Journal of Accountancy

Volume 32 | Issue 6 Article 1

12-1921

American Institute of Accountants. Examinations, November 15-16, 1921

American Institute of Accountants. Board of Examiners

The JOURNAL *of* ACCOUNTANCY

Official Organ of the AMERICAN INSTITUTE OF ACCOUNTANTS

Vol. 32 DECEMBER, 1921 No. 6

American Institute of Accountants

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 15, 1921, 9 A. M. to 12:30 P. M.

Answer all the following questions:

1. Name and describe the principal groups in which the financial transactions of a municipality are summarized in its annual statement.
2. In auditing the books of the Moving Picture Producing Company you find the total balance due from customers as shown by the controlling account in the general ledger is less than half the total debit balances shown by the list you have taken from the customers' ledger. What does this indicate? How should the facts be shown on the balance-sheet?
3. What are the principal objects for which auditors' working-sheets are made and preserved?
4. Entering upon the audit of the A. B. C. Co. you are handed the general books of account. You learn that the company has several departments and practically owns several subsidiary companies. State what influence this knowledge would have upon you in respect to proving the accuracy of the trial balance given to you, what steps you would take, and why.
5. State what you conceive to be the legal duties, responsibilities and liabilities of the professional auditor.
6. Describe a good method of keeping a detailed record of (a) salaries paid, (b) wages paid.

7. State what particular matters should be ascertained and verified in auditing the revenue and expense accounts of
   (a) Shipping companies;
   (b) Taxicab companies.
8. One of the larger church denominations in the United States now requires the annual statements of its parishes to be audited by a certified public accountant. Bearing in mind that in the majority of parishes the church treasurer is custodian of all the church funds, disburses them practically at will and keeps the church books himself, how would you proceed to audit his annual report?
9. State in detail how you would proceed to audit the accounts of a bank.
10. In what circumstances should paid cheques be treated as vouchers? Are cheques always proper and sufficient vouchers for purchases? Give reasons.

Examination in Accounting Theory and Practice

PART I.

NOVEMBER 15, 1921, 1 P. M. to 6 P. M.

Answer any two of the first three problems:

1. At December 31, 1919, after closing the books, a balance-sheet of the A Company was submitted to a meeting of the board of directors. The statement showed an authorized capitalization of $100,000.00, divided into 1,000 shares, of which 800 had been issued at par value, and a surplus account of $23,000.00. The directors declared a 7 per cent. dividend, payable February 1st to stockholders of record January 15th.

   Immediately following the meeting on December 31st, the B Company purchased for cash 90 per cent. of the outstanding stock of the A Company at 130, and the stock was registered in the name of the B Company on the A Company's books.

   The dividend was paid by Company A on February 1st.

   On June 30, 1920, the A Company closed its books and found that it had made a profit of $12,000.00 for the half year.

On July 1, 1920, the directors of the A Company authorized the sale of the unissued stock at 120, to be subscribed and paid for by the stockholders at that date in amounts proportionate to their present holdings. All of the stock was accordingly issued and paid for at that date.

A dividend of 4 per cent. was declared on July 3, 1920, and paid on July 15th. The dividend was applicable to the entire stock issue.

The books of Company A were closed at December 31, 1920, and the profits for the half year were found to be $13,500.00.

The B Company took up its proportion of the subsidiary's earnings on June 30th and December 31st, respectively, before closing its own books. Dividends declared after the acquisition of the stock were treated as a reduction of the investment account.

(a) You are asked to prepare journal entries for these transactions as they would appear on the books of Company B.

Consolidated balance-sheets were prepared on:

December 31, 1919, immediately following the first stock purchase;

July 1, 1920, immediately following the second stock purchase;

December 31, 1920.

(b) State as to each consolidated balance-sheet:

(1) The amount of goodwill appearing therein, assuming that the books of Company A showed a goodwill account of $10,000.00 at each date, and that there was no goodwill account on Company B's books.

(2) The minority interest.

(3) The consolidated surplus, assuming that Company B's books showed surplus of

$46,000.00 at December 31, 1919.
57,000.00 at July 1, 1920.
68,000.00 at December 31, 1920.

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2. The M Company of New York started in business on January 1, 1920, manufacturing a patented article. It entered into a contract with the S Company of Chicago. This contract contained the following provisions:

(a) The S Company shall have the exclusive right to sell the M Company's product.

(b) All goods manufactured by the M Company during the month shall be shipped to the S Company on or before the last day of the month.

(c) All goods shall be shipped on consignment and be billed to the S Company at 120 per cent. of the estimated cost of manufacture.

(d) Cost of manufacture shall include all material, labor and manufacturing expenses, to which shall be added 6 per cent. interest on the M Company's investment in plant assets used in manufacturing.

(e) The S Company shall remit as an advance 60 per cent. of the billed price of the goods on receipt thereof. The remainder of the billed price shall be remitted as soon as the goods are sold. The S Company may sell at any price it chooses, above the billed price, the excess being the profit of the S Company.

(f) Records shall be kept on the M Company's books as follows:

Consignments shall be charged to "S Company, consignee," and credited to "Consignments outward" at billed prices (i.e., estimated cost including interest, plus 20 per cent.).

Advances shall be credited to "S Company, advances."

Sales reported by the S Company shall be recorded as follows:

Debit "S Company" and credit "Sales" at billed prices;

Transfer from "S Company, advances" to "S Company" the advances applicable to goods sold;

Credit "S Company" with remittances in final settlement.

(g) At the end of the year, the M Company shall ascertain the true manufacturing cost to which has been added 6 per cent. interest on plant assets, as well as 20 per cent. of the total so obtained to determine the adjusted bill prices, and shall make the following adjustments:

Raise or lower the balances of the "S Company, consignee" and the "Consignments outward" accounts to the adjusted billed price of goods unsold.

Adjust the "Advances" account so that its balance shall be 60 per cent. of the adjusted billed price of goods received by the S Company and still unsold, offsetting entry to be made in the "S Company" account.

Adjust the sales account and the "S Company" account for any discrepancy between the estimated and adjusted billed prices of goods sold.

Any balance in the "S Company" account, after making these adjustments, shall be due immediately by or to the M Company.

At December 31, 1920, the M Company's trial balance included the following balances:

Manufacturing account (after closing thereto all manufacturing accounts as well as interest on plant assets)	$180,000	
Interest on plant assets		$ 3,000
S Company, consignee	240,000	
Consignments outward (total for the year)		240,000
S Company advances (advances received less those applied in settlement for sales)		18,000
S Company (account balances and is closed)		
Sales		170,000

The M Company has shipped all goods manufactured.

The S Company has paid all advances on goods received and made settlement at estimated billed prices for all goods sold.

Make the adjusting entries required in (g) above.

State the gross profit of the M Company on sales made by the S Company.

Determine the inventory of unsold goods at true manufacturing cost.

ACTUARIAL (Optional)

3. The federal estate tax imposes "a tax equal to the sum of the following percentages of the value of the net estate:

"1 per centum of the amount of the net estate not in excess of $50,000;

"2 per centum of the amount by which the net estate exceeds $50,000 and does not exceed $150,000;

"3 per centum of the amount by which the net estate exceeds $150,000 and does not exceed $250,000."

The rates are further graduated up to 25 per cent.

The net estate is computed by determining the gross estate and making deductions for liabilities, funeral and administration expenses and an exemption for $50,000.

The regulations provide that when the decedent was entitled to receive an annuity of a definite amount during a specified number of years and the right constitutes an asset of his estate, the present worth of the annuity at the time of the decedent's death must be computed on a four per cent. basis and be included in the gross estate.

The regulations further provide that when the decedent possessed a remainder interest in property subject to an estate for a term of years, and such interest constituted an asset of his estate, the present worth of the remainder interest at the time of his death must be computed on a four per cent. basis and be included in the gross estate.

George Smith died on January 1, 1921. His estate consisted of:

Sundry real and personal property valued at $215,000.00;

An annuity of $10,000 per annum, payable at December 31st for a period of twenty years, the tenth payment of which was received on December 31, 1920;

A remainder interest in a fund of $40,000, subject to an estate for fifteen years. This estate will terminate on December 31, 1930.

Liabilities and expenses totaled $35,000.

Present value at 4 per cent. of one dollar due 10 years hence = .675564.

Compute the estate tax.

Answer all the following questions:

4. It has been recently urged that if the replacement cost of fixed assets is greatly in excess of their cost, depreciation should be computed on replacement values, so that the reserve for depreciation will be equal to the replacement value when the time arrives for abandoning the old property and acquiring new. It is contended that if this procedure is followed the company will have sufficient cash to make replacements without impairing the capital. State your opinion in regard to this matter.

5. A corporation has an issue of $100,000 of cumulative preferred stock bearing 6 per cent. dividends. No dividends have been paid for two years. How would you disclose the facts in a balance-sheet dated December 31, 1920, if
   (a) A dividend of $12,000 on the preferred stock was declared on December 27th, payable January 15th, and there is a remaining surplus of $5,000?
   (b) No dividends have been declared and there is a surplus of $17,000?
   (c) No dividends have been declared and there is a surplus of $4,000?
   (d) No dividends have been declared and there is a deficit of $7,000?

6. At December 31, 1920, a company priced its inventory at the market value at that date, which was considerably less than cost. At a meeting of the board of directors, held prior to closing the books for 1920, the probability of a further market decline in 1921 was discussed, and it was decided that some provision should be made for this contingency. State whether you think such a provision is necessary or not; how you would make such provision; and what the effect would be on the profits for 1920.

Examination in Commercial Law

NOVEMBER 16, 1921, 9 A. M. to 12.30 P. M.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions.

1. A made the following promissory note to B:

   "January 31, 1909. I, A, hereby acknowledge my indebtedness to B for services rendered by him for which I promise to pay to B the sum of ten thousand dollars; and in the event of my death I direct the payment of this sum out of the funds of my estate. (Signed) A."

   In 1911, before A's death, B made demand for payment, payment was refused and suit brought. Could B recover?

2. G, holding himself out as the representative of one Lieut. X, head of a navy tuberculosis camp, obtained from A a cheque for $100.00 to the order of Lieut. X as a contribution to the camp fund. G endorsed the cheque with the name "Lieut. X" and obtained the cash thereon from B. A later ascertained that there was no such person as Lieut. X and that there was no such camp fund as was alleged by G. A therefore directed his bank to refuse payment of the cheque when presented. This direction the bank carried out. B thereupon brought action on the cheque to recover from A. Could he succeed?
3. What is the effect when a holder of a cheque procures its certification by the bank on which it is drawn?
4. A opened an account with the X Trust Company in November, 1919, by a deposit of $75,000. On December 29, 1919, the bank paid out of the account $5,000 on a cheque on which A's signature had been forged. On January 2, 1920, A receipted for a statement of the account by the bank and for 18 vouchers or canceled cheques attached thereto, one of which was the forged cheque. As A customarily delegated to his secretary the work of examining statements and keeping the cheque-book, the forgery was not immediately discovered. In March, 1921, the forgery was discovered by A through the report by the bank of an overdraft of the account. The bank refused to make good on the forged cheque and A sued. Did the bank have any defense?

CONTRACTS

Answer two of the following three questions:

5. Under the uniform sales law what remedies may the buyer invoke, at his election, for breach of warranty?
6. When is a contract said to be entire? When separable?
7. On August 11, 1921, C. N. Russell bargained with John McCarty for the purchase of 400 bushels of corn, being part of about 4,000 bushels then owned by McCarty and stored in a certain grain elevator. The price was agreed upon, paid by Russell to McCarty and receipt therefor given. In addition McCarty gave Russell an order directed to the elevator company directing it to deliver 400 bushels of corn to Russell. Russell gave the order to his

agent with directions to deliver it to the captain of a certain steamship expected to arrive the next day to take the 400 bushels of corn on board. The next morning before the arrival of the steamship and the presentation of the order to the elevator company, the elevator and contents were destroyed by fire. Russell afterwards brought suit to recover the purchase price from McCarty. What would be your decision on such suit?

PARTNERSHIP

Answer one of the following two questions:

8. In May, 1921, the firm of Baxter, Brady & Childs made a promissory note to A. W. Voorhis. Childs, a member of the firm, died in July, 1921, and in September, 1921, the note being due and unpaid, Voorhis brought action against Baxter, Brady and the executor of the deceased partner Childs. Did the executor have any defense to the action?
9. In January, 1918, A, B, and C entered into a partnership agreement for the purpose of bringing about the sale on a commission basis of a large manufacturing plant, each of the three to share equally in any commissions earned and no time limit being expressed in the agreement. A having the closest personal relations with the owners of the plant, entered into negotiations which continued with incidental assistance from B and C through 1918, 1919 and part of 1920. Due to differences of opinion among the owners of the plant the negotiations were not successful, and in March, 1920, the owners wrote to A that they had decided not to entertain a proposition for sale at that time. B and C, upon considering this letter, wrote A that, as they deemed the negotiations closed, the agreement of January, 1918, between the three must be considered terminated. A then wrote to B and C stating that before terminating the agreement he desired a further conference between the three. To this letter neither B nor C replied. In August, 1920, B and C started negotiations, brought about a sale of the plant and received as commissions the sum of $60,000. A thereupon sued B and C under the agreement of January, 1918, for a partnership accounting and for one-third of the commissions earned. Could A recover?

CORPORATIONS

Answer both the following questions:

10. You render services connected with the reorganization of a corporation. These services are fairly and reasonably worth $5,000, and you render a bill to the reorganized corporation for that amount. At the request of the directors, you accept instead of cash 100 shares of the stock of the corporation, the shares being of the par value of $100 each. (a) Is the issuance of the stock by the corporation proper? (b) Do you incur any liability by your acceptance?
11. A resolution of the X Corporation provided that all cheques should be signed by the treasurer and countersigned by the president or a director. The treasurer by a series of ingenious excuses obtained the countersignature by certain of the directors of various cheques payable to "cash" or to "bearer." These cheques he misappropriated and turned to his own personal use. The corporation upon discovery of the misappropriation demanded that the directors involved make good the amounts lost. Could the directors be compelled to comply with the demand?

BANKRUPTCY

Answer the following question:

12. (a) What is meant by the term "voluntary bankrupt"? (b) Who may become a voluntary bankrupt?

FEDERAL INCOME TAX

Answer the following question:

13. What is meant by the term "personal service corporation" and how are the earnings of such corporations taxed?

Examination in Accounting Theory and Practice
PART II.

NOVEMBER 16, 1921, 1 P. M. to 6 P. M.

Answer all the following questions:

1. Companies A, B and C were all organized during the year 1918, A and B being engaged in manufacturing, while C acted as selling agent for B at a distant point. The capital stock of C is owned entirely by B, having been

acquired at the organization of C and paid for in cash at par. The capital stock of A and B is owned entirely by John Doe, Richard Roe and Mary Roe in equal proportions (one-third in each company). No dividends were paid by either of the three companies during 1920. It may be assumed that the miscellaneous investments shown on the balance-sheet of the one company and the gross assets of all three corporations remained the same during the year 1920.

Below are shown the balance-sheets of the three companies as at December 31, 1919:

BALANCE-SHEET—COMPANY A—DECEMBER 31, 1919

Assets		Liabilities	
Capital assets:		Capital stock	$150,000.00
Real estate, buildings and machinery (less reserve for depreciation)	$100,000.00	Current liabilities:	
Current assets:		Notes and accounts payable	50,000.00
Inventory of raw and finished materials	50,000.00	Surplus	30,000.00
Accounts receivable	15,000.00		
Cash	10,000.00		
Liberty bonds (fourth 4¼s)	50,000.00		
Deferred charges:			
Prepaid insurance and taxes	5,000.00		
	$230,000.00		$230,000.00

BALANCE-SHEET—COMPANY B—DECEMBER 31, 1919

Assets		Liabilities	
Capital assets:		Capital stock	$250,000.00
Real estate, buildings and machinery (less reserve for depreciation)	$200,000.00	Current liabilities:	
Current assets:		Notes payable	50,000.00
Inventory of raw and finished materials	75,000.00	Accounts payable	10,000.00
Accounts receivable	15,000.00	Surplus	65,000.00
Cash	5,000.00		
Investments:			
In Company C (at cost)	25,000.00		
Miscellaneous stocks (domestic)	50,000.00		
Deferred charges:			
Prepaid insurance and taxes	5,000.00		
	$375,000.00		$375,000.00

BALANCE-SHEET—COMPANY C—DECEMBER 31, 1919

Assets		Liabilities	
Current assets:		Capital stock	$25,000.00
Inventory	$35,000.00	Current liabilities:	
Cash	9,500.00	Accounts payable (to Company B)	10,000.00
Deferred charges:		Miscellaneous	5,000.00
Prepaid taxes	500.00	Surplus	5,000.00
	$45,000.00		$45,000.00

The net income for the year 1920, carried to surplus (per books), was as follows:

Company A	$20,000.00
" B	25,000.00
" C	5,000.00
	$50,000.00

The following items appear in the respective profit-and-loss accounts for the year 1920:

	Company A	*Company B*	*Company C*
Income and profits taxes paid for 1919	$1,500.00	$2,000.00	
Interest accrued on Liberty bonds	2,125.00		
Interest paid on indebtedness incurred to carry Liberty bonds	3,000.00		
Capital additions charged to profit and loss	1,000.00	750.00	
Dividends received from miscellaneous investments		3,000.00	

Prepare balance-sheet as at December 31, 1919, for tax purposes, and also statements showing (1) the determination of the net taxable income of the group, (2) calculation of invested capital and (3) calculation of income and profits taxes payable by the group for the year 1920.

2. "A" (a silk mill in New Jersey), "B" (salesman representing "C") and "C" (commercial bankers in New York) entered into an agreement to manufacture and sell a number of pieces of special quality silk, each to share one-third of the profit of the "venture."

"C" was to furnish the raw material, pay the dyeing and finishing bills and (having control of the sales) to deduct from the accounts of sales certain percentages for discount and commission and charge interest on advances. "A" was to weave the materials and charge the woven goods at cost. The difference between the value of the raw material and the woven goods (manipulation) was also to be paid by "C." All woven goods were to be transferred immediately upon completion to "C" (New York). There was no work in process at end of year.

It was desired to know the result of the "venture" as at June 30, 1921, the record of transactions relative thereto at that date being as follows:

Raw silk purchased by "C" and sent to mill ("A")	$51,814.65
Weaving (manipulation)	14,201.28
(of which $12,811.31 has been paid by "C" to "A")	
Dyeing and finishing bills paid by "C"	6,245.58
Shipments of finished goods from mill "A" to New York ("C")	59,447.82
Sales (gross), finished product, by New York ("C")	58,659.24
Interest on advances charged by "C"	1,338.16
Discounts on sales " " "C"	3,500.39
Commission and guarantee " " "C"	4,122.52
Amount paid by "C" to "A" on account of anticipated profit	1,900.00
Value of raw material, etc., at mill—June 30, 1921	$ 9,476.99
Value of finished goods in New York—June 30, 1921	24,746.59

From the foregoing, prepare manufacturing account, trading and profit-and-loss accounts and the accounts of "A," "B" and "C," respectively.

3. The M. & N. Piano Company, manufacturing various styles of pianos but keeping no established cost records, desires to know the basic unit cost of the instruments manufactured during the year.

The company furnishes the following data, which are verified from sundry bills and other records:

Style	*Number manufactured*	*Additional cost per instrument*
A	166	$ .00
B	212	.15
C	267	.45
D	177	.80
E	148	.85
F	56	.90
G	92	5.68
H	30	1.20
J	242	2.04
K	93	2.44
L	94	4.39
M	96	5.51
S	73	17.66
X (player)	786	84.31
	2,532	

The total cost of production for the year, as shown by the manufacturing account, was $270,344.85.

The basic unit cost for the year preceding was $82.29437, for the current year it is expected to be considerably less.

(a) Prepare the statements required, explaining in addition how you would determine the total cost of each style, and submit your conclusions in a formal report to the company.

(b) How would you value finished units, say, for illustration, style G, in the inventory for balance-sheet purposes at the end of the year?

4. What are the main purposes and advantages of modern cost accounting?

5. The federal government permits a real-estate company receiving the proceeds of the sale of its land in instalments to report its income on the basis of instalments received and to take credit for that proportion of the cost of sales which the instalments paid bear to the total selling price.

What method would you suggest for recording the unreported income and cost?

6. A corporation has a number of investments in stocks and bonds which are listed and have a definite market price from day to day. It carries them at their cost prices in the ledger and wishes to retain these cost prices and, at the same time, to have them shown in the monthly balance-sheet at the market prices.

State a convenient method of doing this without changing the cost values in the ledger.