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Willard Hubbard Lawton

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The New Classification of Electrical Railway Expenses.

By Willard Hubbard Lawton, C. P. A. (Penna.).

Late in February several hundred electrical railway accountants were thrown into a state of exasperation and dismay on the receipt of Circular No. 20 from the Statistician of the Interstate Commerce Commission. This circular contained for their expert consideration a new classification of operating expenses and capital expenditures based on the classification already in use by the Commission for steam railroads. All the experience of twenty years of electrical operation of railways was calmly ignored, and, so far from any attempt to conceal the fact that it was the steam road classification which the Commission wished to force upon the electric roads, the officers of the latter were somewhat humorously (whether intentional or not) invited to send for a copy of the steam classification if they were not familiar with it! Briefly the circular proposed the (1) divisions of all the electric railway companies into two classes based on the amount of annual revenue, $50,000 being the suggested line of demarcation: (2) for all companies below the limit a simple classification divided into five General and twenty-two Subgeneral accounts: and (3) for all above the limit the same General and Subgeneral accounts with the latter further sub-divided into 116 Primary accounts. For all companies, large and small, the same capital accounts were proposed, sixty-two in all. For the benefit of those accountants who may not be familiar with the present Standard Classification used by the electrical railway companies, and to explain why the circular caused such an uproar, I will state that there is but one classification for all companies alike, consisting of thirty-nine operating accounts (increased to fifty at the last annual convention to provide for interurban needs), and but fifteen capital, or construction, accounts.

The response to the circular was prompt and most vigorous. Moved by the unanimous protest of nearly three hundred electric railway accountants, Professor Adams, in charge of the Division of Statistics and Accounts, held another conference in May with
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representatives of the American Street and Interurban Railway Accountants’ Association and of the Public Service Commissions of New York State, at which the tentative classification originally proposed was considerably modified and made to conform more nearly with electrical railway experience.

While our brethren in charge of the accounting of electrical railway companies are most vitally affected by this circular, there are probably many public accountants, and will in the future be very many more, to whom a brief review and criticism of this famous circular will be of interest. There is not, to be sure, a very large practice among electric railways for the C. P. A. fraternity at present, most companies preferring to have their own auditors on salary, but the tendency of the times is toward independent audits by public accountants, and the time will undoubtedly come when the public will not be satisfied with anything short of statements verified by certified public accountants.

It is impossible in an article of this kind to go into an exhaustive analysis of the Commission’s proposed classification and system, but there are a few salient points that will engage the attention of the student.

(1) The modified Classification proposes the division of all electric railway companies into three classes, viz.:

Class A. Annual Gross Revenues—$1,000,000 and over.
Class B. Annual Gross Revenues—$250,000 to $1,000,000.
Class C. Annual Gross Revenues—under $250,000.

For all companies there are provided five General Accounts, which are sub-divided into Primary Accounts ranging from thirty-six in Class C to eighty-eight in Class A, as follows:

<table>
<thead>
<tr>
<th>General Accounts</th>
<th>Primary Accounts</th>
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<tbody>
<tr>
<td></td>
<td>A.</td>
</tr>
<tr>
<td>I. Maintenance, Way and Structures</td>
<td>1-28</td>
</tr>
<tr>
<td>II. Maintenance, Equipment</td>
<td>29-44</td>
</tr>
<tr>
<td>III. Traffic</td>
<td>45-47</td>
</tr>
<tr>
<td>IV. Conducting Transportation</td>
<td>48-72</td>
</tr>
<tr>
<td>V. General and Miscellaneous</td>
<td>73-88</td>
</tr>
</tbody>
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A statement of the accounts provided for Class C will give a general idea of the scope of the classification.
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I. MAINTENANCE, WAY AND STRUCTURES.
1. Superintendence of Way and Structures.
5. Other Operations—Debit.
6. Other Operations—Credit.
7. Depreciation of Way and Structures.

II. MAINTENANCE, EQUIPMENT.
8. Superintendence of Equipment.
10. Maintenance of Cars and Locomotives.
12. Miscellaneous Equipment Expenses.
14. Other Operations—Credit.
15. Depreciation of Equipment.

III. TRAFFIC.

IV. CONDUCTING TRANSPORTATION.
17. Superintendence of Transportation.
18. Power Plant Employees.
19. Substation Employees.
20. Fuel for Power.
21. Other Power Supplies and Expenses.
22. Power Purchased.
25. Other Operations—Credit.
27. Miscellaneous Transportation Expenses.

V. GENERAL AND MISCELLANEOUS.
28. General Expenses.
29. Other Operations—Debit.
30. Other Operations—Credit.
31. Injuries and Damages.
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32. Insurance.
33. Stationery and Printing.
34. Store and Stable Expenses.
35. Rent of Tracks and Terminals.
36. Rent of Equipment.

The above may be termed Subgeneral Accounts in a way, the Primary Accounts of the other two classes being merely subdivisions of the Primary Accounts of Class C.

For all the companies the same capital, or construction, accounts are provided, viz.:

General Account. 

Primary Accounts.

Nos.

I. Road ........................................ 1-32

II. Equipment ................................. 33-37

III. General Expenditures .................. 38-42

It will be noted that the modified classification shows a considerable reduction in the number of accounts for the large companies, though the number for the small ones is increased. This would work a hardship on the large companies, but that the Commission has provided that as long as reports to the I. C. C. are made on the bases prescribed for each class the companies are at liberty to keep such additional sub-accounts of each of the Primary Accounts as they desire.

In submitting the proposed classification the first question the circular asks (after a few preliminary questions, the object of which is shrouded in mystery as yet) is on the advisability of so dividing the companies into classes. This is a point on which all public accountants are entitled to express an opinion, whether actively engaged in railway work or not. The writer is unable to see any benefit whatever to be derived from such a division, and does see serious objection. The object of the Commission is not only to "regulate" the companies, but also to obtain statistical information for the use of the government, the public, and, presumably in all fairness, for the benefit of the roads themselves. It is difficult to say just what proportion of the electrical railways of the United States have revenues of less than $250,000, but the number is large, probably 80 per cent. at least. With that proportion giving only the barest general information in the schedule above stated, of what earthly use will be the statistics of
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more detail collected from the other 20 per cent.? Take a concrete instance: In one State there are two companies in Class A, and one hundred and thirteen in Class B and C; the latter use ties to the value of may times as much as the two large ones; yet the Commission’s statistics as to the number and amount of ties used in that State will be based entirely on the experience of the large companies, which being urban companies will use very few at all comparatively speaking.

In one sense our profession is founded on “evil that good may come.” If books were never “doctored,” if false or ignorant entries were never made, our occupation would be gone. Nevertheless as physicians fight for better sanitation, for better observance of the laws of health, for everything in fact that tends to make their services needless, so I believe it should be our aim to fight any administrative proposition that tends to offer temptation to railway managers to conceal facts. Any accountant who has ever had anything to do with the U. S. Customs is well aware of the shifts and evasions resorted to for the purpose of entering goods of one class in another at a lower rate of duty. The old story of the lawyer who received an enormous fee from a well known merchant for his suggestion to run a thread of cotton through silk goods in order to get the latter in at part silk and part cotton is a case in point. Similarly it would be too much to expect of human nature to suppose that the manager or chief accountant of a small company whose revenues are approaching the limit would not resort to methods which would keep the revenues below the limit, such as crediting real revenue receipts to “refunds” on operating accounts, holding back part of the daily receipts at the close of the year, etc. All this would be destructive to scientific and accurate accounting. The Commission would soon find a surprisingly large number of companies in each class with revenues just a little below the limit and apparently unable to grow beyond it. When the persistence of this remarkable fact aroused suspicion, as it certainly should if for a term of years the majority of companies showed apparently no growth at all, the Commission would find it necessary to employ a large and expensive staff of detectives to ferret out and punish such infractions of the law. Of course, it is to be understood that the writer does not urge this argument per se as a good reason for opposing this division of companies: one might with equally good
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ground oppose the prescribing of any forms of accounts whatever by the Commission. But the fact remains clear that if the Commission wants true and accurate reports upon which to base valuable statistics, it must secure the hearty cooperation of the companies. It will not get it by prescribing arbitrary conditions for which there is no good reason in practice.

The reason of the Commission's proposal is that it would be a hardship on the small company to compel it to adopt the classification proposed for the large company, entailing a needlessly large accounting staff, etc., but it seems to the writer the Commission's logic is faulty. Why will it be any the less a hardship for a company with revenues of $250,000 than for one with revenues of $249,999?

(2) There are many points of detail that call for more or less criticism, but the limits of this article must confine us to a brief mention of a few of the most striking. Under the general account of Maintenance Ways and Structures the classification provides primary accounts for Cleaning and Sanding Track, and Removal of Snow, Ice and Sand. Clearly these should be placed under general account Conducting Transportation. The work embraced in them is purely to facilitate the movement of cars, not to preserve the track. One might as well insist that lubricants for power machinery and cars should be considered as maintenance.

The numbering of accounts might have been done in a little more scientific manner. As it stands now when a company moves from Class C to Class B the matter of making comparisons with past years is always going to cause more or less confusion owing to the same numbers being used for different accounts. It would have been better to have adopted a fixed number for each account in the order named in the classification; then each class would use only the numbers provided for it. This would simplify greatly the work of the Commission itself in making general comparisons of Primary Accounts on the basis of Class C.

While the Classification provides for Operating Revenues (which is not given here through lack of space), Operating Expenses and Capital Expenditures, there is no provision made for such clearing accounts as Taxes Accrued, Supplies Account, and the like. It is to be presumed, however, that these are taken for granted, for the members of the Accountants' Association, at least, were fully aware that such accounts are absolutely necessary.
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It brings out the fact more clearly, however, that when a government undertakes to prescribe rules and regulations it is assuming a very large job. Under the Interstate Commerce Act the Commission is empowered to prescribe forms of accounts for common carriers, and to insure the enforcement of its mandates the law further prescribes heavy penalties not only for failure to obey, but also for keeping any other accounts save those so prescribed. A fine point, perhaps, yet when one considers the Standard Oil and similar cases, one wonders if the path of the electric railway accountant in the future will not be filled with snares and pitfalls for unwary feet.

(3) A very interesting point to public accountants is involved in the classification of capital expenditures in a note to Account No. 61, "Interest and Commissions," of the original circular, and which apparently remains in force under Account No. 39 of the modified, which peremptorily forbids the charging under this account any discounts on securities issued for construction purposes, nor shall they be "considered as a proper charge against construction." Yet legal expenses, taxes and damages may be charged to construction accounts, and to the very account in question may be charged interest on bonds prior to the actual opening of the road for business, as well as commissions paid on securities sold. The result will probably be that all bonds will be taken by underwriters at par, but the commissions to the underwriters will be very heavy!

(4) Criticism is generally ungrateful work, so the writer welcomes with pleasure the opportunity to record his hearty appreciation of two features of the circular at least, viz.: (1) the proposal to have a uniform system of accounting for all electrical railways, an end toward which the American Association has been working for years, and (2) the proposal to take into account the question of depreciation. It is unnecessary to elaborate on the manifest advantages of the idea of uniformity to public accountants. We all readily understand the immense value of having a standard for comparison to the investing public, the taxing authorities and to the companies themselves.

To the majority of railway accountants the idea of depreciation will not be entirely welcome. Few companies are in good position to adopt the principle to-day without serious hindrance to their dividend paying powers. But it must come. Up to the
present time the usual history of electrical railways has been organization on too little or heavily discounted capital, operation for a time with good dividends to the stockholders, and then, when the inevitable wear and tear makes the renewal of costly rolling-stock and power apparatus necessary, failure of dividends, failure to earn interest, foreclosure, and reorganization or consolidation on, what must be admitted sorrowfully, excessively high valuation of properties. The time is coming, if it is not already here, when this sort of thing must cease. New capital cannot always be readily obtained on such terms as reorganization usually offers. The earnings of the companies must provide for the renewal of worn-out equipment as well as its maintenance. All these facts are so well known to public accountants as to be mere platitudes, yet it is astonishing how few electrical railway companies, even though they admit the necessity, are willing, or, in many cases, able to take the drastic steps necessary to put themselves on a sure basis for the future.

It is no doubt in recognition of this trouble that the Commission states in its circular that for the present the depreciation accounting will not be insisted upon, unless ordered by a State Commission having jurisdiction over the major portion of the corporation's business. Undoubtedly if it were there would be widespread failure among the electrical railway companies, but reorganization would probably be upon a better basis, so that the ultimate result would be for the good of the stockholders. But the handwriting is on the wall and it will be a very blind manager or director indeed who does not understand that the Commission will sooner or later proceed to enforce depreciation charges. Thoughtful and conscientious railway and public accountants will do well to turn their serious attention to the study of this problem, that when the time comes there will be some well defined plan to lay before the Commission, lest the companies be confronted with arbitrary rulings which might have disastrous results. For, bad as it is, railway accountants can comply in greater or less measure with the proposed classification, but the best accountant in the world could not stave off the inevitable consequences of an excessively high depreciation charge.

After the nightmare engendered by the classification originally proposed the modified one will probably be hailed with relief and acclamation by electrical railway accountants. While by no means
satisfactory to all they will hope for improvements in the future despite the proverbial inertia of government bureaus. Great credit is certainly due to the unwearying efforts of the representative accountants at Washington, who have accomplished what appeared a hopeless task at the outset. Whether the various State Commissions will support the I. C. C. by adopting this proposed classification remains to be seen. If they do, as it is to be hoped they will, the final step will seem to have been taken to secure uniformity of accounts.

### Simplicity in Municipal Accounts.

Important steps looking to greater uniformity in the accounts and reports of the municipalities of the country were taken at a meeting in Washington, D. C., on May 22, 1908, of the Committee on Uniform Accounts and Reports of the League of American Municipalities. The committee's action will be submitted to the national convention of the League of American Municipalities to be held in Omaha, Neb., in September, for its approval.

Committees were appointed requesting the Municipal Bureau of Research of New York City to make recommendations and a report for a uniform schedule for city budgets; to submit suggestions on the question of making the calendar year the fiscal year in all cities; to confer with officials of the Census Bureau and other bodies with a view of perfecting and making more effective the present system of keeping accounts and rendering reports in the various municipalities, and also to work out a complete report and recommendations of schedules for uniform reports.

General discussion of the subject showed unanimity of opinion among the members for greater uniformity and simplicity in municipal accounts and reports. It is the desire of the committee to have municipal authorities render their accounts and reports in such a manner that anybody can understand them.

The meeting was presided over by Chairman Hugo S. Grosser, of Chicago, formerly city statistician of that city. Among the cities represented were New York, Baltimore, Charleston, Detroit, Duluth, Philadelphia and St. Paul.