Financial Accounting 2026 (Canadian) 1st edition Libby Solutions Manual

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Chapter 1
Financial Statements and Business Decisions

Revised: November 23, 2025

ANSWERS TO QUESTIONS

1. Accounting is a system that collects and processes (analyzes, measures, and records) financial information about an organization and reports that information to decision makers.

2. Financial accounting involves the preparation of the basic financial statements and related disclosures for external decision makers. Reporting is generally on a quarterly and annual basis. Managerial accounting involves the preparation of detailed plans, budgets, forecasts, and performance reports for internal decision makers. Reporting is on an ongoing basis.

3. Financial reports are used by both internal and external groups and individuals. The internal users are the various managers of the entity, e.g. marketing, credit, and purchasing. The external groups include the owners, investors, creditors, governmental agencies, other interested parties, and the public at large.

4. Investors purchase all or part of a business and hope to gain by receiving part of what the company earns and/or by selling their share of the company in the future at a higher price than they paid. Creditors lend money to a company for a specific length of time and hope to gain by charging interest on the loan.

5. An accounting entity is the organization for which financial data are to be collected. Typical accounting entities are a business, a church, a governmental unit, a university, and other nonprofit organizations such as a hospital. A business is defined and treated as a separate entity because the owners, creditors, investors, and other interested parties need to evaluate its performance and its potential separately from other entities and from its owners.

6.

Name of Statement	**Alternative Title**
a. Statement of earnings	Income statement
b. Statement of financial position	Balance sheet
c. Statement of cash flows	Cash flow statement

7. The heading of each of the four required financial statements should include the following:
   (a) Name of the entity
   (b) Title of the statement
   (c) Specific date or the period of time it covers
   (d) Unit of measure

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8. (a) The purpose of the statement of earnings is to present information about the revenues, expenses, and the net earnings of the entity for a specified period of time, in order to help assess its financial performance during that period.
   (b) The purpose of the statement of financial position is to report the financial position of an entity at a given date, that is, to report information about the assets, obligations, and shareholders' equity of the entity as at a specific date.
   (c) The statement of changes in equity reports the way that net earnings, the distribution of net earnings (dividends), and other changes to shareholders' equity affected the company's financial position during the accounting period. The focus in this chapter is on retained earnings. Net earnings for the year increases the balance of retained earnings whereas the declaration of dividends to the shareholders decreases retained earnings.
   (d) The purpose of the statement of cash flows is to present information about the flow of cash into the entity (sources), the flow of cash out of the entity (uses), and the net increase or decrease in cash during the period.

9. The statement of earnings and the statement of cash flows are dated "For the Year Ended December 31" because they report the inflows and outflows of resources during a period of time. In contrast, the statement of financial position is dated "At December 31" because it represents the resources, obligations, and shareholders' equity as at a specific date, December 31.

10. Assets are important to investors and creditors because assets provide a basis for judging whether sufficient resources are available to operate the company. Liabilities are important to creditors and investors because the company must be able to generate sufficient cash from operations or seek further borrowing to meet the payments required by debt agreements. If a business does not pay its creditors, the law may give the creditors the right to force the sale of assets sufficient to meet the creditors' claims.

11. Net earnings is the excess of total revenues over total expenses. Net loss is the excess of total expenses over total revenues.

12. The accounting equation for the statement of earnings is Revenues – Expenses = Net earnings. Revenues result from the sale of goods and services to customers, regardless of the timing of collection of cash from customers. Expenses represent the monetary value of resources the entity used up, or consumed, to earn revenues during the period. Net earnings is simply the excess of revenues over expenses.

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13. The accounting equation for the statement of financial position is:

Assets = Liabilities + Shareholders' Equity

Assets are the probable (expected) future economic benefits owned by the entity as a result of past transactions. They are the resources owned by the business at a given point in time such as cash, accounts receivable, merchandise inventory, machinery, buildings, land, and patents. Liabilities are probable (expected) debts or obligations of the entity as a result of past transactions that will be discharged with assets (usually cash) or services in the future. They are the obligations of the entity such as accounts payable and notes payable. Shareholders' equity is financing provided by owners of the business and by the net earnings generated from the operations of the business. It is the claim of the owners to the assets of the business after the creditors' claims have been satisfied. Shareholders' equity may be thought of as the residual interest because it represents assets minus liabilities.

14. The accounting equation for retained earnings is:

Beginning retained earnings + Net earnings – Dividends = Ending retained earnings

The equation begins with beginning-of-the-year retained earnings, i.e., the prior year's ending retained earnings reported on the statement of financial position. The current year's net earnings reported on the statement of earnings is added to this amount and the dividends declared during the current year are subtracted from this amount. The ending retained earnings amount is reported on the end-of-period statement of financial position.

15. The accounting equation for the statement of cash flows is:

Cash flows from operating activities
+/– Cash flows from investing activities
+/– Cash flows from financing activities
= Change in cash for the period.

The net cash flows for the period represent the increase or decrease in cash that occurred during the period. Cash flows from operating activities are cash flows directly related to earning income (normal business activity including interest paid and income taxes paid). Cash flows from investing activities comprise cash flows that are directly related to the acquisition or sale of productive assets used by the company, such as plant and equipment. Cash flows from financing activities consist of cash flows that are directly related to the financing of the enterprise, such as issuing shares to investors.

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16. Credit managers use customers' financial statements to decide whether to extend them credit for their purchases. Purchasing managers use potential suppliers' financial statements to judge whether the suppliers have the resources necessary to meet current and future demand. Human resource managers use the financial statements as a basis for contract negotiations to determine, for example, what pay rates the company can afford. The net earnings figure can also serve as a basis to pay bonuses not only to management, but to other employees through profit-sharing plans.

17. In Canada, provincial securities legislation created securities commissions, most notably the Ontario Securities Commission (OSC), to regulate Canadian capital markets and the flow of financial information provided by publicly traded companies whose shares trade on Canadian stock exchanges, such as the Toronto Stock Exchange. Similar to the SEC, the OSC plays an influential role in promoting sound accounting practices by publicly traded companies. Since their establishment, these securities commissions have worked with organizations of professional accountants to establish groups that are given the primary responsibilities to work out the detailed rules that Canadian entities must use. The name of the current Canadian group that has this responsibility is the **Accounting Standards Board (AcSB)**. The AcSB is responsible for establishing standards of accounting and reporting by Canadian companies and not-for-profit organizations.

18. The officers of the company, usually the Chief Executive Officer and the Chief Financial Officer, must personally sign a certification that they have designed or supervised the design, implementation, and evaluation of effective, appropriate financial accounting and reporting processes. The executives and officers of the company bear primary responsibility for information prepared and reported in the financial statements and other information contained in the annual report. Top management also nominates members to the Board of Directors to oversee the integrity of the first two safeguards. Those owning shares of the firm vote to elect the Board of Directors, which holds the officers of the company accountable to the shareholders for defects in the internal control and reporting system. It also appoints external, independent auditors who provide advice to companies on how to best comply with regulations on financial reporting.

19. A sole proprietorship is an unincorporated business owned by one individual. A partnership is an unincorporated association of two or more individuals to carry on a business. A corporation is a business that is organized under federal or provincial laws, whereby a charter is granted, and the entity is thus authorized to issue shares as evidence of ownership by the owners (i.e., shareholders). Corporations are legal entities separate from their owners, but sole proprietorships and partnerships are not.

20. Public practice accounting firms normally render three types of service: assurance services, management advisory services, and tax services. Assurance services, including auditing, involves examination of the records and financial statements to determine whether they "fairly present" the financial position and results of operations of the entity in accordance with the applicable accounting standards. Management advisory (consulting) services include providing expert business advice to management. Tax services involve providing tax-planning advice to clients (both individuals and businesses) and preparation of their tax returns.

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Authors' Recommended Solution Time

(Time in minutes)

Mini-Exercises		*Exercises*		*Problems*		*Alternate Problems*		*Cases and Projects*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	5 E	1	12 E	1	45 M	1	45 M	1	30 E
2	5 E	2	20 M	2	60 D	2	60 D	2	20 E
3	5 E	3	25 M	3	30 M	3	30 M	3	30 M
		4	20 M	4	45 M			4	60 M
		5	15 M	5	20 M			5	25 M
		6	20 M			*Continuing Problem*		6	25 M
		7	20 M					7	25 M
		8	25 E			1	45 M	8	*
		9	30 M						
		10	10 E						
		11	20 M						
		12	10 E						

E = Easy M = Moderate D = Difficult

* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

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MINI-EXERCISES

M1–1

	Element	Financial Statement
B	(1) Expenses	A. Statement of financial position
D	(2) Cash flow from investing activities	B. Statement of earnings
A	(3) Assets	C. Statement of shareholders' equity
C*	(4) Dividends	D. Statement of cash flows
B	(5) Revenues	
D	(6) Cash flow from operating activities	
A	(7) Liabilities	
D	(8) Cash flow from financing activities	

*Dividends paid in cash are normally subtracted in the financing section of the statement of cash flows, but IFRS allows companies to report dividends paid in the operating section as well. This issue is covered in Chapter 11.

M1–2

SE	(1) Retained earnings
A	(2) Accounts receivable
R	(3) Sales revenue
A	(4) Property and equipment
E	(5) Cost of sales
A	(6) Inventories
E	(7) Interest expense
L	(8) Accounts payable
A	(9) Land

M1–3

	Abbreviation	Full Designation
(1)	AcSB	Accounting Standards Board
(2)	IFRS	International Financial Reporting Standards
(3)	CPA	Chartered Professional Accountant
(4)	IASB	International Accounting Standards Board

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EXERCISES

E1–1

		Term or Abbreviation	Definition
J	(1)	OSC	A. A system that collects and processes financial information about an organization and reports that information to decision makers
F	(2)	Audit	B. Measurement of information about an entity in terms of the dollar or other national monetary unit
H	(3)	Sole proprietorship	C. An unincorporated business owned by two or more persons
E	(4)	Corporation	D. The organization for which financial data are to be collected (separate and distinct from its owners)
A	(5)	Accounting	E. An incorporated entity that issues shares as evidence of ownership
D	(6)	Accounting entity	F. An examination of the financial reports to ensure that they represent what they claim and conform with international financial reporting standards
I	(7)	Audit report	G. Chartered professional accountant
L	(8)	Publicly traded	H. An unincorporated business owned by one person
C	(9)	Partnership	I. A report that describes the auditor's opinion of the fairness of the financial statement presentations and the evidence gathered to support that opinion
K	(10)	AcSB	J. Ontario Securities Commission
G	(11)	CPA	K. Accounting Standards Board
B	(12)	Unit of measure	L. A company with shares that can be bought and sold by investors on established stock exchanges
M	(13)	IFRS	M. International Financial Reporting Standards

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E1–2

Req. 1

Leon's Furniture Limited
Statement of Financial Position
As at December 31, Current Year
(in millions of Canadian dollars)

Assets	
Cash and cash equivalents	$ 83
Trade receivables	198
Inventories	417
Property, plant, and equipment	652
Intangible assets and goodwill	661
Other assets	211
Total assets	$2,222
Liabilities and Shareholders' Equity	
Liabilities	
Trade and other payables	$ 283
Dividends payable	12
Income taxes payable	4
Long-term debt	453
Other liabilities	441
Total liabilities	1,193
Shareholders' equity	
Contributed capital	165
Retained earnings	857
Other components of equity	7
Total shareholders' equity	1,029
Total liabilities and shareholders' equity	$2,222

Req. 2

Dividends payable represents the amount of dividends that has not been paid yet to the company's shareholders. Retained earnings represent the amount of earnings that has accumulated over time but has not been distributed to shareholders. Total assets reflect the monetary value of the resources that are available to the company for use in generating revenue over time.

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E1–3

Req. 1

READ MORE STORE
Statement of Financial Position
As at December 31, Current Year

ASSETS		**LIABILITIES AND SHAREHOLDERS' EQUITY**	
		Liabilities	
Cash	$ 48,900	Accounts payable	$ 7,000
Accounts receivable	25,000	Note payable	3,000
Store and office equipment	49,000	Interest payable	120
		Total liabilities	10,120
		Shareholders' Equity	
		Contributed capital	100,000
		Retained earnings	12,780
		Total shareholders' equity	112,780
Total assets	$122,900	Total liabilities and shareholders' equity	$122,900

Req. 2

This is the first year of operations and no dividends were declared. Therefore, the balance of retained earnings, $12,780, at year-end consists entirely of the net earnings for the first year.

E1–4

Req. 1

THE UNIVERSITY SHOP
Statement of Earnings
For the Month of September, Current Year

Revenue from sales		$120,000 *
Expenses:		
Cost of sales	$ 40,000	
Salaries, rent, supplies, advertising, and other expenses	38,000	
Utilities	600	
Total expenses		78,600
Net earnings for the period		$ 41,400

* $119,000 + $1,000 = $120,000
(Note: income taxes were ignored in this problem.)

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E1–4 (continued)
Req. 2

This statement of earnings indicates that The University Shop is a profitable company. Although the net earnings amount does not reflect the amount of cash available at the end of September, the cash transactions indicate that the cash available is sufficiently large to cover the cost of the cash register.

E1–5

SYSCO CORPORATION
Statement of Earnings
For the Year Ended June 30, Current Year
(in millions of U.S. dollars)

Revenues:		
Sales	$76,325	
Other revenues	227	
Total revenues		$76,552
Expenses:		
Cost of sales	62,370	
Selling, general, and administration expenses	10,916	
Interest expense	527	
Total expenses		73,813
Earnings before income taxes		2,739
Income tax expense		515
Net earnings		$ 2,224

E1–6

CORUS ENTERTAINMENT INC.
Statement of Earnings
For the Year Ended August 31, Current Year
(in thousands)

Revenues	$1,071,328	($1,594,989 – $523,661)
Cost of sales	671,915	
Depreciation expense	157,645	
General and administrative expenses	505,320	
Other expenses (income), net	124,699	
Interest expense	135,410	
Total expenses excluding income taxes	1,594,989	(sum of all the expenses above)
Earnings (loss) before income tax	(523,661)	(= $422,855 + $100,806)
Income tax expense (recovery)	(100,806)	
Net earnings (loss)	$ (422,855)	

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E1–7

HOME REALTY INC.
Statement of Earnings
For the Year Ended December 31, Current Year

Revenue:		
Commissions ($150,000 + $16,000)	$166,000	
Rental service fees	15,000	
Total revenues		$181,000
Expenses:		
Salaries	62,000	
Commissions	35,000	
Payroll taxes	2,500	
Rent ($2,200 + $200)	2,400	
Utilities	1,600	
Promotion and advertising	8,000	
Miscellaneous	500	
Total expenses (excluding income taxes)		112,000
Earnings before income taxes		69,000
Income tax expense		18,500
Net earnings		$ 50,500

E1–8

A Net Earnings = $91,700 – $76,940 = $14,760;
Shareholders' Equity = $140,200 – $69,000 = $71,200.

B Total Revenues = $74,240 + $14,740 = $88,980;
Total Liabilities = $107,880 – $79,010 = $28,870.

C Net Earnings (Loss) = $69,260 – $76,430 = $(7,170);
Shareholders' Equity = $97,850 – $69,850 = $28,000.

D Total Expenses = $58,680 – $21,770 = $36,910;
Total Assets = $17,890 + $78,680 = $96,570.

E Net Earnings = $84,840 – $78,720 = $6,120;
Total Assets = $25,520 + $79,580 = $105,100.

Company B is a profitable company whereas Company C is not. In addition, Company C's liabilities are relatively much higher than those of Company B. Consequently, lending money to Company C is riskier than lending money to Company B, which appears to have a better capacity to repay the loan over time.

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E1–9

DUCHARME CORPORATION
Statement of Earnings
For the Month of January, Current Year

Total revenues	$299,000
Less: Total expenses (excluding income taxes)	189,000
Earnings before income taxes	110,000
Less: Income tax expense	34,500
Net earnings	$ 75,500

DUCHARME CORPORATION
Statement of Financial Position
As at January 31, Current Year

Assets	
Cash	$ 65,150
Receivables from customers	34,500
Merchandise inventory	96,600
Total assets	$196,250
Liabilities and Shareholders' Equity	
Liabilities	
Payables to suppliers	$ 26,450
Income taxes payable	34,500
Total liabilities	60,950
Shareholders' equity	
Contributed capital (2,600 shares issued)	59,800
Retained earnings	75,500
Total liabilities and shareholders' equity	$196,250

E1-10

Retained earnings, January 1, 2026	$ –
Net earnings for 2026	31,000
Dividends for 2026	(14,200)
Retained earnings, December 31, 2026	16,800
Net earnings for 2027	42,000
Dividends for 2027	(18,700)
Retained earnings, December 31, 2027	$ 40,100

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E1–11

1. Average amount of monthly revenue, $216,000 ÷ 12 = $18,000.
2. Amount of monthly rent, $21,000 ÷ 12 = $1,750.
3. "Supplies, $25,000" is an expense because it represents the cost of supplies used in performing the services sold.
4. "Interest" is an expense because it represents the cost of borrowing. The company has an outstanding loan (from another party); $8,000 is the amount of interest (owed, if not already paid) on that debt for the current year. The interest on the loan for the current year is an expense of the year (whether or not paid by December 31 of current year).
5. Average income tax rate, $21,000 ÷ $60,000 = 35%.
6. For an external decision maker as well as any user of financial statements, revenues represent amounts expected to be received for goods or services that have been delivered to customers, whether or not cash has been received for the goods or services. For Pest Away Corporation, most of the revenues were made for cash and a small percentage of revenues were made on account.
7. The statement of earnings does not report, or make it possible to determine, the ending cash balance. Cash is reported on the statement of financial position under assets and on the statement of cash flows as the final amount reported.

E1–12

(O)	(1)Cash paid to suppliers
O	(2)Cash received from customers
(F)*	(3)Dividends paid
F	(4)Issuance of share capital
(O)**	(5)Interest paid
I	(6)Proceeds from disposal of investment
(I)	(7)Purchases of property, plant, and equipment
(F)	(8)Repurchase of share capital

*Dividends paid in cash are normally subtracted in the financing section of the statement of cash flows, but IFRS allows companies to report dividends paid in the operating section as well. This issue is covered in Chapter 11.

**Interest paid can also be subtracted in the financing section of the statement of cash flows, which is permitted under IFRS. This issue is covered in Chapter 11.

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PROBLEMS

*(**Note to the instructor**: Most students find the Problems in this chapter to be quite challenging.)*

P1–1

Req. 1

NUCLEAR COMPANY
Statement of Earnings
For the Year Ended December 31, Current Year

Total sales revenue (given)	$140,000
Total expenses, excluding income taxes (given)	89,100
Earnings before income taxes	50,900
Income tax expense ($50,900 x 30%)	15,270
Net earnings	$ 35,630

Req. 2

NUCLEAR COMPANY
Statement of Shareholders' Equity
For the Year Ended December 31, Current Year

	Contributed Capital	Retained Earnings
Balance, January 1, current year	$ –	$ – *
Issuance of shares (given)	87,000	–
+Net earnings (from req. 1)	–	35,630
Balance, December 31, current year	$87,000	$35,630

* Because this is the first year of operations, these beginning balances are zero.

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P1–1 (continued)

Req. 3

NUCLEAR COMPANY
Statement of Financial Position
As at December 31, Current Year

Assets		
Cash (given)		$ 25,000
Accounts receivable (given)		12,000
Merchandise inventory (given)		90,000
Equipment, net (given)		45,000
Total assets		$172,000
Liabilities and Shareholders' Equity		
Liabilities		
Accounts payable (given)	$47,370	
Salary payable (given)	2,000	
Total liabilities		$ 49,370
Shareholders' equity		
Contributed capital (given)	87,000	
Retained earnings	35,630	
Total shareholders' equity		122,630
Total liabilities and shareholders' equity		$172,000

Req. 4

Based on the statement of financial position, Nuclear Company has $122,630 in total shareholders' equity compared to $49,370 in total liabilities. This indicates that the company relies more on shareholders than on creditors in financing its resources at December 31.

Req. 5

A creditor will know that $12,000 will be received by this company within a short period but that it must also pay suppliers $47,370, also within a short period. When making a lending decision, a creditor would use this information to determine the likelihood that the company could repay a loan.

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P1–2

Req. 1

KAL'S PLUMBING SERVICES INC.
Statement of Earnings
For the Six Months Ended December 31, Current Year

Revenue from services ($96,000 + $9,000)		$105,000
Expenses:		
Wages for plumber's assistant	$25,500	
Payroll taxes	1,025	
Oil, gas, and maintenance – truck	3,600	
Rent ($3,750 + $750)	4,500	
Supplies used	25,150	
Utilities and telephone	2,775	
Insurance	1,050	
Miscellaneous expenses	1,350	
Depreciation of truck and tools	3,600	
Total expenses		68,550
Earnings before income taxes		36,450
Income tax expense ($36,450 x 30%)		10,935
Net earnings		$ 25,515

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P1–2 (continued)

Req. 2

KAL'S PLUMBING SERVICES INC.
Statement of Financial Position
As at December 31, Current Year

Assets		
Cash[1]		$36,300
Accounts receivable		9,000
Equipment ($27,000 + $4,500)	$31,500	
Less: Depreciation	(3,600)	27,900
Total assets		$73,200
Liabilities and Shareholders' Equity		
Liabilities		
Accounts payable	$ 750	
Income tax payable	10,935	
Total liabilities		11,685
Shareholders' equity		
Contributed capital (initial investment)	36,000	
Retained earnings	25,515	61,515
Total liabilities and shareholders' equity		$73,200

[1] Cash balance = 36,000 – 27,000 – 4,500 + 96,000 – (68,550 – 750 – 3,600) = 36,300

Req. 3

The above two reports reflect the assets, liabilities, shareholders' equity, revenues, expenses, and net earnings, but not the sources and uses of cash. Therefore, it is reasonable to assume that Kal would have needed a statement of cash flows. This will show Kal whether cash increased or decreased during a given period, and the main reasons for the change. A statement of changes in equity would also provide useful information, whether dividends are declared or not.

Req. 4

The statement of earnings indicates to Kal that his business is profitable, and that he can possibly increase his net earnings if he wishes to expand his business. The statement of financial position suggests that his financial situation is quite strong and the information therein can be used to determine how much money he could borrow, if necessary.

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P1–3

Req. 1			***Req. 2–Explanation***
Transaction	*Net earnings*	*Cash*	
(a)	$+85,000	$+70,000	All services performed increase net earnings; cash received during the period was $85,000 – $15,000.
(b)	–0–	+25,000	Cash borrowed is not earnings.
(c)	–0–	–8,000	Purchase of the truck does not represent an expense because the truck is an asset and it has not been used yet.
(d)	–36,000	–30,000	All of the wages incurred reduce net earnings, $36,000; cash paid during the quarter was $36,000 x 5/6 = $30,000.
(e)	–3,000	–4,000	Not all of the supplies were used; expense is the amount used, $4,000 – $1,000 = $3,000.
(f)	–31,000	–15,500	All expenses incurred reduce net earnings; cash paid was $31,000 x ½ = $15,500.
Based only on the above:			
- Net earnings	$15,000		
- Cash inflow		$37,500	

P1–4

Req. 1

The personal residences of the organizers are not resources of the business entity. Therefore, they should be excluded.

Req. 2

It is not indicated whether the $7,000 listed for service supplies and the $68,000 listed for service trucks and service equipment reflect their cost when acquired or the current market value on December 31, the current year. Furthermore, the amounts due from customers may not represent the potentially collectible amount. No details are provided on depreciation rates for the trucks or equipment.

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P1–4 (continued)

Req. 3

The list of company resources (i.e., assets) suggests the following areas of concern:

Company resources:

(1) Service trucks and service equipment – as noted above, it is not indicated whether the $68,000 for service trucks and the $30,000 for service equipment are the cost when acquired or the current market value on December 31, current year. No depreciation details are provided.

(2) Personal residences – as noted above, these items are not resources of the business entity and should be excluded. Usually they would not be subject to creditors' claims against the corporation.

The list of company obligations (i.e., liabilities) suggests the following areas of concern:

Company obligations:

(1) Unpaid wages of $19,000, which are now due, pose a serious problem because only $12,000 cash currently is available.

(2) Unpaid taxes and accounts payable to suppliers – it is not clear when these payments of $8,000 and $10,000, respectively, are due (cash needed to pay them is a problem).

(3) The $50,000 owed on the service trucks is probably long term; however, short-term instalments may be required – these details are very important to the bank.

(4) Loan from organizer – the expected payment date and interest rate are important issues for which details are not provided. This is a major potential cash demand.

In general, the bank should request more details about the specific resources and debts. The personal residences are not a part of the resources of the business entity. The bank should request that the owners provide audited information about the entity's assets and debts.

Req. 4

The amount of shareholders' equity (i.e., assets minus liabilities) for West Company, assuming the amounts provided by the owners are acceptable, would be:

Assets ($322,000 – $190,000)	$132,000
Liabilities	102,000
Shareholders' equity	$ 30,000

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P1-5

Req. 1

	Cash Received	*Balances Immediately After Sale*			
Case	*for the Assets*	*Assets*	*–*	*Liabilities*	*= Shareholders' Equity*
A	$90,000	$90,000		$50,000	$40,000
B	80,000	80,000		50,000	30,000 (note 1)
C	100,000	100,000		50,000	50,000 (note 2)
D	35,000	35,000		50,000	–15,000 (note 3)

Note 1: Includes $10,000 loss on sale of assets, i.e., $80,000 minus $90,000.
Note 2: Includes $10,000 gain on sale of assets, i.e., $100,000 minus $90,000.
Note 3: Includes $55,000 loss on sale of assets, i.e., $35,000 minus $90,000, which results in a negative shareholders' equity of –$15,000.

Req. 2

Case	*To Creditors*	*To Shareholders*	*Total*
A	$50,000	$40,000	$90,000
B	50,000	30,000	80,000
C	50,000	50,000	100,000
D	35,000	-0-	35,000

Explanation: Legally, creditors' claims have a priority over shareholders' claims. Therefore, cash necessary to satisfy all creditors' claims would be disbursed first. Any remaining cash would be distributed to the owners in proportion to their ownership interests. In case D, creditors do not get all of the money owed to them and shareholders do not get any cash, because the total amount of cash is not sufficient to pay the creditors the total amount due to them.

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ALTERNATE PROBLEMS

AP1–1

Req. 1

MCCLAREN CORPORATION
Statement of Earnings
For the Year Ended June 30, Current Year

Total sales revenue (given)	$90,000
Total expenses, excluding income taxes (given)	60,500
Earnings before income taxes	29,500
Income tax expense ($29,500 x 30%)	8,850
Net earnings	$20,650

Req. 2

MCCLAREN CORPORATION
Statement of Shareholders' Equity
For the Year Ended June 30, Current Year

	Contributed Capital	Retained Earnings
Balance July 1, last year	$ – *	$ – *
Issuance of shares (note)	62,000	–
+Net earnings (from req. 1)	–	20,650
Balance June 30, current year	$62,000	$20,650

Note: The issuance of shares is not given and must be calculated. It is total assets of $115,650, less total liabilities of $33,000, less retained earnings of $20,650.

* Because this is the first year of operations, these beginning balances are zero.

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Req. 3

MCCLAREN CORPORATION
Statement of Financial Position
As at June 30, Current Year

Assets		
Cash (given)		$ 13,150
Accounts receivable (given)		9,500
Merchandise inventory (given)		57,000
Equipment, net (given)		36,000
Total assets		$115,650
Liabilities and Shareholders' Equity		
Liabilities		
Accounts payable (given)	$31,500	
Salary payable (given)	1,500	
Total liabilities		33,000
Shareholders' equity		
Contributed capital	62,000	
Retained earnings	20,650	
Total shareholders' equity		82,650
Total liabilities and shareholders' equity		$115,650

Req. 4

Based on the statement of financial position, McClaren Corporation has $82,650 in total shareholders' equity compared to $33,000 in total liabilities. This indicates that the company relies more on shareholders than on creditors in financing its resources at June 30.

Req. 5

A creditor will know that $9,500 will be received by this company within a short period but that it must also pay suppliers $31,500, also within a short period. When making a lending decision, a creditor would use this information to determine the likelihood that the company could repay a loan.

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AP1–2

Req. 1

BRUNO'S LAWN SERVICE
Statement of Earnings
For the Three Months Ended August 31, Current Year

Revenue from services ($50,400 + $2,500)		$52,900
Expenses:		
Gas, oil, and lubrication ($3,680 + $400)	$ 4,080	
Repair of mowers	300	
Wages for helpers	19,000	
Payroll taxes	800	
Truck repairs	820	
Preparation of payroll tax forms	100	
Insurance	480	
Telephone	420	
Miscellaneous supplies used	320	
Interest expense on note	300	
Depreciation, truck and equipment	2,000	
Total expenses		28,620
Net earnings		$24,280

Req. 2

BRUNO'S LAWN SERVICE
Statement of Financial Position
As at August 31, Current Year

Assets		
Cash[1]		$ 14,580
Accounts receivable		2,500
Truck and equipment	9,600	
Less: Depreciation	(2,000)	7,600
Total assets		$24,680
Liabilities and Owner's Equity		
Accounts payable		$ 400
Bruno Clarke, capital		24,280
Total liabilities and owner's equity		$24,680

[1]Cash balance = 50,400 + 10,000 – 6,000 – 3,600 – (28,620 – 400 – 2,000) – 10,000 = 14,580

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AP1–2 (continued)

Req. 3

The above two reports reflect the assets, liabilities, equity, revenues, expenses, and net earnings, but not the sources and uses of cash. Therefore, it is reasonable to assume that Bruno would need a statement of cash flows. This will show Bruno the reasons for the increase in cash during the period and the differences between cash from operations and net earnings.

Because it is the first period of operations and the owner did not make any withdrawals, a statement of changes in equity is not necessary.

Req. 4

The statement of earnings indicates to Bruno that his business is profitable, and that he can possibly increase his net earnings if he wishes to expand his business. The statement of financial position suggests that his financial situation is quite strong, and the information therein can be used to determine how much money he could borrow, if necessary.

AP1–3

Req. 1			***Req. 2 – Explanation***
Transaction	*Net earnings*	*Cash*	
(a)	$+66,000	$+55,000	All services performed increase net earnings; cash received during the period was $66,000 x 5/6 = $55,000.
(b)	–0–	+45,000	Cash borrowed is not profit.
(c)	–0–	–1,900	Purchase of the truck does not represent an expense because the truck is an asset and it has not been used yet. Cash outflow was $9,500 x 20% = $1,900.
(d)	–21,000	–10,500	All of the wages incurred reduce net earnings, $21,000; cash paid during the quarter was $21,000 x 1/2 = $10,500.
(e)	–3,040	–3,800	Not all of the supplies were used; expense is the amount used, $3,800 x 4/5 = $3,040.
(f)	–36,000	–30,000	All expenses incurred reduce net earnings; cash paid was $36,000 x 5/6 = $30,000.
Based only on the above:			
- Net earnings	$5,960		
- Cash inflow		$ 53,800	

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CONTINUING PROBLEM

CON1–1

Req. 1

Penny's Pool Service & Supply Inc.
Statement of Earnings
For the Year Ended December 31, Current Year

Revenues	
Sales revenue	$60,000
Expenses	
Cost of supplies used	8,200
Wage expense	24,000
Other administrative expenses	4,500
Total expenses	36,700
Earnings before income taxes	23,300
Income tax expense	4,000
Net earnings	$19,300

Req. 2

Penny's Pool Service & Supply Inc.
Statement of Changes in Equity
For the Year Ended December 31, Current Year

	Contributed Capital	Retained Earnings
Balance, January 1, current year	$ –	$ –
Issuance of shares	40,000	–
Net earnings	–	19,300
Dividends declared	–	(10,000)
Balance, December 31, current year	$40,000	$ 9,300

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CON1-1 (continued)

Req. 3

Penny's Pool Service & Supply Inc.
Statement of Financial Position
At December 31, Current Year

Assets	
Cash	$ 2,900
Accounts receivable	2,300
Inventories	4,600
Equipment	48,000
Total assets	$57,800
Liabilities and Shareholders' Equity	
Liabilities	
Accounts payable	$ 3,500
Note payable to bank	5,000
Total liabilities	8,500
Shareholders' equity	
Contributed capital	40,000
Retained earnings	9,300
Total shareholders' equity	49,300
Total liabilities and shareholders' equity	$57,800

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CASES AND PROJECTS

FINDING AND INTERPRETING FINANCIAL INFORMATION

CP1–1

Req. 1

The fiscal year ends on the last Saturday of September.

Req. 2

a. Statements of Financial Position – 2 years
b. Statements of Income – 2 years
c. Statements of Cash Flows – 2 years

Req. 3

The company's total assets increased by $275.3 from $13,865.3 to $14,140.6 (amounts in millions).

Req. 4

The balance of merchandise inventories was $1,508.3 million at September 28, 2024.

Req. 5

Assets	=	Liabilities	+	Shareholders' Equity
$14,140.6	=	$7,101.7	+	$7,038.9 (in millions)

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CP1–2

Req. 1

Empire Company Limited reported net earnings of $762.6 million for the fiscal year ended May 4, 2024, as disclosed in the consolidated statements of earnings.

Req. 2

Revenue earned in the fiscal year ended May 4, 2024, was $30,732.6 million. This is also disclosed on the same statements noted above.

Req. 3

Inventories as at May 4, 2024, amounted to $1,771.7 million. This information is disclosed on the consolidated balance sheets.

Req. 4

Cash and cash equivalents increased by $38.3 ($259.6 – $221.3) million during fiscal year 2024. This amount can be found at the bottom of the consolidated statements of cash flows as well as the consolidated balance sheet by computing the difference in the cash amounts at the end of the current and previous years.

Req. 5

The auditor is PricewaterhouseCoopers LLP. This information is found in the independent auditor's report in Empire's 2024 annual report.

CP1–3

Req.1

Total assets for Empire Company Limited were higher at $16,790.3 million compared to $14,140.6 million for Metro Inc.

Req. 2

Empire Company Limited had higher sales at $30,732.6 million compared to $21,219.9 million for Metro Inc.

Req. 3

Metro had a higher growth rate in both total assets and sales. Empire Company Limited's increase in assets was 1.86% [($16,790.3 – $16,483.7) ÷ $16,483.7] compared to an increase of 1.99% for Metro [($14,140.6 – $13,865.3) ÷ $13,865.3].

Empire Company Limited's sales increased by 0.84% [($30,732.6 – $30,478.1) ÷ $30,478.1] compared to Metro's growth rate of 2.39% [($21,219.9 – $20,724.6) ÷ $20,724.6].

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FINANCIAL REPORTING AND ANALYSIS CASE

CP1–4

Req. 1 – Deficiencies include:

(1) Heading: titles of the reports are missing and dates are not in proper form.
(2) Statement of earnings should show revenues and expenses separately.
(3) Statement of financial position should separately report assets, liabilities, and shareholders' equity.
(4) Retained earnings, $30,000, should be reported under shareholders' equity.
(5) Due from customers, $13,000, should be reported under assets, i.e., Trade receivables.
(6) Supplies on hand, $15,000, should be reported under assets.
(7) Accumulated depreciation, $10,000, should be subtracted from service vehicles.

Req. 2 – Financial Statements

PERFORMANCE CORPORATION
Statement of Earnings
For the Year Ended December 31, 2026

Sales revenue ($175,000 + $52,000)		$227,000
Expenses:		
Cost of sales	$ 90,000	
Selling expenses	25,000	
Depreciation expense	10,000	
Salaries and wages	62,000	
Total expenses, excluding income taxes		187,000
Earnings before income taxes		40,000
Income tax expense (25% x $40,000)		10,000
Net earnings		$ 30,000

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CP1–4 (continued)

Req. 2 – Financial Statements

PERFORMANCE CORPORATION
Statement of Financial Position
As at December 31, 2026

Assets		
Cash		$ 32,000
Trade receivables		13,000
Supplies inventory		15,000
Merchandise inventory		42,000
Service vehicles	$ 50,000	
Less: Accumulated depreciation	(10,000)	40,000
Total assets		$142,000
Liabilities and Shareholders' Equity		
Liabilities		
Trade payables		$ 22,000
Note payable		25,000
Total liabilities		47,000
Shareholders' equity		
Contributed capital (6,500 shares issued)	$65,000	
Retained earnings	30,000	
Total shareholders' equity		95,000
Total liabilities and shareholders' equity		$142,000

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CRITICAL THINKING CASES

CP1–5

Req. 1

The personal items owned by Emmanuel should not be included in the financial statements of the company. The company is a separate entity for accounting purposes.

The list of liabilities properly excluded the personal debts of Lucas because these are not debts of the company.

Req. 2

Emmanuel's response does not explain or excuse the presentation in the financial report. It appears that deception is involved because of the listing of personal assets and the exclusion of the related liabilities. Such reporting is misleading and dishonest.

The financial report is not correct even if it were clearly stated that the accounting entity represents the company and owner combined as one entity. If this assumption were used, which would be appropriate only if clearly specified, it would require that ***all*** of the assets and ***all*** of the liabilities of both the company and Emmanuel be included. Preferably the business should be reported as a separate entity. The personal assets and liabilities could be reported as another separate entity.

CP1–6

Req. 1

You should forcefully assert the need for an independent audit of the financial statements each year because this is the best way to assure credibility – conformance with IFRS, completeness, and absence of bias.

You should firmly reject Roger as the auditor because there is no evidence about his competence as an accountant or auditor. Also, he is related to the partner who prepares the financial statements; there is a conflict of interest.

Req. 2

You should strongly recommend the selection of an independent, licensed professional accountant in public practice because the financial statements should be audited by a competent and independent professional who must follow prescribed accounting and auditing standards on a strictly independent basis. An audit by Roger would not meet any of these requisites, particularly the most important one in this case – independence (and absence of bias).

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CP1–7

The textbook does not explicitly cover the elements of independence. The case is designed to permit the students to develop their own values. We have found that it is useful to emphasize the difference between independence in fact and in appearance during these discussions.

Req. 1

Most students feel that there is no problem with independence if the shares held are immaterial in amount. When asked about a possible headline that might read "Auditor who was shareholder is accused of fraud," most students see a problem with the appearance. In fact, professional accounting organizations do not apply a materiality threshold where there is a direct financial interest. Any holding of shares is a problem.

Req. 2

This is an example of an indirect holding of shares. A materiality threshold is applied in these situations. There could be a question of independence if the auditor held a material interest in the mutual fund (relative to her net worth) and the mutual fund held a material interest in the company that she audited.

Req. 3

Codes of Professional Conduct apply only to audit professionals who are members. Oleg's employers may want to assign him to a different company but there is no conflict in this case.

Req. 4

Clearly there is an ethics violation in this case because she would audit statements that covered a period of time when she was responsible for the accounting operations of the company. This is a problem both in appearance and in fact.

Req. 5

The loan from the bank was made under normal lending procedures, terms, and requirements. Therefore, it may not be a source of impairment of independence. However, one has to be careful whether the loan has the appearance of being made under normal credit terms or not.

FINANCIAL REPORTING AND ANALYSIS PROJECT

CP1–8

The solution to this case will depend on the company and/or accounting period selected for analysis.

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CHAPTER 1: FINANCIAL STATEMENTS AND BUSINESS DECISIONS

CHAPTER OUTLINE

I THE FOUR BASIC FINANCIAL STATEMENTS: AN OVERVIEW
- A. The Statement of Financial Position
- B. The Statement of Comprehensive Income
- C. The Statement of Changes in Equity
- D. The Statement of Cash Flows
- E. Relationships among the Four Financial Statements
- F. Notes to Financial Statements
- G. Summary of the Four Basic Financial Statements

II RESPONSIBILITIES FOR THE ACCOUNTING COMMUNICATION PROCESS
- A. International Financial Reporting Standards (IFRS)
- B. Ensuring the Accuracy of Financial Statements

Supplemental material:
- Appendix 1A: Types of Business Entities
- Appendix 1B: Employment in the Accounting Profession Today
- Appendix 1C: Data Visualization

ADDITIONAL RESOURCES

CHAPTER TAKE-AWAYS
CHART OF END-OF-CHAPTER MATERIALS

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CHAPTER LEARNING OBJECTIVES

1-1 Identify the information conveyed in each of the four basic financial statements and describe how investors, creditors, and managers use the information to make decisions.

1-2 Identify the role of International Financial Reporting Standards (IFRS) in determining the content of financial statements and the responsibilities of managers, directors, and auditors for ensuring the accuracy of the financial statements.

SUPPLEMENTARY MATERIAL

1-S1 Describe the different types of business entities.
1-S2 Identify traditional and emerging services, and various career opportunities for professional accountants.
1-S3 Interpreting financial information in charts and graphs.

CHAPTER LEARNING OBJECTIVES AND THE CPA CANADA TECHNICAL COMPETENCIES

This chapter covers material outlined in Section 1: Financial Reporting of the CPA Competency Map.

Chapter LOs	**CPA Technical Competencies**
	1.1 Financial Reporting Needs and Systems
LO1-S1	1.1.1 Evaluates financial reporting needs
LO1-2	1.1.3 Evaluates reporting systems, data requirements and business processes to support reliable financial reporting
LO1-S2	1.1.4 Explains implications of current trends, emerging issues and technologies in financial reporting
	1.2 Accounting Policies and Transactions
LO1-1	1.2.1 Develops or evaluates appropriate accounting policies and procedures
	1.4 Financial Statement Analysis
LO1-2	1.4.2 Evaluates financial statements including note disclosures
LO1-1	1.4.4 Interprets financial reporting results for stakeholders (external or internal)

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CHAPTER SUMMARY

The text materials contain many useful exhibits for this chapter. In addition, other chapter features useful in the teaching of this text are contained in this manual.

The four basic financial statements are the statement of financial position, the statement of comprehensive income, the statement of changes in equity, and the statement of cash flows.

The *statement of financial position* is a statement of financial position that reports dollar amounts for the assets, liabilities, and equity at a **specific point in time.**

The *statement of comprehensive income* is a statement of operations that reports revenues, expenses (and costs), and net income for a **stated period of time.**

The *statement of changes in equity analyzes changes in all components of equity over a stated period of time.*

The *statement of cash flows* reports inflows and outflows of cash by activity for a **specific period of time.**

The financial statements and the parties to the accounting communication process are illustrated here in the context of a large retailing company. The following four chapters will provide a closer look at the process of interpreting financial statements and their use in business decision making. The student will learn to analyze business transactions using basic accounting equations to determine exactly how the results of future business decisions will be reflected in the financial statements. Students will also begin learning how to examine financial statements of other companies to draw inferences about the quality of the decisions their managers make. This is the heart of financial statement analysis. The accounting equation for the statement of financial position, Assets = Liabilities + Shareholders' Equity, is the foundation for the entire accounting process and the understanding of financial statements and the relationships between the individual statements.

CHAPTER LECTURE NOTES

Introduction
Using Financial Statements Information to manage growth: Focus company: Le-Nature's Inc

A. The Players

1. Managers may be owners (owner-manager) or non-owners.
2. Owners (shareholders) are investors. They may also be managers. Owners are referred to as investors, who invest money and/or other

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property in a company in exchange for the company's shares. The motives for investments are numerous:
   a. To meet short-term investment goals by way of periodic dividend receipts.
   b. To meet long-term investment goals through share appreciation. Varying events may cause owners to sell their interest in a company to "new" owners.

3. Additional money for the company may be acquired by borrowing from creditors. The lenders' goals are also two-fold:
   a. To earn interest on the loan.
   b. To receive debt repayment.

Debt and equity investments are referred to as *financing activities*. When the entity purchases or sells stores, this is referred to as *investing activities*.

B. The Business Operations

1. An understanding of business operations is essential for proper interpretation of a company's financial statements.
2. It is important to know about:
   a. Suppliers - the companies from whom goods or services are purchased.
   b. Customers - the companies or individuals to whom goods and services are sold.

C. The Accounting System

1 An understanding of the accounting system and how it processes information to produce reports is critical.
   a. Managerial accounting systems prepare reports for internal decision makers (managers).
   b. Financial accounting systems prepare reports for external decision makers (investors, creditors, suppliers, customers, and government agencies).

2. The focus of the text is accounting for external decision makers, called financial accounting, and the four basic financial statements and related disclosures.

3. In learning the general structure and content of the statements, students should focus on:
   a. the categories (referred to as elements) of the financial statements
   b. relationships between the elements
   c. the significance to the user of the elements.

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D. Why Study Financial Accounting?

1. Financial statements communicate financial information about a company to outside parties.
2. There are two groups or principal users of financial statements emphasized in the text.
   a. Managers– They must interpret the information in the financial statements to make business decisions.
   b. Investors and creditors– they analyze financial statements to determine resource allocation of funds for companies in the form of equity (shares in the company) or debt (loans to the company). In addition various governmental agencies require financial reporting as part of the regulatory environment in which entities conduct their operations.
3. It is important to develop an understanding of financial statements, business operation, and decision-making skills.

I THE FOUR BASIC FINANCIAL STATEMENTS: AN OVERVIEW

1. Financial statements should be accurate and contain adequate disclosures. Decision makers rely on these statements. If errors are made in the statements, lawsuits may result from decisions made on these erroneous statements.
2. Financial statements summarize business activities. These reports are prepared at any point in time and can apply to any time span (such as one year for annual financial statements, one quarter, or one month referred to as interim financial reports).
3. Understanding business definitions and key relationships is crucial to using financial statements.

A. The Statement of Financial Position

1. Appropriate heading (note: Under ASPE it is called a Balance Sheet)
   a. Company name - the accounting entity (separate entity assumption).
   b. Title - Statement of Financial Position (SFP)
   c. Date - at a point in time.
   d. Unit of measure – Canadian dollars, U.S. dollars, Mexican pesos, etc., in thousands, millions of dollars, pesos, etc.

2. Purpose is to report the financial position of the accounting entity at a point in time.

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3. Statement of Financial Position Equation

ASSETS	=	LIABILITIES + SHAREHOLDERS' EQUITY
Economic resources		Sources of financing economic resources Liabilities are amounts owed Equity represents amounts invested by shareholders and earnings retained in the business

4. Elements of the Statement of Financial Position

a. Assets
-these are economic resources controlled by the entity as a result of past transactions that will produce future economic benefit to the entity
-assets initially recorded at cost to acquire (Cost principle). Subsequent valuation of assets will reflect the benefit the entity expects to realize from either the use or the sale of the asset.

b. Liabilities
-are obligations that are the result of past transactions that will require the sacrifice of future economic resources of the entity for which there is no opportunity to avoid
- Creditor financing creates debt to be repaid in the future (notes payable).
- Other amounts owed arising from past events (wages payable, accounts payable, etc.).
- Provisions are estimated amounts payable in the future
- Amounts payable are reported as short-term if payable within 12 months or otherwise as long-term debt

c. Shareholders' Equity results from three categories:
- Contributed capital - amounts invested by the owners
- Retained earnings - accumulations of undistributed earnings (amounts earned by the company reduced by previous dividends)
- Other components that include specific elements of equity
- Owners of corporate shares are not personally liable for the company's debts unless they undertake to guarantee the entity's debt
-represents the residual interest (assets minus liabilities) in the entity

5. Format
a. assets listed in order of liquidity (ease of conversion to cash) or in reverse liquidity
b. liabilities listed by increasing or decreasing order of maturity followed by equity

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c. many international entities list their least-liquid assets first and most-liquid assets last
d. both formats are considered acceptable

B. The Statement of Comprehensive Income

1. Reports the change in shareholders' equity from business activities other than investments by shareholders (issuance of shares) or distributions to shareholders (dividends) for a prescribed period of time.
2. The statement of comprehensive income has two parts. The first part measures the company's performance from business operations ("net earnings"). The second part reports other comprehensive income which is made up of items that are not recognized in earnings
3. Companies can present all items of income and expenses either in one statement of comprehensive income or in two related statements – a statement of earnings and a statement of comprehensive income. Items of comprehensive income may or may not impact future earnings.
4. Appropriate heading
   a. Company name – the accounting entity (separate entity assumption).
   b. Title - Statement of Comprehensive Income. Entities may also elect to prepare two statements, the first detailing profit and loss (revenues less expenses) and the second reporting the elements of comprehensive income.
   c. Date - for a specified time period ended on the period end date (an accounting period).
   d. Unit of measure – Canadian dollars, U. S. dollars, Mexican pesos, etc., in thousands, millions of dollars, pesos, etc.
5. Elements

   Revenues (R)

   Revenues normally are amounts expected to be received for goods or services that have been delivered to a customer, *whether or not the customer has paid for the goods or services.*

   a. These are inflows of net assets from the sale of goods or services in the normal course of business. The inflows may be cash or accounts receivable (the promise of future payments from customers).
   b. Revenue recognition is in the period that goods or services are sold. This may not be the same period as the collection of cash for those goods or services.

   Expenses (E)

   Expenses represent the monetary value of resources the entity used up, or consumed, to earn revenues during the period.

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a. These are outflows of net assets representing resources used to earn the revenues during the period.
Examples:
- Cost of sales expenses - the costs to buy goods for resale or to make the goods that are sold
- Selling, general and administrative expenses - other expenses incurred by the company not directly related to the product costs
- Interest expense - the cost of borrowed funds
- Income tax expense – the taxes owing to the government based on earnings

b. Expense recognition is in the period incurred to earn revenues (**the matching principle**). This may not be the same period that the payment for the expense is made.

Net Earnings (NE)

a. This is also called net income or profit.

b. The statement of comprehensive income equation is: NE = R - E
If revenues exceed expenses, net earnings (NE) results.
If revenues are less than expenses, a net loss (NL) results.
If revenues equal expenses, breakeven results.

C. The Statement of Changes in Equity

1. Appropriate heading
   a. Company name – the accounting entity (separate entity assumption)
   b. Title – Statement of Changes in Equity (SCE)
   c. Date – for a specified time period ended on the period end date (an accounting period)
   d. Unit of measure – Canadian dollars, U.S. dollars, Mexican pesos, etc., in thousands, millions of dollars, pesos, etc.
2. The SCE analyzes all changes to equity accounts during the period. This would include additional investments by shareholders (share capital), profit retained in the business, and dividends declared (retained earnings).
3. The basic retained earnings equation is:
Ending retained earnings = Beginning retained earnings + NI or (-NL) – Dividends Declared

D. The Statement of Cash Flows

1. Appropriate heading
   a. Company name – the accounting entity (separate entity assumption)
   b. Title – Statement of Cash Flows (SCF)
   c. Date – for a specified time period ended on the period end date (an accounting period)

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d. Unit of measure – Canadian dollars, U.S. dollars, Mexican pesos, etc., in thousands, millions of dollars, pesos, etc.

2. This is the only financial statement prepared on the cash basis rather than on the accrual basis.
3. SCF shows cash inflows (receipts) and cash outflows (payments).
4. Three categories are used to classify these cash flows (reflects main activities of the business).
   a. Operating activities – directly related to normal business activities.
   b. Investing activities – acquisitions and divestitures of plant and equipment, intangibles, and other non-current assets.
   c. Financing activities – involves dealings with the company owners and lenders.
5. Combining the three categories of net cash inflows and outflows indicates the change in cash during the period.
6. For this statement, cash includes "cash equivalents" which by definition are those short-term investments that can be easily converted to cash with minimal expected loss in value upon conversion to cash.

E. Relationships among the Four Financial Statements

1. Financial statements that are all derived from the same financial system are related to one another.
2. Net income from the statement of earnings results in an increase in ending retained earnings.
3. IFRS has other comprehensive income in addition to net income. The sum of these two elements refers to comprehensive income. Instructors may choose to delay the coverage of OCI t
4. Ending retained earnings from the statement of changes in equity is one of three components of equity on the statement of financial position.
5. The change in cash on the statement of cash flows added to the cash balance at the beginning of the year equals the balance of cash at the end of the year, which appears on the statement of financial position.

F. Notes to Financial Statements

1. These are an integral part of the financial statements. The statements cannot be adequately interpreted without reading the supplemental information in these notes (footnotes).
2. There are three basic types of notes.
   a. Descriptions of accounting rules applied in the financial statements.
   b. Details about line items in the statements.
   c. Disclosures about items not listed in the statements.

II RESPONSIBILITIES FOR THE ACCOUNTING COMMUNICATION PROCESS

1. Effective communication requires that the recipient of information understands what the sender intends to convey. Therefore, it is

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necessary that the receiver understands the words and symbols in the financial statements.

2. Effective communication is not sufficient in making decisions based on the financial statements. Additionally, the user must understand the measurement rules used to develop the information in the financial statements. These rules are known as International Financial Reporting Standards (IFRS), which are considered to be generally accepted accounting principles (GAAP) in Canada.
3. The users also need to do a "reality check" to see if the listed items are what they purport to be. This is often done by an audit of the financial statements.

A. International Financial Reporting Standards (IFRS)

1. Accounting practices have been in place for centuries. However, there was little uniformity in these practices.
2. In Canada, each province has its own security commission, most notably the Ontario Securities Commission (OSC) that collaborates in the regulation of the capital markets and the flow of financial information. The professional accounting body that works with the securities commissions on these matters is currently the Accounting Standards Board (AcSB). The AcSB is responsible for setting the standards of accounting and reporting for companies, government organizations, and not-for-profit organizations.
3. There are two categories of corporations.
   a. Privately held companies are usually owned by small groups of investors. The shares are not readily available for sale to the public.
   b. Publicly traded companies' shares can be bought and sold on established stock exchanges.
4. For Canadian publicly traded companies, the AcSB has determined that they must prepare their financial statements in accordance with IFRS. IFRS are a set of globally accepted standards produced by the International Accounting Standards Board.
5. Importance of GAAP
   a. provides basis for comparability and consistency
   b. enables users to evaluate companies based on financial statements under the premise that amounts have been determined without manipulations of management (not always the case).
   c. reliance on reported amounts by users influences investment and lending decisions
6. Since GAAP sets the measurement rules for financial reporting, ultimately the share price for a company is affected by changes in these rules. Bonuses for managers are also impacted by such rule changes. A company's competitive edge within its industry may be impaired due to "revealing" disclosures required by GAAP.

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B. Ensuring the Accuracy of Financial Statements

1. Ethical Conduct

Ethics are standards of conduct for judging right from wrong, honest from dishonest behaviour, and fair from unfair practices. To improve decision making in difficult situations, there is a three step process:

i. Identify the effects of the decision on both parties, those who will benefit and those who will be harmed.
ii. Identify alternative courses of action.
iii. Choose the alternative that you would like to see reported on the news.

2. Management Responsibility and the Demand for Auditing

-CEOs and CFOs now have to certify the accuracy of financial statements; knowingly signing a false statement could result in severe penalties
Management has the primary responsibility for the information in the financial statements. Management should:

- maintain a system of controls over both records and assets
- engage independent auditors (usually CPAs) to attest to the fairness of presentations in the financial statements (approved by shareholders at the corporation's annual meeting).
- establish an audit committee of directors to ensure that the controls are in place and the audit is properly carried out.
- these responsibilities are often set out in a report called management responsibility for financial statements

-there were various types of accounting designations: Chartered Accountants (CAs), Certified Management Accountants (CMAs), or Certified General Accountants (CGAs).

-these designations have become one: Chartered Professional Accountant (CPA).
-an audit involves the examination of the financial reports prepared by management to ensure they conform to IFRS.
-The independent audit report contains the opinion as to the fairness of the financial statement presentations in conformity with GAAP. The accountants examining the statements must be "independent" of the company being examined.
-there are numerous ways managers can intentionally prepare misleading financial reports. An audit is intended to minimize that risk. To ensure audits of public companies maintain a high degree of quality, the Canadian Public Accountability Board was created to provide public oversight for auditors of public companies.
- management misrepresentation is an ever-present risk
- government regulations make it more difficult to engage in fraudulent activities

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- Canadian accountants must adhere to a code of professional conduct and standards of independence
- serious ramifications follow when the profession fails to live up to its professional responsibilities (the demise of Arthur Andersen worldwide following the Enron collapse)

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES

1. Those entities in Canada that do not meet the definition of being publicly accountable and therefore are not required to adopt IFRS may use Accounting Standards for Private Enterprises (ASPE) as GAAP. These standards have been developed to meet the needs of users of financial information for private enterprise and are generally considered to be less complex and require less disclosure. For instance ASPE does not use comprehensive income and thus a statement of comprehensive income is not required.

2. Under ASPE a statement of retained earnings is used, rather than a statement of changes in equity.

3. The title used by ASPE is balance sheet, as opposed to statement of financial position.

ADDITIONAL RESOURCES

APPENDIX 1A

Types of Business Entities

1. **Corporation** - This is an entity incorporated under federal or provincial laws. The corporation must file an application for incorporation with the jurisdiction and the government in question will issue a charter to operate as a separate entity. Owners are shareholders who own shares in the company. The corporation is a separate legal and a separate accounting entity from its owners.
   a. Advantages of corporations:
      - limited liability for its owners. Generally, the most owners can lose is their investment.
      - continuity of life
      - ownership transferability ease
      - variety of means to raise large amounts of money
   b. The board of directors is elected by shareholders to make decisions that affect the company.
   c. Disadvantages of corporations:
      - loss of control by shareholders
      - complex reporting may be necessary for various government agencies
      - double taxation

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-Limited liability companies (LLCs) and limited liability partnerships (LLPs) are similar to corporations.

2. **Sole Proprietorship** - This is an unincorporated business owned by one person. The owner is often directly involved in the management of the company. A proprietorship is a separate accounting entity from its owner. *However*, it is not a separate legal entity. As a result, the owner is personally liable for the company's debts. A proprietorship is easy to form.
3. **Partnership** - This is an unincorporated entity with more than one owner. It is organized with a profit motive and owners allocate profits/losses among themselves. A partnership is a separate accounting entity from its partners. *However*, it is not a separate legal entity for liability purposes. A partnership is easy to form. The formation should include the preparation of a partnership agreement (contract) stating the rights and responsibilities of the partners.

APPENDIX 1B

Employment in the Accounting Profession Today

1. The accounting profession:
   - is subject to professional competence requirements
   - is dedicated to service to the public
   - requires a high level of academic study
   - rests on a common body of knowledge
2. Certification requirements for a CPA require:
   - a university degree
   - several accounting courses
   - a minimum of two years of professional experience
   - passing the three-day professional exam – Common Final Examination CFE)

Practice of Public Accounting

1. Public Accounting Practices
   - Audit or Assurance Services: The most important of these services is financial statement auditing. The purpose of the attest function is to lend credibility to the fair presentation of a company's financial statements inconformity with GAAP.
   -Management Consulting Services: These services provide assistance to a company in such areas as accounting services, data processing, budgeting, financial advice, and internal control assistance.
   - Tax Services: Accountants prepare income tax returns and provide tax planning assistance to their clients.

Employment by Organizations

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1. - Accountants are employed by for-profit, not-for-profit, and government organizations. The chief financial officer is part of the management team with a wide range of management, financial, and accounting duties. Accountants in business are involved in general management, general accounting, cost accounting, profit planning and control (budgeting), internal auditing, and computerized data processing.

Employment in the Public and Not-for-Profit Sectors

1. Governmental units and large not-for-profit organizations need accountants for their complex operations. Accountants employed in the public and not-for-profit sectors perform similar duties to those accountants in private organizations.

APPENDIX 1C

Companies use various visual aids to analyze past information as well as to project future trends.These include:

- Bar Graphs
- Line Charts
- Column Charts

Companies may also compile metrics on competitors and industry trends for various purposes,

Note to Instructor: You may choose to illustrate some of these on-screen during class time by referring to the annual report of a well-known public company.

ADDITIONAL TEACHING NOTES

1. Distinguish between the cost recorded for assets and the current market value of those assets. Original cost (historical) and market (current) value are often different amounts.

2. Discuss the accounting equation as "owned - owed = leftovers". The leftovers are the residual amounts accruing to the owners.

3. Contrast the issuance of shares by a company "itself" with the sale of shares "outside" the company in the market place. That is, discuss the concepts of a company issuing shares directly to a shareholder. Contrast this with secondary market trading ("old" shareholders selling directly to "new" shareholders).

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4. Statement of financial position must "balance." That is, the statement of financial position presents the essence of the basic accounting equation. It is the only financial statement that is dated at a point in time.

5. Fraud exists but it is not the norm. Typically, there is wide media coverage on fraudulent financial activities. Many times such attention overshadows the larger group of companies not committing fraud. Livent and SNC-Lavalin are cited as examples of Canadian fraud cases.

6. In this chapter, it is important for the students to begin to gain an understanding of the elements or categories of items on the financial statements and how they are related. The students will gain a better understanding of the importance of these elements and relationships in subsequent chapters.

7. The statement of changes in equity "ties together" the current period's income statement and statement of financial position. The statement of cash flows "ties together" the current period's cash balance and the previous period's cash balance.

8. Alert students to the fact that a large number of accounting opportunities exist in government and not-for-profit organizations.

9. Because of the rapid changes in technology, accountants are being called upon to perform new services related to e-commerce.

10. Discuss the various user groups and their needs. Compare IFRS and ASPE and explain when a company would opt for one framework over another.

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CHART OF END-OF-CHAPTER MATERIALS

LEARNING OBJECTIVE	EXERCISES	PROBLEMS	ALTERNATE PROBLEMS	CONTINUING PROBLEM	CASES AND PROJECTS
1-1	1,2,3,4,5,6,7,8, 9,10,11,12	1,2,3,4,5	1,2,3	1	1,2,3,4,5,8
1-2	1				5,6,7,8

*NOTE TO INSTRUCTORS: All test bank content available online through Test Builder on Connect can be sorted by learning objective, question type, and level of difficulty.

GUIDE TO OTHER CHAPTER FEATURES

Focus Company used for Primary Illustrations/Management Decision Setting
Le-Nature's Inc.

Financial Analysis
- Interpreting Assets, Liabilities, and Shareholders' Equity on the Statement of Financial Position
- Analyzing the Statement of Earnings: Beyond the Bottom Line
- Interpreting Retained Earnings
- Interpreting the Statement of Cash Flows
- Managerial Uses of Financial Statements

International Perspective
- The International Accounting Standards Board and Global Convergence of Accounting Standards

Pause for Feedback
1. Verify total assets and identify assets, liabilities, and equity items.
2. What items belong in the statement of earnings categories?
3. Compute the balance of ending retained earnings.
4. Statement of cash flows and categories

Demonstration Case Summary
- Prepare statement of financial position and statement of earnings together with a summary of information provided by these financial statements, the other statements required, and discuss reasons for an independent audit.

Chapter Take-Aways
- Chapter summary by learning objective

Finding Financial Information
- Statement of Financial Position, Statement of Changes in Equity, Statement of Earnings, and Statement of Cash Flows

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SUPPLEMENTAL ENRICHMENT ACTIVITIES

Note: Many of these activities would be suitable for individual or group applications.

IN THE CLASSROOM

"Acronym" Game:

The business and accounting arenas are inundated with acronyms. A list is provided below. You may wish to cut the sheets in half. At first, give the students the list of names/terms and ask them to derive the acronyms. During the next class, give the students the list of acronyms and ask them to give the phrase each represents. This may help them learn these important terms and acronyms without just sitting down to memorize them. This would be a good exercise for groups. The listing could also be copied front and back as a bookmark to give to students.

"Entities" Exercise (relates to Chapter Supplement A):

Ask students to compare and contrast the characteristics of corporations, sole proprietorships, and partnerships. Have them make a list of advantages and disadvantages of each form of organization. Ask them to list two companies of each type from their general knowledge.

OUTSIDE THE CLASSROOM

LIBRARY PROJECT:

Fraud Readings:

CPA magazine features regular articles concerning fraud. Students could report on additional findings after researching the fraud cases further.

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ACRONYMS

Membership Organizations

Accounting Standards Oversight Council	AcSOC
American Accounting Association	AAA
Auditing Standards Board	ASB
American Institute of Certified Public Accountants	AICPA
Chartered Professional Accountants of Canada	CPA
Financial Accounting Foundation	FAF
Financial Accounting Standards Board	FASB
Financial Executives Institute	FEI
Institute of Management Accountants	IMA
Public Sector Accounting Board	PSAB

Miscellaneous Terms in Accounting, Business, and Economics

Consumer Price Index	CPI
Earnings per Share	EPS
First In, First Out	FIFO
Generally Accepted Accounting Principles	GAAP
Generally Accepted Auditing Standards	GAAS
Gross National Product	GNP
Management Information System	MIS
Over the Counter (stocks)	OTC
Profit & Loss Statement	P&L
Price/Earnings (ratio)	P/E
Research & Development	R&D
Standard & Poor's (index)	S&P

Computer Terms

Disk Operating System	DOS
Data Processing	DP
Electronic Data Processing	EDP
Electronic Funds Transfer	EFT

Government Agencies

Canada Revenue Agency	CRA
Ontario Securities Commission	OSC
U.S. Securities and Exchange Commission	SEC

Professional Certifications

Chartered Accountant	CA
Chartered Professional Accountant	CPA (Canada)
Certified General Accountant	CGA
Certified Internal Auditor	CIA
Certified Management Accountant	CMA
Certified Public Accountant	CPA (US)

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