Journal of Accountancy

Volume 34 | Issue 6 Article 1

11-1922

CPA Examinations, November 16-17, 1922

American Institute of Accountants. Board of Examiners

The JOURNAL *of* ACCOUNTANCY

Official Organ of the AMERICAN INSTITUTE *of* ACCOUNTANTS

Vol. 34 DECEMBER, 1922 No. 6

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 16, 1922, 9 A. M. to 12.30 P. M.

Answer all questions.

No. 1. (10 points):

Define and state the scope of a

(a) Balance-sheet audit,
(b) Complete audit,
(c) Continuous audit,
(d) Special examination.

No. 2. (10 points):

Give, without figures, the form of profit-and-loss statement for a mercantile corporation as suggested by the federal reserve board.

No. 3. (10 points):

Give, without figures, the form of an income and expense statement of a stock-broker showing titles of accounts you would expect to find.

No. 4. (10 points):

Define and give examples of

(a) Tangible assets,
(b) Intangible assets,
(c) Fixed assets,
(d) Current assets.

No. 5. (10 points):

In auditing the annual statement of the town of X you find all the following items of receipts stated under the general head of "Revenues".

1. Taxes received.
2. Loan from the National Bank of X.
3. Dog licenses.
4. Municipal court fines.
5. Bequest from the estate of A to establish a town library.
6. Street assessments collected from owners of abutting property.
7. Permits for parades.
8. Sale of worn-out equipment.
9. Transfer of balance from street opening to street cleaning fund.
10. Deposit by B to cover cost of extra sewer connection.
11. Interest on bank deposits.
12. Donation from C toward street repairs.
13. Annual payment under franchise by X Street Railway Company.
14. Fees from town clerk turned in.
15. Rent of city dock to steam-boat company.
16. Assessments on members of police force for pension fund.
17. Received from B balance of cost of extra sewer connection (see 10).
18. Newsstand privilege in town hall.
19. Proceeds of paving bonds sold at 110.
20. State grant for up-keep of portion of state highway included within the town limits.

Re-state the above items to show the true revenue of the town, with titles of proper accounts to be credited, and indicate how the other items should be shown or treated.

No. 6. (10 points):

State in detail the proper method of verifying securities owned which are carried as quick assets.

No. 7. (10 points):

In the audit of the books and accounts of the U. S. Corporation for the fiscal year ending June 30, 1922, you find that the cashbook consists of a loose-leaf record, typewritten in duplicate. The original sheets which comprise the treasurer's records are given to you for purposes of the audit. The duplicate payment sheets go to the accounts payable department, and the duplicate receivable sheets to the accounts receivable department.

State specifically how you would ascertain in your verification of cash that these cash records were real.

No. 8. (10 points):

The A. B. Land Co. buys a tract of land and makes improvements thereon (streets, side-walks, water and sewer connections, etc.) at a total cost of $50,000, its entire capital. To keep the property restricted it does not sell its lots but disposes of them all in its first year on ninety-nine year leases for flat sums aggregating $100,000, and a nominal rental of $10 a year per lot to cover water and other service. Current expenses just consumed the nominal rentals for the first year. Then the company declares a dividend to its stockholders of $90,000. and its balance-sheet at the close of the first year shows

Assets		Liabilities	
Land and improvements	$50,000	Capital stock	$50,000
Cash	10,000	Surplus	10,000
	$60,000		$60,000

Is this correct accounting procedure or not? Give reasons.

No. 9. (10 points):

On December 31, 1921, Mr. A was living with his wife and two children under 18; his net income for 1921 was $6,000. Mr. B was divorced from his wife in November, 1921, but he still maintained his home and supported his two children there, both under 18; his net income was $2,800. Mr. C was living with his wife and one child at home, and had another child away at a boarding-school, both children under 18. His net income was $3,000.

State the amounts of credits for personal and dependent exemption to which A, B, and C are respectively entitled in their income-tax returns.

No. 10. (10 points):

A purchased property in 1910 at a cost of $10,000. Its fair market value on March 31, 1913, was $3,000. He sold it in 1921 for $5,000.

What amount, if any, of gain or loss should A return for income tax? Give reason.

Examination in Accounting Theory and Practice

PART I

NOVEMBER 16, 1922, 1 P. M. to 6 P. M.

The candidate must answer the first three questions and two other questions.

No. 1. (23 points):

Following is the balance-sheet of the Olympic Manufacturing Company at August 31, 1922:

ASSETS				
Fixed Assets:				
Land and buildings:				
Land		$8,000.00		
Buildings	$30,000.00			
Less reserve for depreciation	6,000.00	24,000.00		
			$32,000.00	
Plant and equipment			24,500.00	
Goodwill			10,000.00	
				$66,500.00
Permanent Investments:				
Stock of the Oak Knoll Co. (80%)			45,000.00	
Advances to Oak Knoll Company (Unsecured)			15,000.00	
				$60,000.00
Current Assets:				
Inventories:				
Finished goods		12,000.00		
Goods in process		7,500.00		
Raw material		5,000.00		
			24,500.00	
Notes receivable			6,000.00	
Accrued interest on notes receivable			90.00	
Accounts receivable		28,400.00		
Less reserve for bad debts		250.00		
			28,150.00	
Cash			625.00	
				$59,365.00
Deferred Charges:				
Manufacturing supplies			165.00	
Prepaid advertising			300.00	
				465.00
				$186,330.00

LIABILITIES

Fixed Liabilities:			
Mortgage on land & buildings			$15,000.00
Current Liabilities:			
Notes payable		$40,000.00	
Accounts payable		35,000.00	
Accrued wages		700.00	
Accrued taxes		140.00	
Accrued interest on mortgage		150.00	
Accrued interest on notes payable		250.00	
			$76,240.00
Capital:			
Capital stock		50,000.00	
Surplus		35,090.00	
Reserve for working capital		10,000.00	
			$95,090.00
			$186,330.00

The Oak Knoll Company has gone into the hands of a receiver with prospects of paying its creditors at the rate of thirty cents on the dollar. The Olympic Manufacturing Company is thereby embarrassed financially, and its creditors call for a statement of affairs and a deficiency account, which you are asked to prepare.

ADDITIONAL INFORMATION AS TO ASSET VALUES, ETC.

		Estimated Value
Land		$10,000.00
Buildings		17,500.00
Plant and equipment		15,000.00
Finished goods		9,000.00
Goods in process		3,000.00
Raw material		4,500.00
Notes receivable and interest—all good		
Accounts receivable		
Good	$13,000.00	13,000.00
Doubtful	8,000.00	5,000.00
Bad	7,400.00	
	28,400.00	
Cash		625.00
Deferred charges—no value.		

The notes-payable account represents four notes, as follows:

Note for $3,000.00 with accrued interest of $50.00 secured by notes receivable of $4,000.00 on which $40.00 interest has accrued.

Note for $25,000.00 with accrued interest of $200.00. The holder of this note also holds the Oak Knoll stock as collateral.

Note for $8,000.00 secured by notes receivable of $1,000.00 on which $30.00 interest has accrued, and by warehouse receipts for raw material having a book value of $4,000.00 and an estimated realizable value of $3,800.00.

Note for $4,000.00 unsecured.

No. 2. (16 points):

Following are the balance-sheets of the Alhambra Trading Company at stated dates:

Assets	Dec. 31 1920	Dec. 31 1921
Land	$3,000.00	$4,000.00
Building	6,000.00	7,500.00
Delivery equipment	900.00	700.00
Store fixtures	1,200.00	1,250.00
Merchandise inventory	7,500.00	8,650.00
Accounts receivable	3,200.00	2,400.00
Notes receivable	800.00	750.00
Cash	675.00	405.00
	$23,275.00	$25,655.00
Liabilities		
Mortgage notes	$4,000.00	$3,000.00
Accounts payable	7,320.00	6,135.00
Reserve for depreciation—building	600.00	750.00
Capital stock	10,000.00	12,000.00
Surplus	1,355.00	3,770.00
	$23,275.00	$25,655.00

The statement of surplus appears as follows:

Balance—December 31, 1920		....	$1,355.00
Add:	Write up of land	....	1,000.00
	Net profit for the year	....	2,915.00
	Total		$5,270.00
Deduct:	Stock dividend	$500.00	
	Cash dividend	1,000.00	$1,500.00
Balance: December 31, 1921			$3,770.00

Depreciation was provided during the year as follows:

Building (credited to reserve)	$400.00
Delivery equipment (asset written down)	300.00
Store fixtures (asset written down)	200.00

A new roof was put on the building and other extraordinary repairs were made at a total cost of $250.00 and charged to the reserve for depreciation.

The mortgage notes are due serially, in annual amounts of $1,000.00.

Prepare a statement of application of funds.

No. 3. (17 points):

A and B entered into partnership on April 1, 1922, investing $20,000 and $10,000 respectively. It was agreed that each partner should have the privilege of withdrawing $200.00 per month; these amounts were to be considered salaries and treated as an expense of the business. If either partner drew more than $200.00 during any month the excess over $200.00 was to be charged to his capital account at the end of the month. If he drew less than $200.00 the difference was to be credited to his capital account. Profits were to be divided in the average capital ratio.

At September 30, 1922, the business was sold for $30,000 and you are asked to determine how this money should be divided. The capital accounts of the two partners appear as follows:

"A"

May 31	$ 50.00	April 1	$20,000.00
August 31	200.00	April 30	100.00
		June 30	200.00
		July 31	150.00
		September 30	50.00

"B"

April 30	$100.00	April 1	$10,000.00
May 31	150.00	July 31	100.00
June 30	200.00		
August 31	100.00		
September 30	75.00		

All entries in the capital accounts after April 1st represent differences between monthly salaries and actual monthly drawings.

No. 4. (22 points):

On January 1, 1922, a concern dealing in a single commodity, had an inventory of merchandise which cost $20,000.00. The goods were marked to sell at 125% of cost and all subsequent purchases during the six months ending June 30, 1922, were marked at the same rate.

The selling price of the inventory at June 30, 1922, was $24,000.00. Purchases and sales by months were:

	Purchases (cost)	Sales (selling price)
January	$8,000.00	$9,000.00
February	9,000.00	9,500.00
March	14,000.00	12,000.00
April	16,000.00	18,000.00
May	13,000.00	22,000.00
June	10,000.00	18,000.00

Compute estimated inventories at cost price at the end of each of the six months.

Compute the rate of turnover for the six months' period using,

(a) the January 1st and June 30th inventories.
(b) all of the inventories.

State which method gives the more accurate results.

No. 5. (22 points):

A corporation issues $500,000 of stock and $300,000 of bonds, and purchases a mine at a cost of $400,000. Careful estimates indicate that the mine contains 2,000,000 tons of ore, and the operating charge for depletion is computed on the basis of this tonnage, calculated at 20 cents per ton.

The officers of the company, after considering the possibility of an over-estimate in the tonnage, decide to create an additional reserve at the rate of five cents per ton mined. This conservative provision is not to affect the operating profits.

The agreement with the bondholders provides that annual sinking-fund contributions shall be made at the rate of thirty cents per ton mined during the year, and that a sinking fund reserve shall be created on the same basis.

At the close of the first year, and before making any of the reserve provisions indicated above, the profit-and-loss account shows a credit balance of $165,000. No consideration has been given to depletion. The quantities mined may be tabulated as follows:

Sold	200,000	tons
Inventory	40,000	"
Used in operations	10,000	"
Total mined	250,000	"

Contributions totaling $50,000 have been made to the sinking-fund trustee.

Make journal entries to close the profit-and-loss account, and to set up the reserves.

Set out all known facts in balance-sheet form.

State what amount is legally available for dividends.

ACTUARIAL

No. 6. (22 points):

Fred Humiston left a will in which he directed that the income from his estate should be paid to his widow and that the principal should be held in trust for a grandson. He also stipulated that the corpus should not be impaired by the purchase of bonds by the trustee at a premium and directed that such premiums paid by the trustee should be amortized.

Humiston died on April 1, 1920. The estate contained five $1,000 bonds of the XYZ Company, bearing 6% interest payable July 1st and January 1st. The bonds were due on July 1, 1925, and were inventoried at 104½.

On July 1, 1920, the trustee purchased five more of the same bonds on a 5% basis.

Compute the price paid by the trustee for the bonds. The present value of $1 due 10 periods hence at 2½% is $.781198402.

Prepare a statement showing the income payable to the widow on July 1, 1920, January 1, 1921, and July 1, 1921.

Examination in Commercial Law

NOVEMBER 17, 1922, 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):

Is the following a negotiable instrument?

"New York, June 1, 1921.

I hereby certify that James K. Sloane has deposited with me Five Hundred Dollars which I promise to pay to his order on demand with interest from date on the return to me of this instrument and of my guarantee for the note for Five Hundred Dollars dated June 1, 1921, made by said James K. Sloane to Thomas J. Smith.

(Signed) Edward F. Wilson".

No. 2. (10 points):

How would you protect yourself against the danger involved in the loss of a negotiable instrument endorsed in blank received by you in due course of business?

No. 3. (10 points):

What is a "notice of dishonor" and what is its purpose?

No. 4. (10 points):

What is an "accommodation party" to a negotiable instrument and what is his liability?

CONTRACTS

Answer two of the following three questions:

No. 5. (10 points):

A leased to B a wooden structure in the city of Rochester, New York, for a period of ten years. The lease contained an agreement on the part of A that in case the structure burned during the term of the lease, A would rebuild it for B's occupancy with all possible diligence. After about three years the building was destroyed by fire. Meanwhile the city, by an ordinance, had extended its fire limits so as to embrace the property in question, the erection of wooden buildings being prohibited. B sued A for his failure and refusal to rebuild the structure. Could he recover?

No. 6. (10 points):

What general rule of contract law is embraced in the term "caveat emptor"?

No. 7. (10 points):

Under the uniform sales act, what are the remedies of the seller when the buyer refuses to accept the goods contracted to be sold?

PARTNERSHIP

Answer one of the following two questions:

No. 8. (10 points):

A and B were partners in the hardware business. B, because of illness, was prevented from attending business for a period of several months, thereby throwing the burden of conducting the affairs of the copartnership entirely upon A. After

B's recovery A demanded compensation at the rate of $40.00 per week for the extra work which he was compelled to do. Upon B's refusal to comply with the demand the partnership was ended and A sought to recover the amount demanded by suit. Could he succeed?

No. 9. (10 points):

Smith, Howe & Rogers were partners engaged in the dry-goods business. Smith and Rogers advocated the establishment in their store of a department for the sale of groceries and similar articles. Howe opposed the plan. Could Smith and Rogers overrule Howe's objection and, as the majority partners, proceed with their plan?

CORPORATIONS

Answer both the following questions:

No. 10. (10 points):

The A. B. Corporation in the year 1921 made net profits of $50,000. or sufficient for a dividend of five per cent. on its stock. No dividend was declared however, and X, a stockholder, sued the corporation for a sum equivalent to five per cent. on the stock held by him. Can he recover?

No. 11. (10 points):

How are shares of stock of a corporation transferred?

BANKRUPTCY

Answer one of the following two questions:

No. 12. (10 points):

What is the object of the bankruptcy law?

No. 13. (10 points):

What is a "composition" in bankrutpcy?

FEDERAL INCOME TAX

Answer the following question:

No. 14. (10 points):

What is the basis for determining the gain or loss from a sale of property acquired prior to March 1, 1913?

Examination in Accounting Theory and Practice

PART II.

NOVEMBER 17, 1922, 1 P. M. to 6 P. M.

The candidate must answer all the following questions:

No. 1. (27 points):

The XYZ Chemical Company manufactures one main product only, known as "Saltero", and a by-product, known as "Scrapto."

From the following information, calculate the profit per ton (2,000 lbs.) of Saltero on every ton sold:

Saltero sells for $600.00 per ton. The selling and administration charges are 20% of the selling price. This product is made from three ingredients, N, O and P, in the following proportions and at the following costs:

N	20%	costs	$100.	per	ton
O	30%	"	50.	"	"
P	50%	"	30.	"	"

Handling and storage charges amount to 10% of the cost of each ingredient.

The plant is divided into five manufacturing departments, of which A, B, C and D are engaged in the manufacturing of Saltero and E in the recovery of the by-product, Scrapto.

The following table shows the cost of direct labor per ton of product handled and the percentage of department factory expense to the direct labor:

Department	Direct labor per ton	Percentage of departmental factory expense to direct labor
A Mixing	$25.00	75%
B Furnaces	12.50	300%
C Washing & drying.......	15.00	100%
D Grinding & packing.......	50.00	50%

General factory expenses that cannot be charged to any one department amount to 50% of the total direct labor.

In department B there is a yield of only 75% of Saltero from the tonnage of the ingredients mixed; the other 25% is treated in department E and one-half of this 25% is recovered as the by-product, Scrapto, the other half being entirely waste.

A net profit of $40.00 per ton is made on the sale of Scrapto after all expenses of every kind are charged against it. No charge is made against Scrapto for the raw material from which it is recovered.

No. 2. (30 points):

On January 1, 1915, a company issued $10,000,000, 10 year, 6% convertible bonds, interest payable semi-annually on July 1st and January 1st. The bonds are convertible at 105 and accrued interest into capital stock at par (100) and accrued dividends on any February 1st or August 1st after 1918, and balances are to be adjusted in cash. The stock pays regular quarterly dividends of 2% on January 15th, April 15th, July 15th and October 15th, respectively.

The bonds when issued were underwritten at 96 by A, B & Co., bankers, and legal, printing and other expenses were incurred, incident to the issue of the bonds, amounting to $100,000, which was set up on the books, together with the bond discount, as a deferred charge to be amortized over the life of the bonds. There is a provision in the trust deed giving the company the option of calling for redemption at 105, on any interest date after 1918, any part of the bonds then outstanding (in multiples of $100,000) with the usual requirements as to due notice, etc.

On February 1, 1919, $3,000,000. bonds were converted
On August 1, 1919, $2,000,000. bonds were converted
On February 1, 1920, $1,000,000. bonds were converted
On March 1, 1920, $1,000,000. bonds were bought in the open market at 104 and accrued interest and thereupon cancelled.

During April, 1920, $1,000,000 bonds were called for redemption on July 1, 1920, but only $990,000 of the called bonds were delivered for redemption on that date and the balance of $10,000 was still outstanding at the close of 1921. The July 1, 1920, coupons were detached from the called bonds redeemed and were separately paid.

(a) Formulate journal entries reflecting the above described transactions with respect to the issue, conversion (February 1, 1919, transactions only), purchase and redemption of the bonds. Provide for a "bondholders' conversion clearing" account to clear the conversion transactions and give effect, by journal entry, to the cash liquidation of the balances incident to those transactions. Also provide for the following accounts:

"Accrued interest on convertible bonds"
"Accrued dividends on capital stock"
"Premium on convertible bonds"

It is not desired that you set up the above suggested accounts in ledger form but merely provide for them in your journal entries; make a brief explanation of each journal entry, commencing with the words, "To record the...."

(b) State the balance in "unamortized debt discount and expense" at the close of 1918, 1919, 1920 and 1921, amplified by a summary showing how you have arrived at your answers and giving consideration to the propriety of carrying, as a deferred charge, that portion of "unamortized debt discount and expense" applicable to called bonds unredeemed. Prove the balance at the close of 1921 by an independent computation.

(c) State whether interest should or should not be accrued after July 1, 1920, on the $10,000 called but unredeemed bonds. Would your answer be the same with respect to interest on matured bonds outstanding?

(d) State when and how you would dispose of the "accrued dividends on capital stock" account and the "premium on convertible bonds" account.

Note: In answering the above questions, take cognizance of years, months and half-months and no other periods of time.

No. 3. (10 points):

Under what conditions is it impossible to set up on the general books, before the stock books are closed, the exact amount of dividends declared? Assuming these same conditions, is the maximum amount payable under the resolution known before the stock books are closed?

No. 4. (10 points):

In auditing the accounts of the M & N Corporation for the period ended September 30, 1922, you find the following items:

(A)—Bonds maturing November 1, 1922	$5,000,000
(B)—Cash on deposit with trustee to meet maturing bonds as above	5,000,000
(C)—Bonds maturing April 1, 1940	7,500,000
(D)—Outstanding notes of $300,000 each, given under an agreement to purchase for $2,000,000 the land upon which the corporation's plants are erected. These notes are of equal amount, maturing serially on February 1st of each year	900,000
(E)—A claim against the company for damages which, in the opinion of the corporation's attorney, will be settled for $35,000	50,000

State how you would show the foregoing items on the balance-sheet to which you would certify as of September 30 (October 1), 1922.

No. 5. (23 points):

You are requested to make an audit of a concern which keeps its books on a cash basis and you receive instructions to prepare a revised statement of profit-and-loss and surplus for the year ended December 31, 1921, and a revised balance-sheet as at January 1, 1922, upon an accrued basis. The books of the company were closed at the end of each year and had been closed for 1921 prior to the commencement of your audit.

What entries would be necessary to bring the books into conformity with your statements, so far as the following insurance account is concerned?

What would be the amount of insurance shown on your profit-and-loss account and what items, taken from this account, would appear on the balance-sheet?

INSURANCE ACCOUNT

1920	DEBITS		
July 2	Premium on fire insurance policy (building) covering period from 8/1/20 to 7/31/22	$2,400.00	
Aug. 15	Premium on fire insurance policy on stock of goods — period from 8/1/20 to 7/31/21	1,800.00	
Sept. 1	Premiums on employees' fidelity bonds—period from 8/1/20 to 7/31/21........	3,000.00	
Oct. 25	Shortage of R. Jones to be reimbursed by Fidelity Insurance Company	900.00	$8,100.00

1921				
Feb.	8	Premium on liability insurance on trucks and salesmen's autos—8/1/20 to 7/31/21	$4,500.00	
Mar.	31	Fire insurance on new building during construction—3/31/21 to 7/31/21......	7,500.00	
Apr.	5	Additional premium on fire insurance (building) due to increased valuation—4/15/21 to 7/31/21	250.00	
July	1	Premium on fire insurance policy (building) 7/1/21 to 6/30/22, covering new building and increased valuation of old building	1,500.00	
Aug.	1	Premium on fire insurance policy on stock of goods—period 8/1/21 to 7/31/22....	1,400.00	
Aug.	1	Premiums on employees' fidelity bonds—8/1/21 to 7/31/22....................	3,000.00	
Dec.	15	Defalcation of P. Smith to be reimbursed by Fidelity Insurance Company in 1922	2,000.00	$20,150.00

Credits

1920				
Dec.	1	Refund due to reduction in rate on fire insurance on building—period 12/1/20 to 7/31/22	$ 200.00	
Dec.	31	Transfer to profit-and-loss to close out account	7,900.00	$8,100.00
1921				
Apr.	15	Payment by Fidelity Insurance Company, reimbursement for loss — R. Jones — 10/25/20	$ 900.00	
Dec.	31	Transfer to profit-and-loss to close out account	19,250.00	$20,150.00

1921

Dec. 31 Premium on liability insurance on trucks and autos — period 8/1/21 to 7/31/22, amounting to $4,500.00—had not been paid.