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AMERICAN INSTITUTE OF ACCOUNTANTS' EXAMINATIONS

(Following is the text of the examinations in auditing, law and accounting presented by the board of examiners of the American Institute of Accountants, May 15 and 16, 1924.)

Auditing

MAY 15, 1924, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions:

No. 1 (10 points):

A & B, a firm, ask your advice as to the advantages and disadvantages of incorporating. Their invested capital is $100,000 and their net income (federal income-tax basis) was $30,000. Their business, hardware retailing in a small but growing town, is run by the partners and three employees. What would you tell them?

No. 2 (10 points):

A & B having incorporated on January 1, A dies February 1. His executor thinks he has grounds for believing that A did not receive his full equity in the incorporation of the old firm. B offers to submit all the books and records to you as auditor acting for both parties. State what books and records you would examine and how you would satisfy yourself that A had or had not received full value for his interest in the firm. (Assume that you have not been employed by either party before.)

No. 3 (10 points):

As the result of the above audit (Question 2) you find A was entitled to $2,000 more for his equity, which B settles by transferring additional stock at par for the amount. On April 1 the books of A's executor show the following receipts:

(a) From sale of above-mentioned stock at par	$2,000
(b) Rent of property owned by A for the quarter ending February 29	300
(c) Dividend on railroad stock declared the previous December 15, but received February 15	300
(d) Six months' interest on a mortgage paid March 31	600
(e) Refund of excess federal income tax which A had paid three years previously	300

and the following disbursements made:

(f) Expenses of A's funeral	500
(g) Rent of A's residence for January, February, and March	300
(h) Household supplies for January	100
(i) Cash advanced to A's widow, sole legatee	1,000
(j) A's federal income tax for the previous year and for one month of the current year	410

Items (a) to (e) are found to be included in the revenue account of the estate, and items (f) to (j) charged to expense. Have you any criticism to offer?

No. 4 (15 points):

A client comes to you for the purpose of being assisted, so far as all accounting matters are concerned, in the consolidation of five manufacturing companies. He informs you that it has been decided that in the first place each concern will send to him a balance-sheet as at the close of its last fiscal year and profit-and-loss accounts for each of the past five years, so that a preliminary statement can be prepared showing the approximate amount of common and preferred stock of the new incorporation that will be turned over to each of the five companies in settlement for its net assets, etc.

The plan outlined for consolidation includes the giving of preferred stock for all tangible assets less liabilities and common stock for the goodwill based upon past profits. He asks you to prepare for him a letter to be sent to each of these five companies requesting such further information as might not ordinarily appear on a balance-sheet and profit-and-loss account, which it would be necessary to have before you in order to prepare the preliminary figures referred to above. Outline the character of the information which you would include in such a letter.

No. 5 (15 points):

To what extent do you consider it obligatory for an auditor to examine minutes? Illustrate by reference to audits of different classes, such as:

(a) An incorporated company;
(b) A university or hospital partly endowed;
(c) The governing body of a political subdivision, such as a town council or board of freeholders;

giving examples of the character of information which you would expect to find in each.

If in any of these cases you were refused access to the minutes what would be your position?

No. 6 (10 points):

In auditing the books of a manufacturing concern state fully what steps you would take to satisfy yourself on the subject of the item "wages" in the current profit-and-loss account.

No. 7 (10 points):

Mention the chief points to be observed in reporting upon the accounts of a partnership where you are acting on behalf of a retiring partner, when the business is to be continued by the remaining partners.

No. 8 (20 points):

Statement

In the course of your examination of the A-B Company of Duluth, Minnesota, you find that the preferred stock is issued under a covenant that the corporation will at all times maintain net current assets of a value twice the amount of the outstanding preferred stock. The articles of incorporation also prescribe that the term "current assets" means the cash and bank balances, merchandise, current customers' accounts and notes, and the cash surrender value of life insurance, if any.

The final trial balance of the A-B Company at December 31, 1923, submitted for your verification and certificate is as follows:

Account	Dr.	Cr.
Accounts payable		$ 350,000
Bills payable to banks		1,300,000
Common stock		2,500,000
Cash and bank balances	$ 525,000	
Cash surrender value of life insurance	150,000	
Customers' accounts and notes	2,150,000	
Deferred charges	110,000	
Merchandise	2,000,000	
Plant and equipment	1,750,000	
Preferred stock		1,500,000
Stocks and bonds	75,000	
Surplus		1,110,000
	$6,760,000	$6,760,000

In verifying the bank balances you find that two bank accounts carrying balances to the credit of the corporation of the aggregate sum of $100,000 since August 1, 1923, have suspended payment on all deposit balances at September 1, 1923, and while these banks were open and conducting business on deposits made after September 1, 1923, the $100,000 was not subject to immediate demand and there is no information available as to when these amounts will be released.

In your review and verification of the customers' accounts you find that every required diligence has been exercised prior to the preparation of the statement above to charge to profit and loss all customers' accounts doubtful of realization. Also you discover that in certain territories served by the corporation many banks are closed on account of agricultural and financial conditions and that the retail dealers in these particular territories who are customers of the A-B Company are unable to make settlements according to the firm's usual terms. Your examination of the credit files and correspondence relative thereto convinces you that the debtors have abundant resources, but at the date of the statement above are unable to make remittances, also that requested extensions have been granted them beyond the regular terms of credit. The aggregate of customers' accounts in this condition is $125,000.

QUESTIONS

(a) State your understanding of the term "current customers' accounts."

(b) Revise the above final trial balance of the A-B Company at December 31, 1923, so as to give proper expression to financial conditions as expressed above.

(c) How would you report with regard to the preferred stock covenants in the articles of incorporation?

Accounting Theory and Practice

PART I

MAY 15, 1924, 1 P. M. TO 6 P. M.

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

No. 1 (22 points):

The Copper Metal Mining Co. has on hand, December 31, 1923, the following metals and ores:

Copper	1,000,000 pounds
Silver	200,000 ounces
Gold	1,000 ounces
Metals in process (at cost)	$75,000.00
Ores on hand (at cost)	5,000.00

The company did not operate during 1922 and had no inventory at the end of that year.

The costs, not including depletion for 1923, were as follows:

Mining	$1,250,000.00
Milling and concentration	700,000.00
Smelting and refining	330,000.00
Administrative and general expenses	100,000.00
	$2,380,000.00

Production of finished metals for the year 1923:

Copper	9,000,000 pounds
Silver	1,600,000 ounces
Gold	10,000 ounces

Market prices of metals, December 31, 1923, listed as:

Copper	$ .13 per pound
Silver	.65 per ounce
Gold	20.00 per ounce

Average prices of metals realized during the year 1923 were:

Copper	$ .145 per pound
Silver	.70 per ounce
Gold	20.00 per ounce

From the foregoing data determine the profit or loss in the two ways named below, before depletion, for the year 1923 and the value of the inventory, at cost, as at December 31, 1923, each metal being valued separately, on the bases (1) that copper is the principal metal and silver and gold by-products and (2) that each metal bears its own share of the costs.

No. 2 (25 points):

An incorporated firm of jobbers deals in a product having a busy season of only six months in each year. During that period the firm borrows considerable sums from bankers on sixty days renewable notes of the company, with the personal guarantees of the directors.

The bankers charge, for this service, ½ per cent. commission and 6 per cent. interest, both deducted in advance, and require that a substantial credit balance be maintained.

Purchases are made on the terms of 2¾ per cent. discount for payment within five days after receipt of merchandise, 1½ per cent. for payment within thirty days, and net after thirty and within sixty days.

The selling terms to customers provide that statements shall be sent to them on the first day of each month, for the goods billed from the first to the last day of the previous month.

For payments within thirty days, 2½ per cent. discount is allowed or 1½ per cent. for payment after thirty but within sixty days; for later payments no discount is allowed.

The president of the company recommends that the system of financing purchases and sales should be changed as follows:

> (1) All purchases of merchandise to be paid for by trade acceptances of the company, payable at thirty days after receipt and acceptance of the goods, less a deduction of 2¾ per cent. (for cash discount) and plus 6 per cent. per annum interest for thirty days on the net balance.
>
> (2) Monthly statements, for sales of the previous month, are to be sent out on the first day of each month, as before, together with a trade acceptance at 60 days from the date when sent, after deducting 1½ per cent. discount from the total amount of the statement. (Customers to return these drafts, duly accepted, within eight days.)
>
> Renewals of the acceptances are to be allowed, in exceptional cases, for not more than half of the original amount of the monthly statement, on the following conditions: The 1½ per cent. discount allowed previously is to be added back. To this total there is to be added 6 per cent. per annum interest for the additional period of credit, plus ¼ per cent. commission and cost of stamps, if renewed for thirty days, or plus ½ per cent. and stamps for sixty days' extension. (It is expected that renewals will be for only 3 per cent. of the total annual sales, divided equally between the additional thirty and sixty days' periods.)

An offer has been received from another banker to discount these trade acceptances at 6 per cent. per annum, plus ¼ per cent. commission.

The average date of discounting may be taken as the tenth of each month.

You are asked to prepare, for the consideration of the board of directors, a statement showing the following details:

(1) The average annual profit or loss on discount and interest for the previous five years.

(2) The percentage of such profit or loss to the average total sales.

(3) The effect of the proposed changes, as compared with the former average annual profit or loss on discount and interest.

(4) Any other probable advantages or disadvantages of the proposed new method of financing.

From the books you ascertain that the annual averages of the previous five years have been as follow:

Total purchases (before deducting discount, but after deducting returns and allowances)	$1,317,500
Overhead expenses	212,500
Total sales (returns and allowances deducted)	1,700,000
Gross profit (after charging overhead)	170,000
Discounts received on purchases	19,500
Discounts given on sales	35,000
Bank charges for commission and interest	19,250

In preparing the statement, show percentages to nearest two figures of decimals. For calculation, each month may be taken as thirty days and the year as three hundred and sixty days.

No. 3 (17 points):

The following comparative balance-sheets and income accounts of the A B Company are submitted to you for scrutiny and comment.

THE A B COMPANY

COMPARATIVE BALANCE-SHEETS—JANUARY 1, 1924 AND 1923

Assets	1924		1923	
Fixed:				
Buildings (cost)	$1,100,000		$1,000,000	
Plant and machinery (cost)	1,750,000		1,500,000	
		$2,850,000		$2,500,000
Deferred:				
Experimental work		500,000		100,000
Current:				
Inventories—				
Raw materials	500,000		400,000	
Finished goods	275,000		250,000	
Supplies	60,000		50,000	
Accounts receivable, trade	900,000		1,000,000	
Accounts receivable, officers	80,000		20,000	
Cash	200,000		300,000	
		2,015,000		2,020,000
		$5,365,000		$4,620,000

Liabilities				
Capital Stock................		$2,000,000		$2,000,000
Current:				
Notes payable to banks.....	$1,000,000		$500,000	
Accounts payable, trade.....	615,000		620,000	
Dividend payable..........	100,000			
		1,715,000		1,120,000
Surplus:				
Balance, Jan. 1, 1923 and 1922	1,500,000			1,500,000
Income for year 1923.......	250,000			
	1,750,000			
Less dividend..............	100,000			
		1,650,000		
		$5,365,000		$4,620,000

Comparative Income Accounts for the Years Ended December 31, 1923 and 1922

		Years ended December 31		
		1923		1922
Sales........................		$9,000,000		$8,000,000
Cost of Sales:				
Raw materials:				
Inventories, beginning of years..................	$ 400,000		$ 300,000	
Purchases...............	4,850,000		3,850,000	
	5,250,000		4,150,000	
Inventories, end of years...	500,000		400,000	
	4,750,000		3,750,000	
Direct labor...............	2,200,000		2,000,000	
Factory overhead, including supplies.................	1,550,000		1,800,000	
		8,500,000		7,550,000
Manufacturing Profit.........		500,000		450,000
Selling Expenses.............	180,000		160,000	
General and Administrative Expenses..................	70,000		90,000	
		250,000		250,000
Net Income..................		$ 250,000		$ 200,000

Reporting thereupon, what points would you consider of most importance for the attention of the management? State how you would emphasize these in your report. Suggest any changes in policy or remedies for existing conditions that appear desirable. What additional information would you require before rendering your report? Do any essential facts appear to have been omitted?

No. 4 (12 points):

You are given the balance-sheet and income account of a holding company owning the control of, or a substantial interest in, fifteen other corporations. Upon examination, you find that the holding company owns the entire capital stock of five of the companies, 60 per cent. of the capitalization of another 5 and 25 per cent. of the capitalization of the remaining companies.

The balance-sheets and income accounts of the fifteen subsidiaries are then submitted to you with the request that you prepare a consolidated balance-sheet and income account.

Explain three different methods of consolidating the assets and liabilities of these companies.

When the stock of the underlying companies is carried on the holding company's books at a discount or premium, how would you dispose of such discount or premium?

The holding company's books showed net income from dividends of $2,000,000. All the subsidiaries had operated during the year at a profit equal to the dividends declared except one of the 60 per cent. owned companies which had paid no dividends and had sustained a loss of $3,000,000. Is this loss reflected in the consolidated income account?

Why is a consolidated balance-sheet preferable to a holding-company balance-sheet?

No. 5 (24 points):

Prepare a federal income-tax return for the year 1923 from the following information:

Your client, Arthur V. Sheridan, was the head of a family consisting of his wife, himself, four dependent children and his sister, aged 15, the expense of whose education and maintenance was borne by him.

In 1923 his wife received a legacy of $50,000 in first Liberty loan second converted 4¼ per cent. bonds; the interest received on these bonds in 1923 was $1,000.

His sister is one of the beneficiaries of a trust fund; her share of the income in 1923 was $560. The income is being accumulated until she reaches the age of 21.

In 1916 your client received $100,000 common stock of the A T Corporation for his services as founder. This stock he transferred to his wife. It had then no market value and paid no dividends in 1923, control of the corporation being acquired by a larger company, which paid $100,000 to secure this common stock.

Remuneration received by A. V. Sheridan, as director of several undertakings, was $12,000 for the year 1923. Interest received on mortgages, notes and bonds amounted to $1,256. Dividends received on preferred stocks of American corporations were $894 for Arthur V. Sheridan and $620 for his wife. A preferred dividend of $240 was declared December 25, 1923, payable January 1, 1924, on stocks owned by your client.

His expenses during 1923 were as follow:

Business traveling expenses, including repairs and supplies for passenger car, $1,120; office rent, etc., $620; legal expense, $300; loss on loans to A. Jones, $800; loss through insolvency of stockbroker, $7,500; loss on speculation in German currency, $1,200; loss on farming operations at summer home, $832; loss on investment in Bolivian bonds, sold December 22, 1923, $7,500. Loss on loan made to High Power Steel Company, $12,500; this amount was lent on debentures: preferred stock, value $3,000, was received in settlement of claim on reorganization of the company in 1923.

Other expenditures during 1923 were interest paid on loans, $857; real-estate and state taxes paid, $1,075; contributions to charities, churches and colleges, $560; to political associations, $250.

A. Show the amounts payable for normal tax and surtax.

(The surtax rate for 1923 was 1 per cent. for taxable income over $6,000 but not over $10,000, with 1 per cent. increase in the tax on each additional $2,000 up to $30,000 and over, but not exceeding $32,000, on which the tax was 13 per cent. The rate then increases 1 per cent. on each additional $2,000 up to $98,000/ $100,000 on which the rate is 47 per cent.)

B. State an alternative method of making the return, by which a saving could be effected in the amount of taxes payable, and give the necessary figures.

ACTUARIAL (OPTIONAL)

No. 6 (24 points):

The British debt to the United States, to be paid by the issuance of bonds, is four billion six hundred million dollars. If interest for the first ten years is to be paid at the rate of 3 per cent. on the annual balance outstanding and thereafter at 3½ per cent., what equal annual payments will discharge the debt with interest in sixty-two years? What debt remains at the end of the tenth year?

(Given) v^{10} @ 3% = .74409412
v^{10} " $3\frac{1}{2}$% = .708918
v^{52} " " = .16714824
v^{62} " " = .1184945

Commercial Law

MAY 16, 1924, 9 A. M. TO 12.30 P. M.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

1. Under the negotiable instruments law, (a) how would you determine the principal amount of the following note:

> January 1, 1924. Three months after date I promise to pay to the order of John Jones the sum of One Hundred Dollars ($100), value received, with interest.
> (Signed) RICHARD SMITH.

(b) Where would you present it for payment?

2. Bowman, a resident of Middleport, N. Y., purchased a piano from the X Piano Company of Buffalo for $300, giving the Piano Company $50 in cash and the following note:

> BUFFALO, N. Y., May 29, 1906.
> $250.
> On or before one year after date I promise to pay to the order of X Piano Company Two Hundred and Fifty Dollars at 418 Main Street, Buffalo, N. Y. Value received with interest.
> The piano for which this note is given shall remain the property of X Piano Company until the note with interest is paid.

On June 3, 1906, the payees endorsed the note and transferred it to Buffalo National Bank for value.

On August 6, 1906, Bowman paid to the Piano Company $50 on account of the note and on December 1, 1906, the further sum of $100. Both of these payments were accepted. Neither payment ever came into the hands of the Buffalo Bank.

In May, 1907, the note having been presented for payment, was refused and the bank sued for the full amount. Could it recover?

3. What is the duty of a bank, at which a note is made payable, and in which the maker has sufficient funds on deposit, when the note is presented for payment?

4. What is a trade acceptance? Explain its use.

CONTRACTS

Answer two of the following three questions:

5. X wrote to Y offering to sell Y 2,000 3-inch boiler tubes for $2.25 each. Y replied, "I will buy 1,200 tubes at your price." Y claimed a contract was made and that X was bound to deliver the 1,200 tubes. Was he?

6. Wickham, a New York business man, had title to a large timber tract in the Northwest which he honestly believed contained approximately 5,000,000 feet of lumber, such belief being based on reports of competent timber experts. Wickham contracted to sell the tract to Monroe, both believing the reports in Wickham's possession to be correct. Actually, unknown to either party, the tract had been stripped of good timber between the time of Wickham's survey and the time of sale. What was Wickham's position?

7. X lawfully came into possession of an oil painting which he sold to A for $75. Afterwards X found that the painting was a valuable one, worth at least $1,200. He tried to collect $1,125 from Y. Could he? Discuss the principle involved.

PARTNERSHIP

Answer one of the following questions:

8. Robert MacFarlane died and in his will he gave to his two sons, Robert, Jr., and William, his property at No. 24 A Street, with all the machinery, fixtures and implements connected with it and used in the dyeing business, each son to share equally. The two sons went into possession of the property and for two years conducted the business, dividing the profits equally. Then Robert, becoming dissatisfied, began an action against William for the partition of the real property (partition being an action by which real estate alone may be divided between coöwners). William defended on the grounds that he and his brother were partners and that until the copartnership was wound up, creditors were paid and the partners' interests adjusted, the property at No. 24 A Street was personalty and could not be the subject of a partition action. Was William's defense good?

9. Tompkins and Sheehan agreed to engage, as partners, in the business of manufacturing radio apparatus, the business to be conducted in Tompkins's name. Tompkins bought certain goods for use in the manufacturing business, the seller knowing nothing regarding the partnership. Subsequently the business failed and the seller, hearing about the partnership, sought to hold Sheehan. Could he do so?

CORPORATIONS

Answer one of the following questions:

10. Name three ways by which a corporation may be dissolved.

11. The X Company, of Pennsylvania, manufactures articles and merchandise used all over the United States. Its business in Massachusetts was handled through the A Company, a large jobbing house, which purchased from the X Company in Pennsylvania and resold to retailers in Massachusetts. The X Company maintained no office in Massachusetts, was never licensed to do business in Massachusetts and paid no taxes to that state. Four times a year salesmen from the home office of the X Company canvassed the retail trade in Massachusetts, educating the trade in the use of the X Company's products and taking orders. Such orders were immediately turned over to the A Company by the salesmen, the A Company filling the orders from its own stock, purchased from the X Company. The state of Massachusetts levied taxes against the X Company on the business thus done and added heavy penalties on the ground that the X Company was doing business in Massachusetts without having obtained the necessary license. Was the state successful in collecting?

BANKRUPTCY

Answer the following question:

12. The Jones Company went into bankruptcy. The trustee went into possession and proceeded to liquidate. A year later the federal internal-revenue department claimed a large portion of the assets in the trustee's hands, for the payment of additional income tax assessed, found due on the audit of previous tax returns. The trustee resisted payment on the ground that claim had not been filed within one year as required by the bankruptcy act and was therefore barred. Was the trustee correct?

INCOME TAX

Answer both the following questions:

13. The X Company during the year 1922 sustained a net loss of $33,000. In 1923 the company made a net profit of $58,000. In making up its return for 1923, it deducted from its net profit for the year its net loss sustained in the year 1922, paying a tax on the difference. Was the return correct?

14. Bender bought 77 shares of stock of Southern States Oil Company on December 2, 1922, for $1,266.50. On February 9, 1923, he received a stock dividend of 23 shares. He sold the hundred shares on July 12, 1923, for $2,284.40. On what amount was he taxable and why?

Examination in Accounting Theory and Practice

PART II

MAY 16, 1924, 1 P. M. TO 6 P. M.

The candidate must answer all the following questions:

No. 1 (27 points):

Drafts of the profit-and-loss accounts and the balance-sheet of the Atlantic Trading Company, showing the results of operations for the year ended December 31, 1923, were prepared for submission to the directors in January, 1924.

Before they were approved, a report of an investigation of the accounts of the company for the years 1919, 1920 and 1921 was received from the internal-revenue department. This report reduced considerably the large amounts of depreciation written off various assets and made a claim for the difference as additional excess profits and income taxes.

The claim was subsequently paid, and the directors decided to have the accounts for the years 1922 and 1923 and the balance-sheets at the end of those years redrafted in order to bring them into agreement with the figures shown in the internal-revenue report.

The accounts on the books of the company appear as follows:

Property Accounts 1922	Valuation Jan. 1	Additions during year	Depreciation Dec. 31	Balance forward
Real estate	$200,503.79	$ 2,249.08*	$10,162.61	$192,590.26
Machinery and tools	2,206.95	1,799.01	1,918.07	2,087.89
Auto trucks	21,521.06	31,000.48	12,360.08	40,161.46
Horse trucks	132.50		132.50	
Horses	800.00	575.00	583.34	791.66
Harness	245.70	61.05	221.75	85.00
Office furniture	1,774.42	2,909.86	1,610.59	3,073.69
	$227,184.42	$38,594.48	$26,988.94	$238,789.96
Property Accounts 1923				
Real estate	$192,590.26	$ 210.00*	$ 3,300.26	$189,500.00
Machinery and tools	2,087.89	1,235.38	1,755.73	1,567.54
Auto trucks	40,161.46	8,782.41	17,134.84	31,809.03
Horse trucks		112.58	66.92	45.66
Horses	791.66	700.00	741.67	749.99
Harness	85.00	80.00	143.00	22.00
Office furniture	3,073.69	3,264.54	3,400.86	2,937.37
	$238,789.96	$14,384.91	$26,543.28	$226,631.59

The internal-revenue agents traced back the original costs of the assets and all additions. Against these total costs they created depreciation reserves at the rates shown below.

You are required to take their figures as at the date to which their examination was restricted (December 31, 1921) and to extend them further, on the same basis, to December 31, 1923. Then bring the amounts of total cost into the accounts of the company, create the necessary reserves for depreciation and state the adjustments required in the profit-and-loss accounts, surplus account and balance-sheets at December 31, 1922, and 1923, in order to show the effect of these changes.

The amounts of additions to the assets, stated in the books of the company for the years 1922 and 1923, are to be taken as correct.

Note that the item of real estate has been divided, by the internal-revenue agents, into three separate classes to show different rates of depreciation.

* The additions to real estate in 1922 and 1923 apply to sheds.

Summary of Report of Internal-Revenue Department Agents

	Total cost to Jan. 1, 1922	Depreciation reserve Jan. 1, 1922	Annual rate of deprecia-tion allowed
Real estate (see below):			
Machinery and tools	$ 8,701.97	$ 4,306.77	20 %
Auto trucks	72,297.42	37,429.11	20 %
Horse trucks	1,691.63	680.39	16⅔%
Horses	5,788.17	2,873.07	20 %
Harness	1,444.59	1,116.92	33⅓%
Office furniture	5,576.92	1,311.03	10 %
Land } Real estate	164,364.60	(none)	(none)
Sheds } Real estate	9,581.14	1,578.11	10 %
Brick buildings } Real estate	39,596.93	2,143.88	2 %
		$51,439.28	
Depreciation reserve (not allocated to specific assets) for period prior to Jan. 1, 1919		12,718.36	
	$309,043.37	$64,157.64	

No. 2 (10 points):

A certain manufacturing concern makes tools and other equipment for use in its own plant and charges them to the capital asset accounts at the market value (which is in excess of cost) and credits the difference between the market and the cost value to profit-and-loss for the period in which the tools and other equipment are manufactured.

In the examination of the customers' accounts of this concern, you find certain credit balances aggregating $13,011.31 arising out of allowances for returned goods, defective goods, etc. It has been the practice of the company to deduct items of this nature from amounts due from customers and to state the net difference in the balance-sheet as "uncollected customers' accounts."

What is your criticism of these methods?

No. 3 (23 points):

The following is a summary of the cash receipts and disbursements of the trustees of the late R. A. Armstrong and a distribution of the estate.

Under the terms of his will, Mr. Armstrong left all his estate in trust for his two children with the exception of his life insurance of $500,000 and his home, valued at $100,000, which he bequeathed to his widow, an annuity to his sister and sundry legacies. The income from the estate he instructed the trustees to pay to his widow during her life.

Receipts:	
Cash and bank balances at date of death	$ 50,000
Life insurance	500,000
Income from bond interest	5,000
Income from dividends on stock	10,000
Income from dry-goods business, net	500,000
Sundry debtors at date of death	15,000
Proceeds of sale of dry-goods business, including new buildings and equipment	5,500,000
Securities sold, stocks and shares	1,000,000
Securities sold, bonds and debentures	500,000
	$8,080,000
Disbursements:	
Sundry creditors at date of death	$ 5,000
Inheritance tax	800,000
Sundry legacies paid in full	300,000
Mrs. Armstrong, net income	300,000
Advances to heirs ($100,000 each)	200,000
Legal expenses	400,000
Funeral expenses	15,000
Cost of constructing extension, dry-goods store	700,000
Cost of annuity for Miss Armstrong, deceased's sister	500,000
	$3,220,000
Balance, being net amount of estate to be divided equally between the two children	$4,860,000

From the figures and information given above, you are asked to prepare correct capital and revenue accounts and state the balance due to the widow and each of the children. (Consider that the widow should receive all the income collected.)

No. 4 (23 points):

You are instructed to investigate the financial condition of a concern by a client who is a large creditor. He informs you that the company about to be investigated has been falling behind in payments and believes that this is caused by a too extensive application of funds, or use of working capital, for the construction of new plants, etc. He furnishes you with a statement supplied by an officer of the company as at the beginning of the year, on the basis of which credit was granted, and requests that you make a report on the financial standing of the concern at the end of the year and on the situation in general.

You find that the company has no general ledger, but that a cashbook, sales book, voucher register and accounts-receivable ledger are kept. You list the assets and liabilities, with the exception of the plant (of the cost of which there is no record in evidence), and obtain the following result of conditions as at the end of the year:

Cash	$ 5,000	Bank loans	$ 14,000
Accounts receivable	24,000	Notes payable	20,000
Inventories	18,000	Vouchers payable	75,000
Sundry assets	4,000	Mortgages payable	10,000
Total assets, excepting plant	$51,000	Total liabilities, excepting capital	$119,000

The balance-sheet, presented by the officer representing the company, at the beginning of the year was as follows:

Cash	$ 40,000	Bank loans	$ 10,000
Accounts receivable	38,000	Notes payable	15,000
Inventories	20,000	Vouchers payable	60,000
Sundry assets	4,000	Mortgages payable	10,000
Plant	250,000	Capital stock	50,000
		Surplus	207,000
	$352,000		$352,000

An analysis of the books of original entry for the year furnished the following summarized results:

Cashbook receipts:		
Cash	$852,500	
Discount	7,500	
To accounts receivable		$850,000
Bank loans		10,000
Cashbook disbursements:		
Vouchers payable	838,500	
Bank loans payable	16,000	
To cash		854,000
Discount		500
Sales book:		
Accounts receivable	$852,000	
To sales		$852,000
Voucher register:		
New construction	25,000	
Operating expenses	798,000	
To vouchers payable		823,000

From trustworthy information, it was gathered that the inventories had decreased $5,000 during the year.

Having completed your investigation and reached conclusions for the purpose intended, what will be the report to your client?

No. 5 (17 points):

The following propositions are presented:

1. Depreciation of physical property is continuous and unavoidable.
2. Interest on invested capital is an element of cost.
3. Cash is a current asset.

4. True value of inventories is cost or market, whichever is lower.
5. True value of fixed assets on the books of a going concern is replacement value.
6. Interest paid previous to operation of a new plant is part of cost of plant.
7. Dividends on stocks accrue day by day.
8. Inter-company profits belonging to minority stockholders have no place in a consolidated balance-sheet.

Without copying or discussing the foregoing propositions at any length, indicate to which of the categories following they belong:

A. Statements of incontrovertible fact, or
B. Statements which are not strictly true.
C. Statements of accepted accounting principle or procedure which are correct, or
D. Statements of accepted accounting principle or procedure which are incorrect, or
E. Controversial statements of accounting principle or procedure for which reputable authority may be found on both sides.