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AMERICAN INSTITUTE OF ACCOUNTANTS EXAMINATIONS

[Following is the text of the examinations in auditing, law and accounting presented by the board of examiners of the American Institute of Accountants November 12 and 13, 1931.]

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 12, 1931, 9 A. M. TO 12:30 P. M.

Answer all the following questions:

No. 1. (10 points):

Define turnover in merchandising or manufacturing, and state how it is to be ascertained.

No. 2. (10 points):

In a qualified certificate appears the following sentence:

> "Depreciation of capital assets has been charged on the basis of the cost of such assets and not on appreciated values."

In the accompanying balance-sheet surplus is stated as a single item.

Your client, a prospective investor in the stock of the corporation in the case, asks you to explain what the sentence means, and to advise him as to what further information he should obtain.

What explanation and what advice would you give him?

No. 3. (10 points):

You are instructed to make the first audit of the accounts of an estate covering a period of two years from date of decedent's death. His assets comprised bonds, stocks, mortgage notes, notes and accounts receivable and cash. At the same date there were direct liabilities consisting of notes and accounts payable and contingent liabilities in respect to notes payable endorsed by decedent, who, however, was not engaged in business.

You find that appropriate investment records and ledger accounts have not been kept, that journal entries without explanations have been made in the cashbook, and that the final cash balance in the cashbook is not in agreement with the balance shown by the bank statement.

State what audit procedure you would follow in verifying the gross and net estate, and the gross and net income of the estate for the two-year period under review.

No. 4. (10 points):

To what extent is a public accountant liable to a creditor of his client who relies upon his certified statement and suffers a loss because of a condition existing in the affairs of the debtor-client which was neither disclosed nor indicated in the accountant's report? State your reasons and discuss.

No. 5. (10 points):

You are employed by the estate of A, deceased, to audit the books and render a statement of the affairs of the firm of A & B, of which A was a member. In the course of your audit you find an item debited to insurance expense designated merely "life-insurance premium." On inquiry you learn from the bookkeeper that it was paid on a joint-life policy of the two partners. You find no record of the receipt of the face of the policy.

What does this suggest to you, and what steps will you take in the matter?

No. 6. (10 points):

Define the following terms:

(a) Cost less accrued depreciation.

(b) Cost of reproduction new less accrued depreciation.

State the conditions under which each method may be used in valuing capital assets.

No. 7. (10 points):

You are auditing an importer's accounts in behalf of a bank which has established commercial letters of credit for large amounts in favor of the importer. The latter signs "trust receipts" when he receives the goods he imports.

How far would you pay attention to the practice of the importer in paying the bank drafts drawn under these credits, and why?

No. 8. (10 points):

In making an audit of a stock-broker's accounts you find the following accounts of customers:

(a) Customer Abbott:

Ledger debit balance, $9,500.

Market value of "long" securities held by broker to protect the account, $6,000.

Above account is guaranteed by Customer Brown.

(b) Customers Carter & Davis, joint account:

Ledger debit balance, $75,000.

Market value "long" securities held, $95,000.

(c) Customer Elliott:

Ledger debit balance, $25,000.

Market value "long" securities held, $6,875.

Above account is guaranteed by Customer Flynn, whose debit balance is $88,000, and

Market value of "long" securities held is $191,000.

Elliott also guarantees the account of Gaunt, whose debit balance is $100,000, and

Market value of "long" securities is $60,000.

(d) Customer (1) Harris, and
(2) Harris, special:

(1) Harris' account shows debit balance, $12,500 and "long" securities, $15,000.

(2) Harris', special, account shows debit balance, $2,100. No securities held.

What procedure should be followed in confirming these accounts? Give reason for each case.

No. 9. (10 points):

When accounts receivable have been sold or hypothecated, how should they appear on the books and/or the balance-sheet which you are certifying without qualification?

No. 10. (10 points):

Criticize the following description of the verification of income in an audit report:

> "Cash received from the rental of boats by the hour or day has been verified from the daily appointment schedules kept by the dock tender (and not by the bookkeeper or cashier). All other receipts for monthly rentals, berth privileges, etc., are received in the form of cheques by mail. As daily receipts recorded agreed with deposits as shown by bank statements, we accept as correct the original entries for these revenues as found in the journal."

Examination in Accounting Theory and Practice

PART I

NOVEMBER 12, 1931, 1:30 P. M. TO 6:30 P. M.

The candidate must answer the first three questions and one other question:

No. 1 (30 points):

The trial balance (condensed) of Company A, as at December 31, 1930, was as follows:

	Dr.	Cr.
Cash	$ 2,438	
Accounts receivable	37,097	
Inventories—January 1, 1930:		
Raw material	7,492	
Jobbing goods	2,564	
Finished goods	10,473	
Machinery and equipment	14,622	
Prepaid insurance	1,300	
Purchases:		
Raw material	88,838	
Jobbing goods	44,045	
Sales:		
Manufactured goods—net		$163,721
Jobbing goods		54,601
Sundry accounts, apart from those detailed, applicable to cost of manufacturing and cost of sales	43,232	
Sundry expense accounts, applicable to profit and loss	51,312	
Notes and accounts payable		24,215
Reserves:		
For depreciation		12,021
For doubtful accounts		3,500
To reduce "Company B's" account to inventory cost value—January 1, 1930		144
Capital stock		18,500
Surplus		26,711
	$303,413	$303,413

Included in the accounts receivable of Company A is an account with "Company B," which is in reality a title only, used by A in selling merchandise on consignment to certain small dealers.

An analysis of this account, as it appears in the accounts-receivable ledger of Company A, is as follows:

	Dr.	Cr.
Balance—January 1, 1930	$ 3,600	
Shipments during 1930	632	
Selling expenses	58	
Cash collections during 1930		$ 2,344
Credit memos. issued in 1930 for goods returned		2,560
	$ 4,290	$4,904
		4,290
		$ 614

All cash collected from the customers of "B" is credited to this company's account on the books of A. This procedure has been in vogue for several years.

A list of balances of customers' consignment accounts of "B" totals $1,218 (which is accepted as correct), representing the prices at which the garments are sold to the public by the customers of "B." These customers remit only for garments actually sold and deduct 20 per cent. for their profit. A garment billed to "B" by Company A at the latter's regular selling price of $2 is then sold to the public by the customers of "B" for $2.90. The same proportion holds throughout. Shipments, inventories and sales consist of 75 per cent. of manufactured goods and 25 per cent. of jobbing goods.

On the articles handled by "B," Company A earns a gross profit of 35 per cent. on its selling price on manufactured goods and 25 per cent. on jobbing goods.

A physical inventory of goods on hand at the plant of Company A, at the close of business, December 31, 1930, was as follows:

Raw material	$6,780
Jobbing goods	4,463
Finished goods	7,246

From the foregoing trial balance and following data, prepare

(1) Journal entries necessary to adjust the account of "Company B;"

(2) Statement of cost of goods manufactured and cost of sales;

(3) Statement of profit and loss for the year ended December 31, 1930;

(4) Balance-sheet as at the close of business, December 31, 1930.

No. 2 (25 points):

Companies M and P are engaged in the exploitation, development and production of minerals. They decide to consolidate and form a Company K with a capital stock of 100,000 shares of no par value.

Under certain rights, acquired for nominal considerations, the holdings of Companies M and P have proved to be very valuable, principally because of discoveries of extensive underground deposits, the cost of which was considerably less than the present intrinsic values.

A disinterested appraisal has been made, and, based upon this appraisal and other assets apart from those appraised, the capital stock of K is to be issued to the stockholders of the subsidiary companies in the following proportions: for each share of M, two shares of K and for each share of P, four shares of K.

The appraisal shows the value of the properties of M to be $2,600,000 and those of P, $4,400,000.

All the stock is exchanged, with the exception of 100 shares of M. Later, 20,000 shares of K stock are sold for cash at $100 a share.

The accounts of M and P, as at the date of consolidation, were as follows:

	M	P
Cash	$ 200,000	$ 100,000
Property	1,600,000	1,800,000
Sundry other assets	500,000	100,000
	$2,300,000	$2,000,000
Sundry liabilities	$ 300,000	$ 600,000
Reserves for depletion and depreciation	800,000	600,000
Capital stock	1,500,000	1,000,000
Surplus (deficit)	300,000	200,000
	$2,300,000	$2,000,000

From the foregoing information

(a) Prepare journal entries to record transactions on books of K.

(b) Prepare a consolidated balance-sheet (in detail) explaining eliminations and adjustments.

(c) Explain basis on which minority interests are computed.

(d) How do you show capital accounts on the consolidated balance-sheet and why?

(e) How do you show property accounts on the consolidated balance-sheet and why?

(f) In preparing a consolidated balance-sheet and income statement as of a subsequent date, what adjustment, if any, would you make with regard to reserves for depletion of mineral deposits?

No. 3 (35 points):

Explanatory Notes

A logging company buys timberland (standing timber), cuts it down, saws it into logs and sells the logs.

The timber is first "cruised" by an expert, who reports upon the approximate amount and condition of each kind of timber on each section.

The land may be sold for a lump sum, at so much per acre or so much per thousand feet logged.

Where the land is close to a river, the skidroad process is employed; if too far away from a river, railroads are built. Frequently, the combination process is used.

When a section "goes under the axe," a camp is built, a road cleared and skidroad or railroad, or both, constructed. The cost is spread over the section cleared, as such equipment is worthless when this particular part is exhausted.

The processes employed are felling, bucking (sawing into logs), branding (a different mark being used for each section), logging and hauling—over skidroad, by railroad to landing on river bank, or direct to the mill. If the logs are dumped into a river, a boom, owned generally by an outsider, is necessary for sorting.

The logs, rafted or railroaded to the mill, are then graded and measured by both owner and buyer. As soon as the content of either raft or car is determined, the mill sends the owner (logger) a credit memorandum for it.

Problem

From the following trial balance and explanatory data, prepare

(a) Balance-sheet, as of December 31, 1930.

(b) Statement of operating cost for the year ended December 31, 1930.

(c) Statement of profit and loss for the same period.

Samoset Logging Company—Camp No. 1
Trial balance—December 31, 1930

	Dr.	Cr.
Cash in bank	$422,500	
Petty cash	1,750	
Accounts receivable	165,450	
Inventories:		
Cook-house	250	
Wangan*	150	
Standing timber (stumpage)	157,800	
Clearing cost	2,400	
Machinery and equipment	22,400	
Tools	1,250	
Cable	8,200	
Skidroads	29,000	
Office fixtures	1,500	
Notes payable		$ 50,000
Accounts payable		18,750
Payrolls accrued		37,100
Bonds—6 per cent		100,000
Capital stock		500,000

*Wangan—A flatboat used by Maine lumbermen for transporting their tools and provisions.

	Dr.	Cr.
Labor	$ 59,400	
Rigging maintenance	4,850	
Sundry operating expenses	900	
Cook-house purchases	12,350	
Cook-house sales		$ 15,250
Wangan purchases	1,210	
Wangan sales		1,320
Log sales		185,200
Salaries—administrative	10,000	
Office expenses	2,550	
Sundry expenses—general	710	
Bond interest	3,000	
	$907,620	$907,620

A survey of the situation, and an analysis of the records, produced the following information:

(1) There was no inventory of logs on hand, January 1, 1930, either in wood or in water.

(2) The cruiser's estimate of the tract contents was 60,000,000 feet.

(3) During the year, 26,040,000 feet were logged and 25,470,000 feet were rigged (placed in heaps or piles).

(4) Inventories, December 31, 1930, were:

Cook-house	$ 300
Wangan	160
Logs in water	2,320,000 feet

(5) Logs sold, 23,150,000 feet.

(6) Labor account was analyzed as follows:

Felling and bucking	$ 17,100
Rigging	36,550
Cook-house	3,540
Wangan	2,210
	$ 59,400

(7) Bond interest is payable semi-annually, July 1st and January 1st, and the dividend declared is 3 per cent.

The brand used in this instance was S L—1.

Fixed assets are to be written off in proportion to footage handled. Equipment depreciation is to be considered as a general expense. Tools are to be written off to felling and bucking, and cable wear-and-tear to rigging.

No. 4 (10 points):

A certain company has an agreement with its president to pay him a bonus of 10 per cent. of that portion of the net profit, after deduction for federal income tax, which is in excess of 6 per cent.

of the invested capital. Invested capital amounts to $300,000.

The profit, before deduction for bonus and tax, was $50,000 and the bonus, to be paid, is a deductible item in computing the tax.

What is the company's net income—i. e., less bonus and tax—and what the true rate of return on investment?

No. 5 (10 points):

A corporation has outstanding $14,000,000 in 6 per cent. bonds, due in 5 years. Interest is payable annually. The corporation desires to retire these bonds by a new 4½ per cent. issue, also due in 5 years.

The brokers suggest an issue of a stated larger amount to be issued mostly to the old bondholders, the balance to be the brokers' commission. No cash is to be received or paid.

This, apparently, should result in a considerable saving in interest, but you point out to the corporation that the cost will, eventually, be about the same.

What amount of bonds did the brokers suggest?

Given: $(1.045)^5 = 1.246182$

Examination in Commercial Law

NOVEMBER 13, 1931, 9 A. M. TO 12:30 P. M.

An answer which does not state reasons will receive no credit. Whenever practicable, give answer first and then state reasons.

GROUP I

Answer all questions in this group.

No. 1 (10 points):

John Mason at the request of Walter Burroughs lent $150 to Burroughs, stating at the time that he, Mason, owed that amount to Charles Evans to whom he was obligated to pay it ten days thereafter. Burroughs, in consideration of the loan and at the time of receiving the $150, promised Mason that he, Burroughs, would pay $150 to Evans ten days thereafter. Evans knew nothing of this loan and promise until he tried unsuccessfully to collect from Mason. After Burroughs' failure to pay, can Evans recover in an action brought by him against Burroughs?

No. 2 (10 points):

Prentice made a valid contract with Adams whereunder Adams was to sell Prentice's goods on commission during the period from

January 1, 1931, to June 30, 1931. Adams made satisfactory sales up to May 15, 1931, and was then about to close an unusually large order when Prentice suddenly and without notice revoked Adams' authority to sell. Can Adams continue to sell Prentice's goods during the unexpired term of his contract?

No. 3 (10 points):

Carlin borrowed $10,000 from White for one year, giving as security a mortgage upon real estate.

(a) Six months later, Carlin died. At the maturity of the loan, what rights has White and against whom can he enforce them?

(b) If White instead of Carlin had died six months after the loan was made, to which of the following persons should Carlin make payment at maturity—White's legatees, heirs, testamentary trustee, administrator, next of kin, executor, devisees?

No. 4 (10 points):

Sanborn in June, 1928, while entirely solvent, executed and gave to his wife as a gift a formal bill of sale of his interest in the Mann Drug Corporation, in which he owned 110 shares of stock, but he retained the stock certificate, the stock was not transferred on the books of the corporation, the corporation was not notified of the bill of sale, and Sanborn continued to vote on the stock and receive dividends until April, 1931. At that time he was hopelessly insolvent and knew it, but without receiving any consideration he indorsed the certificate for these 110 shares to his wife, who had the transfer recorded on the corporation's books. Was this transfer of stock fraudulent as against Sanborn's creditors?

No. 5 (10 points):

Atwood and Chapin were partners and their business was insolvent. Atwood fraudulently represented to Morton that the firm's business was solvent and thereby induced Morton to become a partner and to make a capital investment of $10,000. As soon as Morton discovered the fraud, he personally obtained possession of most of the firm's assets and then notified his partners that he had withdrawn from the firm. Thereafter a creditor of the firm whose claim had arisen prior to Morton's becoming a partner, sued all three partners.

(a) What is the extent of Morton's liability, if any, to the creditor who was suing?

(b) What rights has Morton with respect to the fraud perpetrated on him?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if any are submitted only the first five answers will be considered.

No. 6 (10 points):

In what ways or by what means can the existence of a corporation come to an end?

No. 7 (10 points):

A policy of fire insurance issued to a partnership in its firm name makes no mention of changes in the personnel of the firm.

(a) Does the subsequent withdrawal of a partner affect the validity of the policy?

(b) Does the subsequent admission of a new partner affect the validity of the policy?

No. 8 (10 points):

(a) What is a conditional sale and how does it differ from a lease with an option to purchase?

(b) How in general can a conditional vendor protect his rights?

No. 9 (10 points):

Tompkins makes a negotiable promissory note payable to the order of the First National Bank and before delivery Chase writes his name on the back of it. What kind of endorser, if any, is Chase and what is his liability, if any, to the payee and to subsequent endorsees?

No. 10 (10 points):

(a) What is meant by an act of bankruptcy?

(b) Name the various acts of bankruptcy.

(c) What is a referee in bankruptcy, how does he obtain his position as referee, and what in general are his duties?

(d) What is a trustee in bankruptcy, how does he obtain his position as trustee, and what in general are his duties?

(e) What debts, if any, are not affected by a discharge in bankruptcy?

No. 11 (10 points):

A testamentary trustee duly made an authorized purchase of 400 shares of capital stock (of the par value of $100 each) at 120.

Subsequently he received 400 rights entitling him to subscribe to 100 additional shares at 100. Entirely regardless of taxable income, how should the trustee render account, distinguishing between principal and income of the trust, in each of the following cases:

(a) The trustee exercised his rights and later sold 40 shares at 130.

(b) The trustee did not exercise his rights but sold all the rights at $4.50 each.

No. 12 (10 points):

A corporation in 1925 constructed a factory building for its own use at a cost of $200,000. In 1929 it was insured for $250,000, and upon a total loss by fire during that year the entire amount of the insurance was received from the insurance company. Two hundred thousand dollars of this insurance money was immediately invested in the construction of a new factory which was sold in 1931 for $175,000. In what years and in what amounts would any taxable gain or deductible loss be recognized under the revenue act of 1928? (In your computations, disregard depreciation.)

Examination in Accounting Theory and Practice

PART II

November 13, 1931, 1:30 p. m. to 6:30 p. m.

The candidate must answer all the following questions:

No. 1 (40 points):

You are engaged to examine the record of capital stock, sold and issued, of the Natural Gas Company, from date of incorporation to March 31, 1931, and to make a detailed audit of the books of account during the period of production—January 1 to March 31, 1931.

The company was incorporated January 2, 1928, with an authorized capital of 500,000 shares of the par value of $1.00 each.

Your perusal of the minute book discloses that, pursuant to the provisions of the statutes of the state in which the company was incorporated, the entire capital stock of the company had been issued to P. Smith, in payment for gas leases, oil leases and contracts obtained from landowners at a fixed annual rental, until production of gas, when the rental would be converted to a royalty of 12½ per cent. of the gross value of the gas sold.

It was further disclosed that, under a pre-incorporation agreement, the promoters had sold and collected the proceeds of 205,000 shares of stock at 20 cents a share, which they accounted for as follows:

Proceeds:		
From pre-incorporation subscriptions, 205,000 shares at 20 cents a share		$41,000
Disposition:		
Gas wells—producing	$22,000	
Gas wells—abandoned	11,000	
Leases expired	451	
Leases unexpired	644	
Supervision	1,581	
Cash in bank	5,324	
		$41,000

You notice that certain items only are entered on the books of the company and credited, in total, to leases and contracts, viz.:

Gas wells—producing	$22,000
Leases unexpired	644
Cash (by cheque)	5,324
	$27,968

This record, together with a cheque payable to the company for the amount of the balance in bank and a legal transfer of all rights, titles and interest secured through these funds, was accepted and approved by the board of directors, which ordered that the record and transfers be given proper entry on the books of the company.

In order to raise funds for development of the gas structure, on which the company now holds the leases, Smith offered to donate to the treasury of the company 100,000 shares of stock for resale. The offer was accepted, approved and ratified by the board of directors, which fixed the resale price at $1.00 a share. A further offer of Smith to transfer 200,000 shares from his personal holdings for issuance to pre-incorporation subscribers was also accepted and approved, it being understood that any additional stock obligations to pre-incorporation subscribers would be supplied from the treasury of the company.

The treasurer (a man of means) deposited all receipts from the sale of stock in his personal bank account, relying upon the company's bookkeeper for the proper record of transactions. In checking this record you find the treasury-stock account credited with a remittance to cover 5,000 shares of stock donated by Smith, from his personal holdings, to the treasury of the company for transfer to A. Jones, in payment for pre-incorporation assistance to him, and another remittance of 100 shares, issued to replace a lost certificate. You note, also, that the bookkeeper had failed to obtain remittance for 1,250 shares that had been sold and issued. It was further disclosed that the treasurer had, personally, purchased 1,000 shares from a dissatisfied holder of capital stock, the certificate for which was found surrendered and attached to its relative stub without further transfer. Calling attention of the officers to these irregularities, you are requested to make the necessary corrections.

A trial balance, taken from the books, March 31, 1931, was as follows:

Abstracts of title	$ 670	
Accounts payable		$ 26,439
Accounts receivable	1,967	
Automobile	400	
Auto, expense	194	
Camp buildings	720	
Capital stock authorized		500,000
Cash in bank	182	
Casing, pipe, etc., in stores	10,624	
Development costs	112,364	
Equipment and pipe in place	60,000	
Incorporation costs	674	
Interest paid	718	
Land	4,600	
Land contracts		2,700
Leases and contracts	472,032	
Lease rentals	431	
Notes payable		33,947
Revenue from gas wells		6,114
Royalties paid (12½%)	764	
Salary of manager	900	
Sundry expenses	454	
Surplus donated		100,000
Taxes paid (property)	37	
Traveling	605	
Treasury stock	864	
	$669,200	$669,200

The company has decided to capitalize all development costs and to compute depletion on the basis of 27½ per cent. of gross income and depreciation on the productive life of ten years, without salvage value, in the case of camp buildings and equipment and four years on that of the automobile.

Make the necessary adjustments to bring the accounts in accord with the facts presented. Prepare profit-and-loss account for the three months' period—January 1 to March 31, 1931, and balance-sheet as of March 31, 1931.

Is the rate of depletion determined fully deductible for income-tax purposes?

No. 2 (12 points):

Abel, Budd, Catt and Dunn were partners in a stock-exchange brokerage house. During the year 1929, through speculation, the capital of the firm was reduced to such an extent that it became necessary to seek financial aid. They succeeded in introducing a capitalist, by name Ezee, to become a partner and to invest, as such, $500,000 in cash.

By the terms of the new partnership agreement, interest was to be allowed on capital at the rate of 6 per cent. per annum, and the average sales value of the seats on the exchanges held by the partners, plus cash, was to determine the values of their interests for capital purposes.

It was expressly stipulated that interest on the capital of the four partners—Abel, Budd, Catt and Dunn—should not be credited to them unless earned, but that the interest on Ezee's cash capital of $500,000 should be paid to him in any circumstances.

Profits were to be divided on the following bases:

Abel	30 per cent.
Budd	25 " "
Catt	15 " "
Dunn	10 " "
Ezee	20 " "

The capital accounts as at December 31, 1930, were as follows:

	Average sales value of exchange seats	Cash
Abel	$500,000	$120,000
Budd	300,000	100,000
Catt	180,000	30,000
Dunn	80,000	45,000
Ezee		500,000

The firm sustained a loss of $240,000, during the year 1930, before any distribution of interest on capital had been made.

How should this loss be apportioned?

Submit working papers showing how you reach your conclusions.

No. 3 (38 points):

Following are the condensed balance-sheets of companies A, B, C and D, as at the close of business, December 31, 1930:

Assets	A	B	C	D
Cash	$ 10,000	$ 20,000	$ 4,500	$ 20,000
Accounts receivable	90,000	180,000	145,000	280,000
" " from B	40,000			
" " " C		50,000		
" " " D			75,000	
Inventories:				
Raw material	75,000	100,000	90,000	100,000
Finished goods	60,000	70,000	80,000	90,000
Investments:				
Capital stock of A				50,000
" " " B	50,000			50,000
" " " C		100,000		50,000
" " " D	10,000			
Plant and property	1,580,000	1,970,000	2,175,000	3,110,000
	$1,915,000	$2,490,000	$2,569,500	$3,750,000

Liabilities	A	B	C	D
Notes payable	$ 90,000	$ 100,000	$ 160,000	$ 220,000
Accounts payable to A		40,000		
" " " B			50,000	
" " " C				75,000
Capital stock	1,000,000	1,400,000	2,000,000	3,000,000
Surplus	825,000	950,000	359,500	455,000
	$1,915,000	$2,490,000	$2,569,500	$3,750,000

The capital stock of the several companies owned by the other companies was purchased at par and is carried on the books at cost in each instance.

A consolidation is proposed and decided upon, and the N Banking Company is engaged to make the necessary arrangements for this purpose. The banking company succeeds in securing agreements from the stockholders of the four companies, A, B, C and D, all complying with the terms of the proposal whereby a new company is to be organized and known as the X Y Company.

During the past five years, dividends have been paid annually as follows:—A, 16.55 per cent., B, 17 per cent., C, 15 per cent. and D, 12½ per cent. It is agreed to prorate goodwill among the companies on the ratio of the amount of dividends paid by each during the past five years. It is further agreed that the return of all merchandise sold to, and bought by, one or other of the companies, be accepted and that the full price paid therefor be allowed. The average percentage of net profit on inter-company sales has been A, 20; B, 30; C, 25; D, 35.

The raw materials of D were all bought from C, those of C were bought from B, and those of B from A. A purchased its raw materials in the open market.

The inventories of all companies have been carried on the books at cost.

The X Y Company's authorized capital stock is to consist of 2,000,000 shares of no par value. The stockholders of A, B, C and D have agreed to accept 1,500,000 shares, in return for their own stock and holdings of the other companies, which are to be issued at the nominal value of $10 each in payment of their individual interests in the respective companies. Five hundred thousand shares are to be held for sale by the N Banking Company at not less than $10 a share.

The estimated amount of reorganization and financing expenses is $2,000,000 and is to be paid from the proceeds of the sale of the stock held by the banking company. The balance of the proceeds of the sale of the stock is to be turned over to the X Y Company as additional working capital.

From the foregoing, after giving effect to the transactions enumerated, prepare

(1) Balance-sheet of the X Y Company, to submit to the clientele of the N Banking Company for investment purposes.

(2) Statement of the amount of shares of capital stock that will be received by the holders of stock of A, B, C and D respectively.

No. 4 (10 points):

A fire partly destroyed the building of Company N, resulting in a loss of $20,000. The sound value of the building was determined to be $50,000.

Because of a misunderstanding between the insurance companies and the broker, or negligence on the part of the broker, insurance was carried as follows:

Insurance company	Co-insurance clauses	Amount of insurance
W	None	$10,000
X	100%	10,000
Y	90%	7,500
Z	80%	7,500
		$35,000

The above policies carry a clause to the effect that the insurance company will not be liable for any more of the loss than the ratio which the amount of the policy bears to the insurance, collectible or not.

Compute the amount the assured will receive on each policy.