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FINANCIAL ACCOUNTING

Tools for Business Decision-Making

Sixth Canadian Edition

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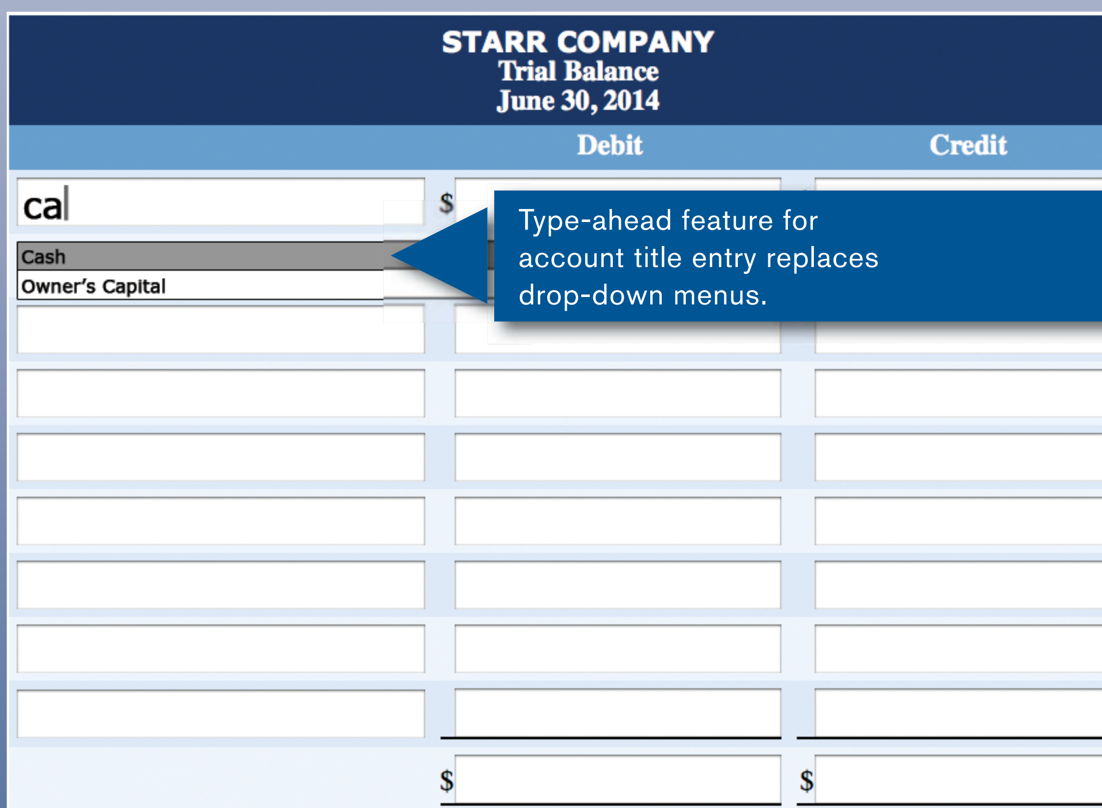

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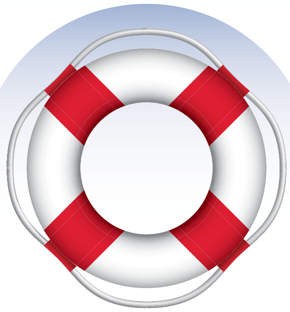

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FINANCIAL ACCOUNTING

TOOLS FOR BUSINESS DECISION-MAKING

Sixth Canadian Edition

Paul D. Kimmel Ph.D., CPA
University of Wisconsin—Milwaukee, Wisconsin

Jerry J. Weygandt Ph.D., CPA
University of Wisconsin—Madison, Wisconsin

Donald E. Kieso Ph.D., CPA
Northern Illinois University, DeKalb, Illinois

Barbara Trenholm MBA, FCA
University of New Brunswick, Fredericton, New Brunswick

Wayne Irvine CFA, CA
University of Calgary, Calgary, Alberta

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ABOUT THE AUTHORS

Barbara Trenholm, MBA, FCA, is a professor emerita at the University of New Brunswick, for which she continues to teach locally and internationally. Her teaching and educational leadership has been widely recognized. She is a recipient of the Leaders in Management Education Award, the Global Teaching Excellence Award, and the University of New Brunswick's Merit Award and Dr. Allan P. Stuart Award for Excellence in Teaching.

Professor Trenholm is a member of the boards of several public and private companies, including Plazacorp Retail Properties Ltd. She is a past board member of Atomic Energy of Canada Limited, the Canadian Institute of Chartered Accountants, and the Atlantic School of Chartered Accountancy and past president of the New Brunswick Institute of Chartered Accountants. She has also served as a chair of the Canadian Institute of Chartered Accountants Academic Research Committee, Interprovincial Education Committee, and Canadian Institute of Chartered Accountants/Canadian Academic Accounting Association Liaison Committee. She has served as a member of the Canadian Institute of Chartered Accountants Qualification Committee, International Qualifications Appraisal Board, and Education Reengineering Task Force and the American Accounting Association's Globalization Initiatives Task Force, in addition to numerous other committees at the international, national, and provincial levels of the profession.

She has presented at many conferences and published widely in the field of accounting education and standard setting in journals, including *Accounting Horizons*, *Journal of the Academy of Business Education*, *CAmagazine*, *CGA Magazine*, and *CMA Magazine*.

Wayne Irvine, CFA, CA, teaches accounting at the Haskayne School of Business, University of Calgary. Prior to his full-time academic career, Wayne worked for 12 years at Price Waterhouse in the audit group and as manager of the Calgary office's continuing education program.

Wayne has taught courses for both the CA School of Business and CMA Alberta and is involved in the new CPA professional education program.

In addition to other publishing projects, he has authored a number of case exams for the CA School of Business and published a case in *Accounting Perspectives*.

Wayne is a four-time recipient of the University of Calgary's Students' Union Teaching Excellence Award and the only member of his faculty to have been awarded a Hall of Fame Teaching award from that organization. He received the Chartered Accountants' Education Foundation teaching award in 2000, 2008, and 2011. In 2008 and 2012, he also won the Commerce Undergraduate Society Award for Outstanding Teaching and Learning and received a distinguished service award from the Institute of Chartered Accountants of Alberta in 2009.

Paul D. Kimmel, Ph.D., CPA, received his bachelor's degree from the University of Minnesota and his doctorate in accounting from the University of Wisconsin. He is an Associate Professor at the University of Wisconsin—Milwaukee, and has public accounting experience with Deloitte & Touche. He was the recipient of the UWM School of Business Advisory Council Teaching Award, the Reggie Taite Excellence in Teaching Award, and a three-time winner of the Outstanding Teaching Assistant Award at the University of Wisconsin. He is also a recipient of the Elijah Watts Sells Award for Honorary Distinction for his results on the CPA exam. He is a member of the American Accounting Association and the Institute of Management Accountants and has published articles in *Accounting Review, Accounting Horizons, Advances in Management Accounting, Managerial Finance, Issues in Accounting Education*, and *Journal of Accounting Education*, as well as other journals. His research interests include accounting for financial instruments and innovation in accounting education. He has published papers and given numerous talks on incorporating critical thinking into accounting education, and helped prepare a catalogue of critical thinking resources for the Federated Schools of Accountancy.

Jerry J. Weygandt, Ph.D., CPA, is the Arthur Andersen Alumni Emeritus Professor of Accounting at the University of Wisconsin—Madison. He holds a Ph.D. in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in *Accounting Review, Journal of Accounting Research, Accounting Horizons, Journal of Accountancy*, and other academic and professional journals. Professor Weygandt is author of other accounting and financial reporting books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association and as a member of the editorial board of *Accounting Review*; he also has served as President and Secretary-Treasurer of the American Accounting Association. In addition, he has been actively involved with the American Institute of Certified Public Accountants and has been a member of the Accounting Standards Executive Committee of that organization. He served on the FASB task force that examined the reporting issues related to accounting for income taxes and as a trustee of the Financial Accounting Foundation. Professor Weygandt has received the Chancellor's Award for Excellence in Teaching and the Beta Gamma Sigma Dean's Teaching Award. He is on the board of directors of M&I Bank of Southern Wisconsin. He is the recipient of the Wisconsin Institute of CPA's Outstanding Educator's Award and the Lifetime Achievement Award. In 2001, he received the American Accounting Association's Outstanding Accounting Educator Award.

Donald E. Kieso, Ph.D., CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Emeritus Professor of Accounting at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. and Arthur Andersen & Co. and research experience with the Research Division of the American Institute of Certified Public Accountants. He is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards. Professor Kieso is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, the AACSB's Accounting Accreditation Committees, and the State of Illinois Comptroller's Commission; as Secretary-Treasurer of the Federation of Schools of Accountancy; and as Secretary-Treasurer of the American Accounting Association. Professor Kieso is currently serving on the Board of Trustees and Executive Committee of Aurora University, and is a member of various other boards. From 1989 to 1993, he served as a charter member of the national Accounting Education Change Commission. He is the recipient of the Outstanding Accounting Educator Award from the Illinois CPA Society, the FSA's Joseph A. Silvoso Award of Merit, the NIU Foundation's Humanitarian Award for Service to Higher Education, the Distinguished Service Award from the Illinois CPA Society, and in 2003 an honorary doctorate from Aurora University.

WHAT'S NEW?

The Sixth Canadian Edition expands our emphasis on student learning and improves upon a highly rated teaching and learning package in the following ways:

Continued Emphasis on Helping Students Learn Accounting Concepts

We have carefully scrutinized all chapter material to ensure that it helps students learn accounting concepts. We have added more explanations, examples, illustrations, and summaries throughout the text to better facilitate learning.

The Accounting Cycle

For many students, success in an introductory accounting course hinges on developing a sound conceptual understanding of the accounting cycle. In past editions, we have received positive feedback regarding the framework that we have used in Chapters 3 and 4. In this edition, we have expanded our use of this framework to include equation analysis in Chapter 3 as well as the closing process in Chapter 4. We also added diagrams describing the impact of original journal entries on adjusting journal entries in Chapter 4.

Missing in Action

We have added a new feature, *Missing in Action,* in Chapter 7 to illustrate how a missing control activity can result in errors or misstatements. We believe this feature, which is much broader than the former *Anatomy of a Fraud* boxes, will be effective in demonstrating the importance of internal controls to both accounting and non-accounting students.

Student-Friendly Companies

One of the goals of the financial accounting course is to orient students to the application of accounting principles and techniques in practice. Accordingly, we have expanded our practice of using numerous examples from real companies throughout the textbook to add more high-interest enterprises that we hope will increase student engagement. For example, we have changed our feature companies to Shoppers Drug Mart and Jean Coutu. References to these companies have been included throughout the textbook, including simplified financial statements in the chapter material where appropriate, ratio analysis, *Using the Decision Toolkit*, end-of-chapter assignments, and detailed financial statements in Appendices A and B at the end of the textbook.

IFRS and ASPE

The fifth Canadian edition was significantly rewritten to incorporate International Financial Reporting Standards (IFRS) and Accounting Standards for Private Enterprises (ASPE), which were still in their infancy at the time of writing the fifth edition. While the pace of change in standards has slowed somewhat, new standards continue to evolve and come into effect. As a result, this sixth edition has undergone a comprehensive updating, refinement, and consolidation of standard changes relevant to introductory accounting students, with a view to helping students succeed in a multiple GAAP world that will continue to change in the future.

Differences between IFRS and ASPE are highlighted throughout the chapter with an ASPE logo where applicable. Each chapter concludes with a *Comparing IFRS and ASPE* table to provide students with a quick summary of the key distinctions between the two sets of accounting standards. End-of-chapter material includes questions, exercises, and problems relevant to both sets of standards. In addition, a case in the Broadening Your Perspective section called *Comparing IFRS and ASPE* focuses specifically on ASPE. The Serial Case, in the same section, follows the development of a small, private company using ASPE at the beginning of the text that later converts to a publicly traded company using IFRS.

Critical Thinking

New to this edition is a critical thinking case in the Broadening Your Perspective section of each chapter. These cases challenge students to apply what they learn in the chapter to a less structured scenario and to think critically on their own to solve typical business problems and to analyze financial information.

Collaborative Learning Activities

Each chapter in this edition highlights one of the Broadening Your Perspective cases with the symbol indicating that the case can be assigned as a group activity. Detailed presentation material and facilitation notes are available online to help instructors engage students to get the most out of working together and supporting each other during the learning process.

Comprehensive Revisions

In addition to the above new features, this edition was subject to comprehensive updating to ensure that it continues to be relevant and fresh.

Our textbook includes more than 235 references to real-world companies. All of the company information was updated and replaced, as necessary. In addition, nearly half of the chapter-opening feature stories were replaced with new stories, while the remainder were updated. More than half of the *Accounting Matters!* insight boxes are new. The *All About You* feature was either replaced or updated in each chapter with new statistics and information applicable to today's student. The *Do It!* activities in this edition were also updated or replaced as required. These activities give students an opportunity to stop and actively test their understanding of the material as they read the chapter.

All hypothetical financial illustrations in the text and end-of-chapter material were reviewed to ensure that the numbers used were realistic. All of the end-of-chapter material was carefully reviewed and real company information updated or replaced, as required. Topical gaps in breadth and depth of coverage, as well as degree of difficulty, were identified and material added or replaced as required. In total, nearly half of the questions, brief exercises, exercises, problems, and cases in the end-of-chapter material either are new or were significantly modified.

New Supplements

Our extensive supplement package for both instructors and students was carefully reviewed and updated. New to the supplements available to students with this edition are problem walk-throughs and QR codes linking to quizzes that can be scanned on smart phones.

KEY FEATURES OF EACH CHAPTER

Chapter 1: The Purpose and Use of Financial Statements

- Feature story is about Shoppers Drug Mart and how accounting aids decision-making
- Identifies the users and uses of financial accounting information and forms of business organization—proprietorship, partnership, private corporation, and public corporation
- Describes the business activities—financing, investing, and operating activities—that affect companies
- Explains the content, purpose, and interrelationships of each of the financial statements—income statement, statement of changes in equity, statement of financial position, and statement of cash flows
- Uses financial statements of a hypothetical company (to keep it simple), followed by those for a real company, Shoppers Drug Mart (to make it relevant)
- Keeping an Eye on Cash describes how each of the business activities—financing, investing, and operating activities—affects cash
- Comparing IFRS and ASPE summarizes key differences in choice of accounting standards and financial statements
- All About You focuses on a student's personal annual report (resumé)
- Using the Decision Toolkit compares Shoppers Drug Mart's financial statements with those of Jean Coutu and their industry
- *Key changes*: Increased references to ethics. Added new illustrations to explain how common shares and retained earnings are calculated in the statement of changes in equity and to reinforce the preparation order of financial statements. Expanded discussion of the differences between Shoppers Drug Mart's simplified statements included in the chapter and its real statements included in the appendix, including a brief introduction to accumulated other comprehensive income.

Chapter 2: A Further Look at Financial Statements

- Feature story is about Plazacorp Retail Properties, its users, and use of accounting standards
- Presents the classified statement of financial position
- Applies ratio analysis to Plazacorp, First Capital Realty, and their industry (working capital, current ratio, debt to total assets, earnings per share, and price-earnings ratios)
- Describes the conceptual framework of accounting
- Keeping an Eye on Cash discusses Apple's free cash flow
- Comparing IFRS and ASPE summarizes key differences in terminology, presentation of earnings per share, and application of the conceptual framework
- All About You introduces a personal statement of financial position
- Using the Decision Toolkit analyzes Canadian Tire's liquidity, profitability, and solvency and those of its industry
- *Key changes*: Updated terminology relating to investments. Moved coverage of accrued receivables and payables to Chapter 4. Expanded coverage of unearned revenues.

Chapter 3: The Accounting Information System

- Feature story is about BeaverTails' experiences with an accounting information system
- Covers transaction analysis, emphasizing the fundamentals while avoiding unnecessary detail
- Explains the first three steps in the accounting cycle, from journalizing to posting to preparation of the trial balance
- Keeping an Eye on Cash relates cash transactions to the operating, investing, and financing activities undertaken by a company
- Comparing IFRS and ASPE indicates that there are no significant differences in this chapter
- All About You feature discusses the importance of keeping track of (accounting for) personal documents and records
- Using the Decision Toolkit prepares a trial balance for lululemon athletica, and identifies on which financial statement each account would be presented
- *Key changes*: Study objectives for journalizing and posting now separated. Numbers used in Sierra Corporation accounting cycle example updated, and new transactions added for accounts payable and income tax. Added illustrations on debit and credit rules and the accounting equation to help students better understand the components of retained earnings. Accounting equation analysis included in the illustration of the recording process. First three steps of accounting cycle now positioned within entire accounting cycle.

Chapter 4: Accrual Accounting Concepts

- Feature story is about Western University's application of accrual accounting

- Explains revenue and expense recognition
- Emphasizes the difference between cash and accrual accounting
- Completes the accounting cycle, from adjusting entries to the closing process
- Keeping an Eye on Cash contrasts the calculation of profit and cash flows from operating activities
- Comparing IFRS and ASPE summarizes key differences in the frequency of adjusting entries and terminology
- All About You feature discusses revenue recognition, including motivations to misstate revenue
- Using the Decision Toolkit reviews the timing of recognizing revenue for Best Buy gift cards
- *Key changes*: Expanded criteria for, and discussion of, revenue and expense recognition criteria. Added a comparison of cash and accrual bases of accounting. Diagrams describing impact of original journal entries on adjusting journal entries and summaries included at the end of each adjusting entry section. Incorporated accounting equation into closing process. Deferred discussion of closing entries for comprehensive income (loss) until Chapter 12.

Chapter 5: Merchandising Operations

- Feature story is about Loblaw's initiatives to improve its process of getting products from its suppliers to its shelves
- Introduces merchandising concepts using perpetual inventory system (the periodic inventory system is presented in an appendix)
- Explains how to record purchases and sales of merchandise
- Presents single-step and multiple-step income statements
- Applies ratio analysis to Loblaw, Metro, and their industry (gross profit margin and profit margin)
- Keeping an Eye on Cash explains the cash conversion cycle
- Comparing IFRS and ASPE summarizes key differences in the classification of expenses on the income statement
- All About You compares shopping experiences on-line, in large chain stores, and in locally owned stores
- Using the Decision Toolkit compares Sobeys' profitability with that of Loblaw and Metro and their industry
- *Key changes*: Updated sales tax information. Clarified illustration of goods in transit. Added illustration of closing entries for inventory in periodic inventory system.

Chapter 6: Reporting and Analyzing Inventory

- Feature story is about lululemon's inventory management
- Explains how inventory quantities and ownership are determined
- Covers cost determination methods and their financial statement effects using perpetual inventory system (the periodic inventory system is presented in an appendix)
- Discusses effects of inventory errors on financial statements
- Outlines how to value and record inventory at the lower of cost and net realizable value
- Applies ratio analysis to lululemon athletica, Limited Brands, and their industry (inventory turnover and days in inventory)
- Keeping an Eye on Cash reviews impact of choice of cost determination method on cash flow
- Comparing IFRS and ASPE indicates that there are no significant differences in this chapter
- All About You is about inventory theft and loss prevention techniques
- Using the Decision Toolkit reviews Under Armour's inventory management and liquidity and that of its industry
- *Key changes*: Expanded discussion of goods in transit and clarified more specifically the nature of misstatements arising from errors in recording purchases of merchandise inventory as well as errors made when determining the cost of this inventory.

Chapter 7: Internal Control and Cash

- Feature story is about cash control at Nick's Steakhouse and Pizza
- Explains the nature of internal control activities and the limitations of internal control
- Identifies control activities over cash receipts and cash payments
- Discusses bank reconciliations in detail as a control feature
- Explains how cash is reported and managed
- Keeping an Eye on Cash explains how too much cash may not necessarily be a good thing
- Comparing IFRS and ASPE indicates that there are no significant differences in this chapter
- All About You feature helps identify how much cash a student will need to pay for a university education
- Using the Decision Toolkit reviews internal control issues at a local basketball association
- *Key changes*: Reorganized and refocused discussion on fraud. Changed the Anatomy of a Fraud boxes to Missing in Action boxes, which focus on the impact of missing internal controls. Explained how to calculate the unadjusted cash balance. Simplified references to bank fees and charges.

Chapter 8: Reporting and Analyzing Receivables

- Feature story is about Canadian Tire's receivables
- Presents the basics of accounts and notes receivable and bad debt estimation
- Explains statement presentation of receivables
- Identifies various ways to manage receivables
- Applies ratio analysis to Canadian Tire, Sears, and their industry (receivables turnover and average collection period)
- Keeping an Eye on Cash explains the impact of receivables management on profit and cash flow
- Comparing IFRS and ASPE indicates that there are no significant differences in this chapter
- All About You feature covers the advantages and disadvantages of credit cards

- Using the Decision Toolkit compares Canadian Tire's receivables management and liquidity with Walmart's, Sears's, and their industry
- *Key changes*: Added a review of accounts receivables transactions and separated the introduction to receivables from accounting for bad debts. Simplified the accounting for nonbank credit cards and their fees. Reordered the discussion of estimating uncollectible accounts, revised the aging schedule, and added general ledger accounts to show how accounts are affected. Clarified which notes are trade receivables, how notes are valued, and use of allowance for doubtful notes account, and added a new section comparing notes receivable and notes payable. Deleted concentration of credit risk discussion and sale and securitization of receivables.

Chapter 9: Reporting and Analyzing Long-Lived Assets

- Feature story is about WestJet's property and equipment
- Covers the acquisition and derecognition of property, plant, and equipment
- Reviews buy or lease decisions
- Explains the calculation and implications of using different depreciation methods
- Discusses the accounting for intangible assets and goodwill
- Reviews the reporting of long-lived assets
- Applies ratio analysis to WestJet, Air Canada, and their industry (return on assets, asset turnover, and profit margin)
- Keeping an Eye on Cash discusses the effect of depreciation on accrual-based profit and cash provided by operating activities
- Comparing IFRS and ASPE identifies differences in terminology, use of the revaluation and valuation models, impairment tests, and disclosure requirements
- All About You feature deals with the decision to buy, rent, or share a car
- Using the Decision Toolkit reviews and analyzes Transat A.T. Inc.'s long-lived assets in comparison to WestJet, Air Canada, and their industry
- *Key changes*: Repositioned discussion of asset retirement costs to determination of cost section. Rewrote leasing section to clarify distinction between operating and finance leases. Combined explanation and calculation of depreciation with other accounting issues related to depreciation, clarified explanations of depreciation methods, added a summary comparison of formulas, and expanded illustration of retirements. Removed discussion of exchanges of assets. Added sample journal entries, general ledger accounts, and equations to property, plant, and equipment and intangible assets sections. Added a summary of the different types of long-lived assets in the reporting section.

Chapter 10: Reporting and Analyzing Liabilities

- Feature story is about Canada Post's liabilities
- Covers current liabilities, including operating lines of credit, sales taxes, property taxes, payroll, short-term notes payable, current maturities of non-current debt, provisions, and contingencies
- Covers non-current liabilities, including instalment notes payable and bonds payable
- Applies effective-interest method of amortization to long-term instalment notes and bonds
- Reviews reporting and analysis of liabilities
- Applies ratio analysis to Canada Post, UPS, and their industry (debt to total assets and times interest earned)
- Keeping an Eye on Cash explores cash effects of debt and the importance of meeting debt covenants
- Comparing IFRS and ASPE summarizes key differences in the definition of probability used to record a contingent liability and in amortizing bond premiums and discounts
- All About You is about student loans
- Using the Decision Toolkit compares Canada Post's liquidity and solvency with Royal Mail's and their industry
- *Key changes*: Expanded discussion of the difference between provisions and contingencies. Condensed and moved detailed coverage of bonds to an appendix to the chapter.

Chapter 11: Reporting and Analyzing Shareholders' Equity

- Feature story is about Tim Hortons
- Discusses corporate form of organization
- Covers issues related to common and preferred shares, including reasons why companies repurchase their own shares
- Explains cash dividends, stock dividends, stock splits, and implications for analysis
- Describes the presentation of equity items in statement of financial position and statement of changes in equity (IFRS) or statement of retained earnings (ASPE)
- Applies ratio analysis to Tim Hortons, Second Cup, and their industry (payout ratio, dividend yield, earnings per share, and return on common shareholders' equity)
- Keeping an Eye on Cash discusses how much cash is enough in order to pay a cash dividend
- Comparing IFRS and ASPE summarizes key differences in issuing shares for noncash considerations, presentation of comprehensive income, the statement of changes in equity and statement of retained earnings, and presentation of earnings per share
- All About You is about investing in shares
- Using the Decision Toolkit compares Starbucks's dividend record and earnings performance with those of Tim Hortons and their industry
- *Key changes*: Increased emphasis on private corporations. Added a summary of the advantages and disadvantages of corporations. Deleted discussion of par value and treasury shares. Combined accounting for common and preferred share transactions into one section. Replaced detailed accounting for reacquisition of shares with a general overview and clarified discussion of how stock splits work. Added a summary of shareholders' equity

transactions and information about cumulative and noncumulative preferred dividends in earnings per share discussion. Condensed discussion about complex capital structures.

Chapter 12: Reporting and Analyzing Investments

- Feature story is about Scotiabank's management of investments
- Explains why companies purchase debt and equity securities as strategic or non-strategic investments
- Describes the various valuation models for non-strategic investments: fair value through profit or loss, fair value through other comprehensive income, amortized cost, and cost
- Describes the accounting for strategic investments, including the use of the equity and cost valuation models
- Discusses other comprehensive income, including the statement of comprehensive income, and accumulated other comprehensive income
- Explains how investments are reported on the financial statements under each of the valuation models used for non-strategic and strategic investments, including the different reporting requirements under IFRS and ASPE
- Introduces consolidation accounting for financial reporting purposes at a conceptual level
- Keeping an Eye on Cash explains how investment-related transactions are treated on the statement of cash flows
- Discusses the accounting for investments in bonds and compares it with bonds payable in a chapter appendix
- Comparing IFRS and ASPE explains differences in the use of the fair value through OCI model, accounting for investments in associates, amortization methods for bond investments, and consolidation of financial statements
- All About You discusses saving for a university education and discusses the benefits of savings options such as a tax-free savings account
- Using the Decision Toolkit explores the various ways of accounting for different types of investments
- *Key changes*: Revised first four study objectives to cover accounting models used for investments without reference to ASPE or IFRS so that coverage could focus on the theoretical basis for each model. How the models are then applied under ASPE and IFRS is now covered in a single study objective. IFRS coverage was updated to be consistent with IFRS 9.

Chapter 13: Statement of Cash Flows

- Feature story is about Teck Resources' cash flows
- Explains the purpose and content of the statement of cash flows
- Describes the preparation of the operating, investing, and financing activities of the statement of cash flows. Splits the operating activities section into two parts, allowing the instructor to use the indirect approach, the direct approach, or both
- Applies ratio analysis to Teck and Freeport-McMoRan (cash current debt coverage, cash total debt coverage, and free cash flow)
- Keeping an Eye on Cash explains cash flow effects of different phases of the corporate life cycle
- Comparing IFRS and ASPE summarizes key differences in classification of activities
- All About You is about how students should save and some of the costs and opportunities of managing cash
- Using the Decision Toolkit calculates cash-based ratios and analyzes cash flows for Stantec
- *Key changes*: Updated definitions of operating, investing, and financing activities. Expanded explanations comparing direct and indirect methods of presentation for operating activities. Introduced coverage dealing with classification manipulations within the statement of cash flows. Added exercises and problems that consisted of more basic cash flow movements.

Chapter 14: Performance Measurement

- Feature story is about Hudson's Bay Company's business strategy, including its acquisitions and divestitures
- Discusses sustainable income, and implications of discontinued operations
- Demonstrates horizontal analysis, vertical analysis, and ratio analysis
- Applies ratio analysis to Hudson's Bay, Sears, and their industry (comprehensive analysis of all ratios)
- Discusses factors that can limit financial analysis, including alternative accounting policies, professional judgement, comprehensive income, diversification, inflation, and economic factors
- Keeping an Eye on Cash outlines the questions the statement of cash flows answers and analyzes Hudson's Bay's cash flows
- Comparing IFRS and ASPE summarizes key differences in reporting of earnings per share, comprehensive income, and segments
- All About You is about investing in the stock market
- Using the Decision Toolkit assesses the liquidity, profitability, and solvency of Goldcorp, Yamana Gold, and their industry
- *Key changes*: Deleted discussion of changes in accounting policies from sustainable income section. Clarified terminology used in horizontal and vertical analysis. Reordered profitability ratios to improve students' understanding of their relationship. Expanded coverage dealing with the relationship between key ratios such as return on assets and return on equity.

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Financial Accounting, Sixth Canadian Edition, features a full line of teaching and learning resources. Driven by the same basic beliefs as the textbook, these supplements provide a consistent and well-integrated learning system. This hands-on, real-world package guides instructors through the process of active learning and gives them the tools to create an interactive learning environment. With its emphasis on activities, exercises, and the Internet, the package encourages students to take an active role in the course and prepares them for decision-making in a real-world context.

FOR INSTRUCTORS

In addition to the support instructors receive from the Wiley Faculty Network, we offer several useful supplements and resources on the book's companion website and in *WileyPLUS*. On these sites, instructors will find the Solutions Manual, PowerPoint presentations, Test Bank, Instructor's Manual, Computerized Test Bank, and other valuable teaching resources.

The supplements are prepared by subject matter experts and contributors who are often users of the text. Supplements are meticulously reviewed by the authors to ensure consistency with the textbook. Supplements like the test bank and the solutions manual are also rigorously checked to ensure accuracy.

FOR STUDENTS

Students will find selected support materials on the book's companion website and an expanded list of resources in *WileyPLUS* that will help them develop their conceptual understanding of class material and increase their ability to solve problems. In addition to other resources, students will find:

- PowerPoint Presentations
- Chart of Accounts
- Checklist of Key Figures
- Annual Reports
- Financial Statement Analysis Primer

ACKNOWLEDGEMENTS

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We have tried our best to produce a text and supplement package that is error-free and that meets your specific needs. Suggestions and comments from users are encouraged and appreciated. Please don't hesitate to let us know of any improvements that we should consider for subsequent printings or editions. You can send us your thoughts and ideas by e-mailing KimmelAuthors@gmail.com.

Barbara Trenholm
Wayne Irvine

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read it!

REAL-WORLD CONTEXT

Real-world companies and business situations give students glimpses into how real companies use accounting in action.

Feature Stories introduce chapter topics using real-world companies that are engaging to students.

CHAPTER 3

The Accounting Information System

The Navigator
Chapter 3

- Scan *Study Objectives*
- Read *Feature Story*
- Read text and answer *Do It!s*
- Review *Comparing IFRS and ASPE*
- Review *Summary of Study Objectives*
- Review *Decision Toolkit—A Summary*
- Work *Using the Decision Toolkit*
- Work *Comprehensive Do It!*
- Answer *Self-Test Questions*
- Complete *assignments*
- Go to *WileyPLUS* for practice and tutorials

Extracts from real company financial statements appear throughout the book.

DANIER LEATHER INC.
Statement of Financial Position (partial)
June 30, 2013
(in thousands)

Shareholders' equity	
Share capital	$11,533
Contributed surplus	954
Retained earnings	43,422
	55,909

The Keeping an Eye on Cash feature helps students understand the connections with, and the significance of, cash.

Keeping an Eye on Cash

Can a company have too much cash? Yes, according to some, including Mark Carney, Governor of the Bank of England and former Governor of the Bank of Canada. In August 2012, Carney noted that Canadian corporations were "sitting on mountains of 'dead money'." The size of the Canadian "mountain" was approximately $600 billion in January 2012, with major Canadian companies such as Suncor Energy ($5.4 billion), George Weston (owner of Loblaw) ($3.5 billion), and Barrick Gold ($2.5 billion) holding significant amounts. Carney noted that Canadian companies should be investing their cash in new property, plant, and equipment or increasing the dividends paid to shareholders. In the United States, the cash mountain was nearly U.S. $1.5 trillion.

Tim Cook, CEO of Apple, informed shareholders at the 2013 annual meeting that he was actively pursuing what to do with the company's growing cash pile. At December 31, 2012, the pile of cash amounted to $137.1 billion (cash and cash equivalents). Possible uses of the cash included increasing the dividend paid to shareholders and buying back shares.

Is too much cash also a problem for small businesses, such as Sharon McCollick's company discussed earlier in the chapter? McCollick might think that she can never have too much cash in her business, but that isn't correct. Having large amounts of cash sitting in bank accounts that pay little or no interest is not an effective management strategy. Cash can be invested in interest-paying investments for the short or longer term. It can also be used to upgrade existing equipment or expand the business when the cash balances increase beyond what is required for normal business operations.

Accounting Matters insight boxes provide glimpses into how real companies make decisions using accounting information and how individuals use accounting information in their decision-making.

ACCOUNTING MATTERS!

NHL Signing Bonuses

Does hiring a top National Hockey League (NHL) player add value to the team? The owner and fans would say so. However, simply agreeing to sign a contract to play for a hockey team is not an economic event that results in an accounting transaction. Despite the team's perceived value rising by the hiring of top talent, a transaction is not recorded until the player starts playing and earns his salary . . . and hopefully generates additional revenue for the team, as well.

On the other hand, signing bonuses do result in an economic transaction and consequently are treated differently. When a player is given a signing bonus to sign with the team, he is paid cash at the time of signing and the team's assets, liabilities, and equities change. NHL signing bonuses can be significant, ranging from $1 million to $10 million over the last few years.

Missing in Action boxes in Chapter 7 help illustrate how a missing internal control can result in errors or misstatements.

MISSING IN ACTION

Kevin Lin works in the IT department at Twillingate Inc. The company provides a MacBook Pro® to all salespeople when they join the company. The laptop must be returned to Kevin when a salesperson leaves. Kevin is responsible for managing the laptops. He tracks them using an Excel spreadsheet that includes the date purchased, serial number, date assigned to a salesperson, date returned by a salesperson, and any repair information. The spreadsheet is sent to the asset clerk in the accounting department every month. One day, Angela Liu, the new asset clerk, decided to verify Kevin's spreadsheet after learning that no one in accounting or IT had ever checked it. When Angela attempted to match the information on the spreadsheet to the physical laptops, she found that two employees had left the company without returning their laptops. In addition, a laptop was identified as being out for repairs for over a year and Kevin hadn't followed up with the repair company. Finally, a laptop listed as unassigned could not be located.

THE MISSING CONTROL

Independent Verification
The asset clerk should have verified Kevin's spreadsheet on a regular basis to ensure all of Twillingate's computer assets were accounted for.

read it!

All About You ▶ Paying for Your University Education

It is important that you consider how much cash you will need to pay for your university education. It is all about planning. Do you know the cost of your tuition? If you don't live at home, what are your costs of renting? Utilities, including your cell phone? Food? Entertainment? Clothing? Transportation? Once you have determined the costs that you will incur, how will you pay for them? Have you applied for every possible scholarship, grant, and bursary? Have you obtained a student loan from the Government of Canada? Do you have credit card debt? Do you have a line of credit? With proper planning, you can reduce the amount that you are going to have to borrow to complete your education.

The hard part about planning how much cash you need is that sometimes you have no idea! Your starting point is to track where your cash is coming from and where it is going. Track what you receive and spend during the course of a day, a week, a month, a term, and then a school year. Try accumulating all of the receipts for items purchased during the course of a week and put them in an envelope. At the end of the week, analyze the receipts to determine where the money has gone. Continue doing so for a month. Once you have reviewed all of the receipts for a whole month, attempt to categorize them by type of expenditure. Or you could try using an Excel spreadsheet to help you keep track and categorize. There are free apps that can help, such as My Student Budget Planner. The website GetSmarterAboutMoney.ca has many tools to help you determine what

An *All About You* feature and activity helps students to link accounting concepts and the lessons learned from real-life situations to some aspects of personal finance, such as applying for a student loan, using credit cards, and buying a car. These topics provide great opportunities for classroom discussion.

comparing IFRS and ASPE

Key Differences	International Financial Reporting Standards (IFRS)	Accounting Standards for Private Enterprises (ASPE)
Terminology	Leases that are essentially the purchase of an asset are called *finance leases*. *Depreciation* is used to describe cost allocation for property, plant, and equipment.	Leases that are essentially the purchase of an asset are known as *capital leases*. *Amortization* may be used instead of *depreciation* for property, plant, and equipment.
Models for valuing property, plant, and equipment	Choice of cost model or revaluation model.	Only cost model allowed.
Impairment requirements for property, plant, and equipment and intangible assets with finite lives	Must determine each year if indicators of impairment are present and, if so, perform an impairment test. Reversals of impairment losses are allowed.	Impairment tests differ between IFRS and ASPE. Reversals of impairment losses are not allowed.
Impairment requirements for intangible assets with indefinite lives and goodwill	Must perform impairment test annually. Impairment losses can be reversed on intangible assets with indefinite lives but cannot be reversed on goodwill.	If indicators of impairment are present, an impairment test must be performed. Reversals of impairment losses are not allowed.
Disclosure	Must provide a reconciliation of the opening and closing carrying amounts of each class of long-lived assets.	Reconciliation not required.

Useful summaries of how accounting standards apply to publicly traded companies using IFRS and private companies using ASPE review the material covered in each chapter.

Summary of Study Objectives

1. ***Identify and discuss the major characteristics of a corporation.*** The major characteristics of a corporation are separate legal existence, limited liability of shareholders, transferable ownership rights, the ability to acquire capital, a continuous life, separation of corporation management from ownership, increased cost and complexity of government regulations, and the possibility of reduced corporate income tax.

   Corporations issue shares for sale to investors. The proceeds received from the issue of shares become the company's legal capital. Shares then trade among investors on the secondary stock market and do not affect the company's financial position.

2. ***Record share transactions.*** If only one class of shares is issued, they are considered to be common shares. When shares are issued for noncash goods or services in a company using IFRS, the fair value of the goods or services received is used to record the transaction if it can be reliably determined. If not, the fair value of the common shares is used. For a private company following ASPE, the more reliable of the two fair values should be used, which is usually also the fair value of the goods or services received.

   The accounting for preferred shares is similar to the accounting for common shares. Preferred shares have contractual provisions that give them preference over common shares for dividends and assets in the event of liquidation. Dividends are quoted as an annual rate (such as $5 preferred), but are normally paid quarterly.

   In addition, preferred shares may have other preferences, such as the right to convert, redeem, and/or retract. However, preferred shares do not have the right to vote—only common shares have voting rights.

3. ***Prepare the entries for cash dividends, stock dividends, and stock splits, and understand their financial impact.*** Entries for both cash and stock dividends are required at the declaration date and the payment or distribution date. There is no entry (other than a memo entry) for a stock split. The overall impact of a cash dividend is to reduce assets (cash) and shareholders' equity (retained earnings). Stock dividends increase common shares and [illegible] affect assets, liabilities, [illegible] splits also have no impact on assets, liabilities, or shareholders' equity. The number of shares increases with both stock dividends and stock splits.

4. ***Indicate how shareholders' equity is presented in the financial statements.*** In the shareholders' equity section of the statement of financial position for companies using IFRS, share capital, retained earnings, and accumulated other comprehensive income, if any, are reported separately. If additional contributed capital exists, then the caption "Contributed capital" is used for share capital (preferred and common shares) and additional contributed capital that may have been created from various sources. A statement of changes in equity explains the changes in each shareholders' equity account, and in total, for the reporting period. Notes to the financial statements explain details about authorized and issued shares, restrictions on retained earnings, and dividends in arrears, if there are any.

   For private companies reporting using ASPE, comprehensive income is not reported and a statement of changes in equity is not required. Instead, a statement of retained earnings is prepared that explains the changes in the retained earnings account for the reporting period. Changes to share capital and any other equity items are disclosed in the notes to the statements.

5. ***Evaluate dividend and earnings performance.*** A company's dividend record can be evaluated by looking at what percentage of profit it chooses to pay out in dividends, as measured by the dividend payout ratio (dividends divided by profit) and the dividend yield ratio (dividends per share divided by the share price).

   Earnings performance can be measured by two profitability ratios: earnings per share (profit less preferred dividends divided by the weighted average number of common shares) and the return on common shareholders' equity ratio (profit less preferred dividends divided by average common shareholders' equity).

Summaries are included to help students review the material just covered.

see it!

CONTENT FOR ALL LEARNING STYLES

In addition to a textbook consistently reviewed as very readable, over 50% of the textbook provides visual presentations and interpretations of content.

Transaction Analyses illustrations visually help students understand the impact of an accounting transaction.

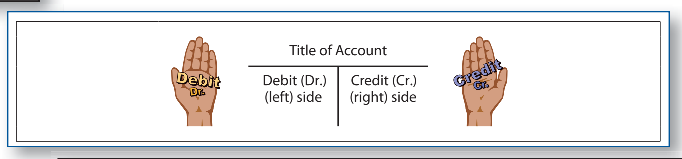
Transaction	October 1: purchased equipment by signing a $5,000 bank loan, plus 6% interest per annum, due to be repaid in three months.				
Basic Analysis	The asset Equipment is increased by $5,000. The liability account Bank Loan Payable is increased by $5,000.				
Equation Analysis	Assets	=	Liabilities	+	Shareholders' Equity
	(2) Equipment +$5,000		Bank Loan Payable +$5,000		
Debit–Credit Analysis	Debits increase assets; debit Equipment $5,000. Credits increase liabilities; credit Bank Loan Payable $5,000.				
Journal Entry	Oct. 1 Equipment	5,000			
	Bank Loan Payable (Purchased equipment by signing a $5,000 bank loan plus 6% interest to be repaid in three months)		5,000		
Posting	Equipment: Oct. 1 5,000		Bank Loan Payable: Oct. 1 5,000		

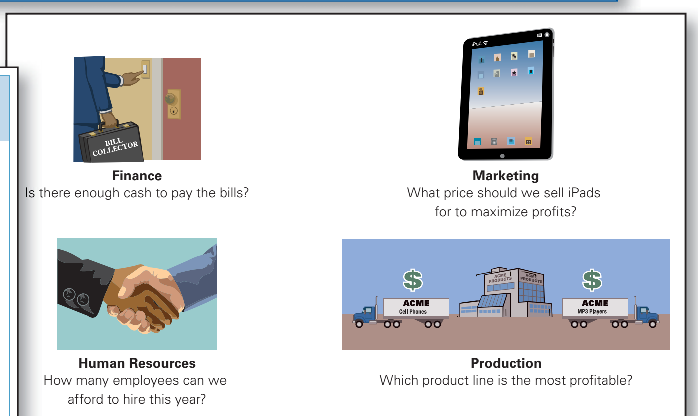
Accounting Equation Analyses appear in the margin next to key journal entries and reinforce the impact of the transaction on the accounting equation. They also report the cash effect of each transaction to reinforce understanding of the difference between cash effects and accrual accounting.

A	=	L	+	SE
+10,000				+10,000

↑Cash flows: +10,000

Infographics reinforce important textual concepts.

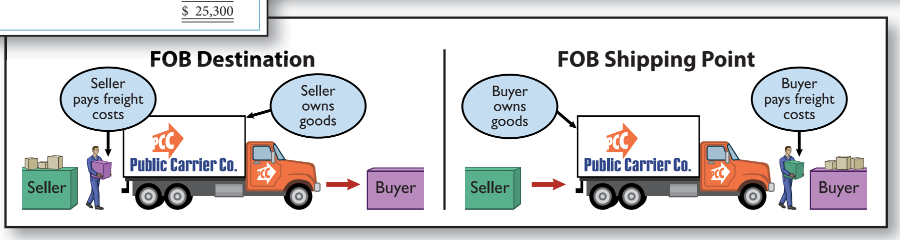




Illustrations are clearly identified and easy to review.

PW AUDIO SUPPLY, INC.
Income Statement
Year Ended December 31, 2015

Revenues		
Net sales	$460,000	
Interest revenue	3,400	$463,400
Expenses		
Cost of goods sold	$316,000	
Salaries expense	45,000	
Rent expense	19,000	
Utilities expense	17,000	
Advertising expense	16,000	
Depreciation expense	8,000	
Freight out	7,000	
Insurance expense	2,000	
Interest expense	1,600	
Loss on sale of equipment	200	431,800
Profit before income tax		31,600
Income tax expense		6,300
Profit		$ 25,300



do it!

KNOW THE FUNDAMENTALS

Knowing the fundamentals of accounting will help you understand what is happening in all areas of a business. Do It! exercises throughout the textbook will help you practise your understanding of accounting.

Clear **Do It!** exercises in the textbook narrative provide step-by-step applications of a concept at the precise moment students acquire the knowledge. Each Do It! in the textbook narrative includes a solution, an Action Plan, and a path of related brief exercises and exercises.

BEFORE YOU GO ON...

▸Do It! Closing Entries

The adjusted trial balance for Nguyen Corporation shows the following selected accounts: Dividends $500; Common Shares $30,000; Retained Earnings $12,000; Service Revenue $18,000; Rent Expense $1,500; Supplies Expense $500; Salaries Expense $8,000; and Income Tax Expense $1,000. (a) Prepare the closing entries at December 31. (b) What is the balance in the Income Summary and Retained Earnings accounts after closing?

Action Plan

- Close revenues and expenses into the Income Summary account.
- Stop and check your work: Is the balance in each individual revenue and expense account now zero? Does the balance in the Income Summary account equal the reported profit (loss)?
- Close the balance in the Income Summary account into the Retained Earnings account.
- Close the Dividends account into the Retained Earnings account. Do not close Dividends into the Income Summary account.
- Stop and check your work: Does the balance in the Retained Earnings account equal the ending balance reported in the financial statements?

Solution

(a)	Dec. 31	Service Revenue	18,000	
		Income Summary		18,000
		(To close revenue account)		
	31	Income Summary	11,000	
		Rent Expense		1,500
		Supplies Expense		500
		Salaries Expense		8,000
		Income Tax Expense		1,000
		(To close expense accounts)		
	31	Income Summary	7,000	
		Retained Earnings		7,000
		(To close income summary)		
	31	Retained Earnings	500	
		Dividends		500
		(To close dividends)		

(b)

Income Summary

	11,000		18,000
CE	7,000	Bal.	7,000
		End. bal.	0

Retained Earnings

		Beg. bal.	12,000
CE	500	CE	7,000
		End. bal.	18,500

Related Exercise Material: BE4-12, BE4-13, BE4-14, and E4-11.

End-of-chapter **Questions**, **Brief Exercises**, two sets of **Problems**, and **Broadening Your Perspective Cases** are all keyed to learning objectives and provide students with further practice opportunities.

Questions

(SO 1) 1. What are current assets? Give four examples of current assets a company might have.
(SO 1) 2. What is meant by the term *operating cycle*?
(SO 1) 3. (a) Distinguish between current assets and non-current assets. (b) Distinguish between current assets and current liabilities. Why does showing

(SO 2) 13. Why can you compare the price-earnings ratio among different companies but not earnings per share?
(SO 2) 14. The TD Bank has a price-earnings ratio of 12 times, while CIBC has a price-earnings ratio of 10 times. Which company do investors appear

Brief Exercises

BE2–1 The following are the major statement of financial position classifications:

1. Current assets
2. Long-term investments
3. Property, plant, and equipment
4. Intangible as

5. Current liabilities
6. Non-current liabilities
7. Share capital

Broadening Your Perspective

Financial Reporting: *Shoppers Drug Mart*

BYP3–1 The financial statements of Shoppers Drug Mart are presented in Appendix A at the end of this book. They contain the following selected accounts:

Accounts payable and accrued liabilities	Income tax expense
Accounts receivable	Inventory
Cash	Land
Dividends	Sales

Comprehensive Do It! problems at the end of each chapter apply the Do It! and address multiple topics.

Comprehensive Do It!

At October 31, 2015, the year-end trial balance for the Blizzard Snow Removal Corporation in Inuvik shows the following balances for selected accounts:

Prepaid insurance	$ 1,800
Equipment	15,000
Accumulated depreciation—equipment	3,000
Bank loan payable	10,000
Unearned revenue	2,100

Blizzard makes its adjusting entries annually. Analysis reveals the following additional data about these accounts:

1. Prepaid insurance is the cost of a one-year insurance policy, effective October 1, 2015.
2. The equipment was purchased on November 1, 2013, and is expected to have a useful life of five years.
3. The bank loan was signed on November 1, 2014, and is repayable in two years. Interest on this 6% loan is due on a monthly basis on the first day of each month.
4. Seven customers paid for the company's six-month, $300 snow removal service package in September. These customers were serviced in October after an early blizzard.
5. Snow removal services provided to other customers but not billed at October 31 totalled $1,500.
6. Income tax instalments have been made each month. Further calculations at year end determine that an additional $250 of income tax will be payable this year.

Instructions

Prepare the adjusting entries at October 31.

Action Plan

- Note that adjustments are being made annually.
- Before determining what adjustments are necessary, look at the amounts that are currently recorded in the accounts.
- After making adjustments, check that the balances in each T account reflect what you meant them to (even when T accounts are not required).
- Show your calculations.

passion success
teaching expertise
collaboration
expertise
passion collaboration
team teaching
passion for teaching
success expertise
collaboration passion

get it!

TOOLS FOR DECISION-MAKING

As an employee, manager, or even a director of your own personal finances, you will make better decisions by learning how to analyze and solve business problems using tools provided throughout each chapter.

DECISION TOOLKIT			
Decision Checkpoints	Info Needed for Decision	Tools to Use for Decision	How to Evaluate Results
Should the company incorporate?	Capital needs, growth expectations, type of business, income tax status	Corporations have limited liability, greater ability to raise capital, and professional managers. In addition, there is a potential for reduced income tax. There is increased cost and complexity from additional government regulations.	Carefully weigh the costs and benefits in light of the particular circumstances.

The Decision Toolkit and the **Decision Toolkit Summary** direct students to the tools and information they need when evaluating business issues.

Using the Decision Toolkit asks students to apply toolkit lessons to a financial statement analysis exercise. Suggested solutions are provided.

DECISION TOOLKIT—A SUMMARY			
Decision Checkpoints	Info Needed for Decision	Tools to Use for Decision	How to Evaluate Results
Should the company incorporate?	Capital needs, growth expectations, type of business, income tax status	Corporations have limited liability, greater ability to raise capital, and professional managers. In addition, there is a potential for reduced income tax. There is increased cost and complexity from additional government regulations.	Carefully weigh the costs and benefits in light of the particular circumstances.
What portion of its profit does the company pay out in dividends?	Profit and total cash dividends	$\text{Payout ratio} = \frac{\text{Cash dividends}}{\text{Profit}}$	A high payout ratio is considered desirable for investors seeking income. A low ratio suggests that the company is retaining its profit for investment in future growth.
What percentage of the share price company payin dividends?	Dividends and share	$\text{Dividend yield} = \frac{\text{Dividend per share}}{}$	A high dividend yield is considered means ut, fit.

USING THE DECISION TOOLKIT

The following selected information (in U.S. millions, except per share information) is available for Starbucks Corporation, one of Tim Hortons' competitors. Note that Starbucks has no preferred shares.

	2012	2011
Profit	$1,383.8	$1,245.7
Cash dividends	543.7	419.5
Shareholders' equity	5,114.5	4,387.3
Weighted average number of common shares	754.4	748.3
Dividends per share	0.72	0.56
Market price per share	45.71	41.58

Instructions

(a) Using the above information, calculate the (1) payout ratio, (2) dividend yield, (3) earnings per share, and (4) return on common shareholders' equity for Starbucks for 2012.

(b) Contrast the company's (1) dividend record and (2) earnings performance with that of Tim Hortons and the industry, which is given in the chapter.

Solution

(a)

(in U.S. millions, except per share information)	Starbucks	Tim Hortons	Industry
1. Payout ratio	$\frac{\$543.7}{\$1,383.8} = 39.3\%$	32.4%	31.0%
2. Dividend yield	$\frac{\$0.72}{\$45.71} = 1.6\%$	1.7%	1.2%
3. Earnings per share	$\frac{\$1,383.8 - \$0}{\$754.4} = \$1.83$	$2.60	n/a
4. Return on common shareholders' equity	$\frac{\$1,383.8 - \$0}{(\$5,114.5 + \$4,387.3) \div 2} = 29.1\%$	34.4%	17.3%

(b) 1. Dividend record: Starbucks' payout ratio is higher than that of both Tim Hortons and its competitors in the industry. Yet its dividend yield is marginally lower than that of Tim Hortons, while still higher than that of the industry. Investors would likely favour Tim Hortons over Starbucks for dividend income because of its higher dividend yield. Tim Hortons' payout ratio is not all that much lower than that of Starbucks and will vary depending on the profit for a particular year.

2. Earnings performance: It is not possible to compare earnings per share between companies, because of the differing capital structures. Starbucks' return on common shareholders' equity is lower than that of Tim Hortons, but still significantly above that of its industry counterparts.

Critical Thinking Cases challenge students to apply what they learn in the chapter to a less structured scenario and to think critically on their own to solve typical business problems.

Critical Thinking Case

BYP10–4 Atlas Limited operates a small wholesale private company selling imported foods to grocery retailers on Prince Edward Island. The company began operations on January 1, 2014, and has just completed its second year of operations. In January 2015, the company moved to a new location and now rents a much larger facility. When the move occurred, additional bank loans were taken out to finance the purchase of some new equipment. The CEO of the business, Jim O'Sullivan, negotiated with the bank to have principal payments (not interest) on any bank loan delayed until 2017. Jim has asked you to review information from the company's financial statements shown below and to accompany him to the bank. He wants you to help him convince his banker to give the company an operating line of credit.

The banker has some misgivings. Jim is not sure why, because the current ratio has risen and the debt to total assets ratio has fallen slightly. He did tell you that a contingent liability relating to a lawsuit launched against the company will be disclosed in the financial statements, but it has not been recorded because an estimate could not be determined.

Shown below are amounts extracted from the financial statements (in thousands).

	2015	2014
Statement of Financial Position Information		
Cash	$ 2,000	$10,000
Accounts receivable	20,000	5,000
Merchandise inventory	30,000	7,500
Property, plant, and equipment, net	60,000	50,000
Accounts payable	30,930	16,550
Bank loan, non-current	40,000	30,000
Common shares	13,000	13,000
Retained earnings	28,070	12,950
Income Statement Information		
Sales	$100,000	$50,000
Cost of goods sold	50,000	20,000
Operating expenses	26,000	10,000
Interest expense	2,400	1,500
Income tax expense	6,480	5,550

Instructions

Explain to Jim why his banker may not want to give the company an operating line of credit. Begin your analysis by discussing how ratios that were covered in this chapter have changed in 2015 compared with 2014 and discuss possible underlying reasons for these changes.

The symbol shown in this critical thinking case, or shown in other types of Broadening Your Perspective cases, include optional **Collaborative Learning Activities** to solve the case in a group environment.

What TYPE of learner are you?

Understanding each of these basic learning styles enables the authors to engage students' minds and motivate them to do their best work, ultimately improving the experience for both students and faculty.

	Intake: To take in the information	To make a study package	Text features that may help you the most	Output: To do well on exams
VISUAL	• Pay close attention to charts, drawings, and handouts your instructors use. • Underline. • Use different colours. • Use symbols, flow charts, graphs, different arrangements on the page, white spaces.	Convert your lecture notes into "page pictures." To do this: • Use the "Intake" strategies. • Reconstruct images in different ways. • Redraw pages from memory. • Replace words with symbols and initials. • Look at your pages.	The Navigator/Feature Story/Preview Infographics/Illustrations Accounting equation analyses Highlighted words Comprehensive Do It! Problem/Action Plan Questions/Exercises/Problems Financial Reporting problem Comparative Analysis problem	• Recall your "page pictures." • Draw diagrams where appropriate. • Practise turning your visuals back into words.
AURAL	• Attend lectures and tutorials. • Discuss topics with students and instructors. • Explain new ideas to other people. • Record your lectures. • Leave spaces in your lecture notes for later recall. • Describe pictures and visuals to somebody who was not in class.	You may take poor notes because you prefer to listen. Therefore: • Expand your notes by talking with others and with information from your textbook. • Record summarized notes and listen. • Read summarized notes out loud. • Explain your notes to another "aural" person.	Preview Accounting Matters! Insight Boxes Do It! Action Plan Summary of Learning Objectives Glossary Comprehensive Do It! Problem/Action Plan Self-Test Questions Questions/Exercises/Problems Financial Reporting problem Comparative Analysis problem Ethics Case	• Talk with the instructor. • Spend time in quiet places recalling the ideas. • Do extra assignments and attempt practice quizzes. • Say your answers out loud.
READING/ WRITING	• Use lists and headings. • Use dictionaries, glossaries, and definitions. • Read handouts, textbooks, and supplementary readings. • Use lecture notes.	• Write out words again and again. • Reread notes silently. • Rewrite ideas and principles in other words. • Turn charts, diagrams, and other illustrations into statements.	The Navigator/Feature Story/Study Objectives Preview Do It! Action Plan Summary of Learning Objectives Glossary/Self-Test Questions Questions/Exercises/Problems Financial Reporting problem Comparative Analysis problem Critical Thinking Case All About You Comprehensive Case	• Do extra assignments. • Practise with multiple-choice questions. • Write paragraphs, beginnings, and endings. • Write your lists in outline form. • Arrange your words into hierarchies and points.
KINESTHETIC	• Use all your senses. • Go to labs, take field trips. • Listen to real-life examples. • Pay attention to applications. • Use hands-on approaches. • Use trial-and-error methods.	You may take poor notes because topics do not seem concrete or relevant. Therefore: • Put examples in your summaries. • Use case studies and applications to help with principles and abstract concepts. • Talk about your notes with another "kinesthetic" person. • Use pictures and photographs that illustrate an idea.	The Navigator/Feature Story/Preview Infographics/Illustrations Do It! Action Plan Summary of Learning Objectives Comprehensive Do It! Problem/Action Plan Self-Test Questions Questions/Exercises/Problems Financial Reporting problem Comparative Analysis problem All About You	• Do extra assignments. • Role-play the exam situation.

Visit www.vark-learn.com and complete the Questionnaire to determine what type of learning style you have.

BRIEF CONTENTS

CONTENTS

CHAPTER 1

The Purpose and Use of Financial Statements

The Navigator is a learning system designed to prompt you to use the learning aids in the chapter and set priorities as you study.

The Navigator
Chapter 1

- Scan *Study Objectives*
- Read *Feature Story*
- Read text and answer *Do It!s*
- Review *Comparing IFRS and ASPE*
- Review *Summary of Study Objectives*
- Review *Decision Toolkit—A Summary*
- Work *Using the Decision Toolkit*
- Work *Comprehensive Do It!*
- Answer *Self-Test Questions*
- Complete *assignments*
- Go to *WileyPLUS* for practice and tutorials

study objectives

Study Objectives give you a framework for learning the specific concepts that are covered in the chapter.

After studying this chapter, you should be able to:

SO 1 Identify the uses and users of accounting.

SO 2 Describe the primary forms of business organization.

SO 3 Explain the three main types of business activity.

SO 4 Describe the purpose and content of each of the financial statements.

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ACCOUNTING MATTERS!

The Feature Story helps you picture how the chapter relates to the real world of accounting and business. You will find references to the story throughout the chapter.

Managing a Healthy Bottom Line

With more than 1,250 stores across the country, and sales in 2012 of nearly $10.8 billion, Shoppers Drug Mart Corporation is Canada's largest drug store chain, reaching 9 out of 10 Canadians.

Like many large companies, Shoppers started out small. Its origins can be traced to 1921, when Leon Koffler opened the first two Koffler drugstores in Toronto. In 1941, his son, Murray Koffler, took over the family-owned business. In 1962, Murray Koffler introduced a new concept in pharmacies by opening the first Shoppers Drug Mart. It featured self-service for customers and offered mass merchandising. Shoppers soon grew into a private corporation with 17 stores, each one owned by a pharmacist as an "Associate." Shoppers franchises stores to pharmacist-owners who can offer personal service to local communities and benefit from the buying power, brand name, and marketing expertise of Shoppers' head office.

Over the years, the company has continued to grow and innovate. In its first year in business, Shoppers created its own Life brand of private label health and beauty and other products. It now carries more than 7,500 private label products under several brand names. Shoppers expanded in 1971 into British Columbia and Alberta and the following year into Quebec, where the stores are called Pharmaprix. In 1985, it opened a food section in some stores. In 1991, it launched the HealthWATCH program, which provides patients counselling and advice on medications and health and wellness. In 2006, it purchased MediSystem Technologies Inc., a provider of pharmaceutical products and services to long-term care facilities in Ontario and Alberta. Shoppers opened its first Murale beauty boutique in 2008 and now has six luxury beauty destinations operating under the trademark Murale.

In 2001, Shoppers became a public corporation, issuing 30 million common shares at a price of $18 per share. That would have been a good investment for anyone who bought initial shares and held on to them, because in 2013, the Shoppers' board of directors and shareholders approved the company's purchase by Loblaw Companies Limited for $33.18 in cash plus 6/10ths of a Loblaw share for each Shoppers' share. That worked out to $61.54 per Shoppers' share. The $12.4-billion buyout, subject to federal government and court approval at the time of writing, merged Canada's largest drug store chain with Canada's largest grocery store chain, creating a company to better compete in the fast-changing retail business, focusing on health and nutrition. "We are delighted to partner with Loblaw to leverage our combined strengths. For our shareholders, this transaction provides significant and immediate value, as well as the ability to benefit from future upside by virtue of their continued ownership of shares in the combined company," said Domenic Pilla, President and Chief Executive Officer of Shoppers Drug Mart.

Shoppers will continue to operate as a separate division of Loblaw. Shoppers and Loblaw stores expected to sell each other's private-label products, expanding the choices for consumers.

How does a company like Shoppers Drug Mart decide to make all these moves in the hopes of boosting profitability? Whether creating its associate business model, becoming a public company, or diversifying into food and beauty products, Shoppers relies on one key tool: accounting.

And the way Shoppers communicates its accounting information to investors, lenders, suppliers, and other interested parties is through its financial statements.[1]

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preview of CHAPTER 1

How do you start a business? How do you make it grow into a widely recognized brand name like Shoppers Drug Mart in our chapter-opening feature story? How do you determine whether your business is making or losing money? When you need to expand your operations, where do you get money to finance the expansion—should you borrow, issue shares, or use company funds? To be successful in business, countless decisions have to be made—and decisions require accounting information, as mentioned in our feature story.

The purpose of this chapter is to show you accounting's role in providing useful financial information for decision-making. The chapter is organized as follows:

THE PURPOSE AND USE OF FINANCIAL STATEMENTS

Uses and Users of Accounting
- Internal users
- External users
- Ethical behaviour by users

Forms of Business Organization
- Proprietorships
- Partnerships
- Corporations
- Generally accepted accounting principles for business organizations

Business Activities
- Financing activities
- Investing activities
- Operating activities
- Summary of business activities

Communicating with Users
- Sierra's financial statements
- Shoppers Drug Mart's financial statements
- Elements of an annual report

Uses and Users of Accounting

STUDY OBJECTIVE 1
Identify the uses and users of accounting.

Essential terms are printed in blue when they first appear. They are listed and defined again in the glossary at the end of the chapter.

Accounting is the information system that identifies and records the economic events of an organization, and then communicates them to a wide variety of interested users. Why does accounting matter to these users? The world's economic systems depend on highly transparent, reliable, and accurate financial reporting. Because of this, accounting has long been labelled "the language of business."

That's one of the reasons why so many Canadians, even those who do not plan on becoming accountants, study accounting. For example, Monique Leroux, president and CEO of Desjardins Group; Elizabeth Marshall, a senator; Zarin Mehta, president and executive director of the New York Philharmonic; George Melville, chairman and owner of Boston Pizza International; Syd Pallister, CFO of Gibbs-Delta Tackle; and Paul Sobey, president and CEO of Empire Company Limited, all have studied accounting in depth.

Whether you plan to become an accountant or not, a working knowledge of accounting will be relevant and useful in whatever role you assume as a user of accounting information. Whether you plan to own your own business, work for someone else in their business, or invest in a business, understanding accounting will be helpful to you. To demonstrate the value of accounting to you as an individual, each chapter includes an "All About You" feature and a related activity in the end-of-chapter material that links an accounting concept to your personal or business life.

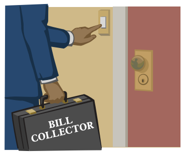
Users of accounting information can be divided broadly into two types: internal users and external users. We will discuss each of these in the sections that follow.

INTERNAL USERS

Internal users of accounting information plan, organize, and run companies. They work for the company. These include finance directors, marketing managers, human resource personnel, production supervisors, and company officers.

In running a business, internal users must answer many important questions, as shown in Illustration 1-1.

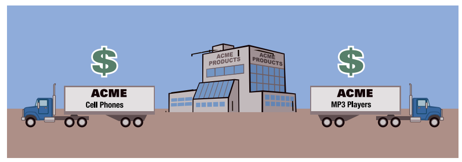
▸Illustration 1-1
Questions asked by internal users



Finance
Is there enough cash to pay the bills?

Marketing
What price should we sell iPads for to maximize profits?

Human Resources
How many employees can we afford to hire this year?



Production
Which product line is the most profitable?

To answer these and other questions, users need detailed accounting information on a timely basis; that is, it must be available when it is needed. For internal users, accounting provides a variety of internal reports, such as financial comparisons of operating alternatives, projections of profit from new sales campaigns, analyses of sales costs, and forecasts of cash needs. In addition, companies present summarized financial information in the form of financial statements for both internal and external use.

Alternative Terminology notes give synonyms that you may hear or see in the workplace and in this text.

EXTERNAL USERS

There are several types of external users of accounting information. Investors use accounting information to make decisions to buy, hold, or sell their ownership interest. Lenders, such as bankers, use accounting information to evaluate the risks of lending money. Other creditors, such as suppliers, use accounting information to decide whether or not to grant credit (sell on account) to a customer. **Investors, lenders, and other creditors** are considered to be the primary users of accounting information.

Alternative Terminology
Investors are also known as *shareholders* and *creditors* are also known as *lenders*.

Some questions that investors, lenders, and other creditors may ask about a company are shown in Illustration 1-2.

▸Illustration 1-2
Questions asked by external users

Investors
Should I purchase shares of this company?

Lenders and Other Creditors
Will the company be able to pay its debts as they come due?

In addition to investors, lenders, and other creditors, there are many other external users with a variety of information needs and questions. For example, potential employees use annual reports to learn about the company and evaluate job prospects. Labour unions use financial information to bargain for better salaries and benefits. And taxing authorities, such as the Canada Revenue Agency, use financial statements to assess a company's income tax.

ETHICAL BEHAVIOUR BY USERS

In order for financial information to have value to its users, whether internal or external, it must be prepared by individuals with high standards of ethical behaviour. Ethics in accounting is of the