NATIONAL UNIVERSITY OF SINGAPORE

EC2204 Financial Accounting for Economists

Semester 2, AY2018-2019
Mid-Term Examination

Time allowed: 1 Hour

Suggested Solutions

Section A: True-False Questions

Consider the following statements.
Determine whether the statement is True or False.
Please shade the bubble form according to the following options:

A: True
B: False

Question 1:

When a firm borrows money from a bank, the immediate effect is an increase in shareholder's equity.

Solution: B (False)

When a firm borrows money, there will be an increase in asset (cash), and increase in liability (loan). Shareholder's equity remains unaffected.

Question 2:

Under accruals accounting, the collection of an account receivable will improve the net profit margin of a company.

Solution: B (False)

No. There will be no change in the net profit.

Question 3:

Under accruals accounting, the collection of an account receivable will improve the current ratio of a company.

Solution: B (False)

No. There will be no change in the current assets. While there is an increase in cash, there is a corresponding fall in account receivables.

Question 4:

Depreciation is a measure of the decline in market value of an asset.

Solution: B (False)

Depreciation is the process of allocating the cost of buildings, vehicles, and equipment to the accounting periods in which they are used. It is independent of the market value.

Question 5:

If a company forgot to record depreciation on equipment for a period, shareholders' equity would be overstated on the balance sheet.

Solution: A (True)

If the adjusting entry to record depreciation for the period is not made, the Accumulated Depreciation account will be understated, which means that Total Assets will be overstated. Depreciation Expense would also be understated, which means that expenses would be understated and net income will be overstated. This overstatement of net income causes shareholders' equity to be overstated.

Question 6:

If a contra-account of $20,000 is mistakenly included in the same column of the trial balance as the account it offsets, the error will cause the debit and credit column totals to differ by $40,000.

Solution: A (True)

A contra-account is an account that is an offset to, or reduction of, another account. Including a contra-account in the same column as the account it offsets will make the columns differ by twice the amount of the contra-account balance.

Question 7:

If a company decides to record an expenditure made this period as an expense, when it should have been recorded as an asset, net income will be overstated in the current period as a result.

Solution: B (False)

Erroneously recording an asset as an expense would overstate total expenses, which would understate net income.

Question 8:

In a deflationary environment, using FIFO (First In First Out) will result in a lower inventory turnover ratio than LIFO (Last In Last Out)

Solution: B (False)

When unit costs are falling, FIFO produces a lower ending inventory value and a higher cost of goods sold. Since Inventory turnover ratio = Cost of goods sold ÷ Average inventory, it will lead a higher inventory turnover ratio instead.

Question 9:

If the Prepaid Rent account is not adjusted at the end of the period, Assets and Net income will both be overstated.

Solution: A (True)

When a company first makes a payment in advance for rent, the payment provides an economic resource to the company, so it is initially recorded as an asset called Prepaid Rent. As time passes, an entry should be made to increase Rent Expense and decreased Prepaid Rent. If that entry is not made, assets will be overstated and expenses will be understated (causing net income to be overstated).

Question 10:

If the receivables turnover ratio rises significantly, the increase may be a signal that the company is extending credit to high-risk borrowers or allowing an overly generous repayment schedule.

Solution: B (False)

The receivables turnover ratio measures the number of times receivables turn over during the period (Net sales ÷ Average net receivables). A higher ratio means faster (better) turnover. Extending credit to high-risk borrowers or allowing an overly generous repayment schedule would most likely slow down collections, which would increase Accounts Receivable, and cause the receivables turnover ratio to decrease.

Section B: Multiple Choice Questions

Question 11:

At the beginning of the year, Orange Limited's Statement of Financial Position reported the following balances:

Total Assets = $195,000; Total Liabilities = $65,000; Share Capital = $10,000.

During the year, the company reported total revenues of $226,000 and expenses of $175,000. Also, dividends during the year totaled $48,000. The company also issued additional shares of $10,000 during the year.

Assuming no other changes, the amount of total equity at the end of the year would be:

A. $78,000

B. $143,000

C. $174,000

D. None of the above

Solution: B

Retained earnings = $195,000 -$65,000 - $10,000 = $120,000 at the beginning of the year. Add revenues of $226,000, subtract expenses of $175,000 and subtract dividends of $48,000 and retained earnings at the end of the year would be $123,000.

Total Equity at end of the year = $10,000 + $10,000 + $123,000 = $143,000

Question 12:

Consider the following information of Blue Group on 31 December 2018:

Accounts Payable	$61,250
Accounts Receivable	$70,500
Building	$50,000
Share Capital	$50,000
Cash	$64,000
Equipment	$30,000
Insurance Expense	$5,000
Land	$125,000
Notes Payable	$175,000
Sales Revenue	$25,000
Salaries Expense	$20,000

What is the amount of retained earnings?

A. $23,250

B. $32,050

C. $53,250

D. None of the above

Solution: C

Blue Group
Balance Sheet
31 December 2018

Assets		Liabilities & Shareholders' Equity	
Land	$ 125,000	Liabilities:	
Equipment	30,000	Notes payable	$175,000
Buildings	50,000	Accounts payable	61,250
Accounts receivable	70,500	Total liabilities	$236,250
Cash	64,000	Shareholders' equity	
		Share capital	$50,000
		Retained earnings	53,250
Total assets	$ 339,500	Total liabilities and Shareholders' equity	$339,500

Question 13:

Ole Company has 100 units in inventory, purchased at $8 per unit. These units have a current market value of $7. The entry to write-down the inventory will include :

A. Credit to Cost of Goods Sold for $100.

B. Debit to Cost of Goods Sold for $700.

C. Credit to Inventory for $100.

D. None of the above

Solution: C

Total cost of inventory = Cost per unit × Number of units in inventory
= $8 × 100 units = $800

Total market value of inventory = Market value per unit × Number of units in inventory
= $7 × 100 units = $700

Write-down = Total cost of inventory cost − Total market value of inventory
= $800 − $700 = $100

The entry to record the write-down includes a debit to Cost of Goods Sold and a credit to Inventory for $100.

Question 14:

Paul Limited has the following information available for the current year:

Net Sales	$ 1,125,000
Bad Debt Expense	90,000
Accounts Receivable, Beginning of Year	180,000
Accounts Receivable, End of Year	82,500
Allowance For Doubtful Accounts, Beginning of Year	63,000
Allowance For Doubtful Accounts, End of Year	93,000

What was the amount of write-offs during the year?

A. $93,000

B. $67,500

C. $60,000

D. None of the above

Solution: C

Ending balance in Allowance for Doubtful Accounts = Beginning balance in Allowance for Doubtful Accounts − Write-offs + Bad Debt Expense

Write-offs
= Beginning balance in Allowance for Doubtful Accounts + Bad Debt Expense − Ending credit balance in Allowance for Doubtful Accounts

= $63,000 + $90,000 − $93,000
= $60,000

Question 15:

The following transactions are February activities of Martial Limited, which provides indoor golf classes:

I. Martial Limited collected $16,800 from customers for lessons completed in February.

II. Martial Limited sold a gift card for golf lessons for $170 cash in February.

III. Martial Limited received $2,000 from services provided to customers in January.

IV. Martial Limited collected $3,200 advanced payments for services to start in June.

V. Martial Limited billed a customer $128 for services provided on 14 February. The bill is to be paid in March.

Which of the following transactions should revenue be recognized in February?

A. Transactions I and II.

B. Transactions I and V

C. Transactions II and IV.

D. None of the above

Answer: B

I.	Yes.
II.	No revenue reported in February; gift card recorded as Deferred Revenue until used by customer.
III.	No revenue reported in February; cash collections in February related to revenues reported in January.
IV.	No revenue reported in February; the revenues will be reported when the services are provided. Record as Deferred Revenue (a current liability).
V.	Yes.

Question 16:

Ashley Limited is a company that sells products to the elderly. It was given that the inventory was $2.4 billion at the end of the quarter, and $2 billion at the beginning of the quarter. Sales Revenue for the quarter was $3.8 billion. Gross Profit was $1.5 billion and Net Profit was $204 million.

Determine the amount of purchases:

A. $2 billion

B. $2.3 billion

C. $2.7 billion

D. None of the above

Solution: C

Sales – COGS = Gross Profit
$3.8 – COGS = $1.5 (in billions)
Solving for COGS, we get: $3.8 – 1.5 = COGS = $2.3 billion.

Now use the Cost of Goods Sold equation (BI + P – EI = CGS) to solve for purchases:

BI + P – EI = COGS
$2.0 + P – 2.4 = $2.3 (in billions)
Solving for P, we get: P = 2.3 – 2.0 + 2.4 = $2.7 billion in purchases

Question 17:

A 2 year insurance premium of $7,200 was paid on 1 January 2018 for coverage beginning on that date. The relevant accounting entry had been correctly accounted for on this date.

Which of the following best describes the adjusting entries on 31 December 2018?

A. A journal entry with a debit to Insurance Expense and a credit to prepaid insurance for $7,200 should be recorded.

B. A journal entry with a credit to Insurance Expense and a debit to prepaid insurance for $3,600 should be recorded.

C. No journal entry needs to be made because payment has already been made.

D. None of the above

Solution: D

2018 Income statement:
Insurance Expense ($7,200 x 12/24) = $3,600

2018 Balance sheet:
Prepaid Insurance ($7,200 x 12/24) = $3,600 (Remaining)

Hence, the related entry would include a debit to Insurance Expense and a credit to prepaid insurance for $3,600. The answer is “None of the above”.

Question 18:

At the start of the current year, Rashford Corporation had a credit balance in the Allowance for Impairment of $1,800. During the year a monthly provision of 2% of sales was made for uncollectible accounts.

Sales for the year were $600,000, and $5,600 of accounts receivable were written off as worthless. No recoveries of accounts previously written off were made during the year.

The year-end financial statements should show:

A. Uncollectible accounts expense of $13,800.

B. Allowance for Impairment with a credit balance of $8,200.

C. Allowance for Impairment with a credit balance of $6,400.

D. None of the above

Solution: B

$1,800 + ($600,000 × .02) - $5,600 = $8,200

Question 19:

For the last several years Mata Corporation has operated with a gross profit rate of 40%. On 1 January of the current year the company had on hand inventory with a cost of $600,000. Purchases of inventory during January amounted to $150,000, and sales for the month were $360,000.

Using the gross profit method, what is the estimated inventory at 31 January?

A. $144,000

B. $216,000

C. $534,000

D. None of the above

Solution: C

($600,000 + $150,000) - ((1.00-40%) × $360,000) = $534,000

Question 20:

Mata Limited reported revenues of $645,000 and expenses of $360,000 for the month of May, before making any month-end adjusting entries. The following data are provided with regard to the adjusting entries:

I. Portion of insurance expiring in May: $2,520.

II. A customer has used the facilities for two weeks in May: however, the fee of $4,200 has not yet been billed.

III. Amount owed for salaries accrued in the last week of May: $1,650.

IV. Depreciation on equipment for May: $1,290.

V. Supplies used in May: $13,125.

Fees collected in advance which have been earned during May: $23,400.Determine the profit after adjustment.

A. $270,615

B. $289,815

C. $294,015

D. None of the above

Solution: C

Income before adjusting entries		$285,000
	Adjustments:	
(a.)	Insurance expiring in May	(2,520)
(b.)	Revenue earned not yet recorded	4,200
(c.)	Accrued salaries expense for May	(1,650)
(d.)	May depreciation expense	(1,290)
(e.)	Supplies expense	(13,125)
(f.)	Earned a portion of unearned revenue	23,400
	Profit after adjustments	$294,015

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