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 12 and 13, 1936.]

BOARD OF EXAMINERS

Examination in Auditing

NOVEMBER 12, 1936, 9 A. M. TO 12:30 P. M.

The candidate must answer all questions.

No. 1 (5 points):

In May, 1936, a grain dealer bought 100,000 bushels of wheat for delivery between July 1st and December 31st at $1.05 a bushel. How should the item be treated on the June 30, 1936, balance-sheet

(a) if the market had risen to $1.25 a bushel?

(b) if the market had fallen to $.85 a bushel?

Give reasons.

No. 2 (5 points):

What exceptions to the rule of professional secrecy about facts discovered in an audit can you mention? Explain.

No. 3 (14 points):

A client of yours asks information about the retail method of inventorying: (a) what it is, (b) what advantages it has over his present custom of inventorying at cost or market and (c) if it will facilitate preparing income-tax returns.

What information would you give concerning the three questions asked?

No. 4 (10 points):

(a) What do you understand is required in a "cash audit"?

(b) What purposes are served by it?

(c) If you were called upon to audit the cash records only what would you say to your client about the limitations of such an audit and its advisability?

No. 5 (10 points):

You are engaged to audit the accounts of the town of X and also those of the town library, which is being supported partly by public and partly by private funds.

State how you will determine the validity of the expenditures in each case.

No. 6 (10 points):

State how you would proceed in verifying the accounts receivable of a merchandising concern.

No. 7 (10 points):

(a) State at least three methods by which sales records may be falsified.

(b) What steps would you take to detect them?

No. 8 (10 points):

(a) State the rates of taxes on payrolls to be imposed under the federal social security act upon (1) employers and (2) employees, for the years 1936 and 1937.

(b) Which of them may be deducted in federal income-tax returns (1) by employers, (2) by employees?

(c) When, for what period, by whom and to whom must returns and payments of these taxes be made?

Ignore exempt classes.

No. 9 (6 points):

Auditing the accounts of Corporation X for the year 1936, you find an investment in the stock of Corporation B at par, on which two extra dividends were received and credited to profit and loss in 1936. Upon inquiry you learn the following facts concerning Corporation B:

On January 2, 1935, an option was given to Corporation Y to buy the entire assets of Corporation B, carried on its books at $400,000, for $500,000, payable $25,000 at date of option, $25,000 semi-annually thereafter to the date of expiration of the option, January 2, 1937, when the balance of $400,000 is payable. If the option be not taken up on the last-named date, the instalments already paid will be forfeited to the B Corporation.

The instalments were paid up to and including July 2, 1936. The balance of $400,000 due January 2, 1937, has not been paid, but Corporation B has renewed the option on receipt of $25,000 and the agreement by Corporation Y to pay $25,000 on July 2, 1937, and the balance of $350,000 on January 2, 1938, the instalments for 1937 being subject to forfeiture as before.

The extra dividends paid by Corporation B were the moneys received from Corporation Y; and another extra dividend from the same source has been declared payable February 1, 1937.

(a) Will you approve the credits to profit and loss for 1936 on the books of Corporation X? State your reasons.

(b) How will you advise your client to deal with the extra dividends in 1937? State your reasons.

No. 10 (12 points):

Describe briefly the essential requirements and the principal advantages of an adequate internal control of inventories; also discuss the importance of costing sales in relation thereto and describe two general methods of costing.

No. 11 (8 points):

Certain concerns demand that charges for purchases, services, etc., be made out on their own invoice forms.

(a) What are the advantages and disadvantages of such a policy to the concern?

(b) How does it affect the outside auditor?

(c) What are the advantages, disadvantages and outstanding characteristics of the standard "simplified invoice form" developed by various associations of purchasing agents? How does it affect the outside auditor?

Examination in Accounting Theory and Practice

PART I

November 12, 1936, 1:30 p. m. to 6:30 p. m.

Solve all problems.

No. 1 (35 points):

A. Arthurs, a real-estate dealer, owned and operated the following buildings:

Stratford Terrace—an apartment house acquired March 1, 1929, at a cost of $350,000 and mortgaged as follows:

First mortgage, dated February 1, 1933, due February 1, 1938, interest payable February 1st and August 1st at 5% per annum	$200,000

Second mortgage, dated April 1, 1933, due April 1, 1938, interest payable April 1st and October 1st at 6% per annum	$90,000

Munroe Building—an office building acquired April 1, 1931, at a cost of $1,500,000, mortgaged as follows:

First mortgage, dated February 1, 1930, due February 1, 1940, interest payable February 1st and August 1st at 5% per annum..	$750,000
Second mortgage, dated May 1, 1934, due May 1, 1937, interest payable May 1st and November 1st at 6% per annum..........	450,000

The above four mortgages were to be reduced by regular instalments, but nothing had been paid off by Arthurs, and on March 1, 1935, the holders formed a committee to operate the two buildings from that date. John Smith was appointed agent and no charge was to be made for his or the committee's services.

Arthurs was to receive 5% of all rents collected after deducting operating expenses, taxes and interest, and he was to pay $100 a month as rent for office space occupied in the Munroe Building. Any balance remaining at the end of the fiscal year was to be applied pro rata by the agent to reduce the second mortgages.

The holders of the mortgages agreed to accept monthly instalments of the year's interest and taxes and in turn to advance, if required, the money for taxes when due. The 1935 taxes were:

Stratford Terrace..............................	$ 5,160
Munroe Building............................	28,000

Depreciation was to be provided at the annual rates of 2% on buildings and 10% on furniture and fixtures, as in previous years.

Arthurs continued to keep the general books, and the agent rendered to him monthly statements of rents billed and collected, operating expenses, taxes, interest and other payments. However, only the cash received from the agent was entered and no record was made of these statements.

The following is a summary of the transactions thus reported covering the operations in the ten months March to December, 1935:

	Stratford Terrace	Munroe Building
Rents billed...............................	$128,500.00	$230,000.00
Rents collected...........................	$124,070.00	$228,000.00

Operating expenses paid	$ 58,000.00	$ 99,810.00
Interest paid—		
First mortgage	10,000.00	27,500.00
Second "	5,400.00	27,000.00
Taxes paid	5,160.00	28,000.00
	$ 78,560.00	$182,310.00
Balance of receipts	$ 45,510.00	$ 45,690.00
5% paid to A. Arthurs	$ 2,275.50	$ 2,284.50

Since December 31, 1934, none of the unamortized mortgage expenses had been written off, nor had provision been made for accruing mortgage interest and depreciation, but all ascertainable direct current liabilities outstanding at December 31, 1935, had been taken up, and the following trial balance was prepared as of the latter date:

	Dr.	*Cr.*
Stratford Terrace:		
Land	$ 50,000	
Building	300,000	
First mortgage		$ 200,000
Second "		90,000
Unamortized expenses—first mortgage	11,100	
" " —second "	9,945	
Reserve for depreciation		35,000
Rents receivable	12,530	
Munroe Building:		
Land	300,000	
Building	1,200,000	
First mortgage		750,000
Second "		450,000
Unamortized expenses—first mortgage	53,375	
" " —second "	28,000	
Reserve for depreciation		90,000
Rents receivable	24,600	
Office furniture	1,360	
" " reserve for depreciation		630
Investments—stocks and bonds	117,500	
Cash	1,686	
Notes receivable	15,400	
Notes payable		16,500
Insurance premiums receivable	3,000	
Prudence Life Assurance Co.		1,250
Kentucky Fire Insurance Co.		1,150
Jameson Realty Co.		4,740
Rent security deposits		3,000
John Smith—agent		4,560

A. Arthurs—personal account	$22,551	
" " —capital "		$502,551
Stratford Terrace:		
Rent income		11,200
Operating expenses	102	
Munroe Building:		
Rent income		28,750
Operating expenses	245	
Interest—first mortgage	10,000	
Commission on insurance premiums		350
Interest received on bonds		1,789
Dividends received on stocks		2,330
Interest on notes received and payable—net		21
Salaries paid	25,412	
Legal expenses	2,600	
Office rent	1,000	
Office expenses	2,465	
Uncollectible rents written off	950	
	$2,193,821	$2,193,821

Prepare adjusting entries, working trial balance and balance-sheet as at December 31, 1935, and a relative income statement for the year.

No. 2 (20 points):

The Parent Corporation, engaged in manufacturing and selling its products in the United States, organized a foreign subsidiary, called The English Company, in London, and one called The French Company in Paris, both as of December 31, 1934. The balance-sheets of The Parent Corporation as at December 31, 1935, and of the two foreign companies as at November 30, 1935 (the end of their fiscal years), together with statements of surplus for the year ended on those dates, are given below:

Assets	The Parent Corporation Dec. 31, 1935 ($)	The English Company Nov. 30, 1935 (£)	The French Company Nov. 30, 1935 (Fcs.)
Cash	241,016	15,013	12,008
Accounts receivable	313,849	17,927	28,695
Inventories	726,615	37,324	40,370
Investment in stock of The English Company—20,000 shares at cost	98,400		

Advances to The English Company....................	78,781		
Investment in stock of The French Company—500 shares at cost..................	3,300		
Advances to The French Company....................	14,900		
Capital assets, less reserves.....	906,442		
Fixtures and equipment, foreign companies, less reserves......		3,800	17,720
Deferred charges.............	19,861	838	1,026
	2,403,164	74,902	99,819

Liabilities

Accounts payable............	378,414	21,107	42,767
Dividend payable Jan. 15, 1936		2,000	
Due to The Parent Corporation (U. S. dollar liability).......		18,263	16,610
Capital stock—			
15,000 shares of $100 each...	1,500,000		
20,000 " " £1 " ..		20,000	
500 " " Fcs. 100 each			50,000
Surplus (*deficit) as below.....	524,750	13,532	9,558*
	2,403,164	74,902	99,819

Surplus

Profit (*loss) from operations...	281,125	17,912	7,786*
Dividend received from The English Company (£2,000)..	9,880		
	291,005		
Less—Provision for depreciation.................	62,101	380	1,772
Net profit (*loss) for the year.................	228,904	17,532	9,558*
Surplus at beginning..........	400,846		
	629,750	17,532	9,558*
Dividends paid...............	105,000	4,000	
Surplus (*deficit) at end...	524,750	13,532	9,558*

The rates of exchange in effect at various dates during the year are stated below:

In effect	English pounds	French francs
Dec. 1, 1934	4.92	6.6
Jan. 1, 1935	4.93	6.6
Feb. 1, 1935	4.94	6.6
Mar. 1, 1935	4.94	6.6
Apr. 1, 1935	4.95	6.3
May 1, 1935	4.95	5.8
June 1, 1935	4.94	5.8
July 1, 1935	4.96	6.0
Aug. 1, 1935	4.95	6.0
Sept. 1, 1935	4.97	6.0
Oct. 1, 1935	5.08	6.0
Nov. 1, 1935	5.06	6.1
Dec. 1, 1935	5.02	6.2
Average 1935	4.97	6.2

The following statement shows the depreciated values on November 30, 1935, of the fixtures and equipment acquired by the foreign companies on the dates given therein:

	The English Company (£)	The French Company (Fcs.)
December 1, 1934	2,400	10,200
June 16, 1935	1,000	5,000
August 8, 1935	400	2,520
	3,800	17,720

The advances to foreign companies, as shown by The Parent Corporation's accounts, are summarized as follows:

	The English Company	The French Company
Balance, November 30, 1935	$ 90,875	$ 998
Add—Shipments in December, 1935, at billing prices (cost 20% less)	13,026	8,902
Cash advanced		5,000
	$103,901	$14,900
Deduct—Cash received	25,120	
Per balance-sheet	$ 78,781	$14,900

The inventories of foreign companies were purchased partly from The Parent Corporation and partly locally, as follows:

	The English Company (£)	The French Company (Fcs.)
Purchased from The Parent Corporation at billing prices	32,106	28,546
Purchased locally	5,218	11,824
Per balance-sheet	37,324	40,370

The cost to The Parent Corporation of the merchandise sold to foreign companies and remaining in the inventories at November 30, 1935, was as follows:

The English Company	$119,736
The French Company	1,361

Prepare a consolidation statement under date of December 31, 1935, showing conversion rates used. Computations and adjustments should be made to the nearest dollar.

No. 3 (20 points):

One of your clients informs you that he has purchased a 750-acre farm, including a herd of about 300 head of cattle for $250,000. An initial payment has been made and the deal will be finally closed and settled in about two weeks.

Neither yourself nor your client knows much about farming, but he wants your opinion on important general matters such as advisability of incorporation, farm accounting, taxation, etc., and desires your presence the next morning at a conference where these and other important matters will be dealt with in a preliminary discussion.

State what matters you would look up at your office in the short time available before the meeting. Also prepare notes that will remind you at the conference of the inquiries you wish to make and how to deal with the important questions and problems that will probably come up for discussion and be presented to you. Avoid bringing up questions of detail and confine yourself to matters of general importance.

No. 4 (15 points):

The balance-sheets of the Anonymous Manufacturing Company at the beginning and the end of the year are shown below:

Assets	January 1	December 31
Current assets:		
Cash	$ 7,928.15	$ 4,720.68
Accounts receivable	11,926.28	14,030.00
Inventories	107,434.69	128,749.71
	$127,289.12	$147,500.39
Advances to employees		201.61
Permanent investments	10,053.63	9,700.00
Plant and equipment, less depreciation	131,900.08	133,124.89
Deferred charges	2,181.48	2,310.88
	$271,424.31	$292,837.77

Liabilities		
Current liabilities:		
Notes payable to bank	$ 14,000.00	$ 30,000.00
Trade accounts payable	3,425.29	4,366.91
Accrued expenses—payrolls, etc.	2,166.48	2,445.20
Federal income tax payable	2,503.33	2,874.55
	$ 22,095.10	$ 39,686.66
Mortgage bonds	50,000.00	41,000.00
Capital stock	100,000.00	100,000.00
Surplus	99,329.21	112,151.11
	$271,424.31	$292,837.77

Also the following information is procured:

The net profit for the year, before deducting federal income tax, was $20,709.58.
The federal income tax for the year amounted to $2,874.55.
Surplus was charged with $13.13 for additional federal income tax for a prior year.
Depreciation expense for the year amounted to $8,659.24.
The company lost its entire investment in the Everywhere Export Corporation, namely 35 shares which originally had cost $353.63.
The company sold an automobile for $110, which had been bought for $677.75 and had been depreciated $519.61 at the time of sale.
Purchases of machinery and equipment during the year amounted to $9,267.37.
Other purchases were an automobile for $641.32 and other equipment $133.50.
A dividend of $5,000 was declared and paid during the year.

Prepare (a) a statement showing the items that contributed to the increases and decreases of the company's working capital and (b) a statement showing the "application of funds."

Also state (c) how the two statements compare in general usefulness to the client.

No. 5 (10 points):

How should the particulars of the following situation be shown on a balance-sheet of December 31, 1935:

Preferred stock:

10,000 shares 7% cumulative of $100 each; redeemable at 115 in 10 years at 1,000 shares per annum; authorized January 1, 1933, and issued on that date together with 40% in common stock of $100 par at $150 a share; three semi-annual dividends and one year's redemption in arrears. The 1,000 shares redeemed on December 31, 1933, were acquired as follows:

400 shares at 105
600 " at 110

Additional 800 shares were acquired at 95 and are held in the treasury for future redemption.

Common stock:

20,000 shares of $100 each, authorized
10,000 shares issued as treasury stock January 1, 1933
4,000 shares subscribed January 1, 1933, at $90 a share, payable on call, $80 a share called and paid in to date.

Examination in Commercial Law

NOVEMBER 13, 1936, 9 A. M. TO 12:30 P. M.

Reasons must be stated for each answer. Whenever practicable give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question rather than on his conclusions.

GROUP I

Answer all questions in this group.

No. 1 (10 points):

(a) Define usury.

(b) What is the general rule of law with respect to usury?

(c) What transactions usually are excepted from the application of this rule?

(d) What are some of the subterfuges adopted in attempts to evade this rule?

No. 2 (10 points):

Answer the following questions on the assumption that the certificate of incorporation (charter) and the by-laws of the corporation contain no provision applicable to the question and that the matter is not covered by a local statute:

(a) Can the president of a corporation who is also a director vote on a resolution fixing his salary as president?

(b) Can a person have rights as a stockholder before a certificate for stock for which he has duly subscribed and paid has been issued to him?

(c) What is a proxy and who may give one?

(d) When funds are turned over to a trustee for the payment of outstanding mortgage bonds and the trustee has been named in the mortgage as the trustee for the bondholders, is the corporation relieved from liability on the bonds?

No. 3 (10 points):

A soap-manufacturing company gave a coupon with each cake of soap and advertised in every practicable way that it would give an adult's round-trip ticket to a specified amusement park for every 25 coupons presented. Plaintiff, a stamp and premium broker, duly presented 100,000 coupons and demanded 4,000 tickets. The manufacturing company refused to deliver the tickets.

(a) Can plaintiff compel delivery of the tickets?

(b) If not, what remedy, if any, has plaintiff?

No. 4 (10 points):

It is a rule applied by courts that "where one claimant has two funds to which he may resort to answer his demand, and another claimant has an interest in only one of such funds, he (the latter) can compel the former to take satisfaction out of the fund in which the latter has no lien."

(a) Can this properly be classified as a rule of the common law?

(b) If not, how would you classify it?

No. 5 (10 points):

Benson for ten years had held a full-life non-cancellable accident and health policy issued by the Accident Company which provided that all annual premiums must be paid in advance at the home office of the company. The premium for each year had been duly paid by Benson's cheque mailed to the home office and accepted by the company. Prior to the premium due date in 1936, Benson duly mailed to the Company his cheque for the proper amount, having funds in his bank sufficient to cover it, this cheque being enclosed in a properly addressed and stamped envelope with a return address, and being mailed in ample time to reach the company's home office one day before the due date. This cheque was not received by the company nor was it cashed by anyone or returned to Benson. The day after the premium was due, the company cancelled the policy and duly notified Benson. Can Benson compel the Accident Company to reinstate the policy by offering a duplicate cheque immediately upon his receipt of the notice of cancellation?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

An investment company sold certain bonds to Clark but refused to take Clark's cheque in payment although Clark offered the cheque in time to enable the vendor to have it certified before delivery of the bonds. Clark refused to give a cheque already certified, but by agreement between the parties the vendor delivered the bonds to a bank in which the vendee had a balance sufficient to cover the purchase price and accepted that bank's cashier's cheque and the bank immediately delivered the bonds to the vendee. Thereafter, but before the cashier's cheque could be cashed, the bank failed. Can the vendor recover the purchase price from the vendee?

No. 7 (10 points):

An infant, twenty years of age, authorized his agent to purchase certain bonds, the agent knowing the infancy of his principal. The agent purchased the bonds, disclosing the name of his principal but not disclosing the fact of infancy. The vendor did not know that the principal was an infant and the agent had every reason to believe that the vendor was ignorant of this fact.

Upon reaching the age of twenty-one, the infant disaffirmed the purchase, returned the bonds and all interest received thereon, and was reimbursed for the purchase price. Is the agent legally responsible to the vendor?

No. 8 (10 points):

Four negotiable promissory notes, payable respectively one, two, three and four months after date, were executed as a part of one transaction; also, as a part of the same transaction, the maker and the payee executed a written agreement which provided that upon default in any one of the notes the remaining ones should immediately become due. Hobbs, to the knowledge of the payee, signed the second and third notes as an accommodation indorser but without either actual or constructive knowledge of the acceleration agreement. The maker defaulted on the first note and thereupon the payee declared all four notes payable and duly notified all indorsers on the first note, of which Hobbs had no knowledge. On the day when the second note matured according to its face, the second note was presented for payment, the maker failed to pay it, and Hobbs was duly notified. Is Hobbs liable as indorser?

No. 9 (10 points):

The authorized common stock of a corporation is 10,000 shares, of which 8,000 are issued and outstanding. The board of directors had authorized the retention of 2,000 shares to meet conversion rights of preferred stockholders, which expire in 1940. The president of the corporation, who has held that office for five years, makes a written contract with the corporation for his services during the next five years and as part of his compensation he is given an option to subscribe immediately for 1,000 shares of common stock at a specified price above par. Is the contract valid as to this option?

No. 10 (10 points):

Holland, Jones and Kerr were partners doing business as note brokers under the name of Holland & Co. The partnership was duly dissolved May 1, 1936, Kerr being named as liquidating partner. On May 20, 1936 Kerr procured and sold to Martin a note purporting to be made by the Acme Corporation and dated May 19, 1936. This transaction was conducted in the name of

Holland & Co. and Martin, who had no actual knowledge that that partnership had been dissolved, gave Kerr a cheque to the order of Holland & Co. in payment of the purchase price and accepted from Kerr a guaranty of the signature on the note signed "Holland & Co." Kerr indorsed the cheque in the name of Holland & Co. and deposited it in his own bank account. The Acme Corporation note proved to be a forgery. Against whom has Martin any rights?

No. 11 (10 points):

For what purposes may an action at law or in equity be brought in the name of a corporation against one or more of its directors or officers? State each purpose separately and specify the remedy or relief to be sought (e. g., damages or injunction).

No. 12 (10 points):

In 1930, John Adams orally promised his brother Henry that he would advance to Henry all cash needed by Henry to enable the latter to take a university course in accountancy, obtain a certificate as a C. P. A. and equip an office for the public practice of accountancy. Henry orally agreed to repay these advances out of the first fees collected by him in his practice as a C. P. A. John made these advances, amounting in total to $6,000, and Henry completed the course, became a C. P. A. in 1935, and began to practise as such. After collection of his first fees, Henry refused to repay any part of the advances, relying upon the statute of frauds.

(a) Upon what provision in the statute of frauds did Henry rely?

(b) Does the statute of frauds bar a recovery by John?

Examination in Accounting Theory and Practice

PART II

November 13, 1936, 1:30 p. m. to 6:30 p. m.

Solve all problems.

No. 1 (30 points):

A company was incorporated on June 10, 1935, with a capital of $750,000 divided into 30,000 shares of no par value.

On June 20, 1936, it acquired a manufacturing plant and site on the following terms:

The purchase price to be $750,000 (the appraised sound value at June 1, 1936) payable by transfer to the vendor of the entire capital stock; the deal to be closed on June 25, 1936; and the company to take possession on June 30, 1936.

The property to be transferred free of all liens, except a mortgage of $250,000 securing the vendor's note for that amount to his bank. The note is payable on or before July 1, 1937.

The vendor to deposit with that bank 10,000 shares of the company's capital stock as additional security on his note. (The note was not indorsed and no bond was signed by the company.)

The vendor immediately to donate and to return 10,000 shares to the company's treasury, to be sold for working capital.

A public offering to be made on June 25, 1936, at $30 a share, of 20,000 shares, of which 10,000 shares each are to be furnished by the vendor and the company. The vendor to use his best efforts to further the sale of these 20,000 shares.

The proceeds from the first 10,000 shares sold in the public offering to be turned over to the company for working capital. The proceeds from the balance of the shares to be turned over to the bank and to be applied against the vendor's note. After payment of the note the mortgage is to be canceled.

Prepare the company's opening balance-sheet as of June 30, 1936, on the supposition that:

(a) None of the shares offered had been sold.
(b) 10,000 shares had been sold.
(c) 15,000 " " " "
(d) 20,000 " " " "
(e) None of the shares had been sold, the vendor can not pay his note and the bank takes possession of the collateral.

No. 2 (25 points):

Company	A	owns	40%	of the	capital	stock	of company	B
"	A	"	30%	" "	"	" "	"	C
"	B	"	10%	" "	"	" "	"	A

Company B owns	50%	of the capital stock of company	C
" C "	10%	" " " " " "	A
" C "	40%	" " " " " "	B

Each company has 10% of its capital stock in its treasury and all stocks are carried on the books at cost.

The assets of the three companies are:

	A	B	C
Investment in A	$ 10,000	$12,000	$15,000
" " B	20,000	4,000	10,000
" " C	30,000	15,000	2,000
Other assets (net)	100,000	50,000	30,000
	$160,000	$81,000	$57,000

(a) Determine the respective amounts of net assets belonging to the outside shareholders of companies A, B and C. Do not consider fractions of dollars in any of the calculations.

(b) Are all the facts given in this problem essential to its solution? If not, show the irrelevant data.

No. 3 (18 points):

At December 31, 1931, the capital of Burns, Doak & Ray, a copartnership, was as follows:

	Partnership interest	
	Capital	% of profit
Burns	$80,000	40%
Doak	50,000	30%
Ray	40,000	30%

On January 1, 1932, Peters paid to Burns $25,000 for one-fourth of his capital and partnership interest as of that date. The new partnership continued to operate in the old firm name.

The partners are entitled to salaries as follows:

Burns	$15,000
Doak	12,000
Ray	10,000
Peters	7,500

Burns is also entitled to a bonus of 10% of the net profits after treating as an expense the partners' salaries and the bonus.

The operating results for the three years ended December 31, 1934, were:

1932......	$30,000	Profit after charging partners' salaries and bonus to Burns
1933......	25,000	Loss after charging partners' salaries
1934......	10,000	Profit after charging partners' salaries but before charging Burns's bonus

During the period the partners' drawings against the salaries and profits (including bonus in the case of Burns) were:

	Burns	*Doak*	*Ray*	*Peters*
1932........................	$20,000	$15,000	$10,000	$7,500
1933........................	15,000	10,000	10,000	7,500
1934........................	25,000	12,000	10,000	7,500

The partnership was dissolved on December 31, 1934, and the assets were realized with the following results:

1935	Book value	Realized	Loss
January..........................	$175,000	$150,000	$25,000
February..........................	30,000	10,000	20,000
March..........................	34,000	14,000	20,000
Total.......................	$239,000	$174,000	$65,000

All the firm's creditors were paid in January, 1935, and cash distributions to the partners were made at the end of January and February, with a final payment at the end of March. The costs of liquidation are to be disregarded.

Prepare a statement of the partners' accounts from January 1, 1932, to the final liquidation on March 31, 1935.

No. 4 (15 points):

On January 1, 1930, the X Manufacturing Company acquired for $1,000,000 in cash all the capital stock of the Y Coal Company. On that date the balance-sheet of the Y Coal Company was as follows:

Assets	
Coal lands, less depletion....................	$400,000
Other assets (Valued in accordance with the accounting practice followed by both companies).......	300,000
	$700,000

Liabilities

Liabilities	$100,000
Capital stock	500,000
Surplus	100,000
	$700,000

The operations of the Y Coal Company are confined to the mining of coal for the exclusive use of the X Manufacturing Company. No inventories of coal are carried by the Y Coal Company, as all coal mined is immediately charged to the X Manufacturing Company at a profit of 50 cents a ton after charging 10 cents a ton to the mining cost for depletion.

The books of the two companies are kept on the same accounting basis but independent of each other and without regard to the requirements of possible consolidation of the balance-sheets. On December 31, 1935, such a consolidation was contemplated for the first time, and on that date the balance-sheet of the Y Coal Company was as follows:

Assets

Coal lands, less depletion	$300,000
Amount due from "X Co."	200,000
Other assets	250,000
	$750,000

Liabilities

Liabilities	$100,000
Capital stock	500,000
Surplus	150,000
	$750,000

Depletion provided by the Y Company was based on the cost of the coal lands to "Y" at the date of acquisition ($500,000) and the estimated number of tons of coal in the lands (5,000,000). The estimated number of tons of coal in the lands at January 1, 1930, was 4,000,000. Between that date and December 31, 1935, 1,000,000 tons were mined. No coal lands were purchased or sold by the Y Company since the date of acquisition and no dividends were ever paid by the Y Company.

The investment by the X Company in the Y Company was carried at December 31, 1935, at cost to the X Company ($1,000,000). On that date the accounts of X Company showed that an amount of $150,000 was due to the Y Company and the difference between this amount and the amount of $200,000 shown as receivable by the Y Company was accounted for as follows:

Cash in transit	$40,000
Inventory in transit (5,000 tons at $2.00)	10,000
	$50,000

The inventory of the X Company contains 5,000 tons of coal (exclusive of the 5,000 tons in transit) at $2 a ton, plus transportation cost, which includes the profit of 50 cents a ton (already mentioned) to the Y Company.

There are no intercompany accounts, relations or transactions other than those indicated in this problem.

The accounts of the Y Company are not to be changed, and all adjustments required for a ready consolidation of the balance-sheets of the two companies are to be made on the X Company's books.

Prepare entries for these adjustments.

No. 5 (12 points):

Your client, Mr. Brown, has concluded arrangements to take over from Mr. Wilson the entire business of the Wilson Company as at June 30, 1936. Mr. Wilson owns all the capital stock, which he has agreed to sell to Mr. Brown for $15,000 cash and a mortgage of $30,000 on the company's plant.

The Wilson Company's balance-sheet on the date of the sale is as follows:

Assets

Cash		$ 3,000
Bonds		12,000
Accounts receivable		16,000
Land		7,000
Buildings at cost	$20,000	
Less depreciation	2,000	
		18,000
Machinery	$25,000	
Less depreciation	10,000	
		15,000
Office equipment	$ 2,000	
Less depreciation	1,000	
		1,000
		$72,000

Liabilities

Accounts payable	$15,000
Notes payable	8,000
Capital stock	25,000
Surplus	24,000
	$72,000

The property was appraised, and on the date of the sale shows the following values:

	Depreciation value	Replacement-new value
Land	$10,000	$10,000
Buildings	20,000	30,000
Machinery	18,000	25,000
Office equipment	1,000	3,000

It was intended to change, as at June 30, 1936, the authorized capital from 250 shares of $100 each to 1,000 shares of no par value and the articles of incorporation had been changed accordingly.

The above balance-sheet was verified by yourself as complete and correct and in agreement with the books, but it was discovered that the $12,000 bonds were pledged as collateral to the $8,000 notes payable. Mr. Brown is fully aware of this.

You are asked by Mr. Brown to make the necessary entries on the books and to prepare a balance-sheet showing the changes that took place upon his purchase of the stock, including the change to no par value and the results of the appraisal. He asks that no mention be made on the balance-sheet of the fact that the bonds were pledged.

Prepare (a) the balance-sheet of the Wilson Company as at June 30, 1936, wherein all changes have been incorporated and (b) give reasons for complying or not complying with Mr. Brown's request.