Automatic Tutoring

Advanced Tutoring and Exam Preparation for Accounting

ACG2021

Introduction to Financial Accounting

Exam #1 Review: Chapters 1-3 & 5

Exam 1 Review includes the following:

- Review Packet
- Review Videos
- 40 Concept Questions
- Additional Practice Questions
- Video Solutions
- 1 Mock Exam
- Formula Sheet
- Tricky Accounts Sheet

Courses we offer:

- ACG2021 – Introduction to Financial Accounting
- ACG2071 – Introduction to Managerial Accounting
- ACG3101 – Intermediate Financial Accounting & Reporting 1
- ACG4111 – Intermediate Financial Accounting & Reporting 2
- ACG50005 – Graduate Level Financial Accounting
- ACG5075 – Graduate Level Managerial Accounting
- More Coming Soon!

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Recommended Study Guide for Exams:

Skim Textbook / Read Summary at the end of each Chapter

Watch Lecture

Do Assigned Homework

Watch Automatic Tutoring Reviews

Complete All Exam Review Practice Questions

Complete Professors and Automatic Tutoring Mock Exam

Thank you for Reviewing with us this semester

Table of Contents

Chapter 1: Financial Accounting

Overview of Accounting .... Page 4 - 5

The Financial Statements .... Pages 6 - 9

Assumptions/Qualitative Characteristics .... Pages 10 - 11

Chapter 2: The Accounting Cycle During the Period

Transaction Analysis .... Pages 12 - 15

Debits/Credits .... Pages 16 - 19

Definitions .... Pages 20 - 21

Chapter 3: The Accounting Cycle At the End of the Period

Revenue & Expense Recognition Principle........ Pages 22-23

Adjusting Entries .... Page 24-30

Shipping Terms .... Page 31

Closing Process .... Page 32 -33

Extra Practice Questions Chapter 3........ Page 34

Chapter 5: Receivables & Sales

Sales Returns, Allowances & Disocounts .... Pages 35-38

Bad Debt Expense (Also called Uncollectible Account Expense) .... Pages 39 - 44

Formulas in Chapter 5 .... Page 45

Extra Practice Questions Chapter 5 .... Page 46

Other Packet Contents

Tricky Accounts Sheet .... Pages 47 - 48

Concept Questions .... Pages 49 - 60

Practice Questions .... Page 61 - 70

Answer Key .... Pages 71-72

Formula Sheet .... Pages 73 - 74

Chapter 1: A Framework for Financial Accounting

Financial Accounting is provided for external users (investors and creditors), while Managerial Accounting is provided for internal users (managers)

Financial Accounting's two functions are:

-measure business info on companies

-communicate these measurements to external parties for decisions

Main Accounting Equation:

** Assets = Liabilities + Stockholders' Equity **

-Asset = resources of the company

-Liability= resources of the company that is owed to someone else

-Equity (Stockholders' Equity) = resources of the company that the company itself owns

Why?

More Financial Accounting Terms:

Revenues - the amount a company receives when they sell products/services

Expenses - the cost to a company of selling their products/services and running the business

Net Income (Loss) = Revenues – Expenses

-When Expenses are higher than Revenues, we have a Net Loss

Dividends – payments made to stockholders, usually in cash

Practice Question: Slayers Inc. has Assets of $100,000 at the beginning of the year and $120,000 at the end of the year. They also have $40,000 of Liabilities at the beginning of the year. The company also says that its Stockholders' Equity increased by $10,000 throughout the year. How much liabilities did Slayers Inc. have at the end of the year?

4 Financial Statements: Shows you how Accounting is done

1) Income Statement

-Reports a company's revenues and expenses, showing their Net Income or Net Loss.

-This shows how much money a company makes every year.

Income Statement is over a period of time

2) Statement of Stockholders' Equity

-Shows how the company's Stockholders' Equity changed throughout the year.

-the two primary components of Stockholders' Equity are:

-Common Stock: external source

-Retained Earnings: internal source, money made by the company every year that the company keeps

Retained Earnings for a new company always begins at 0

Statement of Stockholders' Equity is over a period of time

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Equations to Help with Statement of Stockholders' Equity:

Retained Earnings
Beginning Retained Earnings
+ Net Income
- Net Loss
- Dividends
=Ending Retained Earnings

Change in Stockholders' Equity
Beginning Stockholders' Equity
+ Common Stock Issued
+ Net Income/ - Net Loss
- Dividends
=Ending Stockholders' Equity

The Income Statement needs to be completed before the Statement of Stockholders' Equity

Why?

Practice Question: You have decided to start a company after college. In your first year of business, your company had Sales Revenue of $100,000 and Expenses of $50,000. You also decided to issue $25,000 worth of Dividends. What is your ending Balance in Retained Earnings?

Practice Question: In the second year of your company, you begin with Assets of $100,000 and Liabilities of $75,000. Throughout the year, you have Sales Revenues of $100,000 and Expenses of $120,000. You also issued $10,000 worth of common stock and issued $5,000 worth of dividends. If you finish the year with $130,000 of Assets, how much in liabilities did your company end the second year with?

3) Balance Sheet

-Shows how the company is financially.

-Shows the amount of all Assets, Liabilities, and Stockholders' Equity the company has.

-Assets: are short-term (used in next 12 months) and long-term (held longer than a year)

-Liabilities: are short-term (paid in next 12 months) and long-term (paid in longer than a year)

-Equity: consist of Common Stock and Stockholders' Equity

Assets		Liabilities and Equity	
Cash	$100	Accounts Payable	$200
Prepaid Expense	$900	Unearned Revenue	$300
		Common Stock	$400
		Retained Earnings	$100
Total Assets= $1,000		**Total Liabilities and Equity = $1,000**	

****The Balance Sheet is at one point in time****

4) Statement of Cash Flows

-Takes the cash balance at the beginning and end of the year from the Balance Sheet and analyzes it.

-Consists of 3 Sections:

-Operating Activities: cash from revenue and expenses

-Investing Activities: cash from purchase and sale of investments and long-term assets

-Financing Activities: cash transactions with lenders and stockholders

Practice Question: Looking at the past three financial statements we have discussed, do you believe the Statement of Cash Flows is over a period of time, or at one point in time?

Practice Question: What account belongs on the Income Statement?

A) Prepaid Rent Expense of $1,000

B) Unearned Revenue of $500

C) Dividends of $200

D) Rent Expense of $150

Definitions in Chapter 1:

Corporation- has limited liability and is separate from its owners.

Sole Proprietorship- owned by a single person/ **Partnership-** owned by two or more people

Annual Report- 2 important documents included other than the four financial statements are:

-Management Discussion and Analysis

-Note Disclosures

Generally Accepted Accounting Principles (GAAP) – rules that companies in the US must follow in creating their financial statements.

Financial Accounting Standards Board (FASB) – create and modify GAAP.

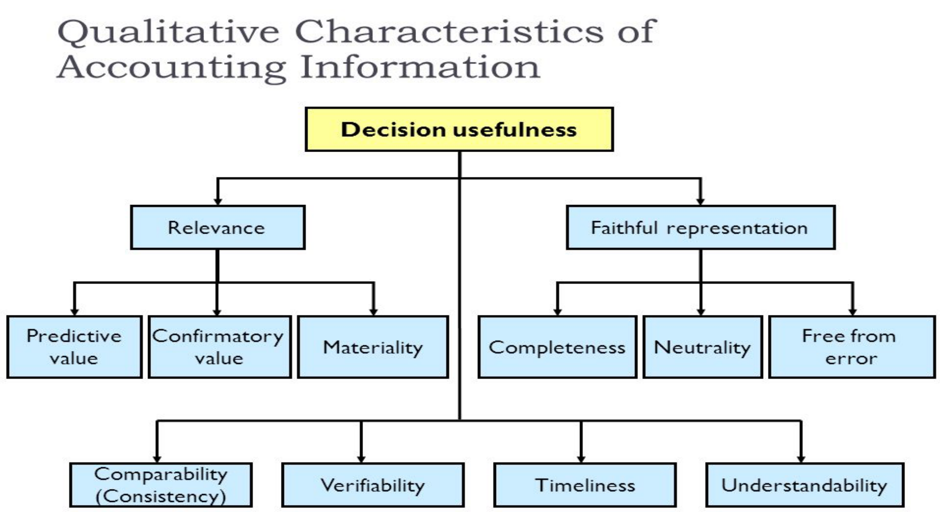
International Accounting Standards Board – rules for companies out of the US in creating their financial statements (instead of GAAP)

Securities and Exchange Commission – legal authority over public companies in the US. Requires companies to follow GAAP.

Auditors- help test the financial statements of different public companies to make sure their financial statements are accurate and follow GAAP. Thus, they help investors and creditors (us) trust that financial statements are correct.

4 Underlying Assumptions in GAAP:

1) **Economic Entity Assumption:** a company is a separate economic unit.
2) **Monetary Unit Assumption:** we use money to measure financial Statements ($'s in the US).
3) **Periodicity Assumption:** Divides the economic life of a company into periods for reporting purposes.
4) **Going Concern Assumption:** a company will continue to operate forever unless stated otherwise.



Faithful Representation is more important than Relevance as a Fundamental Characteristic because if the information isn't accurate, to begin with, all the information is useless

Chapter 2: The Accounting Cycle during the period (end of the period is Ch 3)

The two main functions of financial accounting are to measure business activities and communicate measurements to external parties for decision making (ex: you look at Apple's Income Statement to see whether you should buy the stock).

The first step in measuring transactions is to identify what accounts are affected.

Common Asset Accounts:

-Cash
-Short Term Investments
-Accounts Receivable
-Inventory
-Prepaid Expenses/Supplies

-Plant, Property, and Equipment

Common Liability Accounts:

-Accounts Payable
-Unearned Revenue/Deferred Revenue
-Anything "Payable" with discretion

-Notes Payable

Deferred Revenue is a liability, NOT a Revenue

Why?

Common Equity Accounts:

-Common Stock
-Retained Earnings involves Revenues, Expenses, and Dividends

all accounts listed out is known as a chart of accounts

Our next step is to identify what accounts go up or down in each transaction. After we recognize these, we must check whether Assets still equal Liabilities plus Equity.

-If assets increase, then Liabilities or Equity must also increase.
-If assets decrease, then Liabilities or Equity must also decrease.

Examples: What Accounts Increase/Decrease?

Your company sells shares of stock to raise money for a total of $1,000.

You take out a loan to start your company as a Notes Payable worth $10,000.

You purchase a truck for $10,000 cash. The Fair Value of the truck is $20,000, and a similar truck just sold for $15,000 the week before.

We use cash paid for long-term assets on the balance sheet for now

You purchase a truck for $10,000, paying $5,000 cash and taking out a $5,000 notes payable for the rest.

Prepaid Rent is an Asset that increases when purchased

**Purchased “on account” means increase Accounts Payable (a liability) **

Tricky transactions:

Paid $5,000 on account.

Provided services of $10,000 on account.

We received cash in advance for a service to be provided next year of $25,000.

Bought a laptop for personal use for $1,000.

Paid out cash dividends of $5,000.

Practice Question: An investor invests in land in exchange for common stock. The land has a fair market value of $100,000, a mortgage of $30,000 is taken out, and then common stock is also issued (the business is taking on the mortgage). What is the effect of the investment on the accounting equation?

Practice Question: If the entry to record sales on account is not posted:

A) Stockholders Equity will be overstated.
B) assets will be understated.
C) assets will be overstated.
D) liabilities will be understated.
E) there will be no effect on the company's financial position.

Debits and Credits:

Assets = Liabilities + Equity

Common Stock   Retained Earnings

Net Income (Loss)   Dividends

Revenues   Expenses

D E A L E R

Debit Balance	Credit Balance
Asset	Liabilities
Dividends	Common Stock
Expenses	Revenues

****Even though dividends and expenses are on the right of the equation, they have a debit balance****

Why?

A "normal balance" for an account is what increases them

Practice Question: What is the normal balance of the following accounts? (Debit/Credit)

Cash

Accounts Receivable

Accounts Payable

Service Revenue

Dividends

Prepaid Expense

Deferred Revenue

Retained Earnings

Practice Question: How do we increase or decrease the following accounts? (Debit/Credit)

Increase Inventory by $1,000

Decrease Prepaid Rent Expense by $500

Increase Notes Payable by $12,000

Increase Dividends by $250

Increase Rent Expense by $1,000

Decrease PP&E (Plant, Property, and Equipment) by $100,000

Recording Transactions using Debits and Credits:

Example Scenario: We buy $5,000 worth of inventory using cash. These are known as journal entries.

Inventory ……………………………………. $5,000

Cash ………………………………………….. $5,000

Practice Question: Your company made the following transactions. Identify what type of accounts are affected in each scenario, identify whether they need to be debited or credited, and write out the journal entry for each.

Scenario 1: You start a new company and invest $100,000 cash into it for common stock.

Scenario 2: You have now started the company. You then pay $20,000 cash for Inventory to sell.

Scenario 3: Your company produced services on account worth $10,000.

Scenario 4: Your company collected $5,000 on account.

Scenario 5: Your company paid out $10,000 of cash dividends.

Scenario 6: Your company received $1,000 in advance for services you will perform next year.

Practice Question: Your company received $1,000 last year in advance for admission to a theme park you own. When the customer finally comes to the park:

A) A revenue account is decreased.
B) A revenue account is increased.
C) A liability account is increased.
D) An asset account is decreased.
E) None of the above.

Recapping Chapter 2 so far:

-The first step was to identify what accounts were affected in each transaction.

-Our next step was to see whether each account went up or down and whether the accounting equation stayed in balance.

-We then learned how to increase or decrease these accounts using debits or credits. These debits or credits written out are known as journal entries.

Definitions for Chapter 2:

Journal: a chronological record of all transactions affecting a company. All journal entries are posted here

Journal Entries are put in the Journal

Posting: the name for putting the debits/credits from the journal into the General Ledger

General Ledger: shows each account individually and shows what the debit/credit balance is

Trial Balance: a list of all accounts and their debit and credit balances. Debits here must equal Credits. A trial balance is only for internal use.

General Ledger:

-shows each account individually and whether they have a debit or a credit balance

-commonly shown as a T-Account.

	Cash		
Beginning Balance:	$10,000		
Receiving Cash:	$2,000		
		$5,000	Paying Cash
Ending Balance:	$7,000		

These can be used for ALL the accounts in this class
Receiving cash goes on the left because cash in an asset, and you need a debit (debit = left) to increase an asset

Trial Balance:

-takes all the debit and credit ending balances from the general ledger and lists them in one location.

-goal is to make sure all debits equal credits.

Even if our trial balance is equal, this does not mean there are no mistakes

Why?

Chapter 3: The Accounting Cycle at the end of the period (during is Ch. 2)

In-Last chapter (Ch. 2), we reviewed how transactions are recorded during the year for a company.

-In this chapter, we will focus on how companies at the end of the year take the information from during the year and turn them into financial statements.

Revenue and Expense Recognition:

Conceptual Question: Your company owns a theme park. A customer pays for his ticket to the theme park on August 1st. Then, the customer comes and uses the ticket on October 1st. Should you recognize revenue on August 1st or October 1st?

In this class, we primarily use Accrual Accounting. The following rules only apply when using Accrual Accounting:

> **-Revenue Recognition Principle -** revenues for a company are recognized when goods/services are provided to the customer, NOT when the cash is paid.

> **-Expense Recognition Principle -** any costs incurred to produce revenues should be expensed in the same period as the Revenues (expenses are matched to revenues)

Why?

Accrual vs. Cash Accounting:

-the only difference between the two methods is timing

-In Cash Accounting, we recognize revenue when cash is received and expenses when cash is paid.

-In Accrual Accounting, we recognize revenue when the goods/services are delivered and expenses when they're used to produce revenues. (Most used in this class/used in the USA)

Practice Question: Your company owns a theme park. You generally use electricity each month and then wait for the electric company to send you a bill after (Use electricity in October, then receive the bill in November). For example, your company uses $100,000 worth of electricity in October. Your company then receives a bill for the $100,000 of electricity in November and pays the bill in December.

Part 1: Which month would you recognize the expense under Accrual Accounting?

Part 2: Which month would you recognize the expense under Cash Accounting?

In the US, GAAP (the accounting rules public companies must follow) uses Accrual Accounting

Adjusting Entries:

Conceptual Question: You start a brand-new company washing cars in November of 2020. You washed your first car on December 21st, 2020; however, your customer doesn't pay you until January 2nd, 2021. What journal entry can we do to show revenue in the year 2020 without receiving cash yet?

Adjusting Entries are journal entries performed at the end of the year/period to keep the financial statements updated. There are four different scenarios:

1) Cash is received before performing a service

-example: paying for a ticket before going to a concert
-will result in an Unearned/Deferred Revenue

2) Cash is received after performing a service

-example: your neighbor pays you after you wash his car
-will result in an Accounts Receivable

3) Cash is paid before incurring an expense

-example: paying your rent for the next year
-conceptually, think of buying a bar tab
-will result in a Prepaid Expense

4) Cash is paid after incurring an expense

-example: paying your November electricity bill in December
-will result in an Accounts Payable

the adjusting entries related to these scenarios occur at the **end of the period**

Scenario 1: Cash received before performing a service

-This is commonly applied to theme parks because most people purchase tickets before attending the park.

Walkthrough Example:

-Your company owns a music hall. You receive $10,000 in advance for tickets. Therefore, you will need to do the following journal entry:

-By December 31st, there is still $2,000 worth of prepaid tickets with their concerts not happening until the following year. So this is the adjusting entry that is needed.

-Now, there is $8,000 of Service Revenue that will appear on the Income Statement, and we still have a $2,000 balance of Deferred Revenue beginning the following year, as shown below.

Deferred Revenue

Adjusting Entry:

Ending Balance

Scenario 2: Cash received after performing a service

-This is whenever someone pays a company after a service is performed.

Walkthrough Example:

-Your company provided drinking advice to a customer for $150, but it hasn't been billed at the end of the year. This is the adjusting entry that is needed.

-Your company will now show sales revenue of $150 on your Income Statement for that year. Then, when the cash is collected for these services, the following journal entry is completed:

Practice Question: Your company began with a normal balance of $5,000 in the Deferred Revenue account. You then finished the year with a $10,000 ending balance. You credited the account $100,000 throughout the year for receiving cash before performing your services. If your company earned no other revenue, how much revenue did your company recognize throughout the year?

Scenario 3: Cash paid before incurring an expense

-this is when a company pays in advance for an expense.

-an example would be a company paying all of 2020's rent on January 1st of that year.

Walkthrough Example:

-Your company begins today, on 1/1/2022. To get a head start, you decide to pay two year's worth of rent today for $24,000 cash. Your company would need to make the following entry:

-By December 31st of 2022, your company will have used 12 months of the prepaid rent. Therefore, we will need to do an adjusting entry to show our rent expense for the year and how much prepaid rent we have left.

-We now have $12,000 worth of rent expense in 2022 and only $12,000 worth of prepaid rent left, as shown below.

Prepaid Rent Expense

January 1st payment:

Adjusting Entry:

Ending Balance

Scenario 4: Cash paid after incurring an expense

-this is when a company pays cash after an expense. Called an accrued expense.

-a typical example would be a utility bill. A company will use electricity for a month, and they pay the bill afterward.

Walkthrough Example:

-Your company starts on December 1st of 2020. In that month, your company uses $1,000 worth of electricity in your office; however, you are not billed for December's electricity until the 15th of January. Therefore, you will need to do the following adjusting entry:

-Now, your company correctly has $1,000 of electricity expense in 2020 and has an accounts payable showing that you owe $1,000 in the following year. Therefore, when you pay the electricity company, you will make the next journal entry:

for the past four scenarios, all the adjusting entries occurred at the end of the year
adjusting entries never involve cash

Practice Question: Your company starts with $5,000 worth of supplies at the beginning of the year. Throughout the year, you purchase $10,000 worth of supplies, and at the end of the year, you got your office and count that you only have $2,000 worth of supplies left. Assuming you never completed any other journal entries relating to supplies, what adjusting journal entry is needed at the end of the year?

Practice Question: Apple Pear Inc. signed a 6-month note-payable for $10,000 on November 1st, 2020. The yearly interest rate for this note is 6%, and the note plus all interest will be paid at the end. How much interest expense would Apple Pear Inc. need to record on December 31st, 2020?

Interest Expense= Loan Amount x year interest rate x # months/12

Hard Practice Question: Failure to make an adjusting entry to recognize an accrued expense would result in:

A) Understatement of Expenses, Liabilities, and Equity
B) Overstatement of Expenses and Liabilities
C) Understatement of Expenses and Liabilities and an overstatement of Equity
D) Understatement of Assets and Equity
E) Understatement of Assets and Equity and overstatement of liabilities

If Expenses are understated, Equity is Overstated // If Expenses are overstated, Equity is Understated

Depreciation:

-Depreciation is a particular type of adjusting entry.

-Unlike other adjusting entries where a Prepaid Expense is decreased as it is used, we will use an account called Accumulated Depreciation.

Accumulated Depreciation is known as a contra-asset

-At the end of the year, the following journal entry needs to be made to record depreciation:

Depreciation Expense	$XX,XXX	
Accumulated Depreciation		$XX,XXX

-Accumulated Depreciation keeps track of all the depreciation on Plant, Property, and Equipment throughout the years. With this, we can calculate something called Book Value.

Book Value = Cost of an Asset – Accumulated Depreciation

Recap:

-In chapter 2, we discussed the accounting process that occurs **throughout the year** to record transactions.

-In this chapter (Ch. 3), we have reviewed several entries we need to make at the **end of the year** to prepare for financial statements.

-We will now cover a few more details relating to the end of the year.

-These first chapters cover the entire class. We will now go back to what we have learned and go more in-depth.

Shipping Terms

Conceptual Question: We have learned earlier that we recognize revenue when a good/service is provided. However, what if a good is being shipped to a customer. For example, let's say we are dealing with a company that ships books to customers. Should the company recognize revenue when the goods are dropped off at the post office or when they arrive at the customer?

There are two different terms that we can use:

FOB Shipping Point – ownership changes and revenue is recognized when the goods leave the shipping dock

FOB Destination – ownership changes and revenue is recognized when the goods arrive at the customer

Practice Question: Fat Daddies has started shipping drinks to people to increase their profit. Details about the few orders they have are listed below. How much revenue should Fat Daddies record in 2020?

Order 1- $10,000 worth of drinks were shipped on 12/28 FOB Destination (arriving 2021)
Order 2- $5,000 worth of drinks were shipped on 12/25 FOB Shipping Point (arriving 2021)
Order 3- $8,000 worth of drinks will be shipping out on 1/2/2021 FOB Shipping Point

How much revenue should Fat Daddies record in 2020?

Closing Process:

All accounts on the Balance Sheet are known as **Permanent Accounts.**

A **temporary account** is an account that is only relevant for one year and must be closed out. The three types of temporary accounts are:

-Revenues
-Expenses
-Dividends

These Accounts need to have a balance of 0 at the beginning of every year

Why?

Every Company needs to do the following journal entries the close these accounts at the end of the year:

Revenue	$XX	
Retained Earnings		$XX
Retained Earnings	$XX	
Expenses		$XX
Retained Earnings	$XX	
Dividends		$XX

Retained Earnings
Beginning Retained Earnings
+ Net Income
- Net Loss
- Dividends
=Ending Retained Earnings

Retained Earnings is a permanent Account

In the Accounting Cycle, we complete a trial balance three different times.

-Before any adjusting entries are completed
-After any adjusting entries are completed
-After closing entries are completed

Practice Question: Which of the following accounts would you find on a post-closing trial balance?

A) Dividends
B) Service Revenue
C) Prepaid Rent Expense
D) Salaries Expense

Practice Question: An adjusting entry to record depreciation would include a credit to which account?

A) Property, Plant, and Equipment
B) Depreciation Expense
C) Accumulated Depreciation
D) None of the Above

Chapter 3 Extra Practice Questions:

Question 1: You paid $24,000 for 24 months of Rent on July 1, 2020. This rent will be used every month for the next two years. How much is left in the Prepaid Rent account on December 31, 2020?

A) $24,000
B) $1,000
C) $18,000
D) $6,000

Question 2: You paid $24,000 for 24 months of Rent on July 1, 2020. This rent will be used every month for the next two years. How much is left in the Prepaid Rent account on December 31, 2021?

A) $24,000
B) $1,000
C) $18,000
D) $6,000

Question 3: You start the year with a normal balance in Deferred Revenue of $100,000. You then earn $40,000 worth of that Revenue. You then end the year with a normal balance of $120,000 in the Deferred Revenue account. How much in cash did customers prepay throughout the year?

Question 4: What is the journal entry needed to close out the Dividends account? There is currently a normal balance of $10,000 in Dividends.

Chapter 5: Receivables and Sales

-Last few chapters, we learned a broad overview of the accounting system.

-For the rest of the class, we will go back to what we learned in the past three chapters but go more in-depth.

-We will go down the balance sheet and begin with receivables (mostly accounts receivables)

Accounts Receivable:

-occurs when a customer will pay cash in the future. Usually results from the sale of products or services.

-whenever products or services are provided on account → results in an Accounts Receivable

-can be known as a trade receivable as well. A nontrade receivable would be when cash is owed from someone other than a customer.

Example Question: You wash your neighbor's car in December. Your price for washing a car is $150. However, instead of paying you in December, you agree that he will pay you in January. What is the journal entry required in December to record the washing of the car?

Sales Returns, Allowances, and Discounts

1) Trade Discounts

-a reduction in the price of an everyday item.

-whenever there is a trade discount, the following journal entry is needed.

Example Problem: Lululemon t-shirts usually sell for $100. However, they currently have a trade discount offered, so the t-shirts only cost $70. Therefore, the following journal entry is needed when a customer purchases a t-shirt for $70.

Cash	$70	
Sales Revenue		$70

There is no trade discount account

2) Sales Returns

-occurs when a customer returns a product.

-if the customer paid cash, the company will pay the customer back the cash.

-if the customer purchased the product on account, the company would reduce its accounts receivable balance.

-Sales Returns will have a debit balance and are a contra-revenue account. Therefore, sales Returns are not an expense!

Practice Example: Lululemon sold a t-shirt to a customer for $100 on account. However, the customer is dissatisfied and returns the shirt, and the customer receives full credit. The following journal entry is needed:

Sales Returns	$100	
Accounts Receivable		$100

****Sales Returns have a DEBIT balance****

3) Sales Allowances

-similar to Sales Returns, but the customer does not return the product.

Practice Example: Lululemon sold a t-shirt to a customer for $100 on account. However, the customer is dissatisfied and receives half of the price back as a Sales Allowance. The following journal entry is needed:

Sales Allowances	$50	
Accounts Receivable		$50

****Sales Allowances have a DEBIT balance****

4) Sales Discounts

-a discount is offered to a customer if they pay the cash they owe in a certain period.

-the way problems will display sales discounts is as follows

2/15, n/30

Practice Example: Lululemon sold a t-shirt to a customer for $100 on account. To incentivize the customer to pay the cash quicker, they offer a sales discount of 3/10, n/30. If the customer ends up paying in the discount period, the following journal entry is needed:

Cash	$97	
Sales Discount	$3	
Accounts Receivable		$100

Net Revenue= Sales/Service Revenue – Sales Discounts, Allowances, and Returns
Sales Returns, Allowances, and Discounts are NOT EXPENSE ACCOUNTS

Why?

Net Revenue
Sales/Service Revenue
-Sales Returns
-Sales Allowances
-Sales Discounts
=Net Revenue

****Sometimes a question will mention trade discounts or purchase discounts; these do not affect Net Revenue****

Estimating Uncollectible Accounts

-In general, there will always be some accounts receivable that won't be collected.

-There are two methods for accounting for this:
-Direct Write off method
-Allowance method (required by GAAP)

Direct Write off method

-Under this method, we simply "write off" accounts receivable when we know it won't be collected.

- "write off" is used here to reference a journal entry we will make that reduces the accounts receivable.

-the necessary journal entry when a certain amount of Accounts Receivable is officially uncollectable.

Allowance method

-under this method, we will estimate how much accounts receivable we expect not to receive annually.

-the main difference between the Direct Write off method and the Allowance method is timing.

-We are going to create an account called Allowance for Doubtful Accounts.

-Allowance for Doubtful Accounts:

- -a contra asset
- -has a normal credit balance but can have a debit balance

**** Net Receivables = Accounts Receivable – Allowance for Doubtful Accounts****

Walkthrough Example:

-We have $100,000 of Accounts Receivable left at the end of 2020. However, we are required to use the Allowance method. We calculate that we expect $5,000 of these accounts receivables not to be collected. Therefore, we would need to complete the following journal entry:

-This Allowance for Doubtful Accounts will be under Accounts Receivable on the Balance sheet. Therefore, it decreases net Accounts Receivable.

-When it is official that $2,000 of this Accounts Receivable is not going to be collected, we must complete the following journal entry to complete a “write off”:

The Allowance Method follows Accrual Accounting

Why?

Practice Question: We have $100,000 of Accounts Receivable at the end of the year. We have determined that we expect not to collect $5,000 of this Accounts Receivable in the future through our calculations. If you have a $0 balance in the Allowance for Doubtful Accounts t-account, what journal entry needs to be completed:

Practice Question: You now start the year with $100,000 of Accounts Receivable and a $5,000 normal balance in Allowance for Doubtful Accounts. In February of this year, you determine that $2,500 of those receivables will never be collected. Complete the necessary journal entry to write these off:

Practice Question: Looking at the journal entry from the practice question above, what effect does it have on overall Assets?

A) Increase of Assets
B) Decrease of Assets
C) No effect on Assets

Write-offs under the allowance method do not affect overall Assets

Why?

How much do we estimate:

-most problems won't tell you the amount that is expected to be uncollectible. Instead, you will need to calculate it. There are two different methods:

-Aging method (older accounts are less likely to be collected)
-Percent of Credit Sales method

-the main difference of methods is how the bad debt expense is calculated.

The **aging method calculates the ending balance** in Allowance for Doubtful Accounts, while the **percent of credit sales method calculates the amount of bad debt expense** directly.

	Allowance for Doubtful Accounts		
Beginning Balance:		(a) $20,000	
Written Offs:	(b) $5,000		
Bad Debt Expense:		(c) $10,000	
		(d) $25,000	Ending Balance

Aging of Receivable Method calculates **part d, and then you **must solve to figure out part c****

Practice Question: At the end of 2020, Downtown Fats has an Accounts Receivable balance of $1,000,000 and a normal credit balance of $10,000 in Allowance for Doubtful Accounts. Your company reported $1,000,000 of credit sales in 2020. If your company uses the percent of credit sales method, and it is estimated that 4% of credit sales will be uncollectible, what is the necessary journal entry at the end of 2020:

Under Percent of Credit Sales: **Bad Debt Expense = Credit Sales x % uncollectible**

Practice Question: At the end of 2020, Downtown Fats has an Accounts Receivable balance of $1,000,000 and a normal credit balance of $10,000 in Allowance for Doubtful Accounts. Your company reported $1,000,000 of credit sales in 2020. If your company uses the aging method, and it is estimated that $30,000 of the Accounts Receivable now will be uncollectible, what is the necessary journal entry at the end of 2020

Under the Aging method: Bad Debt Expense = Estimated Uncollectible – Current Balance in Uncollectible

	Accounts Receivable		
Beginning Balance:	$20,000		
Credit Sales:	$5,000		
Write Offs:		$10,000	
Cash Collections:		$5,000	
	$10,000		Ending Balance

	Allowance for Doubtful Accounts		
Beginning Balance:		$20,000	
Written Offs:	$10,000		
Bad Debt Expense:		$15,000	
Collection of previous write-offs:		$10,000	
		$35,000	Ending Balance

These t-accounts will be very helpful on the Exam

Comprehensive Problem: The beginning and ending balance in Accounts Receivable is $100,000 and $120,000, respectively. The beginning balance in Allowance for Doubtful Accounts is a credit balance of $10,000. They reported credit sales for the year of $100,000 and wrote off $5,000 of uncollectible accounts. They also collected $3,000 worth of receivables previously written off. If they estimate that 2% of credit sales will be uncollectable, what is cash collections for the year, and what is the net receivable balance?

Other Information in Chapter 5:

Notes Receivable: like an accounts receivable but requires written proof. It can sometimes be received instead of cash for services as well.

Interest Revenue = Face Value x Annual Interest Rate x # months / 12

Interest Revenue accruing at year end would have the following journal entry:

Formulas:

Receivable turnover ratio:

higher turnover ratio is better

Average collection period:

lower collection period is better

Chapter 5 Extra Practice Questions

Question 1: You have sales revenue for the year of $100,000, trade discounts of $20,000, purchase discounts of $15,000, and sales discounts of $10,000. What is your net revenue?

A) $100,000
B) $80,000
C) $90,000
D) $85,000

Question 2: Downtown Fats has a beginning credit balance of $10,000 in their Allowance for Doubtful Accounts. They report credit sales for the year of $100,000 and estimate that 10% of sales will be uncollectible. If the company wrote off $5,000 of receivable throughout the year, and they are using the percent of credit sales method, what is bad debt expense for Downtown Fats?

Question 3: You start the year with a normal balance in Allowance for Doubtful Accounts of $10,000. They report credit sales for the year of $100,000 and estimate that $12,000 of total receivables will be uncollectible at the end of the year. If the company wrote off $5,000 of receivables throughout the year and uses the aging method, what is the Bad Debt Expense for the year for Downtown Fats?

Thank you for reviewing with Automatic Tutoring!

Tricky Accounts:

Prepaid Expense: This exists when you pay for an expense/bill beforehand. This will be an **Asset**, NOT an Expense.

Unearned or Deferred Revenue: This exists when a customer pays for a good or service before receiving it. This will be a **Liability,** NOT a Revenue.

Retained Earnings: This term is new in accounting, but view it as money a company has made that it "keeps in the business bank account." Profit (called Net Income) increases the Bank Account, and paying yourself (called Dividends) decreases the Bank Account. This is an **Equity Account.**

Accounts Payable: Think of this as a company owing day-to-day bills. This can include electricity bills, utility bills, and any other bills the company must be in the short term. This is a **Liability Account.**

Accounts Receivable: Think of this as when someone owes a company money. This is when a company provides a good or service for a customer but hasn't been paid yet. Because the company will receive Cash soon (and cash is an asset), this is an **Asset Account.**

****Receivable = Asset // Payable = Liability****

Revenues and Expenses: This is when a company EARNS money and USES expenses. As we learned in Chapter 3, Revenues and Expenses are not the same as Cash. Instead, these **are temporary Equity Accounts.**

Interest Expense: Whenever an interest rate is given in this class, it is referring to an annual rate. We will never have an interest rate that is for 6 months. Even if a loan is only outstanding for 5 months, we will calculate the interest for the year (Loan Amount x Annual Interest Rate), and then multiply it by the months over 12 that it is outstanding.

****Loan x Annual Interest Rate x months/12****

Aging Method: Under the aging method in chapter 5, we are calculating how much Accounts Receivable we think we won't get. Therefore, we are solving for what balance our Allowance for Doubtful Accounts should have. To solve for our adjusting entry, we will need to use a T-Account or the formula below to solve for Bad Debt Expense (Concept Questions 39 & 40).

****Bad Debt Expense** = Ending AFDA needed – Current AFDA if a **credit balance****

****Bad Debt Expense** = Ending AFDA needed + Current AFDA if a **debit balance****

Percent of Credit Sales Method: Under the percent of credit sales method in Chapter 5, we are solving directly for bad debt expense. This differs from the Aging method above because we are solving directly for our adjusting entry, rather than the balance we need in Allowance for Doubtful Accounts. Therefore, if we are asked for the Ending Balance in Allowance for Doubtful Accounts, we would need to solve for it using a T-Account (Concept Question 37 & 38).

****Bad Debt Expense** = Credit Sales in year x % Estimated uncollectable******

Net Receivables: On the Exam, if you are asked for Net Receivables, you will use: **Sales or Service Revenue (they are the same), minus Sales Discounts, Allowances, and Returns**. If you see PURCHASE DISCOUNTS, PURCHASE RETURNS, TRADE DISCOUNTS, or any other account that does not have the word "sales" in front of it, IGNORE IT. This is a trick. You are only looking for Sales Discounts, Allowances, and Returns. Purchase Returns & Discounts are material for Exam 2.

Gross Profit: Sales/Service Revenue – Cost of Goods Sold. This is covered on Exam 2, but it is commonly asked on Exam 1 as a trick. Just remember the formula and you'll be good.

****Gross Profit = Sales/Service Revenue – Cost of Goods Sold****

Concept Questions – Chapter 1

1. What is the main Accounting Equation?

A) Assets + Equity = Liabilities
B) Assets + Equity + Liabilities = 0
C) Assets – Liabilities = Equity
D) None of the above

2. What is Net Income, and how do you solve for it?

A) Net Income is the profit made by a company in a period; Revenues - Expenses
B) Net Income is the profit made by a company in a period; Revenues + Expenses
C) Net Income is the investment made in a company in a period; Revenues - Expenses
D) Net Income is the investment made in a company in a period; Revenues + Expenses

3. A Company begins a year with $100,000 in Assets and $30,000 in Liabilities. If the company ends the year with $130,000 in Assets and $10,000 in Liabilities, how much did Equity increase throughout the year?

A) $50,000
B) $70,000
C) $110,000
D) $120,000

4. What are the 2 main components of Stockholder's Equity?

A) Common Stock and Revenue
B) Common Stock and Dividends
C) Retained Earnings and Dividends
D) Common Stock and Retained Earnings

5. You begin 2021 with $100,000 in Assets and $20,000 in Liabilities. Remember, the two main components of Stockholder's Equity are Common Stock and Retained Earnings (in this class, information that isn't needed is given in almost every problem). Accordingly, you are given the following statement regarding 2021:

Common Stock Issued	$10,000
Sales Revenue	$50,000
Expenses	$20,000
Dividends	$5,000
Increase in Liabilities	$10,000

What is Stockholder's Equity at the end of 2021?

6. Remember that this class will have tons of tricky accounts. Slowing down each question will help avoid mistakes dramatically. For each following, identify whether these accounts are an Asset, Liability, Revenue, or Expense.

I. Cash
II. Accounts Payable
III. Accounts Receivable
IV. Rent Expense
V. Prepaid Rent Expense
VI. Sales Revenue
VII. Deferred Revenue

7. What are the three sections of the Statement of Cash Flows?

A) Operating, Investing, and Expensing
B) Operating, Profiting, and Distributing
C) Operating, Distributing, and Financing
D) Operating, Investing, and Financing

8. What are the accounting rules used primarily for public companies in the United States called?

A) Financial Accounting Standards Board (FASB)
B) Generally Accepted Accounting Principles (GAAP)
C) International Accounting Standards Board (IASB)
D) American Financial Accounting Principles (AFAP)

9. What are the two fundamental characteristics of accounting?

10. What are the four financial statements, and what is the correct order of them?

Concept Questions – Chapter 2

11. What would be the effect on the accounting equation of selling common stock for $10,000 cash?

A) Assets would increase and Decrease
B) Assets and Equity would Increase
C) Assets and Liabilities would Increase
D) Liabilities would Increase, and Equity would Decrease

12. When we purchase an asset, which of the following will we use to record it on the books?

A) The Fair Value of the Asset
B) The cash paid for the Asset
C) The price of a similar Asset Purchased
D) None of the above

13. Purchasing a $10,000 truck for $5,000 cash and taking out a $5,000 loan would have what effect on the Accounting Equation?

A) Assets and Liabilities would increase by $10,000
B) Assets would decrease $5,000 and Liabilities would decrease $5,000
C) Assets would increase $5,000 and Liabilities would increase $5,000
D) Assets would Increase $10,000 and Liabilities would increase $5,000

14. How would the following accounts be affected by paying $5,000 on account?

A) Accounts Payable would go up $5,000
B) Accounts Payable would go down $5,000
C) Accounts Receivable would go up $5,000
D) Accounts Receivable would go down $5,000

15. How would the following accounts be affected by receiving $5,000 on account?

A) Accounts Payable would go up $5,000
B) Accounts Payable would go down $5,000
C) Accounts Receivable would go up $5,000
D) Accounts Receivable would go down $5,000

16. What would be the effect if we forgot to record an entry to purchase a $10,000 truck by taking out a $10,000 notes payable?

A) Assets would be understated
B) Assets would be overstated
C) Assets would not be affected
D) Not enough information

17. Debits and Credits will be extremely important for the rest of the course. Do the following accounts have a normal debit or credit balance?

I. Assets

II. Liabilities

III. Common Stock

IV. Dividends

V. Revenues

VI. Expenses

18. How do we increase or decrease the following accounts (debit/credit)?

I. Increase Cash
II. Decrease Accounts Payable
III. Increase Common Stock
IV. Increase Rent Expense
V. Increase Sales Revenue
VI. Increase Dividends
VII. Increase Prepaid Rent Expense

19. You have the following transactions throughout 2020. Fill in the Cash T-Account below and fill in the ending cash balance for 2020.

1/1/2020 - We begin the year with $5,000 in cash.
3/1/2020 – We receive $10,000 cash from services provided.
5/1/2020 – We pay $2,000 cash in expenses.
7/1/2020 – We incur $5,000 of expenses on account.

Cash

20. What would be the overall effect on the accounting equation of purchasing a $100,000 truck by taking out a $30,000 Notes Payable and issuing the remainder in common stock? (Draw arrows below).

Assets = Liabilities + Equity

Concept Questions – Chapter 3

21. What is the difference between Cash and Accrual Accounting?

A) Under Cash accounting, we recognize revenue when a service is performed rather than when a service is provided
B) Under Cash accounting, we recognize revenue when a business wants to rather than when cash is received
C) Under Accrual accounting, we recognize revenue when a service is performed rather than when cash is received
D) Under Accrual accounting, we recognize revenue when cash is received rather than when a service is provided

22. In the US under accrual accounting, when should an expense be recorded?

A) Expenses are recorded when the cash is paid for them
B) Expenses are recorded when they are used to produce revenue
C) Expenses are recorded when a company commits to paying them
D) Expenses are recorded on the last day of every year

23. What is the main difference between cash accounting and accrual accounting?

A) The amount of revenues/expenses we record
B) When a revenue/expense is recorded
C) What activities are considered a revenue/expense
D) None of the above

24. If a company pays $12,000 cash in advance for 1 year of rent on July 1, 2020, how much rent expense will be incurred in 2020? How much prepaid rent will be left at the end of 2020?

A) $12,000; $0
B) $9,000; $3,000
C) $6,000; $6,000
D) $3,000; $9,000

25. On October 1, 2020, the Rowdy Reptile received $5,000 in advance for a 5-month cider membership they provide to customers. How much revenue will Rowdies recognize from this purchase for the year ended December 31st, 2021?

A) $0
B) $2,000
C) $3,000
D) $5,000

26. In the beginning of 2020, New Scooters 4 Less has an accounts payable balance of $1,000. They incur $15,000 in expenses on account and finished with a $5,000 balance in accounts payable. How much cash did New Scooters 4 Less pay relating to their accounts payable?

A) $15,000
B) $9,000
C) $1,000
D) $11,000

27. Which of the following is an adjusting entry relating to an accrued expense?

A) Debit an Expense and Credit an Asset
B) Debit an Expense and Credit a Liability
C) Debit a Liability and Credit a Revenue
D) Debit an Asset and Credit a Liability

28. How do you solve for the Book Value of an Asset?

A) Cost minus Accumulated Depreciation
B) Cost of the Asset
C) Cost plus Accumulated Depreciation
D) Cost minus Depreciation Expense

29. Employees at Automatic Bakery work Monday through Friday every week. In addition, they receive their pay for the week at the end of the workday on Friday. Each week, the employees earn a total of $50,000. For the year 2024, the workweek ends on a Tuesday. What is the necessary adjusting entry on December 31st, 2024?

30. Are the following a permanent account or a temporary account?

I. Cash

II. Accounts Receivable

III. Rent Expense

IV. Prepaid Rent Expense

V. Sales Revenue

VI. Dividends

VII. Common Stock

Concept Questions – Chapter 5

31. What is the journal entry when a company performs $10,000 worth of services on account?

32. What kind of account is a sales return?

A) Revenue account
B) Expense account
C) Contra-revenue account
D) Contra-expense account

33. Do the following accounts have a debit or credit balance?

I. Allowance for Doubtful Accounts

II. Accounts Receivable

III. Sales Return

IV. Sales Allowance

V. Sales Discount

VI. Bad Debt Expense

34. What journal entry is recorded when a sales allowance of $100 is performed?

35. Automatic Bank sells $1,000 of merchandise on account but offers a sales discount with terms 3/10, n/30. What does 3/10, n/30 stand for & what is the journal entry if the customers pays the accounts receivable the next day?

36. What is the journal entry for a write off under the direct write off method? What is the journal entry for a write off under the allowance method?

37. At the end of 2020, Opus Coffee has $1,000,000 of credit sales throughout the year, a credit balance in allowance for doubtful accounts of $10,000, and an ending accounts receivable balance of $250,000. If we use the percent of credit sales method and estimate 5% of credit sales to be uncollectible**, how much is bad debt expense for 2020?**

38. At the end of 2020, Opus Coffee has $1,000,000 of credit sales throughout the year, a credit balance in allowance for doubtful accounts of $10,000, and an ending accounts receivable balance of $250,000. If we use the percent of credit sales method and estimate 5% of credit sales to be uncollectible, **how much is the ending balance in allowance for doubtful accounts at the end of 2020**?

39. At the end of 2020, Opus Coffee has $1,000,000 of credit sales throughout the year, a credit balance in allowance for doubtful accounts of $10,000, and an ending accounts receivable balance of $250,000. If we use the percent of accounts receivable method and estimate 5% of accounts receivable will not be collected, **how much is bad debt expense for 2020?**

40. At the end of 2020, Opus Coffee has $1,000,000 of credit sales throughout the year, a credit balance in allowance for doubtful accounts of $10,000, and an ending accounts receivable balance of $250,000. If we use the percent of accounts receivable method and estimate 5% of accounts receivable will not be collected, **how much is the ending balance in allowance for doubtful accounts at the end of 2020**?

<u>Additional Practice Questions:</u>

1.1 The Stockholders' Equity of Automatic Tutoring at the beginning and end of 2020 totaled $15,000 and $20,000, respectively. Assets at the beginning of 2020 were $27,000. If the liabilities of Automatic Tutoring increased by $9,000 in 2020, how much was total assets at the end of 2020?

1.2 Downtown Fats reported Assets at the beginning of the year at $31,000 and $39,000 at the end of the year. They also reported Liabilities at the beginning of the year at $9,000 and $10,000 at the end of the year. They also reported that they issued $55,000 in stock to the Keg Party and paid dividends totaling $32,000 for the year. What is Downtown Fats's net income or loss for the year?

A) Net Income of $16,000
B) Net Income of $25,000
C) Net Loss of $30,000
D) Net Loss of $16,000
E) None of the above

1.3 Italian Gator had a beginning and ending retained earnings balance of $100,000 and $120,000, respectively. If they reported Revenues for the year of $100,000 and Expenses of $70,000, how much in dividends were paid?

A) $10,000
B) $20,000
C) $30,000
D) $50,000
E) $90,000

1.4 Which of the following accounts would appear in a company's income statement?
A) Unearned Revenue
B) Cash
C) Dividends
D) Prepaid Rent Expense
E) None of the Above

1.5 What financial statement would you look at to see if a company is successfully selling its goods and services?

A) Income Statement
B) Statement of Cash Flows
C) Balance Sheet
D) Both A and B
E) All of the above

1.6 What are the two breakdowns of Stockholders' Equity

A) Revenues and Expenses
B) Retained Earnings and Dividends
C) Net Income and Dividends
D) Retained Earnings and Common Stock
E) Retained Earnings, Net Income, and Dividends

1.7 Cash paid for purchasing a building would be in what section of the Statement of Cash Flows?

A) Operating Activities
B) Investing Activities
C) Financing Activities
D) None, it belongs on the Income Statement

1.8 Assume the company only has the equity accounts we discussed in Chapter 1. You start the year with $100,000 of Assets, $20,000 of Liabilities, and $50,000 of Common Stock. You then finish the year with $120,000 of Assets, $40,000 of Liabilities, and $60,000 of Common Stock. You know that you had Revenues of $100,000 for the year and Expenses of $80,000. How much in dividends did you pay this year?

2.1 What would be the effect on total assets if a company purchased supplies with cash?

A) Increases Total Assets
B) Decreases Total Assets
C) Does not affect Total Assets
D) Not Enough Information

2.2 Which of the following accounts are a liability?

A) Prepaid Expense
B) Dividends
C) Deferred Revenue
D) Cash
E) None of the Above

2.3 Which of the following accounts would be debited when a company pays $12,000 in advance for one year of rent?

A) Cash
B) Rent Expense
C) Prepaid Rent
D) Rent Revenue
E) None of the Above

2.4 JJ's Tavern purchases a building for $200,000 cash, and in addition, signed $150,000 notes payable for the rest. The Fair Value of the building is estimated to be at $400,000, and a similar building down the street sold for $450,000. How much should JJ's Tavern record the building as on their Balance Sheet?

2.5 A trial balance is when a company lists all the accounts that exist in their accounting system (cash, equipment, accounts payable, etc.) and lists whether they have a debit or a credit balance. Then, all the debit balances are added together, and then the credit balances are added together. For example, when Company X completed this, they realized that all their debits equaled their credits.

True/False: Because Company X had all their debits equal their credits, this means there are no possible mistakes in any of their accounts.

2.6 If the entry to record the purchase of supplies on account is posted twice:

A) Assets will be understated
B) Liabilities will be understated
C) Liabilities will be overstated
D) Equity will be overstated
E) None of the above

2.7 What is the effect on the accounting equation when a company declares and pays out cash dividends?

A) Total assets will increase
B) Total liabilities will decrease
C) Total equity will increase
D) Total equity will decrease

3.1 You own a tequila company. This year, you sold $1,000,000 worth of tequila to customers, collected $750,000 from sales this year, and collected $150,000 from sales last year. You also incurred $600,000 worth of expenses from sales this year. Of the $600,000 of expenses you incurred this year, you paid $450,000 and will pay the rest next year. Under Accrual Accounting, what should your net income be?

A) $400,000
B) $1,000,000
C) $300,000
D) $600,000

3.2 Which of the following would be included in an adjusting entry relating to an unearned revenue?

A) Debit to Service Revenue
B) Credit to Deferred/Unearned Revenue
C) Debit to Cash
D) Credit to Service Revenue
E) None of the above

3.3 You paid $1,000,000 cash for a building two years ago. At the time of sale, the fair value was $1,200,000, and a local building sold for $1,500,000. If depreciation expense for the past two years has been $200,000 per year, what is the book value of the building today?

3.4 You take out a Notes payable on October 1, 2020, for $1,000,000 to be paid back in 6 months. The annual interest rate on the Note is 12%. What is the necessary journal entry required on December 31, 2020?

3.5 Employees at Downtown Fats currently earn $5,000 a week total. Employees usually receive pay for their workweek on Friday. So, for example, if an employee worked Monday to Friday, they would receive their paycheck on Friday after the workday. For this year, the calendar end is on a Wednesday. Therefore, the necessary journal entry at the end of the year on a Wednesday would include:

A) A debit to Salaries Payable of $3,000
B) A credit to Salaries Payable of $5,000
C) A credit to Salaries Expense of $2,000
D) A debit to Salaries Expense of $5,000
E) A credit to Salaries Payable of $3,000

3.6 An adjusting entry that includes a debit to a liability account and a credit to a service revenue account is an example of:

A) Deferred revenue
B) Deferred expense
C) Accrued Revenue
D) Accrued expense
E) None of the above

3.7 True/False: One of the reasons for adjusting entries is to update the Balance Sheet and update Revenue/Expense accounts.

3.8 You purchase $24,000 worth of rent that will last your company 24 months. You prepaid this rent on October 1, 2020. How much would rent expense be included (assume the accrual accounting method) on the Income statement for 2022?

3.9 Perform the necessary journal entry to close out the Expense account, which currently has a normal balance of $100,000.

5.1 What effect does a sales return have on Revenues, Expenses, and Equity overall?

A) Decreases net revenues, increases expenses, and decreases equity overall
B) No effect on net revenues, increases expenses and decreases equity overall
C) No effect on net revenues, no effect on expenses, and decreases equity overall
D) Decreases net revenues, no effect on expenses, and decreases equity overall

5.2 Downtown Fats offered a sales discount of 3/5, net 30 to all customers who pay on account. If one customer purchases alcohol of $1,000 on December 1, 2020, and pays for the alcohol on December 4, 2020, what is the necessary journal entry on December 4, 2020, assuming Downtown fats recorded an Accounts Receivable on December 1, 2020?

5.3 How do you calculate net revenue?

5.4 What kind of account is allowance for doubtful accounts?

A) A liability
B) Contra Revenue
C) Contra Asset
D) Expense

5.5 At the end of the year, JJ's Tavern has a debit balance in their Allowance for Doubtful Accounts of $10,000. Suppose JJ's Tavern uses the percent of accounts receivable method and currently has $100,000 of Accounts Receivable, estimating 8% will not be collected. How much will the ending credit balance be after Bad Debt Expense is recorded?

A) $10,000
B) $8,000
C) $18,000
D) $2,000

5.6 At the end of the year, JJ's Tavern has a credit balance in their Allowance for Doubtful Accounts of $10,000. If JJ's Tavern uses the percent of credit sales method and has $100,000 of credit sales this year, estimating 8% total will not be collected, how much will the ending credit balance be after Bad Debt Expense is recorded?

A) $10,000
B) $8,000
C) $18,000
D) $2,000

5.7 What is the journal entry to write off an uncollectible account under both the direct write-off and allowance methods? Assume the write-off is for $10,000.

5.8 What is the overall effect of a write-off under the allowance method?

A) Assets increase
B) Assets decrease
C) Assets don't change
D) Expenses increase

Answer Key- Concept Questions:

1. C
2. A
3. A
4. D
5. $115,000
6. I – Asset / II – Liability / III – Asset / IV – Expense
   V – Asset / VI – Revenue / VII - Liability
7. D
8. B
9. Relevance & Faithful Representation
10. (1) Income Statement, (2) Statement of Stockholder's Equity, (3) Balance Sheet, (4) Statement of Cash Flows
11. B
12. B
13. C
14. B
15. D
16. A
17. I – Debit / II – Credit / III – Credit / IV – Debit
    V – Credit / VI – Debit
18. I – Debit / II – Debit / III – Credit / IV – Debit /
    V – Credit / VI – Debit / VII – Debit
19. **See below**
20. Assets up arrow $100,000; Liabilities up arrow $30,000; Equity up arrow $70,000
21. C
22. B
23. B
24. C
25. B
26. D
27. B
28. A

#19 Answer

Cash	
5,000	
10,000	
	2,000
13,000	

29.

Salaries and Wages Expense	$20,000	
Salaries and Wages Payable		$20,000

30. Permanent = I, II, IV, VII / Temporary = III, V, VI

31.

Accounts Receivable	$10,000	
Service Revenue		$10,000

32. C
33. I – Credit / II, III, IV, V, & VI – Debit

34.

Sales Allowance	$100	
Accounts Receivable		$100

35. 3= 3% off / 10 = if paid within 10 days / n= no fee / 30 = if paid in 30 days

Cash	$970	
Sales Discount	$30	
Accounts Receivable		$1,000

36. **Direct Method:**

Bad Debt Expense	XX	
Accounts Receivable		XX

Allowance Method:

Allowance for Doubtful Accounts	XX	
Accounts Receivable		XX

37. $50,000
38. $60,000
39. $2,500
40. $12,500

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<u>Answer Key- Additional Practice Questions:</u>

1.1 $41,000
1.2 D
1.3 A
1.4 E
1.5 A
1.6 D
1.7 B
1.8 $30,000

2.1 C
2.2 C
2.3 C
2.4 $350,000
2.5 False
2.6 C
2.7 D

3.1 A
3.2 D
3.3 $600,000
3.4 Interest Expense $30,000
Interest Payable $30,000
3.5 E
3.6 A
3.7 True
3.8 $9,000
3.9 Debit Retained Earnings $100,000 and Credit Expenses $100,000

5.1 D
5.2 Cash $970
Sales Discount $30
A/R $1,000
5.3 Sales/Service Revenue – Sales Discounts, Allowances, and Returns
5.4 C
5.5 B
5.6 C
5.7 Direct Write off Method: Debit Bad Debt Expense $10,000 and Credit Accounts Rec $10,000
Allowance Method: Debit Allowance for Doubtful Accounts $10,000 and Credit Accounts Rec $10,000

5.8 C

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Formula Sheet

Chapter 1:

Assets = Liabilities + Stockholders' Equity

Asset = a resource of the company / Liability= a resource of the company that is owed to someone else

Equity= resources of the company that the company itself owns

Net Income = Revenues – Expenses / Net loss = Expenses – Revenues

Retained Earnings
Beginning Retained Earnings
+ Net Income
- Net Loss
- Dividends
=Ending Retained Earnings

Change in Stockholders' Equity
Beginning Stockholders' Equity
+ Common Stock Issued
+ Net Income/ - Net Loss
- Dividends
=Ending Stockholders' Equity

Order of the Financial Statements: Income Statement, Statement of Stockholders' Equity, Balance Sheet

Chapter 2:

Normal Balance= what each account usually has (a debit or credit balance)

Normal Debit Balance= Assets, Expenses, Dividends

Normal Credit Balances= Liabilities, Common Stock, Revenues, Retained Earnings

Account Type	Increase	Decreases
Asset	Debit	Credit
Liability	Credit	Debit
Common Stock	Credit	Debit
Revenue	Credit	Debit
Expense	Debit	Credit
Dividends	Debit	Credit

Chapter 3:

Interest Expense= Loan Amount x Annual Interest Rate x (# months/12)

Journal Entry for Depreciation

Depreciation Expense	$XXX	
Accumulated Depreciation		$XXX

Book Value of an Asset = Cost of Asset – Accumulated Depreciation

Chapter 5:

Sales Returns, Allowances, and Discounts= Contra-Revenue Accounts & have a debit balance

Net Revenue = Sales/Service Revenue – Sales Returns – Sales Allowances – Sales Discounts

Allowance for Doubtful Accounts = Contra Asset & has a credit balance

Net Receivables = Accounts Receivable – Allowance for Doubtful Accounts

Journal Entry for Bad Debt Expense if Accrual Accounting method:

Bad Debt Expense	XX	
AFDA		XX

Journal Entry for Bad Debt Expense if Direct Write-off method:

Bad Debt Expense	XX	
Accounts Rec		XX

AFDA= Allowance for Doubtful Accounts in formulas

Under Aging Method:
Bad Debt Expense = Ending AFDA needed – Current AFDA if a **credit balance**

Bad Debt Expense = Ending AFDA needed + Current AFDA if a **debit balance**

Under Percent of Credit Sales Method:
Bad Debt Expense = Credit Sales in year x % Estimated uncollectable

Accounts Receivable

	Debit	Credit
Beginning Balance:	$20,000	
Credit Sales:	$5,000	
Write Offs:		$10,000
Cash Collections:		$5,000
Ending Balance:	$10,000	

Allowance for Doubtful Accounts

	Debit	Credit
Beginning Balance:		$20,000
Written Offs:	$10,000	
Bad Debt Expense:		$15,000
Collection of previous write offs:		$10,000
Ending Balance:		$35,000

Receivable turnover ratio: Net Credit Sales / Average Accounts Receivable

Average collection period: 365 days / Receivables

Good luck on the Exam!