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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, May 11 and 12, 1933.]

Examination in Auditing

MAY 11, 1933, 9 A. M. to 12:30 P. M.

Answer all the following questions.

No. 1 (10 points):

State what you understand to be the scope of the following:

(a) Balance-sheet audit
(b) Complete audit
(c) Continuous audit
(d) Special audit

No. 2 (10 points):

The E. Z. Corporation issued $100,000 of preferred stock with an obligation to set aside a certain percentage of its annual profits as a reserve for the final redemption of the stock at par, a corresponding fund being accumulated in actual cash. It is further provided that the corporation may use this cash to repurchase its preferred stock in the market, carrying it as treasury stock until redeemed. Such redemption may take place at any time on due notice to the holders.

In the course of time the corporation has set up such a reserve and cash fund to the amount of $50,000. In 1932, owing to the depression in the stock market, it was enabled to buy in the entire issue at an average cost of 10 per cent., or $10,000. Thereupon, after giving "due notice," it redeemed the entire issue, and its balance-sheet now shows cash in the fund of $40,000 and an increase in the surplus of $140,000.

At the annual meeting, which you attend as auditor, you are asked if this additional surplus is available for an extra dividend on the common stock.

What would you reply? Give your reasons.

No. 3 (10 points):

Why should an auditor insist upon examining all insurance policies, life, fire, indemnity, and compensation, in the course of his work?

No. 4 (10 points):

What would you consider a satisfactory voucher for:

(a) Payrolls in a large manufacturing business,
(b) Purchase of a stock-exchange security,
(c) Investment in a mortgage,
(d) Investment in, and the current value of, building-and-loan shares?

No. 5 (10 points):

The A. B. Corporation has ten thousand hands employed in some twenty departments. Its payrolls have always been made up by departments in standard form, and hitherto it has had little trouble in ascertaining each employee's total compensation, as changes from one department to another were very rare. In 1932 it adopted a "spread-the-work" plan which involved not only laying off men for short periods but also switching hundreds of them from one department to another as occasion demanded.

Entering on your annual audit engagement February 1, 1933, you find the entire clerical staff working frantically to make out information returns, the number being greatly increased by the lowering of personal exemptions under the federal income-tax act of 1932. Wages are paid weekly on the hourly basis, so the correct amounts to be returned can be obtained only by tracing each man's time through every departmental payroll.

You are asked to suggest some method by which the data for these information returns may be easily and accurately compiled for the future, without disorganizing departmental cost accounting.

What would you suggest?

No. 6 (10 points):

The X. Y. Corporation becomes insolvent and you are appointed receiver. State in detail the system of accounting you will adopt, and the form of your final report to the court.

No. 7 (10 points):

State in detail how you would audit, verify and classify on the balance-sheet securities in which the surplus funds of a corporation are invested.

No. 8 (10 points):

Give four principal examples of contingent liabilities, and state how you would proceed to discover them.

No. 9 (10 points):

A merchandising corporation shows in its profits for the year under audit a large amount of anticipated cash discounts on its accounts payable. Discuss the pros and cons of this practice.

No. 10 (10 points):

The X. Y. Corporation shows on its balance-sheet, among its assets, the following items:

Notes receivable	$300,000	
Accounts receivable	200,000	
	$500,000	
Less reserves	150,000	
		$350,000

What criticisms have you to offer? State the principle involved.

Examination in Accounting Theory and Practice

PART I

May 11, 1933, 1:30 p. m. to 6:30 p. m.

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

No. 1 (37 points):

You are engaged by the chairman of the reorganization committee of the S Y Manufacturing Company to make an examination of the books of account and records of the company for the period from January 1, 1926, to June 30, 1932, and to render a report. It is specifically requested by the chairman that your report contain an application-of-funds statement embodying a complete summary of securities and cash transactions during the period.

Your examination discloses the following facts:

The company was organized January 1, 1926, to bring together, under the control of one corporate management, five competing concerns manufacturing automobile accessories, with plants located in distant large cities.

The new corporation took over the fixed assets of all the other companies (gross value $8,000,000 less $3,000,000 depreciation), issuing cash and securities therefor, as set forth in the following summary:

Cash and securities issued for net assets acquired

Name of plant	First mortgage 6% gold bonds at par	7% preferred stock at par	No-par common stock at stated value	Cash	Totals
A...........	$ 800,000	$	$	$ 200,000	$1,000,000
B...........		300,000		500,000	800,000
C...........	800,000		400,000		1,200,000
D...........				400,000	400,000
E...........			1,600,000		1,600,000
Totals......	$1,600,000	$ 300,000	$2,000,000	$1,100,000	$5,000,000

In order to provide cash for working capital and to pay off bank loans of $1,000,000, releasing collateral set up at a like book value, additional securities were issued as follows:

$900,000 first mortgage 6 per cent. gold bonds at 90
$700,000 7 per cent. preferred stock at par
100,000 shares, no-par common stock, at $15 per share.

The capitalization of the new company was as follows:

First mortgage 6 per cent. sinking fund gold bonds......	$2,500,000
7 per cent. preferred stock, par value $100 per share.....	$2,500,000
No-par common stock, stated value $10 per share.......	350,000 shares.

Further information, obtained in the course of your examination, is set forth in the tabulation on the following page.

As of January 1, 1928, the corporation issued and sold 5,000 shares of its 7 per cent. preferred stock at par. As of January 1, 1929, it issued and sold 5,000 shares of its 7 per cent. preferred stock at par and 5,000 shares of its no-par common stock at $25

Particulars	1926	1927	1928	1929	1930	1931	Six months ended June 30, 1932	Totals
Net profits transferred to surplus	$400,000	$300,000	$700,000	$ 948,000	$238,000	$700,000*	$600,000*	$1,286,000
Surplus credits—profits on bonds retired				2,000	12,000	50,000		64,000
Dividends declared—								
Preferred	70,000	70,000	105,000	140,000	140,000	140,000		665,000
Common	225,000	225,000	450,000	610,000	450,000			1,960,000
Additions to property (net)	200,000	400,000	500,000	1,000,000	400,000	100,000	25,000	2,625,000
Provisions for depreciation	330,000	350,000	370,000	420,000	480,000	505,000	255,000	2,710,000
Book value of property retired, charged to depreciation reserve	350,000	300,000	250,000	700,000	300,000	300,000	125,000	2,325,000
Expenditures for renewals, charged to depreciation reserve				30,000	20,000			50,000
Salvage recoveries, credited to depreciation reserve	10,000	20,000	5,000	25,000	15,000	10,000		85,000
Bonds retired through sinking fund (a)—								
Principal amount			100,000	100,000	100,000	100,000		400,000
Cost			100,000	98,000	88,000	50,000		336,000
Sales of securities carried as permanent investments (b)—								
Book value				200,000	500,000	300,000		1,000,000
Losses charged to profit-and-loss account				100,000	300,000	200,000		600,000

* Denotes red figures.
(a) Sinking-fund requirement first effective for the year 1928 and company defaulted on 1932 requirement.
(b) Acquired from predecessor companies at date of organization of corporation.

per share, in order to provide additional working capital and for other corporate purposes.

Upon the basis of your examination of the company's accounts, you have prepared the following balance-sheet as of June 30, 1932:

THE S Y MANUFACTURING COMPANY

Balance-sheet, June 30, 1932

Assets

Current:		
Cash	$ 22,160	
Notes receivable	150,000	
Accounts receivable	100,000	
Inventories	425,000	$ 697,160
Prepaid expenses		25,000
Fixed		
Land and property	$10,625,000	
Less: reserves for depreciation	3,420,000	7,205,000
Unamortized bond discount		42,840
		$7,970,000

Liabilities and net worth

Current:		
Bank loans	$ 950,000	
Other notes payable	250,000	
Accounts payable	230,000	
Accruals	90,000	$1,520,000
First-mortgage 6 per cent. sinking-fund gold bonds, maturing January 1, 1941 (a)		2,100,000
Net worth:		
Capital stock—		
Preferred 7 per cent. stock, authorized 25,000 shares, par value $100 each, issued and outstanding 20,000 shares	$ 2,000,000	
Common stock, authorized 350,000 shares no par value, stated value $10 each, issued and outstanding 305,000 shares	3,050,000	
	$ 5,050,000	
Paid-in surplus—excess of sale price of common stock over stated value thereof	575,000	
Earned surplus	1,275,000*	4,350,000
		$7,970,000

* Denotes red figures.
(a) Sinking fund payment of $100,000 due May 1, 1932, has not been paid.

No. 2 (32 points):

In order to obtain a controlled source of crude oil to augment its own small production, the X Refining Corporation purchased the entire outstanding capital stock of the K O Producing Company. The latter company had developed several prolific wells in a pool area, and the owners were looking for a market for the oil. To finance the purchase of the subsidiary, the refining corporation sold $600,000 of 7 per cent. preferred stock and paid cash for the capital stock of the producing company.

At December 31, 1930, you are engaged to submit a report covering the operations for the year 1930. On the basis of information furnished herewith, prepare

(1) Consolidating balance-sheet as at December 31, 1930.
(2) Consolidating profit-and-loss statement for the year 1930.
(3) Consolidated surplus account for the year 1930.

Trial-balances (per books), December 31, 1930

	X Refining Corp.	K O Producing Company
Asset accounts:		
Cash	$ 110,000	$ 24,392
Accounts receivable	125,370	42,600
Inventories	75,640	5,762
Refinery and other property (cost)	1,007,391	
Oil property—		
Lease cost		1,000
Development expense		144,328
Equipment on lease		25,541
Other assets	32,000	31,000
Investment in K O capital stock	719,500	
	$2,069,901	$274,623
Liability accounts:		
Notes payable—banks	$ 150,000	$
Accounts payable	113,689	10,705
Accrued items	15,104	2,827
Reserves for depletion and depreciation	202,321	
Preferred stock—7 per cent.	600,000	
Common stock—		
80,000 shares of $10 each	800,000	
10,000 shares of no par value		100,000
Surplus balance	188,787	161,091
	$2,069,901	$274,623

Investment account in K O stock

Shares bought:		
December 10, 1929	4,900 @ $75	$367,500
December 28, 1929	1,000 @ 65	65,000
January 15, 1930	4,100 @ 70	287,000
	10,000	$719,500

For practical purposes, the date of acquisition was December 31, 1929, and may be so considered in this problem.

X REFINING CORPORATION

Profit-and-loss account (per books)

	Year 1929	Year 1930
Operating revenue	$932,609	$865,392
Operating and general expenses	765,503	775,255
	$167,106	$ 90,137
Depreciation and depletion	79,886	82,401
Net operating income	$ 87,220	$ 7,736
Dividends received on K O stock	24,500	250,000
Net profit	$111,720	$257,736
Dividends paid on preferred stock	$	$ 42,000
Dividends paid on common stock	80,000	120,000
	$ 80,000	$162,000
Net revenue—to surplus	$ 31,720	$ 95,736
Opening surplus	61,331	93,051
Closing surplus	$ 93,051	$188,787

K O Producing Company

Profit-and-loss account (per books)

(Operations commenced January, 1928)

	Year 1928	Year 1929	Year 1930
Barrels of oil produced	101,330	398,742	528,067
Oil sales	$152,309	$477,822	$573,112
Operating and general expenses	136,103	271,597	284,452
	$ 16,206	$206,225	$288,660
Provision for depletion			
Net income	$ 16,206	$206,225	$288,660
Dividends paid—June 15th		$50,000	$100,000
Dividends paid—December 15th		50,000	150,000
	$	$100,000	$250,000
Net revenue—to surplus	$ 16,206	$106,225	$ 38,660
Opening surplus		16,206	122,431
Closing surplus	$ 16,206	$122,431	$161,091

General Information and Remarks

The oil reserves (recoverable oil underground) of the K O Producing Company were estimated, by reliable geologists, to be 1,407,600 bbls. at December 31, 1930.

No depletion has ever been provided in the accounts of the K O Producing Company.

For the sake of simplification, assume that no capital additions have been made in the period under audit.

Inter-company sales, during 1930, amounted to $373,408. Inter-company profit remaining in inventories is nominal and may be ignored.

Disregard federal-income-tax features.

No. 3 (17 points):

From the following data submit, in detail and in total, the value, at cost, of the closing inventory. If there is any inconsistency with regard to the selling prices of the several sizes, state your explanation.

During a certain period, a plate-glass factory cast and rolled about 850,000 square feet of glass. The product, after cutting up in order to eliminate defects, was priced for sale as follows:

Size No. 1	28 cents per square foot
" " 2	24 " " " "
" " 3	22 " " " "
" " 4	20 " " " "
" " 5	14 " " " "
" " 6	5 " " " "

Any product below No. 6 was returned to process and remelted.

As may be seen, the selling price for a given quality varied with the size, the largest perfect sheets selling for the highest price per square foot.

The total cost of materials, manufacture, grinding, polishing, cutting and sorting, including factory expense, was $120,807.

The inventories—in square feet—were

	Opening	Closing
Size No. 1	10,000	12,860
" " 2		11,000
" " 3	10,000	23,000
" " 4		6,000
" " 5		
" " 6		2,000

The sales—at list selling prices—were

Size No. 1	$30,240
" " 2	36,480
" " 3	35,376
" " 4	21,100
" " 5	9,030
" " 6	2,300

No. 4 (14 points):

From the following data, prepare entries for the corporation's books to record all exchange transactions, the exchange position, and profits realized. Show, also, what the result would have been had the exchange risk not been covered.

A United States Corporation, owning the entire capital stock of a foreign company, sells its raw material to this company at cost. From this raw material the foreign company manufactures a certain product which it sells exclusively in its own country. It pays for the raw material bought, and remits the net profits as soon as they are realized in cash.

The unit of this foreign currency is the crown, worth sixty cents at par of exchange.

The rate of exchange declining, the customary measures are taken by the U. S. corporation to guard against exchange losses. These measures consist, principally, of selling forward the foreign currency to be collected. For this reason and purpose, the company's costs and expenses, as well as the proceeds from its sales, must necessarily be determined as nearly as possible in advance.

Crowns are freely bought and sold in the U. S., there being no restriction by the foreign government on the transfer of domestic funds to other countries.

On October 1st, when the crown was selling at 30, the U. S. corporation shipped raw material which cost $30,000 and billed the foreign company for the equivalent of 100,000 crowns, payable December 30th.

It was estimated that all manufacturing, selling, administration and other expenses applicable to this venture would be 120,000 crowns and that the product would be all sold by December 30th for 250,000 crowns. The estimate proved to be correct with one exception, viz:—the goods were actually sold and delivered by December 30th for 255,000 crowns, spot cash, f. o. b. factory.

The rate of exchange had, in the meantime, fallen to 20.

No. 5 (14 points):

An excerpt from the certificate of incorporation of a certain corporation reads as follows:

"So long as five thousand (5,000) or more shares of $7 cumulative preferred stock shall be outstanding the company shall not pay or declare any dividends in cash or property on any of its outstanding shares (exclusive of the cumulative dividends on outstanding shares of $7 cumulative preferred stock) unless the company shall have, out of its net profits or out of its net assets in excess of its capital, purchased and canceled or redeemed an aggregate number of its $7 cumulative preferred stock equal to the sum of the number of shares hereinafter designated for such purchase or redemption in respect of the calendar year in which such dividend payment is made and also in respect of each previous calendar year subsequent to the calendar year 1927. The number of shares of $7 cumulative preferred stock designated for purchase or redemption in respect of each calendar year for the purposes of the foregoing calculation shall be one-half of that number of shares arrived at by dividing the total number of shares of $7 cumulative preferred stock outstanding on the first day of January of such calendar year by the number of full calendar years which will elapse between the first day of January (such day being included) of the calendar year in respect of which such determination is made and January 1, 1943."

There were 10,000 shares of preferred stock outstanding at January 1, 1928. No shares were subsequently sold and the company acquired preferred stock as follows:

In the year 1929	750 shares
" " " 1930	713 "
" " " 1931	526 "

How many shares of preferred stock will have to be acquired in 1932 and in 1933 to permit the company to pay a dividend in each of those years on its common stock?

Submit your answer in tabular form.

Examination in Commercial Law

May 12, 1933, 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):

State in each of the following cases whether or not Culver is legally bound by his promise and state the principles of law on which your answer is based:

(a) Hawkins, upon reaching the age of 65 years, retired from the employ of Culver and immediately thereafter Culver promised to pay Hawkins $100 each month as long as Hawkins lived.

Culver had no established pension plan and at no time prior to his retirement had Hawkins expected or had any reason to expect a pension. Culver made the payments for four years but then discontinued them although Hawkins was still alive.

(b) Culver signed a subscription list by which he promised to give $100 to the Central Church toward the cost of a new organ. Other subscribers signed before and after him. The Central Church purchased the organ but Culver refused to pay the $100.

No. 2 (10 points):

The payee of a note, before its maturity, wrote on the back of it: "I hereby assign all my right and interest in this note to Richard Fay in full. (Signed) Harry C. Witte." The maker failed to pay the note at its maturity and Fay sued Witte as an endorser. Witte defended on the ground that his writing on the back of the note was a qualified endorsement and that he was not liable as an endorser. For whom should judgment be rendered?

No. 3 (10 points):

Laufer sold furniture to Burghard on a conditional sales contract for the sum of $515.39. The furniture was delivered and instalments were collected until the balance due on the contract was $343. Thereupon Laufer lawfully retook possession of the furniture and sold it. Must Laufer account to Burghard for any portion of the proceeds of the re-sale,

(a) if the net proceeds amounted to $400?
(b) if the net proceeds amounted to $200?

No. 4 (10 points):

A certificate of stock for 100 shares of the capital stock of the Bond & Share Company, issued to Lovett & Co., was endorsed by Lovett & Co. in blank and then sold for value to Whitestone & Co. who did not fill in their firm name or otherwise alter the certificate. Thereafter it was stolen from Whitestone & Co. The thief erased the name of Lovett & Co. as the stockholder and their signature as endorser, inserted the fictitious name of Adolph Zitman as stockholder, wrote Zitman's name as endorser, and pledged the certificate with Brown & Co., who received it for value in good faith and without notice or knowledge of the theft or alteration. Does the loss fall upon Whitestone & Co. or upon Brown & Co.?

No. 5 (10 points):

Hoven sold a horse to Turner, to be paid for upon delivery at Turner's residence. Hoven instructed Turner to pay Hoven's agent who would deliver the horse. Upon delivery, Turner gave the agent a cheque drawn to the order of Hoven. The agent endorsed Hoven's name on the cheque and Turner, at the agent's request, guaranteed the endorsement. The agent cashed the cheque and disappeared. Does the loss fall upon Hoven, upon Turner, or upon the bank at which the agent cashed the cheque?

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 will be considered.

No. 6 (10 points):

On August 1, 1932, an ice company by a valid contract sold 7,000 tons of ice to Whitney, who agreed to pay for and remove it by November 1, 1932. On September 3, 1932, Whitney, who had paid no part of the purchase price, notified the ice company that he would not take the ice. What remedies has the ice company?

No. 7 (10 points):

Ingle gave a cheque for $142 drawn on the First National Bank of the town of X to Case, who received it on the morning of November 19, 1930. Case sent his clerk to the First National Bank, on which a run had started at 9 a. m. The clerk took his place in line, which he held until 1 p. m. when he left and went to lunch. Upon his return he took his place at the end of the line, but the bank stopped paying at 2 p. m., before the clerk had reached the paying teller's window, and the bank did not re-open thereafter. Other persons who took places in the line after the clerk had joined it in the morning had their cheques cashed. Ingle had sufficient funds in the bank to meet all cheques drawn by him. Can Case recover in an action against Ingle?

No. 8 (10 points):

Danver was asked by Reid to become a co-surety with Taylor for an obligation owed by Reid to Pawling. Reid had prepared a written guaranty in the body of which the names of Danver and Taylor as sureties appeared. Danver signed this guaranty upon the express condition that Reid would procure Taylor's signature before delivery to Pawling. Reid ignored this condition and gave the written guaranty to Pawling without Taylor's signature. Can Pawling collect from Danver upon Reid's default in the payment of his obligation to Pawling?

No. 9 (10 points):

The Jefferson Plan Corporation was a Delaware corporation having its executive office in Philadelphia, Pa. One of its vice-presidents was served with a summons in Trenton, N. J. The corporation had not procured a permit to do business in New Jersey. It appeared that the vice-president who was served with the summons had an office in Trenton in which he devoted his time to research work on matters affecting the Jefferson Plan Corporation, to the editing of printed literature for that corporation, and to the training of employees for it. Do these facts constitute doing business within New Jersey to such an extent as to give the courts of that state jurisdiction of the Jefferson Plan Corporation?

No. 10 (10 points):

Anthony held a life-insurance policy to which was attached a supplemental contract providing double indemnity for death caused by external violent and accidental means, for which he paid an additional premium. By the terms of the policy this supplemental contract could be discontinued "upon request of the insured and the presentation of the policy to the company for cancellation of this provision." The policy provided also that no person except certain officers at the company's home office was authorized to modify or waive any of the terms of the policy. On March 20, 1930, the company's local agent received from Anthony and mailed to the company's home office in another city the policy and Anthony's written request for the cancellation of the supplemental contract. On that evening Anthony met with an external and violent accident which caused his death at 1 a. m. on March 21, 1930. The policy and request for cancellation were received by the company at 8:30 a. m. on March 21, 1930. Can the company be held for double indemnity?

No. 11 (10 points):

Zindle, a jeweler, gave Mrs. Chapman, a prospective customer, a diamond brooch of the retail value of $5,200 to wear while she was deciding whether or not to purchase it. Mrs. Chapman was accustomed to wearing expensive jewelry, and at all times when she wore this brooch she wore other expensive pieces of jewelry of her own. To all of the jewelry she gave what women of her social standing regarded as reasonable care. Nevertheless, the brooch was lost or stolen. Must she pay for it?

No. 12 (10 points):

The Falk Company purchased the business of the Kissel Company, taking over its assets and assuming its liabilities. Among those liabilities was one to the state of Wisconsin for income taxes for the year ended on the date of purchase. The Falk Company paid those Wisconsin income taxes in the year following. Can it lawfully deduct the amount of them in computing its federal income tax for the year in which they were paid?

Examination in Accounting Theory and Practice

PART II

May 12, 1933, 1:30 p. m. to 6:30 p. m.

Answer only four *questions.*

The candidate must answer any two *of the first three questions, No. 4, and No. 5* or *6.*

No. 1 (27 points):

Coal Distributors, Inc., closed its books for the fiscal year ended November 30, 1932. On March 31, 1933, it was declared bankrupt.

You are engaged by the trustee to make an investigation of the transactions of the company between the dates specified and to render a report.

From the following data

(a) Prepare adjusted balance-sheets in columnar form.

(b) State the matters disclosed by your investigation which you would include in your report to the trustee, giving your reasons for considering them important.

The assets and liabilities, as shown by the books, were as follows:

	November 30, 1932		March 31, 1933	
Accounts payable		$118,000		$140,000
Accounts receivable	$260,000		$292,000	
Reserve for bad debts		7,300		7,300
Cash in bank	2,200		1,700	
Mineral rights	8,600		8,600	
Notes payable—bank		38,600		48,300
Office equipment	5,200		5,200	
Reserve for depreciation		2,100		2,100
Trade acceptances received	19,000		15,000	
" " discounted		19,000		15,000
" " issued		51,000		62,000
Capital stock		50,000		50,000
Surplus		9,000	2,200	
	$295,000	$295,000	$324,700	$324,700

In the course of your investigation the following information is obtained:

Cash in bank was applied by the depository as a partial offset to the notes. Cheques outstanding, at the date of application, March 31, 1933, totaled $5,300. Accounts receivable consisted of the following:

	November 30, 1932		March 31, 1933	
Debtor	Amount owing	Considered worthless	Amount owing	Considered worthless
Ruby Coal Company	$ 10,600	$ 10,600	$ 17,300	$ 17,300
Retail Coals, Inc.	63,500	22,000	58,000	24,000
White Heat Company	52,700	46,000	63,800	63,800
All other customers	113,700	15,000	134,800	19,000
Officers and employees	19,500	17,400	18,100	18,000
	$260,000	$111,000	$292,000	$142,100

In the files you find conclusive evidence that the worthlessness of the accounts, as indicated, was well known to the officers on or before the respective dates.

Trade acceptances discounted were the direct obligations of Ruby Coal Company.

Mineral rights represented the cost, in 1920, of rights to extract certain subsurface deposits. Coal was mined on this property until about July 1, 1924, when operations were discontinued.

Trade acceptances, and accounts payable, consisted of the following:

Creditor	November 30, 1932	March 31, 1933
Greater Mines, Inc.	$ 45,000	$ 3,500
Deep Valley Coal Co.	72,500	2,300
White Haven Mining Co.	4,100	94,500
Pocahontas & Co.	1,300	57,000
All others	46,100	44,700
	$169,000	$202,000

Prior to November 30, 1932, only small and intermittent purchases had been made from White Haven Mining Company and Pocahontas & Co. Greater Mines, Inc., and Deep Valley Coal Company refused further credit to Coal Distributors, Inc. on or about November 30, 1932 (as evidenced by letters on file). The liabilities to these companies were discharged largely by delivery of train-loads of coal directly to customers of those companies (public utilities and coaling docks), such coal being shipped from the mines of White Haven Mining Company and Pocahontas & Co.

No. 2 (27 points):

Company A is a holding company with subsidiary companies B, C, and D. From the information submitted, prepare a statement showing the earnings per share of all the companies applicable to that part of the common capital stock of Company A which is held by the public.

The income and surplus accounts of the several companies, for the year ended December 31, 1932, were as follows:

	Companies			
	A	B	C	D
Net sales		$2,000,000	$300,000	$120,000
Cost of sales		630,000	160,000	42,000
Gross profit		$1,370,000	$140,000	$ 78,000
Selling and delivery expenses		512,000	42,000	27,000
Selling profit		$ 858,000	$ 98,000	$ 51,000
Administrative and general expenses	$ 4,400	320,000	40,000	22,000
Profit from operations	$ 4,400*	$ 538,000	$ 58,000	$ 29,000

* Loss or deficit.

	Companies			
Income credits:				
Dividends from affiliated companies	$527,600	$ 36,350		
Income from investments		60,000	$ 2,500	$ 1,000
Discount on purchases		6,200	2,600	1,800
Interest on loan to Company A		1,800		
	$527,600	$ 104,350	$ 5,100	$ 2,800
Gross income	$523,200	$ 642,350	$ 63,100	$ 31,800
Income charges:				
Discount on sales		$ 24,800	$ 5,200	$ 2,200
Interest paid Company B	$ 1,800			
Bank interest and discount		3,200	400	
Federal tax on income for current year—estimated		79,800	7,900	4,100
	$ 1,800	$ 107,800	$ 13,500	$ 6,300
Net income	$521,400	$ 534,550	$ 49,600	$ 25,500
Dividends paid:				
On preferred stock	$ 75,000	$ 100,000		
On common stock	375,000	400,000	$ 40,000	$30,000
	$450,000	$ 500,000	$ 40,000	$30,000
Surplus	$ 71,400	$ 34,550	$ 9,600	$ 4,500*

The capitalization of the companies is as follows:

	Shares issued	Number of shares owned by affiliated companies A	B
Company A:			
Preferred stock	100,000		3,000
Common stock	500,000		6,000
Company B:			
Preferred stock	25,000	24,000	
Common stock	50,000	49,000	
Company C—common stock	1,000	990	
Company D— " "	1,500		1,480

* Loss or deficit.

All dividends on preferred stocks have been paid to the latest dividend dates at the full accumulative rates.

The unrealized inter-company profit in inventories was as follows:

	December 31 1931	December 31 1932
On sales of Company C to Company B	$40,000	$44,000
On sales of Company D to Company B	28,000	30,000
	$68,000	$74,000

It is the intention of the companies to file individual federal-income-tax returns for the year.

No. 3 (27 points):

From the following data, revise as of December 31, 1929, the machinery, depreciation reserve, surplus and income accounts for the year 1929, wherever necessary, and prepare a schedule showing loss or gain on dismantlements. State what you would advise your client to do with regard to federal taxes, giving your reasons for such advice.

The S Novelty Company was organized January 1, 1926, to take over the business (including the machinery) of three other companies. Capital stock of $1,500,000, in shares of $100 par value each, was issued, $750,000 for cash and $750,000 for the appraised value of the machinery of the three companies which were consolidated to form the S Novelty Company. No stock was issued except for cash or the machinery of the constituent companies, working capital being provided from the proceeds of the sale of stock.

The company's operations were carried on in a rented building. The annual profits and losses of the company from 1926 to 1931, as shown by the books and as returned for federal income taxes, were:

Year	Loss	Profit
1926	$100,000	
1927	90,000	
1928	10,000	
1929		$200,000
1930		220,000
1931		180,000

On February 28, 1932, after the books of the company had been closed for the year 1931, an internal-revenue agent visited the office to examine the records regarding the federal-income-tax return for the year 1929. As the company had shown losses up to the end of 1928, their federal-tax returns had been accepted as rendered. After the agent had been working on the books a few days, he informed the president of the company that an additional federal tax would be demanded for the year 1929, based on an additional income of $54,600, claiming that this increase was due entirely to an adjustment of depreciation. He agreed to the rate of 10 per cent. on plant and machinery and also to the use of the beginning balance in the machinery account as the base for the calculation of depreciation.

You are called upon, at this time, to advise the president of the company as to the proper course to pursue, and you are given an abstract of the machinery account from the ledger, which is as follows:

1926		Dr.	Cr.
Jan. 1	Capital stock (7,500 shares)	$ 750,000	
	Cash	100,000	
	Cash		$ 20,000
	Depreciation		75,000
1927	Cash	150,000	
	Cash		10,000
	Depreciation		83,000
1928	Cash	200,000	
	Cash		50,000
Jan. 1	Appraisal	500,000	
	Depreciation		147,000
1929	Cash	100,000	
	Cash		10,000
	Depreciation		162,000
1930	Cash	50,000	
	Cash		15,000
	Depreciation		171,000
1931	Cash	20,000	
	Cash		5,000
	Depreciation		174,500
Dec. 31	Balance		947,500
		$1,870,000	$1,870,000

You are shown, also, a copy of the appraisal at January 1, 1926, on the basis of which the stock was issued, and a copy of another appraisal as of January 1, 1928, on the basis of which the charge of $500,000 was made to the machinery account in that year.

The bookkeeper has kept memoranda of the machinery sold or scrapped, as follows:

In the year 1926, machinery included in the appraisal of January 1, 1926, and valued at $30,000, scrapped or sold, realized $20,000, and $500 was spent in tearing it down and preparing it for shipment.

In 1927, machinery appraised at $14,000 as at January 1, 1926, was sold for $9,500 and a stamping machine bought in 1926 for $2,000 was scrapped and sold for $500. The expense of tearing down this machinery and preparing it for shipment was $300.

In 1928, the hydraulic presses, included in the appraisal of January 1, 1926, and valued at $70,000, were sold for $45,000 to make room for more modern equipment. The expense of tearing down and preparing for shipment was $750. These presses were valued at $75,000 in the appraisal of January 1, 1928.

Special machinery bought in 1926 for $10,000, which was appraised at $15,000 on January 1, 1928, was sold during 1928 because the work for which it was purchased was no longer performed by the company. The company received $5,000 from the sale, and $250 was spent in removing the machinery and shipping it to the purchaser.

In 1929, miscellaneous machinery included in the appraisal of January 1, 1926, at $15,000 and in the appraisal of January 1, 1928, at $16,000, was sold for $9,000. Preparation for shipment cost $250.

A special machine, purchased in 1927 for $2,000, was sold in 1929 for $1,000, the purchaser paying all freight and dismantlement charges.

Similar memoranda were kept for the years 1930 and 1931.

NOTE.—The figures subsequent to 1929 are given here merely for information.

No. 4 (36 points):

From the following trial balance and supplementary information, you are to prepare a balance-sheet, as at December 31, 1932, and the related profit-and-loss account for the year ended that date. Formal journal entries are unnecessary.

The balance-sheet is to be prepared for a certain creditor, who has guaranteed the payment for your services, and you are requested to make all necessary adjustments, regardless of amount, and to give effect through such adjustments to transactions, valuations or reclassifications which would affect the financial position of the company, rather than through the use of footnotes or qualifications.

General Furniture Company
Trial balance, December 31, 1932

	Dr.	Cr.
Cash	$ 100,000	
Notes receivable—trade	150,000	
Accounts receivable—trade	650,000	
Reserve for bad debts		$ 55,000
Inventories	750,000	
Advances and loans	50,000	
Investments	150,001	
Prepaid insurance and other expense	22,550	
Cash-surrender value of life insurance policy	5,000	
Land	500,000	
Buildings	730,000	
Equipment	350,000	
Reserve for depreciation		195,000
Notes payable—American City State Bank		550,000
Drafts payable		5,000
Accounts payable		420,000
Accrued interest, wages, taxes, etc.		40,000
Note payable—J. B. Lee		50,000
First mortgage bonds, 6 per cent. due June 1, 1938		500,000
Capital stock—13,000 shares of $100 par value each		1,300,000
Unissued capital stock	57,450	
Surplus		575,001
Sales		2,000,000
Cost of sales	1,500,000	
Selling expense	400,000	
Administrative expense	150,000	
General expense	100,000	
Interest paid	32,500	
Interest received		7,500
	$5,697,501	$5,697,501

An analysis of the accounts discloses that cash is composed of

Working funds	$ 8,000
Balance in First National Bank (closed October 15, 1932)	1,000
Balance in First State Bank (closed December 15, 1932)	3,500
Balances in other banks	90,000
	$102,500
Deduct: Overdraft in Second State Bank account	2,500
Net cash balance—per trial-balance	$100,000

NOTE.—Make no provisions for loss on balances in closed banks.

Notes comprise $30,000 due in 1933, $35,000 due in 1934, and $85,000 due in 1935. All these notes are pledged against a bank loan.

Inventories consist of raw material and supplies to the amount of $150,000 and finished product to the amount of $600,000. Raw material and supplies are valued at the lower of cost or market, and finished product at cost as determined by the company. Upon investigation it is found that, due to low production, overhead expenses are abnormally high and that if the company's cost had been so calculated as to include an overhead rate based on normal production, the overhead included in the inventories would be reduced by $100,000.

Investments comprise

Listed bonds, at cost	$140,000
Stock of A B Lumber Co., at cost	10,000
100 shares ($100 par value each) of First National bank stock, at the nominal value of	1
	$150,001

The market value of the listed bonds is found to be $120,000. There is no trading in the stock of A B Lumber Co., but from a balance-sheet of that company submitted to you, it is ascertained that the cost at which this stock is carried is not in excess of the book value thereof, as shown by the balance-sheet of the A B Lumber Co.

Advances and loans, at December 31, 1932, consist of a loan with interest paid to December 31, 1932, to Adams Chemical Co., of $50,000, against which 700 shares of the capital stock of General

Furniture Co. were held as collateral. These 700 shares had a market value at December 31, 1932, of $80 per share. The loan became due December 30, 1932, and under date of January 10, 1933, the Adams Chemical Co. stated that it was unable to reduce the loan or to provide additional collateral and assented to the forfeiture of the 700 shares of collateral stock in cancellation of the indebtedness.

An examination of the advances-and-loans account discloses that the president, J. A. Stewart, had paid off a loan (carried since June 1, 1930) of $25,000 on December 27, 1932, and that on January 6, 1933, a loan of the same amount was again made to Mr. Stewart.

The company is carrying a life-insurance policy, of the face value of $100,000, on the life of the president, the cash-surrender value of which at December 31, 1932, was $5,000. This policy was pledged under the indenture securing the company's bond issue.

The American City State Bank has confirmed its loans to the company in the amount of $550,000. Collateral held by the bank consisting of bonds, notes receivable and accounts receivable, has been found to agree with the company's record, and to comprise all of its bonds and notes receivable, and $200,000 of its accounts receivable.

Drafts payable in the amount of $5,000 represent outstanding drafts of the company, used in lieu of bank cheques to avoid federal taxes, in a form approved by the company's counsel for this purpose.

The note payable in favor of J. B. Lee, vice-president of the company, has been confirmed by Mr. Lee. It is a demand note, dated June 1, 1930, bearing interest at the rate of 5 per cent. Interest on this note has been paid, or accrued, by the company to December 31, 1932.

Unissued capital stock, shown on the trial-balance in the amount of $57,450, is found to represent 400 shares of unissued stock and 200 shares of reacquired stock at a cost of $17,450. The acquisition of 700 shares of collateral, forfeited by Adams Chemical Co., has not been recorded on the books.

NOTE.—In preparing your balance-sheet, do not carry any treasury stock on the asset side thereof.

An analysis of surplus is as follows:

Undistributed profits to December 31, 1931		$405,000
Surplus arising from appraisal of properties, December 30, 1928, less depreciation thereon to December 31, 1932		150,000
Premium on sale of capital stock		30,000
Credit for plant site donated by chamber of commerce in 1920		25,000
		$610,000
Deduct:		
Write-down of inventory of new line of cabinets introduced in 1932	$25,000	
Write-down of First National Bank stock	9,999	34,999
Balance		$575,001

Commitments for the purchase of materials at December 31, 1932, aggregated $100,000, for which the market price, at that date, was $90,000.

No. 5 (10 points):

An old, established corporation, whose books have never before been audited by a public accountant, requests you to make an examination of its accounts as of December 31, 1931.

As a result of your examination, you find the following items included in the accounts:

Debits	
Appreciation of land	$ 800,000
Appreciation of buildings	200,000
Trademarks	2,000,000
Treasury stock—5,000 shares at cost (market value, $30,000)	180,000
Credits	
Reserve for depreciation on appreciation of buildings	$ 15,000
Capital stock, consisting of 200,000 shares of $50 each	10,000,000
Surplus balance, including net earnings plus credits arising from book valuations of trademarks, appreciation, etc., and after deduction for all dividends paid or declared	15,000

You have convinced the officers that the values set up for appreciation of land, buildings and trademarks should be eliminated and the treasury stock canceled. Since there is insufficient surplus to absorb these adjustments, it has been suggested that they be made against the stockholders' net equity and that new shares of no par value be exchanged for the present shares outstanding, on the basis of one new share for one old share.

The plan has been duly approved by the stockholders and the change in capital has been properly authorized, effective as of January 1, 1932.

You are now requested to furnish the necessary entries to record the new set up, in order to prepare and submit a balance-sheet as of March 31, 1932. In the period from December 31, 1931, to March 31, 1932, the net earnings from operations amounted to $40,000. No dividends were paid or declared. All the old shares outstanding have been exchanged for the new ones.

(1) Submit your adjusting journal entries, giving effect to the re-organization of capital, the elimination of all items of appreciation and intangibles, and the cancellation of treasury stock.

(2) Show the amount of the capital-stock account at March 31, 1932, and the manner in which the account would be stated on the balance-sheet at that date.

(3) What is the balance in the surplus account at March 31, 1932?

(4) What footnote, if any, would you place on the balance-sheet submitted as at March 31, 1932?

No. 6 (10 points):

A is the owner of a patent on a mechanical device. In order to arrange for its manufacture and sale, he enters into an agreement with B as follows:

B to advance the funds necessary to manufacture and place the patented device on the market. B's expenditures are to be returned to him out of profits before any division, after which, A and B are to share equally therein.

After a certain period of operation, you are employed to ascertain the amount due A under the contract, the records disclosing the following:

Advances by B	$ 50,000
Accounts receivable	80,000
Accounts payable	25,000
Sales	170,000
Cost of manufacture	80,000
Overhead	10,000
Inventory	30,000
Cash on hand	75,000

(a) Prepare a statement in the form you would render to both A and B.

(b) If there had been an expenditure of $50,000 for machinery and equipment, in addition to the items shown above, what would have been the condition, as between A and B, in conforming with the terms of the contract?