

**NATIONAL UNIVERSITY OF SINGAPORE**  
**EC2204: Financial Accounting for Economists**

**Semester 1, AY2018-2019**

**Time allowed: 2 Hours**

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**INSTRUCTIONS TO CANDIDATES**

1. Write your student number only. Do not write your name.
2. This assessment paper contains FIVE (5) questions and comprises FIVE (5) printed pages, including this page.
3. Answer ALL questions.
4. Start each question on a new page.
5. This is a CLOSED book examination.
6. You may use a scientific (non-graphing) calculator.
7. The total mark for this paper is 50.

**Question 1:**

- (a) (4 marks) Financial Statements are a key source of information for economists. Compare and contrast the Statement of Cash Flows with the Income Statement and Balance Sheet.
- (b) (3 marks) Firms usually raise funds through debt or equity. Discuss the relative advantages of debt financing.
- (c) “Embattled commodity trader Noble Group won over a major opponent of its US\$3.5 billion (S\$4.8 billion) **debt-for-equity restructuring plan**, ending months of accusations and lawsuits.”

*21<sup>st</sup> June 2018, The Straits Times*

(3 marks) Explain why Noble Group might have proposed the exchange of debt for equity.

**Question 2:**

On 1 January 2018, Turin Merchandise purchased a machine for use in operations. The total acquisition cost was \$33,000. The machine has an estimated useful life of three years and a residual value of \$3,000.

Assume that units produced by the machine will total 16,000 during 2018, 23,000 during 2019, and 21,000 during 2020.

- (a) (5 marks) Using the following methods, find the depreciation expense **and** book value at the end of **2019**.
  - (i) Straight line
  - (ii) Units of Production
  - (iii) Double Declining

Consequently, explain which depreciation method will give rise to the highest profits in **2019**.

- (b) (2 marks) On 1 January 2019, the machine was rebuilt at a cost of \$7,000. After it was rebuilt, the total estimated life of the machine was increased to five years (from the original estimate of three years) and the residual value to \$6,000 (from \$3,000).

Assume that the company chose the straight-line method for depreciation, compute the annual depreciation expense after the change in estimates.

- (c) (3 marks) Following (b), after the machine was rebuilt in 2019, it attracted many buyers. On 31 December 2020, the machine was finally sold for \$7,500.
  - (i) Compute the book value on that date.
  - (ii) Prepare the journal entry to record the sale.

**Question 3:**

- (a) (5 marks) On 1 January 2018, Palermo Peach Ltd issued a 3-year bond with a face value of \$50,000 and a stated interest rate of 7%. Because the market interest rate is 9%, the company receives \$47,469 for the bond.
- (i) Determine the interest expense and amount of the discount that will be amortized during the year ending 31 December 2018.
  - (ii) Prepare the journal entry to record the first interest payment on 31 December 2018.
- (b) (5 marks) Consider the following list of financial statement items and amounts for Roma Rooms as of 31 March 2018, the end of its first year in operation.

Accounts Receivable	\$ 40,000
Accounts Payable	30,000
Cash	10,000
Common Stock	20,000
Notes Payable	20,000
Equipment	50,000
Sales Revenue	100,000
Fuel Expense	15,000
Rent Expense	20,000
Advertising Expense	5,000
Salaries and Wages Expense	20,000
Dividends	10,000

Prepare the shareholders' equity section of the balance sheet as of 31 March 2018

**Question 4:**

Consider The Milan Company, a luxury bag maker. Its Balance Sheet for 31 December 2017 and the Income Statement for 2018 are shown below.

The Milan Company  
Balance Sheet  
31 December 2017

Assets	
Cash	\$10,000
Accounts Receivable	5,000
Inventory	12,000
Property and Equipment, Net	<u>20,000</u>
	<u>\$47,000</u>
Liabilities and Shareholders' Equity	
Accounts Payable	\$10,000
Note Payable, Long-Term	5,000
Common Stock	20,000
Retained Earnings	<u>12,000</u>
	<u>\$47,000</u>

The Milan Company  
Income Statement  
For the Year Ended 31 December 2018

Sales	\$13,000
Cost of Goods Sold	3,000
Salaries and Wage Expense	3,000
Interest Expense	1,000
Other Expenses	<u>500</u>
Net Income	<u>\$ 5,500</u>

Additional Information (that have not been reflected above):

- Out of the \$13,000 in sales, \$8,000 in cash was received from customers.
- Bought new land for cash, \$10,000.
- Sold other land for its book value of \$5,000.
- Paid \$1,000 principal on the long-term note payable and \$1,000 in interest.
- Issued new shares of stock for \$10,000 cash.
- Cash dividends of \$1,000 were declared and paid to stockholders.
- Paid \$5,500 on accounts payable.
- No inventory purchases were made.
- All wages were paid in cash.
- Other expenses were on account.

(a) (6 marks) Prepare the Balance Sheet as at 31 December 2018.

(b) (4 marks) Prepare the Statement of Cash Flows (using the direct method).

**Question 5:**

- (a) (5 marks) Liquidity ratios seek to examine the firm's ability to survive in the short run.

The financial information below presents selected information from the Financial Statements of Lazio Leggings, a company that specializes in leggings. Sales revenue during the current year was \$13,700,300 and cost of goods sold was \$8,905,195. All of the sales are made on account and are due within 30 days.

	Prior Year	Current Year
Cash and cash equivalents	\$ 552,330	\$ 599,780
Accounts receivable	4,550,000	3,800,000
Inventory	920,360	1,223,440
Total current assets	8,700,030	8,480,100
Total assets	11,100,020	10,980,000
Total current liabilities	7,200,300	7,476,000
Total liabilities	8,449,900	8,240,700

Using relevant ratios, evaluate the company's liquidity position at the end of the current year.

- (b) (5 marks) In the long run, solvency ratios are more useful to examine the firm's capacity to meet its financial commitments.

Evaluate the different components of the Altman Z-Score in predicting bankruptcy.

**- End of Paper -**