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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 14 and 15, 1935.]

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 14, 1935, 9 A. M. TO 12:30 P. M.

The candidate must answer the first nine questions and either question 10 or question 11.

No. 1 (5 points):

How should receivables representing accounts due in instalments maturing later than one year after date of the balance-sheet be shown on a statement prepared for seeking a three months' loan from a bank? Give your reasons.

No. 2 (15 points):

State briefly your understanding of the meaning in accountancy of the following terms:

Working fund
Fund balance-sheet of a municipality
Debenture
Escrow
Hypothecation
Depreciation
Obsolescence
Amortization.

No. 3 (5 points):

In a detailed audit you find that the item "deferred charges," shown in one aggregate amount on the balance-sheet, comprises discounts on financing, deferred development, advertising and sundry operating expenses. How will you treat this in your report?

No. 4 (5 points):

Entering upon the audit of the A B Corporation you discover that in accordance with its usual custom it has held open its books for fifteen days after the end of its fiscal year and has entered, as of the closing date of said year, the collections of open accounts and cheques drawn in payment of purchase and expense bills, bearing dates prior to the end of the year. No other transactions during the fifteen days are so entered.

Discuss the probable reason for and the effect of this procedure, and state what action you would take in the matter. Give your reasons.

No. 5 (5 points):

In the accounts-payable item on the balance-sheet accountants rarely segregate those past due. Do you think this should be done? Give your reasons, pro and con.

No. 6 (10 points):

The A B Corporation offers you an engagement to make a detailed audit of its books and accounts, your fee to be paid in stock of the corporation at par. For some time the stock has been quoted above par on the local exchange.

State whether or not you would accept such an engagement, and why.

No. 7 (15 points):

Describe how you would proceed in the audit of a bank to verify (a) cash on hand and in other banks amounting to $2,000,000; (b) the collateral loans; and (c) the bank's own investments.

No. 8 (20 points):

The X Corporation desiring additional capital submits to an investment company a statement in which the "net income for 1934 available for dividends" is shown as $65,000.

You are engaged by the investment company to audit the books of the X Corporation for the purpose of verifying this net income. Your audit discloses the following facts which are not shown in the statement, viz.:

(a) Depreciation for the year amounting to $16,000 was not provided;
(b) Dividends of $25,000 on preferred stock were payable on the day following the date of the statement;
(c) A machine manufactured by the corporation for its own use at a cost of $12,000 was charged to machinery account at the market price of similar machines, namely, $17,000;

(d) In accordance with the terms of a trust deed under a bond issue $15,000 should have been credited out of net income to a sinking fund reserve;

(e) There was included in the net income $12,000 derived from non-recurring transactions apart from the usual business operations;

(f) No provision was made for the 1934 federal income tax.

Explain how each item should have been treated on the books or on the statement, and prepare summaries showing (a) the correct net earnings and (b) the net income available for dividends.

No. 9 (10 points):

A corporation has been in business for many years and both business and plant facilities have been continually expanded. It has regularly made good profits and accumulated a large surplus which is shown without explanation on the balance-sheet as a single item.

At an annual meeting the stockholders complain that their dividends have not been commensurate with the prosperity of the corporation as shown by the annual statements, and the president explains vaguely that while most of the surplus is legally available for dividends, there are practical reasons why it can not be distributed at the present time. Not satisfied with this explanation the stockholders thereupon engage you to make an examination and analysis of the surplus account and report thereon.

Assuming that the president's explanation is correct, state what you would expect to discover and report.

No. 10 (10 points):

In 1914 the A Corporation leased property consisting of land, buildings erected thereon and machinery installed therein to the B Corporation for 99 years. Inter alia the lease provided that the property should be returned to the lessor at the termination of the lease in as good condition as when leased and also that any improvements made by the lessee should become the property of the lessor upon termination of the lease.

In 1924 the lessee made extensive additions to the buildings and also scrapped some of the machinery, replacing it with modern equipment at a greater cost than that of the original units leased.

In 1934 the lease was terminated by breach and the lessor came into possession of the property.

What is the federal-income-tax status of the A Corporation in 1934 in respect to

(a) the additions to the buildings and

(b) the improvements to the machinery

made by the B Corporation?

Explain your answers.

No. 11 (10 points):

What are the general advantages of monthly balance-sheets, profit-and-loss and operating statements (a) if prepared by the bookkeeper and (b) if prepared or audited by a public accountant?

Examination in Accounting Theory and Practice

PART I

November 14, 1935, 1:30 p. m. to 6:30 p. m.

Solve problem 1 or 2, problems 3, 4 and 5 and problem 6 or 7.

No. 1 (30 points):

A public service corporation about to issue $53,000,000 first mortgage bonds, to be dated July 1, 1935, and due July 1, 1965, sought bids from underwriters which narrowed down to two:

(1) "A" offers for itself and others for 3½% coupon bonds 101.913 per cent. of par, the company to receive $54,013,890.

(2) "B" offers for itself and others for 3.4 per cent. coupon bonds 100.417 per cent. of par, the company to receive $53,221,010.

The legal and accounting expense of the company applying to the issue is $300,000. Interest is payable semi-annually on January 1st and July 1st.

The company has outstanding an issue of non-callable, three-year 5% coupon notes dated April 15, 1933, due April 15, 1936, amounting to $16,000,000, interest on which is payable semi-annually. The current market price of these notes is 103 and interest.

After awarding the issue to A for offer (1), the president of the company issued the following announcement:

"The management has recommended and the directors have approved the sale of $53,000,000 par value, first mortgage 3½% bonds to "A" which bid 101.913 per cent. to the company. . . .

"The management and directors gave long and serious consideration to offer (2) of "B," carrying a 3.4 per cent. coupon. Although this would mean an interest saving of $53,000 a year over the 30-year life of the bonds the premium offered amounted only to $221,010 as compared with a premium of $1,013,890 in offer (1) of A. The receipt of nearly $800,000 in additional money at this time would be a great advantage to the company in further reducing the short-term debt still outstanding after the completion of this issue. The management is strongly of the opinion that this advantage more than offsets the interest saving under the lower coupon rate."

Assuming you had been asked to help the directors in awarding the bid, what reasoned opinion would you have given?

NOTE.—The calculations in this problem may be made either by arithmetic or by actuarial methods.

On the basis of 3½% interest per annum, payable semi-annually:

Present value of $1 payable after 60 half yearly periods....	$ .35313
" " " $1 per annum over 60 " " "	$36.96399

No. 2 (30 points):

The following statement gives the account balances on the books of a college at the end of the fiscal year before closing:

	Debit	Credit
General current funds		
Cash	$ 17,000	
Investments	20,000	
Accounts receivable	3,000	
Inventories	18,000	
Estimated income	1,385,000	
Appropriations		$1,360,000
Accounts payable		2,000
Reserve for working capital		20,000
Unappropriated surplus (after entering budget)...		111,000
Educational and general expenditures	1,060,000	
Auxiliary enterprises expenditures	252,000	
Other non-educational expenditures	26,000	
Educational and general income		1,070,000
Auxiliary enterprises income		315,000
Other non-educational income		15,000
Transfer to endowment	50,000	
Transfer to plant funds	62,000	
	$2,893,000	$2,893,000

	Debit	Credit
Restricted current funds		
Cash	$ 3,000	
Investments	58,000	
Accounts payable		$ 1,000
Fund balances		60,000
	$ 61,000	$ 61,000
Loan funds		
Cash	$ 1,000	
Investments	5,000	
Notes receivable	36,000	
Income		$ 2,000
Funds principal beginning of year		25,000
Gifts to loan funds during year		15,000
	$ 42,000	$ 42,000
Endowment and other non-expendable funds		
Cash	$ 3,000	
Securities	857,000	
Funds in trust	100,000	
Profit on sales of investments		$ 10,000
Endowment funds principal beginning of year		700,000
Gifts to endowment		100,000
State tax collections for endowment		100,000
Transfer from current funds (temporary)		50,000
	$ 960,000	$ 960,000
Funds subject to annuities		
Cash	$ 1,000	
Investments	99,000	
Fund balances, beginning of year		$ 80,000
Gifts of annuity funds		20,000
	$ 100,000	$ 100,000
Unexpended plant funds		
Cash	$ 4,000	
Investments	15,000	
Expenditures for plant additions	360,000	
Replacement funds balances		$ 15,000
Plant additions funds balances, beginning of year		50,000
State appropriation for plant additions		200,000
Gifts for plant additions		50,000
Income on investments		2,000
Transfer from current funds		62,000
	$ 379,000	$ 379,000

	Debit	Credit
Funds invested in plant		
Educational plant, beginning of year	$3,100,000	
Bonds payable		$ 100,000
Investment in plant		3,000,000
	$3,100,000	$3,100,000
Agency funds		
Cash	$ 2,000	
Investments	8,000	
Fund balances		$ 10,000
	$ 10,000	$ 10,000

Attention is called to the following facts and conditions which are disclosed upon examination of the records:

(1) Notes of loan fund amounting to $500 are found to be uncollectible and are to be written off.

(2) An annuity fund of $1,000 for current purposes has matured through the death of the annuitant.

(3) Included in the educational expenditures of the year from current funds is the sum of $14,000 for new equipment.

(4) Equipment included in plant assets at beginning of year to the amount of $32,000 had worn out or other disposition of it had been made.

(5) Orders and contracts outstanding at close of year and payable from current funds appropriations amounted to $6,000.

(6) An analysis of endowment funds shows that at the beginning of the year $200,000 included therein represent undesignated funds temporarily functioning as endowment.

(7) A further analysis indicates that $100,000 of endowment funds has been expended for a residence hall, the value of which is included in plant assets but not in endowment funds.

(8) Income and expenditures of restricted current funds are included in the budget estimates and in the totals of income and expenditure carried in the general-funds section.

You are required:

(a) To make the necessary closing entries in all funds.

(b) To prepare a balance-sheet after closing.

(c) To prepare a statement of current income, expenditures and surplus for the year.

No. 3 (25 points):

The capital of the co-partnership of Goe & Gettem amounted to $40,000, of which Goe contributed $25,000 and Gettem $15,000. The arrangement with respect to the distribution of profits was that Goe received 60% and Gettem 40%. The capital contributions referred to represented the amount of the capital of the respective partners immediately prior to the admission of Goode as a partner on January 1, 1933.

By agreement among the three partners the aggregate contributed capital of the new firm at its inception on January 1, 1933, was to continue at $40,000, Goode to pay to Goe, personally, $10,000 for the transfer from Goe's capital account to Goode's capital account of a one-quarter interest and Goode to have a 20% interest in the profits or losses, thus making the interests in profits and losses of Goe and Gettem 40% each.

The profits for 1933 amounted to $15,000 and during the year Goe withdrew $7,000, Gettem $5,000 and Goode $2,500. A loss of $25,000 was sustained in 1934 and the withdrawals during that year were: Goe $4,000, Gettem $3,000, Goode $2,000. Goode had advanced $1,000 as a loan and the other liabilities at December 31, 1934, consisted of trade accounts payable.

When it was decided at the end of 1934 to liquidate, the trade creditors were paid in full from the cash on hand and the collections of accounts receivable. Of the then remaining $7,500 assets $6,500 were sold for $1,500 cash. It was agreed that this cash should be distributed before realization of the sole remaining asset of $1,000, the value of which was problematical. Assuming that Goe and Gettem may have to absorb any deficiency on Goode's accounts—

1. How should the $1,500 cash be distributed?
2. How should the proceeds from the sale of the doubtful asset be distributed if $800 is ultimately realized?
3. How if $5,000 is ultimately realized?
4. What is the amount that should be realized so that Goode's share may exactly reimburse his partners for the deficiency assumed by them?

No. 4 (20 points):

The Roane Realty Company purchased a sixty-acre tract of land (43,560 square feet to an acre) for $24,000 and spent $91,620 for improvements and expenses. Of the acreage 701,100 square feet were used for streets, parkways, alleys, etc.

No sales were made during the first year. During the second year lots were placed on the market and sales were made based on two classes. One-third of the land was placed in a class called "A" and the balance was classed as "B." The lots were of equal size and contained 12,750 square feet each. The price was 8¢ per square foot for class A and 7¢ per square foot for class B lots, with discount of 10% on all sales for cash.

In the second year 10 class A and 17 class B lots were sold. Four of the ten sales of class A, and six of the seventeen sales of class B were for cash. The other sales were on the basis of 10% cash and nine additional equal payments.

During the third year all the other lots were sold. Ten class A and twenty-five class B lots were sold for cash; the rest on the ten-payment plan.

Profit is to be considered as earned and unearned. Earned profit is that part of the profit that is realized by actual collection. At the end of the second year (the first year of sales) there was still due on instalment sales an average of four instalments which were paid in the third year. At the end of the third year there was an average balance on instalment sales of three payments, all good and collectible.

State the earned profit for each of the two years in which sales were made. Carrying charges need not be considered.

No. 5 (15 points):

John Gibbon died January 1, 1930, and left his property in trust to his daughter Ethel. The income was to be paid to her as long as she lived and at her death the trust was to go to his nephew, William Gibbon. He appointed John Doe trustee at a fixed fee of $5,000 per annum. All expenses of settling the estate were paid and accounted for by the executor before the trustee took it over.

Ethel died on September 30, 1933, and left all her property in trust to her cousin, Joseph Hart. John Doe was appointed executor and trustee of her estate and he agreed not to make any additional charges for these services. All income was to be paid to Joseph Hart. The estate, which consisted solely of Ethel's unexpended income from the John Gibbon trust, was immediately invested in 4% certificates of deposit.

The property received under the will of John Gibbon on January 1, 1930, was:

10,000 shares of the K. O. Corporation, valued at $100 each.
$300,000 bonds of the K. O. Corporation, paying interest on June 30th and December 31st at 6% per annum.

In the five years ended December 31, 1934 the trustee received the following dividends on the stock:

February 1, 1930	$ 40,000
" " 1931	40,000
" " 1932	40,000
" " 1933	60,000
" " 1934	60,000

and he made the following payments:

Expenses:		
$100 a month, totaling		$ 6,000
Trustees fees:		
$5,000 per annum, totaling		$ 25,000
To beneficiaries:		
Ethel Gibbon		
1930	$27,250	
1931	35,000	
1932	25,000	
1933	37,000	$124,250
William Gibbon		
1933	$17,000	
1934	46,000	$ 63,000
Joseph Hart		
1934		$ 3,000

The surplus income was left on deposit in the bank and drew no interest.

Prepare trustee's accounts covering the five years ended December 31, 1934, showing the beneficiaries' interests.

No. 6 (10 points):

On April 30, 1935 the X Y Z Corporation, a newly organized holding company, acquires all of the outstanding capital stocks of Companies A and B, (the latter company owning the entire outstanding capital stocks of Companies C and D) by issuing all of its own stock share for share to the stockholders of Companies A and B.

It is established that:

(1) The earned surplus of Company A on April 30, 1935 was.....	$150,000
(2) The earned surplus of Company B (including $85,000 representing the combined earned surplus accounts of Companies C and D on the dates they were acquired by B) was.........	235,000
(3) None of the companies A, B, C or D had a capital surplus on April 30, 1935......................................	
(4) The combined earnings of all companies for the two months ended June 30, 1935, were.............................	60,000

Question A

How would you deal with the above items in the June 30, 1935, balance-sheet of the X Y Z Corporation?

You are called into consultation by the directors of the X Y Z Corporation on July 15, 1935. They inform you that they wish to continue dividends of the same amount that the original stockholders of the subsidiary companies have been receiving regularly and that such amount would be $200,000.

Question B

State briefly the advice you would give them. You may assume that the earnings of Companies A and B and also the dividends paid to their respective stockholders have been equal.

No. 7 (10 points):

Company A owns 80% of the capital stock of each of the companies B and C. Company B owns 90% of the capital stock of Company D. Company C owns 95% of the capital stock of Company E. Company D sells to Company E real estate costing $100,000 for $150,000 cash.

On the assumption that there was justification for the sale of the real estate and that the selling price was the fair market value at the time of the sale, show how the profit of $50,000 is to be treated in the consolidation of—

(1) Company B and its subsidiary, Company D
(2) Company C and its subsidiary, Company E
(3) Company A and its subsidiaries, Companies B and C

Examination in Commercial Law

NOVEMBER 15, 1935, 9:00 A. M. TO 12:30 P. M.

Reasons for each answer must be stated. 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):

The Printing Company contracted with the Cook Company to supply stationery to the latter during a stated period, on a cost-plus basis. The contract defined cost as "actual cost of labor and material (including an amount of administrative and overhead charges, attributable to the performance of said agreement, satisfactory to the Cook Company, which said sum is to be determined by the Cook Company after an audit and examination by the Cook Company of the books and accounts of the Printing Company)." The Cook Company, after its audit, notified the Printing Company that the overhead charges made by the latter were not satisfactory to the Cook Company. The dissatisfaction was actual and not capricious but was based on points in dispute among outstanding accountants. Is the Printing Company conclusively bound by the Cook Company's position?

No. 2 (10 points):

A stockholder, exercising a legal right to inspect the financial books of account of the corporation, brought with him a public accountant to advise him in the examination and to make transcripts from the accounts to be taken away by the stockholder. The corporation's officers refused to permit the public accountant to see the accounts or to make transcripts therefrom. Were they justified in their refusal?

No. 3 (10 points):

John Barton was 19 years old and employed as a bookkeeper. He subscribed to a non-cancellable correspondence course in accountancy for which he agreed to pay a stipulated amount. He completed half of the course, paid one-quarter of the stipulated amount, and thereupon, at the age of 20, refused to continue the course or to make further payments. What are the rights of the parties?

No. 4 (10 points):

In June, 1929, Herman was an internal-revenue agent entitled to certain pension and retirement rights. On July 1, 1929, at the instigation of the X Corporation, he resigned and entered the employ of the X Corporation under a written contract which provided that during the rest of his life he was to devote his entire time to the corporation as assistant to the president, for which he was to be paid a salary of $5,120 per annum. On November 13, 1929, the X Corporation discharged him without cause. Assuming that no question of ultra vires was involved, what are his rights under the contract?

No. 5 (10 points):

(a) Define personal property.
(b) Define tangible and intangible.
(c) Define lien.
(d) Define pledge.
(e) What are the usual ways by which title to personal property is acquired?

Group II

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

No. 6 (10 points):

Mason and Dana were negotiating and Mason's attorney prepared a long and carefully drawn contract which was given to Dana for examination. Five days later and prior to its execution, Dana's eyes became so infected that it was impossible for him to read. Ten days thereafter and during the continuance of the illness Mason called upon Dana and urged him to sign the contract, but without in any way misrepresenting the contents of it, and Dana signed without reading it. In a subsequent suit by Mason, Dana claimed that the contract was not binding upon him because he had not and could not have read it prior to his signing it. Is Dana's claim a valid defence?

No. 7 (10 points):

In what respects must a negotiable instrument be changed in order that the change will constitute a material alteration?

No. 8 (10 points):

In the absence of any applicable statute, what is a testamentary trustee's duty as to (a) amortization of premiums on bonds purchased by him, (b) amortization of premiums on bonds purchased by the testator and acquired by the trustee as a part of the trust fund, (c) accumulation of discounts on bonds purchased by the trustee?

No. 9 (10 points):

The Surety Company was a duly organized corporation engaged in the business of issuing surety bonds. In consideration of its regular fee, it became surety on the official bond of a municipal treasurer. The treasurer defaulted and the municipality took his six-months note for the amount of the shortage, but the Surety Company was not notified. The treasurer failed to pay the note at its maturity and the municipality sued him and the Surety Company for the amount of the shortage. Upon trial it appeared that there had been no substantial change in the treasurer's financial condition during the interval between the discovery of the defalcation and the starting of the suit. Was the Surety Company discharged from liability when the municipality accepted the treasurer's note?

No. 10 (10 points):

One of the maxims in equity is: "He who comes into equity must come with clean hands." State briefly the other principal maxims but do not elaborate upon or discuss them.

No. 11 (10 points):

(a) What are the principal kinds or types of insurance?
(b) What is the legal reason why insurance is lawful although bets and wagers usually are unlawful?
(c) What is meant by insurable interest?
(d) Give an example of subrogation in relation to insurance.
(e) What is meant by general average?

No. 12 (10 points):

State the general principles underlying a common carrier's liability for loss or damage to goods shipped by freight.

Examination in Accounting Theory and Practice

PART II

NOVEMBER 15, 1935, 1:30 P. M. TO 6:30 P. M.

Solve problems 1 to 5 and two of the four problems 6 to 9.

No. 1 (30 points):

The following is a summary of an analysis of the "investment in subsidiary companies" account in the ledger of the "P" Company as at June 30, 1935:

Company	Class of stock	Number of shares issued and outstanding	Number of shares owned	Amount at which shares are carried	Last dividend paid or declared for the period ended
"A" Company	7% First preferred.......	5,000	4,000	$ 200,000	June 30, 1932
	7% Second preferred.....	5,000	4,900	245,000	June 30, 1932
	Common...............	10,000	9,990	100,000	Sept. 30, 1929
"B" Company	7% Cumulative preferred..	10,000	8,000	800,000	June 30, 1933
	Common...............	10,000	10,000	1,000,000	June 30, 1933
"C" Company	6% Cumulative preferred..	5,000	4,500	450,000	Sept. 30, 1934
	Common...............	5,000	5,000	500,000	Sept. 30, 1934
				$3,295,000	

The certificate of incorporation of the "A" Company stipulates that in the event of dissolution the 7% first preferred stock shall be entitled to $75 per share before any distribution is made to holders of any other class of stock, and no more. It further provides that after $75 per share has been distributed to the holders of the 7% first preferred stock the holders of the 7% second preferred stock shall be entitled to receive $62.50 per share before any distribution is made to the holders of the common stock; and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "B" Company stipulates that, in the event of liquidation or winding up, the 7% cumulative preferred stock shall be entitled to $105, plus all dividends, before any distribution is made to the holders of the common stock, and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "C" Company stipulates that after providing for all unpaid dividends on the 6% cumulative preferred stock the holders of the preferred and common stocks shall, in the event of dissolution, liquidation or winding up, be entitled, share and share alike, to all remaining assets.

A condensed summary of the assets and liabilities of the several companies as at June 30, 1935 is shown in table on opposite page.

No. 2 (20 points):

The Clark Manufacturing Company is being operated by a committee of its creditors and you are called in to prepare financial statements for information of the creditors. Your examination reveals the following:

1. After the creditors' committee had taken charge, but before the date of your examination, a fire had occurred causing an estimated damage of $80,000, made up as follows:

Machinery and equipment (Book value less depreciation)	$50,000
Inventories	20,000
Customers' merchandise on hand for work to be done thereon	10,000
	$80,000

   (The building occupied was leased and not owned)

   The company had accepted from the insurance companies $57,080 in full settlement for the loss, and this amount was still on deposit at the date of your examination. The cost of clearing the debris and obtaining the equipment considered necessary would be $47,250.
2. There is $130,112 in accounts and notes payable to creditors, parties to an agreement whereby each creditor accepted a note of the corporation, due October 31, 1937 and bearing interest at 5% per annum. The notes are secured by mortgage on all plant property and by all the issued capital stock. The latter is held in escrow. There will be $13,348 interest accrued on the notes at maturity.
3. Expenses have accrued to the amount of $1,532.
4. There is due to the president $30,000 for salary and cash advances for which the corporation gave him a demand note. A part of the agreement with the creditors was a covenant by the president to take capital stock for this note at par. The president could not surrender the note, however, because he had used it as collateral to secure a personal loan. The stock had therefore not yet been issued.

	"A"	"B"	"C"	"D"	"P"
Current assets	$450,000	$1,000,000	$1,200,000	$150,000	$ 100,000
Treasury stock:					
600 shares of "D" Company common				6,250	
Investments:					
1,000 shares of "B" Company					
7% cumulative preferred	50,500				
9,000 shares of "D" Company common			112,500		
Per analysis					3,295,000
Fixed assets, less depreciation	200,000	1,200,000	200,000	17,000	
Other assets	9,500	165,000	27,500	250	25,000
Total assets	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000
Current liabilities	$ 85,000	$ 165,000	$ 240,000	$ 26,250	$ 70,000
Mortgages payable		300,000			
Capital stock					
7% First preferred	250,000				
7% Second preferred	250,000				
7% Cumulative preferred		1,000,000			
6% Cumulative preferred			500,000		
Common	100,000	1,000,000	500,000	100,000	3,000,000
Surplus or *deficit*	25,000	*100,000*	300,000	47,250	350,000
Total liabilities	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000

Prepare a schedule of the minority interest, assuming liquidation at book value.

5. There is a corporation note dated February 1, 1931, payable on demand to the widow of the former treasurer, for $6,900. She has agreed to subrogate her claims to those of the other creditors.
6. The liabilities incurred since the creditors entered into the agreement aggregate $15,699.
7. There are $17,400 notes payable for equipment purchased prior to the creditors' agreement, due in monthly instalments of $2,175 each and secured by chattel mortgage on the equipment.
8. Balances aggregating $3,066 are due employees under an arrangement whereby they received 90% of their earnings in cash and 10% in scrip payable October 31, 1937.
9. A deficit of $178,032 existed at the date of the creditors' agreement. The subsequent loss from operations is $8,942 before adjustment of the fire loss.
10. The authorized capital stock is 150,000 shares of $10 each, of which 50,000 shares are issued and outstanding and placed in escrow for the benefit of creditors. Of the unissued 100,000 shares 5,350 were subscribed in 1928 but the subscriptions were never paid. They are of doubtful status and are given to the creditors' attorney for collection.

From the foregoing data prepare the liabilities side of the balance-sheet as you would submit it to your client, together with footnotes to the balance-sheet which in your opinion are necessary for a clear understanding of the corporation's financial position.

No. 3 (18 points):

Company D makes ferro-chrome at a cost of $127 a ton. The product is sold to Company F at $160 a ton.

Company E makes spiegeleisen (ferro manganese) at a cost of $71 a ton. This is sold to Company F at $90 a ton.

Company F makes steel, some being Bessemer steel and some open-hearth chrome steel, using products of Companies D and E. Its manufacturing statistics show:

Bessemer:	
Materials—	
Pig	105 tons
Spiegeleisen	6 "
	111 "
Loss of weight in manufacturing	11 "
Tons of ingots produced	100 "

Chrome steel:	
Materials—	
Pig	65 tons
Scrap	20 "
Ore	10 "
Ferro-chrome	15 "
	110 "
Loss of weight in manufacturing	10 "
Tons of ingots produced	100 "

It is further shown that in converting ingots into shapes there is a further loss of 10 per cent of the weight of the ingots.

The inventory of Company F shows:

370 tons spiegeleisen
1,200 tons ferro-chrome
9,000 tons Bessemer shapes
23,000 tons Bessemer ingots
18,000 tons chrome steel shapes
46,000 tons chrome steel ingots.

The total inventories before adjustment are:

Company D	$ 120,000
" E	315,000
" F	7,330,000
	$7,765,000

What is the value of the consolidated inventory after eliminating the intercompany profit?

No. 4 (12 points):

On January 1, 1934 a partnership was formed by Payson, Coleman and Burtis. They agreed to contribute $25,000 each, the profits to be shared equally. Coleman, however, put in only $15,000 while Payson put in $35,000 but Burtis did as agreed. Interest at 6% was to be paid on these capital differences and settled between the partners. No interest was to be credited on capital but they were to be charged 6% on drawings. At the close of the year 1934 the interest on drawings was: Payson $425, Coleman $275 and Burtis $315. The firm then owed $50,000 on a note dated August 31, 1934, and due August 31, 1936, interest payable semi-annually at the rate of 6% per annum. The partnership was on a calendar year and accrual basis.

Coleman bought for his own account on January 2, 1934, \$15,000 of good 4½% municipal bonds and \$15,000 of good 5% public utilities bonds. The interest on the municipal bonds was due January 1st and July 1st; interest on the utility bonds was due April 1st and October 1st. On March 15th he borrowed for himself \$20,000 at 6% with these bonds as collateral (\$10,000 on each block of bonds) and his loans were renewed on July 15th and November 15th. Coleman's individual tax return was on a cash basis.

How should the interest be reported on the partnership's and Coleman's federal income-tax returns?

No. 5 (10 points):

The unaudited accounts for the year 1934 of the Bilt-Well Furniture Company are as follows:

Balance-sheet—December 31, 1934.

Assets	
Cash	\$ 8,000
Accounts receivable	50,000
Inventory	343,000
	\$401,000
Liabilities	
Notes payable	\$ 25,000
Trade creditors	45,000
Reserve for bad debts	8,000
Capital stock	150,000
Surplus	173,000
	\$401,000

Surplus and Profit-and-Loss Account year ended December 31, 1934.

Sales	\$230,000
Cost of sales	183,000
Gross profit	\$ 47,000
Expenses	\$ 72,000
Bad debts	16,000
	\$ 88,000
Loss for the year	*\$ 41,000*
Surplus at January 1, 1934	214,000
Surplus at December 31, 1934	\$173,000

An examination discloses that at the end of the year 1934 the following adjustments are necessary:

To reduce inventory to market by	$125,000
To increase reserve for bad debts by	8,000
To set up the liability for:	
Commissions payable to salesmen	5,000
Sundry expenses	2,000

The examination further reveals the following adjustments at the beginning of the year that were accepted by the company but had not been taken up on the books:

Reduction of inventory to market	$100,000
Increase of reserve for bad debts	19,000
Provisions for:	
Unrecorded liabilities	3,000
Commissions due salesmen	1,500

Prepare adjusted accounts.

No. 6 (5 points):

A company refunds a bond issue of $5,000,000 principal amount of 6½% bonds, due five years hence, on which there is still an unamortized debt discount and expense of $250,000, by the issuance of $5,500,000 principal amount of 5½% twenty year bonds at 90. The difference between the amount of cash necessary to retire the old bond issue and the amount produced by the refunding bonds is supplied from the general funds of the company. The expenses of the new issue are $50,000.

Discuss briefly three procedures which may be followed by the company to dispose of the unamortized debt discount and expense applicable to the old issue and list them in the order of your preference.

No. 7 (5 points):

A company with a capital of $25,000,000 contracted for the construction of a new building at its factory. This contract was formally authorized and accepted by the board of directors. Construction commenced in October, 1934, and at December 31, 1934; the engineers estimated that in addition to the payments already made to the contractors, $2,500,000 was necessary to complete the building.

What disclosure do you deem necessary on the December 31, 1934, balance-sheet—

1. If the company's cash balance is adequate and no new financing is intended and
   (a) in case the amount has been formally appropriated
   (b) when not definitely appropriated.
2. If arrangements had been completed early in January, 1935, to raise the $2,500,000 through an issue of bonds.

No. 8 (5 points):

A manufacturer of refrigerators had 4,000 units of a 1933 model on hand at December 31, 1934. In February, 1935, prior to the completion of your audit, these units were disposed of as a job lot for $50,000. Their original cost had been $310,000 and their inventory value at December 31, 1933, was $248,000.

Assuming that the offer had been under consideration prior to December 31, 1934, what would be your opinion of the contention that, since no fair market value existed at the end of the year, the original cost of $310,000 should be restored as the inventory value? Would your conclusion concerning the proper valuation in the balance-sheet of December 31, 1934, be modified if the offer had not been received until February?

No. 9 (5 points):

1. Define a co-insurance clause in an insurance policy.

2. A company carried $50,000 insurance. The policy contained a co-insurance clause stating that the insured agreed to carry insurance to the amount of 80% of the value of the company's insurable assets or become a co-insurer. The company had a fire loss amounting to $40,000. The insurable assets at the time of the fire amounted to $100,000. How much insurance is the company entitled to collect from the insurance company?