THE JOURNAL OF ACCOUNTANCY

NOVEMBER, 1909

VOLUME 9. NUMBER 1

THE HONESTY OF WALL STREET
By ERNEST S. SUFFERN

Illegality of Limited Partnerships as Bankers in New York
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State Administrative Supervision over Local Accounting
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The editors will be glad to receive and to consider for publication articles from well-informed persons, and will welcome especially contributions from expert accountants. The manuscript of articles not available for publication will be returned on request.

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The Honesty of Wall Street.

By Ernest S. Suffern, C. P. A.

The changes in law and stock exchange administration recommended by Governor Hughes' Commission are worthy of serious consideration. There is a world of difference between their point of view and treatment and that of the magazine articles that have been published, which show up Wall Street as the centre of iniquitous practices and conditions. In general the statements of facts in these magazine articles are correct, but it is quite the contrary with the impressions conveyed. Note the inference in the following. One of the magazines, referring to accounts which are known as numbered accounts, because the name of the real owner is concealed behind a number (a practice which enables a man making large trades to conceal his attitude when the fact that he is buying or selling merchandise would affect the market against him, and which in almost every line of activity is considered good business usage), admits that there are legitimate dummy accounts, but adds the statement, "legitimate at least by Wall Street's rather twisted code of ethics." The harm that such statements as this can do in the mind of the public is easily seen.

The apparent aim of these articles is good. In so far as they persuade men of the general futility of stock gambling, their result is beneficial, and their attitude is certainly much better than former invectives by the prophet who tried to teach folks to "beat the system" at its own game. To-day too large a percentage of our country believes that Wall Street is pervaded by unscrupulous and iniquitous practices, and these articles create harm chiefly in continuing and spreading these false impressions as to the rottenness of our great financial center.
The Journal of Accountancy.

The trouble is that few of us reason, and a specious array of figures and irrelevant facts is apt to convince us that the enormous capital invested in and about Wall Street is invested to maintain an extensive system of gambling. One fact not recognized by these articles is that, in times of stress, it is usually the weak and dishonest houses that suspend. Nearly always when a brokerage firm falls into bad practices it is because the firm tries to divert its capital to its own use or to conduct a line of brokerage business altogether too large for the capital invested. They overextend, they can not readily liquidate, and a sharp change in the market forces them to suspend. If several of the insolvent firms are found dishonest, it does not prove that a similar percentage of dishonest houses exist among the ones which continue. On the contrary, those conversant with stock exchange matters know that the large part of stock exchange brokerage firms are thoroughly honorable.

The Investigating Committee appointed by Governor Hughes made careful examination into every condition of stock exchange operations and affairs. Their criticisms are sane and sound and afford an opportunity for serious consideration. Their report is fair and will be appreciated by all those who are seriously considering means for improving stock exchange conditions. In so far as the authorities of the stock exchange find it feasible, they will probably put into effect the recommendations of the Commission. Many practical difficulties will, however, be encountered. The governing board of the stock exchange through a special committee had previously considered abuses which were or might be prevalent and had endeavored to take steps to remedy them.

Governor Hughes' Committee recommends the advisability of a law which should make it a misdemeanor for a broker to do business after he had become insolvent, provided he had on his books an account or accounts which if liquidated would exhaust his assets. The Commission evidently realized the impossibility of holding a broker technically liable for knowing the exact condition of his affairs were they liquidated at any particular moment. To know these facts it is necessary to arrive at the market values of all securities at the selected moment, and, using these figures, to compute the net equity or deficit in all of the accounts. The exact condition of the firm at that time can only be known, then, after all of the accounts have been reduced to a basis of
The Honesty of Wall Street.

dollars and cents as though the stocks were liquidated at the current prices. There is no excuse, however, for those concerns which are insolvent for periods of weeks and even months before their failure, and whose final downfall could have been foreseen and in a measure averted. Taken in time, there is no doubt that in a situation such as this the assets would be much more apt to equal the liabilities than in the case of most of the recent stock exchange failures.

In this connection the Commission takes occasion to recommend that rules be made by the exchange for periodic examinations of the accounts of its members. Objections have been made to this proposal, on the ground that it would give certain members of the exchange too much information about the business of their competitors. No broker would want to have the information pertaining to his firm or his clients become the property of other brokers. However, means could be adopted to prevent unfairness in this respect. Probably in the case of every important stock exchange house which has assigned within the last two or three years, an examination of its affairs some months before failure would have shown a weak condition. In some cases the matter had run on for years. Many failures could be prevented and losses would be greatly minimized if a stock exchange committee could always know the exact condition of every firm's business. This could probably be worked out on a basis somewhat as follows:

The stock exchange committee should receive quarterly or semi-annually condensed reports of every firm's business, made out on a form in some such arrangement as the following:

\[
\begin{align*}
\text{Assets} & \\
\text{Cash on hand and in banks} & \ldots \ldots & \ldots \\
\text{Securities deposited with banks and bankers} & \ldots \ldots & \ldots \\
\text{Less loans against same} & \ldots \ldots & \ldots \\
\text{Equity} & \ldots \ldots & \ldots \\
\text{Securities on hand:} & & \\
\text{At current quotations} & \ldots \ldots & \ldots \\
\text{Unquoted—at cost (value verified)} & \ldots \ldots & \ldots \\
\text{In transfer} & \ldots \ldots & \ldots \\
\text{Total securities on hand} & \ldots \ldots & \ldots 
\end{align*}
\]
The Journal of Accountancy.

Miscellaneous Accounts Receivable:
- Secured (otherwise than by stocks and bonds) ...........................................
- Unsecured ........................................................................................................

Total ..................................................................................................................

Equity (if any) in stocks borrowed and loaned..................................................

*Investments other than securities ..................................................................

Firm’s equity in market transactions or error account ......................................

Total assets ........................................................................................................

Liabilities.

Securities carried for customers:
- Owned outright (if shown on ledger) ............................................................
- On margin ........................................................................................................

Total ..................................................................................................................

Less debit balances against same .................................................................

Net due customers ...........................................................................................

Free balances due customers ...........................................................................

Total due customers ........................................................................................

Other accounts payable ...................................................................................

Deficit (if any) in stocks borrowed and loaned ................................................

Firm’s deficit in market transactions or error account .....................................

Capital accounts of partners ...........................................................................

Profit and loss ...................................................................................................

Total ..................................................................................................................

Total liabilities ..................................................................................................

These examinations could be made by certified accountants selected by the various firms. In addition, the stock exchange committee should have authority to investigate any house at any time when it considers it desirable, by means of accountants of their own choosing, from whom they would receive a similar report.

The chief objections which have been made to such statements have been on the ground of the information which would be revealed. By the above statement no information would be divulged which the houses dealing with a firm would not be entitled to know. The capital invested would be shown. The relation of capital to the volume of business done would also be shown. The securities dealt in and the detailed statement of the position of the firm in the market would not be revealed.

These reports should be submitted direct by the examining

*To be investigated if large.
accountants to the auditing committee of the exchange. They should include not merely the above statements of the liquidated condition of the firm as of a certain date, but also all confidential remarks and comments as to any transactions which appeared questionable or illegitimate. On the other hand, the examined firm would be protected as their internal affairs would not be unnecessarily revealed. Certified accountants of standing may always be trusted to preserve inviolate the affairs of their clients. Nearly every crooked practice would be eliminated by the fear of the examinations, and with the absolute power which rests in the hands of the stock exchange authorities derelictions would become scarce.

The accountants retained in each case would be expected to satisfy themselves of the nature of every "blind" or numbered account. They should be authorized to examine into the current value of any investments not easily negotiable, and they should appraise such securities on a basis which they should decide to be the current value at which the security could be disposed of. It is questionable whether a stock exchange firm has any right to invest large sums of their own and their client's moneys in securities which can not be liquidated at a moment's notice. A ruling might be made requiring that all stock exchange houses keep their investments in sufficiently liquid condition to enable them to be solvent on a basis of immediate convertibility.

There were many valuable suggestions on other lines included in the report of the Committee on Speculation, but probably no single step toward legitimatizing and safe-guarding stock exchange operations would be so important as a step taken by the stock exchange authorities to enable them to ascertain and supervise the financial conditions of its members.
Illegality of Limited Partnerships as Bankers in New York.

By Henry Fletcher, LL.B.

The question of the legality of limited partnerships engaged in the business of banking in New York has become especially important in the last few years, because this arrangement seems to have appealed to many engaged in the banking business in the Wall Street district, with the result that special partners in banking houses have latterly become more and more numerous.

In order to thoroughly understand the present position of limited partnerships engaged in the business of banking in New York State, it will be necessary to review to some extent the history of both the banking and commercial law in this state during the early part of the nineteenth century. In the early years of that century the banking business in New York State had been free, that is, any person, firm, or association was permitted to engage in the banking business without hindrance of any kind, while it was necessary for all banking corporations to obtain special charters from the legislature. This attitude of the State of New York toward the business of banking by others than corporations led to great abuses and to the issue of much worthless bank paper. The banking difficulties at that time resulted in the passage of various acts restricting the number of persons and associations who might engage in the banking business.

The first Restraining Act, as it was called, was passed in 1804. This act restrained private associations from engaging in the business of banking unless specially authorized by the state to do so. It placed private associations on the same basis as corporations, inasmuch as banking corporations had always been compelled to obtain special charters from the legislature. The act of 1804 was re-enacted in the Revised Laws of 1813, but when the privilege of free banking had been abused by individuals, it became necessary to pass a broader act which would restrain individuals, as well as associations, from engaging in the banking business without special authority. Such a law was passed in 1818. The result of this last act was that after 1818 no person, firm, corporation or association could engage in the banking business in New York State without special permission.
Illegality of Limited Partnerships as Bankers in New York.

It is true that these restraining acts were aimed almost entirely at the wholesale issue of banking paper intended to circulate as money; but the acts themselves, particularly the later ones, acted as a restriction on all banking business and restrained every one, except those specially authorized, from engaging in any branch of the banking business. The banking business as it then existed was held by the New York Court of Appeals to consist of three branches: the discount of paper, the acceptance of deposits and the issue of currency. The same court further decided that the restraining acts prevented any person, firm, association or corporation from engaging in any one of the three branches of the banking business unless specially authorized by the legislature.

During the early part of the nineteenth century the commercial law of the United States had been developing, with the result that there was a demand for an organization of some kind in which a man might be a partner, but, as such partner, might limit his liability to the creditors of the firm to which he belonged. The common law of England, and that of New York as well, recognized no partnership except a general partnership, that is, a partnership in which all partners interested in the profits of the business were liable for the full amount of the firm obligations up to the entire amount of their private fortunes. The necessity for a limitation of this partnership liability caused the passage in 1822 of the first Limited or Special Partnership Law enacted in the United States. New York was the first state to copy this law from the French Commercial Code. The act of 1822 provided that any two or more persons might form what was known as a limited partnership for the transaction "of any mercantile, mechanical or manufacturing business." The special partner in such a firm might, under the act, limit his liability to the firm's creditors to the amount originally invested by him in the firm. There was a provision, however, that the law should not be construed "to authorize any such partnership for the purpose of banking or insurance." This clause was inserted for fear that there might be an attempt to claim that special partnerships were impliedly authorized to engage in the banking business.

During the financial troubles about 1837, however, it gradually became apparent that the right to issue notes to circulate as money was the real cause of much of the banking difficulties at that time, and that the right to discount paper and accept deposits was not
necessarily connected with the right of issue as a cause of the
financial disturbances. This attitude of the public mind led in
1837 to the passage of a law repealing the provisions of the Re-
straining Acts, in so far as they prevented private persons, associa-
tions or firms from discounting paper or accepting deposits. The
act, however, referred only to the previous banking law, and there-
fore did not affect in any way the special partnership law which
was passed in 1822. After 1837, therefore, private persons, associa-
tions and general partnerships were on a different basis from
the limited partnerships permitted by the law of 1822. The
former were permitted to discount and accept deposits, whereas
the limited partnerships were still prohibited from engaging in
any branch of the banking business for the reason that the special
partnerships were by law limited to businesses of a mercantile,
mechanical or manufacturing nature. There arose a demand,
however, for special or limited partnerships in businesses other
than those of this character, and the result was that in 1866 the
Partnership Law, relative to limited partnerships, was amended
so that the device of a limited partnership might be used in any
lawful trade or business. This law, however, still continued to
retain the provision that nothing in the law should be construed
to authorize any limited partnership for the purpose of banking or
insurance. It is probable that this provision at the end of the
Special Partnership Law of 1866 was inserted there without
much consideration, and merely following the form laid down in
the law of 1822.

The Limited Partnership Law of 1866 remained in the above
form until 1897 when it was amended so as to provide that a
limited partnership might be organized to do any lawful busi-
ness "except banking and insurance." The law of 1897 was
enacted in the Consolidated Laws of 1909 (Consolidated Laws,
Partnership Law, §30). It will therefore be seen that what was
originally intended in the Partnership Law of 1822 as a state-
ment of a rule of construction to the effect that the law should not
be construed to authorize a limited partnership in banking and
insurance, was changed so that the law now definitely reads that
the limited partnership may exist in any business except banking
and insurance.

Unless the word "banking" be construed to extend only to
the issue of currency the present limited partnership law must
Illegality of Limited Partnerships as Bankers in New York.

make limited partnerships accepting deposits or doing other branches of the banking business absolutely illegal. As we have already seen the term "banking" consisted originally of three branches: loaning money or discounting paper, accepting deposits and issuing currency. To-day the private bankers in Wall Street who advertise and represent themselves as bankers have certainly lost the power to issue currency under the present Banking Law (§107), but have retained two branches of the banking business, as originally defined, i. e., that of discounting paper or making loans and accepting deposits. It can scarcely be claimed by such houses that the banking business referred to in the Partnership Law of 1897 was only the issuing of notes to circulate as money. The special partnerships therefore in the Wall Street district, which accept deposits and engage in all branches of banking business except issuing currency and circulating notes, are illegal.

If it had been the case that the special partnerships were associations recognized at common law, there might have been ground for claiming that a law restraining them from engaging in such branches of banking business as were permitted to private bankers and individuals, would be invalid and unconstitutional. However, since the limited partnership is entirely a creature of statute, it is difficult to argue with success that any reasonable restriction as to the kinds of business in which it might engage is invalid.

The question remains as to the effect of the illegality of the limited partnerships in banking. The rule with regard to limited partnerships has always been that, unless the law is closely complied with, the firm continues in contemplation of law to be a general partnership (Consolidated Laws—Law of Partnership, §34). This rule would undoubtedly be extended to an unlawful limited partnership in the banking business. Inasmuch as such a partnership would be held illegal, the so-called special partners would undoubtedly be held under the law as general partners and would therefore be liable personally for all the debts of the firm. This ruling would absolutely nullify the purpose of those persons who are now known as special partners in Wall Street banking firms, and if these conditions were rightly understood, most of such special partnerships would be discontinued.

At the present time there seems, it is true, little reason why a
special partnership in the banking business should be illegal, and it may be that the present partnership law ought to be amended so as to give the public the privilege of organizing special or limited partnerships to do a banking business. Until such an amendment is made, however, it is believed that the so-called special partners in banking houses in Wall Street have not limited their personal liability by the form of their partnership agreement.
Progress of the Accounting Profession.*

By Joseph E. Sterrett, C.P.A.

It is always gratifying to report a substantial increase of membership, and the report of the Board of Trustees will show a considerable gain in our numbers during the past year. While the gain secured indicates a healthful growth, I am inclined to believe that our membership might be much larger if a more persistent effort was made by the constituent state societies to get into their membership all the accountants to whom certificates have been issued. A comparison of the number of certificates issued with the total membership in the respective state societies and in this Association would seem to indicate that the benefits of such membership are not fully appreciated by many of the holders of C. P. A. certificates. While undoubtedly the state societies do represent the best life of the profession in their several localities, it may be suggested that the effective usefulness of each would be multiplied by the admission to membership of a larger proportion of those who are qualified for such membership.

The report of the trustees embodies, as heretofore, reports of the various officers and committees, and from most of the state societies, to all of which your careful attention is requested. It is neither necessary nor desirable to attempt at this time a comprehensive review of these reports, but the time does seem opportune to refer briefly to a few matters suggested thereby.

The report of the treasurer shows that the Association has kept its expenditures within its income, and while this in itself is commendable and denotes a financial policy that should be adhered to, the fact none the less remains that the Association ought to increase its activities and thereby necessarily increase its budget.

As yet the Association has no fixed habitation. The officers of the Association have always cheerfully given the use of their private offices for trustee and committee meetings, and this course has imposed no serious burden upon them. Viewed, however, from the standpoint of the Association, it will be readily acknowledged, I think by every one, that the lack of suitable headquarters detracts from the dignity and influence of the Association. In my judgment, it is highly desirable that the Association at an

* Annual address by President Joseph E. Sterrett before the American Association of Public Accountants in convention at Denver, Colorado, Oct. 10, 1909.
early date secure one or two good rooms in the city of New York, or such other city as may be selected by the Association, for use as an official residence. The present income of the Association, however, is not sufficient to enable the necessary appropriation to be made, and until means are found of increasing the revenue, it is useless to consider any steps toward the end suggested.

Our profession is constantly widening in its scope, and this Association should take a more active interest in legislative, educational, and business problems. We believe that by training and experience the public accountant is fitted for broad and useful service in the community, and it is gratifying to all of us to see the increasing recognition that is being given to this claim. Under its present form of organization, however, our Association is not fully prepared to deal with many of the problems with which it is confronted or to branch out along useful lines that are constantly opening to it. I am convinced that it would be much to the advantage of the Association if it were to secure the services of an executive officer, who might also perform the duties of the secretary, who would be free from the limitations that are necessarily placed up on one who is at the same time in practice as an accountant. Such a man as I have in mind should be well trained in the ways of business, broad-minded, and of agreeable, but forceful address. He should be capable of initiating work and enlisting the co-operation of members of the Association in carrying out plans undertaken. Being free from professional engagements and free from the implications of personal motive that might be laid at the door of any one in active practice, he would be able to keep in close touch with other representative business and educational bodies, and as occasion might require, act as representative of this Association. Our present secretary, who has labored so faithfully in the interests of the Association, understands that in what I have just said I am not expressing a criticism, but simply stating a condition, and I believe I am not alone among those who are intimately acquainted with the present needs of the Association in feeling that the condition to which I am directing your attention is of such moment as to warrant your very careful consideration. Without increased revenue, however, your Board of Trustees is powerless to act, and how to secure a larger income is a problem not altogether easy of solution. The logical method of increasing our revenue would seem to be
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through an increase of annual dues, but there are practical rea-
sons that tend to make this course difficult if not impossible for
the present. One reason is that a change in the by-laws of the
Association would be necessary, and this in turn would involve a
change in the by-laws of probably all the state societies. An in-
crease in membership dues is never a popular proposal, and it is
quite probable that were such an increase to be proposed it would
fail to meet with satisfactory support. In view of the delay and
the possible opposition that might be encountered in securing an
increase of membership dues, it has been suggested that many
members of the Association would be willing to subscribe, say, for
three years, to an annual fund to be used to supplement the in-
come of the Association. The adoption of this plan would work
no hardship on any one, as subscriptions to the fund would be
purely voluntary, and when the value of the results attained from
the broader activities made possible through this increase of ex-
penditure has been demonstrated, no doubt this provisional
fund would be displaced by an increase of dues or perhaps ren-
dered unnecessary through an increase of membership. What-
ever the means adopted, it seems certain that the Association is
approaching a point (if indeed it has not already reached it)
where its activities must be increased if its usefulness to the
profession is to be at all adequate.

During the past year five states have passed legislation regu-
lating the profession of accountancy. These states are Montana,
Minnesota, Massachusetts, Missouri and Nebraska. It is inter-
esting not only to note the increase of C. P. A. states, but also to
compare the rate of the growth of this legislation. As you all re-
member, the first law was passed in New York in 1896. This law
stood alone for three years, until in 1899 the Pennsylvania statute
was enacted. In 1900 Maryland fell into line, and in 1901 the Califor-
nia law was passed. The last year in which no C. P. A. legisla-
tion was attained was 1902, but in 1903 both the Illinois and
Washington bills were passed. In 1904 only one law was secured
—that of New Jersey—while in 1905 two laws were passed, and
in 1906 only one was added. Since that time the growth has
been more rapid. In 1907 we find three laws enacted, and in
1908 three, while, as has just been stated, during the year we are
now closing five new laws have been made effective.

In addition to the laws that have been enacted, a number of
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bills have failed of passage in other states, but, with the persistence that has characterized the entire C. P. A. movement, no doubt these will be brought forward during the coming winter, and it is expected that next year the list of C. P. A. states will be substantially increased.

A good deal of variety exists in the twenty-one C. P. A. laws that have been passed, and while in recent years the Association through its legislative committee has exercised a helpful influence toward uniformity in essentials, there are bound to be differences in details. The value of C. P. A. legislation depends partly upon the form of the law itself, but even more upon the rules of the board of examiners and the intelligence and fidelity of the members of these boards in executing the law and applying their rules. In all or nearly all of these laws there is a provision, either expressed or implied, giving the board of examiners a wide discretion in carrying out the provision of the act. It is right that such discretionary power should be lodged in the board, as otherwise its actions are hampered and the results achieved must be impaired.

An essential feature that should be found in every C. P. A. law is a provision to the effect that its enforcement shall rest upon a board of examiners that in the ordinary course will be responsive to the best professional sentiments. In this way only is it possible to maintain standards of admission to the profession that will be reasonable in their application to current conditions, and yet constantly progressing toward higher planes.

We should be encouraged by the success that has attended past efforts to secure C. P. A. legislation, and we should press forward with vigor for laws in states where none now exist, but we must not for a moment forget that each new law places a responsibility upon the profession, and in the enforcement of these laws the profession, and especially the examining boards, must be guided by high ideals and entire fidelity of purpose. Because of the intimate relation between the administration of these laws and the development of the profession itself, it seems to me that the Association has not only a right but a duty to maintain a friendly and sympathetic, but none the less vigilant, attitude toward the work that is being done by the boards of examiners. So far as practicable uniform standards should be maintained throughout the country, but this uniformity should be a uniformity secured
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through the attainment of high standards in all the states without the lowering of standards in any.

During the year just closing, further consideration has been given to ways and means for securing from the National government legislative recognition for our profession. Thus far no plan for direct recognition has been deemed feasible, and it is unlikely that Congress can under our constitution enact legislation at all corresponding to our state legislation. Even were such legislation possible, I am not at all sure that it would be desirable, at least at this time. Under such a law the right of admission to practice would most likely be controlled by some commission or body that would be recruited from outside our ranks, and thus, perhaps, not fully responsive to the views of the profession relative to standards of training and conduct, and possibly more or less indifferent to the proper development of accountancy.

As yet the Federal government has not proposed any measure for the regulation of corporations that takes our profession into account, but with our growth in numbers and responsibility, it seems reasonable to believe that legislation may be passed under which the government will accept within suitable limitations the accounts of corporations bearing the certificate of a properly accredited accountant. Inasmuch as many of the largest and best managed corporations have already voluntarily adopted the plan of independent audits by public accountants, legislation aiming to require such audits would hardly meet insuperable objections from the corporations, and it would unquestionably give better results to the government at an infinitely less cost to the taxpayer than the plan of employing an enormous staff of examiners in the Federal service. The latter scheme, which seems to be the one upon which the authorities at Washington have hitherto been working, involves an enormous burden of expense, and for many reasons cannot be efficient.

The need for publicity of corporation accounts is too real to be denied. Mere publicity, however, is of little value unless the accounts are prepared in conformity with correct accounting principles.

The regulation of corporations will, it seems certain, engage the attention of Congress during the coming winter, and whatever the form this legislation may take, the influence of this Associa-
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tion should be exerted to its utmost toward securing therein reason-
able and adequate provisions relative to the treatment of ac-
counts. This is a duty we owe not only to our clients, but as
good citizens, to our government as well.

The past year has witnessed a continued development along
the lines of business education. The report of the Committee on
Education gives an interesting and highly gratifying review of
the work that is being done by the various colleges and university
schools throughout the country in providing courses of instruc-
tion for students of accounting. It seems reasonably certain that
accounting has now demonstrated its right to a place in the curri-
culum of a college, and its general adoption by progressive insti-
tutions of learning should depend upon the working out of inter-
nal arrangements.

This educational development is one of vital importance to our
profession. Perhaps the greatest need from which we suffer
to-day is the lack of high-grade young men of broad education
coming into accountancy. No more attractive field of professional
activity is open to young men of the right equipment, and it is to
be hoped that a larger number will avail themselves of its oppor-
tunities.

It is pleasing to note also the increasing activity of the several
state societies, particularly in the way of holding frequent meet-
ings for the discussion of topics of common interest. Such meet-
ing are an aid not only to an increase of knowledge, but what
is of equal, if not even greater, importance, they promote a true
professional spirit among the members attending the meetings.

In view of the interest manifested by our members in matters
of mutual interest and advancement, it is surprising to learn, as
stated by the Committee on Journal, that of the approximately
2,000 subscribers to The Journal of Accountancy, only a little
more than 300 are accountants or assistants in accountants' offices.
The Journal was established by, and aims to serve, the account-
cy profession and in my judgment it serves it well and deserves
the hearty support of every member of this Association.

The year just closed has been full of encouragement to our
Association and for the results attained the thanks of the Asso-
ciation are due to the several committees the members of which
have labored so enthusiastically for the common good.
Correct Accounting a Fundamental Basis for Regulation and Taxation*

BY ALLEN RIPLEY FOOTE, President, International Tax Association.

Accounts are records of transactions expressed in terms of money. In these records all labor, services and commodities are divested of their diverse physical forms and are reproduced in an identical intangible form, in which form they can be dealt with as factors in mathematical problems. The problems into the solution of which these factors enter are problems for the determination of methods for the effective economic regulation of the financial affairs of persons, partnerships, corporations and governments.

Correct records of all transactions are a fundamental basis for the effective economic regulation of the affairs of every person, partnership, corporation and government.

A correct tabulation is not in itself a correct record. A record, to be correct, must be kept in a way to show, by proper grouping, the true relation between every factor involved in costs of living, costs of distribution, costs of doing business, and in the final statement showing the profit or loss for a fiscal year, or for a period of years. Conclusions, or business and political policies based upon records that are not correct must inevitably be unsound.

The conduct of a person, partnership, corporation or municipal body; of a school district, township, village, city, state, or of the Federal government, when guided without the information that can be derived only from correct accounts, is necessarily guided by guessing, prejudice, and superstition. The science of accounting is to the government of the person, and of every combination of persons, what the science of navigation is to ocean travel. It must be depended upon to guide action to the desired objective point. A correct observation of an untrue compass, or an unintelligent observation of a true compass, must inevitably cause an error in direction.

All theories as to the proper course must submit to the arbitration of facts. Measured by ascertained facts, all theories must

*An address before The American Association of Public Accountants at its Twenty-second Annual Meeting, held in Denver, Colorado October 18-21, 1909.
stand or fall. Those who honestly advocate and those who honestly oppose a policy should vie with each other in requiring a correct record of all transactions involved in carrying such policy into practical effect.

Just judgments are rendered only when based on a correct knowledge of facts.

**Scientific Accounting Is Shown by Correct Grouping.**

There is a wide difference between honest accounting and scientific accounting. One may have a record that will honestly account for every dollar received and expended without having a record that will give any intelligent information regarding the true relation between all economic factors involved in statements of costs or of profits or losses.

The records of all accounts should be intelligently grouped to show the economic effect of every factor essential to a true statement of costs or of profits and losses.

Far greater harm results from unintelligent than from dishonest accounting. In practical affairs unintelligent accounting is the rule, dishonest accounting the exception. The effort to displace both of these forms of incorrect accounting by the adoption of scientific accounting meets with greater resistance from those who know their accounts are honestly kept than from those who know they are not keeping their accounts honestly. The normal man can be more easily persuaded that he should keep his accounts honestly than he can be brought to understand that it is not necessary for him to be dishonest in order to be entirely wrong.

Charges of dishonesty are more frequently based on conclusions drawn from, or on the results of a policy guided by unintelligent accounting than upon dishonest entries showing receipts or disbursements.

Scientific accounting safeguards honesty. It prevents dishonesty.

Losses caused by ignorance are enormously greater than losses caused by dishonesty.

The person, the partnership, the corporation, or the government, whose records are kept by incompetent accountants are the ones from whom ruinous competition is to be feared. The day laborer, the mechanic, the farmer, the manufacturer, the public service corporation, and the government that, through lack of
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ability to keep correct accounts, are incorrectly informed as to the true cost of living, the true cost of their products or the true cost of the services they render, are the ones which, under stress of competition, man with man, partnership with partnership, corporation with corporation, municipality with municipality, state with state, nation with nation, impoverish themselves by accepting wages, selling prices or compensation that are insufficient fully to cover the true cost of that which they can give in exchange.

Incompetent accounting is the cause of more failures than all other causes combined. It gives incorrect information as to costs of living, products and services, which leads to the acceptance of insufficient compensation, a course that must result in failure with a certainty from which there is no escape. No one can pay three dollars and sell for two dollars without impairing his capital. If he makes the transaction often enough his entire capital will be exhausted; his failure will be announced.

Incompetent accounting is the cause of retarded economic development. It fails to show where economies may be effected that will enhance profits or give advantages in meeting competition.

Intelligent economy is as essential to success for a person, a partnership, a corporation, or a government, as is skill for an artisan, intelligence for a farmer, scientific engineering for a manufacturer, or correct economic policies for a government. The art of intelligent economy is dependent upon scientific accounting for development and guidance. There is not a person, nor a combination of persons, from a day laborer to the Federal government, who cannot make an economic gain by employing a competent accountant, until he can do it himself, to group his items of receipts and disbursements in a way to enable him to know where he can economize, where he can get better economic results from his efforts, and a profit over the true entire cost of his living, or of the products or services he sells. Here, more surely than anywhere else, can the fact be demonstrated that money expended for correct accounting, is put to its highest economic use.

Moral law teaches honesty as a principle. Economic law requires honesty as a practice.
Scientific accounting renders honesty possible. Honesty and intelligence must be combined to eliminate errors, voluntarily or unintelligently made. When errors are eliminated, all records will tell the truth, all personal conduct will be right, all policies will be sound, and the prosperity of the people will rest upon a foundation as enduring as the laws of nature that govern the fruitage of the earth.

It is the function of the members of this Association to develop, promulgate and insist upon the universal adoption of scientific accounting. In this direction the people will find economic salvation. No calling of greater helpfulness and honor can enlist the service of men.

**Effective Economic Regulation.**

There can be no effective economic regulation without scientific accounting. This is true of all regulation. It applies with equal force to the regulation of private affairs by the person interested, to the regulation of partnership affairs by the partners interested, to the regulation of corporate affairs by the shareholders interested, and to the regulation of public affairs by the citizens interested.

There can be no scientific accounting without a grouping of items that will correctly show the relation to each other of every essential economic factor in all statements of costs of living, costs of products, and costs of services, whether rendered by public service corporations or by the government.

Declarations in political platforms, measures enacted into laws by legislative bodies, schedules required by the executive administrators of laws, opinions of courts rendered in construing laws, reflect the popular understanding of economic principles. It is their function to apply, not to formulate such principles.

It is the function of associations, devoted to scientific study, to formulate statements of economic principles, and thus to erect standards for the guidance of popular opinion. More than this, it is the duty of such associations to insist upon a correct application of such principles in political platforms, in measures enacted into laws by legislative bodies, in schedules required by executive administrators of laws, and in opinions of courts rendered in construing laws. To this end such associations should organize and persistently conduct a campaign of education de-
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signed to cause the people to understand the requirements of the economic principles involved in a given proposition, or question of public policy. In this way, and in this way only, can a correctly informed public opinion be created that will require public regulations and public policies to conform with scientific economic standards.

That the people may be correctly informed, it is the duty of accountants and economists to analyze platform declarations, the enactments of legislatures and the opinions of courts, to show wherein and how far, if at all, they depart from a correct alignment with the requirements of scientific economic standards. In this way mistakes can be shown and information for their correction can be given.

No service of greater value can be rendered to the people than is rendered when an economic mistake in a political declaration, in a legislative enactment, in an administrative regulation or in the opinion of a court is pointed out. No public man can give better evidence of his fitness for leadership than he will give when he frankly and sincerely changes position to correct a mistake he may have made in applying an economic principle.

It is the boast of our civilization that we have a government of law, not of man. If we are to have a true government by law instead of by man our reliance to secure obedience must be upon respect for law instead of physical force. To command that quality of respect that will manifest itself in obedience, without the presence of potential physical force, our laws must satisfy our sense of justice. Justice must be an expression of intelligence. To maintain our civilization and to advance the line of development, we must aspire to a government of intelligence expressed in law. To attain this the intelligent must guide. Their ability to guide is dependent upon their ability to satisfy the people that the propositions they advocate are just and right. The necessity we are under of creating a correctly informed public opinion in order to obtain the advantages of effective economic regulation of our private and public affairs is the essential distinction and chief glory of our system of government of, for, and by the people.

True statements of costs of living, costs of production and costs of services are an indispensable basis for any regulation or
policy in which such costs are factors. Such statements of costs are an indispensable basis for the assessment of any tax to be levied on property values, or upon gross or net incomes.

A statement of costs can not be made without taking into consideration the value of the property involved and all elements affecting in any way the total deduction that must be made to show net profit or income.

Effective economic regulations cannot be formulated or enforced without the guidance of such statements. Regulations required by law must conform to the requirements of scientific economic standards. Such standards will be destroyed by any attempts to make them conform to the requirements of law.

Read history and it will tell you that there was a time when the people believed divinity lived in the King. Read history and it will tell you that a time came when the people declared that the voice of the people is the voice of God. Read history and it will teach you that divinity has never lived in the King; that the voice of the people is not the voice of God; it will teach you that wherever and whenever a man has uttered a truth, God has spoken.

ESSENTIAL ELEMENTS OF A COST STATEMENT.

In 1890 when the subject of corporation statistics was under consideration by the American Economic Association, I formulated two resolutions which I have revised to apply to this occasion.

Resolved, first, that a committee be appointed to designate the division of accounts and the items to be included in each that should be kept by all persons, partnerships, corporations, and governments, to show costs of living, costs of production, and costs of services.

Resolved, second, that said division be so made that the effect of each essential economic factor will be shown, to the end that correct statistics may be obtained through uniform methods of accounting as a basis for intelligent economic discussion, legislative action and economic regulation.

I supported these regulations with the following statement:

We must first agree on what matters constitute costs. Then we must see to it that these items are honestly included in all statements of cost. This done, we will be in a position to take
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intelligent action upon any proposition of public policy or question of economic regulation in which the question of cost is a factor.

In 1892 I formulated a statement of costs for the operation of a public service lighting plant as follows:

1. Interest upon the full amount of the approved investment at the same rate per annum as the municipality in which the service is being rendered pays on its indebtedness.

2. Taxes of all kinds paid to the municipality or to the state,

3. A per cent. on income necessary to cover depreciation of property from use, mechanical improvements and natural causes.

4. Cost of insurance against risk of loss by fire, injuries to employees and others.

5. A per cent. on income necessary to provide a fund to defray the expenses of experimenting with and testing the merits of improved methods, machinery, or materials, with the view of rendering the plant, its lines and connections, more efficient and safe in operation, and the service more economical and at a lower cost for its users.

6. All salaries and wages paid to the officers and employees of the corporation however employed.

7. Printing, stationery, postage, telegraph and telephone service.

8. Advertising.

9. All material consumed in the ordinary operation, and maintenance of the plant and its connections, charged at its true cost delivered at the point of consumption.

I affirm that all of these items of cost should be included in any statement made to show cost of production or to show net profits or income to be used as a basis for taxation.

Such a statement of cost is a necessary basis for the determination of the per cent. of protection necessary to safeguard American industries from being undersold in their home market by the products of foreign industries produced under more favorable economic conditions.

Such a statement of costs is necessary for the determination of reasonable charges for services rendered by public service corporations.

Such a statement of costs will be necessary for the determina-
tion of the amount of subsidy required for the maintenance of a merchant marine service, whenever and wherever the Federal government may undertake the administration of such a policy.

When effective economic regulation is based upon such statements of cost there will be an end to popular prejudice which is the stock in trade of "frenzied" politicians; there will be an end to the manipulation of corporation accounts which gives opportunity to "frenzied" speculation.

PROGRESS MADE IN ESTABLISHING PUBLIC REGULATION OF INDUSTRIES.

During the seventeen years covering my study of this subject, the public regulation of industries has been confined almost exclusively to the regulation of public service industries. Attempts to make such regulation effective have taken the form of creating state or Federal commissions, endowed with certain powers. The most important of these are the Interstate Commerce Commission created by the Federal government in 1887, and the Public Utility Commissions, created by the states of Wisconsin and New York in 1907. These three commissions have been given power to formulate a uniform system of accounts to be kept by all corporations under their respective jurisdictions. Successful regulation of such corporations will be determined, ultimately, by the scientific accuracy of the system of accounting required by the commissions.

Sufficient experience has been gained to demonstrate the soundness of the proposition that, whenever a special privilege is granted by law, the law authorizing the grant should safeguard the interests of the people by requiring a correct accounting of all operations or business transacted by the beneficiary of the grant; and that charges for services rendered or commodities sold shall not be more than sufficient to pay all costs of operation or production, plus a business profit computed at twice the rate of commercial interest for the use of loanable funds.

This provision in the law will safeguard all franchises necessary for the construction and operation of any public utility, the monopolizing of any national water power or product, the loan of public credit for the construction of irrigation works, the application of the principle of protection in tariff schedules, and the granting of subsidies to the merchant marine.
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If the people are wise they will insist that no grant of a special privilege shall hereafter be made by a municipal, state, or the Federal government without a requirement that the accounts of the business to be carried on by the beneficiary of the grant, whatever its character may be shall be kept as public accounts, uniform for all business of the same class. They will also require that steps be immediately taken to bring under such a system of effective economic regulation all business now being carried on by the beneficiaries of any municipal, state, or Federal grant of a special privilege. This will include tariff duties imposed for the purpose of giving protection and the aid of public credit or subsidies to be paid out of the public treasury for the construction of irrigation works or the upbuilding of our merchant marine.

Under these conditions the people's interest will be better served by a scientifically regulated monopoly than by free competition.

If the people are wise they will insist that no industrial undertaking shall be entered upon by a municipality, a state, or by the Federal government without the safeguard of a mandatory law, requiring that the accounts of the industry shall be kept as public accounts, uniform for all industries of the same class, and that charges for services rendered or commodities sold shall not be less than sufficient to pay all costs of ownership and operation.

If the people are wise they will insist that a correct accounting shall be made for all taxes collected, and public income, from whatever source derived, by whatever authority the power of taxation may be exercised, and that the total collected shall not be more than sufficient to pay all expenses of government economically administered.

Regulation and Publicity.

Publicity will give life to all properly regulated industries, conducted under the protection of a publicly granted special privilege.

Publicity will kill all small competing industries by forcing them out of business, or into great combinations for mutual protection.

The management of industries enjoying special privileges needs official publicity as a protection against popular prejudice.
Public goodwill can be won by the publication of official reports showing that the interest of the people are properly considered and safeguarded.

The management of competing industries needs secrecy as a protection against the interference of competitors. Through ages of experience the people have been taught to depend upon free competition for protection against the exactions of masterful manipulators of industries and commerce. Well may they now stand aghast in the presence of a Federal law that ruthlessly destroys secrecy, which is the very life of competition. Without secrecy competition is impossible.

Existing conditions require an effective demand that municipal, state, and Federal government shall continue their efforts to the regulation of those industries over which they have acquired jurisdiction by grants of special privileges, and that they shall refrain from attempting to regulate industries to which no special privileges have been granted.

The enactment of the Federal law taxing corporate incomes was a mistake. It is class legislation. It arbitrarily and unnecessarily interferes with the accounting systems of every corporation to which it applies.

That it is class legislation is shown by its application to gains made under corporate management only.

The English income tax "is payable in respect of any trade, manufacture, adventure, or concern in the nature of trade."

That it arbitrarily and unnecessarily interferes with the accounting system of every corporation to which it applies, is shown by the requirement that all income statements shall be made for the calendar year instead of the fiscal year of the corporation.

The English income tax provides that "the duty is to be computed on the profits or gains of such trade, manufacture, adventure, or concern. Where the business has existed for three years the assessment is to be upon a fair and just average of three years ending on such day of the year immediately preceding the year of assessment on which the accounts of the business have been usually made up, or alternatively on the average of three years ending on the 5th of April in the year preceding the year of assessment."

A group of New York professional accountants rendered an important service by calling attention, in a joint letter addressed
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to Attorney-General George W. Wickersham, to the ill-fitting adjustment of the requirements of the law to existing accounting methods. The measure was enacted without correcting its arbitrary requirements in this respect. To prescribe a method of ascertaining and reporting net income, "radically at variance with accounting methods generally followed by industrial and trading corporations, with those prescribed for public service corporations under Federal and state laws, with accounting methods followed by many insurance, financial and banking institutions, and with principles recognized by students of accounting," is a mistake of the first magnitude. It is now the duty of every accountant, and of every client of an accountant, to vigorously protest against the administration of the law until its requirements are made to harmonize with existing well-recognized and well-established accounting methods.

We are not living in an era of arbitrary personal government that will permit legislative authority to order sweeping changes in business methods regardless of the wishes of the people. We believe we still have a representative government and that it is the duty of our representatives properly to express the will of the people in the laws they enact. This law has been enacted without authority from the people, expressed in petition or in the declaration of any political platform.

We do not believe in the infallibility of kings, or of our political rulers. Only those are entitled to our confidence who are eager to correct a mistake, by whomever made, whenever they are shown that a mistake has been made.

Conclusion.

What I have said has been said with the purpose of impressing upon you the high dignity and responsibility of your vocation, and with the purpose of impressing upon the public a just appreciation of the values of the services you render.

It is not your function to enact or construe laws.

It is your function to analyze laws and the construction given them with the purpose of commending them, when found to be correctly aligned with sound economic principles and of showing wherein economic errors have been made, if any exist.
The creative powers you may exercise are of the highest order. It is your function to erect standards by which the intelligence and justice manifested in laws may be determined.

Cause your work to honor you and you will possess honor beyond the power of others to bestow or to take away.

Cause your work to honor you and you will prove your worth to yourselves, your community, your state, and your country.

Cause your work to honor you and you will make a contribution to the common good that can not be computed, in terms of the money of accounts, but it will inspire to honorable conduct all with whom you come in contact.

The honor of the nation, like its wealth, is the total of the honor of its citizens.

Men may differ in ability and in worldly possessions, but they need not differ in their sense of honor, their love of justice, their devotion to truth.

These are never failing sources of peace, prosperity, and happiness for all of the people. They are the safeguards of our civilization, the prophecy of our future progress.
Controlling Accounts.

By Walker A. Staub, C. P. A.

The subject of Controlling Accounts may be considered from three standpoints: (a) their purpose, (b) methods of use, and (c) some examples of their application in a practical way; and it is my purpose to consider them from those standpoints in this article.

Purpose.

One of the principal purposes served by Controlling Accounts is that indicated by their title, namely, control. This is obtained by having in the general or private ledger, accounts which represent in aggregates or totals both the transactions and balances of a more or less considerable number of detailed accounts in subsidiary records. By the use of such accounts, statements may be readily prepared from the general ledger which will present information to the management in compact form, especially when approximate figures are wanted quickly.

The importance of making the head of the accounting department of a large and complex business independent of details, which must necessarily be delegated to his subordinates, and still leave him in a position to control and guide their work, is not to be underestimated. This is, in part, accomplished through the medium of this class of accounts.

Another useful service rendered by controlling accounts is that it makes possible the subdividing of the accounting work of a large business. Even in a business of only moderate size it may be desirable or necessary, owing to a multitude of small sales, or some other reason, to employ several ledger clerks, and it is a convenience to be able to apportion the work in such a way that each clerk will be responsible for the correctness of one or more ledgers, the trial balances of which can be proved independently.

It must be a very large business in which any one of the books of original entry, such as sales book, voucher register or cash book can not be easily handled by a single clerk. In these days of mammoth corporations and vast undertakings, however, it is not infrequently necessary to arrange these books so that, by subdivision, a number of persons can be engaged at the same time in building up the sales record or entering items of cash receipts...
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too numerous to render it physically possible for one person to make all the entries and do the balancing in a business day. Needless to say controlling accounts in one form or another are a necessary adjunct of such division of the books mentioned.

Still another use made of controlling accounts is the localization of errors in trial balances, particularly of those controlling accounts of which the details take the form of subsidiary ledgers, such as sales ledgers. This use is one that appeals to most bookkeepers. The saving in time and lightening of work by the use of such accounts is self-evident to any one who understands the elements of bookkeeping or the taking off of a trial balance.

In the absence of positive information to the contrary the writer ventures the opinion that it was probably some bookkeeper who, month after month, had spent many trying hours in hunting elusive errors in a trial balance embracing a number of voluminous ledgers, who first thought of controlling accounts as a labor-saving device. Probably an even earlier use made of controlling accounts, however, were the Bills Receivable and Bills Payable accounts which are really controlling accounts, though not always thought of as such, and with which all the older bookkeepers were perfectly familiar. The Cash Account, when it embraces more than one bank account, is also really a controlling account.

Methods of Use.

There are a number of different ways in which controlling accounts may be used. The method which probably first comes to mind is that wherein the details embraced in the controlling account appear in a subsidiary ledger, be it loose-leaf, card or a bound book. This is usually found to be the most convenient way of handling accounts receivable or stock accounts. To be used in this way, it is necessary to use columnar books of original entry so that all the different classes of items entered in a given subsidiary ledger may be posted in totals to the controlling account in the general ledger. In some cases, however, such as a large department store, the number of sales or accounts receivable ledgers is such that it is not practicable to have a book, such as the cash book, contain sufficient columns to allot one to each ledger. In such a case it is necessary to divide the original records from which postings are made or analyze them—which latter amounts to reverse posting—in such a way that the total of post-
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ings to each ledger may be ascertained. The analysis method is sometimes carried so far as to "sectionalize" the accounts receivable ledger, practically running on memorandum sheets from month to month controlling accounts, with each section of say a hundred pages of the ledger or for each letter in a loose-leaf ledger. The advantage urged for this method by those who make use of it is that while it entails considerable work, this work will not be more than would be required to check back the month's work in case of a difference in the trial balance, and in any event the additional work will be done during the month when the time can best be spared.

For other controlling accounts the details are to be found in the books of original entry, consisting of "open items," which must be scheduled to compare their total with the balance of the controlling account. Bills Receivable, Bills Payable and Vouchers Payable are illustrations of such accounts. In the case of the first two accounts named, the monthly totals of notes received and issued, respectively, may be posted to the debit or credit of the accounts mentioned in the general ledger, and the collections or payments credited or debited either from the cash book, or in the case of notes paid, possibly from the voucher register, the individual notes being marked "paid" or ruled off in the bill books. The uncollected notes receivable may then be scheduled from the Bills Receivable book, and the total compared with balance of the ledger account. The correctness of the Bills Payable account is ascertained in a similar manner. If the notes are numerous and it is desired only to prove the arithmetical correctness of the ledger balance they may be quickly scheduled on an adding machine.

The Vouchers Payable account would be used in practically the same way, the totals of the vouchers entered for a given period being posted to the credit of the general ledger account and the account debited from the cash book with the total of vouchers paid during the same period, the vouchers being marked "paid" (with date or cash book folio) in the voucher register. The aggregate of the unpaid vouchers scheduled from the voucher register—most conveniently on an adding machine—should agree with the ledger balance.

Essentially this same method can be used with certain kinds of accounts receivable, e. g., when the terms of credit are short
and the accounts as a rule collected promptly. Freight charges due railroad agents, the bills being payable either on delivery of the freight or at the end of each week or half month (comparatively few shippers, and these only very large ones, paying monthly) may be cited as an illustration of accounts receivable which lend themselves readily to such treatment.

Still a third method used is to have the details of the account appear in tabular form, the postings to the controlling account consisting of the totals of different columns in the subsidiary record. This record may be, and in fact usually is, the record in which the original entries for certain classes of items or transactions are made. In the columnar form of consumers’ ledger used by many gas, electric and water companies, the monthly or quarterly charges to consumers are made in one column, the total being posted to the debit of an appropriate controlling account—say Accounts Receivable—in the general ledger, the cash collected and discount allowed, if any, are posted in adjoining columns opposite the consumer’s name, the totals of these columns being agreed with the corresponding totals in the cash book which latter are posted to the credit of the controlling account. The uncollected balances shown on the consumers’ ledger are next extended into another column, the total of which should agree with the balance of the controlling account. This last column, which thus forms a trial balance of the consumers’ ledger, is the starting point for the next period’s entries, the operation already described being repeated.

Practical Application.

Controlling accounts are used in connection with all four of the general classes of accounts, viz., asset, liability, income and expense accounts. Some of those more generally used may be noted and briefly commented on:

Asset Accounts.

Cash—This is a controlling account (whether there is a ledger account or not) whenever the transactions and balances of more than one bank account or of bank account and cash drawer are included in the one cash account.

Accounts Receivable—The use of controlling accounts for accounts receivable is so generally understood that no especial comment thereon is needed.
**Controlling Accounts.**

Bills Receivable—This account has already been commented on under the heading of “Methods of Use.”

Stock Accounts—In manufacturing enterprises, where a comprehensive cost system is in use, general ledger accounts of Finished Product, Work in Progress and Materials and Supplies are but the totals of detailed accounts appearing in subsidiary records.

Plant—In many progressive establishments the Plant account is a controlling account supported by a subsidiary ledger giving details of the cost of the various parts of the plant.

**Liability Accounts.**

Bills Payable—This account has already been commented on under the heading of “Methods of Use.”

Accounts Payable—The treatment of this account is analogous to that of Accounts Receivable and is quite generally understood.

Bonds—This is a controlling account in that evidences of indebtedness are held by various bondholders, the balance of this account showing the aggregate outstanding. If the bonds are registered, the bond ledger naturally forms the subsidiary record of the bonds account.

Capital Stock—The capital stock ledger showing the holdings of the various stockholders is auxiliary to the controlling account in the general ledger. The stubs of the stock certificate book (or register, if stubs are not used) may also be used as a basis for testing the agreement of the certificates outstanding with the ledger account.

**Income Accounts.**

It is with regard to income or earnings accounts that perhaps the least use is made of the controlling account, though even here we occasionally find sales accounts shown in condensed totals in the general books, with subsidiary records analyzing the sales into the various classes of articles; or a general ledger account for income from investments supported by a subsidiary record showing the income derived from each separate investment.

**Expense Accounts.**

In connection with comprehensive cost systems which provide for harmony between the cost records and the general books, extensive use is made of the controlling account for showing in
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the general books the aggregates of costs and expenses. A few general accounts, such as Materials, Labor and Works Expense, or possibly a Work in Progress account for each of the principal departments, may be considered sufficient for the purpose of recording in the general accounts totals of costs and expenses which are spread in considerable detail in the cost records. All the administrative expenses may also be put in one general account, an analysis being made in a supplementary record.

Public service corporations which, as a rule, analyze their operating expenses in considerable detail, also find it convenient to have in the general ledger but one account for Operating Expenses; or one account for each of the principal divisions, such as Maintenance, Operation and General Expenses, keeping the detailed accounts either in the old-fashioned many-columned voucher record or in a less cumbersome subsidiary operating expense ledger especially designed for the purpose, the expense for both month and fiscal year to date being shown.

It should be borne in mind that controlling accounts can not be safely used in preparing final statements before the correctness of the balances is tested by reference to the supporting details. One reason is that there might be an error in the controlling account even though the general ledger were in balance, e.g., an error in the footing of the sales book might not affect the general ledger trial balance as the same total of sales would be posted to the debit of Accounts Receivable and to the credit of Sales; the details being correctly posted to the subsidiary ledger, the trial balance of this latter book might be correct and yet would not be in agreement with the controlling account in the general ledger. Naturally a balance sheet and a profit and loss statement prepared from the general ledger would be incorrect, in that there would be an error in the asset Accounts Receivable as well as a compensating error in the amount of sales shown for a given period.

Aside from the possibility of arithmetical error, it is also necessary to test the correctness of the controlling accounts by reference to the details thereof in order to assure one's self of the nature of the items constituting the balance. For instance, bad debts included in the Accounts Receivable controlling account will only come to light when the accounts in the subsidiary ledger are scrutinized. Payments charged to Vouchers or Accounts
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Payable, for which bills had not been credited to that account, would likewise only be detected by scheduling the unpaid vouchers or taking off a trial balance of the accounts payable ledger, if one is kept, and comparing the total with the balance of the controlling account.
State Administrative Supervision Over Local Accounting.*

By Roy Smith, M. C. S.

Definition of subject.—By the expression, State Administrative Supervision over Local Accounting, we mean that part of the different state governments within the United States, exercised by officers or agents of various names and with various degrees of authority, which is extended over the keeping of accounts, and the making of reports of the cities, counties, towns, villages, and other forms of local governments of the respective states. It should be noted that we do not include a treatment of the almost endless statutory requirements made by practically every state legislature regarding numerous details connected more or less closely with the bookkeeping, auditing, and reporting of the different local officers, unless the reports are required to be made to state officials, and unless such auditing is exercised, and bookkeeping is directly supervised by officers or agents of the state.

It should be noted further that there is a sharp distinction between statutory requirements, directions, and limitations, of which we have an abundance in our statute books, and direct supervision by representatives of the state government. The former is the laying down of the rule but the allowing of the local officials and the courts to determine how the rule is applied, or whether or not it is applied at all. The former is like furnishing the yard-stick but allowing the localities to go free-handed in measuring their own goods. In administrative supervision, however, the state not only furnishes the measure but also either does the measuring itself or stands by to see that it is done according to law and in a satisfactory way to the state representatives. The former method has been practiced extensively and for a long time in our states, but the latter method has come into vogue only recently, and as yet only in about half of our states.

We should point out also in this connection that in this paper we do not include a treatment of the numerous cases of specialized supervision such as is sometimes exercised over the account-

* A dissertation submitted to the faculty of the College of Arts of the University of Chicago in candidacy for the degree of Master of Philosophy.
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...ing of officers or boards having to do with only one particular function. Thus there are cases in which the state requires reports from, or examines the accounts of, certain school officials, health boards, and the like; which cases we do not consider, except in a very few instances in which such specialized forms of supervision are closely linked with the more general forms of supervision that form a part of our field of discussion.

Extent of the paper. It may be said that the state supervision which we have under discussion touches local accounting at three different points. First, we have the matter of reports which city, county, town, and other local officers are required to make to state officials and boards, or legislative bodies. These reports, as we shall attempt to point out later, vary, not only in the extent of items included, but also as to the frequency and regularity with which they are required to be made.

The second point of contact between the supervision exercised by a number of our state governments over local accounting, is that of direct auditing or examination of the accounts, records, papers, and vouchers of the different local offices. Here, too, we shall see that there is a great variety in the extent and the intensity with which this form of supervision is exercised. In some states the representatives to which this work is entrusted are enabled by authority and means granted them to cover periodically every detail of the transactions of all local officials, while in other states the representatives for various reasons exercise only very slightly and very seldom their powers of examination of local accounts.

The third point of contact is not only the supervision, but also the establishment by state authorities of definite systems of accounts to be kept in the various departments of local governments. As in the first and second points, so in the third, we find great variation in the extent which the different states have exercised this phase of their supervisory powers over their respective local governments. In some cases the systems required cover in detail practically every form of local accounts, while in others the systems include the accounts of only a few of the local offices.

Our paper, then, will deal with these three points of contact between state authority and local accounting—that is, reports, auditing, and prescription of systems of accounts. We shall
Furthermore deal briefly with the medium through which these three forms of supervision are exercised, and also with the methods used by the various states to enforce their supervision upon the local officials. Since it will be impossible for us to treat fully the systems in use in all the states we shall take up in detail only two, that of Idaho and that of Indiana.

**Purpose of the paper.** It may be well at the outset to set forth very briefly something as to the purpose which the writer has in his present attempt at a treatment of this subject.

First of all, we have been thoroughly convinced, throughout the study of the question, of a general, and, in many cases, an extremely serious need for improvement in the systems of accounting, in the reports, and in the auditing of our local governments. One of our purposes, then, is to formulate briefly and compactly this crying need in this phase of our public activities.

Our further purpose is to make a more or less thorough review for the benefit of those persons who may care to know, cf what the various states have done in the past, and are now doing in the way of supervision over local accounting, and at the same time, as far as we are able, to point out some of the results of such supervision as well as some of the essential features of a thorough system.

**Need for improvement in present accounting methods.**

**General needs.** It is a gratifying thing to any one interested in good government to know that in some cases the accounting of our national, state, and local governments is carried on in a very careful, scientific, and satisfactory way. At this time, when business and governmental activities have become so extensive and intricate, it is of the highest importance for the best welfare of all concerned that the accounting of our governments, as well as of our commercial concerns, be conducted on strictly scientific principles, and that these principles be applied in every detail with the utmost integrity. It is, however, disappointing for the student of this subject to learn of the very numerous cases in which governmental accounting is deplorably deficient and utterly lacking in efficiency when contrasted with the present-day methods employed in our best business institutions.

**Needs regarding reports.**—Perhaps the first point at which we find a serious lack of anything like a proximity to pro-
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Sufficiency is in the matter of reports. The statute books of the different states are permeated with requirements of reports to be made by the numerous officers. It is true, however, that when these reports grow beyond a simple statement of a few facts they often become complicated and characterized by a lack of systematic arrangement, and, therefore, are deprived of much of their usefulness. Mr. Harvey S. Chase, one of the highest authorities on the subject of municipal accounting, refers to the "accounting and reporting of the great majority of the municipalities throughout this country" as being "crude, unsystematic, inaccurate, and away behind the times." He asks himself the question as to whether any of our great businesses could be carried on to-day if their accounting was the same and no better than that of our cities and towns, and replies that the answer is self-evident, that "not one of them could live a year under such conditions."*

Another authority on this subject writes that "the reports of cities have never been designed to present a clear view of the financial operations of the year." It is a fact, however, as this same writer points out, that "a correct judgment of many of our city problems must be based upon a clear understanding of the financial condition of the municipality."† This we have come to realize only after a long and costly experience; and even now, a decade after the above was written, the reports issued by the various cities and local districts in only a small proportion of our states are such that a great amount of benefit can be derived therefrom by the average citizen or public officer. In many cases the reports of cities, towns, and counties, though they may contain scores of pages, give no classification of expenditures other than that based upon the funds against which bills are drawn, since only a list of warrants are given. And in the words of Mr. Hanger, of the U. S. Department of Labor, "these reports are frequently unintelligible even to the most experienced agents, and sometimes contain typographical and other errors, the correction of which necessitates a long and careful search of the record."‡

It is often impossible, therefore, even for an expert, to deter-

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mine from the reports of many of our cities whether a certain department is operated at a gain or at a loss.

Many concrete examples could be cited to illustrate the general remarks just made. A writer in The Journal of Accountancy, referring to the condition of affairs in Minneapolis before the reform in the accounting of that city, says: "Not in one case in a hundred is it possible to present promptly those periodical statements during the fiscal year which are as necessary for the guidance of city officials as for the directors who manage the affairs of large industrial corporations, and the annual reports of comptrollers and treasurers do not afford intelligent citizens the information they require in order to form an opinion as to whether the administration has been successful or unsuccessful."*

Not only are scientific classifications of revenue and expenses sadly lacking in our public reports; but a good general balance sheet, showing the real assets and liabilities of our municipalities, is such a rare specimen in the field of public accounting, even at this time, as to attract a good deal of attention when found. Writing on this subject in regard to New York City only three years ago, Mr. F. A. Cleveland said: "In none of the reports of the comptroller is it possible to obtain in succinct form an intelligent view of the city's true financial position."† It is practically impossible, the same writer points out, for the investor to know what is really back of the city or county bonds he buys, or for a citizen and taxpayer to know whether or not the municipality has been honestly and wisely conducted for a certain period of time.

Needs in Accounting Systems.—But such reports as we have been describing are only reflections of the conditions which we find in the accounting systems now in use in many of our cities, towns, and counties. While it is true that we seldom find a complete published statement of the real and personal assets of a city or county, it is, perhaps, more unfortunate that records, from which such a statement could be made, are seldom kept. In many cases it would be impossible, even for an expert accountant, without an almost endless search among files of old vouchers and papers, to ascertain what the property of a city or county

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has cost the public; and even then he would be unable to determine how much and what property should be on hand at a certain time.

It should be easy to see what evil results may be brought about by such insufficient records. It is not, however, only in the matter of record of assets that our public systems of accounts are deficient. It is in entire systems. Nor is this condition of affairs confined to one or two cities or localities. Even at points where one, upon first thought would naturally expect to find the very best and up-to-date system—that is, in our great cities—one finds, if we are to believe those persons who have been entrusted with important investigations and reforms, conditions little short of chaotic. There were until recently on the books of the city of New York over 2,500 accounts which the city accountants themselves did not know whether they represented assets or liabilities, and some one or two hundred accounts on the general ledger alone, representing millions of dollars, concerning which those in the Comptroller’s office knew practically nothing.*

Mr. Charles W. Haskins, one of the best known accountants of the country, stated, after an investigation a few years ago of the accounts of Chicago, that nobody knew whether the debts of the city were increasing or decreasing, what the real expenditures had been, or what the assets were worth, and that about half a million dollars could be saved annually to the city treasury by the adoption “of certain reforms comprehended within the legitimate sphere of higher accountancy.”†

Prior to the recent reform in the accounts of the city of Minneapolis, it was found that there were deferred assessments valued at over a million dollars which could not be found anywhere on the books, while uncollected taxes were overstated some $376,000. “It was impracticable to ascertain from the books what property was owned by the city or the cost thereof, and no reliable figures could be produced to justify the indebtedness of nearly $10,000,000.”‡ Appropriations were overrun in one year and required to be made up in the next. There was no way of learning the actual cost of improvements made, and it was even

† Proceedings of the National Municipal League, 1901, p. 312.
impossible to determine whether or not all the assessments were collected and paid into the treasury. A determination of the cost of operation of a department was out of the question. Except in cases where comparatively recent reforms have been instituted, this condition seems to be too often the rule, rather than the exception. Special investigations serve not only to reveal the situation at those particular points where they are made, but also to indicate what is probably true to a greater or less degree in other cities, counties and towns. For example, in the case of Minneapolis, it was only after an enormous deficit was discovered that the evils of such a system of accounting were revealed to the public.

Equally serious conditions exist in our counties and smaller cities throughout the country, but they were less noticeable only because they are more scattered and not so large in amounts. Years ago (in 1874 and 1875) in Massachusetts when an investigation of county accounts was made a deplorable conditions of affairs was found in many cases. In one county it was found that the treasurers kept their account books when retiring from office, while many other county officers seldom, if ever, attempted to balance their accounts.*

In 1892 a similar investigation was made among the counties of New York State. The condition there was found to be in some respects as bad as, or worse than, that in Massachusetts seventeen years before. Accounts of various kinds were "bunched together in almost inextricable confusion."† It was found during this investigation that defalcations or shortages had occurred in thirty-three counties.

In this same state there is being carried on at the present time an investigation of the county accounts. What the results of this will be remains to be seen. Similar conditions have in more recent years been found to exist in other states. And it seems that investigations which have not yet been made might reveal some equally interesting facts. An indication of this is seen in the message of Governor Warfield (page 42) to the Maryland Legislature in January, 1906, where he says that "in many counties the records are kept in private account books which are

* House Document, No. 401 (1874)†
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taken away by the officials at the expiration of their terms.” Four years before this Governor Smith of the same state said that many county officers kept the record of receipts, and disbursements, “when kept at all, in old and dilapidated books, which heretofore have often been regarded as personal property of the office holder, to be removed by him, if he so desires, on the expiration of his term” (page 33).

Needs regarding auditing.—Another weakness which is easily seen in our public accounting is in the matter of auditing of the accounts of various officers. It is found upon investigation that the accounts of a number of officials are not audited at all. No provision whatever being made in the statutes for their examination. This is more often true of local accounts than of state accounts. But an evil even greater than that of no audit is that of inefficient audit. This latter is of greater consequence for two reasons: first, because of the greater amounts of funds passing through the hands of this class of officers, and second, because of the fact that the people who think of the matter at all are likely to rest easy, ignorantly thinking that one sort of an audit is as good as any other. Fraud and dishonesty, however, may be almost as easily practiced without discovery in the latter case as in the former.

The inefficient methods of examination of accounts is due to three points of weakness. The first of these lies in the infrequency of the audit. Were such examination of the accounts sufficient in all other respects, the fact that it is made only once in two years, or even less frequently, or “whenever deemed necessary,” would often destroy much of its value. Many cases of shortage could be covered temporarily until such an infrequent examination was finished.

The second point of weakness lies in the persons designated by the statutes to conduct the audit. Generally in the case of local accounts the law empowers one set of county or district officers to examine the books and papers of another set. It is practically always true in such instances that the individuals thus provided to make the examination are personal friends of the officer, or officers, whose books are being checked, or in many cases such persons are business associates, relatives, or political colleagues. It stands to reason that under such circumstances
the examiners would not be inclined to make a careful and searching audit. On the contrary they often voluntarily rely on the word of the friend whose books are being examined.

The third point of weakness of these audits lies in the inability of the auditors. This is closely allied to the second point. The citizens designated by law are often thoroughly honest and reliable men, and possibly in many cases they are shrewd and careful business men; but too frequently they are entirely ignorant of the details and principles of the accounts which they are called upon to audit. Consequently the wrongdoer finds it an easy matter to cover up his fraud.

Either of the three points of weakness would, even in the absence of the other two, be serious. Therefore when two, and in many cases all three, are present, we can easily understand the extreme ineffectiveness of the audit.

It might not be out of order at this point to refer to one instance in which accounts or reports can easily be misleading and serve as the basis for fraud. In one city it was stated that the maintenance of waterworks had cost during the year nearly $830,000. Upon investigation, however, it was learned that of this amount $65,000 was used in repayment of bonds, that over $130,000 was paid into a sinking fund, and that nearly $320,000 was expended for interest, leaving slightly over $300,000 for maintenance proper.*

After a consideration of the needs for improvements in our present local accounting the question naturally arises in our minds as to how these needs can be met. It is our purpose later in this paper, after discussing the systems of supervision now exercised by different states, to take up this question, and to determine in a general way whether or not state supervision has been successful in meeting these needs.

(To be continued)

* Proceedings of the National Municipal League, 1901. Paper by G. W. Hanger
The Journal of Accountancy

Published monthly under the auspices of The American Association of Public Accountants by The Accountancy Publishing Company.
President, J. R. Loomis; Secretary, H. B. Cook; Treasurer, J. P. Johnson.

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EDITORIAL

The Central Bank Issue.

Senator Aldrich, chairman of the National Monetary Commission, appointed by the President over a year ago, is making addresses throughout the country this month upon the subject of banknote issues and the improvement of our banking system. Now that the tariff question has been settled for a time this is probably the most important subject touching business interests that is likely to come before Congress in the near future. Members of the Commission have visited Europe to study the English and Continental systems of banking, and experts have been engaged to write monographs upon topics concerning which more light is needed. There has been some hope that the Commission would be prepared to recommend a plan for the improvement of our currency and banking system during the coming session of Congress. The Senator's speeches, however, make it clear that this hope is not to be gratified. The monographs have first to be published and digested both by members of the Commission and by outside experts whose approval of any plan recommended will be desired. After the subject has been thoroughly discussed and business men and bankers have been made to understand exactly what is the need for reform and what are the obstacles that must be overcome, it seems quite likely that the Commission will then put forth a tentative plan in order to focus the discussion.
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Senator Aldrich is criticized in the press for not bringing forward some definite proposition. This criticism is not justified. Disclaiming the right to speak for the Commission as a body, the Senator nevertheless makes two very positive statements, which will doubtless be accepted as reflecting the views of a majority of the Commission. He declares first that the country is in need of an elastic banknote circulation and practically admits that such a circulation cannot be obtained if the issue of notes is made to depend upon the amount of government bonds available for use as security; and, second, that the present organization of our credit and banking system is in need of improvement. The latter need he considers the more important. He mentions also three other points on which it is fair to assume that the Commission has reached an agreement. Any new credit organization created must not interfere with existing banks or be controlled by the financiers of any section; it must be free from the possibility of partisan or political bias; and branch banking, excellent as it is, cannot be introduced into the United States.

These declarations of principle and policy are tantamount to the statement that the Commission has practically reached a conclusion in favor of the creation of a central bank of issue under government control. This is the same conclusion arrived at by the Special Currency Committee of the New York Chamber of Commerce three years ago. It then met with little favor among bankers or business men, but sentiment in its favor has steadily been growing, and now the advantages of a Central Bank are receiving general recognition in the daily press and financial periodicals. In our opinion the Monetary Commission is wise in preferring to arouse discussion of the subject instead of coming forward with a definite plan. Since no change in our banking system can be made without the approval of Congress, it is absolutely necessary first of all that the people be convinced that a change ought to be made, and this can be brought about only by intelligent discussion.

The panic of 1907 was a very effective object lesson as to the need of banking and currency reform. It furnished conclusive evidence that more than an elastic banking circulation is needed by the United States in order to prevent the recurrence of panic. Even if the national banks had possessed the authority to issue notes against their assets, it is not at all certain that the panic
Editorial.

in October, 1907, would have been averted or even mitigated. The evil day, indeed, might have been postponed, but each of our 20,000 banking institutions would still have been scrambling for possession of the country's stock of lawful money, and that scramble would have aroused panic distrust among depositors. As Senator Aldrich says, the situation calls for more than mere elasticity of the currency. What is most needed is a credit or banking organization so firmly grounded that no financial storm can shake its foundations.

Since any proposal to establish a branch banking system in the United States would undoubtedly be opposed by the great majority of country bankers, this system possesses no practical interest, and the Monetary Commission is wise in declaring through its chairman that they are not considering it as a possibility. There remains, therefore, only one practical and satisfactory method of solving the problem, and that it is by the creation of some central organization. This might be an association of banks, such as has been suggested by Mr. Victor Morowetz, or a large bank under private control, like the Bank of England and the First and Second Banks of the United States, or a bank under government control, like the Bank of France or the Bank of Germany. Senator Aldrich intimates that the Commission favors the latter kind of organization.

A government bank of issue with branches in different parts of the country, if a practical plan of organization and management can be devised, would certainly place the monetary and financial system of the United States on a sound basis. It would relieve the Treasury Department of its present burden of redeeming bank notes, greenbacks, silver dollars and gold certificates, and because of its large gold reserve and power of note issue, recourse to which would always be open to national and state banks through the process of rediscount, it would inspire among bankers and business men a confidence in the solvency of our financial institutions that could not be easily shaken. Furthermore, it would solve the problem of elasticity and so would prevent the wide fluctuations in the rate of interest which are now so burdensome to all classes of business in the United States. At the same time it would tend to bring about a uniformity in the rate of interest in all parts of the United States, for through its branches it would be able to effect a much more equitable distribution of capital than is now possible.
The Journal of Accountancy.

The Denver Convention.

The twenty-second annual meeting of the American Association of Public Accountants, held in Denver, Colorado, during the third week of October, was a most interesting and successful gathering from all points of view. The members of the Colorado society proved themselves masters in the art of hospitality. Several excellent papers were read, and the reports of various committees showed that the interests of the profession were being carefully looked after by competent men. The Journal will publish in the December issue a report of the convention's proceedings and some of the notable papers submitted for discussion.

In his "President's Address," which summarized the work of the Association and the progress made by the profession during the last year, Mr. Sterrett made a suggestion which we hope will bear fruit. Referring to the fact that the public accountant is fitted for broad and useful service in the community, he pointed out that the American Association in its present form or organization is not in a position to render the fullest possible public service. It has no habitation of its own and no executive officer who can give all his time to the furtherance of its aims. He believes that the Association ought as soon as possible to have independent headquarters in New York City in charge of an executive officer who would be free from the limitations that are necessarily placed upon one who is at the same time in practice as an accountant. Said Mr. Sterrett:

Such a man as I have in mind should be well trained in the ways of business, broad-minded, and of agreeable but forceful address. He should be capable of initiating work and enlisting the co-operation of members of the Association in carrying out plans undertaken. Being free from professional engagements and free from the implications of personal motive that might be laid at the door of any one in active practice, he would be able to keep in close touch with other representative business and educational bodies, and as occasion might require, act as representative of this Association. Our present secretary, who has labored so faithfully in the interests of the Association, understands that in what I have just said I am not expressing a criticism but simply stating a condition, and I believe I am not alone among those who are intimately acquainted with present needs of the Association in feeling that the condition to which I am directing your attention is of such moment as to warrant your very careful consideration.
If the value of this suggestion is conceded, and we fail to see any ground for opposition, the only practical obstacle in the way of action is the item of expense. It would probably be impolitic to raise the membership dues of the Association, but among the public-spirited accountants of the entire country it certainly ought not to be difficult to secure guaranty of a fund adequate for the purpose.

ANNOUNCEMENTS

The Maryland Association of Certified Public Accountants recently elected the following officers for the ensuing year: President, C. O. Hall; vice-president, F. L. Brauns; secretary, Elmer Hutter.


J. B. Geijsbeek has handed in his resignation as secretary and member of the State Board of Accountancy of Colorado, on account of lack of time because of his duties as dean of the University of Denver, School of Commerce, Accounts and Finance.

Mr. Ernest S. Suffern, of the firm of Suffern & Son, announces that he is not connected as an officer or director with any corporation. Any statements published to the contrary have been erroneous.

ERRATUM.

In the article on C.P.A. Requirements in the October Journal, it was stated that certificates of accountancy in Montana were to be registered with T. C. Marshall. They are registered with the President of the University of Montana, C. A. Duniway, at Missoula, Mont.

The twenty-second annual meeting of the American Association of Public Accountants, which was held in the city of Denver October 18-21, was an occasion keenly enjoyed by all who were in attendance. The weather conditions were ideal and the program was arranged so that sufficient opportunity was given for the presentation and consideration of technical papers, and interwoven therewith with a delightful series of social events.

The principal papers presented were as follows:

"The Relation Between Accountancy and Economics," by Dr. James E. Le Rossignol, of the University of Denver.


"Depreciation, Renewal and Replacement Accounts," by Herbert G. Stockwell.

"Verification and Treatment of Inventories in Audits and Examinations of Manufacturing and Trading Concerns," by W. R. Mackenzie.

All of these papers were received with a great deal of interest, and the two papers on accounting subjects elicited a general discussion.

In addition to these formal papers, a special committee which had been appointed during the year, presented a report on Accounting Terminology, which, after some discussion, was referred back to the committee with instructions to enlarge its numbers and continue its work during the coming year. Altogether the literary portion of the program was of a high order and will compare favorably with that of previous meetings.

One highly gratifying item of business was the final solution of the difficulties that have existed in accountancy ranks in California during the past three years. A strong delegation from California attended the meeting at Denver and presented the application (which was unanimously accepted) of a new society, which includes in its numbers practically all of the practicing accountants of that state.

The Trustees' report and the President's address showed that the Association had been carrying on its work with its usual activity during the year, and that the affairs of the Association are in a highly satisfactory condition.

Mr. Sterrett and Mr. Roberts were re-elected president and secretary, respectively, and Mr. H. A. Keller, of Ohio, was elected treasurer. The new trustees elected were: John A. Cooper, William F. Weiss and W. Sanders Davies.

C. P. A. Examiners.

The American Association of C. P. A. Examiners held its annual meeting at Denver in October, and elected officers as follows: President, W. A. Chase, of Chicago; vice-president, Joel Hunter, of Atlanta; secretary and treasurer, J. H. Kauffman, of Cleveland; advisory committee, J. E. Sterrett, J. S. M. Goodloe, H. M. Temple, W. T. Hunter, T. E. Doneith.
Current Comment on Corporation Tax Bill.

Hasty Law-Making.

President Taft already has confessed that the corporation tax law was a makeshift. As a revenue measure it was designed as a substitute for the impossible inheritance tax. And its chief purpose is to afford a basis for Federal interference with the affairs of corporations, not justified by existing law. The law was conceived, drafted, recommended and passed in less time that was occupied with some paragraphs of the tariff bill, and yet this measure affects every incorporated commercial interest in the United States. Published correspondence between members of the American Association of Public Accountants and Attorney-General Wickersham, written at the time the bill was introduced, together with the instructions issuing through the Internal Revenue Office to corporations, go still farther in characterizing this scheme as a superficially conceived makeshift, which even if it can stand the test of law is doomed to failure in its practical application.

According to Attorney-General Wickersham the tax will be "easy to collect." Nominally it is to be a tax on corporation incomes. The Attorney-General's formula for figuring corporation income, prescribed through the Internal Revenue Office, is to add together all cash income from whatever sources, and subtract from this sum all money paid out for maintenance and operation, all losses actually sustained, allowances for depreciation, interest paid on bonded debt and taxes paid. The remainder will be recognized as the net income on which the tax will be levied. These figures are to be submitted for the calendar year. It does not require an expert accountant to understand that such figures will bear little relation to actual corporation income. Any tyro in business knows that something other than the cash book is required to determine the profit or loss of a year's transactions. If income is to be figured on the incomplete showing of cash receipts and disbursements, injustice will be done honest corporations, and dishonest managers will have an opportunity for distortion of accounts and evasion of taxes that will destroy whatever equity there may be in the scheme.

When the members of the American Association of Public Accountants directed the attention of Attorney-General Wickersham to these apparent defects in the law, they got little satisfaction for their effort. Their advice, as expert accountants, relative to a matter intimately concerned with corporation accounting, was not required by the Attorney-General. That official not only ruled that their objections were not justified, but gently nominated them for the Ananias Club by assuring them that their statement "would be received with very great incredulity by most minds," and closed the incident by saying "it is now too late to attempt to recast the corporation tax amendment," although that letter was written July 22.

It is now proposed to appeal to Congress for amendments early in the session, which will remove some of the objectionable features of the present law and make it conform more closely to the accepted methods of business accounting. The law is to be tested before the Supreme Court, and many doubts have been expressed of its survival. If a Federal corporation charter law is to be enacted, which, as is promised, will be attractive to all interstate corporations, a much more simple basis for corporation taxation will be afforded and all the requirements of Federal interference for regulation will be served. Why not amend the corporation tax law by striking it off the Federal statute books?—Boston Herald, October 11, 1909.
The United States is now passing through an experience similar to that of New York State with its franchise tax. After several years of litigation the franchise tax is not yet understood, and is only in part collected. Congress also passed what is thought a most popular tax, only to find that the payers of the tax had sentiments different from those of the corporation baiters, and that the proposal which was to be so remunerative in cash and so productive of votes, bears promise of being merely a lawsuit. A tax needs the sanction of popular opinion as much as a law, and the corporation tax commands the respect of nobody. In fact, it is a proposal lacking in popular mandate and oppressive to those subjected to needless annoyance under it.

One reason is that the tax is not a mere tax, but is a device to secure that control over corporations which the Federal government could not otherwise exercise. It is an attempt to elude the prohibition of an income tax by calling it an excise tax, and is therefore quite as much an evasion of law by the taxing power as by those who resist the tax. A leading firm of public accountants has expressed the opinion that the law is obnoxious because it "prescribes a method for ascertaining and reporting net income radically at variance with accounting methods generally followed by industrial and trading corporations, with those prescribed for public service corporations, under Federal and state laws, with accounting methods followed by many insurance, financial, and banking institutions, and with principles recognized by students of accounting."

The American Association of Accountants made a similar criticism of the law at a time when it might have enabled the government to cast the tax in a less objectionable form, but in response to its helpful suggestion it received a letter from the Attorney-General saying that "it was too late to attempt to recast" the bill. It was therefore enacted in haste and is in a fair way to be repented at leisure. It is said that there is no record of any other attempt to levy an income tax upon the difference between cash receipts and disbursements. Gross earnings have been taxed, and so have been net income or profits. The taxation of the difference between cash income and outgo is original with the framers of this law, and is not explained by them or by the Attorney-General in his correspondence. It is not a mere conflict of theories how taxes should be levied. They have been collected in well-known ways. It remains to be seen whether the novel law can be sustained in its entirety. The method of accounting made necessary is so difficult that it tempts even conscientious taxpayers into resolving doubts in their favor. This cannot be proved even in the case of law-abiding corporations, while unscrupulous officials will only pay so much of the tax as they wish.

The law is defensible, if at all, upon the theory that honest corporations have nothing to conceal, and that the outcry against the inquisitorial law is proof of a bad conscience. Only the corporation mad could have such an idea. Corporations have their rightful secrets as well as partnerships, which is merely to say that business enterprises in either form are substantially alike, as in fact they are. At least there can be no doubt of this
Current Comment on Corporation Tax Bill.

in the immense class of private corporations, which enjoy no other franchise than that of doing business in corporate form. To compel them to register their private affairs with a government to which they owe nothing is a usurpation which they naturally resent.—*New York Times.*

*Repeal Rather Than Amendment Desirable.*

Even an "inexpert" can follow that line of reasoning (contained in the letter of the American Association of Public Accountants to Attorney-General Wickesham) intelligently, and it will appeal to him as logical. Yet the Attorney-General of the United States replies to their statement that no system of accounting can give "the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties," that "the bare statement of that proposition will be received with very great incredulity by most minds," that he cannot assent to it himself and that, anyway, it is too late to attempt to recast the corporation tax on the basis of any such proposition. Obviously, the Department of Justice will be found opposing any amendments to the act.

And, after all, perhaps it may be just as well to leave the law as it is for a while. The courts are bound to consider its constitutionality at an early day, and it might easily happen that it would be declared null and void before any amendments could be secured. The company reports for the calendar year 1909 do not have to be filed until next March, and the corporations have until June 30, 1910, in which to pay the new tax. Lots of things may happen meantime. And amending a law that at the moment has the promise of only a very short life would appear to be throwing time and talent and energy away.—*New York Commercial,* October 21, 1909.

Government Department of Accountancy Needed.

After mature consideration experts in the science of accounting are of the same opinion still, that the rules laid down by the corporation tax section of the tariff law for arriving at the annual net income leave much to be desired. * * * * *

The general public is incapable of arbitrating this question. Indeed, the average director of a corporation may not be able to determine which has the right of it. Your captain of industry uses his head, with learned counsel for one hand and expert accountant for the other; he is bound to place much dependence on his hands for the carrying out of the schemes in his head. In such circumstances, in a controversy between the lawyer and the accountant over a question of bookkeeping, the larger faith and credit will inevitably be rested in the accountant. The country has been frequently reminded that the corporation tax section was framed with the greatest care to avoid constitutional pitfalls—by lawyers. There has been no assurance that the prescription for arriving at the taxable quantity, the unknown "x," was similarly arrived at by skilled accountants. Leading representatives of the latter profession express the opinion that no up-to-date bookkeeper would care to go sponsor for the device and few would venture to attest the value of "x" so arrived at.

The matter is obviously important. If the law as law fulfills the requirements of the Constitution it must also illustrate the principles of sound bookkeeping, to be effective for the main purposes, the collection of revenue and the securing to the Government of reliable information respecting management and behavior—the latter, we are told, being the foremost consideration. But, according to practicing accountants who
have examined the law, the operation as prescribed will chiefly test the ability of bookkeepers to do a sum of a nature which no intelligent bookkeeper would ever think of trying to do; which in business experience would never be contemplated; which, indeed, is next to impossible to do except as an abstract proposition, entertainingly involved with the speculations of the "method of least squares," otherwise the mathematics of guesswork. In a word, the accountants seem to regard the formula for finding the amount of net income to be taxed as a sort of puzzle picture for bookkeepers. It is expected, accordingly, that the American Association of Public Accountants will address Congress at the December session, urging that the formula be amended to make it workable, not to say intelligible.

The new legislation is not the first to illustrate the intervention of government into the bookkeeper's field. If the government in this manner is to evade business practices on a large scale, it would seem desirable that a Department of Accounting be instituted, to co-operate with the Department of Justice for the framing of legislation.—Providence (R. I.) Journal, October 19, 1909.

Perplexities of Corporation Tax.

President Taft has had considerable to say concerning the law's delays; in the near future he may be moved to comment on one law's perplexities, namely, the corporation tax law which was passed with his unqualified approval. The president and secretary of the American Association of Public Accountants have just sent out a letter to the members of that organization in which they point out that amendments of that act are necessary and that the changes should be made during the early weeks of the Congress that assembles in December next. It is maintained that this law did not receive the consideration which it demanded, that it is ambiguous and that it brings up questions of inventories in determining income that are very serious indeed. As much has been suspected, surely, from the first. It is one thing for the government to bestow upon itself the power to inquire into the financial conditions and earnings of large business enterprises and another and very different thing to provide ways and means which will enable it to secure the information which it seeks.—Providence (R. I.) Tribune, October 12, 1909.

Amendment Likely.

That the collection of this tax (corporation tax) is going to occasion cost and embarrassment to our business corporations may be confidently expected. And that the defects emphasized by the American Association of Public Accountants exist is rather more than less of a certainty. Before the measure has been in actual operation a great while, a demand for its amendment, in the direction pointed out by the association aforementioned, will probably be heard.—Wall Street Summary, October 13, 1909.

Theory of Law Wrong.

The American Association of Public Accountants find fault with the theory on which the corporation tax is levied, and they are right. No person familiar with taxation would ever have dreamed of imposing a tax on the difference between cash receipts and disbursements. Taxes have been levied on net receipts, but it was found that such a tax was not productive, because there were no net receipts by the time the collectors appeared.
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They have generally been levied on gross receipts, and this has been considered the most equitable because it taxed all alike, and non-productive enterprises were not burdened by an inflexible tax, but taxing the difference between receipts and disbursements is brand new. Watch the disbursements grow.

There is no special need for a tax on corporations, and it will not be productive. It will be like the income tax. The proceeds will be absorbed by the machinery of collection, and instead of being a revenue producer will be a source of expense, as the postal department is.

If the scheme was devised for the purpose of securing Federal control of the corporations, it is cumbrous and indirect. If taxes are necessary, they should be levied on gross receipts. It is doubtful if the tax act will stand anyway, for it is inequitable because it does not tax all alike, but singles out stockholders in corporations as the victims.—Jersey City Journal, October 12, 1909.

Business for Bookkeepers.

The Treasury Department's instructions regarding the returns to be demanded of all corporations, with reference to the tax to be levied upon their net earnings at the end of this year, serve notice of an increased amount and variety of bookkeeping that must be somewhat appalling to their accountants. There is probably no corporation that keeps its accounts in the way that is now prescribed. It is not the invention of accountants or financiers, but of lawyers. As this new corporation tax—unlike any other ever proposed in this country—is retroactive, covering the whole operations of the current year, a new set of books will have to be prepared to change the accounts into the required form.

This is not all. Most corporations are already under compulsion to keep their accounts under various forms, by state or Federal authority, and to make their fiscal year conform with various official dates. But the United States government itself has imposed upon certain corporations, as upon the railroads, a specified form of computing their earnings which is entirely discordant with the form now required. The Interstate Commerce Commission inquires properly into earnings accrued and expenses incurred, which is the only way to determine the company's condition. The collector of internal revenue wants a return of cash receipts and disbursements. The railroads are compelled to conform with the Interstate Commerce Commission's form of bookkeeping under heavy penalties; they are now threatened with additional penalties if they do not change to a wholly different basis of accounting.

The officers of the American Association of Public Accountants have just reprinted a correspondence with the Attorney-General, in which they protest against the obscurities of the corporation tax. Even apart from the confused definition of earnings, they declare that "there is no method in which any such statement as that called for can be prepared short of an entirely independent and separate set of books," thus duplicating the present cost to no useful purpose. Mr. Wickersham replies rather flippantly that it must be done, and it is well for manufacturing corporations especially to know what is before them. This phase of "prosperity" promises abundant employment for bookkeepers—unless the courts should overturn the new tax, as they did the income tax of 1894.—Philadelphia Public Ledger, October 1, 1909.

A London View of the Tax.

There can be no doubt that the bill was deliberately intended to impose a tax on excess of receipts over payments. Indeed, that is the interpretation we ourselves should have put on Section 38, which is set out above.
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This system of accounting is contrary to the regulations of the Interstate Commerce Commission, the American Street Railway and Interurban Association, the National Electric Association, American Gas Institute, the Wisconsin Railroad Commission, and the New York Public Service Commissions, Nos. 1 and 2.

A tax on the excess of receipts over payments savours of the days gone by so far as accountancy is concerned, and it is surprising to find the finance department of any government deliberately supporting such a project. It is a basis unjust and unsatisfactory for almost every class of mercantile undertaking. In a class of business where, for instance, at a certain time exceptionally large debts are incurred, the system would be most unjust. It is difficult to conceive what considerations weighed with the American authorities in framing the measure in this form. The return of net income received has to be made up for the year ended 31st December, no matter what the financial year of the concern may be, and we should also mention that the bill contains the following provision, which is exciting special resentment:

When the assessment shall be made as provided in the section, the returns, together with any corrections thereof, which may have been made by the Commissioner shall be filed in the office of the Commissioners of Inland Revenue, and shall constitute public records and be open to inspection as such.

These particulars go to explain why it is so confidently asserted that the tax must be soon amended, or repealed, if it is not held to be unconstitutional.—London Accountant.

San Francisco Municipal Accounts.

The suggestion that the Society of Certified Public Accountants offer its services to improve and simplify the accounting system of the city should be encouraged. The one thing that is certain about our municipal books is that they are complicated and adapted to give the least possible information at the greatest possible labor.

Confused system of accounting are a wrong to the people, for the tax payers are entitled to know what is being done with their money. Furthermore, such tangles encourage weak and wicked employees of the city to steal. If the books offered no chance to hide defalcations and shortages, the Widbers and the Smiths, to say nothing of the smaller fry who have the handling of the city’s money, would have small temptation to hold out any of it.

San Francisco is about to enter into large public enterprises, and it is necessary to success that accounts should be kept on a plan that will enable the interested citizen to know what money comes in and what is goes out for.

The protection for public money lies in publicity. Therefore, let us have accounts that will tell the people where their affairs stand.—San Francisco Examiner.
Book Department.


To be associated with Appleton's Business Series is, in itself, a recommendation. To be a worthy associate in that company is not an easy task. Mr. John J. Sullivan's book deserves whatever credit it may receive from its publication and merits the same praise that has been bestowed on other volumes in the Appleton series.

In no way have modern books on business law improved on their predecessors than in their analysis and classification of the law. We have before us a book written over thirty years ago, which, at that time, was highly and deservedly praised for its analysis of the law. In fact, the author was a student of pedagogical methods, and applied his knowledge to the preparation of his text. But we find the whole subject of the law divided into a number of separate titles, each title being treated in a separate chapter as a distinct branch of the law. The relation of contracts of sale to the general subject of contracts, for example, is not clearly indicated in this older book by a division into chapters, parts and books. An improvement in this respect has gradually been made, the model being reached, perhaps, in the work of the late Dean Huffcut.

While the book under discussion does not show the genius for analysis that was characteristic of Huffcut's "Elements of Business Law," it is superior to that work in its proportions. Subjects of present-day importance are given the space they deserve. Indeed, some topics of the law, whose value to the ordinary business man is not of recent growth, but which were omitted by the older writers, perhaps from custom, have been included. An example will be found in the chapter entitled, "Rules of Evidence Relating to Contracts."

We do not believe the average business man will gain much from the innovation, recently adopted by Gano and others, of citing the cases from which the illustrations are taken. In fact, Huffcut's method of presenting a number of imaginary and concise cases is to be preferred to the method, here adopted, of setting forth the facts of one decision to illustrate a principle. On the other hand, there are no freak novelties, such as have been used in some recent texts on business law.

The book, it is needless to say, sets forth good law. It is a pity, however, that in these days of accurate and well-classified digests and encyclopedias of law to lighten the task, the author did not improve on all his predecessors by giving a greater amount of attention and space to the conflict of laws on the various jurisdictions within which the book is sure to find a large distribution.

CHARLES W. GERSTENBERG.

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A new work on transportation by Professor Johnson is always welcome. The years of study that he has given to transportation problems, combined with his practical experience as a member of various government commissions, have made him the chief university authority in this field. Professor Johnson writes clearly, and has the happy faculty of appealing both to men of affairs and to economists. The present volume does not add to his previous works, but collects and condenses material which the author has already presented.


Authorities, not realizing the fundamental weakness of our municipal government, have brought about a great confusion in the public mind concerning questions of municipal policy. Professor Rowe explains the ineffectiveness of the organization in the municipality as due to the same causes that lie deeply buried in our political system as a whole. This is our traditional fear of absolutism—and it has kept us from gaining that effectiveness which our business instincts demand. Professor Rowe believes that the American people to-day are beginning to place efficiency above their desire for democratic rule. This will inevitably lead, in his opinion, to a concentration of executive power in the mayor, in which event the City Council will either be destroyed or survive only as a government organ restricted solely to legislative functions.

Administrative problems are, however, not the most difficult problems to be solved in our cities. The proper adjustment of civic and political standards to the conditions of city life is a matter of such fundamental importance that upon it the whole municipal problem may be said to rest. This leads the author to the consideration of two important questions which are discussed in the two chapters on the social and political consequences of city growth. He shows the limitations and restrictions of country life upon an expression of the social desires. The broader civic instinct must be developed by the possibility of new pleasures derived from the presence of large numbers of persons. The city environment furnishes these in the forms of the social club, the theater and the various literary,
Book Department.

musical and scientific societies. These bring the individual into close touch with the life of the community and compel him to think of the city as far more than a protector of person and property. He looks to the city finally to perform a group of services closely connected with the maintenance of his standard of living. The consequences of this enlarged conception of a city's functions will be to bring within its control many of the social pleasures now isolated and exclusive. "The city democracy toward which we are approaching will be a democracy of pleasure and enjoyments, rather than a democracy of the suffrage."

Although Professor Rowe's book is stronger from the point of view of the political philosopher than from the standpoint of the practical business administrator, it has, nevertheless, some valuable comparisons and suggestions concerning the relation of the city to public utilities. Briefly summarized, the principles that the author lays down as those that should govern the granting of franchises are as follows:

(1) The power to determine the charges of public service corporations is of little value unless it carries with it careful control over capitalization.

(2) Control over capitalization cannot be made effective unless it is combined with public supervision over the accounting of such corporations.

(3) In order to prevent the payment of stock dividends new stock should not be issued at less than its market value.

(4) No universal rule can be established with reference to the length of franchise terms. Such terms should range from twenty-five to forty years, depending on the size of the city and the probable annual net return from the use of the franchise.

(5) The city should exact compensation in the form of lower charges rather than large financial returns.

(6) At the close of the franchise term the physical property of the company should revert to the city at its appraised value.


This book is typical of the many books that are coming from the business and technical press at the present time. Authors are turning from the purely technical part of engineering enterprises and devoting their thought to the wider field of administration, organization and valuation. More and more the engineering profession is realizing that it is more difficult to estimate the outcome of an undertaking from the point of view of profit and loss than to determine its success from the standpoint of a strictly engineering proposition. Business men who furnish the money for a railroad, a mine or a factory not only want to know from the engineer that the thing can be accomplished technically, but they ask what will be the cost, and will the income bear a normal proportion to the expenses of maintenance, operation, etc. To answer these questions the engineer must know at least the broad principles of valuation, administration and organization which the experience of the business world have proved and accepted.
The Journal of Accountancy.

At the same time such a book is valuable to the investor or administrator of properties whose interests lie in the income and security of their investments, but whose experience in the practical operation of the enterprise is limited. By a study of the principles of organization in relation to the elementary technical conditions they can form an estimation of the value of the wealth underlying their securities. An example of the method which an investor might pursue in connection with mining property is selected from the chapter on Mine Valuation, page 54:

The G mine in Nevada. It has a capital of $10,000,000 in $1 shares, standing in the market at 50 cents each. The reserves are 250,000 tons, yielding, a profit for yearly division of $7 per ton. It has an annual capacity of about 100,000 tons, or $700,000 net profit, equal to 14 per cent. on the market value. In order to repay the capital value of $5,000,000 and 8 per cent. per annum, it will need a life of (Table III) 13 years, of which 2½ are visible. The size of the ore-bodies indicates a yield of about 1,100 tons per foot of depth. At an exhaustion rate of 100,000 tons per annum, the mine would need to extend to a depth of over a thousand feet below the present bottom. There is always a possibility of finding parallel bodies or larger volumes in depth, but it would be a sanguine engineer indeed who would recommend the stock, even though it pays an apparent 14 per cent.

This chapter is further supplemented by one on the amount of risk in valuation of mines as compared with other commercial enterprises.

The chapter upon Administration will appeal especially to accountants and efficiency engineers. Here the author treats of labor efficiency, skill, intelligence, application, co-ordination, contract work, labor unions, real basis of wages, accounts and technical data and reports, working costs, division of expenditure, inherent limitations in accuracy of working costs, working cost sheets, administrative reports, etc.

Mr. Hoover is well qualified to speak upon this subject not only as an engineer, but as a man with a wide and varied experience in financing and administering large mining enterprises.

L. G.

It Favors the Younger Men.

Viewed from this narrow standpoint, a rule forbidding advertising is clearly altogether in favor of the small man. A giant firm presumably may always be assumed to be in possession of far greater resources, and thus, if paid advertisements were to be the order of the day, could wipe the small man off the road in a very few weeks. Professional accountants all gain by a mutual agreement not to add the costs of advertising to their already heavy expenses; but, in the absence of any such agreement, the benefits of advertising would naturally go to those who were prepared to spend the largest sums upon advertising, and this undoubtedly would not be to the advantage of the small man. It is thus to the advantage of all, but peculiarly to the advantage of the beginner, that advertisements that cost money should be banned.—London Accountant.
Legal Department.

Edited by Charles W. Gerstenberg, Ph.B., LL.B.

Amortization.

A controversy having arisen between the residuary legatee and the executors of the life beneficiary of the trust created by a will, as to whether certain sums were properly credited to income or principal, the court in In re Perkins’ Estate laid down a rule for the guidance of executors and their accountants. Referring to two certain items the opinion reads:

These were amounts credited to principal to reduce premiums on certain bonds bought by the trustee above par. The decree (of the Surrogate’s Court) directed that the said amounts so credited to principal be regarded as income and be paid to the executors of the late life tenant, upon the ground that it was the intention of the testator to secure to his widow the income of the trust created for her benefit, without making any deduction therefrom to pay the premium on securities purchased for investment. This, I think, was an error. In Matter of Stevens, 187 N. Y., 471, the Court of Appeals, in considering all the prior cases, laid down the rule that in the absence of a clear direction in the will to the contrary, where investments are made by the trustee, the principal must be maintained intact from loss by payment of premium on securities having only a definite time to run; while, if bonds are received from the estate of the testator, the whole interest should be treated as income. Chief Judge Cullen said: “If we are to lay down the doctrine that the question is to be determined on the peculiar facts and language of each particular case, no trustee will know how to safely act, and a question constantly arising in the administration of estates will be involved in great confusion, and be the cause of great litigation, the latter often at an expense to the estate greater than the sum involved. Such a result would prove very unfortunate. The justification for the rule is very apparent.” This definite rule was made by the Court of Appeals upon an examination of all the cases, and by a divided court, with a strong dissent, showing that the matter had been advisedly passed upon as a guide to future trustees.

This, then, is a recent restatement of the rule and the reason in In re Perkins’ Estate, 116 N. Y., Suppl. 147.

Bonds.

An interesting decision is that of Brown vs. Ringdahl, in which the Minnesota Supreme Court held that certificates of indebtedness issued to raise money to pay for the construction of a prison do not constitute an indebtedness such as is contemplated by the constitutional provision limiting the aggregate amount of indebtedness to $250,000. The certificates are mere evidences of the holders’ rights to demand and receive from the State Treasurer the proceeds of the tax, authorized by the act to be levied and collected. The act, so says the opinion, contemplated the payment of the certificates from a specific fund, provided for that purpose, and they are not general obligations of the state.—Brown vs. Ringdahl, 122, N. W. R., 469.
The Journal of Accountancy.

Federal Incorporation of Companies Doing Interstate Business.

The Attorney-General, George W. Wickersham, wrote an article for the Harvard Law Review, March, 1909, dealing with the capitalization of corporations. In a more recent article he has dealt with the theme of congressional incorporation, under the title, "State Control of Foreign Corporations." His statement of the law governing the right of a state to regulate the admission and existence within its borders of a foreign corporation is familiar and somewhat trite, the real importance of his utterance being his advocacy of Federal incorporation.

If, as the Supreme Court has directly adjudged, Congress has authority, in the exercise of its power to regulate commerce among the several states, to authorize corporations to construct railroads across the states as well as the territories of the United States, and the power to construct, or to authorize individuals or corporations to construct, national highways and bridges from state to state, why has it not necessarily full power to authorize the formation of corporations to conduct other forms of interstate commerce, not merely transportation, but of that character of interstate commerce dealt with in the Sherman Anti-Trust Law and described in the decisions in the Beef Trust and Danbury Hat cases? Such corporations formed under national law would not be foreign corporations in any of the states, and would therefore be at liberty to transact their business without state permission and free from state interference.—Yale Law Journal, November, 1909, Vol. XIX., p. 1.

Funded Debt.

The right of approximately four hundred women to vote on a certain question depended on the meaning of this term, "funded debt." The question involved, aside from the burning and recently omnipresent one of women's right to the suffrage, is somewhat similar to that presented by the Minnesota decision, above noted. It was held that the issuance of village bonds to establish a waterworks system, to be paid by the annual levy and collection of taxes, constituted the creation of a "funded debt," under the General Municipal Law of the State of New York. The election at which the the proposition to issue the bonds was voted upon, therefore, was void because the women were excluded.—Gould vs. Village of Seneca Falls, 118 N. Y. Suppl., 648.

Trust Companies—Liabilities of Directors and Members of Committees

A case of much interest which has been in the courts of New York State over five years has very recently appeared in the New York court records again. It is an action brought by a stockholder to recover into the treasury of the Commonwealth Trust Company a sum of money as damages suffered by the trust company by reason of alleged negligence of the defendants, all of whom are, or were, directors of the trust company, and some of whom are, or were, members of its executive committee. The matter has once been taken to the Court of Appeals, whose opinion will be found at 191 N. Y., 522. The opinion of the lower court
on the rehearing, which is the subject of this note, is throughout an important contribution to the law, but we will cite portions of it only:

The duties of the directors and members of the executive committee are defined and regulated in the by-laws, in the provision of the banking law, and by relations which exist between the directors and the corporation. * * * I conclude, therefore, that it was recognized on May 27, 1902, under the by-laws, as well as the custom in New York City, that it was the duty of the executive committee to require all loans and investments to be reported to it at its next meeting for approval; unless it be those call or Wall street loans which by custom were often outstanding but one day, and it was the duty of the executive committee to have known of each of the loans in question at the next meeting after the loan was made, and of the directors generally to have known at the next meeting of the board. It is not sufficient to reply that the loans were not presented to the executive committee. It was the duty of that committee to require them to be presented. The directors and the members of the executive committee have active duties and responsibilities. * * * Their duties are not entirely limited to regular meetings. * * * The directors are not spies upon the officers, nor are they expert bookkeepers. * * * It cannot be required that the executive committee or the directors should make at each meeting the same complete examination of the trust company and its affairs as is made on the quarterly examinations—for example, that they should personally examine and handle the notes and the collateral—but they should learn the amount of each note, the time it is due, the names of the makers and indorsers, and the collateral held, as these facts exist upon the day of the meeting, also a full statement of the condition of the bank on each day as kept by every monetary institution. This statement does not contain the full details; but, unless the accounts are falsified, it will not require an expert bookkeeper to know that something is wrong, if any considerable loan or item is omitted from the statement. * * * Under the facts in this particular case, I am not much impressed by the contention that a director is not negligent if he performs his duty as directors of other institutions of the same kind in the city or community performed theirs. * * * * * It is urged that custom permits directors to take vacations; that prudent men take vacations and commit their personal business affairs to employees. * * * * * If they take vacations without making reasonable provision for meetings of the board or the executive committee, they assume the risk of misconduct or mismanagement of the officers, which occasions loss, just as the business man assumes the risk of misconduct of his employee; and, if they, in the discharge of their duties, could have prevented or lessened the loss, they cannot escape liability for that loss by pleading that they were on their vacations, as it was the custom for directors of trust companies to be at this time of the year. A director may be excused by the board for a period of time and escape all liability; for then, through his associate directors, he has made reasonable provision for the management of the company's affairs during his absence.

The decision then proceeds to examine the history of the Commonwealth Trust Company and to examine the particular items on which loss was claimed.—Kavanaugh vs. Commonwealth Trust Co., 118 N. Y. Suppl., 758.

**Trustees.**

Where money is left in trust to pay the income to the cestui and to use part of the principal, if necessary, for her maintenance, a trustee appointed by the court to succeed the deceased trustee nominated by the
The testator who created the trust, will not be permitted to use any of the
principal, for the reason that the creator of the trust is deemed to have
had personal confidence in the original trustee, which confidence was the
sole reason for his extending the power of impairing the principal.—
Whitaker vs. McDowell, 72 Atl., 938 (Conn.).

New York City Accountants.

Comptroller Metz, of New York City, has issued a fifty-page pamphlet
which states the administrative purposes and contains a general description
of the new system of accounting and reporting. It is issued as an appeal to
the public intelligence. A "Manual of Accounting and Business Produce,"
which contains the forms and documents and a detailed description of their
use, is now in press and will soon be issued. This has 500 quarto pages, and
is for the guidance of officers and the clerical staff of the city, and for those
interested in the technical aspects of the city's business.

Comptrollers’ Association to Admit Fiscal
Officers as Delegates

The National Association of Comptrollers and Accounting Officers, an
organization which considers improved methods of public finance, which
has hitherto enrolled fiscal officers of various cities as individuals, has
decided to alter its constitution so as to admit the officers as delegates
to the annual conventions from their respective cities, the municipalities
holding the membership and paying the fees and the expenses of their
representatives at the conventions.

Circular letters to this effect and containing a pro forma ordinance
for adoption by the city governments have been issued to state, county,
and city officials throughout the country.

The association was started in Washington, D. C., five years ago,
Alonza Tweedale, auditor of the District of Columbia, being the moving
spirit and the present president of the organization. The District govern-
ment has adopted practically the plan desired, the membership fee and
traveling expenses of the city's representative to the conventions being
paid from the District's appropriation.

The next convention of the association will be held in New York City
in June, 1910.
C P A. Question Department.

Conducted by Leo Greendlinger, M. C. S.

Criticism and exchange of ideas will clear many a doubt and at the same time improve shortcomings. To solve, compare, and criticize C. P. A. problems, and thereby to aid in bringing about a uniform American standard for C. P. A. examinations, is the object of this department. With the aid of suggestions and criticism from the professional brethren, it can undoubtedly be achieved. Inquiries will be cheerfully answered.

The following are extracts from the C. P. A. examination papers of the State Board of Florida and the State Board of Michigan, given July, 1909.

Michigan C. P. A. Board of Accountancy.

Commercial Law.

What is the source of the Bankruptcy Law of the United States? (b) What are the exceptions to the rule, that on the bankruptcy of a firm, and of an individual member of that firm, the joint and separate creditors cannot prove in competition with one another? (c) What is the jurisdiction and power of a referee in bankruptcy and what compensation is a referee in bankruptcy entitled to?

In what proportion to the actual paid up capital of a Michigan corporation may preferred stock be issued? (b) What must be expressed on the face of preferred stock certificates as regards their redemptions, etc.? (c) When cumulative dividends are permitted, what is the maximum rate per cent. per annum? (d) Does the preferred stock vote the same as the common stock? (e) Under what conditions would preferred stock have equal rights with the common stock in the control of a corporation? (f) Is the transfer upon the books of a corporation necessary to complete the assignee's ownership of a stock certificate? Explain fully.

In what three ways may an employee seek redress for an employer's improper breach of contract for a fixed salary payable at regular intervals?

Distinguish the difference between an open and stated account. (b) To what extent is an account stated conclusive? (c) Does the mere rendering of an account make it an account stated? (d) On what grounds may an account stated be opened? (e) Give the number of years after which the various kinds of actions are barred by the statute of limitations in Michigan on judgments, sealed notes, justices' judgments, notes receivable, and open accounts. (f) Is Michigan one of the states where the seal implies a consideration only where there is no evidence to show that there was no consideration?

What is a contract? (b) How is a contract made? (c) What are some kinds of contracts that must be under seal? (d) Which contracts, if made on Sunday, are void, and which are not void? (e) Give examples of contract which are illegal at common law. (f) Draw up a contract in legal form between a company and a branch house manager, covering the period of employment, salary, the various duties, and other terms, etc., in accordance with the following information: Salary, $5,000 per annum, payable semi-monthly, the company agreeing to allow the manager a one per cent. commission as additional compensation at the end of the year on all net business handled through the branch in excess of $500,000; further, if the expense of doing business at the branch shall be less than 10 per cent. of the gross sales, then the manager is to receive one-third of such saving in the expense of operating. This agreement may be terminated at any time upon written notice being properly served. This
is not to be an agency arrangement. An arbitration clause in case of a dispute in settlement and any other provisions that you may deem necessary to fully protect both the company’s and manager’s interests. (g) What is an agreement? (h) What is the distinction between a good consideration and a valuable consideration? (i) What forms may consideration take?

(a) What is meant by the doctrine of contribution? (b) Explain the doctrine of exoneration. (c) What is the doctrine of marshalling securities?

AUDITING.

What is the average date of the following:

(a) $114.00, due April 10; $140.00, due April 26; $220.00, due May 22; $976.00, due June 6.

(b) June 3, $375.00 on 30 days' time; June 26, $420.00 on 60 days' time; July 16, $500.00 on 4 months' time; September 4, $228.00 on 90 days' time.

(c) Dr. May 16, $437.00 Dr. May 31, $324.00 Cr. May 23, $400.00 Cr. June 16, $300.00

(a) A man invests $2,000.00 in 3 per cent. stock at 84 and $5,000.00 in 4 per cent. stock at 90. After three years he sells the former at 72 and the latter at 101. What rate of interest has he received during the three years on his investment? (b) and to what extent has the value of his capital changed? Show by figures how you worked out the answer.

An American firm has an extensive trade with Spanish and English customers, to whom goods are invoiced in Spanish and English currency, and payments are accepted made by bills in those currencies. The firm’s principal business is, however, in the United States. Explain in what manner you would arrange the books to be kept and the titles of any special accounts that might be necessary to keep.

Jones & Brown are partners, sharing profits equally. Their capital, as it appears on the books of the partnership on the date they dissolve partnership, is: Jones, $2,000, and Brown, $500. The total amount owing by the firm is $5,000, which includes $1,000 due to Jones on a loan, and $500 due to Brown on a loan. The whole of the assets of the firm realize $5,000. Prepare their own accounts and supply details for closing up the partnership, showing the position in which the partners stand with each other.

A certain issue of $100,000 4 per cent. bonds is dated September 1, 1908, and interest begins at that date; but interest is payable on February 1 and August 1, and the principal (with four months' interest) is payable December 1, 1912. What is the value of these bonds on a 3.60 basis at the date of issue? What is their value at the same basis if purchased on December 1, 1908? (Note that you are interpolating into a five-month period, not a six-month, in the beginning.)

A wool dealer's business consists of the following transactions: (a) Buying and selling for his own account; (b) receiving on consignment and selling for commission; (c) consigning to other dealers for sale for his own account. All wool received, whether purchased or consigned is charged to merchandise account, and credited to the vendors or consigners, and all wool disposed of, whether consigned or sold, is credited to merchandise account and charged to the purchasers or consignees. The prices in the pro forma invoices of consigned goods invariably differ from prices shown in the account sales rendered to consignors or received from the consignees. At the end of the year he prepares a statement, treating all wool in his possession as inventory and credits merchandise account therewith; all debit balances on account of goods sold or consigned by
C. P. A. Question Department.

him as accounts receivable; and all credit balances on account of goods purchased or consigned to him as liabilities. The accounts are clerically correct. You are asked to audit his books and certify to the accuracy of his statement. How would you proceed to do this? Write a report thereon not exceeding two hundred words.

Theory of Accounts.

Describe in detail your understanding of and the principles underlying the following systems of wages, and their influence on the labor efficiency in a large manufacturing plant: (a) Day rates, (b) piece rates, (c) differential piece rates, (d) premium plan, (e) bonus plan, and (f) Efficiency system.

Describe how the officers or "insiders" of a corporation could "milk" the corporation to their own personal benefit, outlining the usual methods employed in such cases for the purpose of giving the stockholders and the public a wrong impression of a corporation's condition. (b) How should money received on account of stock subscriptions and forfeited by non-payment of installments as they mature, be treated on the books of the corporation?

What books and records are essential to the use of the double-entry system in (a) manufacturing business, (b) merchandise business, (c) insurance business, and (d) commission business? Give list of books and descriptions of their use.

If a bond reads at 4 per cent., but the amount which will be received is 105 of the nominal par, what is the actual percentage of cash income?

If the value of the property insured is $10,000, and the actual insurance at the time of the fire is 80 per cent., what would be the settlement if the loss was 50 per cent. of the total value? and (b) if the property value was $10,000 with an 80 per cent. co-insurance clause and the actual insurance in force at the time of the fire was $6,000, what would be the owner's deficiency if the loss was 50 per cent. of the total value? (c) How much if the loss was only 40 per cent. of the total in question?

You are engaged to install a complete factory cost and accounting system in a large manufacturing plant. Describe the various steps in the handling of such a proposition and show by charts, the accounts (properly grouped, etc.), the departments (productive and non-productive), logically arranged, and give a list of the various forms, etc., that would be required to record the factory operations to intelligently handle them from an accounting viewpoint as an integral part of the accounting system.

Practical Accounting.

The Adams Company was organized July 1, 1905, under the laws of the state of Michigan, with an authorized capital stock of $100,000, divided into 1,000 shares of $100 each. Their operations have not been very successful. Their stock has never paid any dividends, and their capital, at present, is impaired. The stockholders at a meeting decided to reorganize the company, and for that purpose a committee was appointed to have the properties appraised and to take such measures as they would deem advisable. The condition of affairs as disclosed by the books is as follows:

Real estate and buildings ...................... $35,000.00
Plant and machinery ............................ 28,000.00
Equipment and fixtures ....................... 14,000.00
Tools ............................................. 3,000.00

$80,000.00
The Journal of Accountancy.

<table>
<thead>
<tr>
<th>Inventories</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Finished goods</td>
<td>27,500.00</td>
</tr>
<tr>
<td>Raw material</td>
<td>11,500.00</td>
</tr>
<tr>
<td>Supplies</td>
<td>5,300.00</td>
</tr>
<tr>
<td>Organization expenses</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Less amount written off</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Capital stock</td>
<td>100,000.00</td>
</tr>
<tr>
<td>Treasury stock</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Bonded indebtedness</td>
<td>25,000.00</td>
</tr>
<tr>
<td>Treasury bonds</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>87,700.00</td>
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<tr>
<td>Notes receivable</td>
<td>17,800.00</td>
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<tr>
<td>Cash</td>
<td>3,200.00</td>
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<tr>
<td>Notes payable</td>
<td>26,200.00</td>
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<tr>
<td>Accounts payable</td>
<td>82,000.00</td>
</tr>
<tr>
<td>Loans payable</td>
<td>26,000.00</td>
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</tbody>
</table>

The Baker Company is a corporation also organized under the laws of this state, and in existence for the last five years. The capital stock of this company is $150,000, divided into 1,500 shares of $100 par value. The company has paid an annual dividend of 9 per cent. since organization, and their yearly net profits were as follows:

First year $34,500.00
Second year 33,000.00
Third year 35,000.00
Fourth year 35,000.00
Fifth year 30,500.00

Having learned of the financial embarrassment of the Adams Company, and desiring to get possession of their buildings and real estate, which are adjacent to the Baker Company's property, they propose to the committee of the Adams Company that the two corporations be amalgamated. A consolidation agreement was drawn up, containing among others, the following provisions:

1. The charter of the Baker Company is to be amended and the name changed to that of the Consolidated Manufacturing Company, the latter to absorb the stock of the Adams and Baker Companies respectively.

2. The current assets of the Adams Company are to be taken over at their book value, except that a reserve of 5 per cent. be deducted on notes and accounts receivable.

3. The fixed assets are to be taken over on the following basis:
   a. Real estate and buildings at 15 per cent. increase of book value.
   b. Plant and machinery at 85 per cent. of book value.
   c. Equipment fixtures at 80 per cent. of book value.
   d. Tools at 60 per cent. of book value.
   e. Organization expenses are not to be considered at all.

4. The Consolidated Manufacturing Company to assume the liabilities of the Adams Company to the public, and to issue to the latter capital stock for the excess of the assets over the liabilities. If there be any fractional sum of $100 the Adams Company is to receive a full $100 share for such fractional part.

5. The assets of the Baker Company are to be taken over at their book value, and, in addition, the company is also to be given stock for the goodwill, the latter to be based on the last three years' net profits, and is to be 60 per cent. of that total.

6. The Consolidated Manufacturing Company is to provide for a bond issue of $100,000, with which it is to take up the outstanding bonds of the Adams Company, and to sell the balance in order to raise cash funds. The stockholders of each respective company to have the privilege of taking the bonds at 96.
C. P. A. Question Department.

(7) The Consolidated Manufacturing Company to assume all liabilities to the public of the Baker Company.

Assuming that the last balance sheet of the Baker Company, which is taken to present the true condition of this concern, discloses the following state of affairs:

**Balance Sheet of the Baker Company as on 1908**

<table>
<thead>
<tr>
<th>Current Assets</th>
<th>Current Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash............</td>
<td>$11,740</td>
</tr>
<tr>
<td>Notes receivable</td>
<td>$8,540</td>
</tr>
<tr>
<td>Accounts receivable...</td>
<td>$83,380</td>
</tr>
<tr>
<td>Less reserve for bad debts</td>
<td>4,150</td>
</tr>
<tr>
<td>Total of current assets</td>
<td>931,091</td>
</tr>
</tbody>
</table>

**Inventories:**

- Raw material...... | $9,840            |
- Goods in process.... | 8,750             |
- Finished goods...... | 121,550          |
| Total of current assets | 140,140          |

**Fixed Assets:**

- Buildings... | $30,000           |
- Less depreciation | 1,000             |
- Plant and machinery | 85,700           |
- Less depreciation | 8,570             |
- Equipment and Fixtures... | 34,600          |
- Less depreciation | 3,460             |
| Tools (re-valued)... | 6,560             |
| Total of fixed assets... | 335,000           |

You are required to give: (a) Closing entries for the Adams Company. (b) Journal entries for the Consolidated Manufacturing Company covering capitalization, issue of bonds—taking for granted that the stockholders of the Adams and Baker Companies took advantage of their rights with regard to purchase of bonds—and also payments to be made to the state and county authorities. (c) Balance sheet of the Consolidated Manufacturing Company, placing the assets of Adams Company at the value as shown by the latter's books, crediting the difference between the price paid for them and the revaluation to goodwill paid to the Baker Company.

II. X, Y and Z, foundrymen, unable to meet their obligations, suspend payment January 1, 1908, and appoint a trustee to realize and liquidate for the benefit of their creditors. The books showed the following assets and liabilities:
The Journal of Accountancy.

**Assets:**
- Land and buildings: $125,000
- Machinery and tools: 75,000
- Furniture and fixtures: 10,000
- Materials and supplies: 95,000
- Notes receivable: 15,000
- Accounts receivable: 115,000
- Cash: 450

**Liabilities:**
- Mortgage on foundry premises: $100,000
- Notes payable: 135,000
- Accounts payable: 105,000
- Interest accrued on mortgage: 1,250
- Taxes accrued (estimated): 835
- Capital: 93,385

**Total:** $435,450

The trustee’s cash receipts and payments during the year 1908 were as follows:

**Receipts:**
- Notes receivable (outstanding Jan. 1, 1908): $15,000
- Accounts receivable (outstanding Jan. 1, 1908): 106,500
- Cash sales: 5,435
- Notes receivable (contracted during 1908): 13,500
- Accounts receivable (contracted during 1908): 212,000

**Payments:**
- Notes payable: 25,000
- Accounts payable: 35,000
- Interest on mortgage one year at 5%: 5,000
- Taxes for year 1907: 865
- Purchase of material and supplies: 98,000
- Labor: 135,000
- General expenses: 45,000
- Interest on bills payable to Sept. 30, 1908 at 5%: 2,800

**Total receipts:** $452,435
**Total payments:** $346,665

Other transactions were as follows:
- Sales on credit: $335,000
- Bad debts written off accounts prior to Jan. 1, 1908: $8,000
- Bad debts written off accounts subsequent to Jan. 1, 1908: 2,000
- Discounts and allowances to customers’ accounts prior to Jan. 1, 1908: 500
- Discounts and allowances to customers’ accounts subsequently to Jan. 1, 1908: 300
- Notes received from customers: 20,000
- Notes given to creditors (110,000 being renewals): 180
- Inventory of materials, Dec. 31, 1908: 92,000

At the end of the year the business was returned to the owners, prepare realization and liquidation accounts and balance sheet.

Florida C. P. A. Board of Accountancy.

**Commercial Law.**

Give illustrations of and describe the effect of the following endorsements:
- (a) Regular; (b) Qualified; (c) Restrictive; (d) Protest waived;
- (e) Without recourse.

Define “Treasury Stock,” and give at least one illustration of the proper use of the term.

Name any difference which may exist in the law relating to Treasury Stock, as applied to banks and to other corporations.
C. P. A. Question Department.

Define a "contract." State the essential requirements to any contract. Give some instances of valid verbal contracts.

Name the essential requirements of a "negotiable instrument," and give two examples illustrating (a) Negotiable paper; (b) Non-negotiable paper.

From what source should dividends be paid? Who is responsible, and to what extent, if dividends be improperly paid? May a dividend be legally declared if former losses have impaired the value of the stock?

Define a corporation. Describe the necessary procedure under the laws of Florida to form a corporation, and show the requirements as to (a) number of stockholders; (b) number of directors; (c) capital stock paid in; (d) periodical statements.

Auditing.

In the course of an audit, you find the following classes of security:
(1) Real estate; (2) Mortgages on real estate; (3) Chattel mortgages; (4) Stocks and bonds held as collateral security.

For each of these classes state: (a) The method of examination; (b) Special points to be examined; (c) Form of report.

In auditing a large concern, such as a mining company operating a number of distinct plants, how would you satisfy yourself that the following items were properly accounted for and safeguarded? (1) Advances on payrolls, both cash and merchandise; (2) Unclaimed wages; (3) Purchases which are made by one purchasing agent for all the plants.

In certain lines of business (e.g., real estate companies, sewing machine agencies, retail furniture houses), a large proportion of the sales are made on the installment plan, and at the close of any period a large number of such transactions may be uncompleted. How should the profits from such uncompleted sales be treated in the balance sheet?

How would you audit a set of single entry books, and how would you prepare therefrom statements showing the results obtained by the business?

State (a) how you would inform yourself as to the value; (b) how you would classify; (c) how you would report on, the following assets: (1) Loans and discounts of a bank; (2) Accounts receivable, where the number is considerable.

How would you show in your report of an audit you have made, fluctuations in the value of the following securities owned by the concern: (a) Real estate; (b) Stocks and bonds; (c) Material on hand.

In some cases, the present prices are higher; and, in some they are lower, than when the securities were bought. State your idea of the general principles governing such variations.

Theory of Accounts.

Some wholesale houses send goods to their branches and charge them at selling price, while others charge such goods at a price representing the cost and an arbitrary amount added for expenses. Which, in your opinions, is the better plan from the point of view: (1) Of the General Office; (2) of the Branch Office?

Define and differentiate between income, revenue, receipts. In the case of a concern lending money on mortgage, state to which class or classes the interest on those mortgages belongs, and give details of the manner of entering it on the books.

A Receiver is appointed for a manufacturing concern, and puts you in charge of all the accounting work of his receivership. State the work you would first do on taking over the books: (1) If the books were in balance and a trial balance furnished when the Receiver was appointed. (2) If the books were out of balance or defective. (3) Is it better for the Receiver to continue the old books or to open new ones? Give reasons for your answer.
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A company is organized under the laws of Florida to purchase a patent and to manufacture and sell the patented article. The patent is paid for by the entire issue of stock, and the patentee gives back to the company 49 per cent. of the entire stock, to be used for developing purposes. Describe the formalities which must be complied with, and draw the opening entries in the books, stating what books are required.

Define "Merchandise Account," and outline two methods of keeping it, giving your opinion as to which is the better, and your reasons therefor.

A manufacturing concern, owning lands, buildings, engines, boilers, and machinery, has been in operation for ten years, but has made no allowance for depreciation, current repairs having been charged to "operating expenses," and new machinery bought having been charged to "plant account." You are given carte blanche in the matter of arranging for such depreciation at the time of the audit, and also in the matter of providing for it in the future. State the steps you would take and the entries you would direct for both cases, using your own figures.

Practical Accounting. Part I.

The Alpha Company is organized for the purpose of acquiring a tract of land and forming an amusement resort. Its capital is $50,000. This stock is practically all issued in exchange for deeds for parts of said tract and to long term leases covering the remainder of tract, these leases containing, in all cases, clauses giving the Beta Company, or its assigns, the right to purchase at prices named in the leases and aggregating $74,620.00, on which six per cent. is to be paid as rental; taxes to be paid by the Alpha Company.

The Alpha Company made a deed of trust for $150,000 on all its equities to secure bonds, and issued $72,000 of such bonds in April, 1906. It made a further issue of similar bonds to the amount of $54,000 in April, 1907. With the proceeds of such bonds it improved its property and erected a number of buildings at a cost of $110,000.

In April, 1907, it entered into an agreement with the Beta Company to take charge of the grounds, arrange entertainments, etc. This necessitated further improvements, which were to be paid for by the Beta Company; this company, however, had no money, so the Alpha Company advanced $10,000 to Beta Company, taking therefor the note of the latter company.

The Beta Company finally failed with no assets, and its stockholders disappeared (except the buildings it had erected on the Alpha Company's land, and still owing Alpha Company for the said note), besides owing many other creditors.

The Alpha Company now operated the amusement park on its own account. This involved further loss; and its balance sheet on the 30th of June, 1907, showed as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings</td>
<td>Capital stock</td>
</tr>
<tr>
<td>$100,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Real estate</td>
<td>Bonds—1st issue</td>
</tr>
<tr>
<td>20,000</td>
<td>72,000</td>
</tr>
<tr>
<td>Note of Beta Co.</td>
<td>Due on leases</td>
</tr>
<tr>
<td>10,000</td>
<td>74,620</td>
</tr>
<tr>
<td>Equities on leases valued</td>
<td>Bonds—2d issue</td>
</tr>
<tr>
<td>at 100,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Loss</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>40,620</td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>Mortgage interest, overdue</td>
</tr>
<tr>
<td>$270,620</td>
<td>5,000</td>
</tr>
</tbody>
</table>

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The Alpha Company then concluded negotiations with the Gamma Company, an electric car line company, whose line afforded the chief means of access to the property in question. This company had an authorized capital stock of $50,000, all being issued.

The Alpha Company admitted its solvency, and a majority of its stockholders agreed to surrender and cancel their stock, and to exchange their bonds in the Alpha Company for stock in the Gamma Company.

All the property of the Alpha Company was to be transferred to the Gamma Company, which was to assume all its liabilities, and was to increase its authorized capital to $150,000, and to issue bonds on all its property for $100,000, and, out of the proceeds of these bonds to take up the bonds of the Alpha Company and pay off all indebtedness of Alpha Company, and to pay off its own indebtedness and develop the combined enterprises.

The Gamma Company owned an exclusive franchise for its car line, which, owing to local conditions, was safe from competitors. This line, with equipment, cost $50,000. The yearly net profits were $30,000, and were likely to increase. It valued its franchise at $250,000. It had the real estate owned by the Alpha Company appraised by six independent real estate experts, the lowest valuation being $600,000, and the highest $700,000. Gamma Company had outstanding accounts payable amounting to $15,000.

State the steps required to legalize the transfer of the business of the Alpha Company to the Gamma Company.

Prepare the balance sheet of Gamma Company after the transfer had been made, criticizing any items calling for special attention.

**Practical Accounting. Part II.**

You have audited a set of books of a wholesale grocery corporation, for the year ending June 30, 1909, and find the trial balance to be as follows:

<table>
<thead>
<tr>
<th>Account</th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td></td>
<td>$17,100</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$23,500</td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>4,300</td>
<td></td>
</tr>
<tr>
<td>Bills payable</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td>Bills receivable</td>
<td>8,000</td>
<td></td>
</tr>
<tr>
<td>Buildings (cost five years ago, no depreciation allowed heretofore)</td>
<td>18,500</td>
<td></td>
</tr>
<tr>
<td>Cash in bank</td>
<td>8,200</td>
<td>30,000</td>
</tr>
<tr>
<td>Capital stock</td>
<td></td>
<td>350</td>
</tr>
<tr>
<td>Drawage</td>
<td>1,100</td>
<td></td>
</tr>
<tr>
<td>Discounts</td>
<td></td>
<td>2,000</td>
</tr>
<tr>
<td>Expense</td>
<td></td>
<td>2,800</td>
</tr>
<tr>
<td>Freight account (all in-freight)</td>
<td>2,600</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Mortgage interest</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Mortgages</td>
<td></td>
<td>700</td>
</tr>
<tr>
<td>Mules and vehicles</td>
<td></td>
<td>2,300</td>
</tr>
<tr>
<td>Office furniture and fixtures</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>Petty cash</td>
<td></td>
<td>175,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>3,000</td>
<td>172,000</td>
</tr>
<tr>
<td>Real estate</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>Rent</td>
<td></td>
<td>2,400</td>
</tr>
<tr>
<td>Repairs</td>
<td></td>
<td>3,500</td>
</tr>
<tr>
<td>Sales—Dr</td>
<td>210,000</td>
<td></td>
</tr>
<tr>
<td>Dr</td>
<td>5,000</td>
<td>215,000</td>
</tr>
</tbody>
</table>

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Stationery and printing ........................................... 500
Profit and loss account ........................................... 5,700
Salaries ................................................................. 5,400
Travelling expenses ................................................. 1,800
Wages ................................................................. 1,600
Taxes, 1908 ............................................................. 500

$283,350 $283,350

30th June, 1909

INVENTORY ......................................................... $24,000

The Accounts Receivable are as follows:

Over 1 year old .................................................... 1,200
1 year old ........................................................... 2,500
½ year old ............................................................ 3,000
Current .............................................................. 16,500

$23,500

Prepare such statements as you consider necessary to close the books, to show the results of the business and to show the present value of the business.

Suggest proper treatment of Real Estate, Furniture and Fixtures. These accounts represent actual cost of investment from commencement of business, 6 years ago, to date, repairs having always been charged to P/L A/C. Buildings are of brick. Insurance expires one-half on September 30, and one-half on December 31.

Comments.

The Michigan Board allowed four hours for the Commercial Law and Theory of Accounts papers respectively. In each examination the candidate was asked to answer ten questions. The six questions printed are representative ones. In the examination in Auditing the Board allowed five hours for ten questions. In Practical Accounting the candidates were asked to solve the first and second problems, printed herewith, and two of the others: time allowance, five hours.

In the papers on Theory of Accounts, Auditing and Commercial Law, the Florida Board gave fifteen questions on each, from which ten were to be selected. The first five questions on each paper, printed herewith, were compulsory, the other five elective. The Board allowed four and a half hours on the paper in Theory of Accounts, four hours on the paper in Auditing, and four and a half hours on the paper in Commercial Law. In the case of Practical Accounting the examination was divided into two parts—in the case of the first part four and a half hours, and in the case of the second part three and a half hours was allowed. The first three questions were compulsory in each case, the other two elective. It will be seen that this Board follows somewhat the policy of the Pennsylvania Board in including under Practical Accounting not a long-worded, two-sheet problem, but questions which require an outline of the work rather than the actual performance of it. Members of State Boards will find the paper of the Florida Board quite helpful, and we regret that space does not permit us to print it in full.
C. P. A. Question Department Correspondence.

The Interpretation of Examination Questions.

To the Journal of Accountancy:

I wish to take advantage of your invitation to criticise and exchange ideas relative to one of the problems which appears in the August number of The Journal. I understand it is one of the questions submitted in the June C. P. A. examination. It does not appear to me that the solution you submit conforms with the question as submitted, and I should like to know whether a candidate on examination is expected to answer the questions of this kind in accordance with the terms in which it is stated, or should he allow himself to be guided by his experience in practical accounting.

My own understanding of the matter is that when answering questions candidate should be governed by the terms of the questions as submitted by the examiner and answer accordingly. As an example of the different results obtained by these two methods of answering questions I beg to submit an answer to this problem based on the question as stated by the examiner, except that I have concluded that the examiner intended to state that this consignment of goods was subject to a commission of 5 per cent. instead of a discount of 5 per cent., as consignments of this nature are handled on a commission basis.

Of course, in fairness to the question as stated by the examiner a candidate would not be justified in changing the terms even to this extent, and I would suggest that in order to avoid the confusion caused by probable errors in printing or stating questions, it would be well to have an examiner in attendance at all examinations.

As I understand the statement of the question the only business engaged in by John Dickside was this Manufacturer's Consignment. He received from the manufacturer a consignment of goods valued at $45,000. He sells all these consigned goods for $60,000. Against the credit to Consignor for sales of this lot, John Dickside, in accordance with the terms of the question and his agreement with the Consignor, is authorized to charge Manufacturer's Account:

Freight ...................................................... $1,400
For allowances to customers .................................. 1,500
For commission on sales, 5 per cent. on $60,000 ........... 3,000

His statement of profit and loss, according to the terms of the question, should be charged with the entire amount of freight paid by him, his expenses, the discount he allows on customers' accounts and customers' claims allowed by him, and should be credited by commissions earned together with allowances and freight he has charged to Manufacturer.

Freight ...................................................... $1,400
For allowances to customers .................................. 1,500
For commission on sales, 5% on $60,000 .................... 3,000

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The Journal of Accountancy.

Cash Account, John Dickside

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To capital invested</td>
<td>$15,000</td>
</tr>
<tr>
<td>Customers’ remittances</td>
<td>44,000</td>
</tr>
<tr>
<td>By freight paid</td>
<td>$2,100</td>
</tr>
<tr>
<td>Expenses paid</td>
<td>900</td>
</tr>
<tr>
<td>Acct. sales paid</td>
<td>37,950</td>
</tr>
<tr>
<td>Balance</td>
<td>18,050</td>
</tr>
<tr>
<td>Total</td>
<td>$59,000</td>
</tr>
</tbody>
</table>

Account Sales Rendered by John Dickside to "Manufacturer"

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>By sales</td>
<td>$60,000</td>
</tr>
<tr>
<td>To charges:</td>
<td></td>
</tr>
<tr>
<td>Freight</td>
<td>$1,400</td>
</tr>
<tr>
<td>Allowances</td>
<td>1,500</td>
</tr>
<tr>
<td>Commission</td>
<td>3,000</td>
</tr>
<tr>
<td>Net proceeds</td>
<td>54,10</td>
</tr>
<tr>
<td>Check herewith</td>
<td>37,950</td>
</tr>
<tr>
<td>Balance due shipper</td>
<td>$16,150</td>
</tr>
</tbody>
</table>

Customers’ Ledger Accounts, John Dickside

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To sales</td>
<td>$60,000</td>
</tr>
<tr>
<td>By cash</td>
<td>$44,000</td>
</tr>
<tr>
<td>Discount</td>
<td>400</td>
</tr>
<tr>
<td>Allowances</td>
<td>600</td>
</tr>
<tr>
<td>Balance</td>
<td>15,000</td>
</tr>
<tr>
<td>Total</td>
<td>$60,000</td>
</tr>
</tbody>
</table>

Profit and Loss Account, John Dickside

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Freight</td>
<td>$2,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>900</td>
</tr>
<tr>
<td>Discount</td>
<td>400</td>
</tr>
<tr>
<td>Claims</td>
<td>600</td>
</tr>
<tr>
<td>Net profit</td>
<td>5,900</td>
</tr>
<tr>
<td>By Commissions</td>
<td>$3,000</td>
</tr>
<tr>
<td>Allowances</td>
<td>1,500</td>
</tr>
<tr>
<td>Freight</td>
<td>1,400</td>
</tr>
<tr>
<td>Total</td>
<td>$5,900</td>
</tr>
</tbody>
</table>

Capital Account, John Dickside

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Balance, being new capital after closing Manufacturer’s consignment account</td>
<td>$16,900</td>
</tr>
<tr>
<td>By Original investment</td>
<td>$15,000</td>
</tr>
<tr>
<td>Profit and loss</td>
<td>1,900</td>
</tr>
<tr>
<td>Total</td>
<td>$16,900</td>
</tr>
</tbody>
</table>

Balance Sheet, John Dickside

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash on hand</td>
<td>$18,050</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$16,150</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>15,000</td>
</tr>
<tr>
<td>Capital</td>
<td>16,900</td>
</tr>
<tr>
<td>Total</td>
<td>$33,050</td>
</tr>
</tbody>
</table>
C. P. A. Question Department Correspondence.

The difference in net result as between the above solution and the one given in The Journal is quite marked and seems to justify further discussion of questions of this kind given by the examiner.

Edward C. Gough

New York, N.Y.

Another Solution of Problem 4.

To the Journal of Accountancy:

Referring to the fourth problem set by the New York State Board of Accountancy at the June examination of this year, and to which you allude in an editorial note in your August issue, I do not wonder at its being criticised by accountants. It certainly lacks clearness of expression. All problems prepared for these semi-annual examinations have, as I understand it, an official solution. Whether the one I give hereunder is or is not correct, I submit that it approaches dangerously near being so, having in view the wording of the problem and the reasons advanced for the results reached.

So able an interpreter as Professor Dennis treats the goods as a consignment earning commission for the agent, though no mention is anywhere made of commission. A discount of 5 per cent., however, is referred to as allowable when the agent, Dickside, pays the manufacturer for the goods. Is Dickside, then, liable to the manufacturer as to a principal, and entitled only to commission on gross sales, or as to a creditor whose prices are subject to the named discount? If the former, why is a value of $45,000, mentioned for goods destined to be sold for $60,000?

It is said, too, that Dickside allows claims amounting to $1,500, and that they are all chargeable to the manufacturer; and later on, in the settlement by his customers for $45,000 worth of the $60,000 owing, $600 is taken off for defective goods. From this it must be assumed that the $600 deducted is part of the $1,500, and that the $900 balance will also be deducted when settlement is made by his customers for the remaining $15,000 due. In other words, as he (Dickside) allows the $1,500, it must of course be all to his customers' credit and to the debit of the manufacturer.

Again, he pays freight amounting to $2,100, only $1,400 of which is chargeable to the manufacturer. This would appear to be "in" freight; and its allowance by the manufacturer, and his not being chargeable with any of the difference of $700, indicates to me that said manufacturer is not a principal—though the goods are on consignment—but that, as a creditor only, he lays the goods down at the door of Dickside for $45,000 less freight, subject to a discount of 5 per cent. when paid for; and subject also, and naturally, to proved claims for defects, as well as to "return if not sold."

With this view of the problem my solution must differ from that of Professor Dennis. He mentions an "illegitimate profit" of $900. I do
not find anything in the statement tending to show that Dickside made any such profit. If the manufacturer had allowed $1,500 and Dickside but $600 there would have been a gain to the latter of $900; but it is distinctly stated that Dickside himself allows the $1,500 of claims. Now, Dickside can allow claims to his customers only, and from these he, of course, derives no profit. As a matter of fact, he may stand to lose unless backed by those from whom he purchased. In this case he is so supported, because it is stated that the "total * * * is chargeable to the manufacturer." Professor Dennis also charges the manufacturer, in his "pro forma account sales," with the remaining $700 of freight, despite the clear statement that Dickside pays "$2,100 for freight, of which $1,400 is chargeable to the manufacturer." Surely, one can only infer from this that the other $700 is not so chargeable. Still again, the "account sales rendered" deals only with sales amounting to $45,000, whereas all of the goods are sold of $60,000. If the shipper's account should be credited with the "net proceeds" of the sales, the proceeds of the total of $60,000 should appear in the account "rendered" and there should be no "pro forma" account at all; and the "creditors'" account, so called, and the "pro forma account sales" in balance sheet ought to be merged. My solution follows:

**Account Sales**

Sales............................................................................ $45,000
Charges:
Freight.......................................................... $1,400
Claims and allowances............................................. 1,500
Discount—5%.................................................. 2,250

Net proceeds to shipper's account.............................. $30,850

**Balance Sheet**

Cash.............................................. $18,050
Customers........................................... 14,100
Creditors........................................... $1,900
Capital.............................................. 30,250

$32,150

**Profit and Loss Account**

Discount lost............................................... $400
Expense.............................................. 900
Freight................................................. 700
Balance to capital account................................... 15,250

$17,250

**Capital Account**

Cash.............................................. $15,000
Profit and loss........................................ 15,250

$30,250
C. P. A. Question Department Correspondence.

Professor Dennis prepares a trial balance, a cash account, a creditors' account and a customers' account. As they are not called for by the problem, I omit them.

W. S. Pangborn.

New York, N. Y.

The Adjustment of Partners' Capital Accounts.

To The Journal of Accountancy:

The solution of Problem 2, January, 1907, N. Y. State Examination, which appears in the September issue of The Journal, is, in my opinion, subject to criticism as follows:

There is no reason for adjusting capital balances to basis of profit and loss sharing. No partnership agreement has been broken, and the rate of profit and loss sharing does not have anything to do with the partners' respective balances and the cash they should receive.

Assuming that some breach of partnership contract warranted that capital accounts be adjusted to basis of profit and loss sharing, no partner could be called upon to pay in enough to so adjust; but, on the other hand, practical experience has shown that it is not only more reasonable and practical, but also more correct to allow the partners having excess balances to withdraw same gradually (as the assets realized will allow) until all capital balances bear to the whole remaining capital the same per cent. that profits and losses are shared.

The below is the correct method:

First month. Whole capital, after charging the $400 expense, $89,600. A's capital, after he is charged with 35 per cent. of above expense, $36,660. Net assets to be divided, $21,890.

A's share:

\[
\frac{36,660}{89,600} \times 21,890 = 8,956.33
\]

The other partners' shares of net assets are found by same principle, and the following months are handled upon the same principle.

JAMES Fletcher Ruark, C.P.A. (N. J.)

New York, N. Y.

More About the Adjustment of Parties' Accounts.

To The Journal of Accountancy:

Relative to the C. P. A. problem published in the September issue of The Journal of Accountancy, with solution by Gustave Jacobsson, B.A., I beg to take advantage of your kind invitation to the "brethren" to compare ideas on these solutions.

I do not quite agree with the solution presented, as it does not altogether comply with the conditions set forth in the question as I understand it. The question states that the partners have each drawn sundry amounts against prospective profits, and at the end of the six months' business find that these drawings have been made in error, as there were no profits. Consequently each partner has been drawing from his capital investment in the business, violating thereby the partnership agreement to invest at the risk of the business the capital investments on which their
partnership divisions, i.e., percentages of profits and losses, are based. Consequently when this fact was ascertained it made these partners debtors to the business for the amount of each one's capital impairment; and in simple justice and equity each one should make good his impairment. On this assumption the net capital at time of dissolution was not $90,000, as stated by Mr. Jacobsson, but $92,000. This amount also agrees with the statement of the problem that from an original investment of $100,000 there was a loss of $8,000, leaving net capital $92,000. Mr. Jacobsson's solution is not equitable, in that it further lays a heavy burden on one partner in order to adjust the capital sins of all the partners who are equally guilty.

The statement made in the solution, that the 5 per cent. commission paid to A and B by C and D is a private agreement between the partners which should be eliminated from the problem, does not agree with the statement of the problem as I understand it.

The problem distinctly states, "it being stipulated that from all moneys collected and paid over to C and D a commission of 5 per cent. is to be deducted and divided equally between A and B for their services." It seems to me that there can be no doubt as to the meaning of this sentence. A and B are to collect all the moneys due the firm and to pay its liabilities and for this service to deduct 5 per cent. from the amounts due C and D. It is the usual custom to deduct from the cash collected the commission paid for such service and to pay the beneficiaries the net proceeds, the only difference in this case being that A and B were not allowed commission on their proportion of the collections. It is clear, however, that the commission was to be paid out of the money collected, thus constituting the commission one of the factors of the problem, and not a private agreement outside of the partnership settlement.

I would like to see a discussion of the above if it meets with your approval.

E. C. G.

The Wisconsin R. R. Commission's Accounting System.

The system of accounting as employed by the Wisconsin railroad rate commission was declared to be so superior to the accounting methods in other states by W. J. Hagenah, the chief accountant of the commission, in an address before the Milwaukee Association of Accountants and Bookkeepers, that public utility companies in Illinois, Missouri and other states are adopting it. Mr. Hagenah said when the Wisconsin utility act became effective there were 1,003 public utility companies in the state and that no two had the same system of accounting. Now, he said, the commission's method had become universal in Wisconsin and was giving eminent satisfaction to the companies and the people.
The American Association of Public Accountants.

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1909-1910

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