11-21-1931

Examination questions: Auditing, Saturday Morning, November 21, 1931

Michigan Board of Accountancy

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EXAMINATION QUESTIONS

Auditing

SATURDAY MORNING, NOVEMBER 21, 1931

Question 1:

Realizing that they must ask for a composition from their merchandise creditors, the owners of the Style Clothing Company call a creditors' meeting on March 1, 1930. Open-account creditors agree to a 25 per cent reduction of the liability to them; secured creditors, holding notes, agree to return, and thus to cancel, notes amounting to 20 per cent of their claims. The creditors are convinced that this act is necessary in order that bankruptcy and dissolution may be avoided, and they look forward to future profitable relations with the company.

Your advice is solicited as to the treatment of the liability reduction on the books and on the Federal income tax return for 1930.

Question 2:

On July 18, 1930, the MacMillan Manufacturing Company suffered a fire which destroyed certain of its plant facilities. As a result, temporary quarters, at an annual rental of $12,000.00, payable monthly in advance, were procured for one year, the lease expiring on July 31, 1931. The new plant was completed April 30, 1931, and the rented property vacated and subleased for $1,500.00, payable on May 1, 1931, covering the period from May 1 to July 31, 1931.

In auditing the books on June 30, 1931, you find that the rent paid (11/12 of $12,000.00) had been added to the cost of constructing the new plant and that the $1,500.00 collected in May from the sublessee had been treated as a reduction of the cost of the new plant. What adjustments, if any, do you believe are necessary properly to record these transactions?

Question 3:

During the audit of a manufacturing concern an addition of $50,000.00 is found in the patent account representing, as explained in the journal entry, the value of certain patents, patent rights and processes purchased from the president of the company. The offsetting credit is to capital stock.

(a) What verification for purposes of valuation will be necessary?

(b) How and where will this item be shown on the balance sheet?

Question 4:

In 1920, the X Corporation erected a manufacturing plant in Middletown, Ohio, on land donated to it without restriction by the city. The land had a fair market value at that time of $10,000.00. In 1925, the company sold its land and building in Middletown for $115,000.00, and moved to Gary, Indiana. The city of Gary provided a site, having a fair market value in 1925 of $20,000.00, on which a plant was erected; the gift was subject to the stipulation that title to the property would pass when the company (1) had conducted its manufacturing business on that location for five years, (2) given continuous employment to an average of not less than fifty employees during that period, and (3) paid at least $75,000.00 annnually in wages. All provisions have been complied with and the X Corporation has now acquired title to the property, the market value having increased to $30,000.00. How will the above facts be shown in the statement of profit and loss for the year 1930, and on the balance sheet at December 31, 1930?

Question 5:

An audit of M Company's records on June 30, 1931, reveals the necessity of making only minor adjustments to book figures, all of which are agreed to by the company's officials. The president of the company, however, states that he has submitted a tentative balance sheet to various creditors and to the company's bank and requests that after making the necessary adjustments, you certify to the balance sheet in the form prepared by the company's accounting department.

A review of the company's records reveals the following facts:

(1) "Cash" included bank deposits and petty cash; of the latter item, $1,550.00 was made up of I. O. U's signed by the company's officers.

(2) A large number of receivables had been discounted with a finance company. The balance in the individual accounts so discounted represented the 10 per cent cash withheld by the finance company until the account had been paid in full.

(3) Inventory of finished goods included stock in warehouse in a distant city, receipt for which had been deposited with the bank as collateral.

(4) The values of real estate, machinery and equipment were included at appraised values, the offsetting credit having been included with capital surplus.

(5) Principal and accrued interest of a first mortgage loan appeared in a separate classification below current liabilities. A payment of $15,000.00 was due on the principal April 10, 1932, and interest was payable on April 10th and October 10th of each year.

(6) Under the general classification of surplus, were the following reserves:

Bad debt reserve.

Contingent reserve.

Sinking fund reserve.

Depreciation reserve.

Would you feel that the company's method of classifying assets and liabilities differed from your own to an extent that would prevent your certifying to a balance sheet so prepared, or would you insist that certain alterations of form be made? If you assume the latter attitude on any of the above items, what changes would you make?

Question 6:

In making an audit of a publishing house in which a magazine sales department is maintained, you find the following facts:

A. Cash received—

(1) For one to five-year subscriptions to quarterly magazines is credited directly to income.

(2) From the sale of advertising space in the magazines, billed after each issue is printed and mailed, is credited to income.

B. The cost of printing a reference book given as a premium with subscriptions is charged to advertising expense at the time printed.

What changes in the above procedure will be required to reflect the proper income and cost of sales for each issue of the magazine?

Question 7:

In analyzing the changes in the plant assets of a company you find the following items:

(a) Cost of paving street adjacent to factory, charged to land account.

(b) Property taxes and mortgage interest charged to land held for future expansion.

(c) Used vats and tanks for electro plating, appraised at $475.00, and containing plating liquid worth $25.00, were purchased at a bankruptcy sale for $200.00 and were charged to machinery.

The vats and tanks were installed in the purchaser's factory at a labor cost of $300.00, which was charged to "machinery installation expense."

Discuss the propriety of the above charges and submit a brief explanation of the theory involved in each instance.

Question 8:

The Central Laundry Company authorized an issue of 6 per cent, 10-year first mortgage gold bonds, par value $250,000.00, on April 1,

1927. Of this amount, bonds having a par value of $200,000.00 were immediately sold at a 10 per cent discount, the balance remaining undisposed of.

During 1930, 50 one-thousand dollar bonds were repurchased at 93. On May 1, 1931, these were given to the bank, along with the unissued bonds, as security for an $80,000.00 bank loan.

Indicate how you would set up the bonds and bond discount on a balance sheet dated May 31, 1931.

Question 9:

In auditing the salesmen's accounts of the Raymond Sales Corporation you find the following conditions:

(a) Salesmen are given permanent advances to pay traveling expenses. On the balance sheet date (June 30, 1931) these advances totaled $10,500.00. Each salesman prepared expense vouchers at June 30, 1931, which appeared in vouchers payable in the amount of $6,318.26.

(b) Certain salesmen are permitted to draw against their commissions. The excess of drawings over commissions credited to them was $26,351.12. In both cases, the salesmen in question are still in the employ of the company.

How should salesmen's accounts appear on the balance sheet of June 30, 1931?

Question 10:

What disposition would you make of the following items in the preparation of a balance sheet for a manufacturing company?

(a) Dividends which had not been paid for three years on $750,000.00 of 7 per cent cumulative preferred stock.

(b) An investment of $175,000.00 which represented 100 per cent ownership in a subsidiary.

(c) Notes on which the company is a guarantor.

(d) Collateral deposited with the company on the note of a debtor.

(e) Cash received from sale of company's bonds.

(f) Second-mortgage bonds of a hotel corporation which had been received at par in part payment of equipment sold.

(g) A net credit balance labeled "salesmen's account."

(h) Unabsorbed overhead.

(i) Claims which have been made against a carrier for damages.

(j) Good-will which was purchased for stock at the inception of the company.

Question 11:

The balance sheet and profit and loss statement of a customer of one of your clients has been submitted for credit purposes. The client asks your opinion of the debtor company's condition. You find the following certificate attached to the statements:

"We have inspected the books of The Marvel Supply Company and hereby certify that the attached balance sheet and statement of profit and loss reflect accurately the condition of the company and the operations for the year according to the books.

HARRY TAYLOR & COMPANY,
Auditors."

Discuss the value of this certificate.

Question 12:

The dry kiln of B Company, a furniture manufacturing plant was badly damaged by fire on December 28, 1930. In making an audit of the books on January 15, you determine that the original cost of the kiln built in 1914, was \$26,652.00 and the accrued depreciation to December 28, 1930, was \$13,256.41. Its net sound value according to the recent report of appraisers was \$20,000.00. It was covered by a \$15,000.00 insurance policy which contained the standard 80% co-insurance clause. The management estimates, and the insurance adjuster agrees, that the total loss sustained was \$12,000.00. What disposition would you make of these values on the balance sheet you set up as of December 31,1930?