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Students' Department

H. A. Finney

H. P. Baumann

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H. A. Finney, *Editor*

H. P. Baumann, *Associate Editor*

AMERICAN INSTITUTE EXAMINATIONS

(Note.—The fact that these solutions appear in The Journal of Accountancy should not cause the reader to assume that they are the official solutions of the board of examiners. They represent merely the opinions of the editors of the *Students' Department*.)

Examination in Accounting Theory and Practice—Part II (*continued*)

November 18, 1927, 1 P. M. to 6 P. M.

No. 2 (21 points):

The Golden Fleece Knitting Mills, engaged in the manufacture of woolen sweaters of various kinds, is in need of financial assistance in order to negotiate some heavy purchases of raw material for the coming season.

The company presents the following statement of assets and liabilities, as at October 31, 1926, with the request that you certify it.

Upon ascertaining the facts as set forth hereunder, make such adjustments as you think necessary and submit a revised balance-sheet showing the ratio of current assets to current liabilities and express your opinion as to the financial condition so indicated.

Assets

Cash in banks and on hand		$10,600
Trade debtors	$95,200	
Less: Reserve for losses	9,100	86,100
Due from officers and employees		5,300
Inventories:		
Raw material	$93,000	
Work in process	55,000	
Finished goods	225,000	373,000
Investments—miscellaneous		20,000
Machinery and equipment	$95,900	
Furniture and fixtures	20,600	
	$116,500	
Less: Reserve for depreciation	21,900	94,600
Prepaid insurance		2,200
		$591,800

Liabilities

Notes payable	$140,000
Accounts payable	40,900
Wages accrued	15,600
Taxes accrued	21,000
Interest accrued	5,000
Capital stock	350,000
Surplus	19,300
	$591,800

Upon investigation, you discover that:

(1) The mill operates under a system of "standard costs" using a basic price for wool yarn of $2 per pound. The standard costs for labor, overhead, etc. vary according to the article manufactured.

(2) The company is granted a discount on yarn purchases of 5% off market prices if paid within 30 days from date of invoice, and this discount is handled on the books as a financial income at time of payment of invoice, not as a reduction in cost of raw material.

(3) The market price of yarn, October 31, 1926 was $1.85 per pound.

(4) The inventories were composed as follows:

Raw material (yarn)	
20,000 lbs. at cost, $1.95	$39,000
30,000 " " " 1.80	54,000
Work in process—	
Yarn at standard cost, $2.00	$50,000
Labor and overhead (standard costs)	5,000
Finished goods—	
Yarn at standard cost, $2.00	$200,000
Labor and overhead (standard costs)	25,000

(5) Owing to sundry imperfections necessarily and continually arising in the manufacture, some of the finished articles have to be classed as "seconds" and are sold at 25% less than the selling price of "firsts."

(6) The selling price of "firsts" is 150% of standard cost.

(7) The total production of the mill for the year (both groups being priced at the same standard cost) was "firsts" $680,000, "seconds" $160,000. The inventory of finished goods (as above) contained "seconds" to the value of $60,000 at standard cost.

(8) There were no unpaid bills for yarn included in the accounts payable.

(9) Under a two-year yarn-purchase contract, you find that a shipment of yarn containing 10,000 pounds at the contract price of $1.95 per pound f. o. b. factory or shipping point, left the factory by rail on October 28, 1926, reaching your client on November 5, 1926, with a freight charge of $350. The liability for this merchandise did not appear on the books of the client.

(10) The investments include liberty bonds $3,000, which represents both cost and market value thereof, and also miscellaneous stocks $17,000 at cost, which are not readily realizable and for which no market quotations can be obtained.

Solution:

"Cost or market, whichever is lower" is generally accepted as the most conservative basis of inventory valuation and there appear to be no conditions in this problem which would require the use of any other basis.

An adjustment would be desirable, therefore, to reduce the valuations of the raw material, work in process, and finished goods on hand at October 31, 1926, to the lower of actual cost or market value as of that date.

Market value of the work in process and finished goods can be determined only upon the basis of the market values of the basic elements of cost, i. e., raw material, labor and overhead, inasmuch as there is no information as to any market value of the finished goods and work in process. Furthermore, no information is available as to market prices which would apply to labor and overhead, so that any adjustment to market value in the case of goods in process and finished goods would be possible with respect to the raw material only.

There is no way of determining the actual cost of work in process and finished goods because only standard costs of labor and overhead are stated in the problem. However, it is possible to reduce the material element of the work in process and finished goods from standard cost to market value.

The first step in adjusting the inventory valuations is that of determining the cost and market price of the raw material on hand October 31, 1926. It is not stated in the problem whether the market price for yarn as of October 31, 1926, is f.o.b. the factory or f.o.b. the plant of the Golden Fleece Knitting Mills. If it is $1.85 per pound f.o.b. factory, the freight cost would be a proper addition to the inventory values based upon the market price of $1.85, and this freight cost, upon the basis of the $350 freight charge on the 10,000-pound shipment in transit at October 31, 1926, would amount to $.035 per pound. Neither is it stated in the problem whether or not the prices given as cost of the two lots of yarn appearing in the raw material inventory are inclusive of freight. However, the contract price of $1.95 under the two-year yarn-purchase contract is stated as the price f.o.b. factory. It is not improbable that the 20,000-pound lot of yarn included in the raw-material inventory at the price of $1.95 was purchased under the same two-year contract and represents the cost price f.o.b. factory. It appears reasonable, therefore, though there is no conclusive evidence on the point, that the market price of $1.85 per pound and the prices used as cost in valuing the inventory of raw material, represented prices f.o.b. factory, and an assumption to that effect has been made in this solution

The value of the inventory of raw material on hand and in transit is determined as follows:

	Cost (including freight)		Market (including freight)		Inventory value
	Price	Amount	Price	Amount	
On hand:					
20,000 lbs.	$1.985	$39,700.00	$1.885	$37,700.00	$37,700.00
30,000 lbs.	1.835	55,050.00	1.885	56,550.00	55,050.00
Total					$92,750.00
In transit:					
10,000 lbs.	1.985	19,850.00	1.885	18,850.00	18,850.00
Total					$111,600.00

In valuing the inventory of work in process, the only alternative value to that of standard cost is that determined by including the yarn at market of $1.885 and labor and overhead at standard cost. The necessary adjustment would be as follows:

Work in process—		
At standard cost:		
Yarn—25,000 lbs. at $2.00	$50,000.00	
Labor and overhead	5,000.00	$55,000.00
Adjusted value:		
Yarn—25,000 lbs. at $1.885	$47,125.00	
Labor and overhead (at standard cost)	5,000.00	52,125.00
Amount of adjustment to reduce inventory to market price with respect to yarn		$2,875.00

A similar adjustment should be made with respect to the inventory of finished goods to reduce the value thereof to an amount which will include yarn at market price of $1.885 instead of at standard cost of $2.00 per pound.

The question also arises as to whether the valuation of the inventory of finished goods should be further adjusted on account of the fact that "seconds" are included therein "to the value of $60,000 at standard cost."

It may be contended that, inasmuch as the inventory value of the "seconds," priced on the same basis as "firsts," would be less than their selling price, there can be no objection to so valuing the "seconds." It may be pointed out, in considering the question, that the use of that basis will result in showing a smaller rate of gross profit to net sales than will be shown for "firsts" and that such a showing will reflect the facts.

There is also the possibility to be considered of treating the "seconds" as in the nature of a by-product, the proceeds from the sale of which might be credited to the cost of production of the "firsts," the "seconds" in the inventory of finished goods being valued at selling price (less, possibly, necessary selling expenses). It does not seem, however, that this is an appropriate case for the application of this method of treating "seconds," because (1) of the large proportion of "seconds" produced and (2) the fact that the selling price of "seconds" is substantially in excess of the cost, even if cost be figured on the same basis as that of "firsts," and the use of selling price as a basis for valuing the inventory of "seconds" would, therefore, result in an anticipation of profits.

The editors of this department believe that neither of the methods mentioned above for arriving at the valuation of the inventory of finished goods is correct.

The problem states that, "owing to sundry imperfections *necessarily and continually* arising in the manufacture, some of the finished articles have to be classed as 'seconds' and are sold at 25 per cent. less than the selling price of 'firsts.'" It would appear, therefore, that part of the cost of manufacturing "firsts" consists of the losses arising from the imperfections which necessitate classing part of the product as "seconds."

The difficulty arises when an attempt is made to determine what amount should be included in the cost of the production of "firsts" as representing the loss resulting from the production of "seconds." If the selling price of "seconds" were less than the average cost of production of "firsts" and "seconds," the entire selling prices realizable for "seconds" could properly be credited to the cost of production of "firsts" which would thereby absorb the loss. But in this case the selling price of "seconds" is in excess of the average cost of production.

For the purposes of this solution, the total costs of production, using market price at October 31, 1926, for yarn and standard cost for labor and overhead, are allocated between "firsts" and "seconds" on the somewhat arbitrary basis of the values at selling price of the production for the year.

The computation, by this method, of the values of the finished goods on hand October 31, 1926, is as follows:

(a) Ascertain the cost of production for the year using the market value at October 31, 1926, of $1.885 per pound for yarn and standard cost for labor and overhead.

Total production for year at standard cost:		
Firsts	$680,000.00	
Seconds	160,000.00	$840,000.00
Deduct:		
Labor and overhead (using ratio to total standard cost of $^1/_9$ indicated by the figures given for the inventory of finished goods at October 31, 1926)		93,333.34
Yarn		$746,666.66
Pounds of yarn used: $746,666.66÷$2.00 or		$373,333.33

Total production cost for the year using market value of $1.885 per pound for yarn and standard cost for labor and overhead:	
Yarn:	
373,333.33 lbs. at $1.885	$703,733.33
Labor and overhead (as above)	93,333.34
Total	$797,066.67

(b) Allocate the cost of production for the year as shown in (a) to "firsts" and "seconds" on the basis of their sales values.

	Standard cost	Sales values: Per cent. of standard cost	Sales values: Amount	Sales values: Per cent. of total
"Firsts"	$680,000.00	150.	$1,020,000.00	85.
"Seconds"	160,000.00	112.5	180,000.00	15.
Total	$840,000.00		$1,200,000.00	100.

Cost of production of "firsts"—85% of $797,066.67=	$677,506.67
Cost of production of "seconds"—15% of 797,066.67=	119,560.00
Total	$797,066.67

(c) Apply to the values at standard cost of the "firsts" and "seconds" in the finished goods on hand at October 31, 1926, the ratios of the costs of production determined in (b) to production for the year at standard cost given in the problem.

"Firsts"— $\frac{677,506.66}{680,000} \times \$165,000.00 = \$164,395.00$

"Seconds"— $\frac{119,560.00}{160,000} \times \$60,000.00 = 44,835.00$

Total $209,230.00

The discount on yarn purchases of 5 per cent. off market prices if payment is made within 30 days from date of invoice has not been deducted in arriving at the prices for yarn used in this solution. While at a somewhat higher rate than is usually considered as representing cash discount, the discount is actually received for payment within a certain period, the company has treated the discount as financial income rather than as a reduction of the cost of yarn, and, moreover, it is not known to what extent the discounts have been taken.

The problem does not state the quantity of yarn called for by the two-year yarn-purchase contract or when the two-year period ends. In commenting on this purchase commitment, therefore, no definite information can be given as to the extent of the commitment.

THE GOLDEN FLEECE KNITTING MILLS

Balance-sheet—working papers, October 31, 1926

Assets	Assets and liabilities per company's statement	Adjustments Dr.	Adjustments Cr.	Assets and liabilities as adjusted
Cash in banks and on hand	$10,600			$10,600
Trade debtors	95,200			95,200
Due from officers and employees	5,300			5,300
Inventories:				
Raw material	93,000	(1) $18,850	(2) $250	111,600
Work in process	55,000		(3) 2,875	52,125
Finished goods	225,000		(4) 15,770	209,230
Investments:				
Liberty bonds	3,000			3,000
Miscellaneous stocks	17,000			17,000
Machinery and equipment	95,900			95,900
Furniture and fixtures	20,600			20,600
Prepaid insurance	2,200			2,200
	$622,800			$622,755
Liabilities				
Notes payable	$140,000			$140,000
Accounts payable	40,900		(1) 19,850	60,750
Wages accrued	15,600			15,600
Taxes accrued	21,000			21,000
Interest accrued	5,000			5,000
Reserve for losses	9,100			9,100
Reserve for depreciation	1,900			21,900
Capital stock	350,000			350,000
Surplus	19,300	(1) 1,000		
		(2) 250		
		(3) 2,875		
		(4) 15,770		595*
	$622,800	$38,745	$38,745	$622,755

* Red.

Adjusting journal entries

(1)

Inventory—Raw material	$18,850.00	
Surplus	1,000.00	
Accounts payable		$19,850.00

To record 10,000 lbs. of yarn in transit at October 31, 1926, purchased at the contract price of $1.95 per pound, but of a market value of $1.885 per pound.

(2)

Surplus	$250.00	
Inventory—Raw material		$250.00

To adjust inventory of raw material on hand October 31, 1926, to the lower of cost or market.

(3)

Surplus	2,875.00	
Inventory—Work in process		2,875.00

To adjust inventory of work in process at October 31, 1926, to market value with respect to the material element thereof.

(4)

Surplus	15,770.00	
Inventory—Finished goods		15,770.00

To adjust inventory of finished goods at October 31, 1926, in accordance with the adjusted cost of production of "firsts" and "seconds," effect being given also to the market value of the material element thereof.

THE GOLDEN FLEECE KNITTING MILLS

Balance-sheet October 31, 1926

Assets

Current assets:				
Cash in banks and on hand			$10,600	
Liberty bonds (at cost and market value)			3,000	
Accounts receivable:				
Trade debtors		$95,200		
Less: Reserve for losses		9,100	86,100	
Inventories:				
Raw material—				
On hand	$92,750			
In transit	18,850	$111,600		
Work in process		52,125		
Finished goods		209,230	372,955	
				$472,655
Ratio of current assets to current liabilities—1.95 to 1.				
Due from officers and employees				5,300
Prepaid insurance				2,200
Investments (at cost—market value not ascertainable)				17,000
Fixed assets:				
Machinery and equipment			$95,900	
Furniture and fixtures			20,600	
Total			$116,500	
Less: Reserve for depreciation			21,900	94,600
				$591,755

Liabilities and net worth

Current liabilities:		
Notes payable	$140,000	
Accounts payable	60,750	
Wages accrued	15,600	
Taxes accrued	21,000	
Interest accrued	5,000	
		$242,350
Net worth:		
Capital stock	$350,000	
Less: Deficit	595	349,405
		$591,755

The problem states that the company had submitted its statement of assets and liabilities with the request that it be certified. The problem, however, requires only an expression of opinion as to the financial condition shown by the revised balance-sheet.

A certificate would certainly not be furnished unless an audit had been made of the accounts. In the course of such an audit considerable information would no doubt be obtained which is not given in the problem and, on the basis thereof, additional adjustments might be necessary. Certainly, some investigation would be made of the standard cost used for labor and overhead and of the actual costs of raw materials, labor and overhead in the inventories of work in process and finished goods, and further adjustments of the inventory values might be required.

It is impossible also to express any well informed opinion as to the financial condition indicated by the revised balance-sheet because of the lack of certain information, such as the maturities of the notes payable, the payment dates of the accounts payable, the collectability of the accounts receivable, the amount of the sales and net profit for the year ended October 31, 1926, the cause of the deficit (whether due to operating losses, excessive dividend payments, or some other cause), the balance of the yarn which must be taken under the two-year purchase contract and the period during which it must be taken, etc.

In the absence of the information which would be necessary for an expression of opinion as to financial condition, a guess may be hazarded that the inventories are excessive and that, in spite of the current ratio of 1.95 to 1, some difficulty will be experienced in meeting the current liabilities as they mature, for it will be noted that such liabilities aggregate $242,350 while cash, liberty bonds, and accounts receivable (the latter of an unknown degree of currency) amount in total to only $99,700. At the same time the purchase commitment of unknown amount requires payment for yarn at ten cents per pound above the market price.

If, on the other hand, the large inventory represents goods which will shortly be moved to customers, if terms of sale are such that substantial collections will be received from customers at an early date and if payment of the notes and accounts payable does not have to be made until after such collections have been received, the financial condition may not be cause for alarm in so far as the current situation is concerned.

The existence of the deficit, however, is a somewhat more definite indication of financial weakness, although the impairment of capital, if due to operating losses, would be significant of a more serious condition than if due to excessive dividend payments for the reason that the probable ability to operate at a profit during the ensuing year will have a very important bearing upon the working-capital situation.

The fact that the miscellaneous stocks carried as investments are not readily realizable and have no ascertainable market value is another element of weakness, because not only is it impossible to obtain additional working capital by disposing of them, but also the possibility of their being worth less than cost is quite real.

No. 4 (14 points):

You are requested by Mr. John Blank, owner of all the capital stock of the Hoffbloom Realty Company, to review and comment upon the statements prepared by his manager, and herewith presented, directing special attention to the item "Net profit to common stock" shown in the second of the two statements:

HOFFBLOOM REALTY COMPANY

Tentative profit-and-loss statement and balance-sheet, December 31, 1926

Assets				
Goodwill				$10,000.00
Contracts receivable			$32,880.88	
Other current assets			36,035.54	68,916.42
Deferred expense				4,000.00
Total assets				$82,916.42
Liabilities				
Liabilities				$28,081.77
Surplus account and profits—				
Accrued profits, per surplus account			$13,872.22	
Allocated surplus—Reserve for income tax			237.03	
			$14,109.25	
Reserve account—Reserve for lot-sale contracts		$89,873.73		
Less: Real-estate accounts—				
Land	$26,608.00			
Development expense	32,540.33	59,148.33	30,725.40	
Estimated total profit to date, contingent upon full payment of lot-sales contracts and no further expense			$44,834.65	
Capital stock—common			10,000.00	54,834.65
Total liabilities				$82,916.42

Tentative realization and liquidation statement, December 31, 1926

Assets to be realized—		
Sale price of remaining lots	$16,800.00	
Current assets, per balance-sheet	68,916.42	$85,716.42
Reserve account—		
Reserve for lot-sale contracts	$89,873.73	
Less: Real-estate accounts	59,148.33	30,725.40
		$116,441.82
Liabilities to liquidate, per balance-sheet		28,081.77
Net profit to common stock—to pay face of stock and as profit.		$88,360.05

Upon inquiry, you gather the following information:

Goodwill account was opened as an offset to capital-stock account.

The balance in "Reserve for lot-sales contracts" is the result of crediting the account for all sales and, subsequently, charging amounts (transferred to income) proportionate to payments on contracts.

The "land" and "development" accounts contain the total amount expended on "Hoffbloom addition" which the company was organized to plat and sell.

There is considerable expense yet to be incurred, but there is also income (interest on contracts) which may be treated as, roughly, offsetting the expense.

It is expected that the remaining lots will be sold and that all contracts will be paid off within five years from December 31, 1926, when the company will liquidate.

No dividends have been paid on common stock, but on preferred stock, which was retired in 1926, approximately $9,000 dividends were paid.

Prepare a report, in letter form, for your client, embodying therein a criticism of the statements submitted.

Solution:

Mr. John Blank:

In submitting the statements prepared by your manager you did not state whether any cash is included in the "other current assets." On the assumption that no cash is included in that item, I interpret the statements as reflecting transactions which are summarized as follows:

Goodwill:				
By credit to capital stock			(a)	$10,000.00
Contracts receivable:				
Total sales		$112,982.98		
Charges to other current assets....		36,035.54		
Remainder charged to contracts	(b)	$76,947.44		
Collections ..	(c)	44,066.56		
Balance..................				32,880.88
Other current assets..............			(b)	36,035.54
Cash:				
Collections ..	(c)	$44,066.56		
Land and development costs paid......	(d)	$31,066.56		
Dividends paid	(e)	9,000.00		
Deferred expenses paid ...	(f)	4,000.00		
		$44,066.56		
Cash balance.............				....
Deferred expenses...............			(f)	4,000.00

Liabilities					(d)	$28,081.77
Reserve account:						
Credits for sales	(b)	$112,982.98				
Charges for profits transferred to surplus	(g)	23,109.25				
Balance						89,873.73
Land			(d)	$26,608.00		
Development expense			(d)	32,540.33		
Surplus:						
Credits for profits transferred from reserve	(g)	$23,109.25				
Charges:						
Dividends	(e)	$9,000.00				
Income tax	(h)	237.03				
Total charges		$9,237.03				
Balance						13,872.22
Reserve for income tax					(h)	237.03
Capital stock					(a)	10,000.00
				$142,064.75		$142,064.75

The method of determining some of the amounts shown above may be of interest.

The surplus account shown in your manager's statement has a balance of		$13,872.22	
But it has been charged with:			
Dividends		9,000.00	
Provision for income tax		237.03	
Hence the amount transferred to surplus from the reserve must have been		$23,109.25	(g)
The reserve account has a balance of		$89,873.73	
But a transfer to surplus has been made amounting to		23,109.25	
Hence the total credit to the reserve, representing total sales must have been		$112,982.98	(b)
Since the total sales were		$112,982.98	
And since the uncollected balances are:			
Contracts receivable	$32,880.88		
Other current assets	36,035.54		
Total		68,916.42	
Collections were		$44,066.56	(c)

Collections were		$44,066.56
Known payments have been:		
Dividends	$9,000.00	
Deferred expenses	4,000.00	13,000.00
Assuming no cash balance, the payments on land and development costs were		$31,066.56 (d)

Land cost	$26,608.00 (d)
Development expense	32,540.33 (d)
Total	$59,148.33
Payments from current assets	$31,066.56 (d)
Liabilities	28,081.77 (d)
Total	$59,148.33

No consideration is given in the above computations to cash receipts from the issuance, and payments for the retirement, of preferred stock. They presumably were equal in amount and hence would offset each other.

The collections from sales appear to have been $44,066.56 and the amount transferred to surplus from the reserve was $23,109.25, or approximately 52 per cent. The ratio of gross profit was therefore presumably 52 per cent., and the cost of land sold was 48 per cent. of the selling price. This can not be definitely known for, if the other current assets include any cash collected from sales, the amount transferred from the reserve to surplus would represent less than 52 per cent. of the cash collections and hence the rate of gross profit would be less than 52 per cent.

The rate of gross profit can be roughly tested as follows:

Sales to December 31, 1926	$112,982.98
Selling price of unsold lots	16,800.00
Total	$129,782.98
Cost	59,148.33
Gross profit	$70,634.65
Approximate rate of gross profit	54%

To illustrate the form of statements which we think would more correctly indicate the financial status of the company, we shall estimate the cost of land sold on the basis of a 52 per cent. ratio of gross profit. On this assumption the cost of land sold was approximately 48 per cent. of $112,982.98, or $54,231.83. But since we have no means of verifying this rate, and since 48 per cent. is only an approximation, we wish to caution you as to the desirability of accurately determining the cost of land sold, in preparing any statements along the lines suggested herein.

After having accurately determined the cost of land sold, you should determine the exact rate of gross profit, and multiply the collections by this rate to verify the amount of $23,109.25 transferred from the reserve to surplus.

We have no means of verifying the income-tax provision. If the company operated only during 1926 the tax would be 13.5% ($23,109.25—$2,000.00 credit) or $2,849.75. The company may have been operating for some time, but there is no evidence of the payment of taxes in prior years. In the following statements we are showing the taxes at the amount reported by the manager, but you should investigate this matter.

On the basis of the foregoing assumptions, the following statements are suggested as forms which, when prepared from verified data, would more nearly reflect the facts:

HOFFBLOOM REALTY COMPANY

Profit and loss statement

(Period unknown)

Sales	$112,982.98
Cost of sales	54,231.83
Gross profit (ratio approximately 52%)	$58,751.15
Realized profits based on collections:	
52% of $44,066.56—approximately	$23,109.25
Less federal income tax	237.03
Remainder—Net profit	$22,872.22
Dividends on preferred stock	9,000.00
Remainder—Surplus, December 31, 1926	$13,872.22

NOTE.—The surplus as stated above is subject to the propriety of deferring $4,000 of expenses.

HOFFBLOOM REALTY COMPANY

Balance-sheet, December 31, 1926

Assets

Goodwill		$10,000.00
Contracts receivable		32,880.88
Other current assets		36,035.54
Real estate:		
Land	$26,608.00	
Development expense	32,540.33	
Total	$59,148.33	
Less cost of real estate sold	54,231.83	
Cost of real estate remaining for sale		4,916.50
Deferred expenses		4,000.00
Total		$87,832.92

Liabilities

Liabilities		$28,081.77
Federal income tax		237.03
Capital stock		10,000.00
Surplus		13,872.22
Deferred profit on land sold:		
Gross profit—per profit-and-loss statement	$58,751.15	
Less profit taken into surplus on instalments collected	23,109.25	
Remainder—deferred		35,641.90
Total		$87,832.92

The estimated amount which the stockholders will realize, assuming the sale of the remaining land at the stated price of $16,800, the collection of all contracts receivable, the conversion into cash of other current assets, and assuming that other income will equal the expenses, is shown below:

Capital stock		$10,000.00
Surplus		13,872.22
Deferred profit on past sales		35,641.90
Estimated profit on future sales:		
Selling price	$16,800.00	
Cost	4,916.50	11,883.50
Total		$71,397.62
Deduct:		
Goodwill	$10,000.00	
Deferred expenses	4,000.00	14,000.00
Remainder		$57,397.62

We wish to emphasize the fact that it has been impossible for us to do more than indicate incorrect methods of accounting procedure reflected by the statements submitted to us; verification of the amounts shown by the statements was impossible.

Yours truly,