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Students' Department

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AMERICAN INSTITUTE EXAMINATIONS

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

Examination in Auditing

November 18, 1926, 9 a. m. to 12.30 p. m.

The candidate must answer all the following questions:

No. 1 (10 points):

A client suspects, from a scrutiny of sales and gross-profit figures, that the purchase record is inflated. The client states that all cheques are signed by him personally, that he knows that inventories are correct and that the sales volume checks approximately with orders taken, and he is therefore at a loss to know how there can be any error. The client has called upon you to make what investigation you deem best. Describe the steps you would take in these circumstances and to what purpose.

Answer:

The first step in the investigation would be an examination of the facts upon which the client has based his suspicion that the purchase record is inflated. The auditor should not enter upon a detailed check of purchase records without a preliminary survey which will assure him that the client has correctly ascertained the facts and has drawn reasonably sound conclusions from them.

It may also be remarked, in passing, that the auditor should avoid an assumption of fraud until such a point is reached in his own investigation as will warrant it.

Assuming, then, that the auditor's preliminary examination indicates that the sales for the period and the inventories at the beginning and end of the period are correctly stated and that no unusual market conditions, increased transportation rates, changes in policy as to allowances of various kinds, or similar extraneous causes can be found which will account for the situation, he would next commence a detailed examination of the purchases shown for the period.

The fact that the client signs all cheques personally is no assurance, of course, that the disbursements made by means of such cheques were proper.

After ascertaining that the net purchases shown for the period represent the correct balance of net purchases shown by the ledger accounts for purchases, purchases returns and allowances, duty, freight and cartage, etc. (determined by proving footings and computations of balances), postings from books of original entry would be verified to ascertain that no debits or credits applying to other accounts were posted to these accounts.

Footings of the books of original entry would then be verified to ascertain that there were no misstatements thereof due to errors or efforts to cover up misappropriations of cash.

At this point the auditor would be ready to verify the entries for purchases and the related items enumerated above. If probable sources of the overstatement of purchases had not suggested themselves to the auditor, he would have to decide whether to examine the items for the entire year or to select certain months for tests, and, in either case, whether to examine all items or merely those over a certain amount. Probably tests of several months as to items of a certain amount or over would be the most advisable procedure, until the auditor obtained some clue as to the source of overstatement, followed by detailed examination in the degree indicated as necessary by the preliminary findings.

Each entry would be verified by reference to supporting data proving the receipt of goods, the approval of quantities, prices, quality or grade, etc., by authorized persons. Particular attention would be given to possibilities of duplicate payments, unrecorded returns of purchased goods, and failure to make proper deductions for allowances of various kinds. Invoices would be examined to see that they were in the name of the company and did not cover any purchases of goods for the personal use of individuals which should have been charged to them. This procedure would be for the purpose of determining that all items included in purchases were properly so included.

The auditor would next investigate the methods of handling merchandise and the system of stock records, if any, maintained by the company to ascertain whether any merchandise might have been misappropriated, shipped without being billed, destroyed or lost in any other way.

At some point during the examination some indication would doubtless appear which would influence the auditor's subsequent course, and the exact procedure would be governed by such discoveries.

No. 2 (10 points):

(a) State how you would verify in the audit of a charitable institution the income comprising interest and dividends on securities, rents and contributions.

(b) State two means usually available for checking contributions, other than direct communication with the donors, and give your opinion as to which you consider the more satisfactory and why.

Answer:

(a) For the verification of income on securities in the case of a charitable institution, it would be necessary first to determine what securities were owned. The securities themselves would be verified by inspection or by certificates from the custodians thereof, supplemented by reference to the minutes of trustees' or directors' meetings, published acknowledgments of gifts, records of the purchase of securities for investment or of the exchange of old for new securities, and other probable sources of information as to securities which are or should be on hand. After determination of the income-producing securities owned, the income receivable thereon would be determined by reference to the terms of the instruments in the case of bonds, notes and preferred stocks, and by reference to published dividend records or by correspondence with the companies in the case of common stocks. Actual receipt of the income would be verified by examination of the cash records. Appropriate verification would be required in the case of income receivable by the institution on securities not owned and in the case of securities the income from which might be payable to others. The treatment of bond premium and discount would also be examined to see whether or not provision was being made for amortization of such premium and discount.

Income from rents would be verified by examination of leases or other agreements with lessees or tenants, or, in case of renting agents, by reference to their reports. In either case, an effort would be made to account for all space available for renting, and to obtain satisfactory explanation of any space for which no rent was received. Underlying the verification would be the record of rent-producing property owned which would be ascertained from the various records of the institution, confirmed to the fullest extent possible by independent verification of the property owned. Verification would be necessary, as in the case of securities, if the institution either received the income from property not owned or owned property the income from which was payable to others.

Contributions would be verified by one or more of several methods, depending upon what records were maintained by the institution, such as:

(1) Examination of the stubs or duplicates of receipts where numbered receipts were issued for all contributions.
(2) Comparison of receipts with amounts pledged where pledges were made prior to actual contributions, with particular attention to pledges shown as unpaid.
(3) Comparison with published lists of contributions.
(4) Correspondence with donors.
(5) Reference to the minutes for record of large contributions.

(b) As stated in (a) above, contributions may be verified by examination of duplicate receipts or by reference to published lists of contributions without communicating with donors. It will depend wholly upon circumstances as to which method is more satisfactory, but, in general, the examination of published acknowledgment will be more satisfactory, particularly where such acknowledgment appears in an institution publication sent to all donors.

No. 3 (10 points):

You are called upon to audit the cash accounts, only, of a manufacturing company. What would your examination cover?

Answer:

If called upon to audit the cash accounts, only, of a manufacturing company, an auditor would need to ascertain to what extent he might accept the entries relating to cash transactions without further investigation of their completeness. An audit which merely proved or disproved that cash shown as received and disbursed, respectively, accounted for the change in the balance of cash between the beginning and end of the period, and, possibly, that all cash shown as disbursed was supported by properly signed cheques or receipts would ordinarily be of limited value, and would certainly be futile for the purpose of discovering irregularities resulting from failure to record cash receipts or from disbursements for improper or unauthorized purposes.

It would be to the auditor's interest as well as in accord with his obligations to the client to point out the limitations of an examination restricted to cash accounts only. If the client, however, indicated an understanding of these limitations or still desired to limit the scope of the audit after an explanation of the effect thereof, the auditor would proceed with his examination on the basis of his understanding with the client. The points covered would be as follows:

Receipts:

If the audit of cash accounts is to be detailed, all footings of the original records of cash receipts and all postings to the ledger accounts would be verified and, if possible, all receipts would be identified with specific deposits credited by the banks. Deposits made on the last day or two of the period would be examined in cases where more than one bank account is maintained, in order to detect deposits consisting of the company's own cheques on other banks which might not clear until the subsequent period and might be omitted from the record of cheques issued.

If the audit is to be only a general review of the cash records, sufficient tests would be made of the foregoing matters to satisfy the auditor as to the substantial integrity of the records. Comment should be made, however, that tests only were made and that the entries were not checked in detail.

Disbursements:

In the case of a detailed audit of the cash accounts, footings and postings would be verified completely and paid cheques returned by the bank would be compared with the entries therefor as to payees and amounts while endorsements and signatures would be scrutinized for indications of irregularity. All cheques would be examined to ascertain that they had actually gone through the bank. All cheque numbers would be accounted for and some attempt would be made to see that no unnumbered cheques or cheques taken from the back of a cheque book or from other than the current cheque books had been used and not properly accounted for.

Where a detailed audit is not desired, tests would be made of these matters in sufficient number to assure the auditor of the improbability of there being irregularities. Comment should be made, of course, as to the method followed. If the practice does not prevail of depositing receipts intact and making all disbursements by cheque the auditor's procedure would have to be altered to meet such a condition. Cash disbursements not represented by paid cheques would be examined with a great deal of care and any not represented by satisfactory vouchers therefor would be the subject of special inquiry.

No. 4 (10 points):

A company having an issue of debenture bonds of $500,000, maturing in 20 years from date of issue, is carrying the unexpired bond discount as a deferred charge, the bonds having been issued at 90. The bonds contain a sinking-fund provision requiring the retirement of one-twentieth of the issue annually, the necessary bonds to be called at 105 unless secured through purchase at a more advantageous price. At the beginning of the sixth year, the directors availed themselves of an offer by purchasing fifty $1,000 bonds at 85. How should the bonds purchased and the 15 per cent. discount thereon appear in the accounts?

Answer:

The question states that the company's bonds contain a sinking-fund provision requiring the retirement of one twentieth of the issue annually. This appears to be a conflict in terms. A sinking-fund is strictly defined as a fund accumulating at compound interest to retire a definite liability at its maturity. Within this strict meaning the purchase of bonds could be accomplished only by turning them over to the sinking-fund trustee, who would hold them alive in the fund and continue to collect the interest on them. The company would still regard the bonds as outstanding.

But the question states that one twentieth of the issue is to be retired annually. This would mean that the liability for the retired bonds would disappear from the company's books and from its balance-sheet.

The question is an important one because it affects the amortization of the discount. If a sinking fund is operated in accordance with its strict definition, the purchased bonds will appear as an asset in the fund, and also as a liability, and the discount should be amortized in equal amounts annually (assuming that absolute accuracy did not require the application of a scientifically correct amortization by an actuarial effective-rate method).

It is believed that the question means that the bonds are actually retired. While emphasis has been given above to the strict definition of a sinking fund, it is recognized that the term is often used to denote what would be more accurately defined as a retirement fund. Assuming, then, that the $25,000 of bonds purchased each year were to be canceled and not held alive in a sinking fund, the discount should be amortized by some method which would take into consideration the annually diminishing amounts of bonds outstanding. By using such a method it would be unnecessary to make any adjustment of the bond discount at the time of retiring the required one-twentieth of the issue each year. This would mean that if during the sixth year only $25,000 of bonds had been purchased for retirement at 85, it would have been necessary to credit surplus with 15 per cent. of $25,000, or $3,750.

The fact that the bonds were purchased at the beginning of the year is ignored because it is not known whether provisions for amortization of the bond discount have been based on retirement of the annual quota of $25,000 at the beginning or at the end of the year.

But the company also purchased $25,000 of bonds which it was not obligated to retire until a year later, the unamortized discount on which would have to be charged to surplus either directly or as an offset to part of the 15 per cent. discount on the bonds purchased.

A question now arises as to whether the bonds purchased one year in advance are to be canceled at that date or held in the treasury for a year and presented for cancellation then. If the trustee will agree that a purchase of $50,000 during the sixth year meets the requirements for the sixth and seventh years, the entries should be:

(1)

Bonds payable	$50,000	
Cash		$42,500
Surplus		7,500
To record the purchase and retirement of $50,000 par value of bonds at 85.		

(2)

Surplus....................................	——	
Bond discount............................		——
To charge to surplus the unamortized discount on $25,000 of bonds retired one year in advance of the required date of retirement.		

If the trustee will not agree to accept the purchase in the sixth year as meeting the seventh year's requirements, the company would probably hold $25,000 of the bonds as treasury bonds for presentation the next year. That would affect the foregoing entry only to the extent of dividing the charge of $50,000, one half of the amount being charged to bonds payable and the other half to treasury bonds. The debits and credits to discount and surplus accounts should still be made as in the foregoing entries because the bonds would be virtually dead; no interest would be paid on them, and hence no charge should be made during the year for either interest or discount amortization. That would necessitate relieving the accounts of the discount at the date of acquisition.

No. 5 (10 points):

In the course of your audit of the X Y Z Co., you find in your investigation of its operations that its costs are based upon standard or predetermined costs, the cost system being controlled in the general accounts. All calculations are based upon operating at 75 per cent. of capacity. However, during the year, operations were from 90 per cent. to 95 per cent. of capacity, with the result that factory overhead was over-absorbed to the extent of $75,000, which remains as a credit balance in the burden-control account. The company officers are not quite certain what should be done with this credit balance and ask your opinion. How would you proceed to find a solution of this problem, and what would your recommendations be? Explain, without using figures, what should be done with the credit balance.

Answer:

Inasmuch as the X Y Z Co. has operated at a larger percentage of capacity than anticipated, the actual cost of the product has been overstated due to the use of standard or predetermined costs based upon the distribution of factory overhead over a smaller volume than was actually produced. To the extent that sales during the period were of goods manufactured during the period, therefore, the cost of goods sold was overstated and profits for the period correspondingly understated. The inventory at the end of the period was overstated in so far as it included goods, manufactured during the period, priced at the standard or predetermined cost.

In order to adjust the matter, the respective amounts of goods manufactured which were sold or remained in inventory should be determined and proportionate parts of the $75,000 credit balance in the burden-control account credited to profit-and-loss account and inventory account.

It might also be desirable to adjust the cost records for the year so that each job, product or process, would be stated at actual cost. This might be possible but in many cases would not be practicable.

No. 6 (10 points):

Give seven indications of a healthy financial condition which might appear on the balance-sheet and profit-and-loss statement of a manufacturing concern.

Answer:

Seven indications of a healthy financial condition which might appear on the balance-sheet and profit-and-loss statement of a manufacturing concern are:

1. Adequate working capital.
2. Large amount of cash and marketable securities in proportion to other current assets and to current liabilities.
3. Small amount of obligations involving fixed charges.
4. Large surplus account.
5. Adequate reserves for depreciation, depletion, obsolescence, amortization, etc.
6. Absence of excessive amount of goodwill, patents, or other intangibles.
7. Small amount of inventories of material and merchandise in relation to amount of goods sold.

Indications of a healthy financial condition would not usually be sought in a profit-and-loss statement alone although, of course, in that statement will be found indications as to whether the business is being conducted in such a manner as to improve the financial condition or vice versa. In conjunction with the balance-sheet the profit-and-loss statement would be of value in determining the relation of inventories and accounts receivable to cost of goods sold and sales, respectively; the relation of investment in plant to sales; the amount of interest paid, and other matters of collateral interest in an examination of financial condition.

No. 7 (10 points):

In making a balance-sheet audit of a corporation you notice the following items:

(a) Unissued common stock carried as treasury stock.

(b) Dividend cheques drawn regularly for this unissued stock and charged to "dividends," the cheques being redeposited and credited to treasury-stock account.

(c) Corporation carried life insurance on its president, policy payable to the preferred stockholders.

The treasurer instructs the auditor to make any entries on the books which are deemed necessary. What adjustments, if any, would you make on the books and what special comments should the auditor's report contain?

Answer:

The following adjustments should be made on the books:

(1) An entry crediting surplus and debiting treasury stock for the amount of dividends on treasury stock which has been credited to the treasury-stock account.

(2) An entry crediting treasury stock and debiting unissued stock for the unissued stock carried as treasury stock.

The matter of necessary adjustments with respect to the life-insurance policy payable to preferred stockholders carried by the corporation depends upon what entries have been made. The premiums should, of course, have been charged to expense and not to an asset account. Moreover, the setting up as an asset of the cash surrender value of the policy at the time such value becomes effective would appear to be of questionable propriety in this case. Since the corporation itself is not the beneficiary and since it is not known that the cash value would belong to the corporation in case the policy should be surrendered, there is no basis for treating the cash value as an asset of the corporation.

Comment in the auditor's report would seem to be required in explanation of the adjustment of surplus for dividends previously "paid" on the unissued stock, and also in regard to the payment of premiums on the life-insurance policy payable to preferred stockholders.

No. 8 (10 points):

You have been engaged to make an audit of the books of a corporation for the purpose of submitting certified statements to bankers. You find during the course of your work that the corporation owns all the capital stock of a subsidiary company, but you are refused access to the books of the subsidiary. What position would you take if the officers insisted upon an unqualified statement?

Answer:

If the officers insisted upon an unqualified statement, the auditor could take no position other than that of declining to furnish a statement. The inclusion of any asset in the auditor's statement without qualification in regard thereto would imply that such an asset was, in the auditor's opinion, of the value stated. Since the value of the investment in the subsidiary could be determined only by examination of the subsidiary's books, the least that the auditor could do in the absence of such examination would be to qualify the statement in that respect. The fact that he was refused access to the books, however, would seem to indicate that they might contain information unfavorable to the corporation, and should lead the auditor to refuse to submit any statement without an examination of the books of the subsidiary or a comment that access thereto had been refused.

No. 9 (10 points):

Upon examining the accounts of a manufacturer of musical instruments, who sells to the retail trade on an instalment basis, you find that repossessed instruments (i. e., instruments sold and replevined due to failure of customer to pay instalments due) are included in the inventory at original cost plus cost of reconditioning. Give your reasons for agreeing or disagreeing with this state of the accounts.

Answer:

The inclusion of repossessed instruments in the inventory at original cost plus cost of reconditioning is contrary to generally accepted accounting principles in that it states the inventory at an amount in excess of that determined on the basis of either cost, market, or any other recognized basis of inventory valuation. The instruments should properly be valued at the time of repossession at original cost minus any depreciation due to wear or damage. Subsequent costs of reconditioning these instruments would be proper additions to such adjusted cost in arriving at their inventory value.

When original cost plus reconditioning costs is used as the valuation for inventory purposes, the result is that expenses or costs applicable to the period prior to the inventory date, the period in which the original sale occurred, are not charged against the income of that period but are carried forward to be charged against income of the period in which the instrument is resold.

No. 10 (10 points):

During the course of an audit of the books of a company manufacturing and installing large units of electrical machinery, you find an account receivable of

$100,000 due on contract No. 100. Upon a further examination of this account and contract, you find the following conditions:

The total amount of the contract is $200,000 and by reason of certain concessions the customer agreed to pay one-half upon signing the contract and one-half upon completion of the installation. You find that at December 31, 1925, the contract has been signed, $100,000 has been received, but work on the contract has not been commenced. The following entries appear on the books:

Accounts receivable....................	$200,000	
To sales...........................		$200,000
Cost of sales (estimated)................	120,000	
To reserve for construction costs.......		120,000
Cash................................	100,000	
To accounts receivable................		100,000

The officers of the company advance the explanation that, inasmuch as conservative estimates show that the contract will net a profit of $80,000, and having received $100,000 in cash, they are correct in taking up all the profit. What would you do under these conditions?

Answer:

It was an error for the company to take up any portion of the estimated amount of profit on the contract prior to commencement of the work. After commencement of the work it would be proper to take up only that proportion of the total estimated amount of profit which the cost of completed work bore to the total estimated cost of the completed contract.

Until all or part of the services are performed under the contract, no portion of the profit thereon is earned. Moreover, until the work is commenced, the company has no valid claim against the customer and would have to refund the $100,000 if for any reason the company's part of the contract should not be performed.

The auditor should, under these conditions, suggest that adjustments be made in the accounts as follows:

December 31, 1925

Profit and loss...............................	$ 80,000	
Reserve for construction costs.................	120,000	
Accounts receivable........................		$100,000
Advance collections on contracts..............		100,000

To correct error in recording advance collection from ....and taking up the estimated amount of profit to be earned on contract No.—— not yet commenced.

If the company failed to comply with the suggestion, the auditor should nevertheless make the adjustments in preparing his own statements with suitable comment that the company's books had not been adjusted correspondingly.

CONSOLIDATED BALANCE-SHEET

The following problem appeared in the Illinois C. P. A. examination given in May, 1925:

The following facts are to be considered in preparing a consolidated balance-sheet:

Items Dec. 31, 1923, before affiliation	Co. A	Co. B	Co. C
Goodwill.............................	$......	$20,000	$......
Capital stock..........................	900,000	400,000	300,000
Surplus..............................	100,000	40,000	100,000

1. On December 31, 1923, company A acquired all of the capital stock of company B for $400,000 and 80 per cent. of the capital stock of company C for $360,000; while company B on the same day acquired 10 per cent. of the capital stock of company C for $45,000.

2. During the year ended December 31, 1924, the operations resulted as follows:

Company A, profit $30,000 exclusive of dividend from company B.
Company B, profit $40,000.
Company C, loss $10,000.

3. Company B declared and paid a dividend of 5 per cent. during 1924.

4. Company A declared and paid a dividend of 5 per cent. during 1924.

From the foregoing data prepare as much as possible of a consolidated balance-sheet as of December 31, 1924, setting forth clearly the investments, goodwill, capital stock, surplus, eliminations and minority interests, if any, assuming that none of the three companies enters on its books its share of earnings of an allied company except when received as dividends.

Solution:

In the solution of this problem, it is necessary to set up the balance-sheets of the various companies at December 31, 1924.

These balance-sheets are obtained by means of the working papers on pages 387–388.

Inasmuch as company A and company B have not taken up their shares of subsidiary profits and losses and have, instead, credited to surplus the amount of dividends received, adjustments must be made in the working papers for such profits and losses. The profits of company B to be taken up by company A must first be adjusted for the amount of company B's proportion of company C's loss for the year ended December 31, 1924. The necessary adjustments are as follows:

(1) and (2) To adjust surplus and investment accounts of company A and company B for their respective shares of company C's loss for the year ended December 31, 1924.

(3) To adjust surplus and investment accounts of company A for company A's share of company B's profits for the year ended December 31, 1924.

(4) To adjust surplus and investment accounts of company A for dividend received from company B.

(See pages 389 and 390.)

Company A and Subsidiaries, Company B and Company C

Consolidated balance-sheet December 31, 1924

Assets

Sundry assets		$1,030,000.00
Goodwill		25,000.00
		$1,055,000.00

Liabilities and Net Worth

Liabilities		$
Minority interest in company C (10%)		39,000.00
Net worth:		
Capital stock	$900,000.00	
Surplus	116,000.00	1,016,000.00
		$1,055,000.00

COMPANY A, COMPANY B AND COMPANY C

Working papers for the year ending December 31, 1924

	Balance-sheet December 31, 1923, before affiliation	Adjustments Dr.	Adjustments Cr.	Balance-sheet December 31, 1924	Explanation of adjustments
Company A:					
Assets					
Sundry assets (net)	$1,000,000.00	(2) $30,000.00	(1) $760,000.00		(1) To record investment in companies B and C.
		(3) 20,000.00	(4) 45,000.00	$245,000.00	(2) To record profits for year ended December 31, 1924,
Investment in company B		(1) 400,000.00		400,000.00	exclusive of dividend from company B.
Investment in company C		(1) 360,000.00		360,000.00	(3) To record dividend received from company B.
					(4) To record dividend paid.
	$1,000,000.00			$1,005,000.00	
Net Worth					
Capital stock	$900,000.00			$900,000.00	
Surplus	100,000.00	(4) 45,000.00	(2) 30,000.00		
			(3) 20,000.00	105,000.00	
	$1,000,000.00	$855,000.00	$855,000.00	$1,005,000.00	
Company B:					
Assets					
Sundry assets (net)	$420,000.00	(2) $40,000.00	(1) $45,000.00	$395,000.00	(1) To record investment in company C.
			(3) 20,000.00		(2) To record profits for year ended December 31, 1924.
Goodwill	20,000.00			20,000.00	(3) To record dividend paid.
Investment in company C		(1) 45,000.00		45,000.00	
	$440,000.00			$460,000.00	
Net Worth					
Capital stock	$400,000.00			$400,000.00	
Surplus	40,000.00	(3) 20,000.00	(2) 40,000.00	60,000.00	
	$440,000.00	$105,000.00	$105,000.00	$460,000.00	

COMPANY A, COMPANY B AND COMPANY C

Working papers for the year ending December 31, 1924 (*continued*)

	Balance-sheet December 31, 1923, before affiliation	Adjustments Dr.	Adjustments Cr.	Balance-sheet December 31, 1924	Explanation of adjustments
Company C:					
Assets					
Sundry assets (net)	$400,000.00		(1) $10,000.00	$390,000.00	(1) To record loss for year ended December 31, 1924.
Net Worth					
Capital stock	$300,000.00			$300,000.00	
Surplus	100,000.00	(1) $10,000.00		90,000.00	
	$400,000.00	$10,000.00	$10,000.00	$390,000.00	

COMPANY A AND SUBSIDIARIES, COMPANY B AND COMPANY C

Consolidated balance-sheet, working papers December 31, 1924

Assets	Company A	Company B	Company C	Adjustments Dr.	Adjustments Cr.	Eliminations	Consolidated balance-sheet
Sundry assets (net)	$245,000.00	$395,000.00	$390,000.00				$1,030,000.00
Goodwill		20,000.00					20,000.00 G
Investments:							
Company A's investment in company B	400,000.00						
Add: Company A's share of company B's profits				(3) $39,000.00			
Deduct: Adjustment for dividend received from company B					(4) $20,000.00		
Eliminate present book value:							
Capital stock—100% of $400,000						(A) $400,000.00	
Surplus—100% of $59,000						(A) 59,000.00	
Deduction from goodwill							40,000.00*G
Company A's investment in company C	360,000.00						
Deduct: Company A's share of company C's loss					(2) 8,000.00		
Eliminate present book value:							
Capital stock—80% of $300,000						(B) 240,000.00	
Surplus—80% of $90,000						(B) 72,000.00	
Goodwill							40,000.00 G
Company B's investment in company C		45,000.00					
Deduct: Company B's share of company C's loss					(1) 1,000.00		
Eliminate present book value:							
Capital stock—10% of $300,000						(C) 30,000.00	
Surplus—10% of $90,000						(C) 9,000.00	
Goodwill							5,000.00 G
	$1,005,000.00	$460,000.00	$390,000.00	$39,000.00	$29,000.00	$810,000.00	$1,055,000.00

* Deduction from goodwill.

COMPANY A AND SUBSIDIARIES, COMPANY B AND COMPANY C

Consolidated balance-sheet, working papers, December 31, 1924 (*continued*)

	Company A	Company B	Company C	Adjustments Dr.	Adjustments Cr.	Eliminations	Consolidated balance-sheet
Totals of adjustments brought forward				$39,000.00	$29,000.00		
Liabilities and Net Worth							
Capital stock:							
Company A	$900,000.00						$900,000.00
Company B		$400,000.00					
Eliminate company A's 100%						(A) $400,000.00	
Company C			$300,000.00				
Eliminate company A's 80%						(B) 240,000.00	
Eliminate company B's 10%						(C) 30,000.00	
Minority interest 10%							30,000.00 M
Surplus:							
Company A	105,000.00						
Adjustment for dividends from company B				(4) 20,000.00			
Share of company B's profit 100%					(3) 39,000.00		
Share of company C's loss 80%				(2) 8,000.00			
Adjusted surplus							116,000.00 S
Company B		60,000.00					
Share of company C's loss 10%				(1) 1,000.00			
Adjusted surplus=$59,000							
Eliminate company A's 100%						(A) 59,000.00	
Company C			90,000.00				
Eliminate company A's 80%						(B) 72,000.00	
Eliminate company B's 10%						(C) 9,000.00	
Minority interest 10%							9,000.00 M
	$1,005,000.00	$460,000.00	$390,000.00	$68,000.00	$68,000.00	$810,000.00	$1,055,000.00