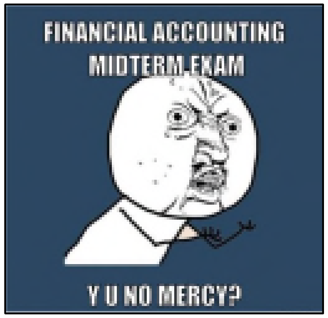
COMM 293 Review Session

By Richard Wong, BCom '14

Wednesday, October 14, 2015
6:30 PM – 8:30 PM



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========== BREAK ==========

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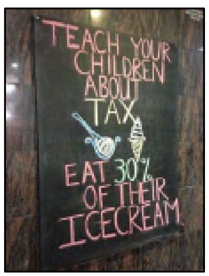
I. INTRODUCTION

Richard Wong, Sauder BCom '14
Accounting and Human Resources

- Past Teaching Assistant – COMM 293

- Past President, UBC Accounting Club / UBC TACS

- Currently pursuing my CPA designation as a Senior Associate with PwC Tax!



- Just wrote the CFE!

II. FINANCIAL STATEMENTS

The two most fundamental equations of financial accounting:

__________ = __________ + __________

__________ = __________

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: ______________________________

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Shareholders' Equity

- Difference between total assets and total liabilities.

Examples: ____

Summary

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

Question #1. Is it an asset, liability, or shareholders' equity account?

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)
   - Assets = Liabilities + Shareholders' Equity

Bread Pitt

as at December 31, 2015

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)
   - Revenues - Expenses = Net Income

Bread Pitt

For the year ended December 31, 2015

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

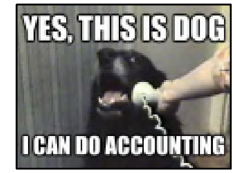
Bread Pitt
as at December 31, 2015
Beginning Retained Earnings, January 1
Net Income
Dividends
Ending Retained Earnings, December 31

4. _________________________ (Statement of Cash Flows)

- Cash flows from operating, investing, and financing activities.
  - Operating: Day to day business activities (ex. Collection of accounts receivables).
  - Investing: Purchasing / selling of assets (ex. Equipment).
  - Financing: Using / reducing debt / equity (ex. Stock issuance).

Question #2. How are the balance sheet, income statement, and statement of retained earnings connected?

Question #3. 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?



III. ACCRUAL ACCOUNTING CONCEPTS

The Three Golden Rules of J/E

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

…UNLESS YOU ARE MAKING AN ADJUSTING / CORRECTING ENTRY.

<u>What do I debit and what do I credit?</u>

Think of <u>debits</u> as what I'm <u>RECEIVING</u>.
Think of <u>credits</u> as what I'm <u>GIVING UP</u>.

<u>Question #4</u>. Florist Gump is a floral boutique in Richmond, BC. Florist Gump engaged in the following transactions in 2015:

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

<u>Required</u>: Prepare a journal entry to reflect each of these events so Flora, the CEO, will "leaf" you alone.

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.

Question #5. 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, 2015. The Merchant of Tennis is counting on you to be "audit" you can be.

a. The Merchant of Tennis purchased a 2-year insurance policy on July 1st, 2014. On this date, it debited insurance expense by $40,000 and credited cash. No other entries pertaining to insurance have been made until today.

What was the error?: ____

	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.

What was the error?: ____

	Debit	Credit

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

What was the error?: ____

	Debit	Credit

IV. MERCHANDISING OPERATIONS

Revenue Recognition Criteria

Revenue and costs must be recognized when:

1. Risks and rewards of ownership have been __________ to the buyer.
2. The seller does not _______ the asset or have any ___________ over it.
3. The amount of revenue can be measured ___________.
4. Collectability is reasonably ___________.
5. Costs can be measured _____________.

Long-Term Contracts

2 methods of recognizing revenue:

1. % of Completion Method = Recognize same % of costs and revenues.
   - Why?: ______________________________.
   - Outcome of contract and stage of completion must be reliably measurable.
2. Completed Contract Method: Recognize revenues and expenses at completion.
   - Used if outcome of contract or stage of completion cannot be reliably measurable.
   - Not permitted under IFRS.

Question #6. Spruce Springsteen Inc. produces industrial lawnmowers for arenas and stadiums in the Lower Mainland. On July 1, 2015, 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, 2015.

	Debit	Credit

Sales Discounts

"2/10, net 30"

If you pay within 10 days, 2% discount.

Balance due in 30 days.

Journal Entry When Item is Sold

DR. Accounts receivable XX
    CR. Sales revenue XX

DR. Cost of goods sold XX
    CR. Inventory XX

Journal Entry If Item is Paid For Within 10 Days (Discount Applicable)

DR. ____________________ XX
DR. ____________________ XX
    CR. ______________________ XX

Journal Entry If Item is Paid For After 10 Days (No Discount)

DR. ____________________ XX
    CR. ______________________ XX

5-10 MINUTE BREAK!
Please complete the CMP Survey!

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V. 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
- 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

Inventory Costing Methods

1. Specific Identification (Specific ID)
   - 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.

High-Level Summary

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.

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Question #7. 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 (revenues – costs) of the Codfather under each of the inventory costing methods?

Specific ID	FIFO	Weighted Average

Inventory Systems

1. Periodic

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

Recognition:

- Purchases: Involve a debit to a temporary account - "___________".
- Revenues: Recorded at time of sale.
- COGS: Recorded after inventory count is completed.

Journal Entries:

Purchases:	DR. Purchases CR. Accounts Payable
Sale to Customer:	DR. Accounts Receivable CR. Sales Revenue
After Inv. Count:	DR. Cost of Goods Sold DR. Inventory CR. Purchases

2. <u>Perpetual</u>

- Inventory record adjusted after each transaction (purchase / sale).
- Up to date. Used by big companies.

<u>Recognition</u>:

- <u>Purchases</u>: Involve a debit to a balance sheet account - "___________".
- <u>Revenues</u>: Recorded at time of sale.
- <u>COGS</u>: Recorded at time of sale.

<u>Journal Entries</u>:

Purchases: *DR. Inventory*
CR. Accounts Payable

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

DR. Cost of goods sold
CR. Inventory

<u>Inventory Turnover</u>

$$\boxed{365 \div \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \text{Inventory Turnover (in Days)}}$$

* Average inventory = (This Year + Last Year) / 2

<u>**Question #8**</u>. Hairanoia sells industrial-strength hairdryers to professional hairdressers. They began the 2015 fiscal year with $4,500 in inventory.
On March 5, 2015, Hairanoia purchased $5,000 of inventory on credit.
On May 9, 2015, 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 journal entry for March 5.

	Debit	Credit

b. Assuming that Hairanoia uses a **perpetual** inventory system, record the journal entry for May 9.

	Debit	Credit

c. Assuming that Hairanoia uses a **periodic** inventory system, record journal entry for March 5.

	Debit	Credit

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

	Debit	Credit

VI. INTERNAL CONTROLS AND CASH

Bank reconciliations tie the cash amount in the company's books to the cash amount in the bank.

Why Perform a Bank Reconciliation?

1. Identify bookkeeping errors.

2. Seek and resolve discrepancies.

3. Contribute to the company's internal controls.

How Do I Perform a Bank Reconciliation?

Perform both a "Bank to Books" AND "Books to Bank" Reconciliation. Both must end up with the same "Adjusted Cash Balance".

Bank to Books

1. Start with the bank's cash balance!

2. Adjust for transactions that the bank has not yet recorded to find the "Adjusted Cash Balance".

+ (Adding)	**- (Subtracting)**
Deposits in Transit (Deposits made on a weekend when the bank was closed.)	Outstanding Cheques (Cheques already written, but have not yet been cashed.)
Bank Errors (Arithmetic Errors, Clerical Errors)	

Books to Bank

1. Start with the company's cash balance!

2. Adjust for transactions that affect cash that have not yet been recorded in the company's books to find the "Adjusted Cash Balance".

+ (Adding)	- (Subtracting)
Interest Earned in Bank Account	Bank Charges Not Yet Recorded in Books
	NSF Cheques* (Bounced Cheques)
Company Errors (Arithmetic Errors, Clerical Errors)	

* NSF is short for "not sufficient funds" and refers to "bounced cheques". When the company receives a cheque, it assumes that the customer has paid and increases its cash balance (DR. Cash / CR. A/R). When it discovers that the customer's cheque has bounced, the company must reduce its cash balance and

re-increase its A/R balance (DR. A/R / CR. Cash). Therefore, to reconcile the cash on the company's books with that of the bank's statement, we must reduce the company's books for the amount of the NSF cheque.

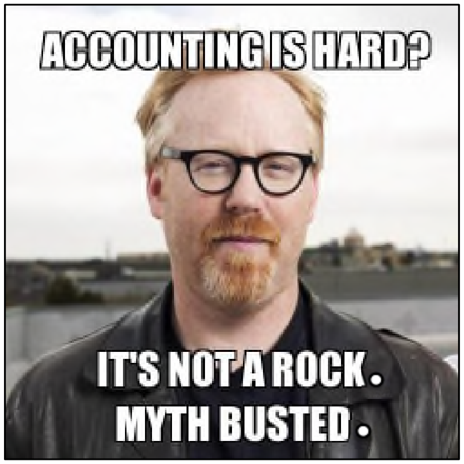
Example: Bread Pitt sells an industrial oven to the Pie Piper for $2,000.

DR. Accounts Receivable	2,000	
CR. Sales Revenue		2,000

Pie Piper pays Bread Pitt by cheque.

DR. Cash	2,000	
CR. Accounts Receivable		2,000

If the cheque bounces, Bread Pitt's cash balance is overstated by $2,000 (they did not receive the payment they thought). To reconcile this, it must decrease its cash balance by $2,000 to match that of the bank's statements.



VII. ACCOUNTS RECEIVABLE

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 #9: 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, 2015:

Accounts receivable, gross (1/1/2015)	$ 500,000
Allowance for doubtful accounts (1/1/2015)	65,000
Total sales in 2015	1,000,000
Payments on account received from customers	52,000
Write-offs of accounts receivable	80,000
Recoveries of bad debts during 2015	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.

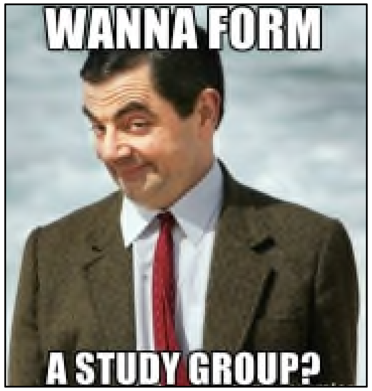
As at December 31, 2015, 50% of gross accounts receivable are current.

Question 10a. Determine the December 31, 2015 balances in "Bad Debts Expense" and "Allowance for Doubtful Accounts" if the company uses the percentage of credit sales method.

Question 10b. Determine the December 31, 2015 balance of "Allowance for Doubtful Accounts" if the company uses the aging method.

VIII. GENERAL ADVICE

- Practice, practice, practice. Don't just memorize!
- Redo any in-class practice problems.
- Do relevant textbook questions.
- Read relevant textbook sections.
- Form a study group?



If all else fails, stick to the basics…

- **Debits = Credits**
- **Assets = Liabilities + Shareholders' Equity**
- **The various types of financial statements are connected through retained earnings.**