

5-1929

## Students' Department

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# Students' Department

H. P. BAUMANN, *Editor*

## ILLINOIS ACCOUNTANCY EXAMINATION

This department has received several requests to solve the following problems which were given by University of Illinois board of examiners in accountancy in the examination in theory of accounts and practical accounting on November 22 and 23, 1928.

**Problem:**

The Hill and Dale Realty Company was incorporated on January 1, 1928, for the purpose of buying and selling real estate. Its activities to date have been confined to the purchase of three tracts of land, two of which have been improved and divided into lots. These tracts are known as the Pelham Park Subdivision, Arlington Hills Subdivision and the Oak Terrace Subdivision. Pelham Park and Arlington are now being sold and it is the intention of the company to improve and put on the market the Oak Terrace Subdivision sometime in 1929. The sales that have been made to date are all on instalment contracts.

The company has called upon you to audit its books and records. The following trial balance was abstracted from the company's general ledger at December 31, 1928:

Particulars	Debits	Credits
Cash .....	\$371,396.60	
Capital stock outstanding .....		\$500,000.00
Pelham Park Land .....	100,000.00	
Arlington Hills land .....	67,500.00	
Oak Terrace land .....	28,800.00	
Pelham Park improvements .....	32,000.00	
Arlington Hills improvements .....	24,000.00	
Furniture and fixtures .....	1,200.00	
Auto bus .....	2,850.00	
R. E. Hill .....	12,400.00	
W. H. Dale .....	11,800.00	
Salesmen's commissions .....	20,475.40	
Office salaries .....	14,200.00	
Interest paid .....	4,350.00	
Legal expense .....	1,950.00	
Receipts on Pelham Sales contracts .....		139,304.00
Receipts on Arlington Hills sales contracts .....		70,288.00
Telephone and telegraph .....	620.00	
Stationery and printing .....	1,125.00	
Advertising .....	14,925.00	
	\$709,592.00	\$709,592.00

An examination of the land-purchase contracts reveals the following:

- Pelham Park land purchased February 1, 1928:
  - Cost of land, 200 acres at \$1,000.00 per acre, \$200,000.00
  - 50% payable in cash
  - 10% payable on February 1, 1929
  - 10% payable on August 1, 1929
  - 10% payable on February 1, 1930
  - 10% payable on August 1, 1930
  - 10% payable on February 1, 1931
  - Interest payable semi-annually on February 1st, and August 1st, at 6%

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Arlington Hills land purchased February 15, 1928:  
 Cost of land, 150 acres at \$750.00 per acre, \$112,500.00  
 60% payable in cash  
 20% payable on February 15, 1929  
 20% payable on February 15, 1930  
 Interest payable semi-annually on February 15th, and August 15th, at 6%

Oak Terrace land purchased September 1, 1928:  
 Cost of land, 60 acres at \$800.00 per acre, \$48,000.00  
 60% payable in cash  
 20% payable on September 1, 1929  
 20% payable on September 1, 1930  
 Interest payable semi-annually on September 1st, and March 1st, at 6%

All of the above contracts provide that the company may resell 50% of the land before it has entirely paid for the whole tract; after 50% of the tract has been sold, all unpaid amounts to the original vendor become due immediately.

Future expenditures for improvements on the developed properties, in addition to those already on the books, not including interest and taxes, were estimated as follows:

Pelham Park . . . . .	\$24,000.00
Arlington Hills . . . . .	30,600.00
	\$54,600.00

The plat of the Pelham Park Subdivision shows that there are 800 lots, to be sold at \$1,000.00 each, while the plat of the Arlington Hills subdivision indicates that there are 600 lots, to be sold at \$900.00 each.

Estimates were obtained indicating that the company's portion of the accrued real-estate taxes for 1928 was as follows:

Pelham Park . . . . .	\$3,600.00
Arlington Hills . . . . .	1,950.00
Oak Terrace . . . . .	320.00
	\$5,870.00

Taxes and interest on the undeveloped tract are to be capitalized; but on the developed tracts they are to be treated as expenses for the current year.

The general ledger of the company does not show the amount of sales; however, an individual ledger card is kept for each lot purchased, having thereon the contract price and all payments received. An analysis of these cards follows:

**Pelham Park:**

Active contract accounts on which all instalments of principal and interest have been paid to date—	
Lots sold: 356 at \$1,000.00 each . . . . .	\$356,000.00
Payments on principal . . . . .	132,912.00
Interest payments . . . . .	3,566.00
Forfeited payments . . . . .	2,826.00
	\$495,304.00

**Arlington Hills:**

Active contract accounts on which all instalments of principal and interest have been paid to date—	
Lots sold: 212 at \$900.00 each . . . . .	\$190,800.00
Payments on principal . . . . .	67,416.00
Interest payments . . . . .	1,272.00
Forfeited payments . . . . .	1,600.00
	\$261,088.00

Income from sales is to be computed on the instalment basis and the same method should be followed in ascertaining the income tax for the year. All sales were instalment sales as defined by the statute. In the case of forfeited contracts, the buyer can not recover the instalments already paid by him.

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Salesmen are entitled to commissions of 10% on the cash received on account of principal. All commissions due had been paid at December 31, 1928.

The legal expenses in connection with the purchase of land consist of the following:

Pelham Park .....	\$400.00	
Arlington Hills .....	300.00	
Oak Terrace .....	300.00	
Legal expense in connection with preparation of form of sales contract .....	450.00	
Legal expense in connection with organizing of company .....	500.00	
		\$1,950.00

The first three items should be capitalized; the last two items should be regarded as current expense.

In verifying the expenditures for fixed assets, you find that the \$2,850.00 on the books for auto bus represents the initial payment and that the bus was purchased on December 31, 1928, for \$9,500.00, the balance being due in ten equal instalments of \$665.00 each on the 31st of each month.

Depreciation on furniture and fixtures should be provided on the basis of 10% per annum. The equipment was purchased at various dates between January 1, 1928, and December 31, 1928.

The minutes provide that the officers, R. E. Hill and W. H. Dale, are to receive \$15,000.00 each for their services during 1928. These salaries have not been expressed on the books.

Prepare the balance-sheet of the company as at December 31, 1928, and a statement of profit and loss reflecting as nearly as possible the profit on each subdivision.

*Solution:*

The following adjusting journal entries are given for the purpose of explaining the adjustments in the working papers on pages 382 and 383:

(1)

Pelham Park land .....	\$100,000.00	
Arlington Hills land .....	45,000.00	
Oak Terrace land .....	19,200.00	
Land contracts payable—due 1929 .....		\$72,100.00
Land contracts payable—due 1930-1931 .....		92,100.00

To charge land accounts with the balance of cost and to set up the liability under the purchase contracts.

(2)

Oak Terrace improvements .....	384.00	
Interest paid .....	3,512.50	
Accrued interest payable .....		3,896.50
To set up accrued interest payable.		

(3)

Pelham Park improvements .....	24,000.00	
Arlington Hills improvements .....	30,600.00	
Reserve for future expenditures for improvements:		
Pelham Park .....		24,000.00
Arlington Hills .....		30,600.00

To charge improvements with proposed additional improvements.

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(4)		
Oak Terrace improvements . . . . .	\$ 320.00	
Taxes . . . . .	5,550.00	
Reserve for taxes . . . . .		\$ 5,870.00
To set up a reserve for estimated accrued real-estate taxes for 1928.		
(5)		
Contracts receivable—Pelham Park . . . . .	356,000.00	
Contracts receivable—Arlington Hills . . . . .	190,800.00	
Sales—Pelham Park . . . . .		356,000.00
Sales—Arlington Hills . . . . .		190,800.00
To record the sales of lots, and contracts receivable.		
(6)		
Receipts on Pelham Park sales contracts . . . . .	139,304.00	
Contracts receivable—Pelham Park . . . . .		132,912.00
Interest received—Pelham Park . . . . .		3,566.00
Forfeited payments—Pelham Park . . . . .		2,826.00
To distribute the receipts on Pelham Park sales contracts.		
(7)		
Receipts on Arlington Hills contracts . . . . .	70,288.00	
Contracts receivable—Arlington Hills . . . . .		67,416.00
Interest received—Arlington Hills . . . . .		1,272.00
Forfeited payments—Arlington Hills . . . . .		1,600.00
To distribute the receipts on Arlington Hills sales contracts.		
(8)		
Pelham Park improvements . . . . .	400.00	
Arlington Hills improvements . . . . .	300.00	
Oak Terrace improvements . . . . .	300.00	
Legal expense . . . . .		1,000.00
To charge land accounts with the legal expenses incurred in connection with the purchase.		
(9)		
Auto bus . . . . .	6,650.00	
Purchase contract—auto bus . . . . .		6,650.00
To set up the liability on the auto bus.		
(10)		
Depreciation—furniture and fixtures . . . . .	60.00	
Reserve for depreciation—furniture and fixtures . . . . .		60.00
To write off depreciation on furniture and fixtures acquired during the year.		
(11)		
Officers' salaries . . . . .	30,000.00	
R. E. Hill . . . . .		12,400.00
W. H. Dale . . . . .		11,800.00
Accrued salaries of officers . . . . .		5,800.00
To record officers' salaries for the year 1928.		

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Particulars	Trial Balance December 31, 1928		THE HILL AND DALE Working papers,	
	Dr.	Cr.	Dr.	Adjust-
Cash .....	\$371,396.60			
Capital stock outstanding .....		\$500,000.00		
Pelham Park Land .....	100,000.00		(1)	\$ 100,000.00
Pelham Park improvements .....	32,000.00		(3)	24,000.00
			(8)	400.00
Arlington Hills land .....	67,500.00		(1)	45,000.00
Arlington Hills improvements .....	24,000.00		(3)	30,600.00
			(8)	300.00
Oak Terrace land .....	28,800.00		(1)	19,200.00
Oak Terrace improvements .....			(2)	384.00
			(4)	320.00
			(8)	300.00
Furniture and fixtures .....	1,200.00			
Auto bus .....	2,850.00		(9)	6,650.00
R. E. Hill .....	12,400.00			
W. H. Dale .....	11,800.00			
Salesmen's commissions .....	20,475.40			
Office salaries .....	14,200.00			
Interest paid .....	4,350.00		(2)	3,512.50
Legal expense .....	1,950.00			
Receipts on Pelham Park sales contracts .....		139,304.00	(6)	139,304.00
Receipts on Arlington Hills sales contracts .....		70,288.00	(7)	70,288.00
Telephone and telegraph .....	620.00			
Stationery and printing .....	1,125.00			
Advertising .....	14,925.00			
	<u>\$709,592.00</u>	<u>\$709,592.00</u>		
Land contracts payable—due 1929 .....				
Land contracts payable—due 1930 and 1931 .....				
Accrued interest payable .....				
Reserve for future expenditures for improve- ments:				
Pelham Park .....				
Arlington Hills .....				
Taxes .....			(4)	5,550.00
Reserve for taxes .....				
Contracts receivable—Pelham Park .....			(5)	356,000.00
Contracts receivable—Arlington Hills .....			(5)	190,800.00
Sales—Pelham Park .....				
Sales—Arlington Hills .....				
Interest received—Pelham Park .....				
Forfeited payments—Pelham Park .....				
Interest received—Arlington Hills .....				
Forfeited payments—Arlington Hills .....				
Purchase contract—auto bus .....				
Depreciation—furniture and fixtures .....			(10)	60.00
Reserve for depreciation—furniture and fix- tures .....				
Officers' salaries .....			(11)	30,000.00
Accrued salaries of officers .....				
Cost of lots sold—Pelham Park .....			(12)	114,098.00
Cost of lots sold—Arlington Hills .....			(12)	59,148.00
Land and improvements:				
Pelham Park .....				
Arlington Hills .....				
Profit and loss:				
Pelham Park .....			(13)	151,588.30
Arlington Hills .....			(13)	85,134.96
Deferred profit on instalment sales .....				
				<u>\$1,432,637.76</u>
Transfer to general profit and loss:				
Profit on Pelham Park lot sales .....				
Profit on Arlington Hills lot sales .....				
Net profit before provision for federal in- come taxes .....				
Federal income taxes for year .....				
Federal income taxes payable .....				

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REALTY COMPANY  
December 31, 1928

ments	Cr.	Profit Pelham Park	and Arlington Hills	loss General	Balance-sheet Dr.	Cr.
					\$ 371,396.60	\$ 500,000.00
					200,000.00	
					56,400.00	
					112,500.00	
					54,900.00	
					48,000.00	
					1,004.00	
					1,200.00	
					9,500.00	
(11)	\$ 12,400.00					
(11)	11,800.00					
		\$13,573.80	\$6,901.60			
		5,500.00	2,362.50	\$14,200.00		
(8)	1,000.00			950.00		
				620.00		
				1,125.00		
				14,925.00		
(1)	72,100.00					72,100.00
(1)	92,100.00					92,100.00
(2)	3,896.50					3,896.50
(3)	24,000.00					24,000.00
(3)	30,600.00					30,600.00
		3,600.00	1,950.00			
(4)	5,870.00					5,870.00
(6)	132,912.00				223,088.00	
(7)	67,416.00				123,384.00	
(5)	356,000.00	356,000.00*				
(5)	190,800.00		190,800.00*			
(6)	3,566.00	3,566.00*				
(6)	2,826.00	2,826.00*				
(7)	1,272.00		1,272.00*			
(7)	1,600.00		1,600.00*			
(9)	6,650.00					6,650.00
				60.00		
(10)	60.00					60.00
(11)	5,800.00			30,000.00		5,800.00
		114,098.00				
			59,148.00			
(12)	114,098.00					114,098.00
(12)	59,148.00					59,148.00
		151,588.30				
(13)	236,723.26		85,134.96			236,723.26
	<u>\$1,432,637.76</u>					
		<u>\$74,031.90</u>		74,031.90*		
			<u>\$38,174.94</u>	38,174.94*		
				<u>\$50,326.84</u>		50,326.84
				6,765.22		
					<u>6,765.22</u>	
					<u>\$1,208,137.82</u>	<u>\$1,208,137.82</u>

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(12)

Cost of lots sold—Pelham Park . . . . .	\$114,098.00	
Cost of lots sold—Arlington Hills . . . . .	59,148.00	
Land and improvements—Pelham Park . . . . .		\$114,098.00
Land and improvements—Arlington Hills . . . . .		59,148.00
To record cost of lots sold:		

	Pelham Park	Arlington Hills	
Cost of land . . . . .	\$200,000.00	\$112,500.00	
Improvements . . . . .	56,400.00	54,900.00	
Total cost . . . . .	\$256,400.00	\$167,400.00	
Lots in plat . . . . .	800	600	
Cost per lot . . . . .	\$ 320.50	\$ 279.00	
Lots sold . . . . .	356	212	
Cost of lots sold . . . . .	\$114,098.00	\$59,148.00	

(13)

Profit and loss—Pelham Park . . . . .	151,588.30	
Profit and loss—Arlington Hills . . . . .	85,134.96	
Deferred profit on instalment sales . . . . .		236,723.26
To defer unrealized profit on instalment sales:		

	Pelham Park	Arlington Hills	Together
Sales . . . . .	\$356,000.00	\$190,800.00	\$546,800.00
Cost of sales			
356 lots at \$320.50	114,098.00		
212 lots at \$279.00		59,148.00	173,246.00
Gross profit . . . . .	\$241,902.00	\$131,652.00	\$373,554.00
Percentage of gross profit . . . . .	67.95%	69.00%	
Collections . . . . .	\$132,912.00	\$ 67,416.00	\$200,328.00
Realized gross profit . . . . .	\$ 90,313.70	\$ 46,517.04	\$136,830.74
Deferred profit . . . . .	151,588.30	85,134.96	236,723.26
Total gross profit . . . . .	\$241,902.00	\$131,652.00	\$373,554.00

Computation of federal income taxes

Profit for the year ended December 31, 1928 (exhibit "B") . . . . .	\$50,326.84
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<i>Add:</i> Non-deductible items:			
Organization expenses .....	\$	500.00	
Estimated accrued real-estate taxes for 1928 .....		5,550.00	\$6,050.00
Taxable income .....			\$56,376.84
Rate of tax .....			.12
Income tax payable .....			\$6,765.22

### Exhibit "A"

#### THE HILL AND DALE REALTY COMPANY

Balance-sheet, December 31, 1928

<i>Assets</i>				
<b>Current assets:</b>				
Cash .....				\$371,396.60
Contracts receivable:				
Pelham Park .....	\$223,088.00			
Arlington Hills .....	123,384.00	346,472.00		\$ 717,868.60
<b>Land and improvements:</b>				
	Pelham Park (being marketed)	Arlington Hills (being marketed)	Oak Terrace (not on market)	
Cost of land .....	\$200,000.00	\$112,500.00	\$ 48,000.00	
Cost of improvements .....	56,400.00	54,900.00	1,004.00	
Total .....	\$256,400.00	\$167,400.00	\$ 49,004.00	
Charged cost of sales .....	114,098.00	59,148.00		
Inventory .....	\$142,302.00	\$108,252.00	\$ 49,004.00	299,558.00
<b>Fixed assets:</b>				
Furniture and fixtures .....	\$ 1,200.00			
Less: Reserve for depreciation .....	60.00	\$ 1,140.00		
Auto bus .....			9,500.00	
				10,640.00
				<b>\$1,028,066.60</b>
<i>Liabilities and net worth</i>				
<b>Current liabilities:</b>				
Accrued interest payable .....		\$ 3,896.50		
Reserve for real-estate taxes .....		5,870.00		
Officers' salaries accrued .....		5,800.00		
Federal income taxes payable .....		6,765.22		
Purchase contract—auto bus .....		6,650.00		
Land contracts payable—due 1929:				
Pelham Park .....	\$ 40,000.00			
Arlington Hills .....	22,500.00			
Oak Terrace .....	9,600.00	72,100.00		
				\$ 101,081.72
Land contracts payable—due in 1930 and 1931 .....				92,100.00
Reserve for future expenditures for improvements:				
Pelham Park .....		\$ 24,000.00		
Arlington Hills .....		30,600.00		54,600.00
Deferred profit on instalment sales .....				236,723.26
<b>Net worth:</b>				
Capital stock outstanding .....		\$500,000.00		
Surplus:				
Profit for the year ended December 31, 1928 (exhibit "B") .....	\$ 50,326.84			
Less: Provision for federal income taxes .....	6,765.22	43,561.62		543,561.62
				<b>\$1,028,066.60</b>

Exhibit "B"

THE HILL AND DALE REALTY COMPANY

Statement of profit and loss for the year ended December 31, 1928

	Pelham Park subdivision	Arlington Hills subdivision	Total
Sales.....	\$356,000.00	\$190,800.00	\$546,800.00
Cost of sales:			
Land and improvements.....	\$256,400.00	\$167,400.00	\$423,800.00
Less: Cost of lots unsold.....	142,302.00	108,252.00	250,554.00
		59,148.00	173,246.00
Gross profit on sales.....	\$241,902.00	\$131,652.00	\$373,554.00
Less: Deferred profit on sales.....	151,588.30	85,134.96	236,723.26
Gross profit realized.....	\$90,313.70	\$46,517.04	\$136,830.74
Forfeitures.....	2,826.00	1,600.00	4,426.00
Total gross profit.....	\$93,139.70	\$48,117.04	\$141,256.74
Interest on instalment accounts.....	3,566.00	1,272.00	4,838.00
Total profit and income.....	\$96,705.70	\$49,389.04	\$146,094.74
Less: Assignable expenses:			
Salesmen's commissions.....	\$13,573.80	\$6,901.60	\$20,475.40
Interest paid.....	5,500.00	2,362.50	7,862.50
Taxes.....	3,600.00	1,950.00	5,550.00
		11,214.10	33,887.90
Profit before general expenses.....	\$74,031.90	\$38,174.94	\$112,206.84
Less: General expenses:			
Office salaries.....			\$14,200.00
Legal expense.....			950.00
Telephone and telegraph.....			620.00
Stationery and printing.....			1,125.00
Advertising.....			14,925.00
Depreciation of furniture and fixtures.....			60.00
Officers' salaries.....			30,000.00
Net profit for year (before provision for federal income taxes).....			\$50,326.84

## *Students' Department*

### COMPUTATION OF COST OF SALES

**Problem:**

The general manager of the Paratex Sales Company hands you the following statement, prepared by the company's bookkeeper, with the request that you recompute the cost of sales for the nine months ended September 30, 1928.

Inventory, December 31, 1927 (physical count, prices based on actual costs incurred for year 1927) .....	\$ 35,261.18
Merchandise purchases, January 1, 1928, to September 30, 1928, at actual cost .....	212,945.30
Total .....	\$248,206.48
<i>Less:</i>	
Book inventory at September 30, 1928, resulting from estimated cost of sales .....	\$34,211.76
Adjustment to raise to physical inventory at same date .....	25,366.09
Total, representing physical inventory, priced at last year's unit costs .....	59,577.85
Cost of sales .....	\$188,628.63

In explanation of the statement the general manager says that during the year monthly statements of profit and loss were prepared, although no physical inventory was made until September 30th. The monthly costs of sales were estimated figures and were obtained by multiplying the number of units sold by the unit prices contained in the physical inventory of December 31, 1927. However, the unit costs of merchandise purchased during the year have decreased and the estimated cost of sales was therefore overstated. The general manager states further that the physical inventory of September 30, 1928, was not priced at the actual costs incurred during 1928, but that the prices employed were the same unit costs as appeared in the December 31, 1927, inventory. He thus concludes that the bookkeeper's estimate of cost of sales at September 30th has resulted in an understatement of the true cost of sales.

Upon inquiry you find that all the items in the inventory of December 31, 1927, were disposed of prior to September 30, 1928, and that the inventory at the latter date is fairly representative of the purchases made during the nine-months period.

**Solution:**

An analysis of the data given shows:

Inventory, December 31, 1927 (physical count, prices based on actual costs incurred for year 1927) .....	\$ 35,261.18
Merchandise purchases, January 1, 1928, to September 30, 1928, at actual cost .....	212,945.30
Total (at actual cost) .....	\$248,206.48
<i>Less:</i> Book inventory at September 30, 1928 (resulting from estimated cost of sales, based on unit prices in the physical inventory of December 31, 1927) .....	34,211.76
Cost of sales at prices based upon the unit prices used in the inventory of December 31, 1927 .....	\$213,994.72

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Less: Merchandise included in inventory of December 31, 1927	\$35,261.18
The amount at which the purchases, January 1, 1928, to September 30, 1928, were charged to cost of sales. . . . .	\$178,733.54
Add: Physical inventory, priced at last year's unit costs. . . . .	59,577.85
The amount of purchases priced at the unit prices used in the inventory at December 31, 1927. . . . .	\$238,311.39
Deduct: Actual cost of the merchandise purchased, January 1, 1928, to September 30, 1928. . . . .	212,945.30
Adjustment, per books, resulting from the overpricing of purchases. . . . .	\$ 25,366.09

The actual cost of purchases applicable to cost of sales and the inventory at September 30, 1928, may now be obtained by prorating the cost as follows:

Particulars	At unit prices used in inventory of December 31, 1928	Percentage	Cost
Purchases charged to cost of sales. . .	\$178,733.54	75%	\$159,708.98
Inventory, September 30, 1928. . . . .	59,577.85	25%	53,236.32
Total. . . . .	\$238,311.39	100%	\$212,945.30

The cost of sales is, therefore:

Inventory, December 31, 1927. . . . .	\$ 35,261.18
*Purchases charged to cost of sales. . . . .	159,708.98
Cost of sales. . . . .	\$194,970.16

Another method which may be used follows:

$\frac{\$25,366.09 \text{ (amount of over-pricing)}}{\$238,311.39 \text{ (purchases at December 31, 1927, prices)}}$  times \$59,577.85 (physical inventory at last year's unit costs) = \$6,341.53 (the amount of overpricing applicable to the inventory at September 30, 1928, priced at last year's unit costs).

Computation of cost of sales:

Inventory, December 31, 1927. . . . .	\$ 35,261.18
Purchases. . . . .	212,945.30
Total. . . . .	\$248,206.48
Deduct: Inventory, September 30, 1928:	
Inventory priced at 1927 prices. . . . .	\$59,577.85
Less: Over-pricing (per above). . . . .	6,341.53
Cost of sales. . . . .	\$194,970.16