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Students' Department: American Institute of Accountants. Examinations, May 17, 1940

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STUDENTS' DEPARTMENT

EDITED BY H. P. BAUMANN

[NOTE.—The answers to Institute examination questions which appear in this department are in no sense official. They have not been reviewed by the board of examiners and represent merely the opinions of the editor of the Students' Department.]

AMERICAN INSTITUTE OF ACCOUNTANTS EXAMINATIONS

ACCOUNTING THEORY AND PRACTICE—PART II

May 17, 1940, 1:30 P.M.

[To conserve space, the problems and questions are being omitted from this department, in view of the fact that the complete examination was published in the June issue. The editors would be glad to receive communications from readers who may feel that they are unduly inconvenienced by this procedure.]

No. 5 (35 points)

Solution:

(a) Comments on the statements as prepared.

The balance-sheet as presented in the problem does not permit a ready analysis of the individual funds for which the trustees of the institution are responsible. A better form would show these separate funds in self-balancing sections, indicating the identity of the funds, and their purposes.

In this particular case, the reader of the balance-sheet might assume that the "surplus" of \$402,000 represented the excess of income over expenditures during the period ended June 30, 1938. This, of course, is not so.

The item of unrestricted donations (\$33,000) shown as income in the statement of income and expenses also is misleading because of its position in the statement. As a matter of fact, the school operated during the year on an unbalanced budget with a resulting deficiency of \$26,000 instead of excess income of \$7,000.

(b) Adjusting journal entries.

A satisfactory fund balance-sheet for the Zenith Junior College should show the segregation of the assets into three sections, as follows:

- (1) General fund
- (2) Endowment fund
- (3) Plant fund

To make this segregation into three self-balancing sections will require certain inter-fund adjustments which follow:

	(1)	
General fund—principal	\$530,000	
Plant fund—principal		\$530,000
To charge the general fund principal and to credit the plant fund		

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principal with the following payments made from the general fund cash:

Amount appropriated from unrestricted gifts for partial payment of the original college property	\$150,000
Amount paid out of current funds for additions	80,000
Amount paid on bonds as they matured:	
Original issue	\$600,000
Balance, June 30, 1938	300,000
	300,000
Amount paid	300,000
Total	\$530,000

(2)

Endowment fund—due from general fund	\$ 15,000	
General fund—due to endowment fund		\$ 15,000
To set up the amount due the endowment fund from the general fund for the depreciation on the rented real estate. (The value of the endowment fund assets was reduced by the amount of this depreciation, and the purpose of this entry is to keep the endowment fund intact.)		

(3)

Endowment fund—depreciation fund bonds	15,000	
Endowment fund—bonds		15,000
To earmark \$15,000 of bonds to indicate the funding of the depreciation reserve. (It is assumed that the bonds will be held until maturity and, therefore, they are transferred at par value.)		

(4)

Endowment fund—due from general fund	105,000	
General fund—due to endowment fund		105,000
To record the amount due to the endowment fund from the general fund arising from the loss on investments sold to pay maturing bonds and to meet expenses:		
Cost of endowment fund investments:		
Rented real estate	\$ 75,000	
Mortgages	140,000	
Bonds	220,000	
	\$435,000	
Total investments	\$435,000	
Endowment fund principal	540,000	
	\$105,000	
Decrease (assumed loss)	\$105,000	

(5)

General fund—due to endowment fund	80,000	
Endowment fund—principal	80,000	
General fund—principal		80,000
Endowment fund—due from general fund		80,000
To credit the general fund for the amount spent for the additions to plant and equipment, and to reduce the amount of the endowment fund principal for the expenditure for "outlays for college buildings and equipment."		

THE ZENITH JUNIOR COLLEGE
BALANCE-SHEET—WORK PAPERS

June 30, 1938

	Balance-sheet (per problem) June 30, 1938	Adjustments		Balance-sheet (after adjustments)
		Debits	Credits	
General fund:				
Cash.....	\$ 6,000			\$ 6,000
Tuition fees receivable.....	8,000			8,000
Inventory of supplies.....	2,000			2,000
Bank loans.....	\$ 15,000			\$ 15,000
Accounts payable.....	9,000			9,000
Principal (surplus).....	402,000	\$530,000 (1)	\$ 80,000 (5)	48,000
Due to endowment fund.....		80,000 (5)	105,000 (4)	40,000
Endowment fund:				
Rented real estate—at cost.....	75,000			75,000
Reserve for depreciation.....	140,000			140,000
Six per cent mortgages—at cost.....	220,000			220,000
\$210,000 five per cent public-utility bonds—at cost (market value \$202,000).....			15,000 (3)	15,000
Principal.....	540,000	80,000 (5)		460,000
Due from general fund.....		105,000 (4)	80,000 (5)	40,000
Depreciation fund bonds.....		15,000 (3)		15,000
Plant fund:				
Plant and equipment—at cost.....	830,000			830,000
Five per cent first-mortgage bonds.....	300,000			300,000
Principal.....	\$1,281,000	\$825,000	530,000 (1)	530,000
Totals.....	\$1,281,000	\$825,000	\$825,000	\$1,369,000

Students' Department

(C) THE ZENITH JUNIOR COLLEGE

BALANCE-SHEET

June 30, 1938
GENERAL FUND

Assets

Current Assets:	
Cash	\$ 6,000
Tuition fees receivable	8,000
Inventory of supplies	2,000
	<u>\$ 16,000</u>

Liabilities and Principal

Current Liabilities:	
Bank loans	\$ 15,000
Accounts payable	9,000
	<u>24,000</u>
Due to endowment fund	40,000
Deficit (schedule I):	
Balance, July 1, 1937	\$ 55,000*
Net income for the year (schedule II)	7,000
	<u>\$ 16,000</u>

ENDOWMENT FUND

Principal:	
Donated funds	\$ 75,000
Less—Amount appropriated for additions to plant and equipment	15,000
	<u>\$ 60,000</u>
Six per cent mortgages—at cost	140,000
Five per cent public-utility bonds (at cost) (Par value \$210,000; market value \$202,000)	220,000
Less—Amount transferred to the depreciation fund—at par value	15,000
	<u>\$ 405,000</u>

Principal:	
Donated funds	\$ 540,000
Less—Amount appropriated for additions to plant and equipment	80,000
	<u>\$ 460,000</u>

Depreciation fund:	
Five per cent bonds—at par value	15,000
Due from general fund	40,000
	<u>\$ 55,000</u>

PLANT FUND

Plant and equipment—at cost	\$ 830,000
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Liabilities:	
Five per cent first-mortgage bonds maturing at the rate of \$15,000 semiannually on June 30th and December 31st of each year:	
Original issue	\$ 600,000
Less—Paid at maturity	300,000
	<u>\$ 300,000</u>

Principal:	
Unrestricted gifts at organization of the college	\$ 150,000
Amount paid on matured bonds	300,000
Additions to plant and equipment	80,000
	<u>\$ 530,000</u>

	<u>\$ 830,000</u>
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* Rec'd.

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Schedule I

THE ZENITH JUNIOR COLLEGE

STATEMENT OF GENERAL FUND DEFICIT

From the origin of the college to June 30, 1938

Receipts:	
Unrestricted gifts at organization	\$300,000
Excess of income over expenses	102,000
	\$402,000
Expenditures:	
Appropriation of unrestricted gifts to plant fund	\$150,000
Payment of matured bonds	300,000
	450,000
General fund deficit	\$ 48,000

Schedule II

THE ZENITH JUNIOR COLLEGE

STATEMENT OF INCOME AND EXPENSES

For the year ended June 30, 1938

Operating income:	
Tuition	\$230,000
Endowment income:	
Rentals	\$ 8,100
Mortgage interest	8,400
Bond interest	10,500 ¹
	27,000
Income from auxiliary enterprises	65,000
Miscellaneous	4,000
	\$326,000
Operating expenses:	
Instruction and research	\$185,000
Expenses of auxiliary enterprises	80,000
Administration	34,000
Operation and maintenance	35,375
Depreciation of rented real estate	1,500
Bond interest	16,125
	352,000
Excess of operating expenses over operating income	\$ 26,000
Unrestricted donations	33,000
	\$ 7,000
Net income for the year ended June 30, 1938	\$ 7,000

¹ The bond interest should have been reduced by amortization of the premium on bonds held. The problem does not include the information necessary to determine the amount of the amortization.