American Institute of Accountants Examinations, November 1933

American Institute of Accountants. Board of Examiners

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 17 and 18, 1932.]

Examination in Auditing

NOVEMBER 17, 1932, 9 A. M. TO 12:30 P. M.

Answer all the following questions:

No. 1 (10 points):

Auditing a corporation in the state of X for the calendar year 1931, you find on its profit-and-loss statement "Taxes paid, $4,200." The ledger account shows the following items:

"Feb.	1	State real-estate tax—½ of 1930............	$1,200	
May	1	" " " "—½ " 1931............	1,200	
Nov.	1	" " " "—½ " 1931............	1,800	
Dec.	31	Contra to profit & loss.....................		$4,200"

Supporting tax bills show that the assessments cover periods for one year from July 1st, agreeing with the state's fiscal year, the taxes being due and payable in two instalments, November 1st and May 1st.

You also discover an unrecorded unpaid bill for a state franchise tax of $3,000, due and payable November 1, 1931, for one year in advance.

Give your analysis of the items, and state how they should be treated.

No. 2 (10 points):

A bank engages you to audit the accounts of the Smith Manufacturing Company, which is seeking a loan. You find that the company is not incorporated and that A. B. Smith is the sole owner of the business.

How far will you go in determining and setting out in your report the personal assets and liabilities of Mr. Smith? State your procedure.

No. 3 (10 points):

State the method of verifying the following accounts in the audit of a stock-brokerage firm.

(a) Customers' accounts (cash balance and securities).
(b) Failed to deliver.
(c) Failed to receive.

No. 4 (10 points):

In 1925 your client, a corporation, issued 100,000 shares of cumulative preferred stock. In 1927 it repurchased 20,000 of these shares and held them as treasury stock until 1932 when it sold them at cost. Dividends for 1930 and 1931 on the preferred stock were suspended, but were declared in 1932 together with the dividend for that year.

You find that the dividends on the 20,000 shares of treasury stock for 1928 and 1929 were entered on the books as income to the corporation, as were also the suspended dividends when declared in 1932, the purchasers of record of these shares receiving only the dividend for 1932.

How will you deal with this matter? Give your reasons.

No. 5 (10 points):

(a) Define "trade acceptance." (b) What is its distinguishing characteristic? (c) As compared with customary trade methods of book accounts what are its advantages and disadvantages (1) to the parties thereto, (2) to the auditor, and (3) to business in general?

No. 6 (10 points):

The A. B. Corporation lends money to its customers, taking their notes secured by warehouse receipts for merchandise in storage. All these notes, together with the warehouse receipts, are pledged by the corporation to secure bank loans.

What steps should the auditor take to verify the notes receivable at the date of his balance-sheet?

No. 7 (10 points):

You are invited to address a regional bankers' convention on the subject of internal check in handling loans and discounts. Give an outline of what you would suggest.

No. 8 (10 points):

In conducting an audit of a wholesale company, you note the following accounts on the general ledger:

Cash discounts lost (debit balance).............	$1,432.73
Cash discounts not taken (credit balance)........	5,733.40

What, in your opinion, is the meaning of these accounts, and how will you dispose of them in preparing the income statement of the business?

Submit pro-forma journal entries illustrating a purchase and a sale under the procedure obviously followed by the company.

No. 9 (10 points):

State three methods of treating cash discounts on sales in the income statement and discuss the reasons for each.

No. 10 (10 points):

In making an audit of a recently organized utility corporation, you find an entry on the books, supported by resolution of the board of directors, as follows:

"Franchises, Dr.	$50,000	
To Surplus		$50,000
To set up expenditures by incorporators prior to date of incorporation in connection with securing franchises."		

State what you would do and your reasons therefor.

Examination in Accounting Theory and Practice

PART I

NOVEMBER 17, 1932, 1:30 P. M. TO 6:30 P. M.

The candidate must answer questions 1 and 2, 3 or *4 and 5* or *6.*

No. 1 (30 points):

You are called upon by the president of a corporation to restate the operating accounts of the company. The chief accountant has recently remodelled the general ledger, introducing accounts for cost of sales, work in progress and other accounts appertaining to the operations. These accounts are maintained in the general ledger, no separate factory ledger having been opened.

At the end of the first month under the new system, the chief accountant has submitted to the president a statement of operations showing:

Net sales	$75,000
Cost of sales	43,700
Operating profit	$31,300

The president has then asked that figures be submitted showing inventories at the beginning, purchases, payrolls, etc., but the chief accountant has met with a serious accident and no one else in the office has been able to furnish the desired information. You are requested to do this.

Show how you would obtain the desired information and state what suggestions you would offer in order that cost of sales could readily be analyzed in the future.

The operating accounts and journal entries are as follows:

LEDGER

Raw materials

Inventory	$30,000	Issues	$25,500
Voucher record	20,000		

Stores

Inventory	$10,000	Issues	$15,150
Voucher record	7,500		

Work in progress

Inventory	$20,000	Cost of sales	$43,700
Raw materials	24,000	Power house	320
Stores	10,000	Plant account	1,500
Voucher record	1,500		
Labor	5,150		
Overhead	6,870		

Pattern shop overhead

Stores	$ 1,150	Work in progress	$ 500
Voucher record	50	General plant expense	150
Labor	75		
Power	240		
Depreciation	100		
Insurance	50		
Taxes	30		

Foundry overhead

Stores	$ 900	Work in progress	$ 1,950
Voucher record	125		
Labor	125		
Power	400		
Depreciation	300		
Insurance	125		
Taxes	75		

Machine shop overhead

Stores	$ 1,500	Work in progress	$ 3,250
Voucher record	350		
Labor	275		
Power	800		
Depreciation	480		
Insurance	200		
Taxes	75		

General plant expense

Raw materials	$ 1,000	Work in progress	$ 1,170
Stores	1,300		
Voucher record	275		
Labor	225		
Pattern shop overhead	150		
Depreciation	80		
Insurance	25		
Taxes	20		

Power house

Raw materials—Coal, etc.	$ 500	Pattern shop	$ 240
Stores	150	Foundry	400
Labor	350	Machine shop	800
Depreciation	140	General offices	160
Insurance	100		
Taxes	40		
Work in progress	320		

Labor—Pattern shop

Voucher record	$ 650	Sundries	$ 650

Labor—Foundry

Voucher record	$ 1,950	Sundries	$ 1,950

Labor—Machine shop

Voucher record	$3,250	Sundries	$3,250

JOURNAL ENTRIES

1

Work in progress	$24,000	
Power house	500	
General plant expense	1,000	
Raw materials		$25,500
Summary of materials used during month.		

2

Work in progress	10,000	
Pattern-shop overhead	1,150	
Foundry "	900	
Machine-shop "	1,500	
Power house	150	
General plant expense	1,300	
Employees' accounts receivable	150	
Stores		15,150
Summary of requisitions for the month.		

3

Plant and equipment	5,000	
Work in progress	1,500	
Raw materials	20,000	
Stores	7,500	
Employees' accounts receivable	150	
Advertising	700	
Prepaid insurance	1,250	
Pattern-shop overhead	50	
Foundry "	125	
Machine-shop "	350	
General plant expense	275	
Salaries	5,000	
Labor—Pattern shop	650	
" —Foundry	1,950	
" —Machine shop	3,250	
" —Power house	350	
Traveling expense	350	
General expense	650	
Accounts payable		$49,100
Summary of voucher record for the month.		

4

Work in progress	5,150	
Pattern-shop overhead	75	
Foundry "	125	
Machine-shop "	275	
General plant expense	225	
Power house	350	
Labor—Pattern shop		650
" —Foundry		1,950
" —Machine shop		3,250
" —Power house		350
Distribution of payrolls.		

5

Work in progress	6,870	
General plant expense	150	

Pattern-shop overhead		$ 650
Foundry "		1,950
Machine-shop "		3,250
General plant expense		1,170
Distribution of overhead for the month.		

6

Plant and equipment	$ 1,500	
Power house	320	
Cost of sales	43,700	
Work in progress		45,520
Cost of shipments during month.		

7

Power house	280	
Pattern-shop overhead	180	
Foundry "	500	
Machine-shop "	755	
General plant expense	125	
Prepaid insurance		500
Reserve for depreciation		1,100
Accrued taxes (property)		240
For proportions applicable to factory, viz.:		

	Depreciation	Insurance	Taxes	Total
Power house	$ 140	$100	$ 40	$ 280
Pattern shop	100	50	30	180
Foundry...	300	125	75	500
Machine-shop	480	200	75	755
General plant	80	25	20	125
	$1,100	$500	$240	$1,840

8

Pattern-shop overhead	$ 240	
Foundry "	400	
Machine-shop "	800	
General office	160	
Power house		1,600
Distribution of overhead for month.		

No. 2 (30 points):

You are engaged by a certain professional association, founded January 1, 1929, to audit the books of account and records for the period of one year and six months ended June 30, 1931. The purpose of this organization is to promote the welfare of the profession. To this end it engages in various activities, principally the publication of monthly bulletins containing data of interest to its members. These bulletins are printed by outside printers and are mailed each month to the membership. At the end of the year, additional bound volumes of the twelve issues are available to the members for $8.60 a volume. Extra copies of the monthly bulletin are sold at 50 cents each.

The membership dues are $10 per annum, payable in advance, and it is customary to charge the members with the full year's dues on January 1st. All dues for 1931 are paid.

A trial balance of the books as at June 30, 1931, before audit adjustments, was as follows:

Cash in bank	$ 5,300	
Accounts receivable—members	11,250	
" " —advertising	625	
Inventory of publications—December 31, 1930	20,800	
Accrued interest receivable	200	
Stocks and bonds	15,000	
Furniture and fixtures	5,400	
Prepaid insurance	70	
Accounts payable		$ 2,700
Reserve for depreciation		1,250
Surplus		37,748
Membership dues—1931		32,500
" " —1932		1,500
Sales of bulletins		4,442
" " advertising matter		3,250
Interest on investments		300
Salaries	10,000	
Printing bulletins	11,420	
Office expense	2,455	
Depreciation	270	
Binding	900	
	$83,690	$83,690

The profit-and-loss account for the year ended December 31, 1930, as disclosed by items in the surplus account on the books, was as follows:

	1930
Membership dues—1930	$38,000
" " —1931	400
Sales of bulletins	9,840
" " advertising matter	4,450
Interest on investments	700
Total	$53,390
Opening inventory	17,600
Binding bulletins	900
Printing bulletins	22,940
Total	$41,440
Closing inventory	20,800
Remainder	$20,640
Salaries	17,700
Office expense	2,600
Depreciation	525
Total	$41,465
Net profit to surplus	$11,925

Inventories of publications (by quantities) on hand, at closing dates, were as follows:

	Bound sets	Unbound sets	Single bulletins
June 30, 1931:			
1931			11,000
1930	250	700	1,500
1929	1,380	1,100	3,500
December 31, 1930:			
1930	300	700	2,000
1929	1,500	1,100	3,700
December 31, 1929:			
1929	1,900	1,100	4,100

The cost of printing is 30 cents a bulletin, and the cost of binding $3 a volume. During the period under review, 6,000 copies of each month's bulletin were printed.

The liabilities as at June 30, 1931, are all shown on the books.

It is agreed that the bound and unbound bulletins for the year 1929 are to be written down to one half on December 31, 1930; and on June 30, 1931, to one quarter of their cost. The bulletins for 1930 are to be written down to three quarters of their cost on June 30, 1931.

You are required to prepare the following statements:

(a) Balance-sheet as at June 30, 1931.

(b) Income statements for the year 1930 and for the six months ended June 30, 1931.

(c) Statement showing opening and closing inventories, purchases, distribution and sales of bulletins for each period. Show quantities and amounts.

Submit your working papers.

No. 3 (25 points):

The X Y Z Syndicate was formed April 1, 1928, and purchased a parcel of vacant city land for the sum of $215,500, the purchase being financed by (a) funds invested by the participants, (b) proceeds of a second mortgage on the property and (c) purchase-money mortgage issued to the vendor.

The syndicate agreement provided that a trustee should hold title to the property, that each of the three participants would be the equitable owner of a one-third interest, that capital should be contributed to the venture in proportion to the respective interests and that interest at the rate of 6 per cent. per annum should be allowed on capital.

Declining real-estate values rendered it impossible to sell the property.

No books were kept, but cheque stubs of the syndicate's bank account revealed the following:

Deposits:		
1928		
Apr. 1	Received from X	$34,000
	" " Y	21,000
	" " Z	20,000
Oct. 1	" " X	5,000
1929		
Apr. 1	Bank loan—3 months—guaranteed by X	50,000
	Received from X	4,000
	" " Y	2,000
	" " Z	2,500
May 1	Sign-board rentals for one year	7,500
1930		
May 1	Received from X	5,000
	Sign-board rentals for one year	7,500
1931		
May 1	Received from Y	2,500
	" " Z	2,500
1932		
Apr. 1	Received from X	2,000
	" " Y	2,000
	" " Z	2,000
Payments		
1928		
Apr. 1	Account of purchase price	70,000
30	Taxes	2,995
May 10	Legal fees	1,000
Oct. 1	Interest on purchase-money mortgage (6%)	3,000
	" " second mortgage (6%)	1,500
1929		
Apr. 1	Interest on purchase-money mortgage	3,000
	" " second mortgage	1,500
	Second mortgage paid	50,000
	Discount on bank loan	750
30	Taxes	3,434
July 1	Discount on loan renewed	750
Oct. 1	" " " "	750
	Interest on purchase-money mortgage	3,000
1930		
Apr. 1	Interest on purchase-money mortgage	3,000
30	Taxes	4,225
Oct. 1	Interest on purchase-money mortgage	3,000
1931		
Apr. 1	Interest on purchase-money mortgage	3,000
30	Taxes	4,150
Oct. 1	Interest on purchase-money mortgage	3,000
1932		
Apr. 1	Interest on purchase-money mortgage	3,000
30	Taxes	3,874

Prepare such statements as you would submit to the participants in this venture, as of June 30, 1932.

No. 4 (25 points):

Henry White, a partner in the investment-banking firm of Black & White, died on December 31, 1931.

The assets and liabilities of the firm, at that date, were as follows:

Cash in bank	$ 11,526.90	
Life-insurance funds receivable	44,700.02	
Marketable securities	978,663.77	
Notes and accounts receivable	23,268.63	
Bonds of Kiln Lumber Co., bankrupt, at 25 per cent. of par	56,250.00	
Seventy-five per cent. interest in logs, lumber, machinery and logging equipment	22,604.25	
Notes payable		$ 500,000.00
Accrued interest		1,500.00
Liability as guarantors of note of Kiln Lumber Co., bankrupt		38,170.31
Accounts payable		14,357.33
Agreement to repurchase $10,000 bonds of Kiln Lumber Co. at 97½		9,750.00
Capital—James Black, 40 per cent.		229,294.37
" —Henry White, 60 " "		343,941.56
	$1,137,013.57	$1,137,013.57

James Black, surviving partner, was appointed trustee to continue the business for a limited period of time.

The transactions to September 30, 1932, were as follows:

The amount due for life insurance was collected.

$712,554.07 was realized on securities which cost $619,483.

$3,725 was expended in exercising rights, the original and newly acquired shares being among those unsold at September 30th.

Notes and accounts receivable realized $17,429.30, but of the balance outstanding at September 30th only $1,000 was considered good.

Foreclosure proceedings were instituted on the bonds of the Kiln Lumber Co. In the final settlement, $4,603.97 was realized in cash and the firm acquired a three-fourth's interest in 10,000 acres of timber lands.

The interest in logs, lumber, machinery and logging equipment realized $2,725.09.

A claim receivable for damages, which was pending December 31, 1930, but not entered on the books, was settled for $3,000.

Notes payable, with interest, amounting to $27,500, were paid.

The liability as guarantors of the note of the Kiln Lumber Co. was discharged by payment of $36,149.73.

One $1,000 bond of the Kiln Lumber Co. had been lost or stolen and, therefore, could not be produced. The remaining bonds were repurchased.

The accounts payable, together with an additional item of $1,275 owing at December 31st but not discovered until later, were duly paid.

The sum of $200,000 was withdrawn in the proportion of the partners' investments.

Expenses incurred, exclusive of interest, totaled $7,328.30, of which $432.15 were unpaid September 30, 1932.

Income amounted to $14,732.03, of which $2,500 had not been received September 30, 1932.

Prepare a statement, in suitable form, for the use of the trustee and of the executor of the estate of the deceased partner.

No. 5 (15 points):

The superintendent of a cheese manufactory reports the following results of a test-run:

46,153 pounds of milk were purchased at the contract price of $3.10 per cwt., on the basis of a butter-fat content of 3.5 per cent., with a premium or discount of 4 cents per cwt., on account of variations from the standard, the total cost being $1,647.66. From this milk, 5,976 pounds of cream, having a butter-fat content of 20 per cent., were sold at a price of 58 cents a pound of butter fat, the remainder yielding 4,491 pounds of uncured cheese, known as No. 1.

The whey from the milk used weighed 29,280 pounds, to which was added 1,384 pounds of whole milk from the purchases of the following day, the combined fluid yielding 1,821 pounds of uncured cheese known as No. 2.

The No. 1 cheese is subject to a shrinkage of 12.3 per cent. in curing, and the No. 2 to a shrinkage of 33 per cent.

From the foregoing data, determine the material cost per pound of cured cheese and the yield per cwt. of milk.

For this purpose, you may assume the value of whey to be 50 cents per cwt., and the price of the whole milk used in the process of the second day the same as that used on the first day.

No. 6 (15 points):

A joint-stock land-bank loan of $1,000 is repayable in 65 semi-annual instalments of $35 each and a final payment of $29.23 at the end of the 33rd year. These payments include interest at the nominal rate of 6 per cent. per annum compounded semi-annually.

What is the amount of the balance at the end of the 20th year? Given at 3 per cent.:

v^{40}	.3065568	$(1+i)^{40}$	3.2620378
v^{26}	.4636947	$(1+i)^{26}$	2.1565913
v^{25}	.4776056	$(1+i)^{25}$	2.0937779

What amounts of principal and interest respectively were contained in the fortieth payment?

Examination in Commercial Law

November 18, 1932, 9 a. m. to 12:30 p. m.

An answer which does not state reasons will be considered incomplete. Whenever practicable, give answer first and then state reasons.

GROUP I.

Answer all questions in this group.

No. 1 (10 points):

Wolff was the selling agent for Knox Mills, Inc., and since 1924 had owned 100 shares of its common stock. Claghorn was president of the corporation. Wolff and Claghorn executed a contract under seal whereby Claghorn agreed to purchase Wolff's stock at par value at any time upon Wolff's request. Wolff gave Claghorn the right to purchase it if Wolff's contract with the corporation should terminate or at any time within 30 days after Wolff's death. The stock certificate was endorsed as follows: "This certificate is subject as to transfer to a certain agreement made between Jacques Wolff and Edwin B. Claghorn, dated November 15, 1926." This contract was made binding upon and to enure to the benefit of the executors, administrators and assigns of each party "provided that no assignment of this agreement shall be made by said Wolff without the written consent of said Claghorn." On November 3, 1930, Wolff duly requested Claghorn to purchase this stock and tendered it to him. Claghorn refused to purchase it on the ground that the contract was void for lack of mutuality and of consideration. Is this contract valid?

No. 2 (10 points):

Dupont drew a cheque on the X bank for \$1.22 payable to the order of Alice Nugent. This cheque was fraudulently raised to \$3,881.22 and the name of the payee changed to Alfred Nugent. Thereafter, this cheque was endorsed by Alfred Nugent and deposited by him in the B bank. The B bank endorsed it, guaranteeing all prior endorsements, and collected \$3,881.22 from the X bank. Prior to the discovery of the fraud, Alfred Nugent closed his account with the B bank and disappeared. Upon whom does the loss fall and why?

No. 3 (10 points):

A boy, twelve years old, whose mother had died and whose father had abandoned him, was being supported by a man who had known both of the boy's parents for several years but who was not related in any way to the boy. One year after this support began, the man procured insurance on the boy's life payable to the man as beneficiary. Two years thereafter the boy died. At all times, from the date of the application for the policy until the boy's death, the insurance company's general agent and its local agent or solicitor knew all of the facts and circumstances of the case. Is the policy valid?

No. 4 (10 points):

Mark Talbot was insolvent. In order to obtain a loan of \$500,000 from Clark Gibbons, Talbot was compelled by Gibbons to purchase from him, for \$378,000, a residence property known to be worth \$250,000, and certain corporate stock of no market value for \$80,000. Talbot signed a note payable to the order of Gibbons carrying interest at the legal rate of 6%.

(a) At maturity, will the note be enforceable by the payee?
(b) At maturity, will the note be enforceable by a holder in due course?

No. 5 (10 points):

Theodore Crawford, in November, 1925, subscribed for 100 shares of the preferred stock of the M Corporation and paid \$2,000 to the corporation on account. Crawford was induced to make and did make this subscription wholly because the corporation's treasurer had formally represented to him that the corporation had a surplus at July 1, 1925, and had legally paid a dividend in the month of July, 1925. Crawford sued for the rescission of his contract and the recovery of the \$2,000, and the following facts were proved: On January 1, 1925, the corporation's books showed a deficit of \$11,484.29. In the following May, a journal entry was made debiting deferred engineering and development expense and crediting surplus with \$22,167.95 for "expenses charged off in 1924, deferred to future operations." This amount was 80% of the 1924 expenditures for engineering. At the same time the corporation paid \$10,000 for 400 shares of its own common stock, which it proceeded to carry at an asset value of \$10,000, although the book value immediately prior to this purchase was \$6.27. The corporation declared and paid a dividend of \$1,591.55 in July, 1925.

(a) On the facts as stated, should Crawford succeed in his action?

(b) If the facts as stated should be amplified, indicate the lines along which further inquiry should be made.

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):

A debtor of the X bank, in liquidation, offered to compromise his indebtedness by the payment of $2,074.10. The state superintendent of banks agreed to consider this offer on condition that the debtor deposit the money in escrow and submit to an audit, and on condition, also, that acceptance of this offer be approved by the court having jurisdiction of the liquidation. The deposit was made and the audit completed but the debtor died prior to acceptance of the offer by the superintendent. The debtor's executor immediately demanded the return of the escrow deposit. Is he entitled to it?

No. 7 (10 points):

Charles Little on his own behalf contracted to sell 1,500,000 gallons of molasses of the usual run from a specified sugar refinery, deliveries to begin three months after the date of the contract of sale. At no time did Little have a contract with the refinery. Shortly after deliveries began, the refinery curtailed its output, for economic reasons, although there was no failure of the sugar crop and no fire or other accident or strike at the refinery. The refinery refused to sell to Little a sufficient quantity to enable him to deliver all of the 1,500,000 gallons. Has Little any valid defence in an action brought against him by the vendee for failure to deliver?

No. 8 (10 points):

Belknap, for an adequate consideration, gave the following written instrument to Pinney on August 5, 1932:

New York, N. Y.

Thirty (30) days after date I promise to pay to the order of Albert Pinney One Thousand Seven Hundred Fifty Dollars ($1,715.) at Liberty Trust Company. Value received. Interest at 6%.

Robert Belknap
James Silliman
Agents of New York Turbine Company.

Against whom, when, and for what amount will Pinney be entitled to enforce this instrument?

No. 9 (10 points):

(a) What circumstances can cause the dissolution of a partnership?

(b) Does dissolution necessarily result in the actual termination of the business formerly conducted by the partnership?

(c) What authority has a partner after dissolution?

No. 10 (10 points):

In September, 1928, Stone was 20 years and 6 months of age. He opened a margin account with stock-broker X and did a certain amount of trading. One month later he transferred to X a similar account which he had with broker Y and caused to be delivered to X 400 shares of the then market value of $17,450. X paid Stone's debit balance of $13,907.91 to broker Y, thus leaving Stone an equity of $3,542.09 in these 400 shares. Two months later Stone closed his account with X, receiving from X $70.99 in full payment of his credit balance. Six weeks thereafter Stone rescinded his agreement with X, disaffirmed all of his transactions with X, and sued X to recover the amount of his equity in the 400 shares ($3,542.09) minus the $70.99 paid to him by X upon the closing of his account. Stone in June, 1928, had deposited $4,000 cash as margin with broker Y. At the time of Stone's disaffirmance of his agreement with X, the 400 shares transferred from Y had a market value of $14,227. How much, if any amount, can Stone recover from X?

No. 11 (10 points):

A corporation's certificate of incorporation or charter provided in article A that holders of preferred stock should be entitled out of surplus or net profits to cumulative dividends at 7%. Article E stated that in any liquidation or dissolution the preferred stockholders "shall be entitled to be paid in full the par value thereof and all unpaid dividends accrued thereon before any amount shall be paid or any assets distributed to the holders of the common shares." Article F read: "The preferred stock shall be subject to redemption at $110 per share plus all unpaid, accrued, or accumulated dividends thereon." The corporation was dissolved and after the payment of all creditors the funds available for distribution did not amount to the total par value of the outstanding preferred and common stock. At the time of dissolution no declared dividends remained unpaid and the preferred stockholders had received annually the full amount of their 7% dividends. How should the available funds be distributed between preferred and common stockholders?

No. 12 (10 points):

(a) What are the principal changes in the income-tax provisions of the revenue act of 1932 as compared with the revenue act of 1928?

(b) Explain, and illustrate by a simple example, how the gift tax will be computed (knowledge of the rates prescribed in section 502 is not required).

Examination in Accounting Theory and Practice

PART II

NOVEMBER 18, 1932, 1:30 P. M. TO 6:30 P. M.

The candidate must answer questions 1 and 2, and any two *of the* three *following questions:*

No. 1 (36 points):

From the following data, you are required to prepare a consolidated balance-sheet of company A and subsidiaries, as at December 31, 1931, including an analysis of consolidated surplus for 1930 and 1931.

		Date	Cost
1.	Acquisitions		
	A—20 per cent. of stock of B	Dec. 31, 1929	$180,000
	A—45 " " " " " B	Mar. 31, 1930	400,000
	A—25 " " " " " B	Sept. 30, 1930	270,000
	90 per cent.		$850,000
2.	A—20 per cent. of stock of C	Dec. 31, 1930	
	B—60 " " " " " C	Dec. 31, 1931	
	A—95 " " " preferred stock of D	Dec. 31, 1930	
	A—80 " " " common " " D	Dec. 31, 1930	
	A—20 " " " stock of E	Dec. 31, 1930	

3. The profits of B for the year 1930 were earned as follows:

First quarter	$ 30,000
Second "	50,000
Third "	70,000
Fourth "	75,000
	$225,000

4. B drew a cheque for $5,000 in favor of A on December 31, 1931, which was not received and therefore not recorded by A until January 2, 1932.

5. Included in the inventories of B, at December 31, 1931, were goods purchased from A in 1931, amounting to $100,000, on which A had taken up a profit of 20 per cent.

6. A has included dividends received from B and E in its profits.

7. The preferred stock of A is 7 per cent. cumulative, and dividends have been paid thereon to December 31, 1931. The preferred stock of D is 6 per cent. non-cumulative and non-participating, and dividends have been paid to December 31, 1930.

The balance-sheets of the several companies, as of December 31, 1931, were as follows:

Assets	A	B	C	D	E
Cash	$ 100,000	$ 95,000	$ 25,000	$ 10,000	$ 30,000
Receivables	540,000	425,000	145,000	20,000	70,000
Inventories	500,000	400,000	100,000	50,000	25,000
Advances:					
To A		100,000			
" C		60,000			
" D	110,000				
Investments:					
In stock of B (90%) at cost	850,000				
" " " C (20%) " "	40,000				
" " " C (60%) " "		130,000			
" preferred stock of D (95%) at cost	95,000				
" common " " D (80%) " "	40,000				
" stock of E (20%) at cost	15,000				
Fixed assets	1,500,000	450,000	150,000	100,000	50,000
Goodwill			20,000	20,000	
	$3,790,000	$1,660,000	$440,000	$200,000	$175,000

Liabilities and Capital	A	B	C	D	E
Accounts payable	$ 535,000	$ 420,000	$155,000	$ 16,000	$60,000
Advances:					
From A				110,000	
" B	95,000		60,000		
Capital stock:					
Preferred—par value $100	1,000,000			100,000	
Common— " " $100	1,000,000	700,000	200,000	50,000	100,000
Surplus:					
Balances, December 31, 1929	880,000	100,000	18,000		
Profits—1930	530,000	225,000	2,000	10,000	20,000*
" —1931	390,000	375,000	5,000	80,000*	50,000
Dividends paid, preferred:					
1930	70,000*			6,000*	
1931	70,000*				
Dividends paid, common:					
March 15, 1930		20,000*			
December 15, 1930	300,000*	70,000*			
" 15, 1931	200,000*	70,000*			15,000*
	$3,790,000	$1,660,000	$440,000	$200,000	$175,000

* Red.

No. 2 (28 points):

The Endicott Company commenced operations January 1, 1931, manufacturing one type of commodity of a standard pattern.

At the end of the year, the bookkeeper prepared and submitted the following statements:

Exhibit A

Statement of profits

Sales, net—3,500 articles at $40	$140,000
Deduct: Cost of 3,500 articles at $28 (exhibit B)	105,000
Net profit	$ 35,000

Exhibit B

Statement of cost of manufacture and cost of sales

Total expense (exhibit C)			$140,000	
Total articles produced	5,000			
Articles in process	500			
Cost per article		$28		
Cost of 5,000 articles at $28				$140,000
Inventory of 1,000 articles at $28			$ 28,000	
" " 500 " " 14			7,000	35,000
Cost of sales—3,500 articles at $30 (exhibit A)				$105,000

Exhibit C

Expenses

Raw material purchases	$40,000	
Less: Inventory—cost, plus freight	3,000	$ 37,000
Salaries and wages		58,000
Freight		4,600
Insurance—factory		2,300
Taxes— "		1,300
Advertising		4,594
Printing and stationery		2,200
Rent of office		2,400
Interest paid		1,800
General expenses		10,505
Repairs—factory and machinery		2,801
Power, light and heat—factory		7,100
Sundry expenses— "		3,000
Supplies— "		900
Experimental work		400
Stable and auto expense—factory		1,100
Total (exhibit B)		$140,000

The accuracy of these statements is questioned, and you are called upon to check them and to prepare a statement in statistical form showing sales, cost of goods sold, gross profit on sales, selling expenses, net profit on sales, general and administrative expenses, net profit on operations, financial charges and net income for the year.

Your investigation discloses the following:

Salaries and wages account—	
Officers' salaries	$17,400
Salesmen's salaries and commissions	16,400
Labor—direct	16,500
" indirect	7,700
Total	$58,000
Accrued wages, not included in above—	
Labor—direct	$ 1,900
" indirect	600
Total	$ 2,500
Freight account—	
Inward	$ 2,800
Outward	1,800
Total	$ 4,600

Insurance account—
Unexpired, $1,700.

Printing and stationery—
On hand, $850.

Interest paid—
$500 applies to 1932.

General expenses—
$1,300 applies to 1932.

Upon consulting with the president, it was decided that the charge for depreciation on the factory building should be 4 per cent. on $52,000, and on machinery 10 per cent. on $16,000, and that provision for bad debts should be $2,100.

The capital stock outstanding was shown to be $275,000 on December 31, 1931.

No. 3 (18 points):

The firm of A, B & C were dealers in securities for their own account and others. On November 30, 1931, the partnership was dissolved because C, whose only capital contribution was his stock-exchange seat, desired to withdraw.

A & B formed a new partnership, taking over all assets and liabilities of the firm, except the stock-exchange seat and the goodwill. (The latter was considered worthless.)

Profits and losses were shared in the ratio of 60, 25 and 15 by A, B and C respectively.

In addition to the trial balance given herewith, which reflects all routine adjustments and accruals, the following information was gathered, as of November 30, 1931:

Customers' free credit balances	$ 202,295
Market value of customers' securities short	36,752
" " " firm " "	29,649
" " " " " long	1,009,479

Trial balance November 30, 1931

Corn Exchange bank	$ 63,215	
National City bank		$ 750,000
Failed to receive		185,483
Stock-exchange seat	350,000	
Goodwill	250,000	
Profit on syndicate transactions		215,932
Loss on joint accounts	79,290	
Partners' salaries	51,583	
Interest received		4,592
Dividends received		21,138
Stock Clearing Corporation	10,000	
Failed to deliver	148,660	
Accrued interest		2,265
Interest paid	68,232	
Interest on partners' capital	42,880	
Salesmen, office and general	255,330	
Customers' ledgers	660,313	228,980
Petty cash	852	
Brokerage	7,543	
Commissions		80,533
Firm securities long	1,458,664	
" " short		16,429
Bank of America		270,000
Revenue stamps	565	
Commissions receivable	4,843	
" payable		7,556
Accrued income—syndicates	5,500	
" expense— "		201,677
Capital accounts:		
A		800,000
B		350,000
C		350,000
Drawing accounts:		
A	12,192	
B		16,147
C	31,070	
	$3,500,732	$3,500,732

From the foregoing data, prepare the opening balance-sheet of the new partnership of A & B, as at December 1, 1931.

No. 4 (18 points):

(a) At December 31, 1930, the Rightform Manufacturing Company was carrying, as current assets, certain temporary investments (at cost), whose respective market values you find to be approximately as follows:

	Cost	Approximate market values
Common stocks:		
400 shares Southern Pacific	$45,320	$37,500
220 " National Biscuit	18,600	17,080
50 " Western Union	9,415	6,675
U. S. Liberty Loan, $4\frac{1}{4}$'s of 1933–1938	21,950	21,150
	$95,285	$82,405

State clearly three methods (in order of preference from the viewpoint of conservatism) of treating these investments in the annual accounts.

(b) The Satisfaction Tailoring Corporation has funds on deposit in several banks, two of which closed during the latter part of 1931 and, at the date of your examination, have not reopened. What is the conservative way to state these frozen deposits on the corporation's balance-sheet at December 31, 1931?

(c) The Interstate Holding Company owns capital stock of three subsidiary companies—A, B and C—amounting to 95, 90 and 60 per cent. respectively, of the total outstanding stock of each. In preparing statements of the holding company, for the guidance of its directors in deciding upon the declaration or omission of dividends, what cognizance, if any, would you take of the following conditions?

(1) The book value of A company's stock is less than that at which it is carried by the holding company, due to heavy losses incurred in the current and preceding years as a result of inefficient management.

(2) The book value of B company's stock is substantially less than that at which it is carried by the holding company, as a direct result of the subsidiary's having declared and paid dividends during the current year in excess of profits.

(3) C company's stock, which is carried on the books of the holding company at an average cost in the open market of $84 per share, is quoted on the New York stock exchange at $10.50 at the balance-sheet date. Investigation shows that this shrinkage is directly attributable to two factors: (a) adverse conditions in the industry, and (b) general financial conditions and other causes entirely unrelated to the business.

State briefly what your treatment of the foregoing factors would be in preparing a balance-sheet for the holding company.

No. 5 (18 points):

The revenue act of 1932 provides for a tax of 13¾ per cent. of the amount of the net income of every corporation. If a consolidated return is filed, the rate is 14½ per cent. These rates apply to the entire amount of net income, as corporations are no longer allowed a specific credit. A net loss of a corporation may be deducted in the succeeding taxable year. Income-tax returns for the year 1932 are due on or before March 15, 1933.

A parent company owns all the outstanding common stocks of 62 operating companies, with the exception of qualifying directors' shares. The books of the parent company and of the subsidiary companies are audited annually by public accountants, and reports are submitted for each company, as well as a consolidated balance-sheet and a consolidated income and profit-and-loss statement.

The parent company maintains a tax department, and the income-tax returns are prepared by this department, but the public accountants are retained to give advice with respect to federal tax matters.

(a) In December, 1932, you are asked for your opinion as to whether a consolidated return should be filed or whether separate returns should be filed for each company. In giving your opinion, state briefly the factors you would take into consideration, with such qualifications as you deem necessary.

(b) You are also requested to confer with the company's tax department and suggest, in a general manner, methods whereby the return, or returns, may be prepared with a minimum of expense and with a consistent treatment of taxable items of income and deductions of all companies.

Do not submit forms: give only an outline of the procedure to be followed in the preparation of the return or returns.