

MODULE 1 Communication and Terminology for the
Workplace

TOPIC 2 Letters of Request and Income Statements

LEARNING OUTCOMES:

By the end of this lesson, participants will be able to:

- ◆ read accounting cases, analyze and evaluate problems, and work out solutions with a partner
- ◆ prepare Income Statements based on given information
- ◆ write a letter to a client requesting more information

TOPIC	SKILLS	CLB COMPETENCE AREA	COMPETENCIES	PRE-TASKS	TASKS	POST TASKS
<ul style="list-style-type: none"> ◆ Letters of Request and Income Statements 	<ul style="list-style-type: none"> ◆ Reading ◆ Writing ◆ Listening/ Speaking 	<ul style="list-style-type: none"> ◆ informational texts – analysis and evaluation ◆ formatted texts ◆ exchanging information ◆ suasion 	<ul style="list-style-type: none"> ◆ understand credit and debit rules in Income Statements ◆ understand the reporting format of Income Statements ◆ understand and using format and standard language of business letter ◆ Analyze and evaluating case studies by applying prior knowledge 	<ul style="list-style-type: none"> ◆ match terminology associated with Income Statements ◆ categorize transactions into different types of revenues and expenses ◆ negotiate meanings of terminology associated with Income Statement 	<ul style="list-style-type: none"> ◆ prepare an Income Statement ◆ write a letter to a client requesting more information ◆ explain and defend decisions after reading and analyzing a case study 	<ul style="list-style-type: none"> ◆ read and discuss problems of managing a small business

Facilitator's Guide for Module 1
Topic 2: Letters of Request and Income Statements

FACILITATOR PREPARATION

Content

Please see Topic 1, Module 1.

Delivery

Make as many copies as necessary of the following handouts:

- ◆ Handout 1 Discussion Questions
 - ◆ Handout 2 Matching Activity
 - ◆ Handout 3 Accounting Activity (optional)
 - ◆ Handout 4 More Discussion Questions
 - ◆ Handout 5 Accounting Activity 2 (optional)
 - ◆ Handout 6 Case 1 and Letter of Request Task
 - ◆ Handout 7 Some Standard Phrases for Letters of Request
 - ◆ Handout 8 Letter of Request to City Brothers
 - ◆ Handout 9 Case 2: Always Fresh Cleaners/Internal Control
 - ◆ Handout 10 Case 3: The Doughnut Shop/Cash Problems
- Terminology List (optional)

Materials needed: access to an overhead projector and OHT 1.

Methodology

Introduction

- (20 minutes)** 1. Distribute Handout 1. Elicit from participants answers to questions 1-17 by dividing class into four groups and assigning four or five questions to each group. Participants negotiate the answers in these groups.
- Review by having a volunteer from each group read or explain the answers to the class.
- (5 minutes)** 2. Explain to the class that in today's lesson, participants will have two tasks. The first is writing a letter of request to a company for more income information. The second is analyzing Income Statements and giving advice to two companies. Participants will have to explain their cases and defend their reasons to each other.

Pre-Tasks

- (30 minutes)** 1. Distribute Handout 2 and elicit explanations for the terms a-q from the class first, then ask participants to work in pairs or alone and match given terms with the explanations/definitions provided.
- Have participants compare their answers and review all answers on the board/OHP.
- Elicit vocabulary explanations from the class.
- (optional)** 2. Instruct participants to go back to questions 1-17 on Handout 1 and negotiate the answers (with a partner) to those questions that were disputed at first. Review orally with the class.
- (optional)** 3. Ask participants to work in groups of three and complete exercises 1-5 on Handout 3. Review orally and on the board (volunteers write the answers). Provide further explanation if necessary.

- (10 minutes)** 4. Show OHT 1 and discuss with the class differences between fixed expenses and variable expenses.

Answers:

i) *Fixed expenses, Variable expenses*

ii) **Fixed Expenses:**

Car loan payment expense

Car Insurance expense

Variable Expenses:

Advertising expense

Telephone expense

Repairs expense

Equipment expense

General expense

- (25 minutes)** 5. Instruct participants to interview their partners using questions from Handout 4. Assign four to six questions per pair, review orally and, if necessary, on the board.

- (30 minutes)** 6. Distribute Handout 5 and have participants work in groups of four on exercises 1-4. Review all exercises orally and exercises 1 and 2 on the board. Have volunteers or assigned participants from each group give a few answers to the class or write them on the board.

Task

(45 minutes)

1. Explain to the class that the first task is a case study that will be used as the basis for a letter-writing task. Review standard letter format and opening and closing statements from the previous lesson. Distribute Handout 6. Have the participants read the case study and work in pairs to answer questions a-c in Part 1. The participants then have to write a letter in Part 2, incorporating information from Part 1. Distribute Handout 7, which has some standard phrases for requesting information. The participants themselves supply the content. Afterwards, have the participants look at each other's letters and comment on their effectiveness. Distribute Handout 8 as a model letter for the participants to keep for future reference.

2. The second task is a jigsaw activity that will allow participants to analyze a case, make decisions, and give reasons for their decisions or advice. Divide the class into groups of three. Each group gets Case 2 (Handout 9). Participants in each group read the case and discuss it according to the questions provided. The participants regroup into new groups and present their plan to new group members. The purpose of the task is to discuss, explain, and defend their solutions based on their prior knowledge and experience. Have a wrap-up discussion to resolve any differences of opinion.

(Note: In order to facilitate group discussion and group decision-making processes, Handout 7 from Module 1 Topic 3 could be distributed prior to the task.)

Post-Task

(30 minutes)

Ask how many participants have or would like to own/manage a small business? What are some of the problems that could be faced? Explain that the final task for the day is to read a case about a problem running a small business: a doughnut shop. Divide the class into groups of three. Distribute Handout 10 (Case 3) and after reading the case, discuss participants' solutions. Conclude with a brief, whole-class discussion on the topic as time permits.

Handout 1

DISCUSS ANSWERS TO THE FOLLOWING QUESTIONS:

1. Name two financial statements.
2. Define each of the following and give four examples of revenue and expense:
 - a) Revenue
 - b) Expense
 - c) Net income
 - d) Net loss
3. Why do businesses prepare income statements?
4. What are the three parts of the heading of the income statement?
5. How does the heading for the income statement differ from that of the balance sheet?
6. What are the two main sections of the income statement?
7. Does the receipt of cash by a business indicate that revenue has been earned? Explain.
8. Does the payment of cash by a business indicate that an expense has been incurred? Explain.
9. The Milan Company, owned by Robert Gennaro, completed its first year of operation on December 31, 198X. State the proper heading for the first annual income statement.
10. Explain how expenses affect owner's equity.
11. Explain how revenue affects owner's equity.
12. How does the owner of a business decide what expense accounts to have for the company?
13. How does the owner of a business decide what revenue account(s) to have for the company?
14. How is the net income or loss of a business calculated?
15.
 - a) Describe a situation when a business could earn a net profit.
 - b) Describe a situation when a business could have a net loss.
16. Define:
 - a) Income statement
 - b) Accounting period
 - c) Accrual accounting
 - d) Matching principle
17. List the four steps in preparing an income statement.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985; and D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 1

1. *Balance sheet, income statement*
 2.

<ol style="list-style-type: none"> a) Refer to Handout 2 - 16 b) Refer to Handout 2 - 7 c) Refer to Handout 2 - 14 d) Refer to Handout 2 - 15 		<i>and refer to Facilitator's Answer Sheet for Handout 2</i>
---	--	--
- | <u>Revenue</u> | <u>Expenses</u> |
|-----------------------------------|-------------------------------|
| <i>Sales of Merchandise</i> | <i>Telephone Expense</i> |
| <i>Services Rendered</i> | <i>Transportation Expense</i> |
| <i>- Repairs</i> | <i>Salaries Expense</i> |
| <i>- Consultation</i> | <i>Utilities Expense</i> |
| <i>Sale of goods manufactured</i> | |
3. *To show profitability of the business in a given accounting period*
 4. *Name of the company*
Name of the statement (e.g., Income Statement).
Date (e.g., for the period ended December 31, 200X)
 5. *On Balance Sheet – Date is a particular day.*
On Income Statement – Date is a fiscal period (e.g., for year 200- or for the fiscal year ending Apr. 30/0X).
 6. *Revenue, expenses.*
 7. *Not necessarily. It could be that the company is paid ahead of providing all services or delivering all goods.*
 8. *No, it doesn't. A business could buy a car for cash but the actual expense (i.e., depreciation) is accrued as the car is used over the years.*
 9. *Milan Company*
Income Statement for the period ended Dec. 31, 198X
 10. *Expenses decrease owner's equity.*
 11. *Revenue increases owner's equity.*
 12. *It depends on the types of expenses incurred or predicted to be incurred (i.e., it depends on the type of a business).*
 13. *It depends on how revenue is earned (through providing services, selling merchandise, or manufacturing and selling goods).*
 14. *Net Income (or Net Loss) = Revenue – Expenses.*
If Revenue > Expenses → Net Income If Revenue < Expenses → Net Loss.
 15.
 - a) *When revenue is greater than expenses.*
 - b) *When expenses are greater than revenue.*
 16. *Refer to Handout 2 and Facilitator's Answers Sheet for Handout 2*

a) 11	c) 2
b) 1	d) 13
 17.
 - i) *Total revenue is listed.*
 - ii) *Total expenses are listed.*
 - iii) *Total revenue and total expenses are calculated.*
 - iv) *Net income is calculated by subtracting total expenses from total revenue, and is written at the bottom of the statement.*

Handout 2

Match the following definitions/explanations with the terms provided on the side. The first one has been done for you.

- | | |
|--|--|
| 1. <u>Accounting period</u> The span of time covered by an income statement. One year is the accounting period for much financial reporting, but financial statements are also prepared by companies for each quarter of the year and also for each month. | a) Expenses |
| 2. _____ Calls for recording revenue in the period in which it is earned and recording expenses in the period in which they are incurred. The effect of events on the business is recognized as services are rendered or consumed rather than when cash is received or paid. | b) Financial statement order |
| 3. _____ Revenue is recorded when received in cash and expenses are recorded in the period in which cash payment is made. Fails to match revenue with related expenses and therefore does not lead to a logical measurement of income. | c) Accounting period |
| 4. _____ At the end of the accounting period the Capital account must be updated to reflect operations for the fiscal period just ended. Depending on the amount of net income, or net loss, and the drawings taken by the owner, there will be either an increase or a decrease in Capital. | d) GAAP (Generally Accepted Accounting Principles) |
| 5. _____ The systematic allocation of the cost of an asset to expense during the periods of its useful life. | e) Income statement |
| 6. _____ The account used to record the withdrawals of cash or other assets by the owner. Closed at the end of the period by transferring its balance to the owner's capital account. | f) Change in capital |
| 7. _____ The cost of the goods and services used up in the process of obtaining revenue. Sometimes referred to as <i>expired costs</i> . | g) Income summary account |

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8. _____ Sequence of accounts in the ledger: balance sheet accounts first (assets, liabilities, and owner's equity), followed by income statements accounts (revenue and expenses). h) Accrual basis of accounting
9. _____ Any 12-month accounting period adopted by a business. i) Matching principle
10. _____ The accounting concepts, measurement techniques, and standards of presentation used in financial statements. Examples include the cost principle, the going-concern assumption, and the objectivity principle. j) Net loss
11. _____ The income statement is a formal financial statement prepared at the end of the accounting or fiscal period. It shows the revenue earned during that period and the expenses incurred to earn those revenue. Total expenses are subtracted from total revenues to calculate the net income or net loss for the accounting period. k) Cash basis of accounting
12. _____ The summary account is the account to which revenue and expense accounts are closed at the end of the period. The balance (credit balance for a net income, debit balance for a net loss) is transferred to the owner's capital account. l) Net income
13. _____ The revenue earned during an accounting period is matched with the expenses incurred in generating this revenue. m) Revenue
14. _____ The excess of revenue earned over the related expenses for a given period. n) Temporary proprietorship accounts
15. _____ The excess of expenses over revenue earned for a given period. o) Depreciation
16. _____ The value of goods sold and services rendered by a business. Equal to the inflow of cash and receivables in exchange for services rendered or goods delivered during the period. p) Fiscal year
17. _____ The accounts for revenue, expenses, and withdrawals, used during the accounting period to classify changes affecting the owner's equity. q) Drawing account

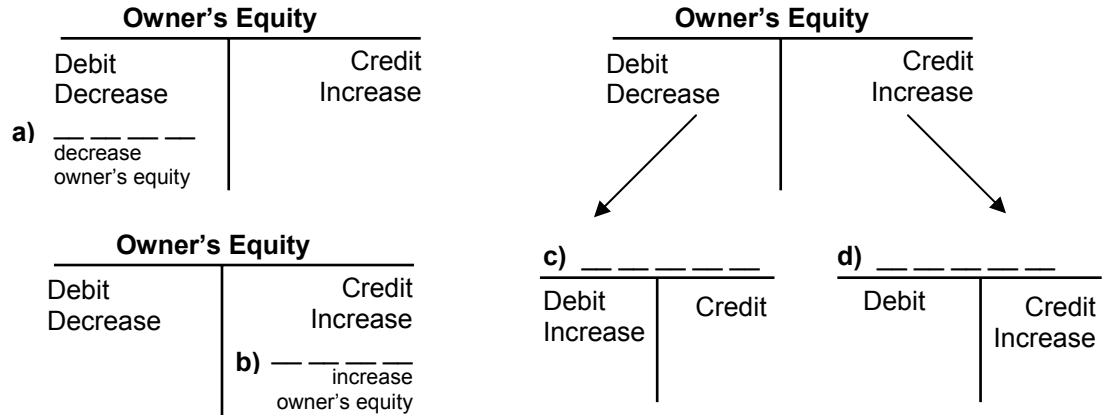
Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985; and D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 2

1. c) – Accounting period
2. h) – Accrual basis of accounting
3. k) – Cash basis of accounting
4. f) – Change in capital
5. o) – Depreciation
6. q) – Drawing account
7. a) – Expenses
8. b) – Financial statement order
9. p) – Fiscal year
10. d) – GAAP (Generally Accepted Accounting Principles)
11. e) – Income statement
12. g) – Income summary account
13. i) – Matching principle
14. l) – Net income
15. j) – Net loss
16. m) – Revenue
17. n) – Temporary proprietorship accounts

Handout 3 (Optional)

Ex. 1. Complete the following diagrams, inserting Revenue or Expenses on broken lines (a, b, c, d):



Ex. 2: Complete the following statements with credits, debits, increase, decrease.

Revenues are _____ because they _____ owner's equity.

Expenses are _____ because they _____ owner's equity.

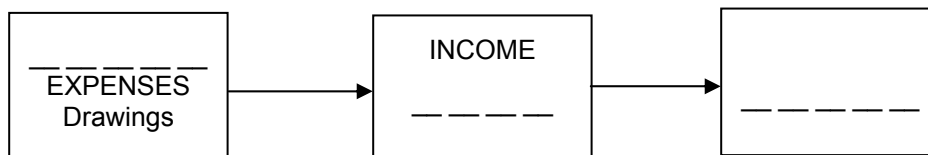
Ex. 3: Categorize the following terms, putting them either on the left or the right side of "T account" for Owner's Equity (Capital)

Owner's Equity		
Credit	Y Credit	Drawings
	Net Loss	Net Income
	Owner's Investment	Debit

Ex. 4: Complete the Owner's Equity section of balance sheet for E. Thomson's business, writing the missing words on the broken lines.

Owner's Equity		
		\$17,736
1. Add: _____ for year	\$33,302	
2. Less: E. Thomson _____	8,500	
3. _____ in Capital		24,802
E. Thomson, Capital, December 31		\$42,538
Total Liabilities and Owner's Equity		\$72,538

Ex. 5: Complete the following diagram using appropriate terms.



Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 3

Ex. 1 a) Expenses

b) Revenue

c) Expenses

d) Revenue

Ex. 2

Revenues are credits because they increase owner's equity

Expenses are debits because they decrease owner's equity

Ex. 3

Owner's Equity

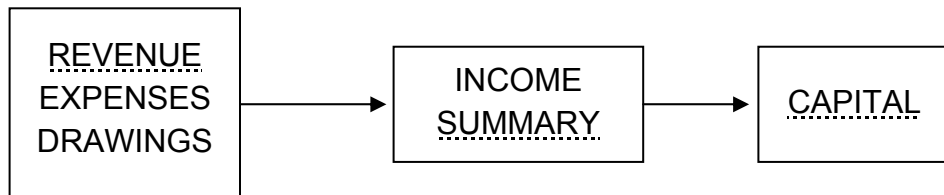
Owner's Equity	
Debit	Credit
Net Loss	Net Income
Drawings	Owner's Investment

Ex. 4 i) Net Income

ii) Drawings

iii) Increase

Ex. 5



OHT 1

Discuss the following questions:

1. What are two categories of expenses?
2. How would you divide the expenses in the statement below into these two categories?

**E. Thomson, DJ
Income Statement
For the year ended December 31, 200X**

Revenue

Fees Earned	\$28,880	
Revenue from Repairs	<u>10,285</u>	\$39,165

Expenses

Advertising Expense	\$3,880	
Telephone Expense	220	
Repairs Expense	1,076	
Equipment Expense	465	
Car Loan Payment Expense	1,000	
Car Insurance	850	
General Expense	<u>280</u>	<u>7,771</u>
Net Income		<u>\$31,394</u>

Net Income \$31,394

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985; and D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

Handout 4

Discuss answers to the following questions:

- 1) Are increases in revenue recorded in the T-accounts as debits or credits? Why?
- 2) Are increases in expenses recorded in the T-accounts as debits or credits? Why?
- 3) What are drawings? Give two examples of transactions that would be recorded using the drawings account. Are they recorded as debits or credits? Why?
- 4) On which financial statement does the drawings account appear? Why?
- 5) What restriction is placed on a business regarding payment of a salary to its owner?
- 6) What account must be used to record the payment of a salary to the owner of a business?
- 7) Which financial statement is prepared first? Why?
- 8) What effect does a withdrawal of assets from the business by the owner have on owner's equity?
- 9)
 - a) What effect does a net income have on the owner's equity?
 - b) What effect does a net loss have on the owner's equity?
- 10) Does a well-prepared income statement provide an exact measurement of net income for the period, or does it represent merely an approximation of net income? Explain.
- 11) How does depreciation expense differ from other operating expenses?
- 12) Assume that a business acquires a delivery truck at a cost of \$4,800. Estimated life of the truck is four years. State the amount of depreciation expense per year and per month. Give the adjusting entry to record depreciation on the truck at the end of the first month, and explain where the accounts involved would appear in the financial statements.
- 13) Which of the ten accounts listed below are affected by closing entries at the end of the accounting period?

Cash	Don Cooks, Drawing
Fees Earned	Don Cooks, Capital
Income Summary	Accumulated Depreciation
Accounts Payable	Accounts Receivable
Telephone Expense	Depreciation Expense
- 14) How does the accrual basis of accounting differ from the cash basis of accounting? Which gives a more accurate picture of the profitability of a business? Explain.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985; and D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 4

- 1) *As credits, because the normal balance of revenue is credit.*
- 2) *As debits, because the normal balance of expenses is debit.*
- 3) *Withdrawal (removal) of money from the company's bank account on behalf of the owner.*
Examples:
 - i) *salary paid to the owner of the company*
 - ii) *withdrawal of cash from the company's bank done by the owner (for his or her personal use)*

Both examples above recorded as debits because both decrease owner's equity.
- 4) *On balance sheet because it is a reduction of owner's equity (or a deduction from owner's capital).*
- 5) *Payment of salary cannot be shown as a business expense.*
- 6) *Drawings account.*
- 7)
 - *Income statement first because revenue and expense accounts have to be closed to income summary account and that account has to be closed to owner's equity account in balance sheet.*
 - *The company wants to know first its profitability for a given accounting period and then its financial position after counting net income.*
- 8) *It decreases owner's equity.*
- 9)
 - a) *It increases owner's equity*
 - b) *It decreases owner's equity*
- 10) *Approximation, because cash from accrued income could be recorded in form of accounts receivables, which in turn might not be fully collected. (Approximation from cash point of view).*
- 11) *It is accounted for over time as the asset is used.*
- 12) $\$4,800 \div 4 \text{ years} = \$1,200 \text{ per year}$ $\$1,200 \div 12 \text{ months} = \100 a month
 Car Depreciation expense \$100
 Accumulated Depreciation, truck \$100
 To record accumulated depreciation for the first month
 Accumulated depreciation on balance sheet (assets)
 Car depreciation expense on income statement (expenses)
- 13) *Fees earned; Income Summary; Telephone Expense; Don Cooks, Drawing; Depreciation Expense.*
- 14) *In accrual basis, revenue is recognized even if cash hasn't been collected and expenses are accrued even if the payments haven't been made. In cash basis accounting, revenue is recognized only when cash is collected/received and expenses are recorded only when cash is paid out.*
 In accrual accounting, we are more concerned with recognizing earned revenue and incurred related expenses, whereas in cash basis accounting, cash collection and cash payout are the main points of recognition of revenue or expenses.
 The accrual basis of accounting gives a better picture of the profitability because it accounts for all revenue earned in a given period and the related expenses, regardless of the cash flow.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985; and D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

Handout 5 (Optional)

Ex. 1. Decide to which statement each of the accounts belong to and what is its usual balance (i.e., debit or credit). The first account, Cash, is done for you.

Account Title	Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit
Cash			Y	
Supplies in stock				
Rent Expense				
D. Moss, Capital				
Office Equipment				
Accounts Payable				
Advertising Expense				
Utilities Expense				
Bank Loan				
Sales				
Accounts Receivable				
Service Revenue				
Other Income				
Land				
D. Moss, Drawings				
Bank Charges				
Mortgage Payable				
Depreciation Expense				

Ex.3 The following transactions occurred during July. For each transaction indicate whether it represents revenue to this accounting firm for the month of July. In each case give a reason for your answer.

- July 1 Received a payment of \$300 from a customer on an account receivable incurred in June.
- 3 Prepared a business proposal for a client to take to her bank manager and was paid \$90.
- 11 Owner invested an additional \$5,000 in the business.
- 15 Obtained a bank loan to purchase new office furniture, \$3,000.
- 19 Performed an accounting service for a client and billed the customer \$350.

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Ex. 2 Check the appropriate box – debit or credit to show what the bookkeeper should do if he or she wants to:

1. Increase the payroll expense account.
2. Increase the notes payable account.
3. Increase the proprietorship (capital) account.
4. Increase the inventory account.
5. Increase the sales account.
6. Decrease the owners' equity account.
7. Decrease the furniture and fixtures account.
8. Decrease the telephone (expense) account.

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- 9. Decrease the sales (income) account.
- 10. Decrease the mortgage (liability) account.

Ex.4 The following transactions occurred during July. For each transaction indicate whether or not it is an expense for this accounting firm for the month of July. In each case give a reason for your answer.

- July 3 Paid \$200 to a creditor to reduce the balance owing from June.
- 9 Paid the weekly office salaries of \$2,850.
- 13 Purchased new office furniture and paid \$3,600 cash.
- 26 Received a bill for \$375 for tuning up the company car. The bill must be paid by September 15.

Adapted from: Costinett, S. The Language of Accounting in English. Inglewood Cliffs: Prentice Hall Regents, 1977.

FACILITATOR’S ANSWER SHEET FOR HANDOUT 5

Ex.1

Account Title	Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit
Cash			Y	
Supplies in stock			Y	
Rent Expense	Y			
D. Moss, Capital				Y
Office Equipment			Y	
Accounts Payable				Y
Advertising Expense	Y			
Utilities Expense	Y			
Bank Loan				Y
Sales		Y		
Accounts Receivable			Y	
Service Revenue		Y		
Other Income		Y		
Land			Y	
D. Moss, Drawing			Y	
Bank Charges	Y			
Mortgage Payable				Y
Depreciation Expense	Y			

- Ex.3** July 1 *No, it does not represent revenue in July. It was recognized as revenue in June (accrual basis of accounting)*
- 3 *Yes, it is a service revenue earned*
- 11 *No, it is only an investment*
- 15 *No, it is recorded as a Bank Loan not a revenue*
- 19 *Yes, it is a service revenue earned even though cash has not been collected yet (accrual basis of accounting)*

Ex. 2

Check the appropriate box – debt or credit to show what the bookkeeper should do if he or she wants to:

- Increase the payroll expense account.
- Increase the notes payable account.
- Increase the proprietorship (capital) account.
- Increase the inventory account.
- Increase the sales account.
- Decrease the owners’ equity account.
- Decrease the furniture and fixtures account.
- Decrease the telephone (expense) account.
- Decrease the sales (income) account.
- Decrease the mortgage (liability) account.

DR.	CR.
Y	
	Y
	Y
Y	
	Y
Y	
	Y
	Y
Y	
Y	

- Ex.4** July 3 *No, it is not an expense. It is a reduction in Accounts Payables.*
- 9 *Yes, it is salaries expense.*
- 13 *No, it is not an expense. Office furniture is recorded as company’s asset.*
- 26 *Yes, it is a transportation or a car expense. (not paid yet but accrued according to accrual basis of accounting.)*

Adapted from: Costinett, S. The Language of Accounting in English. Inglewood Cliffs: Prentice Hall Regents, 1977

Handout 6

Case 1: City Brothers Ltd.

Part 1

You are the loan manager for a bank. A customer, City Brothers Ltd., has applied for a loan to modernize its operations. In order to get the loan, the company has given you an income statement for the last three months that shows a net income of \$16,000. While investigating, you discover the following:

- ◆ Salaries of \$5,000 are owed to workers for last month, but have not been paid or recorded as an expense.
- ◆ The company owes \$1,300 in interest on its loans from another bank.
 - a) How does leaving out these two items affect the net income?
 - b) What is the correct net income?
 - c) What other information would you, as the bank manager, like to see before making a decision?

Part 2

Write a letter to City Brothers Ltd. requesting more information. Explain in detail what additional information you require in order to make a decision on their loan application. Before writing the letter, review the format for a standard business letter and the opening and closing statements from Module 1, Topic 1.

Also, refer to Handout 7 for more useful phrases. Remember, you are writing as a loan manager for a bank.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 6

Case 1: City Brothers Ltd.

Part 1

- a) Not recording \$5,000 in salaries increases income.
Not recording \$1,300 in interest expense also incorrectly increases reported net income of \$16,000.
- b) Reported Income \$16,000
 Less: Salaries Expense \$5,000
 Less: Interest Expense 1,300 6,300
 Correct Net Income \$ 9,700
- c) Would need balance sheet stating amount of liquid assets, total liabilities and also accounts receivable collection information in order to figure out what is the solvency of the business (i.e., ratio of liabilities to liquid assets). Also, information about fixed assets (of the business) that could be used as a collateral for a loan would be useful.

Part 2

For a sample letter of request, refer to Handout 8.

Handout 7

Some Standard Phrases for Letters of Request

Requesting Information

- ◆ It has come to my attention that...
- ◆ I would appreciate it if you could provide us...
- ◆ In order to make our decisions, we require further information...
- ◆ I am writing to request...

Inviting a Reply

- ◆ We look forward to...
- ◆ Would you please let us have this information at your convenience...
- ◆ If you require our further assistance, please provide us with the requested information at your convenience...

Adapted from: Laroque, G., M. Maclean, and W. Marshall. Administrative Writing Memos and Letters. Ottawa: Public Service Commission, 1988.

Handout 8

Letter of Request to City Brothers



City Brothers Ltd.
2014 Consumers Road
York Hills, ON
L3T 4T5

December 17, 200X

Attention: John C. Clark

Dear Mr. Clark:

I am writing to you in reference to your loan application of November 30, 200X to modernize your operations. After reviewing your income statement, we have decided that we need to have more information before we make our decision.

I would appreciate it if you could provide us with a balance sheet stating amount of liquid assets and total liabilities. We also require accounts receivable collection information. Any additional information on fixed assets that could be used as collateral would also be of interest to us.

We look forward to assisting you after receiving the above financial information.

Yours Sincerely,

Eugene Smylski
Loans Manager
People's Bank
275 Bay St.
Toronto, ON
M3M 1X5

ES/cg
cc: M. Jones

Handout 9

Case 2: Always Fresh Cleaners/Internal Control

Always Fresh Cleaners is a dry-cleaning business with eight outlets around the city. Customers leave their clothing at the outlets where it is picked up, taken to a large cleaning plant, and returned the next day to the outlets. Each outlet is small and is run by one person. A four-part cash slip is made out for each order. Copy #1 goes to the cleaning plant with the clothes. Copy #2 is given to the customer. Copy #3 stays at the outlet. Copy #4 is sent to the accounting department at the head office after the cleaning has been paid for. Once the customer has picked up the cleaning, it is possible for the clerk at the outlet to destroy all copies of the cash sales slip and to pocket the money received from the customer.

You have been asked by management to design a system that will prevent this from happening.

Describe the nature of this company's problem. What system would you implement to solve the company's problem?

Adapted from: D'Amico, V., and J. Magnan. Accounting – An Introduction. Mississauga: Copp Clark Pitman Ltd., 1991.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 9***Case 2: Always Fresh Cleaners/Internal Control***Problem:

- ◆ Weaknesses in internal control of the operations.
- ◆ The process of distributing cash slip copies reveals that it is the only way to prove that service has been provided.
- ◆ Cash slip copy #4 is not sent to the accounting department until the service is paid for, creating a perfect opportunity for clerks on duty to destroy all cash slips and pocket the money.

Solution:

- ◆ Improve internal control system in the company.
- ◆ Copy #4 should be sent to the accounting department at the time copy #1 goes to the cleaning plant (the accountants would be informed of the service provided).
- ◆ Accountants would be able to accrue the revenue earned before collecting cash payments from customers.
- ◆ Copy #5 of the cash slip can be added and sent to the accounting department once the cleaning service has been paid for by the customer. This copy could be matched with copy #4.
- ◆ Management can verify accrued revenue against cash collected by comparing the sequence number on cash slips (i.e., all cash slips, and their copies, would be numbered).
- ◆ The cleaning plant should make a record or a copy of cash slip #1 once it is received at the plant.

In summary, the control of cash slips should be exercised by the cleaning plant keeping a record of cash slip #1, and by the accounting department having cash slips #4 and #5.

Handout 10

Case 3: The Doughnut Shop/Cash Problems

You are the owner of Tim Horton's doughnut shop. The store is open every day until 1:00 a.m. and serves most of its customers at night. There is one cash register. When deliveries come, the salesclerk pays for the goods out of the till. The store employees are all part-time. Often four or five people work the various shifts from 4:00 p.m. to 1:00 a.m. You, the owner, count and deposit all the money and prepare a daily cash proof. The cash is always out of balance. In the past week, the results were:

July 11 Over \$0.55
July 12 Short \$0.05
July 13 Short \$1.20
July 14 Over \$1.00
July 15 Over \$0.42
July 16 Short \$0.39
July 17 Over \$0.92

This is very typical and you would like to put a stop to it.

How could you find out if one particular employee is responsible for the cash not balancing?

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

Facilitator's Notes for Handout 10**Case 3: The Doughnut Shop/Cash Problems**

Owner could monitor and record the daily cash operations:

- 1) By having only one employee work a particular shift between 4:00 p.m. and 1:00 a.m. and by counting all the money at the end of this person's shift, over a period of two weeks

Then by comparing the results among different employees over the same period of two weeks

If it was found that the particular employee had a lot of over and short cash balances, the owner should question the employee, give a warning, retrain the employee (in terms of operating the cash register), and, if the problems persists, the employee should pay the difference between the cash register tape's total and the total amount of money in the till on a particular day.

- 3) Payments for the goods delivered should not be made out of the till, but rather from a special account (a pool of money) set up particularly for this purpose.
- 4) Each payment should have a corresponding delivery order form signed by the delivery person and a designated employee making the payment.

Terminology List

- ◆ a financial statement order
- ◆ an accounting period
- ◆ GAAP (Generally Accepted Accounting Principles)
- ◆ a change in capital
- ◆ an income summary account
- ◆ accrual basis of accounting
- ◆ a matching principle
- ◆ net loss
- ◆ net income
- ◆ cash basis of accounting
- ◆ revenue
- ◆ temporary proprietorship accounts
- ◆ depreciation
- ◆ a fiscal year
- ◆ a drawing account
- ◆ owner's equity
- ◆ a journal entry
- ◆ fixed expenses
- ◆ variable expenses
- ◆ closing accounts
- ◆ T-account
- ◆ a depreciation expense
- ◆ an accumulated depreciation