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Michigan Board of Accountancy

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MICHIGAN BOARD OF ACCOUNTANCY

EXAMINATION QUESTIONS

FRIDAY AFTERNOON, MAY 20, 1932

Theory

Question 1:

On July 8, 1931, the directors of the Z Company, acting under the authority of the corporate by-laws, issued stock rights on common stock, whereby the holders of record on August 1, 1931, were entitled to subscribe, for each two shares held by them, to one new share of common at $26 per share, provided their subscriptions were received prior to October 1, 1931, and paid in full prior to October 12, 1931. The fair market value of the common stock on July 8, 1931, was 50. Subscriptions to all the stock thus offered were received and paid for before October 12.

Thereupon the following entry was made on the books of account of the Z Company:

October 12, 1931

Cash	$195,000	
Earned surplus	120,000	
Common stock (par $10)		$ 75,000
Paid-in surplus		240,000

Sale of 7,500 shares of common capital stock at 26 to common stockholders of record on August 1, 1931. The theoretical market value of the rights issued therefor times the number of shares of common stock outstanding at the time the rights were voted gives the expected dilution of the market value of outstanding stock or the earned surplus appropriated.

Argue briefly for or against the above entry.

Question 2:

The directors of the Barton Company decide to segregate the retail end of the business into a separate corporation; accordingly, certain assets, valued at a figure in excess of the book values thereof, are transferred to a new corporation known as the Barton Sales Company in exchange for 90% of its authorized capital stock. The remaining 10% is disposed of by sale at par to the active management of the new company and, in accordance with the plan of reorganization, the cash so realized is given at once to the stockholders of the Barton Company as a special "reorganization" dividend. The stock received

in exchange for the assets is held by the Barton Company. Is the latter, or its stockholders, subject to liability for Federal income tax as the result of these transactions?

Question 3:

Outline and explain several methods which may be used to determine the amount of the reserve for bad debts on notes and accounts receivable.

Question 4:

A magazine publishing company contemplates charging the following items against its surplus account at the end of 1931, on the theory that they are abnormal losses which would not occur except in a year as chaotic as 1931:

Magazine returns during 1931 (at selling price) in excess of normal returns	$ 51,640.12
Rebates to advertisers on account of failure to meet 1931 circulation expectations	65,450.50
Write-down of plants and machinery, acquired in prior years in exchange for no-par capital stock, to fair values at December 31, 1931	178,903.00

What is your opinion as to the propriety of these charges?

Question 5:

The proprietor of a flower shop, whose books are on a calendar-year accrual basis, holds a lease on his store expiring May 1, 1932. At April 30, 1932, his books contain a proper accrual of rent for the months of November, 1931, to April, 1932, inclusive, at the rate of $500.00 per month. The owner agrees to renew the lease for the fiscal year ending May 1, 1933, at a monthly rental of $350.00 and to accept $350.00 per month for the past-due rent.

The flower shop books contain a liability account of $750.00 for accrued real estate taxes for the calendar years 1930 and 1931, and $125.00 for the four months of 1932. Although these taxes are payable by the lessee in accordance with the terms of the lease, the lessor agrees to assume the liability for them and for all future real estate taxes.

What disposition of the above-mentioned reductions in liabilities should be made on the books of the lessee?

Question 6:

A company sells $400,000.00 of its $500,000.00 7% first-mortgage bonds, the balance of $100,000.00 being put up as security on a $75,000.00 bank loan. How should the bond liability be shown on the balance sheet?

Question 7:

What is your conception of a current asset?

Give your reasons for the inclusion in or exclusion from current assets of the following items at December 31, 1931:

(*a*) Securities having a readily realizable market value at the balance-sheet date. These identical securities have been owned for two years and the management states that the intention is to hold them until the funds represented therein are needed.

(*b*) Unexpired insurance premiums.

(*c*) A note receivable for $100,000.00 which falls due January 4, 1933.

(*d*) Inventories of obsolete parts whose sale is somewhat problematical. A supply of these parts is necessary in order to service old-style machines which are still in use throughout the country.

(*e*) Unamortized bond discount, all of which will be charged off during the coming year.

(*f*) Cash deposited in special dividend account for the express purpose of paying a dividend already declared and due ten days following the balance-sheet date.

(*g*) Cash in hands of sinking fund trustee, all of which is to be used to retire serial bonds and meet interest payments maturing within eight months after the balance-sheet date.

Question 8:

What is your understanding of the character of the following accounts? Indicate their place in the financial statements of a corporation.

(*a*) Reserve for uncollectible accounts
(*b*) Certificates of deposit
(*c*) Accrued interest receivable
(*d*) Unabsorbed factory burden
(*e*) Reserve for Federal income tax
(*f*) Reserve for loss on uninsured property
(*g*) Goodwill arising through consolidation
(*h*) Leasehold improvements

Question 9:

Question 15:

The ABC Company, a corporation organized January 1, 1929, was a continuation of the partnership A, B and C in which both personal services and capital were material income-producing factors. All the capital stock of the corporation was owned by A, B and C in equal amounts.

In January, 1932, A, B and C ask whether the combined Federal income taxes paid by the corporation and by themselves as individuals for the three years ending December 31, 1931, were in excess of the amount of Federal income taxes they would have had to pay if they had operated the business as a partnership during that period.

From the following information you are to answer their question by preparing a computation of the tax that would have been paid by A, B and C if

they had continued to operate as a partnership:

(1) Details of surplus account of the corporation follow:

Date	Particulars	Dr.	Cr.
12/31/29	Net profits year ending 12/31/29.....		$43,417.27
4/ 1 /30	Dividends declared and paid	$21,000.00	
12/31/30	Net profits year ending 12/31/30		14,700.74
4/ 1 /31	Dividends declared and paid	30,000.00	
12/31/31	Net loss year ending 12/31/31	4,316.91	
12/31/31	Balance	2,801.10	
	Totals	$58,118.01	$58,118.01

(2) Federal income taxes paid by the corporation were:

Year	Amount
1929	$5,366.18
1930	1,595.56

(3) The books of the corporation are kept on the accrual basis.

(4) The sole taxable income of A, B and C consisted of salaries and dividends received from ABC Company and was as follows:

Particulars	A	B	C
Year ending December 31, 1929:			
Salaries	$ 3,000.00	$ 3,000.00	$ 3,000.00
Dividends.....	—	—	—
Year ending December 31, 1930:			
Salaries	6,000.00	6,000.00	6,000.00
Dividends	7,000.00	7,000.00	7,000.00
Year ending December 31, 1931:			
Salaries	3,000.00	3,000.00	3,000.00
Dividends	10,000.00	10,000.00	10,000.00

(5) A, B and C had no deductible expenses for the years 1929, 1930 and 1931. Personal exemptions of A, B and C were $1,500.00 each for these years.

(6) The normal tax rates for the individual Federal income tax returns for the years 1929, 1930 and 1931 were:

Year	First $4,000.00	Second $4,000.00	Over $8,000.00
1929	½%	2%	4%
1930-'31	1½%	3%	5%

(7) Surtax rates for all three years were:

1% on net income between $10,000 and $14,000
2% on net income between 14,000 and 16,000
3% on net income between 16,000 and 18,000
4% on net income between 18,000 and 20,000

Question 10:

The Reliable Manufacturing Company purchased 85% of the capital stock of the Marquette Company at March 31, 1932, at which date the balance sheet of the latter company was as follows:

ASSETS

Cash	$ 3,182.16
Accounts receivable	96,312.14
Inventories	71,611.22
Other current assets	2,631.87
Fixed assets at appreciated values (net)	192,614.63
Patents	1.00
Total assets	$366,353.02

LIABILITIES AND NET WORTH

Accounts and notes payable	$ 67,979.40
Common no-par stock at paid-in values, 2,000 shares	184,375.00
Earned surplus	63,998.62
Surplus arising from appreciation of physical properties	50,000.00
Total liabilities and net worth	$366,353.02

The purchase price paid for the 1,700 shares of Marquette Company stock was $300,000.00. The sole purpose of the transaction was the desire on the part of the directors of the Reliable Manufacturing Company to obtain the use of certain patents held by the Marquette Company.

Steps were taken immediately to dissolve the Marquette Company by selling most of its assets and distributing the proceeds to stockholders as follows:

Cash:		
On hand		$ 3,182.16
Proceeds from sale of all assets except inventories and patents		225,000.00
Total		$228,182.16
Paid to creditors		67,979.40
Net cash		$160,202.76
Inventories at agreed valuation		65,000.00
Patents at agreed valuation		250,000.00
Total distributable assets		$475,202.76
Distributed to:		
Minority stockholders in cash—15%		$ 71,280.41
Reliable Manufacturing Company—85%		
Cash	$ 88,922.35	
Inventories and patents	315,000.00	403,922.35
Total, as above		$475,202.76

The above transactions were approved by the directors and stockholders of both companies.

What valuation should be placed upon the patents and inventories ac-

quired by the Reliable Manufacturing Company as a result of the above-mentioned transactions? What disposition should be made by the company of the liquidating cash dividend of $88,922.35?

Question 11:

Prepare an analysis of the causes of the decrease of $1,597.33 in gross profits of the M Company during 1931 as reflected in the following statement of gross profit:

Particulars	Net Sales	Cost of Sales		
		Material	Labor	Overhead
1930—				
Department A	$247,378.90	$ 66,792.30	$32,159.26	$49,475.78
Ratio to net sales...	100.00%	27.00%	13.00%	20.00%
Department B	79,855.06	35,136.23	16,769.56	22,359.42
Ratio to net sales...	100.00%	44.00%	21.00%	28.00%
Department C	54,879.22	30,183.57	14,268.60	18,110.14
Ratio to net sales...	100.00%	55.00%	26.00%	33.00%
Totals	$382,113.18	$132,112.10	$63,197.42	$89,945.34
Ratio to net sales...	100.00%	34.57%	16.54%	23.54%
1931—				
Department A	$199,486.75	$ 59,846.03	$19,948.68	$43,887.08
Ratio to net sales...	100.00%	30.00%	10.00%	22.00%
Department B	92,647.80	33,353.21	15,750.13	24,088.43
Ratio to net sales...	100.00%	36.00%	17.00%	26.00%
Totals	$292,134.55	$ 93,199.24	$35,698.81	$67,975.51
Ratio to net sales...	100.00%	31.90%	12.22%	23.27%

The number of units and the character of the products sold in Departments A and B remained practically the same in both years. Department C, being unprofitable, was eliminated in December, 1930.