Commerce Mentorship Program

COMMERCE 293
Financial Accounting

Midterm Review Session Notes Package

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CUS Commerce Mentorship Program
COMM 293 - Intro to Financial Accounting
Midterm Review Session
Tutor: Richard Wong

AGENDA

1. Introduction – Richard Wong

2. Financial Statements / Accounting Cycle (Ch. 1/2)

3. Conceptual Framework (Ch. 2)

4. Basic Journal Entries (Ch. 2/3)

5. Adjusting and Correcting Entries (Ch. 4)

6. Interpreting Accounting Info (Ch. 6)

7. Revenue Recognition (Ch. 7)

8. Sales Discounts (Ch. 7)

9. A/R, ADA, and Bad Debt (Ch. 7)

Section 1: *Introduction - Richard Wong*

Richard Wong

4th Year BCom - Accounting and HR

- Teaching Assistant - COMM 293
- President, UBC Accounting Club
- President, UBC Tax Assistance Clinic for Students

Interesting Fact: Worked in over 20 different jobs including..

- Guest Services Assistant Manager
- Library Help Desk Assistant
- Teaching Assistant
- Tax Associate
- Traffic Attendant
- Usher
- Field Surveyor
- Marketing Assistant

Section 2: *Financial Statements and the Accounting Cycle*

The two most fundamental equations of F.A.:

______________ = _______________ + _________________________

________________ = ________________

_____________________:

- Resource **controlled by an entity**
- Result of **past** events
- Has **future benefits / value**

Examples: ____________, ___________, _______________

_____________________:

- Present obligation of the company
- Result of **past** events
- Settlement involves **outflow of resources**

Examples: ____________, ___________, _______________

______________________________:

- Difference between **total assets** and **total liabilities**

Examples: __________, _________, ____________

_____________ / _____________:

Assets		Liabilities + S/E	
DR		DR	
CR		CR	

Sample Questions

1. Asset, Liability, or Shareholders' Equity Account?

Cash	Asset	Liability	Shareholders' Equity
Accrued expense	Asset	Liability	Shareholders' Equity
Common shares	Asset	Liability	Shareholders' Equity
Retained earnings	Asset	Liability	Shareholders' Equity
Prepaid expenses	Asset	Liability	Shareholders' Equity
Patents	Asset	Liability	Shareholders' Equity
Goodwill	Asset	Liability	Shareholders' Equity
Advertising expenses	Asset	Liability	Shareholders' Equity

Types of Financial Statements:

1. ________________________
   - Assets = Liabilities + S/E

ABC Inc.

____

as at December 31, 2012

Assets	**Liabilities**
Cash	Accounts Payable
Building	Bonds Payable
Equipment	**Shareholders' Equity**
Inventory	Common Shares
	Retained Earnings
Total Assets	Total Liabilities and Shareholders' Equity

2. ________________________
   - Revenues - Expenses = Net Income

ABC Inc.

____

as at December 31, 2012

Revenues
Sales Revenue
Total revenue
Expenses
Cost of goods sold
Rent expense
Supplies expense
Total expenses
Net Income

3. ________________________

- Beginning R/E + __________ - ___________ = Ending R/E

ABC Inc.

____

as at December 31, 2012

Retained earnings, January 1
Net income
Dividends
Ending R/E

4. _______________________

- Cash flows from Operating, Investing, and Financing
- Covered in Chapter 5

Sample Questions

2. The Sock Market sells socks to Finance students at Sauder. On December 31, The Sock Market reports $20,000 in equipment, $10,000 in bonds payables, $15,000 in patents, and $1,000 in salary expenses. How much will the Stock Market have in Shareholders' Equity on their balance sheet?

Section 3: *Conceptual Framework*

3 Assumptions of Financial Reporting

1. ___________ ___________ - Transactions of company separate from owner's personal transactions.

2. Going Concern - Company will not ___________ in near future.

3. _________________ - Statements will be prepared _______________ at minimum

4 Qualitative Characteristics That Make F/S Useful

1. ____________________ - People can understand it

2. __________________ - Same in different countries

3. ________________ - If relevant, you must tell people.

4. ________________ - Must use most reliable info.

2 Constraints of F/S

1. ________-_____________ - Information should only be prepared if perceived benefits exceed the costs.

2. __________________ - Only care if amount is significant.

4 Principles You Must Follow When Preparing F/S

1. ___________________ - What you originally paid for it.

2. _________________________ - Recognize revenue when work is done/product is delivered, collectability is ensured, and future costs can be estimated with reasonable assurance.

3. _______________ - Expenses and revenues incurred together.

4. _______________ - Don’t hide anything.

Sample Questions

3. Which of the following is true?
   a) The accrual method of accounting provides financial statements that have high relevance and low reliability.
   b) The accrual method of accounting provides financial statements that have low relevance and high reliability.
   c) The accrual method of accounting is more reliable than the cash method of accounting.
   d) The accrual method of accounting provides financial statements that balance relevance and reliability.

4. Which of the four types of financial statements do not result from the accrual method of accounting? ________________________

5. Why do we not produce financial statements on a daily basis? _____________________
____

6. Would I have to disclose the following in the notes to the financial statements?

XYZ Inc is being sued _________ Joe the Janitor is sick _______

Section 4: *Journal Entries*

The Three Golden Rules of J/E

1. __________ = __________

2. Always __________ expenses
3. Always __________ revenues

…UNLESS ____________________________________

What do I debit and what do I credit?

Think of debits as what I'm _____________________.
Think of credits as what I'm ______________.

Sample Questions

7. Florist Gump is a floral boutique in Richmond, BC. Florist Gump engaged in the following transactions in 2013:

a. Collected $ 300,000 in accounts receivable on January 5th.

	Debit	Credit

b. Issued 100 common shares for $15 per share on February 8th.

	Debit	Credit

c. The owner, Flora Bell, brought her car to Florist Gump's headquarters on March 10th for marketing initiatives (she intends to park it outside to attract attention). The car originally cost Flora $ 40,000 and had a value of $20,000 on December 31, 2012. Her local car dealership was willing to pay her $30,000 for the car on March 10th, 2013 but she politely declined. Flora wants the car back on March 10th, 2014 to give to her daughter, Tinker Bell.

	Debit	Credit

d. Flora used company funds to pay $2,000 of personal property taxes on April 15th.

	Debit	Credit

e. Florist Gump purchased $ 30,000 of inventory, on account, on May 13th.

	Debit	Credit

f. Paid $ 4,000 to suppliers on account on June 15th.

	Debit	Credit

g. Florist Gump sold $ 1,000 of inventory on July 18th. This inventory cost Florist Gump $ 250. The customer is willing to pay $ 400 on cash and the remaining on account.

	Debit	**Credit**

h. Florist Gump purchased a 1-year insurance policy on December 1st for $24,000. The insurance will be paid in monthly instalments on the last day of each month.

	Debit	**Credit**

Required: Prepare a journal entry to reflect each of these events.

Section 5: *Adjusting and Correcting Entries*

Was a mistake made?

YES

1. ________ incorrect entry
2. Do _________ __________
3. Do _____________________
4. ________ ______ from 1-3

NO

Do normal journal entry
To account for end of period

Sample Questions

8. The Merchant of Tennis is a sports shop in Shakespearean times. After discussions with their auditors, they discovered that several adjusting and correcting entries are still required.

Required: Please make the year-end adjusting entries required for December 31, 2013 and describe its effects on net income, total assets, total liabilities, and total shareholders' equity.

a. The Merchant of Tennis forgot to amortize their racket making machine. The machine amortizes at $ 5,000 per year.

	Debit	Credit

Effect of Error: ____

b. The Merchant of Tennis purchased a 2-year insurance policy on July 1st, 2012. On this date, it debited insurance expense by $40,000 and credited cash. No other entries pertaining to insurance have been made until today.

	Debit	Credit

Effect of Error: ____

c. At the end of the year, staff reported $2,000 of supplies inventory on their balance sheet. However, a detailed count by their auditors produced only $1,100 of supplies.

	Debit	**Credit**

Effect of Error: ____

d. The company recorded a collection of $20,000 from its supplier by debiting cash and crediting accounts payable.

	Debit	**Credit**

Effect of Error: ____

e. The Merchant of Tennis received a 2-year loan of $10,000 on July 1, 2013. Interest is paid at 10% every 6 months on account.

	Debit	**Credit**

Effect of Error: ____

Section 6: *Interpreting Accounting Info*

Gross margin ratio = _____________ / _______________

Net profit margin = ______________ / _______________

Return on Equity = ___________ / ________________
where _______________________ =
(_______________ + ______________) / 2

Return on Assets = (____________ + _______________) /
____
where _______________________ =
(_______________ + ______________) / 2

Section 7: *Revenue Recognition*

Revenue and costs must be recognized when:

1. Product is ______________________________ by the customer
2. We can **estimate** ____________________ **with high** __________
3. We are sure the **customer will** ______ for the product

% of Completion Method = recognize same % of costs and revenues

- WHY: _____________________________
- outcome of contract and stage of completion must be reliably measured

Completed Contract: Recognize revenues and expenses at completion.

Sample Questions

9. Spruce Springsteen Inc. produces industrial lawnmowers for arenas and stadiums in the Lower Mainland. On July 1, 2013, they struck a deal with Stadium X to manufacture 4 industrial lawnmowers for a total price that will be within the range of $1,000,000 and $1,400,000 (depending on market rates at the time of delivery).

   Stadium X paid a deposit of $200,000 on July 1st and will pay the remainder upon completion of the contract. Total costs to manufacture all 4 machines are $500,000. On December 31st, 2 lawnmowers were finished and delivered to Stadium X.

   Required: Prepare the 2 journal entries that Spruce Springsteen Inc would record on December 31, 2013.

   Revenue

	Debit	Credit

   Costs

	Debit	Credit

10. Bread Pitt sells ovens to local family-owned bakeries.

    Bread Pitt signed a contract with Lots of Loaves on January 1, 2013 for one new industrial oven at a cost of $2,200,000. Lots of Loaves made a non-refundable deposit of $100,000 and agreed to biweekly payments of $200,000 until the price is paid off.

    Bread Pitt was able to deliver the oven to Lots of Loaves on December 1, 2013 and did so at a total manufacturing and delivery cost of $1,400,000. To ensure that the equipment is perfect for the user, Bread Pitt gave Lots of Loaves an unlimited right to return until February 5, 2014.

    Required: How much in revenue and costs should Bread Pitt recognize in 2013?

11. Lan Lord is a manufacturer of wireless routers who entered into a contract on October 1, 2009 with the province of British Columbia. The contract price is fixed at $500 million and Lan Lord expects that the project will be complete by the end of 2012. Other information re: the contract is provided below. Lan Lord has a December 31st year-end.

In $ millions	**2009**	**2010**	**2011**	**2012**
Costs incurred (during the year)	80	125	140	75
Estimated costs to complete at the end of the year	320	235	130	0

<u>Required</u>: Determine the amount of revenue and gross profit that Lan Lord would record in 2009 and 2010 using the Completed Contract method.

<u>Required</u>: Determine the amount of revenue and gross profit that Lan Lord would record in 2009 and 2010 using the Percentage of Completion method. Please round to the nearest million.

2009

Revenues

Gross Profit

2010

Revenues

Gross Profit

Section 8: *Sales Discounts*

2/10, net 30.

If you pay within 10 days, 2% discount
Balance due in 30 days

Typical Journal Entries

Payment for merchandise with Credit Card:

DR. _______________
DR. ________________________________
CR. ______________________

Payment for merchandise with 2% discount

DR. _______________
DR. ________________________________
CR. ______________________

Payment for merchandise with no discount

DR. _______________
CR. ______________________

<u>Section 9: *ADA and Bad Debt*</u>

1. ______________________________

- Use historical data to determine % that goes uncollected

2. __________________________________

- Use historical data to determine % that goes uncollected 0-30 days, 30-60 days, 60-90 days, and over 90 days out

Estimate of Uncollectible Amount

DR. Bad debt expense
CR. Allowance for doubtful accounts

When A/R Becomes Bad

DR. Allowance for doubtful accounts
CR. Accounts receivable

If Client Repays Bad Debt

DR. Accounts receivable
CR. Allowance for doubtful accounts

DR. Cash
CR. Accounts receivable

Calculating ending allowance for bad debts

Beginning allowance for bad debts
+ ________________________
- _________________
+ ________________
= Ending allowance for bad debts

Wok on Water is the largest wholesaler of pots and pans in Western Canada. Approximately 60% of the company's sales are made on credit and customers have twenty days from the date of sale to remit payment.

The following information is available for the year ended December 31, 2013:

Accounts receivable, gross (1/1/2013)	$ 500,000
Allowance for doubtful accounts (1/1/2013)	65,000
Total sales in 2013	1,000,000
Payments on account received from customers	52,000
Write-offs of accounts receivable	80,000
Recoveries of bad debts during 2013	15,000

Wok on Water provides for doubtful accounts using either of the following calculations:

1) 5% of credit sales for the year, or
2) 10% of current receivables and 25% of receivables which are overdue as at year-end.

As at December 31, 2013, 50% of gross accounts receivable are current.

Part A:
Determine the December 31, 2013 balances in "Bad Debts Expense" and "Allowance for Doubtful Accounts" if the company uses the percentage of credit sales method.

Part B:
Determine the December 31, 2013 balance of "Allowance for Doubtful Accounts" if the company uses the aging method.