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Problem No. 12 (Demonstration)

On April 1, 1912, W. B. Hone, A. J. Hone, and F. G. Hone, all being general partners in the firm of L. B. Hone's Sons, building contractors, decided, in order to preserve the organization of their business in case of the death of any of the partners, to incorporate.

Accordingly they filed a certificate of incorporation with the secretary of state at Albany, and paid the organization tax and filing fee in the amount of $15.75 ($12.50 tax, $3.25 filing fees) out of $500 advanced by W. B. Hone. The par value of the shares was $100 each.

The balance sheet of the copartnership was as follows: assets: land and buildings (net value), $35,000; machinery and tools (net value), $9,500; 10M Mich. Cent. 4's (cost), $9,887.50; horses, wagons, and harness (net value), $500; furniture and fixtures (net value), $1,000; building materials, $7,929.04; contracts in progress, $18,417.23; cash, $12,395.84; accounts receivable, $22,486.75; notes receivable and interest, $3,025.17; unexpired insurance, $425. Liabilities and capital: taxes accrued, $125; salaries and wages accrued, $250; accounts payable, $7,528.82; capital, W. B. Hone, $40,237.28; capital, A. J. Hone, $35,182.16; capital, F. G. Hone, $37,243.27.

Upon the formation of the corporation and the taking over of the business, each partner received 83 1-3 shares of stock and notes bearing interest at the rate of 6% per annum for the balance of his capital account. The corporate name was L. B. Hone's Sons, Incorporated.

After the new books had been opened it was discovered that charges to contracts in the amount of $325.72 had been omitted from the schedule and that $53.75 had been omitted from the accounts payable. On April 3d a cheque in the amount of $100 was received from the firm's brokers for interest, due April 1st, which had been collected on the Mich. Cent. 4's. The cheque was handed to W. B. Hone.

Prepare:

(*a*) Journal entries opening the books of the corporation.

(*b*) Balance sheet of the corporation, April 1, 1912.

(*c*) Skeleton ledger accounts showing the closing of the firm's books.

SOLUTION TO PROBLEM NO. 12

The problem presented herewith should be interesting, if somewhat novel, because of the fact that it was taken from actual experience. It illustrates one of the peculiar situations which arise in practice.

Incorporation was resorted to in this case partly for the purpose of preserving the organization against death and partly to avoid having any action for employer's liability brought against the individual members of the firm by employees; also to avoid any individual difficulties with labor unions, etc.

Judging from the combined capital accounts of the three partners as shown by the balance sheet of the copartnership one might have expected the capital stock of the corporation to have been from $100,000 to $125,000. It was pointed out by counsel that such procedure would increase the organization tax and the subsequent corporation taxes and that no more would be gained than if the capital stock were nominal in amount. As a consequence $25,000 was decided upon as the amount at which the corporation would be capitalized; the difference between the par value of 83 1-3 shares of stock and the capital of each partner being covered by notes of the corporation.

In order that there might be funds out of which to pay the expenses of incorporation one of the partners advanced $500. In this respect the same question arises as in problem 11, as to how, not having achieved existence the corporation could hold funds and make disbursements. Legally perhaps it could not. What really happened it seems was that one of the partners advanced in trust for the proposed corporation an amount which was made available for disbursements on account of the corporation.

The entry affecting the receipt of cash for expenses and the corresponding disbursements might perhaps more properly be made after the formal entry opening the books, if it were contended that no expenses could arise until the corporate life had begun. On the other hand if the entries were to be made chronologically there could be no question as to the priority. So much for theory. As a matter of practice, one entry would be made in the journal (setting up the capital stock) while the other (organization expenses, etc.) would be made in the cash book. Both would probably be made as of April 1, 1912 and no one could consistently complain thereat.

Expressed in the form of journal entries and using the formal method of recording the organization of the company the items under discussion would appear as follows:

1912			
April 1	Capital stock unissued	$25,000.	
	To Capital stock authorized		$25,000.
	To record the organization of L. B. Hone's Sons, Incorporated, incorporated under the laws of the State of New York with an authorized capital stock of $25,000 divided into 250 shares of $100 each.		
	Cash	500.	
	To W. B. Hone		500.
	For cash advanced for expenses of organization.		
	Organization expense	15.75	
	To Cash		15.75

Following these entries would come the act of taking over the assets and liabilities of the copartnership, and the issuing of the capital stock to the individuals. The entry recording same would be based on the balance sheet of the copartnership, substituting for the capital accounts of the partners, the capital stock and notes payable of the corporation.

The entry would appear as below:

Land and buildings	$35,000.	
Machinery and tools	9,500.	
Horses, wagons and harness	500.	
Furniture and fixtures	1,000.	
Mch. Cent. 4's (10M)	9,887.50	
Building materials	7,929.04	
Contracts in progress	18,417.23	
Cash	12,395.84	
Accounts receivable	22,486.75	
Notes receivable and interest	3,025.17	
Unexpired insurance	425.	
To taxes accrued		$ 125.
Salaries and wages accrued		250

Accounts payable	7,528.82
Notes payable	87,662.71
Capital stock	25,000.

For the assets and liabilities of L. B. Hone's Sons taken over by L. B. Hone's Sons, Incorporated in exchange for capital stock and notes payable as above.

With the exception of those affecting the discrepancies discovered after the books of the corporation were opened the journal entries are now complete. In connection with the latter, it may be said that the question of disposition of these items is not so difficult as it would have been had not the parties in interest have been the same in each organization. If the schedule representing contracts in progress had been correct, it would have shown $325.72 more than it did show. The effect of this would have been to increase the capital of the partners. Likewise a correct schedule of accounts payable would have shown $53.75 more than was shown, with a corresponding decrease in the capital accounts of partners. The net effect of these items would have been to increase the capital $271.97. If this had been done, the notes payable when issued would have been greater in amount to that extent. For practical purposes, the error may be corrected by distributing the amount among the three interested parties and issuing new notes for the correct amounts ($31,994.60, $26,939.49, $29,000.59) issuing additional notes for $271.97 ($90.66 each), or crediting the amount ($271.97) to accounts payable, representing the individuals. The objection to the latter would be that unless paid to the partners immediately they would loose the interest at 6% to which they are entitled and which was borne by the notes. It is therefore thought desirable to make an entry as follows:

Contracts in progress	$325.72	
To Accounts payable		53.75
Notes payable		$271.97

From the above entries the accounts may be set up and adjusted so that the following balance sheet will result:

L. B. HONE'S SONS, INCORPORATED

Balance Sheet—April 1, 1912

Assets			*Liabilities and Capital*		
Land & buildings		$ 35,000.	Capital stock outstanding		$ 25,000.00
Machinery & tools		9,500.	Notes payable		87,934.68
Horses, wagons & harness		500.	Current liabilities:		
Furn. & fixtures		1,000	Taxes accrued	$ 125.	
Mich. Cent. 4's (par $10,000)		9,887.50	Sal. & wages acc.	250.	
			Accounts payable	8,082.57	
			Total current lblts.		$ 8,457.57
Working assets:					
Material & sup.	$ 7,929.04				
Invested in contracts	18,742.95				
Total working assets		$ 26,671.99			
Current assets:					
Cash	$ 12,880.09				
Accounts rec.	22,486.75				
Notes rec. & int.	3,025.17				
Total current assets		$ 38,392.01			
Deferred charges to expense:					
Unexp. insurance	$ 425.				
Organization exp.	15.75				
Total deferred charges to exp.		$ 440.75			
Total assets		$121,392.25	Total liabilities and capital		$121,392.25

The problem calls for skeleton ledger accounts showing the closing of the firm's books. Since what is true of one asset account is true of all asset accounts in this particular case—and the same may be said of the liabilities—it is thought that time and labor may be saved if the assets are represented collectively and respectively by single accounts called "copartnership assets" and "copartnership liabilities." In following the entries it may help if it is known that the assets and liabilities were first debited and credited respectively to L. B. Hone's Sons, Incorporated; that account was closed when the capital stock and notes were received; the latter two accounts were closed when the stock and notes were distributed among the partners.

Copartnership assets

$120,566.53	$120,566.53

Copartnership liabilities

$7,903.82	$7,903.82

L. B. Hone's Sons, Inc.

Assets	$120,566.53	Liabs.	$7,903.82
Contr's.	325.72	A/c pay.	53.75
		Capital stk.	25,000.
		Notes	87,934.68
	$120,892.25		$120,892.25

W. B. Hone, Capital

Stock ..	$ 8,333.33	$40,237.28
Notes ..	31,994.60	90.65
	$40,327.93	$40,327.93

Capital Stock L. B. H. Sons Inc.

$25,000.	$25,000.

A. J. Hone, Capital

Stock ..	$ 8,333.33	$35,182.16
Notes ..	26,939.49	90.66
	$35,272.82	$35,272.82

Notes payable L. B. H. Sons Inc.

$87,943.68	$87,943.68

F. G. Hone, Capital

Stock ..	$ 8,333.33	$37,243.27
Notes ..	29,000.59	90.66
	$37,333.92	$37,333.93

Problem No. 12-A (Practice)

In order to avoid personal liability the firm of Smith Brothers, comprised of A. L., B. M., and C. N. Smith, incorporated in New York, on July 1, 1912, under the title of Smith Brothers, Incorporated with an authorized capital of $50,000, divided into 500 shares of the par value of $100 each. A. L. Smith advanced $1,000 for expense. The organization tax and filing fees were $28.75; legal expenses paid in connection with incorporation, $300.

The balance sheet of the copartnership was as follows: Assets, investments, $14,962.50; notes receivable and interest, $8,025; furniture and fixtures, $2,000; accounts receivable, $18,946.25; land and buildings, $50,000; materials and supplies, $12,-

483.12; equipment, $15,000; insurance unexpired, $250; cash, $10,573.43; motor trucks, $5,000; goods in process, $20,318.79. Liabilities and capital; bond and mortgage payable and interest $10,300; taxes accrued, $275; salaries and wages accrued, $1,250; accounts payable $18,496.27; notes payable and interest $10,125; proprietorship, A. L. Smith, $50,000; B. M. Smith, $45,321.16; C. N. Smith, $21,791.66.

When the business was transferred to the corporation each partner received $166 2-3 shares of stock and notes for the balance of his investment.

From the foregoing prepare:

(*a*) Journal entries opening the books of the corporation.

(*b*) Balance sheet of the corporation, July 1, 1912.

(*c*) Skeleton ledger accounts showing the closing of the co-partnership books.