commerce
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CMP

COMM 293

MIDTERM REVIEW SESSION

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Section 1: Accounting Basics

Accounting Equation:

- Assets = Liabilities + Shareholder's Equity
- Must always be balanced

Balance sheet components

Assets:

- Under control of entity
- Result from past business events/transitions
- *Inflow* of future economic benefits must be probable
- Historical cost principle: recorded at historical cost when asset is purchased
- Examples: _________, ___________________________, __________________,

  __________________, _________, ____________

Liability:

- Debts or firm obligations
- Result from past business events/transactions
- *outflow* of future economic benefits must be probable
- Examples: ____________________, ____________________,

  ____________________, ____________________

Shareholders' Equity

- What's left over after subtracting total liabilities from total assets
  1) Contributed capital: permanent investments by shareholders determined by number of shares outstanding
  2) Retained earnings: amount earned but not yet distributed to shareholders

     Beginning RE + _____________ – _____________ = ending RE

  3) Others

Financial statements

Balance sheet:

- Reports amount of assets, liabilities, and shareholders' equity of an entity
- Financial ____________ at a ________at time
- Organization: current and non-current / in order of liquidity

Statement of comprehensive income / income statement:

- Reports revenue less expenses
- Financial ____________ over a ________ of time

Statement of changes in equity / retained earnings statement:

- Provides information on ________________________over a ________of time

Statement of cash flows:

- Accrual accounting reflects economic events when they happen rather cash exchanges (revenue ≠ cash collected)
- Reports inflows and outflows of cash over a ________ of time
- Three components:
  1) Operating activities
  2) Investing activities
  3) Financing activities
- Two formats:
  1) Direct method
  2) Indirect method

Income statement components

Revenue:

- The earnings that a business has from sales of goods or services
- Results in ________ in equity

Expenses:

- Outflows or depletions of assets or incurrence of liabilities
- Results in ________ in equity

ʕ •ᴥ•ʔpractice - classify accounts

Accounts receivable

Allowance for doubtful accounts

Building

Accumulated depreciation

Notes payable

Unearned revenue

Prepaid expenses

Common shares

Sales revenue

Retained earnings

Tax expenses

Goodwill

Cost of goods sold

Accounting standard used in Canada:

- public entities: must use ________ (International Financial Reporting Standards) set by ________ (International Accounting Standards Board)
- private entities: use ________ *or* ________ (Accounting Standards for private Enterprises)

Disclosure Process:

- annual reports: financial statements + MD&A
- press releases
    - quarterly reports
    - others

Section 2: Accounting Cycles

The Accounting Cycle:

1. journalize transactions (**journal entries**)
2. post transactions to the general ledger (**T-account**)
3. trial balances (**debits = credits**)
4. adjusting journal entries
5. adjusted trial balance
6. prepare financial statements
7. closing journal entries
8. post-closing trial balance

Journal Entries – Debits & Credits:

- increase in asset:
- increase in liability:
- increase in common stocks:
- increase in revenue:
- increase in expense:
- increase in gain:
- increase in loss:
- increase in dividends:

DEAD rule: debit expenses, assets, dividends

T-account:

- After journal entries are prepared, post dollar amounts to each account affected by the transaction
- normal balance: debit accounts have debit balances & credits accounts have credit balances

Double-entry accounting systems:

- at all times, the debit movements must _______________ credit movements in the accounts
- each transaction affects at least ________ accounts

Recognizing revenue and expenses

- use accrual accounting according to GAAP – recorded as incurred
- **revenue recognition principle**: revenues must be recorded when earned, regardless of when cash is received
- **expense recognition / matching principle**: costs incurred to generate revenue should be recognized as expenses in the period that revenue is recognized, regardless of when cash is paid

Adjusting Entries:

Deferrals:

- prepaid expenses: expenses paid in cash ________ *they* are used or consumed; ________ account
- unearned revenues: cash received ________ services are performed; ________account

Accruals:

- accrued revenues: revenues for services performed but ________ received in cash
- accrued expenses: expenses incurred but ________ paid in cash

ʕ •ᴥ• ʔ**Practice – prepaid expenses**

Journalize the transactions:

January 1: company pre-pays the full year of rent for $120,000

Every month end, company records rent expense

ʕ •ᴥ•ʔPractice – unearned revenue

Journalize the transactions:

A property management company receives full-year rental payments of $120,000 in advance from a tenant.

Every month end, company records revenue

<u>Depreciation:</u>

- allocating the cost of a tangible assets over its useful life
- accumulated depreciation: contra asset account; credit account
- book value = _________________ – _________________________

<u>Closing entries:</u>

- balance sheet accounts are permanent accounts
- income statement accounts are temporary account
- must close out all temporary accounts to have zero balance at the period end
- four-step process:
  1) close all revenues and gains to _________________
  2) close all expense and losses to _________________
  3) close the income summary account to _________________
  4) close dividends to _________________

ʕ •ᴥ• ʔ**Practice - Accounting Cycle**

ABC Company prepares financial statements on a monthly basis. At the beginning the June 2019, the company had the following account balances. Prepare T-accounts for June.

Cash $ 2,800
A/R $4,600
Equipment $3,600
Accumulated depreciation $1,300

Taxes payable $1,500
Common shares $100
Retained earnings $8,100

Some additional information about ABC for the month of June:

1. **On June 15, the company paid the $1,500 taxes owing**
2. **On June 22, the company collected $3,500 on A/R**
3. **On June 25, the company billed a client for $5,000 plus $600 tax for services provided in the month of June; $600 is collected on behalf of government**

Journalize transactions and update the T-accounts.

The computer equipment was purchased for $3,600 and is being depreciated over 36 months on straight-line basis. Record depreciation expense at end of the period. Prepare Journal entry and update the T-accounts.

Prepare trail balance

Close out the temporary accounts to RE and update T-accounts.

balance sheet classification:

- assets:
    - current assets (expect to convert to cash within one year or its operating cycle): ____________, ____________, ____________

- long-term investments: ____
- Property, plant, and equipment (PP&E): ___________, ___________, ___________
- Intangible assets: ___________, ___________, ___________

- liabilities & SE:
  - current liabilities (paid within one year): ________________, ________________, ________________
  - long-term liabilities (paid after one year): ________________, ________________, ________________
  - shareholders' equity
- operating cycle: the average time to turn inventory to cash

<u>Multi-step income statement:</u>

- Net sales
  <u>- COGS</u>
  =
  <u>- operating expenses</u>
  =
  - interests
  <u>- taxes</u>
  =

Section 3: Inventory

<u>Two inventory systems:</u>

- perpetual: continuous tracking

  pros:

  1)

2)
3)
4)
cons:
1)
2)

- periodic: calculated at period end

  pros:
  1)

  cons:
  1)
  2)

<u>Journal Entries – Inventory:</u>

purchase inventory		
sales of goods		For period inventory system, COGS is recorded at period end instead of time of sale
transportation costs buyer incurs		consider as part of costs of purchasing inventory
transportation costs seller incurs		

purchase discount		Due to early payments; reduces cost of inventory
Purchase allowance		Due to incorrect or defected item; reduces cost of inventory Not physically returned
Purchase returns		reduces cost of inventory physically returned
Returns and allowance from the perspective of seller		contra-rev account

ʕ •ᴥ• ʔPractice – account for inventory transactions

Journalize the following transactions

Cash purchases of inventory, $3,900

Sale on account (including credit cards), $19,400

Cost of goods sold (perpetual inventory system), $4,200

Collections on account, $18,900

Purchase discount:

- 2/10, n/30

  Meaning: the buyer can get a _____ cash discount if it pays cash in _____ days.

  Otherwise, the buyer must pay the net amount in _____ days

- Cash discount = __________* __________

COGS:

- Beginning inventory

  + new purchases (net of allowance, discount, returns)

  =

  - ending inventory

  =

Ownership of goods

- FOB shipping point: title and responsibility of goods transfer from seller to

  buyer ____________________________________

- FOB destination: transfer from seller to buyer

  ____

Inventory cost components:

- Inventory: goods that a business holds for sales purpose
- Cost of inventory: whatever costs directly related to inventory
- Cost of purchased inventory: ______________+ ______________–

  ______________ – ______________

Inventory cost flow assumptions:

- Specific identification:
  - Tracks specific costs with specific goods
  - Usually for expensive or unique goods
  - Requires very detailed information, thus very expensive
- First-in, first-out (FIFO)
  - Assume the earliest goods purchased are the first to be sold
  - The ______________ are first recognized as COGS
- Last-in, first-out (LIFO)
  - Assumes the latest goods purchased are the first to be sold
  - The ______________ are first recognized as COGS
- Weighted average cost method

  Three-step process:

  1) Average cost per unit = $COGAS / #units AS
  2) $COGS = ______________ * ______________
  3) $ending inventory = ______________* ______________

ʕ •ᴥ• ʔPractice – cost flow assumptions

The following shows ABC company's inventory records on Oct 31, 2018

10/1 beginning inventory 100 units @ $9.2 =

10/15 purchase	**700 units @ $10 =**
10/26 sale	**600 units @ $20 =**

The company operating expenses throughout the year of a total is $3,000, and the company is not subject to income taxes. Prepare income statement at year end under weighted-average and FIFO assuming periodic system is used.

<u>Effects of cost flow choice & implications:</u>

- In periods of rising prices, LIFO results in higher COGS and lower ending inventory, and thus results in lower net income and lower income taxes
- Incentives for choosing one method over another:
  - Net income effects: prefer to report higher earnings
  - Income tax effects: prefer to pay less taxes
- IFRS prohibits the use of LIFO
- Average-cost method always have results between FIFO and LIFO

<u>Financial statement analysis – inventory turnover:</u>

- Inventory turnover =

____

- Average inventory = ____
- how many times average inventory sold and replaced during a period
- in general, the higher the better

- average days in inventory = _____________________________
- indicated how long inventory is expected to be held by company
- in general, the lower the better

inventory valuation – lower of cost or market (LCM):

- if the market value is lower than original cost, conservatism dictates

  ____

- a previous written down ______ be reversed under IFRS
- write up ______ allowed

Section 4: Internal Control

The Fraud Triangle:

- ___________ & : ______________ & ______________

Internal Control:

- processes by which the company provide reasonable assurance regarding reliability of the company's financial reporting, the effectiveness and efficiency of its operations, and its compliance with applicable laws and regulations
- related regulation: ________ (US) & ________ (Canada)
- 6 principles:
  1) Establish of responsibility
  2) Segregation of duties
  3) Documentation procedures
  4) Physical controls
  5) Independent internal verification
  6) Human resource controls

- Accounts that are more susceptible to fraud: _________, ___________________

Section 5: Accounts Receivables

Recognizing & Recording Receivables:

Sales made	
Collections on bills	
Returns and allowances	
Sell A/R	

Bad debt expenses:

In the same period of sales made		An estimate *contra-A/R account
When an account determined as uncollectible		
When a previously written-off account becomes collectible		

- _________ – _________ = net realizable value of A/R
- Two methods of estimating the amount of bad debt expense:
  - Percentage of credit sales method: _________________* ________________
  - Aging of A/R method: expected value according to _____________________

  ____

ʕ •ᴥ• ʔ**Practice – ADA**

Journalize the following transactions:

1. **Credit sales $100,000**

2. **The company estimates that 3% of the credits sales are uncollectible**

3. **Cash collections $93,700**

4. **Write-offs of uncollectables, $1,800**

Financial statement analysis – receivables turnover:

- Receivables turnover = ___________________________________
- How many times average receivables are recorded & collected during the year
- In general, the higher the better
- Average collection period = ___________________________________
- The average time it takes a customer to pay its accounts
- In general, the shorter the better