Journal of Accountancy

Volume 28 | Issue 6 Article 1

11-1919

Examinations, November 13 and 14, 1919

American Institute of Accountants. Board of Examiners

The Journal of Accountancy
Official Organ of the American Institute of Accountants
Vol. 28 DECEMBER, 1919 No. 6

American Institute of Accountants
BOARD OF EXAMINERS
Examination in Auditing
NOVEMBER 13, 1919, 9 A. M. TO 1 P. M.

Answer any ten questions and no more:

1. Outline in the case of a balance-sheet audit a programme of instructions for verification of cash and bank balances.
2. Outline a system of internal check for a wholesale grocery concern doing a business of $3,000,000 a year, with about 2,000 customers. The system should co-ordinate with an annual audit by professional accountants.
3. A corporation owns nearly all of a block of land. The remaining portion is purchased subject to an existing lease. The corporation sets aside out of surplus an amount believed to be sufficient to extend its plant over the entire block at the expiration of the lease. What ledger title should be given to the amount set aside, and how should the amount be set up on the balance-sheet?
4. In making "detailed" audits some auditors verify all postings and footings of general and subsidiary ledgers, even though controlling accounts are kept. State reasons for and against such procedure.
5. Describe three methods of calculating depreciation and suggests cases in which each might be feasible or desirable.
6. The federal reserve board stipulates that paper to be eligible for re-discount must be supported by a statement of the borrower showing a satisfactory excess of quick assets over current liabilities.
   (a) For such purpose what items are
      1. Quick assets?
      2. Current liabilities?

(b) A man owns 100% of the stock of each of two corporations. The business of one corporation is leased to the other, so that the lessee corporation has title to all quick assets. What kind of a statement should be submitted?

7. In auditing the accounts of a corporation for the first time you find that during prior years the federal income-tax returns (which had not been audited by the government) were, in your opinion, inaccurate and that a substantial additional amount of taxes is due to the government. Your client claims that the returns were correct, having been prepared under the advice of counsel. You believe that the client is acting in good faith. What, if anything, would you recommend? What bearing, if any, would the facts have upon a balance-sheet to be certified by you?
8. Describe a proper arrangement of audit working papers:
   (a) During the audit;
   (b) When ready for filing.
9. In the audit of the accounts of an instalment house with 20,000 open accounts, where weekly payments are due and made in currency, how would you verify the outstanding balances?
10. You ascertain that a client owes a substantial amount for assessments against local benefits. No liability therefor appears on the books. How would you proceed to determine the amount due? How would you reflect such amount on the balance-sheet?
11. On March 15, 1919, you received instructions to audit the accounts of a large corporation whose fiscal year ended December 31, 1918. The corporation has subscribed for Liberty bonds through various banks and at December 31, 1918, certain subscriptions had been paid for in full and delivery of the bonds accepted, while in other cases part payments only had been made. Bonds have also been delivered to employees who have subscribed and paid for them in full. Describe how you would proceed to verify the asset shown on the balance-sheet at December 31, 1918, representing bonds on hand and part payments made on subscriptions, so that you can give an unqualified certificate to your clients as of December 31, 1918.

13. In making an audit of a trust estate you find the following amounts treated as income:
    - (a) Profit on retirement of $10,000 bonds paid off at par plus 5%.
    - (b) Dividend of $500 due prior to decedent's death.
    - (c) Interest on $10,000 note for half-year to June 30th (testator having died on March 31st).
    - (d) Dividend of $1,000 for half-year to June 30th received July 1st.

    What criticism, if any, would you advance in regard to these credits?

Examination in Commercial Law

NOVEMBER 13, 1919, 2 P. M. TO 6 P. M.

Give reasons for all answers.

NEGOTIABLE INSTRUMENTS

Answer three of the following four questions:

1. (a) A holds B's note for $5,000, which is drawn to the order of A. How can A transfer the note to C and at the same time avoid liability on it?

   (b) Mention the various kinds of endorsements and give an example of each.
2. A received from B a negotiable promissory note for $2,500 payable on demand to the order of B and endorsed by B to the order of A. Six months later the maker of the note became insolvent. Has B any defense to an action by A against him as endorser? Explain fully.
3. A delivered his cheque to B for $150 in payment for a horse and later gave notice to the bank on which it was drawn not to pay it. What are B's rights (a) against the bank and (b) against A?
4. As an accommodation to B, A on June 1, 1919, endorsed B's note for $1,000 payable to C's order on July 1, 1919. On July 2, 1919, C endorsed and delivered the note to D. What rights, if any, has D against A?

CONTRACTS

Answer two of the following three questions:

5. A, having contracted on January 1, 1919, to sell B 100 bbls. of flour to be delivered on July 1, 1919, notified B on

February 1, 1919, that he would not perform the contract. What were B's rights upon the receipt of this notice?

6. A, in New York, wrote B in Buffalo, offering certain goods for sale at a certain price. B wrote a letter to A accepting the offer and posted it in Buffalo. Before A received the letter he received a telegram from B stating that he withdrew the acceptance. Was a valid contract made? Explain the principles involved.
7. What are the rights of a vendor of personal property when the vendee wrongfully refuses to accept delivery thereof?

CORPORATIONS

Answer both the following questions:

8. What is meant by issuing of stock, and in return for what may stock lawfully be issued?
9. From what funds may dividends be paid and who determines whether and when they shall be paid?

BANKRUPTCY

Answer both the following questions:

10. Define and distinguish insolvency at common law and under the federal bankruptcy act.
11. A commences a suit against B and obtains an attachment of B's property. Thirty days thereafter A enters judgment. The next day a petition in bankruptcy is filed against B, and twenty days thereafter he is adjudged a bankrupt. What is the effect, if any, on A's attachment and judgment?

PARTNERSHIP

12. A and B were partners in business. A died and C was appointed executor of his will. What are the rights, if any, of C, as executor, with respect to the partnership assets and business?

INCOME TAX

Answer two of the following three questions:

13. To what extent are salaries of officers and bonuses given to employees deductible in computing the net income of corporations under the federal income-tax law?

14. A New York corporation received during the year dividends amounting to $2,000 on stock of a Massachusetts corporation owned by it and $1,000 on stock of a British corporation owned by it. Do these dividends constitute taxable income of the New York corporation under the federal income-tax law?
15. A purchased a plot of vacant land in 1903 for $5,000. In 1919 he sold it still vacant for $7,500. How should this transaction be treated by A in preparing his income-tax return?

Examination in Accounting Theory and Practice

PART I

NOVEMBER 14, 1919, 9 A. M. TO 1 P. M.

Answer questions 1 *and* 3, *and any three other questions:*

1. Spark Plug and Auto Supply, Inc., is the manufacturer of a patented spark plug and is also dealer in automobile supplies. From the following trial balance (as of October 31, 1919), and information prepare balance-sheet and profit and loss statements showing cost of manufacture of spark plugs and gross and net profit on sales.

Advertising	$26,450	
Accounts receivable	180,105	
" payable		$42,500
Bills receivable	35,000	
" payable trade creditors		22,700
" " First National bank		150,000
Bonds 5% 1st mortgage		250,000
Building factory	225,000	
Bad debts written off	7,850	
Capital stock:		
Common fully paid		
Authorized $250,000		
Issued		100,000
6% Preferred.		
Authorized and issued		300,000
Dividend preferred stock	18,000	
Delivery expenses	7,140	
Delivery, equipment and trucks	9,250	
Directors' fees	2,500	
Discount on sales	12,200	
Freight: raw materials	12,050	
" automobile supplies	2,345	

Finished goods	34,320	
First National Bank current account	51,850	
General expenses	14,770	
Goods in process	13,250	
Heat, light and power	22,200	
Interest on bonds	9,375	
Insurance and taxes: factory	17,400	
Labor: productive	233,846	
" non-productive	99,444	
Liberty bonds	195,000	
Loose tools	15,270	
Machinery and plant	165,090	
Office furniture and fixtures	1,200	
Payroll		4,278
Patent rights	30,000	
Purchases: raw materials	450,960	
" automobile supplies	141,690	
Repairs	14,050	
Rent: warehouse	3,875	
Reserve for depreciation: buildings		20,500
" " " machinery		16,836
" " bad debts		8,000
Real estate: factory site	150,000	
Shop supplies and expenses	15,560	
Surplus		173,011
Sales: spark plugs		1,063,020
" automobile supplies		137,595
Salaries: office and general	14,500	
" salesmen	34,600	
Travelling expenses	22,300	
	2,288,440	2,288,440
Inventories, Nov. 1, 1918:		
Raw materials	14,500	
Automobile supplies	22,450	
Inventories, Oct. 31, 1919:		
Raw materials	27,300	
Automobile supplies	19,200	
Finished goods	50,400	
Loose tools	10,500	
Goods in process	17,205	

Reserve for bad debts to be adjusted to 5% of open accounts.

Depreciation for the 12 months ended October 31, to be allowed as follows:

Factory buildings	2%
Machinery	5%
Delivery equipment	10%
Furniture and fixtures	$200

Disregard fractional parts of a dollar.
Patent rights expire Oct. 31, 1925.
Advertising, $950.00 applies to next season.
Taxes on factory buildings accrued, $1,400.00.
First mortgage 5% gold bonds are a first charge on all the assets of the company. Interest payable quarterly on the first of February, May, August and November.

2. The certificate of incorporation of the company referred to in the preceding question provides for the redemption of preferred stock "out of surplus profits," $30,000 to be redeemed November 1, 1919, and $30,000 yearly thereafter. The stock redeemed in 1919 is to be purchased at 105 and accrued dividends, in 1920 at 110, and so on, the 1928 redemption being at 150.

Assuming that purchases of stock are made in accordance with the above requirements and that the directors take the necessary steps for the cancellation of the issue, explain how the various transactions should be recorded in the books of the company and illustrate your answer by journal entries.

How would you show the accounts in the balance-sheet at any time during the redemption period?

3. In Mr. Jones' private ledger he keeps accounts with each investment he makes, one of which is an investment of 1,000 shares (par value $100) of the A. B. Company, which he acquired in July, 1914, for $85,000. After this date and up to December 31, 1918, he makes further purchases and sales of this stock. A certified public accountant called in to prepare Mr. Jones' income-tax return for 1918 finds that these and other transactions have been written up in the following manner, no effort to show the profit on the sale of 1,000 shares on June 1, 1918, having been attempted:

INVESTMENT A. B. COMPANY ACCOUNT

		Dr.	*Cr.*
July 1/14.	1,000 shares purchased..............	$85,000	
Dec. 31/14.	Entry to carry this stock at par......	15,000	
May 31/15.	Purchased 1,500 shares at par........	150,000	
Nov. 30/15.	Sold 300 shares at 125.............		37,500
Dec. 31/15.	Profit and loss—profit on sale of 300 shares	7,500	

July 1/16.	Stock dividend of 50% on 2,200 shares declared from profits accumulated prior to Mar. 1, 1913.............	110,000	
Feb. 28/17.	Sold 700 shares @ 110...............		77,000
Dec. 31/17.	Profit and loss, profit made on sale of 700 shares	7,000	
June 1/18.	Sold 1,000 shares @ 125.............		125,000

Rewrite this entire account to show how it should have been kept in order to show the actual profit on each sale, and also calculate the actual profit on the last sale of 1,000 shares. What is the book value of the total shares on hand December 31, 1918?

4. Discuss the treatment of expenditures for (I) ordinary repairs and (II) replacements in their relation to capital expenditures, profit and loss and reserve for depreciation.
5. A corporation carries on its books an account with patents it has acquired from time to time by outright purchase during a period of ten years. They are still carried at original cost and it is decided to determine their present value, based upon the expiration of the life of the patents. Describe how you would proceed accurately to secure this result.
6. A wholesale and retail company, which also manufactures most of the goods sold by it, determines through its cost system in the factory the cost of manufacture and proposes to bill its wholesale department for all goods manufactured at cost plus 10%. What effect will such procedure have on statements issued by this company?
7. State briefly the reasons advanced against including interest on owned capital in manufacturing costs.

Examination in Accounting Theory and Practice
PART II

NOVEMBER 14, 1919, 2 P. M. TO 6 P. M.

Answer questions 1 *and* 2, *and any five other questions.*

1. A. and B. trading in partnership decide to admit C. as from January 1, 1919.

   They agree with C. as follows:

   C. is unable to contribute any tangible assets as his capital investment, but agrees to allow his share of the profits to be credited to his capital account until he shall have one-fifth interest. C. is to share profits and losses to the extent of one-fifth.

C. is to receive a salary of $3,000 per annum, payable monthly in addition to his share of profits.

Balance-sheet of A. and B. at December 31, 1918, is as follows:

Assets		*Liabilities*		
Cash	$ 1,500	Accounts payable		$8,000
Accounts receivable	10,000	Capital accounts		
Merchandise	7,500		A. $10,000	
Furniture & fixtures	1,500		B. 5,000	
Goodwill	2,500		——	15,000
	$23,000			$23,000

During the six months ended June 30, 1919, the business has sustained unusual losses and it is decided to dissolve the partnership.

The balance-sheet at that date is as follows:

Assets		*Liabilities*		
Cash	$ 500	Accounts payable		$12,500
Accounts receivable	12,500			
Merchandise	5,000	Capital accounts		
Furniture & fixtures	1,500		A. $10,000	
Goodwill	2,500		B. 5,000	
Deficit			——	15,000
Being loss on trading for six months	5,500			
	$27,500			$27,500

Accounts receivable were sold for $9,000, the buyer assuming all responsibility for collection and loss, if any.

Merchandise realized $6,500 and furniture and fixtures $500.

You are asked to make an examination of the accounts from January 1st and to prepare statements showing the realization of assets, the adjustment of the partnership accounts and the distribution of the funds.

In your examination you find that C. has not drawn his salary for four months, and that B. has advanced to the partnership $2,500 by way of a temporary loan. These liabilities you find are included in the sum of $12,500 shown as accounts payable.

C. is ascertained to be worthless.

2. The Pan-American Chemical Company, a New York corporation, owns a plant in Chile where nitrate of soda is manufactured and shipped to the United States. The accounts in Chile are kept in the local currency (pesos) and the following is a summary of the transactions during 1918:

1/1/18	New York	remitted by	telegraphic transfer	$30,000			
				which realized		120,000	pesos
4/1/18	"	"	"	$30,000	"	150,000	"
7/1/18	"	"	"	30,000	"	180,000	"
10/1/18	"	"	"	30,000	"	150,000	"

There were paid in wages for plant construction 120,000 pesos
There was paid for operating.................300,000 pesos

At December 31, 1918, the unpaid payroll for operating labor amounted to 60,000 pesos and one-sixth of the nitrate produced during the year remained in inventory.

You may assume that the production, construction and shipments were spread evenly over the whole twelve months, and that the only element entering into costs of production and construction in Chile was labor.

The average quoted exchange rates in Chile and New York were as follows:

1/1/18 to 6/30/18	3 pesos = $1.00
7/1/18 to 12/31/18	5 " = 1.00
At the close of business 12/31/18 the rate suddenly dropped to	6 " = 1.00

You are required to show the accounts affected in both pesos and American dollars and to prepare a trial balance as at 12/31/18 for the purpose of incorporating the Chilean accounts on the New York books.

3. If in consolidating the accounts of a holding company and its subsidiary companies you find that in the case of one of the subsidiary companies the holding company owns only 60% of its voting stock, state briefly how you would treat this subsidiary company's accounts in the consolidated balance-sheet and why your proposed treatment reflects the true financial position of the combined companies more clearly than other methods with which you may be familiar.

4. From the following comparative balance-sheets of the ABC Company at December 31, 1917, and December 31, 1918, prepare a short statement showing the funds realized during the year and the disposition made thereof:

Assets:	Dec. 31, 1917	Dec. 31, 1918
Capital assets	$600,000.00	$900,000.00
(Replacement values as shown by appraisal were used at December 31, 1918)		
Inventories	1,000,000.00	1,160,000.00
Accounts receivable	850,000.00	800,000.00
Cash	200,000.00	550,000.00
Deferred charges	20,000.00	10,000.00
	$2,670,000.00	$3,420,000.00

Liabilities:	Dec. 31, 1917	Dec. 31, 1918
Capital stock	$1,000,000.00	$1,000,000.00
Bonds (issued at par)		500,000.00
Capital surplus, representing excess of sound replacement value of appraisal at December 31, 1918, over the book value of capital assets at that date		150,000.00
Bank loans	750,000.00	400,000.00
Accounts payable	500,000.00	600,000.00
Reserve for depreciation and replacements	100,000.00	200,000.00
(The reserve at December 31, 1918, represents the difference between the replacement and sound value of the appraisal at December 31, 1918)		
Surplus	320,000.00	570,000.00
	$2,670,000.00	$3,420,000.00

Note.—The profits for the year were $450,000 and dividends were paid during the year amounting to $200,000. The sum of $100,000 was charged to operation for depreciation during the year and $50,000 was charged against the reserve for replacements.

5. Is there any distinction between the figure shown as "invested capital" in a corporation's excess profits tax return and the capital value upon which capital stock tax is calculated?

6. In setting up the balance-sheet of a corporation which has an issue of 100,000 shares of stock of no par value, but a stated value of $5 a share, and an excess of assets over liabilities of $1,500,000, how would you show the capital on the balance-sheet?
7. State how you would show on the balance-sheet, if at all, consigned goods held for account of a principal?
8. In which section of the balance-sheet and in what order would you show the following items: wages, accounts payable, taxes, notes payable, interest accrued payable?
9. Would you advise showing profits for prospectus purposes before or after deducting war profits and income taxes? State your reasons briefly.