

1936

## Examination, May 1936

District of Columbia. Board of Accountancy

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### Recommended Citation

District of Columbia. Board of Accountancy, "Examination, May 1936" (1936). *State Publications*. 29.  
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BOARD OF ACCOUNTANCY  
DISTRICT OF COLUMBIA  
EXAMINATION, MAY 1936

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MAY 14, MORNING SESSION

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Auditing

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QUESTION 1:

In the audit of a large industrial company, to what extent may an auditor rely on the system of internal check maintained by the company?

QUESTION 2:

Is an auditor responsible for revealing a lack of consistency from one year to another in the application of accounting principles by a company whose accounts he is now in the process of examining?

QUESTION 3:

In what way may contingent liabilities exist with respect to the following items:

- (a) Notes receivable discounted
- (b) Unfulfilled contracts
- (c) Mortgage on land, the land having been sold

QUESTION 4:

Outline the procedure you would recommend where you are called upon to verify by test-check approximately 50,000 accounts receivable. You may assume any situation with which you are familiar.

QUESTION 5:

Describe *briefly* the minimum procedure with which you would be satisfied for the audit of the 54 commercial checking accounts maintained by a manufacturing company in different sections of the country.

QUESTION 6:

Distinguish between prepaid expenses and deferred charges and their classification for balance-sheet purposes.

QUESTION 7:

Under what conditions would you pass additions to fixed assets in the form of overhead charges on construction work undertaken by the company whose accounts you are examining?

**QUESTION 8:**

How would you determine whether all liabilities had been recorded in the books of account?

**QUESTION 9:**

In preparing the consolidated balance sheet of a company having many subsidiaries, you are confronted with situations where a number of companies are but 50% owned yet where unquestionably operating control exists. What factors will determine your decision to consolidate or not?

**QUESTION 10:**

You are informed by a client that because none of numerous notes from customers are past due, no reserve for bad debts is required. What circumstances might compel you to disagree with him?

**QUESTION 11:**

In general, what responsibilities for inventories do public accountants assume?

**QUESTION 12:**

How would you disclose on a balance sheet dated December 31, 1935, the possession of debentures purchased by the company in anticipation of a sinking-fund installment due January 2, 1936?

**QUESTION 13:**

By means of a reduction during the year in the stated value of its common no-par stock, a company has absorbed a large deficit existing at the beginning of the year. A net profit results from the year's operations. How would you state these facts on your balance sheet at the close of the year?

**QUESTION 14:**

To what extent is an auditor on an engagement justified in accepting the proffered services of the controller and his assistants?

**QUESTION 15:**

How would you verify interest and dividends received on investments in bonds or stocks?

# BOARD OF ACCOUNTANCY DISTRICT OF COLUMBIA

EXAMINATION, MAY 1936

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MAY 14, AFTERNOON SESSION

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## Principles and Practice of Accounting

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### QUESTION 1:

A 60% subsidiary company issues a stock dividend in no-par common stock having a stated value of \$30; of the surplus transferred to stated value, one-half was earned before the parent company's interest was acquired and one-half thereafter. How should the parent company record the dividend received, and what will be the effect on a consolidated balance sheet?

### QUESTION 2:

How should premiums paid on bonds prematurely retired be reflected on the financial statements of a corporation?

### QUESTION 3:

What principles determine the necessity for consolidation or non-consolidation of financial statements in the case of parent and subsidiary relationships?

### QUESTION 4:

What disclosure, if any, on a balance sheet would you recommend when the corporation has failed to deposit before the end of the year the usual sinking-fund installment with a debenture trustee?

### QUESTION 5:

During 1935 the stockholders of the A company authorized that 10,000 shares of unissued capital stock be reserved for sale to officers over a period of years at a price equal to market less 20%. In accordance with this understanding the officers purchased 1,000 shares before the end of the year at \$32 a share. How should the company's balance sheet reflect these facts?

### PROBLEM 6:

From the following information prepare the necessary adjustments and a corrected statement of profit and loss:

Alpha Betical Company, Inc. operates a department store in a midwestern city. Inventories of certain departments—restaurant, candy, bakery, etc., are valued on the basis of cost, and have been reduced to the lower of cost or market. The inventories of the remaining sections are computed on the retail-inventory method. The inventories of the "retail departments" have been taken on the basis of selling prices

appearing on the merchandise at the close of business at January 31, 1936; all of the required markdowns having been taken prior to the inventory and the inventory priced accordingly.

Several specialty departments are leased to concessionaires who supply their own merchandise and pay their own invoices. Cash received on cash sales and the collection of charge sales are deposited in the regular bank account of Alpha Betical Company, Inc. The net collections, after deduction of 10% on cash sales and 12½% on charge sales, are remitted to concessionaires monthly.

The profit-and-loss trial balance for the year ended January 31, 1936 is as follows:

	<i>Debit</i>	<i>Credit</i>
Sales .....	\$ .....	\$1,592,700.00
Returned sales .....	125,000.00	.....
Inventory—2/1/35 .....	177,000.00	.....
Purchases (net) .....	965,000.00	.....
Provision for shrinkage .....	12,000.00	.....
7% loading account .....	.....	62,090.66
Administrative expenses .....	99,000.00	.....
Occupancy expenses .....	130,000.00	.....
Publicity expenses .....	68,000.00	.....
Buying expenses .....	48,000.00	.....
Selling expenses .....	210,000.00	.....
Leased department income .....	.....	17,500.00
Net loss .....	.....	161,709.34
 Total .....	 <u>\$1,834,000.00</u>	 <u>\$1,834,000.00</u>

Your investigation reveals that:

(1) Sales and returned-sales accounts are composed as follows:

	<i>Sales</i>	<i>Returned Sales</i>
Sales price—		
Retail departments .....	\$1,527,700.00	\$122,200.00
Cost departments .....	30,500.00	800.00
Additional charge for retailers occupation tax—		
Retail departments .....	32,500.00	1,850.00
Cost departments .....	2,000.00	150.00
 Total .....	 <u>\$1,592,700.00</u>	 <u>\$125,000.00</u>

(2) Sales of leased departments of \$155,000 and returns of leased departments of \$14,500 are excluded from sales and returned-sales accounts.

(3) Inventory at 2/1/35 is composed as follows:

Cost departments .....	\$ 1,700.00
Retail departments (including loading of 7% on net cost) .....	175,300.00

(4) Aggregate selling prices of 2/1/35 inventory amounted to \$295,000.

(5) Purchases consisted of following—

Purchases, cost departments (net) .....	\$ 15,900.00
Purchases, retail departments (net) .....	887,009.34
7% loading on net cost of purchases, retail departments .....	62,090.66

(6) Aggregate selling prices of net purchases for retail departments amounted to \$1,640,000.00.

- (7) Inventories at 1/31/36 were:  
 Cost departments, at lower of cost or market ..... \$ 2,100.00  
 Retail departments at selling prices ..... 476,000.00
- (8) Additional markup on purchases of \$20,000 were taken during the year.
- (9) Markdowns amounted to \$58,000 and markdown cancellations to \$2,500 during the year.
- (10) The reserve for loading account showed a balance of \$11,468.22 as established at January 31, 1935 to reduce inventory to cost.
- (11) Reserve for inventory shrinkage account at January 31, 1936 shows a balance of \$12,000 accumulated by monthly provisions based on a percentage of sales.

PROBLEM 7:

The management of Company A has asked you to prepare analyses of the changes in the property-plant-and-equipment account and the reserve-for-depreciation account for the year 1935, as follows:

- Additions
- Retirements
- Transfers
- Additions to reserves—
  - (a) Through charges to income account
  - (b) Through transfers
- Retirements charged to reserves
- Transfers from reserves.

The information is required for Company A, Company B (a subsidiary of Company A), and Companies A and B consolidated.

The companies follow the practice of making net monthly entries to the property accounts and reserves for depreciation.

For your use in obtaining the above information the following facts are available:

	<i>Company A</i>	<i>Company B</i>
Account balances:		
Property, plant and equipment—		
At December 31, 1934.....	\$180,921.37	\$39,865.42
At December 31, 1935.....	209,763.57	32,801.30
Reserve for depreciation—		
At December 31, 1934.....	78,756.29	29,753.75
At December 31, 1935.....	113,649.75	29,947.56
Depreciation expense—		
At December 31, 1935.....	39,758.29	9,547.67
On January 1, 1935, the following transfer took place from Company B to Company A:		
Property .....	\$11,570.21	
Reserve .....	9,178.26	

In addition Company A sold a piece of land at cost to an outside interest for \$10,000.

You may assume that only fully depreciated properties were retired, and that there was no profit or loss resulting from the retirements.

# BOARD OF ACCOUNTANCY DISTRICT OF COLUMBIA

EXAMINATION, MAY 1936

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MAY 15, MORNING SESSION

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## Commercial Law

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### AGENCY

#### QUESTION 1:

A owned a lumber business which he allowed his nephew B to carry on in B's name. B made a bargain with C, a grocer, that C furnish him with groceries and take his pay in lumber. B had the lumber delivered to C and received the groceries. B died after that. A, finding a charge on the books against C for the lumber, sues C for the price. C pleads set-off and payment by the price of the groceries. C acted in good faith, supposing B to be the owner. How should the suit be decided, and why?

### BANKRUPTCY

#### QUESTION 1:

What are the primary purposes of existing bankruptcy laws?

#### QUESTION 2:

- (a) What are the respective functions of receiver and trustee, and who appoints them?
- (b) Must they be attorneys or can a C.P.A. serve?
- (c) What documents and information must be filed with the court very soon after the petition?

#### QUESTION 3:

How far is provable in bankruptcy a claim of the bankrupt's brother on a note on which he received a considerable part payment the day before the bankrupt filed his petition? **Explain.**

### CONTRACTS

#### QUESTION 1:

- (a) When is performance of contract effectual?
- (b) What is the cardinal rule with regard to interpreting contracts?
- (c) Name some additional rules.

#### QUESTION 2:

M's car needed painting. He intended to have the work done immediately, and so told his neighbors in course of conversation. While M was away for a few days, P, at the public garage patronized by M, painted M's car. When M returned home, he was much pleased, but when P presented him with a reasonable bill for labor and materials, M refused to pay. What rights has P?

## CORPORATIONS

### QUESTION 1:

- (a) Is a stockholder entitled to inspect the books and accounts of the corporation? Explain your answer.
- (b) Name the circumstances in which the equity courts will interfere with the management of private corporations.

### QUESTION 2:

Briefly, what is the nature and scope of the Federal Securities Act and the Federal Securities Exchange Act?

### QUESTION 3:

Jones, president of Jones & Company, signed in blank as president a number of its stock certificates and put them in possession of Brown, its secretary, for use in making transfers. Brown fraudulently filled out these certificates for 250 shares, sealed them with the seal of the company, and sold them to Smith for \$175 a share, this being the market price of the stock. Smith knew nothing of Brown's fraud. What are the rights of Jones & Company and of Jones?

## INSURANCE

### QUESTION 1:

After a valid contract of insurance has been effectuated, in what ways, if any, may the right of either party to cancel the policy accrue?

## NEGOTIABLE INSTRUMENTS

### QUESTION 1:

- (a) What does the Negotiable Instruments Law set forth as to the rights of a holder in due course?
- (b) As to the rights of an accommodation indorser against the accommodated party, what is the legal relationship between them?

### QUESTION 2:

A surety signs a promissory note and leaves it with his principal on condition the principal shall get another to sign before he delivers it to the payee. The principal delivers it without complying with this condition. If the payee has no notice of the condition, what is the liability of the surety on the note?

## PARTNERSHIP

### QUESTION 1:

- (a) Can a firm be a partner? Can a corporation be a partner? Explain your answers.
- (b) Discuss how a partnership may hold realty.

### QUESTION 2:

- (a) A person may unintentionally become liable as a partner by letting it appear that he is one; but what two other main facts must exist?
- (b) How may the formation of a partnership be affected by the Statute of Frauds?

### QUESTION 3:

A, B and C became partners in a contracting business under articles fixing four years for the duration of the partnership. At the end of one year, C, being in poor health, without consulting his co-partners, sold and assigned to his brother, K, all his interest in the firm. K was a man of good character and excellent business ability, but was not personally agreeable to A. What, if anything, can A do to prevent K acting as a member of the firm?

## SALES

### QUESTION 1:

- (a) What elements are essential to a contract of sale?
- (b) What is a gift and what are its essentials?
- (c) What is garnishment?

### QUESTION 2:

- (a) How can the right for creditor to sue on a debt barred by statute of limitations be revived or the time to sue extended?
- (b) What is the effect of breach of warranty with respect to contract of sale, and what is remedy if the sale is executed, and what is remedy if sale is executory?

## TAXATION

### QUESTION 1:

- (a) What is the object of rules of evidence in all court or Board of Tax Appeals hearings?
- (b) What is general rule respecting the admission of evidence?

### QUESTION 2:

In June 1922 Jones subscribed for 10 shares of installment stock in the Filmore Building and Loan Association, under the customary plan of nearly all building and loan associations. This stock matured in 1932, and the amount credited to Jones in that year in excess of the amounts paid in by him has been treated as income for 1932, under the Federal income tax law. Is this correct? Explain.

## MISCELLANEOUS

### QUESTION 1:

Generally, in what order do claims for debts against property of a person dying intestate have preference?

# BOARD OF ACCOUNTANCY DISTRICT OF COLUMBIA

EXAMINATION, MAY 1936

MAY 16, MORNING SESSION

## Practical Accounting

### PROBLEM 1:

The Electrical Manufacturing Company manufactures and distributes radios through jobbers. National Distributing Corp. buys radios on a cost-plus contract which contains the following provisions:

1. Electrical Manufacturing Company is to furnish its standard models under the National trade name. These are to be shipped F. O. B. factory as completed.

2. National is to be billed during the year for radios shipped at the following unit prices: Model A, \$10.00; Model B, \$20.00; Model C, \$30.00.

3. Prices are to be adjusted at the end of the year to average factory cost figured at the closest cent per unit plus a 10% allowance to cover shipping, general and administrative expense and profit. In figuring factory cost, average material and labor costs for radios completed during the year are to be used and burden is to be figured by departments based on annual departmental cost without considering labor and burden in process at the beginning of the year. Any differences disclosed as a result of your investigation are to be prorated between ending inventories and cost of sales on a proportionate basis.

You are requested to prepare:

1. A statement of profit and loss for the year ended December 31, 1935, showing detail of cost of sales. Ignore any provision for Federal income tax.

2. A statement of unit costs of production for the year ended December 31, 1935.

3. A statement of the account with National Distributing Corp. as of December 31, 1935.

The trial balance of Electrical Manufacturing Company as of December 31, 1935, follows:

<i>Account</i>	<i>Debit</i>	<i>Credit</i>
Cash .....	\$ 250,000	
Accounts receivable—general .....	275,000	
National Distributing Corp. ....	125,000	
Inventories .....	425,000	
Land, buildings and equipment .....	1,225,000	
Reserve for depreciation .....		\$ 340,000
Accounts payable .....		195,000
Capital stock .....		1,200,000
Earned surplus .....		550,000

Net sales .....		3,450,000
Cost of sales .....	2,900,000	
Burden absorbed in production .....		705,100
Cabinet-shop expense .....	231,600	
Machine-shop expense .....	227,000	
Assembly-department expense .....	220,200	
Building expense .....	100,000	
Receiving expense .....	25,638	
Warehouse and shipping expense .....	61,500	
Selling and administrative expense .....	374,162	
	<u>\$6,440,100</u>	<u>\$6,440,100</u>

Your examination discloses the following facts:

1. Building expense is to be divided on the basis of floor space as follows: cabinet shop, 30%; assembly department, 30%; machine shop, 25%; receiving department, 5%; warehouse and shipping, 5%; and general office, 5%.

2. Inventories at December 31, 1935, as shown by the records, were as follows:

<i>Particulars</i>	<i>Material</i>	<i>Labor</i>	<i>Burden</i>	<i>Total</i>
Raw material .....	\$120,000	\$.....	\$.....	\$120,000
Work in process—				
Cabinet shop .....	6,500	6,000	7,500	20,000
Machine shop .....	7,000	6,000	12,000	25,000
Assembly department .....	20,000	12,000	13,000	45,000
Finished radios .....	85,000	55,000	75,000	215,000
Total .....	<u>\$238,500</u>	<u>\$79,000</u>	<u>\$107,500</u>	<u>\$425,000</u>

3. Finished radio accounts are analyzed as follows:

<i>Particulars</i>	<i>Model A</i>	<i>Model B</i>	<i>Model C</i>	<i>Total</i>
Production transferred from work in process:				
Material .....	\$480,000	\$ 922,400	\$279,000	\$1,681,400
Labor—				
Cabinet shop .....	44,000	136,000	40,000	220,000
Machine shop .....	20,000	75,000	15,000	110,000
Assembly department .....	72,000	156,000	52,000	280,000
Burden—				
Cabinet shop .....	55,000	168,500	50,000	273,500
Machine shop .....	40,000	148,000	30,000	218,000
Assembly department .....	54,000	119,100	39,000	212,100
	<u>\$765,000</u>	<u>\$1,725,000</u>	<u>\$505,000</u>	<u>\$2,995,000</u>
Inventory January 1 .....	10,000	90,000	20,000	120,000
	<u>\$775,000</u>	<u>\$1,815,000</u>	<u>\$525,000</u>	<u>\$3,115,000</u>
Sold .....	750,000	1,700,000	450,000	2,900,000
	<u>\$ 25,000</u>	<u>\$ 115,000</u>	<u>\$ 75,000</u>	<u>\$ 215,000</u>

4. The statistical records show the following production and sales for the year :

<i>Particulars</i>	<i>Model A</i>	<i>Model B</i>	<i>Model C</i>
Inventory January 1 .....	1,200	4,500	800
Produced .....	80,000	100,000	15,000
	81,200	104,500	15,800
Net sales .....	78,200	98,500	12,800
	3,000	6,000	3,000
Inventory December 31 .....	3,000	6,000	3,000

5. Inventories at January 1, 1935 were as follows :

<i>Particulars</i>	<i>Material</i>	<i>Labor</i>	<i>Burden</i>	<i>Total</i>
Raw material .....	\$ 80,000	\$.....	\$.....	\$ 80,000
Work in process—				
Cabinet shop .....	8,000	8,000	9,000	25,000
Machine shop .....	10,000	4,000	6,000	20,000
Assembly department .....	30,000	14,000	16,000	60,000
Finished radios .....	50,000	30,000	40,000	120,000
	\$178,000	\$56,000	\$71,000	\$305,000
Total .....	\$178,000	\$56,000	\$71,000	\$305,000

6. The company maintains perpetual inventories and job costs, using the first-in, first-out basis. Direct labor is charged directly to jobs and reconciled with the payroll records. Burden is charged to jobs on the basis of arbitrary percentages of direct labor which must be adjusted at the end of the year.

7. The physical inventory at December 31, 1935 shows raw material of \$115,000, a shortage of \$5,000. Work in process is taken from job tickets which are found to be correct as to quantities, and which include material and labor priced at cost. The finished radio inventory is found to be correct as to physical quantities but contains 1,000 Model C machines which had been rendered obsolete by engineering changes and which were sold in January 1936 as a job lot for \$20,000.

8. It has been decided to charge the raw-material-inventory shortage to receiving expense and prorate that expense over material placed in production during the year and the remaining raw-material inventory.

9. The account with National Distributing Corp. is analyzed from the books as follows :

Shipments—			
Model A	40,000 @ \$10.00 .....	\$	400,000
Model B	30,000 @ 20.00 .....		600,000
Model C	10,000 @ 30.00 .....		300,000
			\$1,300,000
Payments on account .....			1,175,000
Balance due .....			125,000
			125,000

PROBLEM 2:

At December 31, 1935, the dividends in arrears on the three classes of \$100-par preferred stock of X Co. amounted to \$6,049,171.00, as follows:

<i>Class of Preferred</i>	<i>Outstanding Shares</i>	<i>Dividends in Arrears</i>
5¼% .....	924	\$15.375
6 .....	169,076	17.625
8 (callable at 110) .....	130,000	23.50

As at April 1, 1936, all preferred stockholders agreed to exchange their holdings at par plus their claims on dividends and premium to date for a new issue of 5% \$100-par preferred stock of one class which is to be listed at once on the exchange. It was further agreed that they accept the new stock at par for the par of their old holdings plus the amount of their claims to the even dollar thereof, and cash for their claims of less than one dollar.

Prepare a journal entry to record the recapitalization.

How should the company advise its stockholders to report the exchange for Federal income-tax purposes?