

1935

Examination of November 1935

Minnesota State Board of Accountancy

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MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

WEDNESDAY, NOVEMBER 13, 1935—8:30 A. M. TO 12:00 M.

Economics and Public Finance

(Answer ten questions)

QUESTION 1:

List the various economic effects upon the United States which will result from the conflict between Italy and Ethiopia, distinguishing with regard to each one as to the difference if Italy is successful or if Ethiopia is successful, and also indicating the differences arising from a short conflict and those which would follow a prolonged war, together with a statement of different effects which might be produced if the conflict became general rather than confined to the two nations in question.

QUESTION 2:

Economic policies are often determined by political expediency. With the Presidential election coming on in 1936, if you were a candidate for the Presidency against the present incumbent either in his own party or in another party, realizing the importance of the "farm vote," so called, what economic idea would you put forth as being better for the farmer than the agricultural policy under which the country is now operating. Give reasons therefor.

QUESTION 3:

On the theory that "land is the original source of all material wealth, and that life itself is dependent upon it" and defining land from an economic viewpoint as including all natural resources and productive power included in and controlled by the possessor of the earth's surface, explain the various ways in which land is a productive agent, including a statement as to the ways in which the productive power of land is limited.

QUESTION 4:

A Governmental unit needs the auditing services of a hundred men. It establishes an auditing staff and employs a hundred C.P.A's. Another Governmental unit need auditing information which would require the same number of men for the same period of time. It decides that instead of establishing a staff of its own it will employ enough independent accountancy practitioners to furnish

them with independent audits based on procedure which it determines. Three groups are interested as the result of these audits: a. The Government as a whole, by reason of the possible returns to it from powers of taxation enjoyed by it; b. The business units whose records will be examined and who may later be obliged to report to the Government for errors of omission or commission, and who may be benefited by suggestions brought out in the reports; c. The hundred certified men who in the first instance will be Government employees and in the second will be independent practitioners, either employers or employees.

Explain the different ways in which each group may be affected, depending upon whether the work is done by a Government unit for itself or by an independent practitioner for the Government.

QUESTION 5:

List the various factors which have their effect in determining the efficiency of labor, indicating in each case your idea as to how labor efficiency may be increased in connection with each of the factors named.

QUESTION 6:

Much was said in connection with the Utilities Bill before the last Congress, which would lead one to believe that utility magnates are highly dangerous citizens. The official records show that the cost of electricity in 1913 averaged 8.1c per kilowatt hour; in 1930, 6.6c; in 1932, 6.4c; in 1935, 5.6c.

List and explain the various factors involved in this decrease in the cost of electricity to the individual consumer.

QUESTION 7:

Name what you consider to have been the greatest accomplishment of the various types of legislation usually denominated as the New Deal, giving your reasons. At the same time indicate the attempt which you believe has had the most serious lasting effect upon the economic condition of the country.

QUESTION 8:

In discussing economic conditions and measures there has been a consistent attempt to label humanity as belonging to either the industrial or business class, the laboring class or the consumer class and then to attempt to develop balanced equations in their respective relationships. In general the consumer wanted to buy things cheaper; the laborer wanted to get more for his services; the industrialist wanted to obtain a larger profit, which usually meant a higher price.

Economic life is as full of hazards as physical life. List the ever-present risks confronting each of these groups.

QUESTION 9:

It has often been said that we are passing through a peaceful revolution. Indicate the differences which history will record between the recent and present years as distinguished from the changes occurring in that period usually referred to as the Industrial Revolution.

QUESTION 10:

Explain the part which credit plays in the maintenance of an extended business system.

QUESTION 11:

Define Value, Price, Demand, Diminishing Utility, Distribution.

QUESTION 12:

Explain the differences between economic and business concepts of cost.

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

WEDNESDAY, NOVEMBER 13, 1935—1:00 P. M. TO 5:30 P. M.

Practical Accounting

PROBLEM 1:

The Universal Manufacturing Company was unable to meet the semi-annual interest payment due September 1, 1931, on its 6% first-mortgage bonds and on its 7% gold notes, both issues maturing March 1, 1938; the principal amounts outstanding at the date of default were \$3,250,000.00 and \$1,700,000.00, respectively. At the instance of the indenture trustees, receivers were appointed to take over the assets and to continue the operation of the company as at September 1, 1931. On October 15, 1934, a petition was approved by the court authorizing a reorganization in accordance with the provisions of section 77B of the Federal Bankruptcy Act. A plan of reorganization, effective March 31, 1935, was approved by the court; included therein were the following provisions for the liquidation of existing obligations:

For each \$100.00 in principal amount of 6% first-mortgage bonds (with September 1, 1931, and subsequent interest coupons attached), new securities to be issued as follows:

\$50.00 in principal amount of 6% first-mortgage refunding bonds, dated February 1, 1935, and due in ten years, and

2½ shares of Class A stock of no-par value.

For each \$100.00 in principal amount of 7% gold notes (with September 1, 1931, and subsequent interest coupons attached), new securities to be issued as follows:

\$20.00 in principal amount of 6% refunding notes, dated February 1, 1935, and due in ten years, and

1 share of Class A stock of no-par value.

For each \$100.00 of general claims (trade accounts payable, etc., totaling \$52,500.00), new securities to be issued as follows:

\$20.00 in principal amount of 6% refunding notes, dated February 1, 1935, and due in ten years, and

1 share of Class A stock of no-par value.

For each 5 shares of outstanding \$100-par-value preferred stock (of which there is a total of 25,000 shares), 1 share of new Class B stock of no-par value will be issued.

The 100,000 outstanding shares of \$10-par-value common stock are to be canceled without consideration.

No provisions for interest accruing on the bonds and notes subsequent to

September 1, 1931, have been entered on the records of the corporation. A capital-surplus account of \$549,367.00 was created in a prior year through appreciation recognized from an appraisal of the land, buildings and machinery. The earned-surplus account contained a debit balance at December 31, 1934, of \$2,163,058.29, which was reduced at March 30, 1935, by the net profit to that date, per books, of \$25,119.17. The minutes of the board of directors contain a resolution to charge the earned-surplus deficit at March 31, 1935, subject to adjustments thereto, against the existing capital surplus and the surplus resulting from the reorganization.

The court has approved the fees of attorneys and others, in connection with the reorganization, totaling \$275,000.00, but no entry therefor has been made. The board of directors has also approved the payment of the above fees along with the following unentered items, which appear to be proper, as charges against the existing capital surplus and the surplus resulting from the reorganization:

Additional provision for losses on deposits in closed banks	\$ 150,000.00
Additional provision for bad debts.....	50,000.00
Write-off of unamortized bond and note discount and expense	63,047.12
Write-off of obsolete inventories.....	119,000.00
Reduction of book value of abandoned plant to estimated salvage value	2,150,000.00
	=====

A stated value has been placed by the board of directors on the new Class A stock of \$10.00 per share, and on the new Class B stock of \$1.00 per share.

From the foregoing information, prepare the following:

Statement of surplus accounts for the three months ended March 31, 1935.

Statement showing the obligations liquidated in reorganization, the new securities created and the resulting increment from each class of liability liquidated, as at March 31, 1935.

PROBLEM 2:

As at November 1, 1935, A Company refunded its defaulted mortgage obligations into a single issue of 4½% first-mortgage bonds, due in 6 equal biennial installments from November 1, 1937 to November 1, 1947. The new issue was sold to bankers so as to yield the company 97 after all expenses. Details of the old issues follow:

<i>Nature of Obligation</i>	<i>Maturity</i>	<i>Unamortized Discount and Expense (Bonds- Outstanding Principal Basis) at</i>			
		<i>Unpaid</i>	<i>Nov. 1, 1935</i>		
First-mortgage 6% notes	May 1, 1940	\$450,000.00	\$13,500.00		
5½% purchase-money obligations	\$10,000 each Jan. 1	60,000.00	1,150.00		
7% debentures	{ \$60,000 Mar. 1, 1936 } { 60,000 Mar. 1, 1937 } { 90,000 Mar. 1, 1938 }	210,000.00	1,550.00		
Totals		\$720,000.00	\$16,200.00		
		=====	=====		

Compute on two or more bases the discount and expense to be charged to profit and loss for the two remaining months of 1935.

PROBLEM 3:

From the following unclassified data taken from the comparative balance sheets and the books of the Rale Manufacturing Company, prepare a statement of application of funds for the year ending December 31, 1934.

Increases or causes of increases in balance-sheet accounts—		
Provision for depreciation on buildings	\$6,000.00	
Building, representing cost of new wing	52,000.00	
Machinery, representing—		
New Machinery purchased	\$28,000.00	
Less—Machinery sold for \$7,000.00 (profit included as current operating income), cost	10,000.00	18,000.00
		<hr/>
Ten-year sinking-fund first-mortgage bonds sold at 90 on January 2, 1934	200,000.00	
Unamortized bond discount and expense at December 31, 1934.....	18,000.00	
Sinking-fund cash	20,000.00	
Sinking-fund reserve (charged to surplus)	20,000.00	
Net operating profit for year ending December 31, 1934	250,000.00	
Prepaid life-insurance premiums (prepaid to December 31, 1936) ...	12,000.00	
Amortization of prepaid insurance charged to surplus	12,000.00	
Dividends receivable on life-insurance policies (offset credited to surplus)	2,500.00	
Cash surrender value of life-insurance policies (offset credited to surplus)	9,000.00	
Decreases or causes of decrease in balance-sheet accounts—		
Reserve for fire loss, consisting of cost of replacing building de- stroyed by fire, \$75,000.00, less annual credit to account, charged to operations as an expense, \$5,000.00	70,000.00	
Reserve for depreciation on machinery representing—		
Depreciation accrued on machinery sold	\$6,000.00	
Less—Depreciation charged to operating expense	5,500.00	500.00
		<hr/>
Patents written off	2,000.00	
Preferred stock retired at a premium of 10%, which premium was charged to surplus; par value	300,000.00	
Dividends paid on preferred and common stocks	75,000.00	
Decrease in working capital	149,500.00	
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MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

THURSDAY, NOVEMBER 14, 1935—8:30 A. M. TO 12:00 M.

Commercial Law

AGENCY

(Answer three questions)

QUESTION 1:

Name the three general classes of agents, and define each.

QUESTION 2:

- (a) Give the general rule governing the scope of an agent's authority.
- (b) For what purpose may an agency be created?

QUESTION 3:

The Johnson Company gave credit to Adams who was really the agent for Bailey. The agency was unknown at the time, but it was ascertained after Bailey failed. Could Adams be held for the obligation?

QUESTION 4:

A, who was general agent for his principal, submitted a matter to arbitration. The principal refused to perform the award. The other party to the award brought suit to recover on the award. Can he recover?

BANKRUPTCY

(Answer two questions)

QUESTION 1:

- (a) What is the legal status of referees in bankruptcy?
- (b) And how are they appointed and removed?

QUESTION 2:

How is the trustee in bankruptcy selected?

QUESTION 3:

Is an adjudication in bankruptcy against the partners as individuals necessary to one against the partnership?

CONTRACTS

(Answer three questions)

QUESTION 1:

Give the essentials of a valid contract.

QUESTION 2:

Define void, voidable, and unenforceable contracts.

QUESTION 3:

While M, a woman twenty-one years of age, was convalescing from a severe attack of fever, the physician who was attending her persuaded her to enter into an agreement to convey to him certain of her property for an inadequate consideration. Upon what grounds, if any, could M resist an action on this contract?

QUESTION 4:

A, the owner of a cotton mill, contracted with B, who was a manufacturer of machinery, for some machinery to be used by A in the manufacture of a new type of cotton goods, the machinery to be completed by a certain time. A then contracted with C, a wholesale dealer, to deliver to C a large quantity of this new type of cotton goods by a certain date, and on the strength of this, C secured many orders from retailers for the cotton goods, and contracted to deliver same by a certain date. B violated his contract by failing to complete and deliver the machinery, and by reason of this breach, A was unable to fulfill his contract with C, and C, being unable to deliver to the retailers, suffered great loss. C sued B for breach of contract. Can he recover? Explain your answer.

CORPORATIONS

(Answer three questions)

QUESTION 1:

- (a) Name some of the powers impliedly conferred upon every corporation.
- (b) Name some of the powers which will not be implied.

QUESTION 2:

A stockholder in a corporation pledged his stock with a bank as collateral for a loan. In whom did the voting power then reside?

QUESTION 3:

A manufacturing corporation operated a motor bus between its plant and an adjoining city, charging a regular fare for transportation of passengers. Thomas Brown, while a passenger on this bus, sustained serious personal injuries through the negligence of the driver, and thereupon sued the corporation in tort for damages. It appeared from the evidence that the corporation had exceeded its authority in operating the motor bus, and that such operation was clearly ultra vires. Can Brown recover damages? Explain your answer.

QUESTION 4:

A had a judgment against B, C, and D, who owned all the stock in a corporation, and who had no property except this stock. Could A collect his judgment by levying an execution on the property of the corporation; and why?

INSURANCE

(Answer two questions)

QUESTION 1:

What is insurance, and how did it originate?

QUESTION 2:

What are the principal classes of insurance that have been developed in comparatively recent times?

QUESTION 3:

- (a) What is the basis of the contract of insurance?
- (b) What is mutual insurance?

NEGOTIABLE INSTRUMENTS

(Answer three questions)

QUESTION 1:

- (a) What is negotiable paper?
- (b) What was the original purpose of negotiable commercial paper?
- (c) Name the essentials to a negotiable bill or note.

QUESTION 2:

What implied warranties are made by an endorser of negotiable paper?

QUESTION 3:

A owed B \$500, money lost at gambling, and signed a promissory note in regular form for the amount. B discounted the note at his bank before maturity. A refused to pay the note to the bank when it became due, and when sued set up the defense that it was a gambling contract. Could the bank recover of A?

QUESTION 4:

- (a) When must a check be presented for payment, and what are the consequences if it is not presented for payment when it should have been?
- (b) Are the words "for value received" and "or order" necessary to negotiability of an instrument; if not, what purpose, if any, do they serve?
- (c) In case of a demand note, it is clear you might safely buy it on the day of its date, or the day after. But how long a time from its date must elapse before such a note becomes stale, and you are put upon inquiry by reason of its having been so long outstanding and unpaid?

PARTNERSHIP

(Answer three questions)

QUESTION 1:

(a) What are some of the tests by which we can determine whether the parties intended to enter into a partnership?

(b) Is a partner's interest subject to levy and sale on execution for his individual debts?

QUESTION 2:

(a) M and Y were partners conducting a mercantile business. M having died, Y wound up the partnership affairs, the time occupied in so doing being about six months. In the distribution of the partnership effects, Y claimed compensation for his services. Was he entitled to it?

(b) Blair was admitted into the firm of Brown & Company on January 1, 1935. At that time the firm was indebted, among others, to Edwards. The firm becoming insolvent and the assets and those of the other partners being insufficient to pay its debts, Edwards sought to hold Blair liable individually for the deficit on his claim. Can he do so?

QUESTION 3:

A partnership agreement provided for a definite term. Upon the expiration of that term the partnership was continued without any new agreement. How does this affect the partnership?

QUESTION 4:

A, B and C, having formed a lawful partnership, engaged in the manufacture of office furniture. A and B agreed that it was necessary for the firm to purchase some new machinery, but C claimed that such machinery was unnecessary, and refused to agree to its purchase. A and B constituted a majority of the firm. What remedy have A and B if C persisted in his refusal?

SALES

(Answer three questions)

QUESTION 1:

(a) What is the maxim of caveat emptor, and to what defects does it apply?

(b) What implied warranties of quality are there on a sale of chattels?

QUESTION 2:

(a) Define delivery and give the different kinds.

(b) What is the effect of a delivery of a greater quantity of goods than that contracted for?

QUESTION 3:

A sent an order to B in these words: "Send me by American Express Company, C.O.D., 3 dozen instruments, No. 88, your catalogue, \$48 each." The goods being tendered A by the Express Company, he refused to pay the price until he had an opportunity to examine them. Was he so entitled?

QUESTION 4:

K and F entered into a written contract for the sale and delivery of goods. After delivery of part of the goods the contract was cancelled by word of mouth. F sued K for damages for failure to deliver the balance of the goods, and contended that the oral cancellation of the contract was insufficient. Was this contention good?

TAXATION

(Answer three questions)

QUESTION 1:

- (a) Distinguish between fees and taxes.
- (b) Name six states of the Union that have income tax laws.

QUESTION 2:

Under the Federal Income Tax Law, what is constructive receipt of income? Cite two examples of constructive income.

QUESTION 3:

What is the nature of the Federal Estate Tax and against whom is it a charge?

QUESTION 4:

To what extent may the Commissioner of Internal Revenue promulgate regulations under a Federal Revenue Law giving him authority to make such regulations?

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

THURSDAY, NOVEMBER 14, 1935—1:00 P. M. TO 5:30 P. M.

Practical Accounting

PROBLEM 1:

From the information following, compute the interests of parent company and minority stockholders in the earned surplus and current year's earnings of subsidiaries, using the basis established by the company.

Bryan Oil Co. holds a controlling interest in five subsidiary companies which were established by it in past years to take over certain acquired marketing outlets. The charter of each of these companies provides that if preferred-stock dividends are in arrears for three or more years, voting control will pass to the preferred stockholders. Hence in the process of consolidating the accounts, subsidiary earnings or losses have always been divided between majority and minority interests, as follows:

(1) Profits, after deduction of preferred dividends for the year, are divided on the basis of common-stock ownership.

(2) Losses, after provision for preferred dividends for the year, are absorbed in their entirety by the parent company.

Data relating to the subsidiaries and stock ownership therein follow:

	<i>Earned Surplus</i>	<i>Net Profit for Year Ended</i>	<i>Common Stock Owned by Bryan Oil Co.</i>	<i>6% Preferred Stock (Par Value \$100)</i>	
				<i>Shares Outstand- ing at 12-31-34</i>	<i>Owned by Bryan Oil Co.</i>
Oker Oil Co.	\$ 4,397.86*	\$1,057.86*	51%	600	10%
River Oil Co.	10,497.86*	3,860.72	60	700	None
Colt Oil Co.	14,963.40	6,740.98	51	600	20%
Ripper Oil Co.	3,290.48*	7,498.20	55	400	25
White Oil Co.	9,247.68*	5,742.90	51	800	5

All preferred-stock dividends to January 1, 1934, were paid prior to that date, notwithstanding the existence of a deficit, the parent company having guaranteed all accounts with creditors. No dividends were paid or accrued in 1934.

PROBLEM 2:

F. L. Williams, an attorney, has asked you to determine his Federal income-tax liability for the calendar year 1935 based on estimates for the year which he has furnished you. He is married and has three children, 20, 16 and 15 years of age. Mrs. Williams has no separate income.

An analysis of Mr. Williams' estimates revealed the following receipts:

1. Salary as attorney for Board of Education, DuPage County..... \$ 1,200.00
2. Share of income of partnership, Williams, Pope and Jones, as shown by partnership return..... 25,250.00
3. Dividends from domestic corporations..... 12,500.00
4. Dividend from exempt Building and Loan Association..... 350.00
5. Cash royalties received from oil lands..... 3,250.00
6. Proceeds from sale of securities..... 62,425.00
7. Interest on mortgage notes..... 2,785.00

Estimates of expenditures were as follows:

1. Contributions: Community Chest, \$500; County Hospital, \$50.00; Democratic Campaign Fund, \$250.00; Church, \$250.00; total..... \$ 1,050.00
2. Local real-estate and personal-property taxes..... 398.00
3. Special assessment taxes for street improvements..... 325.00
4. Personal living expenses..... 18,500.00
5. Interest on loans..... 2,400.00
6. Purchase of securities..... 68,250.00
7. Gifts to children..... 15,000.00

The following information was obtained with reference to security sales:

<i>Item</i>	<i>Date Sold</i>	<i>Date Acquired</i>	<i>Sales Price</i>	<i>Cost</i>
A	11-14-35	11- 2-26	\$11,250.00	\$16,725.00
B	5- 8-35	1- 8-33	9,875.00	8,625.00
C	6- 4-35	7-18-34	21,325.00	21,950.00
D	9-24-35	8- 6-22	475.00	4,675.00
E	11-12-35	11- 5-28	10,500.00	9,125.00
F	1-16-35	(see note)	9,000.00	(see note)

Note: Item F was received as a gift from Mr. Williams' father on December 25, 1932. The tax cost basis to the father was \$16,450.00 at April 16, 1915; the value at December 25, 1932, was \$7,000.00.

Besides the normal tax of 4%, the surtax on income totaling \$26,000 is \$2,240.00; on the next \$6,000 the surtax is 19% and on the next \$6,000, 21%.

The percentages of capital gain or loss to be accounted for are 100% on sales and exchanges of assets held for not more than 1 year; 80%, 1-2 years; 60%, 2-5 years; 40%, 5-10 years; and 30%, more than 10 years.

PROBLEM 3:

On May 1, 1934 the heirs of John Smith, deceased, organized the John Smith Machine Corporation with an authorized capital of \$25,000.00 for the purpose of acquiring and operating the John Smith Machine Works, a sole-proprietorship belonging to the estate of John Smith. Accordingly the entire capital stock of the corporation consisting of 250 shares with a par value of \$100.00 per share was issued to the estate in exchange for the net assets of the business as existing at April 30, 1934, excepting the land and the building which were retained by the estate. The stock received by the estate was immediately distributed to the heirs. Before April 30, 1935, the corporation in exchange for its promissory note

amounting to \$20,000.00, acquired from certain of the stockholders for cancellation and retirement, four-ninths of the outstanding capital stock.

The corporation continued to use the books of the proprietorship without making an adjustment for the changes in the capital structure of the business.

From the above particulars and following information prepare the net worth section of a balance sheet of the corporation as of April 30, 1935 giving effect in detail to all changes occurring to the business during the year.

TRIAL BALANCE—APRIL 30, 1935

<i>Accounts</i>	<i>Debit</i>	<i>Credit</i>
Cash in bank	\$14,385.98	
Accounts receivable	16,235.47	
Reserve for doubtful accounts		\$2,150.00
Unexpired insurance premiums	465.39	
Inventory of work in process, April 30, 1934	2,834.69	
Capital stock purchased	20,000.00	
Land	26,350.00	
Building	28,475.35	
Reserve for depreciation of building		11,959.65
Machinery	53,964.72	
Reserve for depreciation of machinery		42,637.98
Accounts payable		2,897.71
Note payable on purchase of capital stock		20,000.00
Capital account of proprietorship April 30, 1934.....		84,566.29
Sales		54,553.28
Material	12,378.49	
Labor	18,493.26	
Factory expenses	8,962.43	
Depreciation, building, \$569.51; machinery, \$5,396.47.	5,965.98	
General expenses	10,253.15	
	<hr/>	<hr/>
Totals	\$218,764.91	\$218,764.91
	<hr/> <hr/>	<hr/> <hr/>
Inventory of work in process, April 30, 1935.....	\$2,619.50	
	<hr/> <hr/> <hr/>	

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

FRIDAY, NOVEMBER 15, 1935—8:30 A. M. TO 12:00 M.

Auditing

(Answer ten questions)

QUESTION 1:

In what respects does a detailed audit of cash differ from a balance-sheet audit of that item?

QUESTION 2:

Would you consider it proper for balance-sheet purposes to deduct an overdraft in one bank account from a debit balance in another, especially if you discover that the overdraft represents checks drawn and entered, but not delivered to creditors until after the reconciliation date?

QUESTION 3:

The cashier of a company concealed for several years a defalcation of \$10,000 by the following process: on December 31 of each year he deposited in C Bank a check for that amount drawn on D Bank. He would charge C Bank on that date but credit D Bank several days later. How would proper auditing procedure have detected the fraud in an examination as at December 31?

QUESTION 4:

Do you regard it necessary to segregate on the balance sheet accounts receivable from employees representing sales, or accounts due from affiliated companies?

QUESTION 5:

How should receivables be classified that represent (a) "retained percentages" withheld by customers pending completion of contracts, and (b) deposits on bids?

QUESTION 6:

Draft an inventory certificate which is to be furnished to you by your client.

QUESTION 7:

You are to be responsible for the count of a certain inventory. Outline briefly the general procedure you would wish to follow.

QUESTION 8:

What is meant by "the natural business year" and what should be the auditor's attitude toward it?

QUESTION 9:

Part of the inventory of the E Company at June 30, 1935 was also on hand at June 30, 1934. On the latter date the cost was reduced to market but during the year following the market price rose to a figure exceeding original cost. The company has restored original cost in the June 30, 1935 inventory. Give reasons for or against this procedure.

QUESTION 10:

You have been asked to devise a formula for the determination of the value of the goodwill of a trading enterprise the sole proprietor of which has recently died. What formula would you suggest?

QUESTION 11:

What responsibility should an auditor assume for liabilities which arise after the balance-sheet date?

QUESTION 12:

A certain corporation pays quarterly dividends in cash or in no-par-value common stock at the option of the shareholder. How would you set forth on a balance sheet the obligation for such a dividend and in what amount?

MINNESOTA STATE BOARD OF ACCOUNTANCY

EXAMINATION OF NOVEMBER 1935

FRIDAY, NOVEMBER 15, 1935—1:00 P. M. TO 5:00 P. M.

Accounting Theory

(Answer ten questions)

QUESTION 1:

A growing tendency has been noted of indicating the State of incorporation on the balance sheets of industrial companies. What is the value of this disclosure?

QUESTION 2:

Name three operating ratios and three financial ratios of importance to management. Give reasons for their importance.

QUESTION 3:

A manufacturing company has experienced difficulty in the handling of its creditors' accounts, a number of invoices having been paid twice. What general improvements in the system of internal check would you suggest to obviate such errors? You may assume that the operations of the company are sufficiently large to warrant any necessary division of labor.

QUESTION 4:

The M Company, formerly a close corporation with all its stockholders active in the management, has recently floated a new stock issue through bankers and now seeks your advice concerning annual reports to stockholders. Name five requirements of a good annual report, which you consider essential.

QUESTION 5:

"Cost of sales should be stated on a basis of cost under normal operations." Explain the foregoing quotation from an accounting text and indicate how "abnormal" costs can be reflected in the income statement.

QUESTION 6:

How do "standard" costs differ, if at all, from "estimated" costs?

QUESTION 7:

What objections are frequently raised to consolidated balance sheets as informative statements? What remedies, if any, are available?

QUESTION 8:

Among the accounts of the Y Company you discover an account with a debit balance called "Deferred maintenance." What is the possible significance of this account?

QUESTION 9:

Name and describe briefly the various kinds of surplus.

QUESTION 10:

In 1931 the Z Company purchased its own common stock having a par value of \$170 at a cost of \$2,380.00. At that time the company charged treasury-stock account with \$170 and capital surplus with \$2,210.00. At December 31, 1933 the company's auditors, for statement purposes, made an entry charging treasury-stock account and crediting capital-surplus account in the amount of \$2,210.00. This entry was not taken up on the books of the company. During 1934 the company, in accordance with a resolution of the board of directors, transferred the then remaining balance of capital surplus, or \$90,341.10, to capital-stock account for the purpose of increasing the stated value thereof. The capital-surplus account had shown no other changes since the beginning of the year. Subsequent to the transfer the company sold the treasury stock for \$2,720.00, crediting \$2,550 to profit and loss. What adjustments, if any, would you recommend in the company's accounts?

QUESTION 11:

A acquires a 40% interest in the capital stock of B on January 1, 1925. An additional 40% was acquired on January 1, 1934.

(a) Should dividends paid by B on January 10, 1925 (declared January 3, 1925) be regarded by A as income or as a reduction of cost of investment?

(b) What treatment should A give dividends declared and paid by B after January 1, 1934 out of surplus earned subsequent to January 1, 1925 but before January 1, 1934?

(c) What should be the principle for determining surplus eliminations for a consolidated balance sheet at the date of obtaining an 80% control and thereafter?

(1) Should book values at the two respective dates of acquisition be considered?

(2) Should book value at the date of obtaining the 80% control govern solely?

QUESTION 12:

State five major changes or new provisions in the 1934 Federal revenue act affecting individual returns.