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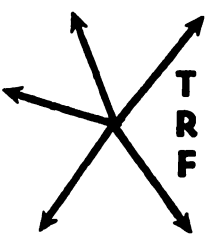

TRANSPORTATION RESEARCH FORUM

PRIVATE ENTERPRISE—the employment of capital generated from the private sector of the economy to derive a profit—is completely dependent upon accurate financial reporting. Owners, lenders, suppliers, labor and governmental regulating and taxing authorities must rely upon the accuracy of profit and loss statements and balance sheets, not only to assess the financial condition of the business in its current accounting period but, more importantly, to appraise its viability as a going concern.

The real worth of any business is not the aggregate of the value of its various assets. It is the quantum of earnings derived from the employment of those assets. The single most important financial statistic is still: What is the real excess of gross revenues over costs? Costs met by out-of-pocket cash payments, such as compensation, materials, taxes and interest are easy to determine. More difficult is the cost of the use of the assets involved—depreciation of tangible assets or amortization of intangibles.

In simpler times it was deemed sufficient to recover the cost of an asset less its salvage value, over its useful life. Thus, a machine which made widgets and which cost $100, a 10 percent salvage value and a ten-year life would be recovered by charging earnings $9.00 per year for ten years. An alternative method was to recover cost over estimated production. The cost of the asset described above would be recovered as widgets are produced. If it was estimated that the machine would produce 1,000 widgets, 9 cents per unit would represent the depreciation cost.

However, it was recognized early in the game that simplistic approaches to cost recovery did not properly account for every asset in every business. Unique assets required special cost recovery techniques.

Retirement - replacement - betterment accounting was developed as a method to account for the cost recovery of some very unique assets, namely, the depreciable components of the railroad track structure—rails, ties, other track materials and ballast. This method of accounting for these assets has been employed for over 60 years and has been specifically prescribed by the Interstate Commerce Commission (hereinafter, the "ICC") since 1914.

Basically, under the retirement aspect of this method of accounting, the investment in what otherwise would be the depreciable elements of the track structure, is not recovered ratably, but is charged to the income account only in the year when the element is "retired" on the books of the company, i.e., its useful life having been exhausted, it is written out of the investment account.

Under the replacement facet of the method of accounting, the cost of a pure replacement in kind is expensed; for example, if a 130-pound rail laid in 1950 were replaced by a 130-pound rail in 1974, the cost of the latter would be expensed and the investment attributable to the former would remain in the account. Thus the old rail is, in effect, retired at the cost of the new rail installed.

Finally, to illustrate the betterment component of this method, if a 120-pound rail is replaced by a 130-pound rail, the excess of the cost of the 130-pound rail over the current cost of a new 120-pound rail, is capitalized, and the balance, the cost at current prices of a 120-pound rail, is expensed.

It thus can be readily seen that the current rail account (Account No. 9 in the ICC Classification of Accounts) represents the cost of the original rail laid, plus betterments which have been made and capitalized over the years.

The retirement - replacement - betterment method of accounting for depreciation has been critically examined, approved or applied by the Internal Revenue Service (hereinafter, the "IRS"), the American Institute of Certified Public Accountants (hereinafter, the "AICPA"), all of the public accounting firms, certifying to annual reports to stockholders and the courts.

It has, however, been the subject of some criticism. Always the voice of criticism has been a relatively small one, yet it has been heard with undulating volume on changing frequencies, and, at times has even attracted the attention of large audiences; an obvious example of the "media being the message." Nevertheless, the critic has performed a service, for without him the mettle out of which betterment accounting has been forged would never have been tried, or tested, to determine its strength as we know it to be today.

At the outset, it is important to note that the retirement-replacement-betterment method of accounting is a method of depreciating railroad track structure. Mr. Leonard Spacek, a former partner in the firm of Arthur Andersen & Co., and one of the most outspoken critics of this accounting method, sought to exclude retirement-replacement-betterment accounting from what he called "depreciation accounting."

In his 1957 testimony before the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations, otherwise known as the Blatnick Committee, Mr. Spacek stated: "Now, either you take depreciation in its entirety, or you take replacement accounting in its entirety."

It is clear beyond question, however, that retirement-replacement-betterment

Why Retirement-Replacement-Betterment Accounting Should Continue to be Applied to Railroad Track Structure

*by Robert J. Casey**

accounting is one of the many accepted methods of depreciation. In the recent case of **Chicago, Burlington & Quincy R. Co. v. United States,** 455 F. 2d 993 (U.S. Ct. Cl. 1972), the Court in citing the landmark case of **Boston & Main R. Co. v. Commissioner,** 206 F. 2d 617 (1st Cir. 1953) stated: Retirement accounting, however, works differently. Rather than making annual adjustments for depreciation, the asset is carried on the books at its full value (usually cost) during its useful life. Then, at the time of retirement from service, the book value, diminished by the asset's salvage value, is charged to current expense. Retirement accounting thus results in deferred depreciation for any given asset. However, over an extended period of time, the depreciation deductions taken under retirement accounting for all assets in the account should closely approximate conventional ratable depreciation methods.

The Court in **Chicago, Milwaukee, St. Paul & Pacific R. Co. v. United States,** 404 F. 2d 960 (Ct. Cl. 1968) also recognizes retirement-replacement-betterment accounting as an accepted method of depreciation stating at page 969: Under [the retirement-replacement-betterment method], taxpayer did not calculate its depreciation by estimating the portion of each particular asset in service that was used up during the year. Instead the deduction allowed for depreciation was measured by the entire cost of all assets that were retired from service during the year.

The Internal Revenue Service has also recognized retirement-replacement-betterment as a method of accounting for depreciation. Income Tax Regulation, Section 1.48-1 (b), provides: A deduction for depreciation is allowable if the property is of a character subject to the allowance for depreciation under Section 167 and the basis (or cost) of the property is recovered through a method of depreciation, including, for example, the unit of production method and the retirement method as well as methods of depreciation which measure the life of the property in terms of years.

In addition to acceptance by the Courts and the Revenue Service, the accounting profession has approved the retirement-replacement-betterment method of depreciation accounting. **Accountants' Handbook, Fifth Edition** by Wixon, Kell and Bedford, 1970 edition, page 17-20.

This paper will be devoted to analyzing the primary criticisms made of retirement - replacement - betterment accounting and presenting its advantages over ratable depreciation accounting. While the views of this author on the issue will not be inconspicuous, throughout this article all significant arguments proffered by the critics will be made as fairly as possible. At the outset, it is felt that a review of the historical highlights of this controversy will indicate how closely, in the past, the merits of retirement-replacement-betterment accounting were examined. This review will essentially focus on four periods: the pre-1957 ICC hearings; the 1957 Blatnick Committee hearings; the 1959 AICPA blessing; and, the 1962 AICPA blessing.

HISTORICAL BACKGROUND

Since at least the late 19th century, the retirement-replacement-betterment accounting for track components has been consistently followed for both book and tax purposes by most railroads and it was incorporated in the ICC Uniform System of Accounts in 1914. During this period numerous studies, for various reasons, were made of railroad property accounting methods. On January 1, 1943, pursuant to one of these studies, the ICC made a significant change in railroad accounting practices when it ordered retirement-replacement-betterment depreciation accounting for categories of road property, except track structure, to be replaced by ratable depreciation accounting. Three years subsequent to this change, and following another detailed study of accounting for the depreciation of railroad track structure during the period 1917-47, the ICC concluded that the retirement-replacement-betterment method of accounting for track components should continue to

**Member of the law firm of Casey, Craig & Constance, New York, N.Y. and Washington, D.C. He is admitted to practice in New York and Washington, D.C.*

be employed as adequately reflecting the true cost of the track investment consumed in the year's operation.

The issue was raised again before the ICC in 1957. In a letter dated May 17, 1956, to the then Chairman of the ICC, Anthony F. Arpaia, the propriety of the accounting method used for railroad financial reporting was questioned by the then Vice President of the New York Stock Exchange, Phillip L. West. As a result of a companion letter to the same effect written shortly thereafter by Mr. West to the AICPA, a committee designated the "Committee on Relations with the Interstate Commerce Committee" was established. The members of the committee and their firm affiliation were: Howard D. Murphy, Chairman, Price Waterhouse & Co.; W. R. Blew, Ernst & Ernst; Nels C. Nelson, Peat Marwick, Mitchell & Co.; G. F. Schweitzer, Lybrand, Ross Bros. & Montgomery; Russell D. Tipton, Haskins & Sells; and, Arthur J. Abbott, Arthur Andersen & Co. That Committee, after several months of research into the ratable versus retirement-replacement-betterment depreciation issue prepared a report (with only Mr. Abbott dissenting), dated April 1, 1957, in which it concluded that "no substantial useful purpose would be served" by a change to ratable depreciation accounting techniques.

Shortly after the release of that Report, the Subcommittee on Legal and Monetary Affairs of the Committee on Government Operations of the House of Representatives, otherwise referred to as the Blatnick Committee conducted four days of public hearings. These hearings were in response to various reports from the daily and financial press that "unrealistic Interstate Commerce Commission accounting procedures" were causing, as again alleged in the press by one accountant, the investing public to be "led to a shearing." Testimony was heard from representatives of the AICPA, investment banking firms, the New York Stock Exchange, and major accounting firms as well as critics of retirement-replacement-betterment accounting for depreciation. By far the overwhelming weight of testimony adduced at those hearings established that the retirement-replacement-betterment method of accounting could not be so indicated.

Those same critics in 1959 attempted to resurrect the issue by using as their sounding board the Committee on Professional Ethics of the AICPA. Inquiry was made of that committee whether an auditor was guilty of violating the American Institute of Accountant's Rules of Professional Conduct when he states that financial statements of a railroad are in conformity with accounting principles and practices prescribed or authorized by the ICC, without making reference to generally accepted accounting principles. This Committee also gave its continued blessing to the betterment method of railroad accounting by stating in pertinent part: There is a strong presumption that the accounting prescribed by the ICC constitutes generally accepted accounting principles in the industry . . . In the absence of some authoritative statement by the committee prescribing the reporting standards for what has been concluded is a special reporting problem, the validity of any reporting practice must rest on general use and general acceptance.

Finally, on January 25, 1962, the ICC issued Order No. 33581 effective July 1, 1962, which, at Section 25.1 thereof, provided in substance that carriers under its jurisdiction would be permitted to prepare and publish financial statements "based on generally accepted accounting principles for which there is authoritative support, provided that any variance from this Commission's prescribed accounting rules contained in such statements is clearly disclosed in footnotes to the statements . . . except in reports to this commission."

The latest attack has two premises: (1) an assumption that replacements of the depreciable components of the track structure do not occur uniformly; and (2) that the present method of accounting for the track structure is not flexible enough to permit the reflections of obsolescence, thereby creating a mismatch between cost and revenues.

As to uniformity of replacement practices, the following facts must be observed. On any railroad replacement and betterment programs on the track structure represent a minor fraction of total operating expenses; for example, in the case of one major road such programs average 3 to 4 percent of annual operating expenses. In addition, the intramanagement decision as to whether the physical plant should be constantly maintained at its optimum level, which obviously will have an effect on uniformity, is not peculiar to the railroad industry. In this respect, sound management will not be influenced by the company's method of accounting for depreciation.

With respect to obsolescence, it must be kept in mind that it occurs in the following circumstances:

1. A management decision not to continue operations due to insufficient traffic;

2. Built-in obsolescence which exists where trackage has been constructed for a specific purpose, for example, a branch

line constructed to serve a mineral deposit, such as a coal mine, which has a predetermined useful life; and

3. Mergers and combinations which result in excess trackage which perforce must be abandoned.

No method of accounting can totally accommodate the foregoing changes. In every going business there exists unrecovered costs. In a growing business, this unrecovered cost constitutes a high percent of original cost. In a static business, it hovers around 50 percent of original cost. In a declining business, the percentage factor declines proportionately. As the Haskins & Sells study has indicated, this unrecovered cost would be nearly the same which ever method of accounting has been utilized.

As noted, management decisions, based on declining traffic, are no different in the railroad industry than in manufacturing industries—they are both intracompany, and neither can be deemed to have stemmed from the use of one accounting procedure versus another.

Obsolescence on branch lines occasioned by a depleting asset, such as a mineral deposit, are the easiest to accommodate, and in fact are recognized today by both the ICC and IRS which permit the amortization of the investment over the estimated remaining life of the mineral deposit.

Obsolescence occasioned by mergers and combinations are the most difficult to anticipate, and, in point of fact, cannot be accommodated on any accounting theory.

The railroad industry is faced by an additional hurdle—the Interstate Commerce Commission. In the event a managerial decision to abandon trackage is made, a petition to the Commission for permission to abandon triggers long and costly hearings. When a manufacturer can determine with reasonable accuracy when his operations will cease, he can undertake an orderly amortization of his unrecovered cost over the intervening years. Not so a railroad which depends upon the ultimate ICC order for permission to abandon.

In addition to the foregoing, it is suggested that the current method of accounting employed within the industry is somewhat akin to a LIFO method of accounting, and in this respect during inflationary periods, and we all can see a continuation of inflation, this method represents the most conservative method of accounting and reporting.

From this thumbnail historical tracing it should be clear that, insofar as railroad track accounting is concerned, every carefully considered analysis of the merits of this accounting technique has concluded that the unique nature of this category of railroad property dictates its continued use. This conclusion was reached by the AICPA Committee on Relation with the ICC, the AICPA Committee on Professional Ethics and from the evidence adduced by the Subcommittee on Legal and Monetary Affairs of the Committee on Government Operations of the House of Representatives.

Perhaps more important than the theoretical dispute is an important concept that has a very strong bearing on whether ratable depreciation accounting should be substituted for retirement-replacement-betterment depreciation accounting. That concept, often referred to as a convention, is "consistency in financial reporting."

Not surprisingly, the convention of "consistency in financial reporting" is another aspect of the dispute here under analysis with respect to which the advocates of the present method of accounting and the advocates of ratable depreciation accounting are at variance. This is understandable since it is incumbent on the latter to establish the validity of putting aside the convention of "consistency" in reporting before ratable depreciation accounting can be substituted. Here again, it is submitted that the critics have failed to carry their burden of proof.

The importance of consistency in financial statements has been expressed quite clearly in **Accountants' Handbook, Fifth Edition** by Wixon, Kell and Bedford, 1970, The Ronald Press. At page 1.21 thereof the authors state: Consistency is defined by Kohler (A Dictionary for Accountants) as "Continued uniformity, from one period to another, in methods of accounting . . ." This is obviously of prime importance to the comparability of an entity's financial statements as between periods. Without this continued uniformity of valuation bases, methods of accrual, etc., the user of the statements would find it difficult if not impossible to determine whether reported changes in financial position and results of operations were actual changes or merely reflected a change in accounting methods.

To the same effect, but addressed specifically to retention of the present method of accounting for the depreciation of the track structure, was the statement of Mr. Pierre Bretey, before the Blatnick Committee. Mr. Bretey stated: However, it should again be emphasized that the importance of accounting uniformity should not be minimized. This is particularly true in considering such a drastic proposal to substitute replacement accounting in track by depreciation accounting. Far from deceiving or mislead-

ing the investor in railroad shares, this accounting treatment clearly portrays a financial actuality and were a change as proposed initiated, the final results, in that a 60 year consistency of method would be altered, would be one of greater confusion. At all costs it would seem desirable to maintain a treatment approved by both the Interstate Commerce Commission and the tax authorities over so long a period. [Emphasis added]

The AICPA is of like mind. In a letter to Mr. Owen Clark, former chairman of the ICC, dated March 29, 1957, (with Mr. Arthur J. Abbott of Arthur Andersen & Co. dissenting) the Committee on Relations with the ICC based its otherwise unanimous conclusion, that railroad betterment accounting should be maintained, to a significant extent, on the need for consistency in financial reporting. In that letter it was stated: As to track components, however, the committee, in consideration of the long history of the use of replacement accounting by railroads with respect thereto, the unique matters of this category of railroad property, its relatively stable physical quality, and the mature economic status of the industry, has concluded, with one member dissenting, that no substantial useful purpose would be served by a change to depreciation accounting techniques in the absence of evidence indicating that depreciation-maintenance procedures would provide some appropriate charges to income for the use of such property.

Despite the imposing weight of this authority, the critics unaccountably continue to ignore this convention and to demand a change over to ratable depreciation method.

A method advanced by one critic of betterment accounting to overcome the importance of consistent financial statements was to simply allege that "consistency" is an antiquated concept, now of little importance. In Objectives of Financial Statements for Business Enterprises, by Arthur Andersen & Co., 1972, at page 41 thereof, that firm elucidates its view generally of consistency in financial reporting as follows: Consistency is another concept that has been frequently mentioned and highly revered. Yet it has often stood in the way of progress and improvement. Consistency has been a necessary corollary of failure to define objectives. Now consistency is used to lend an air of virtue to continuing practices previously adopted no matter how unsound.

It is shocking that nowhere in that publication's discussion of consistency is cognizance taken of the chaos and distortion of income that invariably ensues whenever one method of depreciation accounting for a major portion of a corporation's assets is substituted for another.

It is not the desire of this writer, however, to use uniformity and consistency in financial reporting as a shield from a critical analysis of the merits of present track accounting. It is submitted that retirement-replacement-betterment accounting is a reliable and accurate method of accounting for the depreciation of a mature railroad track structure, and realistically measures the economic health of the enterprise.

PRIMARY CRITICISMS

Despite the weight that must be given to the mass of authoritative approval summarized above and the need for consistency in financial reporting, it is not suggested herein that this necessarily mandates the continued application of the present method of accounting for track structure today. This conclusion can only be reached by valuing these aspects in light of the criticisms advanced and the merits inherent in the method of accounting.

Generally Accepted Accounting Principles

Over the years the few critics of the retirement - replacement - betterment method of accounting for railroad track structure have persistently sought to discredit it by alleging that it was contrary to "generally accepted accounting principles." For example, the letter dated September 17, 1963, written by Arthur Andersen & Co. to Mr. Robert E. Wetechey, then President of the AICPA, and the memorandum attached thereto state the basis of the recent criticism as: Most public accounting firms which have been giving opinions on railroads' financial statements on the basis of ICC regulations, started in 1962 (on the 1961 financial statements) to relate their opinions to generally accepted accounting principles. Thus, this was the first time these firms were in effect stating either (1) that replacement accounting was in accordance with generally accepted accounting principles, or (2) that the difference between replacement accounting and depreciation accounting did not have a material effect on the financial statements. To our knowledge neither of these positions have been supported at the present time insofar as the major railroads are concerned.

Parenthetically, it should be noted that the considerable attention given to the Andersen arguments in this dispute is felt to be justified since that firm has been and apparently still is, the sole exponent of the theory that the present longstanding method of accounting for

the depreciation of the track structure must be replaced by a ratable method.

Obviously, the definition given by the Andersen firm to the term, "generally accepted accounting principles," controls the thrust of its statement. That definition is revealed in an address, by Mr. Leonard Spacek, before the Milwaukee Control Controllers Institute of America on February 12, 1957. Before the controllers he stated: The accountant has the responsibility to see that the standards of financial accountability imposed on corporations under the term "generally accepted accounting principles" are those which meet the standards of morality and economic trust as dictated by the public and which result from public law . . . Therefore, the standards of financial accountability must be defined by the profession to give everyone assurance that they are clearly in accord with the public's standards of morality.

Thus, Mr. Spacek considers the term to represent a very subjective, broad and flexible standard for financial accountability.

A similarly broad definition, encompassing numerous variations from what are often termed predominant practices, is contained in Section 1026.03 of the Accounting Principles Board (APB). There it is stated: Generally accepted accounting principles are conventional—that is, they become generally accepted by agreement (often tacit agreement) rather than by formal derivation from a set of postulates or basic concepts. The principles have developed on the basis of experience, reason, custom, usage, and to a significant extent, practical necessity.

The sensitivity on the part of most accountants and their professional societies to the requirement that the definition of "generally accepted accounting principles" be broad and flexible, (as stated by Mr. Spacek and the APB) has repressed any previous attempt to prescribe a particular method or rate of depreciation. This principle was succinctly expressed by Mr. H. D. Murphy, former Chairman of the AICPA, Committee on Relations with the ICC during his statement before the Blatnick Committee. Mr. Murphy, at that time, stated: One observation should be made about depreciation—there is no generally accepted accounting principle stipulating either the rate or method of computing depreciation.

Some of the methods which have been used to apportion the cost of physical assets to periodic earnings are listed in **Intermediate Accounting**, by Meigs, **et al.** Under the category, "straight-line methods," the authors list "time related methods" and "output related methods;" under the category, "decreasing change methods," are listed the "arbitrary assignment," "fixed percentage of declining balance," "sum of the digits" and "appraisal methods;" and, also listed, in addition to retirement or replacement methods, are "interest method."

Certainly retirement-replacement-betterment accounting can comfortably fit within the definition given to "generally accepted accounting principles" by the APB. Indeed, the foregoing historical synopsis presented establishes this. It will be recalled that, in response to attacks in 1956 and 1962, hearings, studies and discussions were conducted by highly respected impartial persons and organizations considered expert in this area. Repeatedly, the same conclusion was reached, that the accuracy and reliability of the present method of track accounting in light of the unique nature of the property and the advantages inherent in the continuity of financial reporting mandated its continued use.

Investors Misled

During the Blatnick Committee hearing the accuracy and investor reliance on this accounting method were investigated. Representative Porter Hardy, Jr., a committee member, questioned Mr. Murphy, former Chairman of the AICPA Committee on Relations with the ICC on the charge that "even though it may be more convenient, because of the peculiar structure of the railroad plant, the accounting procedures do not protect the public interest because they do not give a true picture of the earnings or the losses of the operation." The exchange on this issue was as follows:

Mr. Hardy: . . . I think the chairman mentioned a moment ago that there was a vast understatement in earnings as between what the results would have been if depreciation accounting had been used.

Mr. Murphy: I have trouble believing that is correct, that there is an understatement, Mr. Hardy. The reason that I conclude that the earnings are fairly presented, using this method of accounting, if I might use an example—let's assume for the moment that you are spending money on capital additions at the rate of $100 a year. You expect to spend that every year.

We will assume a four-year life. You would have two alternatives. Once you have your plant at the level where you are going to keep it, and continue that $100 a year, if you depreciated each one of those items over a four-year life, you would get exactly the same charge to income as if you just charged the $100 a year to income directly, and didn't depreciate any of it.

Mr. Hardy: Let me see if I can just button down then the difference in what I thought was a difference in the thinking here. It is your view, then, that actually the present method of accounting didn't really make any appreciable difference in the statement of income?

Mr. Murphy: That is right.

At the time of these hearings, it should be noted that, generally, public accounting firms were relating their opinions on financial statements to investors to the principles of accounting prescribed or authorized by the ICC. Since that time, however, there have been two significant developments briefly noted above that should have entirely disarmed critics of the present method.

First, the ICC issued Order No. 33581 on January 25, 1962, which became effective on July 1, 1962, permitting public reporting in conformity with generally accepted accounting principles as follows: Sec. 25.1 Financial Statements Released by Carriers. Carriers desiring to do so may prepare and publish financial statements in reports to stockholders and others, except in reports to this Commission, based on generally accepted accounting principles for which there is authoritative support, provided that any variance from this Commission's prescribed accounting rules contained in such statements is clearly disclosed in foot-notes to the statements;

Second, the Committee on Auditing Procedure in September, 1962, issued its Statement No. 32, which included comments relating to the applicability of the first reporting standard ("The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.") to regulated companies: 38 . . . The basic postulates and broad principles of accounting comprehended in the term "generally accepted accounting principles" which pertain to business enterprises in general apply also to such regulated companies. Accordingly, the first reporting standard is equally applicable to opinions on financial statements of such regulated companies presented for purposes other than filing with their respective supervisory agencies, and material variances from generally accepted accounting principles, and their effects should be dealt with in the independent auditor's report in the same manner followed for companies which are not regulated . . .

In the wake of these statements most accounting firms auditing railroads began to relate their opinions to "generally accepted accounting principles."

For some members of the accounting profession to continue to allege that investors currently are being deceived because of railroad financial reporting techniques, is to level a criticism at "generally accepted accounting principles," not railroad accounting practices. If such is the case, it would seem that a forum on railroad accounting is an inappropriate arena for waging a contest of such grave consequences to the entire accounting profession.

MERITS OF RETIREMENT-REPLACEMENT-BETTERMENT ACCOUNTING

It is felt that retirement-replacement-betterment accounting is more realistic and accurate than ratable depreciation accounting since, under present accounting methods, investment accounts are charged with actual betterments and currently charged with the costs of the restoration of prior depreciation. It is far more conservative than ratable depreciation. In reflecting replacement cost as opposed to their original cost, it is a more realistic measure of the cost of doing business. After all, for a going concern the more critical question is not "what did its assets cost," it is "what will it cost to replace the asset so it can stay in business." Thus, as components of the track structure are replaced from time to time to maintain the track in safe condition, the replacement facet of the present method does charge a fair and proper amount for the use of such property against operations in each period. In other words, it is felt that railroad operating accounts currently reflect the actual costs of the wearing out of the track elements in current use, whereas the ratable depreciation method if applied to such property would completely disregard current replacement cost and would include in the accounts fixed amounts representing depreciation charges based on estimated lives and outdated historical costs.

The strongest argument which could be made by the advocates of ratable depreciation accounting is that its use would have the same effect on financial reporting as betterment accounting. (Of course, if such an argument were accepted, the concept of "consistency" would prevent substitution of methods.) This would result from the "maturity" of the railroad industry. Economic maturity in the railroad industry is considered as having been attained in the sense that the physical plant which it has built up over the past hundred years or more has generally leveled off. The part played by "maturity" in cost recovery is discussed in Financial Accounting, by George O. May, where he states at page 124: Depreciation accounting is one of those habits which is not really beneficial unless acquired early in youth.

The time element is vitally important in regard to every aspect of the depreciation problem. A scheme which would be manifestly desirable if adopted in the early stage of an enterprise is of doubtful value when the enterprise has reached maturity, so that in terms of property units, replacements substantially equal exhaustion.

Of course, any comparison of ratable depreciation accounting methods must take place at the theoretical level, since ratable depreciation accounting of track components has never, and, it is submitted, could never realistically take place. The track structure consists of hundreds of thousands of lengths of steel rail, track fastenings and other track material, and millions of crossties and track fastenings laid over an enormous tonnage of ballast. Each item standing by itself is a minor component part of the entire "track structure" but absolutely essential to its usability.

Further, the fact is that track maintenance is not performed on the basis of a linear unit. Any given segment of track on which replacement work is done in 1974 would very likely be subdivided in later years. For example, if track components between Mileposts 175 to 200 are replaced in 1974, it is likely that the next program would involve something like Mileposts 160 to 180 and 190 to 210. In these circumstances, it is submitted that a ratable method of depreciation is unworkable—that **dollars** rather than **assets** would be traced, a subversion of any theory of depreciation.

Neither does the critic note the most important fact relating to this tempest in a teapot. In 1966 the Treasury Department under Assistant Secretary for Tax Policy Stanley Surrey and the Association of American Railroads jointly retained Haskins & Sells to determine whether retirement-replacement-betterment method of accounting for the depreciation of the track structure yielded a greater cumulative allowance than would a ratable method. That firm's conclusion was that the retirement-replacement-betterment method yielded a reasonable allowance and one which did not exceed that which a ratable method would have generated.

CONCLUSION

The foregoing establishes:

1. That the retirement-replacement-betterment method of depreciation railroad track components reflects a reasonable and accurate charge against income.

2. The present method of accounting for track is consistent with the ratable method of depreciation where mature asset accounts are involved, as demonstrated by Mr. H. D. Murphy, former chairman of the A.I.A. Committee on Relations with the ICC at the Blatnick Committee hearings (page , **supra**). Proof of such consistency is established by the opinion letter of Haskins & Sells to the Treasury Department and the Association of American Railroads.

3. A huge but inestimable expense would be incurred as a result of attempting to maintain corporate records which would itemize specific components of the track structure so precisely as to permit the computation of an accurate deduction for ratable depreciation.

4. The lack of comparability with prior years' operating results for the year of changeover and for one life cycle of the longest lived component of the track structure would be a disservice both to the investing public and to the industry as it tries to compete in the capital markets.

Proponents of change must discharge a heavy burden of proof to make a case for requiring a changeover, a track at which they have repeatedly failed in the past.