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American Institute of Accountants Examinations, May 16-17, 1923

American Institute of Accountants. Board of Examiners

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AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

Examination in Auditing

MAY 16, 1923, 9 A. M. to 12.30 P. M.

Answer all questions.

No. 1 (8 points) :

(a) What is meant by a deferred charge to operation? Name three examples, and state how each is proved correct in an audit.

(b) What is the difference between a liquidated and a contingent liability in the accounting sense of the terms? Give an example of each.

No. 2 (8 points) :

In what ways may actual examination of insurance policies, life and fire, be useful to the auditor in the course of his work?

No. 3 (10 points) :

An auditor verified in 1921 the existence of a mortgage of \$10,000 by inspecting the public records. In 1922 he found that \$5,000 had been paid on account of this mortgage, evidenced by a receipt from the mortgagee. Thereupon without further action he certified a balance-sheet showing this mortgage indebtedness as \$5,000. Was his course correct or not? Explain.

No. 4 (8 points) :

How would you audit and verify the notes and bills payable of a corporation?

No. 5 (8 points) :

What would you consider a satisfactory voucher for

- (a) Pay-roll in a large manufacturing business;
- (b) Purchase of a stock-exchange security;
- (c) Investment in a mortgage?

No. 6 (8 points) :

Describe fully (or illustrate in skeleton form with proper captions if preferred) a working balance-sheet.

No. 7 (8 points) :

A died in 1916 leaving certain shares of stock to his widow, B, who in 1922 gave the stock to her son, C, who immediately sold it. In his federal income-tax return C claimed as a loss the difference between the sale price and the market value on the date on which he received the stock from his mother. Was he right or wrong? Why?

No. 8 (8 points) :

What federal income-tax returns are required in the case of a partnership? What returns are required when a new partner is admitted during the taxable year?

No. 9 (8 points) :

What is a stock dividend? From what sources may it arise? Does the declaration of such a dividend imply that the previous surplus of the corporation has been unreasonably large and not necessary to the business? Explain.

No. 10 (8 points) :

In auditing the accounts of a private firm in which there are several partners, to what points should the auditor look in order to be assured that the partners' accounts are correctly stated in the balance-sheet?

No. 11 (10 points) :

A partner in a stock-brokerage firm, not active in the management, suspects his firm of conducting a bucket-shop. He secures the following balance-sheet from the firm's books, and he asks your advice. He has previously made an examination of customers' accounts and found all accounts, both long and short, amply margined at 20%. The market has been

rising steadily for nearly a year. What would be your advice, and why?

BALANCE-SHEET ITEMS	
Cash	\$ 400,000.00
Due from customers, long	2,500,000.00
Due from brokers for stock borrowed	25,000.00
Securities on hand	75,000.00
Firm trading accounts, long	450,000.00
Due to customers, short	375,000.00
Due to brokers for stock on loan	150,000.00
Firm trading accounts, short	2,850,000.00
Capital, surplus and profit and loss	75,000.00

No. 12 (8 points) :

You have been retained by a manufacturing corporation as a consulting accountant and are requested to advise the officers what steps to take in order to determine the cause of an apparent deficiency in the inventory of factory material and work in process.

What would you suggest?

Examination in Accounting Theory and Practice

PART I.

MAY 16, 1923, 1 P. M. to 6 P. M.

Answer all the following questions.

No. 1 (33 points) :

Your firm audits, annually, the books of the Non-Bessemer Iron Mining Company.

The following cost sheet and condensed profit-and-loss statement are the result of your audit :

COST SHEET FOR YEAR 1922				
(900,000 tons mined)				
	Labor	Supplies and expense	Total	Cost per ton
1. Mining	\$ 615,000	\$ 164,000	\$ 779,000	.866
2. Timbering	108,000	72,000	180,000	.200
3. Underground tramming and hoisting	108,000	900	108,900	.121
4. Pumping	45,000	7,200	52,200	.058
5. Mine captains, foremen and shift bosses	27,000		27,000	.030
6. Crushing and stockpile	54,000	8,100	62,100	.069

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	Labor	Supplies and expense	Total	Cost per ton
7. Power, light, heat and water	9,000	198,000	207,000	.230
8. Loading from stockpile ...	18,000	7,200	25,200	.028
9. Superintendence and mine office	36,000	3,600	39,600	.044
10. General maintenance	45,000	162,000	207,000	.230
	<u>\$1,065,000</u>	<u>\$ 623,000</u>	<u>\$1,688,000</u>	<u>1.876</u>
11. Fixed charges and general expense			472,000	.524
12. Total cost			<u>\$2,160,000</u>	<u>2.400</u>

CONDENSED PROFIT-AND-LOSS STATEMENT
FOR THE YEAR 1922

Total sales800,000 tons @ \$4.80..	\$3,840,000
Cost of ore sold800,000 tons @ 2.40..	1,920,000
Gross profit		\$1,920,000
Deduct:		
Cost beyond the mine	\$1,280,000	
Royalties	480,000	
Administrative expense	60,000	1,820,000
Net profit800,000 tons @ .125..	\$ 100,000

From a cursory review of the foregoing, it is apparent that several of the items of cost per ton are unusually high and the net profit per ton is correspondingly low. Therefore it is decided that an investigation shall be made to ascertain the correctness or otherwise of the tonnage mined.

The following information relative to operation is obtained, and you are directed by your principals properly to apportion the costs in accordance therewith; show the true net profit on the ore sold; prepare a revised cost sheet showing costs for both broken and hoisted ores and a revised condensed statement of profit and loss.

The usual mining procedure is breaking away the ore, tramming (loading on cars and hauling to the shaft), hoisting to surface, crushing and loading on stockpile.

The practical miner calls ore "mined" only when it reaches the stockpile. Your investigation discloses the fact that while 900,000 tons reached the stockpile, and this tonnage was the basis for the per-ton cost on the cost sheet, an additional quantity of 125,000 tons was completely mined to the tramming stage. This broken ore, because of its high analysis of iron content, has a better market value than the ordinary ore and will be left as

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it is until it can be stockpiled by itself. This condition may be considered as analogous to that of goods in process in a manufacturing concern.

Note that the hoisted ore should not be charged for the expense incurred in producing the broken ore.

No. 2 (30 points):

The following is a brief summary of the balance-sheets of three companies at a given date:

	A	B	C
Total assets	\$1,500,000	\$2,000,000	\$3,500,000
Total liabilities	\$ 250,000	\$ 750,000	\$1,100,000
Capital stock (shares of \$100 each)....	1,000,000	750,000	2,000,000
Surplus	250,000	500,000	400,000
	\$1,500,000	\$2,000,000	\$3,500,000

Each corporation owned part of the capital stock of the others carried on their respective books as follows:

	Capital stock in		
	A	B	C
A owned		15%	15%
Carried at		\$ 100,000	\$ 300,000
B owned	15%		10%
Carried at	\$ 150,000		175,000
C owned	5%	5%	
Carried at	50,000	60,000	

The three companies agreed to consolidate and each to accept its pro rata share in the capital stock of a new corporation (D) having 1,000,000 shares of no par value.

What percentage of the shares of corporation D will the stockholders of A, B and C respectively receive and what will be the total equity or paid-in value of the consolidated capital?

No. 3 (15 points):

The M and N Coal Corporation is formed with a paid-up capital of \$6,000,000 (60,000 shares, par value \$100) and a resolution is passed authorizing the purchase of the outstanding capital stock of the K O Company.

The balance-sheet of the K O Company, at the date of acquisition is as follows:

<i>Assets</i>	
Current	\$1,750,000
Fixed	4,500,000
Deferred	250,000
	\$6,500,000

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<i>Liabilities</i>	
Current	\$ 500,000
Funded debt	1,000,000
Capital stock	2,000,000
Surplus	3,000,000
	\$6,500,000
	\$6,500,000

Six million dollars was paid for the total capital stock of the K O Company which, after acquisition, was canceled.

Prepare the opening entries, spreading the assets and liabilities of the old company on the books of the new company.

No. 4 (15 points):

You are requested to audit the books of the A Company, engaged in the business of buying second mortgages, at the end of a period of six months and you find the following conditions relative to the mortgages purchased during the period:

Mortgages purchased, all dated July first and set up at face value, classified as follows:

1-year term	\$25,000
2-year term	25,000
3-year term	25,000
	\$75,000
	\$75,000

The costs to the company for these three classes of mortgages were respectively:

1-year term	\$22,500
2-year term	21,250
3-year term	20,000
	\$63,750
	\$63,750

The mortgages are repayable in equal semi-annual instalments.

The discount has been credited direct to profit and loss.

Would you prepare your statement to conform to the books or would you make adjustments? If the latter, indicate their nature and give reasons therefor.

No. 5 (7 points):

Express, briefly, your views on the subject of accounting relative to unpaid cumulative preferred dividends.

Examination in Commercial Law

MAY 17, 1923, 9 A. M. to 12.30 P. M.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

No. 1 (10 points) :

In what particulars is the following paper not in the usual form?

Boston, Mass.
I, Thomas H. Green, promise to pay to James Malone
or order Two Hundred Dollars. Value received.
(Signed) THOMAS H. GREEN.

No. 2 (10 points) :

Andrew J. Morse drew a cheque on the A. B. Bank to the order of Samuel Winter in payment for goods purchased. Winter held the cheque more than three months before presenting it for payment. During that time the A. B. Bank failed. Morse had, however, withdrawn his deposits before the failure. Was Morse released from liability on the cheque?

No. 3 (10 points) :

What are personal defenses to a negotiable instrument and in what circumstances may they be invoked? Name some personal defenses.

No. 4 (10 points) :

What is (1) a collateral note, (2) a judgment note?

CONTRACTS

Answer two of the following three questions:

No. 5 (10 points) :

Jones acted as a broker in the sale of Smith's home, and Smith agreed to pay him a commission of five per cent. The state of New York requires all real-estate brokers to be licensed and to pay a license fee. Jones had no such license. Smith refused to pay Jones his commission, and Jones sued. Could he recover?

No. 6 (10 points) :

State what contracts in general may be assigned and what may not.

No. 7 (10 points) :

A made a written contract with B to purchase B's dry-goods store, A paying B \$2,000 at the time when possession was given and agreeing to pay the balance of \$2,500 on or before January 1, 1923. On January 3, 1923, the balance due being unpaid, A secured B's agreement to postpone the payment until April 1, 1923. On March 5, 1923, B sued A for the balance due. Could he recover?

PARTNERSHIP

Answer one of the following two questions:

No. 8 (10 points) :

A, B and C are engaged as partners in the lumber business. A dies and bequeaths his entire estate to his son, X. X desires to come into the firm in his father's place. What are X's rights?

No. 9 (10 points) :

Martin and McBride were copartners in a certain business. Martin sued McBride for supplies furnished to the latter by the former for the operation of an independent business carried on by McBride, entirely independent of the partnership. Could Martin recover?

CORPORATIONS

Answer two of the following three questions:

No. 10 (10 points) :

Explain the principal advantages of doing business as a corporation rather than as a copartnership or as an individual.

No. 11 (10 points) :

The X Y Corporation is engaged in the grocery business in the city of Harrisburg, Pennsylvania. Its directors, by a resolution duly adopted, authorized the officers to enter into a copartnership agreement with W, the object being to operate a grocery store in Philadelphia, W to supervise the running

of the store and to furnish some capital, the corporation to furnish the balance of the necessary capital and to attend to the buying of all stock. The agreement was adopted. Was it a valid agreement?

No. 12 (10 points) :

A corporation which was in financial difficulties determined to cease business. It proceeded to sell certain assets, the proceeds of which were distributed pro rata among the stockholders as a dividend in liquidation. Later, on the petition of the creditors, the corporation was declared bankrupt, and the trustee in bankruptcy brought suit against the stockholders to recover the amounts distributed to them. Were the trustee's suits successful?

FEDERAL INCOME TAX

Answer both the following questions:

No. 13 (10 points) :

Define the terms "capital assets" and "capital gain" as defined by the present income-tax law.

No. 14 (10 points) :

How is "capital gain", mentioned in the preceding question, taxed under the present income-tax law?

Examination in Accounting Theory and Practice
PART II.

MAY 17, 1923, 1 P. M. to 6 P. M.

Answer questions 1, 2, 3, 4 and either 5 or 6.

No. 1 (35 points) :

The X Machine Company received its charter and commenced business on January 2, 1922. The production of machines started July 1, 1922.

The business consists of the manufacture and sale of a standard machine, 200 of which have been sold to date at a uniform

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price of \$500 each, through agents who receive a commission of 15%, payable 1/3 on receipt of order, 1/3 on shipment of goods and 1/3 on payment of bill.

The general manager and the sales manager have individual agreements with the company by which the former is to receive a commission of 10% and the latter a commission of 6% on net profits after provision for federal taxes.

There are issued 100,000 shares no-par-value common stock for "services" but no value is shown on the books of the company nor in the minutes.

Trial balances are given as of January 2, June 30 and December 31, 1922, prior to closing.

Prepare a balance-sheet as at December 31, 1922, and profit-and-loss statement for the year making all necessary adjustments, capitalizing such items of expense as appear to you applicable to development and setting up a reserve for federal taxes computed on the basis of 12½% of net profit with the statutory deduction of \$2,000.

TRIAL BALANCES (BEFORE CLOSING)
Debits

	Jan. 2	1922 June 30	Dec. 31
Cash	\$ 50,000	\$ 33,468	\$ 22,646
Accounts receivable (trade).....			26,500
Prepaid insurance		1,125	1,427
Tools		4,287	6,511
Machinery and equipment		23,411	34,768
Office furniture and fixtures		1,400	1,450
Patents applied for		1,127	1,327
Organization expense		2,371	2,371
Labor			9,675
Purchases			26,506
Administrative and office salaries		2,420	4,650
Rent of factory		1,000	3,000
Agents' commissions		750	15,000
Royalties			1,030
Telephone and telegraph		147	387
Postage		37	86
Light, heat and power		125	580
Insurance		50	350
Automobile expense		147	330
Engineering salaries		1,367	2,850
Magazine advertising		1,500	1,825
Entertainment		119	287
Office stationery and supplies		377	622
Travelling		227	527
Miscellaneous expense		115	388
Returned sales			1,000
Depreciation			2,137
	\$ 50,000	\$ 75,570	\$ 168,230

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Credits

Capital stock preferred	\$ 50,000	\$ 62,500	\$ 86,000
Accounts payable (trade)		12,425	13,145
Notes payable (banks)			7,500
Interest earned		145	365
Discount on purchases			288
Sale of scrap			120
Sales			52,500
Accounts payable, agents		500	6,175
Capital stock, common (100,000 shares)			
Reserve for depreciation			2,137
	\$ 50,000	\$ 75,570	\$ 168,230

The inventory at December 31, 1922, was valued at \$13,290.

No. 2 (30 points) :

A and B are equal heirs in an estate of \$100,000 consisting entirely of real-estate mortgages.

B resides in the city in which two of these mortgages are placed—one, a 6% first mortgage of \$1,600, dated January 31st; the other a second mortgage, payable \$25 monthly with interest at 6% on the decreasing balance. The balance of the second mortgage at March 31st, after payment of the \$25 then due, was \$700. These two mortgages are handled by B. All the rest are in another city in which A resides and are under his control.

One mortgage of \$2,500 falls due and will be paid, with six months' interest at 6%, on April 30th, and B proposes that, in part settlement, he take over the two which are in his hands. A agrees to this.

Prepare statements of financial condition at April 30th before collections mentioned above are made, journal and cashbook entries reflecting the transactions and final statements for both A and B, each of whom keeps his books on the same basis.

No. 3 (9 points) :

A corporation spends \$500,000 on an advertising campaign during the first six months of the year 1922 and expects to begin to secure benefits therefrom on and after July 1, 1922, and for three succeeding years. How would you handle this expenditure on the published balance-sheet and profit-and-loss account issued to stockholders? How would you handle it on the income-tax return for 1922?

No. 4 (8 points):

What would be the effect on unit costs of a change in the calendar providing for a year of thirteen months of twenty-eight days each instead of twelve months as at present?

No. 5 (18 points):

The annual sinking-fund deposit, with interest at 6% per annum, necessary to accumulate \$500,000 over a period of 80 years is \$286.27. The amount of an annuity of one dollar at 6% at the end of various periods is as follows: 20 years, \$36.78559120; 40 years, \$154.76196562; 60 years, \$533.12818089; 80 years, \$1,746.59989137. Show, by means of a table, how a sinking-fund-method reserve for amortization of a franchise, which cost \$500,000 and has 80 years to run, would compare with a reserve for the same purpose derived by the straight-line method.

ACTUARIAL

No. 6 (18 points):

(a) What terminable annuity, payable quarterly for ten years, would be required to repay a loan of \$32,840.00, the nominal rate of interest being 4 per cent. per annum?

(b) What would be the required amount to set aside annually providing for a sinking fund to repay loan, as above, at the end of ten years instead of repaying it quarterly?

Given $(1.01)^{40} = 1.4889$.