

**DEPRECIATION AND
WASTING ASSETS, AND THEIR
TREATMENT IN COMPUTING
ANNUAL PROFIT AND LOSS**

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Depreciation and wasting assets, and their treatment in computing annual profit and loss by P. D. Leake

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ANNUAL PROFIT AND LOSS

BY

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"The Need of Present Accounting for Past Unexpired Capital Outlay";
*"Can the Annual Assessment of Industrial Profit and Loss be Raised to an
Exact Science?"; "The Use and Misuse of the Sinking Fund";*
"Goodwill: Its Nature and How to Value It"; etc., etc.


THIRD EDITION

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PREFACE TO THIRD EDITION

THIS work has been carefully revised, and three chapters have been added dealing with the following subjects—

The “then value” of plant as discussed in the case of *The National Telephone Company v. The Postmaster-General*.

Memorandum and criticism on the financial proposals of the London County Council report on London electricity supply.

Depreciation and controlled establishments under the Munitions of War Act, 1915.

The economic and political importance of advancing the science of measuring the annual profits of industry is becoming plainer to the many who are seeking answers to the questions: “What is the fair share of capital and what is the fair share of labour in the annual profits of industry?” It is obvious that before such questions can be satisfactorily answered, it must be possible to ascertain the annual profits of industry with such a degree of accuracy as shall exclude the irregular methods and wholesale guesswork at present prevailing. It is only by means of the study and use of better methods in dealing in financial accounts with depreciation and wasting

assets that the annual computation of industrial profit and loss can attain this necessary standard.

The subject of the proper treatment in accounts of depreciation and wasting assets should receive the attention of Scientific Institutions, Technical Colleges, and Universities. But it should at the same time be fully realised that present teaching facilities are not enough, because present knowledge is necessarily limited to past practice now rapidly becoming obsolete. There should therefore be constant effort to advance this important subject by means of systematic study and research. An interesting line of thought was suggested recently in the course of an address by the President at one of the annual meetings of the Engineering Section of the British Association when discussing the question: "What is the workman's share in the present state of things?" The President pointed out that investigation shows the average capital expended in engineering works per individual employed was, before the war, about £200, and the dividends paid thereon averaged 4 per cent. per annum; while at that time the average wages for men and boys, skilled and unskilled, was about £70 per annum. These figures show that according to the then available statistical material the annual earnings of a workman in the engineering industry are equal to the annual dividends—referred to as the earnings—of £1,750 of capital invested in that industry. Since then the earnings measured in money values of both workmen (human effort) and capital have, of course, greatly increased.

But the real earnings of capital in any year cannot be measured by the dividends actually paid—though

this is often assumed to be so—because dividends sometimes amount to more and sometimes to less than the true annual profits. Neither are the true annual earnings of capital to be measured even by the balances of annual Profit and Loss accounts as at present drawn, because these often show results which are grossly inaccurate in consequence of errors—sometimes of omission and sometimes of commission—in regard to that factor of annual expense represented by expired capital outlay on wasting assets.

It is a self-evident proposition that the amount of the combined earnings of labour and capital in any year is automatically limited to an amount equal to the value of the product of the industry in that year, less all economic expenditure incurred in producing and selling other than salaries and wages. The expression “combined earnings” means, of course, salaries and wages (labour's earnings) on the one hand, and interest and profits (capital's earnings) on the other hand.

How far then are we able at present accurately to measure the amount of the combined earnings available in any year? The amount of the product is known, and the amount of salaries and wages (labour's earnings) is known, but owing to obsolete methods of accounting for capital outlay on wasting assets as it expires year by year, the amount of economic expenditure—other than salaries and wages—which must be deducted from the amount of the product is not known. The reason is that one important factor of economic expenditure—expired capital outlay, commonly called depreciation—is merely guessed at without any attempt at measurement by means of

systematic observation and record. It follows therefore that the true annual profits of industry which alone constitute the earnings of capital are not known, and thus there exists in the industrial world at the present time no accurate measure of the amount which defines and limits the combined earnings of labour and capital in any year.

When this unsatisfactory state of affairs is remedied—and it is capable of being remedied—an important new factor will become available to assist arbitration tribunals and Whitley councils in arriving at clearly-reasoned decisions on all questions concerning the division of annual earnings between labour and capital because the true annual earnings will, for the first time, be known. Such questions generally involve either increase or decrease of wages, and the advance of the science of measuring annual profit and loss will materially assist in rendering possible true co-partnership between labour and capital. And above all it will make more visible the direct connection which must always exist between increased production and increased earnings for division between labour and capital.

The nature and deplorable results of the present failure to account currently for capital invested in the wasting assets of industry may best be explained by a simple illustration. An investment of capital in an ordinary annuity is sometimes likened to an investment of capital in industrial plant—a very important division of wasting assets—because the value of each is gradually wasted and comes to an end in the process of giving, during a strictly limited life-period, an annual yield consisting in each case partly of capital and