1935

Examination of May 1935

Minnesota State Board of Accountancy

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

WEDNESDAY, MAY 15, 1935—8:30 A.M. to 12:00 M.

Economics and Public Finance

(Answer ten questions)

QUESTION 1:

There is a provision in a bill now before Congress providing that a 100% tax shall be levied on what are known as "War Profits." Explain the economic theory underlying such a bill.

QUESTION 2:

Name and explain the ways in which double taxation is said to exist in this country, taking into account all forms of taxes levied by either Federal, State, or Local Governments.

QUESTION 3:

(a) What functions has money under present economic conditions? (b) What effect on the general level of prices is noted by a sudden sharp increase or decrease in the money volume? (c) What effect do changes in quantity of money produce on bank credit?

QUESTION 4:

Explain the theory on which the income derived from business is distributed among the various factors involved in the establishment and maintenance of that business.

QUESTION 5:

In the present-day attempts at solving the problems growing out of the world-wide business collapse, how would you distinguish between the fields of economics, sociology and ethics as factors which should be considered?

QUESTION 6:

Much discussion is now being had in governmental circles, both Federal and State, with regard to the American banking system in general, some believing that there should be but a single Federal banking plan with State supervision entirely released, others believing that the present dual system is the best, but that it needs changing at several points, and a few have even suggested that the Federal system should be eliminated. If you had the power to write a law which would cover all of the banking activities in the country, what plan would you write into the law? Do not attempt to detail too closely, but indicate general provisions.

QUESTION 7:

Indicate whether true or false and explain the following: (a) Monopoly prices can be and sometimes are lower than the prices under freely competitive conditions. (b) The selling price of a piece of land is derived from and is dependent upon the annual rent which the land yields. (c) The state has no moral right to tax some people in order to get money to aid others.

QUESTION 8:

The Guffey Bill seeks to legally classify the coal mining industry as a public utility. As introduced, it specifically provides that allowance shall not be made in determining cost for either depletion or depreciation. Explain your views on this matter.

QUESTION 9:

In recent years there has been an increasing tendency in the administration of large industrial or business concerns to effect a separation of ownership and management. While at the beginning in nearly all cases the owners were the managers, it is now true that a large percentage of managerial individuals do not have an ownership interest the equivalent of a year's salary. What are the economic effects of this changed condition?

QUESTION 10:

Explain the economic points involved in Dr. Townsend's Old Age Plan and Senator Long's Share-the-Wealth Plan.

QUESTION 11:

The Work-Relief Bill, carrying the largest peace-time appropriation ever made, has been styled a bill to abolish the dole system. President Roosevelt has laid down the following seven rules for its spending: "1. All jobs must be useful, resulting in permanent improvement in living conditions or future new wealth for the nation. 2. Wages paid are to be larger than the dole but not so large as paid by private industry, so that incentive to take private work will not be lost. 3. A large percentage of the work must provide direct labor. 4. Preference will be shown projects that are self-liquidating with reasonable prospect that the Government will get its money back. 5. Projects will compete as little as possible with private industry. 6. Jobs are to continue until private work is available. 7. Employment will be concentrated where most of the workless are located." Comment on each rule, indicating whether from an economic point of view its effect is likely to be permanent or temporary.

QUESTION 12:

An undisputed statement has been made and printed to the effect that while all securities listed on the New York Stock Exchange have gained in quoted values 18½ billion dollars since January 1, 1933, the quotations on utility securities have shown a 3½ billion dollar loss since January 1, 1933. This discrepancy is probably accounted for by the special drive on the utility field. Discuss the arguments made pro and con with reference to the legislation particularly aimed at utilities.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

WEDNESDAY, MAY 15, 1935—1:00 P.M. to 5:30 P.M.

Practical Accounting

PROBLEM 1:

Adam and Bede are partners in the A. B. Hay & Feed Company. The articles of partnership include the following provisions:

(1) Interest at the rate of 6% is to be credited to each partner's account at the end of the year; the interest computation is to be based on the respective capital accounts as of the end of the preceding year.

(2) Remaining profits, if any, are to be divided equally.

(3) In the case of the death of either partner, the partnership is to be carried on by the surviving partner not more than 60 days after the date of death, at which time final liquidation and settlement are to be made.

Adam died on August 15, 1934. Under the terms of the will, a trust was set up, the life tenant of which was Adam's wife. The remainder men were Adam's two sons. The will provided that the capital of the trust was to be kept intact. The interest in the A. B. Hay & Feed Company was included in the assets of the trust.

The capital accounts at December 31, 1933 were:

Adam	$76,250.00
Bede	37,950.00

Profits were as follows:

7½ months ended August 15, 1934	$12,826.00
9½ months ended October 15, 1934	17,346.20

Bede made a settlement with the trustee of Adam's trust as of October 15, 1934 whereby Bede paid to the trustee $100,000 for Adam's capital as of December 31, 1933 and Adam's portion of the estimated goodwill of the company. In addition, Bede paid the trustee Adam's share of profits for the year 1934 to October 15, 1934.

Set up journal entries recording the above transactions on the trustee's books.

PROBLEM 2:

The Fox Drug Co. was organized July 1, 1926 by Peter Fox and James Cruze. Capitalization of the company consisted of 500 shares of $100-par-value common stock and 750 shares of 7% $100-par cumulative-preferred stock. Fox subscribed for common stock totaling $25,000 in payment of which he turned over to the company certain processes and formulas which were recorded at par. Cruze subscribed for a similar amount of common stock in payment of which he turned over a building which was likewise recorded at the par value of the stock. The preferred stock was sold to outsiders at par.

On June 1, 1928, the company was reorganized in order to secure additional capital for new buildings and certain new types of laboratory equipment. Additional preferred stock of $75,000 was authorized and issued at par as of July 1. The common stock was canceled and 4,000 shares of no-par stock were authorized having a stated value of $25 a share. Each share of old common received four shares of new no-par stock. Fox and Cruze each purchased 1 share of the new common at $25 a share in order to maintain control. The balance of the shares were sold to the public at $37.50 a share. The difference between stated value and sales price was credited to surplus.

Within a short period of time, the company's business began to decline and at December 31, 1933 it was decided to reorganize in order to write off inflated asset values and eliminate unpaid preferred dividends which had accumulated from January 1, 1933. In this connection the officers have asked you to summarize for them from what sources funds have been obtained and for what purposes they had been expended, from the inception of the business in 1926. You are requested to prepare this information.

The trial balance of the company at December 31, 1933 was as follows:

Cash in banks	$ 34,897.78	
Accounts receivable	48,837.26	
Inventories	79,680.56	
Other current assets	4,763.92	
Machinery and laboratory equipment	39,019.17	
Office furniture and fixtures	6,239.26	
Land and buildings	96,592.73	
Formulas, processes, patents and copyrights	20,000.00	
Notes payable		$ 20,000.00
Accounts payable		38,937.72
Accrued liabilities		6,298.00
Other current liabilities		5,726.28
Allowance for depreciation — machinery and laboratory equipment		15,607.68
Allowance for depreciation—office furniture and fixtures		3,119.63
Allowance for depreciation—buildings		9,659.27
Allowance for doubtful accounts		11,519.26
Common stock, no par		100,000.00
7%-cumulative-preferred stock, $100 par		150,000.00
Surplus (deficit*)		30,837.16
	$330,030.68	$330,030.68

*Red.

Additional facts to be considered are:

(1) Common-stock dividends were paid at the rate of $10 a share on December 31, 1927, $3 per share in 1928 and 1929, and $1.50 per share in 1930.

(2) In 1926 and 1927, $20,000 of the formulas account was written off to earnings. During the life of the company, certain rights and processes were sold for $10,000 which were credited to patents.

(3) In 1928, the original building was sold for $38,000. Accumulated depreciation at the time of sale was $2,500.

PROBLEM 3:

From the data following prepare—

(a) An analysis of the reserve for bad debts and losses on repossessions for 1934.

(b) A statement of cost of goods sold for 1934.

The Excelsior Machine Co. produces and sells industrial sewing machines. Certain of its balance-sheet accounts at December 31, 1933 follow:

Receivables	$1,090,000	
Less—Reserve for bad debts and for loss on repossessions	300,000	$ 790,000
Inventories, at cost—		
Finished goods	$ 370,000	
Work in process	40,000	
Raw material	180,000	590,000

Profit-and-loss data for the year 1934:

Net sales	$2,000,000
Purchases of raw material	350,000
Direct labor	250,000
Factory burden	790,000
Repossessions—	
Credits allowed to customers	130,000
Inventory value of repossessed merchandise	80,000
Bad debts charged off, other than on repossessions	8,700
Bad-debt recoveries	5,000

The inventories at December 31, 1934, by physical count, valued at cost, were:

Raw material	$170,000
Work in process	35,000
Finished goods	410,000

It is the policy of the company to set up 1% of net sales as a reserve for bad debts, and to credit all bad-debt recoveries to the reserve.

Inspection of the final inventories shows that burden of $8,500 is included in work in process. Work in process was included in the opening inventories at prime cost. The burden on the opening inventories would have been $9,200 if computed on the same basis as that contained in the closing inventory.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

THURSDAY, MAY 16, 1935—8:30 A.M. to 12:00 M.

Commercial Law

AGENCY
(Answer three)

QUESTION 1:
A, as principal, employed B as his agent to perform certain duties for A, and B entrusted the performance of part of his duties, as agent, to C, without the knowledge of A. C entered into certain contracts, under his employment for A, with D. What is the law with reference to the acts of C with D binding A?

QUESTION 2:
May an agent act for both parties in any contract or other instance? If so, under what circumstances or conditions?

QUESTION 3:
If an agent, without the authority of the principal, intermingles the money of the principal by depositing it in bank in the agent's private account, and the bank fails and the entire deposit is lost, does the loss of the amount fall upon the principal or the agent? Why?

QUESTION 4:
Define: (a) Agency; (b) Principal; (c) Agent.

BANKRUPTCY
(Answer two)

QUESTION 1:
How far is provable in bankruptcy a claim of the bankrupt's landlord for rent to accrue under a written lease having one year yet to run?

QUESTION 2:
What discretion has the trustee in bankruptcy regarding doubtful assets?

QUESTION 3:
When is confession of insolvency an act of bankruptcy? Name several other acts of bankruptcy.

QUESTION 4:
When are the following claims provable: (1) Claims arising on contract; (2) Claims against the bankrupt as indorser; (3) Judgments rendered after the filing of the petition; (4) Claims for damages for breach of contract; (5) Claims for damages for wrongs or injuries?

CONTRACTS

(Answer three)

QUESTION 1:

Black was indebted to Brown on a judgment note in the sum of $500 and the note was past due. Brown was about to enter judgment on the note. Green entered into an oral contract with Brown that in consideration of Brown's refraining from taking judgment against Black on the note, he, Green, would pay Brown the amount of Black's indebtedness. Green would receive no benefit from such forbearance. Brown refrained from taking judgment on the note. Green later refused to pay Black's indebtedness to Brown, and Brown brought action on the oral contract. Can he recover?

QUESTION 2:

In May, 1933, a wealthy publisher offered, through publication in his several newspapers, to award $25,000 to the person whose plan for abating the smoke nuisance was accepted by the municipal authorities of a certain large city. In October of the same year notices of the same type were placed in the same newspapers withdrawing the offer. In November of that year, a young engineer having read the offer but not the revocation, did submit a secret plan he had evolved from much research and study, to relieve the smoke nuisance, and it was accepted and made public by the municipal authorities. He sued the publisher for the award the latter had offered. Should the suit be successful? Give reasons.

QUESTION 3:

What is the cardinal rule of construction of contracts? State six other rules of construction of contracts.

QUESTION 4:

What do you understand by the "Statute of Frauds"? Define: (a) Contract; (b) Consideration; (c) Executory contract; (d) Subrogation.

CORPORATIONS

(Answer three)

QUESTION 1:

The directors of a domestic manufacturing corporation, owning land and machinery, pursuant to a vote of a majority of the stockholders, but against a protest of a minority, propose in good faith to sell and transfer to a new company the whole property of the corporation, taking stock in payment. The minority stockholders desire to restrain the corporation and directors from making such sale and transfer, on the ground that it will not be advantageous to the stockholders, which is a fact. They apply to you; what advice will you give them?

QUESTION 2:

There is a suit by a creditor of a de facto corporation against fifty stockholders to collect a debt of the corporation. The stockholders had in good faith attempted to incorporate under a valid law, and had honestly transacted business as a corporation, although incorporation was not complete. Are the stockholders liable as partners?

QUESTION 3:

What is the "trust fund" doctrine?

QUESTION 4:

Discuss the power the State has over corporations created by it.

INSURANCE

(Answer two)

QUESTION 1:
Explain what amounts to an insurable interest.

QUESTION 2:
Primarily, what is the basis of the liability of members of a mutual insurance company?

QUESTION 3:
Is a contract of insurance assignable?

QUESTION 4:
Briefly define these kinds of insurance policies: (a) Endowment; (b) Tontine; (c) Assessment; (d) Old Line; (e) Blanket; (f) Voyage.

NEGOTIABLE INSTRUMENTS

(Answer three)

QUESTION 1:
State the effect of giving authority in a note to sell collateral securities.

QUESTION 2:
Lea executed and delivered to Perrin a promissory note in the following form: "For value received, on or before June 30, 1932, I promise to pay to Stanislaus Perrin or order Nine Thousand Dollars, or at his option, give the holder all my interest in Patent XB-73941. (Signed) Leo Lea, at Baltimore, Maryland, January 1, 1932." Is the instrument negotiable in this form?

QUESTION 3:
Who is a "holder in due course?"

QUESTION 4:
Name the different kinds of endorsements. When was the "Negotiable Instrument Law" first adopted, and what is its purpose?

PARTNERSHIP

(Answer three)

QUESTION 1:
Blaine, Bates and Bennett were partners as second-hand car dealers. By the articles, they were to share the profits equally. No provision was made as to losses. Blaine had contributed $12,000, Bates $8,000, and Bennett nothing, to the capital. After running a year and losing half their capital, they decided to wind up the business. As between themselves, what are their respective rights and obligations?

QUESTION 2:
Doe and Roe were copartners. Doe owed X $4,000. To settle this account Doe gave X a note for $4,000 signed by himself, and indorsed by him with the firm name, Doe & Roe. The note being unpaid at maturity, X sued the firm of Doe & Roe. Roe alone defended. The evidence showed that Roe knew nothing of the transaction until the note was overdue. Doe was unable to pay the note, but the firm of Doe & Roe had such ability. Was the firm liable? Explain.

QUESTION 3:
John Bradley was employed as a clerk on salary by a firm doing business as John Bradley & Company. Adams, who knew Bradley, went to the store of the

firm, found Bradley, and, after talking with him alone, sold goods of the kind dealt in by the company, which later were billed to and delivered to the firm. Adams did not ask who constituted the firm of John Bradley & Company, did not know, and was not informed by Bradley. Adams sued Bradley individually for the bill. Can he recover?

QUESTION 4:
To what extent, if any, is a firm liable for the torts of a partner? Briefly define, so to differentiate, the following: (a) Limited Partnership; (b) Joint Stock company; (c) Voluntary association.

SALES

(Answer three)

QUESTION 1:
What do you understand by the terms (a) Law Merchant; (b) Uniform Sales Act?

QUESTION 2:
Define: (1) Express warranties; (2) Implied warranties; (3) Sale.

QUESTION 3:
Zimmer, a dealer, ordered from Zander 500 cases of liquor at $25 a case, f.o.b. point of delivery, terms of payment, thirty days. After the goods had been shipped, and before reaching destination, the seller learned that Zimmer had become insolvent, and he then stopped the goods in transitu. Zimmer had sold the liquor to Zeigler, at a profit of $5 a case. Because of Zander's failure to deliver the liquor, Zimmer brought suit to recover the loss he had sustained. Was he entitled to recover? Give reasons.

QUESTION 4:
When does title pass under a conditional sale? When does title pass under a sale on trial or approval?

TAXATION

(Answer three)

QUESTION 1:
What do you understand by the term "direct tax," as used in the Constitution of the United States?

QUESTION 2:
Why is it that a personal property tax is said to be a "tax on conscience"? What reforms, if any, would you advocate in the matter of taxation, State or Federal?

QUESTION 3:
Name the Federal excise taxes now in effect which directly touch almost all business concerns?

QUESTION 4:
If you believe any of the provisions of the present Federal income tax law, with respect to determining net income, are inconsistent with sound accounting, name such provisions, or as many as five.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

THURSDAY, MAY 16, 1935—1:00 P.M. to 5:30 P.M.

Practical Accounting

PROBLEM 1:

The New Deal Subsidiary Corporation is wholly owned by the New Deal Corporation. You have been called in by the trustee for the 6% debentures of the New Deal Subsidiary Corporation to prepare a balance sheet of that company as of December 31, 1934.

In examining the indenture, you discover the following provisions:

> "The New Deal Corporation guarantees that the net earnings of the New Deal Subsidiary Corporation during each year shall be at least 150% of the annual interest charges on all its indebtedness outstanding at the end of the year. 'Net earnings,' as referred to herein, shall be the excess of cash receipts over cash disbursements before interest deductions. The New Deal Corporation further guarantees that so long as any of the 6% debentures of the New Deal Subsidiary Corporation are outstanding, the value, not exceeding market, of the tangible assets of the subsidiary at the end of each year shall be at least 125% of the total amount of all its funded debt and notes payable. The New Deal Subsidiary Corporation shall, upon determination of any deficiency or deficiencies, as set forth above, bill the New Deal Corporation for such deficiency or deficiencies, and adjust the balance sheet and profit-and-loss statement at the end of each year to conform with the requirement of the indenture. The New Deal Corporation shall pay such deficiency or deficiencies in cash."

Other facts discovered in the course of your examination are:

There were no additions to fixed assets in 1934, but fixed assets totaling $56,500 were charged to the reserve for depreciation.

The amount of accounts receivable written off against the reserve for bad debts during 1934 was $24,000.

Market values at December 31, 1934 of $100-par common stock of the Q.E.D. Company, the 7% preferred stock of the I.O.U. Company, and the no-par value stock of the F.O.B. Company were 60, 50 and 42½, respectively.

THE NEW DEAL SUBSIDIARY CORPORATION

Debits	Trial Balances After Closing Dec. 31, 1933	Trial Balances Before Closing Dec. 31 1934
Fixed assets	$ 5,256,500	$ 5,200,000
Amortization of debt discount and expense		30,000
Inventories	384,000	588,000
Prepaid interest		12,000
Cash	625,000	498,000
Operating expenses (including provisions for depreciation and bad debts)		1,128,500
Customers' accounts receivable	439,000	275,000
Unamortized debt discount and expense	277,500	247,500
Other interest expense		6,000
Property taxes		80,000
Investments (see schedule below)	4,850,000	4,850,000
Interest on funded debt		420,000
	$11,832,000	$13,335,000
Credits		
Common stock, no-par value, 6,000 shares	$ 3,000,000	$ 3,000,000
Reserve for bad debts	78,000	78,000
Sales to customers		981,000
Accrued property taxes	200,000	245,000
Reserve for depreciation	897,000	1,014,000
5% note payable September 1, 1935		360,000
Reserve for losses on investments		255,000
6% debentures, due April 1, 1943	7,000,000	7,000,000
Earned surplus	552,000	297,000
Accrued interest on funded debt	105,000	105,000
	$11,832,000	$13,335,000

INVESTMENTS

Q. E. D. Company	$100-par common stock	17,500 shares	$1,750,000
I. O. U. Company	7% preferred stock	11,000 shares	1,100,000
F. O. B. Company	No-par common stock	40,000 shares	2,000,000
			$4,850,000

PROBLEM 2:

A and B are the inventors of a process having to do with the production of sheet metal, and applications for letters patent covering the process were filed in their names prior to June 15, 1932. On that date an indenture was drawn creating a trust which had for its purposes the acquisition and holding of the applications and the resultant letters patent, the development of the process and the distribution of royalties received from manufacturers operating under the patents. The administrators named in the indenture were A and B and their fees for services rendered in this capacity were fixed at $10.00 per month each, commencing July 1, 1931.

On June 16, 1932, C, D, E and F purchased shares of beneficial interest in the trust at a price of $25.00 per share as follows:

C	250 shares	E	25 shares
D	30 shares	F	95 shares

Exclusive right and title to the applications and the resultant letters patent were acquired by the trust from A and B for $10,000.00, payable $5,000.00 in cash and $5,000.00 in 200 beneficial-interest shares. The cash and shares were paid to A and B in equal amounts.

On July 10, 1932, the trustees negotiated a $3,000.00 loan due in one year with interest at the rate of 5% payable in advance, the proceeds to be used in the development and perfection of the process and in defraying such legal and other expenses as might arise in connection therewith. The loan was repaid at maturity.

Development of the process was completed prior to December 31, 1932 and the total amount of development and legal and other expenses incurred by the trust on this account was $6,566.35.

Through the efforts of a promoter, licenses were granted to several operators shortly after the completion of the development work. The licenses provided for the payment of royalties by the operators on the basis of $2.00 per ton of production under the licenses, and the trustees contracted to pay the promoter for his services at the rate of $.25 per ton.

The combined output under the patents of all licenses in the four six-month periods ended December 31, 1934 follows:

Six Months Ended	*Tons*
June 30, 1933	7,230
December 31, 1933	10,433
June 30, 1934	16,187
December 31, 1934	15,208

Royalties due the trustees under the licenses were received by the trustees monthly.

On June 30, 1933 and at the end of each six-month period thereafter, the trustees distributed dividends to the beneficial owners of the trust, as follows:

June 30, 1933	$10,200.00
December 31, 1933	17,400.00
June 30, 1934	28,308.00
December 31, 1934	27,600.00

Prepare an analysis of trustees' cash account showing the total amount of dividends distributed to each of the beneficial owners and the balance of cash on hand at the end of each of the six-month periods beginning July 1, 1932 and ending December 31, 1934.

PROBLEM 3:

The Stanley Implement Company reported net taxable income for the calendar year 1934 of $150,000.

Compute the estimated excess-profits tax payable for 1935, if any, after giving consideration to the following transactions recorded in 1934:

(a)	Dividends paid to stockholders	$80,000
(b)	Interest earned on Cook County Poor Relief Bonds	25,000
(c)	Loss realized on sales of Ajax Building Corporation bonds	42,000
(d)	Income tax for 1934	20,625
(e)	Dividends received	45,000

The value declared on the company's capital stock at December 31, 1933, as reported on its 1934 capital-stock tax return, was $800,000. Present estimates are that taxable net income for 1935 will be $132,000.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

FRIDAY, MAY 17, 1935—8:30 A.M. to 12:00 M.

Auditing

(Answer ten questions including No. 1 and No. 8)

QUESTION 1:

Draft a form of certificate to accompany the financial statements you have prepared for Best Products Company of New York. The balance sheet indicates a net worth of $10,000,000. Your examination for the fiscal year ended March 31, 1935 has just been completed and you have complied, with certain exceptions, with the minimum requirements laid down in the pamphlet, "Verification of Financial Statements." The exceptions are:

(a) You have made no examination of the assets of a foreign subsidiary which consist of cash and receivables totaling $22,000 after conversion at the current rate of exchange.

(b) You have circularized neither debtors nor creditors.

(c) You have found inadequate provision for bad debts in the amount of $50,000.

QUESTION 2:

In your 1934 audit of the accounts of a paving contractor, you find that payments of more than $100,000 have been made during the current year to public officials responsible for securing contracts for the company, the charge having been made to advertising expense. These payments amount to more than one-half the total selling and administrative expenses for the year. Would you regard their disclosure vital to your certificate or financial statements? If the disclosure is agreed to, illustrate the procedure you would employ.

QUESTION 3:

In a pamphlet issued recently by a local civic association appears the statement, "when the annual expenditures of a city are referred to, what is meant are the disbursements of the general fund?" Discuss the meaning of "general fund" and, in general, the truth of the quoted statement.

QUESTION 4:

Enumerate briefly the steps you would take in a security count where there are some two hundred items.

QUESTION 5:

In your audit of a large manufacturing company you discover that the directors have authorized the yearly distribution to major officers of a bonus equal to

2% of net profit. The president of the company has taken the position that in arriving at the figure on which the 2% should be applied, neither Federal income tax nor the bonus itself should be deducted. What argument would you advance in favor of or in opposition to the president's stand?

QUESTION 6:

During a first audit of a brokerage concern for which you are being compensated at regular per-diem rates, you bring to light a cleverly concealed defalcation on the part of an unbonded employee which has been accumulating over a period of years and which exceeds $100,000. By your prompt report of the matter, the employee is apprehended and most of the funds are recovered. Do you believe you are justified in asking the clients for additional compensation for yourself beyond your regular per diems?

QUESTION 7:

In the course of your audit of a corporation you learn that during the year a large sum was loaned to the president for the purpose of maintaining the market price of the company's common stock. His trading operations were fortunate in that they resulted in substantial profits to himself. Before the close of the company's fiscal year the loan was repaid by the president, with interest. In view of the fact that no indebtedness owing from the president existed on the balance-sheet date, would it be proper to omit from your report any mention of the transaction?

QUESTION 8:

Outline briefly the minimum requirements in a large department store of a system of internal check that should safeguard the handling of receipts on account from customers.

QUESTION 9:

What audit procedure should accompany your first examination of the capital-stock account of a company?

QUESTION 10:

The vice-president in charge of the credit department of a bank, having been given a copy of a customer's annual audit report you have just completed, asks you to confer with him on certain questions which he feels that with your knowledge of the business you can easily answer for him. In view of the confidential relationship which exists between the professional accountant and his client, would you feel free to answer his questions?

QUESTION 11:

How would you display minority stockholders' interest on a consolidated balance sheet?

QUESTION 12:

In your report on the accounts of a listed company how would you call attention, if at all, to the fact that this year's compensation to officers has increased from $200,000 in 1933 to $450,000 in 1934 by virtue of a bonus plan approved by the board of directors at the beginning of the latter year? Net profit for 1933 was $17,000 as compared with net profit after bonus in 1934 of $360,000.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF MAY 1935

FRIDAY, MAY 17, 1935—1:00 P.M. to 5:00 P.M.

Accounting Theory

(Answer ten questions)

QUESTION 1:

In the prospectus of a short-term note issue you find a statement reading, "net profit before any deduction for interest and before providing for depreciation has averaged for the last five years two and one-half times the interest requirements of this issue presently to be outstanding." If a prospective investor should ask you to discuss with him the meaning of this statement, what would you tell him?

QUESTION 2:

A certain manufacturing enterprise prior to the depression enjoyed a working-capital ratio of approximately 2 to 1. Now, with a greatly reduced volume and despite the payment of dividends throughout the depression from surplus previously accumulated the ratio has risen to nearly 10 to 1. Explain how this apparent paradox may exist.

QUESTION 3:

A music publisher has charged the cost of plates (from which the music is printed) to a capital-asset account which he depreciates at the rate of 5% annually. The depreciated book value of plates has risen each year notwithstanding a more or less constant volume of sales and a rather consistent book net profit. You learn that many of the published numbers sell for years, while others have a life of only a few weeks and that any forecast of future sales of publications would be impossible. Outline a depreciation policy which you believe the publisher should adopt in preference to the one now in force.

QUESTION 4:

What general principles should be observed in the valuation of investments (an asset)?

QUESTION 5:

X company owns five manufacturing plants, one of which has been completely shut down for more than a year. Should depreciation be taken on this plant and, if so, how should it be reflected in the income or surplus accounts?

QUESTION 6:

In preparing consolidated statements—

a. What part of the surplus of a subsidiary company may be taken up as earned surplus?

b. How should dividends on preferred stock of a subsidiary in the hands of the public be treated in the consolidated income account?

c. If a company owns 95% of the stock of a company which sustained a loss of $100,000 in 1934, what loss should be reflected in the consolidated income account?

QUESTION 7:

If a company filed a Federal capital-stock tax return in 1934 assigning a value of $8,000,000 to its capital stock, had a net taxable income for 1934 of $1,500,000, and paid out $200,000 in dividends during the year, what proportion of the income, if any, will be subject to the excess-profits tax?

QUESTION 8:

By the terms of a trust indenture, a company is required to deposit $100,000 annually on April 1, in a sinking fund for the retirement of funded debt. In preparing a balance sheet as at December 31, what, if any, effect does this provision have on the statement?

QUESTION 9:

What is the significance of the term "going value" when applied to industrial companies?

QUESTION 10:

M. Company commenced operations July 1, 1934, with an authorized and subscribed capital of $200,000, one half paid in by July 5, 1934. No further demands have been made on subscribers and at December 31, 1934 you find that the $100,000 paid in in cash is probably ample for the present scale of the company's operations. Stock certificates have been issued in the amount of the $100,000 paid in. What are your suggestions for reflecting the unpaid subscriptions on the balance sheet?

QUESTION 11:

Distinguish between the terms "consolidated balance sheet," "consolidating balance sheet," and "combined balance sheet."

QUESTION 12:

A client sold several blocks of securities during 1934. These securities had been received as gifts from the client's parents at various dates since December 31, 1920. Several items had been held by the parents since March 1, 1913.

(a) What information would be required for the purpose of computing profit or loss?

(b) How does the Revenue Act of 1934 limit losses resulting from these sales?