

ASA ACCOUNTING 217 MIDTERM REVIEW SESSION

Chapter 5

NOTE: As GST is testable later in the course, this topic will not be explored in this course guide

Freight Costs:

Freight costs are a common topic on exams and need close attention as there are different accounting treatments depending on whether the costs are attributable to the buyer or the seller.

FOB shipping point = BUYER is responsible for the freight costs, as they are responsible from the shipping point.

FOB Destination = SELLER is responsible for delivering the goods to the destination, therefore they are responsible for the costs.

What to record:

	Buyer Side:	Seller Side
FOB Shipping point	DR: Inventory XXX CR: Cash XXX	No entry
FOB Destination	no entry	DR: Freight out XXX CR: Cash XXX

For the buyer, the freight costs are added to the cost of the inventory. For sellers using FOB shipping, the freight is an operating expense, therefore, it does not affect the value of the inventory.

Purchase/Sales Discounts

If a company wants to improve the time it takes for their customers to pay back their accounts receivables, they may use discounts on their account sales. They are added as terms to the receivable, such as: 5/15, n/30. If the buyer pays off their payable within the specified time, they receive a discount. Otherwise, they pay the regular amount. For example, for the terms given, the buyer would receive a 5% discount if they paid back before 15 days. If they paid after that period, they would pay the regular amount.

Buyer Side	Seller Side
<i>Initial entry</i>	<i>Initial entry</i>
Dr: Inventory XXX CR: Accounts Payable XXX	DR: Accounts Receivable XXX Sales Revenue XXX
 <i>1. Within the discount range</i>	 <i>(1) The buyer takes the discount</i>
DR: Accounts Payable XXX CR: Cash XXX (AP - Inventory) CR: Inventory XXX (AP* Discount %)	DR: Cash XXX DR: Sales Discount XXX CR: Accounts Receivable XXX
 <i>2. Outside of the discount range</i>	 <i>(2) The buyer does not take the discount</i>
DR: Accounts Payable XXX CR: Cash XXX	DR: Cash CR: Accounts Receivable

As seen in the above chart, the buyers side will simply account for the discount by crediting the inventory, thereby reducing the inventory account by the value of the discount. For the seller, they instead create a contra account called "Sales Discount."

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Example 5-1

On Feb 5, 20X1, Anderson Sporting Goods purchases 45 new bikes on account from Arthur's Bike Inc. for \$205 each with terms 3/15, n/45. Freight costs on the purchase are \$38. Assume that Arthur's Bikes use FOB shipping point. Record the journal entries Arthur's Bike Inc. would record if Anderson Sporting Goods pays off their payable on Feb 10. What would you record if instead they pay off the payable on Feb 28, 20X1 and the terms of the freight costs was FOB Destination?

Example 5-2

Repeat Example 5-1 from Anderson Sporting Good's perspective.

Purchase/Sales returns

If a customer is unhappy with the goods purchased they may request a return. As the buyer, you are reversing the amounts that were returned. Therefore, the Accounts payable or cash that you previously recorded needs to be reversed by the amount that you returned. The seller side may be a bit more confusing, as you also need to adjust the inventory and COGS based on the original cost of the goods that were returned.

Note that forgetting to adjust the inventory is one of the most common mistakes made when doing one of these questions.

<u>Buyer Side</u>		<u>Seller Side</u>	
Dr. Accounts Payable	XXX	DR: Sales Returns and allowances	XXX
CR: Inventory	XXX	CR: Accounts Receivable	XXX
		DR: Inventory	XXX
		CR: COGS	XXX

Example 5-3

William's Watches sells 250 watches costing \$100 each to Samuel's Department Store for \$150 per watch on Jan 5, 20X1. Freight costs are \$35. On Jan 10, 20X1, Samuel's Department Store returns 20 defective watches. William's watches uses FOB Destination. Record the journal entries that Samuel's Department store would make on both Jan 5, 20X1 and Jan 10, 20X1.

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Example 5-4

Repeat example 5-3 from the William's Watches perspective.

Chapter 6

Inventory Systems

FIFO

When a company decides to sell their inventory, this method assumes that the cost of the inventory is that of the oldest units that the company purchased. For example, if they start with 100 units at 1 dollar per unit, then later on buy 100 more units at 2 dollars each, the first 100 units sold will cost 1 dollar.

Moving Average

This method requires that the company recalculate the cost of their inventory any time a sale occurs. When a sale occurs, the average cost of the units need to be calculated. To do this, take the total cost of all available inventory and divide it by the total units available. Multiply this rate against the number of units sold to calculate the cost of the units sold.

Example 6-1

To start the year 20X1, Arthur Young's Lights has 150 units in their warehouse costing \$2 per unit. The following outlines the activity during the first month:

Jan 8: Purchased 50 units costing \$3 per unit.

Jan 16: Sold 80 units for \$5 per unit.

Jan 21: Purchased 30 units costing \$4 per unit

Jan 27: Sold 110 units for \$8 per unit.

Using the Perpetual FIFO method, What is the COGS and ending inventory based on this information?

Example 6-2

Repeat example 2-1 using the moving average method.

Errors made when recording inventory

Errors can be made in the recording either the cost of the inventory, or the purchase of equipment. When errors like these occur, they can impact other accounts as well. The impact will be summarized in the following table:

Type of mistake:	Cost of inventory is <u>recorded incorrectly</u>	Purchase of inventory <u>was recorded too early</u>
Inventory	Overstated	Overstated
COGS	Understated	No effect
Gross Profit	Overstated	No effect

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Profit, before income tax	Overstated	No effect
Income tax	Overstated	No effect
Net Income	Overstated	No effect
Retained earnings	Overstated	No effect
Accounts Payable	No effect	Overstated

Example 6-3

Sue's Suit's Accountant Ralph is doing the inventory count. He accidentally counts inventory worth \$5,000 twice. What impact does this have on retained earnings?

Chapter 7

Internal Controls

All companies require internal controls in place to ensure that they are compliant with accounting laws and regulations, have effective operations and provide reliable financial reporting.

Bank Reconciliations

Banks and companies both report their own transactions independent from each other. As a result, there can sometimes be errors in reporting, or errors in timing. As a result, it is necessary to reconcile both the bank and book numbers

Example 7-1

Use the following information to calculate the unadjusted balance per books on July 31:

1. On June 30, the adjusted cash balance per bank was \$5,360
2. In July, the bank statement shows deposits of \$1,950
3. In July, the company recorded deposits totaling \$2,700
4. In July, the company wrote and recorded cheques totaling \$1,555
5. In July, cheques cleared the bank totaling \$1,670

The unadjusted balance per books on July 31 is:

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Chapter 8

Uncollectible Accounts Receivables

For a variety of reasons, a company may not be able to collect all of their receivables from their customers. To prepare for this, companies often set up A/R aging schedules to try to estimate the amount that will be uncollectible in each bucket (See example 4-1). From this, they must record a debit for Bad debt expense, and a credit for Allowance for Doubtful Accounts. When it is determined that the receivable will not be probably not be collectable, the company will then write off the receivable by debiting the AFDA, and crediting the A/R.

Example 8-1

In 20X1, Ron Meyer Agriculture performed services for customers for \$55,000 on Jun 15, \$15,000 on Oct. 21, \$60,000 on Nov. 20, and \$40,000 on Dec.20. All transactions were on account. Based on past performance, the accountant creates an allowance for doubtful accounts. Assume the year end is Dec. 31, 20X1.

<u>Numbers of days outstanding</u>	<u>Estimated % uncollectible</u>
0-30 days	10%
31-60 days	20%
61-90 days	30%
90+ days	50%

Given this information, create an aging schedule, and record the necessary journal entries.

Example 8-2

One of Ron Meyer Agriculture's customers goes bankrupt and cannot pay off \$20,000 of their outstanding receivables. Record the entry to write off the receivable.