



COMMERCE 293

Intro to Financial Accounting

Midterm Review Package

Tutor: Richard Wong

1. Introduction

2. Financial Statements

3. Financial Statement Assumptions & Constraints

4. Basic Journal Entries, Adjustments, and Corrections

5. Revenue Recognition and Sales Discounts

6. Inventory

7. A/R, ADA, and Bad Debt

Section 1: Introduction

Richard Wong, BCom 2014, Accounting and HR

- Past Teaching Assistant - COMM 293
- Past President, UBC Accounting Club / UBC TACS
- Pursuing the 'opportunity of a lifetime' at PwC

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

Guest Services Assistant Manager, CLC Assistant, Parker, Usher, Field Surveyor, Marketing Assistant, Bookstore Sales Clerk

Section 2: Financial Statements

The two most fundamental equations of financial accounting:

$$\begin{array}{c} \text{_____} = \text{_____} + \text{_____} \\ \text{_____} = \text{_____} \end{array}$$

Assets:

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

Examples: _____

Liabilities:

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

Examples: _____

Shareholders' Equity:

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

Examples: _____

When you..	Total Assets	When you..	Total Liab.
DR an Asset		DR a Liab.	
CR an Asset		CR a Liab.	

Question #1. Asset, Liability, or Shareholders' Equity?

Cash	Asset	Liability	Shareholders' Equity
Common shares	Asset	Liability	Shareholders' Equity
Retained earnings	Asset	Liability	Shareholders' Equity
Prepaid expenses	Asset	Liability	Shareholders' Equity
Income tax payable	Asset	Liability	Shareholders' Equity
Goodwill	Asset	Liability	Shareholders' Equity
Advertising expenses	Asset	Liability	Shareholders' Equity

Types of Financial Statements:

1. _____ (Statement of Financial Position)

- $\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$

Bread Pitt	
as at December 31, 2014	
Assets	Liabilities
Cash	Accounts Payable
Building	Bonds Payable
Equipment	Shareholders' Equity
Inventory	Common Shares
	Retained Earnings
Total Assets	Total Liabilities and Shareholders' Equity

2. _____ (Statement of Comprehensive Income)

- $\text{Revenues} - \text{Expenses} = \text{Net Income}$

Bread Pitt	
as at December 31, 2014	
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

Bread Pitt	
as at December 31, 2014	
Retained earnings, January 1	
Net income	
Dividends	
Ending Retained earnings, December 31	

4. _____

- Cash flows from Operating, Investing, and Financing activities
 - Operating: Day to day business activities (ex. A/R collection)
 - Investing: Purchasing / selling of assets (ex. Equipment)
 - Financing: Using / reducing debt / equity (ex. Stock issuance)

Question #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: Financial Statement Assumptions & Constraints

Assumptions, Principles, and Characteristics

- _____ - Transactions of the company are separate from the owner's personal transactions.
- Unit of Measure - The Canadian dollar is used to value items on the financial statements.
- _____ - What you originally paid for it.
- _____ - What a rational, unbiased person is willing to pay for it.
- Going Concern - Company will not _____ in near future.
- _____ - If relevant, you must tell people.
- Reliability - Must use most reliable information.
- Periodicity - Statements will be prepared at least _____.
- _____ - Same in different countries.
- Prudence / Conservatism - Be conservative and cautious.

- _____ - Expenses and revenues incurred together.
- Revenue Recognition - Recognize revenue when work is done/product is delivered, collectability is ensured, and future costs can be estimated with reasonable assurance.
- _____ - Don't hide anything.

Constraints of Financial Statements

1. _____ - Information should only be prepared if the perceived benefits exceed the costs.
2. _____ - Only care if amount is significant.

Question #3. Which one 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.

Question #4. Why do we not produce financial statements on a daily basis?

Question #5. 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: Basic Journal Entries, Adjustments, and Corrections

The Three Golden Rules of J/E

1. _____ = _____
2. Always _____ expenses
3. Always _____ revenues

...UNLESS YOU ARE MAKING AN ADJUSTING / CORRECTING ENTRY.

What do I debit and what do I credit?

Think of debits as what I'm RECEIVING.
Think of credits as what I'm GIVING UP.

Question #6. Florist Gump is a floral boutique in Richmond, BC. Florist Gump engaged in the following transactions in 2014:

- 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. Flora, the CEO, used company funds to pay \$2,000 of personal property taxes in April.

	Debit	Credit

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

	Debit	Credit

e. Florist Gump paid \$4,000 to suppliers on account on June 15th.

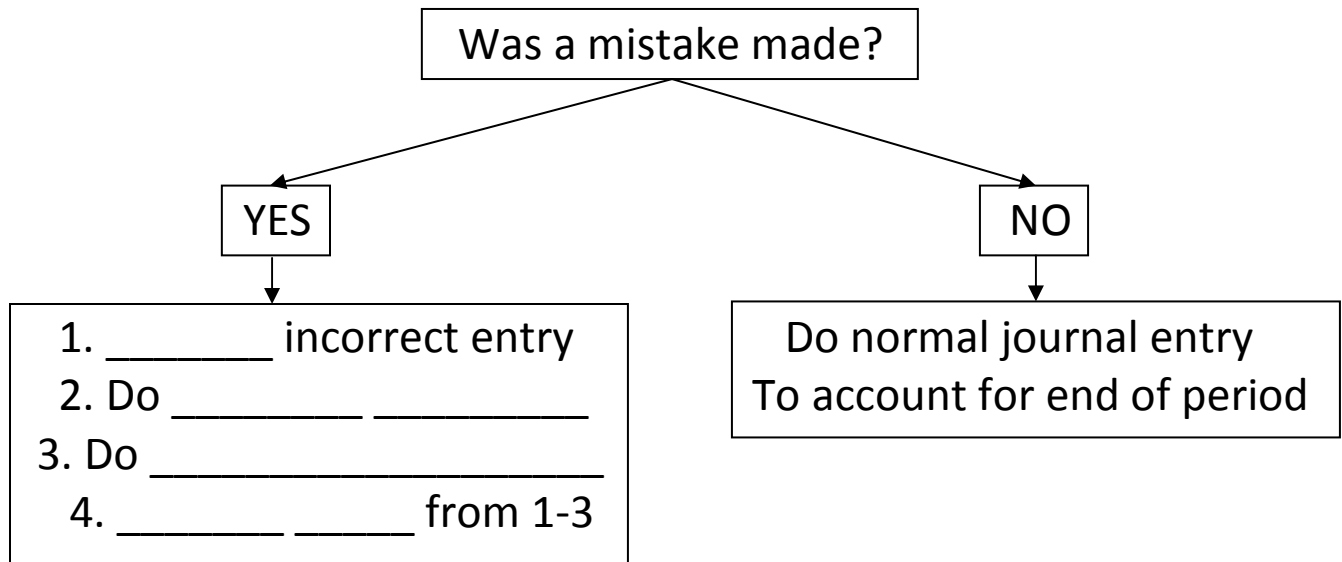
	Debit	Credit

f. 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

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

Adjusting and Correcting Entries



Question #7. 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, 2014.

- a. The Merchant of Tennis purchased a 2-year insurance policy on July 1st, 2013. 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

b. 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

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

	Debit	Credit

Section 5: Revenue Recognition and Sales Discounts

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.

Question #8. Spruce Springsteen Inc. produces industrial lawnmowers for arenas and stadiums in the Lower Mainland. On July 1, 2014, 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, 2014.

	Debit	Credit

Sales Discounts

2/10, net 30.

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

Journal Entry with Discount

DR. _____
DR. _____
CR. _____

Journal Entry without Discount

DR. _____
CR. _____

Section 6: Inventory

Inventory: Tangible items that are...

- Held for sale by a business OR
- Used to produce goods for sale by a business.

Inventory is a _____ asset as it is generally used within 1 year.

Inventory is displayed on financial statements through:

- _____ on the Balance Sheet
- _____ on the Income Statement

Cost of Goods Sold ("COGS"): Cost of inventory sold by your business

1. Is an _____ and is therefore **ALWAYS** _____

Two ways to calculate:

Number of goods sold x Per Unit Cost = COGS

Beginning Inventory + Purchases - Ending Inventory = COGS

3 Inventory Costing Methods:

1. Specific Identification

- Each item is individually identified and recorded
- Used primarily for _____ items

2. First in, First Out (FIFO)

- Earliest goods purchased are the _____ goods sold

3. Weighted Average

- COGS is based on the average cost per unit.

If unit costs are rising...

- FIFO provides the _____ cost of goods sold, the _____ net income / gross profit, and the _____ ending inventory.

If unit costs are declining...

- FIFO provides the _____ cost of goods sold, the _____ net income / gross profit, and the _____ ending inventory.

Question #9. The Codfather is a fish market based out of Seattle, Washington.

On January 1, they purchased 10 pink salmon for \$5 each. (Fish #1-10)

On January 5, they purchased an additional 10 pink salmon for \$8 each. (Fish #11-20)

On January 10, they purchased an additional 10 pink salmon for \$10 each. (Fish #21-30)

On January 12, a customer purchased 15 pink salmon from the Codfather for \$20 each (They chose fish #1-10, 11-14, and 21 - The customer felt that there was something fishy about #15-20).

Required: What is the gross profit of the Codfather under each of the inventory costing methods?

Specific ID

FIFO

Weighted Average

2 Inventory Systems:

1. Periodic

- Company physically counts inventory remaining @ end of period
- Not as up to date, but easier and cheaper

PURCHASES: Involve DR. a temporary account - “_____”

REVENUES: Recorded at time of sale

COGS: Recorded after inventory count is completed

Purchases: *DR. Purchases* *CR. Accounts Payable*

Sale to Customer: *DR. Accounts receivable* *CR. Sales revenue*

After Inv. Count: *DR. Cost of goods sold / Inventory* *CR. Purchases*

2. Perpetual

- Inventory record adjusted after each transaction (purchase / sale)
- Up to date, used for big companies

PURCHASES: Involve DR. a balance sheet account - “ _____ ”

REVENUES: Recorded at time of sale

COGS: Recorded at time of sale

Purchases: DR. Inventory CR. Accounts Payable

Sale to Customer: DR. Accounts receivable CR. Sales revenue

DR. Cost of goods sold CR. Inventory

Inventory Turnover (Average inv = (This year + Last year) / 2)

$$365 \div \frac{\text{Cost of goods sold}}{\text{Average inventory}} = \text{Inventory Turnover (in days)}$$

Question #10. Hairanoia sells industrial-strength hairdryers to professional hairdressers. They began the 2013 fiscal year with \$4,500 in inventory.

On March 5, 2013, Hairanoia purchased \$5,000 of inventory on credit.

On May 9, 2013, Hairanoia sold 10 hairdryers to Shear Madness for \$4,500. The client paid in cash. The inventory cost the company \$300 per unit.

a. Assuming that Hairanoia uses a **perpetual** inventory system, record the J/E for March 5.

b. Assuming that Hairanoia uses a **perpetual** inventory system, record the J/E for May 9.

c. Assuming that Hairanoia uses a **periodic** inventory system, record the J/E for March 5.

d. Assuming that Hairanoia uses a **periodic** inventory system, record the J/E for May 9.

Section 7: ADA and Bad Debt

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 ADA

Beginning ADA
+ _____
- _____
+ _____
= Ending ADA

Calculate ending A/R

Beginning A/R
+ _____
- _____
+ _____
+ _____
= Ending A/R

Question #11: 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, 2014:

Accounts receivable, gross (1/1/2014)	\$ 500,000
Allowance for doubtful accounts (1/1/2014)	65,000
Total sales in 2014	1,000,000
Payments on account received from customers	52,000
Write-offs of accounts receivable	80,000
Recoveries of bad debts during 2014	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, 2014, 50% of gross accounts receivable are current.

Part A:

Determine the December 31, 2014 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, 2014 balance of “Allowance for Doubtful Accounts” if the company uses the aging method.