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Students' Department

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Students' Department

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In regard to the following attempt to present the correct answers to the questions asked in the examination held by the American Institute of Accountants in May, 1919, the reader is cautioned against accepting the answers as official. They have not been seen by the examiners—still less endorsed by them.

AMERICAN INSTITUTE EXAMINATION

THEORY AND PRACTICE, PART II.

Question 1:

The following trial balance of the B. C. Cotton Company is taken from the books after inventories and deferred charges have been posted. The accounts are ready to close for the period. The consigned goods account has been inactive for six months and will continue so for the present. Prepare statement to show for the quarter ended March 30, 1918, total manufacturing expenses, cost of goods made, cost of goods sold and net profit, and submit a balance-sheet as of March 30, 1918.

TRIAL BALANCE

	Dr.	Cr.
Cloth		268,337.28
Labor	33,862.99	
Light	132.72	
Royalties	50.00	
Oils	38.62	
Finishing	7,455.55	
Cash	119,126.06	
Liberty bonds	1,000.00	
Supplies	1,276.06	
Starch	800.00	
Fuel	1,455.99	
Water	202.24	
Freight inward	1,353.99	
Accounts receivable	63,492.58	
Accounts payable		313.45
Notes payable		225,000.00
Building and machinery	341,378.14	
Tenements	1,610.99	
Insurance	350.00	
Taxes	567.71	
General expense	542.88	
Rents receivable		378.87
Commissions	7,121.42	
Interest paid	2,539.90	
Discount taken		4,016.26
Purchases, material	162,403.68	
Surplus		168,866.14
Discount allowed	899.50	
Capital stock		362,500.00
Waste sales		1,401.39

Inventory, finished goods	3/30	114,069.57	
Inventory, process	3/30	31,464.02	
Inventory, materials	3/30	113,860.99	
Inventory, fuel	3/30	1,250.00	
Inventory, starch	3/30	800.00	
Inventory, supplies	3/30	1,300.00	
Prepaid taxes	3/30	208.96	
Unexpired insurance	3/30	660.41	
Prepaid interest	3/30	5,100.00	
Consigned goods	3/30	14,438.42	
		1,030,813.39	1,030,813.39

Inventories of finished goods have been credited to cloth account and inventories of goods in process and materials to purchase account.

INVENTORIES JANUARY 1, 1918

Finished goods, January 1, 1918	132,833.85
Goods in process, January 1, 1918	22,258.01
Materials, January 1, 1918	143,566.55

Answer to Question 1:

In order to give the information which is asked for it is necessary to eliminate the inventories from the cloth account and purchase account.

Cloth account, as given		268,337.28
Add inventory finished goods, 1/1/18		132,833.85
		401,171.13
Less inventory finished goods 3/30/18		114,069.57
Sales for period		287,101.56
Purchases, material account, as given		162,403.68
Add inventory process goods 3/30/18	31,464.02	
Inventory material 3/30/18	113,860.99	145,325.01
		307,728.69
Less inventory process goods 1/1/18	22,258.01	
Inventory material 1/1/18	143,566.55	165,824.56
Purchases for period		141,904.13

With these figures at hand the statements asked for may be prepared as per the following exhibits.

EXHIBIT A

B. C. COTTON COMPANY

Profit and Loss Statement

January 1, 1918, to March 30, 1918

Cloth sales	287,101.56	
Deduct: cost of goods sold (exhibit B)	227,312.44	
Gross profit on sales		59,789.12

Selling and general expense:			
Commissions		7,121.42	
General expense		542.88	7,664.30
Net profit on operations			52,124.82
Discount, interest, rents.			
Add:			
Discounts taken	4,016.26		
Less discounts allowed	899.50	3,116.76	
Rents received		378.87	
		3,495.63	
Less interest paid		2,539.90	955.73
Net profit—January 1, 1918, to March 30, 1918			53,080.55

SURPLUS

March 30, '18, balance	221,946.69
	221,946.69
Jan. 1, '18, balance	168,866.14
Mar. 30, '18, profit as above	53,080.55
	221,946.69

EXHIBIT B

B. C. COTTON COMPANY

Statement Showing Cost of Manufacture, Cost of Goods Sold and Manufacturing Expense

January 1, 1918 to March 30, 1918

Goods in process, Jan. 1, 1918				22,258.01
Cost of manufacture:				
Material:				
Inventory, Jan. 1, 1918		143,566.55		
Purchases	141,904.13			
Freight inward	1,353.99	143,258.12		
		286,824.67		
Less inventory, Mar. 30, 1918		113,860.99		
Gross cost materials used		172,963.68		
Less waste sales		1,401.39		
Net cost of material used			171,562.29	
Labor			33,862.99	

Manufacturing expenses:			
Light	132.72		
Royalties	50.00		
Oils	38.62		
Finishing	7,455.55		
Supplies	1,276.06		
Starch	800.00		
Fuel	1,455.99		
Water	202.24		
Insurance	350.00		
Taxes	567.71	12,328.89	217,754.17
			240,012.18
Deduct: goods in process: Mar. 30, 1918			31,464.02
Cost of goods manufactured			208,548.16
Add: finished goods inventory, Jan. 1, 1918			132,833.85
			341,382.01
Deduct: finished goods inventory Mar. 30, 1918			114,069.57
Cost of goods sold			227,312.44

EXHIBIT C

B. C. Cotton Company

Balance-sheet

March 30, 1918

Assets			*Liabilities*		
Fixed assets:			Current liabilities:		
Building and machinery		341,378.14	Accounts payable	313.45	
			Notes payable	225,000.00	225,313.45
Investments:					
Liberty bonds	1,000.00		Capital stock and surplus:		
Tenements	1,610.99	2,610.99	Capital stock	362,500.00	
			Surplus	221,946.69	584,446.69
Current assets:					
Inventories:					
Finished goods	114,069.57				
Consigned goods	14,438.42				
Goods in process	31,464.02				
Material	113,860.99				
Fuel	1,250.00				

Starch	800.00		
Supplies	1,300.00		
	277,183.00		
Accounts receivable	63,492.58		
Cash	119,126.06	459,801.64	
Deferred charges:			
prepaid taxes	208.96		
Unexpired insurance	660.41		
Prepaid interest	5,100.00	5,969.37	
		809,760.14	809,760.14

The only point to be noted is the treatment of the sale of waste. Some would consider this an item of miscellaneous income like the rent from the tenements. Since the waste is a saving from the material used, it seems more logical to consider it a reduction of the cost of that material.

Question 2:

From the following statement of facts set up the trial balance of the Broad Exchange bank, December 31, 1918, after closing, and prepare therefrom a condensed statement of condition as of the same date:

Due from banks, $74,975; time certificates of deposit, $10,000; cashier's cheques, $496,349.75; re-discounts, $400,000; customers' loans, $500,000; bills purchased, $550,000; exchanges for clearing house, $320,000; due to banks, $834,000; certified cheques, $12,500; cash, $956,750; demand certificates of deposit, $2,500; transit department, $100,000; on deposit with Federal Reserve bank, New York, $48,500; demand loans, $125,000; time loans, $80,000; bonds and mortgage owned, $100,000; coupon deposits, $3,750; on deposit with National City bank, $53,062.50; depositors, $765,910; banking house, $200,000; furniture and fixtures, $25,000; capital stock issued and outstanding, $500,000; securities owned, $96,812.50; surplus, $201,090.25; accrued interest receivable, $1,075; interest purchased, $125; unearned discount, $5,200.

Answer to Question 2:

TRIAL BALANCE, BROAD EXCHANGE BANK, DECEMBER 31, 1918

Customers' loans	500,000.00
Bills purchased	550,000.00
Demand loans	125,000.00
Time loans	80,000.00
Bonds and mortgages	100,000.00
Securities	96,812.50
Banking house	200,000.00
Furniture and fixtures	25,000.00
Due from banks	74,975.00
National City bank	53,062.50

Federal Reserve bank, New York	48,500.00	
Transit items	100,000.00	
Exchanges for clearing house	320,000.00	
Cash	956,750.00	
Accrued interest receivable	1,075.00	
Interest purchased	125.00	
Capital stock		500,000.00
Surplus		201,090.25
Due to banks		834,000.00
Depositors		765,910.00
Demand certificates of deposit		2,500.00
Time certificates of deposit		10,000.00
Coupon deposits		3,750.00
Certified cheques		12,500.00
Cashier's cheques		496,349.75
Notes re-discounted		400,000.00
Unearned discount		5,200.00
	3,231,300.00	3,231,300.00

BROAD EXCHANGE BANK

Condensed statement of condition, December 31, 1918

Assets		*Liabilities*	
Loans	1,255,000.00	Capital stock	500,000.00
Bonds and mortgages	100,000.00	Surplus	201,090.25
Securities	96,812.50	Unearned interest, net	4,000.00
Banking house	200,000.00	Due to banks	834,000.00
Furniture and fixtures	25,000.00	Demand deposits	768,410.00
Due from banks	276,537.50	Time and special deposits	13,750.00
Cash and clearing house cheques	1,276,750.00	Certified and cashier's cheques	508,849.75
		Notes re-discounted	400,000.00
	3,230,100.00		3,230,100.00

Question 3:

Define:

(a) Treasury stock
(b) Nominal accounts
(c) Accrued interest
(d) Controlling account
(e) Deferred charges.

Answer to Question 3:

(a) Treasury stock is such portion of the capital stock of a corporation as has been fully paid for and legally issued and has since been acquired by the issuing corporation, either by purchase or by donation.

(b) Nominal accounts represent those items which are temporarily carried among the assets and liabilities, but are only nominally such, as representatives of the increase or decrease of the net worth. They therefore represent the profits or losses and expenses of a business and are closed into the revenue account, the final result of which represents the net profit or loss in one amount.

(c) Bonds and sometimes notes bear interest payable at specified future dates. This interest accrues from day to day and becomes an asset due at the next specified date in the case of bonds or notes owned and a liability in case of those issued, in proportion to the number of days that have elapsed since the beginning of the interest period as compared with the total number of days in the period.

(d) A controlling account is an account kept on the general ledger which represents in one account the sum of all the transactions and of all the balances of a group of accounts kept on another ledger or other book called a subsidiary. The subsidiary book is not always a ledger, but may be a record of individual items, such as a notes receivable register or voucher record.

(e) Deferred charges are in reality expenses, but differ from those which are at once chargeable against revenue, in that they were not incurred for the current year alone but were intended to benefit one or more future years as well. They therefore hold an intermediate position between real assets and ordinary expenses. Such an item is an insurance premium paid October 1 covering a year from that date. As three-quarters of the time covered is in the next year, three-quarters of the premium paid may be carried forward as an asset under the head of deferred charges if the books are closed at the end of the calendar year.

When the organization expenses of a concern have been large, it is manifestly unfair to charge them all off against the first year's operations, since subsequent years will receive an equal benefit from them, if they are legitimate and proper. Therefore they can be carried as an asset, to be charged off during as many years as would be reasonable.

Question 4:

What should be the controlling factor in determining whether or not certain items may properly be capitalized?

Answer to Question 4:

The controlling factor in determining whether or not an item shall be capitalized—that is included among the fixed assets in which the capital is invested—is whether it constitutes an addition to the actual value of the permanent property of a business, either in the shape of entirely new fixed assets such as a new building or new machinery or of such actual additions to fixed assets already in existence as will cause a distinct increase in their intrinsic value.

Alterations to fixed assets which increase their intrinsic value should not be permanently capitalized, neither should they be charged off at once as an expense. As their effect is to increase future profits they should be gradually charged off against those profits, and in the meantime should be carried as deferred charges, or as betterments.

Question 5:

(a) How should a trading company, acting also as agent for an individual trader, show on its balance-sheet the unsold consigned goods of the principal?

(b) How should the principal show the goods on his own balance-sheet?

Answer to Question 5:

(a) As a consignee is in possession of the goods merely as an agent and has no title to them, they are neither an asset nor the cause of a liability. Therefore no notice of the goods should be taken on the balance-sheet, which is a statement of assets and liabilities. If any advances have been made on the goods, the amount would appear as an asset under the heading "advances on consignments."

(b) The principal should show the goods as an item of the inventories, at cost plus any expenses incurred in putting them in the hands of the agent.

Question 6:

Name the elements essential to the proper calculation of a depreciation charge.

Answer to Question 6:

Original cost, including all the elements of cost necessary to bring it to a condition in which it is ready to produce value.

Probable life, estimated on the basis of the character of the asset and the conditions attendant upon its use.

Repairs, since an asset that is kept in first class repair does not depreciate as fast as one that is not.

Danger of obsolescence, unless provided for by a special reserve for contingencies, such as obsolescence or inadequacy.

Break-up or scrap value, since the loss from depreciation is lessened by the amount realized from the asset when finally discarded.

Question 7:

How would you prove in quantities the inventory of materials at beginning of year if you had superintended an actual inventory at end of year?

Answer to Question 7:

I could do this only in case I could get the necessary information from the records or from the working conditions. If the concern is making standard goods, the quantity of each class of material per unit in each class of product multiplied by the number of units manufactured during the year would give the quantity of material consumed, due consideration being given to the material in the goods in process. The inventory at the end of the year plus the quantity consumed during the year, minus the purchases during the year should give the quantity on hand at the beginning of the year. If the records do not show the quantity used during the year or if the quantity in the different units varies so that there is no regularity about it, no figures could be produced that would be trustworthy.

Question 8:

Give journal entry to express declaration of a dividend.

Answer to Question 8:

Surplus	xxx	
Dividend No..........		xxx
To record declaration of dividend of................. per cent. on capital stock, payable.................to stockholders of record.............., as per resolution of the board of directors at meeting held...........		

Question 9:

How would you treat unclaimed dividends?

Answer to Question 9:

It is usual to mail cheques for dividends to all the stockholders on the day on which the dividend is payable. If letters containing the cheques are not returned as undelivered, all the stockholders are presumed to have received them. If some of the cheques are not presented to the bank for payment, they must be treated like any other outstanding cheques, and no entry would be made on the books. If some of the cheques are returned undelivered, they may be deposited in the general bank account, being credited to "unclaimed dividends." They would be an active liability, since the stockholders are liable at any moment to appear and demand them.

If cheques are not sent out but stockholders are notified to call for their dividends or to send orders for them, the whole dividend would be credited to dividend account. Any dividends not called for would be represented by the credit balance of this account, which would appear as a liability in the balance-sheet.

Question 10:

Can you mention any distinction between dividends declared out of income and dividends declared out of profits realized from the increment of invested values?

Answer to Question 10:

There would be no distinction in the treatment on the books, the profits in either case being credited and the dividends charged to surplus. In notifying the stockholders of a dividend out of profits realized from the increment in invested values, the directors should be very careful to state the source of the dividend, in order that the stockholders may not get an exaggerated idea of the operating profits of the business.

It is to be noted that the question reads "profits *realized* from the increment in invested values." If the profits are realized, it must be that the assets have been sold. If the increment is merely the reflection of a rise in market value, a dividend based on it would be unauthorized, since dividends must be predicated on actual profits and not on those which may be temporary only.

Question 11:

Define

(a) Contingent liability
(b) Actual liability

Answer to Question 11:

(a) A contingent liability is one that is not at present an enforceable claim but may become so, usually through the default or action of some third party. Examples are the endorsement on a note receivable that has been discounted, which will not become a claim unless the maker fails to pay it; claims for damages that may be settled adversely to the concern; and guarantees, such as those given by the makers of automobile tires, agreeing to replace the tires if they do not meet certain mileage requirements.

(b) An actual liability is one the amount of which is settled and must be paid in full at some more or less definitely fixed time or on demand. Such are ordinary accounts payable, notes payable and bonds.

Actuarial Questions (Optional)

Question 12:

A bond, bearing interest at 5% per annum, payable annually, and repayable in five years, with bonus of 10%, is for sale. What price can a purchaser pay who desires to realize 6% on his investment?

(V^5 @ 6% = .7473)

Answer to Question 12:

The purchaser of the bond can afford to pay the present value of the benefits which he will receive, which are (assuming the par of the bond is $1,000.00):

(a) The par plus a 10% bonus, or $1,100 due at maturity, five years hence.

(b) The interest payments of $50 to be collected at the end of each of five years.

Since the present value of 1 due 5 periods hence at 6% is .7473,
the present value of $1,100.00 is .7473 × 1100, or $822.03.

The interest payments are an annuity, the present value of which is computed as follows:

Present value of 1 due 5 periods hence	.7473	
Compound discount	.2527	
Present value of annuity of 1 (.2527 ÷ .06) =	4.2116	
Present value of annuity of 50 (4.2116 × 50) =	210.58	
Present value of $1,100 at maturity		822.03
Present value of interest annuity		210.58
Price to be paid on a 6% basis		1,032.61

While not required by the question, it is desirable to set up a schedule of amortization to prove the answer.

Year	Credit interest	Debit cash	Debit bond account	Carrying value
				1,032.61
1	61.96	50.00	11.96	1,044.57
2	62.67	50.00	12.67	1,057.24
3	63.43	50.00	13.43	1,070.67
4	64.24	50.00	14.24	1,084.91
5	65.09	50.00	15.09	1,100.00
	317.39	250.00	67.39	

Note—not part of the answer. If the examinee does not remember the formula for calculating the present value of an annuity, he may find it by calculating the value of each payment separately, thus:

$50.00 \div 1.06 =$	47.17
$47.17 \div 1.06 =$	44.50
$44.50 \div 1.06 =$	41.98
$41.98 \div 1.06 =$	39.60
$39.60 \div 1.06 =$	37.36
Present value of annuity	210.61

Question 13:

A lease has five years to run at $1,000.00 a year payable at the end of each year, with an extension for a further five years at $1,200.00 a year. On a 6% basis what sum should be paid now in lieu of the ten years' rent?

(V^5 @ 6% = .7473)

Answer to Question 13:

The present value of the ten rents is computed as follows:

(a) Present value of an immediate annuity of 5 rents of $1,000 each, discounted at 6%.

(b) Present value of an annuity of 5 rents of $1,200 each, deferred for five periods.

(a) Since the present value of 1 due 5 periods hence at 6% = .7473, the compound discount is .2527.

and the present value of an annuity of 1 = 4.21167

and the present value of an annuity of 1000 = 4211.67

(b) If the five rents of $1,200 each were to be discounted at the beginning of the sixth year of the lease, their present value would be that of an ordinary annuity, computed thus:

Present value of annuity of 1	4.21167
Multiply by	1,200
	5,054.00

But since these rents are discounted at the beginning of the first year, multiply by	.7473
Present value of last five rents	3,776.85
Present value of first five rents	4,211.67
Present value of ten rents	7,988.52

Setting up an amortization schedule to prove:

SCHEDULE OF AMORTIZATION OF LEASEHOLD PREMIUM

End of year	Debit rent	Credit interest	Credit leasehold	Balance of premium
				7,988.52
1	1,000.00	479.31	520.69	7,467.83
2	1,000.00	448.07	551.93	6,915.90
3	1,000.00	414.95	585.05	6,330.85
4	1,000.00	379.85	620.15	5,710.70
5	1,000.00	342.64	657.36	5,053.34
6	1,200.00	303.20	896.80	4,156.54
7	1,200.00	249.39	950.61	3,205.93
8	1,200.00	192.36	1,007.64	2,198.29
9	1,200.00	131.90	1,068.10	1,130.19
10	1,200.00	67.81	1,132.19	
	11,000.00	3,009.48	7,990.52	

It is manifest at the end of the fifth year that there is a slight inaccuracy, the balance being $5,053.34 instead of $5,054.00, as calculated. This is owing to not carrying the calculation of V^5 beyond four decimals. The true value is a trifle more than .747258. But in these calculations a discrepancy of only $2.00 out of $11,000.00 in ten years is considered entirely satisfactory for all practical purposes.

NOTES IN A BALANCE-SHEET

Editor, Students' Department:

SIR: In the January number of THE JOURNAL OF ACCOUNTANCY you mention in answer to question 4 regarding valuation of inventory, that as far as financial standing is concerned cost valuation should be used showing the market value as a note. I am very much interested in this and would thank you to inform me as to the technical handling of such a note in the books and in the final balance-sheet.

Your courtesy in the above matter will be very much appreciated.

Yours very truly,

A. W. E.

New York.

The use of notes in a balance-sheet is open to the objection that they cannot be made a necessary part of the statement, because the table will balance whether they are included or not. Therefore, if the note calls attention to some fact that is considered detrimental by the officers of a company, they can leave it out without impairing the accuracy of the effective figures. This is especially true if the note is a foot-note below the balance-sheet, and therefore not even included between the lines ruled above and below it.

The best way is to make it as far as possible an integral part of the balance-sheet by inserting it on the same line as the account to which it refers. Suppose two cases in an inventory that cost $100,000: first that at the date of the balance-sheet the goods were worth on the market only $90,000; and second that the market price had risen to $110,000. The balance-sheet might show:

1st inventory (cost $100,000) worth	$90,000
2nd inventory (now worth $110,000) cost	100,000

The officers would be justified in objecting to the first entry, but would of course be very glad to let the second one stand.

Only the amount of the inventory that appears in the regular column of the balance-sheet would appear in the books. The notes are merely explanatory and are not part of the accounts.

When Is a Profit Made?

Editor, Students' Department:

Sir: It is requested that you discuss the following problem:

Company "A" enters into a contract with company "B" whereby company "A" supplies to company "B" a certain piece of raw material and company "B" performs certain labor operations thereon for cost plus a stipulated profit of $10.00 per unit.

The terms of the contract are: company "B" is to store the finished units until sale is made by company "A" and as company "B" ships (to purchasers as directed by company "A") the cost plus the profit becomes payable. The question involved is, when does company "B" earn the profit? Would it be permissible on account of income tax to defer the profit until it is payable?

It is the writer's opinion that theoretically the profit is earned when the work is completely performed, but in the event of heavy manufacture and light sales toward the end of the fiscal year, there is danger that following that method large profits would be shown and hence a considerable income tax become due and payable for the year, but the funds to pay such tax might not become available for a considerable time.

The terms of the contract do not stipulate what method of settlement is to be made if company "B" accumulates a large stock of completed units, which company "A" does not sell, but it is assumed that company "B" will refuse to manufacture the units after a reasonable stock has been accumulated, until sales are made. A. B. B.

Youngstown, Ohio.

The answer to this letter depends upon an important condition that is not stated, namely, the time when B is to be paid for the work it has done, unless it is intended that B shall wait until sales are made before receiving any payment, which does not seem probable.

Company A sells the goods, although they are shipped by company B. Therefore it must be understood that company A collects from the customers and pays company B the amount due it for its work on the material.

Company B has nothing to do with selling the goods and should not be affected by any delay on the sales. It holds the goods in storage and ships them out purely as an accommodation to company A, probably to save cartage or freight. Therefore the situation as between the two companies is exactly the same as if company B returned the goods to company A upon completion of the work on them. Storing the goods subject to the orders of company A has the same effect as delivering them to company A.

It follows that, when company B notifies company A that certain units are finished and are held for orders, company B has the right to consider that it has earned the agreed $10.00 per unit, that it can charge company A in current account and that it can expect payment within a reasonable time. In that case company B has earned the profit on completion of its work.

However, if company B has been so short-sighted as to make a contract which provides that it is not to be paid until the goods are sold, it has not earned its profits until company A sells. In that case it should carry its share in the goods at whatever cost it has put into them until a sale is made, when it can charge company A at $10.00 and thus realize its profit.

Therefore it all depends upon the time at which company B can charge the account of company A and expect payment. No profit is made on any transaction until some one owes for the goods or the services.

If company A owes company B on completion of the work, as should be the case, the more work company B can do, the better, provided its storage capacity is not too limited. On the other hypothesis, company B must use its best judgment as to how many units it must furnish in order to be sure always to have enough on hand with which to make deliveries on the sales of company A.

Fire Loss

Editor, Students' Department:

SIR:—Will you advise me what entries to make properly to adjust the following fire loss on books:

Estimated loss on fixtures and building		3,500.00
Amount of insurance paid		2,800.00
Finished goods—estimated loss		8,500.00
Merchandise—estimated loss		625.00
Machinery department A		225.00
Machinery department B	2,000.00	
Furniture department B	325.00	2,325.00
Furniture department C		192.08
Office furniture		510.00
Estimated loss		12,377.08
Amount of insurance paid		9,000.00

Yours truly,

Philadelphia, Pennsylvania. F. D. M.

In case of a fire loss, the transactions must be put on the books in the order in which they occurred.

First record the fire.

Fire loss (in posting, detail the items)	15,877.08	
Fixtures and buildings		3,500.00
Finished goods		8,500.00
Merchandise		625.00
Machinery, department A		225.00
Machinery, department B		2,000.00
Furniture, department B		325.00
Furniture, department C		192.08
Office furniture		510.00
To record estimated loss by fire		
Cash	11,800.00	
Fire loss, insurance on buildings		2,800.00
Fire loss, insurance on contents		9,000.00
Payments by insurance companies		
Surplus	4,077.08	
Fire loss, loss on buildings		700.00
Fire loss, loss on contents		3,377.08
Net loss resulting from fire.		

Surplus is charged because the loss is an accidental and extraneous loss. Profit and loss would be charged only in case a fire were considered part of the normal operations of the business.