5-21-1932

Examination Questions: Auditing, Saturday Morning, May 21, 1932

Michigan Board of Accountancy

MICHIGAN BOARD OF ACCOUNTANCY

EXAMINATION QUESTIONS

SATURDAY MORNING, MAY 21, 1932

Auditing

Question 1:

A, B, and C are the officers and directors and the owners of 55% of the outstanding capital stock of the Cyril Building Corporation, the remaining stockholders being inactive in the company's affairs. In September, 1931, A, B, and C employed an individual to purchase corporate obligations (first-mortgage bonds) in the amount of $70,000.00, maturing October 15, 1931, at as great a discount as the bondholders could be induced to accept. Cash loans equal to the par value of the maturing bonds were made by the corporation to the three individuals in order that the purchases might be made, and at maturity the bonds, which had been purchased at an average price of 60, were formally redeemed by the corporation and the loans to the individuals canceled.

What would be your attitude, as auditor, as to these transactions in the preparation of a certified balance sheet of the Cyril Building Corporation at December 31, 1931? You were appointed auditor by the stockholders at a special meeting held on May 2, 1932.

Question 2:

During the course of an audit as at December 31, 1931, you find that your client in 1925 purchased two acres of land adjacent to its present plant for future expansion, subject to a first mortgage, the maturity of which was May 10, 1929. The mortgage has not been refinanced but has been extended for one year at each May 10th since 1929, the date of the annual 6% interest payment. The bank which owns the mortgage informs you that, subject to the usual interest payment at May 10, 1932, it will grant the customary one-year extension of the mortgage to May 10, 1933. Your client is in good financial position. How will you show the mortgage liability on the balance sheet?

Question 3:

You are called upon by Mr. John A. Wall, President of the Wall Paper Company, to furnish him with a brief memorandum setting forth the advantages of an annual audit of the company's accounts. He explains that while he feels disposed to employ your services, several members of his board of directors have stated that the customary annual audit, in this year of depression, might well be dispensed with as an unnecessary luxury.

Prepare a brief letter which he may pass on to his board of directors.

Question 4:

(*a*) What is the scope of a balance-sheet audit?

(*b*) Prepare an index of the working-papers of an imaginary balance-sheet audit.

Question 5:

What items other than customers' accounts are often found in a receivable ledger? How would you dispose of them for balance-sheet purposes?

Question 6:

During 1931 you find that certain minority stock interests held for many years as investments by the Z Company were exchanged for real estate bonds, several of which were in default before the end of the year. The par value of the bonds is, however, greatly in excess of the cost of the stocks exchanged, and the excess has been credited to capital surplus account. What principles should govern in determining the income or loss (a) for Federal income tax purposes, and (b) for the purposes of preparing a balance sheet and statement of profit and loss which you may certify to without qualification?

Question 7:

In your audit of the books of the Gable Sales Company, dealer in automobiles, you find on hand 14 used cars, acquired in trades, having a total book value of $4,800.00. The book value represents the trade-in values at which the used cars were acquired. The cost up to the end of the fiscal period of putting the 14 cars in salable condition was $643.19, which has been charged to expense, and in addition, it is estimated that approximately $550.00 will be required to complete the overhauling before they can be sold. Not more than $3,500.00 is, however, expected from the ultimate sale of these cars and you are informed that the experience of the dealer has been fairly uniform in this respect. A commission of a flat 10% is allowed salesmen on all used-car sales.

How would you express these items in your report to the company?

Question 8:

An investment trust company of the management type maintains the following surplus accounts:

(1) Capital surplus; in this account are credited and debited gains and losses arising from the valuation of securities on hand at market prices at December 31 of each year. On December 31, 1931, the debit balance in this account was $42,346,655.18.

(2) Surplus from realized security gains; to this account are transferred gains or losses previously credited or debited to capital surplus with respect to investments sold, together with any further gain or loss resulting from movements of market values since the next previous December 31. On December 31, 1931, the debit balance in this account was $5,368,775.54.

(3) Earned surplus; to this account are credited interest and dividends received less administrative expenses and interest paid. The account is debited with cash dividends paid on preferred and common stocks and in 1931 it was credited with the sum of $49,500,000.00 which arose from the reduction in the declared value of the common stock outstanding from $27.50 a share to a par value of $5.00 a share. The credit balance of this account at December 31, 1931, was $48,689,230.69.

In the minutes of a special meeting of the stockholders on December 12, 1931, you find that the reduction in value of the common stock was approved and that the credit to earned surplus was authorized, against which, according to the resolution, "any debit balances of other surplus accounts shall be carried."

In preparing a balance sheet of the company at December 31, 1931, how would you display the item of surplus?

Question 9:

Name and discuss briefly six expenses which may not be deducted from the income of a corporation in the preparation of its Federal income tax return.

Question 10:

Prepare a liability certificate suitable for the signature of the officers of a company you are auditing.

Question 11:

During the course of your audit of the accounts of the Y Company, you discover an account, detailed below, covering merchandise shipped to customers on consignment.

Particulars			Dr.	Cr.
Balance, January 1, 1931 at billing prices to customers (factory cost $14,214.96)			$ 18,834.12	
Shipments to customers at billing prices (factory cost $93,531.63); offsetting credit to sales			127,386.91	
Cash received from customers as indicated by following account-sales rendered:				
Sales (factory cost $88,326.53)		$139,426.91		
Less:				
20% commission	$27,885.38			
Freight, storage, and other charges...	1,263.81	29,149.19		$110,277.72
Defective merchandise returned by customers, credited to this account at billing price and charged to defective merchandise (an expense) account. Factory cost of these returns was $4,383.66, and the merchandise had no scrap value				5,568.11
Totals			$146,221.03	$115,845.83
Debit balance per books at December 31, 1931......				30,375.20
Totals			$146,221.03	$146.221.03

Prepare journal entries adjusting the above-mentioned account and state how you would treat the balance on the financial statements of the company at December 31, 1931.