative's offices and departments. In doing so, however, instead of requiring that the president shall submit to them each year an account of stewardship—a balance sheet and an operation account—instead of requiring that the president as chief executive shall lay before them a definite proposal as to what in his opinion should be undertaken during the next fiscal period, based on experience and the best judgment of managers, it makes a by-law which requires that each of the chiefs of the 1,000 offices in the several departments or establishments shall come personally before committees of the board and answer their questions; and preparatory to such an inquisition it also requires that each such officer shall submit a statement of his plans, with estimates for expenditures; moreover, that this statement shall be submitted through the head of the department or establishment directly, without review or revision by the president as chief executive.

Is a weak board desirable?

On the one hand, imagine yourself sitting as a member of a committee of this board of five hundred trustees interviewing the chiefs of as many of the 1,000 different divisions in the service as would be possible within the period of a session; imagine yourself by this method trying to get from these chiefs statements which would enable you to think intelligently about the many technical details of many kinds of business transacted, with all of which you are unfamiliar; and with this smattering of knowledge attempting to do what no administrator would attempt to do, namely, to decide administrative questions a year in advance. Then again, imagine yourself sitting with the whole board at the end of a session, attempting to take intelligent action on matters reported by one or the other of some thirty different committees which have submitted for your consideration a long list of decisions about administrative details without first having before them a definite plan. Let it also be understood that the persons who have been drawn before these committees are fearful

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lest the information which they give will be used against them to limit their powers and to circumscribe their actions, and that these committees are so organized that they are without the means of coördinating their efforts—and you have a picture of board management that I would get before you as a basis for judgment as to whether or not this is the best way to control the broad policies of a large business. Is this what you would expect if you were a member of a board of a business corporation?

Is a weak executive desirable?

On the other hand, imagine yourself chosen by the stockholders as chief executive. Imagine yourself in complete isolation, selecting heads of departments who are asked to confer with you about matters of current business, but who in fact are helpless because the board, through its committees, insists on directing the heads of bureaus and divisions what to do—how to do it—insists upon placing upon each chief such limitations and restrictions as to make effective executive direction and control impossible. Imagine yourself responsible to your electors for everything that goes wrong, but with no staff for ascertaining what is being done—with no means provided for having statements of operating conditions and results brought currently to your attention, with every little bureau chief an autocrat within the limitations prescribed by the board. Imagine yourself a weak sovereign with a nominal kingship over a thousand feudal lords each well fortified behind his own walls, and you have the picture of the chief executive of your corporation.

THE CONSTITUTION OF THE UNITED STATES IN THEORY AND IN PRACTICE

But you may say: Why this appeal to the imagination? If by reference to the every-day experience of the average man a clear picture has been drawn, the end of this introduction has been served. This description is not fiction, neither is there anything in it that is new or far-fetched. It may seem strange, but it is true to life.

A century of institutional decay:
Governor Wilson in his work on Congressional Government
What is Involved in the Making of a National Budget

has pointed to some very interesting facts about the development of the activities of our federal government. In this, he describes the evolution of powers under the constitution, as a gradual invasion of the executive by the congress. He speaks of the constitution as an idol that we have worshipped in form, rather than as an organic principle which we have followed.

In this relation he says: * "The constitution of 1787 is still our constitution; it is now our form of government in name rather than in reality * * * the actual form of our present government is a scheme of congressional supremacy." (page 10)

Speaking of the presidency as it is, as distinguished from the presidency as it was contemplated by the constitution, Governor Wilson says: "That high office has fallen from its original first estate of dignity because its power has waned; and its power has waned because the power of congress has become predominant." (page 43)

And again speaking about the congress, he says: "Congress * * * very early divided itself into standing committees * * * and set itself through these to administer the government (page 44) * * *; it has entered more and more into the details of administration until it has virtually taken into its own hands all the substantial powers of government. * * * it (congress) does not domineer over the president himself, but makes his secretaries its humble servants; not that it would hesitate to deal with the chief magistrate, but because our latter presidents have lived by proxy; they are the executives in theory and the secretaries are the executives in fact * * *." (page 45)

Nor have the powers of the heads of departments been developed at the expense of the president, as is set forth in the same text: "It cannot be said that this change has raised the cabinet in dignity and in power; it has only altered their relation to the scheme of government; * * * but although the heads of departments are thus no longer simple counselors of the president, having become in a very real sense parts of the executives, their guiding power in the conduct of affairs instead of advancing has steadily diminished because while they were being made indirectly parts of the machinery of the administration, congress has extended its own sphere of administration so that it is getting into the habit * * * of managing everything."

* See Congressional Government, 15th edition (Boston, 1900).
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A concluding characterization by the same authority is also in point: "We have had no great administrators * * *. The presidency is too silent and inactive, too little like a premiership and too much like a superintendency." (page 204)

It is evident to everyone who has come into close contact with the government of the United States as it is that, even with our hard and fast written constitution, it is not what the fathers intended, but what four generations of the children who have lived in ignorance of what the government is doing have made it.

Constitutional principles impaired:

The principle which is fundamental to constitutional government is responsibility. This is the principle which democracy forced upon a predatory hierarchy that exercised its powers as a result of conquest. The evident purpose of our constitution was to provide the means for determining and enforcing official responsibility. Since its adoption, however, every step has been away from this purpose. A few brief references will suffice to make clear the initial concept.

Article I begins with the statement, "All legislative powers herein granted shall be vested in the congress of the United States." This broad statement of principle was not left to stand alone, but was made more specific as bearing on responsibility for management. Section 8 of article I provides that "Congress shall have power to lay and collect taxes, duties, imposts and excises, and to borrow money on the credit of the United States," while section 9 requires that "no money shall be drawn from the treasury but in consequence of appropriations made by law." Thus to congress is given the power and responsibility for determining all matters of legislative policy and for deciding what revenues shall be provided and what amount shall be expended.

Provision made for a strong executive:

But it is also clearly evident that the power given congress was not intended to be used in a manner to deprive the executive of the exercise of discretion or to interfere with the location and enforcement of responsibility for efficiency in management or for the economy with which funds are expended. Article II begins with the statement that "The executive power shall be in a president of the United States." In the very same paragraph
What is Involved in the Making of a National Budget

which gives to congress control over appropriations is found the constitutional requirement corresponding to the initial concept of a budget, viz., that the administration shall publish "a regular statement and account of the receipts and expenditures of all public money." This idea is further developed in a subsequent clause which makes it the duty of the president to lay before congress and the country a definite constructive statement or proposal. The constitution specifically states that the president "shall from time to time * * * recommend for their consideration such measures as he shall judge necessary and expedient." In these clauses of the constitution are to be found almost an exact definition of modern budget procedure, and this prescribed procedure too is brought into definite relation with those prescriptions of powers, duties, and limitations that are to be interpreted in terms of official responsibility.

Provision made for a strong legislature:

On the one hand, it is clear that the intent of the framers of the constitution was to make the congress a representative board which would give attention to broad questions of policy; on the other it is quite as evident that it was not intended that the congress should take action within the field of administration. Congress was made responsible for determining how, under the constitution, the government shall be organized, for directing and controlling what service shall be rendered, for deciding what amount of funds shall be raised by revenue measures, and what amount shall be borrowed in order to meet prospective expenditures. There is nothing in this instrument or in the discussion prior to its adoption to indicate that it was contemplated that, when the government had expanded its activities to such an extent that it had 500,000 people on its pay roll, the congress would attempt to decide whether the salary of a particular janitor should be $600 or $700 a year. There is nothing to suggest that the congress should turn over to irresponsible committees or subcommittees of its own members the determination of how many clerks shall be used in each of one thousand different offices and subdivisions of administrative work and what shall be the salary paid to each clerk. There is nothing in the constitution to suggest that the congress should finally develop into a political employment bureau and pass on the promotion and demotion of indi-
individual employees. There is nothing to suggest that it should attempt to administer all the details, thereby breaking up executive discipline and reducing chiefs of divisions to subservience to the chairmen of its committees. On the other hand there is every reason to think that the very purpose of the constitutional prescriptions quoted was to enable congress to confine its activities to questions of policy; to enable its members to give their thought to a well considered plan or programme of work and to the determination of the amounts that would be necessary to carry on the work of the government as well as the methods of financing these expenditures. This without doubt was the intention of those broad-minded men who framed the constitution.

But what has happened is this: Although the government is at the present time employing thousands of technically trained administrative officers, it has, through its congressional committees, proceeded to handicap and limit these men in such manner as to deprive the people of the benefits of an efficient service. Congress itself has gone over into the field of administration—has attempted to decide practically every question involving administrative discretion, has restricted the use of the judgment and training of experts who have been employed to manage the technical details of public business, with the result that public funds are wasted and the people are thoroughly dissatisfied with the public service. And not a little of this dissatisfaction is due to the manner in which each branch of the service has sought to discredit the other in the eyes of the people.

*Inefficiency and waste the result of irresponsibility:*

Not only has administrative efficiency been impaired, but members of congress have also been handicapped by being so overwhelmed with details that congress has been forced both to abandon its real work and also to turn over the administrative details to its committees. Thus at present the administration is controlled by irresponsible committees and subcommittees who determine what shall be done by irresponsible bureau heads. The government is operated at a high cost. Matters of policy and finance are neglected. All the particular functions for which each branch of the government was established have been subverted. Instead of developing the powers of government along such lines as effectively to establish and enforce responsibility
for each action taken, instead of evolving a system which will provide for a constantly increasing efficiency with experience acquired in the management of affairs, instead of utilizing the executive branch of the government for giving to the public the best possible service at the least possible cost, there has been an evolution of processes and activities that has been in the direction of destroying all responsibility for inefficiency and waste. Congress has undertaken to settle matters which should be left to administrative judgment. The president, as chief executive, has failed to assume the leadership and to exercise the powers granted. Although initially the president gave much of his personal time and thought to the details of administration, as these details became more numerous and encumbering the chief executive, having failed to develop an expert staff, became farther and farther removed from administrative considerations, until at the present time he, as the only officer who represents the people as a whole and who is constitutionally responsible for the manner in which the business is done, is in almost complete isolation. Instead of being an executive his chief function is a negative one—that of vetoing legislation; his chief occupation is that of a distributor of party patronage.

**What may be done under Our Constitution**

In considering what is involved in making a national budget the first question to be decided is whether we shall undertake to develop an efficient government under our present constitution, or accept the conclusion of certain writers that we are practically helpless until we adopt the British system.

**Fallacy of reasoning from analogy:**

In my opinion there are two fallacies in the reasoning that leads to this conclusion. *First*, premises for reasoning are used which are not based on experience. We have never tried to develop; we have never taken the steps necessary to find out whether or not our constitution is adapted to efficient administration. *Second*, the history of parliamentary government is itself an argument in favor of our own system if adequately developed. In urging a parliamentary system it is commonly said that the parliament dominates the government. As a matter of fact (except
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in the matter of his own selection and tenure) the head of the British administration controls the legislature. In other words, the prime minister is a real executive such as a businessman is accustomed to. It is the prime minister as the head of the administration who assumes responsibility for the manner of doing business; he assumes responsibility for making report to the parliament on what has been done; he assumes responsibility for submitting to the parliament definite proposals as to what in his opinion should be undertaken; he even goes to the point of assuming responsibility for recommending what financial measures should be taken in order to meet the proposed expenditures. On these proposals he is ready to stand or fall as they may appeal or fail to appeal to the judgment of the people. Incidentally, the result has been that by reason of the executive's assuming responsibility for leadership before the country he has forced the parliament to consider and act on broad measures of public policy instead of spending their time to decide whether or not a particular janitor's salary shall be increased $10 a month.

Incidentally, the result of executive leadership has been that all matters of administration are left to the prime minister and the heads of departments who are selected by him, and the parliament finds time to consider questions of policy. By reason of the prime minister's laying before parliament a definite statement which shows present conditions and past results as well as one which contains definite proposals as to what in his opinion should be undertaken, he has placed in the hands of members of the legislative branch the data necessary to the consideration of policy and forced them to engage in oral debate on issues affecting the general welfare of the nation. This attitude and procedure have kept the parliament out of the realm of petty politics and kept the whole record of the governmental proceedings before the country.

Our constitution adopted to efficient budget procedure:

Those who point to this result as a reason for changing our constitutional form do so on the theory that it would be more consistent with ideals of popular government to have an executive selected by the legislature and for an indeterminate tenure, than to have an executive chosen by an independent electoral
college for a fixed term of years. In my opinion this conclusion is not based on experience nor is it based on sound reasoning. The plan has not operated that way in private corporations. Moreover, under a constitution like our own an effective executive has never been developed, and therefore no comparison can be made. The fact is that the development of an effective chief executive has never been seriously considered. When an effective executive has been developed it will be time for us to compare the relative advantages and disadvantages of the one system or the other. Theoretically, there are some very definite and concrete advantages in favor of a legislative recall of the executive, such as obtains under the British system. On the other hand there are many advantages which might be urged for a fixed term of years and for independence of the executive—the system provided for by our own constitution. At this time what the country needs is not a change in the form of government, but constructive leadership by a real executive using the powers already conferred; leadership which will demand for itself a competent staff that may be used to keep the executive informed about what is going on; leadership which is based on a knowledge of existing conditions; leadership which is not afraid to assume responsibility for going before the people; leadership which will utilize the superior powers of the president to formulate issues which may be understood and force the acceptance or rejection of a definite welfare programme; leadership which stands for efficiency in the conduct of the affairs of the government.

In my opinion all these results can be obtained under our constitution. Our present system of election is quite as well adapted to constructive leadership as is the English method, provided the leader becomes a real executive after he has been elected and forgets that he is a part of a non-governmental agency organized for the purpose of controlling the electorate. There is a difference in the method of enforcing responsibility here, but there is also a difference in the stability which may be given to policies for which the president becomes the advocate. In any event even a mistaken policy cannot last more than four years. As a matter of fact there is no ruler in the world who is more sensitive to public opinion than the president of the United States; nor is there any leader who is less potent when he does not have public opinion and the congress back of him.
Changes Needed in Organization of the Chief Executive

Before a national budget may be adopted a second decision must be reached, namely, that the president of the United States may be given the ordinary machinery of a corporate business with which to conduct its affairs. At present the president has practically no staff. For the constitutional head of an administration there is practically no means for obtaining information about what is going on. In order to get together a statement of financial condition as of June 30, last, and an operation account for the fiscal year ended on that date, it was necessary to collect the data de novo. Even the analysis of estimates and the preparation of summaries in such form as to present the appearance of a budget required a special investigation and report. There has never been developed in the government of the United States a regular organization for doing these things, and there has never been a basis for clear thinking about any problems of administration, to say nothing of enabling the executive to submit to congress and to the country an annual budget. The organization of the office of chief executive of the government of the United States is about the same as would be established to conduct the correspondence and manage the household of a society belle in the city of New York. The organization and technique which have been developed in departments for keeping members of the cabinet in touch with what is going on would discredit any department executive in the world. With few exceptions business experience and knowledge of results are written in the brain tissues of those who have the immediate contact with the problem, and this memory and experience is made available to irresponsible committees of congress through a process of inquisition, or in compliance with special statute law. The record thus made is a distorted picture, drawn by those who have no responsibility for accuracy of portrayal and who are animated by a spirit of hostility toward administrative officers who are responsible. Moreover, when such a record is made it is made available too late to have any administrative significance.

Changes in Congressional Organization

The introduction of a budget system will also require a re-
What is Involved in the Making of a National Budget

organization of the congressional committee system in such manner that congress may be equipped to consider and determine questions of policy instead of attempting to determine matters of minor administrative detail. Such an organization would be necessary to cooperation between the legislative and executive branches in reaching decisions that would commend themselves to the country and would make for the adaptation of the government to the needs of the people. Another important result of such a system would be to establish in congress a majority and minority leadership which would stand for or stand against the proposals of the responsible head of the administration. It would bring about a new alignment in partisan politics which would place the president, as he should be, at the head of the pro-administration party. In other words it would force the organization of parties on pro-administration and opposition lines. This would be effected without any change in the constitution.

What I wish to impress is this: A budget procedure is more than a technique. A budget is more than an account. Its preparation is primarily a technical matter, but its use rests on a broad democratic principle. A budget is essential to the effective operation of constitutional government. It is necessary to the location and enforcement of official responsibility. It is one of the cornerstones of modern democratic political organization. It finds its first expression in Magna Charta. In its modern development it is the most effective instrument for making government responsive to the will of the people that has ever been devised.

Another important fact must be faced. The creation of another committee in congress, or the organization of a joint committee, will not reach any of these ends. A joint committee may be essential to intelligent legislative action, and in a bi-cameral legislature may be an essential part of the machinery required for determining what requests will be granted and what revenues will be raised; but if this agency is employed to make a budget it can only serve to divert attention while the Congress still further invades and subverts executive power.

Conclusion

The question before the American people is: Shall we hold a single man responsible for the efficiency with which the public
business is managed and for the economy with which funds are
used, or shall we still further enlarge on a system of irresponsible
congressional committees? The question for the chief executive
to decide is whether he will accept the easy and customary course
or go before the country assuming responsibility for every item
contained in a budget prepared and submitted in the manner
prescribed by the constitution.

The issue which is presented to congress is: Will it recognize
the increasing limitations of a practice that has already reduced
that branch of the service to a body which makes progress by the
momentum of mass and weight, and whose action is in consider-
able measure determined by forces that are not controlled by
ideals of public welfare, or will it assume the normal constitu-
tional functions of a legislative agency which will have time and
opportunity to discuss important issues and gain the respect of
one hundred million people for the manner and intelligence in
which the legislative business of the nation is conducted?

These are large responsibilities, but they must be met before
the government of the United States may be efficiently managed,
and the millions of dollars taken from the pockets of the people
may be economically applied to the welfare purposes for which
our federal establishment is organized and is maintained.
Treatment of Interest on Manufacturing Investment

(Second Series)

Interest as an Element of Production Costs

By Edward L. Suffern

The discussion as to whether interest shall or shall not be treated as an element of cost rather than as an element of profit, appears to the writer to involve the manner in which a fact plus a point of view shall be stated. Hence such a discussion will of necessity be inconclusive, for the viewpoints do not agree.

Terms and definitions of terms do not help us much, but facts remain facts however we view them. If a man should borrow all the capital for his business, at what point would his costs terminate and his profits begin? If we were to take his point of view, it would have to be that no profits could accrue until interest as well as insurance and other general charges had been covered. It is beside the mark to say that the interest he would have to pay should be considered as a part of the profits payable to the lender. So far as he is concerned, there can be no profits to him until his interest has been earned, and it certainly is part of his cost of doing business.

That interest rates are variable does not affect the fact—other elements are variable likewise—material and labor are variables when one location is compared with another, yet they must be treated as costs quite as surely as if they were everywhere the same.

If a contract were taken for the construction of some special machine tools, on the basis of cost and a percentage, and this contract required one-third of the plant capacity and one-third of the working capital for a given period, it seems clear that no accurate record of costs could be made that did not include interest as one of the elements of production. No true comparison could be made as to the relative advantage of special as against regular classes of output without including in the costs of each the interest item.

In many classes of industries the distribution of the interest as an element of production costs might be considered as an un-
necessary refinement of accounting. In textile production, for example, where the variation of costs of different classes of output is determined so largely by the difference in cost of material, and where the labor and machine usage elements are practically the same for all outputs, it may be quite possible to treat the interest item as a whole, rather than to distribute it through production. Even in such instances, however, the relative economy of using one type of machines over another type is affected by interest considerations.

In the opinion of the writer, the manner in which interest shall be expressed depends very largely upon the conditions obtaining in each instance, the character of the business and the output and the uniformity or variations thereof. In other words: What is it you ought to know? Determining this, how should this knowledge be obtained?

Interest Should be Included as Part of the Cost

BY J. LEE NICHOLSON

The writer firmly believes in the theory that interest on capital invested should be charged to the proper expense accounts before ascertaining the actual profit from manufacturing or trading.

There is a large difference in risk between capital invested in stocks, bonds and real estate and capital invested in manufacturing or other commercial undertakings; and it is not to be disputed that capital invested in commercial enterprises is liable to far greater risk than that of capital invested in securities. It is only fair that the capital invested in commercial enterprises should have credit for at least the same return as that in securities before a trading profit is shown.

The two articles in the April number of The Journal by Wm. Morse Cole and A. Hamilton Church give such logical reasons for the inclusion of interest as a part of the cost that the writer desires to quote the following paragraphs as aptly setting forth his views:

"Prices must be fixed at such a point that they shall at least cover (1) materials, or goods; (2) labor, or service; and (3) expense burden, or what are commonly called 'overhead charges.' Obviously, if the last of these is not quite fully covered, the continuance of production or
Treatment of Interest on Manufacturing Investment

service is not economically advisable (unless, of course, the work serves other purposes than those which are immediately connected with the initial enterprise). If, again, the income provided by the price gives less than a proper amount as interest on the investment—investment in the form of capital locked up in machinery, facilities, material, or waiting produce—the return is not economically sufficient to make the enterprise self-supporting. If this interest is not included in the expense burden, therefore, it must be added later, somewhere, before one can know whether the return is adequate to make the enterprise self-supporting. Since one of the purposes of accounting is to show whether the return is adequate, the interest would seem necessarily to be involved somewhere in the accounting.”

W.M. Morse Cole.

“Wherever capital is made use of, whether in the power plant, in the erection of buildings, or in the purchase of costly special machinery, the use of such capital has to be paid for, somehow and somewhere. It is only rational that it should be paid for by just those processes (and therefore those jobs) which involve its use. To exclude interest charge from cost of these jobs is to ignore one of the most important matters that we should know, namely—how far this use of capital is economically justified.”

A. Hamilton Church.

The citing of some examples may tend to throw additional light on this most interesting subject.

Take, for example, a textile plant. This plant comprises a yarn mill, a weaving mill, and a knitting mill. The yarn mill manufactures the yarn for both the other mills. As there are many mills manufacturing yarn exclusively, this company is in position either to buy yarn or manufacture it itself.

The prime question of importance in reference to the yarn mill is whether or not it is profitable to maintain this mill considering the capital tied up. The capital invested in this particular mill, we will say, amounts to $200,000.00. If the yarn were bought instead of manufactured, this $200,000.00 could be invested in other departments of the business, or invested to draw interest for the company, or distributed to the stockholders, thereby allowing them to invest the proportion they receive at interest.

It is the writer’s opinion, considering that the total investment is used in manufacturing, that it is necessary to charge the interest of the investment to the cost of production. No true
The Journal of Accountancy

comparison can be made between the cost of the yarn manufactured and the purchase price of yarn, unless the interest is charged as stated.

For another illustration let us take a plant manufacturing axles, one mill being located in the east, and another one in the west, both plants manufacturing exactly the same product. The western plant was recently established to meet western competition, and, as the cost of freight is a large item, the advisability of this matter can be readily understood. In the western plant the machinery was purchased, but the building and grounds were leased for twenty-one years, with the privilege of purchase at the expiration of that time. The eastern plant was owned in its entirety. The company therefore had a rental charge against manufacturing in one plant, and no charge for rental in the other. This company had not, up to this time, ever charged interest against its manufactured product, and now the question arose as to how to compare the costs between the eastern plant and the western plant. As all other elements were equal, and no interest was charged on the capital used in manufacturing in the eastern plant, the result would necessarily show that the cost was greater to manufacture goods in the west than it was in the east. The question was naturally settled by the eastern plant charging against the cost of production interest for that part of the capital used in the manufacture of the product in the east. In no other way could a comparison of production costs be made. The opponents of interest charged as costs perhaps would claim that the rent of the western plant would be charged as administrative expenses. In answer to this, I would say that whatever expense is necessary to operate a plant must be charged against the cost of the product if true costs are to be obtained. It is just as necessary to have buildings and grounds in connection with a manufacturing establishment, as it is to have machinery and workmen for turning out the product.

Suppose we take it for granted that the concession is made that the rent of a building, used only for manufacturing purposes, should be charged as cost of production. Why, then, should not the interest on the capital invested—where the building is owned—be charged against the cost of the product?

Fundamentally, the question is whether or not interest on capital should be charged as an expense of doing business. If
Treatment of Interest on Manufacturing Investment

it is conceded that interest should be so charged, surely no one can seriously make an argument that this charge should not be allocated over those elements of business where the capital is invested.

It may be of interest to the readers of The Journal to submit a few additional opinions besides those contained in the April number.

In Cost Accounts by L. Whitten Hawkins, page 109, he says:

"No charge should be made in cost accounts for the services of a principal, nor for interest on his own capital. Whatever return is produced by this is profit, and not an expense of manufacture."

In the bulletin of the American Economic Association, pages 119 and 120, Arthur Lowes Dickinson is quoted as stating:

"The manner in which capital is provided cannot affect the cost of manufacture."

This statement was referred to by Wm. Morse Cole in the same bulletin, pages 129 and 132, from which the following quotation is taken:

"Mr. Dickinson and I, you see, are in perfect agreement as to what we want—namely, isolation of causes; but the line of cleavage between causes we are inclined to draw differently. Mr. Dickinson, conceiving profit to be a certain surplus divisible between all three of the agents of production—labor, land, and capital—wishes to exclude all interest from cost; while I, conceiving profit to be only what is left after rent, pure interest, and wages have been paid—that is, virtually the compensation for risks taken—wish pure interest, and pure interest only, to count as a cost. Many accountants count as cost all interest on investment, including all risk elements."

J. C. Duncan, in the same bulletin, pages 146 and 147, also in answer to Mr. Dickinson, states:

"To the speaker's mind all such charges are really direct additions to the cost of production, and should be apportioned directly to the various departments involved. Rent and interest should not be regarded as divisions of profits, because profit does not start until provision is made for these items."
The Journal of Accountancy

F. E. Webner, in his book Factory Costs, in commenting on Mr. Dickinson's views, writes as follows:

"From the standpoint of practical costing, Mr. Dickinson's logic is not satisfactory. The interest on an investment in plant and equipment or rent paid for use of factory would seem to be almost as direct an incident of cost as labor, material, power, or incoming freight. It is obvious that the manufacturer cannot make his product without a plant, and its rental or interest charge is usually one of the first incurred manufacturing expenses. Why, then, should it be differentiated from all other manufacturing expenses and be excluded from the cost of product?"

Mr. Webner, in commenting on the views of J. C. Duncan, on page 155 of his book, has this to say:

"It is very obvious that rent of factory buildings and interest on money invested in factory and for manufacturing purposes must appear in some way in the cost of conducting the business, whether they be regarded as production costs or as a division of profits. From the practical standpoint any cost necessarily incurred in the production of goods is most conveniently and most safely included in production costs."

On page 47 of Multiple Costs by Stanley Gerry is the following quotation:

"We may even carry this a stage further, and also charge to the factory interest on the stocks of raw material on the same basis, for whatever advantage accrues to the factory from the employment of extra capital the cost of same should appear as a charge against its efficiency."

Interest Does Not Enter Into the Cost of Production

By J. Porter Joplin, C.P.A.

The prime object in obtaining the cost of manufactured goods, merchandise to be sold, or some commodity to be supplied to the public, is to assist in determining the price for which the merchandise or commodity can be sold and allow a reasonable and fair margin of profit; also to enable manufacturers, producers or dealers to compete intelligently in the open market. Another reason why a correct cost accounting is desirable is the demand for and the necessity of a correct or fair value of all merchandise or products which would enter into the balance sheet as an asset when such balance sheet is needed or is in demand.
Treatise of Interest on Manufacturing Investment

In determining the cost of manufactured goods it is necessary to know what has gone directly into such goods, such as labor and material, to which should be added its correct proportion of overhead charges or burden; and when goods, product, or material of any description is manufactured or created through power, or machinery, or fixtures a fair figure for depreciation on the machinery used should be added.

Why the question of interest should enter into the cost of material or manufactured goods has not been cleared up with any degree of satisfaction by the exponents of this view. It is a fundamental principle that when goods are bought or manufactured to be sold, no profits are to be considered until a sale is perfected, and yet by following out the plan of charging interest in determining costs a profit is taken (on paper) at an early stage of the proceedings. Neither does it seem logical to charge interest on an amount invested in certain machinery when the machinery is only one factor in the invested capital needed to produce the product on which the cost is to be determined, and in some cases a factor of the least magnitude. As a general principle it would seem not to serve the end for which it was intended, and is a most undesirable practice.

A balance sheet prepared along lines where interest has been included in determining the value of goods in process or of manufactured articles is open to severe criticism and it is doubtful if a balance sheet so prepared would be accepted as being sound in premise. It certainly would not be viewed with the same favor when seeking additional working capital or a temporary loan as the one presented where no interest has been figured in determining the value of the product on the basis of cost.

Invested capital most certainly has its place, and is considered in due course at the end of each closing period. After all charges against profits have been made, including interest on borrowed money, and fixed charges such as interest on bonded indebtedness, it receives the residue, either in the form of dividends, or added book value to the capital stock as reflected in the surplus of an incorporated company, or in the capital account of an individual or of a firm of individuals.
Determination of the Income Rate of Investment

By Bertram D. Kribben, C.P.A., LL.B.

The precise determination of the income rate of investments is a problem which, though rarely resorted to in commercial circles, occasionally confronts the accountant. Comparatively few accountants are proficient in the use of logarithms, and for the purpose of illustrating a sufficiently accurate method by which the income rate of investments may be determined without the use of logarithms, the writer submits the following method. It is based on the methods of successive approximations coupled with interpolation.

The values of an investment do not vary in the same ratio of progression in which the income rate varies, but they vary with the power of the rate. Hence when large values are to be computed, or the investment has a long time to run, simple interpolation is inaccurate. Simple interpolation is also insufficiently accurate when the required argument exceeds one-half of the difference of the arguments employed. But when the investments are comparatively small simple interpolation will, in the majority of cases, be sufficiently exact.

The doctrine of interpolation is thus stated by Professor Chauvenet:

Let $T, T + w, T + 2w, T + 3w$, etc., express equidistant values of the variable; $F, F', F'', F'''$, etc., corresponding values of the given function; and let the differences of the first, second and following orders be formed as expressed in the following table:

<table>
<thead>
<tr>
<th>Argument</th>
<th>Function</th>
<th>1st diff.</th>
<th>2d diff.</th>
<th>3d diff.</th>
<th>4th diff.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$T$</td>
<td>$F$</td>
<td>$a$</td>
<td>$b$</td>
<td>$c$</td>
<td>$d$</td>
</tr>
<tr>
<td>$T + w$</td>
<td>$F'$</td>
<td>$a'$</td>
<td>$b'$</td>
<td>$c'$</td>
<td>$d'$</td>
</tr>
<tr>
<td>$T + 2w$</td>
<td>$F''$</td>
<td>$a''$</td>
<td>$b''$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$T + 3w$</td>
<td>$F'''$</td>
<td>$a'''$</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$T + 4w$</td>
<td>$F''''$</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The differences are to be found by subtracting downwards, that is, each number is subtracted from the number below it,
Determination of the Income Rate of Investments

and the proper algebraic sign must be prefixed. The differences of any order are formed from those of the preceding order in the same manner as the first differences are formed from the given functions. The even differences (2d, 4th, etc.) fall in the same lines with the argument and function; the odd differences (1st, 3d, etc.) between the lines.

Now denoting the function corresponding to a value of the argument $T + nw$ by $F^{(n)}$ we have from algebra:

$$F^{(n)} = F + na + \frac{n(n-1)}{1.2} b + \frac{n(n-1)(n-2)}{1.2.3} c + \frac{n(n-1)(n-2)(n-3)}{1.2.3.4} d + \text{etc.}$$

in which the coefficients are those of the $n^{th}$ power of a binominal.

In the formula the interpolation sets out from the first of the given functions, and the differences used are those of their respective orders. If $n$ be taken successively equal to 0, 1, 2, 3, etc., we shall obtain the functions of $F$, $F'$, $F''$, $F'''$, etc., and intermediate values are formed by using fractional values of $n$. We usually apply the formula only to interpolating between the function from which we set out and the following one, in which case $n$ is less than unity. To find the proper value of $n$ in each case let $T + t$ denote the value of the argument for which we wish to interpolate a value of the function; then

$$nw = t \quad n = \frac{t}{w}$$

that is, $n$ is the value of $t$ reduced to a fraction of the interval $w$.

The formula therefore becomes for simple interpolation:

$$F^{(n)} = F + n[a + \frac{n-1}{2} (b + \frac{n-2}{3} (c + \frac{n-3}{4} + \text{etc.}))]$$

But when the powers of the fractional part of the argument are required it becomes:

$$F^{(n)} = F + n[a + \frac{b}{2} + \frac{c}{3} + \frac{d}{4} + \frac{e}{5}, \text{etc.}]$$

$$+ \frac{n^2}{1.2} (b - c + \frac{11d}{12} - \frac{5e}{6} +), \text{etc.}$$

$$+ \frac{n^3}{1.2.3} (c - \frac{3d}{2} + \frac{7e}{4} +), \text{etc.}$$

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In the problem to be presented the terms beyond c become insensible.

Let us now take a problem with which an accountant is liable to be confronted in his practice. The amounts and the periods are both stated at large amounts so that the full effect of the method may appear, and inasmuch as bonds or investments are more frequently bought between interest maturity dates than on them the problem is thus stated:

Required the income rate on $1,000,000—3½% per annum interest bearing bonds, interest payable semi-annually, dated January 1, 1907, maturing in thirty years, bought March 20, 1912, for $948,000.00.

The first step is to determine approximately the amount of the 50 period function.

An inspection of bond tables shows that the function required, .94022222, lies between 50 and 49 periods at both of the rates .0195 and .01925. We therefore use the function for 50 periods at the rates .0195 and .01925 respectively for the purpose of obtaining a tentative argument, and inasmuch (as will appear later) as we shall, for the purpose of accurately determining the rate, need, according to the method of interpolation, at least four successive functions, we further use the functions for the arguments .019 and .01875 thus:

<table>
<thead>
<tr>
<th>Argument rate</th>
<th>Function value</th>
<th>1st diff.</th>
<th>2d diff.</th>
<th>3d diff.</th>
</tr>
</thead>
<tbody>
<tr>
<td>.0195</td>
<td>.93648705</td>
<td>.00764444</td>
<td>.00008222</td>
<td>.00000096</td>
</tr>
<tr>
<td>.01925</td>
<td>.94470149</td>
<td>.00772566</td>
<td>.00008318</td>
<td>.00000084</td>
</tr>
<tr>
<td>.019</td>
<td>.95281813</td>
<td>.00780984</td>
<td>.00008222</td>
<td>.00000096</td>
</tr>
<tr>
<td>.01875</td>
<td>.95996799</td>
<td>.00789084</td>
<td>.00008318</td>
<td>.00000084</td>
</tr>
</tbody>
</table>
Determination of the Income Rate of Investments

Then we compute an approximate rate in which we denote the tentative function required .94022222 by y, thus:

<table>
<thead>
<tr>
<th>Argument</th>
<th>Function Value</th>
<th>Function Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>.0195</td>
<td>.93648705</td>
<td>.93648705</td>
</tr>
<tr>
<td>.01925</td>
<td>.94413149</td>
<td>.94022222</td>
</tr>
<tr>
<td>Difference</td>
<td>.00025</td>
<td>.00764444</td>
</tr>
</tbody>
</table>

Solving the equation we have as the value of $x$, .000122
Argument

<table>
<thead>
<tr>
<th>Argument</th>
<th>.0195</th>
</tr>
</thead>
</table>

Tentative rate

.019378

We next recompute the present value of $948,000$ at this rate. It involves work unless logarithms are used. The value is expressed by the problem .948000 ÷ (1 + .019378)^4/9. The answer is .93994800, very nearly and sufficiently exact for present purposes. Substituting this as the new value of y we restate the equation, the last member becoming .939948 - .93648705 = .00346095, and we have .00025 : .00764444 = $x : .00346095$.

Hence $x$ is .000113
Argument

<table>
<thead>
<tr>
<th>Argument</th>
<th>.0195</th>
</tr>
</thead>
</table>

New rate

.019387

Recomputing the function y, with this value we find it to be .93994433 very nearly. This is substantially within a few cents of the 50 period value.

We now compute its value by the formula:

$$F(n) = F + n(a - 1/2b + 1/3c) + \frac{n^2}{2} (b - c) + \frac{n^3}{3}$$

This is sufficient as the remaining terms are insensible and we have

$$w = .0195 - .01925 = .00025; t = .0195 - .019387 = .000113.$$
We have from the approximation \(0.00025 = 0.00764444\), therefore \(0.00001 = 30.578\), and to obtain the correction for the rate we have

\[
\frac{0.00001210}{30.578} = \frac{0.000004}{0.0193870} = \text{correction}
\]

and we have as the rate

\[
0.0193866
\]

This rate computed for 50 periods gives \(0.93994446\), within \(0.00000003\) of the function required and leaves in practice 3 cents to be distributed over 50 periods of accumulation and renders any recomputation of the present value of \(y\) with this rate superfluous.

The precision of this method is doubtless worthless from a commercial standpoint. It has value, however, for the student and the accountant, so that if it be required of him to state actually the values of investments he may have a method involving less work than he might otherwise have.
The Accounting of Interest and Discount on Notes

By John Bauer

Assistant Professor of Economics, Cornell University

Second Article

In the preceding article, the cycle of the interest account was completed, the various items having been followed through a regular financial period. We now turn to a critical examination of the account itself.

Theoretically the nature of the different entries in the interest account can be explained from first to last according to correct principles. We are concerned throughout with asset and liability values and their changes, and not with earnings and costs, as is usually assumed. But it is nearly impossible for a beginning student to follow the abstruse and complicated relationships without confusion. Even a person understanding the account pretty thoroughly is likely to fall into momentary confusion in explaining a particular entry. As a matter of fact, the great majority of writers are either altogether wrong in their explanation of the entries, or they make no pretense of explanation, satisfying themselves with mere rules.

From a practical standpoint we may make the following principal criticisms against the Interest account:

(1) It does not give sufficient information about the business. It is not enough for the manager to know what were the net interest gains above costs, or net costs above gains, for a period. He should know separably what were the gains and what the costs. The two have no dependence upon each other; the gains come from notes receivable and the costs from notes payable—why should the two be balanced against each other? Certainly, to find the standing of the business you would not balance notes payable against notes receivable. Is it any more desirable to balance the returns realized from the one against the costs of the other?

As a matter of fact, the manager of the business should know in detail the facts relating to earnings and those relating to-
costs. He should know not only the complete interest earnings, but also those from the different classes of notes, e.g., mortgage or unsecured, interest bearing or non-interest bearing. Likewise he should know not only the total interest costs, but also those from different classes of obligations. Obviously these facts cannot be secured from the Interest account as it stands, except through a great deal of separate analysis and calculation. An account should show clearly and directly its share of the facts and results of the business. The Interest account falls far short of this standard.

(2) It has no statistical value. For statistical purposes, the items of the account should be homogeneous; the debits should represent one certain kind of transactions, and the credits a certain kind; then the sum of the debits for the period should represent something distinctive, likewise the sum of the credits; the debits and credits should be definitely related and their balance should show a precise fact or result of the business. Look at the Interest account: the entries are mixed and confused; they have no clear relations to each other; the sum of debits signifies nothing, nor does the sum of credits. Statistically the account is worth exactly nothing, and it is the statistical end of accounting that is becoming more and more important to proper control of the business.

(3) When the third class of entries during the period is omitted, which is usually the case both as the account is taught by most texts and as it is employed by most business concerns, even the net results are vitiated. The net earnings or net costs may be over or under stated. Perhaps two illustrations will suffice to bring out this point clearly.

Suppose during the month a note of $1,000 is acquired with interest accrued $30; Notes Receivable is debited $1,000, but the interest accrued, $30, which should be debited to Interest, is neglected. Now, at the end of the month in calculating the interest accrued on notes receivable, $32 is included for the note in question, allowing an extra accrual of $2 for the time the note was held by the business. The $32 appears then as a credit in red ink, and, since it has no offsetting debit anywhere, obviously the effect is to show earnings of $32 for the month—a gross and indefensible misstatement. If, however, the $30 interest accrued had been properly debited when the note was
first acquired, this would appear as an offset to the $32 red ink credit at the end of the month, and there would appear then only $2 earning for the period on the note in question—which would be proper. The $30 interest accrued when the note was acquired could in no sense be regarded as earnings of the business. It was an asset, and if it was not debited then as it should have been, and was included in the inventory of assets at the end of the period, it resulted in showing unwarranted gains—which, if taken out of the business, would constitute withdrawal of capital and not profits.

Again, suppose there was acquired during the period a non-interest bearing note of $1,000 with sixty days to maturity. Notes Receivable is debited $1,000, but the discount of $10, which should be credited to Interest to show the real value of the note, is neglected. But, at the end of the period a calculation of the discount due on all notes receivable is entered as a red ink debit to Interest. Now, in reference to the one note in question there is a discount of $8; since there is no offsetting credit, the showing is a cost of $8—which is absurd. Notes receivable should produce earnings, not costs. If, however, the $10 discount due when the note was acquired had been properly credited, then with the $8 discount due at the end of the month debited, this showing would be correct, namely earnings of $2 for the period on the note in question.

Likewise, if the interest accrued or discount due on notes payable is disregarded when notes are assumed by the firm during the period, the results are wrong. In the first case, the interest costs are grossly overstated, and in the second earnings are shown instead of costs—which is ridiculous.

To be sure, in a business where few notes are handled, these inaccuracies are not a matter of great importance, and perhaps, since their effect is in opposite directions, they largely counterbalance each other. The latter proposition is likely to apply particularly to a business handling large amounts of all kinds of notes. Still, they are inaccuracies, and in so far as they are allowed they prevent the manager from knowing as definitely as he should where the business stands and what it is doing.

Properly to meet the criticisms that have been made, the general Interest account should be broken up into six individual accounts. Four of these are directly connected with Notes Re-
receivable and Notes Payable and constitute subsidiary asset and liability accounts, and two are pure proprietorship accounts, which finally are closed into Loss and Gain.

The individual accounts are (1) Interest Accrued on Notes Receivable, (2) Discount on Notes Receivable, (3) Interest Accrued on Notes Payable, (4) Discount on Notes Payable, (5) Interest Earnings, (6) Interest Costs.

(1) Interest Accrued on Notes Receivable has to do with interest bearing notes owned by the business. The face value of these notes is recorded in Notes Receivable account and the values above face should appear in Interest Accrued on Notes Receivable. The form of the account and the various entries are as follows:

INTEREST ACCRUED ON NOTES RECEIVABLE

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. At the beginning of the period: interest accrued on notes receivable.</td>
<td>1. During the period: interest payments on notes receivable.</td>
</tr>
<tr>
<td>2. During the period: interest accrued on new notes receivable acquired by the business.</td>
<td></td>
</tr>
<tr>
<td>3. At the close of the period: interest accrued during the period on all notes owned by the business during that time. (The corresponding credit goes to Interest Earning.)</td>
<td></td>
</tr>
</tbody>
</table>

This is a pure asset account. At the beginning of the period there is debited the total interest accrued at that time, an asset of the business. In all subsequent entries, the debits are increases and the credits decreases in this form of assets. There are two kinds of increases and one kind of decrease. The increases are due (1) to any interest accrued on new notes receivable acquired by the business,* and (2) to interest accruals due to passage of time; † Any decrease is due to interest payments received.‡ At the close of the period, the balance of the account

*Suppose a $1,000 note with $30 interest accrued is acquired; Notes Receivable is debited $1,000, and Interest Accrued on Notes Receivable, $30; both debits represent increases in asset value.
†Interest accrues day by day, i.e., the value of any note owned grows daily larger, and so might be debited daily. But that would be rather impracticable, and to save time the accruals for the entire period are debited in one entry at the close of the period.
‡Suppose $100 cash for interest due is received, at the moment payment is received the value of interest accrued suddenly decreases by $100 and cash obviously increases. Consequently Interest Accrued on Notes Receivable is credited and Cash is debited. There is merely an exchange of asset values.
The Accounting of Interest and Discount on Notes

is an asset, showing the value of interest accrued at that time on all notes owned by the business.||

We have seen that the interest accruals for the period are debited in one entry at the close of the period—representing asset increases for the time covered. Now, what should be the corresponding credit? Since there is no corresponding decrease in any other form of assets, obviously there is a pure gain and the credit is an increase in proprietorship. Suppose, we provide an Interest Earnings account. Then from the asset standpoint, the increase in value is debited to Interest Accrued on Notes Receivable, as has been explained, and from the proprietorship standpoint, it is credited to Interest Earnings. This account will be considered separately later in the discussion.||

(2) The second account to be considered is Discount on Notes Receivable. It has to do with non-interest bearing notes owned by the business and like the foregoing account is subsidiary to Notes Receivable. Remember that non-interest bearing notes owned by the business are debited to Notes Receivable at their face value, which represents a future, not real, value. The difference between face and real value is recorded in Discount on Notes Receivable. The form of the account and the entries are as follows:

DISCOUNT ON NOTES RECEIVABLE

Dr.  
1. During the period: discounts allowed on notes receivable when prepaid.  
2. At the close of the period: all decreases in discounts on notes held during the period due to the passage of time. (The corresponding credit goes to Interest Earnings.)

Cr.  
1. At the beginning of the period: discount due on notes receivable.  
2. During the period: discount due on new notes receivable acquired by the business.

In theory this must be considered a negative asset account, but it is one of a rather peculiar nature. Usually negative asset accounts deal with liabilities, but this merely represents

||This becomes the first entry of the next period. If the interest accruals were debited day by day as they take place, then a balance of the account could be taken at any moment and it would show the total value of interest then accrued on all notes receivable. Ideally it should be possible to take such a balance any day, but practically it is enough if it is taken at the end of every week or month.

||If accruals were recorded day by day as they take place, from the asset standpoint they would be debited daily to Interest Accrued on Notes Receivable, and from the proprietorship standpoint credited daily to Interest Earnings.
an offset against overvalued positive assets carried in Notes Receivable. At the beginning of the period we have credited the discount due on all non-interest bearing notes owned by the business at that time. This credit combined with the face value debited to Notes Receivable gives the real value of the notes. Then all increases in discount due are credits and all decreases are debits. Since with the passage of time the value of the notes becomes greater and greater and the offsetting discount therefore smaller and smaller, there can be only one kind of increase, namely, through the acquisition of new non-interest bearing notes by the business.* But, there are two kinds of decreases in discount, (1) those due to the prepayment of notes,† and (2) decreases due to the passage of time, i. e., the notes increase in value day by day as they approach maturity and the offsetting discount value correspondingly grows smaller.‡ The balance of the account at the close of the period shows the discounts then due on all notes owned by the business.

We have seen that the decrease in discount due to the passage of time is debited. What is the corresponding credit? From another view, this decrease is really an increase in notes receivable values. Since with this increase there is no corresponding decrease in some other form of assets, the corresponding credit must be an increase in proprietorship; it is a gain realized from the notes through the passage of time. This should be credited to Interest Earnings account.||

(3) The next account that we have to consider is Interest Accrued on Notes Payable. It has to do with interest bearing notes owned by the business. It is in nature just the reverse

* Suppose a $1,000 note due in 60 days is acquired. Notes Receivable is debited $1,000, and Discount on Notes Receivable credited $10, the two combined giving the real value of the note.
† Someone pays you a $1,000 note with still 60 days to maturity; you credit Notes Receivable $1,000, debit Cash $990, and debit Discount on Notes Receivable $10, the latter being a sudden decrease in this form of negative assets. The payment cancelled not only $1,000 in Notes Receivable but also $10 offsetting value in Discount on Notes Receivable.
‡ These decreases in discount might be debited daily as they take place, but practically it is sufficient if they are entered in a lump sum at the close of the period.
|| Interest is the increase of value due to the passage of time; it is value created by time. An interest-bearing note, if its rate is equal to the market rate, is worth exactly its face at the moment of issue, and then becomes more and more valuable as time passes and interest accrues. A non-interest bearing note at the moment of issue is worth a sum which with regular interest (approximately) to maturity is then equal to the face value. In either case, the value of the note increases as time goes on. From the note standpoint, the increase in either case is an asset and is debited; from proprietorship standpoint it is a gain and is credited. The nature of the gain is exactly the same in either case, and should be so shown in the accounts. The gains should be credited to the Interest Earning account.
of Interest Accrued on Notes Receivable discussed above. It is connected with Notes Payable just as the other is connected with Notes Receivable. The form and entries of the account follow:

**INTEREST ACCRUED ON NOTES PAYABLE**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. During the period: interest payments made on notes.</td>
<td>1. At the beginning of the period: interest accrued on notes payable.</td>
</tr>
<tr>
<td>2. During the period: any interest accrued on new notes payable assumed by the business.</td>
<td>2. During the period: any interest accrued on new notes payable assumed by the business.</td>
</tr>
<tr>
<td>3. At the close of the period: interest accrued during the period on all notes owed by the business during that time. (The corresponding debit goes to Interest Costs.)</td>
<td>3. At the close of the period: interest accrued during the period on all notes owed by the business during that time. (The corresponding debit goes to Interest Costs.)</td>
</tr>
</tbody>
</table>

This is a pure negative asset or liability account. It records a debt owed by the business. At the beginning of the period, it has credited the total interest accrued on notes payable at that time. The face of the notes credited to Notes Payable, plus the interest accrued credited here, gives the real value of the notes owed by the business. All subsequent credits to the account are increases in interest accrued against the business, increases in liability; all the debits are decreases.

On account of previous discussions it is not worth while to analyze the individual items. At the close of the period, after all entries have been made, the balance of the account is the amount of interest then accrued against the business, or, if the accruals are credited daily as they take place, such a balance could be taken at any moment.

Observe the third credit entry, the interest accrued during the period on notes owed by the business during that time. This is an increase in liability due to the passage of time. Since there is no corresponding increase in assets, the corresponding debit must be a decrease in proprietorship. This is a cost incurred from the notes through the passage of time and should be debited to Interest Costs.

(4) The fourth account is Discounts on Notes Payable. Again in view of previous discussions it is not worth while to analyze the account extensively. It is subsidiary to Notes Pay-
able and has to do with non-interest bearing notes owed by the business. It is the reverse of Discount on Notes Receivable. The form and entries are as follows:

**DISCOUNT ON NOTES PAYABLE**

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. At the beginning of the period:</td>
<td>1. During the period: discounts received on notes payable when prepaid,</td>
</tr>
<tr>
<td>discount due on notes payable.</td>
<td></td>
</tr>
<tr>
<td>2. During the period: discount on new notes payable assumed by the</td>
<td>2. At the end of the period: all decreases in discounts on notes receivable owed during the period, due to the passage of time. (The corresponding debit goes to Interest Costs.)</td>
</tr>
<tr>
<td>business.</td>
<td></td>
</tr>
</tbody>
</table>

At the beginning of the period, the debit entry is a present offset against the future values credited to Notes Payable. At the end of the period, after all entries have been made the balance is the offset which then stands against Notes Payable. Again, if the decreases in the discount were debited as they take place, such a balance could be taken at any time. But, again, periodical balances are sufficient.

With the lapse of time, the notes approach nearer to maturity, their value increases, and the discount therefore decreases. This is a credit entry which resolves itself into an increase in liability. Since there is no corresponding increase in positive assets, the corresponding debit must be a decrease in proprietorship; it is a cost of the business and should be debited to Interest Costs.*

(5) The next two accounts are altogether different in nature from any of the foregoing. They are fundamentally proprietorship instead of asset accounts. So far, except incidentally, the increases in value due to the passage of time have been regarded primarily from the standpoint of the notes, and not from their effect upon proprietorship. Now we shall regard them, not as additions to note values owned or owed, but as earnings or costs of the business. The increases are the same as before but are viewed from a different standpoint. Consequently where before we had a debit, we now have a credit, and *vice versa*.

The first of the two accounts is Interest Earnings. The form and entries are as follows:

*Just as all notes receivable earn interest for the business, so all notes payable, with or without interest, earn interest against the business.*
The Accounting of Interest and Discount on Notes

INTEREST EARNINGS

Dr. Cr.

At the close of the period:
1. Interest accrued during the period on all notes receivable owned by the business during that time. (Corresponding debit appears in Interest Accrued on Notes Receivable.)
2. Decreases in discounts due on notes receivable held during the period, the decreases being due to the approaching maturity of the notes. (The corresponding debit goes to Discount on Notes Receivable.)

This is a pure account, recording increases in proprietorship, and only those due to the working of time. We enter here interest earnings and nothing else. However, we record real earnings, not apparent; we include those from non-interest bearing notes receivable as well as from the interest bearing, and only the earnings that belong to the period. Necessarily the entries are all credits and are made at the close of the period, at the moment when the adjustments are made in the subsidiary notes accounts discussed above.*

This account might well serve to bring together all interest earnings for the period, however realized. Thus it might include not only the items recorded above but also interest earnings of bonds, mortgage notes, and personal accounts. In this way it would be of considerable statistical value, showing clearly the interest earning from various sources from period to period.

Obviously the account contains credit entries only. When all interest earnings are recorded for the period, they are summarized and are then transferred and credited to Loss or Gain, General Income, Surplus, or some subsidiary proprietorship account.

(6) The last account to be considered is Interest Costs. Its form and entries are as follows:

*However, the entries may be made daily as the earnings are actually realized, although this would be a waste of time in practice.
INTEREST COSTS

Dr. 

At the close of the period:
1. Interest accrued during the period on all interest bearing notes owed by the business during that time. (The corresponding credit appears in Interest Accrued on Notes Payable.)
2. Decreases in discounts due on notes owed during the period, the decreases being due to the approaching maturity of the notes. (The corresponding credit appears in Discount on Notes Payable.)

We need not discuss this account extensively. It is a pure account, dealing with decreases in proprietorship and those only that are due to the working of time. It records the interest costs exactly as the previous account records the earnings, and its purpose and serviceability are the same. It contains debit entries only, which, when summarized, are transferred to Loss and Gain or other proprietorship accounts.

So much, then, for the rather tedious analysis and presentation of the principles of interest accounting. It would seem that the analysis here presented is superior in every way to the general Interest account as taught and practised. The advantages may be briefly summarized as follows: (1) The nature of the accounts is more easily perceived and readily explained; there is less danger of theoretical confusion. (2) Each account shows clearly a definite set of facts; there is not a jumble of unrelated items; clear statistical records are kept, and the costs and earnings are definitely shown for the convenience of the business.

There is but one objection—more work is required than with the old Interest account. However, the additional work is amply justified by the clearer and more definite results. With a concern which handles a large number of notes the additional work is almost negligible. Perhaps where very few notes are handled the old accounts may well be continued. Otherwise such a course is not in accord with good modern theory or practice of accounting.
The Proposed Tax on Incomes

It was to be expected that the income tax bill as submitted to the House of Representatives would meet with a considerable amount of adverse criticism. It would be difficult to imagine any bill of so far reaching a character which would not excite keen opposition, and no doubt the makers of this bill fully expected to be the butt of abuse from many different sections of the country. But looking at the matter impartially it may be admitted at once that, while the bill is far from perfect, it is so great an improvement upon previous legislation of a similar character that the warmest praise should be accorded to the legislators who are responsible for its making.

We make no argument for an income tax as such, and readily admit the force of opposition to the principle, but recognizing the certainty that such taxation will become law, it is necessary to consider its probable application.

It has been said by a well-known authority on legislation that there was deeper ignorance on the subject of income taxation than upon almost any other class of legislation which could be mentioned. It was thought apparently even by some of the mem-
bers of the ways and means committee, that in the case of the income tax all that was necessary was to specify that incomes in excess of a certain amount should be taxed and that the method of taxation might safely be left to the officers of the treasury department. There was an astonishing lack of interest on the part of the public in the preparation of the income tax section of the Underwood tariff bill. Every business man and a large percentage of investors were so intimately interested in the provisions of the section of the bill dealing with the customs tariff upon imports that they entirely overlooked or deemed of no particular moment the section which embodies provisions for the taxation of income. Fortunately, however, the drafting of this bill was left in capable hands and the subcommittee appointed to this particular duty was ready to listen to expert advice, and has honestly endeavored to introduce into the bill such phraseology as will ensure a workable business-like act.

Times out of number mention has been made of the impracticable and futile provisions of the corporation tax law, and accountants generally have been kept informed of the campaign undertaken by the American Association to secure an amendment of that law which would permit corporations to adopt the fiscal rather than the calendar year. Now, however, this amendment has been dropped because in the passage of the income tax bill—which is comparatively certain—the corporation tax law will be repealed and its absurd provisions can work no further injury.

It would be foolish to pretend that the Underwood tariff bill in so far as it concerns incomes is ideally perfect. Indeed, in one particular at least, it is far from being what accountants and business people would desire to have it. This is in the regulations relative to the reports of individual income. In the case of corporations, joint stock companies and insurance companies the bill provides that the fiscal year shall be permitted to be the basis of inventory and report but this permission is not extended to individuals. In support of this differentiation the framers of the bill maintain that by collection at the source of income the amount of tax to be collected directly from the individual is comparatively small and therefore the right to use the fiscal year is unimportant, but it must be remembered that the law makes no levy upon partnerships and therefore in or-
Editorial

der to reach the income of partnerships the tax will be collected from the income of the several partners. Such income must be based upon the revenues of the partnership or firm, and it requires no argument to prove that a vast number of unincorporated firms find it almost compulsory to adopt a fiscal period not coincident with the calendar year.

But, while we may regret the failure of the legislators in Washington to extend the fiscal privilege so far as we wish, we may feel profoundly thankful that the utterly ridiculous regulation whereby the calendar year was made obligatory in regard to corporation inventories and reports has been avoided in the preparation of this superseding bill.

In the original draft there were certain ambiguities which it was felt might render difficult the administration of the law, and in response to suggestions a few changes have been made. It is apparently the desire of members of both houses that the legislation to be enacted shall be of the kind which for lack of a better name may be called “business like.”

It is not our purpose to deal specifically with the provisions of the bill except in one or two particulars.

A good deal of opposition to the bill has been made on the score that holders of guaranteed bonds would not be reached by such a law inasmuch as the companies issuing those bonds have guaranteed the holders against impairment of capital or interest, and the case of Mr. Andrew Carnegie has been frequently cited. It has been pointed out that if the United States Steel Corporation is compelled to pay the income tax on the Carnegie bonds such payment must come out of the pockets of the common stockholder. But frankly and looking at the matter without partiality, is the government or is the nation responsible for the agreements entered into by a company with its creditors? Would it be proper and just so to frame legislation that the rights of common stockholders jeopardized by the action of their directorate should be protected at the expense of a sacrifice of principle? The theory of taxation at the source is one that is generally accepted as the best, and it would seem utterly unreasonable to suppose that this should not be adopted because by its adoption the provisions of a guaranteed bond issue would bear hardly upon those responsible for such provisions.

It should be remembered also that under the provisions of
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the bill the additional tax on amounts of income over $20,000 is collected from the recipient of the income, and is not collected at the source. Therefore, although it may be decided by the courts that the Steel Corporation must pay the one per cent on the Carnegie bonds, that does not indicate that Mr. Carnegie himself will escape the payment of the entire amount of additional tax.

It has been argued that the exemption of $4,000 in the case of individuals is far too high and savors too strongly of class legislation. We believe that the exemption might be considerably decreased with advantage, and it seems to us that it might be put as low as $1,000 per annum, but even if this were done the income tax law would still be class legislation. Practical taxation of incomes must always be legislation against a class because it is universally recognized that the idea of collection of an income tax from all incomes is entirely beyond possibility. In theory it might be well enough to propose a universal tax on income. In practice such a tax could never be collected. Therefore the revival of the old objection on the subject of class legislation seems to us utterly beside the point.

Possibly before this issue of The Journal of Accountancy will have reached its readers the tariff bill will have passed the House of Representatives, and it may be that changes not foreseen at present will have been introduced, but at the time of writing the bill, in so far as it concerns taxation of incomes, is a distinct improvement upon any of its predecessors of similar intent. And the fact that expert advice has been accepted in this case leads to a fairly confident hope that in future legislation having a technical bearing will be prepared with due attention to technical requirements.

For the Good of the Profession

In the April number of The Journal appeared a letter from a correspondent, in which The Journal was charged with asking support “for the good of the profession.” To this The Journal must plead guilty, but in extenuation of the offense it may be said that the request which distressed our correspondent was not for
Editorial

financial support, but for contributions of articles and help in the way of suggestions and comment.

Phrases are sometimes so hackneyed that they do not carry their full weight of meaning. "For the good of the profession" is a legitimate appeal, but it is not probable that one accountant in a hundred recognizes just how much it does mean, or in other words, how much more powerful an agent for the good of accountancy The Journal could be made if it had the hearty support and cooperation of its subscribers.

The accounting conditions of this country are in a state of change. Requirements are changing; methods are changing; the ends to be attained are changing. Accountants must keep up with these changing conditions. But how can this be done?

Among the subscribers and readers of The Journal are found the most active and progressive accountants of the country. These men are in touch with actual accounting conditions, and every one of them is meeting and solving problems which are new—and solving them at a cost of much time, trouble and thought. The same difficulties are coming up over and over again in the various parts of the country, and being solved each time with the same expenditure of time, trouble and thought.

Suppose that every progressive accountant of the country when he encountered a new and difficult problem reported it and his solution of it to The Journal. Suppose that those who considered the solution imperfect, inadequate, or not the best, sent in to The Journal their own views as to the proper solution. And suppose every active accountant of the country sent The Journal full notice of accounting legislation, accounting events, or any other accounting information of real interest to the profession. Suppose, still further, that the best qualified accountants of the country contributed articles on the more difficult problems and procedure of the calling as the need arose.

If this were done, would not The Journal be a real clearing house of accounting information? Would it not be the most potent, the most effective and the most influential single agency for the advancement of the profession? Would there be one live accountant in the country who did not take The Journal?

Why, on the other hand, may it be asked, is this not so? Why is it that so often the accountant working out some difficult problem for himself, jealously guards his secret instead of
giving it to the profession, in so far as professional propriety will reasonably permit? Why is it that out of the many hundreds of possible contributors to The Journal, its actual contributors are so few?

In the really progressive professions and callings an unstinted contribution to the common fund of knowledge obtains. If a doctor makes an important discovery, performs a new operation, or performs an old one in a new way, he hastens to announce it to the world through his journal. If an engineer successfully solves some new and intricate problem of construction, or discovers a short cut or a better method, he promptly proclaims it to the engineering world through the columns of his journal.

This spirit is found in every other active trade and profession, with perhaps the single exception of the law, and here there are no such changing conditions as confront accountancy. But even in the legal profession we find a rich literature in which every phase of law is treated voluminously. There is no attempt and, in fact, no possibility of concealing for private good the knowledge which is the capital of the calling.

It is time for Accountancy to wake up. The calling is conspicuously lacking in the shoulder touch, in the esprit de corps which makes a profession and makes for the good of its membership. If accountancy is to be a real profession, its professional obligations cannot be evaded or avoided. Every member must do his part “for the good of the profession.” In helping others he will help himself.
Department of Practical Accounting

Conducted by John R. Wildman, M.C.S., C.P.A.

Problem No. 17 (Demonstration)

The Kent Wire Screen Company having acquired all of the capital stock of the Derby Wire Netting Company, it is proposed to merge the latter with the former as of July 1, 1912.

The trial balances June 30, 1912, of the respective companies after closing, are as follows:

Kent Wire Screen Company

Land and buildings, $525,750; equipment, $85,729.43; motor trucks, $8,780.25; furniture and fixtures, $6,943.27; Derby Wire Netting Company, capital stock, par value $100,000, cost $97,713.50; materials and supplies, $18,379.51; goods in process, $16,591.46; finished goods, $23,468.46; cash, $12,640.31; accounts receivable, $54,345.26; notes receivable and interest, $10,132.75; sinking fund, $45,376.59; deferred charges to expense, $1,537.82; first mortgage 6% gold bonds payable, due 1927, $250,000; taxes accrued, $5,250; salaries and wages accrued, $3,178.29; accounts payable, $85,216.04; due to Derby Wire Netting Company, $536.12; notes payable and interest, $41,273.25; interest accrued on bonds payable, $2,500; reserve for depreciation of plant and equipment, $69,434.91; preferred capital stock outstanding, $250,000; common capital stock outstanding, $150,000; profit and loss surplus, $50,000.

Derby Wire Netting Company

Land and buildings, $240,327.92; machinery and tools, $48,934.27; horses, wagons, and harness, $6,387.35; furniture and fixtures, $8,500; capital stock of the Improved Screen Door Company, par $20,000, cost $23,457.86; patents, $10,000; raw materials, $23,721.89; goods in process, $32,568.34; finished goods, $18,478.27; cash, $14,686.43; accounts receivable, $57,395.05; due from the Kent Wire Screen Company, $536.12;
notes receivable and interest, $8,037.50; sinking fund, $30,483.14; consignment, $1,000; deferred charges to operations, $1,250; first mortgage 5% gold bonds payable, due 1930, $100,000; taxes accrued, $2,787; salaries and wages accrued, $5,843.62; accounts payable, $114,527.16; due the Improved Screen Door Company, $10,000; notes payable and interest, $51,673.53; interest accrued on first mortgage bonds, $833.33; reserve for sinking fund, $30,483.14; reserve for depreciation of plant and equipment, $37,329.52; common capital stock outstanding, $100,000; profit and loss surplus, $72,286.84.

From the foregoing submit:
(a) The entries on the books of The Kent Wire Screen Company necessary to effect the merger.
(b) The necessary entries on the books of the Derby Wire Netting Company.
(c) Balance sheet of The Kent Wire Screen Company after the merger.

**Solution to Problem No. 17**

A consolidated trial balance of the books of the Kent Wire Screen Company and the Derby Wire Netting Company serves the dual purpose of showing the situation with regard to the individual companies and the effect of the consolidation. It is therefore presented before beginning a discussion of the various requirements of the problem, and is as follows:

<table>
<thead>
<tr>
<th>Consolidated Trial Balance June 30, 1912</th>
<th>Eliminations</th>
<th>Trial Balance June 30, 1912</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debits</td>
<td>Kent</td>
<td>Derby</td>
</tr>
<tr>
<td>Land and buildings .....................</td>
<td>$766,077.92</td>
<td>$257,500.00</td>
</tr>
<tr>
<td>Machinery, tools and equipment ..........</td>
<td>134,663.70</td>
<td>85,729.43</td>
</tr>
<tr>
<td>Horses, wagons, harness and motor trucks</td>
<td>15,167.60</td>
<td>8,280.25</td>
</tr>
<tr>
<td>Furniture and fixtures ...............</td>
<td>15,443.27</td>
<td>6,943.27</td>
</tr>
<tr>
<td>Derby Wire Netting Co., stock, $100,000 par</td>
<td>$97,713.50</td>
<td>97,713.50</td>
</tr>
<tr>
<td>Materials and supplies ...............</td>
<td>42,101.40</td>
<td>18,379.51</td>
</tr>
<tr>
<td>Goods in process .....................</td>
<td>49,195.80</td>
<td>16,591.46</td>
</tr>
<tr>
<td>Finished goods ........................</td>
<td>41,946.73</td>
<td>23,721.18</td>
</tr>
<tr>
<td>Cash ..................................</td>
<td>27,326.74</td>
<td>12,540.31</td>
</tr>
</tbody>
</table>

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Accounts receivable .......... $111,740.31
Notes receivable and interest $18,170.25
Sinking funds ................. 75,859.73
Deferred charges to expense 2,787.82
The Improved Screen Door Co., $20,000 par .......... 23,457.86
Patents ...................... 10,000.00
Kent Wire Screen Co. ......... 536.12
Consignment .................. 1,000.00

Total debits .............. $1,334,903.13 $98,249.62 $907,388.61 $525,764.14

Credits
First mortgage 6% bonds, due 1927 .............. $250,000.00 $250,000.00
Taxes accrued ................... 8,037.00 5,250.00 $ 2,787.00
Salaries and wages accrued. 9,021.91 3,178.29
Accounts payable .............. 119,740.31 536.12
Due Derby Wire Netting Co. ........ 536.12
Notes payable and interest 92,946.78 41,273.25 51,673.53
Interest accrued on bonds payable 3,333.33 2,500.00 833.33
Reserve for depreciation plant and equipment 106,764.43 69,434.91 37,329.52
Preferred capital stock outstanding 250,000.00 250,000.00
Common capital stock outstanding 152,286.50 97,713.50 150,000.00 100,000.00
Profit and loss surplus ....... 122,286.84 50,000.00 72,286.84
First mortgage 5% bonds, due 1930 .......... 100,000.00 100,000.00
The Improved Screen Door Co. .................. 10,000.00 10,000.00
Reserve for sinking fund .. 30,483.14 30,483.14

Total credits .............. $1,334,903.13 $98,249.62 $907,388.61 $525,764.14

The object of this problem is to show the effect of a merger on the accounts of the companies involved. In New York State, "Any corporation lawfully owning all of the stock of any other corporation organized for and engaged in business similar or incidental to that of the possessor corporation may merge such other corporation with it and be possessed of all estate, property, rights, privileges and franchises of such other corporation." A consolidation differs from a merger in that "any two or more corporations organized for the purpose of carrying on any kind of business of the same or similar nature which a corporation organized under the business corporations law might carry on, may consolidate into a single corporation." The essential difference between the two is that in the case of merger all the stock of the subsidiary or adjunct company must be owned by
the parent company, whereas in consolidation no cross-ownership of stock is necessary.

The entire capital stock of the Derby Wire Netting Company was owned by the Kent Wire Screen Company and carried on the books as an asset. The ownership of the capital stock made the merger possible legally and the merging of the accounts followed. It was not consistent for the Kent Wire Screen Company to take up the assets and liabilities of the Derby Wire Netting Company and carry the stock of the latter as an asset.

No more was it consistent to consider accounts between companies as assets and liabilities of the respective companies. Hence the necessity for eliminating in the consolidated trial balance the accounts between companies and the capital stock.

The capital stock of the Derby Wire Netting Company in the amount of $100,000 par was, it will be noted, carried on the books of the Kent Wire Screen Company at cost, namely, $97,713.50. This latter amount is therefore the amount at which the elimination is shown both on the debit and credit sides of the consolidated trial balance. Since the common capital stock of the Derby Wire Netting Company outstanding is $100,000, and the cost to the Kent Wire Screen Company was but $97,713.50, there appears in the consolidated trial balance, opposite the item common capital stock outstanding, the amount of $152,286.50, of which $2,286.50 is the excess over $150,000 of the common capital stock of the Kent Wire Screen Company. This amount of $2,286.50 will be recognized as the difference between $100,000 and $97,713.50. This difference from the point of view of the Kent Wire Screen Company after the merger becomes in effect surplus, and in setting up the balance sheet after the merger should be treated as such.

Previous to the merger, the Kent Wire Screen Company owed the Derby Wire Netting Company $536.12 on open account. In merging the two companies this amount is treated as an elimination since in the very nature of things a concern may not owe itself money.

The matter of offsets should, in case of mergers and consolidations, receive careful attention. It often becomes necessary in practice to spend considerable time in reconciling accounts between or among companies in order that when the accounts of the companies are put together intercompany trans-
actions may be in agreement. This is especially true of capital stock, bonds, accounts receivable, and sometimes interest, notes receivable and interest, advances, consignments, and other items of a similar nature to the ones mentioned above.

From the consolidated trial balance there may now be prepared the entries on the books of the Kent Wire Screen Company necessary to show the effect of the merger. It is not thought that any additional light will be thrown on the solution of the problem by setting forth the assets and liabilities in detail since they are shown very clearly in the consolidated trial balance. They have therefore, in the entry which follows, been set up under the general captions of sundry assets and of sundry liabilities.

Sundry assets ........................................... $525,228.02
Accounts receivable (account of Kent W. S. Co.) ...  536.12
  To Sundry liabilities .................................. $353,477.30
  Derby W. N. Co., outstanding capital stock ................. 100,000.00
  Profit and loss surplus ......................... 72,286.84
  To place on the books of the Kent Wire Screen Co. the assets, liabilities, capital and surplus of the Derby Wire Netting Co. in accordance with the terms of merger of the two companies as of July 1, 1912.

Accounts payable (Derby W. N. Co.) ..................  536.12
  To accounts receivable (Kent W. S. Co.) .................  536.12
  To offset accounts between companies after merger.

Derby W. N. Co., outstanding capital stock .......... 100,000.00
  To Derby W. N. Co., stock (asset) ................... 97,713.50
  Profit and loss surplus ..................... 2,286.50
  To offset the accounts between companies relating to capital stock and take up as surplus on the books of the Kent W. S. Co., the difference between the par and cost of Derby W. N. Co. capital stock.

The closing entries on the books of the Derby Wire Netting Company are simple in the extreme. They consist merely in setting up an account with the Kent Wire Screen Company and closing out to this account all other accounts on the books. As in the previous case, it is not thought necessary to itemize the assets and liabilities. The entries are as follows:
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The Kent Wire Screen Co. .................................................$525,764.14
To sundry assets .........................................................$525,764.14

To close out all assets to the Kent W. S. Company in accordance with the terms of merger of July 1, 1912.

Sundry liabilities .........................................................353,477.30
Capital stock ..............................................................100,000.00
Profit and loss surplus ..............................................72,286.84
To Kent W. S. Co. .........................................................525,764.14

To close out liabilities, capital stock and surplus to the Kent W. S. Co. in accordance with the terms of merger of July 1, 1912.

The above entries complete the requirements of the problem except as to the balance sheet of the Kent Wire Screen Company after the merger which appears below.

THE KENT WIRE SCREEN COMPANY

BALANCE SHEET—JUNE 30, 1912

Assets

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and buildings</td>
<td>$766,077.92</td>
</tr>
<tr>
<td>Machinery, tools and equipment</td>
<td>134,663.70</td>
</tr>
<tr>
<td>Horses, wagons, harness and motor trucks</td>
<td>15,167.60</td>
</tr>
<tr>
<td>Furniture and fixtures</td>
<td>15,443.27</td>
</tr>
<tr>
<td>Patents</td>
<td>10,000.00</td>
</tr>
<tr>
<td>Securities owned</td>
<td>23,457.86</td>
</tr>
<tr>
<td>Working and trading assets:</td>
<td></td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>$42,101.40</td>
</tr>
<tr>
<td>Goods in process</td>
<td>49,159.80</td>
</tr>
<tr>
<td>Finished goods</td>
<td>41,946.73</td>
</tr>
<tr>
<td>Total working and trading assets</td>
<td>133,207.93</td>
</tr>
</tbody>
</table>

Total current assets: $157,237.30

Sinking funds .....................................................75,859.73
Deferred charges to expense ..................2,787.82
Consignments .......................................................1,000.00

Total assets .....................................................$1,334,903.13

Liabilities and Capital

Capital stock outstanding:
Preferred .........................................................$250,000.00
Common ..........................................................150,000.00

Total capital stock outstanding ..................$400,000.00
Department of Practical Accounting

Bonds outstanding:
Kent Wire Screen Co. 6's due 1927 .................... $250,000.00
Derby Wire Netting Co. 5's due 1930 ............. 100,000.00
Total bonds outstanding ............................................ 350,000.00

Current liabilities:
Taxes accrued ........................................................... $8,037.00
Salaries and wages accrued ................................... 9,021.91
Accounts payable .................................................. 209,743.20
Notes payable and interest .................................. 92,940.78
Int. accrued on bonds payable ............................... 3,333.33
Total current liabilities ............................................. 323,082.22

Reserves:
Depreciation of plant and equipment ............... $106,764.43
Sinking fund .............................................................. 30,483.14
Total reserves ........................................................ 137,247.57
Profit and loss surplus ........................................... 124,573.34
Total liabilities and capital ...................................... $1,334,903.13

Problem No. 17-A (Practice)

The following items appear on the balance sheet of the American Pin Company, June 30, 1912: Land, buildings, equipment, etc., $335,000; capital stock of the Bronx Pin Ticket Company, par, $50,000; cost, $57,400; patents, $15,000; working and trading assets, $37,500; cash, $10,000; accounts receivable, $32,000; due from Bronx Pin Ticket Company, $375.82; deferred assets, $1,500; first mortgage 6% gold bonds payable, due 1922, $100,000; taxes accrued, $3,250; salaries and wages accrued, $4,327.82; accounts payable, $123,749.83; notes payable and interest, $80,125; interest accrued on first mortgage bonds payable, $2,500; reserve for depreciation of buildings and equipment, $35,000; preferred capital stock outstanding, $75,000; common capital stock outstanding, $50,000; profit and loss surplus, $14,823.17.

The American Pin Company having acquired all the capital stock of the Bronx Pin Ticket Company, the balance sheet of which appears below, it is proposed to merge the two companies as of July 1, 1912.

THE BRONX PIN TICKET CO.

Assets—land, buildings, and equipment, etc., $260,000; capital stock of the Blauser Pin Tray Company carried at par, $35,000;
patents, working, and trading assets, $32,625; cash, $10,365.27; 
accounts receivable, $37,943.86; sinking fund, $3,236.92; deferred 
charges to expense, $1,200. Liabilities and capital—first mort-
gage 5% gold bonds payable, due 1925, $50,000; taxes accrued, 
$2,750; salaries and wages accrued, $3,147.83; due to creditors, 
$144,720.30; due to American Pin Company, $375.82; notes 
payable and interest, $31,372.53; interest accrued on first mort-
gage bonds payable, $1,250; reserve for depreciation of plant 
and equipment, $27,500; common capital stock outstanding, 
$50,000; profit and loss surplus, $69,254.57.

Prepare:

(a) The entries on the books of the American Pin Company.
(b) The entries on the books of the Bronx Pin Ticket Com-
pany.
(c) Balance sheet of the American Pin Company after the 
merger.
Meeting of the Board of Trustees

The regular semi-annual meeting of the Board of Trustees of the American Association of Public Accountants was held at the Lawyers' Club, in the city of New York, on Monday, April 14th, 1913.

There were present:
President, Robert H. Montgomery.
Treasurer, James Whitaker Fernley.
Vice-Presidents: Arthur Young (Illinois), Herbert M. Temple (Minnesota), Clarkson E. Lord (New Jersey), William F. Weiss (New York), Charles S. Jenckes (Rhode Island), George Mahon (Virginia).
The Secretary, A. P. Richardson.
J. J. McKnight, representing the president of the Ohio Society, was accorded the privilege of the floor.
The minutes of the preceding meeting as printed and distributed to trustees were approved.
The report of the treasurer showed total receipts amounting to $9,229.02 and disbursements $5,706.88. Balance on hand, $3,522.14.
The report of the secretary was received and filed. In this report the secretary discussed the work of his office at considerable length. On the subject of federal legislation the report reviewed the work which has been done in Washington in regard to the introduction of the fiscal in preference to the calendar year in the case of corporation reports, and stated that there was a gratifying change in regard to the reception accorded to constructive criticism.

Under the caption The Kentucky Situation, a brief résumé of the efforts to effect harmony was given, and the prospects for the new society were discussed.
The secretary reported a successful tour to the societies in the south, west and northwest, and expressed the opinion that a considerable amount of benefit had been derived from the effort to establish closer relationships between the national and state organizations. In nearly every place visited there was a prompt and enthusiastic response to the plea for co-operation as soon as the work undertaken by the national association was described.
The report of the executive committee reviewed the work done in the six months. Two mail votes had been taken. One in regard to the admittance of the Kentucky Society of Public Accountants, and one in regard to the publication of C. P. A. questions. In both cases the vote was affirmative. The report also referred to the appointment of a sub-committee to investigate the practicability of holding the 1914 convention in Washington, D. C. The sense of the sub-committee was that it would be advisable to hold a convention without depending upon the invitation of a state society, and Washington seemed to be a satisfactory
place for such convention. The report recommended that the question of holding the 1914 convention in Washington be seriously considered by the association.

This suggestion was approved by the board of trustees and referred to the 1913 meeting in Boston.

The president stated that the committee on accounting terminology had not yet completed its report, but that progress was being made.

In lieu of a report from the committee on annual meeting, a tentative programme was submitted and a vote of thanks was extended to the annual meeting committee for the work which had been done in preparation for the convention.

The report of the committee on federal legislation dealt with three activities which were undertaken in the half year. The first of these was the introduction of the fiscal year in corporation reports to the government; the second, a suggestion for clearer language in legislation in regard to accounting matters, and the third the endeavor to induce members of the association to become affiliated with commercial clubs and other business organizations. The report stated that several hearings had been attended in Washington and that there was every indication that a considerable amount of success had attended the efforts made. The campaign for betterment of legislation must be continued. The idea of affiliation with business organizations was being well received.

The report of the committee on Journal showed progress during the half year and again drew attention to the need for articles from members of the association. Subscriptions and advertising were showing an increase.

The report of the membership committee was read and the applications favorably mentioned were approved for admittance.

The chairman of the committee on state legislation, Mr. J. S. M. Goodloe, reported orally upon the work done by his committee through the past six months, particularly in regard to legislation in Delaware, Tennessee, Texas, Kansas, Kentucky, Alabama and Oregon, and also in regard to suggested amendments to legislation in Minnesota, Ohio and Washington. The committee was endeavoring to prevent the passage of unsatisfactory bills or amendments.

Upon motion, duly carried, the committee was requested to prepare a digest of provisions which should be inserted in every C. P. A. bill—this to be presented to the association and printed in the year book.

The report of the special committee on credit information dealt with the campaign which had been begun to obtain the views of bankers in regard to the certification of borrowers' statements. The report stated that the replies had been very favorable and a digest of them would be prepared and circulated among bankers and note brokers and among some of the larger borrowers.

The president referred to the question of state legislation in regard to reports of corporations and read letters in reply to a circular which had been sent out urging state societies to take action to securing the
Meeting of the Board of Trustees

introduction of the fiscal year. Upon motion, duly seconded, the question was referred to the committee on state legislation.

Trial Board

The board of trustees then adjourned and convened as a trial board to hear cause why the Kentucky Association of Public Accountants should not be dropped from membership as provided in article VII, section 1 of the by-laws of the association. By unanimous vote of the members of the trial board the Kentucky Association of Public Accountants was expelled from membership in the American Association of Public Accountants.

Upon resumption as the board of trustees the secretary reported the following deaths:

J. B. Simpson, president of the Alabama Society; Arthur J. Besson, New Jersey; J. W. Barber, California; and F. C. Tufts, of Massachusetts.

It was resolved that minutes should be made expressing the regret of the board of trustees at the deaths of its member, Mr. J. B. Simpson, of Alabama, and its former member, Mr. F. C. Tufts—expressions of sympathy to be sent to the members of state societies with which Mr. Simpson and Mr. Tufts had been associated.

At the conclusion of the meeting, the president of the New York State Society invited the members of the board of trustees to attend a meeting of the New York State Society to be held that evening in New York.

The following were elected members of the American Association of Public Accountants:

Georgia Society of Certified Public Accountants:
Fellow:
Charles Neville, C.P.A.

Illinois Society of Certified Public Accountants:
Fellow:
Artemas R. Hopkins, C.P.A. (subject to consent of the New Jersey Society).

Kentucky Society of Public Accountants:
Fellows:
W. S. Parker
Thomas E. Turner
Overton S. Meldrum
Enos Spencer
Charles G. Harris
James S. Escott
A. H. Ummethun
Homer F. Harris
T. A. Pedley
The Journal of Accountancy

L. Comingor

Associates:
J. C. Mahon
Frederick L. Brigham
Arthur J. Wrege
Edward F. Stoll
Arthur B. Zubrod
William J. Ryans

Certified Public Accountants of Massachusetts, Incorporated:

Fellows:
Frederick Stewart, C.P.A.
Hazen P. Philbrick, C.P.A.
J. Chester Crandell, C.P.A.

Associate:
Ralph K. Hyde, C.P.A.

Michigan Association of Certified Public Accountants:

Fellows:
William Leslie, C.P.A.
David Smith, C.P.A.
A. Van Oss, C.P.A. (subject to consent of New York State Society)

Missouri Society of Certified Public Accountants:

Fellow:
James B. Campbell, C.P.A. (Minn.) (subject to consent of Minnesota Society)

New York State Society of Certified Public Accountants:

Fellows:
Paul E. Bacas, C.P.A.
S. G. H. Fitch, C.P.A.
Harold D. Greeley, C.P.A.
Joseph J. Klein, C.P.A.
John H. Koch, C.P.A.
Paul L. Loewenwarter, C.P.A.
Marcus A. Muller, C.P.A.
Francis D. Neville, C.P.A.
A. T. Spratlin, C.P.A.
W. J. Struss, C.P.A.
DeKay Winans, C.P.A.
Albert F. Young, Jr., C.P.A.
E. B. Wade, C.P.A.

Rhode Island Society of Certified Public Accountants:

Fellow:
William B. Sherman, C.P.A.

Tennessee Society of Public Accountants:

Fellows:
Ira P. Jones
William C. Slayden
J. Roy Curtis
Meeting of the Board of Trustees

Fred E. Ivy
Robert Hall Jones
Robert L. Bright
M. Orion Carter
John G. Parks
Henry E. N. F. Mason
Allen B. Fisher
George Milton Clark

Associate:
J. Douglas Lord

Wisconsin Association of Public Accountants:
Fellows:
Wesley T. Cole.
George P. Johnson

Washington Society of Certified Public Accountants:
Fellow:
Herbert E. Post, C.P.A.

North Carolina State Board of Accountancy

The State Board of Accountancy provided for in the act passed during the last session of the legislature of North Carolina consists of four members, three of whom are accountants and one an attorney. The Board met on April 19, and elected the following officers:

President—Moreland R. Lynch, High Point.
Treasurer—G. G. Scott, Charlotte.
Secretary—J. D. Hightower, Greensboro.

The fourth member of the board is David Stern of Greensboro.

The board will hold its first examination on August 25, at Wilmington, North Carolina.
Pennsylvania C. P. A. Examinations of November, 1912

(Continued)

COMMERCIAL LAW

Answers by Walter D. Stewart, LL.B.

Member of the Philadelphia Bar

QUESTION I

Samuel Mason died leaving a will in which he appointed Robert Goodman his trustee, giving him full power in his discretion to make sales of any stocks, bonds or securities forming part of his estate. Goodman was seized with a lingering illness which largely incapacitated him from actively attending to the duties of the trust and he accordingly gave a power of attorney to one William Sampson, duly executing it as trustee under the will of Samuel Mason, and authorizing Sampson to sell and dispose of the securities as his attorney. Sampson, acting in good faith, sold some stock at a price far below its real value. Goodman died, a new trustee was appointed, and he brought suit to recover from the purchaser the stock which had been sold. Can he do so, and if so why?

Answer to Question I

There are but two possible reasons why the stock can be recovered from the purchaser: (1) That it was a bad bargain, and (2) that Goodman, the original trustee, had no power to delegate his authority to Sampson. The first reason has no foundation in law, as the parties were dealing at arm's length, and both were entitled to the benefit of the best bargain that they could drive. As to the second reason, it appears that the delegation of authority to sell stock was proper for the reason that the trustee was, in the words of the trust, given "full power in his discretion to make sale, etc." It was, therefore, an exercise of his discretion to delegate the power of sale to another. The acts of the agent were binding on the trustee, and the sale which the agent made was, therefore, good and complete. If any one could be held responsible for the loss occasioned by the sale of the stock it would possibly be Mason's estate or Sampson, but as this is a matter outside of the scope of the case stated, there is no need to go into it.

Question 2

Robert Filmore under a written agreement leased unto James Thompson a house in the city of Philadelphia for the term of five years at the
rent of $40 per month. Property was enhanced a good deal in value at the end of two years and the landlord suggested to his tenant that it would be only the fair thing if he should increase the rent to $50 a month. To this the tenant agreed, writing a letter in which he said, "I agree hereafter to pay the sum of $50 per month for the property rented by me from you." Notwithstanding this letter, however, the tenant refused to pay more than $40 a month and the landlord brought suit to recover the agreed amount of $50. Can he recover? State the reasons for your answer.

Answer to Question 2

A contract in order to be enforceable must be supported by a consideration, which means that there must be some benefit to be derived by the party making the promise in return for the promise made. In the case stated, the parties have already entered into a valid contract by which one has agreed to lease certain premises to the other for the term of five years at certain rent. As long as the lessee performs all the covenants contained in the lease he is entitled to stay on the premises for the full five years. Any agreement on the part of the lessee to pay an increased rent would result in any benefit to the lessee, and is, therefore, void and not enforceable, and the landlord should not be permitted to recover the amount of the increased rent. (See Taylor vs. Winterd, 6 Phila. Reports, 126.)

Question 3

Thomas Brown died leaving a will in which after one or two other provisions he provided as follows: "All the rest of my estate I give unto my friend Edward Simpson to hold the same in trust and collect the income and pay the same unto my wife for her life, and at her death to deliver the principal to my children in equal shares." In his estate were 100 shares of stock of the Pennsylvania Railroad Company. The trustee, desiring to take advantage of a rise in the market price of the stock, sold the same through his brokers and endorsed the certificate, which stood in the name of Thomas Brown, as trustee, and the broker presented it to the railroad company for transfer. The railroad company refused to make the transfer. Was its position right or wrong, and what remedy had the trustee against the company?

Answer to Question 3

A corporation or a transfer agent for a corporation is under no obligation to permit of a transfer of stock if such acquiescence would expose the agent or his principal to a successful claim by any one for the replacement of the stock or for its value. The corporation or the transfer agent is in a sense the custodian of the rights of stock owners.
The Journal of Accountancy

The purchaser of stock does not receive the certificate of his vendor, but a new one made out in his own name and reciting nothing contained in the former. He is, therefore, protected in the enjoyment of his purchase, even though there was no right to make the transfer to him. For this reason an unauthorized transfer is a wrong done to the owners of stock, for which not only the person who makes it, but anyone knowingly assisting in the wrong, is responsible. The corporation—or its transfer agent—has in its keeping the primary evidence of title to the stock, and is justly held to proper diligence and care in its preservation. From this it results that it may rightfully demand evidence of authority to make a transfer before it permits the transfer to be made. Its own safety requires that it be satisfied of the right of the person proposing to make a transfer to do what he proposes. Generally, sufficient evidence of such right is found in the possession of legal title to the stock, but in equity, whatever puts a party upon inquiry is notice of what inquiry must reveal.

Where a party dies intestate, the administrator or executor of his estate is entitled to sell the stock of the estate without showing any other authority than that he has been appointed administrator or executor. A trustee of an insolvent estate would seem to stand on the same footing. His primary duty is administration; that is, to dispose of the personal property and therewith pay the debts of the deceased insolvent and make distribution among the next of kin or legatees. There is, however, a marked difference between the powers of an administrator or executor and those of an ordinary trustee. The common duty of the latter is not administration or sale, but custody and management. The power of sale is not a necessary incident to the trust. If in truth he has not such power, the corporation or transfer agent, by accepting his certificate and issuing others in lieu thereof to his transferee, is assisting him to destroy the rights of the beneficiary in the trust. But it has been held that the mere designation of the stockholder as trustee, without a specification of the trust or names of the beneficiary is not such notice to the transfer agents as to make it their duty to look beyond the legal title, for it did not point to any sources of information. It, therefore, seems that the railroad company has no right to refuse to make the transfer, and the trustee has two remedies: (1) By a bill in equity against the railroad company to compel them to transfer the stock, and (2) An action against them to recover whatever actual damage may have been suffered by the refusal to transfer the stock when the same was requested. Such actual damage would arise in the event of a decline in the value of the stock.

Question 4

Henry Evans, desiring to purchase a team of horses, requested a friend of his named Robert Thompson to procure a team for him. Thompson went to Frederick Wilson, the owner of some horses, and, desiring to make some profit in the transaction himself, purchased a team for the
Pennsylvania C. P. A. Examinations of November, 1912

sum of $800, which he agreed to pay therefor. The transaction was wholly in Thompson's name and Wilson sold the horses to him and knew nothing whatever about Evans. Thompson was to pay for the horses in thirty days. They were delivered to him and he in turn delivered them to Evans for the price of $1,000, which Evans paid him therefor. Thompson failed to pay Wilson, however, and Wilson then brought suit against Evans for the $800, the price at which he sold them to Thompson. Can he recover? State the reasons for your answer.

Answer to Question 4

There is no privity of contract between Wilson and Evans. The transaction between Wilson and Thompson was entirely separate from the transaction between Thompson and Evans; and although Evans authorized Thompson to procure a team for him, yet when Thompson procured that team he did so as an entirely independent purchaser. Wilson cannot, therefore, recover from Evans.

Question 5

Having come to an adjustment of certain accounts between them, Howard Pine gave unto Samuel Barnes his note for $577.19. The time of the settlement was January, 1912. After the note had been signed by Pine and delivered to Barnes and the parties had separated, Barnes observed that the note was written upon an old printed form of a note on which there had been printed as part of the date, the figures "190." In filling in the note, the figure "2" had been added so that the note apparently read "January, 1902." To correct this, Barnes took his pen and made a figure one through the cypher. What effect had this upon the note if any?

Answer to Question 5

The Negotiable Instruments Act of May 16, 1901, provides that where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration he may enforce payment thereof according to its original tenor. A change in date is specified under the act as a material alteration. The case stated, however, does not seem to come under the provisions of the act, as the change of the date of the note was not an alteration, but the correction of a mistake. If it could be proved that the change was merely to correct some mistake and to make the note conform to the original intention of the parties, it would not avoid the note, but it would be still enforceable as against the maker. (See
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Hammerschlag vs. Union National Bank of Wilmington, 13 W. N. C., No. 205.)

Question 6

One Frank Hastings was the owner of the household furniture in the house where he lived, including a piano. Being pressed for money, he desired to make a sale of the piano, and Thomas Stone agreed to purchase it from him for $100 and paid him the cash therefor. Hastings said that he was about to move in a few days and that it would be convenient if the piano were left at the house until the time of removal, when Stone could come and take it away. To this Stone agreed. The following day, however, the landlord distrained upon all the furniture in the house for unpaid rent. Was Stone entitled to claim and to take away the piano which he had bought and paid for? State the reasons for your answer.

Answer to Question 6

The general rule of law is that all goods on the premises are liable to distress for rent in arrear. There are certain exceptions to this rule in the case of goods left on the premises in the course of trade, but the case stated does not come within any of the exceptions. The title to the goods is immaterial, and as long as they remain on the premises the landlord is entitled to levy on them for rent. Under the circumstances Stone would not be entitled to remove the piano which he had bought and paid for.

Question 7

Samuel Ellison gave a bond and mortgage secured upon his house for the sum of $5,000. He failed to pay interest and the mortgage was foreclosed. The holder of the mortgage bought the property at sheriff's sale for $50. He afterwards sold the property for the sum of $6,000, thus receiving more than the amount he had loaned to Ellison. Notwithstanding this, he brought suit upon the bond to recover from Ellison the sum of $4,050 with interest. Is he entitled to recover?

Answer to Question 7

A mortgage in Pennsylvania is in the nature of a security for the payment of a debt. The property is pledged as collateral for the payment of the debt represented by the bond, which in the case stated was for the sum of $5,000. A default having been made in the payment of the interest as specified in the bond, it was then the privilege of the holder of the mortgage to proceed to sell the property which was the collateral he held for the payment of the note or bond. The property was offered at public sale by the sheriff and was sold for $50. It is
immaterial who purchased the property. The amount of the debt was only reduced by the amount of the proceeds of the sheriff sale. As a result, there was still due to the holder of the mortgage the sum of $4,950 with interest, and the holder of the bond was entitled to proceed on it to recover that amount from Ellison, his mortgagor.

Question 8

James Black wrote to William Tomlinson offering him one hundred barrels of apples at $3 per barrel. Tomlinson replied, “I accept your offer, you guaranteeing apples to be shipped immediately and free from all defects.” The market price of apples rose within the next week one dollar per barrel, and no apples arriving Tomlinson wired, asking why his apples had not been shipped. To this Black replied that he had sold the apples elsewhere and was not shipping any to him. Tomlinson then brought suit for the one dollar per barrel advance in price. Can he recover? State the reasons for your answer.

Answer to Question 8

In order to make a contract complete and binding on all parties there must be an offer made by one of the parties to the other, which offer must be accepted without any qualifications. In the case stated, Tomlinson accepted the offer, but not in the terms in which the offer was made. He had another condition, to wit: That the party making the offer guarantee the apples to be shipped immediately and free from all defects. A contract was, therefore, not made, and Black was not obliged to ship the apples. Tomlinson was, therefore, not entitled to recover.

Question 9

The Maple and Elm Street Railway Company was incorporated with an authorized capital stock of $250,000, all of which was issued. Frederick Wheeler was the President of the Road and, being engaged in stock speculation and in need of money, he issued 500 additional shares of stock, to which he procured the signature of the secretary and affixed the seal in the regular way. This stock he sold and received the money, which he appropriated to his own use. Afterwards the fraud was discovered. What are the rights of the holders of this over-issued stock? Are they entitled to be considered stockholders of the company or can they recover the value of the stock in cash from the corporation? Give your reasons for your answer.

Answer to Question 9

A corporation is bound to recognize as members the bona fide holders of stock issued by the president and secretary without authority, where such officers have charge of issuing stock and the certificates are not on their face distinguishable from stock properly issued, provided such issue does not increase the corporation’s capital beyond the authorized
amount. By *bona fide* holders are meant those who have paid a valuable consideration for the stock without notice of the fraud; but if such stock would increase the corporation's capital beyond the authorized amount, the holders thereof do not become stockholders in the ordinary sense of the word, but the corporation must refund to them the amount advanced on the stock. The reason upon which the law is based is that the regular stockholders have intrusted the president and secretary with the authority and power to issue certificates of stock, and where such officers have exceeded their authority and one of two innocent parties must suffer by reason thereof, the law holds that the one who must suffer is he who has afforded the opportunity for the commission of the fraud. (See Willis vs. Fry, 13 Phila. Reports, 33.) It might be added, however, that the Corporation Act of 1874 provides that certificates of stock must be signed by the president and countersigned by the treasurer, so that the stock certificates signed by the president and secretary, without the treasurer's signature, would under Pennsylvania law be void, and would be notice to the subscriber of the fraud committed in their issuance.

**Question 10**

Five persons agree to organize a corporation for the purpose of carrying on the manufacture of iron and steel. Each is to contribute $10,000 and receive stock to that amount. Owing to the necessity of advertising, a month or so must elapse before the charter can be obtained and they are all desirous of expediting the matter as much as possible. Two of their number, accordingly, who are most active, purchase some machinery for installation in the property which they rent, and lumber and other materials for making alterations in the building. The purchases are all made in the name of the Star Iron Works, which they have selected as the name of the company. Owing to a disagreement between them, however, the company is not formed. Are the other parties liable for the purchases made by the two above mentioned, and if so upon what theory?

**Answer to Question 10**

The directors and promoters of a proposed corporation who enter into a contract for work to be done or material to be furnished for the corporation before obtaining a charter are personally liable on such contract. (See Dengler vs. Helms, 4 Walker, 476.) In the case stated the three persons who were not concerned in the purchase of machinery merely agreed to subscribe to a certain amount of stock of the proposed corporation, and it was contemplated that they should become liable only as such subscribers or stockholders. There is nothing in the question which indicates that the three inactive parties authorized the purchase of the machinery or ratified the transaction after it was completed. In the absence of such authorization or ratification they could not be held liable for the purchase price.
New York C. P. A. Examinations of January, 1913

Answers by Paul-Joseph Esquerré, C.P.A.

Practical Accounting—Part I

Question I

Company C was incorporated in May, 1910, to acquire the stock of companies A and B. Company C's capital stock is divided into preferred, $2,500,000; common, $1,500,000; all the stock is outstanding and fully paid; it has been issued (a) for stock to the stockholders of companies A and B, (b) $20,000 of preferred for organization expenses, (c) for cash. The stockholders of A and B received preferred stock for the intrinsic, undepreciated book value of the assets, as reflected by the following balance sheets of their companies at June 30, 1910, and $300,000 of common stock divisible equally to companies A and B.

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>A</th>
<th>B</th>
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</thead>
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<tr>
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<td>254,000</td>
<td>318,000</td>
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<tr>
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<tr>
<td>Machinery and</td>
<td>21,000</td>
<td>17,000</td>
<td></td>
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</tr>
<tr>
<td>Transportation</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>equipment</td>
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<td>Investment in</td>
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<tr>
<td>land</td>
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<tr>
<td>Investment in</td>
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<tr>
<td>bonds—Co. B</td>
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<tr>
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<tr>
<td>stocks</td>
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<tr>
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<td>Materials and</td>
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<tr>
<td>supplies</td>
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<td>Cash</td>
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<td>receivable</td>
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<td>Demand notes—</td>
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<tr>
<td>Co. B</td>
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<td>Accrued interest</td>
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<tr>
<td></td>
<td>$1,100,820</td>
<td>$1,245,756</td>
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</table>

Between July 1 and July 31, 1910, the following transactions occurred: organization expenses paid in cash by Company C, $5,000; intercompany advances by C: to A $60,000, to B $60,000; Company A reduced its accounts payable by $25,000, its loans payable by $30,000, and
The Journal of Accountancy

its audited vouchers by $15,000; Company B reduced its accounts payable by $295,000, liquidated its audited vouchers unpaid and its interest due under the bonds.

The manufacturing operations of the period show: Company A—labor, $10,000; overhead expense, $9,000; materials consumed, $9,886; inventory of goods in process, $46,300, of finished goods, $59,740; selling expenses paid, $1,600; administration expenses, $2,500; sales, $72,500; collections of open accounts, $86,400. Company B—labor, $3,600; overhead, $2,350; materials, $5,210; inventory of goods in process, $40,000, of finished goods, $45,380; sales, $36,000; collection of open accounts, $109,150; administration expenses, $3,000.75; selling expenses, $1,040.

No materials were purchased during the period and the current expenses were paid as soon as the invoices were audited. Company A declared a dividend of $100,000 and Company B a dividend of $25,000.

Prepare the consolidated balance sheet of companies A and B and C, at July 31, 1910, to be submitted to the directors of Company C, and so arranged as to show them the exact detail of the properties that they control.

Answer to Question I

Consolidated Balance Sheet of Companies A, B, C, at March 31, 1910

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Eliminations and additions</th>
<th>Consolidated balance sheet</th>
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<tbody>
<tr>
<td>Capital Assets:</td>
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<tr>
<td>Plant and land</td>
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<td>275,000.00</td>
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<td>572,000.00</td>
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<td>Machinery and tools</td>
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<td>276,000.00</td>
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<td>505,200.00</td>
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<td>Transportation equipment</td>
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<td>17,000.00</td>
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<td></td>
<td>38,000.00</td>
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<td>120,000.00</td>
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<td>200,000.00</td>
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<td>Stockholders' equity</td>
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<tr>
<td>Working and Trading Assets:</td>
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<td>Materials and supplies</td>
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<td>$49,090.00</td>
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<td>$94,204.00</td>
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<td>139,120.00</td>
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<tr>
<td>Demand notes, Co. B</td>
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<td>Accounts receivable</td>
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<tr>
<td>Dividends receivable</td>
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</table>
# New York C. P. A. Examinations of January, 1913

## Liabilities

### Capital Liabilities:

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Eliminations</th>
<th>Consolidated balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital stock outstanding:</strong></td>
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<tr>
<td>Preferred</td>
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<td>$102,000.00*</td>
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<td>Bonds, 6%, 1915, J &amp; J</td>
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<td>$1,500,000.00*</td>
<td>$1,500,000.00</td>
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<tr>
<td><strong>Total:</strong></td>
<td>$800,000.00</td>
<td>$1,000,000.00</td>
<td>$1,860,000.00*</td>
<td>$4,030,000.00</td>
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### Current Liabilities:

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<thead>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Demand notes payable</td>
<td>$35,000.00</td>
<td>$35,000.00</td>
<td></td>
<td>$5,000.00*</td>
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<tr>
<td>Advances by affiliated companies</td>
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<td>$250,500.00</td>
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### Surplus:

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</tr>
</thead>
<tbody>
<tr>
<td>Reserve for depreciation</td>
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<td>$30,000.00</td>
<td></td>
<td></td>
<td>$54,900.00</td>
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<td>Reserve for doubtful accounts receivable</td>
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<td>$2,000.00</td>
<td>$7,000.00</td>
<td>$16,000.00</td>
<td>$16,000.00</td>
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<tr>
<td>Reserve for contingencies</td>
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<td></td>
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<tr>
<td><strong>Total:</strong></td>
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<td>$32,000.00</td>
<td>$77,900.00</td>
<td>$204,622.50</td>
<td></td>
</tr>
</tbody>
</table>

### 2. Available for dividends:

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
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<td>$25,000.00</td>
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<td></td>
</tr>
<tr>
<td>Loans payable</td>
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<td>$3,200.00</td>
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<td></td>
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<tr>
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<td>$125,000.00</td>
<td>$125,000.00</td>
<td>$204,622.50</td>
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</tr>
<tr>
<td><strong>Total:</strong></td>
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<td>$1,304,154.25</td>
<td>$4,125,000.00</td>
<td>$2,110,300.00</td>
<td>$4,433,528.25</td>
</tr>
</tbody>
</table>

---

* Intercompany holdings.

† Investment eliminated because represented by the assets which represent its value, less the liabilities for which they are subject.

‡ Composed of:

- Excess of cost over intrinsic value of assets of A and B .......................................................... $310,000.00

### Surplus of A and B:

a. Appropriated for reserves ............................................................... $77,900.00

b. Available for dividends ................................................................. $127,000.00

- $514,900.00

### CASH—COMPANY A

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>$17,420.00</td>
<td>Accounts payable</td>
<td>$25,000.00</td>
</tr>
<tr>
<td>Company C</td>
<td>$60,000.00</td>
<td>Loans payable</td>
<td>$30,000.00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$86,400.00</td>
<td>Audited vouchers</td>
<td>$15,000.00</td>
</tr>
<tr>
<td>Interest on bonds</td>
<td>$1,800.00</td>
<td>Labor</td>
<td>$10,000.00</td>
</tr>
<tr>
<td></td>
<td>$80,754.00</td>
<td>Factory expense</td>
<td>$8,000.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Selling</td>
<td>$1,600.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Administration expense</td>
<td>$2,500.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balance</td>
<td>$73,520.00</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td>$165,620.00</td>
<td></td>
<td>$165,620.00</td>
</tr>
</tbody>
</table>

### Balance ................................................................. $73,520.00

Red ink entries are indicated by italics.
## GOODS IN PROCESS—COMPANY A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>$45,000.00</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>9,886.00</td>
</tr>
<tr>
<td>Cash—labor</td>
<td>10,000.00</td>
</tr>
<tr>
<td>Cash—factory expense</td>
<td>8,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$72,886.00</strong></td>
</tr>
<tr>
<td>Balance</td>
<td><strong>$46,300.00</strong></td>
</tr>
</tbody>
</table>

## PROFIT AND LOSS—COMPANY A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finished goods</td>
<td>$44,846.00</td>
</tr>
<tr>
<td>Selling expense</td>
<td>1,600.00</td>
</tr>
<tr>
<td>Administration expense</td>
<td>2,500.00</td>
</tr>
<tr>
<td>Surplus</td>
<td>23,854.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$72,800.00</strong></td>
</tr>
</tbody>
</table>

## FINISHED GOODS—COMPANY A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods in process</td>
<td>$26,586.00</td>
</tr>
<tr>
<td>Balance</td>
<td>69,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$95,586.00</strong></td>
</tr>
</tbody>
</table>

## SURPLUS—COMPANY A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>$100,000.00</td>
</tr>
<tr>
<td>Balance</td>
<td>34,854.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$134,854.00</strong></td>
</tr>
<tr>
<td>Balance</td>
<td><strong>$34,854.00</strong></td>
</tr>
</tbody>
</table>

## CASH—COMPANY B

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>$19,175.00</td>
</tr>
<tr>
<td>Company C</td>
<td>60,000.00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>109,150.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$188,325.00</strong></td>
</tr>
<tr>
<td>Balance</td>
<td><strong>$132,734.25</strong></td>
</tr>
</tbody>
</table>
New York C. P. A. Examinations of January, 1913

GOODS IN PROCESS—COMPANY B

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>$49,341.00</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>$5,210.00</td>
</tr>
<tr>
<td>Cash—labor</td>
<td>$3,600.00</td>
</tr>
<tr>
<td>Cash—factory expense</td>
<td>$2,350.00</td>
</tr>
<tr>
<td></td>
<td>$60,501.00</td>
</tr>
<tr>
<td>Balance</td>
<td>$40,500.00</td>
</tr>
</tbody>
</table>

PROFIT AND LOSS—COMPANY B

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finished goods</td>
<td>$49,961.00</td>
</tr>
<tr>
<td>Sales</td>
<td>$98,000.00</td>
</tr>
<tr>
<td>Selling expense</td>
<td>$1,040.00</td>
</tr>
<tr>
<td>Administration expense</td>
<td>$3,000.75</td>
</tr>
<tr>
<td>Interest on bonds</td>
<td>$450.00</td>
</tr>
<tr>
<td>Surplus</td>
<td>$43,548.25</td>
</tr>
<tr>
<td></td>
<td>$98,000.00</td>
</tr>
</tbody>
</table>

FINISHED GOODS—COMPANY B

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods in process</td>
<td>$20,001.00</td>
</tr>
<tr>
<td>Inventory</td>
<td>$46,380.00</td>
</tr>
<tr>
<td>Balance</td>
<td>$96,341.00</td>
</tr>
</tbody>
</table>

SURPLUS—COMPANY B

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>$25,000.00</td>
</tr>
<tr>
<td>Balance</td>
<td>$44,548.25</td>
</tr>
<tr>
<td></td>
<td>$69,548.25</td>
</tr>
</tbody>
</table>

CASH—COMPANY C

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred capital stock</td>
<td>$465,100.00</td>
</tr>
<tr>
<td>Common capital stock</td>
<td>$1,200,000.00</td>
</tr>
<tr>
<td></td>
<td>$1,665,100.00</td>
</tr>
<tr>
<td>Balance</td>
<td>$1,540,100.00</td>
</tr>
</tbody>
</table>

CAPITAL STOCK, PREFERRED—COMPANY C

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred capital stock</td>
<td>$2,500,000.00</td>
</tr>
<tr>
<td>Investment in stocks</td>
<td>956,000.00</td>
</tr>
<tr>
<td>Investment in stocks</td>
<td>1,058,000.00</td>
</tr>
<tr>
<td>Organization expenses</td>
<td>20,000.00</td>
</tr>
<tr>
<td>Cash</td>
<td>465,100.00</td>
</tr>
<tr>
<td></td>
<td>$2,500,000.00</td>
</tr>
</tbody>
</table>

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The points of interest in this problem appear to be:

1. The amount of cash which has been obtained by Company C through the issue of stock is not given; and since the amount of stock issued by C in exchange for the capital stock of A and B is not mentioned, the accurate building up of the cash account of C depends upon the understanding of what constitutes "intrinsic, undepreciated book value of the assets."

2. The goodwill which, so far as C is concerned, represents the difference between the intrinsic book value of the assets and the price paid for the stock of A and B, i.e., $300,000, will have to be expressed in the consolidated balance sheet at a figure which can be obtained only from careful consideration of its components.

3. All the intercompany holdings will have to be eliminated from the consolidation, upon the ground that this exclusion will not in any way alter the status of a single one of the assets of A and B controlled by C. If this test cannot be applied to a proposed elimination, it should not be made.

1. The Amount of the Issues of Stock for Cash:

The term "intrinsic undepreciated book value" means all the assets of A and B, as appearing on the balance sheets submitted, less their liabilities to outsiders, no cognizance whatever to be taken of the reserves. Thus, since the intrinsic undepreciated book value of the assets of A and B is in the aggregate $2,014,000, this amount of preferred stock was issued by C to the stockholders of A and B. Further, if $20,000 of the same stock was issued for organization expense, the company must have received $465,100 in cash for the balance. As to the common stock, it is plain that the price paid in stock by Company C for the excess of cost
over intrinsic value being $300,000, the balance of the authorization, i.e.,
$1,200,000, was issued for cash.

2. *The Component Parts of the Goodwill:*

The assets of A and B, as appearing in the balance sheets of
these two companies at June 30, 1910, aggregate ..................$2,346,376.00
Deducting from this figure the amount which has been acquired
through the use of credit, i.e., through the incurrence of
liabilities to outsiders ..................................................331,676.00
We obtain an amount of ..............................................$2,014,900.00
Which represents, according to principles of accounting, *per* 1,800,000.00
of assets acquired through the use of the capital contribu-
tions of the stockholders, as evidenced by the capital stock
liabilities of the two companies.

Deducting the capital stock, a remainder of .......................$ 214,900.00
which cannot be anything else than the assets acquired by
companies A and B through the reinvestment of their un-
divided profits of prior periods, as measured by:

a. The surplus available for dividends .........................$ 137,000.00

3. *The Eliminations:*

Irrespective of their importance to companies A and B in their
capacity as separate entities, the debts of A to B and of B to A are
nothing to C, who owns the stock of both. *It is plain that if, for instance,*
the demand notes held by A against B were to be repaid by the latter,
A would have more cash, and less claims against other companies, while
B would have less cash, and a lesser amount of liabilities to outsiders.
But it is also evident that the consolidation of the cash account of A,
B and C would give a figure absolutely identical with the one shown in
the balance sheet, i.e., $1,746,354.25, which is the true extent of C's
control of available cash. If the same reasoning is applied to any one
of the eliminations shown in the above solution, the same result will be
obtained.

The elimination of the investment in stocks of other companies as

carried by C in its balance sheet, must be eliminated because, instead of
expressing the amount of the investment, it is required that the assets
which it controls, subject to whatever liabilities attach to them, be ex-
pressed in detail. The elimination of the capital stock of companies
A and B is indicated by logic. If the said stock originally controlled
the assets of A and B, and has since been replaced by the stock of C, it is
only the latter which controls the assets; the former is a nonentity to
C for purposes of a consolidated balance sheet. It represents only
documentary evidence of the transfer of the assets which were originally
acquired out of it.

Although the requirements of the problem do not call for ledger
accounts, they have been given here as they may be of help to the
student of accounting.
The Journal of Accountancy

b. The surplus appropriated for the purpose of reserves...$ 77,900.00

$ 214,900.00

Thus we have found two of the components of the goodwill acquired by Company C. As to the third, it must, of necessity, be the $300,000 of common stock issued by C in excess of the intrinsic value of the assets of A and B. To prove that the resulting figure of $314,900.00, which is called goodwill on the consolidated balance sheet submitted above, is truly what it pretends to be, let us assume that instead of expressing its investment in stocks of other companies at cost, as appears to have been done, Company C had expressed it at the par of the stocks acquired. The journal entry would have been:

Investment in stocks of other companies... $1,800,000.00
Goodwill ........................................ 514,900.00
To capital stock preferred .......... $2,014,900.00
   Capital stock common ........ 300,000.00

For acquisition of the stock of companies
A and B, the goodwill being represented by:
1. Undivided profits ........... $137,000.00
2. Appropriations of surplus... 77,900.00
3. The goodwill value of the
   investment covers the in-
   trinsic value of the assets
   acquired .................. 300,000.00

$514,900.00

Question 2

Karl Smith is a real estate broker and agent who, among other things, manages properties in consideration of commissions, ranging from 3% to 5% on rent collections. For the last two years his books have been kept in haphazard fashion and in violation of the law of agency. They are incomplete as to footings and postings; no trial balance of the general ledger has been obtained and no reconciliation of bank balances has been established during the above mentioned period. The tenants' rent book is a species of "tickler" in which the current rent charges are entered in pencil and inked in when paid; the names of the tenants of properties not leased are also entered in pencil and erased when the tenants move, the new names being entered in the places thus left vacant.

Having accidentally discovered irregularities in the tenants' book, Karl Smith has discharged his bookkeeper-cashier and engaged an accountant to conduct an examination of his books, records and accounts, discover the extent of the shortage, which he fears is considerable, and install a new system of accounts.

After spending considerable time in an attempt to place the books on an accounting basis, the accountant finally obtains the following trial
New York C. P. A. Examinations of January, 1913

balance of the ledger, as of September 30, 1912, installs a new system
which will permit his client to fulfill his accounting duty as an agent and
renders a preliminary report accompanied by a statement showing clearly
the financial status of the relations of Karl Smith to his principals:

TRIAL BALANCE

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$350.20</td>
</tr>
<tr>
<td>Petty cash</td>
<td>100.00</td>
</tr>
<tr>
<td>The Augusta Terrace (a)</td>
<td>216.00</td>
</tr>
<tr>
<td>The Victoria Court (a)</td>
<td>385.00</td>
</tr>
<tr>
<td>The St. Quentin Court (a)</td>
<td>660.00</td>
</tr>
<tr>
<td>The Audubon Court (a)</td>
<td>270.00</td>
</tr>
<tr>
<td>The Evening Despatch (b)</td>
<td>75.00</td>
</tr>
<tr>
<td>The Morning News (b)</td>
<td>35.00</td>
</tr>
<tr>
<td>The Union Wall Paper Co. (b)</td>
<td>111.20</td>
</tr>
<tr>
<td>The Janitors' Supplies Co.</td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>45.25</td>
</tr>
<tr>
<td>Insurance account (c)</td>
<td>920.10</td>
</tr>
<tr>
<td>Karl Smith, drawings (d)</td>
<td>16,930.00</td>
</tr>
<tr>
<td>Cash shortage (e)</td>
<td>350.00</td>
</tr>
<tr>
<td>Salaries</td>
<td>12,140.00</td>
</tr>
<tr>
<td>Office expense</td>
<td>3,130.00</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,139.75</td>
</tr>
</tbody>
</table>

\[ \text{Total} \quad \text{Debits} = \text{Total} \quad \text{Credits} \]

Notations by the accountant:

(a) Remittances on account of collection of October rents, paid in
advance upon signing lease, not as yet credited to principals.
Settlements to be made on the 29th of every month.

(b) Balances represent payments from March to June, 1912, for ad-
vertising, decorating and supplies, for the account of managed
properties. Paid bills cannot be found; no detail available; item-
ized receipted bills asked for by letter; no answer at September
30, 1912.

(c) Premiums on fire insurance placed by agent for account of sundry
clients not principals. Premiums will be paid to agent if risk is
accepted and he will deduct commissions of from 5% to 15% from
settlement with companies.

(d) Probably contains charges which might properly be capitalized
under caption “Furniture and Fixtures” if positive information
were available.

(e) Entries made in cash book by accountant, for rent collections ap-
pearing in monthly statements to principals but not appearing in
cash book or in duplicate of bank deposits obtained from banks.

(f) According to the terms of his employment the agent must remit
on the fifth day in every month.

Prepare the preliminary report and the statement submitted by the
accountant to Karl Smith, as at September 30, 1912.
The Journal of Accountancy

Answer to Question 2

EXHIBIT A

Agency Balance Sheet of Karl Smith, Real Estate Agent, Showing His Relation to His Principals at September 30th, 1912

<table>
<thead>
<tr>
<th>Assets held for the account of the principals:</th>
<th>Liabilities to principals payable in subsequent period:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash .................................. $350.20</td>
<td>The Frederick Apartment $2,385.30</td>
</tr>
<tr>
<td>Petty cash .......................... 100.00</td>
<td>The Venetian Court ...... 2,500.00</td>
</tr>
<tr>
<td><strong>Total</strong> ......................... $450.20</td>
<td>The Franklin Castle ...... 3,231.00</td>
</tr>
<tr>
<td><strong>Claims against principals:</strong></td>
<td>St. Martin Hall .......... 2,850.70</td>
</tr>
<tr>
<td>a. October rent collections remitted with September rents:</td>
<td></td>
</tr>
<tr>
<td>The Augusta Terrace..$215.00</td>
<td></td>
</tr>
<tr>
<td>The Victoria Court.... 805.00</td>
<td></td>
</tr>
<tr>
<td>The St. Quentin Court. 650.00</td>
<td></td>
</tr>
<tr>
<td>The Audubon Court... 270.00</td>
<td></td>
</tr>
<tr>
<td><strong>$1,940.00</strong></td>
<td></td>
</tr>
<tr>
<td>b. Disbursements for advertising, decorating and janitor's supplies, awaiting distribution to various owners:</td>
<td></td>
</tr>
<tr>
<td>The Evening Despatch.$ 75.00</td>
<td></td>
</tr>
<tr>
<td>The Morning News.... 35.00</td>
<td></td>
</tr>
<tr>
<td>Union Wall Paper Co... 111.20</td>
<td></td>
</tr>
<tr>
<td>Janitors' Supplies Co... 45.25</td>
<td></td>
</tr>
<tr>
<td><strong>Total .................... $266.45</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total ..................... $2,206.45</strong></td>
<td></td>
</tr>
</tbody>
</table>

Offsets of credits to principals:
Rents credited to principals and charged to tenants; not as yet credited *$390.00*

Agency deficiency ...........$9,860.35

Total ..........................$12,907.00
Total ..........................$12,907.00
New York C. P. A. Examinations of January, 1913

EXHIBIT B

Personal Balance Sheet of Karl Smith, Real Estate Agent, at September 30th, 1912

Furniture and equipment, $4,150.75 Insurance receivable (see contra) 920.10
Insurance payable (see contra) 920.10

Total .......... $5,070.85
Deficit ................. 5,709.60

$10,780.45

EXHIBIT C

Profit and Loss Account for Two Years Ended September 30th, 1912

Salaries .................. $12,140.00 Commissions .................. $22,510.00
Office expense .............. 3,130.00 Cash shortage .............. 380.00
Net profit—drawing acct. 6,860.00

$22,510.00

DRAWING ACCOUNT

Drawings .................. $16,930.00 Net profit .................. $6,860.00
Capita]—impairment ...... 10,070.00

$16,930.00

CAPITAL

Impairment .................. $10,070.00 Balance .................. $4,360.40
Deficit .................. 5,709.60

$10,070.00

Karl Smith, Esq.,
Real Estate Agent,
New York.

Dear Sir:

In accordance with your request of ............. I have made an examination of your books, records and accounts for the last two years, and in connection therewith I beg to submit, attached hereto, the following described exhibits:

* The two components of the balance shown by the tenant's account.
The Journal of Accountancy

Exhibit A. Balance sheet of the agency of Karl Smith, real estate agent, showing the status of his relations to his principals at September 30th, 1912.

Exhibit B. Personal balance sheet of Karl Smith, real estate agent.

Exhibit C. Profit and loss account of Karl Smith for the two years ended September 30th, 1912, followed by his drawing account and his capital account as adjusted at September 30th, 1912.

Your suspicions in regard to the extent of the shortage which you claimed to be due to the peculations of your bookkeeper-cashier are grounded only to an extent which is almost insignificant in comparison with the deficiency shown by your accounts in connection with your relations with your principals.

Your agency balance sheet shows that you have appropriated $9,860.35 of the funds which were intrusted to you in virtue of the terms of your employment as an agent. The admittedly involuntary conversion of these trust funds to your own use, was rendered possible by your failure to comply with the requirements of the law of agency which regulates your relations with your principals. Under the provisions of that law, an agent is required to keep his money and his property aside from that of his principals, and that of his principals aside from that of third parties. Unquestionably, your accounting has been of such a nature that the said requirements have been violated. Had you so kept your books that the cash received from the tenants of your principals would have been recorded in separate accounts so earmarked as to indicate the ownership of the funds represented therein, or, at least, in a separate agency cash account common to all your principals, you would not have taken advantage of the available cash balance of a cash account which you treated as your own, to increase your asset furniture and fixtures, and to defray the cost of running your business over and above the returns thereof in the line of profits. In this connection, it may be well to point out to you that while I have shown the asset furniture and fixture, as belonging to you, it is evident that it would belong to your principals if they were to claim it upon the ground that you have violated the terms of your employment, thereby inflicting upon them an injury for which you are liable.

The seriousness of your financial condition is far too evident on the face of your balance sheet to require extensive comments. You have no assets of your own, and it is impossible for you to remain engaged in your present business, unless you are able to obtain the funds necessary to restitute to your principals that which you have taken from them.

The cash shortage which appears on the debit side of your profit and loss account represents, so far as I have been able to ascertain from the conditions of your books, the extent of the defalcation of your bookkeeper-cashier. The peculiar method of keeping the so-called tenants' rent book, which has been in vogue in your office, has enabled your employee successfully to hide from you the fact that he was taking
advantage of an extraordinary looseness in accounting methods. It may be interesting to point out to you that even in the event of the said employee having been under bond, it would not be possible to hold the bonding company owing to the fact that your own carelessness and lack of control of your finances has led him into temptation, and deprived the bonding company of the employer’s collaboration, to which they are entitled.

While attempting to analyze your drawing account, I have received the impression that not a few of the charges made therein could have been made to the asset account, furniture and fixtures. However, I have refrained from adjusting the account, owing to the lack of positive information on the subject. I will point out to you that even though corrections of such a nature could be made to a considerable extent, they would not help you in the least, since, avowedly, you have acquired the asset furniture and fixture out of funds to which you had no right whatever.

In connection with what is called on the agency balance sheet submitted herewith “Claims against principals,” it must be stated that the attempt on my part to obtain duplicate bills for the amount of $266.45, which is shown as undistributed to the various principals, has failed up to date. As soon, however, as said duplicates and the required information are obtained, the accounts referred to will be closed by charges to the individual principals.

The spirit of the new accounting system which I have installed is so to arrange your accounts that each trial balance of your general ledger will show:

Your personal assets, your personal liabilities and your income debits and credits; and so far as your principals are concerned, the assets which you hold in trust for their account, the debts which you have contracted for their account, the balances of their account current, and, on either side of the trial balance, if the occasion arises, the debit or credit accounts which act as contras one of the other.

As soon as your business has been rehabilitated, it will, of course, be necessary to have at least one agency bank account where all the funds of your principals will be deposited, and upon which you will draw for your own account only at the time when you are entitled to the commissions on your collections of the month.

The tenants’ ledger which has been placed in operation, is so arranged as to show monthly the tenants’ arrears of the prior month, the charges for the current month, the credits for arrears or current rent, either in the form of cash paid by the tenant or in the form of concessions chargeable to the principals.

The cash book shows, in separate columns, the cash receipts and the cash disbursements made for the account of each one of the properties managed.

The voucher record contains in appropriate columns, the details of
the liabilities incurred by you for the account of the principals in connection with the management of their properties.

From these different records the following entries will be made monthly:

- Debit "Tenants" and credit "Principals' account current" with the current rent.
- Credit "Tenants," debit "Principals' cash" with the collections.
- Debit "Principals," credit "Principals' audited vouchers" with the amount of the invoices received during the month.
- Debit "Principals' audited vouchers," credit "Principals' cash" with the amount of liquidation of liability for audited vouchers.
- Debit "Principals' account current" and credit "Agent's commission account" with the commissions on the collections.
- Debit "Principals' account current" and credit "Principals' cash" with the remittances of the month.
- Debit "Agent's general cash" and credit "Principals' cash" with the amount of the check covering the commissions.

Thus the trial balance of your agency will reveal the following:

Debits
- Agency cash
- Tenants—uncollected rents

Credits
- Principals' audited vouchers unpaid
- Principals' account current

I have also drawn a form of monthly statements to principals, which, besides giving more detailed information than the one you are using at present, will enable you to check personally the different data recorded therein. The form will contain practically a copy of your agency transactions with your individual principals as shown by the columnar books referred to above. Under the provisions of the law, your principals are entitled to such a copy, if they care to have it. The monthly statements will show:

The arrears of rent and of charges made against tenants for electricity, telephone service and extension and miscellaneous items collectible from the tenant; the current rent and current charges as stated above; the collections of arrears and current charges; all the required information in connection with the bills received for work done on the properties managed; commission charged by you, and the remittance accompanying the statement.

Yours truly,

(To be continued)
Correspondence

Importance of Comments on Reports

Editor, The Journal of Accountancy:

Sir: In your March issue, we notice that Mr. R. J. Bennett answers question 7 of the Pennsylvania C. P. A. examinations of November, 1912, in detail. On page 220 of The Journal he has the following words: "I have carefully examined the books and accounts for the past five years and have set forth the entire data in the accompanying statement."

We would like to ask the gentleman just what he means by the above sentence. In doing this we do not mean to place ourselves in a position where it would appear that we desired to "try to be smart," for such is not the case.

In our territory we find one of the most important features of accounting work is the letter, or text, that is written accompanying the report. It is one that has given our office a great deal of work and hard study, and we are trying to improve on this particular subject in every way that we can, and our special object in writing this letter is to find out from Mr. Bennett what he means by the sentence that we have brought up. We find that it is highly advantageous to state plainly whether or not we audited the books, the exact time that we covered in all the departments of the books, and how we verified the inventories, the accounts receivable and bills receivable and the accounts payable.

We audited a large wholesale grocery house only a few months ago and the proprietor, when we came to checking up the merchandise, was out of town, and his secretary and treasurer advised our accountants that as the accountants who had made the examination for some three or four years previous to our examination had not done this, he would rather they would not go into it. We did not like this, but our men were working under his direction and, of course, his wishes had to be respected. However, when we turned in our report, we stated in the text of it that we did not get invoices to support the giving of the cheques, as this was requested to be passed up by the secretary and treasurer. As soon as the proprietor found this out, we were called down to his office and he very plainly informed us that he had been informed that the merchandise account had been thoroughly checked each year and this was a big surprise to him, and he positively stated that next year he wanted us to check the account very carefully, even though it took twenty days to do it. The account that we refer to was handled on the following basis: The firm carried no accounts payable ledger for the reason that everything was paid for by cash and discount taken whenever it was possible. Two columns on the cash book represented the merchandise account, one column was used for foreign purposes and one for local purposes, cheques were drawn from time to time, paying off different firms, and then entered on the cash book, giving the name of the
The Journal of Accountancy

firm and the amount placed in one of the merchandise columns. Very frequently they would get some New York exchange and sometimes they would lump ten, fifteen or twenty cheques in one amount and enter it on the cash book, say to merchandise. Of course, the cheque stub, or register, would show the amount in detail.

Suppose we had reported to the wholesale grocery that we refer to that we had audited, or examined, their accounts without telling them plainly what we had not done, and a big defalcation had sprung up in the merchandise account, where should we be? We know of any number of accounting firms, and some of them the very best firms of New York, Chicago and other places, that have had their representatives in this territory, who have been bitterly censured because of certain omissions which could have been easily obviated had they stated what they did and did not do. In other words, is it not highly important for the protection of the profession and one's office to be careful to state in detail what is done, giving special attention to the dates covered, say in checking back the representative accounts, verifying accounts receivable, going into the inventory and accounts payable, and other phases that might need particular attention?

In conclusion, from Mr. Bennett's statement, would the average layman construe from the text of his report that by this expression, "I have carefully examined the books and accounts for the past five years and have set forth the entire data in the accompanying statement," that he had thoroughly audited the books, verified the accounts receivable and payable, gone over the inventories, and to what extent, and if proven by certain calculations other than the mere checking of them or going over them? If you will give us your views on this matter and have Mr. Bennett answer us, personally, or through The Journal, we shall very much appreciate it.

Yours very truly,
O. R. Ewing & Company.

Memphis, March 22, 1913.

Mr. Bennett's Reply

Editor, The Journal of Accountancy:

Sir: The letter from O. R. Ewing & Co. to The Journal of Accountancy has been forwarded to me for reply. It is customary for the accountant to write a report or letter to accompany the statements or exhibits which he submits to his client, but the length of the report must, of course, depend upon the accountant's judgment as to how much information he should place therein. Sometimes this report or letter covers only a few lines, while at other times it is more extended and may cover even several pages. Of course the matter contained should be set forth clearly and unmistakably, with any suggestions or recommendations deemed necessary, and perhaps explanatory paragraphs bearing on items which appear in the accompanying exhibits. It seems in-
advisable, however, to encumber the report with references to minor matters which could be brought orally to the attention of the bookkeeper or office manager. It seems unfair also for the accountant to use his official position to criticize employees unless the occasion really demands it. In many cases unimportant errors can be corrected, or even a change in plans brought about with more harmonious results, through personal advice rather than through criticism of work by way of the report. A kind word costs nothing, and a few words of advice may work wonders in the life of an employee.

Sometimes it is advisable to present a supplementary report. This may be directed to the president, the treasurer or the office manager, setting forth ways and means for improving the accounting and office methods. It will be seen that this does not form a part of the report, but is simply a separate letter of suggestions and instructions.

I am grateful for the suggestions regarding the sentence in my answer to question 7 in the March issue of The Journal. It evidently could be materially improved by a change in wording and by stating more clearly the scope of the examination. Instead of saying, "I have set forth the entire data," I might have stated that the information contained therein had been condensed from the book accounts as a result of my investigations. Other qualifying words could also have been included, such as would obviously come to one's mind in an actual case. Of course the exhibit itself indicates the period under review, while the letter states that I have made a careful examination of the books covering the five years ended December 31, 1911. The letter or report is very important, as suggested in my opening remarks on question 7, yet my answer was prepared more to illustrate the manner of preparing reports and statements than to set up model phraseology. I heartily agree, however, in the emphasis which Ewing & Co. place upon the report, because if it is made at all it should be made carefully; but if it is made lengthy for the purpose of saying something or for offering advice, there is always the possibility of saying more than is necessary and of being misunderstood.

Faithfully yours,

R. J. BENNETT.

Philadelphia, April 1, 1913.

Louisiana State Board of Accountancy

The Governor of Louisiana has appointed Guy V. W. Lyman of New Orleans to fill the vacancy in the state board of accountancy.

Mr. Lyman is secretary of the Society of Louisiana Certified Public Accountants.

The new board organized by the selection of C. E. Wermuth as president, Moses Elkins as secretary, and G. V. W. Lyman as treasurer. The examination to be held in New Orleans on May 23 and 24 will be the first since 1911.
Oregon State Board of Accountancy

The Governor of Oregon has announced the personnel of the Board of Accountancy created under act passed this year. The following are the members of the new board:

John Y. Richardson, Portland.
Arthur Berridge, Portland.
A. McE. Ball, Portland.
W. H. Wann, Medford.
Charles L. Parrish, Klamath Falls.

The Oregon law becomes effective June 4th.

Tennessee State Board of Accountancy

The Governor of Tennessee has appointed the first board of accountancy under the new law as follows:

George M. Clark, Chattanooga, three-year term.
F. M. Pike, Memphis, three-year term.
Walter S. Black, Knoxville, three-year term.
Ira P. Jones, Nashville, two-year term.
O. R. Ewing, Memphis, one-year term.

Announcements

Wright, Schooley and Morse, public accountants, announce that their office is now in the Woolworth Building, New York.

It is announced that M. H. Bennett, William Mackendrick and Frederick F. Hahn, certified public accountants, have consolidated their practices under the firm name of Bennett, Mackendrick and Hahn, with offices in the Hellman Building, Los Angeles, California.

D. B. Lewis & Company, certified public accountants, Boston, Massachusetts, announce that they have transferred their office from 708 to 542 Exchange Building, 53 State Street.

It is announced that T. B. Cornell has withdrawn from the firm of Smith, Brodie & Cornell, certified public accountants of Kansas City. The business will be continued by F. A. Smith and A. F. Brodie under the firm name of Smith & Brodie.

The Pace Institute of Accountancy announces that Harold Dudley Greeley, L.L.M., C.P.A., has been elected director of the division of accounting instruction in the metropolitan schools. Mr. Berton L. Maxfield, Ph.B., continues as director of the division of law instruction. Approximately 2500 students are enrolled for the professional three-year courses in the Pace Institute of Accountancy and the nineteen affiliated resident schools conducted in conjunction with the Young Men's Christian Association in New York and other prominent cities.
BOOK DEPARTMENT

BUILDERS' ACCOUNTS. BY JOHN A. WALBANK, F.C.A. GEE & COMPANY. LONDON, 1913. THIRD EDITION. 96 PAGES. $1.40.

There is a very slight difference between the former edition of Builders' Accounts and the present volume, the most important being the fact that provision is made in the pay roll book for handling health insurance under the English national insurance act of 1911. Otherwise no changes of importance have been made since the book first appeared in 1903. That no improvements are suggested during a period in which American building methods have made such enormous strides would seem to indicate that the book will be of but little value to an American.

It is claimed that the system described may be adapted to the needs of both small and large contracting builders, yet the system suggested as suitable for large undertakings has such very burdensome and antiquated methods that we cannot see how even in England it can be advantageously used. For instance, as to pay roll, the foreman makes daily returns in writing, giving the name of each workman. The idea of the foreman writing the names of all the men each day is amusing. No method is suggested for distinctive serial numbers for various classes of work, such as contracts, jobbing work, extra, etc. The overhead, added to actual cost, is a percentage on the wages, instead of in addition thereto a percentage on material handled.

The financial records are made cumbersome by regarding the cost records as an integral part, instead of being partly subservient thereto. The stores issued are handled in a columnar book instead of on cards or loose leaf—an almost impossible procedure for a large contractor. Accrued wages at closing period are not considered sufficiently important to distribute to the jobs and contracts to which they belong, yet it is advised to take profits on the finished portion of uncompleted contracts. Accrued wages are shown only on the pay roll account as a total. The overhead expenses are not treated scientifically in a separate section of the profit and loss account, thus losing the value of that part of the system whereby they are considered in the cost accounting. Payments of the notes payable are not covered by cheque, although all other payments are so covered. Safeguards on pay roll and other well-known internal checks are not mentioned.

It was to have been hoped that a book from the press of 1913 would give us an insight into the progress in modern accounting of our brethren across the water, but we are disappointed in this. We must, in fact, refuse to accept it as a modern English book. Nevertheless, as nothing like it exists in America it is a valuable book for students and small builders.

JOHN B. GRIJSBEK.
The Journal of Accountancy

INTEREST AND BOND VALUES. By M. A. MacKenzie, M.A., F.I.A.,
A.A.S. Toronto University Press. 1912. 94 + 10 pages. Cloth. $2.

The purpose of this book is to set forth in a clear and simple manner
the principal facts relative to interest computations and the calculations
of bond values, and also to explain the use of the various tables con-

The use of algebraic symbols and expressions is almost unavoidable
in a book of this nature, and some of the pages will doubtless seem
formidable to those not accustomed to algebra. However, the algebraical
portions of the book are comparatively small, and should not militate
against its value to the business man or student unfamiliar with higher
mathematics. The most original work is found in the problems and
exercises in the latter part of the text. These are well selected, and a
solution of them by the reader should be of great benefit and will much
increase his grasp of the subject. A valuable addition is the insertion
of five tables of interest computations, covering twelve different rates
from one to five per cent for any number of periods from one to fifty.
In the case of the tables, it would possibly have been better to have the
number of decimal places uniform, say seven or eight, instead of four
in some instances and six in others.

LEROY L. PERRINE.

BOOKS RECEIVED FOR REVIEW

Accountants' and Bookkeepers' Vade Mecum. By G. E. Stuart Whatley,
London. 2d edition, 1913. 168 pages. 8vo, cloth. Price, $2.50. Gee
& Co.
Accounting Principles. By S. F. Racine. 1913. 274 pages. 8vo, cloth.
Price, $3. S. F. Racine Co.
Buyer's Key for Textile Cost Finding. By F. P. Bennett. 1913. 35
Cost Finding in the Cloak and Suit Industry. By Philip Frankel. 1913.
Cost Reports for Executives as a Means of Plant Control. By B. A.
Franklin. 1913. 149 pages. 8vo, cloth. Price, $5. Engineering Maga-

Experiments in Industrial Organization. By E. Cadbury. 1913. 296
pages. 8vo, cloth. Price, $1.60. Longmans, Greene & Co.

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The American Association of Public Accountants

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Principles of Double-Entry Bookkeeping
By CHARLES M. VAN CLEVE

Of course the object of advertising a book is to sell it, but in this case that is not the only object. Even if he did not sell a single copy the author of this treatise would consider himself amply repaid if by means of these advertisements he could persuade accountants to adopt an intelligible form of report, because he is convinced that that is the one thing needed to raise the art of accounting to its proper place in the estimation of the public. The people in general have no technical knowledge of bookkeeping, but they know that in order to determine how much an individual or a firm or a corporation is worth one must deduct the total of the liabilities from the total of the assets, and therefore they know that the form of statement showing assets and liabilities equal isarrant nonsense.

The book explains double-entry bookkeeping, and for that reason it is recommended to all who appreciate the difference between a man who can give a rational explanation of his operations and one who merely follows a mechanical routine. But the accountant does not need the book to enable him to make his report in proper form. All he needs to do is to keep his books and make his balance sheet exactly as he has always been accustomed to do it—and then to consider what the items on his balance sheet mean. In the case of a corporation, and under normal conditions, all of the items under the head of "Assets" represent assets from the standpoint of the stockholders, and therefore the items under the head of "Liabilities" are the only ones about which there is any question. In regard to each of these items the only question is: Does it represent liability from the standpoint of the stockholders? If it does not, it must represent part of the net capital. As illustrated in the advertisement in the March number of The Journal, the accountant now enters on the left-hand side the assets and the total, and on the right-hand side the liabilities and the total, and also the balance, which represents the net capital. He carries the balance down on the left-hand side and then enters on the right-hand side the various items which compose the net capital, giving the totals to show that the two sides are equal.

That process is of universal application: no balance sheet ever has been made or ever can be made to which it will not apply, and any person of ordinary intelligence can apply it. If accountants will adopt that simple suggestion and make their statements in a form showing assets, liabilities and net capital separately, they will be surprised to find how much higher a place their occupation will hold in public esteem.

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