Financial Accounting Tools for Business Decision Making (Canadian) 8th edition Kimmel Solutions Manual

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CHAPTER 2

A FURTHER LOOK AT FINANCIAL STATEMENTS

LEARNING OBJECTIVES

1. Identify the sections of a classified statement of financial position.
2. Identify and calculate ratios for analyzing a company's liquidity, solvency, and profitability.
3. Describe the framework for the preparation and presentation of financial statements.

SUMMARY OF QUESTIONS BY LEARNING OBJECTIVES AND BLOOM'S TAXONOMY

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
Questions														
1.	1	K	8.	1	K	15.	2	C	22.	3	C	29.	3	C
2.	1	C	9.	2	K	16.	2	C	23.	3	C	30.	3	C
3.	1	C	10.	2	K	17.	2	K	24.	3	C	31.	3	C
4.	1	K	11.	2	K	18.	2	C	25.	3	C	32.	3	K
5.	1	C	12.	2	C	19.	2	C	26.	3	C	33.	3	C
6.	1	C	13.	2	C	20.	2	K	27.	3	C	34.	3	C
7.	1	C	14.	2	C	21.	2	C	28.	3	C			
Brief Exercises														
1.	1	K	3.	1	AP	5.	2	AP	7.	2	AN	9.	3	C
2.	1	K	4.	1	AP	6.	2	AN	8.	3	K	10.	3	C
Exercises														
1.	1	K	3.	1	AP	5.	1	AP	7.	2	AN	9.	3	K
2.	1	AP	4.	1	AP	6.	2	E	8.	2	AN	10.	3	C
Problems: Set A and B														
1.	1	K	3.	1	AP	5.	2	AN	7.	2	AN	9.	3	E
2.	1	AP	4.	1	AP	6.	2	AN	8.	2	AN	10.	3	E
Cases														
1.	1	K	3.	2	C	5.	1,2	AN	7.	3	E			
2.	1	K	4.	3	S	6.	2	AN	8.	2,3	E			

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Legend**:** The following abbreviations will appear throughout the solutions manual file.

LO	Learning objective	
BT	Bloom's Taxonomy	
	K	Knowledge
	C	Comprehension
	AP	Application
	AN	Analysis
	S	Synthesis
	E	Evaluation
Difficulty:	Level of difficulty	
	S	Simple
	M	Moderate
	C	Complex
Time:	Estimated time to complete in minutes	
AACSB	Association to Advance Collegiate Schools of Business	
	Communication	Communication
	Ethics	Ethics
	Analytic	Analytic
	Tech.	Technology
	Diversity	Diversity
	Reflec. Thinking	Reflective Thinking
CPA CM	CPA Canada Competency Map	
cpa-e001	Ethics	Professional and Ethical Behaviour
cpa-e002	PS and DM	Problem-Solving and Decision-Making
cpa-e003	Comm.	Communication
cpa-e004	Self-Mgt.	Self-Management
cpa-e005	Team & Lead	Teamwork and Leadership
cpa-t001	Reporting	Financial Reporting
cpa-t002	Stat. & Gov.	Strategy and Governance
cpa-t003	Mgt. Accounting	Management Accounting
cpa-t004	Audit	Audit and Assurance
cpa-t005	Finance	Finance
cpa-t006	Tax	Taxation

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ANSWERS TO QUESTIONS

1. (a) Current assets are assets that are expected to be converted into cash, sold, or used up within one year of the company's financial statement date or its operating cycle, whichever is longer.

(b) Examples of current assets include cash, accounts receivable, inventory, and supplies. Current assets are listed in order of liquidity in the current asset section of the statement of financial position.

LO 1 BT: K Difficulty: S Time: 3 min. AACSB: None CPA: cpa.t001 CM: Reporting

2. The term operating cycle stands for the average time it takes to go from cash to cash in producing revenue. In a merchandising business, this means the time it takes to purchase inventory on account, pay cash to suppliers, sell the inventory on account, and then collect cash from customers. In a service business, it stands for the time it takes to pay employees, provide services on account, and then collect the cash from customers.

LO 1 BT: C Difficulty: M Time: 3 min. AACSB: None CPA: cpa.t001 CM: Reporting

3. (a) Current assets are assets that are expected to be converted into cash, sold, or used up within one year of the company's financial statement date or its operating cycle, whichever is longer. Non-current assets are assets that are not expected to be converted into cash, sold, or used up by the business within one year of the financial statement date or its operating cycle. In other words, non-current assets are all assets that are not classified as current assets.

(b) Current assets are assets that are expected to be converted into cash, sold, or used up within one year of the company's financial statement date or its operating cycle, whichever is longer. Current liabilities are obligations that are to be paid or settled within one year of the company's financial statement date or its operating cycle, whichever is longer. Ideally, current assets will exceed current liabilities for a company.

Showing items as current in nature matters because doing so assists the user of the financial statements to assess the business's liquidity.

LO 1 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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4. (a) Current liabilities are obligations that are to be paid or settled within one year of the company's financial statement date or its operating cycle, whichever is longer.

(b) Examples of current liabilities include bank indebtedness, accounts payable, accrued liabilities, and current maturities of long-term debt. Current liabilities are listed in the order in which they are expected to be paid, in the current liability section of the statement of financial position.

LO 1 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

5. (a) The major differences between current liabilities and non-current liabilities are:

Difference	Current Liabilities	Non-Current Liabilities
Source of payment	Existing current assets or other current liabilities	Other than existing current assets or other current liabilities
Time of expected payment	Within one year	Beyond one year
Nature of items	Debts pertaining to the operating cycle and other Short-term debts	Mortgages, notes, loans, bonds, and other non. current liabilities

(b) Some liabilities, such as bank loans, appear on the statement of financial position with a current and non-current portion. Included in the balance of the bank loan payable are principal payments that will be due in the next year. That amount must be shown as a current liability as at the company's financial statement date. The remaining principal balance is classified as a non-current liability.

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6. (a) Contra accounts are accounts that offset the account to which they relate. Contra accounts serve to keep track of and disclose the amount of the reduction to the balance of the related account and arrive at its carrying amount. An example is accumulated depreciation, which is offset against the related asset account to arrive at the asset's carrying amount.

(b) In the case of property, plant, and equipment, users find it useful to know the historical cost of assets as well as the cumulative amount of depreciation (contra account called accumulated depreciation) that has been recorded to date on them. The difference between cost and accumulated depreciation is referred to as the carrying amount, also commonly known as net book value or just simply book value.

LO 1 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

7. Current assets and liabilities are listed in the statement of financial position in the order in which they are expected to be converted into cash, sold or used up in the case of assets and paid or settled, in the case of liabilities; that is, in their order of liquidity. Liquidity is enhanced when an asset can be converted to cash more quickly than another asset. In the case of liabilities, some liabilities will be paid more quickly than others and so they would be deemed to be more liquid. Other assets are listed in the order of permanency. Long-term assets, such as property, plant, and equipment, are usually presented in order of permanence, with the most permanent (land) being presented first.

LO 1 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

8. (a) The two components of shareholders' equity and the purpose of each are: (1) Share capital is used to record investments of assets, i.e. cash, in the business by the owners (shareholders). If there is only one class of shares, it is known as common shares. (2) Retained earnings is used to record accumulated profit, net of any losses and dividends declared, retained in the company.

(b) Under ASPE, the ending balances of share capital and retained earnings would appear on the statement of financial position and the ending balance of retained earnings would also appear on the statement of retained earnings. Under IFRS, the presentation on the statement of financial position would be the same, and both share capital and retained earnings would appear on the statement of changes in shareholders' equity.

LO 1 BT: K Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

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9. Data analytics is the process of analyzing enormous amounts of data to find patterns and correlations, trends, and other valuable insights to enhance decision-making. Big Data refers to a situation where the volume, velocity, and variety of data require cost-effective, innovative forms of information processing in order to provide useful information.

LO 2 BT: K Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

10. Examples of large amount of data available to businesses include customer credit history, customer demographics, and customer on-line activity.

LO 2 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

11. (a) Walmart records more than 1 million customer transactions every hour. Data collected includes the items purchased, customer information, method of payment, and store location.

(b) With this information, Walmart would be better able to decide which items to stock in a particular store, how the economy is doing in different parts of the country, where to expand and so on.

LO 2 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

12. Intracompany ratio comparisons compare elements and ratios within the same financial statements (example, current assets and current liabilities) or between the statement of income and the statement of financial position (example, basic earnings per share) from the same company. Intracompany ratio comparisons can also involve comparing elements or ratios in two or more accounting periods for the same company.

Intercompany ratio comparisons compare elements or ratio results between different companies.

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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13. (a) Liquidity ratios measure a company's short-term ability to pay its current liabilities and meet its unexpected needs for cash. Examples of liquidity ratios include working capital and current ratios.

(b) Solvency ratios measure a company's ability to survive over a long period of time. An example of a solvency ratio is the debt to total assets ratio.

(c) Profitability ratios measure a company's operating success for a given period of time. Examples of profitability ratios include basic earnings per share and the price-earnings ratio.

LO 2 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

14. (a) Working capital is arrived at by deducting current liabilities from current assets.

(b) Positive working capital means that there are more current assets than current liabilities. Whenever there is positive working capital, the current ratio is greater than 1:1.

(c) Having positive working capital does not mean that a company has enough cash to operate. It could mean the company has significant accounts receivable or inventory. The working capital may be a very large amount and yet the company may have no cash as it is instead borrowing all of the necessary cash from the bank to make day-to-day payments to suppliers and employees.

LO 2 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

15. The current ratio is a better measure of liquidity than working capital when making comparisons between different businesses. The amount of working capital is an absolute amount. It could vary tremendously depending on the size of the operations of the business. The current ratio on the other hand presents a relationship of current assets to current liabilities and is therefore appropriate as a tool to compare the liquidity of different sized businesses.

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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16. Current assets include accounts receivable and inventory. These may have increasing balances because of uncollectible receivables or slow-moving inventory. This would cause the current ratio to increase. Even though the current ratio may seem high, it is an artificial measure of liquidity if receivables and inventory cannot be easily or quickly converted into cash. Consequently, the current ratio alone does not provide a complete assessment of liquidity.

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

17. Dong Corporation is more solvent as only 45% of its assets are financed by debt whereas 55% of Du's assets are financed by debt. A company carrying a higher proportion of debt has an increased likelihood of encountering financial difficulties and is therefore considered less solvent.

LO 2 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

18. Raising money using debt increases a company's level of risk compared to raising money through equity because the terms of repayment of debt require cash outflows for the payment of interest and repayment of principal. These payments tap into cash balances and could hurt the company's liquidity. In contrast to debt, equity does not have to be repaid.

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

19. Basic earnings per share comparisons among different companies are difficult due to variations in the financing structure of the companies and in the number of shares issued. Hence, there is no industry average for basic earnings per share. On the other hand, since the price-earnings ratio uses basic earnings per share relative to the market price of the common shares, the ratio can be compared among companies.

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

20. Investors appear to favour TD Bank. Its higher price-earnings ratio indicates that investors are willing to pay proportionately more for TD's shares and have more favourable expectations of future growth.

LO 2 BT: K Difficulty: S Time: 5 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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21. Increases in the basic earnings per share, price-earnings ratio, and current ratio are considered to be signs of improvement because:

- An increase in the basic earnings per share means that the amount of net income per share is greater than in the previous period.
- An increase in the price-earnings ratio means that the share price has increased at a greater rate than the company's basic earnings per share, which implies the market believes future net income will continue to increase.
- An increase in the current ratio indicates that the company has more current assets available to settle its current liabilities and is more liquid (assuming the components of current assets (e.g., receivables and inventory) are also liquid.

On the other hand, the debt to total assets ratio measures how much of the company is financed by debt. The more debt a company has, the higher the debt to total assets ratio. A company with a higher debt level has increased financial risk due to higher fixed interest and principal repayments, and is less solvent than a company with a lower level of debt.

LO 2 BT: C Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

22. (a) The conceptual framework is a coherent system of interrelated objectives and fundamentals that can lead to consistent standards. The framework prescribes the nature, function, and limits of financial accounting statements. It guides choices about what to present in financial statements, decisions about alternative ways of reporting economic events, and the selection of appropriate ways of communicating such information.

(b) Internationally, the conceptual framework may vary from country to country. Canadian companies use the same framework, whether they are reporting under IFRS or under ASPE.

LO 3 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

23. (a) The primary objective of financial reporting is to provide information useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the company.

(b) The main users of financial reporting are investors, lenders, and other creditors.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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24. Stewardship stands for the management of a business' assets. Shareholders often delegate the management of a business to employees. It is important to users of financial information that a business have good stewardship to ensure that the highest return on investment is realized for investors and that risk is lowered for the providers of debt.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

25. The going concern assumption states that the business will remain in operation for the foreseeable future. The timing of when the asset will be converted to cash or used in operations and when liabilities are to be paid determines their classification on the statement of financial position. Since the business is expected to remain in operation for the foreseeable future, these elements can continue to be reported in accordance with their respective current or non-current classifications. If the company were about to be shut down, all of its assets and liabilities would be classified as current.

LO 3 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

26. The fundamental qualitative characteristics are (1) relevance and (2) faithful representation.

Relevant information will impact a user's decision by having predictive value, confirmatory value, or both. Faithful representation means that the financial statements should reflect the economic reality of what really exists or has happened. The information must be complete, neutral, and free from material error.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

27. Enhancing qualitative characteristics make useful financial information more useful (i.e. they enhance its usefulness). To be useful, financial information must reflect the two fundamental qualitative characteristics of relevance and faithful representation. Enhancing characteristics bring more specific support to the objectives achieved by using the fundamental qualitative characteristics. Enhancing qualitative characteristics include comparability, verifiability, timeliness and understandability. Enhancing qualitative characteristics cannot enhance the usefulness of financial information that is not useful (i.e. information which does not reflect the fundamental qualitative characteristics).

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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28. Materiality is related to relevance in that they are both defined in terms of what influences or makes a difference to the decision-maker. In order to be relevant to a financial statement user, a transaction, a narrative explanation in the notes to the financial statements, or an amount reported for an element must make a difference to the user in the making of a decision. An item is considered to be material if its omission or misstatement could influence the decision.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

29. Neutrality is achieved by exercising prudence. Prudence means exercising caution when making judgements. It does not mean being overly conservative when making a judgement. Often estimates need to be arrived at in the measurement of financial statement elements. A fair and neutral approach should be used in arriving at estimates. There should be no bias in interpreting the facts of a situation to arrive at a prudent, yet realistic estimate.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

30. The four enhancing qualitative characteristics are (1) comparability, (2) verifiability, (3) timeliness, and (4) understandability. There is no prescribed order in applying these characteristics. Company information is more useful when it can be compared over time or to information from other companies. If information is verifiable, it can be relied on more than information that is less verifiable. Information that is presented in a timely fashion is more useful than information that is less current. Information that can be understood by persons with a reasonable knowledge of business is more useful than information that is not as understandable.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

31. The cost constraint means that information will be presented only when the benefit associated with it exceeds the cost of obtaining and providing it. In attempting to fulfill a completeness objective when obtaining financial information, one could expend considerable resources. The cost of this search may greatly outweigh any benefit in achieving the completeness objective. Consequently, the search for completeness will be restricted by this constraint.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

32. The elements of financial statements are broad categories or classes of financial statement effects of transactions and other events. They include assets, liabilities, equity, income (which includes revenues and gains), and expenses (which include losses). The grouping is selected in accordance with the economic characteristics of the transactions.

LO 3 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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33. The two bases are historical cost and fair value. The fair value basis of accounting is applied to those assets that are intended to be sold and whose fair value is readily available. Securities traded on the stock exchanges would be a good example of assets reported at their fair value. The historical cost basis of accounting is used for most of the remaining assets used by the business. Since in most cases the intention is to use the assets to earn revenue, the fair value of the asset is not as relevant as its historical cost.

LO 3 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa.t001 CM: Reporting

34. In order to be relevant for decision making, the measurement of elements of financial statements need to reflect amounts that are reliable. For assets that are intended to be sold, the fair value of the assets becomes the most relevant measurement as it approximates the current amount of cash that could be obtained on the sale of the asset. On the other hand, for assets held for use by the corporation, the value at resale is not as relevant to the financial statement user. In that case, the historical cost of the assets is the better measurement for reporting the financial statement element. An example of a revenue generating asset is land used for a parking lot. It is relevant to compare the actual cost of the land to the amount of the revenue generated from its use. Using the historical cost basis of accounting gives a faithful representation to the financial statement users.

LO 3 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa.t001 CM: Reporting

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SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 2.1

a.	5	Accounts payable	i.	8	Dividends declared
b.	1	Accounts receivable	j.	5	Income tax payable
c.	3	Accumulated depreciation	k.	1	Inventory
d.	3	Buildings	l.	3	Land
e.	1	Cash	m.	2	Long-term investments
f.	7	Common shares	n.	6	Mortgage payable, due in 20 years
g.	5	Current portion of mortgage payable	o.	4	Patents
h.	5	Deferred revenue	p.	1	Prepaid insurance
			q.	1	Supplies

LO 1 BT: K Difficulty: S Time: 10 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

BRIEF EXERCISE 2.2

a.	4	Accounts payable	i.	3	Goodwill
b.	2	Accumulated depreciation	j.	1	Interest receivable
c.	4	Bank indebtedness	k.	1	Inventory
d.	5	Bank loan payable, due in three years	l.	1	Notes receivable, due in six months
e.	1	Cash	m.	1	Prepaid rent
f.	6	Common shares	n.	6	Retained earnings
g.	4	Deferred revenue	o.	4	Salaries payable
h.	2	Equipment	p.	1	Supplies
			q.	1	Trading investments

LO 1 BT: K Difficulty: S Time: 10 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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BRIEF EXERCISE 2.3

SHUM CORPORATION
Statement of Financial Position (Partial)

Assets

Current assets		
Cash		$16,400
Accounts receivable		14,500
Inventory		9,000
Supplies		4,200
Prepaid insurance		3,900
Total current assets		48,000
Property, plant, and equipment		
Land		65,000
Buildings	$110,000	
Less: Accumulated depreciation—buildings	33,000	77,000
Equipment	$70,000	
Less: Accumulated depreciation—equipment	25,000	45,000
Total property, plant, and equipment		187,000
Total assets		$235,000

(Assets = Liabilities + Shareholders' equity)

LO 1 BT: AP Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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BRIEF EXERCISE 2.4

HIRJIKAKA INC.
Statement of Financial Position (Partial)

Current liabilities	
Accounts payable	$22,500
Salaries payable	3,900
Interest payable	5,200
Income tax payable	6,400
Deferred revenue	900
Current portion of mortgage payable	5,000
Total current liabilities	$43,900

LO 1 BT: AP Difficulty: M Time: 5 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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BRIEF EXERCISE 2.5

a. ($ in thousands)

2018	2017
Working capital:	Working capital:
$273,323 – $138,428 = $134,895	$277,967 – $157,188 = $120,779
Current Assets – Current Liabilities	
Current ratio:	Current ratio:
$273,323 / $138,428 = 2.0:1	$277,967 / $157,188 = 1.8:1

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

b. The working capital increased in 2018 and the current ratio also increased. Rogers Sugar's liquidity is stronger in 2018 compared with 2017.

LO 2 BT: AP Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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BRIEF EXERCISE 2.6

a. (in US$ millions)

2018	2017
Debt to total assets ratio:	Debt to total assets ratio:
$\frac{(\$523{,}312 + \$2{,}682{,}839)}{(\$507{,}580 + \$4{,}375{,}374)} = 65.7\%$	$\frac{(\$603{,}952 + \$2{,}864{,}371)}{(\$525{,}402 + \$5{,}542{,}442)} = 57.2\%$

$$\frac{\text{Total Liabilities}}{\text{Total Assets}}$$

b. The company's solvency was weaker in 2018 compared with 2017 because total debt has increased as a proportion of total assets.

LO 2 BT: AN Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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BRIEF EXERCISE 2.7

a. ($ in millions)

2018	2017
Basic earnings per share:	Basic earnings per share:
$\frac{\$167}{272}$ = $0.61 per share	$\frac{\$2,029}{273}$ = $7.43 per share

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

Price-earnings ratio:	Price-earnings ratio:
$\frac{\$25.9(}{\$0.61}$ = 42.6 times	$\frac{\$25.8}{\$7.43}$ = 3.5 times

$$\frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

b. The large decrease in net income and in the basic earnings per share during the year would indicate that profitability has deteriorated in 2018. In spite of the decrease in net income, investors appear to have more confidence in Air Canada's future income as indicated by the substantial increase in the price-earnings ratio in 2018.

LO 2 BT: AN Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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BRIEF EXERCISE 2.8

a. Faithful representation
b. Verifiability
c. Understandability
d. Cost
e. Going concern
f. Fair value

LO 3 BT: K Difficulty: M Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

BRIEF EXERCISE 2.9

a. 10
b. 5
c. 13
d. 8
e. 12
f. 9
g. 1
h. 2
i. 4
j. 3
k. 11
l. 6
m. 7

LO 3 BT: C Difficulty: C Time: 15 min. AACSB: None CPA: cpa.t001 CM: Reporting

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BRIEF EXERCISE 2.10

a. Sosa Ltd. has purchased the land for sale and not for use. The fair value of the land becomes the more relevant measurement as it approximates the current amount of cash that could be obtained on the sale of the asset.

b. Mohawk has purchased land for use and not for sale. The fair value is not as relevant to the financial statement user in this case. The historical cost of the land is the better measurement for reporting the land on the statement of financial position.

LO 3 BT: C Difficulty: S Time: 5 min. AACSB: None CPA: cpa.t001 CM: Reporting

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SOLUTIONS TO EXERCISES

EXERCISE 2.1

a.	5	Accounts payable and accrued liabilities
b.	1	Accounts receivable
c.	3	Accumulated depreciation
d.	3	Buildings and leasehold improvements
e.	7	Common shares
f.	5	Current portion of long-term debt
g.	5	Dividends payable
h.	4	Patents
i.	5	Income and other taxes payable
j.	1	Income and other taxes receivable
k.	1	Inventories
l.	3	Land
m.	6	Long-term debt
n.	1	Prepaid expenses

LO 1 BT: K Difficulty: S Time: 10 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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EXERCISE 2.2

a.

BUHLER INDUSTRIES INC.
Statement of Financial Position (partial)
September 30, 2018
(in thousands)

Assets

Current assets			
Accounts receivable		$ 58,272	
Income tax receivable		2,802	
Inventory		171,612	
Prepaid expenses		2,810	
Total current assets			$ 235,496
Non-current assets			
Long-term other receivables		$28,413	
Investments		5,736	34,149
Property, plant, and equipment			
Land		$ 3,673	
Buildings	$28,556		
Less: Accumulated depreciation	18,510	10,046	
Equipment	$60,869		
Less: Accumulated depreciation	54,891	5,978	
Computer equipment	$ 8,437		
Less: Accumulated depreciation	7,401	1,036	
Total property, plant, and equipment			20,733
Total assets			$290,378

b. Buhler Inc. does not report any cash as it is operating with a negative bank balance likely covered by a line of credit which would be reported as bank indebtedness on the statement of financial position.

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EXERCISE 2.3

TRANSCONTINENTAL INC.
Statement of Financial Position (partial)
October 28, 2018
(in millions)

Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable and accrued liabilities	$ 431.6	
Income taxes payable	14.8	
Deferred revenue	16.0	
Current portion of long-term debt	254.9	
Total current liabilities		$ 717.3
Non-current liabilities		
Long-term debt	$1,209.8	
Deferred income taxes payable	98.4	
Other long-term liabilities	122.6	
Total non-current liabilities		1,430.8
Total liabilities		2,148.1
Shareholders' equity		
Common shares	$ 642.4	
Retained earnings	979.8	
Accumulated other comprehensive income	10.8	
Total shareholders' equity		1,633.0
Total liabilities and shareholders' equity		$3,781.1

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EXERCISE 2.4

a. Net income = Revenues – Expenses
= $183,040 – $158,680– $4,550 – $5,200
= $14,610

Retained earnings = Beginning retained earnings + Net income – Dividends declared
= $116,520 + $14,610 – $0
= $131,130

b.

SUMMIT LTD.
Statement of Financial Position
December 31, 2021

Assets

Current assets			
Cash		$ 24,040	
Accounts receivable		20,780	
Supplies		1,240	
Prepaid insurance		1,420	
Total current assets			$47,480
Long-term investments			28,970
Property, plant, and equipment			
Land		$194,000	
Buildings	$133,800		
Less: Accumulated depreciation	50,600	83,200	
Equipment	$ 66,100		
Less: Accumulated depreciation	21,470	44,630	
Total property, plant, and equipment			321,830
Total assets			$398,280

Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable	$21,050	
Interest payable	2,100	
Current portion of mortgage payable	30,500	
Total current liabilities		$ 53,650
Mortgage payable ($104,000 – $30,500)		73,500
Total liabilities		127,150
Shareholders' equity		
Common shares	$140,000	
Retained earnings	131,130	
Total shareholders’ equity		271,130
Total liabilities and shareholders' equity		$398,280

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EXERCISE 2.5

BATRA CORPORATION
Statement of Income
Year Ended July 31, 2021

Revenues		
Service revenue		$113,600
Rent revenue		18,500
Total revenues		132,100
Expenses		
Salaries expense	$44,700	
Operating expenses	32,500	
Rent expense	10,800	
Depreciation expense	3,000	
Utilities expense	2,600	
Interest expense	2,000	
Supplies expense	900	
Total expenses		96,500
Income before income tax		35,600
Income tax expense		5,000
Net Income		$30,600

[Revenues – Expenses = Net income or (loss)]

BATRA CORPORATION
Statement of Changes in Equity
Year Ended July 31, 2021

	Common Shares	Retained Earnings	Total Equity
Balance, August 1, 2020	$ 15,000	$17,940	$32,940
Issued common shares	10,000		10,000
Net income		30,600	30,600
Dividends declared		(12,000)	(12,000)
Balance, July 31, 2021	$25,000	$36,540	$61,540

[Ending retained earnings = Beginning retained earnings ± Net income or (loss) – dividends declared]

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EXERCISE 2.5 (CONTINUED)

BATRA CORPORATION
Statement of Financial Position
July 31, 2021

Assets

Current assets		
Cash	$ 5,060	
Trading investments	20,000	
Accounts receivable	17,100	
Supplies	1,500	
Total current assets		$ 43,660
Property, plant, and equipment		
Equipment	$62,900	
Less: Accumulated depreciation	6,000	
Total property, plant, and equipment		56,900
Total assets		$100,560

Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable	$ 4,220	
Interest payable	1,000	
Deferred revenue	12,000	
Bank loan payable	21,800	
Total liabilities		$ 39,020
Shareholders' equity		
Common shares	$25,000	
Retained earnings	36,540	
Total shareholders' equity		61,540
Total liabilities and shareholders' equity		$100,560

(Assets = Liabilities + Shareholders' equity)

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EXERCISE 2.6

a. Current ratio:

$$\frac{\$60,000}{\$40,000} = 1.5:1$$

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

b. Current ratio:

$$\frac{(\$60,000 - \$20,000)}{(\$40,000 - \$20,000)} = 2:1$$

c. The request of the CFO to pay off an accounts payable ahead of the due date is clearly done to manipulate the current ratio. Her instructions to make the payment came after she was presented with the calculation of the current ratio. In this case the current ratio that is meant to show Padilla's liquidity position has been artificially altered by a simple payment on account.

That said, it is not unethical to pay an account payable in advance of its due date. Rather, it is the motivation for the transaction that would lead one to conclude that the CFO is acting unethically.

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EXERCISE 2.7

a. (in thousands)

2019	2018
Working capital: $89,934 – $42,661 = $47,273	Working capital: $93,064 – $27,343 = $65,721

Current Assets – Current Liabilities

Current ratio:

$\frac{\$89,934}{\$42,661} = 2.1:1$	$\frac{\$93,064}{\$27,343} = 3.4:1$

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Debt to total assets ratio:

$\frac{(\$42,661 + \$66,075)}{(\$89,934 + 23,964)} = 95.5\%$	$\frac{(\$27,343 + \$95,492)}{(\$93,064 + \$29,971)} = 80.3\%$

$$\frac{\text{Total Liabilities}}{\text{Total Assets}}$$

b. Le Château's liquidity deteriorated in 2019 when compared to 2018, while remaining strong. Its solvency also deteriorated and is quite poor.

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EXERCISE 2.7 (CONTINUED)

c.

	2019			
	Le Château	Aritzia	Reitmans	Industry
Working capital (in thousands)	$47,273	$145,246	$219,367	n/a
Current ratio	2.1:1	2.6:1	2.8:1	2.8 :1
Debt to total assets ratio	95.5%	40.5%	31.1%	44.8%

	2018			
	Le Château	Aritzia	Reitmans	Industry
Working capital (thousands)	$65,721	$105,727	$205,105	n/a
Current ratio	3.4:1	2.0:1	2.7:1	2.5:1
Debt to total assets ratio	80.3%	49.7%	31.7%	43.5%

Based on working capital and the current ratio, Le Château's liquidity is the worst (lowest) of the three companies, as the current ratio is below that of Aritzia and Reitmans as well as the industry average. Compared to 2018, Aritzia and Reitmans improved working capital and the current ratio, while both deteriorated for Le Château. The industry average current ratio also improved.

Based on the debt to total assets ratio, Reitman's solvency is the best (lowest) of the three companies and better than the industry average. Aritzia's solvency improved. Le Château's solvency is the worst of the three companies.

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EXERCISE 2.8

a. (in millions)

2018	2017
Basic earnings per share:	Basic earnings per share:
$\frac{\$852.5}{385.7}$ = $2.21 per share	$\frac{\$731.1}{393.1}$ = $1.86 per share

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

Price-earnings ratio:	Price-earnings ratio:
$\frac{\$41.35}{\$2.21}$ = 18.7 times	$\frac{\$45.89}{\$1.86}$ = 24.7 times

$$\frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

b. The increase in the basic earnings per share during the year would indicate that profitability has improved in 2018.

c. Saputo's income rose by 17% in 2018. On a per share basis earnings per share increased by 19% because there were fewer shares outstanding. Since earning per share is the denominator in the price-earnings ratio, one would expect the price-earnings ratio to decline. The price-earnings ratio also declined due to the 10% decline in share market price.

d. Investors appear to be less optimistic about Saputo's future profitability as its price-earnings ratio has declined

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EXERCISE 2.9

a.	7	g.	1
b.	10	h.	6
c.	11	i.	4
d.	3	j.	5
e.	2	k.	9
f.	8	l.	12

LO 3 BT: K Difficulty: M Time: 20 min. AACSB: None CPA: cpa.t001 CM: Reporting

EXERCISE 2.10

1. a. The historical cost basis of accounting is involved in this situation.
   b. The historical cost basis of accounting has been followed. The land is for use and should be reported at its historical cost.

2. a. The fair value measurement basis of accounting is involved in this situation.
   b. The historical cost principle has not been violated since the parcel of land is being held for resale and not for use. The land should be reported at fair value.

3. a. The assumption involved in this situation is the going concern assumption.
   b. The going concern assumption has been violated. The elements on the statement of financial position should have been classified between current and non-current.

4. a. The cost constraint is involved in this situation.
   b. There has been no violation of the cost constraint. The practice adopted is acceptable.

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SOLUTIONS TO PROBLEMS

PROBLEM 2.1A

Item	Statement of Financial Position Category
Accounts payable	Current liabilities
Accounts receivable	Current assets
Accumulated depreciation	Contra asset to property, plant, and equipment
Cash	Current assets
Common shares	Share capital
Computer equipment	Property, plant, and equipment
Current portion of long-term debt	Current liabilities
Furniture and equipment	Property, plant, and equipment
Goodwill	Goodwill
Land, buildings and improvements	Property, plant, and equipment
Long-term debt	Non-current liabilities
Prepaid expenses	Current assets
Deferred revenue	Current liabilities

LO 1 BT: K Difficulty: S Time: 15 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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PROBLEM 2.2A

a.

Item	Statement of Financial Position Category
Accounts receivable	Current assets
Accumulated depreciation—aircraft	Property, plant, and equipment (contra account)
Accumulated depreciation—buildings	Property, plant, and equipment (contra account)
Accumulated depreciation—ground, property and equipment	Property, plant, and equipment (contra account)
Accumulated depreciation—spare parts	Property, plant, and equipment
Aircraft	Property, plant, and equipment
Buildings	Property, plant, and equipment
Cash	Current assets
Ground and other property and equipment	Property, plant, and equipment
Intangible assets	Intangible assets
Inventory	Current assets
Other assets (non-current)	Other assets
Prepaid expenses, deposits, and other	Current assets
Spare parts	Property, plant, and equipment
Trading investments	Current assets

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PROBLEM 2.2A (CONTINUED)

b.

WESTJET AIRLINES LTD.
Statement of Financial Position (partial)
December 31, 2018
(in thousands)

Assets

Current assets			
Cash		$1,301,421	
Trading investments		93,771	
Accounts receivable		145,544	
Inventory		39,742	
Prepaid expenses, deposits, and other		190,242	
Total current assets			$1,770,720
Property, plant, and equipment			
Aircraft	$5,634,255		
Less: Accumulated depreciation	1,911,279	$3,722,976	
Ground and other property and equipment	$ 188,003		
Less: Accumulated depreciation	115,684	72,319	
Spare parts	$ 389,504		
Less: Accumulated depreciation	134,896	254,608	
Buildings	$ 136,780		
Less: Accumulated depreciation	40,992	95,788	
Total property, plant, and equipment			4,145,691
Intangible assets			54,851
Other assets			786,793
Total assets			$6,785,055

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PROBLEM 2.3A

a.

Item	Statement of Financial Position Category
Accounts payable and accrued liabilities	Current liabilities
Advance ticket sales	Current liabilities
Current portion of long-term debt	Current liabilities
Deferred income tax (long-term)	Non-current liabilities
Deferred revenue	Current liabilities
Long-term debt	Non-current liabilities
Other current liabilities	Current liabilities
Other long-term liabilities	Non-current liabilities
Other shareholders' equity items	Shareholders' equity
Retained earnings	Shareholders' equity
Share capital	Shareholders' equity

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PROBLEM 2.3A (CONTINUED)

b.

WESTJET AIRLINES LTD.
Statement of Financial Position (partial)
Liabilities and Shareholders' Equity
December 31, 2018
(in thousands)

Current liabilities		
Accounts payable and accrued liabilities	$654,422	
Advanced ticket sales	695,367	
Deferred revenue	224,608	
Other current liabilities	62,914	
Current portion of long-term debt	637,896	
Total current liabilities		$2,275,207
Non-current liabilities		
Long-term debt	$1,442,913	
Other long-term liabilities	312,410	
Deferred income tax	424,958	
Total non-current liabilities		2,180,281
Total liabilities		4,455,488
Shareholders' equity		
Share capital	$ 548,979	
Retained earnings	1,640,077	
Other shareholders' equity items	113,511	
Total shareholders' equity		2,302,567
Total liabilities and shareholders' equity		$6,758,055

(c) Yes, these two amounts agree. Assets of $6,758,055 thousand equal total liabilities plus shareholders' equity of the same amount.

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PROBLEM 2.4A

a.

MBONG CORPORATION
Statement of Income
Year Ended December 31, 2021

Revenues		
Service revenue	$213,900	
Interest income	500	
Total revenues		$214,400
Expenses		
Salaries expense	$129,800	
Operating expense	39,400	
Depreciation expense	6,200	
Repair and maintenance expense	2,800	
Insurance expense	2,200	
Utilities expense	2,000	
Interest expense	1,500	
Supplies expense	1,000	
Total expenses		184,900
Income before income tax		29,500
Income tax expense		6,000
Net income		$23,500

[Revenues – Expenses = Net income or (loss)]

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PROBLEM 2.4A (CONTINUED)

MBONG CORPORATION
Statement of Changes in Equity
Year Ended December 31, 2021

	Common Shares	Retained Earnings	Total Equity
Balance, January 1	$30,000	$221,000	$251,000
Issued common shares	4,200		4,200
Net income		23,500	23,500
Dividends declared		(5,000)	(5,000)
Balance, December 31	$34,200	$239,500	$273,700

(Beginning equity ± Changes to equity = Ending equity)
[Ending retained earnings = Beginning retained earnings ± Net income or (loss) – dividends declared]

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PROBLEM 2.4A (CONTINUED)

a. (continued)

MBONG CORPORATION
Statement of Financial Position
December 31, 2021
Assets

Current assets			
Cash		$ 11,900	
Trading investments		20,000	
Accounts receivable		14,200	
Supplies		200	
Prepaid insurance		2,000	
Total current assets			$ 48,300
Property, plant, and equipment			
Land		$156,000	
Buildings	$72,000		
Less: Accumulated depreciation—buildings	18,000	54,000	
Equipment	$66,000		
Less: Accumulated depreciation—equipment	17,600	48,400	
Total property, plant, and equipment			258,400
Total assets			$306,700

Liabilities and Shareholders' Equity

Current liabilities			
Accounts payable		$15,000	
Salaries payable		3,000	
Current portion of bank loan payable		1,500	
Total current liabilities			$ 19,500
Non-current liabilities			
Bank loan payable ($15,000 - $1,500)			13,500
Total liabilities			33,000
Shareholders' equity			
Common shares		$ 34,200	
Retained earnings		239,500	
Total shareholders' equity			273,700
Total liabilities and shareholders' equity			$306,700

(Assets = Liabilities + Shareholders' equity)

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PROBLEM 2.4A (CONTINUED)

b. The statement of income reports the net income or loss for the period. This figure is then used in the statement of changes in equity, along with dividends declared and any issues (or repurchases) of shares, to calculate the balances in common shares and retained earnings at the end of the period. These ending balances are then used in the statement of financial position to determine shareholders' equity and complete the accounting equation.

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PROBLEM 2.5A

a.

1. Working capital

Current assets – Current liabilities

$ 446,900 – $142,500 = $304,400

2. Current ratio

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\frac{\$446,900}{\$142,500} = 3.1 : 1$$

3. Debt to total assets

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$

$$\frac{\$452,500}{\$1,072,200} = 42.2\%$$

4. Basic earnings per share

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

$$\frac{\$160,000}{40,000} = \$4.00$$

5. Price-earnings ratio

$$\frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

$$\frac{\$35.00}{\$4.00} = 8.8 \text{ times}$$

b. Johanssen's liquidity has improved dramatically as the working capital is greater in 2021 and the current ratio is almost double that of 2020. On the other hand, the solvency has deteriorated as the debt to total assets ratio is higher in 2021. Johanssen's profitability has improved as the basic earnings per share ratio has increased in 2021, as has investors' expectations for future profitability as indicated by the increased price-earnings ratio.

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PROBLEM 2.6A

a.

Working capital	=	Current assets	–	Current liabilities		
Chen	=	$407,200	–	$166,325	=	$240,875
Caissie	=	$190,400	–	$133,700	=	$56,700

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Chen			Caissie		
$\frac{\$407,200}{\$166,325}$	=	2.4 :1	$\frac{\$190,400}{\$133,700}$	=	1.4 :1

Chen is significantly more liquid than Caissie. It has a higher current ratio and more current assets available to pay current liabilities as they come due.

b.

$$\text{Debt to total assets} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

Chen			Caissie		
$\frac{(\$166,325 + \$108,500)}{(\$407,200 + \$532,000)}$	=	29.3%	$\frac{(\$133,700 + \$40,700)}{(\$190,400 + \$139,700)}$	=	52.8%

Caissie is considerably less solvent than Chen. Caissie's debt to total assets ratio of 52.8% is almost double that of Chen's ratio of 29.3%. The lower the percentage of debt to total assets, the lower the risk that a company may be unable to pay its debts as they come due.

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PROBLEM 2.6A (CONTINUED)

c.

	Chen	Caissie
Service revenue	$1,800,000	$620,000
Operating expenses	1,458,000	438,000
Interest expense	10,000	4,000
Income tax expense	85,000	35,400
Total expenses	1,553,000	477,400
Net income	$ 247,000	$142,600

$$\text{Basic earnings per share} = \frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

Chen	Caissie
$\frac{\$247,000}{76,000} = \$3.25$	$\frac{\$142,600}{62,000} = \$2.30$

$$\text{Price-earnings ratio} = \frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

Chen	Caissie
$\frac{\$25.00}{\$3.25} = 7.7$ times	$\frac{\$15.00}{\$2.30} = 6.5$ times

Based on the price-earnings ratio, investors believe that Chen will be more profitable than Caissie in the future. It is not meaningful to compare basic earnings per share between companies.

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PROBLEM 2.7A

a. (in thousands)

		Alexa Ltd.	Beta Ltd.
1.	Working capital	$1,000 + $9,000 + $20,000 – $15,000 = $15,000	$7,000 + $4,000 + $11,000 – $16,000 = $6,000
2.	Current ratio	$\frac{\$30,000}{\$15,000}$ = 2.0:1	$\frac{\$22,000}{\$16,000}$ = 1.4:1
3.	Debt to total assets	$\frac{\$15,000 + \$85,000}{\$30,000 + \$110,000}$ = 71.4%	$\frac{\$16,000 + \$44,000}{\$22,000 + \$118,000}$ = 42.9%
4.	Basic earnings per share	$\frac{\$9,000}{900}$ = $10.00	$\frac{\$11,000}{5,500}$ = $2.00
5.	Price-earnings ratio	$\frac{\$80}{\$10}$ = 8.0 times	$\frac{\$24}{\$2}$ = 12.0 times

b. Liquidity

With a current ratio of 2.0:1, Alexa is more liquid than Beta and Alexa has a stronger ratio than the industry average of 1.6:1.

Solvency

Beta is more solvent than Alexa as evidenced by its lower debt to total assets ratio, which is better than the industry average of 57%.

Profitability

Although the basic earnings per share ratio does not provide a basis for comparison by investors, the price-earnings ratio can be calculated to compare to each other or to the industry average of 10.0 times.

The price-earnings ratio, which reveals investors' sentiment concerning future profitability, shows that Beta is favoured over Alexa. This corresponds to the large difference in the debt to total assets ratio of both companies. Debt to total assets is very high for Alexa, increasing the risk of the investment made by shareholders.

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PROBLEM 2.8A

a. The higher the amount of working capital, the better a company' liquidity. From 2019 to 2021 Pitka Corporation's working capital deteriorated and showed a constant downward trend over the three-year period.

A higher current ratio is evidence of better liquidity for a company (assuming the components of the current assets are also liquid). Although the current ratio stayed the same from 2019 to 2020, it deteriorated 2020 to 2021 and is low.

A smaller (lower) debt to total assets ratio shows evidence of better solvency. The percentage of total liabilities to total assets increased from 2019 to 2020, showing deterioration in the solvency for Pitka. On the other hand, the ratio improved substantially from 2020 to 2021.

The higher the basic earnings per share, the better the profitability. Profitability decreased from 2019 to 2020, but improved from 2020 to 2021.

The investors appeared to have less confidence in the future net income of Pitka as evidenced by Pitka's price-earnings ratio, which declined from 2019 to 2020. This view changed as demonstrated by the climb in the price-earnings ratio from 2020 to 2021.

b. Liquidity

Pitka's current ratio, although steady in 2019 and 2020, declined slightly in 2021. This trend is of concern given the low level of liquidity the company has with a current ratio of 1.1:1.

Solvency

Pitka's debt to total assets ratio improved in the last year. It appears to be reasonable in size, as does the solvency of the company in 2019.

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PROBLEM 2.8A (CONTINUED)

b. (continued)

Profitability

Pitka's profitability declined and then recovered as is demonstrated by the basic earnings per share ratio. The price-earnings ratio in 2021 indicates expectations of improving profitability.

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PROBLEM 2.9A

a. The objective of financial reporting is to provide information that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the company. In this case, the information will be used by the team's bank. Bucky's suggestions concerning how elements should be reported on the financial statements do not meet the objective of financial reporting. His suggestions would lead to a violation of the fundamental basis on which financial statements are prepared: accrual accounting. The suggested changes to the financial statements would not portray economic reality and would not faithfully represent the performance of the business and its financial position at December 31, 2021. Bucky's suggestions show bias and an attempt to portray a financial picture that would be perceived as more favourable than it is in reality.

b. 1. Failing to include the estimated expenses for utilities and the corresponding liability for the utilities already consumed by December 31, 2021 violates accrual accounting. The expense was incurred and a liability exists, and although the exact amount is not known, a reasonable estimate can be made as this type of expense occurs often. The definitions of the elements have been met. Failing to include the expense would represent an error of omission done on purpose to increase the profitability and reduce the liabilities of the company at December 31, 2021.

2. Unless the company uses the revaluation model for all of its long-lived assets, increasing the value of the building to its fair value would violate the historical cost basis of accounting. It is likely far more relevant to the financial statement user of this company to see the original purchase price of the building rather than its fair value as it is unlikely to be resold soon. Assets and revenue (from the recording of an unrealized gain from the increase in the value of the asset) would be overstated if Bucky's instructions were followed.

3. The signing bonus paid to Wayne Crosby does not represent an asset at December 31, 2021. No future benefit can be derived from this payment as it was not conditional upon the occurrence of a future event. Consequently, the expenditure does not fit the definition of an asset.

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PROBLEM 2.10A

a. The advantage of the fair value basis of accounting is that it represents a more up-to-date measurement of the value of the asset reported. Consequently, the amounts reported are more relevant to the financial statement users. The disadvantage of the fair value basis of accounting and corresponding advantage of historical cost is that historical cost is more reliable and shows the amount paid for the asset. The historical cost might provide a more faithful representation because it can be easily verified and is neutral.

b. The reason a company might choose to adopt the fair value basis of accounting for real estate is that assets reported on the statement of financial position will have higher values than they would using the historical cost basis. It is inherent in the nature of real estate that the land will increase in value over time. Creditors will find the fair value a more relevant basis for making lending decisions. The increase in the assets will have a corresponding increase in equity.

c. The reason a company might choose to adopt the historical cost basis of accounting for real estate is that assets reported on the statement of financial position will have more faithful representation because it reports the actual cost of the asset when it was acquired and this measurement can be easily verified and it is neutral. There is also a significant cost to obtaining reliable fair value information, on a regular basis, to be reported in the financial statements.

d. When comparing real estate companies, the reader is well advised to read the accounting policy note to the financial statements disclosing the measurement policy used for the real estate property. One would need to determine the corresponding fair value for real estate for the company that used the historical cost basis of accounting. In fact, this information is required to be disclosed for real estate companies, even if they adopted the historical cost basis of accounting, to improve comparability and disclosure. Otherwise, trying to compare businesses that use different bases of accounting would be very difficult.

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PROBLEM 2.1B

Item	Statement of Financial Position Category
Accumulated amortization—patents and trademarks	Intangible assets (contra account)
Accumulated depreciation—industrial machinery and equipment	Property, plant, and equipment (contra account)
Bank overdraft	Current liabilities
Cash	Current assets
Common (ordinary) shares	Share capital
Current borrowings and debts	Current liabilities
Income tax payable (current)	Current liabilities
Industrial machinery and equipment	Property, plant, and equipment
Inventories	Current assets
Land	Property, plant, and equipment
Long-term investments	Non-current assets
Non-current borrowings and debts	Non-current liabilities
Patents and trademarks	Intangible assets
Prepaid expenses	Current assets
Trade accounts payable	Current liabilities
Trade accounts receivable	Current assets

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PROBLEM 2.2B

a.

Item	Statement of Financial Position Category
Accounts receivable	Current assets
Accumulated depreciation—buildings	Property, plant, and equipment (contra account)
Accumulated depreciation—equipment	Property, plant, and equipment (contra account)
Buildings	Property, plant, and equipment
Cash	Current assets
Equipment	Property, plant, and equipment
Goodwill	Goodwill (after intangibles)
Trading investments	Current assets
Inventory	Current assets
Land	Property, plant, and equipment
Patent	Intangible assets
Prepaid expenses	Current assets

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PROBLEM 2.2B (CONTINUED)

b.

DEVON LIMITED
Statement of Financial Position (partial)
December 31, 2021

	Assets		
Current assets			
Cash		$100,460	
Trading investments		52,520	
Accounts receivable		13,345	
Inventory		105,320	
Prepaid expenses		13,950	
Total current assets			$285,595
Property, plant, and equipment			
Land		$207,290	
Buildings	$ 58,275		
Less: Accumulated depreciation	27,595	30,680	
Equipment	$287,400		
Less: Accumulated depreciation	146,550	140,850	
Total property, plant, and equipment			378,820
Intangible assets			
Patent			20,225
Goodwill			39,590
Total assets			$724,230

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PROBLEM 2.3B

a.

Item	Category
Accounts payable	Current liabilities
Common shares	Shareholders' equity
Current portion of mortgage payable	Current liabilities
Mortgage payable	Non-current liabilities
Retained earnings	Shareholders' equity
Deferred revenue	Current liabilities

b.

DEVON LIMITED
Statement of Financial Position (partial)
December 31, 2021

Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable	$ 13,100	
Deferred revenue	14,180	
Current portion of mortgage payable	29,000	
Total current liabilities		$ 56,280
Non-current liabilities		
Mortgage payable		231,255
Total liabilities		287,535
Shareholders' equity		
Common shares	$115,400	
Retained earnings	321,295	
Total shareholders' equity		436,695
Total liabilities and shareholders' equity		$724,230

c. Yes, the total assets of $724,230 matches the total liabilities and shareholders' equity.

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PROBLEM 2.4B

a.

BEAULIEU LIMITED
Statement of Income
Year Ended December 31, 2021

Revenues		
Service revenue	$193,100	
Interest income	500	
Total revenues		$193,600
Expenses		
Salaries expense	$145,600	
Interest expense	8,000	
Depreciation expense	5,400	
Utilities expense	3,700	
Insurance expense	2,400	
Total expenses		165,100
Income before income tax		28,500
Income tax expense		5,000
Net Income		$23,500

[Revenues – Expenses = Net income or (loss)]

BEAULIEU LIMITED
Statement of Changes in Equity
Year Ended December 31, 2021

	Common Shares	Retained Earnings	Total Equity
Balance, January 1	$25,000	$34,000	$59,000
Issued common shares	20,000		20,000
Net income		23,500	23,500
Dividends declared		(3,500)	(3,500)
Balance, December 31	$45,000	$54,000	$99,000

(Beginning equity ± Changes in equity = Ending equity)
[Ending retained earnings = Beginning retained earnings ± Net income or (loss) – dividends declared]

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PROBLEM 2.4B (CONTINUED)

a. (continued)

BEAULIEU LIMITED
Statement of Financial Position
December 31, 2021

Assets

Current assets			
Cash		$11,170	
Accounts receivable		7,500	
Prepaid insurance		250	
Total current assets			$ 18,920
Long-term investments			20,000
Property, plant, and equipment			
Land		$145,800	
Buildings	$105,000		
Less: Accumulated depreciation—buildings	12,000	93,000	
Equipment	$ 32,000		
Less: Accumulated depreciation—equipment	19,200	12,800	
Total property, plant, and equipment			251,600
Total assets			$290,520

Liabilities and Shareholders' Equity

Current liabilities			
Accounts payable		$ 9,550	
Salaries payable		6,170	
Current portion of mortgage payable		35,100	
Total current liabilities			$ 50,820
Non-current liabilities			
Mortgage payable ($175,800 - $35,100)			140,700
Total liabilities			191,520
Shareholders' equity			
Common shares		$45,000	
Retained earnings		54,000	
Total shareholders' equity			99,000
Total liabilities and shareholders' equity			$290,520

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PROBLEM 2.4B (CONTINUED)

b. The statement of income reports the net income or loss for the period. This figure is then used in the statement of changes in equity, along with dividends declared and issues (or repurchases) of shares to calculate the balances in common shares and retained earnings at the end of the period. These ending balances are then used in the statement of financial position, to determine shareholders' equity and complete the accounting equation.

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PROBLEM 2.5B

a.

1. Working capital

Current assets – Current liabilities

$253,850 – $156,550 = $97,300

2. Current ratio

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\frac{\$253,850}{\$156,550} = 1.6 : 1$$

3. Debt to total assets

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$

$$\frac{\$288,550}{\$719,150} = 40.1\%$$

4. Basic earnings per share

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

$$\frac{\$96,600}{40,000} = \$2.42$$

5. Price-earnings ratio

$$\frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

$$\frac{\$30.00}{\$2.42} = 12.4 \text{ times}$$

b. Fast's liquidity has improved as the working capital is larger in 2021 and the current ratio is greater than that of 2020. The solvency has improved as the debt to total assets ratio is a smaller percentage in 2021 than in 2020. Fast's profitability has improved dramatically as the basic earnings per share ratio has increased by a large amount in 2021, as has the price-earnings ratio, suggesting that investors are excited about the company's future prospects.

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PROBLEM 2.6B

a.

Working capital	=	Current assets	–	Current liabilities		
Belliveau	=	$180,000	–	$75,000	=	$105,000
Shields	=	$700,000	–	$300,000	=	$400,000

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Belliveau			Shields		
$\frac{\$180,000}{\$75,000}$	=	2.4 :1	$\frac{\$700,000}{\$300,000}$	=	2.3 :1

Belliveau is slightly more liquid than Shields as it has a higher current ratio, even though its absolute working capital amount is lower.

b.

$$\text{Debt to total assets} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

Belliveau			Shields		
$\frac{(\$75,000 + \$190,000)}{(\$180,000 + \$600,000)}$	=	34.0%	$\frac{(\$300,000 + \$200,000)}{(\$700,000 + \$800,000)}$	=	33.3%

The debt to asset ratios are similar and both companies are solvent. The lower the percentage of debt to total assets, the lower the risk that a company may be unable to pay its debts as they come due.

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PROBLEM 2.6B (CONTINUED)

c.

	Belliveau	Shields
Service revenue	$450,000	$890,000
Operating expenses	390,000	679,000
Interest expense	6,000	10,000
Income tax expense	10,000	65,000
Total expenses	406,000	754,000
Net income	$ 44,000	$136,000

$$\text{Basic earnings per share} = \frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares}}$$

Belliveau	Shields
$\frac{\$44,000}{200,000} = \$0.22$	$\frac{\$136,000}{200,000} = \$0.68$

$$\text{Price-earnings ratio} = \frac{\text{Market price per share}}{\text{Basic earnings per share}}$$

Belliveau	Shields
$\frac{\$2.50}{\$0.22} = 11.4$ times	$\frac{\$6.00}{\$0.68} = 8.8$ times

Investors have higher expectations for Belliveau's future profitability, as evidenced by the price-earnings ratio. It is not useful to compare basic earnings per share between companies.

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PROBLEM 2.7B

a. (in US$ millions)

		Clear Ltd.	Dot Ltd.
1.	Working capital	$2,000 + $18,000 + $48,000 – $30,000 = 38,000	$14,000 + $8,000 + $22,000 – $30,000 = $14,000
2.	Current ratio	$\frac{\$68,000}{\$30,000}$ = 2.3:1	$\frac{\$44,000}{\$30,000}$ = 1.5:1
3.	Debt to total assets	$\frac{\$30,000 + \$178,000}{\$68,000 + \$220,000}$ = 72.2%	$\frac{\$30,000 + \$90,000}{\$44,000 + \$236,000}$ = 42.9%
4.	Basic earnings per share	$\frac{\$16,000}{1,800}$ = $8.89	$\frac{\$22,000}{11,000}$ = $2.00
5.	Price-earnings ratio	$\frac{\$78.00}{\$8.89}$ = 8.8 times	$\frac{\$28.00}{\$2.00}$ = 14.0 times

b. Liquidity

Both companies are liquid, with Clear having a stronger position with a current ratio that is higher than the industry average.

Solvency

Dot is more solvent than Clear as evidenced by its lower debt to total assets ratio. Dot also has a debt to total assets ratio that is lower than the industry average.

Profitability

Although the basic earnings per share ratio does not provide a basis for comparison, investors appear to have more confidence in the future net income of Dot as evidenced by Dot's price-earnings ratio. Both Clear and Dot have lower price-earnings ratios than the industry.

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PROBLEM 2.8B

a. The higher the amount of working capital, the better a business' liquidity. From 2019 to 2020, Giasson Corporation's working capital improved. It then deteriorated from 2020 to 2021, decreasing by $17,000.

A higher current ratio is evidence of better liquidity for a business, assuming all components of current assets are also liquid. The current ratio for Giasson has been deteriorating steadily from 2019 to 2021. The corporation remains liquid, as its current ratio was 1.5:1 in 2021.

A smaller debt to total assets ratio shows evidence of better solvency. The percentage of total liabilities to total assets increased from 2019 to 2020, showing deterioration in the solvency for Giasson. On the other hand, this ratio improved from 2020 to 2021. Less than half of the company's assets have been financed using debt.

The higher the basic earnings per share, the better evidence of improved profitability. Profitability increased from 2019 to 2020 but declined significantly from 2020 to 2021 indicating poorer profitability.

The investors appear to have less confidence in the future profitability of Giasson as evidenced by Giasson's price-earnings ratio which declined from 2019 to 2021.

b. Liquidity

Giasson's current ratio, although declining over the past two years, demonstrates adequate liquidity. There is $1.50 of current assets available to cover each $1 of current liabilities.

Solvency

Giasson's debt to total assets ratio, although deteriorating from 2019 to 2021, remains modest in size and so the solvency of the company continues to be good.

Profitability

Giasson's profitability is declining as is demonstrated by the basic earnings per share ratio and the price-earnings ratio.

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PROBLEM 2.9B

a. The objective of financial reporting is to provide information that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the company. Virginia's suggestions concerning how elements should be reported on the financial statements do not meet the objective of financial reporting. Two of her suggestions would lead to a violation of the fundamental basis on which financial statements are prepared: accrual accounting. The suggested changes to the financial statements would not portray the economic reality and would not faithfully represent the performance of the construction company and the financial position at its year end. Virginia's suggestions show bias and an attempt to portray a financial picture that would be perceived as more favourable than it is in reality.

b. 1. Failing to include the estimated expense and the related liability for the damages that have already occurred by the end of the year violates accrual accounting. The expense was incurred and a liability exists that can be estimated. The definitions of the elements have been met. Failing to include the expense would represent an error of omission done on purpose to increase the profitability and reduce the liabilities of the construction company at its year end.

2. The suggestion of increasing the revenues from construction would result not only in the recording of revenue but the recording of an accounts receivable. The revenue from construction has not been earned as no work has been performed. Furthermore, no account receivable should be recorded because no asset exists yet. Because revenue would be overstated if recorded, equity would also be overstated if Virginia's instructions were followed. Virginia's suggestions would not faithfully represent the reality of the performance of Ace Construction Limited for the current fiscal year.

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PROBLEM 2.9B (CONTINUED)

b. (continued)

3. Although there are no fixed repayment terms for the bank overdraft, the bank can require repayment on demand since no contract or agreement has been entered into to delay the repayment of the overdraft. For this reason, the classification of the bank overdraft as a non-current liability would falsely portray the financial position of Ace Construction Limited at the year end. When assessing the construction company's liquidity, the users of the financial statements would be misinterpreting the financial position because of this misclassification. Classifying the debt as non-current would not faithfully represent the economic reality of the construction company's liquidity position.

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PROBLEM 2.10B

a. The advantage of the fair value basis of accounting is that it represents a more up-to-date measurement of the value of the asset reported. Consequently, the amounts reported are more relevant to the financial statement users. The disadvantage of the fair value basis of accounting and corresponding advantage of historical cost is that historical cost is more reliable and shows the amount paid for the asset. The historical cost might provide a more faithful representation because it can be easily verified and is neutral.

b. The following is the recommended basis of measurement that should be used for the following purchases:

1. Due the nature of the asset, a textbook purchase should be recorded at the historical cost basis of accounting because of its intended use. The objective of owning the asset is to use it and not to immediately resell it at a profit.

2. In the case of an iPad, the use of the asset will be limited due to technological obsolescence. Because of this obsolescence, the iPad purchase should be recorded and reported using the historical cost basis of accounting.

3. Software is very similar to the iPad of item 2 above in that it becomes technologically obsolete very quickly. On the other hand, the manufacturer has recognized this problem and has included in the sale of the software, automatic upgrades to attempt to deal with the future needs and demands of the purchaser. This asset is purchased for use and not for resale at a gain and consequently, the historical cost basis of accounting should be used for its recording and reporting.

4. If the purchase of the used car is for use in the business, the historical cost basis of accounting should be used. On the other hand, if the purchase is for resale, the fair value basis of accounting should be used.

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PROBLEM 2.10B (CONTINUED)

b. (continued)

5. Since the intention of the buyer of land is to eventually build a home on the land, the purchase of the land should be recorded using the historical cost basis of accounting. If the intention changes over the years and the buyer decides to resell the property and intends to hold the land for resale at a gain, the reporting of the asset should change to the fair value basis of accounting used for investments, assuming the fair value is readily available.

LO 3 BT: E Difficulty: C Time: 30 min. AACSB: None CPA: cpa.t001 CM: Reporting

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CT2.1 FINANCIAL ANALYSIS CASE

Transaction	Current Assets	Current Liabilities	Retained Earnings	Cash Flow
Selling common shares for cash	Increase			Increase
Paying off an accounts payable	Decrease	Decrease		Decrease
Buying supplies on credit	Increase	Increase		
Borrowing money with payment due in 5 years	Increase			Increase
Buying land with cash	Increase Decrease			Decrease
Using up supplies	Decrease		Decrease	
Paying for prepaid insurance	Increase Decrease			Decrease
Using utilities that the company will pay for later		Increase	Decrease	
Collecting an accounts receivable	Increase Decrease			Increase

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CT2.2 FINANCIAL REPORTING CASE

a. Total current assets were $376,829,000 at January 31, 2019, and $335,003,000 at January 31, 2018.

Total assets were $1,022,921,000 at January 31, 2019, and $930,948,000 at January 31, 2018.

b. Current assets are listed in the order of liquidity from most to least liquid. Cash is the most liquid asset and is reported first. Non-current assets are listed in order of permanency, with property, plant, and equipment listed first.

c. The current liabilities total $176,881,000 at January 31, 2019, and $171,212,000 at January 31, 2018. The total liabilities at January 31, 2019 and January 31, 2018 were $601,817,000 and $548,792,000, respectively.

d. The current liabilities are listed in order of due date from those due first to those due last, with accounts payable and accrued liabilities listed first. It is not clear what order was chosen for non-current liabilities. Accounting standards do not suggest any particular order for the presentation of non-current liabilities.

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CT2.3 FINANCIAL ANALYSIS CASE

a.

	North West (in thousands)	Sobeys (in millions)
1. Working capital	$376,829 – $176,881 = $199,948	$2,622.9 – $2,672.4 = $(49.5)
2. Current ratio	$\frac{\$376,829}{\$176,881}$ = 2.1:1	$\frac{\$2,622.9}{\$2,672.4}$ = 1.0:1
3. Debt to total assets	$\frac{\$601,817}{\$1,022,921}$ = 58.8%	$\frac{\$5,389.0}{\$8,472.0}$ = 63.6%

b. Liquidity: Working capital is not comparable, because of the differing sizes of the two companies involved. However, using the current ratio to assess liquidity, we can determine that North West is significantly more liquid than Sobeys and well ahead of the industry average. Sobeys is in a difficult position of having a working capital deficiency.

Solvency: The higher a company's percentage of debt to total assets is, the greater the risk that this company may be unable to meet its maturing obligations. North West has a better ratio than the industry while Sobeys has a worse ratio.

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CT2.4 FINANCIAL REPORTING CASE

a. McCain's multinational structure means that accounting personnel from various countries are involved with preparing financial statements. Since IFRS is a global standard, most of the accounting personnel would be familiar with IFRS. Also, by using one standard across all subsidiaries, there is no need to make adjustments for various GAAP differences (this was often the case for Canadian multinationals prior to the adoption of IFRS). For McCain, it means that the company will reduce cost as well as the chance for errors.

In addition, the users of McCain's financial statements are located throughout the world. Those located in countries using IFRS, or wishing to compare McCain's financial statements to other global public companies, would better understand financial statements prepared using this standard.

b. Relevance – Researchers have found that companies who voluntarily adopt IFRS find that IFRS' accounting measures are better tools for evaluating performance. Therefore, IFRS statements are more relevant to McCain's management. Also, when global lenders are looking at financial statements prepared according to IFRS, they are no longer concerned about differences in GAAP. This increases the relevance to lenders.

Faithful Representation – In comparison to ASPE, IFRS requires more detailed information to be disclosed in the notes to the financial statements. From a user's perspective, more information and explanation are provided to help understand the economic event being depicted.

Comparability – McCain Foods is a global company that competes against various other global companies (most of whom follow IFRS). By adopting IFRS, it is easier for McCain to compare its results to other similar companies. This information would be useful to both internal users (management) as well as external (lenders).

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CT2.4 (CONTINUED)

b. (continued)

Understandability – When different accounting standards are used by various companies within a corporate group, they are less understandable. Furthermore, when users are not resident in the country where the head office of the company is located, they often have a difficult time understanding financial statements that are presented using standards that they are not familiar with. For instance, a McCain manager in a United States subsidiary that follows U.S. GAAP may have difficulty understanding the statements of a McCain subsidiary located in the U.K. (that follows IFRS).

c. The assumption that small companies would avoid IFRS can relate to many things like:

i. Not planning to take their company public in the future;
ii. They like the simplicity and familiarity of ASPE;
iii. They have many competitors, customers, and suppliers that use ASPE which makes their financial statements comparable and understandable.

Examples of why private companies may adopt IFRS:

i. Private companies that plan to be public sometime in the near future or who have foreign private investors, may choose to adopt IFRS.
ii. Private companies that have global shareholders or lenders (who are more familiar with IFRS). They may also want to provide financial statements to customers.

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CT2.5 FINANCIAL ANALYSIS CASE

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. Sheila paid $25,000 for 10,000 common shares of Kenmare Architects Ltd. (or $2.50 per share) when the company was formed. This amount is reported as the balance in the Common Shares account on the statement of financial position of December 31, 2020.

Sheila's mother paid $10,000 for 1,000 common shares (or $10.00 per share) in early 2021. This amount paid can be determined by calculating the increase of $10,000 ($35,000 less $25,000) in the Common Shares account on the statement of financial position of December 31, 2021.

b. By December 31, 2020, Uncle Harry wanted $8,000 of the loan paid off in 2021. This amount is classified as the current portion of the loan due at December 31, 2020. The actual amount of principal paid in 2021 was $30,000. This amount paid can be determined by calculating the total decrease in the loan payable from December 31, 2020 to December 31, 2021: [($52,000 + $8,000) less ($26,000 + $4,000)]. During 2020, Uncle Harry received only interest, in the amount of $3,600, as indicated in the statement of income for interest expense. In 2021, Uncle Harry received $32,700. This amount is equal to the principal repayment of $30,000 and the interest of $2,700.

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CT2.5 (CONTINUED)

c.

	2021		2020	
Current ratio	$46,000 / $33,580	= 1.4:1	$31,000 / $22,490	= 1.4:1

Although the current ratio is unchanged, we need to further examine the account balances that make up the ratio. There has been deterioration in liquidity due to the declining cash balance and a significant rise in accounts receivable which may indicate difficulty in collecting amounts owed from customers. This decreased cash flow from customers has probably caused the increase in accounts payable, as the company seems to have delayed payment to suppliers.

d.

	2021		2020	
Debt to total assets	$59,580 / $106,000	= 56.2%	$74,490 / $103,000	= 72.3%

Kenmare's solvency improved significantly. The decrease in the ratio occurred mainly because of changes in the numerator rather than in the denominator. Total liabilities fell because of the large pay down of the loan from the uncle even though accounts payable rose. This had an impact on the statement of income by lowering interest expense because of the lower loan balance. Because Kenmare's debt level is lower, the amount of interest expense is also lower, making the business more profitable.

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CT2.5 (CONTINUED)

e.

	2021		2020	
Basic earnings per share	$\frac{\$7,910}{11,000}$	= $0.72	$\frac{\$3,510}{10,000}$	= $0.35

The basic earnings per share more than doubled because net income more than doubled while there was only a 10% increase in the number of shares.

f. Sheila paid $2.50 per share for her shares ($25,000 ÷ 10,000). The amount Sheila's mother paid for her shares was $10.00 per share ($10,000 refer to part (a) above ÷ 1,000).

	2021		2020	
Price-earnings ratio	$\frac{\$10.00}{\$0.72}$	= 13.9 times	$\frac{\$2.50}{\$0.35}$	= 7.1 times

The service revenue increased 20% from 2020 to 2021 [($120,000 – $100,000) ÷ $100,000]. The net income increased by 125% from 2020 to 2021 [($7,910 – $3,510) ÷ $3,510]. Sheila's salary increased by 25% from 2020 to 2021 [($74,000 – $59,000) ÷ $59,000].

The price-earnings ratio changed mostly because of the price difference paid by the two shareholders. Sheila's mother paid four times the price Sheila paid for her shares. This increase is very dramatic, taking into account other ratios for measurement of performance.

The fourfold increase in the share price is not justified by the financial performance of the business. The future profitability of the business is based on the amount of service revenue that can be generated by the single employee, Sheila, and is therefore limited.

g. The likely reason for the sale in shares in 2021 was to obtain $10,000, which was used to repay the debt to Uncle Harry earlier than originally scheduled.

LO 1,2 BT: AN Difficulty: C Time: 40 min. AACSB: Analytic CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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CT2.6 DATA ANALYTICS CASE

a.
1. Permanent address location
2. Citizenship
3. Prior education and grades
4. Age
5. Gender
6. Prior courses or programs
7. Grades obtained on prior courses taken at institution
8. Number of courses dropped
9. Number of course repeated
10. Program change history
11. Past payment history including any delinquencies
12. Payment method

b. Ordering and supplying of support material and textbooks are based on projected enrolment. The bookstore would want to ensure that there would be no stockouts for any of the material in order to maximize sales. The student ID card would be used to access sport facilities provided by the college or university. Data on usage and time of day when the facilities are used could help in the planning and delivery of the service to maximize fees for this service. Student ID cards are used to access health services, photocopying or reproduction services, meal plans and parking passes, all of which would benefit from knowing the type of service provided, any trends in demand and pricing information to better serve students and generate the most revenue.

c. Sensor data on vending machines can provide feedback on the type of products that are in demand, and any trends in pricing information. Comparing levels of sales of different machines at different locations on campus will provide information on the optimal selection of future locations for vending machines.

d. Admission requirements often draw on grades history to decide on whether or not a student is eligible for enrollment. During the delivery of a program, academic advisors can draw on grades information to determine if a student requires additional assistance, counselling or if they should be allowed to progress in a particular program or be placed on probation. Academics, with the aid of the grades data can determine if the student has satisfied the requirement of the program of study to determine if a degree or certificate can be awarded. Upon request, official transcripts of grades are issued as proof of attendance, grades and graduation status used by potential employers or by other educational institutions, governing bodies or associations in the field of study.

LO 2 BT: AN Difficulty: M Time: 20 min. AACSB: Analysis CPA: cpa.t001 CM: Reporting

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CT2.7 ETHICS CASE

a. The stakeholders in this case are:

Kathy Onishi, controller
Redondo's vice-president of finance
Users of the company's financial statements, including shareholders and creditors

b. The ethical consideration in this situation is whether or not switching from ASPE to IFRS would affect the decisions of the users of the financial statements. Because Redondo Corporation is a private corporation, the use of IFRS is not required. It is ethically preferable to disclose the most financially relevant information to the users of the financial statements so that they can make informed decisions. One should question the reasoning of Redondo's vice-president of finance, who is focusing on the effect of the implementation on the net income for the year.

c. As the controller, by supporting the conversion from ASPE to IFRS, Kathy could gain the trust and respect of the board of directors and the shareholders in general. The users of the company's financial statements will find the information provided under IFRS to be more useful in making comparisons with Redondo's competitors. This in turn will lead to better decisions being made by users of the financial statements.

Stakeholders most affected by retaining ASPE include management of the business (including the board of directors), creditors, shareholders, and potential new shareholders.

LO 3 BT: E Difficulty: M Time: 15 min. AACSB: Ethics CPA: cpa.t001 and cpa.t005 CM: Reporting and Finance

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CT2.8 SERIAL CASE

a. Software Solutions' financial statements will include the statement of financial position, statement of income, statement of changes in equity, and statement of cash flows. It may also include a statement of comprehensive income. It will also include the notes to the financial statements.

The statement of financial position reports the assets, liabilities, and shareholders' equity at a specific date. The statement of income presents the revenues and expenses and resulting net income or loss for a specific period of time. The statement of changes in equity summarizes the changes in equity accounts, including common shares and retained earnings, for a specific period of time. Finally, the statement of cash flows provides information about the cash inflows and cash outflows provided or used for operating, investing, and financing activities for a specific period of time.

b. Because Software Solutions is a public company, it is required to have its financial statements audited. The auditor's report provides users with assurance that the financial statements are fairly presented. As a public company, Software Solutions is also required to file its financial statements on a timely basis with the regulator of the stock exchange on which its shares trade.

c. By looking at the statement of financial position and determining the composition of Software Solutions' current assets and current liabilities, we can assess its ability to pay its short-term obligations. We can also calculate liquidity ratios, such as working capital and the current ratio, for the current and prior periods to help determine its ability to meet its current obligations. This will not guarantee that Software Solutions is able to pay ABC's invoices in the future, but it will provide some assurance with respect to how it has performed in the past. The statement of cash flows also provides information to determine if Software Solutions generates positive cash flows from its operating activities.

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CT2.8 (CONTINUED)

d. By looking at the types of revenues and expenses reported in the statement of income, we can determine if Software Solutions is profitable. If revenues earned by Software Solutions exceed expenses incurred, then Software Solutions is profitable. As well, profitability ratios that measure a company's ability to generate net income over a period of time can be determined. These profitability ratios include basic earnings per share and the price-earnings ratio. The latter measures investors' expectations about Software Solutions' future profitability.

e. By looking at the statement of financial position, we can determine Software Solutions' total liabilities, and the mix of current and non-current debt. We can also calculate solvency ratios, such as the debt to total assets ratio, to determine whether Software Solutions has the ability to repay its total debt. Solvency ratios help measure a company's ability to survive over a long period of time.

Reviewing the company's statement of income and statement of cash flows helps in determining whether Software Solutions is able to pay its interest expense. The more profitable the company, the better able it is to make the interest payments on its debt and generate sufficient cash to repay its obligations.

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CT2.8 (CONTINUED)

f. Be aware that the financial statements of Software Solutions provide a historical perspective of what has already taken place. The financial statements may not prove to be the best indicator of what will happen in the future. Consumer tastes change and as a result the demand for Software Solutions' products may also change.

As well, consider this business opportunity from your perspective. Ask yourself if the price obtained for the hours worked is reasonable, considering some of the risks involved. There is a risk that, by taking on this obligation, additional opportunities cannot be pursued. Does Anthony Business Company have the ability to meet the demands of Software Solutions? Is it able to commit to providing 500 hours of service per month? Does it have enough staff to enable the company to do so? Does it have enough cash to pay for the staff that will be required, along with other operating expenses, and wait 30 days from the date of the invoice to collect from Software Solutions?

LO 2,3 BT: E Difficulty: M time: 40 min. AACSB: Analytic CPA: cpa.t001 CM: Reporting

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