American Institute of Accountants Examinations, November 14-15, 1940

American Institute of Accountants. Trial Board

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 on Nov. 14 and 15, 1940.]

EXAMINATION IN AUDITING

November 14, 1940, 9 a.m. to 12:30 p.m.

[The candidate must answer all questions.]

No. 1 (4 points)

New machinery, which replaced a number of employees, was installed and put in operation in the last month of the fiscal year. The employees had been dismissed after payment of an extra month's wages and the amount was added to the cost of the machinery.

Discuss the propriety of the charge and, if improper, offer alternative treatment.

No. 2 (4 points)

A corporation decides that the petty cash fund, maintained on the imprest fund system at one of its branches (John Jones, petty cashier) is too large to be kept in the office in cash and proposes to establish the fund in a bank account in the name of the corporation and to authorize the bank to pay checks drawn against the account by John Jones. Give a reasoned opinion of this proposal.

No. 3 (4 points)

As a part of the interim work in connection with an annual examination, undertaken two months before the end of the year, trial balances of the customers ledgers containing about 50,000 accounts were checked, footed and agreed with the controls, and a satisfactory test circularization was made. All bookkeeping is done by hand.

What additional auditing procedures, if any, should be followed in connection with receivables at the year end? The question of bad debts may be disregarded.

No. 4 (4 points)

Describe, in not over one hundred words each, the meaning of "internal control" and "internal audit."

No. 5 (8 points)

(a) Discuss generally the auditor's procedure followed in connection with confirmations of account-receivable balances.
(b) Name the two principal types of confirmation requests and state the essential difference between them.
(c) Give examples of other classes of assets or liabilities where each type is commonly used.

No. 6 (8 points)

On the books of a company is an account called "Exchange Check Account" which has many debits and credits but no balance at the end of any month. The controller explains that it represents accommodation purchases for company employees and others. Company checks are charged to the account, checks received from employees and others are credited. Should further investigation be made? Give reasons and discuss.

No. 7 (8 points)

(a) What are the usual liabilities and financial obligations or requirements in connection with a substantial mortgage bond issue not in default?
(b) How may they be ascertained and verified?

No. 8 (12 points)

(a) State in a general way to what extent physical tests of quantities should be made in the verification of inventories.
(b) Describe the extent of reasonable physical tests in the verification of the following specific types of inventories:
   1. Scrap and ore at smelting furnaces.
   2. Merchandise held for sale by a wholesale jobber of dry goods.

3. Operating, maintenance, and repair supplies in a factory.
4. Merchandise held for sale by a retailer of men's or women's clothing.
5. Merchandise held for sale by a dealer in musical instruments, pianos, radios, phonographs, etc.

No. 9 (12 points)

A manufacturing concern which has been your client for several years acquires control of another manufacturing company on April 1, 1940. The 1939 accounts of this subsidiary had been examined by public accountants. You are requested to make the 1940 examination with the object of consolidating the accounts of the two companies at the end of the year.

Discuss to what extent and purpose the accounts for the periods prior to 1940 should be examined.

No. 10 (12 points)

(a) What is an "encumbrance" and how is it recorded on the general books of a municipality?

(b) What is meant by the term "encumbrance method" as used by municipalities and what are its advantages?

(c) The general fund account of a municipality is kept under the "encumbrance method." At the close of the year

1. Bills aggregating $25,000 with evidence attached showing delivery on or before the end of the fiscal year and duly approved for payment had not been recorded among the liabilities.
2. Appropriations had been encumbered to the amount of $24,000 of these bills.

State in the form of properly explained journal entries what adjustment should be made, bearing in mind that budgetary and other accounts of the fund are kept in the same section of the general ledger.

(d) What are "nonrevenue funds"? Name and briefly describe several.

No. 11 (12 points)

(a) The balance-sheet of a company operating a large number of retail stores shows among the assets an item "leases" of relatively considerable amount.

1. What would this item normally represent and how should it be shown on the balance-sheet?
2. How may the amount be verified?

(b) How should a portfolio of marketable securities be inspected in a first audit of a manufacturing company?

No. 12 (12 points)

You are engaged by a Casualty Insurance Company to investigate a claim which has been filed under a fidelity bond issued by it for loss alleged to have been caused by embezzlement perpetrated by the branch office manager of the insured.

The claim consists of a list of seventy-five names with an amount shown after each one, the total of which amounts to $16,000 and is accompanied by the statement of the insured that these names and amounts represent account-receivable balances on the branch books which are the result of fictitious entries by its office manager to cover peculations amounting to $16,000.

The branch manager has absconded. The insured, however, is willing that any or all of the available records of its office be checked.

Upon inquiry at the head office of the insured it was ascertained that the manager had complete charge of all transactions at the branch which dealt only in one commodity. He reported daily to the main office the quantities received and sold, the details of the charge sales and the amount of cash received, distinguishing on the daily report between cash sales and collections on accounts receivable. All disbursements relating to the branch office were made by check from the main office. The branch office manager made a deposit daily of all receipts in a special bank account from which withdrawals could only be made by the proper officers located at the main office.

It was also found that the daily report showed the quantities on hand at the beginning and end of each day. The balance so shown at the close of each month was checked by a representative of the main office who took an actual inventory of the merchandise on hand. No large inventory shortages had ever occurred.

The representatives of the insurance company, your client, tell you that the branch manager was covered by a fidelity policy to December 31, 1939, in the principal sum of $5,000. On account of increased business this was considered inadequate and on January 1, 1940, an increase of $10,000 was duly made in the coverage making the limit of liability under the policy $15,000. The defalcation was discovered on April 30, 1940, and the loss reported in the claim of $16,000 was the accumulated loss to the latter date. The extent of the loss was computed by the insured after complete and quite successful circularization of all branch customers and the insurance company is willing that you make judicious use of this circularization so as to save further annoyance to the insured and his customers.

Explain briefly the steps which you would take in the investigation of this claim for the insurance company and state what results you would expect from each.

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART I

November 14, 1940, 1:30 p.m. to 7:30 p.m.

[*Solve all problems.*]

No. 1 (15 points)

Of each of the following inventory methods (a) describe the principal features; (b) give at least one situation, business, or industry in which it is used to advantage and considered good accounting practice, and in each case give the reason for its selection; also (c) state whether it is permissible for federal income-tax purposes:

Retail method.
Using a constant price for so-called normal quantity of materials or goods in stock (base-stock method).
Last-in, first-out.
First-in, first-out.
Average cost.
Deducting from the inventory a reserve for price changes or an estimated depreciation in the value thereof.

No. 2 (15 points)

The combined assets and liabilities of a parent company and its subsidiaries were as follows:

Assets

Current assets	$ 636,000
Intercompany accounts receivable	258,000
Investment of parent in subsidiaries	1,268,000
Properties, less reserves for depreciation	1,093,000
Deferred charges	13,000
Goodwill	306,000
	$3,574,000

Liabilities

Current liabilities	$ 174,000
Intercompany accounts payable	295,000
Funded debt—subsidiaries	130,000
Funded debt—parent company	696,000
Subsidiaries' capital and surplus at acquisition	1,298,000
Capital stock—parent company	460,000
Capital surplus—parent company	154,000
Earned surplus	367,000
	$3,574,000

The balance-sheets of thirty-eight "nominal" companies, each showing $1,000 capital stock and $1,000 receivable on intercompany account and nothing else, are not included in the above combined balance-sheet. However, the parent company carries the investment in these companies among the assets at par and includes the offsetting amount in the intercompany accounts payable.

Among the investments of the parent company is an amount of $6,000 representing bonds of a like principal amount of a subsidiary.

Preferred stocks of three subsidiaries are held by the public in the amounts of $10,000, $5,000, and $5,000, respectively. They are nonparticipating and all dividends had been paid.

The common stocks of all subsidiaries are 100% owned except the stock of one company of which 10% is held by the public. On the date of the balance-sheet the capital and surplus at acquisition of this company amounted to $40,000 and surplus earned since acquisition amounted to $30,000. No common dividends had ever been paid.

Complete the consolidation on a columnar work sheet.

No. 3 (20 points)

From the following trial balance of the accounts of Watson College and the additional information given, prepare a balance-sheet in the proper institutional form:

	June 30, 1939 Dr.	Cr.
Cash	$ 43,500	
Deposit accounts		$ 2,500
Income from endowment investments		85,500
Income from college operations		100,000
College operating expenses	195,000	
Interest accrued on securities purchased	500	
Inventories		
School supplies	5,000	
General	3,000	
Investments		
Bonds	875,500	
Mortgages	270,000	
Stocks	990,000	
Real estate	100,000	
Mortgages payable secured by college plant		250,000
College plant		
Land	95,000	
Buildings	1,000,000	
Ground improvements	50,000	
Equipment	160,000	
Profit on sale of endowment fund investments		4,000
Prepaid college expenses	2,000	
Accounts receivable		
Students	3,000	
Miscellaneous	1,000	
Notes receivable	20,000	
Notes payable		2,000
Accounts payable		3,000
Reserve for doubtful accounts receivable		500
Reserve for depreciation of buildings held as endowment fund investment		5,500
Reserve for contingencies		5,000
Excess of assets over liabilities		3,355,500
	$3,813,500	$3,813,500

ADDITIONAL INFORMATION

1. An analysis of the cash account shows that the cash should be divided as follows:

Current funds	
Imprest cash	$ 1,000
On deposit	35,000
Loan funds	2,000
Endowment funds	4,000
Funds subject to annuity agreements	1,500
	$43,500

2. Investments were all made from endowment funds with the exception of $25,500 in bonds purchased from funds subject to annuity agreements. The income and principal of the latter funds are to be used to make certain definite payments during the life of the annuitants. Excess of annuity payments over income has been charged to the principal of the fund.
3. Notes receivable represent loans made to students from funds which are restricted to that purpose.
4. Memorandum records show that $11,500

of endowment funds are loaned temporarily to the current fund.

5. These records also show that $50,000 of endowment funds are invested in the college's plant which is in full accord with the endowment terms.
6. The income from $895,000 of endowment principal is restricted.
7. It was decided that the reserve for depreciation of real estate carried among the investments be funded.

No. 4 (20 points)

The Beverly Company went into receivership on January 31, 1940. From the information given below prepare (a) a statement of affairs and (b) a deficiency account of that date.

TRIAL BALANCE
January 31, 1940

	Dr.	*Cr.*
Cash	$ 24,000	
Notes receivable	25,000	
Accounts receivable	75,000	
Inventory	50,000	
Marketable securities	40,000	
Land	25,000	
Buildings	150,000	
Machinery and equipment	175,000	
Prepaid expenses and deferred charges	7,000	
Notes payable		$ 20,000
Accounts payable		151,000
Accrued wages		9,000
Accrued taxes		12,250
Accrued interest on first mortgage bonds		3,750
First mortgage bonds due February 15, 1940		115,000
Reserve for depreciation—buildings		25,000
Reserve for depreciation—machinery and equipment		85,000
Reserve for doubtful accounts receivable		5,000
Reserve for contingencies		25,000
Common stock		150,000
Surplus	30,000	
	$601,000	$601,000

According to estimates made by the receiver in consultations with the management, assets are expected to realize the following amounts:

Notes receivable	$15,000
Accounts receivable	50,000
Inventories, after $5,000 is spent to complete work in progress	35,000
Marketable securities, 70% of book value	28,000
Land	30,000
Buildings	90,000
Machinery and equipment	60,000

Other data to be considered:

Notes receivable totaling $4,000 have been discounted of which $1,000 will have to be paid by Beverly Company as endorser.

Notes payable are secured by marketable securities having a book value of $25,000.

The first mortgage bonds are secured by a mortgage on the land and buildings.

It is estimated that contingencies covered by the reserve therefor will result in actual liabilities of $20,000.

Accrued wages are all of recent origin.

No. 5 (30 points)

On June 1st the Polar Corporation consigned 100 refrigerators to the AB Company, to be sold as follows:

Cash price—$180 less 5% discount

Time-payment plan—$180 net, one-third cash on delivery, the balance in 24 monthly payments of $5. All credit sales are subject to the approval of the Polar Corporation as to credit risk. Refrigerators will be repossessed when time-payment contracts are two months in default and will be returned to the manufacturer for reconditioning.

The manufacturing cost of each refrigerator was $60, and $400 freight was prepaid on the shipment. The AB Company paid $200 truckage and deposited with the consignor $7,500 cash, thus advancing in all $7,700 to secure the consignment.

This sum is to remain credited to the AB Company until all refrigerators are sold and fully paid or repossessed. However, on December 31st of the current year, and thereafter on the last day of each month, the consignor must refund to the AB Company the amount, if any, by which the original deposit exceeds the aggregate of (1) the full sales price of the unsold refrigerators and (2) the uncollected instalments on time-payment contracts.

The AB Company will receive a commission of $30 on each refrigerator sold for cash or on approved time-payment contract. The AB Company will promptly remit all collections less commissions in full on all such sales. Commissions on defaulted contracts that had been approved by the Polar Corporation will not be recoverable from the AB Company.

On June 30th the AB Company reported that they had sold 60 refrigerators, 20 for cash and 40 on the time-payment plan. The latter sales had been duly approved by the Polar Corporation. The amounts collected had been remitted according to agreement.

Instalments on the 40 time-payment contracts were collected for July, August, and September and had likewise been remitted.

In October and November collections were made and remitted on only 30 of these contracts, and the refrigerators sold on the ten defaulting contracts were repossessed and returned to the Polar Corporation on November 30th. The latter expects to sell these refrigerators at $100 each after spending $10 each for inward freight and cost of reconditioning.

December collections on time-payment contracts were made in full and the AB Company reported cash sales of 20 refrigerators, and 20 remaining in stock. The Polar Corporation received these collections and the net proceeds from the cash sales on December 31st.

The Polar Corporation in accounting for instalment sales follows the plan of recognizing income only in terms of amounts collected.

From the foregoing data prepare:

(a) The entries that will record the transactions on the books of the Polar Corporation.

(b) Comprehensive summaries of these entries showing and explaining the following resulting balances at December 31, 1939:

1. Consignment.
2. Repossessed refrigerators.
3. Cash.
4. AB Company.
5. Profit realized.
6. Profit not realized.
7. Loss on defaults.

EXAMINATION IN COMMERCIAL LAW

November 15, 1940, 9 a.m. to 12:30 p.m.

[Reasons must be stated for each answer; no credit will be given for an answer unsupported by a statement of reasons. 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)

On October 1st, a certified public accountant entered into a legally valid contract with a corporation whereby he agreed to audit the corporation's books for the year ending December 31st, next, his work to begin December 1st. On November 15th, the accountant learned that the corporation had become insolvent after October 15th. On November 20th, a stockholder of the corporation, who was neither an officer nor a director of it, orally promised the accountant that if the accountant would make the audit the stockholder would pay the accountant's fee if the corporation did not pay it. The accountant made the audit to the satisfaction of everyone concerned, but the corporation failed to pay his fee. State every principle of law which would have a favorable or an adverse bearing on the accountant's right to enforce the stockholder's promise to pay the fee, and explain how the principle is applicable. You need not express an opinion with respect to the stockholder's legal liability.

No. 2 (10 points)

A sole proprietor, owning and operating a small retail business, is considering whether he should incorporate his business. List and explain briefly any disadvantages which would ensue from such incorporation.

No. 3 (10 points)

State in each of the following cases whether the negotiability of an otherwise negotiable instrument would be destroyed if—

(a) It were written in pencil;
(b) It contained the following promise: "I promise to deliver to John Smith or order 100 tons of gold-bearing ore from the North Star mine";
(c) It contained the following promise: "I promise to pay James Jones or order $1,000 when he becomes 21 years of age";
(d) It contained the following promise: "I promise to pay Richard Rose $100" at a specified date.

No. 4 (10 points)

Define the following terms as they relate to the law of contracts so as to differentiate one from another and give a brief example illustrating each one: (a) void; (b) voidable; (c) unenforceable.

No. 5 (10 points)

X borrowed Y's automobile without paying any consideration therefor for the avowed purpose of driving it from St. Louis to Memphis and return in order to make an audit in Memphis. Without Y's knowledge or consent, X drove this car to Kansas City and return, and on the return trip, the car was damaged, without negligence by X, as a result of a highway defect. This trip to Kansas City was occasioned by an unexpected request that X make an audit there. Y was not employed by or in any way associated with X and Y had no interest in or connection with either of these audits.

(a) What kind of bailment is this?
(b) Can Y hold X financially responsible for the damage to the car?

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 in the order written by the applicant will be considered.]

No. 6 (10 points)

(a) Give a simple example of a gift to take effect at death.
(b) Give a simple example of a gift in contemplation of death.
(c) For what reasons, other than a desire to help the donee, are such gifts usually made?
(d) Give a simple example of a gift causa mortis.

No. 7 (10 points)

Brown, a licensed real estate broker, notified Jones that certain real property could be purchased from the Security Bank. Jones, who knew that Brown would be entitled to a commission, falsely told him that he was not interested in purchasing the property. Immediately thereafter Jones signed a contract with the bank for the purchase of this property, falsely representing to the bank that no broker had brought about the sale. Brown was unable to collect a commission. If Brown has any legal rights against Jones, on what principle of law would they be based?

No. 8 (10 points)

On May 28, 1939, the Benjamin Corporation procured a policy of fire insurance and the property covered thereby was destroyed by fire on June 25, 1939. Upon refusal of the insurer to pay this loss, the corporation sued the insurance company. The latter defended on the ground that on December 15, 1937, the corporate existence of the Benjamin Corporation was terminated by proclamation under a statute of its state of incorporation because of its failure to pay its franchise tax. This statute provided that the corporate existence of a tax-delinquent corporation "shall immediately cease and shall be deemed dissolved without further legal proceedings" upon the publication of such a proclamation.

(a) Is the insurance company's defense valid?
(b) Would it have been valid if the action had been brought by a receiver duly appointed to wind up the corporation's affairs?

No. 9 (10 points)

(a) Define "infant" as the term is used in the law.
(b) In determining whether property or service for which an infant attempted to contract is a "necessary," what factors, circumstances, or considerations are taken into account?

No. 10 (10 points)

A certified public accountant in making his first audit of the books and accounts of a corporation notes that the assets include a parcel of real property. The secretary of the corporation gives him an abstract of title.

(a) Describe an abstract of title and mention three kinds or types of items that might be found in one.
(b) What use should the accountant make of this abstract?

No. 11 (10 points)

(a) What is a mortgage on personal property called? (Give the legal name for that kind of mortgage.)
(b) In what principal respect does such a mortgage differ from a pledge?

No. 12 (10 points)

X owns 48% of the capital stock of a corporation conducting a profitable but highly competitive business, Y holds 49%, and Z holds 3%. X enters into a legally binding contract with Z for the purchase of Z's stock. Z, without excuse, breaches his contract and refuses to deliver the stock. What can X legally do about it?

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART II

November 15, 1940, 1:30 p.m. to 7:30 p.m.

[Solve all problems.]

No. 1 (10 points)

From the following trial balances of a wholly owned subsidiary prepare a statement of sources and application of funds:

	January 1	December 31
Assets		
Current assets	$ 400,000	$ 501,000
Fixed assets, less reserve	1,000,000	1,016,000
Deferred charges	50,000	40,000
Goodwill	650,000	60,000
	$2,100,000	$1,617,000
Liabilities		
Current liabilities	$ 200,000	$ 250,000
Capital surplus	300,000	....
Earned surplus	700,000	....
Capital stock	800,000	....
Intercompany account	100,000	1,367,000
	$2,100,000	$1,617,000

On March 31st $600,000 of goodwill was charged off—$300,000 to capital surplus and $300,000 to earned surplus.

In the first half of the year the subsidiary bought the assets of a business, consisting of $100,000 equipment and $50,000 inventory and accounts receivable. The amount paid was $170,000, the excess of $20,000 being considered the value of the goodwill acquired.

Old machinery was sold for $1,000; it had a book value of $12,000 and $8,000 depreciation had been provided.

On June 30th, the subsidiary company was dissolved and made a division of the parent company. Its accounts were continued in a separate divisional ledger.

A net profit of $317,000, after providing $80,000 depreciation and $10,000 for amortization of goodwill, had been made and was credited to intercompany account.

The deferred charges consist of unexpired insurance and prepaid current expenses.

The solution to this problem will be graded with special regard to form.

No. 2 (20 points)

The balance-sheets and profit-and-loss statements of John Doe Manufacturing Company and its wholly owned subsidiary, Blank Sales Company, were submitted as follows:

BALANCE SHEETS—DECEMBER 31, 1939

Assets	John Doe Mfg. Co.	Blank Sales Co.	Combined
Cash	$ 150,000	$ 75,000	$ 225,000
U. S. Government bonds—at cost, not in excess of market value	300,000	100,000	400,000
Trade accounts receivable:			
Customers—less reserves	10,000	650,000	660,000
Blank Sales Co.	490,000	....	490,000

Inventories—at the lower of cost or market	$ 600,000	$ 200,000	$ 800,000
Investment in Blank Sales Co.	375,000	....	375,000
Investment in 1,000 shares of common stock, $5 par value, of John Doe Mfg. Co. (carried at the cost of the common stock of $10 par value exchanged therefor)	....	20,000	20,000
Other assets	25,000	30,000	55,000
Property, plant and equipment—at cost	950,000	275,000	1,225,000
Prepaid expenses	35,000	25,000	60,000
Expenses of registration and listing of stock	15,000	....	15,000
	$2,950,000	$1,375,000	$4,325,000
Liabilities			
Notes payable	$ 200,000	$ 100,000	$ 300,000
Accounts payable—including amounts due to affiliated companies	325,000	665,000	990,000
Federal taxes on income	150,000	35,000	185,000
Reserve for depreciation	250,000	75,000	325,000
Common stock, $10 par value	750,000	150,000	900,000
Common stock, $5 par value	375,000	....	375,000
Surplus			
At January 1, 1939	$ 596,250	....	$ 951,250
At July 1, 1939	....	$ 355,000	
Net profit per statement of profit and loss	510,000	115,000	625,000
	$1,106,250	$ 470,000	$1,576,250
Dividends paid	206,250	120,000	326,250
	$ 900,000	$ 350,000	$1,250,000
	$2,950,000	$1,375,000	$4,325,000

Statements of Profit and Loss

	John Doe Mfg. Co.	Blank Sales Co.	Combined
	Year ended Dec. 31, 1939	Six months to Dec. 31, 1939	
Net sales	$4,200,000	$3,300,000	$7,500,000
Cost of goods sold	3,570,000	3,025,000	6,595,000
	$ 630,000	$ 275,000	$ 905,000
Selling and administrative expenses	75,000	140,000	215,000
	$ 555,000	$ 135,000	$ 690,000
Other income:			
Commission earned	$	$ 25,000	$ 25,000
Dividends received	120,000	1,000	121,000

Miscellaneous	$ 5,000	$ 4,000	$ 9,000
	$ 125,000	$ 30,000	$ 155,000
	$ 680,000	$ 165,000	$ 845,000
Miscellaneous deductions from income	$ 20,000	$ 15,000	$ 35,000
Federal taxes on income	150,000	35,000	185,000
	$ 170,000	$ 50,000	$ 220,000
Net profit	$ 510,000	$ 115,000	$ 625,000

Also the following information was given:

1. In June, 1939, the authorized capital stock of John Doe Manufacturing Company was changed from 100,000 shares of $10 to 250,000 shares of $5 each and the shareholders agreed to exchange their stock on the basis of 1¾ shares of the new for each share of the old stock. Accordingly all the 75,000 outstanding shares of the old $10 stock were exchanged for 131,250 shares of the new $5 stock on July 1, 1939.
2. On July 1, 1939, the company acquired all the outstanding 15,000 shares of Blank Sales Company for 75,000 shares of its new $5 stock.
3. Immediately after July 1, 1939, certain shareholders of John Doe Manufacturing Company disposed of a portion of their holdings to an underwriter, receiving $20 per share. The shares were offered to the public at $22.50.

   In view of the wider distribution of its stock after the public offering the company arranged to list its common shares on the stock exchange and agreed to pay all expenses of listing and of registering the stock under the securities act of 1933, amounting to $15,000.
4. The inventories of Blank Sales Company included merchandise bought from John Doe Manufacturing Company at the latter's regular sales prices, as follows:

January 1, 1939	$ 50,000
June 30, 1939	30,000
December 31, 1939	40,000

5. The net sales of John Doe Manufacturing Company included net sales to Blank Sales Company as follows:

January 1 to June 30, 1939	$1,500,000
July 1 to December 31, 1939	2,500,000

6. Commissions earned by the Blank Sales Company included $2,000 received from John Doe Manufacturing Company and charged to the latter's selling expenses.
7. Dividends received had been credited to income.
8. Throughout the year the rate of gross profit on sales remained the same.
9. All depreciation had been charged to the production cost, the office equipment having been written down to nominal value in previous years.
10. No entries had been made recording the conversion of the John Doe Manufacturing Company capital stock.

From the foregoing data prepare a columnar work sheet distinctly showing the consolidated balance-sheet and profit-and-loss statement of John Doe Manufacturing Company and its wholly owned subsidiary, Blank Sales Company. The candidate must show or mention how the 1,000 shares of John Doe Manufacturing Company stock owned by the Blank Sales Company should be treated.

No. 3 (20 points)

The Citizens Light and Power Company's trial balance of December 31, 1939, is given below:

	Dr.	*Cr.*
Amortization of debt discount and expense	$ 100	
Amortization of utility plant acquisition adjustments	400	
Bonds		$100,000

Capital stock		$ 75,000
Cash and working funds	$ 13,500	
Construction work in progress	14,900	
Contributions in aid of construction		25,000
Customers' advances for construction		365
Customers' deposits		750
Depreciation	5,875	
Dividend appropriations—capital stock	6,000	
Dividends declared		1,500
Earned surplus		4,185
Extraordinary property losses	35,000	
Interest accrued		2
Interest charged to construction		200
Interest on long-term debt	2,500	
Interest receivable	200	
Interest revenues		400
Materials and supplies	4,500	
Notes and accounts payable		2,000
Notes and accounts receivable	7,000	
Notes receivable discounted		1,000
Operating expenses	32,000	
Operating revenues		60,000
Other deferred debits	1,550	
Other interest charges	2	
Prepayments	1,000	
Property losses chargeable to operations	1,000	
Reserve for amortization of utility plant acquisition adjustments		4,300
Reserve for depreciation of utility plant		66,525
Reserve for uncollectible accounts		500
Taxes	6,500	
Taxes accrued		3,500
Unamortized debt discount and expense	3,200	
Utility plant acquisition adjustments	10,000	
Utility plant in service	200,000	
Totals	$345,227	$345,227

ADDITIONAL INFORMATION

1. The bonds are dated July 1, 1925, and are due July 1, 1955. Interest at the rate of 5% per annum is paid on January 1st and July 1st. The bonds were originally issued at 94. The appropriate adjustment at December 31, 1939, has not been made.
2. The charge to "depreciation" includes $100 for depreciation on trucks and other equipment used on construction work which is still uncompleted.
3. $10,000 (face value) of the company's bonds were purchased and retired on December 31, 1939, at 95. The January 1, 1940, coupons had been removed and will be paid separately. The entry for the bond purchase and retirement has not been made.
4. On October 1, 1939, equipment which cost $1,500 broke down and was scrapped. It was acquired on April 1, 1935, and had been depreciated at the rate of 20% per annum. The cost of removing and disposing of the equipment was $50. The bookkeeper made the following entry:

Other deferred debits	$1,550	
Utility plant in service		$1,500
Cash		50

No depreciation has been recorded on this equipment during 1939.

Prepare:

(a) The entries called for by the "additional information."

(b) The balance-sheet of December 31, 1939.
(c) The earned-surplus account for the year 1939.
(d) The income account for the year 1939.

Problem 4 (20 points)

The will of E. M. Dodd, who died on December 31, 1933, provided cash bequests of $40,000 to Mrs. Dodd and $15,000 each to two children, the residuary estate to be divided equally among the three beneficiaries. Mrs. Dodd was appointed executrix and trustee without fees or other emoluments.

By court order Mrs. Dodd was to receive a family allowance of $4,000 a month, commencing January 1, 1934, payable from income or from any cash principal available if the income should be inadequate. The estate never had enough cash available to pay up the full allowance nor could any part of the cash bequests be paid. Accordingly a considerable liability to Mrs. Dodd had accumulated toward the end of 1939 for the unpaid portion of the family allowance, as shown by the following trial balance of the estate ledger at December 31st of that year:

	Dr.	*Cr.*
Cash	$ 200	
Securities	20,000	
Building A	200,000	
Reserve for depreciation		$ 36,000
Building B	160,000	
Reserve for depreciation		38,400
Mortgage—building B		32,000
Revolving fund—building A	1,800	
Revolving fund—building B	2,400	
Mrs. E. M. Dodd—family allowance		288,000
Mrs. E. M. Dodd—paid on account	178,000	
Estate corpus		168,000
	$562,400	$562,400

The balance in the estate corpus account was made up as follows:

Appraisal of assets	$365,000
Deduct—Funeral expenses, etc.	15,000
	$350,000
Add—Income	
Dividends received	6,000
Rentals, after deducting expenses and mortgage interest to date	100,000
	$456,000
Deduct—Family allowance	288,000
Balance	$168,000

For want of cash the beneficiaries decided to settle all liabilities by transfer of property and they requested their attorney to petition the court for approval of the following agreement to take effect as of December 31, 1939:

The building B and its revolving fund are to be conveyed to Mrs. Dodd subject to the mortgage. In turn she agrees to waive all her claims against the estate for expenditures not refunded to her, including one of $5,000 for estate income taxes paid by her and not collected from the estate, and in addition to pay attorney's fees of $6,000 for the estate. Furthermore, all beneficiaries agree to have the family allowance discontinued after December 31, 1939, and also to waive their claims to the cash bequests.

The court gave its approval to the agreement and ordered an intermediary accounting by the trustee as of December 31, 1939.

Prepare:

(a) Adjustments to the trial balance.
(b) Columnar work sheet showing the trial balance before and after adjustment.
(c) Statement of Mrs. Dodd's account.
(d) Statement of estate corpus.
(e) Trustee's intermediary accounting in the form of a charge and discharge statement.

No. 5 (30 points)

The Metal Products Company operates a plant at which is produced a standardized line of small metal articles that do not differ very much in type, cost, or sales value.

It has been decided to include burden in the production cost at departmental normal rates, and you are called in to calculate these rates from the following normal annual operating data prepared by the company:

PRODUCTIVE CAPACITY OF MANUFACTURING DEPARTMENTS

	Machine hours	Direct labor Hours	Direct labor Dollars
Machining A	50,000	100,000	80,000
Machining B	40,000	40,000	30,000
Bench Assembly	......	60,000	27,000
Packing	......	50,000	25,000

MISCELLANEOUS OPERATING DATA

	Occupied area square feet	Book value machinery and equipment	Number of employees	Horse power Installed	Horse power Usage factor
Machining A	18,000	$ 75,000	60	125	80
Machining B	15,000	60,000	24	80	80
Bench assembly	20,000	12,000	36	..	..
Packing	10,000	18,000	30	10	50
Maintenance	4,000	9,000	..	5	40
Receiving and stores	13,000	8,000	..	5	60
General plant	2,000	4,000	..	..	..
Warehousing and shipping	18,000	14,000	..	15	60
	100,000	$200,000	150	240	

INDIRECT LABOR, MATERIALS, SUPPLIES AND EXPENSES

	Supervision and indirect labor	Supplies and sundry expenses	Maintenance Materials	Maintenance Labor *
Machining A	$15,000	$18,000	$ 8,000	$ 9,000
Machining B	8,000	12,000	5,000	4,000
Bench assembly	7,200	2,000	500	1,000
Packing	6,000	3,000	800	600
Maintenance	8,000	5,000	1,000	500
Receiving and stores	4,000	1,800	300	200
General plant	16,000	8,000	500	300
Warehouse and shipping	10,000	8,500	1,500	1,000
	$74,200	$58,300	$ 17,600	$16,600

* Maintenance labor is charged directly to the various departments from maintenance department time tickets.

Other Expenditures and Charges

Unemployment tax at the rate of 3%
Old age benefit tax at the rate of 1%

Workmen's compensation—per $100 payroll		
Machining departments....	$	2.50
General plant department..		.75
Other departments........		1.50
Purchased power............	18,000	
Rent, light and heat.........	30,000	
Insurance and sundry taxes...	2,400	
Depreciation at 10% per annum....................	20,000	

The receiving and stores department receives and stores the sheet metals, all of which enter into the manufacturing processes through machining department A. There is not much difference in the costs of the several kinds of metal used, and in the time to machine them, for the various products do not vary greatly.

The general plant department consists of the superintendent's and the paymaster's offices.

The warehousing or shipping department stores and ships the manufactured product only.

All direct labor is paid at hourly rates. All employees work about the same number of hours per annum. They earn less than $3,000 per annum, except the superintendent and the foreman of machinery department A who receive $8,000 and $5,000 per annum, respectively.

From the foregoing information prepare a comprehensive summary of the normal annual burden, leading to and showing the departmental burden rates. State the basis or bases on which the burden should be applied to the direct manufacturing costs.