COMMERCE MENTORSHIP PROGRAM

MIDTERM REVIEW SESSION

COMM 293

PREPARED BY

ELIZABETH LIN

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Chapter 1. Accounting in Action

1.1 What is Accounting?

Accounting is an information system that *identifies*, *records*, and *communicates* the economic events of an organization or individual to interested users.

REMEMBER: Economic events are *financial* in nature.

Accounting is important for:

a) Internal Users
   - i) Management
   - ii) Finance
   - iii) Human Resources
   - iv) Marketing

b) External Users
   - i) Customers
   - ii) Investors
   - iii) Creditors
   - iv) SEC/CSA
   - v) CRA

In COMM 293, we will be focusing on External Users.

Basics of Accounting:

a) The Accounting Equation
b) Financial Statements
c) Rules, Principles, and Assumptions
d) Types of Businesses

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1.2 The Accounting Equation (Balance Sheet)

A = L + SE
Assets = Liabilities + Shareholders' Equity

Assets: Economic resources
Liabilities: Financing for economic resources from creditors
Shareholders' Equity: Financing for economic resources invested by shareholders and earnings retained

REMEMBER: The Accounting Equation must always be balanced.

Assets:

a) Economic resources that the entity owns or controls
b) The result of past transactions/economic events
c) Provide future economic benefits

Liabilities:

a) The firm's obligations or debts
b) The result of past transactions/economic events

Shareholders' Equity:

a) Financing provided by the owners of a corporation and from earnings retained over time
b) Consists of:
    i) Common Shares/Stocks
    ii) Retained Earnings

1.3 Financial Statements

Financial statements are used by firms to communicate their financial information to interested users.

The Four Basic Financial Statements:

a) Balance Sheet
    i) Reports the entity's assets, liabilities, and shareholders' equity *at a point in time*
b) Income Statement
    i) Reports the entity's profits (revenues less (-) expenses) *for a period of time*
c) Statement of Retained Earnings
    i) Reports how the entity's financial position has been impacted by its profit, dividends, and other changes in the shareholders' equity *over a period of time*
d) Statement of Cash Flows
    i) Reports the entity's cash inflows and outflows in its operating, financing, and investing activities *over a period of time*

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1.4 Rules, Principles, and Assumptions

Financial statements are recorded in accordance to the Canadian GAAP to ensure consistency and accuracy:

a) Public entities in Canada must use IFRS set by IASB
b) Private entities in Canada have the option to use IFRS or ASPE

In COMM 293, we will be focused on IFRS.

The Disclosure Process:

a) Public entities are obligated to disclose their economic events in a timely manner

Regulators:

a) Securities regulation in Canada is done on a provincial level

Auditors:

a) Decide whether the entity's financial statements comply with GAAP

Principles and Assumptions:

a) Historical Cost Principle
b) Fair Value Principle
c) Monetary Unit Assumption
d) Economic Entity Assumption

1.5 Types of Businesses

Proprietorship

a) Single owner
b) Unlimited liability

Partnership

a) Two or more parties act as co-owners
b) Unlimited liability (unless co-owners are in a limited liability partnership)

Corporation

a) Owned by shareholders
b) Limited liability
c) Unlimited life

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1.6 Practice Questions

1. Which is an economic event? Why?

   A. Monk's Café pays Jerry $250,000 as a signing bonus.
   B. Newman promises to pay Kramer $100,000 a year from now.

2. A jester living in the 12th century wishes to travel and clown the king of the neighbouring kingdom, but does not have enough money for the trip. The jester's friend thus lends him money while the king he serves chooses to invest in his travels in exchange for entitlement to part of his future profits. Who is the creditor? Who is the shareholder? Why?

3. a) If Apple's liabilities are valued at $300,000 and its Shareholders' Equity is valued at $550,000, how much are its assets worth?

b) At the beginning of 2023, Pear Inc's assets are worth $80,000 and its liabilities are valued at $60,000. At the end of 2023, Pear Inc's assets are worth $100,000 and its liabilities are valued at $30,000. What was Pear Inc's Shareholders' Equity at the beginning of the year? What much is it now? What was the change in each account?

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Chapter 2. The Recording Process

2.1 The Accounting Equation (Expanded)

Balance Sheet: **Assets = Liabilities + Shareholders' Equity**
Statement of Retained Earnings: **Shareholders' Equity = Common Stocks + Retained Earnings**
Retained Earnings = Revenues - Expenses - Dividends
Income Statement: **Net Income = Revenues - Expenses**

The Ultimate Expanded Accounting Equation:
Assets = Liabilities + Common Stocks + Revenues - Expenses - Dividends

2.2 Transactions

Accounts:
a) The standardized format entity's use to address items to track transactions
b) Chart of Accounts is a list of all accounts used by the firm for its transactions

Transaction Analysis (Balancing the Accounting Equation):
1. Identify if a transaction/economic event has occurred.
   a. Has the entity's financial position been impacted? Can it be reliably recorded?
2. Identify and classify the accounts.
   a. At least two accounts must be impacted by every transaction
   b. Identify their titles and classify its type of account (Asset? Liability? etc.)
3. Determine if the account has increased (+) or decreased (-).
4. Ensure that the accounting equation remains in balance.

The Accounting Cycle:
1. Analyze the tranaction
2. Record journal entries
3. Post amounts in the general ledger
4. Prepare trial balance (make sure debits equal credits)
5. Adjust accounts as necessary
6. Prepare the completed financial statements to share with interested users
7. Close revenues, gains, expenses, and losses to Retained Earnings

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2.3 The Journal, Ledger, and Trial Balance

Journal Entries:

a) Record accounts as either "Debits" or "Credits"
b) Summarize the effects of transactions
c) Transactions are always recorded in chronological order.

T-account:

a) A tool used to represent an account

General Ledger:Febuary 31, 2024

a) Where the T-accounts and their balances are posted (from the Journal Entries)
b) Shows the impact of economic events on each individual account balance

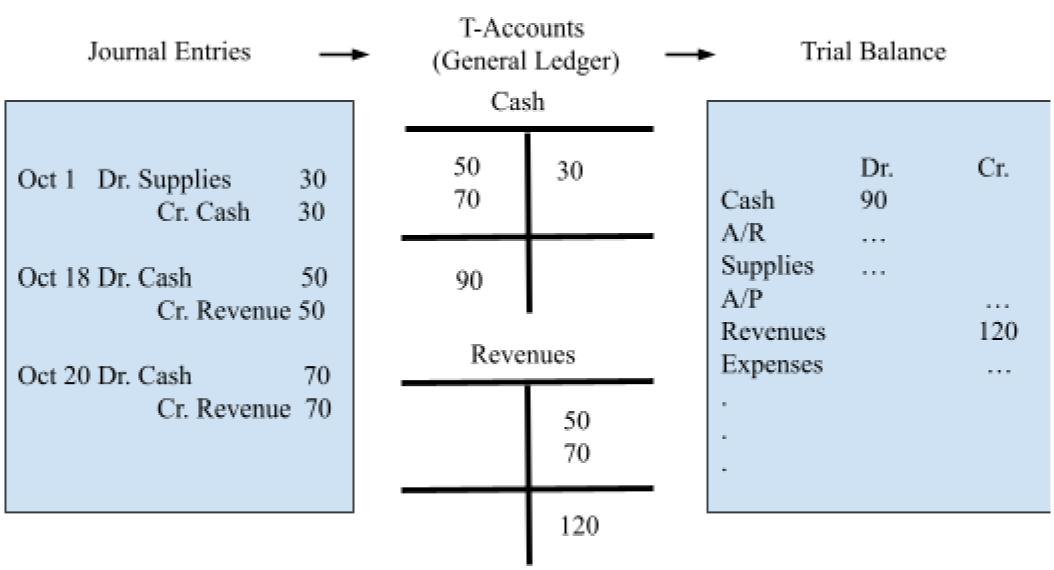
What is the normal balance for an account?

a) **DEA = LER**
b) Debit: Dividends, Expenses, Assets
c) Credit: Liabilities, Equity, Revenue

REMEMBER: "Debit" and "Credit" ≠ "increase" and "decrease". They simply indicate "left" and "right".
REMEMBER: Double-Entry Accounting System (Change in Debit = Change in Credit)

Trial Balance:

a) The list of accounts and their balances *at a given time*
b) Prepared at the end of the accounting period
c) Used to prepare the financial statements



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2.4 Practice Problems

1. Dividends, Expenses, and Assets are always debited.
    a) True
    b) False

2. On October, Ross founded Paleontology Clothing, a merchandise store that sells trendy clothing to paleontologists. Journalize the following transactions for October.

October:

1. Ross invests $100,000 in the firm as the sole shareholder.
5. Ross employs his friends and promises to pay them $20,000 each.
7. 4 mannequins are purchased for $3,000 each. Ross pays $5,000 in cash and signs a 2-year note payable at 10% interest for the remaining amount.
13. A bill for $1,500 is received from Dino Tales Magazine, who advertised Ross' store.
17. Paid for 80 dinosaur shirts priced at $20 each with cash.
24. Declared and paid a $800 cash dividend to Ross.
28. Paid $3,000 to Mannequin Cleaner Inc. for a one year mannequin maintenance coverage beginning on November 1.
30. Paid $8,000 for October's rent.

Chapter 3. Adjusting the Accounts

3.1 Periodicity, Measurement, Recognition

Periodicity Assumption:

a) The financial information of entities are separated into artificial time periods (monthly, quarterly)
b) Calendar years (Jan 1 to Dec 31) vs. Fiscal years (the year starts on any date besides Jan 1)

Measurement:

a) What amounts should be recognized (Cash Basis vs. Accrual Basis)?

In COMM 293, we will be using the Accrual Basis:

a) Revenues and expenses are recorded as earned/incurred
b) Records both cash and non-cash transactions
c) Conforms to IFRS

Recognition:

a) When should the effects of operating activities (revenue and expenses) be recognized?

Revenue Recognition Principle:

a) Revenues are recorded when earned, regardless if there has been a monetary exchange

Scenarios:

1. Cash received *before* revenue is earned

    Dr. Cash
        Cr. Unearned Revenue (Liability)

2. Cash received *on the same date* revenue is earned

    Dr. Cash
        Cr. Revenue

3. Cash received *after* revenue is earned

    Dr. Accounts Receivable
        Cr. Revenue

Expense Recognition Principle (Matching Principle):

a) Expenses are recorded when incurred, regardless if there has been a monetary exchange
b) Expenses match with revenues

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Scenarios:

1. Cash paid *before* expense is recognized

    Dr. Prepaid Expenses (Asset)

        Cr. Cash

2. Cash paid *on the same date* expense is recognized

    Dr. Expenses

        Cr. Cash

3. Cash paid *after* expense is recognized

    Dr. Expenses

        Cr. Expense Payable (Liability)

3.2 Adjustments

Adjustments are needed because of:

a) The Revenue and Expense Recognition Principles
b) Operating activities that take place over more than one period
c) Errors that occur when preparing journal entries

Two Main Types of Adjusting Entries:

a) Deferrals
    i) Prepaid Expenses (expenses paid in cash *before* they are used)
    ii) Unearned Revenues (cash received *before* services are performed)
b) Accruals
    i) Accrued Revenues (revenues earned but *not yet* paid in cash or recorded)
    ii) Accrued Expenses (expenses incurred but *not yet* paid in cash or recorded)

Scenarios:

a) Expenses Understated
    i) The incurred Expense has not yet been recorded
    ii) Prepaid Expenses need to be recognized
b) Expenses Overstated
    i) Payment that was recorded in the Expense account covers more than the current period
c) Revenue Understated:
    i) Recorded Revenue has not yet been earned
    ii) Revenue that was deferred has not yet been recognized
d) Revenue Overstated:
    i) Payment received before Revenue is earned
    ii) Revenue is recorded before it has been earned

Prepare an Adjusted Trial Balance after all adjustments have been journalized and posted.

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3.3 Depreciation

What is depreciation?

a) An accounting method of allocating the cost of a tangible asset over its useful life
b) The reduction of the value of an asset
c) Only applies to assets with limited lifespans (e.i. Property, Plant, and Equipment, or PP&E)
    i) Do not depreciate land (unlimited useful life)

Journal Entry:

a) Dr. Depreciation Expense
    Cr. Accumulated Depreciation (Contra-asset)

The calculation of depreciation requires:

a) Acquisition Cost
    i) Includes all costs paid to acquire an asset
b) Useful Life of the Asset (estimation)
    i) Expected service life of the asset to the present owner
c) Residual Value (estimation)
    i) Estimated value of a fixed asset at the end of its useful life
d) Net Book Value
    i) Cost of the Depreciable Asset - Accumulated Depreciation

Three Depreciation Methods:

a) Straight-Line Method
    i) Equal portion depreciated in each year of an asset's useful life
    ii) Most companies use straight-line method of depreciation in their financial reports
    iii) **Depreciation Expense = Depreciable Amount/Useful Life**
    iv) **Depreciable Amount = Acquisition Cost - Residual Value**
b) Units-of-Production Method
    i) Depreciation expense is dependent on production or use
c) Double-Declining-Balance Method
    i) Assumes that depreciation expense is higher in the early years of an asset's production life

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3.4 Practice Problems

1. a) Boeing Inc. sold $300 worth of planes to EastJet on October 1. Cash was collected for the sale on November 1. When will revenue be recognized? What is the journal entry?

b) Crosby, who works at EastJet, received a commission for selling a $100 plane on October 2. The commission was paid in full on November 2. When will expense be recognized? What is the journal entry?

2. a) Ronaldo pays $6,000 for a one-year lobster tank insurance with cash on January 1, 2023. Record the journal entry on January 1, 2023.

b) It's Febuary 31, 2024, but Ronaldo got too distracted by his lobsters that he forgot to make the journal entry on December 31, 2023. Record the adjusting journal entry.

c) Did any overstatements or understatements occur when the proper adjusting journal entry was not made on December 31, 2023? If so, what account(s) was/were overstated/understated?

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Chapter 4. Completing the Accounting Cycle

4.1 The Closing Process

Why do we close?

a) Balance Sheet accounts are carried forward to the next period
   - i) Consists of *permanent accounts* (Assets, Liabilities, and Shareholders' Equity)

b) Income Statement accounts are *not* carried forward to the next period
   - i) Consists of *temporary accounts* (Revenues, Expenses, Gains, Losses, Dividends Declared)
   - ii) Close all temporary accounts to establish a 0 balance in each for the next period
   - iii) Transfer net income (or loss) to Retained Earnings

Steps of the Closing Process:

1. Close all revenues and gains to the Income Summary account
2. Close all expenses and losses to the Income Summary account
3. Close the Income Summary account to Retained Earnings
4. Close Dividends to Retained Earnings

4.2 Post-Closing Trial Balance

Post-Closing Trail Balance

a) Prepared after all temporary accounts have been closed
b) Only permanent accounts from the Balance Sheet will appear
c) All temporary accounts from the Income Statement should equal 0
d) Debits should equal Credits
e) Ready to start the process for the next year!

4.3 Balance Sheet Classification

The Balance Sheet includes:

a) Current Assets (converted to cash or used up within one year or firm's operating cycle)
b) Long-Term Investments (investments in stocks, bonds, assets, or notes receivables)
c) Property, Plant, Equipment (PP&E)
d) Intangible Assets (patents, copyrights, goodwill)
e) Current Liabilities (obligations paid within one year or firm's operating cycle)
f) Long-Term Liabilities (obligations paid after one year or firm's operating cycle)

Accounts are ordered by liquidity (how quickly the account can be converted to cash)

Operating Cycle:

a) Average time to turn inventory to cash
b) Usually assumed to be one year

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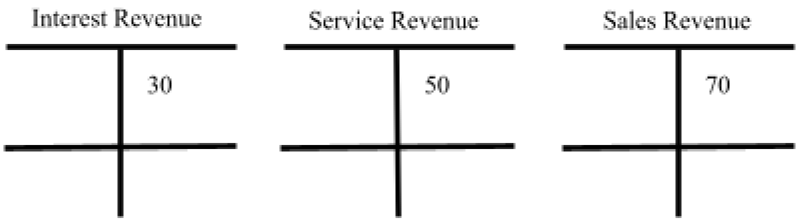
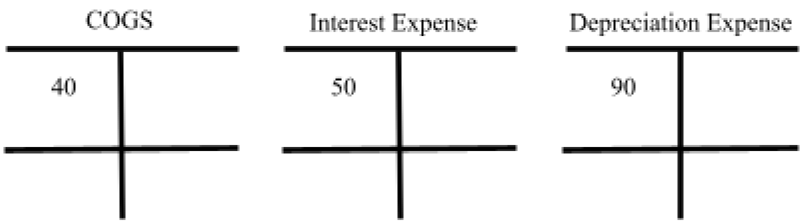
4.4 Practice Problems

1. It's time for Napoleon to close his book. Prepare the closing entries.

a) Prepare the closing entries for Napoleon's Revenue and Gain accounts.



b) Prepare the closing entries for Napoleon's Expense and Loss accounts.



c) Close Napoleon's Income Summary account to Retained Earnings.

d) Close Dividends ($20) to Retained Earnings.

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Chapter 5. Accounting for Merchandising Operations

5.1 Merchandising

Merchandising Companies:

a) Companies that buy and sell products, not services, as their primary source of revenue
b) Retailers (sales to consumer) vs. Wholesalers (sales to retailers)

Inventory (or Merchandise):

a) Tangible products held by the company for sale to customers
b) Current asset on the Balance Sheet
c) Includes all costs to bring inventory to the present location and condition (ex. freight-in)

Inventory Systems:

a) Perpetual inventory system
    i) Inventory movement is constantly being tracked
b) Periodic inventory system
    i) Inventory movement is tracked only at the end of each accounting period

Cost of Goods Sold (COGS):

a) Total direct cost of producing the products in the inventory that were sold to customers

Ending Inventory = Beginning Inventory + Purchases - Cost of Goods Sold

5.2 Operating Cycle

Operating Cycle of a Merchandising Company:

1. Buy Inventory
    a. Freight Costs
    b. Returns and allowances
    c. Discounts
2. Sell Inventory
    a. On credit or cash sale
3. Collect Cash

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5.3 Purchase Discounts, Allowances, and Returns

Perpetual System:

a) Purchase discount

    Dr. Accounts Payable
        Cr. Inventory
        Cr. Cash

b) Purchase Allowance

    Dr. Accounts Payable
        Cr. Inventory

c) Purchase Return

    Dr. Accounts Payable
        Cr. Inventory

Periodic System:

a) Purchase discount

    Dr. Purchase Discount
        Cr. Cash

b) Purchase Allowance

    Dr. Accounts Payable
        Cr. Purchase Allowance

c) Purchase Return

    Dr. Accounts Payable
        Cr. Purchase Returns

The Inventory System is not directly impacted in the Periodic System.

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5.4 Practice Problems

1. Claire bought $4,000 worth of merchandise from Claire's on account to sell at her pottery class.

a) If Claire pays for the $3 delivery cost on account, what is the journal entry for Claire and Claire's?

b) If Claires pays for the $3 delivery cost, what is the journal entry for Claire and Claire's?

c) Claire realized she can't afford her Sauder tuition and must return $70 of Claire's' merchandise. Assuming the perpetual inventory system is used, what is Claire's (not Claire's') journal entry?

d) Claire realized that $1,200 worth of Claire's' merchandise is damaged and wishes to receive an allowance. Assuming the periodic inventory system is used, what is Claire's (not Claire's') journal entry?

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Chapter 6. Inventory

6.1 Inventory Types

Merchandising Company:

a) All inventory is considered merchandise

Manufacturing Company:

a) Finished goods inventory
b) Work in progress
c) Raw materials

6.2 Ownership of Goods

FOB Shipping Point:

a) Buyer pays for freight costs (buyer owns the goods once they are shipped)

FOB Destination:

a) Seller pays freight costs (buyer owns the goods once the delivery has arrived)

Consigned Goods:

a) Inventory is given to another party (consignor) sell, who receives a commission from the sale
b) Consignor does not own the inventory

6.3 Cost Flow Assumptions

First-in, First-out (FIFO):

a) Assumes that the first goods purchased are the first goods sold

Last-in, First-out (LIFO):

a) Assumes that the last goods purchased are the first goods sold

Average Cost:

a) COGS is distributed evenly among the goods

6.4 Additional Equations

Inventory Turnover = Cost of Sales/Average Inventory

a) Shows how many times the average inventory has been produced and sold in a period

Average Days in Inventory = 365/Inventory Turnover Ratio

a) Shows how long the company expects to hold its inventory

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6.5 Practice Problems

1. Chanandler opened a make-up brand. Bloomingdales agrees to act as a consignor for Chanandler. On January 2, Bloomindales sold $800 worth of Chanandler's make-up. Record Bloomindale's journal entry.

2. A gatekeeper wants to opens a candle lighting pop-up stand at the front of their gate. They bought 50 candles at $1 each on Day 1, 60 candles at $2 each on Day 2, and 3 candles at $100 each on Day 3. On Day 4, they sold 70 candles at $10 each.

a) Using FIFO, what is the COGS? What is Ending Inventory Balance?

b) Using LIFO, what is the COGS? What is Ending Inventory Balance?

c) Using the Average Cost Method, what is the COGS? What is Ending Inventory Balance?

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Chapter 8. Accounts Receivable

8.1 Measuring and Reporting Receivables

Types of Receivables:

a) Accounts Receivable
    i) Created when companies sell to customers on open accounts, or are owed for normal credit sales of a product

b) Notes Receivable
    i) Written promises of payment from another party with specific terms

c) Other Receivables
    i) Loan Receivables, etc.

Receivables can be classified as Current (short-term) or Non-Current (long-term).

Scenarios:

a) When revenues and sales are recognized

    Dr. Accounts Receivable
        Cr. Sales Revenue

b) When reduced due to collection on billings

    Dr. Cash
        Cr. Accounts Receivable

c) When reduced due to returns and allowances

    Dr. Sales Returns/Allowances
        Cr. Accounts Receivable

8.2 Uncollectible Accounts Receivable

Bad Dept Expense:

a) Uncollectible balances on Accounts Receivable (recorded on Income Statement)

Accounting for Bad Dept Expense:

a) Direct Method
    i) Record bad dept expense only when the uncollectibles result in a loss

        Dr. Bad Dept Expense
            Cr. Accounts Receivable

    ii) Issues: Does not adhere to the Matching Principle (not allowed by IFRS)

b) Allowance Method
    i) An estimate of the expected amount of bad dept expense is made each period

        Dr. Bad Dept Expense
            Cr. Allowance for Doubtful Accounts (Contra-asset)

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Calculating Bad Debt Expense:

a) Percentage of Credit Sales Method
    i) Usually based on prior credit history
    ii) **BDE = Sales on Account * Historical %**
b) Aging of Receivables Method
    i) Estimation based on the "age" of the receivables (not due, 1-30 days past, 31-60 days past, etc.)
    ii) Necessary to calculate the ending balance of ADA before deriving the BDE

8.3 Notes Receivable

Characteristics:

a) Written promise
b) Total amount of money loaned
c) Parties involved (Maker and Payee)
d) Maturity date
e) Applicable interest

Maturity Date Types:

a) On Demand
b) On a Stated Date
c) At the End of a Stated Period

Interest = Face Value of Note * Annual Interest Rate * Time in Terms of One Year

Valuation of Notes Receivable:

a) Honoured
    i) Determine value for the total cash received at the maturity date
b) Dishonoured/Defaulted
    i) Cannot be repaid by maturity date, but collection is still anticipated; reclassify from Note Receivable to Accounts Receivable
    ii) Not expected to be collected; write-off the Notes Receivable and its interests

8.4 Other Receivables Equations

Receivables Turnover = Net Credit Sales/Average Net Accounts Receivables

a) The number of times average receivables are recorded and collected during the year

Average Collection Period = 365/Receivables Turnover

a) Average time it takes for a customer to pay its accounts

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8.5 Practice Problems

1. a) Binotto decided he has too much physical cash, so he went to the local petting zoo and bought Laughing Cow Energy Drinks at a value of $1,000 from Horner and received a 5% discount on his purchase. Record the journal entry for Horner.

b) Binotto returned $2 worth of Laughing Cow Energy Drinks to Horner. Record the journal entry for Horner.

2. Homer and Marge Inc. has a net credit sale of $8,000. It uses the Percentage of Credit Sales bases and estimates that 1% of its net credit sales will be uncollectible. What is the estimated bad debt expense? Record the journal entry.

3. Hormer and Co. has a net credit sale of $4,000, cost of goods sold of $5,300, average net accounts receivables of $3,400, and net income of $2,500,800. What is its receivables turnover?

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