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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 13 and 14, 1924.)

Auditing

NOVEMBER 13, 1924, 9 A. M. TO 12:30 P. M.

The candidate must answer all the following questions:

No. 1 (8 points):

Define and distinguish between depreciation, obsolescence and amortization. State what, in your opinion, are proper rates for writing off four of the following assets:

1. Brick buildings
2. Banking office equipment
3. Machinery
4. Book plates
5. Steel ships
6. Motion picture productions

No. 2 (8 points):

What items in the balance-sheet of a manufacturing and trading concern would you normally classify as current assets and current liabilities? State upon what tests you would rely to determine whether items in part or in entirety were properly classified under such headings.

No. 3 (8 points):

State your views of a proper differentiation between (a) capital expenditure and expense, (b) current income and deferred income and (c) deferred charges and deferred assets.

No. 4 (8 points):

Describe how you would proceed in the audit of a bank, having a capital of $1,000,000, to verify the cash on hand and in banks amounting to $2,426,725.90; the collateral loans; the bank's own investments.

No. 5 (8 points):

The total amount of the inventory of merchandise of a trading concern is shown to have been increasing each year while the gross profits have been diminishing. State the probable reasons for this and how you would proceed to discover the real cause. Suggest some method of preventing the over-valuation of the inventory and the accumulation of unsalable stock.

No. 6 (10 points):

What procedure would you follow in verifying the inventories of (a) a department store, (b) a manufacturing concern operating a cost system in which unfinished work is controlled by a "work in process" account on the general ledger?

State, as to (b), whether you would accept, as the inventory figure, the balance in the controlling account or the detailed cost sheets and what circumstances would govern your decision. Mention two circumstances, apart from mathematical errors, in which you would ask that the figures presented for work-in-process inventory be reduced.

No. 7 (8 points):

Describe how entries dealing with consigned goods should appear on the books of the consignor and those of the consignee and through what data the entries arise.

On the books and on the balance-sheet of a consignee, you find among the items, "Consigned goods unsold $98,425.00" and "Consignor's account for unsold goods $98,425.00." Are these items strictly in order? Give your reasons.

No. 8 (8 points):

Draft with illustrative entries (a) form for computation of unexpired insurance, (b) form to provide the proper amount for monthly entry on the books of bank discount on loans. From your illustrations provide the journal entries for charging the proper expense accounts and for carrying forward, or setting up, the balance of the asset or the liability, as the case may be.

No. 9 (8 points):

During the course of an audit of a manufacturing concern, the owner states to you that on account of extensive repairs the building has been maintained in perfect condition and, in fact, was in better condition at the close of the year than at the beginning and therefore no depreciation should be written off in the year. State what your position, as auditor, would be toward the owner and with respect to the accounts on the books, giving your reasons. State, also, what your position would be with reference to a balance-sheet certificate.

No. 10 (8 points):

What attitude should an auditor take with respect to the refusal by the officers of a corporation to produce its minute-book for inspection in a balance-sheet audit which is being made for the first time, although the corporation has been in existence for ten years? Explain fully.

No. 11 (8 points):

Discuss your position, as auditor, in the following instance:

It has been customary for a certain concern to hold open its books at the end of the year for, approximately, fifteen days and mark back, as of the closing date, sundry transactions occurring in the interim, consisting of the collection of open accounts and cheques drawn in payment of purchase and expense bills bearing date prior to the end of the year.

No. 12 (10 points):

The directors of a certain corporation submitted a statement to its bank in which the net income for the year was shown to be $115,000.

You are engaged by the bank to audit the books of account and records of this corporation for the purpose of verifying the net income as shown by the statement.

Your audit discloses the following facts which were not taken into consideration:

(a) There was no provision for depreciation, amounting to $27,500;

(b) Dividends of $12,500, on preferred stock, were payable on the day following the closing of the books;

(c) Machinery, manufactured by the company for its own use, had been charged to plant account at market prices;

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

(e) There was included in the net income, reported by the directors, $18,000 derived from transactions apart from the usual business operations of the company.

State in what respects the net income, as reported by the directors, is incorrect and explain how each of the above items should be treated on the books of the corporation at the closing date.

Accounting Theory and Practice

PART I

NOVEMBER 13, 1924, 1 P. M. TO 6 P. M.

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

No. 1 (25 points):

La Belle Manufacturing Company makes a product which retails during the summer and fall, the sales being particularly heavy the first half of the calendar year. For certain reasons, the company stores its finished product in a licensed public warehouse from which all shipments are made.

The general manager, who is also the treasurer, has a contract whereby he receives an annual salary of $12,000 plus a bonus of 10% of the net profits of the company, both charged to administrative expense. The bonus is computed semi-annually but payment withheld until after the audit report is received.

Your audits of the books of this company have been made without restriction for several years. In your report for the six months ended December 31, 1923, you make the following two statements:

Exhibit C

PROFIT-AND-LOSS STATEMENT

FOR THE SIX MONTHS ENDED DECEMBER 31, 1923

Sales, less returns and allowances	$213,900	100.00%
Deduct—		
Cost of goods sold, per exhibit D	89,800	41.98%
Gross profit on sales	$124,100	58.02%

Brought forward		$124,100	58.02%
Deduct—			
Selling expense	$26,075		
Administrative expense, including bonus	35,525		
		61,600	28.80%
Net profit on operations		$ 62,500	29.22%
Deduct—			
Financial expense		27,800	13.00%
Net profit, to surplus		$ 34,700	16.22%

Exhibit D

STATEMENT SHOWING COST OF MANUFACTURE AND COST OF SALES
FOR THE SIX MONTHS ENDED DECEMBER 31, 1923

Goods in process, beginning of period	$ 33,680
Raw materials used	769,360
Direct labor	433,632
Factory overhead	202,713
	$1,439,385
Goods in process, end of period	110,556
Cost of manufacture	$1,328,829
Add—	
Finished stock, beginning inventory	167,291
	$1,496,120
Deduct—	
Finished stock, ending inventory	1,406,320
Cost of goods sold	$ 89,800

The amount of net profit carried to surplus does not seem unusual but in making up your percentage analysis you are forcibly impressed with the rate per cent of gross profit. An examination of your previous reports shows rates averaging 20%, which leads you to believe that something must be wrong.

A review of your audit procedure assures you that your work is correct and you conclude that if error exists it must be in the inventory of finished goods, December 31, 1923. The cost of these goods has been obtained by frequent periodic tests throughout the year wherein all costs entering into the product are carefully noted. You check the computations of the value of goods in process, December 31, 1923, and find them correct, but a further investigation regarding the finished stock furnishes you with the following trustworthy data:

Balance in warehouse, June 30, 1923	90,700 gross
Additions to storage, per deposit receipts, July 1 to December 31, 1923	674,100 "
	764,800 gross

Brought forward		764,800 gross
Deductions from storage, per orders on file, July 1 to December 31, 1923:		
Out of receipts prior to July 1, 1923	23,810 gross	
Out of receipts subsequent to June 30, 1923	64,790 "	
		88,600 "
Balance in warehouse, December 31, 1923		676,200 gross

Make whatever changes in the above operating statements you deem necessary, but, as these statements are in agreement with the books, it is essential that you explain any changes you make, redrafting the statements. If no changes are made, what comments would you make in your audit report?

No. 2 (32 points):

The I. Roussim Manufacturing Corporation is requested by its bankers to file with them a balance-sheet, duly certified, showing its condition as of December 31, 1923.

The corporation asks you to examine its books of account and certify to the following balance-sheet which is in accord with the general ledger.

BALANCE-SHEET—DECEMBER 31, 1923

Assets		
Land	$ 80,000	
Building	127,500	
Machinery	224,000	
Furniture	5,000	
Goodwill	100,000	
Cash	33,800	
Receivables	120,000	
Investments	50,000	
Inventory	155,000	
Prepaid expense	2,575	
Total		$897,875
Liabilities		
Notes payable	$120,000	
Creditors	62,000	
Bonds	100,000	
Total		282,000
Net worth:		
Capital stock	$500,000	
Undivided profits	115,875	
		$615,875

Your examination discloses the following:

A. The land was valued by an appraisal company as at July 10, 1923, and the appraisal increase of $39,500 credited to undivided profits.

B. The building, machinery and furniture were recorded at cost. Depreciation had been written off regularly and at an adequate rate, viz.:—buildings, $22,500; machinery, $96,000; furniture, $3,000.

C. The goodwill has been estimated by the officers of the corporation and the amount credited to undivided profits, July 1, 1923.

D. The cash balance is composed as follows:

On hand	$2,000
Defunct state bank	1,800
X national bank	33,000
Y state bank (overdraft)	(12,000)
Sinking-fund trustees	9,000
	$33,800

The cash on hand includes I. O. U.'s of a former salesman, $575; the defunct state bank has been closed for some time; the receiver expects, eventually, to pay 50 cents on the dollar: the overdraft in Y state bank is caused, partly, by holding open the cash-book and entering, as of December 31, 1923, cheques issued to creditors in January, 1924, amounting to $9,000.

E. The receivables include:—$15,000 initial payment for new machinery ordered under contract, in amount, $45,000; $20,000 consignment sales on which a profit of $6,000 is expected; claim $16,000 for refund, treasury department. This claim, with an amended return for 1921, was filed with the local collector December 27, 1923.

F. Investments consist of U. S. Liberty bonds at par which are pledged on notes payable.

G. The inventories, priced at cost, are as follows:

Raw materials	$ 52,000
Goods in process	16,000
Finished goods	87,000
	$155,000

H. Prepaid expense consists of prepaid insurance, $1,650, and office supplies, $925.

J. Notes payable include a demand note due the president in amount $30,000 and $50,000 due X National bank secured by the U. S. Liberty bonds: the balance to other banks.

K. Creditors' account includes payroll, $18,000, and accrued interest, $320.

L. Bonds, issued January 1, 1921, 30 years, 6%; sinking-fund payment required, $3,000 yearly.

M. Capital stock:

6% preferred, authorized and issued	$300,000
Common, authorized and issued	200,000

Dividends were declared and paid in July, 1923, 3% on preferred and 2% on common. On January 15, 1924, 3% was declared on preferred and 4% on common, payable February 15, 1924.

N. The undivided-profits account showed a

Debit balance, January 1, 1923, of	$ 27,825
Credits for the year 1923	156,700
	$128,875
Dividends, July, 1923	13,000
Credit balance, December 31, 1923	$115,875

Prepare your own balance-sheet from the foregoing and attach certificate. State briefly your reason for each change made.

No. 3 (18 points):

The treasurer of the Standard Company wishes to buy the interest in the company owned by the retiring president. The price agreed upon is the correct book value of the capital stock. Both officers wish to be fair but doubt exists as to whether the book values of fixed assets are correctly stated.

During the first four years the depreciation taken depended upon the profits made. At the end of the fourth year an internal-revenue officer examined the returns of the company together with its records and, for taxing purposes, established the following rates which were accepted:

Buildings	2%
Machinery	5%
Tools	10%
Furniture and fixtures	15%

At the beginning of the 5th year, the company entered upon its books the values as set forth in an appraisal recently completed. Thereafter, it depreciated on the cost values at the rates prescribed by the government officer.

A detailed schedule of the fixed assets follows:

	Jan. 1, '18 Cost	Depreciation	Dec. 31, '21 Carrying value	Jan. 1, 1922 Appraisal value New	Sound
Land	$ 7,500	None	$ 7,500	$ 10,000	$ 10,000
Buildings	45,000	None	45,000	100,000	93,662
Machinery	28,000	$15,000	13,000	60,000	48,483
Tools	2,100	1,700	400	4,000	3,504
Furniture	3,000	1,500	1,500	5,000	4,790
	$85,600	$18,200	$67,400	$179,000	$160,439

The following is the balance-sheet, December 31, 1923, from which it will be seen that the "sound" values were placed upon the books, January 1, 1922, and depreciation taken on original costs at government rates:

Assets

Current		$161,318	
Fixed—less depreciation		154,519	
Deferred charges		1,553	
			$317,390

Liabilities

Current		$83,010	
Capital stock (par $100)	$300,000		
Less, deficit	65,620		
		234,380	
			$317,390

Give the correct book value per share and show how you arrive at your figures.

No. 4 (25 points):

You are engaged by the M Manufacturing Company—organized January 1, 1923—to audit its books for the calendar year 1923. You do the work the latter part of February, 1924, taking an inventory as of February 29, 1924, which is as follows:

	Twelve months 1923		Inventory	Jan. & Feb. 1924		Inventory
Article	Production	Sales	Dec. 31, '23	Production	Sales	Feb. 29, '24
A	70,000	60,000	10,000	4,000	8,000	6,000
B	60,000	57,000	3,000	9,000	9,000	3,000
C	25,000	22,000	3,000	5,000	7,000	1,000
D	40,000	35,000	5,000	3,000	4,000	4,000

Investigation discloses that the selling prices have remained constant, a discount of 20 and 10 being allowed from the list price with an additional 1% for cash in 10 days.

The company has no cost system, but costs have been estimated by the factory superintendent who is vice-president of the company. Your check of the production costs and the sales discloses the following:

Article	Superintendent's estimated cost	Your corrected cost	List price
A	$3.50	$4.50	$6.00
B	4.80	3.20	10.00
C	4.25	2.89	8.00
D	2.00	3.50	4.00

At a conference you explain to the officers that the estimated costs are incorrect because of errors in distributing factory overhead. They accept your corrected costs and change the list prices of A and D to $6.50 and $4.75 respectively, effective March 1, 1924.

The books of the company have been closed showing an operating profit of $32,654.80, for the year 1923, which was carried to surplus, the inventory of finished goods being priced at estimated cost.

What changes, if any, would you make in the inventory? What effect would such changes have on the profit-and-loss statement? How would you show the inventory on the balance-sheet? Give reasons for your answers.

ACTUARIAL (OPTIONAL)

No. 5 (25 points):

A lends B $1,000 for 8 years, interest 5%, payable annually. B pays A $50 per annum, interest, and provides a sinking fund by annual payments at interest dates to meet the principal of the loan at maturity. He is unable, however, to invest the sinking fund at a rate higher than 3%.

(1) What is the annual cost of the loan to B?

(2) If, in place of making these payments to the sinking fund, B pays the amounts to A (who, also, is unable to invest these and other small sums at a rate higher than 3%):

(a) What difference does this make to A? Give reasons and proof.

(b) Show, in tabular form, how A should record these transactions on his books.

Given:

$$(1+i)^8 @ 3\% = 1.266770$$
$$(1+i)^8 @ 5\% = 1.477455$$

Commercial Law

NOVEMBER 14, 1924, 9 A. M. TO 12.30 P. M.

Maximum credit for each question answered is 10 points.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

No. 1:

Taylor held Thompson's note for $400. Taylor was indebted to Thompson on an open account for $400. Taylor transferred the note to King in the usual course of business for value. When due, King presented the note to Thompson, who refused payment on the ground that Taylor owed to him, Thompson, an amount equal to the note. Did Thompson, the maker, have a good defense?

No. 2:

Styles made a note to Johnson dated January 1, 1924, and due April 1, 1924. The note contained no provision as to interest. The note was not paid by Styles when due but it was allowed to run until September 1, 1924, when Styles paid it. Could Johnson collect any interest?

No. 3:

McDonald becomes the holder in due course of a note purporting to have been made by Knapp and bearing endorsements in blank by Abbott, Perrin and Pringle. The maker's name was forged. When due the note was duly presented for payment, payment refused, and notice of dishonor given to all parties. Could McDonald collect and from whom?

No. 4:

When should a draft be presented to the drawee for acceptance or payment?

CONTRACTS

Answer two of the following three questions:

No. 5:

The A Company, a New York corporation made a contract with the B Company in Norway for its yearly supply of Norwegian cod-liver oil of certain specifications. Payments for oil were to be made by drafts. A shipment of 200 barrels arrived in New York early in August, the A Company accepting a draft for the purchase price payable September 1st, and took the oil from the steamer to its plant. The oil when tested (the testing process requiring about 10 days' time) proved to be of lower grade than required by the specifications. The A Company notified the B Company by cable of the defects, offered to return the oil to the B Company and refused to pay the draft on September 1st, (the draft being still held by the B Company). The B Company refused to accept a return of the oil and sued for the purchase price claiming that the A Company had accepted the oil. Did the A Company have a defense?

No. 6:

Jones and Chambers were both road-building contractors. Bids were called for by the state of New Jersey for the building of a certain state road in that state. Jones proposed to Chambers that Chambers refrain from bidding in consideration of Jones' refraining from bidding against Chambers on another road soon to be built and an agreement was entered into to that effect. Jones, however, entered a bid on both jobs and was awarded both contracts. Chambers sued Jones for the profits made under the second contract alleging breach of the agreement between them. Could Chambers recover?

No. 7:

Wood contracted with Long, a shirt-maker, for 1000 shirts for men. Long manufactured and delivered 500 shirts which were paid for by Wood, who at the same time notified Long that he could not use or dispose of the other 500 shirts and directed Long not to manufacture any more under the contract. Long proceeded to make up the other 500 shirts, tendered them to Wood, who refused to accept, and Long then sued for the purchase price. Could he recover?

PARTNERSHIP

Answer one of the following two questions:

No. 8:

Barr and Nelson, co-partners, received in the course of business a note made by Nash. Barr endorsed the note in the firm name. The note not being paid at maturity was protested by the holder and notice given to Barr. In a suit against Barr and Nelson as endorsers, Nelson defended on the ground that he had not had notice. Was his defense good?

No. 9:

Bigelow engaged the services of Ely to manage a public garage owned by Bigelow. A written agreement was entered into under which Bigelow agreed to pay Ely a salary of $45 a week and 15% of the net profits of the business. Did the agreement constitute Bigelow and Ely as partners?

CORPORATIONS

Answer one of the following two questions:

No. 10:

Explain the meaning of the words "ultra vires" as applied to corporations, illustrating by an example, actual or fictitious.

No. 11:

In what circumstances, if at all, has a corporation power to purchase its own stock?

BANKRUPTCY

Answer the following question:

No. 12:

Outline briefly the principal steps in a bankruptcy proceeding.

INCOME TAX

Answer both the following questions:

No. 13:

What is earned income as defined by the income-tax law of 1924 and what is its application under the law?

No. 14:

On January 10, 1923, A purchased stock of a certain corporation for $10,000. On August 15, 1923, he received dividends amounting to $1,200, all of which were paid out of earnings of the corporation accumulated prior to March 1, 1913. In December, 1923, A sold the stock for $8,000.

(A) Was the dividend of $1,200 taxable?

(B) What was A's deductible loss on the sale of the stock?

Accounting Theory and Practice

PART II

NOVEMBER 14, 1924, 1 P. M. TO 6 P. M.

The candidate must answer all the following questions:

No. 1 (24 points):

Two public-utility companies, A and B, are owned and controlled by the same persons. Each company has an electric department, a gas department and a street railway (transportation) department. For managerial control, all sales between the various departments and the companies are billed so as to allow a 10% operating profit on sales to the selling department. In preparing statements of earnings, the companies include in sales and expense the inter-departmental and inter-company transactions at billed prices.

You make an audit of the companies' books and records for the year ended December 31, 1923, and find the statements of earnings from operations, submitted to you, to be correct on the above basis.

You are required to prepare a statement showing (1) the companies' figures as presented herewith, (2) the sales, expenses and net earnings of each department of the two companies separately with the inter-departmental profits of the respective companies eliminated and (3) the consolidated sales, expenses and net earnings of the two companies, by departments, with inter-company and inter-departmental profits eliminated.

The statement you prepare should show clearly how the final results are obtained.

The companies' statements are as follows:

	Company B	Company A
Gross sales:		
Electric department	$ 8,000,000	$2,000,000
Gas department	750,000	500,000
Transportation department	1,500,000	750,000
Total gross sales	$10,250,000	$3,250,000
Operating and maintenance expenses:		
Electric department	$7,200,000	$1,800,000
Gas department	712,500	450,000
Transportation department	1,485,000	742,500
Total operating and maintenance expenses	$ 9,397,500	$2,992,500
Net earnings from operations:		
Electric department	$ 800,000	$ 200,000
Gas department	37,500	50,000
Transportation department	15,000	7,500
Total net earnings from operations	$ 852,500	$ 257,500

The transactions between the departments during the year at the billed prices are as follows:

Company B	
Electric dept., sold to gas dept., company B	$ 40,000
Electric dept., sold to trnsprtn. dept., company B	300,000
Electric dept., sales of power and light for internal use of electric dept., company B	30,000
Electric dept., sold to electric dept., company A	800,000
Electric dept., sold to trnsprtn. dept., company A	50,000
Company A	
Electric dept., sold to gas dept., company A	$ 20,000
Electric dept., sold to trnsprtn. dept., company A	100,000
Electric dept., sales of power and light for internal use of electric dept., company A	15,000

No. 2 (16 points):

A partnership, under the firm name of Bond & Young, commenced a general commission business, January 1, 1904.

Bond contributed $5,000 and Young $500 as their respective capital investments in the business.

The partnership agreement provided that Bond should receive four-sevenths of the profits and Young, three-sevenths, no interest to be allowed on partners' accounts.

They wish to separate as at January 1, 1924, Bond to continue the business as at present conducted, taking over all the assets and assuming all liabilities; Young to retire and pay any indebtedness to the firm he may have incurred or receive whatever amount to which he may be entitled.

You are called upon, the latter part of April, 1924, to ascertain and, from the data furnished herewith, report as to whether Young is debtor to the firm or creditor and to what extent.

No books of account were kept, except that the accounts receivable were recorded and all the cheque-book stubs were available. From these, it was gathered that Bond and Young each drew out of the business an average of $20,000 per annum.

The following properties were in the firm name January 1, 1924:

Farm lands in Virginia	$250,000
(Giving an average yearly yield of $75,000 from produce, the crops maturing in March)	
Fruit orchards in Florida—cost	220,000
(Averaging a $48,000 harvest, the crops maturing in January)	
Auto. and trucks	10,000
(Depreciated value, January 1, 1924)	
Cash in bank	75,000
Building—Washington street, New York	150,000
(Present value)	
Furniture & fixtures—cost	10,000
(Averaging age of five years)	
Accounts receivable—good	105,000
Total	$820,000
The only liabilities being:	
Accounts payable	$120,000

No. 3 (10 points):

The American Manufacturing Company owns all the capital stock of the Columbia Selling Company. Condensed balance-sheets of these companies, as at December 31, 1923, were as follows:

American Manufacturing Company

All assets	$1,500,000
All liabilities	$ 300,000
Capital stock	700,000
Capital surplus, arising from appreciation of plant	200,000
Earned surplus	300,000
	$1,500,000

Columbia Selling Company

All assets	$ 250,000
All liabilities	$ 50,000
Capital stock	100,000
Earned surplus	100,000
	$ 250,000

The Columbia Selling Company is incorporated under the laws of X state.

It has been decided, in order to effect certain savings, to incorporate, as at December 31, 1923, a new company of the same name under the laws of the state of Y and increase the capital stock to $150,000, which is to be owned by the American Manufacturing Company.

There will be no change in the assets or liabilities, no cash or its equivalent being introduced in the reincorporation.

Prepare condensed balance-sheet for the Columbia Selling Company after the reincorporation and state your reasons for the changes made in capital stock and surplus.

No. 4 (20 points):

It is proposed to make the following changes in the capital of a certain company in order to reduce the annual expenses appertaining thereto.

An issue is to be made of $1,100,000, 10-year, 5%, first mortgage bonds with a first lien on the plant and equipment and $1,000,000, 10-year, 6%, second mortgage bonds, giving a general lien on all the assets of the company, subject to the prior lien of the first-mortgage bondholders.

All the bonds are redeemable at par: they are to be sold to an underwriting syndicate at 95, the syndicate to pay all expenses of the issue.

The proceeds from the sale of the bonds are to be used to redeem the outstanding balance of 18,475 shares ($1,847,500) of 8%, second preferred stock at 105 as provided by the terms of the issue. All the second preferred shares are then to be canceled.

(Assume a quarterly dividend on second preferred stock to have been declared, payable at date of redemption).

The common stock is to be changed into shares of no par value, in the proportion of five new shares for one old share. This stock appeared on the last balance-sheet as follows:

Common stock authorized, 115,000 shares, par value $100	
Issued, 6,000 shares, book value at date of formation of the company	$1,250,514

Prepare a balance-sheet giving effect to the proposed changes with regard to bonds, capital stock and surplus in accordance with the foregoing data and the following details:

1st preferred convertible, 8%, authorized 35,000 shares, par value $100—	
Total outstanding, 24,315 shares	$2,431,500
Sinking fund, on deposit with trustee, to retire 1st and 2nd. preferred stocks	1,275,833
Surplus	731,252

All preferred shares previously purchased had been canceled and written off at cost from the sinking fund.

Show how much the company should save by this new arrangement and mention any advantages or disadvantages to be derived therefrom.

No. 5 (20 points):

The following items are included in the income-tax return of John Jones, single, a United States' citizen living in New York, for the year 1923.

For income-tax purposes, indicate which items are taxable for both surtax and normal tax, for surtax only, allowable deductions to arrive at net income, credits against net income for normal tax and credits against tax payable. If any income or deductions are improperly included, indicate which they are and why they should not be considered.

Securities sold:		
Cost, April, 1922	$1,000.00	
Sold, March, 1923	700.00	$ 300.00
Personal exemption		1,000.00
Dividends—		
U. S. Steel Corporation, common stock		500.00
Lost Hope Gold Mining Co. of Arizona		1,000.00
(Notice sent with dividend says earned surplus was exhausted by payment of last previous dividend)		
Dividend from John Barker & Co., Ltd., London, England	£10. 0. 0.	45.00
Less British income tax deducted at source	3. 0. 0.	13.50
	£ 7. 0. 0.	$ 32.50
Rent paid for business property		2,500.00
Other business expenses		7,500.00
Business income		20,000.00
Interest received on U. S. railway bonds containing 2% tax-free covenant clause		800.00
Interest received on New York city corporate stock		450.00
Interest received on loan to friend		10.00
Interest paid on mortgage on dwelling house		600.00
Interest paid on bank loans		120.00

Taxes, etc. on dwelling house—	
Sewer assessment	$ 250.00
Regular levy	400.00
Premium paid on life-insurance policy, Jones' sister, beneficiary	200.00
Payments to Jones' mother, residing in London—$100 per month.	1,200.00
Contributions—	
To church	100.00
Red Cross	100.00
Golf-club trophy fund	50.00

Calculation of tax is not required. Classify the items as between income, deductions, credits against net income for normal tax, credits against tax payable, non-taxable income and unallowable deductions.

Explain any classification which you think requisite.

All terms are used in the sense employed by the United States treasury department.

No. 6 (10 points):

John Jones, president and owner of 90% of the capital stock of the Jones Commission Company, asks you to audit the accounts of his company and submit a report to him with copies.

The audit will cover the transactions during the three months ended December 31, 1923, and is being made to determine the general accuracy of the records and the trustworthiness of the accounting staff.

Your report will consist of a general statement in narrative form without balance sheet or income statement.

In the reply to your request for confirmation of the bank balance, you are advised that there is a liability to the bank for a loan amounting to $20,000. The bookkeeper informs you that this represents the discount of the personal note of John Jones, drawn to the order of the Jones Commission Company and credited to his personal account on the company's books. Your inspection of the records substantiates this statement and you further ascertain that the credit to John Jones' personal account had been extinguished by withdrawals of cash equalling or exceeding the proceeds of the note.

What action would you take regarding the transactions relative to this note?