

NATIONAL UNIVERSITY OF SINGAPORE

EC2204 Financial Accounting for Economists

Semester 2, AY2019-2020

Mid-Term Examination

Time allowed: 1 Hour

Suggested Solutions

Question 1:

Which of the following statements about expenses are correct?

Statement 1:

Unpaid expenses may be included as an expense on the income statement.

Statement 2:

Prepaid expenses are assets that should appear on the balance sheet.

- A. Statement 1 only.
- B. Statement 2 only.
- C. Both Statements 1 and 2 are correct.
- D. Both Statements 1 and 2 are incorrect.

Solution: C

Both Statements 1 and 2 are correct.

Question 2:

Which of the following statements about depreciation are correct?

Statement 1:

Total depreciation expense over an asset's useful life will be identical under all methods of depreciation.

Statement 2:

Depreciation is higher and profit is lower in the short run when using accelerated methods as compared to straight-line methods.

- A. Statement 1 only.
- B. Statement 2 only.
- C. Both Statements 1 and 2 are correct.
- D. Both Statements 1 and 2 are incorrect.

Solution: C

Both Statements 1 and 2 are correct.

Question 3:

Which of the following statements about the allowance for impairment are correct?

Statement 1:

The Allowance for Impairment represents the difference between the face value of accounts receivable and the estimated collectible amount of accounts receivable.

Statement 2:

The Allowance for Impairment represents cash set aside to make up for bad debt losses.

- A. Statement 1 only.
- B. Statement 2 only.
- C. Both Statements 1 and 2 are correct.
- D. Both Statements 1 and 2 are incorrect.

Solution: A

Only Statement 1 is correct.

Statement 2 is incorrect as the Allowance for Impairment does not represent cash.

Question 4:

Which of the following statements about overstatement of inventory are correct?

Statement 1:

An overstatement of ending inventory will cause an overstatement of assets and an understatement of shareholders' equity on the balance sheet.

Statement 2:

An overstatement of beginning inventory causes net profit to be overstated.

- A. Statement 1 only.
- B. Statement 2 only.
- C. Both Statements 1 and 2 are correct.
- D. Both Statements 1 and 2 are incorrect.

Solution: D

Both Statements 1 and 2 are incorrect.

Statement 1 is incorrect. If ending inventory is overstated, then assets will be overstated. Cost of goods sold will be understated, so net profit will be overstated and shareholders' equity will be overstated.

Statement 2 is incorrect. Beginning inventory is added in the equation to determine cost of goods sold, so if it is overstated, then cost of goods sold is overstated. If the cost of goods sold expense on the Income Statement is overstated, then net profit will be understated.

Question 5:

Which of the following statements about accounts receivables are correct?

Statement 1:

The collection of an account receivable will cause total assets to decrease.

Statement 2:

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.

- A. Statement 1 only.
- B. Statement 2 only.
- C. Both Statements 1 and 2 are correct.
- D. Both Statements 1 and 2 are incorrect.

Solution: D

Both Statements 1 and 2 are incorrect.

Statement 1 is incorrect The collection of an account receivable will cause total assets to remain unchanged.

Statement 2 is incorrect. The receivables turnover ratio measures the number of times receivables turn over during the period. 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.

Question 6:

Consider Orion Limited with the following accounting records in the Balance Sheet:

| | |
|---------------------|---------|
| | \$ |
| Land | 135,000 |
| Building..... | 65,000 |
| Equipment | 35,000 |
| Accounts receivable | ? |
| Cash | 90,000 |
| Notes payable..... | 90,000 |
| Accounts payable | 45,600 |
| Share Capital..... | 190,000 |
| Retained Earnings | 49,400 |

Determine the amount of Accounts Receivable for Orion Limited.

- A. \$40,000
- B. \$50,000
- C. \$60,000
- D. None of the above

Answer: B

Total amount of Assets
= Total amount of Liabilities + Equity
= 90,000 + 45,600 + 190,000 + 49,400
= \$375,000

Accounts Receivables
= 375,000 - 135,000 - 65,000 - 35,000 - 90,000
= \$50,000

Use the following to answer Questions 7 and 8:

Leo Tan set up a company Leo's Repairs on 1 March 2019. During the month, the following transactions occurred and were recorded in the company's books:

1. Leo received shares for investing \$25,000 cash and \$100,000 of equipment in the business.
2. The company paid \$2,000 cash to rent office space for the month.
3. The company received \$16,000 cash for repair services provided during March.
4. The company paid \$6,200 for salaries for the month.
5. The company provided \$3,000 of services to customers on account.
6. The company paid cash of \$500 for monthly utilities.
7. The company received \$3,100 cash in advance of providing repair services to a customer.
8. The company paid dividend of \$5,000.

Question 7:

Determine the net profit that appear in the Income Statement for Leo's Repairs in March.

- A. \$7,300
- B. \$9,300
- C. \$10,300
- D. None of the above

Solution: C

$$(3) \$16,000 + (5) 3,000 - (2) \$2,000 - (4) 6,200 - (6) \$500 = \$10,300$$

Question 8:

Determine the amount of equity that appear in the Balance Sheet of Leo's Repairs at the end of March.

- A. \$133,300
- B. \$144,100
- C. \$150,200
- D. None of the above

Solution: D

$(1) \$25,000 + (1) \$100,000 + (3) \$16,000 + (5) \$3,000 - (2) \$2,000 - (4) \$6,200 - (6) \$500 - (8) \$5,000 = \$130,300.$

Hence, the answer is "None of the above."

Question 9:

The following transactions occurred during April, the first month of operations for Aquila Products Limited:

1. Issued 50,000 shares in exchange for \$600,000 cash
2. Purchased a piece of land for \$400,000, making a \$150,000 cash down payment and signing a note payable for the balance.
3. Made a \$60,000 cash payment on the note payable from the purchase of land.
4. Purchased equipment on credit from Andromeda Limited for \$63,000.

Determine the value of total assets of Aquila Products at the end of April.

- A. \$453,000
- B. \$790,000
- C. \$853,000
- D. None of the above

Solution: C

$$\text{Cash} = \$600,000 - \$150,000 - \$60,000 = \$390,000$$

$$\text{Total amount of assets} = \$390,000 + \$400,000 + \$63,000 = \$853,000$$

Question 10:

Sagittarius Media had the following assets and liabilities at the beginning and end of the current year:

| | <u>Assets</u> | <u>Liabilities</u> |
|----------------------------|---------------|--------------------|
| Beginning of the year..... | \$114,000 | \$68,000 |
| End of the year..... | \$135,000 | \$73,000 |

If Sagittarius Media issued additional shares for \$12,000 and paid dividends \$5,000 during the year, what was the amount of net profit earned by Sagittarius Media?

- A. \$9,000
- B. \$16,000
- C. \$23,000
- D. None of the above.

Correct Answer: A

Beginning equity = \$114,000 - \$68,000 = \$46,000

Ending equity = \$135,000 - \$73,000 = \$62,000

Increase in equity = \$62,000 - \$46,000 = \$16,000

Net profit = \$16,000 - \$12,000 + \$5,000 = \$9,000

Question 11:

On 1 May 2019, the inventory of Hercules Shoes was \$60,000. Sales Revenue during May are expected to total \$70,000, with a gross profit margin of 45%.

Because of anticipated back-to-school sales, the owner wants to have an inventory of \$105,000 on hand at the beginning of June. How much goods should the company purchase at the end of May to meet the desired inventory level for June?

- A. \$38,500
- B. \$83,500
- C. \$108,500
- D. None of the above.

Solution: B

Cost of goods sold = $55\% \times \$70,000 = \$38,500$

Goods available = $\$38,500 + \$105,000 = \$143,500$

Purchases = $\$143,500 - \$60,000 = \$83,500$

Question 12:

Pegasus Office Services issued shares for \$10,000 cash and \$15,000 of computer equipment.

Which of the following journal entries should be made to record this transaction?

- A. Debit Share Capital \$25,000
Credit Cash \$10,000,
Credit Computer Equipment \$15,000
- B. Debit Cash \$10,000
Debit Share Capital \$5,000
Credit Computer Equipment \$15,000
- C. Debit Computer Equipment \$15,000
Credit Share Capital \$5,000
Credit Cash \$10,000
- D. None of the above

Solution: D

The double entry should be as follows:

Debit Cash \$10,000,
Debit Computer Equipment \$15,000
Credit Share Capital \$25,000

Hence, the answer is "None of the above."

Question 13:

In January, Gemini Limited pays \$4500 in cash to the local newspaper for advertisements to be run during the months of January, February, and March. The advertisement cost \$1,500 per month.

Determine the journal entry to record the payment in January.

- A. Debit Advertising Expense \$1,500
 Debit Prepaid Advertising \$3,000
 Credit Cash \$4,500
- B. Debit Advertising Expense \$4,500
 Credit Cash \$4,500
- C. Debit Accounts Payable \$4,500
 Credit Cash \$4,500
- D. None of the above

Solution: A

When a company pays for something that provides benefits future periods, the cost is reported as an asset. The prepayment is reported as an asset when purchased.

The journal entry includes a debit to Advertising Expense for \$1,500 (the \$1,500 paid for January), a debit to Prepaid Advertising for \$3,000 (the amount paid in advance for February and March at \$1,500 per month), and a credit to Cash for \$4,500 (the total amount paid).

Question 14:

An asset's carrying amount is \$36,000 on 1 January 2016. The asset is being depreciated \$500 per month using the straight-line method.

Assuming the asset is sold on 1 July 2017 for \$25,000, the company should record:

- A. A loss on sale of \$2,000
- B. A gain on sale of \$2,000
- C. Neither a gain or loss is recognized.
- D. None of the above

Correct Answer: A

If the asset's carrying amount is \$36,000 on 1 January 2016 and is being depreciated \$500 per month, \$9,000 ($18 \times \$500$) of additional depreciation expense would be recognized by 1 July 2017.

Thus, the asset's carrying amount on that date would be \$27,000. If the asset is sold for \$25,000, a loss on sale of \$2,000 should be recognized.

Question 15:

Pisces Company installs a manufacturing machine in its factory at the beginning of the year at a cost of \$87,000. The machine's useful life is estimated to be 5 years, or 400,000 units of product, with a \$7,000 residual value. During its second year, the machine produces 84,500 units of product.

Determine the machines' second year depreciation under the double-declining-balance method and unit production method:

- A. Double Declining Balance: \$20,880
Unit Production Method: \$16,900
- B. Double Declining Balance: \$34,800
Unit Production Method: \$18,378
- C. Double Declining Balance: \$26,880
Unit Production Method: \$18,880
- D. None of the above

Solution: A

Double-declining-balance method

$$\text{Year 1 } \$87,000 \times 20\% \times 2 = \$34,800$$

$$\text{Year 2 } (\$87,000 - \$34,800) \times 20\% \times 2 = \$20,880$$

Unit production method

$$(\$87,000 - \$7,000)/400,000 = \$.20 \times 84,500 = \$16,900$$

Question 16:

Virgo Limited reported sales revenue (all of which arose from credit sales) of \$48,000 on the income statement. Balance sheet information includes the following:

| | |
|--|----------|
| Accounts Receivable, beginning of year | \$ 5,400 |
| Accounts Receivable, end of year | 960 |
| Deferred Revenue, beginning of year | 0 |
| Deferred Revenue, end of year | 9,300 |

How much cash was collected from customers during the year?

- A. \$13,740
- B. \$52,440
- C. \$61,740
- D. None of the above

Answer: C

Cash received from customers
= Cash collected on account + Payments in advance

Ending Accounts Receivable
= Beginning Accounts Receivable + Sales on account – Cash collected on account

Cash collected on account
= Beginning Accounts Receivable + Sales on account – Ending Accounts Receivable
= \$5,400 + \$48,000 – \$960
= \$52,440

Ending Deferred Revenue
= Beginning Deferred Revenue + Payments in advance – Related services provided to customers

Payments in advance
= Ending Deferred Revenue – Related services provided to customers – Beginning Deferred Revenue
= \$9,300 – \$0 (since all sales were on account) – \$0
= \$9,300

Cash received from customers
= Cash collected on account + Payments in advance
= \$52,440 + \$9,300
= \$61,740

Question 17:

If the total amount that should have been debited to Rent Expense is mistakenly debited to Prepaid Rent, what will be the effect on the financial statements for the year?

- A. Revenues will be overstated.
- B. Assets will be overstated.
- C. Expenses will be overstated.
- D. None of the above

Solution: B

If Rent Expense is not debited, expenses will be understated.

Debiting Prepaid Rent will cause that asset account to increase and, as a result, assets will be overstated.

Question 18:

What are the effects on the accounting equation from the adjustment for income tax expense accrued, but not paid, at the end of the accounting period?

- A. Total liabilities will decrease and total shareholders' equity will decrease
- B. Total liabilities will increase and total shareholders' equity will decrease
- C. Total liabilities will decrease and total shareholders' equity will increase
- D. None of the above

Solution: B

The amount of income tax accrued, but not paid, during the current period should be recorded as an increase to the liability, Income Tax Payable, and an increase to Income Tax Expense.

An increase in an expense account results in a decrease to shareholders' equity.

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