ERROR CORRECTION

EXERCISE 1

Case 1 – Supplies for P24,000 were purchased on September 30, 2019. The purchase was initially recorded as supplies expense. 20% of the supplies remains at year-end, but no year-end adjustment was made.
Case 2 – A 3-month rent totalling to P750,000 was collected in advance from a lessee on December 1, 2019. The rent was initially recorded as rent income, and no year-end adjustment was made.
Case 3 – The electricity bill for December 2019 total to P200,000. The bill was paid and recorded as expense on January 2020.
Case 4 – A one-year, 10%, P600,000 promissory note was received on April 1, 2019. The whole interest was recorded as an interest income upon collection on March 31, 2020.
Case 5 – A minor repair on an equipment on January 2, 2019, totalling to P150,000, was capitalized. The remaining useful life of the said equipment on the date of repair is 5 years.
Case 6 – The annual depreciation of P1,000,000 was erroneously recorded as P100,000 in 2019.

Requirements:

1. *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.*

	2019	2020	2021
a. Assets	______	______	______
b. Liabilities	______	______	______
c. Net Income	______	______	______
b.R etained earnings, if the books are still open	______	______	______
c. Retained earnings, if the books are already closed	______	______	______

2. *Provide the correcting entry if the error was discovered in 2019, and*
   a. *The books are still open* b. *The books are already closed*
3. *Provide the correcting entry if the error was discovered in 2020, and*
   a. *The books are still open* b. *The books are already closed*
4. *Provide the correcting entry if the error was discovered in 2021, and*
   a. *The books are still open* b. *The books are already closed*

EXERCISE 2

You were engaged to audit the accounts of SANA ALL Co. for the first time in 2022. During the audit, you discovered the following errors committed during the years 2020, 2021, and 2022, as follows:

	2020	2021	2022
Omission of salaries payable at year-end	P 620,000	P 704,000	P 788,000
Supplies purchased during the year recorded as expense, but only 40% is used on the year of purchase, while the remaining 60% is used the following year	20,000	35,000	40,000
Overstatement on ending inventory as a result of unintentional double-counting of units	59,000	82,000	34,000
Understatement on ending inventory as a result of computational errors	49,000	20,000	28,000
Advances from customers recorded as sales upon collection; actual deliveries are made the following year	99,000	101,000	73,000
Deliveries to customers at year-end but were recorded as sales only upon collection the following year	44,000	11,000	36,000
Advances to suppliers recorded as purchases upon payment; actual delivery (by supplier) and receipt of merchandise both occurred the following year	20,000	22,000	16,000
Receipt of purchased merchandise at year-end but were recorded as purchases only upon payment the following year	14,000	15,000	9,000
Major repairs on equipment at the beginning of each year recorded as repairs and maintenance expense, but should have been capitalized; annual depreciation that should have been recorded is 20% of cost	100,000	120,000	80,000

Requirements:

1. *Determine the effects of the errors to*
   a. *2020, 2021, and 2022 net income*
   b. *December 31, 2021 balance of retained earnings (books are closed)*
   c. *December 31, 2022 balance of retained earnings (books are closed)*
   d. *December 31, 2021 working capital*
   e. *December 31, 2022 working capital*
2. *Determine the adjusted net income for*
   a. *2020, if the unadjusted net income is P23,665,000*
   b. *2021, if the unadjusted net income is P24,050,000*
   c. *2022, if the unadjusted net income is P28,670,000*

EXERCISE 3

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

	Dec. 31, 2020	Dec. 31, 2021
Ending inventory	P48,000 understated	P40,500 overstated
Depreciation expense	P11,500 understated	

An insurance premium of P330,000 was prepaid in 2020 covering years 2020, 2021 and 2022. The entire amount was charged to expense in 2020. In addition, on December 31, 2021, a fully depreciated machinery was sold for P75,000 cash, but the sale was not recorded until 2022. There were no other errors during 2020 and 2021, and no corrections have been made for any of the errors.

1. *What is the total effect of the errors on PEANUT's 2021 net income?*
   A.1 23,500 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, 2021?*
   A.7 5,500 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, 2021?*
   A.1 56,000 understatement *C. 133,000 understatement*
   B. 87,000 overstatement *D. 85,000 understatement*

EXERCISE 4

You were engaged to audit the 2019 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 2020 and 2021 that may have possible effects on your client's financial statements.

Transactions in 2020

- December salaries totalling to P523,000 paid in January 2021 were recorded as expense in 2021.
- 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, 2021 to shareholders on record on January 15, 2021. No entry was made for the declaration.

Transactions in 2021

- The dividends declared last December 30, 2020 was paid on January 31. The entry included a debit to retained earnings and a credit to cash.
- 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 2022.
- A payment from a customer for P98,000 was recorded as sales. The goods were shipped by your client in 2022.
- A collection of accounts receivable for P50,000 on December 30 was recorded in 2022.
- December salaries were recorded in January 2022 upon payment.

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

	2020	2021
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 2020 and 2021.
2. Determine the effect of the errors to the 2020 and 2021 working capital of your client.
3. Compute for the adjusted retained earnings as of December 31, 2020 and December 31, 2021.

EXERCISE 5

You have been engaged to examine the books and other records of MOUNTAIN Corporation, which started its operations in 2020. Your examination disclosed the following information:

- Reported profit (loss) for the year: 2020 – (P250,000); 2021 – P320,000; 2022 – P380,000.
- The company, during the three-year period, failed to recognize accruals and deferrals at year-end. The amounts omitted were as follows:

	2020	2021	2022
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 2021	28,000
End of 2022	64,000

- The company purchased a machine costing P80,000 on August 31, 2020. 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 2021 and 2022 amounting to P60,000 and P100,000, respectively, were recorded when paid in 2022 and 2023, respectively.
- The Retained Earnings account is as follows:

	2020	2021	2022
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	(250,000)	320,000	380,000
December 31 balance	(100,000)	300,000	650,000

Requirements:

1. *Compute for the correct profit (loss) for the years 2020, 2021 and 2022.*
2. *Compute for the correct retained earnings balance at December 31, 2020, 2021, and 2022.*
3. *Prepare audit adjusting entries in 2022.*

EXERCISE 6

The condensed income statement of ABSOLUTE Corporation for the year ended December 31, 2021 is presented below:

Absolute Corporation
Income Statement
For the year ended December 31, 2019

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

The December 31, 2021 audit of the company's financial statements disclosed the following errors:

- The December 31, 2021 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 2020, although the goods were shipped in December 2021 and were excluded from the December 31 physical inventory.
- Purchases of P30,000 made in December 2021 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, 2021 and the proceeds were credited to Sales account. The machine was acquired on January 1, 2016 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 2021.

What is the corrected net income for the year ended December 31, 2021?

A.2 28,000 *B. 166,000* *C. 258,000* *D. 224,000*

EXERCISE 7

You have been engaged for the first time by Jokers Corporation to audit their financial statements as of and for the period ended December 31, 2021. The comparative statement of financial position and income statement are shown below:

Jokers Corporation
Statement of Financial Position
For the periods ended December 31, 2020 and 2021

	2021	2020
ASSETS		
Current Assets		
Cash	350,000	282,000
Accounts receivable	850,000	795,500
Inventory	1,233,000	1,205,000
Other current assets	15,000	10,000
Total	2,448,000	2,292,500
Noncurrent Assets		

PPE	5,500,000	6,000,000
Long-term investments	3,000,000	3,000,000
Total	8,500,000	9,000,000
Total Assets	10,948,000	11,292,500
LIABILITIES and EQUITY		
Current Liabilities		
Accounts payable	556,000	579,000
Note payable	0	100,000
Total	556,000	679,000
Noncurrent Liabilities		
Bonds payable	4,000,000	4,500,000
Loan payable	0	1,000,000
Total	4,000,000	5,500,000
Equity		
Ordinary share capital	3,000,000	3,000,000
Share premium	50,000	50,000
Retained earnings	3,342,000	2,063,500
Total	6,392,000	5,113,500
Total Liabilities and Equity	10,948,000	11,292,500

Jokers Corporation
Income Statement
For the period ended December 31, 2021

Sales	5,900,000
Cost of sales	(3,054,000)
Gross profit	2,846,000
Depreciation expense	(500,000)
Salaries expense	(300,000)
Utilities expense	(105,500)
Interest expense	(582,000)
Rent expense	(60,000)
Other expenses	(20,000)
Net income	1,278,500

Based from your audit procedures, you have ascertained the following:

- On July 1, 2020, the entity hired a new accountant. Starting from the same day,
  - Salaries for the month are paid and recorded on the 5th day of the next month. Salaries in December 2020 total to P22,000, while salaries in December 2019 total to P25,000.
  - Utilities for the month are paid and recorded on the 7th day of the next month. Utilities expense in December 2018 and 2021 are P35,000 and P42,000, respectively.
- P500,000 from the bonds payable and the whole amount of loan payable were paid on December 31, 2021. The interest rate for the bonds payable is 10% of the outstanding balance, while the interest on the loan payable is 12% annually.
- The one-year note payable was paid at the end of April of 2021. The interest rate is 12%.
- No other interest-bearing liabilities arose nor were settled during the year.
- On November 15, 2021, the entity rented a space in a near town for the anticipated Christmas season sale. The lease term is two (2) months for P60,000. This is the only lease contract in effect as of the end of 2021, and no other lease contracts were entered into nor expired within 2021. The entity appropriately accounted for this as operating lease.
- Dividends for P300,000 were declared in December 30, 2021, to be paid on January 30, 2022. The entity was not able to provide any journal entry for the declaration. No dividends were paid and declared in 2018.

Requirements:

1. *What is the adjusted net income for 2021?*
   A.1 ,291,500 B. 1,269,500 C. 1,234,500 D. 1,295,500 E. 1,310,500
2. *Because of the errors, the overstatement/(understatement) in the 2020 retained earnings is?*
   A.(57,000) B. 57,000 C. (65,000) D. 65,000 E. 8,000
3. *Because of the errors, the overstatement/(understatement) in the 2020 retained earnings is?*
   A.3 60,000 B. 352,000 C. 52,000 D. (52,000) E. (248,000)
4. *Because of the errors, the overstatement/(understatement) in the 2021 liabilities is?*
   A.(367,000) B. (310,000) C. (10,000) D. (67,000) E. 67,000

SHAREHOLDERS' EQUITY

EXERCISE 1

The following information has been taken from the ledger accounts of F Corp.

Total income since incorporation	P317,000
Total cash dividends declared	60,000
Proceeds from sale of donated stock	40,000
Total value of stock dividends distributed	30,000
Gains on treasury stock transactions	18,000
Unamortized discount on bonds payable	32,000
Treasury stock	20,000
Appropriated for plant expansion	70,000
Unpaid cash dividends	24,000

Determine the current balance of unappropriated retained earnings.
a. P 227,000 b. P157,000 c. P 137,000 d. none of these

EXERCISE 2

Your audit client, Zion Inc., is a public enterprise whose share is traded in the over-the-counter market. At December 31, 2020, Reyes had 3,000,000 authorized shares of P10 par value ordinary stock, of which 1,000,000 shares were issued and outstanding. The stockholders' equity accounts at December 31, 2020 had the following balances.

Ordinary Stock	P10,000,000
Additional Paid In Capital	3,750,000
Retained Earnings	3,250,000

Transactions during 2021 and other information relating to the stockholders' equity accounts were as follows:

- On January 5, 2021, Zion issued at P54 per share, 50,000 shares of P50 par value, 9% cumulative convertible preferred stock. Each share of preferred stock is convertible at the option of the holder, into two shares of ordinary stock. Zion had 300,000 shares of preferred stock. The preferred stock has a liquidation value equal to its par value.
- On February 1, 2021, Zion reacquired 10,000 shares of its ordinary stock for P16 per share.
- On April 30, 2021, Zion sold 250,000 shares (previously unissued) of P10 par value ordinary stock to the public at P17 per share.
- On June 18, 2021, Zion declared a cash dividend of P1 per share of ordinary stock, payable on July 12, 2021 to stockholders of record on July 1, 2021.
- On November 10, 2021, Zion sold 5,000 shares of treasury stock for P21 per share.
- On December 14, 2021, Zion declared the yearly cash dividend on preferred stock, payable on January 14, 2022 to stockholders of record on December 31, 2021.
- On January 20, 2022, before the books were closed for 2021. Zion became aware that the ending inventories at December 31, 2020 were understated by P150,000 (after tax effect on 2020 net income was P90,000). The appropriate correction entry was recorded the same day.
- After correcting the beginning inventory, net income for 2021 was P2,250,000

Requirements:

1. *Ordinary Stock*
   a. 10,000,000 b. 12,500,000 c. 12,450,000 d. 14,250,000
2. *Additional Paid In Capital*
   a. 5,725,000 b. 5,700,000 c. 5,500,000 d. 5,525,000
3. *Unappropriated retained earnings*
   a. 4,125,000 b. 4,045,000 c. 4,035,000 d. 3,955,000
4. *Treasury stock*
   a. 160,000 b. 55,000 c. 50,000 d. 80,000
5. *Total stockholders' equity*
   a. 22,190,000 b. 24,690,000 c. 24,770,000 d. 24,840,000
6. *Book value per share of ordinary stock*
   a. 17.71 b. 17.89 c.17.82 d.15.41

EXERCISE 3

The capital section of the balance sheet of the J Co., Dec. 31, 2020, appears as follows:

Preferred stock, 6 percent, P100 par of 5,000 shares	P 500,000
Equity of common stock, 50,000 shares	3,500,000
Total Capital	P 4,000,000

At Dec. 31, 2021, the capital section appears as follows:

Preferred stock, 6 percent, P100 par of 4,500 shares	P 450,000
Equity of common stock,60,000 shares	4,550,000
Total Capital	P 5,000,000

Certain 2021 transactions follows:

(1) The additional 10,000 shares of no-par common stock were sold at P60 per share. The par value of common stock is P40 per share. The first 50,000 shares were issued at P50.
(2) Net income for 2021 was P665,000.

(3) Preferred stock, 500 shares, was purchased for the treasury at P110 each.
(4) Cash dividends paid: preferred, P30,000; common, P180,000.

Requirements:

1. *What is the adjusted retained earnings balance at the end of 2021?*
   a. P 1,455,000 b. P 2,155,000 c. P1,400,000 d. none of these
2. *The total stockholders' equity at the end of 2021 should be:*
   a. P5,000,000 b. P 5,055,000 c. P 4,555,000 d. none of these

EXERCISE 4

SMDC Corporation was authorized at the beginning of 2020 with 300,000 authorized shares of P100, par value ordinary shares. At December 31, 2020, the shareholders' equity section of SMDC was as follows:

Share capital, par value P100 per share; authorized 300,000 shares; issued 30,000 shares	P3,000,000
Share premium	300,000
Retained earnings	450,000
Total shareholders' equity	P3,750,000

On June 15, 2021, SMDC issued 50,000 ordinary shares for P6,000,000. A 5% share dividend was declared on September 30, 2021 andissued on November 10, 2021 to shareholders of record on October 31, 2021. Market value of ordinary share was P110 per share ondeclaration date. The profit of SMDC for the year ended December 31, 2021 was P475,000.

During 2022, SMDC had the following transactions;

Mar. 1	SMDC reacquired 3,000 shares of its ordinary shares for P95 per share.
May 31	SMDC sold 1,500 treasury shares for P120 per share.
Aug. 10	Issued to shareholders one right for each share held to purchase two additional ordinary shares for P125 per share. The rights expire on December 31, 2022.
Sep. 15	25,000 rights were exercised when the market value of ordinary share was P130 per share.
Oct. 31	40,000 rights were exercised when the market value of the ordinary share was P140 per share.
Dec. 10	SMDC declared a cash dividend of P2 per share payable on January 5, 2023 to shareholders of record on December 31, 2022.
Dec. 20	SMDC retired 1,000 treasury shares and reverted them to an unissued basis. On this date, the market value of the ordinary share was P150 per share.
Dec. 31	Profit for 2023 was P500,000.

Based on the above and the result of your audit, determine the following as of December 31, 2023:

1. *Share capital*
   a.P 21,400,000 b. P21,300,000 c. P14,800,000 d. P21,250,000
2. *Share premium*
   a. P4,627,500 b. P3,007,500 c. P4,632,500 d. P4,592,500
3. *Total retained earnings*
   a. P600,000 b. P565,000 c. P557,000 d. P560,000
4. *Total equity*
   a. P26,397,500 b. P25,932,500 c. P26,492,500 d. P26,445,000

EXERCISE 5

The shareholders' equity section of the San Miguel Corporation's balance sheet as of December 31, 2021 is presented below:

12% Preference share capital, P100 par	P 270,000
Ordinary share capital, P20 par	1,598,400
Share premium – preference	36,800
Share premium – ordinary	235,200
Share premium – treasury shares	3,200
Retained earnings	1,585,840
Total shareholders' equity	P3,729,440

San Miguel had 65,000 ordinary shares as December 31, 2020.

The following shareholders' equity transactions were recorded in 2021 and 2022:

2021
May 1 - Sold 9,000 ordinary shares for P24, par value P20.
July 1 - Sold 700 preference shares for P124, par value P100.
Jul. 31 - Issued an 8% share dividend on ordinary shares. The market value of ordinary share was P30 per share.
Aug. 30 - Declared cash dividends of 12% on preference shares and P3 per share on ordinary shares.
Dec. 31 - Profit for the year amounted to P1,345,040.

2022
Feb. 1 - Sold 2,200 ordinary shares for P30.
May 1 - Sold 600 preference shares for P128.
May 31 - Issued a 2-for-1 split of ordinary shares. The par value of the ordinary share was reduced to P10 per share.
Sep. 1 - Purchased 1,000 ordinary shares for P18 to be held as treasury shares.
Oct. 1 - Declared cash dividends of 12% on preference shares and P4 per share on ordinary shares.
Nov. 1 - Sold 1,000 shares of treasury shares for P22.
Dec. 31 - Profit for the year amounted to P991,520.

Determine the amounts, as required, in San Miguel Corporation's comparative financial statements as of and for the years ended December 31, 2021 and 2022.

1. *Total equity as of December 31, 2022*
   a. *P4,175,200* c. *P4,182,400*
   b. *P4,171,200* d. *P4,157,200*

2. *Basic earnings per share for 2021*
   a. *P17.12* c. *P 8.56*
   b. *P 8.21* d. *P18.49*

3. *Basic earnings per share for 2022*
   a. *P7.40* c. *P5.86*
   b. *P7.34* d. *P5.81*

EXERCISE 6

The Company adopted the following stock compensation plan for its employees. For each case, compute the amount of expense that should be recognized each year.

CASE 1

In connection with a stock option plan for the benefit of key employees, the company intends to distribute treasury shares when the options are exercised. These shares were bought in 2025 at P42 per share. On January 1, 2026, the Company granted stock options for 100,000 shares at P38 per share as additional compensation for services to be rendered over the next three years. The options are exercisable during a 2-year period beginning January 1, 2029, by grantee still employed by the Company. Market price of the Company's stock was P47 per share at the grant date. The fair value of the stock option is P12 on grant date. No stock options were terminated during 2026.

CASE 2

On January 1, 2027, the Company granted stock options to certain key employees as additional compensation. The options were for 100,000 shares of P2 par value ordinary stock at an option price of P15 per share. Market price of this stock on January 1, 2027, was P20 per share. The fair value of each stock option on January 1, 2027 is P8. The options were exercisable beginning January 1, 2027 and expire on December 31, 2018. On April 1, 2027, the Company's stock was trading at P21 per share, all the options were exercised.

CASE 3

Vesting condition
- Three years of continued employment
- Assumptions:
  - 100 share options granted to each of the 1,000 employees on January 1, 2023
  - FV of each share option is P30.00
  - Exercise price is P120.00, par value of each share of stock is P100.00
- Actual and revised estimate of employees who leave the company
  - 2023 - 40 employees left, revised estimate is 50 of remaining employees will leave the entity
  - 2024 – 20 employees left; revised estimate is 40 of remaining employees will leave the entity
  - 2025 – 30 of the remaining employees left.

CASE 4

Vesting condition
- Employees must remain in the entity's employ during the vesting period

- Shares will vest as follows:
  - End of 2027, if earnings increase by at least 18%
  - End of 2028, if earnings over two years increase by average of at least 13%
  - End of 2029, if earnings over three years increase by average of at least 10%
- Assumptions:
  - 100 share options granted to each of the 1,000 employees on January 1, 2027 (total shares – 100,000)
  - FV of each share option is P30.00

• Actual and revised estimate of entity's average earnings
  - End of 2027: actual- 14%; est. earnings in 2018- 14%
  - End of 2028: actual- 10%; est. earnings in 2019-6%
  - End of 2029: actual- 8%

• Actual and estimate of employees who will leave the company
- 2027 - 60 employees left, add'l employees to leave - 70
- 2028 – 50 employees left; add'l employees to leave - 30
- 2029 – 40 employees left

EXERCISE 7

At the beginning of year 1, an entity grants to a senior executive 30,000 share options. The grant is conditional upon the executive remaining in the entity's employ until the end of year 3.
The share options can be exercised if the entity's share price increases from P20 at the beginning of year 1 to above P30 at the end of year 3. If the share price is above P30 at the end of year 3, the share options can be exercised at any time during the next five years, i.e., by the end of year 8.
The entity estimates the fair value of the share options on grant date to be P5 per option. This estimate takes into account the following market condition:

- The possibility that the share price will exceed P30 at the end of year 3, i.e., the share options become exercisable; and
- The possibility that the share price will not exceed P30 at the end of year 3, i.e., the share options will be forfeited.

The following actual events occurred in year 1 to 3:

Year 1
- The share price has increased to P24.
- The entity's estimate of the fair value of the options Is P4 at the end of year 1. This takes into account whether the market condition will be satisfied by the end of year 3.

Year 2
- The share price has decreased to P22. However, the entity remains optimistic that the share price target will be met by the end of year 3.
- The estimated fair value of the share options is P3. Again, this estimate takes into account the market condition noted above.

Year 3
- The share price only reaches P28 by the end of year 3.
- The estimated fair value of the share options is zero, as the market condition has not been satisfied.

Based on the preceding information, determine the following:

1. *Compensation expense for year 1*
   A. P30,000 B. P40,000 C. P50,000 D. P60,000
2. *Compensation expense for year 2*
   A. P30,000 B. P40,000 C. P50,000 D. P60,000
3. *Compensation expense for year*
   A. P0 B. P30,000 C. P40,000 D. P50,000
4. *Share options outstanding at the end of year 2*
   A. P70,000 B. P80,000 C. P90,000 D. P100,000
5. *Cumulative compensation expense for the three-year period*
   A. P0 B. P70,000 C. P100,000 D. P150,000

LIABILITIES

EXERCISE 1

At December 31, 2018, KISU Company's liabilities include the following:

- P10 million of 10% notes are due on March 31, 2023. The financing agreement contains a covenant that requires KISU to maintain current assets at east equal to 200% of its current liabilities. As of December 31, 2018, KISU has breached this loan covenant. On February 10, 2019, before KISU's financial statements are authorized for issue, KISU obtained a period of grace from MAYUMI Bank until January 31, 2020, having convinced the bank that the company's normal 3 to 1 ratio will be re-established during 2019.
- P15 million of noncancelable 12% bonds were issued at face value on September 30, 1997. The bonds mature on August 31, 2019. KISU expects to have sufficient cash available to redeem the bonds at maturity.

- P20 million of 10% bonds were issued at face value on June 30, 1999. The bonds mature on June 30, 2028, but bondholders have the option to call (demand payment on) the bonds on June 30, 2019. However, the call option is not expected to be exercised, given prevailing market conditions.

What portion of KISU Company's debt should be reported as a noncurrent liability?
A. 10 million B. 30 million C. 20 million D. zero

EXERCISE 2
THIRTYFOUR COMPANY sold 700,000 boxes of "puto mix" under a new sales promotional program. Each box contains one coupon, which if submitted with P40, entitles the customer to a kitchen knife. Thirtyfour pays P60 per knife and P5 for handling and shipping. Thirtyfour estimates that 70% of the coupons will be redeemed, even though only 250,000 coupons had been processed during 2020.

Requirement: How much should Thirtyfour report as liability for unredeemed coupons at December 31, 2020?
A. P6,000,000 C. P15,600,000
B. P9,600,000 D. P12,250,000

EXERCISE 3
You are engaged to audit the December 31, 2020, financial statements of THIRTYFIVE COMPANY, a manufacturer of household appliances. Your audit disclosed the following situations.

1. In June 2020, the company began producing and selling a new line of dishwasher. By the end of the year, it had sold 120,000 to various dealers for P15,000 each. The product was sold under a 1-year warranty, and the company estimates warranty costs to be P750 per dishwasher. Thirtyfive had paid out P30 million in warranty expenses as of December 31, 2020 which is also the amount shown as warranty expense in its income statement for the current year.

2. In response to your letter of audit inquiry, Thirtyfive's lawyer informed you that the company is involved in a lawsuit for violating environmental laws regulating hazardous waste. Although the litigation is pending, Thirtyfive's lawyer is certain that Thirtyfive will most probably have to pay cleanup costs and fines of P5,500,000. Thirtyfive neither accrued nor disclosed this loss in the financial statements.

3. Thirtyfive is the defendant in a patent infringement suit by Megan Yang over Thirtyfive's use of hydraulic compressor in several of its manufactured appliances. Thirtyfive's laywer informed you that if the suit goes against your audit client, the loss may be as much as P10 million. However, the lawyer believes that the loss of this suit is only possible. Thirtyfive did not in any way disclose this pending litigation in its financial statements.

Requirements:
1. What amount of warranty expense should be shown on Thirtyfive's income statement for the year ended December 31, 2020?
A. P30,000,000 C. P60,000,000
B. P0 D. P90,000,000
2. What amount of warranty liability should be shown on Thirtyfive's statement of financial position as of December 31, 2020?
A. P60,000,000 C. P30,000,000
B. P90,000,000 D. 0
3. What amount of lawsuit liability should be reported as a provision on Thirtyfive's December 31, 2020, statement of financial position?
A. P10,000,000 C. P15,500,000
B. P5,500,000 D. P0

EXERCISE 4
MUSIK Company carries a wide variety of musical instruments, sound reproduction equipment, recorded music, and sheet music. To promote the sale of its products, MUSIK uses two promotion techniques – premiums and warranties.

Premiums
The premium is offered on the recorded and sheet music. Customers receive a coupon for each P10 spent on recorded music and sheet music. Customers may exchange 200 coupons and P200 for a CD player. MUSIK pays P340 for each CD player and estimates that 60% of the coupons given to customers will be redeemed. A total of 6,500 CD players used in the premium program were purchased during the year and there were 1,200,000 coupons redeemed in 2020.

Warranties
Musical instruments and sound reproduction equipment are sold with a one-year warranty for replacement of parts and labor. The estimated warranty cost, based on past experience, is 2% of sales. Replacement parts and labo for warranty work totalled P1,640,000 during 2020.

MUSIK uses the accrual method to account for the warranty and premium costs for financial reporting purposes. MUSIK's sales for 2020 totalled P72,000,000 – P54,000,000 from musical instruments and sound reproduction equipment and P18,000,000 from recorded music and sheet music. The balances in the accounts related to warranties and premiums on January 1, 2020, were as shown below:

Inventory of premium CD players	399,500
Estimated premium claims outstanding	448,000

Estimated liability from warranties 1,360,000

Based on the preceding information, determine the amounts that will be shown on the 2020 financial statements for the following:

1. Warranty expense
   A.1 ,640,00 B. 1,080,000 C. 800,000 D. 360,000
2. Estimated liability from warranties
   A.1 ,920,000 B. 1,080000 C. 240,000 D. 800,000
3. Premium expense
   A.1 ,836,000 B. 840,000 C. 756,000 D. 2,189,500
4. Inventory of premium CD players
   A.3 99,500 B. 569,500 C. 2,210,000 D.739,500
5. Estimated premium claims outstanding
   A. 364,000 B. 840,000 C. 756,000 D. 672,000

EXERCISE 5

On November 1, 2020, 69 passengers on PARL Airlines Flight No. 143 were injured upon landing when the plane skidded off the runway. Personal injury suits for damages totalling P10 milion were filed on January 12, 2021 against the airline by 21 injured passengers. The airline carries no insurance. Legal counsel has studied each suit and advised PARL that it can reasonably expect to pay 70% of the damages claimed. The financial statements for the year ended December 31, 2020 were authorized for issue on February 12, 2021. During the past decade, the company has experienced at least one accident per year and incurred average damages of P4,100,000.

What journal entry should be made as of December 31, 2020?

A.	Loss from accident claims	10,000,000	
	Liability from accident claims		10,000,000
B.	Loss from accident claims	7,000,000	
	Liability from accident claims		7,000,000
C.	Loss from accident claims	4,100,000	
	Liability from accident claims		4,100,000
D.	Loss from accident claims	2,870,000	
	Liability from accident claims		2,870,000
E.	No entry is required		

EXERCISE 6

On January 1, 2020, DIAZ Corporation issued 3-year, 4,000 convertible bonds at face value of P1,000 per bond. Interest is to be paidannually in arrears at the stated coupon rate of 6%. Each bond is convertible, at the holder's option, into 200 P2 par value ordinaryshares at any time up to maturity. On the date of issuance, the prevailing market interest rate for similar debt without the conversion privilege was 9%. On the same date, the market price of one ordinary share was P3. The bonds were converted on December 31, 2021.

The following present value factors are obtained from the present value tables:

	6%	9%
Present value of 1 for 3 periods	0.83962	0.77218
Present value of an ordinary annuity of 1 for 3 periods	2.67301	2.53130
Present value of an annuity due of 1 for 3 periods.	2.83339	2.75911

1. The liability component of the convertible debt is
   A. 4,000,000 B. 3,696,232 C. 1,600,000 D. 3,730,242
2. The equity component of the convertible debt is
   A. 303,768 B. 1,973,621 C. 1,600,000 D. 2,400,000
3. The interest expense to be reported in DIAZ Company's income statement for the year ended December 31, 2019 is
   A. 101,000 B. 110,107 C. 240,000 D. 341,000
4. The entry to record the bond conversion on December 31, 2019 should include a credit to share premium – issuance of
   A. 2,289,893 B. 2,400,000 C. 2,593,661 D. – 0 –

EXERCISE 7

On January 1, 2020, Lessee Inc. leased an equipment from Lessor Company. The agreement includes the lease term which is 3 years, and requires Lessee to pay P40,000; P50,000; and P60,000 on December 31, 2020; 2021; and 2022, respectively. The equipment, which has a useful life of 20 years, is considered to be of low value.

Requirements:

1. *Prepare the journal entries for 2020, 2021, and 2022.*
2. *How much is the rent income to be recognized by Lessor Company for 2020, 2021, and 2022?*
3. *How much is the rent expense to be recognized by Lessee Inc. for 2020, 2021, and 202?*

EXERCISE 8

Raven Company bought a machinery on January 1, 2020 for P2,139,335. The useful life of the machine is 5 years. On the same day, Eagle Corporation leased the said machinery for 5 years. Raven required Eagle to pay P550,000 every December 31. The implicit rate for this agreement is 9%, and the current market rate is 12%. (Use four decimal places for PVF)

Requirements:

Lessee

1. *At how much shall the Lease Liability be initially measured?*
2. *At how much shall the Right of Use Asset be initially measured?*
3. *How much is the rent expense for 2020 and 2021?*
4. *How much is the depreciation expense for 2020 and 2021?*
5. *How much is the interest expense for 2020 and 2020?*
6. *What is the carrying value of the Right of Use Asset as of December 31, 2021?*
7. *What is the carrying value of the Lease Liability as of December 31, 2021?*
8. *Prepare the journal entries for 2020 and 2021*

Lessor

9. *At how much shall Lease Receivable be initially measured?*
10. *At how much shall Unearned Interest Income be initially recognized?*
11. *How much is the rent income for 2020 and 2021?*
12. *How much is the interest income for 2020 and 2021?*
13. *What is the balance of Lease Receivable as of December 31, 2021?*
14. *What is the carrying value of Lease Receivable as of December 31, 2021?*
15. *Prepare the journal entries for 2020 and 2021*

EXERCISE 9

On January 1, 2020, Lessor Company leased an equipment to Lessee Company. The details are as follows:

Cost of equipment	2,058,440
Annual rental payable every December 31	400,000
Lease term	8 years
Useful life of machinery	10 years
Implicit rate before initial direct cost	11%
Implicit rate after initial direct cost	10%
PV of OA of 1 for 8 years at 11%	5.1461
PV of OA of 1 for 8 years at 10%	5.3349

Lessor paid initial direct costs of P75,520 on January 1, 2017.

Requirements:

Lessee

1. *At how much shall the Lease Liability be initially measured?*
2. *At how much shall the Right of Use Asset be initially measured?*
3. *How much is the depreciation expense for 2020 and 2021?*
4. *How much is the interest expense for 2020 and 2021?*
5. *What is the carrying value of the Right of Use Asset as of December 31, 2021?*
6. *What is the carrying value of the Lease Liability as of December 31, 2021?*
7. *Prepare the journal entries for 2020 and 2021*

Lessor

8. *At how much shall Lease Receivable be initially measured?*
9. *At how much shall Unearned Interest Income be initially recognized?*
10. *How much is the interest income for 2020 and 2021?*
11. *What is the balance of Lease Receivable as of December 31, 2020? December 31, 2021?*
12. *What is the carrying value of Lease Receivable as of December 31, 2020? December 31, 2020?*
13. *Prepare the journal entries for 2020 and 2021*

EXERCISE 10

On January 1, 2020, Bessor Company leased its machine costing P1,859,000 to Bessee Company. The estimated useful life of the machine is 6 years; the lease term is 5 years. Bessee is required to pay P500,000 every December 31. The agreement includes an unguaranteed residual value of P100,000 at the end of the lease term. The implicit rate of the lease agreement is 12%. Bessee paid P50,000 as initial direct cost. (Use four decimal places for PVF)

Requirements:

Lessee

1. *At how much shall the Lease Liability be initially measured?*
2. *At how much shall the Right of Use Asset be initially measured?*
3. *How much is the depreciation expense for 2020 and 2021?*
4. *How much is the interest expense for 2020 and 2021?*
5. *What is the carrying value of the Right of Use Asset as of December 31, 2021?*
6. *What is the carrying value of the Lease Liability as of December 31, 2021?*
7. *Prepare the journal entries for 2020 and 2021*

Lessor

8. *At how much shall Lease Receivable be initially measured?*
9. *At how much shall Unearned Interest Income be initially recognized?*
10. *How much is the interest income for 2017 and 2018?*
11. *What is the balance of Lease Receivable as of December 31, 2020? December 31, 2021?*

12. *What is the carrying value of Lease Receivable as of December 31, 2020? December 31, 2021?*
13. *Prepare the journal entries for 2020 and 2021*

INTANGIBLES

EXERCISE 1

The following amounts are included in the general ledger of THIRTYTWO CORPORATION at December 31, 2020:

Organization Costs	P 72,000
Trademarks	45,000
Patents	225,000
Discount on Bonds Payable	105,000
Deposits with advertising agency for ads to promote goodwill of company	30,000
Costs of equipment acquired for various research and development projects	320,000
Costs of developing a secret formula for a product that is expected to be marketed for at least 20 years	240,000

Requirement: On the basis of the information above, what is the total amount of intangible assets to be reported by Thirtytwo in its statement of financial position at December 31, 2020?

A. P342,000 *C. P510,000*
B. P270,000 *D. P830,000*

EXERCISE 2

The THIRTY COMPANY engaged in the following transactions at the beginning of 2020:

1. Purchased a patent for P700,000 that had originally been filed in January 2014. The acquisition was made to protect another patent that the company had filed for in January 2016 and subsequently received.

2. Purchased the rights to a novel by a best-selling novelist in exchange for 100,000 ordinary shares (P10 par) selling for P60 per share. The book sells 1 million copies in 2020 and is expected to sell a total of 500,000 copies in the future years.

3. Purchased the franchise to operate a ferry service from the government for P100,000. A bridge has been planned to replace the ferry, and it is expected that it will be completed in five years. The company hopes that the ferry will continue as a tourist attraction, but profits are expected to be only 20% of those earned before the bridge is opened.

4. Paid P280,000 to attorneys for services to successfully defend the patent acquired in transaction 1.

5. Paid a taxi operator P500,000 to have the company name prominently displayed on his taxis for two years.

Based on the preceding information, determine the carrying value of the value at the end of 2020:

1. Patent

A. P630,000 *C. P910,000*
B. P656,250 *D. P650,000*

2. Copyright

A. P2,000,000 *C. P3,000,000*
B. P0 *D. P4,000,000*

3. Franchise

A. P100,000 *C. P80,000*
B. P84,000 *D. P76,000*

EXERCISE 3

THIRTYONE ENTERPRISES developed a new machine that reduces the time required to mix the chemicals used in one of its leading products. Because the process is considered to very valuable to the company, Thirtyone patented the machine.

Thirtyone incurred the following expenses in developing and patenting the machine:

Research and development laboratory expenses	P 750,000
Materials used in the construction of the machine	240,000
Blueprints used to design the machine	96,000
Legal expenses to obtain patent	360,000
Wages paid for the employees' work on the research, development, and building of the machine (60% of the time was spent in actually building the machine)	900,000
Expense of drawing required by the Patent Office to be submitted with the patent application	51,000
Fees paid to Patent Office to process application	75,000

One year later, Thirtyone Enterprises paid P525,000 in legal fees to successfully defend a patent against an infringement suit by Gaya-gaya Company.

Requirements:

1. What is the total cost of the patent?

A. P993,000	*C. P564,000*
B. P486,000	*D. P126,000*

2. What is the total cost of the new machine?

A. P1,362,000	*C. P780,000*
B. P0	*D. P876,000*

3. What is the entry to record the legal fees paid for the successful defense of the patent against infringement suit.

A. Patents	*525,000*	
Cash		*525,000*
B. Legal Fees Expense	*525,000*	
Cash		*525,000*
C. Machinery	*525,000*	
Cash		*525,000*
D. Amortization expense – Patents	*525,000*	
Cash		*525,000*

EXERCISE 4

CAMERA Corporation has provided information on intangible assets as follows:

- A patent was purchased from Patintero Company for P6 million on January 1, 2020. On acquisition date, the patent was estimated to have a useful life of 10 years. The patent had a net book value of P6 million when Patintero sold it to CAMERA.
- On February 1, 2021, a franchise was purchased from the Franchisor Company for P1,440,000. The contract which runs from 20 years provides that 5% of revenue from the franchise must be paid to Franchisor. Revenue from the franchise for 2018 was P7,500,000.
- The following research and development costs were incurred by CAMERA in 2021:

Materials and equipment	426,000
Personnel	567,000
Indirect costs	306,000
Total	1,299,000

- Because of recent events, CAMERA, on January 1, 2021, estimates that the remaining useful life of the patent purchased on January 1, 2020, is only 5 years from January 1, 2021.

1. *On December 31, 2021, the carrying value of the patent should be*

A.4 ,320,000	*B. 6,000,000*	*C. 1,680,000*	*D. – 0 –*

The unamortized cost of the franchise at December 31, 2021 should be

A.9 99,000	*B. 1,356,250*	*C. 1,440,000*	*D. 1,374,000*

3. *How much should be charged against CAMERA's income for the year ended December 31, 2021?*

A. 2,280,000	*B. 2,826,000*	*C. 2,820,000*	*D. 1,725,000*

EXERCISE 5

The following costs were incurred by THIRTYTHREE COMPANY during 2020:

Searching for applications of new research findings	P 57,000
Trouble-shooting in connection with breakdowns during commercial production	87,000
Adaptation of an existing capability to a particular requirement or customer's need as part of continuing commercial activity	39,000
Engineering follow-through in an early phase of commercial production	45,000
Radical modification of the formulation of a glassware product	78,000
Laboratory research aimed at discovery of new knowledge	204,000
Testing for evaluation of new products	72,000
Quality control during commercial production, including routine testing of products	174,000
Materials consumed in research and development projects	177,000
Consulting fees paid to outsiders for research and development projects	300,000
Personnel costs of persons involved in research and development projects	384,000
Indirect costs reasonably allocable to research and development projects	150,000
Materials purchased for future research and development projects	102,000
Research and Development costs reimbursable under a contract to perform research and development for Client Corporation	1,050,000
Design, construction, and testing of preproduction prototypes and models	870,000

Routine on-going efforts to refine, enrich, or otherwise improve upon qualities of existing product	750,000
Total	P4,539,000

Requirement: What is the total amount to be classified and expensed as research and development for 2020?

A. P3,342,000 *C. P2,394,000*
B. P2,292,000 *D. P2,220,000*

EXERCISE 6

ELDER WAND, Inc. has its own research department. However, the company purchases patents from time to time. The following is a summary of transactions involving patents now owned by the entity:

- During 2016 and 2017, ELDER WAND spent a total of P459,000 in developing a new process that was patented (Patent A) on April 1, 2018; additional legal and other costs of P50,000 were incurred.
- A patent (Patent B) developed by Gin Yus, an inventor, was purchased for P187,500 on December 31, 2019, on which date it had an estimated useful life of 12 ½ years.
- During 2018, 2019, and 2020, research and development activities cost P510,000. No additional patents resulted from these activities.
- A patent infringement suit brought by the company against a competitor because of the manufacture of articles infringing on Patent B was successfully prosecuted at a cost of P42,600. A decision in the case was rendered in June 2020.
- On July 1, 2021, Patent C was purchased for P172,800. This patent had 16 years yet to run.
- During 2022, ELDER WAND expended P180,000 on patent development. However, the company is still undecided as to how the patent, if approved by the Bureau of Patents, will generate probable future economic benefits.

Assume that the legal life of each patent is also its useful life.

1. *What is Patent A's carrying value on December 31, 2022?*
   A.1 20,888 *B. 497,125* *C. 38,125* *D. 388,113*
2. *What is Patent B's carrying value on December 31, 2022?*
   A.1 41,250 *B. 28,906* *C. 32,092* *D. 173,342*
3. *What is Patent C's carrying value on December 31, 2022?*
   A.1 62,000 *B. 327,600* *C. 159,840* *D. 156,600*
4. *What is the total patent amortization expense to be reported in ELDER WAND's income statement for the year endedDecember 31, 2022?*
   A.3 7,300 *B. 28,741* *C. 74,325* *D. 28,300*