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## Students' Department

H. P. Baumann

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# Students' Department

H. P. BAUMANN, *Editor*

## OHIO C. P. A. EXAMINATION

### PRACTICAL ACCOUNTING

Examination Thursday, November 2, 1933—1:30 P. M. to 6:30 P. M.

#### Problem No. 2

The A Company of Cleveland, Ohio, purchased the business of The Products Company on December 31, 1925, and operated it until December 31, 1928, which time you were engaged to make an audit for the three years then ended; for which the surplus account shows as follows:

Net profit for the year 1926.....		\$117,900
Net profit for the year 1927.....		48,504
Dividends paid—1926.....	\$ 42,000	
Dividends paid—1927.....	22,000	
Factory employees bonus—1926.....	45,000	
Factory employees bonus—1927.....	30,000	
Charitable contributions—1926.....	3,004	
Balance December 31, 1928.....	24,400	
	<u>\$166,404</u>	<u>\$166,404</u>

"Cash on hand," as listed on the trial balance of December 31, 1928, includes receipts for advances to officers of \$2,500, and memorandum of liability to the cashier for \$1,000 for funds advanced by him. "Cash on deposit" when reconciled to amount reported by bank indicates that a cheque for \$5,000 received from an old reliable customer for his December account had been protested and charged back by the bank but the return of the cheque had not been entered on the company's books.

Accounts receivable after all necessary adjustments were aged as follows:

December.....	25%	July 1 to September 30..	5%
November.....	10%	January 1 to June 30...	10%
October.....	5%	Year 1927.....	30%
		Year 1926.....	15%

Uncollectible accounts aggregating \$54,000 are worthless. These accounts represent all the unpaid amounts for 1926; one third of those for 1927 and one-half of those for the first six months of 1928. These uncollectible accounts of 1926 and 1927 were actually charged off in the accounts receivable ledger at the close of the respective years but the general ledger control has not been adjusted.

It was estimated in 1927 that 50 per cent. would be recovered on deposits in the bank closed during that year. The loss, for purposes of this problem, may be regarded as a non-deductible tax item.

On January 1, 1928, a cost system was put into effect on the basis of "standard" or "budgeted costs." The finished inventory at the beginning of 1928, which was entirely disposed of during the year, was priced at actual cost which also represented the "standard cost" at that date. Early in the year a considerable reduction was made in labor rates which accounted for the large labor variance. This reduction is to continue indefinitely and the standards for 1929 will be adjusted accordingly. The rate of overhead absorption during 1928 was considered to be normal and will be continued indefinitely.

The company did not pay the bond interest due July 1, 1928, and thereafter

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nor principal payment due January 1, 1929. A bondholders' protective committee was formed in 1929 and proposed the following plan of reorganization:

- Bonds and B Company liability to be converted into 6% preferred at par. Accrued interest to be waived if plan is consummated.
- Preferred to be converted into 2,000 shares of no par common.
- Present common stock to be surrendered and cancelled.
- Life insurance policy to be surrendered for working capital.
- Officers' salaries to be limited to \$30,000 a year.

Prepare (1) pro forma balance-sheet and three year income and expense statement giving retrospective effect to the proposed plan; and (2) usual statement of income and expense and surplus for the same period.

Trial balance—"A" Company—December 31, 1928

Cash on hand . . . . .	\$ 2,000	
Cash on deposit . . . . .	9,000	
Accounts receivable . . . . .	175,000	
Inventory—raw material 12/31/28 . . . . .	125,000	
Inventory—finished 12/31/28 (standard basis) . . . . .	270,000	
Advances to officers . . . . .	14,000	
Life insurance surrender value (available 12/31/28) . . . . .	8,000	
Deposits in closed bank . . . . .	30,000	
Plant and equipment . . . . .	581,000	
Treasury bonds—\$6,000 par value (acquired 3/1/28) . . . . .	3,000	
Unamortized portion of bond discount and expense . . . . .	28,000	
Depreciation reserve . . . . .		\$ 184,000
Accounts payable . . . . .		149,000
Accounts payable—B Company . . . . .		180,000
Accrued interest on bonds . . . . .		9,600
Notes payable—closed bank . . . . .		22,000
Notes payable—life insurance . . . . .		3,000
6% bonds (dated 1/1/26—due \$40,000 annually) . . . . .		320,000
Capital stock—preferred 7% cumulative . . . . .		200,000
Capital stock—common . . . . .		200,000
Surplus . . . . .		24,400
Sales . . . . .		650,000
Cost of sales . . . . .	480,000	
Labor variance . . . . .		50,000
Overhead variance . . . . .	20,000	
Officers' salaries . . . . .	55,000	
General and administrative expenses . . . . .	48,000	
Selling expenses . . . . .	134,400	
Life insurance premium expense . . . . .	4,000	8,000
Bond interest expense . . . . .	9,600	
Bond expense amortization . . . . .	4,000	
	\$2,000,000	\$2,000,000
	\$2,000,000	\$2,000,000

Analysis of accounts

	Finished inventory	Raw material inventory	Labor variance	Overhead variance
Debits:				
Inventory 1/1/28 . . . . .	\$300,000	\$ 50,000		
Purchases . . . . .		225,000		
Labor . . . . .			\$100,000	
Manufacturing expense . . . . .				\$170,000
Transfers . . . . .	450,000			
	\$750,000	\$275,000	\$100,000	\$170,000
Total debits . . . . .	\$750,000	\$275,000	\$100,000	\$170,000

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	Finished inventory	Raw material inventory	Labor variance	Overhead variance
<i>Less: credits:</i>				
Transfers to cost of sales . . . . .	\$ 480,000			
Transfers to finished inventory		\$ 150,000	\$ 150,000	\$ 150,000
Balance 12/31/28 . . . . .	<u>\$270,000</u>	<u>\$125,000</u>	<u>\$ 50,000</u>	<u>\$ 20,000</u>

	Income and expense			
	1926		1927	
Sales . . . . .		\$1,800,000		\$1,250,000
Finished product—beginning . . .	\$ 350,000		\$ 200,000	
Raw materials—beginning . . . . .	75,000		100,000	
Raw materials—purchases . . . . .	700,000		500,000	
Labor . . . . .	250,000		200,000	
Manufacturing expenses . . . . .	257,000		212,000	
Life insurance premium . . . . .	4,000		4,000	
Officers' salaries . . . . .	60,000		55,000	
General and administrative ex- penses . . . . .	60,000		50,000	
Bond interest . . . . .	12,000		33,600	
Bond expense amortization . . . .			8,000	
Selling expenses . . . . .	201,000		181,000	
Federal income taxes . . . . .	13,100 (10%)		7,896 (14%)	
Inventory end—finished . . . . .		200,000		300,000
Inventory end—raw . . . . .		100,000		50,000
Net profit . . . . .	117,900		48,504	
	<u>\$2,100,000</u>	<u>\$2,100,000</u>	<u>\$1,600,000</u>	<u>\$1,600,000</u>

*Solution:*

Explanatory adjusting entries

	Dr.	Cr.
(1)		
Advances to officers . . . . .	\$ 2,500	
Cash on hand . . . . .		\$ 2,500
To set forth the amount due from officers which amount was carried in the cash on hand account.		
(2)		
Cash on hand . . . . .	\$ 1,000	
Due to employee . . . . .		\$ 1,000
To set forth the amount due to the cashier for funds advanced by him.		
(3)		
Accounts receivable . . . . .	\$ 5,000	
Cash on deposit . . . . .		\$ 5,000
To charge back the cheque for \$5,000 which cheque had been protested but not entered on the company's books.		

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	(4)	Dr.	Cr.
Bad debts:			
1926.....		\$ 27,000	
1927.....		18,000	
1928.....		9,000	
Accounts receivable.....			\$ 54,000

To clear the bad debts from the general ledger controlling account as follows:

Accounts receivable:	
Balance per trial balance.....	\$175,000
Customer's cheque returned.....	5,000
	_____
Balance, as adjusted.....	\$180,000
	_____

Age	Per cent. of total accounts receivable	Balance	Written off
1926.....	15%	\$27,000	\$27,000
1927.....	30%	54,000	18,000
Jan. 1 to June 30, 1928.....	10%	18,000	9,000
		_____	_____
Total written off.....			\$54,000
			_____

	(5)		
Notes payable—closed bank.....		\$ 22,000	
Deposits in closed bank.....			\$ 22,000
To offset the notes payable in the closed bank against the amount on deposit therein. (Note.—The right of offset is assumed)			

	(6)		
Loss on deposit in closed bank—1927.....		\$ 4,000	
Deposits in closed bank.....			\$ 4,000
To write off 50% of the balance remaining in the latter account after applying the notes payable as an offset. The remaining balance was estimated to be 50% collectible in 1927.			

NOTE.—In this solution, the statement that "50% would be recovered on deposits in the bank" is interpreted as meaning that 50% of the balance remaining after applying the notes payable as an offset would be recovered. If no consideration is given to the notes payable of \$22,000, in interpreting this point, we have the following result.

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Amount of deposits .....	\$30,000	Dr.	Cr.
50% thereof .....	\$15,000		
Amount of notes payable .....	22,000		
Balance due on notes .....	\$ 7,000		

This does not appear to be reasonable, as the problem states that a percentage would be recovered (presumably by the company).

(7)

Bond interest—1928 .....	\$ 9,300		
Accrued interest on bonds .....			\$ 9,300
To accrue interest on the bonds outstanding in the hands of outsiders for the year 1928, as follows:			
Interest at 6% on \$320,000 of bonds for the two months from January 1, 1928, to March 1, 1928 .....	\$ 3,200		
Interest at 6% on \$314,000 (\$320,000 less treasury bonds of \$6,000) of bonds for the ten months from March 1, 1928, to December 31, 1928 .....	15,700		
Total .....	\$18,900		
Less: amount accrued on trial balance ..	9,600		
Additional provision .....	\$ 9,300		

During the year 1928, the cost of manufacturing was:

Raw materials .....			\$150,000
Labor .....			100,000
Overhead .....			170,000
Total .....			\$420,000

There was transferred to cost of sales .....			\$480,000
which included the opening inventory of finished goods (entirely disposed of during the year) amounting to .....			300,000
leaving a balance of .....			\$180,000

The transfers from the raw materials, labor and overhead accounts amounting to .....			\$450,000
were allocated, as follows:			
To cost of sales .....	(2/5)		\$180,000
To inventory .....	(3/5)		270,000
Total .....			\$450,000

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However, the actual cost of manufacturing, as shown above, was \$420,000, and not the \$450,000 which the company had transferred. The actual cost should have been allocated as follows:

	Cost of sales 2/5	Inventory 3/5	Total
Raw materials . . . . .	\$ 60,000	\$ 90,000	\$150,000
Labor . . . . .	40,000	60,000	100,000
Overhead . . . . .	68,000	102,000	170,000
Totals . . . . .	<u>\$168,000</u>	<u>\$252,000</u>	<u>\$420,000</u>

The adjusting entries follow:

	Dr.	Cr.
(8)		
Cost of sales . . . . .	\$ 18,000	
Inventory—finished (12/31/28) . . . . .		\$ 18,000
To correct the inventory of finished goods at December 31, 1928.		
(9)		
Inventory—raw material January 1, 1928 . . . . .	\$ 50,000	
Purchases . . . . .	225,000	
Labor . . . . .	150,000	
Manufacturing expense . . . . .	150,000	
Inventory—raw material, December 31, 1928 . . . . .		\$125,000
Cost of sales . . . . .		450,000
To record the details of the cost of manufacturing, per the analysis of accounts.		
(10)		
Labor variance . . . . .	\$ 50,000	
Manufacturing expenses . . . . .	20,000	
Labor . . . . .		\$ 50,000
Overhead variance . . . . .		20,000
To transfer the variance accounts to the labor and manufacturing expense accounts.		
(11)		
Inventory—finished, January 1, 1928 . . . . .	\$300,000	
Inventory—finished, December 31, 1928 . . . . .		\$252,000
Cost of sales . . . . .		48,000
To record the inventories of finished goods.		
(12)		
Factory employees bonus—1926 . . . . .	\$ 45,000	
Factory employees bonus—1927 . . . . .	30,000	
Charitable contributions—1926 . . . . .	3,004	
Surplus . . . . .		\$ 78,004

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Dr.                      Cr.

To re-state the surplus charges to be set up in the operating accounts.

NOTE.—No attempt is made to distribute the factory bonuses between the cost of sales and inventories of finished goods. These charges are considered as additional cost of sales in this problem as it is assumed that the inventories prior to January 1, 1928, were valued at actual cost. The problem so states: "the finished goods inventory at the beginning of 1928, . . . , was priced at actual cost."

(13)

Life insurance premium expense—1928.....	\$ 5,334	
Life insurance premium—1926.....		\$ 2,667
Life insurance premium—1927.....		2,667

To credit the life insurance premium expense accounts for the years 1926 and 1927 for the pro-rata interest in the cash surrender value of the policy as at December 31, 1928.

NOTE.—The common practice is to credit surplus account for  $\frac{2}{3}$  of the cash surrender value available at the end of the third year of the policy. However, in this problem, which requires a statement of the income and expense accounts for the three years, adjustments should be made to the operating accounts rather than to surplus.

(14)

Treasury bonds.....	\$ 3,000	
Unamortized portion of bond discount and expense..		\$ 3,000

To increase the book value of the treasury bonds to cost.

(15)

Unamortized portion of bond discount and expense. . .	\$ 319	
Bond expense amortization.....		\$ 319

To reduce the amount of the bond discount amortization by the amount applicable to the treasury bonds. The bonds, purchased on March 1, 1928, (2 years and 2 months after date of issuance) have, presumably, 7 years and 10 months of remaining life at the date of purchase. The portion of the \$3,000 of discount on these bonds, which is applicable to the 10 months of 1928, is, therefore,  $\frac{10}{94}$  of \$3,000 or \$319.

(16)

Bond expense amortization—1926.....	\$ 4,000	
Bond expense amortization—1927.....		\$ 4,000

To transfer to the year 1926, the portion of bond discount applicable to that year. Provision for the two years was charged to 1927.



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	<i>Dr.</i>	<i>Cr.</i>
(17)		
Bond interest—1926 . . . . .	\$ 12,000	
Bond interest—1927 . . . . .		\$ 12,000
To transfer to the year 1926, one-half year's interest charge, entered in 1927 in error.		
(18)		
Due from federal government . . . . .	\$ 12,320	
Federal income taxes—1926 . . . . .		\$ 8,400
Federal income taxes—1927 . . . . .		3,920
To record the over-payment of income taxes for the years 1926 and 1927.		
Amount paid . . . . .	1926 \$13,100	1927 \$7,896
As corrected . . . . .	4,700	3,976
Overpayment . . . . .	\$ 8,400	\$3,920
(19)		
Surplus . . . . .	\$150,665	
Net profits per books—1926 . . . . .		\$ 79,937
Net profits per books—1927 . . . . .		29,413
Net profits per books—1928 . . . . .		41,315
To reduce the profits for the years 1926 and 1927 and to increase the loss for 1928, per the working papers.		
(20)		
Advances to officers . . . . .	\$ 80,000	
Officers' salaries—1926 . . . . .		\$ 30,000
Officers' salaries—1927 . . . . .		25,000
Officers' salaries—1928 . . . . .		25,000
To give effect to the proposed plan to limit the officers' salaries to \$30,000 per year.		
(21)		
6% bonds . . . . .	\$320,000	
Accounts payable—B company . . . . .	180,000	
Treasury bonds—\$6,000 par value . . . . .		\$ 6,000
6% preferred stock . . . . .		494,000
To give effect to the proposed plan to issue 6% preferred stock for the 6% bonds outstanding and the accounts payable to B Company.		
(22)		
Capital stock—preferred 7% cumulative . . . . .	\$200,000	
Capital stock—2,000 shares, no-par common . . . . .		\$200,000
To give effect to the conversion of the old preferred stock for the new no-par common.		
(23)		
Surplus . . . . .	\$ 37,000	
Unamortized portion of bond discount and expense . . . . .		\$ 37,000

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	<i>Dr.</i>	<i>Cr.</i>
To write off the unamortized bond discount and expense account.		
(24)		
Cash on deposit . . . . .	\$ 8,000	
Life insurance surrender value . . . . .		\$ 8,000
To give effect to the surrender and cancellation of the life insurance policy.		
(25)		
Surplus . . . . .	\$ 4,000	
Life insurance premium—1926 . . . . .		\$ 1,333
Life insurance premium—1927 . . . . .		1,333
Life insurance premium—1928 . . . . .		1,334
To give effect, in the operating statements to the cancellation of the life insurance.		
(26)		
Surplus . . . . .	\$ 80,000	
Advances to officers . . . . .		\$ 80,000
To give effect to the reduction in officers' salaries to \$30,000 per year—which salaries had been paid in cash.		
(27)		
Surplus . . . . .	\$ 45,600	
Bond interest—1926 . . . . .		\$ 24,000
Bond interest—1927 . . . . .		21,600
To give effect to the cancellation of the bonds, and bond interest paid in cash during the years 1926 and 1927.		
(28)		
Accrued interest on bonds . . . . .	\$ 18,900	
Bond interest expense—1928 . . . . .		\$ 18,900
To give effect to the waiver of accrued bond interest for the year 1928.		
(29)		
Unamortized portion of bond discount and expense . . .	\$ 11,681	
Bond expense amortization:		
1926 . . . . .		\$ 4,000
1927 . . . . .		4,000
1928 . . . . .		3,681
To give effect to the cancellation of bonds and cancel the charge for bond discount amortization in the pro forma operating statements.		
(30)		
Federal income taxes:		
1926 . . . . .	\$ 5,800	
1927 . . . . .	7,084	
Surplus . . . . .		\$ 12,884
To give effect to the adjustment for federal income taxes after adjusting the operating statements according to the plan of reorganization.		

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	<i>Dr.</i>	<i>Cr.</i>
(31)		
Net profits:		
1926.....	\$ 53,533	
1927.....	44,849	
1928.....	48,915	
Surplus.....		\$147,297
To give effect to the adjustment in profits in the pro forma operating statements.		
(32)		
Notes payable—life insurance.....	\$ 3,000	
Cash.....		\$ 3,000
To record the payment in cash of the notes payable—life insurance.		
(33)		
Capital stock—common.....	\$200,000	
Surplus.....		\$200,000
To write off book value of capital stock—common per plan of reorganization.		
(34)		
Surplus.....	\$ 98,320	
Paid-in surplus.....		\$ 98,320
To transfer balance in surplus to paid-in surplus.		



A Company—Working papers—Statement of income and expense for the year ended December 31, 1926

Accounts	Profit and loss per trial balance		Adjustments		Profit and loss as adjusted		Adjustments to obtain pro forma statement		Pro forma profit-and-loss statement	
	Expense	Income	Dr.	Cr.	Expense	Income	Dr.	Cr.	Expense	Income
Sales		\$1,800,000				\$1,800,000				\$1,800,000
Finished product—beginning	\$ 350,000				\$ 350,000				\$ 350,000	
Raw materials—beginning	75,000				75,000				75,000	
Raw materials—purchases	700,000				700,000				700,000	
Labor	250,000				250,000				250,000	
Manufacturing expense	257,000				257,000				257,000	
Factory employees bonus			\$45,000 (12)		45,000				45,000	
Officers' salaries	60,000				60,000			\$30,000 (20)	30,000	
General administrative expenses	60,000				60,000			24,000 (27)	36,000	
Bond interest	12,000				12,000			4,000 (29)	16,000	
Bond expense amortization	4,000				4,000				4,000	
Selling expenses	201,000				201,000				201,000	
Inventory end—finished		200,000				200,000				200,000
Inventory end—raw		100,000				100,000				100,000
Bad debts			27,000 (4)		27,000		\$58,000		27,000	
Net profit before federal taxes							\$58,000		105,000	
Totals					\$2,100,000	\$2,100,000	\$58,000	\$58,000	\$2,100,000	\$2,100,000
Net profit before federal taxes (brought forward)					\$ 47,000	\$ 47,000	\$ 5,800 (30)	\$58,000	\$ 10,500	\$ 105,000
Federal taxes (10%)	13,100		3,004 (12)	\$ 8,400 (18)	4,700	3,004			3,004	
Charitable contributions	4,000			2,667 (13)	1,333			1,333 (25)		
Life insurance premium	117,900			79,937 (19)	37,963		53,533 (31)		91,496	
Net profit after federal taxes			\$91,004	\$91,004	\$ 47,000	\$ 47,000	\$59,333	\$59,333	\$ 105,000	\$ 105,000

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Accounts	Profit and loss per trial balance		Adjustments		Profit and loss as adjusted		Adjustments to obtain pro forma statement		Pro forma profit-and-loss statement	
	Expense	Income	Dr.	Cr.	Expense	Income	Dr.	Cr.	Expense	Income
Sales		\$1,250,000				\$1,250,000				\$1,250,000
Finished product—beginning	\$ 200,000				\$ 200,000				\$ 200,000	
Raw materials—beginning	100,000				100,000				100,000	
Raw materials—purchases	500,000				500,000				500,000	
Labor	200,000				200,000				200,000	
Manufacturing expense	212,000				212,000				212,000	
Factory employees bonus			\$30,000 (12)							
Officers' salaries	55,000				55,000			\$25,000 (20)		
General administrative expenses	50,000				50,000			21,600 (27)		
Bond interest	33,600			\$12,000 (17)	21,600			4,000 (25)		
Bond expense amortization	8,000			4,000 (16)	4,000					
Selling expense	181,000				181,000					
Inventory end—finished		300,000				300,000				300,000
Inventory end—raw		50,000				50,000				50,000
Bad debts			18,000 (4)				\$50,600			
Net profit before federal taxes							\$50,600		\$50,600	
Totals					\$1,600,000	\$1,600,000	\$50,600	\$50,600	\$1,600,000	\$1,600,000
Net profit before federal taxes (brought forward)						\$ 28,400	\$ 7,084 (30)	\$ 50,600	\$ 11,060	\$ 79,000
Federal taxes (14%)	7,896			3,920 (18)	3,976			1,333 (25)	4,000	
Life insurance premiums	4,000			2,667 (13)	1,333				63,940	
Loss on deposit in closed bank			4,000 (6)		4,000					
Net profit after federal taxes	48,504			29,413 (19)	19,091		44,849 (31)			
Totals	\$1,600,000	\$1,600,000	\$52,000	\$52,000	\$ 28,400	\$ 28,400	\$51,933	\$51,933	\$ 79,000	\$ 79,000

A Company—Working papers—Statement of income and expense for the year ended December 31, 1928

Accounts	Profit and loss per trial balance		Adjustments		Profit and loss as adjusted		Adjustments to obtain pro forma statement		Pro forma profit-and-loss statement	
	Expense	Income	Dr.	Cr.	Expense	Income	Dr.	Cr.	Expense	Income
Sales.....		\$650,000								\$ 650,000
Finished product—beginning.....			\$300,000 (11)		\$ 300,000				\$ 300,000	
Raw materials—beginning.....			50,000 (9)		50,000				50,000	
Raw materials—purchases.....			225,000 (9)		225,000				225,000	
Cost of sales.....	\$480,000		18,000 (8)	\$450,000 (9)						
				48,000 (11)						
Labor.....			150,000 (9)	50,000 (10)	100,000				100,000	
Manufacturing expenses.....			150,000 (9)		170,000				170,000	
			20,000 (10)					\$25,000 (20)	30,000	
Officers' salaries.....	55,000				55,000					
General administrative expenses.....	48,000				48,000				48,000	
Bond interest.....	9,600		9,300 (7)		18,900		18,900 (28)			
Bond expense amortization.....	4,000			319 (15)	3,681		3,681 (29)			
Selling expense.....	134,400				134,400				134,400	
Inventory end—finished.....				252,000 (11)		252,000				252,000
Inventory end—raw.....				125,000 (9)		125,000				125,000
Bad debts.....			9,000 (4)		9,000				9,000	
Labor variances.....	20,000	50,000	50,000 (10)							
Overhead variances.....	4,000	8,000	5,334 (13)	20,000 (10)	1,334					
Life insurance premiums.....		47,000		41,315 (19)		88,315		1,334 (25)		39,400
Net profit.....							\$48,915 (31)			
	\$755,000	\$755,000	\$986,634	\$986,634	\$1,115,315	\$1,115,315	\$48,915	\$48,915	\$1,066,400	\$1,066,400

*Students' Department*

A Company—Pro forma balance-sheet—December 31, 1928

Requirement (1)	Assets	Liabilities and net worth	
Current assets:		Current liabilities:	
Cash in bank and on hand.....	\$ 9,500	Accounts payable.....	\$149,000
Accounts receivable.....	126,000	Due to cashier.....	1,000
Inventories:			
Raw materials.....	125,000	Total current liabilities.....	\$150,000
Finished product.....	252,000		
Total current assets.....	\$512,500		
Due from federal government*.....	12,320	Net worth:	
Advances to officers.....	16,500	6% preferred stock.....	\$494,000
Deposits in closed banks.....	4,000	Common stock—no par (2,000 shares).....	200,000
Fixed assets:		Total.....	\$694,000
Plant and equipment.....	\$581,000	Surplus—paid in.....	98,320
Reserve for depreciation.....	397,000	Total net worth.....	792,320
Total.....	\$942,320	Total.....	\$942,320

\* It is assumed that the amount will be recovered upon filing claims for refund.



A Company—Pro forma statement of income and expense—three years ending December 31, 1928

Requirement (1)	Year 1927			Year 1928			Three years		
Sales.....		\$ 1,800,000		\$ 1,250,000		\$ 650,000		\$ 3,700,000	
Cost of goods sold:									
Inventory at beginning—raw materials.....	\$ 75,000		\$ 100,000		\$ 50,000		\$ 75,000		
Purchases.....	700,000		500,000		225,000		1,425,000		
Total materials available.....									
Inventory at end—raw materials.....	100,000		50,000		125,000		125,000		
Total materials used.....									
Labor.....	675,000		550,000		150,000		1,375,000		
Manufacturing expense.....	295,000		230,000		150,000		675,000		
Manufacturing expense variance—1928.....	257,000		212,000		150,000		619,000		
Total.....	\$ 1,227,000		\$ 992,000		\$ 470,000		\$ 2,689,000		
Labor variance—1928.....					50,000		50,000		
Cost of goods manufactured.....	\$ 1,227,000		\$ 992,000		\$ 430,000		\$ 2,639,000		
Inventory at beginning—finished goods.....	350,000		200,000		300,000		350,000		
Total finished goods available.....	\$ 1,577,000		\$ 1,192,000		\$ 730,000		\$ 2,989,000		
Inventory at end—finished goods.....	200,000		300,000		252,000		252,000		
Total cost of goods sold.....	1,377,000		892,000		468,000		2,737,000		
Gross profit on sales.....	\$ 423,000		\$ 358,000		\$ 182,000		\$ 963,000		
Operating expenses:									
Selling expenses.....	201,000		181,000		\$ 134,400		\$ 516,400		
General and administrative expenses.....	60,000		50,000		48,000		158,000		
Officers' salaries.....	30,000		30,000		30,000		90,000		
Bad debts.....	27,000		18,000		9,000		54,000		
Total operating expenses.....	318,000		279,000		221,400		818,400		
Net profit before federal taxes and other charges.....	\$ 105,000		\$ 79,000		\$ 39,400		\$ 144,600		
Deduct:									
Federal taxes.....	10,500		11,060				21,560		
Charitable contributions.....	3,004		4,000				3,004		
Loss on deposit in closed banks.....							4,000		
Total federal taxes and other charges.....	13,504		15,060				28,564		
Surplus net profit.....	\$ 91,496		\$ 63,940		\$ 39,400		\$ 116,036		

*Students' Department*

A Company—Statement of income and expense and surplus—three years ending December 31, 1928

Requirement (2)

	Year 1926	Year 1927	Year 1928	Three years
Sales	\$1,800,000	\$1,250,000	\$650,000	\$3,700,000
Cost of goods sold:				
Inventory at beginning—raw materials	\$ 75,000	\$ 100,000	\$ 50,000	\$ 75,000
Purchases	700,000	500,000	225,000	1,425,000
Total material available	\$ 775,000	\$ 600,000	\$275,000	\$1,500,000
Inventory at end—raw materials	100,000	50,000	125,000	125,000
Total materials used	\$ 675,000	\$ 550,000	\$150,000	\$1,375,000
Labor	295,000	230,000	150,000	675,000
Manufacturing expense	257,000	212,000	20,000	619,000
Manufacturing expense variance—1928				20,000
Total	\$1,227,000	\$ 992,000	\$470,000	\$2,689,000
Labor variance—1928			50,000	50,000
Cost of goods manufactured	\$1,227,000	\$ 992,000	\$420,000	\$2,639,000
Inventory at beginning—finished goods	350,000	200,000	300,000	350,000
Total finished goods available	\$1,577,000	\$1,192,000	\$720,000	\$2,989,000
Inventory at end—finished goods	200,000	300,000	252,000	252,000
Total cost of goods sold	1,377,000	892,000	468,000	2,737,000
Gross profit on sales	\$ 423,000	\$ 358,000	\$182,000	\$ 963,000
Operating expenses:				
Selling expenses	\$ 201,000	\$ 181,000	\$134,400	\$ 516,400
General and administrative expenses	60,000	50,000	48,000	158,000
Officers' salaries	60,000	55,000	55,000	170,000
Bad debts	27,000	18,000	9,000	54,000
Total operating expenses	348,000	304,000	246,400	898,400
Net income from operations	\$ 75,000	\$ 54,000	\$ 64,400	\$ 64,600
Financial expenses:				
Bond interest	\$ 24,000	\$ 21,600	\$ 18,900	\$ 64,500
Bond expense amortization	4,000	4,000	3,681	11,681
Total financial expense	28,000	25,600	22,581	76,181
Net profit, before federal taxes and extraneous charges	\$ 47,000	\$ 28,400	\$ 86,981	\$ 11,581
Deduct:				
Federal taxes	\$ 4,700	\$ 3,976		\$ 8,676
Charitable contributions	3,004			3,004
Life insurance premium	1,333		\$ 1,334	4,000
Loss on deposit in closed bank	1,333			4,000
Total federal taxes and extraneous charges	9,037	9,309	1,334	19,680
Surplus net profits	\$ 37,963	\$ 19,091	\$ 88,315	\$ 31,261
Deduct: dividends paid	42,000	22,000		64,000
Net income (decrease*) in surplus	\$ 4,037	\$ 2,909	\$ 88,315	\$ 95,261

*The Journal of Accountancy*

A Company—Reconciliation of net profits and paid-in surplus—per pro forma statements

December 31, 1928

Net profits for the three-year period ended December 31, 1928.....		\$116,036
<i>Deduct:</i> dividends declared as follows:		
Year	Amount	
1926.....	\$42,000	
1927.....	22,000	
	\$64,000	64,000
Balance.....		\$ 52,036
<i>Adjustments due to plan of reorganization:</i>		
Write-off of capital stock—common.....	\$200,000	
<i>Less:</i> unamortized bond discount and expense.....	37,000	163,000
		\$215,036
<i>Total.....</i>		
<i>Deduct:</i> net increase in profits per pro forma statement:		
Reduction of officers' salaries paid.....	\$80,000	
Cancellation of bonds and accrued interest paid.....	45,600	
Cancellation of life insurance.....	4,000	
	\$129,600	
<i>Less:</i> additional federal income taxes.....		116,716
		\$ 98,320
Paid-in surplus, December 31, 1928.....		