1938

Examination: November 16 to 19, 1938

Kentucky. State Board of Accountancy

W. A. Hifner

William Cotton

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STATE BOARD OF ACCOUNTANCY OF KENTUCKY

Examination

November 16, to 19, 1938

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City Bank Building, Lexington, Ky.

WILLIAM COTTON, C. P. A., Treasurer
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ROBERT MILLER, C. P. A., Secretary
Columbia Building, Louisville Ky.

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

Examination

November 16, to 19, 1938

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—AUDITING

NOVEMBER 16, 1938—9 A. M. TO 12 M.

1

In auditing the books of a municipality, how would you verify the following:

(a) Collection of Fines and Costs for violation of City Laws and Ordinances.
(b) Collection of Ad Valorem taxes.
(c) Collection of occupational license fees.

2

Name (a) three types of defalcation which should be discovered by a balance sheet audit; (b) three types which would not be.

3

You are advised that an Officer of the Company opens all incoming mail and that after inspecting all checks received for the payment of accounts receivable, turns them over to the bookkeeper in charge of accounts receivable ledgers for recording and posting.

You are further advised that the accounts receivable bookeeper makes a detailed report to the cashier at the end of the day which report presumably includes the checks received by mail and turned over to him and also all cash and checks received by him direct during the day.

Explain briefly what changes in the above procedure you consider necessary to strengthen the internal control over receipts.

4

You are called on to make a detailed audit of a concern which is exclusive distributor for a radio. You find commission from the sale of radios to be their only source of revenue.

You are advised by the owners of the business who are operating it through an employed manager that they believe the gross profit as shown by the records to be incorrect and understated and wish your audit to determine whether or not their belief is correct.

What method of verification would you use to determine the correct gross profit?

5

In connection with an audit of an automobile dealer you have made an actual inspection and count of all new and used cars and determined the following:

New cars were included in the inventory at actual cost.

Used cars were included in the inventory at trade-in-value-allowed to the purchaser at time of trade.

Parts and supplies as reflected by a perpetual inventory record were at cost and represented less than 1 per cent of the total inventory.

In view of the above facts what additional information, if any, would you require before you would be willing to certify that in your opinion the inventory was not grossly overstated?

6

You are preparing the financial statements for the President's annual report to the stockholders of a corporation. You will prepare a balance sheet, a statement of profit and loss and surplus and a certificate. What information, if any, would you give in regard to the accounts listed below, in addition to the captions and amounts, and how would you present it?

a. Officers Salaries.
b. Depreciation for Current Year.
c. Fixed Assets.
d. Marketable Securities.
e. Accounting Methods Followed by the Corporation.
f. Inventories.
g. Customers' Accounts and Notes.
h. Accrued Taxes.

7

In the course of the audit of a corporation as of October 31, 1938, you find an insurance policy on the life of the president. The original date of the policy is September 30, 1930, and the current premium has been paid. The policy recites that the cash value of the policy at the end of the ninth policy year is $5,000.00. How would you compute the cash value at October 31, 1938?

EXAMINATION—AUDITING—(Continued)

8

You are auditing the books of a retail furniture store which sells merchandise on the installment plan. A large part of the collections are made by collectors who have regular routes. The condition of the accounts handled by two collectors leads the management to believe that some of the collections have not been turned in. For certain reasons it is not practical to attempt to verify the accounts by correspondence with the customers. What procedure would you suggest?

9

You are employed to make regular annual examinations of a bank, your reports to be addressed to the directors. Which of the following would you verify by correspondence with the debtors and creditors?

Due from Banks.
Due to Banks.
Individual Deposits.
Savings Deposits.
Certificates of Deposit.
Time Loans.
Demand Loans.
City and County Funds on Deposit.

10

During the course of an audit you request the secretary of the corporation to let you see the minute book. He shows some reluctance and asks you what the minutes have to do with your audit. How would you answer him?

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—THEORY OF ACCOUNTS

NOVEMBER 16, 1938—1 P. M. TO 4 P. M.

1

On July 1, 1936, the X Printing Company purchased all the assets, except realty, of the Y Printing Company for $300,000.00 cash.

The X Printing Company set this account up on its books as follows:

Equipment	$100,000.00
Account Receivable	75,000.00
Subscription Lists and Good Will	150,000.00
Total	$325,000.00
Prepaid Subscriptions	25,000.00
NET	$300,000.00

On July 1, 1938, the X Printing Company purchased a new press for $15,000.00, paying therefor $5,000.00 in cash and two old machines received in the purchase of Y Printing Company. The only idea you can obtain of the cost of the two old machines is a statement from the management that they were probably some 5 to 10 years old when purchased on July 1, 1936, and that they would cost, new, about $12,500.00 each. The Y Printing Company has been computing depreciation at 10% per annum on the $100,000.00 of equipment purchased.

What entries would you make covering the transaction? The only entry that has been made is charging the equipment account with the $5,000.00 cash payment.

2

In 1924 the X Corporation purchased, at a bankrupt sale, a 200-acre tract of land on which there was a fully equipped coal mine, for the lump sum of $20,000.00. It allocated this cost as follows:

Land, surface value	$ 1,000.00
Coal, estimated 10,000,000 tons @ 1/10 cent	10,000.00
Equipment	9,000.00

On December 31, 1937, its balance sheet showed the above items plus the following:

Reserve for Depreciation	$9,000.00
Reserve for Depletion on Costs	8,000.00
Reserve for Depletion, percentage basis	4,000.00

Total tonnage from acquisition in 1924 to Dec. 31, 1937, amounted to 12,200,000 tons.

On Jan. 1, 1938, the property was sold for the lump sum of $25,000.00. How should the profit on this sale be computed?

3

When an individual dies during the year, his personal representative is required to file an income tax return for the decedent, showing income and deductions from the first of the year to date of death. In such case there is permitted a deduction for the personal exemption equal to the pro rata of the allowable exemption according to his status (married or single) up to the date of death, plus a pro rata of the personal exemption of $1,000.00 from date of death to the end of the year.

Upon what theory of accounting is there permitted for a decedent any part of a personal exemption for the period after his death?

4

Whiskey must be aged for four years in a bonded warehouse before it can be "Bottled in Bond". Is it proper to add the following to inventory values:

Depreciation on Warehouses.
Taxes on Warehouses.
Federal Withdrawal Taxes.
Interest on Investment.
Interest on Bank Loans.
Officers' Salaries (Some Portion).
Insurance on Whiskey in Bond.

Answer yes or no and give brief reasons, for each item.

EXAMINATION—THEORY OF ACCOUNTS—(Continued)

5

What is meant by "current assets"? "Current liabilities?"

A cigarette manufacturer carries leaf tobacco from crops of several years for proper aging and blending. Part of the tobacco purchased in 1938 may not be sold as finished product until possibly 1942. Is this a current asset at December 31, 1938? Give reasons for your answer.

6

In auditing the records of a corporation with a large number of stockholders you find the following conditions:

Building and ground costing \$100,000.00 and subject to depreciation of \$10,000.00 is carried on their records at \$1.00.

An excessive reserve of \$100,000.00 has been provided for possible loss on securities owned.

Inasmuch as the adjustments to assets have not affected the taxable income of the corporation, would you consider it your duty to reveal the fact that the assets were grossly understated?

7

Classify the following as operating or non-operating items:

1. Merchandise sales.
2. Income from services rendered.
3. Sales discount.
4. Returns and allowances.
5. Interest on borrowed money.
6. Profit on sale of capital assets.
7. Interest and dividends received.
8. Cash discounts received.
9. Cash discounts paid.
10. Depreciation.
11. Property taxes.
12. Income taxes.

8

When a company erects its own plant, charging as cost the direct costs of material, labor and direct supervision, is it proper to charge as cost any part of general overhead?

9

A corporation has as one of its assets capital stock of a subsidiary corporation which it purchased for the purpose of controlling the corporation. How should this asset be classified on the balance sheet?

10

In making an audit of the O Company for the year 1937 you find unamortized bond discount account with a debit balance of \$1,000.00. Upon analysis of this account you ascertain the following facts:

Original bond issue \$100,000.00 10-year bonds, due serially \$10,000.00 per annum, sold at 95. Jan. 1, 1935	\$5,000.00
Jan. 1, 1936, retired 10M at par	500.00
Jan. 1, 1937, retired 10M at par	500.00
Oct. 1, 1937, bought issues due Jan. 1, 1938, 1939, and 1940, @ 90. and retired	3,000.00

The corporation has enjoyed a large taxable income each year. Would you accept the account as stated? If not, what corrections would you make?

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—COMMERCIAL LAW

NOVEMBER 17, 1938—8:30 A. M. TO 12:00 M.

1

What portion of the authorized capital stock of a corporation, organized under the laws of Kentucky, must be subscribed before the corporation can legally start to do business?

2

A taxpayer, resident in Kentucky, has omitted from his annual returns for State and County taxes certain assets subject to tax. How many years may the Tax Commissioner go back in filing suit for additional taxes and what penalties may be assessed?

3

Which of the following assets of a corporation are subject to State and County taxes? This is a Kentucky corporation and all of its assets are located in Kentucky.

Inventories.
Land.
Machinery.
Buildings.
Accounts Receivable—Customers.
Amounts Due from Officers.
U. S. Treasury Notes.
Capital Stock of a Subsidiary.
Cash in Bank.
Cash on Hand.

4

Adams, Brown and Crow have organized to do business as merchandise jobbers under the name of Kentucky Wholesale Foods Company. The business is to be operated as a partnership. Is any legal procedure necessary that would not be necessary if the firm was to be known as Adams, Brown & Crow?

5

In the audit of a distillery you find that warehouse receipts on company owned whiskey are pledged to secure bank loans. Occasionally, when bulk whiskey is sold new receipts are issued and delivered to the customer before the original receipt is withdrawn from the bank. No fraud is intended and it is seldom that more than a few days elapse before new collateral is substituted at the bank and the old warehouse receipts are drawn down and canceled. Would you find any fault with this practice? Give reasons for your answer.

6

An employee of a firm of Certified Public Accountants, during the course of an audit, cashed a check at the client's office. The bank returns the check to the client marked, "Not sufficient funds". The client asks the firm to make the check good. Upon investigation, it is discovered that the employee is indebted to employees of several other clients for small loans. What is the legal liability of the firm in regard to the check and the loans. What procedure would you suggest in regard to the whole matter?

7

A, the holder of record of one hundred shares of stock in X Corporation, obtained a loan equal to one-half the value of his stock from a broker. He gave the certificates of stock to the broker accompanied by an assignment and power of attorney. The broker sold the shares to B and made a transfer under his power of attorney. Soon thereafter the broker became bankrupt. A informed the corporation of all of the facts and directed that the transfer of the shares on its books not be made. B sues A in an attempt to compel him to assign his interest in the stock. Will B be successful? Answer fully.

8

The directors of a corporation voted to pay certain property taxes for the holders of its shares. These taxes were the personal liability of the stockholders and payment by the corporation was to be made to the stockholders upon a proper showing that the taxes had been paid by the stockholders. In due course, payment was made to all stockholders liable for the tax. The Old Ladies' Home, a charitable corporation and holder of a large block of the stock, was not liable for the tax and therefore received no payments. How-

EXAMINATION—COMMERCIAL LAW—(Continued)

ever, the Home demanded that the corporation pay to it, as dividends, an amount equal to the tax which it would have been required to pay if it were liable for the tax. Is the Old Ladies' Home entitled to the payment?

9

John Smith and William Jones constitute the firm of Smith-Jones and Company. Sam Brown is taken in as an additional partner. Subsequently, Smith-Jones and Company are bankrupt. To what extent is Brown liable to the creditors of the firm for old debts contracted by the firm before he was taken in as a partner?

10

(a) Is there any difference between a sale and a contract of sale?
(b) What is consideration?

11

You are employed by the A Company to revise its accounting procedure. After making a survey of the business you determine that the best results could be obtained with a bookkeeping machine, and the President of the A Company requests you to order for them such a machine as you deem adequate for the purpose. You place the order with the X Company and complete your engagement and receive your fee. Six months later the X Company sends you a check for $100.00 as an expression of its appreciation of your having given it the business. You accept and deposit the check. The A Company thereafter hears of the matter and demands the amount you received from the X Company. Can it recover?

12

You have been employed for some time by the accounting firm of A. & B. at a salary of $300.00 per month. In order to avoid social security taxes, the firm makes you a partner, sharing 5% in the net profits with a guarantee the total will not be less than $3,600.00 per annum. All parties are fully aware that such 5% of the profits will not equal the guarantee. Thereafter, as such partner, you obligate the firm, as endorser on your personal note, which you are unable to meet at maturity. Is the firm liable?

13

Upon the death of a partner, what are the rights of the decedent's widow or other personal representative in the control of the partnership affairs?

14

A owned 80% of the capital stock of the X corporation, which was devised to a trust company, in trust, for his infant daughter. What rights have either the trust company or the infant daughter in

(a) The assets of the X Corporation?
(b) The management of the X Corporation?

15

A occupies a building under a 20-year lease from B. The lease expired according to its terms on January 1, 1938. B died July 1, 1936, and appointed A his executor and trustee of his estate. Upon expiration of the lease, A, as trustee, renewed the lease for a 10-year period to himself, individually, upon the same terms as the old lease. The beneficiaries of B's estate opposed such renewal, claiming the rent was not sufficient. Would A be permitted to continue his occupation of the building?

16

Upon the death of an individual who takes charge of his estate, and from whom do they derive their authority?

A died testate, devising all his property, amounting to about $100,000.00, to his wife. The widow requests that you help her determine what debts and taxes she may owe, and render such accounting as may be necessary, in order to take possession of the property in her own name. Outline the necessary steps and procedures.

17

If one endorser of a negotiable note is released, does it release all other endorsers?

18

What act or acts passes title to a negotiable instrument?

EXAMINATION—COMMERCIAL LAW—(Continued)

19

A frequent criticism of the Kentucky Income Tax Act is that the items of gross income and deductions are not identical with the Federal Act, thus imposing an undue burden on the taxpayer by requiring the computations on a different basis. To overcome this, it has been argued the Kentucky Act should merely require a duplicate of the Federal return, with computation of the tax at the prescribed rates. Would this be equitable and fair? If not, give reasons.

20

A died testate and without issue on February 1, 1938. His will devised one-half his estate, in fee, to his widow, and the other one-half to the X Trust Company as trustee for his niece, both principal and income to be held in trust until the niece becomes 21 years of age, at which time it is to be paid over to her.

For the remainder of the year, during administration, the estate received interest and dividends of $5,000.00; paid the State and County taxes (assessed July 1, 1936); paid the widow $2,400.00 for living expenses and paid $500.00 to the X Trust Company as trustee.

Indicate the various income tax returns that should be filed and the gross income and exemptions for each.

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—PRACTICAL ACCOUNTING

NOVEMBER 17, 1938—1:00 P. M. TO 5:00 P. M.

PROBLEM 1

The balance sheet of the Barlow Company on Dec. 31, 1937, was as follows:

The Barlow Company

Assets		
Cash		$ 50,000.00
Receivable, Net		10,000.00
Inventories		125,000.00
Marketable Securities, at Cost		75,000.00
Plant and Equitment, Cost	$770,000.00	
Less Reserves for Depreciation	200,000.00	570,000.00
Organization Expense		5,000.00
Patents		15,000.00
Total Assets		$ 850,000.00
Liabilities		
Notes Payable, Current		$ 40,000.00
Accounts Payable		30,000.00
Accrued Expense		20,000.00
Bonded Indebtedness		180,000.00
Preferred Stock—1,500 sh. @ 100. par		150,000.00
Common Stock—4,200 sh. @ 100. par		420,000.00
Earned Surplus		10,000.00
Total Liabilities		$ 850,000.00

The balance sheet of the White Corporation on Dec. 31, 1937, was as follows:

The White Corporation

Assets		
Cash		$ 200,000.00
Receivables, Net		250,000.00
Inventories		300,000.00
Plant and Equipment, Cost	$2,000,000.00	
Less Reserves for Depreciation	500,000.00	1,500,000.00
Treasury Stock:		
4,000 sh. Pfd. @ Average Cost of 110.00	440,000.00	
2,000 sh. Com. @ Average Cost of 90.00	180,000.00	620,000.00
Total Assets		$2,870,000.00
Liabilities		
Accounts Payable		$ 250,000.00
Accrued Expense		50,000.00
Preferred Stock—10,000 sh. @ 100. par		1,000,000.00
Common Stock—10,000 sh. @ 100. par		1,000,000.00
Earned Surplus		570,000.00
Total Liabilities		$2,870,000.00

The White Corporation has recently bought on the market 200 shares of the preferred stock of the Barlow Company at an average price of $82.00 per share; and has acquired 200 shares of Barlow Company common stock by exchange as follows: One-half share of White Corporation treasury preferred for each share of Barlow Company common. These transactions are not reflected in the foregoing balance sheet.

EXAMINATION—PRACTICAL ACCOUNTING—(Continued)

PROBLEM 1 (Continued)

The White Corporation—(Continued)

The White Corporation agrees on Dec. 31, 1937, to purchase all the assets of the Barlow Company, except cash and marketable securities on the following basis:

A. Current assets are to be valued at 70% of book value. Current liabilities are to be assumed by the purchaser, and the net difference paid in cash.

B. Fixed assets are to be appraised, and paid for, at appraisal values, one-half in cash, and one-half in first mortgage bonds of the purchaser, at 90.

C. Patents are to be valued at $1.00, payable in cash.

D. Good will is to be capitalized at 10% on the average earnings of the Barlow Company for the past three years in excess of 6% return on preferred and 2% return on common stock. Net profits are to be adjusted as follows:

1. Non operating litems are to be excluded.
2. Depreciation is to be adjusted to an agreed amount of $5,000.00 per year.
3. Administrative salaries for any year not to be in excess of 20% of adjusted earnings for such year, before provision for return on capital.

Good Will is to be paid for one-half in cash, and one-half in common capital stock of The White Corporation, @ par.

The Preferred Stock of the Barlow Company is callable at 105. Appraisal value of the plant and equipment of the Barlow Company is $378,000.00. The face amount of 10-yr. outstanding bonds of the Barlow Company, due Jan. 1, 1940, and callable at 101 is $200,000.00, the difference on the balance sheet representing bond discount. Marketable securities of the Barlow Company are sold on the market Jan. 1, 1938, for $60,000.00. The Barlow Company also sells 130 shares of White Corporation common on the market for $14,850.00 on the same day. The Barlow Company liquidates Jan. 1, 1938, suffering liquidation expense of $6,501.00.

The White Corporation issues on Dec. 31, 1937, $600,000.00 face value first mortgage bonds in order to undertake the purchase of the Barlow Company and to supply working capital. Bonds not issued in exchange are disposed of through an underwriting house, at 95. The White Corporation cancels all its treasury stock on Jan. 1, 1938.

Your examination of the records of the Barlow Company discloses the following:

Year	Book Profits; Loss*	Depreciation Charge	Administrative Salaries	Fire Loss	Profit; Loss* on Sale of Securities
1935	***$154,800.00**	00	$10,000.00	$40,000.00	00
1936	125,000.00	$40,000.00	15,000.00	00	$ 5,000.00
1937	13,000.00	20,000.00	12,000.00	00	***10,000.00**

You may ignore income taxes throughout this problem.

Required:

1. Complete work sheets.
2. Balance sheets for the White Corporation after giving effect to the above, as of Dec. 31, 1937, and as of Jan. 1, 1938.
3. Liquidating statement for the Barlow Company, showing distributions per share.

* Losses are printed in bold face type.

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—PRACTICAL ACCOUNTING

NOVEMBER 18, 1938—8:30 A. M. TO 11:00 A. M.

PROBLEM 2

In the course of a September 30th, audit, you find a new account on the general ledger of a client, which is captioned "Insurance-Interest". This account has a debit balance of $1,934.06. The ledger shows this debit balance to consist of two cash disbursement items of $1,026.45 and $907.61, respectively, both payments having been made to a premium finance corporation.

Examination of the insurance policies develops the fact that the client has recently revised his insurance program, and has had his fire and tornado policies rewritten for a three-year period beginning with June 1st. Total premiums were $23,137.18, of which $4,627.48 was a down payment charged to Insurance Paid in Advance, leaving $18,509.70 which was financed. The agreement with the premium finance company contained the following schedule of monthly payments:

	Principal	Interest	Total
August, 1938	$ 841.35	$185.10	$ 1,026.45
September, 1938	841.35	66.26	907.61
October, 1938	841.35	63.10	904.45
November, 1938	841.35	59.95	901.30
December, 1938	841.35	56.79	898.14
January, 1939	841.35	53.64	894.99
February, 1939	841.35	50.48	891.83
March, 1939	841.35	47.33	888.68
April, 1939	841.35	44.17	885.52
May, 1939	841.35	41.02	882.37
June, 1939	841.35	37.86	879.21
July, 1939	841.35	34.71	876.06
August, 1939	841.35	31.55	872.90
September, 1939	841.35	28.40	869.75
October, 1939	841.35	25.24	866.59
November, 1939	841.35	22.09	863.44
December, 1939	841.35	18.93	860.28
January, 1940	841.35	15.78	857.13
February, 1940	841.35	12.62	853.97
March, 1940	841.35	9.47	850.82
April, 1940	841.35	6.31	847.66
May, 1940	841.35	3.15	844.50
Totals	$18,509.70	$913.95	$19,423.65

The amount payable to the premium finance corporation is to be reflected on the books only as each payment is made. Therefore, do not set up the total unpaid premium as a liability.

Prepare (a) the audit adjustment entries as of September 30, 1938, and (b) write a memorandum for the bookkeeper explaining the proper handling of the account, including a columnar schedule covering the life of the policies, which he is to use as the basis of his monthly entries.

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—PRACTICAL ACCOUNTING

NOVEMBER 18, 1938—12:30 P. M. TO 5:30 P. M.

PROBLEM 3

Albert Johnston died on May 31, 1937, leaving a will, the pertinent provisions of which read as follows:

"1. I direct that all my just debts, funeral expenses and the expense of administering my estate shall first be paid.

2. I bequeath to my wife, Mary Johnston, the sum of $50,000.00 to be her property absolutely.

3. I bequeath to my wife, Mary Johnston, my farm, on which I now reside and comprising about 300 acres of land, for and during her natural life, with remainder, at her death, to my son, John Johnston.

4. I bequeath to my son and only child, John Johnston, all the rest and residue of my estate, of whatsoever nature, to be his property abolutely."

The will was probated and the wife, Mary Johnston, qualified as Executrix on June 10, 1937, at which time the Court appointed three men to appraise the estate.

On October 1, 1937, the appraisers filed report with the County Court, appraising the estate as follows:

Farm 300 Acres @ 200	$ 60,000.00
½ Interest in Partnership of Johnston & Son	25,000.00
Cash in Bank	45,000.00
40M Par Value U. S. Treasury 3¼% Bonds Due Apr. 15, 1946, A. & O. @ 104	41,600.00
Accrued Interest 4/15 to 5/31	162.50
60M Par 5½% S. F. Bonds American Telephone & Telegraph Co., 1943 M. & S. @ 112	67,200.00
Accrued Interest 3/1 to 5/31	825.00
100 Sh. Common Capital Stock of Citizens Union Natl. Bank @ 400	40,000.00
Farm Equipment and Live Stock	3,000.00
Total Gross Estate	$282,787.50

The widow came to you on November 10, 1937, and requested your assistance to determine the following facts:

Kentucky and Federal income taxes due by the decedent and by the estate.

Federal estate taxes due by the estate.

Kentucky inheritance taxes payable by the Executrix and chargeable to each beneficiary.

Amount due to son as residuary legatee.

Upon investigation you ascertain the following facts:

At May 31, 1937, the widow was 60 years of age and the son was 35 years of age.

Under Kentucky Statutes the present value of a life estate at the age of 60 years is 47.31%.

The firm of Johnston and Son was a partnership engaged as engineers in which invested capital and personal services were income determining factors, father and son each owing a half interest. It had always kept its books and reported its income on a cash basis. For the period January 1 to May 31, 1937, it collected fees of $16,500.00 and paid expenses of $6,500.00. Included in such disbursements is a fee of $1,500.00 paid an associate engineer for his 1/3 of a job that had been completed in 1936. The full contract price of $4,500.00 was paid to Johnston & Son on June 15, 1937. The appraisers did not take this $4,500.00 into consideration in appraising the partnership assets, and it is not included in the value stated.

EXAMINATION—PRACTICAL ACCOUNTING—(Continued)

PROBLEM 3—(Continued)

The receipts and disbursements of the Executrix from June 10 to November 10, 1937, were as follows:

Receipts

June	10,	Transfer from Decedent's Account	$ 45,000.00
July	1,	Dividend, Bank Stock	500.00
	2,	Proceeds Public Sale Farm Equipment and Live Stock	3,000.00
Sept.	1,	Interest Coupons A. T. & T Bonds	1,650.00
		Proceeds Sale 60M A. T. & T. Bonds @ 113½	68,100.00
Oct.	1,	Dividend, Bank Stock	500.00
Oct.	15,	Interest Coupons, U. S. Treasury Bonds	650.00
		Total Receipts	$119,400.00

Disbursements

Funeral Expenses and Monument	$ 1,500.00
Note to Bank—Principal	20,000.00
Note to Bank—Interest Mar. 1 to Sept. 1, 1937	600.00
Proven Claims, Small Bills	150.00
Ad Valorem Taxes (Assessed July 1, 1936)	2,426.00
Mary Johnston, Bequest	50,000.00
Attorneys Fees and Court Costs	2,500.00
Stamp Tax on Bonds Sold	24.00
Total Disbursements	$ 77,200.00
Balance in Bank, Nov. 10, 1937	$ 42,200.00

Receipts and disbursement of Albert Johnston for the period January 1–May 31, 1937, were as follows:

Receipts

Jan.	1	Balance in Bank	$ 40,000.00
Jan.	1	Dividend, Bank Stock	500.00
	15	Sale of Tobacco	6,500.00
Mar.	1	Interest Coupons, A. T. & T. Bonds	1,650.00
	1	Borrowed from Bank	20,000.00
Apr.	1	Dividend, Bank Stock	500.00
		Interest Coupons, U. S. Treasury Bonds	650.00
May	1	Johnston & Son, Withdrawal	50,000.00
	10	Sale 100 sh. Common Stock General Motors Corp. (Cost Apr. 10, 1927, $8,000.00)	4,125.00
		Total Receipts	$123,925.00

Disbursements

Feb.	1	Ad Valorem Taxes (Assessed July 1, 1935)	$ 2,675.00
	15	Federal Income Tax for 1936 (Cash Basis)	4,850.00
Mar.	1	Purchase 60M A. T. & T. Co. Bonds	67,500.00
	15	Ky. Income Tax (Cash Basis)	1,650.00
Apr.	1	Church Dues	500.00
Jan. 1 May	31	Various Personal Expenses	1,750.00
		Total Disbursements	$78,925.00
		Balance in Bank, May 31, 1937	$45,000.00

EXAMINATION—PRACTICAL ACCOUNTING—(Continued)

PROBLEM 3—(Continued)

There will be further stamp transfer taxes of $20.00; Court Costs of $30.00; and your fee of $500.00.

Required:

1. Statements of taxable income and resulting income tax, both Kentucky and Federal, for the decedent and his estate for 1937.

2. Statement of net estate subject to Federal estate, and the resulting tax. (In determining the net estate, the Statute allows an exemption of $40,000.00.) This to be computed under the Revenue Act of 1935 only, ignoring the Revenue Act of 1926.

3. State of distributive share of each beneficiary subject to Kentucky inheritance tax and the resulting tax. (There would be no statutory exemption.)

4. Residuary estate distributable to son.

Data Supplied:

For 1937, the Federal normal tax was 4% and surtaxes as follows:

First	$10,000		$300.00
Next	2,000	@ 7%	
"	2,000	@ 8%	
"	2,000	@ 9%	
"	2,000	@ 11%	
"	2,000	@ 13%	

Kentucky State income tax rates are as follows:

First	$3,000	@ 2%
Next	1,000	@ 3%
"	1,000	@ 4%
Over	5,000	@ 5%

1935 Federal estate tax rates are $9,600.00 on net estate of $100,000.00 plus 17% on excess up to $200,000.00; $26,600.00 on net estate of $200,000.00, plus 20% on excess up to $400,000.00.

The Kentucky inheritance taxes are as below:

First	$ 10,000.00	@ 2%
Next	10,000.00	@ 3%
"	10,000.00	@ 4%
"	15,000.00	@ 5%
"	15,000.00	@ 6%
"	40,000.00	@ 7%
"	100,000.00	@ 8%
"	200,000.00	@ 9%

STATE BOARD OF ACCOUNTANCY OF KENTUCKY

EXAMINATION—PRACTICAL ACCOUNTING

NOVEMBER 19, 1938—8:30 A. M. TO 10 A. M.

PROBLEM 4

Prepare a statement of application of funds from the following data, in the form in which you would present it to a client.

X COMPANY—TRIAL BALANCES AFTER CLOSING

Assets:	Sept. 30, 1937	Sept. 30, 1938
Cash	$ 40,261.20	$ 38,750.25
Accounts Receivable	169,250.00	180,130.54
Marketable Securities	70,000.00	72,525.00
Cash Value of Life Insurance	9,285.00	10,360.00
Inventories	140,350.25	148,120.75
Advances to Employees	1,520.00	3,240.00
Prepaid Expenses	2,650.00	3,120.25
Land	25,000.00	35,000.00
Buildings	155,250.25	196,375.00
Machinery and Equipment	95,860.00	105,250.00
Automobiles and Trucks	12,420.25	12,525.00
Furniture and Fixtures	3,725.00	3,725.00
Investment in Subsidiary	79,000.00	149,000.00
Sinking Fund for Retirement of Bonds—Cash	00	5,000.00
Totals	$804,571.95	$963,121.79
Liabilities		
Accounts Payable	$ 85,220.21	$ 90,525.21
Notes Payable	100,000.00	100,000.00
Accrued Expenses	15,850.00	20,560.00
Mortgage Bonds Payable—Due in 1945	40,000.00	40,000.00
Reserve for Contingencies	10,000.00	5,720.36
Common Stock	250,000.00	330,000.00
Preferred Stock	100,000.00	100,000.00
Earned Surplus	124,501.74	147,071.82
Unrealized Surplus from Appreciation—(Entry Dated Sept. 30, 1938)	00	40,000.00
Reserve for Depreciation—Buildings (2%)	30,525.00	33,741.25
Reserve for Depreciation—Machinery and Equipment (10%)	40,205.00	45,492.50
Reserve for Depreciation—Automobiles and Trucks (25%)	6,750.00	8,118.15
Reserve for Depreciation—Furniture and Fixtures (10%)	1,520.00	1,892.50
Totals	$804,571.95	$963,121.79
Dividends Paid During Year		$75,000.00

Machinery and equipment fully depreciated and written out of accounts during year, $5,000.00—also automobiles, $2,000.00.

Market value of securities was $72,500.00 at September 30, 1937, and $72,100.00 at September 30, 1938.

The charge to reserve for contingencies represented costs in connection with certain litigation against the company.

Additional taxes for 1935 were paid during the year in the amount of $5,220.00 and charged against surplus.