 Fifth Canadian Edition

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# FUNDAMENTALS OF FINANCIAL ACCOUNTING



 Fifth Canadian Edition

# FUNDAMENTALS OF FINANCIAL ACCOUNTING

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**Mc  
Graw  
Hill**  
Education



**Fundamentals of Financial Accounting  
Fifth Canadian Edition**

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# Dedication

Barb, Harrison, and Daniel, my Mom, and (memory of) my Dad

**FRED PHILLIPS**

Herman and Doris Hargenrater,  
Laura Libby, Oscar and Selma Libby

**PATRICIA AND ROBERT LIBBY**

Mom and Dad—Thank you for teaching me the importance of doing things right the first time around and for inspiring me to work hard and always do my best. And to Pat, Payton, and Avery—thank you for your support and for teaching me something new every day.

**BRANDY MACKINTOSH**

# Meet the Authors



## Fred Phillips

Fred Phillips is a professor and the George C. Baxter Scholar at the University of Saskatchewan, where he teaches introductory financial accounting. He also has taught introductory accounting at the University of Texas at Austin and the University of Manitoba. Fred has an undergraduate accounting degree, a CPA, CA (Canada), and a PhD from the University of Texas at Austin. He previously worked as an audit manager at KPMG.

Fred's main career interest is accounting education. He has been recognized with more than 26 awards, as chosen by his students and peers. In 2006, Fred was awarded the title Master Teacher at the University of Saskatchewan. In 2011, he was admitted to the 3M National Teaching Fellowship, the highest honour for undergraduate teaching in Canada. In 2012, Fred received the L. S. Rosen Outstanding Educator Award, the American Accounting Association's Innovation in Auditing and Assurance Education Award, and the American Accounting Association's Award for Outstanding Research in Accounting Education. Most recently, he received the Edwards MPAcc Teaching Effectiveness Award and, for the third time in his career, the University of Saskatchewan Student Union's Teaching Excellence Award. His peer-reviewed publications include education-focused research and instructional cases in *Issues in Accounting Education*, as well as professional judgment studies in *Journal of Accounting Research* and *Organizational Behavior and Human Decision Processes*, among others. Fred is a current member of the Teaching, Curriculum, & Learning and Two-Year College sections of the American Accounting Association. In his spare time, he likes to play tennis, drink iced cappuccinos, and relax with his family.



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Bob was selected as the AAA Outstanding Educator in 2000, and received the AAA Outstanding Service Award in 2006 and the AAA Notable Contributions to the Literature Award in 1985 and 1996. He has received the Core Faculty Teaching

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### Patricia A. Libby

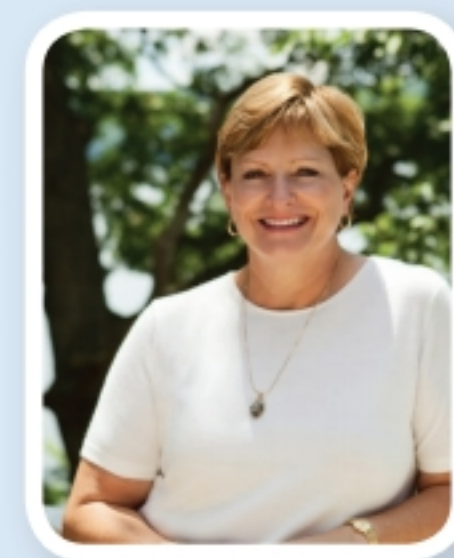
Patricia Libby is associate professor of accounting at Ithaca College, where she teaches the undergraduate financial accounting course. She previously taught graduate and undergraduate financial accounting at Eastern Michigan University and the University of Texas. Before entering academe, she was an auditor with Price Waterhouse (now PricewaterhouseCoopers) and a financial administrator at the University of Chicago. She is also faculty advisor to Beta Alpha Psi and the Ithaca College Accounting Association. She received her BS from Pennsylvania State University, her MBA from DePaul University, and her PhD from the University of Michigan; she also successfully completed the CPA exam (Illinois).

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Brandy was selected as the Edwards School of Business Most Effective Professor in 2015 and again in 2016. She also received the Edwards School of Business Most Approachable Professor Award in 2014 and 2016. Brandy has received the University of Saskatchewan Student Union's Teaching Excellence Award multiple times, most recently in 2015. Her scholarly interests relate to accounting education and case writing. She has published cases in *Issues in Accounting Education*, and most recently won the 2016 Canadian Academic Accounting Association case-writing competition.



# BRIEF CONTENTS

Your Personal Coach . . . XII

## CHAPTER 1

Business Decisions and Financial Accounting 2

## CHAPTER 2

The Balance Sheet 50

## CHAPTER 3

The Income Statement 108

## CHAPTER 4

Adjustments, Financial Statements, and Financial Results 166

## CHAPTER 5

Fraud, Internal Control, and Cash 232

## CHAPTER 6

Merchandising Operations and the Multi-step Income Statement 282

## CHAPTER 7

Inventory and Cost of Goods Sold 330

## CHAPTER 8

Receivables, Bad Debt Expense, and Interest Revenue 376

## CHAPTER 9

Long-Lived Tangible and Intangible Assets 424

## CHAPTER 10

Liabilities 480

## CHAPTER 11

Shareholders' Equity 538

## CHAPTER 12

Statement of Cash Flows 586

## CHAPTER 13

Measuring and Evaluating Financial Performance 644

## APPENDIX A

Summarized Financial Statements of The Home Depot A-1

## APPENDIX B

Excerpts from the Fiscal 2016 Annual Report of Lowe's Companies, Inc. B-1

## APPENDIX C

Present and Future Value Concepts C-1

## APPENDIX D

Wiki Art Gallery Inc. D-1

## APPENDIX E

Investments in Other Corporations E-1

Glossary GL-1

Business Index IN-1

Topical Index IN-4

# CONTENTS

Your Personal Coach . . . XII

## CHAPTER 1

Business Decisions and Financial Accounting 2

**Pizza Palace Inc.** 2

---

Understand the Business 3

Organizational Forms 3

Accounting for Business Decisions 4

Study the Accounting Methods 8

The Basic Accounting Equation 8

Financial Statements 10

Evaluate the Results 18

Using Financial Statements 18

Useful Financial Information 19

Supplement 1A 24

Careers That Depend on Accounting Knowledge 24

Review the Chapter 25

Demonstration Case 25

Chapter Summary 27

Solution to Self-Study Practice 28

Key Terms 28

Homework Helper 29

Practice Material 29

Mini-Exercises 30

Exercises 35

Coached Problems 39

Group A Problems 41

Group B Problems 43

Skills Development Cases 44

Continuing Case 49

Endnote 49

## CHAPTER 2

The Balance Sheet 50

**Pizza Palace Inc.** 50

---

Understand the Business 51

Building a Balance Sheet 51

Transactions and Other Activities 53

Study the Accounting Methods 54

Step 1: Analyze Transactions 54

Steps 2 And 3: Record and Summarize 59

The Debit/Credit Framework 61

Preparing a Trial Balance and Balance Sheet 68

Evaluate the Results 70

Assessing the Ability to Pay 70

Balance Sheet Concepts and Values 72

Supplement 2A 74

Accounting Careers 74

Review the Chapter 76

Demonstration Case 76

Chapter Summary 78

Solution to Self-Study Practice 80

Key Terms 80

Homework Helper 80

Practice Material 81

Mini-Exercises 82

Exercises 88

Coached Problems 94

Group A Problems 96

Group B Problems 99

Skills Development Cases 103

Continuing Case 106

Endnote 107

## CHAPTER 3

The Income Statement 108

**Pizza Palace Inc.** 108

---

Understand the Business 109

Operating Activities 109

Income Statement Accounts 110

Study the Accounting Methods 112

Cash Basis Accounting 112

Accrual Basis Accounting 113

The Expanded Accounting Equation 117

Unadjusted Trial Balance 124

Review of Revenues and Expenses 126

Evaluate the Results 127

Net Profit Margin 127

Income Statement Limitations 128

Review the Chapter 130

Demonstration Case A 130

Demonstration Case B 131

Chapter Summary 134

Solution to Self-Study Practice 135

Key Terms 136

Homework Helper 136

Practice Material 137

Mini-Exercises 138



Exercises	143
Coached Problems	151
Group A Problems	154
Group B Problems	156
Comprehensive Problem	159
Skills Development Cases	160
Continuing Case	164

## CHAPTER 4

Adjustments, Financial Statements, and Financial Results	166
--	-----

### Pizza Palace Inc. 166

---

Understand the Business	167
Why Adjustments are Needed	167
Study the Accounting Methods	170
Making Required Adjustments	170
Preparing an Adjusted Trial Balance and the Financial Statements	181
Closing Temporary Accounts	185
Evaluate the Results	186
Adjusted Financial Results	186
Review the Chapter	190
Demonstration Case	190
Chapter Summary	197
Solution to Self-Study Practice	198
Key Terms	198
Homework Helper	198
Practice Material	199
Mini-Exercises	200
Exercises	204
Coached Problems	212
Group A Problems	214
Group B Problems	216
Comprehensive Problems	218
Skills Development Cases	224
Continuing Case	229

## CHAPTER 5

Fraud, Internal Control, and Cash	232
-----------------------------------	-----

### Koss Corporation 232

---

Fraud and Internal Control	233
Fraud	233
Changes to Corporate Governance in Canada	235
Internal Control	238
Internal Control for Cash	241
Controls for Cash Receipts	241
Controls for Cash Payments	245
Controls from Bank Procedures	248
Cash Reporting	248
Bank Statement	248
Bank Reconciliation	250

Reporting Cash	254
Restricted Cash	254
Supplement 5A	255
Petty Cash Systems	255
Review the Chapter	256
Demonstration Case	257
Chapter Summary	258
Solutions to Self-Study Practice	259
Key Terms	259
Homework Helper	259
Practice Material	260
Mini-Exercises	260
Exercises	264
Coached Problems	267
Group A Problems	270
Group B Problems	273
Comprehensive Problem	276
Skills Development Cases	277
Continuing Cases	279
Endnotes	281

## CHAPTER 6

Merchandising Operations and the Multi-Step Income Statement	282
--	-----

### Walmart 282

---

Understand the Business	283
Operating Cycles	283
Inventory Systems	284
Study the Accounting Methods	287
Recording Inventory Purchases	287
Recording Inventory Sales	291
Inventory Purchases and Sales Transactions Compared	296
Evaluate the Results	296
Multi-Step Income Statement	296
Gross Profit Analysis	297
Supplement 6A	299
Sales of Bundled Products/Services	299
Supplement 6B	302
Recording Inventory Transactions in a Periodic System	302
Review the Chapter	302
Demonstration Case	302
Chapter Summary	304
Solutions to Self-Study Practice	305
Key Terms	305
Homework Helper	306
Practice Material	306
Mini-Exercises	307
Exercises	309
Coached Problems	315
Group A Problems	318
Group B Problems	320

Comprehensive Problem	323
Skills Development Cases	323
Continuing Cases	327

## CHAPTER 7

Inventory and Cost of Goods Sold	330
----------------------------------	-----

### Hudson's Bay Company 330

---

Understand the Business	331
Inventory Management Decisions	331
Types of Inventory	331
Study the Accounting Methods	332
Balance Sheet and Income Statement Reporting	332
Inventory Costing Methods	334
Lower of Cost and Net Realizable Value	338
Evaluate the Results	340
Inventory Turnover Analysis	340
Supplement 7A	343
Recording Inventory Transactions Using Last-In, First-Out (LIFO)	343
Supplement 7B	345
FIFO, LIFO, and Weighted Average in a Perpetual Inventory System	345
Supplement 7C	348
The Effects of Errors in Ending Inventory	348
Review the Chapter	350
Demonstration Case	350
Chapter Summary	351
Solution to Self-Study Practice	352
Key Terms	353
Homework Helper	353
Practice Material	353
Mini-Exercises	354
Exercises	357
Coached Problems	363
Group A Problems	365
Group B Problems	367
Comprehensive Problem	369
Skills Development Cases	371
Continuing Cases	374
Endnotes	375

## CHAPTER 8

Receivables, Bad Debt Expense, and Interest Revenue	376
---	-----

### VF Corporation (VFC) 376

---

Understand the Business	377
Advantages and Disadvantages of Extending Credit	377
Study the Accounting Methods	378
Accounts Receivable and Bad Debts	378

Methods for Estimating Bad Debts	382
Notes Receivable and Interest Revenue	386
Recording Notes Receivable and Interest Revenue	387

Evaluate the Results	391
Receivables Turnover Analysis	391
Supplement 8A	395
Direct Write-Off Method	395
Review the Chapter	395
Demonstration Case A: Bad Debts	395
Demonstration Case B: Notes Receivable	397
Chapter Summary	398
Solutions to Self-Study Practice	399
Key Terms	400
Homework Helper	400
Practice Material	400
Mini-Exercises	401
Exercises	403
Coached Problems	409
Group A Problems	411
Group B Problems	414
Comprehensive Problems	416
Skills Development Cases	417
Continuing Cases	422

## CHAPTER 9

Long-Lived Tangible and Intangible Assets	424
---	-----

### Cedar Fair 424

---

Understand the Business	425
Definition and Classification	425
Study the Accounting Methods	426
Tangible Assets	426
Intangible Assets	442
Evaluate the Results	445
Turnover Analysis	445
Impact of Depreciation Differences	447
Supplement 9A	450
Natural Resources	450
Review the Chapter	451
Demonstration Case	451
Chapter Summary	454
Solutions to Self-Study Practice	455
Key Terms	456
Homework Helper	457
Practice Material	457
Mini-Exercises	458
Exercises	462
Coached Problems	466
Group A Problems	468
Group B Problems	470

Comprehensive Problem	472
Skills Development Cases	473
Continuing Cases	478
Endnote	479

## CHAPTER 10

Liabilities 480

**General Mills** 480

---

Understand the Business 481

The Role of Liabilities 481

Study the Accounting Methods 482

Measuring Liabilities 482

Current Liabilities 482

Long-Term Liabilities 491

Contingent Liabilities 498

Evaluate the Results 499

Debt-to-Assets Ratio 499

Times Interest Earned Ratio 500

Supplement 10A 501

Straight-Line Method of Amortization 501

Supplement 10B 503

Effective-Interest Method of Amortization 503

Supplement 10C 508

Simplified Effective-Interest Amortization 508

Review the Chapter 512

Demonstration Case A: Accrued Liabilities and Deferred Revenue 512

Demonstration Case B: Notes Payable and Accrued Interest 514

Demonstration Case C: Bonds Payable 514

Chapter Summary 516

Solution to Self-Study Practice 517

Key Terms 517

Homework Helper 518

Practice Material 518

Mini-Exercises 519

Exercises 521

Coached Problems 525

Group A Problems 528

Group B Problems 531

Comprehensive Problem 533

Skills Development Cases 534

Continuing Cases 536

## CHAPTER 11

Shareholders' Equity 538

**Molson Coors Brewing Company** 538

---

Understand the Business 539

Corporate Ownership 539

Equity versus Debt Financing 541

Study the Accounting Methods 542

Common Share Transactions 542

Stock Dividends and Stock Splits 550

Preferred Shares 553

Retained Earnings 556

Statement of Shareholders' Equity 556

Evaluate the Results 557

Earnings Per Share (EPS) 557

Return on Equity (ROE) 558

Price/Earnings (P/E) Ratio 559

Supplement 11A 560

Owners' Equity for Other Forms of Business 560

Review the Chapter 564

Demonstration Case A: Share Issuance and Repurchases 564

Demonstration Case B: Cash and Stock Dividends 565

Chapter Summary 566

Solutions to Self-Study Practice 567

Key Terms 568

Homework Helper 568

Practice Material 568

Mini-Exercises 569

Exercises 571

Coached Problems 577

Group A Problems 579

Group B Problems 580

Comprehensive Problem 582

Skills Development Cases 583

Continuing Cases 585

Endnotes 585

## CHAPTER 12

Statement of Cash Flows 586

**Under Armour, Inc.** 586

---

Understand the Business 587

Business Activities and Cash Flows 587

Classifying Cash Flows 588

Study the Accounting Methods 591

Relationship to Other Financial Statements 591

Preparing the Statement of Cash Flows 592

Evaluate the Results 604

Evaluating Cash Flows 604

Operating Cash Flows Revisited (Direct Method) 607

Supplement 12A 612

Reporting Disposals of Property, Plant, and Equipment (Indirect Method) 612

Supplement 12B 613

T-Account Approach (Indirect Method) 613

Review the Chapter 615

Demonstration Case A: Indirect Method 615

Demonstration Case B: Direct Method 616

Chapter Summary	618
Solutions to Self-Study Practice	618
Key Terms	619
Homework Helper	619
Practice Material	620
Mini-Exercises	620
Exercises	623
Coached Problems	630
Group A Problems	633
Group B Problems	636
Skills Development Cases	638
Continuing Cases	642
Endnotes	643

## CHAPTER 13

Measuring and Evaluating Financial Performance 644

**The Home Depot, Inc.** 644

---

Understand the Business	645
Horizontal, Vertical, and Ratio Analyses	645
Study the Accounting Methods	646
Horizontal (Trend) Computations	646
Vertical (Common-Size) Computations	648
Ratio Computations	650
Evaluate the Results	652
Interpreting Horizontal and Vertical Analyses	652
Interpreting Ratio Analyses	653
Assessing Underlying Accounting Decisions and Concepts	659
Supplement 13A	662
Non-Recurring and Other Special Items	662
Supplement 13B	663
Reviewing and Contrasting ASPE and IFRS	663
Review the Chapter	665
Demonstration Case	665
Chapter Summary	666
Solutions to Self-Study Practice	667
Key Terms	667
Homework Helper	667
Practice Material	668
Mini-Exercises	668
Exercises	670
Coached Problems	675
Group A Problems	679
Group B Problems	684
Skills Development Cases	688
Continuing Case	689
Endnotes	690

## APPENDIX A

Summarized Financial Statements of The Home Depot A-1

## APPENDIX B

Excerpts From the Fiscal 2016 Annual Report of Lowe's Companies, Inc. B-1

## APPENDIX C

Present and Future Value Concepts C-1

## APPENDIX D

Wiki Art Gallery Inc. D-1

## APPENDIX E

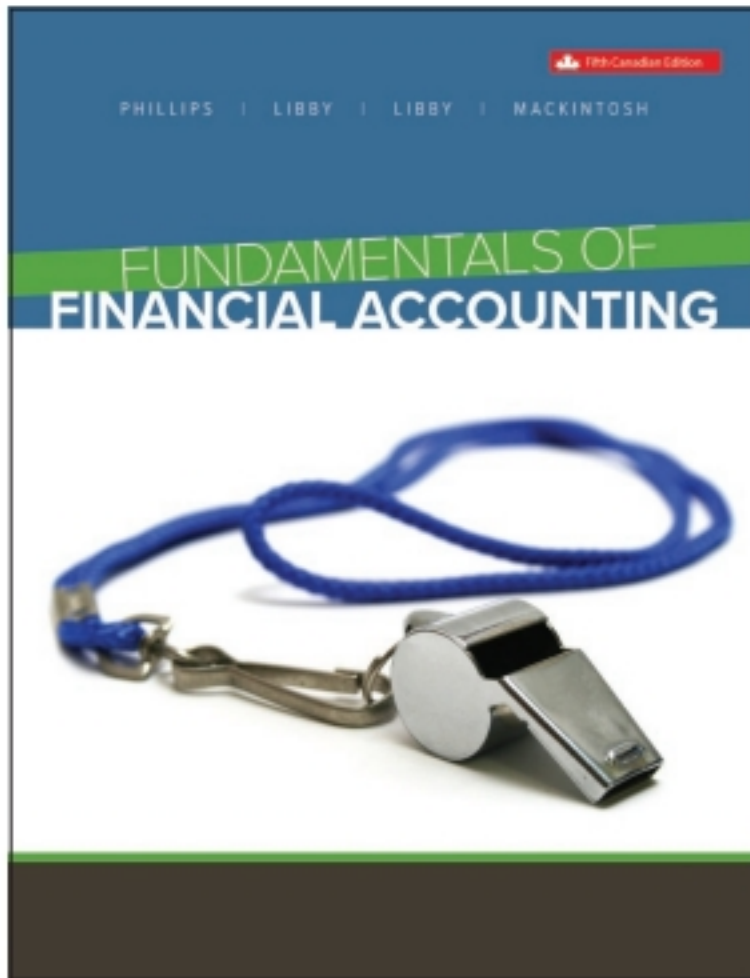
Investments in Other Corporations E-1

Glossary GI-1

Business Index IN-1

Topical Index IN-4

# Your Personal Coach . . .



Phillips, Libby, Libby, and Mackintosh's *Fundamentals of Financial Accounting*, fifth Canadian edition, arms students with a secret weapon for success in financial accounting—the best personal coach on the market. The cover of this text features the quintessential representation of a coach—a whistle. Simple, maybe, but this whistle captures the essence of this text brand as your coach. The following are highlights of Phillips's innovative student-centred approach:

**WRITING THAT STUDENTS CAN READ.** What does it mean to say that a book is “readable”? In the case of *Fundamentals of Financial Accounting*, fifth Canadian edition, it simply means that it's the most enjoyable accounting textbook your students have ever read. Through a mix of conversational wording, humour, and everyday examples, *Fundamentals of Financial Accounting* achieves a style that maintains rigour without sacrificing student engagement. Open this textbook to any page and read for yourself; *Fundamentals of Financial Accounting* offers **the most engaging read** of any financial text.

**STUDENT-FRIENDLY COVERAGE OF DIFFICULT TOPICS.** Written with students in mind, *Fundamentals of Financial Accounting* handles difficult concepts in a way that reflects the balance of preparer and user concepts, and keeps students from being overwhelmed.

- The **accounting process** is covered in three chapters (2, 3, and 4).
- The purpose of a **statement of cash flows** is introduced at the beginning of the text, but the mechanics of preparing one are studied at the end.
- **Ratios** are introduced throughout the chapters and then pulled together at the end (13).
- **Individual concepts** are introduced throughout the text as needed to explain specific accounting practices and then pulled together at the end.
- **Award-Winning Continuing Case:** Key accounting judgments that affect business decisions in the workplace are learned by students through an award-winning continuing case in the assignment material for Chapters 5 through 12.

# ... in Financial Accounting

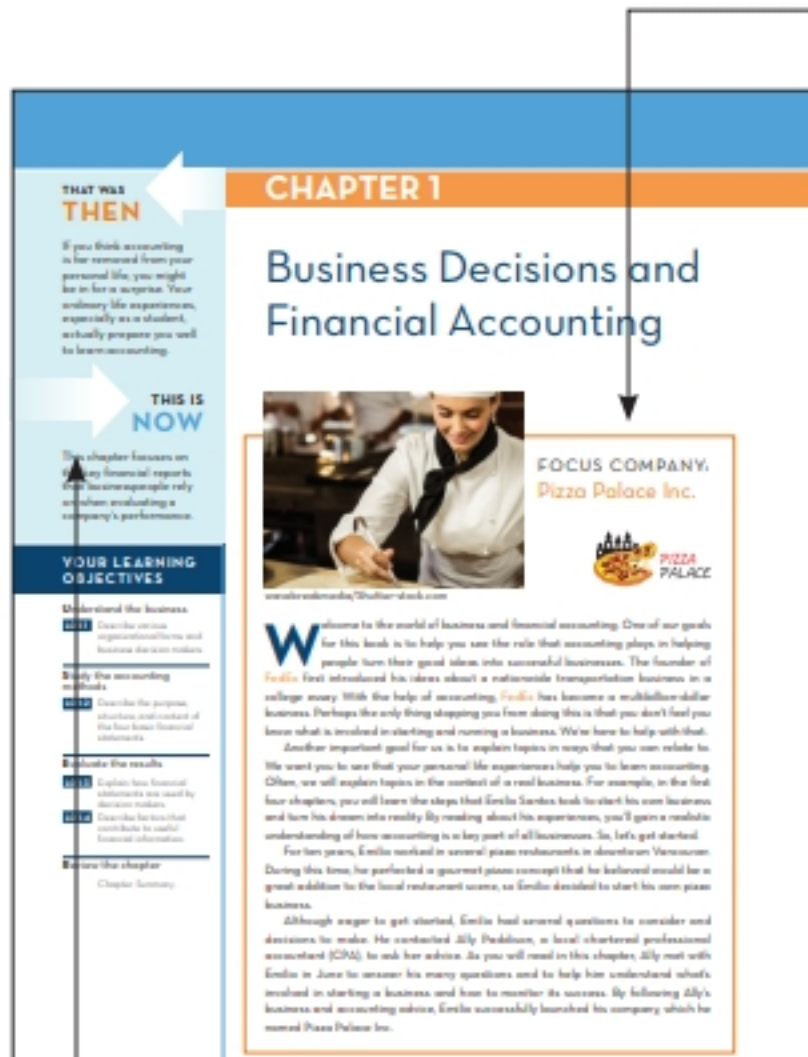
**CURRENT.** Phillips reflects current accounting standards in Canada. Covering both International Financial Reporting Standards (IFRS) and Accounting Standards for Private Enterprise (ASPE), Phillips discusses key differences between IFRS and ASPE in a boxed feature at the end of each chapter.

**BALANCED.** Phillips delivers a balanced approach. Throughout, understanding the preparation of financial statements is balanced with the importance of using the financial statements to guide decision making.

**EXTENSIVE END-OF-CHAPTER EXERCISES AND PROBLEMS.** Students build confidence and success with a wealth of end-of-chapter discussion questions, exercises, coached and comprehensive problems, skills development cases, and continuing cases.

# Stay Focused . . .

The best way to learn to prepare and use financial statements is to study accounting in real business contexts.



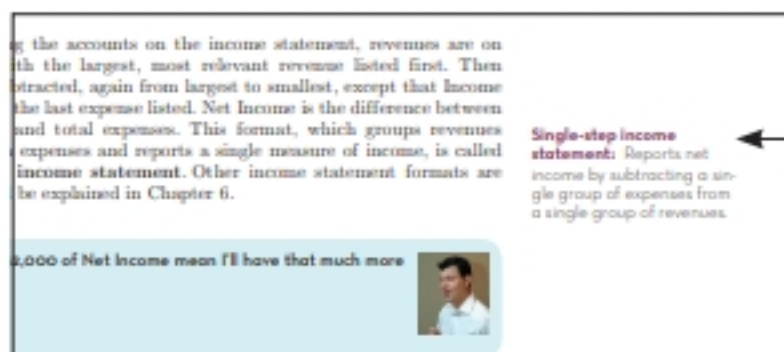
**FOCUS COMPANY APPROACH.** The Focus Company approach integrates each chapter's material with a real-world company, its decisions, and its financial statements.

Not all students learn financial accounting with ease. With so many distractions these days, it is difficult to keep both majors and non-majors focused on the big picture. The authors of *Fundamentals of Financial Accounting* fifth Canadian edition understand the challenges instructors face and the need for a financial accounting text that is relevant, easy to read, and current. *Fundamentals of Financial Accounting* responds by using carefully chosen focus companies that students not only recognize but are familiar with because they have visited or used those companies' products.

Students often feel that they lack the real-world experience needed to understand accounting, a subject they believe has little impact on their daily lives. *Fundamentals of Financial Accounting's* chapter openers provide real-world situations and examples that illustrate how accounting principles are part of day-to-day activities that students might not have thought about from an accounting perspective, from companies like the local pizza restaurant to the world's most familiar businesses, such as Hudson's Bay Company, Walmart, Cedar Fair, Molson Coors Brewing Company, Under Armour, and General Mills. Through crisp, clear, and engaging writing, the financial decisions these companies make and the financial statements they use come alive for students and they are able to see the big picture of how accounting relates to the real world—their world.

**THAT WAS THEN/THIS IS NOW.** To provide connectivity in students' minds, each chapter opens by briefly putting into perspective the information learned in the previous chapter and what will be learned in the present chapter.

**KEY TERMS.** All key terms are defined within the text in which the terms are first introduced, reinforcing student understanding and recapping important text points.



# ... on the Real World

**SPOTLIGHT FEATURES.** Each chapter includes Spotlight features focusing on financial reporting, IFRS and ASPE, ethics, the world, business decisions, internal controls, and Canada. These features are designed to further engage students and provide instructors with material for in-class discussion.

**SPOTLIGHT ON Financial Reporting**

**The Ultimate Irony: Teacher Late with Report**

K12 Inc. claims to be the leader in computer-based instruction for grades K to 12. The company's financial statements claim to get its own computerized accounting systems working in time to meet an important deadline. K12 admitted that it was struggling with "the integration of diverse accounting systems" and that it would be about a month late releasing its annual report. The company explained that it had recently acquired several other companies' computerized accounting systems. To ensure all of the transactions were

← **Spotlight on Financial Reporting** These features connect chapter topics with real-world disclosures provided in the financial statements of our focus companies and other contrasting companies.

**Spotlight on IFRS and ASPE** Specific discussions on International Financial Reporting Standards (IFRS) and how they differ from Accounting Standards for Private Enterprises (ASPE) are grouped together in the Spotlight on IFRS and ASPE box at the end of each chapter.

**SPOTLIGHT ON IFRS and ASPE**

As International Financial Reporting Standards (IFRS) are adopted around the world, the transaction analysis process in this chapter becomes even more important. In the U.S., which explains accounting rules in detail, ASPE and IFRS are less detailed and require more judgment when analyzing transactions. This difference in emphasis exists because ASPE and IFRS are used across many different countries, where business practices and legal systems are different, placing slightly more emphasis on general principles than on detailed rules, which are more easily and broadly applied around the world.

**SPOTLIGHT ON Ethics**

**35 Days Hath September?**

It seems some managers—specifically those at Computer Associates (CA)—believe in the **period assumption**. CA was charged with financial statement fraud for improving five days of sales in September—a month that has only thirty days. To make sure they had met their September sales targets, CA included the first five days of sales in the September income statement. This accounting fraud led managers to be perceived as successful and tricked investors into thinking CA was a successful company.

← **Spotlight on Ethics** The text ensures that students start off with a solid grounding in ethics. Shining the spotlight on ethical issues in each chapter prompts the student to think about tough ethical decisions and to practise making these decisions in the end-of-chapter cases.

**Spotlight on the World** Students are kept apprised of the ongoing changes in the accounting profession around the world through these features.

**SPOTLIGHT ON The World**

**Direct versus Indirect Method Presentation**

ASPE and IFRS currently allow companies to use either the direct or indirect method to present cash flows. The Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have spoken in the past about removing this choice and allowing only the direct method. The direct method is more detailed and shows the operating cash receipts and cash payments with the objective of a cash flow statement. However, the indirect method shows the accrual income to cash flows from operations, which is an advantage over the direct method.

**SPOTLIGHT ON Business Decisions**

**Lehman Brothers' Operating Cash Flows and the Financial Crisis**

Lehman Brothers Holdings, Inc. was one of the largest and most profitable companies in the world. But cash flow and working capital management problems led to its bankruptcy only a month before the stock market crash of 2008. The following table comparing net income and net operating cash flows reveals the company's problems:

15.0
------

← **Spotlight on Business Decisions** Found throughout the text, these features help students to develop strong decision-making skills by illustrating the relevance of accounting in real-world decision making and the lessons learned from global economic crises.

**Spotlight on Controls** These features highlight applications of internal control principles in the workplace.

**SPOTLIGHT ON Controls**

**Sources of Inventory Shrinkage**

Independent verification of inventory quantities is important. A recent study found that \$34 billion of inventory goes missing from U.S. retailers each year. Although the largest cause of shrinkage (accounting for 36 percent of lost units), an even larger portion is from employee theft. To avoid hiring dishonest employees, companies screen employees through employment and criminal background checks. To deter and detect employee theft, companies use surveillance cameras and complex computer programs that monitor

**SPOTLIGHT ON Canada**

**Mentorship Program Offers Vision to Aboriginal Youth**

The Martin/CPA Canada Accounting Mentorship Program (AMP) was an initiative of the Prime Minister Paul Martin and CPA Lloyd Posna. AMP's purpose is to provide a vision to young youth who seek university degrees and develop their interest in pursuing business in accounting. The AMP high-school students who aspire to complete post-secondary education with accountants from seven of the profession's top firms. These students participate

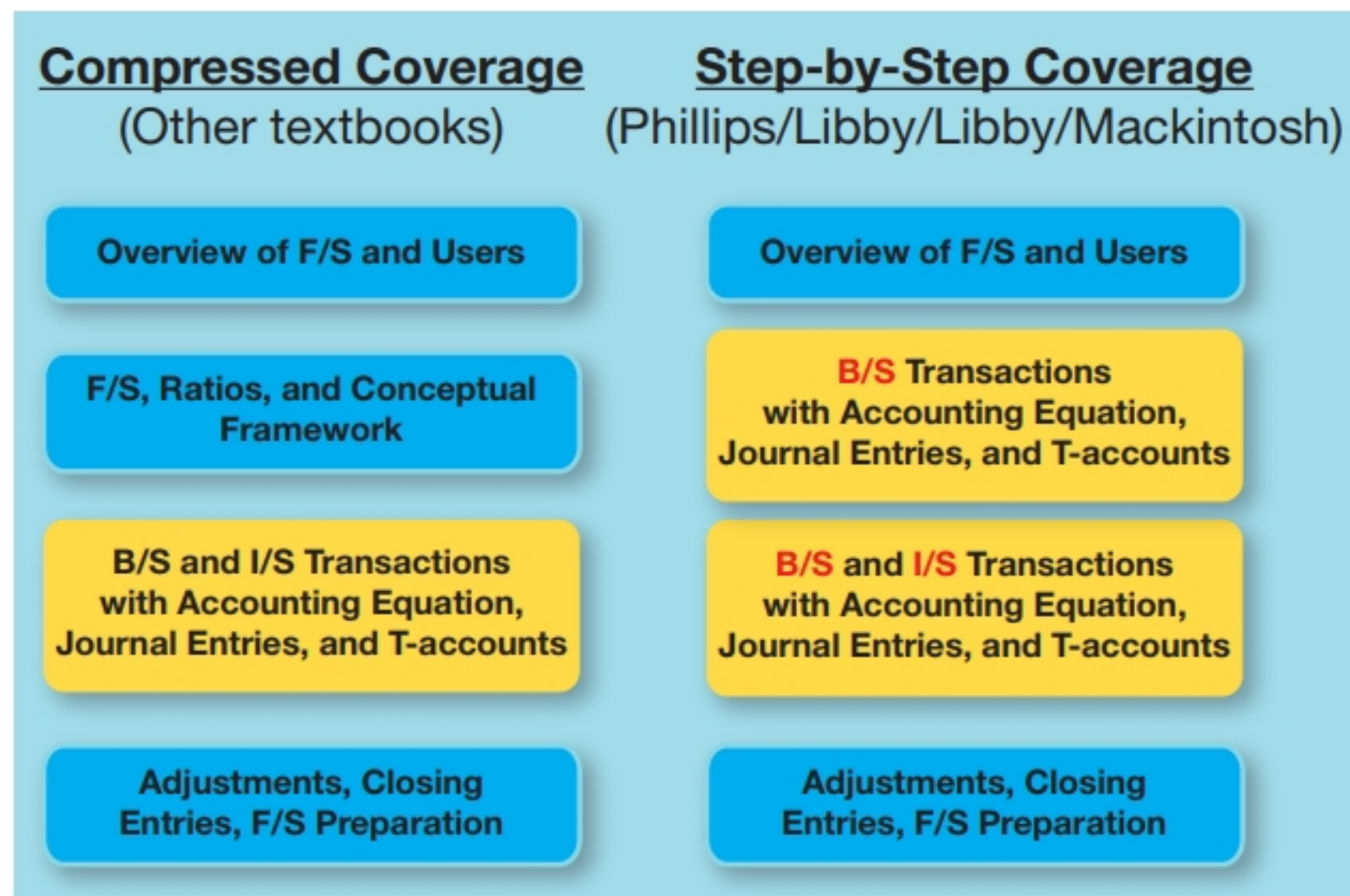
← **Spotlight on Canada** These boxes feature information on accounting and business practices specific to Canadian and Aboriginal communities.



# Dedicated and Coached . . .

**A PROVEN TEACHING AND LEARNING METHODOLOGY.** Faculty agree the accounting cycle is the most critical concept to learn and master for students studying financial accounting. The approach to this topic in Phillips/Libby/Libby/Mackintosh is based on the belief that students struggle with the accounting cycle when transaction analysis is covered in one chapter. If students are exposed to the accounting equation, journal entries, and T-accounts for both balance sheet and income statement accounts in a single chapter, many are left behind and are unable to grasp material in the next chapter, which typically covers adjustments and financial statement preparation.

The accompanying graphic shows how, unlike other textbooks, the Phillips/Libby/Libby/Mackintosh approach spreads transaction analysis coverage over two chapters so that students have the time to master the material. In Chapter 2 of *Fundamentals of Financial Accounting*, students are exposed to the accounting equation and transaction analysis for transactions that affect only balance sheet accounts. This provides students with the opportunity to learn the basic structure and tools used in accounting in a simpler setting. In Chapter 3, students are exposed to more complex transactions that affect both balance sheet and income statement accounts. As a result of this progressive approach to transaction analysis, students learn more, as documented in peer-reviewed research.<sup>1</sup> We have also seen that our approach prepares students to learn adjustments, financial statement preparation, and more advanced topics.



<sup>1</sup>F. Phillips and L. Heiser, "A Field Experiment Examining the Effects of Accounting Equation Emphasis and Transaction Scope on Students Learning to Journalize," *Issues in Accounting Education* 26, pp. 681–699 (2011).

# ... for Student Motivation and Success

**COACH'S TIP.** Virtually every student has been inspired by a great coach at some time or another. Throughout the chapters, Coach's Tips provide students with advice and guidance on learning the material. Coach's Tips appear again in the problem material to offer encouragement as students work to reinforce what they've learned.



**COACH'S TIP**  
Any account name containing *receivable* is an asset and any containing *payable* is a liability.

## COACHED PROBLEMS

### CPI-1 Preparing an Income Statement, Statement of Retained Earnings, and Balance Sheet

Assume that you are the president of Nuclear Company. At the end of the first year of operations (December 31, 2017), the following financial data for the company are available:

**COACHED PROBLEMS.** Every chapter includes three problem sets: Coached Problems, Group A Problems, and Group B Problems. The Coached Problems go beyond the traditional check figures to advise students on the process of solving a problem in addition to its outcome.

**HOW'S IT GOING?** Research shows that students learn best when they are actively engaged in the learning process. *Fundamentals of Financial Accounting* provides plenty of this active learning feature to engage the student, provide interactivity, and promote efficient learning. These quizzes ask students to pause at strategic points throughout each chapter to ensure they understand key points before moving ahead. Answers are strategically placed at the end of the chapter summary so that students don't accidentally read them before answering the questions.

## HOW'S IT GOING?

### Self-Study Practice 1.1

In the space provided, indicate (a) the type of account (A = asset, L = liability, SE = shareholders' equity, R = revenue, E = expense), and (b) whether it is reported on the income statement (I/S), statement of retained earnings (SRE), balance sheet (B/S), or statement of cash flows (SCF).

## SOLUTION TO SELF-STUDY PRACTICE

### Solution to SP1.1

	Type	Statement
1.	A	B/S
2.	E	I/S

**THE USER FRAMEWORK.** The USER Framework provides a "road map" to each chapter, showing how accounting functions work at all levels of the firm. Students learn to



- Understand the business decisions that managers make,
- Study the accounting methods used,
- Evaluate the reported results from the viewpoint of financial statement users, and
- Review how the accounting methods affect the managers' decisions.

**ANALYZE, RECORD, SUMMARIZE.** A systematic accounting process is used to capture and report the financial effects of a company's activities. This process includes three basic steps:

### Step 1: Analyze Transactions

Transaction analysis involves determining whether a transaction exists and, if it does, analyzing its impact on the accounting equation.

### Steps 2 and 3: Record and Summarize

One way to record and summarize the financial effects of transactions would be to enter your understanding of their effects into a spreadsheet. By summing each spreadsheet column, you could compute new balances at the end of each month and report them on a balance sheet.

These helpful steps appear throughout various chapters to support learning.

**1 Analyze**

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

(a) Cash +15,000 = Pizza Revenue (+R) +15,000

---

**2 Record**

(a) dr Cash (+A) 15,000	15,000
cr Pizza Revenue (+R, +SE)	15,000

---

**3 Summarize**

dr +	Cash (A)	cr -	dr -	Pizza Revenue (R, SE)	cr +
Beg. bal. 10,000				0	Beg. bal. (a)
(a) 15,000				15,000	(a)

# Review and Practice Materials . . .

## REVIEW OF THE CHAPTER

To effectively evaluate and guide student success with the appropriate feedback, you need homework and test materials that are easy to use and tied to the chapter discussions.

Each chapter of *Fundamentals of Financial Accounting* is followed by an extensive variety of end-of-chapter material that applies and integrates topics presented in the chapter. We have retained many of the popular items from prior editions and added new types of end-of-chapter materials, including a Homework Helper, multi-perspective discussion questions, comprehensive problems, and continuing cases.

**DEMONSTRATION CASE.** Each chapter provides demonstration cases of activities in real-life situations. These exercises have students analyzing, preparing, and summarizing actual information.

### DEMONSTRATION CASE

The introductory case presented here reviews the items reported on the income statement, statement of retained earnings, and balance sheet. To do so, we'll use the financial statements of a fictional company, Over Armour, Inc. that develops, markets, and distributes athletic apparel and gear. Following is a list of items and amounts (in thousands of Canadian dollars) in Over Armour's financial statements for the quarter ended September 30, 2017.



### CHAPTER SUMMARY

Describe various organizational forms and business decision makers.

LO1-1

- Sole proprietorships are owned by one individual, are relatively inexpensive to form, and are not treated legally as separate from their owners. Thus, all profits or losses become part of the taxable income of the owner, who is also responsible personally for all debts of the business.
- Partnerships are businesses legally similar to sole proprietorships, but with two or more

**CHAPTER SUMMARY.** Each chapter concludes with an end-of-chapter summary, organized by chapter learning objectives, that revisits the learning objectives from the beginning of the chapter.

**KEY TERMS.** The Key Terms list includes all key terms used in the chapter. In addition to the definitions available in the text of each chapter, full definitions of all key terms are found in the Glossary near the end of the text.

### KEY TERMS

Accounting	Financial Statements	Publicly Accountable Profit-Oriented Enterprise
Accounting Standards for Private Enterprises (ASPE)	Generally Accepted Accounting Principles (GAAP)	Separate Entity Assumption
Accounts	Income Statement	Statement of Cash Flows
Balance Sheet	International Financial Reporting Standards (IFRS)	Statement of Retained Earnings
Basic Accounting Equation		Unit of Measure Assumption

### HOMEWORK HELPER

#### Alternative terms

- The balance sheet also can be called the *statement of financial position*.
- The income statement also can be called the *statement of operations*.
- Net income can also be called *net earnings*.

#### Helpful reminders

**HOMEWORK HELPER.** The Homework Helper immediately precedes each chapter's homework materials, highlighting subtleties discussed in the chapter and providing practice advice so that students can avoid common pitfalls when completing homework.

## PRACTICE MATERIAL

**QUESTIONS.** Each chapter includes ten to twenty multi-perspective discussion questions that ask students to explain and discuss terms and concepts presented in the chapter. Selected questions, denoted with an icon, are designed to help students begin developing critical thinking skills. These questions are ideal for sparking debate at the beginning of class or when transitioning between or reviewing topics.

### PRACTICE MATERIAL

QUESTIONS (🔍 Symbol indicates questions that require analysis from more than one perspective.)

1. Define accounting.
2. Valeri is opening a hair salon but she does not know what business form she should select. What can you tell her about the advantages and disadvantages of operating as a sole proprietorship versus a corporation? 🔍

### MINI-EXERCISES

LO1-1 MI-1 Identifying Definitions with Abbreviations

Abbreviation	Full Designation
1. CPA	Chartered Professional Accountant
2. GAAP	
3. IFRS	

**MINI-EXERCISES.** Each of these assignments illustrates and applies a single learning objective from the chapter.

# ... Build Confidence and Success

**EXERCISES.** These additional assignments illustrate and apply single and multiple learning objectives from the chapter.

**EXERCISES**

**E1-1 Reporting Amounts on the Four Basic Financial Statements** LO1-2

Using the following table and the equations underlying each of the four basic financial statements, show (a) that the balance sheet is in balance, (b) that net income is properly calculated, (c) what caused changes in the retained earnings account, and (d) what caused changes in the cash account.

**COACHED PROBLEMS**

**CPI-1 Preparing an Income Statement, Statement of Retained Earnings, and Balance Sheet** LO1-2

Assume that you are the president of Nuclear Company. At the end of the first year of operations (December 31, 2017), the following financial data for the company are available:

Cash	\$0,000
Accounts Receivable	\$9,500

**PROBLEMS (COACHED, GROUP A, AND GROUP B).** Each chapter includes three problem sets to help students develop decision-making skills. Coached problems include question-specific tips to assist students who need a little help getting started. Groups A and B are similar problems, but without the coaching. Excel templates are tied to selected end-of-chapter assignments designated with the excel icon.

**LEVEL UP QUESTIONS.** In each chapter, particularly challenging questions, designated by the Level Up icon, require students to combine multiple concepts to advance to the next level of accounting knowledge.

**LO1-2** **M1-15 Relationships Among Financial Statements**

Items from the income statement, statement of retained earnings, and balance sheet of **Electronic Arts Inc.** are listed below in alphabetical order. Solve for the missing amounts, and explain whether the company was profitable.

**TIP:** Use Exhibit 1.6 to identify relations among the items, then solve for amounts.

Electronic Arts Inc.	
Contributed Capital	\$2,030
Dividends	0

**COMPREHENSIVE PROBLEMS**

**LO2-3, 3-3, 4-1, 4-2, 4-3, 4-4, 4-5, 4-6** **C4-1 From Recording Transactions (Including Adjusting Journal Entries) to Preparing Financial Statements and Closing Journal Entries**

Consider the following, using what you learned in Chapters 2, 3, and 4. Brothers Harry and Herman Hamyerdsley began operations of their machine shop (H Tool Co.) on January 1, 2010. The annual reporting period ends December 31. The balance on January 1, 2017, appears below (the amounts are rounded to thousands of dollars).

**COMPREHENSIVE PROBLEMS.** Selected chapters include problems that cover topics from earlier chapters to refresh, reinforce, and build an integrative understanding of the course material. These are a great resource for helping students stay up to date throughout the course.

**SKILLS DEVELOPMENT CASES.** Each chapter offers cases designed to help students develop analytical, critical thinking, and technological skills. These cases are ideal for individual assignments, class discussions, and group projects. Encourage your students to find financial information in an actual annual report. The first case of every chapter presents an opportunity to connect your students with real-world financial reporting.

**SKILLS DEVELOPMENT CASES**

**LO1-2, 1-2, 1-3** **S1-1 Finding Financial Information**

Refer to the summarized financial statements of **The Home Depot** in Appendix A at the back of this book.

**Required:**

1. What is the amount of net income for the year ended January 29, 2017?

**CONTINUING CASE**

**CCI-1 Financial Statements for a Business Plan** LO1-2, 1-3

Nicole Mackisey is thinking of forming her own spa business, Nicole's Getaway Spa (NGS). Nicole expects that she and two family members will each contribute \$10,000 to the business and receive 1,000 shares each.

Nicole forecasts the following amounts for the first year of operations, ending December 31, 2017: cash on hand and in the bank, \$2,150; amounts due from customers from spa treatments, \$1,750; facilities and equipment, \$75,000; amounts owed to vendors

**CONTINUING CASE.** In Chapter 1, students are introduced to Nicole's Getaway Spa (NGS). In each chapter, the Continuing Case feature extends this case and requires students to apply topics from the current chapter. Chapters 5 through 12 present a continuing case involving the Wiki Art Gallery (WAG) (see Appendix D). This case depicts a setting in which accounting information is used to determine a company's selling price. By examining accounting decisions in an easy-to-use multiple-choice format, students learn that not all numbers are what they appear at first glance.

# What's New in the Fifth Edition?

In response to feedback and guidance from numerous financial accounting faculty, the authors have made many important changes to the fifth Canadian edition of *Fundamentals of Financial Accounting*, including the following:

- Integrated new focus companies, including Molson Coors Brewing Company and Koss Corporation, a headphone manufacturer
- Reorganized topics within Chapters 5 through 7 to improve cohesiveness and introduce additional depth
- An introduction to the topic of fraud (as in the fourth edition) in Chapter 5 that now also discusses and illustrates the related topic of internal controls, including cash controls and electronic documentation of cash disbursements
- A discussion in Chapter 6 that illustrates merchandising operations, including inventory sales (as in the fourth edition); however, this topic is now preceded by merchandise inventory purchases, consistent with the natural sequence of business events
- A focus in Chapter 7 on inventory costing and valuation (as in the fourth edition) that now includes a discussion of inventory turnover and gross profit analyses in assessing the likelihood of inventory write-downs
- New end-of-chapter material in each chapter to support new topics and learning objectives, with more than fifty revised and updated end-of-chapter assignments, exercises, problems, and cases
- A new Spotlight on Canada box that discusses accounting and business practices specific to Canadian Aboriginal communities
- Additional Help Me Solve It animations that walk students through an end-of-chapter question hand-picked by the author to provide students with insight into understanding and completing the question

*Fundamentals of Financial Accounting* fifth Canadian edition has also kept certain features that reviewers noted were very useful and necessary. These include

- Comparisons of the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) in a boxed feature at the end of each chapter
- Comprehensive problems (spanning multiple chapters)
- Two critical thinking cases with questions throughout most chapters, in easy to use multiple-choice format.
- Check figures for some Exercises and Group A and Group B Problems, just to name a few

## DETAILED CHANGES BY CHAPTER

### CHAPTER 1

- New description of financial statement users, with new illustration (Exhibit 1.2)
- Updated dates for sample financial statements
- Expanded discussion of conceptual framework, with new illustration (Exhibit 1.10)
- Revisions to end of chapter material: updated numerical data for real-world companies, revised annual report case to reflect updated financial statements

### CHAPTER 2

- New illustration of accounting cycle
- Expanded learning objectives to include trial balance preparation
- Revised illustration of T-accounts to include normal balance (Exhibit 2.7)
- Updated dates for sample financial statements
- Update analysis of current ratios in Spotlight on Financial Reporting
- Revisions to end of chapter material: updated numerical data for real-world companies, revised annual report case to reflect updated financial statements

### CHAPTER 3

- Updated dates for sample financial statements
- Changed terminology from “unearned revenue” to “deferred revenue” to align better with new Revenue Recognition standards
- New IFRS/ASPE comparison box in relation to new Revenue Recognition standards
- New illustrations to compare timing of revenue recognition and cash receipt (Exhibit 3.5)
- New illustrations to compare timing of expense recognition and cash payment (Exhibit 3.6)
- New transactions to illustrate contemporary technology, such as online Facebook advertising and automated monthly disbursements
- New format for accounting equation effects to illustrate link between income statement and balance sheet
- Updated demonstration case
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to include transaction analysis and determination of income effects, revised annual report case to reflect updated financial statements

## CHAPTER 4

- Updated dates for sample financial statements
- **New** illustration to tie adjustments to accounting cycle (Exhibit 4.2)
- **New** illustration of adjustment effects on balance sheet and income statement (Exhibit 4.5)
- Continued use of new accounting equation format illustrating link between income statement and balance sheet
- Updated demonstration case
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 5

- Substantial changes from the fourth edition: removed the discussion of press releases, the illustration of European financial statements, the introduction of the basic business model, and repeated coverage of external users. Inserted an explanation of internal control and cash reporting along with supporting examples.
- **New** focus company (Koss Corporation) to illustrate how internal control deficiencies allowed the VP Finance to steal \$31.5 million to pay for extravagant credit card purchases
- **New** categorization of fraud types
- Expand discussion of internal control to include new COSO cube
- **New** illustration of electronic documents used to process cash disbursements
- **New** discussion of petty cash transactions and p-cards in Spotlight on Controls
- **New** discussion and illustration of reporting restricted cash
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 6

- Substantial changes from the fourth edition: removed internal control topics (now in Chapter 5), and relocated journal entries for inventory purchases (previously in Chapter 7) to accompany inventory sales in this chapter (Chapter 6)
- Updated focus company illustrations with Walmart and new Planet Fitness material contrast financial statements of service company with merchandiser (Exhibit 6.2)

- **New** illustration of cost-of-goods-sold equations to distinguish periodic and perpetual inventory systems
- Expanded discussion of shrinkage to include book-to-physical adjustment
- **New** exhibit comparing journal entries for inventory purchase and sale transactions (Exhibit 6.8) in a perpetual system (periodic system entries are included in the chapter supplement)
- **New** supplement created to discuss the concept of bundled sales, which stems from the new Revenue Recognition standards
- Expanded discussion to include using the net method for sales discounts and estimating significant returns of sales
- Updated demonstration case
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 7

- Inventory purchases and the corresponding journal entries have been removed and are now in Chapter 6 to accompany inventory sales.
- **New** Spotlight on Financial Reporting discussing the LCM write-down at Lululemon for its see-through yoga pants fiasco
- Updated inventory turnover analysis in Exhibit 7.7, involving Harley-Davidson, McDonalds, and HBC
- **New** Spotlight on Financial Reporting to tie inventory turnover and gross profit to LCM
- Updated demonstration case
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 8

- Updated focus company illustrations with VF Corporation—the maker of North Face jackets, JanSport backpacks, Wrangler jeans, and Vans shoes
- Updated Spotlight on Financial Reporting showing days to collect for Kellogg Company
- Updated receivables turnover analysis in Exhibit 8.7, involving VF Corporation, Kellogg's, and Skechers
- **New** Spotlight on Business Decisions showing how Target monitors its additional revenues over its costs of having customers pay for items on credit
- Updated demonstration case featuring Rocky Mountain Chocolate Factory

- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 9

- Updated focus company illustrations with Cedar Fair
- Eliminated discussion of cash-only tangible asset purchase
- Revised depreciation formula presentations to highlight depreciation rates
- New illustration to explain calculation and journalizing of gain/loss on disposal
- Revised amortization presentation to show Accumulated Amortization rather than directly reducing asset
- Updated fixed asset turnover analysis in Exhibit 9.5, involving Cedar Fair, Six Flags, and Yahoo!
- New illustration in Homework Helper to show common causes of changes in account balances
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 10

- Updated focus company illustrations with General Mills
- New Spotlight on Business Decisions to discuss accounting for crowdfunding liabilities arising from Kickstarter and Prosper arrangements
- Replaced quick ratio with debt-to-assets ratio
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 11

- New focus company, Molson Coors Brewing Company
- Revised list of reasons for stock repurchases, supported by new Spotlight on Business Decisions involving Safeway's treasury stock purchase to boost EPS
- Expanded illustration of dividend journal entries to include closing entry
- New section to illustrate simple statement of shareholders' equity
- New Spotlight on the World to discuss the U.S. government's JOBS Act and crowdfunding equity
- New ratio analyses in Exhibit 11.7, involving Molson Coors Brewing Company and Anheuser-Busch Inbev

- Inserted cash dividends into demonstration case A
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 12

- Updated focus company illustrations and financial information for Under Armour Inc.
- Final section of chapter illustrates user analyses that are possible with direct method but not indirect method presentation
- Deleted spreadsheet approach, previously in chapter supplement
- Revised demonstration cases to be more consistent with approaches illustrated in chapter
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## CHAPTER 13

- Updated information regarding the focus company (Home Depot), including all narrative interpreting and comparing financial results
- Revised Exhibit 13.5 and related discussion to reflect changes made to all other chapters
- New Spotlight on Business Decisions to discuss impact of supply chain financing on current ratio
- Revisions to end of chapter material: updated numerical data for real-world companies, revised exercises to encourage reflection on income effects of adjustments, revised annual report case to reflect updated financial statements

## APPENDIXES A & B: HOME DEPOT SUMMARIZED FINANCIAL STATEMENTS AND EXCERPTS FROM THE FISCAL 2016 ANNUAL REPORT OF LOWE'S COMPANIES INC.

- Summarized financial statements of The Home Depot and updated excerpts from the fiscal 2016 Lowe's Annual Reports

## APPENDIX C: PRESENT AND FUTURE VALUE CONCEPTS

- Reviewed and updated all end-of-chapter material

#### APPENDIX D: WIKI ART GALLERY, INC.

- The award winning critical thinking case, WIKI Art Gallery, Inc., is now included as an appendix instead of online in Connect. This is to allow for easier access and referencing for students when they are completing the multiple choice questions relating to this case throughout most chapters.

#### APPENDIX E: INVESTMENTS IN OTHER CORPORATIONS

- Updated focus company—Rogers Communications
- Revised discussion of mergers and acquisitions

### SUPERIOR LEARNING SOLUTIONS AND SUPPORT

The McGraw–Hill Education team is ready to help you assess and integrate any of our products, technology, and services into your course for optimal teaching and learning performance. Whether it's helping your students improve their grades or putting your entire course online, the McGraw–Hill Education team is here to help you do it. Contact your Learning Solutions Consultant today to learn how to maximize all of McGraw–Hill Education's resources!

For more information, please visit us online: <http://www.mheducation.ca/he/solutions>



# Advice on Working in Teams

Accounting information is always created and shared with others, making teamwork an important skill to develop. Our research finds that whether you select your own teammates or your instructor assigns them to you, taking certain steps can improve the chances of your team being successful.<sup>2</sup>

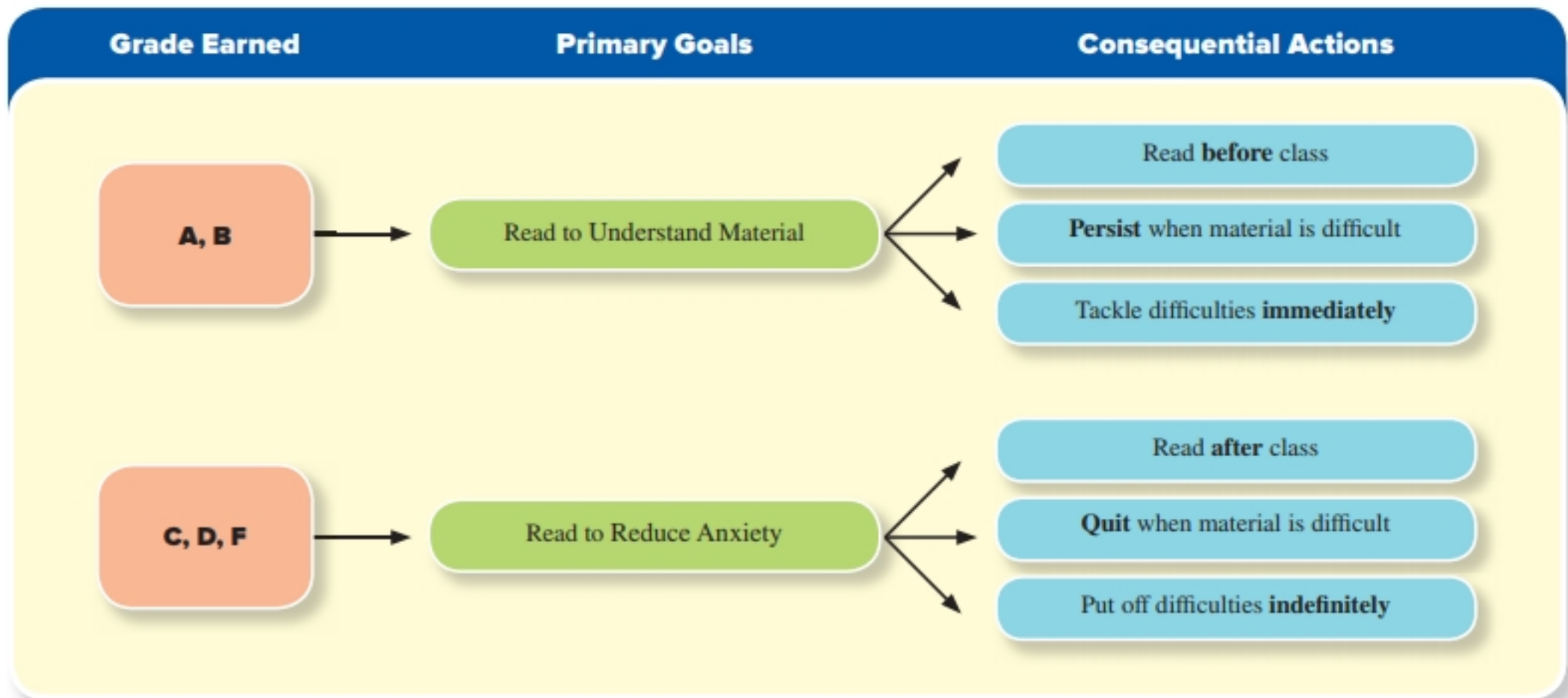
- 1. Know what you want.** Talk with your teammates about the quality of work your team aspires to produce and the amount of commitment to reach that goal. Define the general rules by which the team will work. How will the team determine who does what? How often will you meet, and for how long? How will you keep in touch between meetings? Spending a few minutes at the start to put these “rules” in writing can save you much frustration and disappointment later.
- 2. Plan how to get there.** Team projects can feel overwhelming at first, and you may be tempted to quickly split up the work so that everyone can get started on it. Do not do this. Take the time to identify (a) the specific steps needed to complete the project, (b) the skills required at each step, and (c) the strengths of each team member. Two benefits of being in a team are that you do not have to be an expert in everything and you do not have to do it all yourself. So assign work to team members based on their strengths and workloads, ensuring that everyone gets to do their fair share. Our research shows that teams earn better grades when everyone participates in a meaningful way.
- 3. Work as a team.** Teams are more than just groups of people. To be a team, you must be committed to the same goal and be willing to “step up” when you can. Teams can accomplish much when working as single unit, but not without the individual effort made by team members. Our research shows that the highest project grades are earned when team members work together, bringing their skills and abilities to bear on each task.
- 4. Build the team.** Teams rarely are perfect when they first start. It takes time to build the trust that is needed when relying on others. Help team members along by scheduling times to review one another’s work and to give constructive feedback on how it can be improved. As a team, assess the whole team’s performance and the openness of its communication. Do this often, and small difficulties will be less likely to turn into big problems.

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<sup>2</sup>S. Hilton and F. Phillips, “Instructor–Assigned and Student–Selected Groups: A View from Inside,” *Issues in Accounting Education* 25, pp 15–33 (2010).

# Advice on Using Your Text

What does it take to do well in your Financial Accounting course? Our research finds that the way you read and use your textbook can have a major impact on your course performance.<sup>3</sup> The following graphic summarizes our primary findings, which suggests four things you can do to improve your chances of earning a good grade.



- 1. Read the chapters to learn rather than just to get through them.** Learning doesn't miraculously occur just because your eyes have skimmed all the assigned lines of the textbook. You have to think and focus while reading to embed the material in your understanding and memory. Use the text's learning objectives to focus on what's really important in the chapters.
- 2. Don't be discouraged if you initially find some material challenging to learn.** At one time or another, both the best and weakest students describe themselves as both "confused" and "having a good grasp of the material," "anxious" and "confident," and "overwhelmed" and "uncomfortable." The simple fact is that learning new material can be challenging and initially confusing for anyone. Success does not depend as much on whether you become confused as it does on what you do when you become confused.
- 3. Clear up confusion as it arises.** A key difference between the most successful students and the least successful students is how they respond to difficulty and confusion. When successful students are confused or unsure, they immediately try to enhance their understanding through re-reading, self-testing, and seeking outside help if necessary. In contrast, unsuccessful students try to reduce anxiety by delaying further reading or by resorting to memorizing without understanding. Aim to clear up confusion when it arises because accounting, in particular, is a subject for which your understanding of later material depends on a thorough grasp of earlier material.
- 4. Think of reading as the initial stage of studying.** Abandon the idea that "studying" only occurs during the final hours before an exam. By initially reading with the same intensity that occurs when later reviewing for an exam, you can create extra time for practising exercises and problems. This combination of concentrated reading and extensive practice is likely to contribute to better learning and superior exam scores.

<sup>3</sup>B.J. Phillips and F. Phillips, "Sink or Skim: Textbook Reading Behaviors of Introductory Accounting Students," *Issues in Accounting Education* 22, pp 21-44 (2007).

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Colin Haime, *Vancouver Island University*

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Peggy Wallace, *Trent University*

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Richard Wright, *Fanshawe College*

Eliza Zuliani, *University of Toronto*

I want to thank my husband, our two daughters, and the other members of my family. Words alone cannot express the gratitude I feel for their encouragement, support, and patience throughout this process. Thank you for being just as excited about this edition as I am!

*Brandy Mackintosh* Edwards School of Business University of Saskatchewan

## The Complete Course Solution

We listened to educators from around the world, learned about their challenges, and created a whole new way to deliver a course.

Connect2 is a collaborative teaching and learning platform that includes an instructionally designed complete course framework of learning materials that is flexible and open for instructors to easily personalize, add their own content, or integrate with other tools and platforms.

- Save time and resources building and managing a course.
- Gain confidence knowing that each course framework is pedagogically sound.
- Help students master course content.
- Make smarter decisions by using real-time data to guide course design, content changes, and remediation.



### MANAGE — Dynamic Curriculum Builder

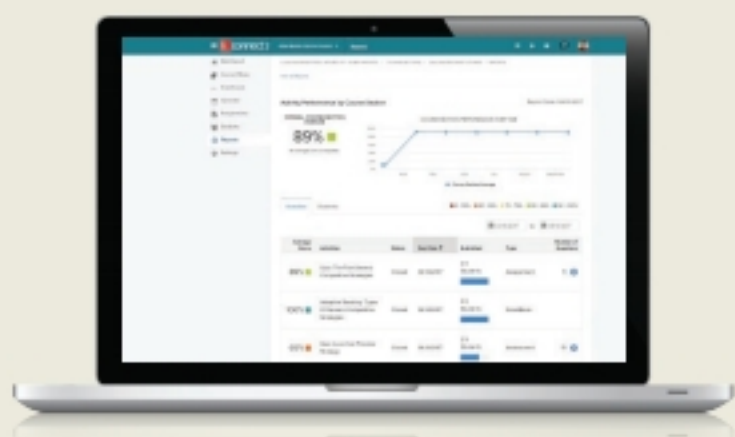
Quickly and easily launch a complete course framework developed by instructional design experts. Each Connect2 course is a flexible foundation for instructors to build upon by adding their own content or drawing upon the wide repository of additional resources.

- Easily customize Connect2 by personalizing the course scope and sequence.
- Get access to a wide range of McGraw-Hill Education content within one powerful teaching and learning platform.
- Receive expert support and guidance on how best to utilize content to achieve a variety of teaching goals.

### MASTER — Student Experience

Improve student performance with instructional alignment and leverage Connect2's carefully curated learning resources. Deliver required reading through Connect2's award-winning adaptive learning system.

- Teach at a higher level in class by helping students retain core concepts.
- Tailor in-class instruction based on student progress and engagement.
- Help focus students on the content they don't know so they can prioritize their study time.



### MEASURE — Advanced Analytics

Collect, analyze and act upon class and individual student performance data. Make real-time course updates and teaching decisions backed by data.

- Visually explore class and student performance data.
- Easily identify key relationships between assignments and student performance.
- Maximize in-class time by using data to focus on areas where students need the most help.



#### Course Map

The flexible and customizable course map provides instructors full control over the pre-designed courses within Connect2. Instructors can easily add, delete, or rearrange content to adjust the course scope and sequence to their personal preferences.



#### Implementation Guide

Each Connect2 course includes a detailed implementation guide that provides guidance on what the course can do and how best to utilize course content based on individual teaching approaches.



#### Instructor Resources

A comprehensive collection of instructor resources are available within Connect2. Instructor Support and Seminar Materials provide additional exercises and activities to use for in-class discussion and teamwork.

## THAT WAS THEN

If you think accounting is far removed from your personal life, you might be in for a surprise. Your ordinary life experiences, especially as a student, actually prepare you well to learn accounting.

## THIS IS NOW

This chapter focuses on the key financial reports that businesspeople rely on when evaluating a company's performance.

## YOUR LEARNING OBJECTIVES

### Understand the business

**LO1-1** Describe various organizational forms and business decision makers.

### Study the accounting methods

**LO1-2** Describe the purpose, structure, and content of the four basic financial statements.

### Evaluate the results

**LO1-3** Explain how financial statements are used by decision makers.

**LO1-4** Describe factors that contribute to useful financial information.

### Review the chapter

Chapter Summary

# CHAPTER 1

## Business Decisions and Financial Accounting



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FOCUS COMPANY:  
Pizza Palace Inc.



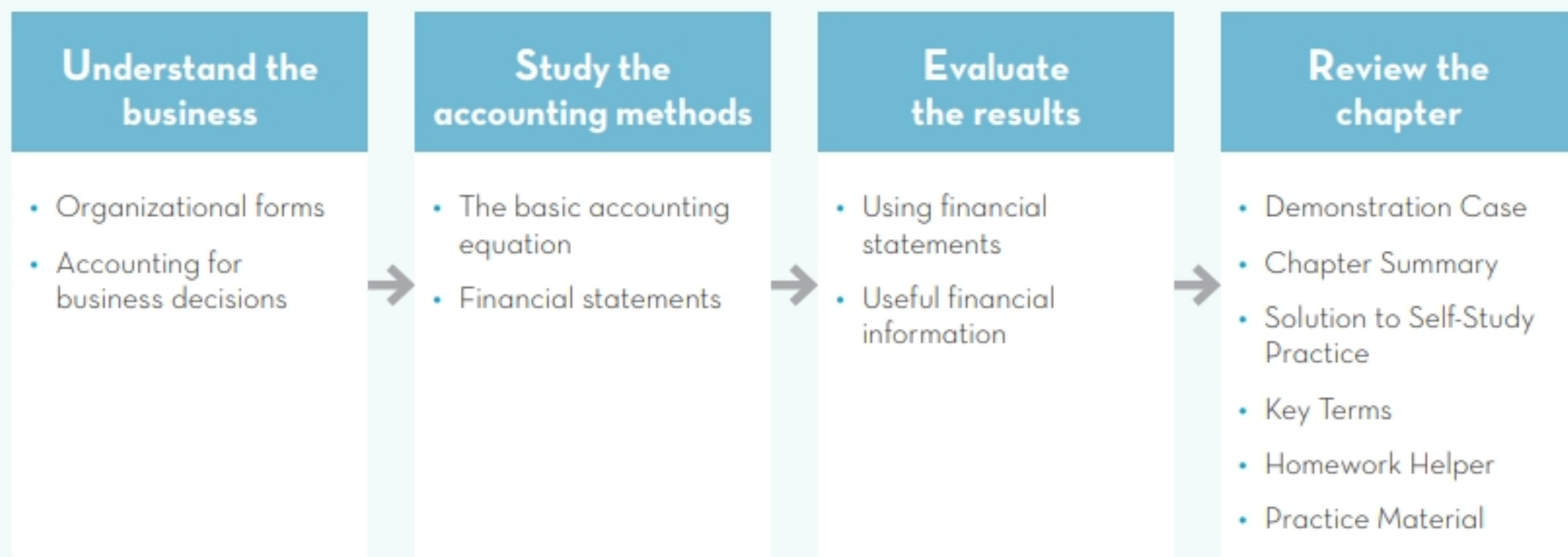
Welcome to the world of business and financial accounting. One of our goals for this book is to help you see the role that accounting plays in helping people turn their good ideas into successful businesses. The founder of FedEx first introduced his ideas about a nationwide transportation business in a college essay. With the help of accounting, FedEx has become a multibillion-dollar business. Perhaps the only thing stopping you from doing this is that you don't feel you know what is involved in starting and running a business. We're here to help with that.

Another important goal for us is to explain topics in ways that you can relate to. We want you to see that your personal life experiences help you to learn accounting. Often, we will explain topics in the context of a real business. For example, in the first four chapters, you will learn the steps that Emilio Santos took to start his own business and turn his dream into reality. By reading about his experiences, you'll gain a realistic understanding of how accounting is a key part of all businesses. So, let's get started.

For ten years, Emilio worked in several pizza restaurants in downtown Vancouver. During this time, he perfected a gourmet pizza concept that he believed would be a great addition to the local restaurant scene, so Emilio decided to start his own pizza business.

Although eager to get started, Emilio had several questions to consider and decisions to make. He contacted Ally Paddison, a local chartered professional accountant (CPA), to ask her advice. As you will read in this chapter, Ally met with Emilio in June to answer his many questions and to help him understand what's involved in starting a business and how to monitor its success. By following Ally's business and accounting advice, Emilio successfully launched his company, which he named Pizza Palace Inc.

# ORGANIZATION OF THE CHAPTER



## Understand the Business

### ORGANIZATIONAL FORMS

“Emilio, we should start by talking about how you want to organize your business.”



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“Well, I’m opening a gourmet pizza restaurant. What else do I need to know?”

©The McGraw-Hill Companies Inc./Brian Moeskau, photographer

Ally outlined three primary ways in which businesses can be organized: sole proprietorship, partnership, and corporation.

#### Sole Proprietorship

This is a form of business owned (and usually operated) by one individual. It is the easiest form of business to start because it doesn’t require any special legal procedures. The owner just gets a business licence and they’re good to go. A sole proprietorship is considered a part of the owner’s life, with all profits (or losses) becoming part of the taxable income of the owner, and the owner is personally liable for all debts of the business.

#### Partnership

A partnership is similar to a sole proprietorship, except that profits, taxes, and legal liability are the responsibility of two or more

#### LEARNING OBJECTIVE 1-1

Describe various organizational forms and business decision makers.