

Calamba Review Center – Laguna (LCRC)

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CPA REVIEW (May 2019 Batch)

Auditing Problem

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ERROR CORRECTION

PROBLEM 1

Case 1 – A one-year insurance for P120,000 paid on October 1, 2018 was initially recorded as an expense. No year-end adjustment was made.

Case 2 – A 3-month rent was collected in advance from a lessee on December 1, 2018. The rent was initially recorded as rent revenue, and no year-end adjustment was made.

Case 3 – Utilities for December 2018 totalling to P600,000 was paid in January 2019. The expense was paid upon payment.

Case 4 – A one-year, 12%, P100,000 promissory note was received on April 1, 2018. The whole interest was recorded as an income upon collection on March 31, 2019.

Case 5 – The annual depreciation of P1,000,000 was erroneously recorded as P100,000 in 2018.

Requirements:

- Complete the table below by determining the effect on the given by writing (U) for understated, (O) for overstated, and (X) for unaffected, for each case above.

	<u>2018</u>	<u>2019</u>	<u>2020</u>
a. Net income	_____	_____	_____
b. Retained earnings, if the books are still open	_____	_____	_____
c. Retained earnings, if the books are already closed	_____	_____	_____

- Provide the correcting entry if the error was discovered in 2018, and
 - The books are still open
 - The books are already closed
- Provide the correcting entry if the error was discovered in 2019
 - The books are still open
 - The books are already closed
- Provide the correcting entry if the error was discovered in 2020
 - The books are still open
 - The books are already closed

PROBLEM 2

You have been engaged to audit the accounts of LAGOON Co. for the first time in 2018. During the audit, you discovered the following information:

	<u>Year ended December 31,</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
Omission of salaries payable at year-end	225,000	249,000	262,000
Ending inventory overstated as a result of overcounting items at year-end	70,000	55,000	77,000
Ending inventory understated as a result of wrong pricing and computational errors	40,000	14,000	32,000
Collection from a customer recorded as sales but deliveries are made the following year	84,000	90,000	96,000
Delivery of merchandise to customers at year-end recorded as sales only upon collection the following year	47,000	43,000	29,000
Receipt of merchandise from suppliers at year-end recorded as purchases only upon payment the following year	16,000	22,000	20,000
Major repairs on equipment at the beginning of each year, charged repairs expense but should have been capitalized. Estimated remaining useful life is 5 years.	300,000	250,000	210,000

Requirements:

- Determine the effects of the errors to
 - 2016, 2017, and 2018 net income
 - 2018 retained earnings at year-end, before closing
 - 2018 retained earnings at year-end, after closing
 - 2017 effects on working capital
 - 2018 effects on working capital
- Determine the adjusted net income for
 - 2016, if the unadjusted net income is P3,540,000
 - 2017, if the unadjusted net income is P4,050,000
 - 2018, if the unadjusted net income is P4,670,000

PROBLEM 3

The December 31 year-end financial statements of PEANUT Company contained the following errors:

	<u>Dec. 31, 2017</u>	<u>Dec. 31, 2018</u>
Ending inventory	P48,000 understated	P40,500 overstated
Depreciation expense	P11,500 understated	

An insurance premium of P330,000 was prepaid in 2017 covering years 2017, 2018 and 2019. The entire amount was charged to expense in 2017. In addition, on December 31, 2018, a fully depreciated machinery was sold for P75,000 cash, but the sale was not recorded until 2019. There were no other errors during 2017 and 2018, and no corrections have been made for any of the errors.

1. What is the total effect of the errors on PEANUT's 2018 net income?

A. 123,500 overstatement	C. 192,500 understatement
B. 27,500 overstatement	D. 177,500 understatement
2. What is the total effect of the errors on the amount of PEANUT's working capital at December 31, 2018?

A. 75,500 overstatement	C. 225,500 understatement
B. 40,500 overstatement	D. 144,500 understatement
3. What is the total effect of the errors on the balance of PEANUT's retained earnings at December 31, 2018?

A. 156,000 understatement	C. 133,000 understatement
B. 87,000 overstatement	D. 85,000 understatement

PROBLEM 4

You were engaged to audit the 2018 financial statements of LAKE Corporation for the first time. You are currently determining whether there are errors committed by your client, and their corresponding effect on the financial statements if there are any.

Based from your audit procedures, you were able to determine some transactions that transpired in 2017 and 2018 that may have possible effects on your client's financial statements.

Transactions in 2017

- December salaries totalling to P523,000 paid in January 2018 were recorded as expense in 2018.
- A one-year insurance for P120,000 paid on July 1 was recorded as expense. No adjustment was made at year-end.
- A lease contract for 6-months was entered into on December 1. Monthly rent to be paid by LAKE is P20,000. A two-month advance was paid on December 1, which was recorded by your client as an expense. No year-end adjustment was made.
- A minor repair on October 1 performed on a machine was capitalized by your client. The cost is P32,500, and the remaining useful life of the machine on December 31 is 3 years.
- A P600,000 dividend was declared on December 30, to be paid on January 31, 2019 to shareholders on record on January 15, 2019. No entry was made for the declaration.

Transactions in 2018

- The dividends declared last December 30, 2018 was paid on January 31. The entry included a debit to retained earnings and a credit to cash.
- Sales return for P134,000 on a 2018 credit sale, received in February, was recorded as a debit to other expense and credit to accounts receivable.
- A payment for P60,000 made to a supplier on December 24 was recorded as a purchase. The goods were shipped by the supplier in 2019.
- A payment from a customer for P98,000 was recorded as sales. The goods were shipped by your client in 2019.
- A collection of accounts receivable for P50,000 on December 30 was recorded in 2019.
- December salaries were recorded in January 2019 upon payment.

Your client prepared the following schedule of change in retained earnings:

	<u>2017</u>	<u>2018</u>
Retained earnings, beginning	9,826,540	11,701,540
Net income	1,875,000	1,995,500
Dividends paid		(600,000)
Retained earnings, ending	11,701,540	13,097,040

Requirements:

1. Compute for the adjusted net income for 2017 and 2018.
2. Determine the effect of the errors to the 2017 and 2018 working capital of your client.
3. Compute for the adjusted retained earnings as of December 31, 2017 and December 31, 2018.

PROBLEM 5

You have been engaged to examine the books and other records of MOUNTAIN Corporation, which started its operations in 2017. Your examination disclosed the following information:

- Reported profit (loss) for the year: 2017 – (P250,000); 2018 – P320,000; 2019 – P380,000.
- The company, during the three-year period, failed to recognize accruals and deferrals at year-end. The amounts omitted were as follows:

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Accrued expenses	20,000	25,000	30,000
Accrued income	32,000	30,000	26,000
Prepaid expenses	12,000	18,000	24,000
Unearned income	15,000	10,000	8,000

- Goods which were in transit at year-end were omitted from the physical count. These goods have been properly recorded as purchases during the year:

End of 2018	28,000
End of 2019	64,000

- The company purchased a machine costing P80,000 on August 31, 2017. The amount was recorded as expense. The company depreciates all its property, plant and equipment using the straight-line method, rounded to the nearest month and disregarding scrap values. This equipment had an estimated useful life of 8 years.
- Dividends declared at the end of 2018 and 2019 amounting to P60,000 and P100,000, respectively, were recorded when paid in 2019 and 2020, respectively.

- The Retained Earnings account is as follows:

	<u>2017</u>	<u>2018</u>	<u>2019</u>
January 1 balance		(100,000)	300,000
Share premium	150,000		
Gain on redemption of preference shares			30,000
Gain on sale of treasury shares - ordinary		80,000	
Dividends paid			(60,000)
Profit (loss) for the year	<u>(250,000)</u>	<u>320,000</u>	<u>380,000</u>
December 31 balance	<u>(100,000)</u>	<u>300,000</u>	<u>650,000</u>

Requirements:

1. Compute for the correct profit (loss) for the years 2017, 2018 and 2019.
2. Compute for the correct retained earnings balance at December 31, 2017, 2018, and 2019.
3. Prepare audit adjusting entries in 2019.

PROBLEM 6

The audited income statement of PEAK Corporation shows a net income of P175,000 for the year ended December 31, 2018. Adjustments were made for the following errors:

- December 31, 2017 inventory overstated by P22,500.
- December 31, 2018 inventory understated by P37,500.
- A P10,000 customer's deposit received in December 2018 was credited to sales in 2018. The goods were actually shipped in January 2019.

What is the unadjusted net income of PEAK for the year ended December 31, 2018?

- A. 234,000 B. 125,000 C. 170,000 D. 200,000

PROBLEM 7

The condensed income statement of ABSOLUTE Corporation for the year ended December 31, 2018 is presented below:

Absolute Corporation
Income Statement
For the year ended December 31, 2018

Sales	1,000,000
Cost of goods sold	<u>(600,000)</u>
Gross income	400,000
Operating expenses	<u>(150,000)</u>
Net income	<u>250,000</u>

The December 31, 2018 audit of the company's financial statements disclosed the following errors:

- The December 31, 2018 inventory is understated by P31,000.
- Accrued expenses of P4,000 and prepaid expenses of P6,000 were not recognized in the company's books.
- Sales of P5,000 were not recorded until January 2019, although the goods were shipped in December 2018 and were excluded from the December 31 physical inventory.
- Purchases of P30,000 made in December 2018 were not recorded although the good were received and properly included in the December 31 physical inventory.
- A machine was sold for P10,000 on July 1, 2018 and the proceeds were credited to Sales account. The machine was acquired on January 1, 2015 for P60,000. At that time, it had an estimated useful life of 6 years with no residual value. No depreciation was recorded on this machine in 2018.

What is the corrected net income for the year ended December 31, 2018?

- A. 228,000 B. 166,000 C. 258,000 D. 224,000

PROBLEM 8

CRISPY Corporation has been using the accrual basis of accounting. However, an examination of the records reveals that some expenses and revenues have been handled on a cash basis by the inexperienced bookkeeper of the company. Income statements prepared by the bookkeeper reported P145,000 net income for 2017 and P185,000 net income for 2018. Further review of the records reveals that the following items were handled improperly.

- Rent of P6,500 was received from a lessee on December 23, 2017. It was recorded as income at that time even though the rental pertains to 2018.
- Salaries payable on December 31 have been consistently omitted from the records of that date and have been recorded as expenses when paid in the following year. The salary accruals recorded in this manner were P5,500 for December 31, 2016; P7,500 for December 31, 2017; and P4,700 for December 31, 2018.
- Invoices for office supplies purchased have been charged to expense accounts when received. Inventories of supplies on hand at the end of each year have been ignored, and no entry has been made for them. Supplies on hand were P6,500 on December 31, 2016; P3,700 on December 31, 2017; and P7,100 on December 31, 2018.

1. What is the corrected net income for 2017?
A. 133,700 B. 144,200 C. 146,700 D. 139,300
2. What is the corrected net income for 2018?
A. 184,700 B. 197,700 C. 185,600 D. 190,900

CASH AND CASH EQUIVALENTS

PROBLEM 1

The accountant of CROWN COMPANY is in the process of preparing the company's financial statements for the year ended December 31, 2018. He is trying to determine the correct balance of cash and cash equivalents to be reported as a current asset on the statement of financial position. The following items are being considered:

- Balances in the company's accounts at the Metropolitan Bank:
 - Current account P 81,000
 - Savings account 132,600
- Undeposited customer checks of P 22,200 (including a customer check dated January 2, 2019 for P 3,000)
- Currency and coins on hand of P 3,480
- Petty cash of P 4,000 (currency of P 1,200 and unreplenished vouchers for P2,800)
- P120, 000 in a current account at the Philippine National Bank. This represents a 20% compensating balance for P600,000 loan with the bank. Everlasting Company is legally restricted to withdraw the funds until the loan is due in 2019.
- Treasury bills:
 - Two- month maturity bills P 90,000
 - Seven- month bills 120,000

What is the correct balance of cash and cash equivalents to be reported in the current assets section of the statement of financial position?

- A. P547,480 B. P427,480 C. P430,280 D. P327,480

PROBLEM 2

Your audit of the December 31, 2018, financial statements of LEGACY CORPORATION reveals the following:

Current account at Prime Bank	P (30,000)
Current account at Prudent Bank	135,000
Treasury bills (acquired 3 months before maturity)	300,000
Treasury bills (maturity date is December 31, 2018)	1,500,000
Payroll account	390,000
Foreign bank account-restricted (translated using the December 31, 2017, exchange rate)	2,000,000
Postage stamps	1,250
Employee's postdated check	4,500
IOU from the vice-president	8,000
Credit memo from a supplier for a purchase return	8,100
Traveler's check	21,000
Money order	12,900
Petty cash fund (P 3,000 in currency and expense vouchers for P12, 000)	15,000

What amount would be reported as "cash and cash equivalents in the statement of financial position on December 31, 2018?"

- A. P840,050 B. P873,900 C. P849,400 D. P861,900

PROBLEM 3

You were engaged by DAUGHTERS Corporation to audit their financial statements as of and for the period ended December 31, 2018. In your audit of their cash and cash equivalents, with a balance of P15,750,000, you were able to obtain the following breakdown:

Cash on Hand	565,000
BPI Savings Account (Acct No. 788045)	635,000
BPI Savings Account (Acct No. 788046)	200,000
MB Savings Account (Acct No. 3343)	560,000
BDO Checking Account (Acct No. 00101)	4,900,000
BDO Checking Account (Acct No. 00102)	(30,000)
CB Checking Account (Acct No. 4009)	(80,000)
Rural Bank of AAA Account (Acct No. 0019)	30,000
PNB Time Deposit	100,000
DB Savings Account (Acct No. 1001)	340,000
LB Savings Account (Acct No. 22248)	5,000,000
Petty Cash Fund	50,000
Payroll Fund	840,000
Dividend Fund	1,200,000
Bond Sinking Fund	650,000
IOU From Employees	90,000
Treasury Bills	300,000
Investment in Equity Securities	400,000

Based from your audit procedures, you noted the following:

- Cash on Hand balance includes:
 - a check for P50,000, dated January 3, 2019, issued by Swish Co., a customer;
 - a check for 18,000, dated December 30, 2018, issued by Swoosh Corp., a customer;
 - a check for P24,000, dated December 29, 2018, issued to Jazz Corp.;
 - a check for P6,000, dated January 8, 2019, issued to Mirage Co.;
 - a check for P15,000, dated June 3, 2018, issued to Melon Company (the payee agreed to extinguish the liability of Daughters because it was Melon's fault the check was not deposited); and,
 - a money order for P10,000
- Information related to BPI Savings Accounts are as follows:
 - Account No. 788045 includes the 10% compensating balance from a loan with a principal amount of P500,000. The loan was entered into last October 4, 2018, and will mature on October 4, 2020. The compensating balance is under a formal agreement, thus, is legally restricted.
 - Account No. 788046 includes the 8% compensating balance from a loan with a principal amount of P100,000. The loan was entered into last December 1, 2018, and will mature on November 30, 2019. The compensating balance is legally restricted.

- The MB Savings Account includes the 10% compensating balance from a P300,000 loan that will mature on December 31, 2020. The compensating balance is under an informal agreement and is essentially unrestricted in use.
- The negative balances of BDO Checking Account No. 00102 and CB Checking Account no. 0019 are both due to overdrafts.
- Rural Bank of AAA was closed last November 8, 2018, and is in the process of liquidation. Based from their liquidation process, it was determined that all depositors will be able to recover 70% of their deposit, or P500,000, whichever is lower. The amount is to be paid on June 30, 2020.
- The 90-day PNB Time Deposit was entered into last December 1, 2018.
- The accounts in DB and LB are foreign currency denominated. Both accounts were translated to Philippine Peso using the current exchange rate on December 31, 2018. The deposit in LB is restricted for a planned plant expansion in that country for the next five years.
- The breakdown of the Petty Cash Fund is as follows: bills and coins – P42,000; IOU from employee – P6,000; transportation expense – P2,000
- The Bond Sinking Fund was set up in 2014 to settle the bonds payable that will mature on July 1, 2019.
- The Treasury Bills were acquired last December 1, 2018. P200,000 will mature on February 28, 2019; the rest will mature on March 31, 2019.
- Investment in Equity Securities includes the following:
 - 10,000 ordinary shares of White Corporation; the fair value on December 31, 2018 is P250,000; the entity intends to hold the investment for trading purposes.
 - 15,000 redeemable preference shares of Black Company; the value on December 31, 2018 is P150,000, which is equal to its acquisition cost last November 1, 2018; the redemption date of the shares is on January 31, 2019.

Requirements:

1. How much shall be presented as Cash and Cash Equivalents as of December 31, 2018?
2. Based from the items initially included as Cash and Cash Equivalents, how much shall be transferred and presented under Current Assets as of December 31, 2018?
3. Based from the items initially included as Cash and Cash Equivalents, how much shall be transferred and presented under Non-Current Assets as of December 31, 2018?
4. Based from the items initially included as Cash and Cash Equivalents, how much shall be transferred and presented under (or deducted also from) Current Liabilities as of December 31, 2018?
5. Prepare the adjusting journal entries on December 31, 2018.

PROBLEM 4

Requirement: For each of the following cases, compute for the cash overage or shortage.

Case 1

From the general ledger of your client, you determined that the balance of their cash is P40,000 as of December 31. A physical count of cash held by the cashier on the same date revealed that bills total to P35,000, and coins total to P1,498.

Case 2

From the general ledger of your client, you determined that the balance of their cash is P100,000 as of December 31. The December bank statement showed an ending balance of P144,000. Checks issued in December, presented for payment only in January of next year, are as follows:

<u>Check Number</u>	<u>Amount</u>
1214222	P12,400
1214256	16,600

Case 3

You have been engaged to audit the December 31, 2018 financial statements of UNANG BIRIT Corporation, which started its operations last January 1, 2018.

In your audit of their cash, you were able to count P122,484 in currency. The bank statement for the month of December 2018 shows a balance of P257,890. Outstanding checks for the month is P2,350.

Pertinent transactions that occurred during the year and some audit notes are presented below:

- 2,000 ordinary shares, P200 par, were issued for P250/share.
- A building was purchased, cash basis, for P300,000.
- Furniture and office equipment were purchased, cash basis, for P75,000.
- Paid administrative expenses for the year total to P89,560
- Sales, all on credit, amounted to P1,680,000. The gross profit rate of the entity is 45%.
- The ending balance of accounts receivable is P245,000, while the ending balance of the accounts payable total to P355,000. All purchases are on account.
- Based on the physical count, inventory costing P476,000 are still unsold.
- The balance of the building presented in the trial balance is P250,000, net of accumulated depreciation and mortgage payable.
- Depreciation expense for the period total to P35,000: P5,000 for office equipment; P10,000 for furniture; and P20,000 for building.

PROBLEM 5

The bookkeeper-cashier of the SM COMPANY absconded on the evening of April 16, 2018, apparently with a large portion of the company's cash. He had taken with him certain accounting records, including the cash journals and the general ledger. You are called upon to ascertain, if possible, the shortage with which the missing employee may be charged.

A statement of financial position prepared from the books and other files follows:

SM Company	
Statement of Financial Position	
December 31, 2017	
ASSETS	
Cash	P 32,670
Accounts receivable	226,230