1936

Examination questions [1936, November]

District of Columbia. Board of Accountancy

BOARD OF ACCOUNTANCY DISTRICT OF COLUMBIA

EXAMINATION QUESTIONS

NOVEMBER 19, 1936—MORNING SESSION

Auditing

QUESTION 1:

In the accounts of the B Company you discover an item of unclaimed dividends which has been carried in the accounts-payable ledger in a constantly increasing amount over a period of years. On the balance sheet, the account has always been merged with trade accounts payable. How would you verify the account and what adjustment or other disposition of the item would you make in your annual audit of and report on the company's accounts?

QUESTION 2:

What recommendations would you offer a client who desires to have his records reflect the best accounting practices with respect to trade and cash discounts on purchases? His capital is sufficiently large to insure his taking advantage of all discounts.

QUESTION 3:

How may an auditor test for raw-material overstock in a manufacturing business where perpetual-inventory records are maintained?

QUESTION 4:

What valuation of repossessed merchandise would you approve?

QUESTION 5:

The Federal income-tax law prescribes that the basis of valuation "in the case of merchandise on hand at the beginning of the year [shall be] the inventory price of such goods." Explain this statement and argue for or against it.

QUESTION 6:

What should the attitude of the auditor be toward the "natural business year"?

QUESTION 7:

What are some of the principal classes of contingent assets? Should they be mentioned in the balance sheet?

QUESTION 8:

A substantial amount of discount on capital stock has been charged to the fixed-asset account of a public-utility enterprise you are auditing. Would you approve of the procedure the company has followed? Indicate how you would disclose the item or dispose of it in your audit report.

QUESTION 9:

How would you verify the item of royalties received?

QUESTION 10:

A wholly owned subsidiary of the B Company, whose books have been maintained on a cash basis, was liquidated during the year 1936 and in the course of the preliminary work accompanying your audit of the parent for the calendar year 1936 you find that the net amount of the liquidating dividend received consisted of the following items of the subsidiary's net worth:

Capital stock—common	$100,000.00
Earned surplus January 1, 1936	20,214.80
Net profit January 1, 1936 to June 30, 1936	65,487.44
Total dividend received, representing net assets having a fair market value of	$185,702.24

Without computing the tax, describe the various kinds of Federal taxes for 1936 to which the above items would be subject. If they are exempt from tax, why?

QUESTION 11:

In computing under the 1936 Federal Revenue Act the income tax, excess-profits tax and undistributed-profits tax, which of these taxes may be deducted from the income subject to these taxes?

QUESTION 12:

Do you regard it proper to capitalize overhead on a company's own machinery construction?

QUESTION 13:

The Securities and Exchange Commission has been urging, in some cases compelling, business enterprises to reveal to investors sales and cost of sales. What are the reasons usually advanced against such disclosures? What is your opinion?

QUESTION 14:

An investment company owns bonds of industrial corporations which it has purchased at different times at market. They are carried at cost and adjusted monthly on a pro rata basis so that at maturity their book value will be the redemption price. What is this method of adjustment called and how would you designate the method of valuation on the balance-sheet?

QUESTION 15:

C Company from time to time sells its accounts receivable to a discount corporation, with recourse, 80% of the account being advanced in cash. What balance-sheet notations does this call for? How would you as an auditor determine the unpaid accounts at the balance-sheet date?

BOARD OF ACCOUNTANCY
DISTRICT OF COLUMBIA

EXAMINATION QUESTIONS

NOVEMBER 20, 1936—MORNING SESSION

Commercial Law

Agency

QUESTION 1:

Brown operated an automobile sales agency. He authorized a bank to honor checks drawn on his deposit by his agent, Jones. Brown's death occurs, of which fact the bank has no knowledge, and Jones continues to issue checks against the deposit. Brown's administrator brings suit against the bank to recover the amounts of the checks drawn on the deposit after the death of Brown. Must the administrator win or lose his suit? Why?

Bankruptcy

QUESTION 2:

After start of bankruptcy proceedings, what are the principal duties of the bankrupt?

QUESTION 3:

(a) How does the discharge of a bankrupt affect the liability of others who with him are on joint and collateral obligations?
(b) What becomes of unclaimed dividends in bankruptcy, and when?

QUESTION 4:

(a) What is a composition in bankruptcy?
(b) When may an offer of composition be made, and how must it be accepted?

Contracts

QUESTION 5:

John Doe, with intent fraudulently to escape his creditors, conveys valuable real estate to his brother-in-law, Richard Roe, without consideration, and under an agreement that Richard shall re-convey the real estate back to John at any time John may request. After the lapse of four years, John requests Richard to re-convey to him the said real estate, but Richard refuses to do so. What remedy, if any, has John against Richard?

QUESTION 6:

Williams telegraphed Johnson asking the price of a certain quantity of coal which price Johnson sent. Williams replied that the price was too high. Johnson then telegraphed a lower price. Williams telegraphed back, saying, "consider coal sold, will see you tomorrow and arrange particulars." Williams failed to see Johnson the next day, and afterwards refused to take the coal; Johnson though in the meantime had himself bought a quantity of coal at a certain price with the sale to Williams in view. Williams was sued by Johnson for breach of contract. Could recovery be had? Give reasons for your answer.

Corporations

QUESTION 7:

(a) Can a corporation be sued by one of its stockholders?
(b) To what extent may a corporation make by-laws for the transaction of its business?
(c) What is the substance of the United States Supreme Court decision in the Dartmouth College Case, in the early days of the Republic?

QUESTION 8:

At a meeting of a board of directors at which five members were present, director A moved that the corporation enter into a contract with director B, which contract was very advantageous to B. On vote, directors, A. B and C voted aye and directors D and E nay. The chair declared the motion carried and ordered the contract made. D consults you as to the validity of the action of the board. What would you advise him?

QUESTION 9:

A manufacturing corporation as an accommodation gave its note payable to Brown or order, to enable Brown to raise money for his own personal benefit, and at the same time signed a note of Brown's payable to Green, or order, for the same purpose, designating itself as surety on the latter note. A purchaser of these two notes, before due, for full value and without notice, except the notes, brought suit to recover thereon against the corporation. (a) Can said purchaser recover on the first note? (Why? (b) Can he recover on the second note? Why?

Insurance

QUESTION 10:

The by-laws of a building association provided that all property upon which mortgages were held should be kept insured and the policy deposited with the association, and in the event of a failure of a borrowing member to procure insurance or secure a renewal, this was to be done by the association at his expense. Upon obtaining a loan from the association, John Jones procured insurance and deposited the policy as required by the by-law. When the policy expired he received no notice of it, and the association failed to secure a renewal, and the property being thereafter partially destroyed by fire, Jones sued the association for the loss thus sustained. What should the judgment be, and why?

Negotiable Instruments

QUESTION 11:

(a) State the elements necessary to impress the character of negotiability of an instrument.
(b) In what two important respects does a negotiable instrument differ from one not negotiable?
(c) Under the Negotiable Instrument Act what constitutes a payment of a sum certain, or under what circumstances may a sum payable be said to be a sum certain?

QUESTION 12:

(a) What is the liability of a general indorser of a negotiable instrument?
(b) What is meant by "protesting" paper? How is it done and what is the purpose of it?

Partnership

QUESTION 13:

(a) Can a partner bind his firm by false representations?
(b) What is the fundamental difference between a joint stock company and a partnership?
(c) On what principle and for what reason is one partner liable for all the debts of the firm? Explain fully.

QUESTION 14.

Jay, carrying on a mercantile business, desiring to increase his capital, borrowed $15,000 from Kay under a written agreement to pay Kay annually one-tenth of the net profits of the business in lieu of interest and to repay the principal sum when he should continue business. (a) What was the legal relation of Jay and Kay as between themselves? (b) And as to third persons?

QUESTION 15:

Cummings, to secure an indebtedness of the firm of which he was a senior partner, executed in the name of the firm a mortgage on the real estate of the firm and another on its personal property. Both mortgages were given by Cummings without express authority from his co-partners and there was no subsequent ratification. Were these mortgages, or either of them, binding on the firm?

Sales

QUESTION 16:

White bought goods from Black at a time when White was insolvent and had no expectation of being able to pay for them. He made no false representations. He immediately sold the goods to Green in payment of a pre-existing debt. Green had no knowledge of the foregoing facts. As attorney for Black what action would you advise, and why?

QUESTION 17:

Adams was a traveling man for Blum. He sold goods by sample. He sold Clark a bill of goods which Blum delivered. On his next trip Adams presented Clark with a statement for the goods, and was paid. Adams left the employment of Blum without accounting to him for the payment made by Clark. Blum sued Clark. What was the result, and why?

Taxation

QUESTION 18:

(a) As to method used in the valuation of inventories in determining income under the Federal Revenue Acts, what are the two fundamental requirements?
(b) Under the income tax provisions of the Federal Revenue Acts, when the method of valuation used is cost or market whichever is lower, on what part of the inventory is there an important exception?

QUESTION 19:

A taxpayer in 1931 purchased 500 shares of stock at $125 a share, and in 1934, by reason of the ownership of such stock, received 500 rights entitling him to subscribe to 100 additional shares at $100 a share. Upon issuance of the rights each of the shares of stock in respect of which the rights were issued had a fair market value of $120, and the rights had a fair market value of $3.00 each. The taxpayer exercised his rights to subscribe to the additional shares. Later, he sold one of such shares for $140.00. Compute his taxable gain on the sale, or state the rule applicable to the case.

MISCELLANEOUS

QUESTION 20:

What is the distinction between executor and administrator, if any, and whence do they derive authority?

BOARD OF ACCOUNTANCY
DISTRICT OF COLUMBIA

EXAMINATION QUESTIONS

NOVEMBER 20, 1936—AFTERNOON SESSION

Principles and Practice of Accounting

QUESTION 1:

Explain the following quotation and indicate your reasons for agreeing or disagreeing with it:

"The excess of the gross amount of an obligation over the net proceeds received therefrom represents interest payable at maturity, and on a balance sheet the unaccrued portion of such interest should appear as a reduction of the face value of the indebtedness."

QUESTION 2:

What recommendation would you offer as to the treatment of gains or losses from the sale of treasury stock?

PROBLEM 3:

F, G and H enter into an agreement with a farmers' marketing association to dispose of the peach crop of its members. The three individuals will act jointly as the agent of the association, will share equally in income accruing to them as agent, and will be compensated as follows: $500 each plus one-third each in a bonus based on the net yield to the association. "Net yield" is defined in the agreement as "selling price less freight and commission-dealers' commission and expenses and less compensation to parties of the second part (F, G and H)." The contract further specifies that if "the average net yield is greater than $1 per bushel," the bonus will be "10% of the net yield above $1, 1% of the net yield above $1.12½, and additional one per cent, up to a maximum of 10%, of successive 12½-cent additions to such net yield, it being contemplated that said bonus shall in no event exceed 20% of the net yield above one dollar."

You have been called upon to prepare a statement for presentation to the association, based on your interpretation of the contract, showing the profit to the association and the amount of cash to be paid to each of the three individuals. The crop amounted to 152,564 bushels, and was sold by F ,G and H to commission dealers at an average selling price of $2.20 from which the dealers deducted commission of 6%, freight of $14,713.20, and expenses of $3,289.35. Out of the net proceeds (which were remitted direct to the association) advances were made to F amounting to $8,000 and to G, $2,500.

PROBLEM 4:

Corporation M has an estimated net income for 1936 before Federal taxes of \$5,000,000.00, including \$500,000.00 in dividends from domestic subsidiaries. By virtue of a provision of an indenture dated July 1, 1936, the company is required to set aside \$1,000,000.00 out of earnings for the retirement of its bonds. You are requested to compute for the directors the maximum amount which, under the conditions stated, can be distributed out of the current year's earnings. The tax rates are:

Normal tax rates—
- 8% of first \$ 2,000.00
- 11% of next 13,000.00
- 13% of next 25,000.00
- 15% of remainder

Surtax rates—
- 7% of first 10% of adjusted net income
- 12% of next 10% of adjusted net income
- 17% of next 20% of adjusted net income
- 22% of next 20% of adjusted net income
- 27% of balance of undistributed net income

PROBLEM 5:

You are requested to prepare a suitable statement of assets and liabilities of the XYZ Bondholders' Committee for the XYZ Transit Company. Your statement is to cover all transactions of the Committee during the period from January 1, 1927, the date of its inception, to June 30, 1936.

The records of the Committee are kept on a cash-receipts-and-disbursements basis. From them you derived the following information:

CASH RECEIPTS:	
Proceeds of notes payable to the depositary, the A Trust Company	\$440,000
Contributed by the XYZ Transit Company to the Committee's expenses	38,500
	\$478,500
CASH DISBURSED:	
Depositary fees	\$106,000
Fees to attorneys of the Committee	45,000
Fees to Committee members	7,850
Salary of secretary of the Committee	15,000
Interest on notes payable	132,500
Listing of certificates of deposit on the Stock Exchange	58,000
Advertising, interest, principal payments, etc.	37,825
Printing and stationery	29,850
Mailing and postage	15,675
Sundry Committee expenses	8,675
Clerk hire	5,925
	\$462,300
Deposited with the A Trust Company	\$ 16,200

Other information discovered by you in the course of your examination included the following:

(1) Certain liabilities of the Committee were unpaid at June 30, 1936; these were—

Interest on notes payable for year ended June 30	$26,400.00
Depositary fees and expenses for the period January 1, 1936 through June 30, 1936	8,379.26
Fees to Committee members and attorneys	Undetermined

(2) The notes payable to the A Trust Company bear interest at the rate of 6%, are due on demand and are secured by $58,000,000 6% bonds of the XYZ Transit Company held by the A Trust Company as depositary.

(3) Of $60,000,000 6% bonds of the XYZ Transit Company outstanding, a total of $58,000,000 has been deposited with the Committee.

(4) The XYZ Transit Company has made payments on principal totaling 35% since January 1, 1927. Interest has been paid to date. Principal and interest payments have passed directly from the Transit Company to the bank, as trustee, and thence to the original bondholders.

(5) The depositary agreement provides that expenditures of the Committee are to constitute a first lien against deposited securities to the extent of 1% thereof.

(6) The agreement also provides that title to the bonds deposited with the Committee passes to the Committee. Certificates of deposit equal face value to the bonds have been issued to the depositors.