

1923

## Examination [1923]

Virginia State Board of Accountancy

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EXAMINATION  
VIRGINIA STATE BOARD OF  
ACCOUNTANCY

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RICHMOND, VIRGINIA  
NOVEMBER, 7, 8 AND 9, 1923

PRICE 25 CENTS PER COPY

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**VIRGINIA STATE BOARD OF ACCOUNTANCY**

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EXAMINATION VIRGINIA STATE BOARD  
OF ACCOUNTANCY

NOVEMBER 7, 8 AND 9, 1923

COMMERCIAL LAW

NOVEMBER 7TH, 1923, 9:30 A. M. TO 1:00 P. M.

*Give reasons for all answers*

*Do not repeat questions but designate them by numbers and letters*

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NEGOTIABLE INSTRUMENTS

*Answer four of the following five questions*

1. (a) What is the legal rate of interest in Virginia?  
(b) What is meant by "usury"?  
(c) What is meant by an endorsement "without recourse"?  
(d) When, if at all, does a check operate as an assignment of funds to the credit of the drawer?  
(e) What is a negotiable instrument?  
(f) What constitutes a material alteration?  
(g) What constitutes a holder in due course of negotiable paper?
2. A holds the note of B endorsed by C, D, and E. A desires to sue. In what order are the endorsers liable, and how many may be sued?
3. A solicits from B a loan of \$1,000.00. B agrees to loan him the money upon a note endorsed by C and D. In the presence of B, C endorsed the note, with the express proviso that both D and E shall also endorse it. A secures the endorsement of D but not that of E, and then delivers the note to B. The note is not paid. Can B recover from C on his endorsement?
4. A draws a check for \$500.00 in favor of B on the American National Bank of Richmond, Va. B endorses and transfers the check for value, and without notice of any infirmity in the check, to C. Subsequently A notifies the bank that the check was obtained by fraud by B. Is the bank right in refusing payment to C?
5. A is the maker, and B, C, and D endorsers, of a negotiable note which comes to E as a *bona fide* holder, for value, in due course and before maturity. The note is due at the bank on October 1, 1923. E presents it for payment on that day and payment is refused. The note is not protested although it does not waive demand and notice of protest. Can E hold B, C, and D liable upon the note?

## CONTRACTS

*Answer four of the following five questions*

6. What is the statute of limitations on:
  - (a) An open account?
  - (b) A negotiable note?
  - (c) An instrument under seal?
  - (d) A judgment?
  - (e) A deed of trust?
7. A corporation leases a store, possession to be given at a future date. Prior thereto it dissolves and two of the stockholders orally promise the lessor to be responsible for the rent. Can they be held?
8. A, on the first day of July, 1923, places in the warehouse of B, certain household furniture to be stored. There was no agreement between A and B as to liability for the furniture in case of destruction by fire. On the 15th of August, 1923, the warehouse of B burns, destroying the property of A as well as other property. What are the rights of A in the premises?
9. John Jones, in selling out his drug business in the city of Richmond to a competitor, agrees not to enter into the same business again in the said city for a period of ten years. Is the agreement enforceable?
10. Jones offers to sell to Smith his automobile for \$1,000.00. Smith replies that he will give him \$950.00. Jones refuses this, and thereupon Smith says that he will accept the \$1,000.00 offer. Jones then refuses to sell. Is he bound?

## CORPORATIONS

*Answer all of the following questions*

11. A business corporation makes a considerable profit. A majority of the stockholders demand a declaration of a dividend. The directors refuse, expressing an intention to start a surplus. Can the stockholders compel them?
12.
  - (a) What is a domestic corporation?
  - (b) What is a foreign corporation?
  - (c) How is a corporation formed under the laws of the State of Virginia? How dissolved?
13. A charter is granted to the Spotless Corporation to do a cleaning and pressing business. No authority is given in the charter to issue bonds. The corporation issues \$25,000.00 of bonds secured upon real estate belonging to the corporation. Are these bonds valid?

## PARTNERSHIP

*Answer all of the following questions*

14. A, B, C, and D form a partnership in which A is the general, and B, C, and D are the limited partners. The certificate of partnership set forth that the limited partners have contributed \$2,000.00 each to the capital stock of the company. In fact, B and C have only contributed \$500.00 each to the capital stock, which fact was known to D when he signed the certificate of partnership. E, relying upon the statements contained in the certificate, extends credit to the company. The company fails and E seeks to hold D personally liable for the debt. Can he do so?
15. Notice of dissolution of partnership by the retirement of one partner is published in a local newspaper. Is this sufficient to release the retiring partner as to further dealings with a prior regular customer having no actual knowledge of his retirement?
16. S and P form a partnership for the purpose of conducting a grocery business. Of the capital invested in the partnership S contributes \$10,000.00 and P \$5,000.00. Both agree to give their entire time to the business, but nothing is said as to how the profits are to be divided. At the end of the first year the parties determine to dissolve the partnership, having on hand then \$4,000.00 undivided profits. How much would each party be entitled to receive from the profits and capital respectively?

## FEDERAL INCOME TAX

*Answer the following question*

17. In June 1915, A purchased a dwelling for the sum of \$15,000.00. He resided in the dwelling until December 1, 1920, when he sold the property at a loss. During 1920 he paid out for taxes \$186.00, for insurance \$60.00, for repairs \$130.00, and for interest on mortgage \$250.00. His net loss on the sale was \$1200.00. In preparing an income tax return, for 1920, how would you treat the items specified?

## BANKRUPTCY

*Answer the following questions*

18. A voluntary petition in bankruptcy is filed by A on the 1st day of July, 1922. Within what time has A the right to file his petition for discharge in bankruptcy?
19. What are the duties of:
  - (a) A receiver in bankruptcy?
  - (b) A trustee in bankruptcy?
20. Does bankruptcy discharge a judgment rendered against a person for slander?

# PRACTICAL ACCOUNTING—PART 1

NOVEMBER 7, 1923, 1:30 TO 6:00 P. M.

## PROBLEM 1

The following is a Balance Sheet of the BIGFORD PAPER COMPANY, as at June 30, 1923:

### ASSETS

Cash.....		\$ 50,000
Accounts Receivable.....		125,000
Inventories.....		425,000
Advances to General Pulp Co.....		19,000
Advances to Pulpwood Cutters.....		45,000
Stocks Owned.....		7,500
Land—Plant Site—Owned.....		10,000
Timberlands Owned.....		137,500
Mill Buildings.....		365,000
Machinery & Equipment.....		435,000
Water Power Rights:		
Developed.....	\$600,000	
Undeveloped.....	20,000	620,000
Patent Rights.....		3,500
Prepaid Expenses.....		7,500
		\$2,250,000

### LIABILITIES

Accounts Payable.....		\$ 105,000
Notes Payable.....		470,000
Accrued Liabilities.....		10,000
Reserve for Depreciation:		
Buildings.....	\$200,000	
Machinery & Equipment.....	220,000	420,000
Capital Stock—Common.....		300,000
Surplus.....		945,000
		\$2,250,000

Four of the Directors of the Bigford Paper Company, own (jointly) the entire Capital Stock of the General Pulp Company, which they purchased in 1919 for \$75,000 (par value). Operations have been very satisfactory and the following is a Balance Sheet of the General Pulp Company as at June 30, 1923.

BALANCE SHEET OF THE GENERAL PULP COM-  
PANY, AS AT JUNE 30, 1923

ASSETS

Cash.....		\$ 85,000
Accounts Receivable.....		55,000
Inventories.....		90,000
Land—Plant Site.....		2,500
Mill Buildings.....		70,000
Machinery & Equipment.....		102,000
Prepaid Expenses.....		500
		\$405,000

LIABILITIES

Accounts Payable.....		\$ 90,000
Bigford Paper Company.....		\$ 19,000
Notes Payable.....		60,000
Reserve for Depreciation:		
Buildings.....	\$20,000	
Machinery & Equipment.....	36,000	56,000
Capital Stock—Common.....		75,000
Surplus.....		105,000
		\$405,000

Because of the type and location of the General Pulp Company's factory, the Directors of the Bigford Paper Company made an offer, which was accepted, to purchase the Capital Stock of the General Pulp Company for the sum of \$350,000.

Appraisals were made of both plants, and the appraised valuations were certified by the American Valuation Company to be as follows, (as of June 30, 1923):

BIGFORD PAPER COMPANY'S PLANT

	Cost to Replace	Allowances for Depreciation	Sound Depreciated Value
Land—Plant Site.....	\$ 50,000	\$	\$ 50,000
Timber Lands.....	285,000		285,000
Mill Buildings.....	875,000	300,000	575,000
Machinery & Equipment.....	1,375,000	375,000	1,000,000
Water Power Rights:			
Developed.....	900,000		900,000
Undeveloped.....	50,000		50,000
Total.....	\$3,535,000	\$675,000	\$2,860,000

## GENERAL PULP COMPANY'S PLANT

	Cost to Replace	Allowances for Depreciation	Sound Depreciated Value
Land.....	\$ 25,000	\$	\$ 25,000
Mill Buildings.....	175,000	40,000	135,000
Machinery & Equipment.....	205,000	51,500	153,500
Totals.....	\$405,000	\$91,500	\$313,500

Change was made in Bigford Paper Company's charter to permit of a Bonded Indebtedness, as well as to increase its authorized Capital Stock to

Common (Maximum).....	\$2,500,000
Preferred—8% Cumulative (Maximum).....	1,000,000
Total Authorized.....	\$3,500,000

A Syndicate headed by Ames & Co., agreed to underwrite at 92-½, \$800,000 of an authorized issue of \$1,000,000 of 7-½% First Mortgage Gold Bonds, Convertible into 8% Cumulative Preferred Stock at option of holder, \$200,000 of Bonds to remain in Treasury. In preparing prospectus for sale of Bonds the Directors caused the value of both plants to be written up to Appraised Sound values. The Brokers required a Consolidated Balance Sheet that reflected the write up of Plant Assets and reflecting therein the proceeds from proposed financing.

Legal expenses in connection with issue of Bonds are estimated to be \$10,000.00.

From the proceeds from sale of Bonds, the following amounts are to be paid at once:

For Purchase of General Pulp Company Stock.....	\$350,000
Borrowed Money Repaid.....	350,000

There have been declared on the General Pulp Company's books a 100% cash dividend, payable as at June 30, 1923, and a 300% Stock Dividend. Bigford's Directors declare a 700% stock dividend.

You are called upon to prepare the following:

- (a) Entries on General Pulp Company's books, made necessary by foregoing.
- (b) Amended Balance Sheet of General Pulp Company, reflecting all changes by above entries, as at June 30, 1923.
- (c) All necessary entries on books of Bigford Paper Co.
- (d) Amended Balance Sheet of Bigford Paper Company, reflecting all changes by reorganization and Bond issue, per above entries, as at June 30, 1923.
- (e) Consolidated Balance Sheet as at June 30, 1923.

## THEORY OF ACCOUNTS

NOVEMBER 8, 1923—9:00 A. M. TO 12:30 P. M.

*Answer all questions*

*Do not repeat questions but designate them by numbers and letters*

1. Name the several classes of dividends. What do you understand by the meaning of a dividend paid out of capital? Are there any conditions under which such a dividend is justifiable? Give reason for your answer.
2. A transportation company sells tickets for twenty-five and fifty rides at a combination rate lower than its single cash fare charge. How would you apportion monthly the revenue received from the sale of such combination tickets, many of which remain unredeemed at the end of each month?
3. Describe the system of accounting records that you would install for a business with which you may be familiar, showing how such records are co-related, and submit a balance sheet and profit and loss statement, with or without figures, taken therefrom at the close of the first accounting period.
4. You are called in to verify the claim for a loss by fire prepared by a manufacturer for presentation to an insurance company and you find the following items included in the manufacturing cost.
  - (a) Insurance on factory buildings and equipment.
  - (b) Taxes.
  - (c) Rent of factory buildings.
  - (d) Interest on Capital invested in Fixed Assets.
  - (e) Watchmen's salaries and expenses.

State fully whether or not you consider these items proper charges to the cost of manufacture.

5. State the several items that should, in your opinion, be debited and credited direct to Surplus Account.
6. State to what general ledger account, if any, the following discounts should be posted on your books, giving your reasons therefor:
  - (a) Discounts on Stock and on Bonds given to defray costs of construction.
  - (b) Discounts taken by your banker when he handles your notes for current loans.
  - (c) Discounts that you allow your customers for cash payments of their accounts.
  - (d) Discount allowed by you to your customers for purchasing in quantity lots.
  - (e) Discount allowed you for cash on your invoices for merchandise purchased but not actually taken at the time of inventory because the invoices were not due at that time.

7. A Customers Ledger trial balance submitted to you shows several accounts with credit balances, and the Creditors Ledger trial balance shows several accounts with debit balances. State where you would place these items on the balance sheet?
8. Define and give an example of:
  - (a) Secret Reserve
  - (b) Depletion
  - (c) Factory Burden
  - (d) Amortization
  - (e) Bonus Stock
  - (f) Depreciation
  - (g) Contingent Assets
  - (h) Deferred Liabilities
9. What is represented by the balance standing in the Sales Account on the books of a broker? Give reason for your answer.
10. You are instructed by the Receiver of a Manufacturing Business to examine the accounts and report to him upon (a) the financial position of the Concern and (b) the causes that have contributed to the failure. Prepare such statements, using your own figures, as you think will give the necessary information to the Receiver and the Creditors.

## PRACTICAL ACCOUNTING—PART II

NOVEMBER 8, 1923—1 P. M TO 6 P. M.

### PROBLEM 2

The Virginia Sand and Gravel Corporation in order to purchase certain sand and gravel pits, found it necessary to re-finance its business. This was done through the stockholders and certain bankers who underwrote a new bond issue. At July 31, 1922, their balance sheet, prior to giving effect to re-financing, follows:

#### *Assets*

Cash.....	\$ 22,000.00
Accounts Receivable.....	85,000.00
Notes Receivable.....	90,000.00
Inventory—Sand ready for Market.....	18,000.00
Inventory—Supplies.....	3,500.00
Sand and Gravel Pits.....	45,000.00
Fixed Properties.....	295,000.00
Prepaid Expense.....	8,000.00
Stock Discount (On Common Stock).....	100,000.00
	<hr/>
	\$666,500.00

#### *Liabilities*

Accounts Payable.....	\$177,000.00
Notes Payable.....	150,000.00
1st Mortgage Bonds.....	100,000.00
7% Preferred Stock (Dividends Passed 2 Years)....	100,000.00
Common Stock.....	100,000.00
Surplus.....	39,500.00
	<hr/>
	\$666,500.00

The re-financing consisted of: Cancellation of common stock; surrender of cumulative dividends on preferred stock (not declared for two years); issue of one share of no par value common stock for each share of par value common cancelled; sale of \$250,000.00 of \$100.00 par value preferred stock for cash; 1st mortgage bonds issue increased to \$400,000.00; sand and gravel pits purchased \$300,000.00; equipment purchased \$50,000.00, and accounts payable liquidated \$150,000.00; estimated expense of bond issue and discount \$50,000.00. After giving effect to the re-financing, a balance sheet was submitted to the bankers as at July 31, 1922.

After one year the following balance sheet was submitted to the bankers who underwrote the bond issue:

*Assets*

Cash.....	\$ 25,000.00
Accounts Receivable.....	85,000.00
Notes Receivable.....	95,000.00
Inventory of Sand ready for Market.....	30,000.00
Inventory of Sand 50% Manufactured.....	20,000.00
Sand and Gravel Pits.....	450,000.00
Fixed Properties.....	461,500.00
Prepaid Expense.....	38,500.00
Bond Discount.....	50,000.00
	<hr/>
	\$1,255,000.00

*Liabilities*

Accounts Payable.....	\$ 74,000.00
Notes Payable.....	160,000.00
1st Mortgage Bonds.....	400,000.00
7% Preferred Stock.....	350,000.00
No Par Value Common Stock.....	100,000.00
Surplus.....	171,000.00
	<hr/>
	\$1,255,000.00

The following credits for the year are included in the Surplus Account:

Appraisal of Fixed Properties.....	\$100,000.00
Appraisal of Sand and Gravel Pits.....	100,000.00

Depreciation of \$33,500 and Depletion of \$45,000.00 were written off the Fixed Properties Account and Sand and Gravel Pit Account respectively.

After submitting the foregoing Balance Sheet you are advised by the bankers that in the absence of detailed statements they are unable to satisfactorily account for the changes during the year. You are therefore requested by them to prepare such statements as will enable them to intelligently pass upon the results for the year.

PROBLEM 3

On January 1st 1923 the condition of the State Manufacturing Company was as follows:

*Assets*

Cash.....	\$ 8,672.40
Accounts Receivable.....	75,092.36
Notes Receivable.....	5,961.25
Merchandise Inventory.....	62,784.62
Machinery and Equipment.....	15,441.58
Furniture and Fixtures—Office.....	2,246.28
Unexpired Insurance.....	321.79
	\$170,520.28

*Liabilities*

Accounts Payable.....	\$ 51,944.30
Notes Payable.....	27,000.00
Capital Stock.....	75,000.00
Surplus.....	16,575.98
	\$170,520.28

On the night of June 26th 1923 they suffered a loss by fire. It was estimated by the Insurance Adjusters that the value of the damage to the merchandise was \$20,000.00, and to the Machinery and Equipment \$9,000.00; while the Furniture and Fixtures were a total loss. These figures were agreed upon by both parties.

The company's ledger at the close of business June 26th 1923 showed the following balances:

	Debit	Credit
Capital Stock.....	\$	\$ 60,000.00
Surplus.....		16,575.98
Cash.....	6,390.52	
Accounts Receivable.....	84,626.51	
Notes Receivable.....	9,875.32	
Accounts Payable.....		38,405.65
Notes Payable.....		30,000.00
Machinery and Equipment.....	15,941.58	
Furniture and Fixtures—Office.....	2,346.28	
Inventory January 1, 1923.....	62,784.62	
Dividends.....	3,000.00	
Sales.....		189,602.83
Material.....	96,032.78	

Labor.....	32,601.94	
Power, Light and Heat.....	1,831.84	
Factory Expense.....	3,876.52	
Office Salaries.....	10,500.00	
Office Expenses.....	506.87	
Selling Expenses.....	3,641.25	
Insurance (Unexpired \$321.79).....	628.43	
	<hr/>	<hr/>
	\$334,584.46	\$334,584.46
	<hr/>	<hr/>

The records show that for three years previous the gross profit on cost has been as follows:

1920.....	20%
1921.....	18%
1922.....	22%

Also that for these years and prior the Machinery and Equipment and Furniture and Fixtures have been depreciated at the rate of 10% per annum.

Insurance was carried as follows:

Machinery and Equipment.....	\$10,000.00
Furniture and Fixtures.....	1,500.00
Merchandise Inventory.....	25,000.00
All policies containing the 80% coinsurance clause.	

Prepare a statement showing the amount of the State Manufacturing Company's claim against the Insurance Company. Give journal entries necessary to express the transactions on the books of the company and prepare final Balance Sheet.

#### PROBLEM 4

The partnership of Ames, Brooks & Cox finding that their products are yearly becoming less marketable, the three partners mutually agree to liquidate the business and dissolve the partnership. The Articles of Co-partnership state that the capital investments of Ames is \$90,000.00, Brooks \$45,000.00, and Cox \$15,000.00, and provide that profits and losses are to be distributed one-half to Ames, three-tenths to Brooks and one-fifth to Cox. Considerable assets have been converted into cash on June 1st when you are engaged as Accountant to advise the the partners how to distribute the cash fund then on hand. You find that the partners' capital contributions are as stated in the Articles, that they owe merchandise creditors \$15,000.00 and the bank for loans \$11,000.00, that Ames has loaned the partnership \$8,000.00 and that Cox has made a similar loan of \$7,000.00. There is \$75,000.00 cash available at that date for distribution. On August 1st you are again called in to distribute \$56,000.00 additional cash realized, and on October 1st you are requested to advise distribution of the final cash collections of \$15,000.00, all partnership assets then having been sold. Show in tabulated form or by debits and credits to accounts the amounts to be distributed in each of the three installments.

# AUDITING

NOVEMBER 9, 1923—9:00 A. M. TO 1:00 P. M.

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1. You are engaged to make a monthly audit for a corporation dealing in machinery and mill supplies and to render monthly an income and profit and loss statement and balance sheet. Perpetual inventories are kept by the "Cost of Sales" method (i. e. extending cost of sales in the sales records). Would your procedure be the same for the monthly audits as at the close of the fiscal year? Explain fully. Assuming that at the end of the fiscal year there was a large difference between the perpetual inventory and the physical inventory taken what would be your attitude and how would you treat this difference in your last monthly profit and loss statement and in the annual statement for the year?
2. The Directors of a manufacturing concern, incorporated in Virginia, which you audit annually, deem it expedient to pay an interim dividend out of the current year's profits. Accordingly at the close of the seven months operations you are called in to advise them as to an amount that would not then nor prospectively for the balance of the fiscal year be a payment out of capital. State fully your method of procedure and draft a short report to your client covering your investigation.
3. In making a balance sheet audit what verification would you make of and how would you classify, the following: (a) Good Will (b) Donated Capital Stock (c) Property leases (d) Patents (e) Work in Process (f) Reserve for Customers' Discounts (g) Federal Taxes Payable (h) Branch Store.
4. In an audit of a Cash Account state fully how you would verify the receipts, disbursements and the resultant cash balance when the cash book shows:
  - (a) All receipts deposited in bank and all disbursements made by check.
  - (b) The bank and cash transactions kept together.In the event your audit is begun twenty days after the close of the fiscal year what steps should be taken to establish the cash balance for the balance sheet?
5. Name the various general classifications of Funds usually found in the balance sheet of a municipality. Construct a balance sheet showing the items contained in each Fund, using your own figures, and state how you would verify each item in making an audit.
6. State your procedure in making an examination of a State bank. In what particular essentials would the audit differ in the case of a State bank belonging to the Federal Reserve System; a National bank; Savings bank; Trust Company?

7. In auditing the accounts of a company in connection with a proposed plan of refinancing, to be evidenced by an issue of long term bonds, what special features would you consider required your special attention? What particular information should be given in the company's prospectus and in what respect would the balance sheet contained therein differ from the ordinary balance sheet? Explain fully.
8. In the audit of any manufacturing corporation with which you are familiar what special points in the balance sheet, aside from the correctness of the figures, would you consider required careful consideration? Would your answer be the same in the case of:
  - (a) A balance sheet audit.
  - (b) A detailed audit.
9. In auditing the books of a large corporation to what extent would you examine the minute-book and to what particular items would you direct your attention? What verification would you make of the outstanding capital stock and how would you satisfy yourself that the transfers of stock had been properly made? Suggest a method whereby the corporation may be safeguarded against liability in making transfers of stock.
10. You are called in to audit the books of a company where fraud is suspected. To what should you direct special attention— Explain fully.