PROBLEM 3

A city loses its electric light plant, which showed in the books at cost less depreciation represented by debenture redemptions at $275,000. through destruction by fire. Insurance to the amount of $200,000 was received. Replacement of the plant cost $450,000. to finance which $250,000 of debentures were issued at par. How should these facts be reflected in the balance sheet?

ANSWER. According to the question, the liability of the city on an asset costing $450,000 is $525,000, so that the question really resolves itself into a decision as to how to display the discrepancy. There can be no doubt but there is no actual asset for this $75,000, but cities very often carry debenture liabilities for which they have no actual capital assets.

For example, suppose that in order to finance a discount of $100,000 on a million dollar bond issue, a city issued further bonds of $110,000 at 92. It has no actual capital asset to offset the $110,000, but it is in such case merely providing for payment of an increased interest rate in the shape of discount on bonds, which is operative during the life of the bonds. Therefore, whilst no actual asset is created, an intangible asset in the form of a deferred charge to future revenues of the city is called into existence, and displayed as such in the balance sheet and consequently in the ledger.

The facts in the case under consideration afford a very close parallel to the latter example, and there is no doubt but that accounting practice discountenances the exhibit of a capital liability greater than the asset. Therefore by some means, the asset should be displayed as equal to the liability, but in such manner that no one may be misled.

It is suggested that the following would meet the case:

Electric Light Asset, at cost	450,000	
Elec. Light Deficiency, caused by fire	75,000	
		525,000

The deficiency will be depreciated to the repayments or sinking fund, in precisely the same manner as the tangible asset.