

REVIEW FOR EXAM NO. 3, ACCT-2301 (SAC)
(Chapters 7-10)

A. CHAPTER 7 (Accounting for Receivables)

1. Valuation of Accounts Receivable.

- a. Matching Principle recognizes uncollectible receivables (losses) at the time the sales occur.
- b. Bad Debts Expense/Allowance for Doubtful Accounts is an estimate, since it is not known as to who will default, when, or in what amount.

c. Uncollectible Receivables Accounting Methods.

(1) Direct Write-Off Method: (Page 274)

- (a) Does not match revenues and expenses during the accounting period.
- (b) Acceptable procedure only when the amount is insignificant (not material).

(2) Allowance Method: (Page 275)

- (a) Percent-of -Sales (Income Statement Approach):
 - historical bad debt percentage of credit sales for the current period
 - add computed amount to the allowance account
- (b) Percent-of-Receivables (Balance Sheet Approach):
 - total receivable amount is multiplied by a historical percentage
 - adjust the allowance account to computed amount.
- (c) Aging-of- Receivables (Balance Sheet Approach):
 - detailed analysis of outstanding accounts receivable individual accounts
 - adjust the allowance account to computed amount

d. Illustrated Entries for Recording Bad Debts Expense:

(1) Direct Write-Off Method:

20xx
 Mar 27 Bad Debts Expense.....\$ 360
 Accounts Receivable-Mary Spencer..... \$ 360
 To record write-off of an uncollectible account.

(2) Allowance Method:

20xx
 Dec.31 Bad Debts Expense..... \$1,810
 Allowance for Doubtful Accounts..... \$1,810
 *To record estimated amount of
 uncollectible accounts.*

	20xx		
Mar 27	Allowance for Doubtful Accounts.....	\$ 285	
	Accounts Receivable-Arno Fall.....		\$ 285
	<i>To record write-off of an uncollectible account.</i>		

2. Notes Receivable. (Page 281)

a. Characteristics:

- (1) Promissory note – written promise to pay.
- (2) Specific amount of money (face value or principal).
- (3) Payable at a definite time.
- (4) Note is a negotiable instrument and can be transferred by endorsement.

b. Life of a Note: (Page 282)

- (1) Can be expressed in terms of: (a) Days
(b) Months
- (2) Determination of maturity date.

c. Interest: (Page 282)

- (1) Rate of interest on a note is the rate charged for use of the principal for one year.

(2) Formula for calculating interest: ($P \times i \times t = I$)

Example Note (\$1,000 note, 9% interest rate, for 120 days)

		Interest			
<u>Principal</u>	x	<u>Rate</u>	x	<u>Time</u>	= <u>Amount</u>
\$ 1,000		9%		120 Days	\$30
\$1,000		.09		120/360	\$30

d. Maturity Value. (Formula: $MV = P + I$)

The sum of the principle (face) amount and the interest earned.

e. Journal Entries Related to Notes Receivable. (Review entries on Pages 283-284)

B. Chapter 8 (Accounting for Long-Term Assets)

1. Plant Assets. (Page 303)

a. Definition - Tangible assets used in business and have a permanent or long life.

b. Cost of Plant Assets.

- (1) All costs necessary to make asset ready for its intended purpose.
- (2) Cost of land includes purchase price plus all related fees, commissions, etc.
Does not include such items as fencing, sidewalks, paving parking lots, signs, etc., which are depreciable and are accounted for separately as land improvements.

2. Lump-Sum Purchase. (Page 305)

- a. Single purchase involving several plant asset (i.e., land, building, machinery, etc.)
- b. Cost allocated on the basis of their relative market values.

3. Depreciation Definition. Allocating to expense, the cost of an asset over its useful life, in a systematic manner. (Page 305)
4. Accumulated Depreciation - contra-account (subtracts from the related asset account on the face of the Balance Sheet).
5. Depreciation Factors/Considerations. (Page 305)
 - a. Acquisition Cost
 - b. Residual Value (RV), Salvage Value (SV), Trade-In (TI), or Scrap Value (all the same).
 - c. Useful Life
 - d. Depreciable Cost (Cost - Salvage Value)
 - e. Book Value (BV) = (Cost - Accumulated Depreciation)

6. Depreciation Methods. (Page 306)

a. Information Available:

Cost of Machine.....	\$ 20,000
Estimated Salvage Value	\$ 2,000
Estimated Production (Over life).....	24,000 Units
Estimated Useful Life.....	5 Years
Current Year Production.....	5,000 Units

b. Straight-Line Depreciation:

$$\frac{\$ 20,000 - \$ 2,000}{5 \text{ Years}} = \$ 3,600/\text{Year}$$

c. Units-of-Production Depreciation:

(1) Rate Computation: $\frac{\$ 20,000 - \$ 2,000}{24,000 \text{ Units}} = \$.75/\text{Unit}$

(2) Depreciation: 5,000 Units x \$.75 = \$ 3,750

d. Double-Declining-Balance Depreciation:

(1) Rate Computation: $\frac{100\%}{5 \text{ Yrs.}} = 20\% (x 2) = 40\%$

(2) Depreciation:

<u>Yr</u>	<u>Carrying Amount</u>	<u>Factor</u>	<u>Annual Deprec.</u>	<u>Accum. Deprec.</u>
1	\$20,000	40%	\$8,000	\$ 8,000
2	12,000	40%	4,800	12,800
3	7,200	40%	2,880	15,680
4	4,320	40%	1,728	17,408
5	2,592	40%	592(*)	18,000

(*) Note: You cannot depreciate below the Salvage Value of \$2,000. The actual computation is \$1,036.80 but only \$592 can be taken as the depreciation amount.

7. Disposal of Assets. (Page 312)

a. Sale.

(1) Information Available:

Cost of Machine.....	\$5,000
Accumulated Depreciation.....	4,200
Cash Received on Sale.....	900

(2) Journal Entry to Record Sale:

Cash.....	\$ 900	
Accumulated Depreciation-Machines.....	4,200	
Machinery.....		\$ 5,000
Gain on Sale of Assets.....		100

b. Exchange of Plant Assets. (Page 323)

(1) Commercial Substance Definition - An exchange has commercial substance if a firm's future ***cash flows*** change as a result of the transaction.

(2) Commercial Substance Rules:

- (a) Record gains and losses when commercial substance ***exists***.
- (b) Gains and losses are absorbed into the cost of the new asset when commercial substance ***does not*** exist.

c. Depreciation account is updated for any partial year use, up to the date of disposal, before recording the disposal of an asset.

8. Natural Resources. (Page 315)

a. Long-term assets.

b. Physically extracted in operations and is not replaced. Referred to as wasting assets.

c. Depleted based on units of production (similar to depreciation).

d. Depletion is recorded by charging to an expense account and crediting an accumulated depletion account.

e. <u>Data:</u>	Cost.....	\$400,000	<u>Depletion Calculation:</u>
	Salvage Value.....	\$ 20,000	$\frac{\$400,000 - \$20,000}{1,000,000 \text{ tons}} = \0.38 per ton
	Est. Production.....	1,000,000 tons	
	1 st year Production....	90,000 tons	

f. Journal Entry:

Depletion Expense.....	\$ 34,200	
Accumulated Depletion - Coal.....		\$ 34,200
(90,000 x \$0.38 = <u>\$34,200</u>)		

g. Natural Resources are reflected on the Balance Sheet at cost, less accumulated depletion.

9. Intangible Assets. (Page 317)

- a. Assets that have no physical existence, but have value.
- b. Examples.
 - (1) Patents (3) Goodwill
 - (2) Copyrights (4) Trademarks
- c. Amortization - Write-off of intangible assets to expense, over their useful life.
- d. Goodwill.
 - (1) The value of all favorable attributes that are related to a business as a whole. A business is said to have goodwill when it's rate of expected future earnings is greater than that normally expected in the industry.
 - (2) Recorded only when there is an exchange transaction that involves the purchase of an entire business and the price paid exceeds the fair market value of the net assets acquired.
 - (3) Goodwill is not amortized. It is tested annually to determine if there is any impairment of its value.

C. Chapter 10 - (Accounting for Long-Term Liabilities).

1. Characteristics of Bonds Payable. (Page 381)
 - a. Bond Indenture - Contract with bond purchasers.
 - b. Denominations - Normally issued in denominations of \$1,000 or \$5,000.
 - c. Interest - Bond interest is usually paid semi-annually. (normal expense for tax purposes)
2. Types of Bonds.
 - a. Serial Bonds - Principal amount due in installments (mature at different dates).
 - b. Term Bonds - Principal amount due in lump sum (end of period).
 - c. Debenture/Unsecured Bonds - Sale is based on the general credit standing of the corporation (no collateral).
 - d. Secured Bonds - Collateral is used.
3. Bond Interest Rates.
 - a. Contract (Stated / Coupon) Rate - Rate of interest paid to the bond holders (Investors).
 - b. Market (Effective) Rate - Rate of return investor gets, based on the amount paid for the bond.
4. Present Value Application. (Page 395)
 - a. Present Value proceeds of a bond issue is it's selling/market price.
 - (1) PV of the Bond Principal and all of the period interest payments (all future cash payments).
 - (2) Present value cash flows are determined using the market (effective) interest rate.

5. Bond Issue Pricing. (Page 384)

- a. Sold at Par (Face Amount) - (Market Rate = Contract Rate)
- b. Sold at a Discount - (Market Rate > Contract Rate)
- c. Sold at a Premium - (Market Rate < Contract Rate)

6. Periodic Interest Payments.

a. Formula:
$$\frac{\text{Bond Face Amount}}{(\$100,000)} \times \frac{\text{contract interest rate}}{7\%} = \frac{\text{Bond Interest Payment}}{\$7,000} / 2 = \$3,500$$

- b. Bond interest payments are made every 6 months.

7. Amortization of Bond Discount/Premium.

- a. Straight-Line Method (constant amount of interest expense) (Pages 385 & 387)

$$\text{Interest Expense} = \text{Cash Interest Payment} + \frac{\text{Discount Amount}}{\text{No. of Periods}}$$

(Or)

$$\text{Interest Expense} = \text{Cash Interest Payment} - \frac{\text{Premium Amount}}{\text{No. of Periods}}$$

- b. Effective Interest Method (constant rate of interest) (Page 397)

$$\text{Interest Expense} = \text{Carrying Amount} \times \text{Market Rate} / 2$$

8. Bond Retirement. (Page 388)

- a. Callable Bonds - Bonds redeemable at option of the corporation (before maturity).
- b. Convertible Bonds - Bonds are redeemable at option of the investor. Bondholder has the option to convert bonds to common stock, at a specified ratio.
- c. Pay off face value at maturity.
- d. Purchase bonds on the open market.

9. Bond Journal Entries. (Pages 382-387)

- a. Issued at Par
- b. Issued at a Discount
- c. Issued at a Premium