CHAPTER 1

The Purpose and Use of Financial Statements

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems	BYP
1. Identify the uses and users of accounting.	1, 2, 3, 4	1	1	1A	1B	3, 5, 7
2. Describe the primary forms of business organization.	5, 6, 7, 8	2	2	2A	2B	3, 7
3. Explain the three main types of business activity.	9, 10, 11, 12	3, 4	3, 4	3A	3B	7
4. Describe the purpose and content of each of the financial statements.	13, 14, 15, 16, 17, 18, 19, 20	5, 6, 7, 8, 9, 10	5, 6, 7, 8, 9, 10, 11, 12, 13	4A, 5A, 6A, 7A, 8A, 9A, 10A	4B, 5B, 6B, 7B, 8B, 9B, 10B	1, 2, 4, 6

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Identify uses of accounting information.	Moderate	30-40
2A	Determine forms of business organization and accounting standards.	Moderate	20-30
3A	Identify business activities.	Simple	25-30
4A	Classify accounts.	Simple	20-30
5A	Prepare accounting equation.	Simple	20-30
6A	Determine missing amounts; answer questions.	Complex	30-40
7A	Prepare financial statements.	Moderate	35-45
8A	Prepare statement of cash flows; comment on adequacy of cash.	Moderate	25-35
9A	Calculate missing amounts; explain statement interrelationships.	Moderate	40-50
10A	Prepare corrected statement of financial position; identify financial statements for ASPE.	Complex	35-45
1B	Identify users of accounting information.	Moderate	30-40
2B	Determine forms of business organization and accounting standards.	Moderate	20-30
3B	Identify business activities.	Simple	25-30
4B	Classify accounts.	Simple	20-30
5B	Prepare accounting equation.	Simple	20-30
6B	Determine missing amounts; answer questions.	Complex	30-40
7B	Prepare financial statements.	Moderate	35-45
8B	Prepare statement of cash flows; comment on adequacy of cash.	Moderate	25-35

ASSIGNMENT CHARACTERISTICS TABLE (Continued)

Problem Number	Description	Difficulty Level	Time Allotted (min.)
9B	Calculate missing amounts; explain statement interrelationships.	Moderate	40-50
10B	Prepare corrected statement of financial position; identify financial statements for ASPE.	Complex	35-45

ANSWERS TO QUESTIONS

1. 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.

2. Internal users of accounting information work for the company and include finance directors, marketing managers, human resource personnel, production supervisors, and company officers.

   External users of accounting information do not work for the company. The primary external users are investors, lenders, and other creditors. Other external users include labour unions, customers, the Canada Revenue Agency (CRA), and securities commissions.

3. Internal users may want the following questions answered:
   - Is there enough cash to purchase a new piece of equipment?
   - What price should we sell our product for to cover costs and to maximize profits?
   - How many employees can we afford to hire this year?
   - Which product line is the most profitable?
   - How much of a pay raise can the company afford to give me?

   External users may want the following questions answered:
   - Is the company earning enough to give me my required return on investment?
   - Will the company be able to repay its debts as the debts come due?
   - Will the company stay in business long enough to service the products I buy from it?

4. Ethics are important because, without the expectation of ethical behaviour, the information presented in the financial statements would have no credibility for the accounting profession. Without credibility, financial statement information would be useless to financial statement users.

5. (a) Proprietorship: Proprietorships are easier to form (and dissolve) than other types of business organizations. They are not taxed as separate entities; rather, the proprietor pays personal income tax on the company's profits. Depending on the circumstances, this may be an advantage or disadvantage.

   Disadvantages of a proprietorship includes unlimited liability (proprietors are personally liable for all debts of the business) and difficulty in obtaining financing compared to other forms of organization. In addition, the life of the proprietorship is limited as it is dependent on the willingness and capability of the proprietor to continue operations.

Answers to Questions (Continued)

5. (Continued)

(b) Partnership: Partnerships are easier to form (and dissolve) than a corporation; although not as easy as a proprietorship. Similar to a proprietorship, partnerships are not taxed as separate entities. Instead, the partners pay personal income tax on their share of profits. Depending on the circumstances this may be an advantage or disadvantage.

Disadvantages of partnerships include unlimited liability (partners are jointly and severally liable for all debts of the business) and difficulty in obtaining financing compared to corporations. In addition, the life of a partnership can be limited depending on the terms of the partnership agreement and actions of the other partners.

(c) Private corporation: Advantages of a private corporation include limited liability (shareholders not being personally liable for corporate debts), indefinite life, and transferability of ownership. In many cases, depending on the size of the corporation, a creditor such as a bank will ask for a personal guarantee which will void the limited liability advantage. In addition, transferability of ownership may be limited since shares are not publicly traded.

Disadvantages of a private corporation include increased government regulations and paperwork. The fact that corporations are taxed as a separate legal entity may be an advantage or a disadvantage and corporations often receive more favourable income tax treatment than other forms of business organizations. As mentioned above, depending on the size of the corporation, many of the advantages of the corporate form are not available to a small private corporation.

(d) Public corporation: The advantages of a public corporation include limited liability, indefinite life, and transferability of ownership. These features make it easier for publicly-traded corporations to raise financing compared to other forms of business organizations. Corporations often receive more favourable income tax treatment than other forms of business organizations.

Disadvantages include increased government regulations and paperwork. In addition, because the shares of public companies are listed and traded on Canadian or other exchanges such as the Toronto Stock Exchange (TSX), these corporations are required to distribute their financial statements to investors, lenders, creditors and other interested parties and the general public. This requirement involves greater costs to the corporation.

Answers to Questions (Continued)

6. While both public and private corporations enjoy many of the same advantages and disadvantages, one key difference is that public corporations list their shares for sale to the public on Canadian or other stock exchanges. In contrast, while private corporations issue shares, they do not make them available to the general public or trade them on public stock exchanges.

   Private corporations may also not enjoy the advantages of limited liability and ease of transfer of ownership that public corporations generally experience because of their size and distribution of shares.

7. (a) Public corporations must apply International Financial Reporting Standards (IFRS). Private corporations can apply either IFRS or Accounting Standards for Private Enterprises (ASPE).

   (b) The information needs of users of public corporations and private corporations are different. Users of financial information of public corporations require more extensive disclosure. They may also be benefit from the enhanced comparability to global companies provided by international standards. Since private corporations tend to be smaller with easier access to company information, their users do not require as extensive reporting.

8. The reporting entity concept means that economic activity of any business organization or economic entity is kept separate and distinct from the activities of the owner and all other economic entities. In the case of corporations such as Shoppers Drug Mart, it also means that economic activities of related corporations that are owned or controlled by one corporation are consolidated. The results of these individual companies are also reported separately as separate economic entities.

9. (a) Assets are what the company owns such as cash and equipment.
   (b) A liability is an amount the company owes such as accounts payable and income tax payable.
   (c) Shareholders' equity represents the residual interest (assets less liabilities) of a company at a point in time and includes share capital and retained earnings, in addition to other possible components.
   (d) Revenues are an increase in a company's economic resources from operating activities such as the sale of a product.
   (e) Expenses are the cost of assets that are consumed or services that are used in the process of generating revenues. Examples include cost of goods sold, rent expense, and salaries expense.

Answers to Questions (Continued)

10. Operating activities are the activities that the organization undertakes to earn a profit. They include the day-to-day activities which generate revenues and cause expenses to be incurred. In order to earn profits, a company must first purchase resources they need to operate. The purchase of these resources (assets) are considered to be investing activities. Finally, the company must have sufficient funds to purchase assets and to operate. While some of the necessary cash will be generated from operations, often the company has to raise external funds by either issuing shares or borrowing money. Financing activities involve the activities undertaken by the company to raise cash externally.

11. (a) Two examples of operating activities are revenue generated from providing auto repair services and the expenses related to paying employee salaries.

    (b) Two examples of investing activities are the purchase of property, plant, and equipment, such as a building, and the sale of a long-term investment.

    (c) Two examples of financing activities for a corporation are borrowing money (debt) and selling shares (equity).

12. Local companies providing services and therefore generate service revenue would include doctors, dentists, law practices and accountants. The names of these businesses would likely include the name of the practitioners or groups providing these services.

    Local companies providing sales revenue would include farms that provide produce or milk products and the retail stores selling the local produce to customers.

13. A fiscal year is an accounting time period that is one year in length, but does not have to end on December 31. Corporations can select their fiscal year end based on when their operations are low or when inventory is low. Selecting a fiscal year end when operations are low provides more time for accounting staff to complete the year-end reporting requirements. If inventories are low, this simplifies the inventory count and minimizes the business disruption caused by counting the inventory.

14. The internal accounting records do use exact figures. However, for presentation purposes, it is unlikely that the use of rounded figures would change a decision made by the users of the financial statements. As well, presenting the information in this manner makes the statements easier to read and analyze thereby increasing their utility to the users. Rounding the numbers to the nearest million does not have a material impact on decision-making using the financial statements.

Answers to Questions (Continued)

15. Assets = Liabilities + Shareholders' Equity
$7,473,721 = $3,150,394 + $4,323,327 (amounts are in thousands of dollars)

16. A statement of changes in equity explains the changes in the components of shareholders' equity, such as share capital and retained earnings. Examples of items that increase the components are issue of shares (increases share capital) and profit (increases retained earnings). Examples of items that decrease the components are repurchases of shares (decreases share capital) and payment of dividends (decrease retained earnings).

17. (a) The primary purpose of the statement of cash flows is to provide financial information about the cash receipts (inflows) and cash payments (outflows) of a company for a specific period of time.

    (b) The three categories of the statement of cash flows are operating activities, investing activities, and financing activities. These categories represent the three principal types of business activities.

18. The statement of financial position is prepared *as at a specific point* in time because it shows what the business owns (its assets) and what it owes (its liabilities). These items are constantly changing. It is necessary to select one point in time at which to present them. The other statements (income statement, statement of changes in equity, and statement of cash flows) cover a *period* of time as they report activities and measure performance that takes place over time.

19. (a) The income statement reports profit for the period. The profit figure from the income statement is shown on the statement of changes in equity as an addition to beginning retained earnings. If there is a loss it is deducted from the opening balance of retained earnings.

    (b) The statement of changes in equity explains the change in the balances of the components of shareholders' equity (for example, common shares and retained earnings) from one period to the next. The ending balances are reported in the shareholders' equity section of the statement of financial position.

    (c) The statement of cash flows explains the change in the cash balance from one period to the next. The ending balance of cash reported in the statement of cash flows agrees with the ending cash balance reported in the current assets section on the statement of financial position.

Answers to Questions (Continued)

20. (a) Companies using IFRS must report an income statement, statement of changes in equity, statement of financial position, and statement of cash flows. In addition, companies using IFRS may also need to prepare a statement of comprehensive income.

    (b) Companies using ASPE must report an income statement, statement of retained earnings, statement of financial position, and a statement of cash flows.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 1-1

	(a) Type of Evaluation	(b) Type of User
Investor	5	External
Marketing manager	4	Internal
Creditor	3	External
Chief financial officer	6	Internal
Canada Revenue Agency	1	External
Labour union	2	External

BRIEF EXERCISE 1-2

(a) 1 Proprietorship
(b) 4 Private corporation
(c) 3 Public corporation
(d) 2 Partnership
(e) 4 Private corporation

BRIEF EXERCISE 1-3

(a) O
(b) F*
(c) F
(d) F
(e) I
(f) O

Note to instructors: As we will learn later in Chapter 13, companies reporting under IFRS have a choice in classifying dividends paid as an operating or financing activity. We have chosen to classify dividends paid as financing activities in this textbook.

BRIEF EXERCISE 1-4

	(a)	(b)
1.	O	NE
2.	F	+
3.	O	-
4.	O	+
5.	O	-
6.	I	-

BRIEF EXERCISE 1-5

(a)	Total assets	=	Total liabilities + Shareholders' equity
		=	$55,000 + $120,000
		=	$175,000
(b)	Total assets	=	Total liabilities + Shareholders' equity (share capital + retained earnings)
		=	$170,000 + ($100,000 + $90,000)
		=	$360,000
(c)	Total liabilities	=	Total assets – Shareholders' equity (share capital + retained earnings)
		=	$150,000 – ($50,000 + $25,000)
		=	$75,000
(d)	Shareholders' equity	=	Total assets – Total liabilities
		=	$500,000 – ($500,000 ÷ 2)
		=	$250,000

BRIEF EXERCISE 1-6

Beginning of Year: Assets = Liabilities + Shareholders' equity
Beginning of Year: $800,000 = $500,000 + Shareholders' equity
Beginning of Year: Shareholders' equity = $300,000

(a) ($800,000 + $150,000) = ($500,000 – $80,000) + Shareholders' equity
Shareholders' equity = $530,000

(b) Assets = ($500,000 – $50,000) + ($300,000 + $50,000 + $75,000)
Assets = $875,000

(c) ($800,000 – $80,000) = Liabilities + ($300,000 + $110,000)
Liabilities = $310,000

BRIEF EXERCISE 1-7

(a) IS
(b) SFP
(c) SCE
(d) SCF
(e) SFP
(f) SCF
(g) IS
(h) SCE

BRIEF EXERCISE 1-8

(a) A
(b) L
(c) A
(d) A
(e) SE
(f) L
(g) SE
(h) A

BRIEF EXERCISE 1-9

		Share Capital	Retained Earnings	Total Shareholders' Equity
(a)	Profit	NE	+	+
(b)	Issue of common shares	+	NE	+
(c)	Dividends paid to shareholders	NE	-	-
(d)	Cash	NE	NE	NE
(e)	Loss	NE	-	-
(f)	Issue of long-term debt	NE	NE	NE

BRIEF EXERCISE 1-10

(a)	(1) Common Shares	(2) Retained Earnings	(3) Total Shareholders' Equity
Beginning balance	$100,000	$350,000	$450,000
Issue additional shares	25,000		25,000
Profit		75,000	75,000
Dividends paid		(5,000)	(5,000)
Ending balance	$125,000	$420,000	$545,000

(b)	(1) Common Shares	(2) Retained Earnings	(3) Total Shareholders' Equity
Beginning balance	$100,000	$350,000	$450,000
Issue additional shares	25,000		25,000
Loss		(75,000)	(75,000)
Dividends paid		(5,000)	(5,000)
Ending balance	$125,000	$270,000	$395,000

SOLUTIONS TO EXERCISES

EXERCISE 1-1

(a) Chief Financial Officer – Does Facebook generate enough cash to expand its product line?

Human Resource Manager – What is Facebook's annual salary expense?

(b) Creditor – Does Facebook have enough cash available to make its monthly debt payments?

Investor – How much did Facebook pay in dividends last year?

Other examples are also possible.

EXERCISE 1-2

		Proprietorship	Partnership	Public Corporation	Private Corporation
1.	No personal liability	F	F	T	T
2.	Owner(s) pay(s) personal income tax on company profits	T	T	F	F
3.	Generally easiest form of organization to raise capital	F	F	T	F
4.	Ownership indicated by shares	F	F	T	T
5.	Required to issue quarterly financial statements	F	F	T	F
6.	Owned by one person	T	F	F	F
7.	Limited life	T	T	F	F
8.	Usually easiest form of organization to set up	T	F	F	F
9.	Requires the use of IFRS as its accounting standards	F	F	T	F
10.	Shares are closely held	F	F	F	T

EXERCISE 1-3

1.	O
2.	I
3.	O
4.	F
5.	F
6.	F
7.	O
8.	O
9.	O
10.	F

EXERCISE 1-4

	(a)	(b)
1.	O	-
2.	I	-
3.	F	+
4.	I	-
5.	O	+
6.	F	+
7.	I	+
8.	F	-
9.	F	-
10.	O	-

EXERCISE 1-5

1. SFP
2. IS, SCE
3. IS
4. SCE, SFP
5. IS
6. SCE
7. SFP
8. IS
9. SFP
10. IS
11. SCF
12. SCF
13. SFP
14. SFP
15. SCE, SFP

EXERCISE 1-6

(a) Assets – Liabilities = Shareholders' equity
2014: \$440,000 – \$290,000 = \$150,000
2015: \$520,000 – \$350,000 = \$170,000

(b) Change in shareholders' equity \$170,000 – \$150,000 = \$20,000 increase

(c)
1. Profit is \$20,000 = the increase in shareholders' equity
2. Profit is \$25,000 = the increase in shareholders' equity + dividends paid of \$5,000
3. Loss of \$5,000 = the increase in shareholders' equity – common shares issued of \$25,000
4. Profit is \$15,000 = the increase in shareholders' equity + dividends paid of \$5,000 – common shares issued of \$10,000

EXERCISE 1-7

[1] Total revenues – Profit = Total expenses
$1,000,000 – $150,000 = $850,000

[2] Common shares, end of year $100,000 = Beginning balance of common shares + Issue of shares of $100,000

[3] $150,000 equal to profit given above

[4] Beginning balance of retained earnings plus profit less dividends = Ending balance of retained earnings.
$0 + $150,000 – Dividends = $100,000
Dividends = $50,000

[5] Beginning balance in shareholders' equity + Issue of shares + Profit – Dividends = Ending balance in shareholders' equity
$0 + $100,000 + $150,000 – $50,000 = $200,000

[6] Total Assets – Total liabilities = Shareholders' equity
$1,050,000 – $850,000 = $200,000 or [5] above

[7] Total revenues – Total expenses = Profit
Total revenues – $250,000 = $50,000
Total revenues = $300,000

[8] Beginning balance of common shares + Issue of shares = Common shares, end of year
$0 + Issue of shares = $20,000
Issue of shares = $20,000

[9] $50,000 equal to profit given above

[10] Common shares, end of year + Retained Earnings, end of year
$20,000 + $40,000 = $60,000

[11] Liabilities + Shareholders' equity = Total assets
$150,000 + $60,000 (from [10]) = $210,000

[12] $60,000 (from [10]) or $210,000 (from [11]) − $150,000 total liabilities = $60,000 total shareholders' equity

EXERCISE 1-8

($ in thousands)

(a) Assets – Liabilities = Shareholders' equity
2012: $3,243,696 – $2,285,697 = $957,999
2011: $2,940,459 – $2,010,346 = $930,113

(b) Assets = Liabilities + Shareholders' equity
2012: $3,243,696 = $2,285,697 + $957,999

Assets = Liabilities + Shareholders' equity
2011: $2,940,459 = $2,010,346 + $930,113

(c) Change in shareholders' equity $957,999 – $930,113 = $27,886 increase

(d)

Shareholders' equity, Dec. 31, 2011	$930,113
Add: Profit	?
Deduct: Dividends	22,229
Other shareholders' equity items	65,181
Shareholders' equity, December 31, 2012	$957,999

Solving for profit: $957,999 + $65,181 + $22,229 − $930,113 = $115,296

EXERCISE 1-9

(a)

L	Accounts payable	L	Income tax payable
A	Accounts receivable	A	Land
L	Bank loan payable	A	Merchandise inventory
A	Buildings	L	Mortgage payable
A	Cash	SE	Retained earnings
SE	Common shares	A	Supplies
A	Equipment		

(b) *Note to instructors*: Students may list the accounts in the following statement in any order within the assets, liabilities, and shareholders' equity classifications as they have not yet learned how to classify/order accounts.

AVENTURA INC.
Statement of Financial Position
November 30, 2015

Assets	
Cash	$ 20,000
Accounts receivable	19,500
Merchandise inventory	18,000
Supplies	700
Land	44,000
Buildings	100,000
Equipment	30,000
Total assets	$232,200
Liabilities and Shareholders' Equity	
Liabilities	
Accounts payable	$ 26,200
Income tax payable	6,000
Bank loan payable	34,000
Mortgage payable	97,500
Total liabilities	163,700
Shareholders' equity	
Common shares	20,000
Retained earnings	48,500
Total shareholders' equity	68,500
Total liabilities and shareholders' equity	$232,200

EXERCISE 1-10

(a)

E	Administrative expenses
E	Cost of goods sold
NR	Dividends
E	Finance expenses
R	Finance income
E	Income tax expense
E	Selling and distribution expenses
R	Sales

(b)

REITMANS (Canada) Limited
Income Statement
Year Ended February 2, 2013
(in millions)

Revenues		
Sales		$1,000.5
Finance income		5.6
Total revenues		1,006.1
Expenses		
Selling and distribution expenses	$550.2	
Cost of goods sold	372.1	
Administrative expenses	47.4	
Finance expenses	1.3	
Total expenses		971.0
Profit before income tax		35.1
Income tax expense		8.5
Profit		$ 26.6

EXERCISE 1-11

KON INC.
Income Statement
Year Ended December 31, 2015

Revenues		
Service revenue		$61,000
Expenses		
Salaries expense	$30,000	
Rent expense	12,400	
Utilities expense	2,400	
Office expense	1,600	
Total expenses		46,400
Profit before income tax		14,600
Income tax expense		3,000
Profit		$11,600

KON INC.
Statement of Changes in Equity
Year Ended December 31, 2015

	Common Shares	Retained Earnings	Total Equity
Balance, January 1	$20,000	$58,000	$78,000
Issued common shares	10,000		10,000
Profit		11,600	11,600
Dividends		(5,000)	(5,000)
Balance, December 31	$30,000	$64,600	$94,600

EXERCISE 1-12

(a)

Camping revenue		$168,000
Expenses		
Operating expenses	$130,000	
Income tax expense	10,000	140,000
Profit		$ 28,000

(b)

SEA SURF CAMPGROUND, INC.
Statement of Changes in Equity
Year Ended December 31, 2015

	Common Shares	Retained Earnings	Total Equity
Balance, January 1	$30,000	$18,000	$48,000
Issued common shares	10,000		10,000
Profit		28,000	28,000
Dividends		(12,000)	(12,000)
Balance, December 31	$40,000	$34,000	$74,000

Note to instructors: Students may list the accounts in the following statement in any order within the assets, liabilities, and shareholders' equity classifications as they have not yet learned how to classify/order accounts.

SEA SURF CAMPGROUND, INC.
Statement of Financial Position
December 31, 2015

Assets

Cash	$ 7,500
Supplies	2,500
Equipment	119,000
Total assets	$129,000

Liabilities and Shareholders' Equity

Liabilities	
Accounts payable	$ 5,000
Bank loan payable	50,000
Total liabilities	55,000
Shareholders' equity	
Common shares	40,000
Retained earnings	34,000
Total shareholders' equity	74,000
Total liabilities and shareholders' equity	$129,000

EXERCISE 1-13

1. Yu Corporation is distributing nearly all of this year's profit as dividends. This suggests that Yu is not pursuing rapid growth. Companies that are pursuing opportunities for growth normally retain their profit and pay low, or no, dividends.

2. Surya Corporation is not generating sufficient cash from operating activities to fund its investing activities. The company is borrowing to finance its investing activities. This is common for companies in their early years of existence. It could also be in an expansion stage.

3. Naguib Ltd. is financing its assets in a slightly higher proportion through equity than through debt. The company has $450,000 ($200,000 + $250,000) of total assets, which are funded 44.4% ($200,000 ÷ $450,000) by liabilities and 55.6% ($250,000 ÷ $450,000) by equity. Since equity does not have to be repaid and does not require interest payments, the company appears to be in a healthy financial position.

4. Rijo Inc. does not have any liabilities and its assets are completely financed by equity. This places it in a very strong financial position since there are no outside claims on the company's assets. This also means that the company is using its own funds to finance assets. While this reduces risk, it may also reduce return if borrowed funds can be employed to generate an internal return higher than the cost of borrowing.

SOLUTIONS TO PROBLEMS

PROBLEM 1-1A

(a) 1. The South Face Inc. is an external user of accounting information in assessing the credit-worthiness of their customer.

2. An investor purchasing common shares of Orbite Online, Inc. is an external user.

3. In deciding whether to extend a loan, the Caisse d'Économie Base Montréal is an external user.

4. As an employee of Tech Toy Limited, the CEO is an internal user.

(b) 1. In deciding to extend credit, South Face would focus its attention on the statement of financial position of the new customer. The terms of credit they are extending require repayment in a short period of time. Funds to repay the credit would come from cash on hand and other current assets. The statement of financial position of the new customer will show if the company has enough current assets to meet its current obligations.

2. Since the investor intends to hold the shares for a long period of time (at least five years), s(he) should focus on the company's income statement. The income statement reports the company's past performance in terms of revenues, expenses, and profit. This is generally regarded as a good indicator of the company's future performance.

3. The Caisse is interested in two things—the ability of the company to make interest payments on a monthly basis for the next three years and the ability to repay the principal amount at the end of the three years. In order to evaluate both of these factors, the focus should be on the statement of cash flows. This statement provides information on the cash the company generates from its operations on an ongoing basis. It also tells whether the company is currently borrowing or repaying debt.

4. The CEO should focus on the statement of cash flows as this statement clearly sets out the cash generated from operating activities and the amount the company has spent in the past on purchasing equipment and paying dividends.

Note to instructors: Other answers may be valid provided they are properly supported.

PROBLEM 1-2A

(a)
1. The professors should incorporate their business as a private corporation because of their concerns about legal liabilities. A corporation is the only form of business that provides limited liability. Since the professors do not need access to large amounts of investment capital, a private corporation provides the limited liability advantage the professors need.

2. Joseph should run his bicycle rental shop as a proprietorship because this is the simplest and least costly form of business organization to establish and eventually dissolve. He is the only person involved in the business and is planning to operate for a limited time.

3. Robert and Tom should form a public corporation when they combine their operations. This is the best form of business for them to choose because they expect to raise funds in the coming year. A public corporation will enable them to raise significant amounts of funds for their manufacturing company. A corporation may also receive more favourable income tax treatment.

4. A partnership would be the most likely form of business for Darcy, Ellen, and Meg to choose. It is simpler to form than a corporation and less costly.

5. Hervé is most likely to select to operate his business as a private corporation. This will assist him with the liability of storing goods for others. He will also be able to raise funds to purchase equipment, rent space in airports, and hire employees. It is easier to raise funds through a private corporation rather than a proprietorship or partnership.

(b)
1. ASPE
2. ASPE
3. IFRS
4. ASPE
5. ASPE

PROBLEM 1-3A

(a)

	Operating	Investing	Financing
Indigo Books & Music	Sale of books	Purchase of store equipment	Issue of shares
High Liner Foods	Payment for fish	Purchase of production equipment	Borrowing money from a bank
Mountain Equipment Co-op	Payment for inventory	Purchase of store fixtures	Borrowing money from a bank
Ganong Bros.	Payment of salaries and benefits	Purchase of production equipment	Payment of dividends to shareholders
Royal Bank	Payment of interest on savings accounts	Purchase of office equipment	Issue of bonds

(b) Financing

Issuing shares is common to all corporations. Issuing debt is common to most corporations. Borrowing from a bank is common to most companies. Payment of dividends is common to many, but not all, corporations. Issuing bonds is common to large public corporations.

Investing

Purchasing property, plant, and equipment is common to most companies—the types of assets would vary according to the nature of the business. Some types of companies require a larger investment in long-lived assets. A new business or expanding business would be more apt to be acquiring assets.

Operating

The general activities identified above would be common to most corporations with the exception of the payment of interest on savings accounts. The source of the cash receipt (for example, from the sale of books) and cash payment (for example, for the payment for fish) would vary by the nature of the business.

PROBLEM 1-4A

	(a)	(b)
Accounts payable	L	SFP
Accounts receivable	A	SFP
Bank loan payable	L	SFP
Cash	A	SFP
Common shares	SE	SFP, SCE
Equipment	A	SFP
Income tax expense	E	IS
Income tax payable	L	SFP
Interest expense	E	IS
Office expense	E	IS
Prepaid insurance	A	SFP
Rent expense	E	IS
Repairs and maintenance expense	E	IS
Salaries payable	L	SFP
Service revenue	R	IS
Vehicles	A	SFP

PROBLEM 1-5A

(a) and (b)

			(b)		
		(a)	Assets	Liabilities	Shareholders' Equity
Accounts payable	$6,400	L		$ 6,400	
Accounts receivable	10,800	A	$10,800		
Bank loan payable	9,000	L		9,000	
Cash	1,250	A	1,250		
Common shares	1,000	SE			$ 1,000
Equipment	19,400	A	19,400		
Income tax payable	2,000	L		2,000	
Interest payable	100	L		100	
Prepaid insurance	600	A	600		
Retained earnings	12,250	SE			12,250
Salaries payable	1,000	L		1,000	
Supplies	1,200	A	1,200		
Unearned revenue	1,500	L		1,500	
Totals			$33,250	$20,000	$13,250

Assets = Liabilities + Shareholders' equity
$33,250 = $20,000 + $13,250

(c) Beginning balance in Retained Earnings + Revenues – Expenses – Dividends = Ending balance in Retained Earnings
$2,250 + $72,000 – $50,000 – $12,000 = $12,250

PROBLEM 1-6A

(a) (All amounts are in millions of dollars)

Sears

[1] Total assets = Total liabilities + Total shareholders' equity
Total assets = $1,638.7 + $1,092.0
Total assets = $2,730.7

[2] Total liabilities = Total assets – Total shareholders' equity
Total liabilities = $2,479.1 – $1,076.4
Total liabilities = $1,402.7

[3] Shareholders' equity, beginning of year – Repurchase of shares – Dividends + Total revenues – Total expenses – Other decreases in shareholders' equity = Shareholders' equity, end of year
$1,092.0 − $0.1 − $101.9 + $4,511.1 – [3] − $14.8 = $1,076.4
[3] Total expenses = $4,409.9

Canadian Tire

[4] Total liabilities = Total assets – Total shareholders' equity
Total liabilities = $12,338.8 – $4,409.0
Total liabilities = $7,929.8

[5] Total assets = Total liabilities + Total shareholders' equity
Total assets = $8,417.8 + $4,574.6 [6]
Total assets = $12,992.4

[6] Shareholders' equity, beginning of year – Repurchase of shares – Dividends + Total revenues – Total expenses – Other decreases in shareholders' equity = Shareholders' equity, end of year
$4,409.0 − $225.0 – $97.7 + $11,451.0 – $10,951.8 − $10.9 = $4,574.6

PROBLEM 1-6A (Continued)

(b) At the end of the most recent fiscal year, Canadian Tire has a higher proportion of debt financing and Sears has a higher proportion of equity financing. Canadian Tire financed 35.2% ($4,574.6 million ÷ $12,992.4 million) of its assets with equity and 64.8% of its assets with debt ($8,417.8 million ÷ $12,992.4 million). For the same period, 43.4% ($1,076.4 million ÷ $2,479.1 million) of Sears's assets were financed by equity and 56.6% ($1,402.7 million ÷ $2,479.1 million) by debt. Canadian Tire is slightly more risky because more of its assets are financed by debt.

(c) Both retailers typically have low inventories at the end of December and at the end of January as a result of the Christmas sales, with little or no new inventory purchased during the month of January so no major differences in financial position at the end of December compared to January would be anticipated. As long as there were no significant economic events that affected one company more than the other in the intervening period (January), it is unlikely that the different year-end dates would affect the comparison in (b).

PROBLEM 1-7A

(a)

ONE PLANET COSMETICS CORP.
Income Statement
Month Ended June 30, 2015

Revenues		
Service revenue		$12,000
Expenses		
Salaries expense	$3,400	
Office expense	1,500	
Utilities expense	1,300	
Supplies expense	1,200	
Interest expense	800	
Total expenses		8,200
Profit before income tax		3,800
Income tax expense		700
Profit		$ 3,100

ONE PLANET COSMETICS CORP.
Statement of Changes in Equity
Month Ended June 30, 2015

	Common Shares	Retained Earnings	Total Equity
Balance, June 1	$ 0	$ 0	$ 0
Issued common shares	25,000		25,000
Profit		3,100	3,100
Dividends paid		(1,000)	(1,000)
Balance, June 30	$25,000	$ 2,100	$27,100

PROBLEM 1-7A (Continued)

(a) (Continued)

Note to instructors: Students may list the accounts in the following statement in any order within the assets, liabilities, and shareholders' equity classifications as they have not yet learned how to classify/order accounts.

ONE PLANET COSMETICS CORP.
Statement of Financial Position
June 30, 2015

Assets

Cash	$ 6,000
Accounts receivable	4,000
Supplies	1,400
Equipment	32,000
Total assets	$43,400

Liabilities and Shareholders' Equity

Liabilities	
Accounts payable	$ 2,300
Bank loan payable	14,000
Total liabilities	16,300
Shareholders' equity	
Common shares	25,000
Retained earnings	2,100
Total shareholders' equity	27,100
Total liabilities and shareholders' equity	$43,400

(b) The financial statements must be prepared in the order of (1) income statement, (2) statement of changes in equity, and (3) statement of financial position. This is because each subsequent financial statement depends on information contained in the previous statement. The profit from the income statement flows to the retained earnings account on the statement of changes in equity. The shareholders' equity totals in the statement of changes in equity (for example, for common shares and retained earnings) then flow to the shareholders' equity section of the statement of financial position.

PROBLEM 1-8A

(a)

		Activity
Cash dividends paid	$ 10,000	financing
Cash paid to purchase equipment	35,000	investing
Cash payments for operating activities	120,000	operating
Cash receipts from operating activities	140,000	operating
Cash received from issue of long-term debt	20,000	financing
Cash received from issue of shares	20,000	financing

(b)

MAISON CORPORATION
Statement of Cash Flows
Year Ended December 31, 2015

Operating activities		
Cash receipts from operating activities	$140,000	
Cash payments for operating activities	(120,000)	
Net cash provided by operating activities		$20,000
Investing activities		
Purchase of equipment	$(35,000)	
Net cash used by investing activities		(35,000)
Financing activities		
Issue of long-term debt	$ 20,000	
Issue of shares	20,000	
Payment of dividends	(10,000)	
Net cash provided by financing activities		30,000
Net increase in cash		15,000
Cash, January 1		12,000
Cash, December 31		$27,000

(c) The company is generating less cash from operating activities (+$20,000) than it is using in total for its investing activities (–$35,000) and the payment of dividends (–$10,000). The company, however, is making up the deficiency by generating cash from financing activities. Cash from financing activities is not a renewable source of cash and usually entails future cash payments in the form of interest on debt, principal repayment, and dividend payments for shares.

PROBLEM 1-9A

(a)

[1] Operating expenses = Revenue – Profit before income tax
Operating expenses = $90,000 – $30,000
Operating expenses = $60,000

[2] Profit = Profit before income tax – Income tax expense
Profit = $30,000 – $6,000
Profit = $24,000

[3] Profit (from [2]) = $24,000

[4] Ending retained earnings = Beginning retained earnings + Profit – Dividends
Ending retained earnings = $0 + $24,000 (from [2]) – $10,000
Ending retained earnings = $14,000

[5] Total issued common shares = $12,000

[6] Total profit = $24,000 (from [3])

[7] Total equity = Beginning balance + Issued common shares + Profit – Dividends
Total equity = $0 + $12,000 (from [5]) + $24,000 (from [6]) – $10,000
Total equity = $26,000

[8] Land = Total assets (from [9]) – Cash – Accounts receivable – Building – Equipment
Land = $110,000 – $5,000 – $10,000 – $60,000 – $25,000
Land = $10,000

[9] Total assets = Total liabilities + Shareholders' equity
Total Assets = $110,000

[10] Accounts payable = Total liabilities – Bank loan payable
Accounts payable = $84,000 – $50,000
Accounts payable = $34,000

[11] Common shares = $12,000 (from the Statement of Changes in Equity)

[12] Retained earnings = $14,000 (from [4])

[13] Shareholders' equity = Total liabilities and shareholders' equity – Total liabilities
Total shareholders' equity = $110,000 – $84,000
Total shareholders' equity = $26,000

PROBLEM 1-9A (Continued)

(b) (1) In preparing the financial statements, the first statement to be prepared is the income statement, followed by the statement of changes in equity, and then the statement of financial position.

Note to instructors: While the statements must be prepared in this sequence, these statements can be presented in a variety of orders. Often the statement of financial position is presented first, as the most “permanent” statement.

(2) The reason the statements must be prepared in a certain order as indicated above, is that each statement depends on information in the previously prepared statement. For example, the profit figure from the income statement is used in the statement of changes in equity to calculate the ending balance of retained earnings. The shareholders’ equity section of the statement of financial position is then completed using the ending balances of common shares and retained earnings as calculated in the statement of changes in equity.

PROBLEM 1-10A

(a) 1. Remove the boat from the listing of assets since it does not belong to the corporation. Remove the boat loan payable from the listing of liabilities since this is a personal loan of Guy Gélinas.

2. Remove the $10,000 outstanding receivable from Guy's brother. This is not a company receivable and should not be listed on the company's statement of financial position.

3. Correct the Common Shares account to remove the extra amount that had been added to "balance":

Remove accounts receivable	$10,000
Remove boat asset	24,000
Remove bank loan	(40,000)
Net adjustment to common shares	$ 6,000

Provide separate totals for liabilities and shareholders' equity as the two components that are financing the assets of the company.

(b)

GG CORPORATION
Statement of Financial Position
July 31, 2015

Assets

Cash	$20,000
Accounts receivable ($50,000 − $10,000)	40,000
Merchandise inventory	36,000
Total assets	$96,000

Liabilities and Shareholders' Equity

Liabilities	
Accounts payable	$34,000
Total liabilities	34,000
Shareholders' equity	
Common shares [$50,000 + $6,000 (from (3) above)]	56,000
Retained earnings	6,000
Total shareholders' equity	62,000
Total liabilities and shareholders' equity	$96,000

(c) As a private company, GG Corporation should also prepare an income statement, a statement of retained earnings, and a statement of cash flows.

PROBLEM 1-1B

(a) 1. An investor purchasing common shares of Fight Fat Ltd. is an external user.

2. As a potential creditor, Comeau Ltée is an external user.

3. The chief financial officer is an internal user.

4. As a potential creditor, Drummond Bank is an external user.

(b) 1. In making an investment in common shares, the Ontario investor is becoming a partial owner (shareholder) of the company. In this case, the investment will be held for at least three years. The information that will be most relevant to him/her will be on the income statement. The income statement reports the past performance of the company in terms of its revenue, expenses and profit. This is the best indicator of the company's future potential.

2. In deciding to extend credit to a new customer, Comeau would focus its attention on the new customer's statement of financial position. The terms of credit they are extending require repayment in a short period of time. Funds to repay the credit would come from current assets. The statement of financial position of the new customer will show whether the company has enough current assets to meet its current obligations.

3. In order to determine whether the company is generating enough cash to increase the amount of dividends paid to investors, the CEO of Private Label needs information on the amount of cash generated and used in various activities of the business. The statement of cash flows is the most useful statement for this purpose. This statement presents the amount of cash at the beginning and end of the period as well as the details of the amount of cash generated by operating activities and the amount spent on expanding operations (investing activities).

4. In deciding whether to extend a loan, the Drummond Bank is interested in two things: the ability of the company to make its monthly interest payments for the next five years and the ability to repay the principal amount at the end of five years. In order to evaluate both of these factors the focus should be on the statement of cash flows. This statement provides information on the cash the company generates from its operating activities on an ongoing basis. This will be the most important factor in determining if the company will survive and be able to repay the principal and interest on the loan.

Note to instructors: Other answers may be valid provided they are properly supported.

PROBLEM 1-2B

(a)

1. Dawn will likely operate her vegetable stand as a proprietorship because she is planning on operating it for a short time period. A proprietorship is the simplest and least costly business organization to form and dissolve.

2. Joseph and Sabra should form a private corporation when they combine their operations. A private corporation will be easier and less expensive to form than a public corporation. It will also be an easier type of organization in which to raise funds than a proprietorship or partnership. A corporation may also receive more favourable income tax treatment.

3. The professors should incorporate their business as a private corporation because of their concerns about the legal liabilities. A corporation is the only form of business that provides limited liability to the shareholders.

4. Abdur would likely form a public corporation because he needs to raise funds to invest in inventories and property, plant, and equipment. He has no savings or personal assets and it is normally easier to raise funds through a corporation than through a proprietorship or partnership. A public corporation will allow Abdur to raise larger amounts of funds by selling shares to the public.

5. A partnership would be the most likely form of business for Mary, Richard and Jigme to choose. It is simpler to form than a corporation and less costly.

(b)

1. ASPE
2. ASPE
3. ASPE
4. IFRS
5. ASPE

PROBLEM 1-3B

(a)

	Operating	Investing	Financing
WestJet Airlines	Payment for jet fuel	Purchase of airplanes	Issue of shares
University of Calgary Students' Union	Payment of salaries and benefits	Purchase of office equipment	Borrowing money from a bank
GlaxoSmithKline	Payment of research expenses	Purchase of other companies	Issue of bonds
Maple Leaf Sports & Entertainment	Payment for facilities rentals	Purchase of equipment	Payment of dividends to shareholders
Empire Company	Receipt of revenue from sales of food from Sobeys	Purchase of real estate to build Sobeys store	Repaying money to a bank

(b) <u>Financing</u>

Issuing shares is common to all corporations. Borrowing from and repaying money to a bank is common to most companies. Payment of dividends is common to many, but not all, corporations. Issuing bonds is common to large corporations.

<u>Investing</u>

Purchasing property, plant, and equipment would be common to most companies—the types of assets would vary according to the type of business. Some types of businesses require a larger investment in long-lived assets. A new business or expanding business would be more likely to engage in investing activities (for example, acquiring assets). The purchase of other companies would not be common to all companies.

<u>Operating</u>

The general activities identified above (sales and expenditures) would be common to most businesses, although the service or product might change.

PROBLEM 1-4B

	(a)	(b)
Accounts payable	L	SFP
Accounts receivable	A	SFP
Bank loan payable	L	SFP
Buildings	A	SFP
Cash	A	SFP
Common shares	SE	SFP, SCE
Cost of goods sold	E	IS
Equipment	A	SFP
Income tax expense	E	IS
Income tax payable	L	SFP
Interest expense	E	IS
Land	A	SFP
Merchandise inventory	A	SFP
Mortgage payable	L	SFP
Office expense	E	IS
Prepaid insurance	A	SFP
Salaries payable	L	SFP
Sales	R	IS

PROBLEM 1-5B

(a) and (b)

			(b)		
		(a)	Assets	Liabilities	Shareholders' Equity
Accounts payable	$10,800	L		$10,800	
Accounts receivable	16,400	A	$ 16,400		
Bank loan payable	40,000	L		40,000	
Cash	11,250	A	11,250		
Common shares	5,000	SE			$ 5,000
Income tax payable	2,000	L		2,000	
Interest payable	400	L		400	
Prepaid insurance	700	A	700		
Retained earnings	42,250	SE			42,250
Salaries payable	2,050	L		2,050	
Supplies	1,250	A	1,250		
Unearned revenue	2,500	L		2,500	
Vehicles	75,400	A	75,400		
Totals			$105,000	$57,750	$47,250

Assets = Liabilities + Shareholders' equity
$105,000 = $57,750 + $47,250

(c) Beginning balance in Retained Earnings + Revenues – Expenses – Dividends = Ending balance in Retained Earnings
$22,250 + $172,000 – $140,000 – $12,000 = $42,250

PROBLEM 1-6B

(a) (All amounts are in millions of dollars)

Tim Hortons

[1] Total liabilities = Total assets – Total shareholders' equity
Total liabilities = $2,204.0 – $1,154.4
Total liabilities = $1,049.6

[2] Total shareholders' equity = Total assets – Total liabilities
Total shareholders' equity = $2,284.2 – $1,094.1
Total shareholders' equity = $1,190.1

[3] Shareholders' equity, beginning of year – Repurchase of shares – Dividends + Total revenues – Total expenses – Other decreases in shareholders' equity = Shareholders' equity, end of year
$1,154.4 − $18.7 − $[3] + $3,123.8 – $2,716.0 − $222.9 = $1,190.1
[3] Dividends = $130.5

Starbucks

[4] Total assets = Total liabilities + Total shareholders' equity
Total assets = $2,973.1 + $4,387.3
Total assets = $7,360.4

[5] Total assets = Total liabilities + Total shareholders' equity
Total assets = $3,104.7 + $5,114.5 (from [6])
Total assets = $8,219.2

[6] Shareholders' equity, beginning of year – Repurchase of shares – Dividends + Total revenues – Total expenses – Other decreases in shareholders' equity = Shareholders' equity, end of year
$4,387.3 − $1.1 − $543.7 + $13,604.6 – $12,219.9 − $112.7 = $5,114.5

PROBLEM 1-6B (Continued)

(b) At the end of the most recent fiscal year, Tim Hortons has a higher proportion of debt financing and Starbucks has a higher proportion of equity financing. Starbucks financed 62.2% (U.S. $5,114.5 million ÷ U.S. $8,219.2 million) of its assets with equity and 37.8% of its assets with debt (U.S. $3,104.7 million ÷ U.S. $8,219.2 million). For the same period, 52.1% ($1,190.1 million ÷ $2,284.2 million) of Tim Hortons' assets were financed by equity and 47.9% ($1,094.1 million ÷ $2,284.2 million) by debt. Tim Hortons is slightly more risky because more of its assets are financed by debt.

(c) As long as there are no unusual transactions or economic events that affect one company differently than another during the intervening period of time (October through December), or at each company's year-end date, the differing year ends should not have a significant impact on the assessment of the financial position and performance for the two companies.

If there are significant currency fluctuations between U.S. and Canadian dollars, it will not be possible to compare absolute amounts unless they are converted to the same currency. However, if the amounts were converted into percentages, such as was done in (b) above, percentages can be compared despite different currencies or sizes of the two companies.

PROBLEM 1-7B

(a)

AERO FLYING SCHOOL LTD.
Income Statement
Month Ended May 31, 2015

Revenues		
Service revenue		$12,600
Expenses		
Fuel expense	$3,300	
Rent expense	2,200	
Office expense	2,300	
Salaries expense	1,000	
Repair and maintenance expense	700	
Interest expense	100	9,600
Profit before income tax		3,000
Income tax expense		600
Profit		$ 2,400

AERO FLYING SCHOOL LTD.
Statement of Changes in Equity
Month Ended May 31, 2015

	Common Shares	Retained Earnings	Total Equity
Balance, May 1	$ 0	$ 0	$ 0
Issued common shares	50,000		50,000
Profit		2,400	2,400
Dividends		(800)	(800)
Balance, May 31	$50,000	$1,600	$51,600

PROBLEM 1-7B (Continued)

(a) (Continued)

Note to instructors: Students may list the accounts in the following statement in any order within the assets, liabilities, and shareholders' equity classifications as they have not yet learned how to classify/order accounts.

AERO FLYING SCHOOL LTD.
Statement of Financial Position
May 31, 2015

Assets

Cash	$ 5,300
Accounts receivable	10,200
Equipment	60,300
Total assets	$75,800

Liabilities and Shareholders' Equity

Liabilities	
Accounts payable	$ 2,200
Bank loan payable	22,000
Total liabilities	24,200
Shareholders' equity	
Common shares	50,000
Retained earnings	1,600
Total shareholders' equity	51,600
Total liabilities and shareholders' equity	$75,800

(b) The financial statements must be prepared in the order of (1) income statement, (2) statement of changes in equity, and (3) statement of financial position. This is because each subsequent financial statement depends on information contained in the previous statement. The profit from the income statement flows to the retained earnings in the statement of changes in equity. The shareholders' equity totals (for example, for common shares and retained earnings) in the statement of changes in equity then flow to the shareholders' equity section of the statement of financial position.

PROBLEM 1-8B

(a)

		Activity
Cash payments for operating activities	$109,000	operating
Cash paid for equipment	40,000	investing
Repayment of long-term debt	15,000	financing
Cash dividends paid	13,000	financing
Cash receipts from operating activities	158,000	operating

(b)

FURLOTTE CORPORATION
Statement of Cash Flows
Year Ended June 30, 2015

Operating activities		
Cash received from customers	$158,000	
Cash paid to suppliers	(109,000)	
Net cash provided by operating activities		$49,000
Investing activities		
Cash paid to purchase equipment	$(40,000)	
Net cash used by investing activities		(40,000)
Financing activities		
Repayment of long-term debt	$(15,000)	
Cash dividends paid	(13,000)	
Net cash used by financing activities		(28,000)
Decrease in cash		(19,000)
Cash, July 1, 2014		40,000
Cash, June 30, 2015		$21,000

(c) The company is not generating sufficient cash from its operating activities ($49,000) to pay for the total of its investing activities ($40,000) and dividend payments ($13,000). If the company expects to continue to use cash for investing activities and dividend payments in future years, it will either have to generate more cash from its operating activities or from its financing activities (for example, borrow money) as its ending cash balance will not sustain this cash outflow on its own.

(b)

PROBLEM 1-9B

(a) [1] Operating expenses = Service revenue – Profit before income tax
Operating expenses = $85,000 – $35,000
Operating expenses = $50,000

[2] Profit = Profit before income tax – Income tax expense
Profit = $35,000 – $9,000
Profit = $26,000

[3] Profit = $26,000 (same as [2])

[4] Dividends = Beginning retained earnings + Profit – Ending retained earnings
Dividends = $20,000 + $26,000 – $31,000
Dividends = $15,000

[5] Beginning total equity = Beginning common shares + Beginning retained earnings
Beginning total equity = $25,000 + $20,000
Beginning total equity = $45,000

[6] Total common shares issued = $10,000

[7] Profit = $26,000 (same as [3])

[8] Dividends = $15,000 (same as [4])

[9] Ending total equity = Ending common shares + Ending retained earnings
Ending total equity = $35,000 + $31,000
Ending total equity = $66,000

[10] Cash = Total assets – (Accounts receivable + Land + Buildings + Equipment)
Cash = $85,000 (from [11]) – ($15,000 + $20,000 + $40,000 + $5,000)
Cash = $5,000

[11] Total assets = Total liabilities and shareholders' equity
Total assets = $85,000

[12] Common shares = Total liabilities and shareholders' equity – (Liabilities + Retained earnings)
Common shares = $85,000 – ($19,000 + $31,000)
Common shares = $35,000

[13] Retained earnings = $31,000 (as per statement of changes in equity)

PROBLEM 1-9B (Continued)

(b) (1) In preparing the financial statements, the first statement to be prepared is the income statement, followed by the statement of changes in equity, and then the statement of financial position. While the statements must be prepared in this sequence, these statements can be presented in a variety of orders. Often the statement of financial position is presented first, as the most "permanent" statement.

(2) The reason the statements must be prepared in a certain order as indicated above, is that each statement depends on information in the previously prepared statement. For example, the profit figure in the income statement is used in the statement of changes in equity to calculate the ending balance of retained earnings. The shareholders' equity section of the statement of financial position is then completed using the ending balances of the shareholders' equity components (such as common shares and retained earnings) as calculated in the statement of changes in equity.

PROBLEM 1-10B

(a)

1. Remove the $3,000 of service revenue that has not yet occurred.

2. Remove the $12,000 rent expense. This is not an actual transaction and cannot be listed on the company's income statement.

3. Remove the $4,000 vacation expense. This is not a business expense but rather a personal expense of the business owner.

4. Remove accounts receivable from the revenue section of the income statement since it is a current asset and does not belong on the income statement.

(b)

INDEPENDENT BOOK SHOP LTD.
Income Statement
Year Ended March 31, 2015

Revenues	
Service revenue ($41,000 – $3,000)	$38,000
Expenses	
Office expense	5,000
Profit before income tax	33,000
Income tax expense	5,000
Profit	$28,000

(c) As a private company, Independent Book Shop should also prepare a statement of financial position, a statement of retained earnings, and a statement of cash flows.

BYP 1-1 FINANCIAL REPORTING

(a) Shoppers presents the following five statements: Statement of Earnings (which we call income statement in the chapter), Statement of Comprehensive Income, Balance Sheet (which we call statement of financial position), Statement of Changes in Shareholders' Equity (which we call statement of changes in equity), and Statement of Cash Flows.

All of the above financial statements, except the Statement of Comprehensive Income, were discussed in this chapter.

(b) As demonstrated in the table below, while Shoppers' sales increased in 2012, its profit decreased.

($ in thousands)	2012	2011	Change
Sales	$10,781,848	$10,458,652	$323,196
Profit (net earnings)	608,481	613,934	(5,453)

Profit is affected by revenue and expenses incurred by Shoppers during the year. An increase in sales does not always translate into an increase in profit. For Shoppers, an increase in operating and administrative expenses in 2012 offset the increase in sales and contributed to an overall decrease in profit (net earnings).

(c)

($ in thousands)	(1) December 29, 2012	(2) December 31, 2011
Total assets	$7,473,721	$7,300,310
Total liabilities	3,150,394	3,032,480
Total shareholders' equity	4,323,327	4,267,830

BYP1-1 (Continued)

(d)

($ in thousands)	December 29, 2012	December 31, 2011
Share capital	$1,431,315	$1,486,455
Retained earnings	2,916,348	2,806,078

Yes, the above balances taken from the statement of changes in equity agree to the same amounts reported in the shareholders' equity section of the balance sheet. Note that these do not comprise all of Shoppers' shareholders' equity. Other shareholders' equity items make up the remainder of the total shareholders' equity balances reported on both statements as shown below.

($ in thousands)	December 29, 2012	December 31, 2011
Share capital	$1,431,315	$1,486,455
Retained earnings	2,916,348	2,806,078
Sub-total	4,347,663	4,292,533
Other shareholders' equity accounts	(24,336)	(24,703)
Total shareholders' equity	$4,323,327	$4,267,830

(e)

($ in thousands)	December 29, 2012	December 31, 2011
Cash	$104,529	$118,566

This information can be obtained on the balance sheet (statement of financial position) or on the statement of cash flows.

BYP 1-2 COMPARATIVE ANALYSIS

(a) and (b) [Shoppers ($ in thousands)]

1.	2012	2011	% change
Assets	$7,473,721	$7,300,310	2.4%
Liabilities	3,150,394	3,032,480	3.9%
Shareholders' equity	4,323,327	4,267,830	1.3%

2.	2012	2011	% change
Sales	$10,781,848	$10,458,652	3.1%
Profit	608,481	613,934	(0.9)%

Jean Coutu ($ in millions)

1.	2013	2012	% change
Assets	$1,392.7	$1,072.8	29.8%
Liabilities	281.9	423.6	(33.5)%
Shareholders' equity	1,110.8	649.2	71.1%

2.	2013	2012	% change
Net sales revenue	$2,468.0	$2,463.2	0.2%
Profit	558.4	230.0	142.8%

(c) Shoppers experienced growth in assets, liabilities, and shareholders' equity, however its liabilities grew faster than its assets which is not always a positive sign. In addition, despite a 3.1% increase in sales, there was a slight decrease in profit as a result of increased operating and administrative expenses.

Jean Coutu experienced a much larger growth rate than Shoppers. Not only did its assets increase by 29.8% but its liabilities declined by 33.5% in the same period. While there was only a small increase in sales revenue, its profit increased by 142.8%. However, it is important to note that the majority of this increase was the result of a one-time gain on the sale of Rite Aid (a drugstore chain in the U.S. formerly owned by Jean Coutu) and is not expected to recur.

(d) In 2013, Jean Coutu's fiscal year (March 2012 through February 2013) covers the majority of the same period as Shoppers' fiscal year (January 2012 through December 2012). The same is true for Jean Coutu's 2012 fiscal year and Shoppers 2011 fiscal year. Consequently, unless there was a significant economic impact that affected the drugstores in the non-overlapping period of two months (January and February), I would have no concerns about the comparisons made in (c) as they both cover a one-year period..

BYP 1-3 COMPARING IFRS AND ASPE

(a) Both public and private companies are separate legal entities owned by shareholders. One of the key differences between the two types of companies is the availability of the shares. Shares of public companies are traded on organized stock exchanges and are available to the general public. In contrast, shares of a private company are not made available to the general public nor are they traded on a public stock exchange.

Another difference is access to capital. Since public companies are traded on organized stock exchanges, they generally have more access to capital than private companies. Private companies tend to rely upon bank financing for capital.

Public and private companies also differ in terms of the amount of information they disclose publicly. Public companies are required to file financial statements with the regulators of the stock exchange. This makes their statements widely available. In contrast, private companies do not have any requirement to make their financial statements publicly available.

(b) The key users of public company financial statements are shareholders, lenders and other creditors, regulators, analysts, and the general public. In contrast, the key users of private company financial statements are generally lenders and other creditors as well as private shareholders.

(c) The key difference between the users of users of public and private financial statements is the different areas of emphasis of the users' objectives and needs when reviewing the financial statements. Users of public company financial statements can represent a wide range with varying levels of understanding about the company and its operations. They tend to be a broad group of users who benefit from detailed disclosure that will help them make the appropriate financial decision to invest or to lend, etc. On the other hand, users of private company financial statements tend to be a small group, who usually have a high degree of understanding of the company and its operations. They consist mostly of lenders and other creditors and a small group of shareholders. These users tend to place a greater emphasis on liquidity, solvency, and short-term cash flow planning.

BYP1-3 (Continued)

(d) One of the main reasons that Canada adopted IFRS is that these global set of standards will be beneficial to investors, lenders, other creditors, and other financial statement users by increasing the comparability and quality of financial statements. In other words, users will be able to make an "apples to apples" comparison. If Canadian public companies had a choice of which GAAP to use then it would entirely defeat the purpose of increasing comparability among public companies.

(e) Since most private companies in Canada are small to medium-sized businesses, the Accounting Standards Board (AcSB) decided that IFRS, with its extensive disclosure reporting requirements and sophisticated reporting, was not appropriate for most of these companies. However, since private companies can represent a wide range of companies – from large multinationals to small local restaurants, the AcSB decided it was best if private companies have a choice of which standard to adopt. A company's choice of which GAAP to adopt is generally driven by users' objectives and needs.

BYP 1-4 CRITICAL THINKING ACTIVITY

Note to instructors: All of the material supplementing this group activity, including a suggested solution, can be found in the Collaborative Learning section of the Instructor Resource site accompanying this textbook as well as in the Prepare and Present section of *WileyPLUS*.

(a) Divide revenue by the hourly rate charged to clients:
IMS: $1,020,000 ÷ $17 per hour = 60,000 hours
PCS: $900,000 ÷ $30 per hour = 30,000 hours

(b) Knowing the hours worked from the above, we can derive the hourly salary by dividing total salary expense for each company by the hours worked as follows:
IMS: $600,000 ÷ 60,000 hours = $10 per hour
PCS: $450,000 ÷ 30,000 hours = $15 per hour

(c) IMS uses larger facilities because its rent expense is higher. This makes sense because they have larger types of cleaning equipment that will need to be stored. Furthermore, the company has a larger staff given the size of its operations and may need more office.

(d) PCS has higher other operating expenses because that company owns and operates vehicles.

(e) Given that both companies pay interest at the same rate, IMS has the larger bank loan because its interest expense higher.

(f) The most significant factor that makes PCS more profitable is the fact that this company charges its clients an hourly rate that is double the hourly wage rate paid to its employees. IMS is not able to charge its clients at double the wage rate?

BYP 1-5 ETHICS CASE

(a) The stakeholders in this situation are the new CEO and CFO, and the creditors and investors who rely on the financial statements to make business decisions.

(b) The CEO and CFO should not sign the certification until they have taken steps to assure themselves that the most recent reports accurately and completely reflect the activities of the business. However, as the current management of the company, they cannot refuse to sign the certification just because they are new. They are the management team now and must assume the responsibilities that go with these positions.

(c) The CEO and CFO have no alternative other than to take the steps necessary to assure themselves of the accuracy and completeness of the financial information, and, if accurate, sign the certification. If the information is not accurate or complete, they need to make the required corrections to the financial information.

BYP 1-6 "ALL ABOUT YOU" ACTIVITY

Note to instructors: Answers will vary by student.

(a) You may want to be working as

- An accountant working towards an accounting designation
- A financial analyst
- A financial advisor
- A manager

The steps needed to get there will vary depending on the work destination identified.

(b) The basic elements of a resume include:

- An objective (your goals)
- A summary of your qualifications/accomplishments
- Experience highlights
- Employment history
- Education and training
- Other matters such as continuous education, languages, awards, memberships, affiliations and community involvement, as applicable

(c) You can provide references which can substantiate the information on your resume and evidence of education (diplomas and transcripts).

BYP 1-7 SERIAL CASE

(a) Cookie Creations is a proprietorship. A proprietorship has a lower administrative burden than a corporation—fewer regulations and procedures to adhere to. She may also have more flexibility in working for herself (or less depending on the demands of the business). In addition, as a separate proprietorship, all of the profits of the business belong to Natalie. However, she also has personal and unlimited liability for the debts of the business. She may also have difficulty in raising capital to grow the business.

Koebel's Family Bakery Ltd. is a private corporation. It would have limited liability for the shareholders' investments in the business compared to a proprietorship. However, this feature may be negated by a demand from creditors (such as the bank) for a personal guarantee by the shareholders. Profits would be shared with the other shareholders by way of dividends. More regulations and paperwork would be required as a corporation compared to that of a proprietorship, however, more opportunities would also exist to share the administrative burdens and to grow the business.

(b) Cookie Creations may use a simple form of accounting, possibly even the cash basis of accounting. Given its current size, it likely has no requirements to produce financial statements to external creditors. It could also choose to follow Accounting Standards for Private Enterprises (ASPE) if it was required to produce financial statements for external users.

Koebel's Family Bakery Ltd. would most likely use Accounting Standards for Private Enterprises (ASPE).

(c) Natalie will need information on the revenues and cost of the cupcake services and supplies so she can determine if the new contract is profitable. She will need this information more often initially (for example, on a weekly basis) so she can monitor the results of the contract and its impact on the operations of the bakery. She will also need forecasts of cupcake orders to plan the work, determine staffing and delivery schedules, and purchases of supplies. If the cupcake contract requires a loan to expand to meet demand, she will need financial statements so lenders can assess the financial health of the business. Natalie would also find financial statements useful to better understand her business and identify financial issues as early as possible. Monthly financial statements would be best because they are more timely.

BYP 1-7 (Continued)

(d) The users of Koebel's Family Bakery would include the existing shareholders (Natalie's parents), potential shareholders such as Natalie, creditors such as the bank, taxing authorities, such as CRA, and major customers such as the national coffee shop.

Natalie's parents are internal users and they need information to plan, organize and run the company and determine if they can obtain the financing to meet the increase demand. Natalie needs information to determine if her parents' business is a sound investment for her and what her responsibilities as administrator would be. The national coffee shop needs information to determine if Koebel's Family Bakery is able to deliver the quantities of cupcakes needed, The users would need all four financial statements—income statement, statement of retained earnings (since it is assumed that Koebel's Family bakery follows ASPE, however, if it follows IFRS then it would be required to prepare a statement of changes in equity), statement of financial position, and statement of cash flows—to assess the financial health of the company.

(e) The following are examples of activities that Koebel's Family Bakery is likely to be engaged in:
Operating activities would include revenue generated from the sale of cookies or from providing cookie-making lessons, paying for ingredients and supplies to make cupcakes, the payment of utilities for the bakery and interest on bank loans.

Investing activities may include the purchase of equipment for the bakery.

Financing activities may include borrowing money from the bank (debt) and paying dividends to shareholders (equity).

Legal Notice

Copyright