Examination Questions: Auditing, Saturday Morning, November 17, 1934

Michigan State Board of Accountancy
Auditing

QUESTION 1:

You are engaged, after the closing of the fiscal period, to make an audit of a manufacturing company. What general steps would you follow in verifying cash?

QUESTION 2:

Why is it ordinarily impracticable for an auditor to assume full responsibility for taking and pricing the inventory? What is the general nature of the responsibility which the auditor can and does properly assume in connection with inventories?

QUESTION 3:

The R company has a 40% interest in the capital stock of the T company and has received from it an 8% cash dividend. Accompanying the dividend check is a notice stating that the dividend has been paid out of surplus arising from the reduction of stated capital. What entry should be made on the books of the R company? Why?

QUESTION 4:

In setting up the balance sheet of X company, how would you display employees’ subscriptions to unissued capital stock which are being paid for on an instalment basis? Would your presentation be different if the stock being sold is treasury stock?
QUESTION 5:

B is in the business of buying instalment paper from dealers in electric refrigerators. His practice is to advance 90% of the unpaid account to the dealer, add 6½% to the unpaid account as a carrying charge, and to secure a note from the customer for the total, payable in equal instalments over a fifteen-month period beginning one month after the date of the note, the monthly payment by the customer to include interest at 6% on the unpaid balance. A reserve of 10% of the original unpaid account is retained by B until the note is paid in full, at which time the reserve is paid to the dealer. What simple rate of interest does B actually earn if it be assumed that carrying charges are to be regarded as interest?

QUESTION 6:

On a first balance-sheet audit of a large corporation, what procedure would you follow with respect to capital stock?

QUESTION 7:

The White Construction Company has several large contracts in process of completion. Certain of these jobs are on a cost-plus basis and others are on a contract-price basis. No profit or loss has been taken on these jobs for the period under audit. Discuss the points affecting profit and loss which the auditor must consider.

QUESTION 8:

In auditing the books of a public-utility company, the stock of which is widely held, you find that certain officials are heavily indebted to the corporation, apparently without authorization. What procedure would you follow under such circumstances?

QUESTION 9:

In auditing the accounts of a stockbroker, what would be your program for the first day?

QUESTION 10:

On the books of a manufacturing company you are auditing, you find numerous debit balances in the trial balance of accounts payable. (a) How would you satisfy yourself concerning these items? (b) In what way might a dishonest employee create such debit balances and how might he appropriate funds thereby?
QUESTION 11:

A manufacturer of refrigerators had 4,000 units of a 1932 model on hand at December 31, 1933 which had been completed in 1932. In February, 1934, prior to the completion of your audit, these units were disposed of as a job lot for $50,000, their original cost having been $310,000, and their inventory value at December 31, 1932, $248,000.

Assuming that the offer had been under consideration prior to December 31, 1933, what would be your opinion as to contention of the recently appointed comptroller of the company that since no fair market value existed at the end of the year, the original cost of $310,000 should be restored as the inventory value? Would your conclusion as to the proper valuation in the balance sheet of December 31, 1933 be modified if the offer had not been received until February?

QUESTION 12:

Following is a transcript of an asset account appearing on the records of an investment trust you are auditing:

Associated Light Company—no par common

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
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<tbody>
<tr>
<td>1934</td>
<td>1934</td>
</tr>
<tr>
<td>Jan. 4 100 shares at $90.00</td>
<td>July 14 100 shares at $82.00</td>
</tr>
<tr>
<td>$9,000.00</td>
<td>$8,200.00</td>
</tr>
<tr>
<td>Aug. 31 100 shares at $70.00</td>
<td>Aug. 31 Balance</td>
</tr>
<tr>
<td>7,000.00</td>
<td>7,800.00</td>
</tr>
<tr>
<td>$16,000.00</td>
<td>$16,000.00</td>
</tr>
<tr>
<td>Aug. 31 Balance ...........$7,800.00</td>
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At September 30, the market price of the stock is 73. The manager of the trust is of the opinion that the stock could properly be shown on the balance sheet at the original cost of $9,000.00, and that the $1,200.00 which he saved by selling the stock on July 14 and buying it back six weeks later after the "bottom" had in his opinion been reached could properly be taken up as income. However, he states that he has decided that the more conservative method is to permit the stock to remain at its present book value of $7,800.00. What is your opinion concerning the basis of valuation to be followed?