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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 15 and 16, 1934.]

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 15, 1934, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions:

No. 1 (5 points):

(a) State how a straight voucher system is used, recorded and controlled.

(b) May it be used in conjunction with an accounts-payable ledger, and in what way?

(c) Under what conditions is it preferable in conjunction with an accounts-payable ledger?

No. 2 (10 points):

In the annual audit of the firm of John Doe & Co. you find it has sold a substantial part of its accounts receivable to the X Discount Co., receiving an advance of 60% of their face value, the balance to be received when and as the accounts are collected from customers.

The advance was credited to the account of The X Co. when received, but in closing its books for the year the firm has deducted it from the total accounts-receivable balance on the theory that the accounts sold no longer belong to the firm and that the 40% equity in them is due from the purchaser.

You are requested to certify the resulting balance-sheet in this form without mentioning the sale of the accounts, if possible.

(a) Analyze the above transaction, and

(b) State three methods from which you could choose in order to give a certificate, qualified or unqualified.

(c) Which method would you adopt? Give your reasons.

No. 3 (5 points):

You are employed by the firm of Smith & Jones to close its books and prepare a balance-sheet, profit-and-loss statement, and federal income-tax returns for the firm and for each partner. You are not to audit the books. Neither partner keeps private books but each gives you memoranda of his "other" income and allowable deductions and credits.

With the usual income-tax forms you find additional ones which prescribe:

(1) That the taxpayers must state the fact if they employed anyone, and if so whom, to prepare or advise in the preparation of the return, and to what extent such assistance or advice was received: and

(2) That the person giving such service must make affidavit as follows:

> "I, acting as (advisor or attorney) for the hereto subscribed taxpayer affirm that I prepared the return, that the information set out in the return and accompanying schedules, if any, correctly and truly represents the information furnished or discovered by me during the course of preparation of the return, and that such information is true to the best of my knowledge and belief."

(a) How would you word the taxpayers' statements on these forms in the above cases?

(b) As a certified public accountant with all the responsibilities the title implies, what would you do to protect yourself in respect to the affidavit? Give your reasons.

No. 4 (15 points):

In the course of your audit of the X Machine Corporation for the year 1933 you discover that the plant account has been written down one-half its book value by the journal entry—

"Dec. 31, 1933.	Reserve for depreciation....	$........	
	To plant account..................		$........"

You learn that this was authorized by the board of directors, and you are shown a draft of the proposed report to stockholders in which it is recited that the amount represents the net book value, as of January 1, 1933, of plant and equipment which was idle during the entire year; that its purpose is to show the investment in plant at a conservative figure in accord with general conditions due to the depression; that its effect is to confine the annual depreciation charge to plant actually engaged in production during the year; and that the profit-and-loss statement thus shows the true profit made on actual production and sales. It is further intimated in somewhat guarded language that when and as business improves and the idle plant resumes normal production, the value now charged off will be restored to plant account.

State whether or not you will approve this procedure by certifying the corporation's statements, and give your reasons in full.

No. 5 (5 points):

How should the executor of an estate charge the following items as between corpus and income?

1. Physician's fees for last illness.
2. Funeral expenses.
3. Expenses of probating will.
4. General expenses of executor.
5. Loss on sale of investment.
6. Legal fees for collection of rents.
7. Legal fees for defending claims against the estate.
8. Executor's commissions.
9. Repairs to office buildings.
10. Estate and inheritance taxes.
11. Fire-insurance premium.
12. Special assessments adding permanent value to real estate.
13. Monthly allowances to beneficiaries.
14. Expenses incident to a change in executor.

No. 6 (20 points):

Give the program you would follow in making a balance-sheet audit of a small trading corporation.

No. 7 (10 points):

Brown, Smith & Jones, a firm, decide to dissolve partnership and to liquidate the business. Lacking confidence in each other, the partners employ you to conduct the liquidation and to determine the correct amounts due from or to each partner.

Describe in detail the steps you will take.

No. 8 (10 points):

You are making an audit of the X Corporation, among whose assets you find stocks and bonds of the Y Company of a substantial amount. In support of their value you are offered a balance-sheet of the Y Company certified by a fellow member of the American Institute. After careful study of this balance-sheet you are convinced there are serious errors in it and you can not conscientiously accept it. You explain the matter and point out the doubtful items to the officers of the X Corporation, whereupon, after securing the consent of the Y Company, they instruct you to make an audit of the Y Company also.

Bearing in mind the provision in the Institute's rules of professional conduct—that no member shall encroach upon the business of another member—what will you do? Give your reasons. Also state your understanding of the meaning of this provision of the rules.

No. 9 (10 points):

You are engaged in auditing the accounts of the American Manufacturing Company, a small corporation, the president owning approximately 96% of the outstanding capital stock. The company had been exceedingly profitable for a number of years and had invested some of its profits in good marketable securities so that funds would be available for an addition to its plant. Examining the securities you find in place of $25,000 par value of bonds, carried on the books at $20,000, a demand note for $20,000 signed by the president. The minutes of the board of directors show that these securities were lent to the president for his use as collateral to secure some personal transactions which have no relation to the affairs of the corporation. The securities are held by the Manufacturers' National Bank as collateral for the president's personal note, and you have received the bank's confirmation.

How will you show this condition in the balance-sheet and how will you qualify your certificate?

No. 10 (10 points):

You are to audit the accounts of the Kaslek Manufacturing Company at December 31, 1933, and your certified balance-sheet is to be used for credit purposes. On December 28, 1933, the corporation sold a piece of idle property, the terms of sale being one third cash, one third in a note due in 30 days and one third in a note due in 60 days. The price was determined by outside appraisal of October 15, 1933, and your investigation revealed that the transaction was apparently regular in every way. There were the proper resolutions in the minutes and all the necessary documents were produced for inspection. You also find that the cash had been duly deposited. You discover, however, that the purchasing company is controlled by a stockholder of your client, and you suspect that the transaction took place for the purpose of window dressing. On the date of your examination the first note is unpaid and the second note is not yet due. It more than doubled the current assets and therefore greatly improved the current asset position.

How will you deal with these facts in the balance-sheet and certificate?

Examination in Accounting Theory and Practice

PART I

NOVEMBER 15, 1934, 1:30 P. M. TO 6:30 P. M.

Solve all problems

No. 1 (25 points):

On January 1, 1933, the F Company purchased 90% of the stock of company G and 80% of the stock of company H. Wishing to acquire the remaining stock of the more profitable company (company H) company F on June 30, 1933, disposed of 200 shares of its holdings in company G at a price of $160 per share, and on that date was successful in acquiring an additional 10% of the stock of company H in exchange for the entire proceeds of the sale of company G stock.

The investment accounts on the books of company F are carried at cost except the account representing the investment in capital stock of company G: this account has been credited with the proceeds of the 200 shares sold.

From the following post-closing trial balances of the three companies at December 31, 1933, prepare:

1. A consolidated balance-sheet
2. A statement of consolidated earned surplus
3. A statement of goodwill

Assets	F	G	H
Current assets	$152,500	$150,000	$105,000
Investment in subsidiary companies—			
Company G:			
Capital stock	220,000		
Advances	25,000		
Company H:			
Capital stock	214,000		
Advances	40,000		
Buildings and equipment		170,000	235,000
	$651,500	$320,000	$340,000
Liabilities			
Capital stock:			
Company F—3,000 shares	$300,000		
Company G—2,000 shares		$200,000	
Company H—1,000 shares			$100,000
Due to parent company		25,000	40,000
Accounts payable	235,000	40,000	25,000
Surplus at beginning of year	166,500	60,000	145,000

Profit for the year	*$ 20,000	$ 15,000	$ 40,000
Dividends (paid Dec. 31, 1933)	*70,000*	*20,000*	*10,000*
	$651,500	$320,000	$340,000

* Dividends received from subsidiary companies, less expenses of parent company.
It is assumed that the profits of the companies for the year 1933 were divided equally between the two six months periods.

No. 2 (20 points):

John Jones set up an irrevocable trust for the benefit of his eldest daughter, Joan Jones, to run until 1935, when she would be thirty years old and would receive the principal of the estate outright. If she should die before attaining the age of thirty, the trust would go to her younger sister, Ethel Jones. The net income of the trust could be withdrawn by the beneficiary at any time.

By the terms of the trust agreement John Jones was to be trustee during his life and was to receive a fee of $1,000 a year in lieu of commissions.

Any investments made for the trust were to be subject to the approval of the trustee only and not to be bound by any legal rulings regarding trust investments.

There was paid into the trust by gift from John Jones on January 1, 1921, the sum of $100,000 which was to be invested by the trustee.

On December 31, 1930, Joan died and bequeathed her entire estate to her brother Paul Jones to be held in trust for him. He was to receive the income and had the right of appointment of the principal. John Jones was made trustee and was to receive an annual fee of $1,000 instead of commissions.

The trial balance of John Jones, trustee, at December 31, 1930 was as follows:

Debits	
Cash—principal	$ 7,000
Cash—income	9,550
$300,000 par bonds 4% R. R. & I. due 1955 at cost, investment of principal	275,000
Stocks—2,000 shares of $100 each at cost, investment of undistributed income funds	150,000
Oil Venture Syndicate—investment of undistributed income funds	12,500
Accrued interest on bonds	950
Payments to beneficiary from income during 1930	2,500
Expenses applicable to income for year 1930	1,850
Expenses applicable to principal paid during 1930	1,250
Trustees' fees for year 1930	1,000
	$461,600

Credits	
Principal of trust—balance January 1, 1930	$275,000
Undistributed income balance January 1, 1930	138,500
Interest on bonds	12,800
Dividends	14,000
Profits on sale of principal investment bonds	9,200
Profits on stocks sold	9,600
Due trustee for fees	2,500
	$461,600

Analysis of undistributed income at January 1, 1930:	
Interest received	$ 80,000
Dividends received	89,000
Profits on stocks sold	30,000
	$199,000
Expenses charged to income	$ 16,500
Fees to trustee	9,000
Payments to beneficiary	35,000
	$ 60,500
Balance December 31, 1930	$138,500
Analysis of principal at January 1, 1930:	
January 1, 1921	$100,000
Increase to principal through sale of investments	190,000
Total	$290,000
Payment of expenses applicable to principal	15,000
Balance December 31, 1930	$275,000

During the three years ended December 31, 1933, the following transactions took place:

On December 31, 1931, the Oil Venture Syndicate was liquidated by receiving (a) 1000 shares no-par-value stock of the Oklahoma Oil Producers, Incorporated, of which the market value at December 31, 1931, was $10 a share; (b) $6,250 in cash; and (c) $12,500 5% Stanton Oils of California bonds due in 1955 of which the market value at December 31, 1931, was 80.

During the year 1932 the trustee sold $150,000 par value of the 4% R. R. & I. bonds at a net profit of $25,000 and invested the money in U. S. government 3¾% bonds at 100 net.

During 1932 the trustee invested $10,000 of undistributed income funds of the Paul Jones trust in Standard Oil of New Jersey at $40 per share, receiving 250 shares; the expense of the purchase amounted to $50.

On January 25, 1933, the trustee sold $12,500 par value bonds of Stanton Oils of California for $12,500 net and invested the proceeds in Tulsa city 4% bonds at 100 net.

During the three years ended December 31, 1933, there was collected:

Interest on R. R. & I. bonds	$26,321.25
Interest on Stanton Oils of California	625.00
Interest on U. S. government bonds	10,053.75
Interest on Tulsa city bonds	500.00
Dividends on stocks	40,000.00

During the same three years there was disbursed:

Payments to Ethel Jones as beneficiary	$ 6,000.00
Payments to Paul Jones as beneficiary	10,000.00
Expenses paid chargeable to income of the principal trust	4,000.00
Expenses paid chargeable to income of the undistributed income trust	3,500.00
Fees paid trustee	3,000.00
The account payable to trustee at Jan. 1, 1931, was liquidated	

No legal accounting was filed by the trustee during the whole period of the trusts.

Prepare statements from which the trustee may file this legal accounting. Disregard all taxes.

No. 3 (20 points):

The "A" Telephone Company was incorporated on January 1, 1931, for the purpose of acquiring and holding securities of companies operating telephone systems. The authorized capital stock consisted of 2,500 shares of $6 cumulative preferred stock without par value and 3,000 shares of common stock without par value. The authorized funded debt was $500,000. On January 1, 1934, three years later, the company voluntarily filed a petition in bankruptcy. An attorney for the bondholders' committee has asked you to examine the accounts and records of the company to determine why it was necessary to file such a petition when it had a surplus of $361,500 as shown by the following analysis of the company's surplus account:

Analysis of surplus account
January 1, 1931, to December 31, 1933

Date				Debit	Credit
1- 1-31	Excess of consideration paid in by shareholders, for shares having no par value, over the amount allotted to stated capital, as follows:				$285,000
	Cash paid in by shareholders....		$500,000		
	Capital stock issue:				
	2,000 shares $6 dividend, no par, preferred stock, stated value $100 per share.......	$200,000			

	3,000 shares no par common stock, stated value $5 per share.......	$15,000	$215,000		
	Excess consideration paid in....		$285,000		
1- 1-31	Discount on purchase of 5,000 shares (total authorized) "B" Telephone Company common stock, par value $100 per share. The company entered this stock in its investment account at par, $500,000				$ 10,000
7- 1-31	Discount on sale of $500,000 par value "A" Telephone Company 6% ten year debenture bonds, dated 7-1-31................			$50,000	
12-31-31	Net profit from operations for the year ended December 31, 1931, (includes $50,000 undistributed profit for the same year, of the "B" company which was taken into earnings by charging that company's current account)............................				20,000
12-31-31	Dividends declared on preferred stock for the year ended December 31, 1931...........			12,000	
12-31-31	Dividends waived by shareholders owning 500 shares of preferred stock.............				3,000
1- 1-32	Discount on purchase of $400,000 par value "C" Telephone Company 5%, twenty year, sinking fund gold bonds, dated January 1, 1922................................				20,000
6-30-32	Unrealized profit from the exchange of "B" Telephone Company's common stock for 6,000 shares (total authorized) "C" Telephone Company common stock without par value. The latter stock was taken into the investment account at the stated value thereof, namely, $600,000..............				100,000
6-30-32	Discount on sale of 500 shares of "A" Telephone Company $6 cumulative preferred stock, stated value $100 per share........			5,000	
12-31-32	Net profit from operations for the year ended December 31, 1932, (includes $20,000 undistributed profit for the six months ended December 31, 1932, of the "C" Telephone Company which was taken into earnings by charging that company's current account)............................				10,000
12-31-32	Dividends declared on preferred stock for the year ended December 31, 1932...........			13,500	
1- 1-33	Discount on purchase of 600 shares of the company's preferred stock. This stock was canceled..........................				9,000
12-31-33	Net loss from operations for the year ended December 31, 1933....................			15,000	
				$95,500	$457,000
					95,500
	Balance December 31, 1933...............				$361,500

The articles of incorporation authorize the directors to purchase preferred capital stock which is to be retired from earned surplus.

At the date of filing the petition in bankruptcy, the total investments owned by the company consisted of the 6,000 shares of "C" Telephone Company's common stock and $5,000 par value, United States Treasury bonds. The latter bonds were purchased at par. The "C" Telephone Company went into the hands of a receiver on July 31, 1933.

From the foregoing data prepare an adjusted analysis of surplus account. Comment briefly upon any additional facts which you feel will be of value to your client.

No. 4 (15 points):

On April 1, 1929, a company sold $500,000 of its first-mortgage bonds at 90. The bonds matured to the amount of $50,000 on each of the next ten anniversaries of the date of issue. Those due in 1930 were paid; those due in 1931 were not paid but by agreement with the holders were extended for one year. During 1930 the company borrowed from its officers 1,250 shares of its own capital stock of a par value of $100 each (out of 1,300 shares outstanding) and obtained a bank loan of $100,000 with these borrowed shares as collateral. Interest was paid on this loan and on the bonds, but the bond maturities in 1932 were not met. The officers resigned and were replaced by executives approved by the creditors. The collateral to the bank loan was offered for sale at public auction and bought in by the bank for $20,000, which was applied in reduction of the loan. Thereafter the new officers of the company, in their personal and private capacities, entered into an agreement with the bank, which contained the following provisions:

(1) The bank agreed to sell and the officers to buy the 1,250 shares of stock for $20,000 payable at the rate of $500 per month plus interest, beginning January 1, 1933.

(2) The officers agreed to seek a five-year extension of the maturities on all bonds which by their face were due on or after April 1, 1933; these efforts were made and proved successful before that date arrived.

(3) The bank agreed to (and did) acquire all of the bonds which had matured on April 1, 1932, and agreed further that it would not exercise any of its rights to enforce collection of either these past-due bonds or of the now unsecured loan so long as (a) the officers were not in default on their stock-purchase obligations and (b) interest on

the past-due bonds and the unsecured loan was paid currently; provided, however, that the company made quarterly payments, to apply on the principal of the past-due bonds and unsecured notes, equal to as many multiples of $5,000 as might be paid from the sum of its net income and the net accretion to its depreciation reserve, computation of these amounts to begin as at April 1, 1933, and to be cumulative, and payment to be made within thirty days after the close of each quarter.

During its fiscal year ended March 31, 1934, the company's net income before depreciation was respectively $8,000, $16,000, $14,000, and $12,500 for the first, second, third and fourth quarters; expenditures for replacements charged against its depreciation reserve were respectively $4,500 and $6,000 for the first and second quarters. All interest obligations were met and payments to apply on the principal of past-due bonds and on the unsecured loan were made in accordance with the agreement outlined above. At March 31, 1934, the company's only indebtedness other than that discussed herein consisted of audited vouchers for current purchases and expenses amounting to $35,000, including interest due April 1, 1934, and its surplus was $67,500.

1. Prepare a statement showing the liabilities side of the company's balance-sheet at March 31, 1934, in such form as in your opinion would merit an unqualified certificate.

2. Explain any changes which you would make in that statement if the company had been a party to the agreement outlined above.

3. Explain how the amortization of the cost of floating the bond issue in 1929 would be affected by the extension secured in 1933.

No. 5 (10 points):

Adams and Bede commence in business in copartnership on January 1, 1930. Adams contributes $40,000 as capital and Bede $25,000. It is agreed that profits will be divided in the proportions of ⅔ to Adams and ⅓ to Bede and that 6% interest per annum will be credited on the original capitals. No interest is to be charged on drawings or credited on any excess of interest and profits over drawings. During the term of the partnership Adams' drawings amount each year to $10,000 and Bede's to $7,500. At the close of business on December 31, 1932, Bede retires from the firm and is paid from partnership funds the balance standing to the credit of his capital account. The net profits of the partnership were proportionate to the sales which for the three years ended December 31, 1932, respectively amounted to $250,000, $200,000 and $175,000. Adams will continue the business as a sole trader and at the commencement of business on January 1, 1933, prepares the following statement from the books:

Cash	$ 10,203.16
Accounts receivable	16,813.87
Inventories	24,311.97
Prepaid expenses	250.00
Fixed assets	40,000.00
Goodwill	15,000.00
	$106,579.00
Accounts payable	$ 24,861.05
Notes payable	15,000.00
Accrued liabilities	750.00
Reserves:	
For bad debts	2,500.00
Depreciation	12,000.00
	55,111.05
Capital	51,467.95
	$106,579.00

Prepare a statement of the partners' capital accounts for the three years ended December 31, 1932.

No. 6 (5 points):

A and B were partners under an agreement that the profits were to be equally divided and that A was to furnish one fourth and B three fourths of the capital actually used during each calendar year, interest at 6% per annum to be charged or credited on any differences.

Examine the following transcripts of their capital accounts and ascertain whether or not the entries at the end of the year were correctly made.

A—Capital

	Debits		Credits		
Sept. 1, 1933	Withdrawal	$3,000	Jan. 1, 1933		$10,000
Dec. 31	Interest on above for 4 months	60	Dec. 31	P. & L.	4,400

B—Capital

	Debits		Credits		
July 1, 1933	Withdrawal	$2,000	Jan. 1, 1933		$30,000
Dec. 31	Interest on above for 6 months	60	Dec. 31	P. & L.	4,400

No. 7 (5 points):

The Theatre Company rented films from the Film Company and agreed to pay as rental 15% of the Theatre Company's gross receipts up to a point where it earned a profit (before deducting the rental) equal to one-half of the total rental and beyond that point at the rate of 50% of the gross receipts.

Calculate the film rental for a period in which the gross receipts amounted to $1,000 and the expenses (other than rental) amounted to $400.

Examination in Commercial Law

November 16, 1934, 9 a. m. to 12.30 p. m.

Reasons must be stated for each answer. Whenever practicable, give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

Group I

Answer all questions in this group.

No. 1 (10 points):

Backus, in the excitement of a railroad accident, lost unregistered coupon bonds and stock certificates endorsed in blank which he had been carrying in a brief case. These were found by another passenger who made no attempt to ascertain or find the loser but two weeks later sold the bonds and the certificates. The purchaser paid full value for them and had no knowledge of Backus' loss. Did the purchaser become the legal owner of the bonds and the certificates?

No. 2 (10 points):

Andrews was appointed trustee of certain real property by a written instrument which specified that the income was to be paid to a named beneficiary during the latter's life and that title to the property was to be conveyed to another beneficiary upon the death of the life-tenant. What duties, if any, may Andrews delegate to assistants or agents?

No. 3 (10 points):

(a) Define "ultra vires" as used in the law with respect to corporations.

(b) Give an example of an ultra-vires act.

No. 4 (10 points):

Watson and Titus were partners, under a partnership agreement which made no mention of the death of either. Watson by his will bequeathed his interest in the partnership to his wife. Upon Watson's death, did his wife become a partner with Titus by virtue of this legacy in Watson's will?

No. 5 (10 points):

Davis borrowed money from Harrison and gave him as security a power of attorney to collect future rents from Davis' tenants.

(a) Would this power of attorney be canceled by Davis' death prior to the repayment of the loan?

(b) Can a tenant who knows of Davis' death discharge his obligation for rent accrued prior thereto by paying Harrison?

Group II

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

No. 6 (10 points):

Kenyon was a business man in the city of X. He signed a subscription list by which he agreed to contribute $1,000 towards the purchase of a building for the local chamber of commerce. Other subscribers for the same amount signed this list both before and after Kenyon signed it and Kenyon knew of these other subscriptions. The building was purchased in accordance with and in reliance upon this subscription list. Can Kenyon be compelled to pay the amount of his subscription?

No. 7 (10 points):

Define and explain briefly (a) patents, (b) copyrights and (c) trademarks.

No. 8 (10 points):

A drawee of a draft, in answer to an inquiry by the payee, wrote that he would honor a draft for $1,000 by Samuel Thompson. A draft on this drawee by Samuel Thompson for $1,000 was duly presented but acceptance was refused because the words "with exchange" had been added. Can the payee collect from the drawee?

No. 9 (10 points):

Define "common law" and briefly differentiate it from statutory law.

No. 10 (10 points):

In a state where gambling is and always was unlawful, Olsen owes Marks a gambling debt and Marks engages Shepard to collect it on a 25% fee. Shepard collects the amount of the debt but refuses to transmit any part of it to Marks. Can Marks recover in an action against Shepard?

No. 11 (10 points):

Define "stoppage in transit," state who may exercise this right, and in general when the right ceases to exist.

No. 12 (10 points):

Emerson rented a furnished apartment containing a radio connected with receiving wires on the roof of the apartment house (with which radios in other apartments also were connected). Emerson removed this radio and substituted one of his own without injury to the connecting wires. At the termination of his lease he removed his own radio and reconnected the landlord's. The landlord claimed both radios. On what principle of law was this claim based? Should the landlord's contention be sustained?

Examination in Accounting Theory and Practice

PART II

November 16, 1934, 1:30 p. m. to 6:30 p. m.

Solve all problems

No. 1 (30 points):

On December 31, 1928, the Star Drug Company with an outstanding capital of $500,000, the Mormon Drug Company with an outstanding capital of $400,000 and the Gulf Drug Company with an outstanding capital of $450,000—all shares of $100 each—merged into one operating company known as Continental, Inc. with a capital stock issue of 1,350,000 shares of no par value.

The stockholders of the three merging companies received the

1,350,000 shares in return for their aggregate holdings of $1,350,000 par, i.e. 100 shares of Continental, Inc. for each share of the merging companies. On the above date Continental, Inc. also took over all the assets and liabilities of the three companies. Their individual charters were, however, kept alive.

On December 31, 1933, five years later, the balance-sheet of Continental, Inc. was:

Assets		
Cash		$ 150,000
Accounts receivable		
Star Drug Co. customers	$ 125,000	
Mormon Drug Co. customers	100,000	
Gulf Drug Co. customers	70,000	295,000
Inventory:		
Star Drug Co. products, materials, etc.	140,000	
Mormon Drug Co. products, materials, etc.	120,000	
Gulf Drug Co. products, materials, etc.	115,000	375,000
Plant and equipment at present values appraised on December 31, 1933—		
Star Drug Co. plant	1,500,000	
Mormon Drug Co. plant	1,300,000	
Gulf Drug Co. plant	1,000,000	3,800,000
		$4,620,000
Liabilities		
Accounts payable		$ 89,000
Bonds of subsidiary companies		
Star Drug Company	$1,197,400	
Mormon Drug Company	783,160	
Gulf Drug Company	519,440	2,500,000
Capital stock outstanding		785,000
Surplus		1,246,000
		$4,620,000

At December 31, 1933, Continental, Inc.'s stockholders decided to decentralize and restore to each of the original companies its proportion of assets and liabilities. The net worth was to be prorated on the basis of each company's capital investment on December 31, 1928, and it was found that the Star Drug Company was to receive 40%, the Mormon Drug Company 36% and the Gulf Drug Company 24%.

On December 31, 1928, the three merging companies owned each other's stock as follows:

The Star Drug Company owned—	
1,200 shares Mormon Drug Co., cost	$ 100,000
2,500 shares Gulf Drug Co., cost	200,000

The Mormon Drug Company owned—	
1,000 shares Gulf Drug Co., cost	$ 75,000
500 shares Star Drug Co., cost	50,000
The Gulf Drug Company owned—	
50 shares Mormon Drug Co., cost	10,000
400 shares Star Drug Co., cost	30,000

A summary of Continental, Inc.'s surplus shows:

Surplus of merging companies—December 31, 1928	
Star Drug Company	$ 190,000
Mormon Drug Company	375,000
Gulf Drug Company	81,000
Excess of par over book value of intercompany holdings	100,000
Earnings of five years	892,500
	$1,638,500
Less—Dividends paid	392,500
Balance, December 31, 1933	$1,246,000

It was decided that in the redistribution each of the three companies would receive a proportionate share of the cash; its own accounts receivable and inventory; its original investments in the other companies at original cost to itself and its own plant and equipment. On the other hand, each would assume a proportionate share of the current liabilities but would become wholly liable for its own outstanding bonds. All differences were to be charged or credited to current account for future settlement.

From the foregoing data prepare:

1. A statement showing in columnar form the balance-sheets of the three drug companies after decentralization on December 31, 1933.
2. A statement showing that the adopted ratio 40: 36: 24 approximately agrees with the proportions existing on December 31, 1928.

No. 2 (20 points):

The following accounts covering the year 1933 are submitted by The Electric Company which sells and installs electric alarm systems for banks and other institutions:

Balance-sheet—December 31, 1933

Assets

Current assets:		
Cash	$ 25,000	
Accounts receivable	237,500	
Inventories	53,000	
Unbilled contracts	38,000	$353,500

Fixed assets:		
Factory equipment	$164,000	
Less: reserve for depreciation	33,000	$131,000
Patents, less amortization		75,000
Prepaid insurance, commissions, etc.		13,500
		$573,000

Liabilities

Current liabilities:		
Accounts payable	$ 80,800	
Salesmen's commissions	9,500	
Accrued wages	2,700	$ 93,000
Capital stock:		
Six per cent. preferred	$200,000	
Common	50,000	250,000
Earned surplus:		
Balance, January 1st	$102,000	
Net profit for 1933	140,000	
	$242,000	
Less: preferred dividends paid	12,000	230,000
		$573,000

Profit-and-loss statement
Year ended December 31, 1933

Income from contracts:		
Installation contracts	$313,000	
Repair service	30,000	
Inspection contracts	50,000	$393,000
Cost of contracts:		
Materials, labor and factory overhead:		
Installation contracts	$131,250	
Repair service	20,000	
Inspection contracts	10,000	161,250
Gross profit on contracts		$231,750
Selling expenses	$ 60,000	
General and administrative expenses	38,750	98,750
		$133,000
Other income		7,000
Net profit for year		$140,000

Additional information is procured as follows:

1. Accounts receivable segregation:

Completed contracts—current	$110,000
Completed contracts—due July 1, 1935	25,000
Due from officers and employees—current	7,000
Uncompleted installation contracts—billed	75,000
Overdrawn salesmen's accounts	2,000
Stockholders' subscription, represented by demand note receivable, dated March 1, 1928	7,500
Contract balance, past due, secured by customer bank stock, face value $12,000 not marketable	11,000
	$237,500

2. Preferred dividend for half year ended December 31, 1933, declared December 15, 1933, payable January 15, 1934.	
3. Installation contracts are not collectible until completed.	
4. The cost of installation contracts equals 50% of the installation contract income.	
5. Uncompleted installation contracts (billed in 1932), one-half completed at December 31, 1932	$ 75,000
6. Uncompleted installation contracts, one-third completed at December 31, 1933 and fully billed to customers	75,000
7. Unbilled contracts, no work thereon at December 31, 1933	38,000
8. Inspection service contracts are billed annually in advance, the charges being of uniform amount each month. The billings in 1932 were the same as in 1933.	
9. Federal and state taxes are estimated to equal 17½% of the net profits. The change in the method of accruing income need not be considered.	

Prepare the adjusted balance-sheet and profit-and-loss account, also a surplus account showing the adjustments thereto.

No. 3 (10 points):

A corporation presents the following condensed statement as of the close of the year:

Cash	$ 90,000	Dividends payable	$ ....
Other assets	1,510,000	Other liabilities	500,000
		Common stock	500,000
		6% preferred stock	300,000
		8% preferred stock	200,000
		Surplus	100,000
	$1,600,000		$1,600,000

The 6% stock is cumulative, the 8% stock is non-cumulative, and both participate equally in the remaining surplus profits by being entitled to an extra dividend equal to the excess of any common dividend rate over and above 6% per annum.

A. Compute the book value per share for each class of stock in the following cases:

1. Current year's dividends unpaid.
2. Dividends unpaid for two years.
3. Dividends unpaid for three years.

B. What dividends could legally be declared to the various classes of stockholders, assuming that the 6% stock is non-participating, the 8% stock is participating on the basis stated and no dividends are in arrears?

No. 4 (10 points):

At a given date the condensed balance-sheets of two firebrick companies were as follows:

Alpha Firebrick Co.

Fixed assets, at cost less depreciation........	$1,800,000	Capital stock: Authorized—12,000 shs. Issued—8,000 shs....	$ 800,000
Current assets........	867,000	Liabilities............	620,000
Goodwill.............	None	Surplus..............	1,247,000
	$2,667,000		$2,667,000

Beta Firebrick Co.

Land at cost..........	$ 277,000	Capital stock.........	$ 500,000
Buildings at cost, less depreciation........	50,000	Liabilities............	120,000
Equipment, at cost less depreciation........	100,000	Surplus..............	257,000
Current assets........	100,000		
Goodwill.............	350,000		
	$ 877,000		$ 877,000

Alpha Company then bought all the assets of Beta Company, giving in payment $400,000 of its own stock. This purchase price included payment at book value for buildings, equipment and current assets, the balance being payment for the land. The latter contained a deposit of fireclay estimated at 12,000,000 tons, which was the primary reason inducing Alpha Company to acquire the properties. It was estimated that when the clay deposit was exhausted the residual land would be worth not more than $10,000 and the equipment and buildings would be worth nothing. The goodwill on the books of Beta Company had been set up in the early post-war years by a credit to surplus, in an attempt to set up a large investment for purposes of excess-profits tax.

How should the properties be taken up by Alpha Corporation and what charges to profit and loss should be made thereafter in respect to depletion, depreciation and obsolescence, assuming (1) that the buildings would outlast the clay deposit and that the equipment would be sufficiently provided for by an annual provision of 10% of the cost to Alpha Company. Use straight-line rates, on per ton or time basis, as you think proper. Give reasons for what you do.

No. 5 (5 points):

K Company holds a first mortgage of $25,000 and L Company a second mortgage of $10,000 on real estate of M Company.

M Company has defaulted in payment of one year's interest of $1,500 on the K Company mortgage and assigns future rents to K Company authorizing the latter to manage the property as mortgagee in possession.

Six months later L Company institutes foreclosure proceedings and pending final sale thereunder the K Company is appointed by the court as receiver for rents.

How should the rents and expenses be treated in the books of K Company during (a) the first six months (b) the second six months? Give reasons.

No. 6 (5 points):

Your audit of the records of N, a bankrupt company, disclosed the following entries made one day before adjudication by the court.

a) Journal entry crediting the account receivable of O Company and debiting the account payable of O Company with $10,000 to offset accounts representing mutual dealings.

b) Cashbook entry applying entire bank balance of $25,000 in reduction of an unmatured note of $50,000 to the same bank.

c) The sale and delivery of all merchandise on hand at current market sales prices to P Company, holder of unmatured notes payable of the N Company which are personally endorsed by officers of the N Company. The merchandise is delivered in full and final settlement of these notes.

Comment upon these transactions.

No. 7 (5 points):

In 1929 T Company purchased a large factory building and, to finance the deal, executed a purchase-money mortgage of $100,000 payable in 10 years. In 1933 it sold the property to U Company which deducted from the sales price of $150,000 the amount due on the purchase-money mortgage of $100,000.

In the course of your examination of the books of T Company for the year ended December 31, 1934, you find a journal entry recording the sale of the property.

How should the realty transaction be shown on the balance-sheet, assuming that there is a marked deflation in realty values and that the U Company was declared bankrupt on December 1, 1934?

No. 8 (5 points):

The Island Syndicate offers to build a bridge across The Narrows at a cost of $20,000,000 and to accept in payment the city's 4% bonds, redeemable in 25 years, interest payable semi-annually. The annual maintenance charges are estimated at $50,000 a year. It is proposed to charge tolls—5 cents for foot passengers and 50 cents for vehicles. Based on these charges and assuming a ratio of foot passengers to vehicles of 1 to 20, how many tolls of each class would be necessary each year in order to provide for maintenance, interest and a sinking fund (earning the same rate of interest as the bonds) sufficient to retire the bonds at maturity? The amount of $1 after 50 interest periods is $2.692.

No. 9 (5 points):

On January 1, 1930, the V Company issued $1,000,000 bonds at 95. In terms of the issue $200,000 are to be retired on January 1, 1933, and $500,000 by annual amounts of $100,000 on January 1st of each of the five years next succeeding, the balance of $300,000 to be retired on January 1, 1939. Prepare a table showing the amortization of the discount by the bonds-outstanding method.

No. 10 (5 points):

In the course of your examination of the accounts of the Grander Company, Incorporated, you find that the company entered into certain irregular transactions. The company may be liable for damages as a consequence of the first of these transactions, while in the second it has performed a contract which is voidable by the other party who appears on the company's books as a debtor for the agreed contract price. In the third place certain ultra-vires transactions have been fully completed on both sides but others are still open, the company including in its book debts the amount due from the second party arising out of these transactions.

How would you deal with the foregoing transactions in your report?