NATIONAL UNIVERSITY OF SINGAPORE

EC2204 Financial Accounting for Economists

Semester 1, AY2019-2020
Mid-Term Examination

Time allowed: 1 Hour

Suggested Solutions

Question 1:

Lion Limited was formed with $300,000 cash contributed by its owners in exchange for common stock. The company borrowed $150,000 from a bank.

Subsequently, the company purchased $50,000 of inventory and paid cash for it. The company also purchased $350,000 of equipment by paying $50,000 in cash and issuing a note for the remainder.

What is the amount of the total assets to be reported on the balance sheet?

A. $400,000

B. $750,000

C. $800,000

D. None of the above

Answer: B

Cash from owners of $300,000 + Cash from borrowing of $150,000 + Inventory purchased for $50,000 − Cash paid for inventory of $50,000 + Equipment purchased for $350,000 − Cash paid for equipment of $50,000
= $750,000.

Question 2:

At the end of last financial year, Zebra Company's assets totaled \$430,000 and its liabilities totaled \$370,000. During the current year, the company's total assets increased by \$29,000 and its total liabilities increased by \$12,000.

Determine the shareholder’s equity of Zebra Company at the end of the current year:

A. \$17,000

B. \$60,000

C. \$77,000

D. None of the above

Solution: C

Shareholder’s Equity = Assets − Liabilities

Beginning shareholder’s equity = \$430,000 − \$370,000 = \$60,000

Change in shareholder’s equity = Change in assets − Change in liabilities
= \$29,000 − \$12,000 = \$17,000

Hence, Ending shareholder’s equity = Beginning shareholder’s equity + Change in shareholder’s equity = \$60,000 + \$17,000 = \$77,000

Question 3:

The following accounts are taken from the Financial Statements of Penguin Limited as of 31 December 2018.

Accounts Payable	$ 2,075
Accounts Receivable	800
Selling & Administrative Expenses	2,500
Cash	2,200
Common Stock	2,000
Dividends	1,900
Income Tax Expense	400
Interest Expense	75
Other Expenses	500
Notes Payable	5,000
Other Assets	2,500
Other Liabilities	3,000
Other Operating Expenses	2,000
Other Revenue	300
Property and Equipment	11,000
Retained Earnings, 31 December 2017	4,800
Salaries and Wages Expense	3,000
Supplies	300
Service Revenue	10,000

What is the amount of Retained Earnings on the Balance Sheet as of 31 December 2018?

A. $4,725

B. $5,725

C. $6,725

D. None of the above

Solution: A

Total revenues = Service Revenue + Other Revenue = $10,000 + $300 = $10,300

Total expenses = Salaries Expense + Interest Expense + Income Tax Expense + Selling & Administrative Expenses + Other Expenses+ Other Operating Expenses = $3,000 + $75 + $400 + $2,500 + $500 + $2,000 = $8,475

Net Profit = Revenue – Expenses = $10,300 − $8,475 = $1,825

Ending Retained Earnings = Beginning Retained Earnings + Net Profit - Dividends = $4,800 + $1,825 − $1,900 = $4,725

Question 4:

Using accrual basis accounting, which of the following errors would most likely lead to an overstatement of net profit in the current year?

A. Recording revenue next year since the cash is collected next year, although the performance obligation is satisfied in the current year.

B. Recording an expense next year as cash is paid next year, although it is incurred this year

C. Failing to adjust the Deferred Revenue account for the portion of rent earned this year

D. None of the above.

Solution: B

The expense recognition principle states that expenses should be recorded in the same period as the revenues they generate, not necessarily the period in which cash is paid for them. As a result, not recording an expense even though it was incurred this year would understate expenses and overstate net profit for the current year.

Not recording revenue even though it was earned would understate net profit in the current year.

Failing to adjust the Deferred Revenue account for the portion earned this year would also understate net profit in the current year.

Question 5:

Giraffe Company contracted for a 30-second commercial (an advertisement) that aired during the F1 Racing in Singapore at a cost of $1.2 million. It is legally obligated to pay for the commercial, but has not yet done so.

Given that Giraffe Company had not accounted for the transaction previously, examine how the balance sheet would be affected on the day the commercial aired.

A. It does not affect the balance sheet

B. It increases both assets and liabilities by $1.2 million

C. It increases liabilities and decreases shareholders' equity by $1.2 million each

D. None of the above

Correct Answer: C

Because the commercial aired, Giraffe Company is obligated to pay the $1.2 million; that amount will be reported as a liability on the balance sheet.

Because the commercial aired, the $1.2 million is an expense that will be reported on this month's income statement; expenses decrease net profit, which decrease shareholders' equity.

Question 6:

Cow Inc. received payment from a customer in June for a service that was to be provided in July.

How would this be reflected in the basic accounting equation for the month of July?

A. Assets will not change, liabilities will decrease, and shareholders' equity will increase.

B. Assets will increase, liabilities will increase, and shareholders' equity will not change

C. Assets will decrease, liabilities will not change, and shareholders' equity will increase

D. None of the above

Correct Answer: A

In June, when the payment from the customer was received, the company would increase assets (Cash) and increase liabilities (Deferred Revenue).

In July, revenues increase, which increases net profit and the shareholders' equity account Retained Earnings.

In addition, since the company fulfilled its obligation to perform the service, the related liability (Deferred Revenue) decreases.

Question 7:

On 31 December 2018, Meow Limited paid $9,800 to rent a storage facility from 1 July 2019 to 1 July 2020.

Which of the following statements about the effect of this transaction on Meow Limited's financial statements is correct?

A. Prepaid Rent in the amount of $9,800 will be reported as a liability on the balance sheet at 31 December 2018.

B. Prepaid Rent in the amount of $9,800 will be reported as an asset on the balance sheet at 31 December 2019.

C. Rent Expense in the amount of $9,800 should be reported on the income statement for the year ended 31 December 2018.

D. None of the above

Solution: D

When a company pays for something that provides benefits in future periods, the cost is reported as an asset. This prepayment would be recorded as an asset called Prepaid Rent.

Prepaid Rent in the amount of $9,800 (the amount of the prepayment) will be reported as an asset (rather than a liability) on the balance sheet at 31 December 2018.

Further, since six months of the prepayment remain unused, Prepaid Rent in the amount of $4,900 (one-half of the amount of the prepayment) will be reported as an asset on the balance sheet at 31 December 2019.

Since the prepayment covers the period from 1 July 2019 to 1 July 2020, the income statement for the year ended 31 December 2018 is unaffected by this transaction.

Question 8:

Eagle Company reported Wages Payable of $1,500 at the beginning of the year and $5,000 at the end of the year. The income statement for the year reported Wages Expense of $112,400.

How much wages was paid in cash during the year?

A. $105,900

B. $108,900

C. $112,400

D. None of the above

Solution: B

Ending Wages Payable = Beginning Wages Payable + Wages Expense during the year − Wages paid in cash during the year

Wages paid in cash during the year = Beginning Wages Payable + Wages Expense during the year − Ending Wages Payable
= $1,500 + $112,400 − $5,000 = $108,900

Question 9:

On 31 July 2018, Shark Company paid for a new two-year insurance policy that cost $27,000 in cash. Proper accounting entries have been entered for this transaction.

Which of the following include the correct adjusting entries to be made on 31 December 2018?

A. Debit to Insurance Expense $6,750

B. Debit to Prepaid Insurance $6,750

C. Credit to Prepaid Insurance $5,625

D. None of the above

Solution: C

Five of the 24 months of insurance coverage has expired (or been used). The adjusting entry will include a debit to Insurance Expense and a credit to Prepaid Insurance for $5,625 (or $27,000 × 5/24).

Question 10:

Horse Stables Limited had beginning inventory of $54,000. During the financial year ending 31 March 2019, the company purchased $109,800 of merchandise. On 31 March 2019, the closing inventory was $39,600.

If the Gross Profit Margin was 40%, determine Horse Stables Limited's Sales Revenue.

A. $82,800

B. $135,000

C. $207,000

D. None of the above

Solution: C

Cost of goods sold = Beginning inventory + Purchases − Ending inventory
= $54,000 + $109,800 − $39,600 = $124,200

Cost of goods sold percentage = 100% − Gross profit percentage
= 100% − 40% = 60% (or 0.60)

Sales Revenue = Cost of goods sold ÷ Cost of goods sold percentage
= $124,200 ÷ 0.60 = $207,000

Question 11:

Snaky Flaky Company uses the FIFO method to assign costs to inventory and cost of goods sold. The company uses a periodic inventory system. Consider the following information:

Date	Description	Units	Cost per unit
January 1	Beginning inventory	100	$ 5
June 2	Purchase	75	$ 4
November 5	Sales	125	

Determine the Cost of goods sold and ending Inventory balances for the year.

A. Cost of goods sold $550; Ending inventory $250.

B. Cost of goods sold $625; Ending inventory $175.

C. Cost of goods sold $600; Ending inventory $200.

D. None of the above

Solution: C

Ending inventory (in units) = Beginning inventory + Purchases − Units sold
= 100 + 75 − 125 = 50

Beginning inventory	100 units × $5	$ 500
+ June 2 purchase	75 units × $4	300
= Goods available for sale		$ 800
− Ending inventory	50 units × $4	200
= Cost of goods sold	(100 units × $5) + (25 units × $4)	$ 600

Question 12:

Tiger Industries had been selling its product for $40 per unit, but recently lowered the selling price to $30 per unit. The company's current inventory consists of 200 units purchased at $32 per unit. The market value of this inventory is currently $26 per unit.

How much should the company's inventory be reported on the balance sheet?

A. $5,200

B. $6,000

C. $6,400

D. None of the above

Answer: A

Total lower of cost or market = Lower of cost or market per unit × Number of units in inventory = $26 × 200 units = $5,200

Question 13:

In an inflationary environment, which of the following statement with regard to the use of LIFO (Last in First out) to measure inventory is correct.

A. LIFO results in a higher book value of inventory and lower inventory turnover ratio than FIFO.

B. LIFO results in a lower book value of inventory and lower inventory turnover ratio than FIFO.

C. LIFO results in a lower book value of inventory and higher inventory turnover ratio than FIFO.

D. None of the above

Solution: C

When unit costs are rising, FIFO produces a higher inventory value (when compared to LIFO.

The inventory turnover is calculated by dividing cost of goods sold by average inventory. Since LIFO produces a lower inventory value when unit costs are rising (which means the denominator would be lower), LIFO would result in a result in a higher inventory turnover ratio.

Question 14:

An intern made a mistake and recorded depreciation expense for the year twice. This error will cause:

A. Assets to be overstated.

B. Liabilities to be understated.

C. Shareholders equity to be understated.

D. None of the above

Answer: C

Depreciation is recorded with a debit to Depreciation Expense (to increase that expense account) and a credit to Accumulated Depreciation (to increase that contra-asset account).

If the entry is recorded twice, total assets will be understated and expenses will be overstated.

The overstatement of expenses will cause net profit to be understated and, as a result, shareholders' equity will also be understated.

Question 15:

On 31 December 2018, Deer Limited records an adjusting entry to accrue interest on a note.

On 31 January 2019, Deer Limited receives cash for $4,680, which represents two months of accumulated interest on the note (December 2018 and January 2019).

Upon receipt of this interest payment, which of the following journal entries should be made to record this transaction?

A. Debit Cash for $4,680 and Credit Interest Receivable for $4,680

B. Debit Cash for $4,680, Credit Interest Receivable for $2,340, and Credit Interest Revenue for $2,340

C. Debit Interest Receivable for $2,340, Debit Cash for $2,340, and Credit Interest Revenue for $4,680.

D. None of the above

Solution: B

The entry includes a debit to Cash for $4,680 (the amount of the payment), a credit to Interest Receivable for $2,340 (the one month of interest accrued at 31 December 2018), and credit Interest Revenue for $2,340 (the second month of interest earned during January 2019).

Question 16:

Sheep Company uses the allowance method in managing the Accounts Receivables.

Mr Sheep writes off a customer account balance when it becomes clear that the particular customer will never pay. How will this write-off affect the company's net profit and accounts receivable turnover ratio?.

A. Net profit and the account receivable turnover ratio will both decrease.

B. Net profit will decrease; the account receivable turnover ratio will not change

C. Net profit will not change; the account receivable turnover ratio will decrease

D. None of the above

Solution: D

When the allowance method is used and a customer account is written off, a decrease is recorded in Accounts Receivable, which would be offset by a decrease in the contra-account, Allowance for Doubtful Accounts.

A write-off does not affect revenues, expenses, or net profit.

The accounts receivable turnover ratio is calculated by dividing net sales revenue by average net receivables. Since net receivables are not affected by a write-off, this ratio would not be impacted.

Hence, both net profit and accounts receivables turnover ratio are not affected.

Question 17:

On 1 January 2017, Gryphon Company bought a new delivery truck for $30,000. The company plans to use the truck for 4 years, after which it will be sold for $6,000.

Using double-declining-balance, determine the depreciation expense for 2020 (the fourth year of use):

A. $0

B. $1,500

C. $3,750

D. None of the above

Answer: A, C or D

<u>The following analysis is based on the assumption that residual value is equal to $6,000.</u>

2017:
= ($30,000 − $0) × 2 / 4 = $15,000

2018:
= ($30,000 − $15,000) × 2 / 4 = $7,500
Book value at end of 2018 = $30,000 − ($15,000 + $7,500) = $7,500
The book value at the end of 2018 is greater than the residual value of $5,000. As such, the amount calculated above is the amount of depreciation that can be taken.

2019:
= [$30,000 − ($15,000 + $7,500)] × 2 / 4 = $3,750
Book value at end of 2019 would be $3,750 [or $30,000 − ($15,000 + $7,500 + $3,750)], which is less than the residual value of $6,000. Recording the calculated amount of depreciation expense in 2019 would cause the book value to drop below the residual value.

Revised calculation:
Depreciation expense = Beginning book value of $7,500 (calculated above) − Residual value of $6,000 = $1,500

2020:
No depreciation will be taken since book value equals residual value.

<u>I recognize that $6,000 might be interpreted as the market value (instead of residual value, from the phrasing of the question. Hence, I am willing to accept both option C and D as well.</u>

Question 18

Company A uses an accelerated depreciation method while Company B uses the straight-line method.

All other things being equal, during the first year of the asset's use, how will Company A perform relative to Company B?

A. Lower asset values and lower net profit

B. Lower asset values and higher net profit

C. Higher asset values and higher net profit

D. None of the above

Answer: A

Using an accelerated depreciation method, Company A would report higher expenses, lower net profit, and a lower carrying value of the asset than Company B.

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