COMM 293
2018W1 Midterm Review Package

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commerce
undergraduate
society

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1. Accounting Basics

Asset = Liabilities + Shareholders' Equity

Asset:

- Economic resources that a business owns
- Has capacity to provide future services or benefits
- Resulted from past business events

Liabilities:

- Creditors' claims against assets
- Resulted from past business events
- Must be paid before ownership claims

Shareholders' equity:

- "Residual claim": leftover equity after creditors are paid
- Calculated as asset minus liabilities

Revenue: gross **increases** in shareholders' equity resulting from business activities entered into for the purpose of earning income

Expense: the cost of assets consumed or services used in the process of earning revenue. They are **decreases** in shareholders' equity that result from operating the business.

Financial Statements:

- Balance Sheet (at a **point** in time)

- Income Statement (for a **period** of time)

- Statement of Changes in Equity (over a **period** of time)

- Statement of Cash Flows (over a **period** of time)

Generally Accepted Accounting Principles (GAAP) in Canada

Public companies must use **IFRS**, private companies can use **IFRS** or **ASPE**.

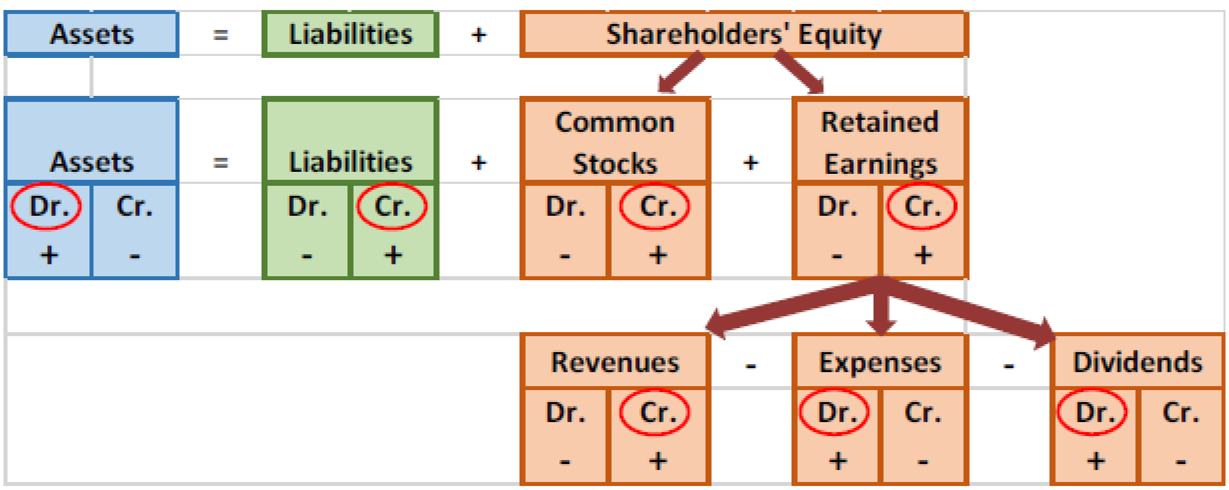
PRACTICE: Please find the correct classification for the following accounts, and indicate on which financial statement they will appear.

Accounts receivable
Retained earnings
Notes payable
Cost of goods sold
Prepaid expense

Inventory
Common shares
Sales revenue
Unearned revenue
Accumulated depreciation

Debit & Credit

In double entry accounting system, a journal entry's total debit amount must equal total credit amount.



Credit: Xin Zheng, PhD

2. Adjustments

When and what to recognize?

Accrual basis vs Cash basis

Revenue recognition principle & Expense recognition principle

(matching principle):
when revenue (expenses) is incurred, no matter when cash is received (paid).

PRACTICE: How to prepare journal entries when cash is received before / at the same time when / after revenue is earned?

Before At the same time After

What if cash is paid before expense is incurred? (e.g. insurance, rent)

Period end adjusting entries:

Deferrals: cash before events (e.g. cash received before service rendered)
Accruals: cash after events (e.g. service rendered before customer pays)

Depreciation

Way of **allocating** the **cost** of a tangible asset over its useful life. It is not the same as decrease in the asset's **market value**. Salvage value and useful life are estimates, which require professional judgment.

Depreciation expense per period = (cost – salvage value) / useful life
Accumulated depreciation: a contra-asset account on balance sheet

Book value = cost – accumulated depreciation
(Again, book value does not mean market value)

PRACTICE:
Joe started a late-night food delivery business serving hungry UBC students. In the beginning of 2018, Joe bought a car for $4000 and estimated that it would last 5 years, after which he would sell it for $500. At the end of 2018, Joe asks you to prepare journal entries related to depreciation for the year.

Closing Process: close out all temporary accounts into **income summary**, and eventually into **retained earnings**.

Permanent accounts: carry balances forward.
e.g. Cash, accounts receivable, loans payable, contributed capital
Temporary accounts are closed every period.
e.g. sales revenue, utilities expense, loss on disposal, dividends declared

PRACTICE: Joe's business became an instant hit after launch. He earned $2000 in revenue and incurred $500 expense in the first month. Please help him prepare journal entries to close revenue and expense accounts into income summary.

3. Inventory

Goods that a company holds for sale to customers

PRACTICE:

Circle the correct inventory system that has the following features:

Keeps track of inventory on hand	Perpetual	Periodic
Better internal control	Perpetual	Periodic
Cheaper to maintain	Perpetual	Periodic
Good for big firms with complex inventory system	Perpetual	Periodic
Account adjusted only at period end	Perpetual	Periodic

Journal entries for perpetual inventory system

Purchase Inventory:

Dr Inventory

Cr Accounts payable (credit sale) or Cash (cash sale)

Transportation and stocking cost incurred by buyer is added to inventory value.

Sale of goods (two parts):

Dr Accounts receivable

Cr Sales revenue

Record cost of goods sold:

Dr Cost of goods sold (or cost of sales)

Cr Inventory

Journal entries for periodic inventory system

Purchase Inventory:

Dr Purchases (Asset)

Cr Accounts payable

Sale of goods:

Dr Accounts receivables

Cr Sales revenue

Cost of goods sold:

No entry as sales are recorded.

Record COGS at year end.

Dr Cost of goods sold

Cr Purchase

Determine COGS at end of year:

Beginning inventory

+ Net Purchases in the year*

= Cost of goods available for sale (COGAS)

Less Ending inventory (from physical count)

= Cost of Goods Sold

<u>Purchase Discounts, Allowances and Returns (entries for periodic systems in *italic*)</u>

Purchase discount: e.g. 2/10, n/30

Dr Accounts payable

Cr Inventory / *Purchase Discounts*

Cr Cash

Purchase Allowance:

Dr Accounts payable

Cr Inventory / *Purchase Allowances*

Purchase Return:

Dr Accounts payable

Cr Inventory / *Purchase Returns*

<u>Ownership of Goods</u>

FOB shipping point vs FOB destination

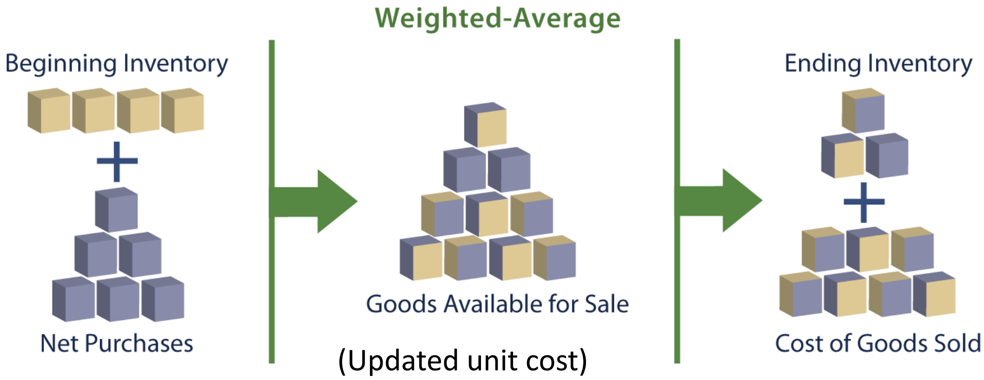
Consigned goods

Inventory Costing Methods

- **Specific Identification**
  - Identify each product in inventory and record purchasing cost.
  - Customized, exotic products. Time- & cost-consuming but precise
- **First-In, First Out**
  - May not be the same flow of physical inventory (i.e. grocery store)
  - COGS charged to first purchased inventory
  - If running out of current batch, charge to next batch

Keep track of remaining units in each "batch"

- **Weighted Average**
  - Inventory batches are mixed (i.e. gas station)
  - Update unit cost after each purchase
  - COGS = Avg. unit cost * # units sold



PRACTICE

Jason is a professional dealer who buys iClickers (inventory) from graduating students and sells them to incoming freshmen to make a profit. Here is a summary of his business activities this year.

Date	**Purchase / Sale**	**Price ($ each)**	**Quantity**
April 28	Purchase	9	2
April 30	Purchase	10	3
May 2	Sale	25	1
May 3	Sale	30	2
May 25	Purchase	11	2
July 2	Sale	28	3

What is Jason's total cost of goods sold under <u>FIFO</u> and <u>weighted average</u> methods, respectively?

FIFO:

Weighted Average:

Lower-of-Cost-or-Market (LCM):

Inventory is written down if **market value** drops below its original cost.
No write-ups allowed. Reversion of write-downs allowed under IFRS.
Rationale behind it: **Accounting Conservatism**

PRACTICE

BeaverBox sells protective cases for smartphones. After Samsung recalled Galaxy Note 7 phones, BeaverBox can no longer sell its custom fit Note 7 cases. There are 30000 cases in stock and each case costs $5 to manufacture. The company currently sells this case for $15 each. Sales manager estimates that all remaining Note 7 cases can only be sold as scrap plastic to a recycling company for $0.5 each. Please prepare journal entries to write-down BeaverBox's inventory.

4. Accounts Receivable

Classification: current vs non-current
A/R is often recorded when

a. revenue is recognized
b. returns or allowances occur
c. cash is collected from customers who previously purchased on account

<u>Bad debts</u>

Part of accounts receivable may become uncollectible. **Indirect** method is commonly used. Estimate requires professional judgment. Rationale behind indirect method: matching principle.

Allowance for doubtful accounts is a contra-account under accounts receivable.

PRACTICE

Bob sells office supplies to local businesses on credit. A recent storm destroyed plants of many of his clients. On Jan. 1, Bob estimated that 3% of total accounts receivable would become uncollectible. He had $100000 outstanding receivables. Please prepare journal entries to record bad debt expense.

a. Estimate the amount of bad debt expense for this period (percentage of credit sales or aging of accounts receivable)

b. When a certain amount of A/R becomes uncollectible

On Mar.1, in light of extended business suspension of his biggest client FloppyDiskDepot, who owed $1500, Bob determined that he would never be able to collect the money. Assume that the $1500 had been recorded in allowance for doubtful accounts.

c. When a previously written-off account becomes collectable
On Mar. 15, FloppyDiskDepot resumed operation and confirmed with Bob that they would pay the full amount owed by the end of March.

d. When cash is received
On Mar.30, Bob received a $1500 cheque from FloppyDiskDepot.

Disposal of Accounts receivable

Company transfers accounts receivable for a fee. Do not confuse it with bad debts.

PRACTICE

XYZ company has a large amount of accounts receivable. To improve liquidity, management decided to sell $100000 A/R to a third-party collector for a 5% fee. Please prepare journal entries for this transaction.

Promissory notes

Usually have specified interest rate, face value and terms.
Face value * annual interest rate * time in terms of one year = interest

PRACTICE

Anthony's Pasta Bar is an iconic restaurant in Vancouver serving mega-size pasta dishes. Due to the venue's increasing popularity, management decides to finance a renovation project to increase seating capacity. On Feb. 1, Anthony's signed a promissory note with a face value of $100000 due in ten months. Interest is to be paid at maturity at 9% per annum. Please prepare journal entries for the **LENDER**.

The lender has a Sep. 30 year end. Interest accruals need to be adjusted at year end.

On Nov.1, Anthony’s paid interest and the principal.

5. Internal Control

Bank Reconciliation

Reconcile balance in accounting records and bank records to check for discrepancies, which typically result from timing difference and errors. Bank statements may also show items that are not yet recorded by the company.

Timing difference: uncashed cheques.

Errors: clerical errors, bank errors

PRACTICE

On July 3, ABC company conducted a bank reconciliation. The following transactions were reported by the bank. Please prepare journal entries.

June 6	a client sent in a $500 wire transfer to pay for products purchased in May.
June 15	the bank charged $25 monthly fee
June 30	$20 interest was credited into the company’s account