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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 18 and 19, 1926.]

Examination in Auditing

NOVEMBER 18, 1926, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions:

No. 1 (10 points):

A client suspects, from a scrutiny of sales and gross-profit figures, that the purchase record is inflated. The client states that all cheques are signed by him personally, that he knows that inventories are correct and that the sales volume checks approximately with orders taken, and he is therefore at a loss to know how there can be any error. The client has called upon you to make what investigation you deem best. Describe the steps you would take in these circumstances and to what purpose.

No. 2 (10 points):

(a) State how you would verify in the audit of a charitable institution the income comprising interest and dividends on securities, rents and contributions.

(b) State two means usually available for checking contributions, other than direct communication with the donors, and give your opinion as to which you consider the more satisfactory and why.

No. 3 (10 points):

You are called upon to audit the cash accounts, only, of a manufacturing company. What would your examination cover?

No. 4 (10 points):

A company having an issue of debenture bonds of $500,000, maturing in 20 years from date of issue, is carrying the unexpired bond discount as a deferred charge, the bonds having been issued at 90. The bonds contain a sinking-fund provision requiring the retirement of one-twentieth of the issue annually, the necessary bonds to be called at 105 unless secured through purchase at a more advantageous price. At the beginning of the sixth year, the directors availed themselves of an offer by purchasing fifty $1,000 bonds at 85. How should the bonds purchased and the 15% discount thereon appear in the accounts?

No. 5 (10 points):

In the course of your audit of the X Y Z Co., you find in your investigation of its operations that its costs are based upon standard or predetermined costs, the cost system being controlled in the general accounts. All calculations are based upon operating at 75% of capacity. However, during the year, operations were from 90% to 95% of capacity, with the result that factory overhead was over-absorbed to the extent of $75,000, which remains as a credit balance in the burden-control account. The company officers are not quite certain what should be done with this credit balance and ask your opinion. How would you proceed to find a solution of this problem, and what would your recommendations be? Explain, without using figures, what should be done with the credit balance.

No. 6 (10 points):

Give seven indications of a healthy financial condition which might appear on the balance-sheet and profit-and-loss statement of a manufacturing concern.

No. 7 (10 points):

In making a balance-sheet audit of a corporation you notice the following items:

(a) Unissued common stock carried as treasury stock.

(b) Dividend cheques drawn regularly for this unissued stock and charged to "dividends", the cheques being redeposited and credited to treasury-stock account.

(c) Corporation carried life insurance on its president, policy payable to the preferred stockholders.

The treasurer instructs the auditor to make any entries on the books which are deemed necessary. What adjustments, if any, would you make on the books and what special comments should the auditor's report contain?

No. 8 (10 points):

You have been engaged to make an audit of the books of a corporation for the purpose of submitting certified statements to bankers. You find during the course of your work that the corporation owns all the capital stock of a subsidiary company, but you are refused access to the books of the subsidiary. What position would you take if the officers insisted upon an unqualified statement?

No. 9 (10 points):

Upon examining the accounts of a manufacturer of musical instruments, who sells to the retail trade on an instalment basis, you find that repossessed instruments (i.e., instruments sold and replevined due to failure of customer to pay instalments due) are included in the inventory at original cost plus cost of reconditioning. Give your reasons for agreeing or disagreeing with this state of the accounts.

No. 10 (10 points):

During the course of an audit of the books of a company manufacturing and installing large units of electrical machinery, you find an account receivable of $100,000 due on contract No. 100. Upon a further examination of this account and contract, you find the following conditions:

The total amount of the contract is $200,000 and by reason of certain concessions the customer agreed to pay one-half upon signing the contract and one-half upon completion of the installation. You find that at December 31, 1925, the contract has been signed, $100,000 has been received, but work on the contract has not been commenced. The following entries appear on the books:

Accounts receivable....................	$200,000	
To sales..............................		$200,000
Cost of sales (estimated)...............	120,000	
To reserve for construction costs.......		120,000
Cash..................................	100,000	
To accounts receivable................		100,000

The officers of the company advance the explanation that, inasmuch as conservative estimates show that the contract will net a profit of $80,000, and having received $100,000 in cash, they are correct in taking up all the profit. What would you do under these conditions?

Examination in Accounting Theory and Practice

PART I

NOVEMBER 18, 1926, 1 P. M. to 6 P. M.

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

No. 1 (37 points):

You are employed by the X Company, engaged in the manufacture of electric washing machines, to make an audit of its books of account and records for the year ended December 31, 1925.

From the following trial balance (abstracted from the company's books as of December 31, 1925, before closing) and accompanying data, prepare such adjusting entries as you think necessary; a balance-sheet as at January 1, 1926, and a detailed statement of income and profits for the year ended December 31, 1925.

Cash	$ 235,240	
Accounts receivable	547,000	
Notes receivable	36,250	
Land	150,000	
Buildings	450,000	
Machinery and equipment	1,000,000	
Tools	51,000	
Reserve for depreciation—Buildings		$131,000
" " " —Machinery and equipment		310,000
" " " —Tools		27,500
Stationery and office supplies	12,620	
Salesmen's salaries	87,500	
Inventory—Work in process and finished goods, December 31, 1924	525,000	
" —Materials, December 31, 1924	350,000	
Reserve for bad debts	1,600	
Donations	350	
General office salaries	32,520	
Unexpired insurance	2,650	
Return sales and allowances	31,720	
Power, light and heat	37,650	
Maintenance and repairs	39,265	
Sundry factory expenses	37,875	
Factory supplies	73,060	
Direct labor	450,000	
Materials purchased	1,625,000	

Depreciation, buildings	$6,000	
" machinery and equipment	60,000	
" tools	12,500	
Sales		$3,340,000
Indirect labor	242,000	
Insurance	18,700	
Executive salaries	110,000	
Miscellaneous office expense	3,700	
Interest paid	8,400	
Bank loans		50,000
Trade accounts payable		81,000
Accrued wages		24,650
Property taxes	12,950	
Traveling expense, salesmen	14,820	
Advertising	18,000	
Capital stock, common—$100 par per share		1,000,000
" " preferred—7% cumulative, $100 par per share		350,000
Accrued local taxes		8,750
Surplus		973,970
Tools produced for company's use		11,000
Dividends paid	24,500	
	$6,307,870	$6,307,870

During the course of your audit, the following facts are disclosed:

The cashbook was held open at the close of the accounting period and collections on customers' accounts of $20,000, received in January, 1926, were included in the period under review as cash in transit.

The accounts receivable are found to be in bad condition and to include $12,000, admittedly worthless, and $17,000 on which only a fifty per cent. recovery is expected. Of the bad accounts, $11,000 relate to prior years as do $8,000 of the doubtful accounts. All accounts written off by the company in 1925 relate to prior years. Notes receivable are considered to be good. Your examination of the bad debt reserve indicates a debit balance of $1,600, per books, as at December 31, 1925.

The inventories, December 31, 1925, consist of the following:

Raw materials	$380,000
Factory supplies	18,600
Work in process and finished goods	750,000

The work in process and finished goods inventories comprise the following elements of cost:

	1924	1925
Labor	$100,000	$140,000
Materials	300,000	400,000
Factory overhead	125,000	210,000

Overhead is distributed on the basis of productive labor and your examination of the cost accounts discloses the following:

	Actual productive labor	Actual overhead	Rate used in cost system
1923	$400,000	$490,000	125%
1924	300,000	480,000	125
1925	450,000	540,000	150

The company computes its depreciation on the basis of rates applied to cost values at January 1, 1925, although effect has been given, on the books of the company, to an appraisal of all properties as of January 1, 1925.

Following is a summary of the property accounts and reserves for depreciation:

	Book value Dec. 31, 1924 (cost)	Appraisal values Jan. 1, 1925
Gross value:		
Land	$50,000	$150,000
Buildings	300,000	450,000
Machinery and equipment	600,000	1,000,000
Tools	50,000	40,000
Reserves for depreciation:		
Buildings	$150,000	$125,000
Machinery and equipment	400,000	250,000
Tools	30,000	15,000

The following rates of depreciation used by the company are found adequate: buildings, 2%; machinery and equipment, 10%; tools, 25%. Additions to the property accounts during 1925 consisted entirely of tools manufactured in the company's plant. These were not completed and ready for use until December 31, 1925. Charges to the tool account represent the following items: materials, $1,000; labor, $4,000; overhead, $6,000.

The company has made no provision for federal taxes for 1925 and admits that its liabilities are, in this respect, understated. It claims, however, that it has no federal tax liability for taxes for prior years. Upon examination of the company's returns and tax file, you find that although heavy losses, incurred in 1921 and 1922, would practically offset the profits of 1923 and 1924, the company made very large profits in 1918, 1919 and 1920; that a field agent has made an examination and found an additional tax liability for these years of $100,000. A letter in the files from the company's tax attorneys estimates the liability at

$75,000 and your own scrutiny of the returns for these years serves to confirm this estimate.

Among the stipulations of the preferred stock agreement is a clause to the effect that annually, on or before March 31st of each year, the company shall set aside, out of the earnings of the calendar year preceding, the amount of $25,000 to purchase for retirement and cancellation an equivalent par amount of preferred stock which is callable by lot at par.

No. 2 (15 points):

The X Y Z company maintains a central warehouse at Chicago and operates stores in Chicago and several other cities.

Goods are shipped from the warehouse to the stores when the proper formal requisitions are made by the store managers, and these goods are billed at purchase cost, plus a certain percentage to cover actual warehouse expense, the freight thereon being paid by the receiver.

Reports of quantities on hand are sent by each store manager to the central warehouse every week. In some instances, surplus stock of one store is shipped to another upon instructions by the central warehouse and in such cases the freight from point of shipment to destination is paid by the receiver.

Dead stock is usually sold by each store at special sales but at times such stock is returned to the central warehouse which sells it to jobbers specializing in odd lots.

State the more important points to be watched and noted when valuing the inventory and determining profits by stores.

No. 3 (25 points):

A trial balance, as at December 31, 1925, and (so-called) quarterly operating statements of the A B company, together with certain supplementary information, are herewith presented.

You are required to prepare therefrom correct balance-sheet as of December 31, 1925, and income account for the period ended at that date, making what adjustments you think necessary and outlining, briefly, the governing accounting axioms and principles on which they are made; also reconcile the correct profit or loss for the year with that shown on the "operating" statement.

Trial balance—December 31, 1925

Land	$ 100,000	
Buildings	1,000,000	
Machinery	1,500,000	
Accounts receivable	170,000	
Notes receivable	20,000	
Cash	75,000	
Capital stock, common—$100 par		$1,000,000
Five year 7% notes, dated January 1, 1925		500,000
First mortgage 6% twenty year bonds—$1,000,000 par value issued—dated January 1, 1925		900,000
Notes payable— N. Y. national bank		500,000
Accounts payable		201,000
Sales		500,000
Purchases, raw material	425,000	
Operating expenses—factory	150,000	
Depreciation, buildings—2% per annum	20,000	
" machinery—10% " "	150,000	
Reserve for depreciation		170,000
Salaries, officers	30,000	
" salesmen	20,000	
" office	10,000	
Interest on 6% bonds	60,000	
" " 7% notes	35,000	
" " notes due bank	6,000	
	$3,771,000	$3,771,000

Operating statements

Three months ending:	Mar. 31	June 30	Sept. 30	Dec. 31	Yr. 1925
Sales	$	$	$	$500,000	$500,000
Raw material purchased	$	$	$200,000	$225,000	$425,000
Operating expense, factory				150,000	150,000
Salaries paid:					
Officers	7,500	7,500	7,500	7,500	30,000
Salesmen				20,000	20,000
Office	1,000	1,000	2,000	6,000	10,000
Interest:					
On bonds	15,000	15,000	15,000	15,000	60,000
On 7% notes	8,750	8,750	8,750	8,750	35,000
On notes due bank				6,000	6,000
	$32,250	$32,250	$233,250	$438,250	$736,000
Loss	$32,250	$32,250	$233,250		$236,000
Profit				$61,750	
Construction:					
Buildings	$500,000	$500,000			$1,000,000
Machinery		500,000	$1,000,000		1,500,000

Inventories—December 31, 1925:

Raw material, $100,000; goods in process, $75,000; finished goods, $75,000. Manufacturing operations started October 1, 1925. No raw material was used for construction. Officers and clerks were wholly engaged in supervising and recording construction work to October 1, 1925. Notes to the N. Y. national bank can be renewed for period in excess of one year.

No. 4 (23 points):

A manufacturing plant, operating to the date of negotiations relative to disposition, was acquired by a newly formed corporation, the price therefor being based on present sound values which were stated to be as follows:

	Present sound value	Age
Machinery	$116,500	4½ years
	26,300	4 "
	217,300	2½ "
	16,750	2 "
	57,550	1 year
Equipment	$13,300	6 years
	11,650	2 "
	27,660	1 year
Buildings—A	$285,700	12 years
A	15,000	5½ "
B	525,000	5 "
A	16,600	1 year

The estimated life of the machinery is ten years from date of original purchase; of equipment, fifteen years from date of purchase; of buildings A, thirty years and of buildings B, forty-five years.

It is desired to set up the assets on the books at present reproductive values, with a corresponding depreciation reserve to bring their net book value to the "sound values" given above. Compute the "reproductive value", the depreciation reserve, and give the future annual depreciation provision, all on the basis of a uniform rate each year until the book value is extinguished.

It may be assumed for the purpose of your answer that there will be no salvage value.

No. 5 (23 points):

A city, with its fiscal year ending April 30th, prepares its budget and makes its tax levy for the subsequent fiscal year during March, taxes being payable on or after November 1st.

In consequence of a bond election held in June, 1915, bonds of $1,000,000 were issued dated August 1, 1915, due in 20 years. A sinking fund is to be provided, calculated on a basis of 4% compounded annually.

An audit having been made as of April 30, 1926, the balance in the sinking fund of $409,588.25 was found to differ from the actuarial requirements.

Calculate the correct amount which should have been in the fund and ascertain the annual adjustment necessary thereafter in order to meet the bonds at maturity, as the difference is to be spread over the subsequent levies and not provided for in the next levy only.

Presume that 4% interest will be earned in future, that all taxes are collected in full by the end of the fiscal year and that a deposit of the correct amount is made in the sinking fund annually on April 30th.

Given at 4%:

$$
\begin{array}{ll}
v^{8}=.7306902 & (1+i)^{8}=1.3685690 \\
v^{9}=.7205867 & (1+i)^{9}=1.4233118 \\
v^{10}=.6755642 & (1+i)^{10}=1.4802443 \\
 & (1+i)^{19}=2.1068492 \\
 & (1+i)^{20}=2.1911231 \\
 & (1+i)^{21}=2.2787681
\end{array}
$$

Examination in Commercial Law

NOVEMBER 19, 1926, 9 A. M. TO 12:30 P. M.

(Each satisfactory answer is entitled to 10 points)

Answer two questions on negotiable instruments, two on contracts, two on corporations, two on federal income tax and one question each on partnership and bailment.

Classify each answer under its proper heading, as proper classification will be considered as part of a correct answer.

Set forth the reasons and legal principles involved in each answer.

1. Norton, owner of a pulp mill in Maine, negotiated with Burns for the sale of the mill. Burns lived in New York City, where Norton arranged to meet him. Norton left Maine on October 2nd, met Burns in New York and on October 5th they executed the contract of sale. On October 4th the mill was destroyed by fire, a fact unknown to both parties when the contract was signed. What are the rights of the parties?

2. One of three members retires from a firm, the two remaining members assuming, by written agreement, all responsibility for the then outstanding debts. Before these debts are paid a combination of unfortunate circumstances renders the new firm insolvent. Can the retiring partner be held for any part of the debts?

3. What is a common carrier's liability for goods he carries, and what conditions free him from the liability?

4. A has, among other items of income for 1925, the following dividends:

United States Steel Corporation	$350
New York Central Railroad Co.	175
Kerr Lake Mines, Ltd. (a Canadian corporation operating entirely in Canada)	125
Corporation (a British holding corporation whose sole income for five years past was dividends from a domestic corporation)	250
American Tobacco Company	300

A's total net income exceeded $12,000. How would you treat the above dividends in preparing A's federal income-tax return for 1925?

5. You are treasurer of the A corporation with power to sign commercial paper. Draw and sign a negotiable promissory note binding upon the corporation as maker.

6. Jones ordered Cleary, a tailor, to make him a suit of clothes at a cost of $80. Cleary made the suit, but Jones refused to accept it and defended Cleary's action at law, pleading as a defense the statute of frauds. Was this a good defense?

7. A corporation is formed for the purpose of manufacturing, buying, selling and dealing in drugs, chemicals and similar products. The corporation, under authority of its board of directors, contracts to purchase the land and building occupied by it as a factory and store. G, a stockholder, sues in equity to restrain the corporation from completing the contract, claiming that, as the certificate of incorporation contained no provision authorizing the corporation to purchase real estate, the contract was *ultra vires*. Was G's claim correct?

8. A borrowed $75 from B, giving to B as security for the loan a valuable Swiss watch. B placed the watch in his office safe. Burglars entered B's office, broke open the safe and took its contents including the watch. Is B liable for the loss of the watch?

9. A makes and delivers to B a negotiable note payable ninety days after date, but fails to date the paper. B fills in a wrong date and negotiates it to C for value. What, as to C, is the correct date of maturity?

10. Explain what is meant by the term "withholding agent" as used in the federal income-tax law.

11. The X corporation increases its authorized capitalization from $100,000 to $200,000. Can the directors offer the increased stock for subscription to the public generally?

12. A firm of three members decided to dissolve and discontinue business. One of the members secretly obtained a lease of the property which the firm had occupied for many years, the new lease to begin when the old one expired. This member obtained the lease prior to the dissolution, but it was known at the time that dissolution was contemplated. After dissolution the member sold the lease at a large profit. The other partners immediately sued to recover a share of the profit thus made. Could they succeed?

13. A contract made, executed and delivered in Texas is the subject of a suit in Illinois. The laws of which state govern the validity and construction of the contract?

14. Is it necessary that a negotiable instrument contain the words "value received"?

15. Is a partnership required to make an income-tax return under the federal income-tax law? How are partnership profits taxed for income-tax purposes?

Examination in Accounting Theory and Practice

PART II

November 19, 1926, 1 p. m. to 6 p. m.

The candidate must answer all the following questions:

No. 1 (27 points):

During the month of December, 1925, the Non-such Oil Company prepared a budget covering the six months from January 1 to June 30, 1926, the main purpose being an endeavor to forecast the company's *cash position* as of June 30, 1926.

Below are given the figures used in compiling the budget and the actual figures for the six months.

From these and the data following, you are required to prepare a statement for presentation to the board of directors, showing a comparison between estimated and actual results and, in addition thereto, a brief but comprehensive report, to be read in conjunction therewith, explaining the differences and their effect on the company's cash position as shown by the statement.

The figures given cover all sources of revenue and expense.

NON-SUCH OIL COMPANY

	Estimated	Actual
Sales of crude oil	$4,000,000	$3,610,000
Sales of refined products:		
Gasoline	4,400,000	4,200,000
Kerosene	420,000	406,000
Other	1,555,200	1,580,400
Purchases of refined products:		
Gasoline	315,000	380,000
Other		102,000
Operating expenses:		
Direct charges	1,620,000	1,560,000
Materials and supplies from warehouses	180,000	170,000
Marketing expenses	2,290,400	2,222,240
General and administrative expenses	900,000	800,000
Capital additions:		
Direct charges	2,000,000	1,800,000
Materials and supplies from warehouses	1,500,000	1,500,000
Interest on bonds	60,000	60,000
Bond sinking fund	50,000	50,000
Preferred stock dividend	350,000	350,000
Preferred stock sinking fund	200,000	200,000
Accounts receivable:		
January 1st	900,000	900,000
June 30th	1,200,000	1,100,000
Accounts payable:		
January 1st	700,000	700,000
June 30th	800,000	750,000
Inventories of materials and supplies:		
For operating purposes, January 1st	50,000	50,000
" " " June 30th	50,000	50,000
For new construction, January 1st	500,000	500,000
" " " June 30th	500,000	400,000

NOTES:
(1) There are no marketing expenses on crude oil sales.
(2) Purchases of materials and supplies are paid for within the month received.

Statement of quantities

	Purchases	Production	Sales	Refinery consumption
Crude oil (barrels):				
Estimated		4,000,000	2,000,000	2,000,000
Actual		3,800,000	1,900,000	1,900,000
Refined products (gallons):				
Gasoline:				
Estimated	3,000,000	50,400,000	40,000,000	
Actual	4,000,000	47,880,000	42,000,000	
Kerosene:				
Estimated		8,400,000	6,000,000	
Actual		7,980,000	5,800,000	
Other:				
Estimated		21,000,000	19,440,000	
Actual	1,200,000	19,950,000	17,560,000	
Refinery loss:				
Estimated		4,200,000		
Actual		3,990,000		

NOTE: 1 barrel equals 42 gallons.

No. 2 (30 points):

The assets and liabilities of four companies are given herewith:

(A) Holding company.

(B) Manufacturing subsidiary of which A owns 80% of the stock, the rest being owned by outside interests.

(C) Company of which 95% of the stock is owned by B, the rest by outsiders.

(D) Selling company, 92% of the stock being owned by A and 8% by outsiders.

The building occupied by D was purchased from A for $1,550,000, although A paid only $1,000,000 for it. D has provided depreciation reserve on the $1,550,000 at the rate of 4% per annum for 5 years.

Prepare a consolidated balance-sheet eliminating the excess valuation of the buildings due to the inter-company profit taken by A in selling a building to D at a profit of $550,000; and show the liability to the minority stockholders of each company and, by schedule, the minority interests and consolidated surplus.

Arrange the balance-sheet, as to sequence and grouping of items, as you think best.

	A	B	C	D
Assets				
Land		$160,000	$130,000	$ 300,000
Buildings		940,000	536,000	1,550,000
Equipment		135,000		120,000
Machinery		731,000		
Patents	$ 600,000			
Investments at par in stock of subsidiaries	1,476,000	570,000		
Owing from other companies included in this consolidation	2,853,000	116,000		
Inventories:				
Raw material		320,500	136,000	
Finished goods		142,200	128,000	1,215,000
In process		167,313		
Accounts receivable		496,300		1,885,000
Deferred charges		13,200		
Cash	385,100	142,750	1,730	213,000
Marketable securities	115,000		500,000	
	$5,429,100	$3,934,263	$1,431,730	$5,283,000
Liabilities				
Capital stock	$2,000,000	$1,500,000	$600,000	$ 300,000
Surplus	2,210,800	212,963	557,730	634,000
Owing to companies included in this consolidation		1,720,000	116,000	1,133,000
Bonded debt				1,250,000
Notes payable	1,200,000		45,000	1,286,000

Liabilities	A	B	C	D
Accounts payable	$18,300	$113,400		$322,000
Reserves:				
Depreciation, machinery and equipment		292,400		48,000
Depreciation, buildings		95,500	$113,000	310,000
	$5,429,100	$3,934,263	$1,431,730	$5,283,000

No. 3 (20 points):

Having been appointed to ascertain the financial condition of Snow, Frost & Co., stockbrokers, as at June 30, 1926, you and your staff attended the office of this concern at the close of business on the date aforesaid.

The cash and securities on hand (both in the office and safe-deposit vault) were counted and listed and details secured regarding securities in transfer, securities deposited as collateral for loans, those held by other brokers for the firm's account and those held as margin for customers' accounts as well as customers' "short" commitments.

All these data have since been verified by you.

The books of the firm have been closed, under your direction, as at June 30, 1926, the general ledger showing the balances as follows:

Cash	$ 75,000
Loans payable to banks	145,000
Due other brokers	1,400,000
Customers' accounts—Dr.	1,450,000
" " —Cr.	80,000
Advances to salesmen	750
Securities owned	400,000
Stock-exchange seat	90,000
Partners' capital and undivided profits	390,750

The securities, above mentioned as verified, have been valued at "market", as at June 30, 1926, and relative to such valuation, the following facts have been ascertained:

Value of securities in office and vault	$ 176,000
" " " in transfer	15,000
" " " deposited as collateral for bank loans	190,000
" " " held by other brokers for the firm's account	1,955,000
" " " owned by firm	495,500

An analysis of the customers' accounts and a comparison with the value of securities held as margin therefor together with the value of customers' "short" commitments, disclosed the following facts:

(1) The firm held as collateral for customers' accounts with ledger debit balances amounting to $1,337,500, securities having a market value of $1,787,000.

(2) The firm held as collateral for customers' accounts with ledger debit balances amounting to $110,000, securities having a market value of $90,000.

(3) Customers' accounts with ledger debit balances amounting to $2,500 were unsecured.

(4) Customers with ledger credit balances amounting to $7,500 owed the firm, on account of "short" sales, securities having a market value of $9,000.

(5) Customers with ledger credit balances amounting to $42,500 owed the firm, on account of "short" sales, securities having a market value of $32,500.

(6) Customers' accounts with ledger credit balances amounting to $30,000 had no "short" commitments.

(7) There were included in the securities deposited as collateral for bank loans, those having a market value of $5,000 which belonged to customers who had no ledger balances.

From the foregoing, you are required to prepare a balance-sheet setting forth:

(a) The financial condition of the firm as appearing by its general ledger accounts before adjustments.

(b) The adjustments resulting from the valuation of the securities accounted for and verified in your examination.

(c) The firm's financial condition after all such valuations and adjustments.

No. 4 (23 points):

Company X, a close corporation, has $200,000 fully paid common stock of which $150,000 was owned by A. Other capital stock of the company is $1,000,000 six per cent. cumulative non-voting preferred.

A died in 1920 and, by will, appointed B trustee with authority to continue the investment in the common stock of company X and to divide the net income from dividends among his four children during their lives.

C, one of the beneficiaries, learns that although the company has ample working capital and has been making large profits, these profits are not distributed. He so informs the trustee, B, who calls upon you to investigate.

You obtain the following information:

Prior to 1921, the four managers and directors of the corporation each received \$15,000 per annum for services, and any balances of profits remaining after the payment of dividends were carried to surplus account. The board of directors remained the same but in 1921 and later years the balances of net profits were carried forward in the profit-and-loss account.

At each annual meeting of stockholders, from 1921 to 1925 inclusive, resolutions were adopted granting the following additional remuneration to the board of directors for equal division: (a) a commission on the net profits of each separate year, after payment of the directors' salaries, at the rate of 2½% on the first \$100,000 or part thereof; 5% on the next \$100,000 or part thereof, and 7½% on any excess; (b) a bonus of 5% on the amounts available for dividends at the end of each year after payment of directors' salaries and commissions.

The net profits for the five years, after making provision for reserves and depreciation but before charging directors' salaries or commissions, were:

For the year 1921	\$250,000
1922	215,000
1923	245,000
1924	296,000
1925	220,000

In each of the five years, 6% was paid on the preferred and 10% on the common stock.

Prepare a brief but comprehensive report including a statement setting forth the amounts paid in each of the five years to the board of directors and to the two separate classes of stockholders.