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Overview of Corporate Financial Reporting

Dollar Store Business Is No Small Change

When Salim Rossy opened a general store in Montreal in 1910, he financed it with his earnings from peddling items like brooms and dishcloths in the countryside around Montreal. By the time Rossy's grandson Larry took charge in 1973, S. Rossy Inc. had grown into a chain of 20 five-and-dime stores, with most items priced at either 5 or 10 cents. In 1992, the company opened its first Dollarama store, selling all items for \$1. Today, the business, now called Dollarama Inc., is Canada's largest dollar store chain. It operates more than 1,300 stores in all provinces and now sells goods at between \$1 and \$4.

How do large companies such as Dollarama finance growth? Like many businesses that reach a certain size, Dollarama eventually became a public company, issuing shares that trade on the Toronto Stock Exchange (TSX). The company's initial public offering, in 2009, raised \$300 million, which was used to open new stores. The company's growth has been steady ever since. By 2011, it had more locations than Canadian Tire, and recently it has opened an average of one new store a week. It plans to operate 2,000 locations across Canada by 2031—an increase over its previous plan of 1,700 stores by 2027.

In its 2021 fiscal year ended January 31, 2021, the company had more than \$4.0 billion in sales—an increase of more than \$200 million over the previous year. The company reported that just over 60% of this growth was increased sales at existing stores, with the balance being sales at new stores opened during the year. The company was even able to increase its dividend—the money it pays to shareholders out of its profits.

On March 31, 2021, Dollarama announced that its board of directors had approved a 7.0% increase in the quarterly cash dividend to holders of common shares, from \$0.047 to \$0.0503 per common share.

Management at all companies is constantly looking for ways to increase sales, often using marketing campaigns featuring sale prices on certain products. This isn't the case for Dollarama. Given the fixed price points of the company's products, there are no sale prices or markdowns to advertise. Instead, the company uses almost all of its marketing budget to advertise new store openings. Accepting credit cards as a form of payment is one way that Dollarama has also been able to increase its sales. It has found that the average transaction size for customers using credit cards is twice as large as the average cash transaction. Not only does this help increase sales, but it also makes processing the transaction faster and contactless.

Shareholders and other stakeholders, such as banks and suppliers, use a company's financial statements to see how the company has performed and what its future prospects might be. Shareholders use them to make informed decisions about things such as whether to sell their shares, hold onto them, or buy more. Creditors use financial statements to assess a company's ability to service its debts (pay interest and repay principal), while suppliers may use them to determine whether to allow the company to purchase on credit. Companies communicate all this information through financial reporting, and the tool used to prepare financial information is accounting.

Whether or not Dollarama achieves the revenue, profit, and store growth it hopes for will be reported in the company's future financial statements. These financial statements will tell the story of whether Dollarama got the best bang for its buck.¹

CORE QUESTIONS

If you are able to answer the following questions, then you have achieved the related learning objectives.

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

<p>Introduction to Financial Accounting</p> <ul style="list-style-type: none"> • What is financial accounting? 	<p>1. Define financial accounting and understand its relationship to economic decision-making.</p>
<p>Users and Uses of Financial Accounting</p> <ul style="list-style-type: none"> • Who needs an understanding of financial accounting and why? 	<p>2. Identify the main users of financial accounting information and explain how they use this information.</p>
<p>Forms of Business Organization</p> <ul style="list-style-type: none"> • What is a corporation? • What differentiates a corporation from other forms of business? 	<p>3. Describe the major forms of business organization and explain the key distinctions between them.</p>
<p>Activities of a Business</p> <ul style="list-style-type: none"> • What are the three categories of business activities? • What are examples of financing activities? • What are examples of investing activities? • What are examples of operating activities? 	<p>4. Explain the three categories of business activities and identify examples of transactions related to each category.</p>
<p>Financial Reporting</p> <ul style="list-style-type: none"> • What information is included in a set of financial statements? • What is the reporting objective of the statement of income? What does it include? • What is the reporting objective of the statement of changes in equity? What does it include? • What is the reporting objective of the statement of financial position? What does it include? • What is the reporting objective of the statement of cash flows? What does it include? • What type of information is in the notes to a company's financial statements? 	<p>5. Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.</p>

1.1**Introduction to Financial Accounting****LEARNING OBJECTIVE 1**

Define financial accounting and understand its relationship to economic decision-making.

The opening story is an example of how a large company grows. Whether a business is borrowing money for a start-up or expansion, restructuring the organization, or deciding whether to purchase or lease equipment, it needs to have accounting information to make the best decisions. You, too, will use accounting information to help you make decisions, whether

it's determining if you should buy a company's shares, apply for a job there, or enter into a contract with it.

What Is Financial Accounting?

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Financial accounting is the process by which information on the transactions of an organization is captured, analyzed, and used to report to decision makers *outside* of the organization's management team. Financial accounting is sometimes referred to as external financial reporting due to its focus on providing accounting information to external decision makers. These external decision makers are often referred to as **financial statement users** and include the owners (normally referred to as **investors**) and those who have lent money to the organization (normally referred to as **creditors**). The primary purpose of financial accounting information is to aid these users in their economic decision-making relative to the organization. Because these users are generally outside of the organization and are not involved in its day-to-day operations, the financial accounting information they receive is often their only "window" into the organization.

Users inside the organization (**management**) also use financial accounting information, but they generally require the information at a different level of detail. For example, managers in a national retail chain may need information for a particular store rather than for the organization as a whole. Managers may need different information altogether, such as information needed to develop forward-looking budgets rather than to report on past transactions. It is important to note that management has access to all of the organization's financial information, including information that is never shared with those outside of the organization. This information is known as **managerial accounting** and will be the basis for another course in your business studies.

Management prepares two broad types of accounting reports:

- Reports for internal use only (for use by management): This is known as managerial accounting. Its purpose is to inform decision-making.
- Reports for external use (for use by others outside the organization): This is known as financial accounting. Its purpose is to help external users make decisions.

Financial accounting, the focus of this textbook, can be as simple as determining the daily sales of a food truck or as complex as recording and reporting on the economic condition of your university, a multinational corporation, or the Government of Canada. All of these entities need to know economic information in order to continue to operate efficiently and effectively. Financial accounting provides vital financial information that enables people and organizations to make decisions. Because it is very likely that you will be a financial statement user in some way, it is important that you have at least a basic understanding of what financial accounting is (and is not), what it is trying to accomplish, and how it does so.

The focus of this book is the financial accounting information produced by profit-oriented organizations, although we will occasionally refer to not-for-profit organizations or governments. We will concentrate on the **financial statements**, which are management's reports to the company's owners that are produced at the end of each accounting period, such as every quarter or every year. The annual financial statements are included in the company's **annual report** together with the **management discussion and analysis (MD&A)** of the company's results for the year. The annual report is made available to the company's owners, but many other parties, such as lenders, financial analysts, credit-rating agencies, securities regulators, and taxing authorities, also use it.

1.2 Users and Uses of Financial Accounting

LEARNING OBJECTIVE 2

Identify the main users of financial accounting information and explain how they use this information.

Who Needs an Understanding of Financial Accounting and Why?

Before we answer these questions, let's take some time to think a little about the game of hockey. (Yes, hockey. After all, what's a Canadian textbook without a hockey reference?) Whether you have lived in Canada your whole life or you are here studying from some other part of the world, chances are good that you have seen a professional hockey game on television or perhaps even in person. During the game, the TV commentary or the conversations of those around you would have included terms like *icing*, *charging*, *slashing*, *five-hole*, *hash marks*, *neutral zone*, and so on. These would have been confusing terms the first time you heard them, but once they were explained to you, your ability to follow the game and understand it at a deeper level would have improved. The same thing is true of financial accounting. Through the text's 12 chapters, we will learn the language of financial accounting and how to interpret financial accounting information so you can come away with a deeper understanding of the subject.

So, let's rephrase our opening question and think about "Who needs to understand the rules of professional hockey?" Many groups likely come to mind fairly quickly, including:

- players (including their agents and players' union)
- coaches and general managers
- referees, linesmen, and off-ice officials
- fans
- TV commentators, arena announcers, and sports journalists
- league officials
- team owners
- suppliers, advertisers, and landlords

We can call these people *stakeholders* because they have a stake in understanding hockey. Now, let's take this list of hockey stakeholders and find the parallel business stakeholders who would have a similar stake in a business, as shown in **Exhibit 1.1**.

EXHIBIT 1.1 Similarities between Hockey Stakeholders and Business Stakeholders

Hockey Stakeholders	Parallel Business Stakeholders
Players, including their agents and players' union	Employees, unions
Coaches and general managers	Management
Referees, linesmen, off-ice officials	Auditors, federal and provincial government departments, legislators
Fans	Potential investors, customers
Announcers, TV analysts, sports journalists	Stock analysts, brokers, financial advisors, business reporters
League officials	Stock exchange regulators
Team owners	Shareholders, board of directors
Suppliers, advertisers, landlords	Creditors, suppliers, landlords

Now, let's consider some of the questions that each of the stakeholders in a business may be trying to answer about that business that would require an understanding of financial accounting, as shown in **Exhibit 1.2**.

These groups of business stakeholders are often known as *financial statement users*. Throughout this book, we will be looking at the information needs of many of these users and

EXHIBIT 1.2 Questions That Stakeholders in a Business May Be Asking

Business Stakeholders	Potential Questions They May Be Trying to Answer about the Business
Employees, unions	Is the business profitable? Will I earn a bonus this year? Can the company afford to negotiate increased wages? Is the company pension plan in decent shape?
Management	How do this year's sales compare with last year's? How do they compare with the budget? Are we maintaining our profit margins on certain product lines? How much do we owe our employees and suppliers?
Auditors, federal and provincial government departments, legislators	Has the company presented its financial information fairly? How does the company's financial information compare with the information submitted for taxation or payroll purposes?
Potential investors, customers	What are the long-term prospects for this company? Has the management team done a reasonable job? Will this company be around to honour its warranties?
Stock analysts, brokers, financial advisors, business reporters	What are the company's trends? What are the prospects for this company? How has this company performed relative to expectations?
Stock exchange regulators	Has the company complied with the financial reporting standards and listing requirements?
Shareholders, board of directors	Has the company generated a sufficient return on our investment? How effectively has management used the resources at their disposal? Does the company generate enough income to be able to pay dividends?
Creditors, suppliers, landlords	Should we extend credit to this company? Is this a credible and successful company that we want to attach our brand to? Should we enter into a lease with this company?

discussing how they use financial accounting information in making a variety of decisions. The breadth of this list of users illustrates that, no matter which path you take in your business studies, having a basic understanding of accounting information will be essential to business success or could be a job requirement. As we move through the chapters, try to see yourself in one or more of these roles and think about the ways in which you can make use of the accounting information that you will no doubt come across.

The primary goal of this book is to help you become an intelligent user of accounting information by enhancing your ability to read and understand corporate financial statements. You may become a manager, accountant, banker, or financial analyst, and even if you do not end up working directly in the finance industry, you will invest in the shares or bonds of a company at some point in your life. If you work in a company, whether in sales, human resources, or other areas, your decisions will likely have an impact on what is reported to owners. Whatever your business role, you will make decisions about companies, such as whether to invest in their shares, lend them money, or sell them goods or services on credit. In making these decisions, it will be important for you to understand the information that is presented in corporate financial statements. You must know what each piece of information tells you about the company, but also what it does not tell you. You should also understand that some information that is useful in making certain decisions is not contained in the financial statements.

This book has been written for a broad readership, understanding that many of you will play multiple roles as owners (shareholders), creditors, and managers of companies. It starts with the assumption that you know little or nothing about accounting. It also assumes that you are not training to be an accountant, although that may be your objective. Therefore, this book does not emphasize accounting procedures. Instead, it emphasizes the underlying concepts of accounting and the analysis of financial statements. However, it is not really possible to have a knowledgeable understanding of the end result of the accounting process without first having an overall view of how the accounting system works. For this reason, the first three chapters present the basic mechanics of the accounting system. The remaining chapters are then devoted to more detailed accounting issues and concepts, and to a more in-depth analysis of financial statements.

We will now explore the financial statement users in more detail. **Exhibit 1.3** lists the various financial statement users, categorizing them as either internal or external users.

EXHIBIT 1.3 Users of Financial Statement Information

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Internal users:

Management

External users:

Shareholders, the board of directors, and potential investors

Creditors (for example, financial institutions and suppliers)

Regulators (for example, a stock exchange)

Taxing authorities (for example, the Canada Revenue Agency)

Other corporations, including competitors

Securities (stock) analysts

Credit-rating agencies

Labour unions

Journalists

Since the focus of financial accounting is reporting to external users, let's look at these users and their information needs in greater detail.

Shareholders, the Board of Directors, and Potential Investors

KEY POINTS

Shareholders are investors who have invested resources into a company in exchange for a share of its ownership.

A company is owned by its **shareholders**, who have invested resources in the company in exchange for a share of its ownership. As noted in the **Key Points**, because these investors own a share of the company, they are referred to as shareholders.

There may be a single shareholder in the case of a **private company** or many thousands of shareholders in the case of a **public company**. We will discuss the distinctions between private and public companies a little later in the chapter, so for now it is just important to understand that companies are owned by their shareholder(s). In situations where there are numerous shareholders, they elect a **board of directors** to represent their interests. The board of directors is given the responsibility of overseeing the management team that has been hired to operate the company.

The board of directors, individual shareholders, and potential investors all require information to enable them to assess how well management has been running the company. Just like hockey fans look at the arena scoreboard to see how their team is doing in terms of the score, shots on goal, and so on, stakeholders in a business look at a company's financial reports to determine how it's doing in a number of areas. Business stakeholders want to make decisions about buying more shares or selling some or all of the shares they already own (similar to a hockey team's general manager deciding whether to acquire a star player or trade an underperforming one). They will analyze the current share price (as reflected on the stock exchange) and compare it with the original price that they paid for the shares. Are the shares now worth more or less? They will also be comparing the share price with the company's underlying value, which is reflected in the financial statements and other sources of information they have about the company.

Individual shareholders will also want to assess whether the current board of directors has effectively carried out its oversight role. They will seek to answer questions such as:

- Is the company heading in the right direction (that is, has the strategic direction approved by the board resulted in increased sales, profits, and so on)?
- Is it making decisions that result in increased value to the shareholders?
- Is the company generating a sufficient return on the resources invested in it by the shareholders?

Creditors

Creditors are those who lend money or otherwise extend credit to a company rather than invest in it directly as investors do. There are two major groups of creditors:

1. Financial institutions and other lenders
2. Suppliers, employees, and the various levels of government

Financial institutions, such as banks and credit unions, lend money to companies. They do so seeking to generate a return on these loans in the form of **interest**. Of course, the lenders also want to ensure that the money they lend out will eventually be repaid (that is, the loan **principal** will be repaid). Loans can either be short-term or extend over several years. These lenders need financial accounting information to assess the company's ability to service the loan. One of the ways this is done is by looking at the cash flows the company generates through its operations. They are also generally interested in the amount of the company's inventory, equipment, buildings, or land, because these may be pledged as security by the borrowing company in the event that it cannot repay the loan. Large companies also enter into long-term borrowing arrangements by issuing corporate bonds. Rather than borrowing from a single lender, companies that issue bonds borrow from many lenders. Nevertheless, these lenders are also concerned about the company's ability to service the debt (pay interest and repay principal) over the term of the bond, and their financial accounting information needs are similar to those of other lenders.

The other group of creditors includes suppliers, employees, and various levels of government. These groups often sell goods or provide services prior to receiving payment. For example, a supplier may agree to sell goods or provide services to a company and agree to wait 30 days for payment. Employees are another common creditor as they normally work for the company and then receive payment after the fact, such as at the end of every two weeks or at the end of a month. Different levels of government may also be creditors of a company as they wait to receive tax payments or payroll deduction amounts. These users may focus on the amount of cash in the company because they are concerned about being paid.

Regulators

The regulators who are interested in financial statements are numerous. For example, the federal and provincial governments have regulations related to how companies report their financial information and are interested in ensuring that these regulations are followed. The stock exchanges, on which the shares of public companies are traded, have regulations about the timing and format of information that companies must convey to them and to investors. Companies not complying with these regulations can be delisted, meaning their shares cease to trade on the exchange, which greatly affects their ability to raise capital.

For Example



Heath Korvola/Getty Images

Wildflower Brands Inc. (formerly Wildflower Marijuana Inc.) is a BC-based company that focuses on building reputable brands and quality products that incorporate the synergistic effects of plants and their extracts. It is a publicly traded company whose shares trade on the Canadian Securities Exchange (CSE). On February 3, 2021, the British Columbia Securities Commission announced a cease trade order on Wildflower's shares as a result of the company failing to file its audited annual financial statements

by the filing deadline. The company explained that the delay was due to challenges with the audit of the company's 2019 financial statements, which prevented the audit of the company's 2020 financial statements, which, in turn, meant that they could not be submitted to the securities regulator. The company noted that it was continuing to work with the British Columbia Securities Commission to determine the steps needed for it to move forward in a manner that would result in a resumption of trading for the company's shares.²

Taxing Authorities

The **Canada Revenue Agency (CRA)** is the federal taxing authority in Canada and is responsible for federal tax collection. Corporate taxes are primarily based on taxable income, which is calculated based on accounting net income. As such, the CRA is another key user of a company's financial accounting information.

Other Users

Additional users of financial statement information include other companies, securities analysts, credit-rating agencies, labour unions, and journalists. Other companies may want information about the performance of a company if they are going to enter into contracts with it. If it is a direct competitor, they may seek information that will help assess the competitor's strength and future plans. Securities analysts and credit-rating agencies use the financial statements to provide information about the strengths and weaknesses of companies to people who want to invest. Labour unions need to understand the company's financial health in order to negotiate labour contracts with management. Companies often give journalists news releases that disclose financial information such as expected earnings. The journalists may refer to the actual financial statements to validate the information they were given and to supplement the original information.

It is important to understand that all of these users are using the same set of financial statements in spite of the diversity of their information needs. The bodies that establish the international and domestic standards for financial reporting are aware of all of these users, but have taken the position that they will emphasize the needs of investors and creditors in the determination of standards. As such, many pieces of information that particular users may want cannot be found in the financial statements, and these users must look to other sources of information as well.

The types of financial information gathered and made available to stakeholders vary depending on the form of organization a business has, which we discuss next.

1.3 Forms of Business Organization

LEARNING OBJECTIVE 3

Describe the major forms of business organization and explain the key distinctions between them.

What Is a Corporation?

Businesses can be operated in a number of different forms, including as a corporation, as a proprietorship, or as a partnership. Most businesses of any significant size operate as corporations and, as such, this text will focus on the accounting information related to that form of business. However, most of the accounting issues that we will identify in the text also apply in some degree to the other forms of business. If you have a good understanding of corporate

accounting, it is not a big challenge to understand the nuances of accounting for proprietorships or partnerships.

As previously mentioned, corporations are owned by shareholders, with the initial shareholders having provided cash or other assets to a corporation in exchange for share certificates. These shares are called **common shares**. One of the key distinctions between corporations and other forms of business is that corporations are separate legal entities; that is, they are legally distinct from their owners. This is where the “Limited” or “Ltd.” that you see in the names of many corporations comes from; it refers to the fact that the company has limited legal liability. Since the corporations are separate legal entities, they can enter into contracts and be sued. In the event the company fails, the liability of shareholders is limited to their investment in the corporation.

There are two main types of corporations: public companies (which are also known as *publicly traded companies*) and private companies (which are also known as *privately held companies*). The distinction between the two is whether or not the company’s shares are listed on a public stock exchange. Public companies are companies whose shares are listed on public stock exchanges such as the Toronto Stock Exchange (TSX), the TSX Venture Exchange (TSXV), or the Canadian Securities Exchange (CSE). Public companies are also referred to as listed companies. The shares of private companies trade privately and are not listed on public exchanges. The shares of public companies are often widely held, meaning that they are owned by a large number of individuals or entities. Some portion of their ownership will usually change hands every day. On the other hand, shares of a private company are often narrowly held, meaning that they are owned by a relatively small number of people. It is not as easy to transfer ownership in a private company.

Shareholders are not typically involved in the day-to-day operations, except in small private corporations. Given that public companies have a large number of shareholders who are not involved in day-to-day activities, the shareholders typically elect a board of directors to represent them. The board of directors has the authority to hire (and fire if necessary) the management team who will manage the company’s day-to-day operations. These senior executives, along with the other managers they hire, are known as *management*. To keep shareholders informed of the performance of their investment in the company, management reports periodically to the shareholders. Financial statements are normally prepared for shareholders quarterly (every three months). Annual financial statements are also produced and are included in the company’s annual report. It is these annual financial statements that we will be focusing on.

For Example

There are more than 1.32 million businesses operating in Canada. More than 800,000 of these are corporations. The vast majority of these are small, privately held companies. In fact, there were only 3,289 public companies trading on Canada’s two largest stock exchanges, the TSX and TSX Venture Exchange, as of February 2021. While the number of public companies may be small, their value is very significant. These 3,289 public companies were valued at \$3,477.1 billion, according to the quoted market value of their shares.³

What Differentiates a Corporation from Other Forms of Business?

There are a number of key distinctions between corporations and the other forms of business: partnerships and proprietorships. **Exhibit 1.4** outlines a number of the key distinctions to help you understand them. It is important to be aware of these differences, but also to understand that there are circumstances in which it makes sense to organize a business using each of these three main forms of business.

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EXHIBIT 1.4 Key Distinctions between the Forms of Business

Distinguishing Feature	Corporation	Proprietorship	Partnership
Number of owners	Can be a single owner or multiple owners	Single owner	Multiple owners
Separate legal entity?	Yes, shareholders' personal assets <i>are not</i> at risk in the event of legal action against company	No, owner's personal assets <i>are</i> at risk in the event of legal action	No, partners' personal assets <i>are</i> at risk in the event of legal action
Owner(s) responsible for debts of the business?	Only to extent of investment	Yes	Yes
Taxed?	Yes, taxed separately	No, profits taxed in hands of owner	No, profits taxed in hands of owners
Costs to establish	Most expensive	Least expensive	Moderately expensive
Cost to maintain	Most expensive	Least expensive	Moderately expensive
Must make their financial information available	Yes, on a quarterly and annual basis	No	No

1.4 Activities of a Business

LEARNING OBJECTIVE 4

Explain the three categories of business activities and identify examples of transactions related to each category.

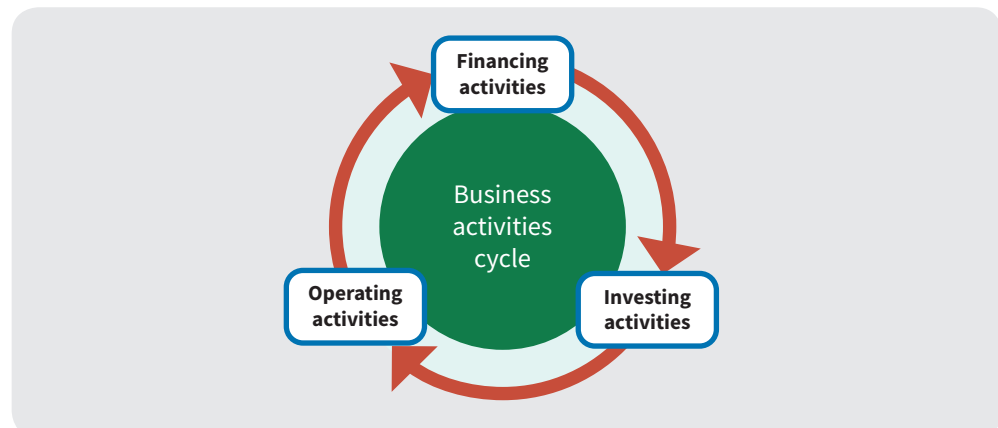
What Are the Three Categories of Business Activities?

To understand the information in financial statements, it is useful to think about the fundamental types of activities that all businesses engage in and report on. As illustrated in [Exhibit 1.5](#), all of the activities of businesses can be grouped into three categories: (1) **financing activities**, (2) **investing activities**, and (3) **operating activities**. Each of these involves inflows and outflows of cash into and out of the company.

Now, let's explore each category.

EXHIBIT 1.5 The Three Categories of Business Activities

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What Are Examples of Financing Activities?

The first activities of all companies involve obtaining the funding (or *financing*) needed to purchase the equipment or buildings they need to start operations. At the outset of the business, funding may also be required to pay for the initial purchase of inventory, pay a landlord a deposit on rented space, pay for advertising, and so on. While these activities are a necessity for new companies, they also continue as companies grow and expand. Companies obtain funding from two primary sources: (1) investors and (2) creditors, as explained in the **Key Points**.

Companies obtain funding from investors by issuing them shares (common shares) in the company in exchange for cash or other assets. These shares represent the investor's ownership interest in the company. For example, if the investor owns 10% of the shares issued by the company, they normally own 10% of the company. Since investors own, or hold, shares in the company, we normally refer to them as *shareholders*. Shareholders purchase shares seeking to generate a return, which may be realized in two different ways. First, they hope to receive **dividends**. These are payments made by a company that distribute a portion of the company's profits to shareholders. The other way shareholders seek to make a return is by being able to sell their shares to other investors for more than they paid for them. This gain, or increase in value, is known as **capital appreciation**. Of course, when the sale occurs, investors may also experience a loss if they receive less than the initial amount paid for the shares. The funds that flow into the company from the initial issuance of shares to its shareholders form part of what is called **shareholders' equity**. The issuance of shares is a financing activity. Sales of shares by one investor to another investor do not impact the company's cash flows.

KEY POINTS

A company's financing comes from two sources:

- investors, through the issuance of shares;
- creditors, through taking out loans or making purchases on credit.

For Example

Companies often try to establish a pattern of declaring and paying dividends in order to make their shares attractive to investors. The **Bank of Montreal** holds the record among Canadian public companies for the longest continuous stretch of paying dividends to its shareholders, having done so each year since 1829!⁴

Once a company has some shareholders' equity, it is then able to seek funding from the second primary financing source, creditors. Creditors are entities that lend money to a company. Banks are the most common example of a creditor. Creditors seek a return from the money they lend to a company. This return is the interest they receive for the time they have allowed the company to use their money. Of course, creditors also expect to get their money back. This is known as a *return of principal*. As noted in the **Key Points**, investors and creditors are each looking for two types of return.

If a company is operating profitably, it has an internal source of new funding because generally not all of those profits are being paid out to shareholders as dividends. Any profits that are kept or retained by the company are known as **retained earnings**. If a company's retained earnings are less than the funding it requires to grow (such as money to purchase additional equipment or carry new lines of inventory), the only way it can expand is to obtain more funds from investors (existing shareholders or new investors) or to borrow from creditors. How much to borrow from creditors and how much funding to obtain from investors are important decisions that the company's management must make. Those decisions can determine whether a company grows, goes bankrupt, or is bought by another company. **Exhibit 1.6** shows examples of financing activities.

KEY POINTS

While the nature of the returns are different, both investors and creditor are looking for two types of returns.

- Investors seek dividends and capital appreciation;
- Creditors seek interest and a return of capital.

Typical Financing Activities

Inflows: Taking out a loan (borrowing money)
 Issuing shares
 Outflows: Repaying loan principal
 Paying dividends

EXHIBIT 1.6 Typical Financing Activities

KEY POINTS

A company's investing activities are related to two things:

- buying and selling property, plant, and equipment;
- buying and selling the shares of other companies.

What Are Examples of Investing Activities?

Once a company obtains funds, it must invest them to accomplish its goals. Most companies make both long-term and short-term investments in order to carry out the activities that help them achieve their goals. Most short-term investments (such as the purchase of raw materials and inventories) are related to the day-to-day operations of the business and are therefore considered operating activities. Many long-term investments are related to the purchase of property, plant, and equipment that can be used to produce goods and services for sale. Companies can also invest in the shares of other companies, and these may be either long-term or short-term investments. The **Key Points** summarize the two types of investing activities.

Exhibit 1.7 shows examples of investing activities.

EXHIBIT 1.7 Examples of Typical Investing Activities

Typical Investing Activities

- Inflows: Proceeds from the sale of property, plant, and equipment
 Proceeds from the sale of shares of other companies
- Outflows: Purchase of property, plant, and equipment
 Purchase of shares of other companies

What Are Examples of Operating Activities?

Operating activities are all of the activities associated with developing, producing, marketing, and selling the company's products and/or services. While financing and investing activities are necessary to conduct operations, they tend to occur on a more sporadic basis than operating activities. The day-to-day ongoing activities of a company are generally classified as operating activities, as explained in the **Key Points**.

Exhibit 1.8 shows examples of operating activities.

EXHIBIT 1.8 Examples of Typical Operating Activities

Typical Operating Activities

- Inflows: Sales to customers
 Collections of amounts owed by customers
- Outflows: Purchases of inventory
 Payments of amounts owed to suppliers
 Payments of expenses such as wages, rent, and interest
 Payments of taxes owed to the government

KEY POINTS

A company's operating activities are related to the company's revenues and expenses, which fall into two basic categories:

- inflows from sales to and collections from customers;
- outflows related to payment of the expenses of the business.

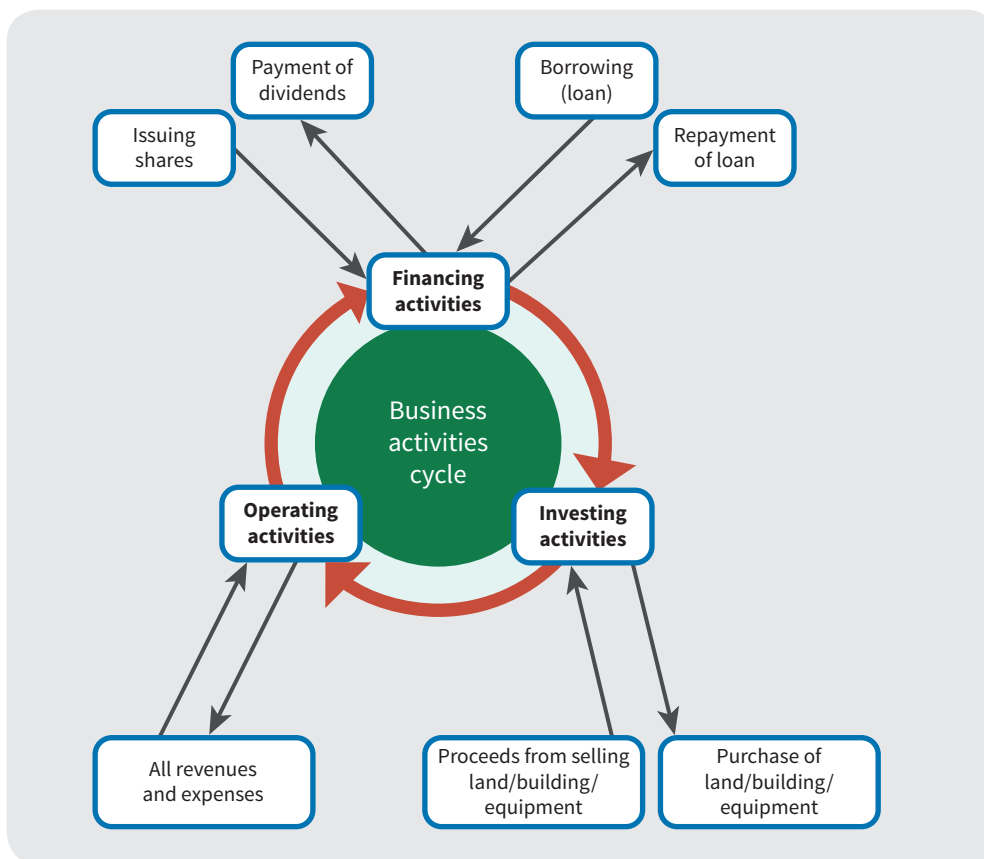
Of the three categories of activities, operating activities are considered the most critical to a company's long-run success or failure. If the company is not successful at generating cash flows from its operations, it will ultimately run out of cash, as financing sources will dry up because it will be unable to attract new investors or lenders. It would then have to sell the property, plant, and equipment that it uses to generate its revenues, which would mean it would not be able to continue operating.

Exhibit 1.9 illustrates the principal inflows and outflows associated with the three categories of business activities.

The financial statements provide information about a company's operating, financing, and investing activities. By the end of this book, you should be able to interpret financial statements as they relate to these activities. To help you become a successful user of financial statement information, in Appendix A at the back of the book, we present the financial statements of **Dollarama Inc.**, which were included in the company's 2020 annual report. As noted in the feature story, Dollarama is a Canadian retailer. Let's walk through the various types of information contained in this part of Dollarama's annual report.

EXHIBIT 1.9 The Three Categories of Business Activities: Key Inflows and Outflows

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Assess Your Understanding

Attempt the following problems and review the solutions provided:

- Chapter End Review Problem 1-1
- Demonstration Problem 1-1 in Wiley's course resources

1.5 Financial Reporting

LEARNING OBJECTIVE 5

Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

What Information Is Included in a Set of Financial Statements?

The components of the financial statements are shown in [Exhibit 1.10](#).

Let's look at each component of the financial statements in detail, including what it sets out to do and what information it includes.

EXHIBIT 1.10 Components of the Financial Statements**Components of the Financial Statements**

Statement of income
 Statement of changes in equity
 Statement of financial position
 Statement of cash flows
 Notes to the financial statements

What Is the Reporting Objective of the Statement of Income? What Does It Include?

The objective of the **statement of income** is to present the results of the company's operating activities for a month, a quarter, or a year (**Exhibit 1.11**). The sum of these operating activities is known as the company's **profit**, which is determined by subtracting the **expenses** incurred in the period from the **income** earned during the same time period. Profit, which is also known as **net income**, **net earnings**, or **earnings**, is a standard measure of corporate performance. Of course, it is possible to have a **net loss**, which would mean that the expenses for the period exceeded the income earned.

EXHIBIT 1.11 Alternative Names for the Statement of Income**The Statement of Income Is Also Known as the ...**

Statement of operations
 Statement of net earnings
 Statement of earnings
 Statement of profit or loss

Income (which includes both **revenues** and **gains**) is defined as increases in economic resources other than those contributed by shareholders. Revenues result when resources flow *into* the company from its ordinary activities, such as sales of goods and services. Gains results from activities that are outside its normal course of operations. An example is when a company sells some of its equipment that it has finished using and the proceeds of sale are greater than the amount the equipment is recorded at by the company.

Expenses are defined as decreases in economic resources, other than distributions to shareholders. They are more commonly thought of as the money or other resources that flow *out of* the company in the course of generating revenues. Expenses include things like the cost of the goods the company sells or the wages that are paid to the employees making these sales. A company can incur **losses** on sales that are outside its normal course of operations. An example is when a company sells equipment that it has finished using, but the proceeds of sale are less than the amount the equipment is recorded at by the company. As both gains and losses are outside of the company's normal operations, they are presented separately from revenues and expenses on the statement of income, so that the users of the financial statements are able to make this distinction.

Refer to the consolidated statement of net earnings and comprehensive income for Dollarama in Appendix A. It is called a **consolidated financial statement** because it consolidates the financial information for the main or **parent company** plus the financial information of all the other companies that it controls (known as the **subsidiary companies**). The time period of the statement is indicated at the top, where it reads "January 31, 2021, and February 2, 2020." Companies are required to provide **comparative information** (the results of both the current period and preceding period) so that users can assess the changes from the previous period. As noted above, this statement reports on the company's operating performance for the year ended January 31, 2021. This period is also known as the company's **fiscal year**. You may be wondering why Dollarama's fiscal years ended on different days in 2021 and 2020 (that is, January 31 in 2021 and February 2 in 2020). This is because the company has established that its fiscal year ends on the Sunday closest to January 31 each year. Finally, it is

also important to note that the numbers in Dollarama's financial statements are presented in thousands of Canadian dollars. Some Canadian companies, whose shares trade on U.S. stock exchanges, report in U.S. dollars instead of Canadian dollars.

For Example



rblfmr/Shutterstock.com

Canada Goose Holdings Inc. is a Toronto-based company that designs, manufactures, and sells premium outdoor apparel. The company's shares are listed on both the Toronto Stock Exchange and the New York Stock Exchange. While a substantial portion of the company's revenues, inventory purchases, and expenses are in foreign currencies, including U.S. dollars, euros, and British pounds sterling, the company prepares its financial statements in Canadian dollars.

Canada Goose is an example of a company that changed its fiscal year. In 2019, Canada Goose changed its year end to the Sunday closest to March 31, rather than using a calendar basis of 12 months ending March 31, which it had historically used. This means that, rather than every fiscal year ending on March 31, it will end on the Sunday closest to that, date. For example, the company's 2020 fiscal year ended on March 29. The company explained that the change will result in the company having 52- or 53-week reporting cycles.⁵

Revenue

From the statement, we can see that Dollarama generated revenues (or sales) of more than \$4.0 billion during its 2021 fiscal year. This would be the sales from all 1,356 stores that the company owned and operated across Canada as of January 31, 2021. From the comparative information, we can see that the company's sales increased 6.3% over the prior period. This trend is positive, and we could read the management discussion and analysis (MD&A) section of the company's annual report to get additional details regarding the change in revenues. As the name implies, the MD&A section is where senior management discusses and analyzes the financial statements. (We will explore more aspects of an MD&A later in the chapter.) A look at Dollarama's MD&A tells us that, while overall sales grew 6.3% over the previous year, sales grew 3.2% in existing stores (which Dollarama refers to as "organic growth") and the balance of the growth resulted from the company opening 65 new stores during the year. The MD&A also indicates that 73.7% of the sales resulted from products priced higher than \$1.25. We can also see that Dollarama's sales are somewhat seasonal: 27.4% of sales occur in the fourth quarter, with December being the biggest month. Other holidays, such as Easter, St. Patrick's Day, Valentine's Day, and Halloween, are also periods of increased sales. As you can see, while the information presented in the statement of income is useful, it often needs to be supplemented with other information in order to carry out meaningful analysis.

Expenses

Expenses are also presented under various categories, including cost of goods sold (or *cost of sales*, or *cost of merchandise sold*); selling, general, and administrative expenses (or *operating expenses*); interest expense; and income tax expense (or *provision for income taxes*). As you would expect, cost of sales is a significant expense for a company like Dollarama. As a retailer, it purchases finished goods to sell in its stores. The other significant cost would be the wage costs for all of the company's employees, whether they work at the retail locations, warehousing and distribution operations, or at the company's head office. The cost of operating store locations would also be a significant expense. These costs are included in general, administrative, and store operating expenses. Dollarama provides some additional information on the makeup of cost of sales and general, administrative, and store operating expenses in Note 17 to the financial statements. This is another example of providing information in addition to that presented in the statement itself so users can fully understand the financial information.

Gross Profit

Gross profit (or *gross margin*) is another very important number presented on the statement of income for all companies that sell goods. It is equal to the difference between the revenue received from the sale of the goods and the amount these goods cost the seller. From Dollarama's statement of net earnings, we can see that this amounted to almost \$1.78 billion in 2021. It is often more meaningful to express gross profit as a percentage of revenue than as a dollar figure. For Dollarama, the gross profit percentage was 43.8% in 2021. This means that, for every dollar in sales revenue, the company had just under \$0.44 after paying for its products. This gross profit must then be used to cover the rest of the company's operating costs, such as wages, utilities, and advertising. Another way of looking at this is to consider that, on average, the products Dollarama sells for \$1 cost the company just over \$0.56 to purchase.

Net Earnings

Net earnings (*net income* or *profit*) is the amount of the company's revenue that remains after paying all of its expenses, such as product costs, wages, store operating costs, interest, and income taxes. In the case of Dollarama, the company had net earnings of \$564 million for 2021. If we reflect this as a percentage of sales, we can see that for every \$1 in sales revenue, Dollarama earned about \$0.14 in net earnings. In other words, for every \$1 in sales revenue, Dollarama incurred total expenses of about \$0.86.

Earnings per Share

At the bottom of the statement of income is an **earnings per share** disclosure. Basic earnings per share is the company's net income divided by the average number of common shares that are outstanding (owned by shareholders of the company) during the year. Shareholders find this calculation useful since it puts the performance of their investment into perspective. In other words, a shareholder who holds 10,000 shares of Dollarama can determine his or her share of the earnings during the period. In the fiscal year ended January 31, 2021, Dollarama's basic earnings per share were \$1.82. Therefore, that investor's share of the earnings for 2021 would be \$18,200. The board of directors determines how much of the company's earnings, if any, will be paid to shareholders as dividends. Dollarama's board paid declared quarterly dividends (paid every three months) to its shareholders in 2021. These ranged from \$0.044 to \$0.047 per share. As Dollarama had an average of 311 million shares issued in 2021, dividends totalling \$55.6 million were declared in fiscal 2021. This means that Dollarama's board distributed just over 10% of the company's earnings as dividends and retained and reinvested the balance to grow the company.

On some statements of income, there will also be a diluted earnings per share amount, which is normally lower than the basic earnings per share. Dollarama has indicated that its diluted earnings per share were \$1.81. Diluted earnings per share reflects the earnings per share figure that would have been determined if all of the securities that can be converted into shares actually had been converted. More advanced financial accounting courses discuss diluted earnings per share in more detail.

Exhibit 1.12 lists of some of the items you can expect to see on the statement of income.

EXHIBIT 1.12 Common Statement of Income Items

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Common Statement of Income Items

Sales revenues	The total amount of sales of goods and/or services for the period.
Other income	Various types of revenues or income to the company other than sales, including interest or rental income.
Cost of goods sold	The cost of the inventory that was sold during the period.
Selling, general, and administrative expense	The total amount of other expenses (such as wages and utilities) during the period that do not fit into any other category.
Depreciation expense (amortization expense)	The allocation of part of the cost of long-lived items such as equipment or a patent.
Interest expense	The amount of interest incurred on the company's debt during the period.
Income tax expense (provision for taxes)	The taxes levied on the company's profits during the period.

Ethics in Accounting

Accounting standards allow companies to choose among different measurement methods. These choices can affect the information on financial statements and provide management with the opportunity to select methods that can raise or lower income and report revenues and/or expenses at different times. When management selects accounting methods to achieve a specific reporting

objective, it is called **earnings management**. Most times, managers will use earnings management legitimately, but as a user of the financial statement information, it is important that you recognize the circumstances that make it possible for earnings to be managed in an unethical way.

What Is the Reporting Objective of the Statement of Changes in Equity? What Does It Include?

The **statement of changes in equity** provides details on how each component of shareholders' equity changed during the period (see **Exhibit 1.13**). As we begin thinking about the concept of **equity**, it can help to use the example of home ownership to illustrate that equity is a “net” number. For example, if we were trying to determine the equity that a person had in their home, we would calculate it as the value of their home (what they could sell it for) less the amount of any mortgage(s) that would have to be paid off if the home were sold. This difference would be the person's equity in the home, also known as homeowner's equity. Continuing with this example, we can see that the homeowner's initial equity in the home would be equal to their down payment. We can also see that their equity would be increased by both increases in the value of the home and repayments of the mortgage. Since the shareholders of a company are its owners, we can use a similar approach when thinking about their equity in the company. It includes the amount put into the company by shareholders when the company initially issued shares and any income generated by the company that has not been distributed to shareholders as dividends. We call these amounts **share capital** and retained earnings, which are the earnings or income that have been “retained” by the company and reinvested into the business. There are a couple of other components of equity that can appear in the statement of equity, including contributed surplus and accumulated other comprehensive income. We will ignore these in the early part of the book in order to concentrate on share capital and retained earnings. These other components will be discussed in later chapters.

The Statement of Changes in Equity Is Also Known as the ...

Statement of shareholders' equity
Statement of changes in shareholders' equity
Statement of equity

EXHIBIT 1.13 Alternative Names for the Statement of Changes in Equity

The objective of the statement of changes in equity is to illustrate the changes to a number of different components of equity. For example, this statement will explain changes to each class of shares issued by the company if the company issued additional shares during the year or repurchased and cancelled others. The statement will also explain the changes in the company's retained earnings during the year, which will be equal to the net income for the period less any dividends that the company's board of directors declared during the period; that is, the amount of earnings that has been retained rather than distributed. Of course, it is possible that a company has a net loss rather than net income. If the loss exceeds the opening retained earnings balance, then retained earnings would be negative. If a company's retained earnings balance is negative, it is referred to as a *deficit*.

If we refer to Dollarama's consolidated statements of changes in shareholders' equity in Appendix A, we can see the changes to the company's share capital. During the year ended January 31, 2021, the company received \$32.4 million when it issued 1.7 million common shares. We can also see that the company repurchased 1.6 million of its shares during the year and cancelled them. The company had received \$2.4 million when it had initially issued the repurchased shares, so this amount was removed from share capital when they were

repurchased. The balance of the price paid to repurchase the shares, which was an additional \$84.6 million, increased the company's deficit (which has the same effect as if it were deducted from retained earnings) because it is treated like a dividend. It is another way of returning profits to shareholders.

Looking at the changes to Dollarama's retained earnings, we can see that the other significant change in shareholders' equity was the company's net earnings of \$564.4 million, which was also reported on the company's statement of earnings. We will come back to the changes in retained earnings frequently throughout the book, so it will be important for you to understand that the retained earnings of a company are determined as shown in [Exhibit 1.14](#).

EXHIBIT 1.14 How to
Calculate Retained Earnings

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Retained Earnings =

$$\begin{array}{r} \text{Opening Retained Earnings} \\ + \text{Net Income} \\ - \text{Dividends Declared} \\ \hline \text{Ending Retained Earnings} \end{array}$$

As previously mentioned, the two components of shareholders' equity that we will be focusing on throughout the early parts of the textbook are listed in [Exhibit 1.15](#).

EXHIBIT 1.15 Common
Shareholders' Equity
Components

Common Shareholders' Equity Components

Share capital	Represents the funds received when the shares were initially issued by the company to investors. There can be different types of shares (common shares and preferred shares). There can also be different classes of shares; in other words, shares that have different rights and privileges.
Retained earnings	The company's earnings (as measured on the statement of income) that have been kept (retained) and not paid out as dividends. If retained earnings has a negative balance, meaning that net losses have exceeded net income, it is referred to as a deficit.

What Is the Reporting Objective of the Statement of Financial Position? What Does It Include?

The **statement of financial position** is also known as the *balance sheet*. The term *financial position* indicates that this statement presents the company's financial status at a particular point in time. The consolidated statement of financial position for Dollarama is shown in Appendix A. In the case of Dollarama, the information presented is as at January 31, 2021, and February 2, 2020, which are the dates the company's fiscal years ended, also known as its *year end*. This means that the amounts in the statement are those that existed on those dates, which are considered to be the beginning and end points of the current accounting period. In the transition from one accounting period to the next, the ending balances of one accounting period become the beginning balances of the next accounting period. The statement of financial position is often described as a snapshot of a company's financial position at a particular point in time.

The format of this statement of financial position is known as a **classified statement of financial position** and is typical of most Canadian statements of financial position, which present information in order of **liquidity**. Liquidity refers to how soon something will be received, realized, or consumed, or else settled or paid. Canadian companies use a 12-month period to distinguish between items that are **current** and those that are **non-current**. Current items are those that will be received, realized, or consumed, or else settled or paid within 12 months from the year end. Those that are non-current will *not* be received, realized,

or consumed, or settled or paid within 12 months from the year end. It is important to note that other formats can be used to present a company's financial position, but all of them will reflect this notion of liquidity because it is critical for financial statement users to be able to assess a company's liquidity.

Throughout the book, we will learn about a number of ways that liquidity is commonly assessed. One of the most common measures of liquidity is **working capital**. This is quantified as the difference between a company's **current assets** (assets that are cash or will become cash within the next 12 months) and its **current liabilities** (liabilities that must be settled within the next 12 months). It measures a company's ability to meet its short-term obligations using its short-term assets. The working capital equation is shown in **Exhibit 1.16**.

Working Capital

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

EXHIBIT 1.16 Working Capital Equation

Using this equation, we can determine that Dollarama's working capital at January 31, 2021, was negative \$220.8 million (\$1,100.4 million – \$1,321.2 million), meaning that the company did not have sufficient current assets to settle its current liabilities. This means the company will need to use some of its future earnings, find additional funds by taking on debt or issuing shares, or sell some assets in order to settle its current liabilities.

So what makes up the company's financial position? Individuals, if asked about their own financial position, would probably start by listing what they own, such as a car, a computer, or a house, and then listing what they owe to others, such as bank loans and credit card balances. What is owned less what is owed would be a measure of an individual's net worth (wealth or equity) at a particular point in time. A company lists exactly the same types of things in its statement of financial position. They are referred to as **assets**, **liabilities**, and shareholders' equity. These are the three components of the **accounting equation**, which provides the structure to the statement of financial position (see **Exhibit 1.17**).

The Accounting Equation

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

EXHIBIT 1.17 The Accounting Equation

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Assets

When asked for a simple definition of an asset, many people reply that it is something of value that the company either owns or has the right to use. In fact, the accounting definition of an asset is very similar. Assets must meet three criteria, shown in **Exhibit 1.18**.

Characteristics of an asset

1. It is an economic resource controlled by an entity.
2. The company expects future economic benefits from the use or sale of the resource.
3. The event that gave the company control of the economic resource has already happened.

EXHIBIT 1.18 Characteristics of an Asset

The assets that Dollarama lists on its statement of financial position include:

- cash, accounts receivable, prepaid expenses, prepaid income taxes, and inventories
- right-of-use assets (which are assets being leased)
- property, plant, and equipment (often called *capital assets*)
- intangible assets (*intangible assets* lack physical form)
- goodwill

While later chapters discuss in more detail how each of these assets meets the criteria of control and future economic benefits, we can look at Dollarama's inventory as an example for now. Control of the inventory is proven either by possession of the goods or by legal documentation. The inventory has future economic benefits because the company can later sell it and receive cash in the amount of the selling price. The presence of the inventory or the underlying documents of the purchase indicates that the event that gave the company control has already happened.

The total assets of Dollarama as at January 31, 2021, were \$4.22 billion. **Exhibit 1.19** lists the assets normally found on a statement of financial position.

EXHIBIT 1.19 Assets Found on a Statement of Financial Position

Common Assets	
Current assets	
Cash	The amount of currency that the company has, including amounts in bank accounts.
Short-term investments	Short-term investments in shares of other companies.
Accounts receivable	Amounts owed to the company by its customers as a result of credit sales.
Inventory	Goods held for resale to customers.
Prepaid expenses and deposits	Amounts that have been paid by the company but the underlying service has not yet been used. Common examples include insurance premiums or rent paid in advance.
Non-current assets	
Property, plant, and equipment	Land, buildings, equipment, vehicles, and so on that the company purchases to use to generate revenues in the future; they are <i>not</i> purchased to resell.
Right-of-use assets	Land, buildings, equipment, vehicles, and so on that the company is leasing or renting to use to generate revenues in the future.
Intangible assets	Licences, patents, trademarks, copyrights, computer software, and other assets that lack physical form. These are also acquired to generate revenues in the future.
Goodwill	A premium that has been paid on the acquisition of another company related to factors such as management expertise and corporate reputation that will result in higher future earnings.

Liabilities

A simple definition of liabilities might be amounts that the company owes to others. (They are also known as *debt* and *obligations*.) The accounting definition of liabilities encompasses this concept and refers to items that will require the outflow or sacrifice of economic resources in the future to settle an obligation that exists as a result of a transaction that has already taken place. In most cases, the economic resource that will be sacrificed is cash, but a company can also settle liabilities by providing services or goods. For example, most of you will pay your university the full amount of the semester's tuition before or at the beginning of the semester. The university has a liability to you for this amount, which it will settle by providing the related course instruction over the semester. Alternatively, a warranty liability for a washing machine could be satisfied with a new part or by providing the services of a repair person. Liabilities must meet three criteria, as shown in **Exhibit 1.20**.

EXHIBIT 1.20 Characteristics of a Liability

Characteristics of a Liability
1. It is a present obligation of the entity.
2. The company expects to settle it through an outflow of economic resources.
3. The obligation results from an event that has already happened.

The liabilities that Dollarama lists on its statement of financial position include:

- accounts payable and accrued liabilities (representing amounts owed to suppliers, unpaid wages, unpaid taxes, or estimates of warranty obligations)
- dividends payable (representing dividends that the board has declared but that have yet to be paid to shareholders)
- income taxes payable (representing amounts owing to federal or provincial governments)
- lease liabilities (representing the outstanding estimated principal portion of lease payments for leases of right-of-use assets)
- long-term debt, including the current portion (representing the principal that remains to be repaid to lenders)

The total liabilities of Dollarama as at January 31, 2021, were \$3.89 billion. **Exhibit 1.21** includes some of the more common liabilities found on the statement of financial position.

Common Liabilities

Current liabilities

Bank indebtedness	Amounts owed to the bank on short-term credit.
Accounts payable (trade payables)	Amounts owed to suppliers from the purchase of goods on account (on credit).
Deferred revenue	Amounts owed to customers for advance payments until the related goods or services have been provided.
Dividends payable	Amounts owed to shareholders for dividends that have been declared by the board of directors.
Accrued liabilities	Amounts owed related to expenses that are not yet due, such as interest and warranty expense.
Income taxes payable	Amounts owed to taxing authorities.

Non-current liabilities

Notes payable	Amounts owed to a creditor (bank or supplier) that are represented by a formal agreement called a <i>note</i> (sometimes called a <i>promissory note</i>). Notes payable often have an interest component, whereas accounts payable usually do not.
Lease liabilities	Amounts owed to creditors (landlords or lessors) related to leased assets (right-of-use assets).
Long-term debt	Amounts owed to creditors due beyond one year.
Deferred income taxes	Amounts representing probable future taxes the company will have to pay.

EXHIBIT 1.21 Common Liabilities Found on a Statement of Financial Position

Shareholders' Equity

The last major category in the statement of financial position is the section called *shareholders' equity*. This section captures the amount of the shareholders' interest in the assets of the company. Shareholders' equity is often referred to as the **net assets** of the company or the shareholders' residual interest in the company's assets. This is the amount of assets that would remain after all of the company's liabilities were settled. If the accounting equation is rearranged (as in **Exhibit 1.22**), you can see that shareholders' equity is equal to the company's assets less its liabilities.

The Accounting Equation (Rearranged)

$$\text{Assets} - \text{Liabilities} = \text{Shareholders' Equity (Net Assets)}$$

EXHIBIT 1.22 The Accounting Equation (Rearranged)

If there are no liabilities, shareholders' equity would be equal to the company's assets. When there are liabilities, shareholders' equity is equal to the company's assets less those liabilities.

It is important to understand that this amount is determined using the values of the assets and liabilities as they are reflected on the statement of financial position. These values will often differ from those in the current market. Throughout the text, we will explore the reasons why these values differ. For now, let's consider a company's inventory. It is reflected on the company's statement of financial position at its cost to the company, but this amount will differ from what the company would sell it for. The selling price would also differ if it were an urgent or distress sale (that is, if the company desperately had to sell the goods) rather than a sale in the ordinary course of its operations.

Based on Dollarama's statement of financial position, shareholders' equity at January 31, 2021, was \$330 million.

$$\begin{aligned} \text{Assets} - \text{Liabilities} &= \text{Shareholders' Equity} \\ \$4.22 \text{ billion} - \$3.89 \text{ billion} &= \$330 \text{ million} \end{aligned}$$

Note that the market value of the shares held by a company's shareholders is another measure of the shareholders' wealth in the company. By **market value**, we mean the price at which the shares are trading in the stock market. This value is likely very different from the amount of shareholders' equity reported on the statement of financial position because it reflects the market's expectations of future earnings and events.

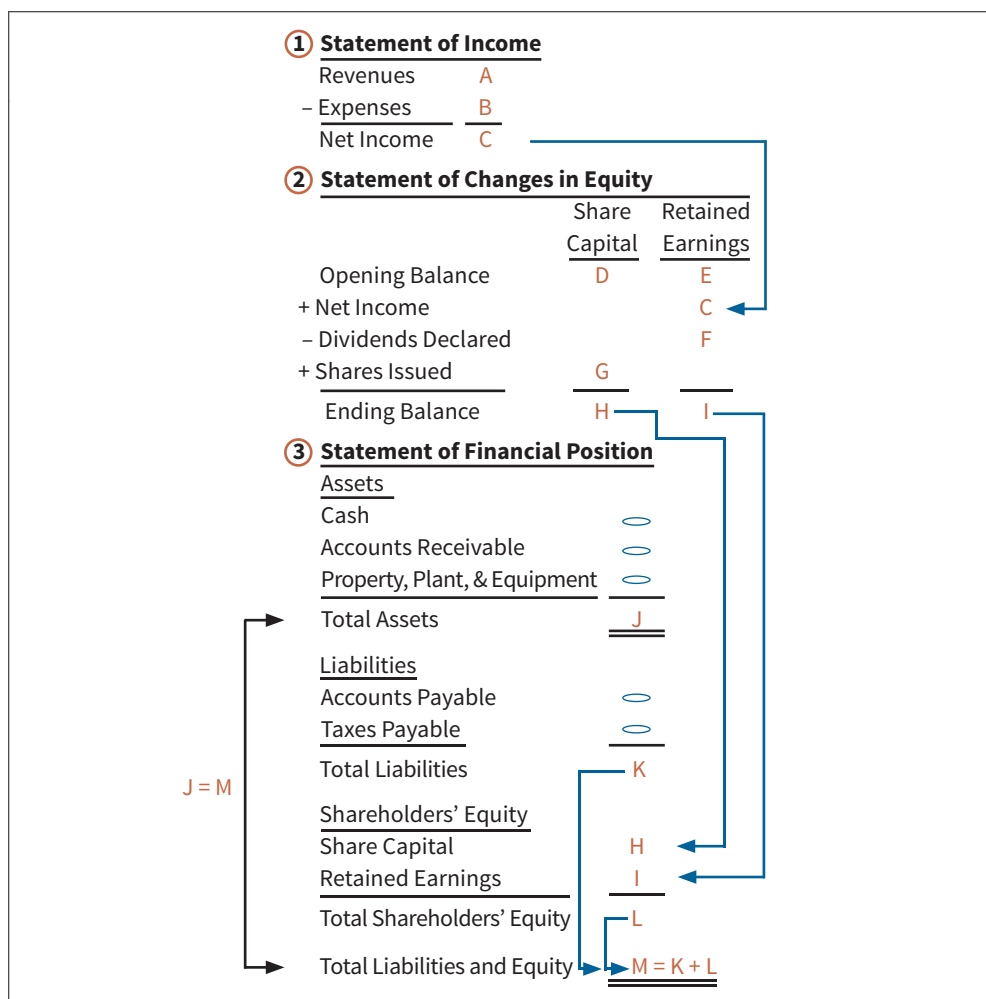
One of the objectives of the statement of financial position is to enable financial statement users to assess the relative proportions of liabilities and shareholders' equity to better understand a company's financing strategy. For Dollarama as at January 31, 2021, total liabilities were \$3.89 billion and total shareholders' equity was \$330 million, relative to total assets of \$4.22 billion. The proportion of liabilities is 92.2% ($\$3.89 \text{ billion} \div \4.22 billion), which means that Dollarama has financed virtually all of its assets using debt rather than the equity of shareholders. Specifically, it gets 92.2% of its financing from creditors. This high percentage of debt to equity demonstrates that the company has grown its operations using external financing (debt) rather than internal financing (equity). While the use of debt can be a good thing, generally the higher the proportion of debt to equity, the greater the financial risk facing the company. We will discuss the concept of leverage—using other people's money to make money—in Chapter 10.

Most North American companies present liabilities before shareholders' equity when preparing their statements of financial position, which presents a net asset perspective. This emphasizes that the creditors to whom these liabilities are owed have a priority claim on the company's assets, while the claims of the shareholders are secondary. Companies are not required to follow this presentation format, and some companies present shareholders' equity before liabilities, which presents a net debt perspective. Others reverse the order in which assets are presented, reporting non-current assets before current assets. When reading a statement of financial position, it is important to note the presentation format being used.

As discussed in the section on the statement of changes in shareholders' equity, equity is usually composed of a number of components. For now, we will focus on two: share capital and retained earnings. The first component, share capital (some companies use the term *common shares*), records the amount that the investors originally paid (invested) for the shares that the company issued. The second component, retained earnings, keeps track of the company's earnings less any amounts that the company pays to the shareholders in dividends. As mentioned previously, we will ignore the other components of shareholders' equity until later in the text.

Exhibit 1.23 illustrates how information flows between the first three financial statements. The statement of income is generally prepared first in order to determine net income. This statement is then used when preparing the statement of changes in equity. Finally, the share capital and retained earnings balances are used when preparing the statement of financial position.

EXHIBIT 1.23 Information
Flows between the First Three
Financial Statements

[Take5 Video](#)


What Is the Reporting Objective of the Statement of Cash Flows? What Does It Include?

The **statement of cash flows** (sometimes called the *cash flow statement*) presents the flows of cash related to the three categories of business activities, which we discussed earlier in the chapter. The reporting objective of this statement is to enable financial statement users to assess the company's inflows and outflows of cash related to each of these activities, so they can see where the company's cash came from and how it was used.

Dollarama's consolidated statement of cash flows in Appendix A presents the company's inflows and outflows of cash for the years ending January 31, 2021, and February 2, 2020. This statement differs from the statement of income in that it measures cash flows during the period rather than the revenues and expenses for the period, which may not be received or paid in cash. Cash is very important to the company's operations and this statement is critical to a user's evaluation of a company. Given the importance of this statement, Chapter 5 of the text is focused on how the statement is prepared and used. For now, we will review the basic content of the statement.

The cash flow statement has three sections that report the sources and uses of cash and cash equivalents for the three categories of business activities described earlier: operating, financing, and investing (see [Exhibit 1.24](#)).

Subsections of the statement of cash flows

- Cash flow from operating activities
- Cash flow from investing activities
- Cash flow from financing activities

EXHIBIT 1.24 Subsections of
the Statement of Cash Flows

[Take5 Video](#)

Operating activities include all inflows and outflows of cash related to the sale of goods and services. They are the activities that the company performs in its normal operations. The starting point in this section is frequently net earnings (or net income or profit) from the statement of income. There are adjustments to this amount because the recognition (recording) of revenues and expenses does not necessarily coincide with the receipt and payment of cash, as we will see in future chapters. For instance, sales could be either cash sales or sales on account. That is, customers can pay at a later date, resulting in an account receivable rather than cash. Expenses may also be paid later if the company is given credit by its suppliers, which would result in an account payable. Because operating activities are the backbone of the company, a positive cash flow from operations is essential to the company's long-term health. Dollarama generated an inflow of cash of \$889.1 million from its operating activities in the fiscal year ended January 31, 2021, compared with an inflow of \$732.5 million in the previous year.

Investing activities generally involve the purchase and sale of long-term assets such as property, plant, and equipment, and investments in other companies. In the case of Dollarama, we can see the company purchased property, plant, and equipment costing \$140.0 million and intangible assets costing \$27.8 million during the year ended January 31, 2021. It sold a small amount of long-term assets during the period, which generated \$593,000 in proceeds. It also made an investment in another company for \$97.2 million. This resulted in net cash outflows of \$264.5 million for the period. Companies that are growing, and even those that are just maintaining their current operations, normally have negative cash flows from investing activities. This results from them spending more cash to purchase new long-term assets than they are receiving as proceeds from the sale of long-term assets that they have finished using in their operations.

Financing activities are transactions that either result from new funds being received from investors or creditors or from the return of funds to these two groups. Typical activities in this category are the issuance of shares, the proceeds of new borrowings, the repayment of debt, or the payment of dividends. Dollarama's cash flow from financing activities was an outflow of \$275.9 million for the year ended January 31, 2021. We can see from this that the company obtained little new funding from either shareholders or creditors. The company did borrow \$300 million from creditors during the period, repaid \$463.8 million to creditors, and actually returned funds to shareholders through the repurchase of the company's shares (\$87.0 million) and the payment of dividends (\$54.8 million), which exceeded the \$32.4 million received from issuing new common shares.

Overall, we can see that Dollarama had a net increase in cash of \$348.7 million during the year ended January 31, 2021. This is the sum of the cash flows from the three categories of business activities ($\$889.1 - \$264.5 - \$275.9 = \348.7). This explains why the company's cash balance increased from \$90.5 million at the start of the year to \$439.2 million at the end of the year.

Exhibit 1.25 provides a summary of the financial statements.

EXHIBIT 1.25 Summary of the Financial Statements

Summary of the Financial Statements	
Statement of income	Measures the operating performance of a company over a period of time.
Statement of changes in equity	Measures the changes in the company's equity over a period of time, differentiating between changes that result from transactions with shareholders and those resulting from the company's operations.
Statement of financial position	Measures the resources controlled by a company (assets) and the claims on those resources (by creditors and investors) at a given point in time.
Statement of cash flows	Measures the change in cash flow through operating, financing, and investing activities over a period of time.

Assess Your Understanding

Attempt the following problems and review the solutions provided:

- Chapter End Review Problems 1-2 and 1-3
- Demonstration Problem 1-2 in Wiley's course resources

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What Type of Information Is in the Notes to a Company's Financial Statements?

You may have noticed that some of the items in the financial statements directed the user to specific notes. These **notes to the financial statements** are a critical part of the financial statements. In them, management gives more detail about specific items, such as the various types of inventory held by the company and its long-term assets. By including additional explanations in notes rather than in the financial statements, management keeps the company's statements simple and uncluttered. Note disclosures help to increase the usefulness of the financial statements and enhance the user's understanding of the various components of the statements.

A full discussion of notes will be left to succeeding chapters, but some attention should be paid to two notes that normally appear at the beginning of the notes to the financial statements. These are the note explaining the basis on which the financial statements have been prepared and the note outlining the significant accounting policies used in the preparation of the statements. Dollarama presented this information in the second and third of 19 notes that were included with the company's financial statements.

From these two notes, we can see that Dollarama's financial statements were prepared using **International Financial Reporting Standards (IFRS)**, which are the accounting standards that must be followed by Canadian public companies. From these notes, we can also learn more about the choices and judgements made by management in applying these reporting standards. As you progress through the book, you will learn that these choices have important implications for how to interpret the statements. Comparing two companies that have made two different choices and judgements would pose difficulties. To help users compare various companies, management must therefore disclose in this note the major accounting principles that it uses.

Climate Change Impact

Financial statement users are increasingly interested in information about how climate change could impact a company's financial statements. In Canada, the majority of all professionally managed investments, including those managed by the **Canada Pension Plan Investment Board**, the **Caisse de dépôt et placement du Québec**, the **Ontario Teachers' Pension Plan**, and numerous Canadian universities require that environmental, social, and governance (ESG) issues be considered in their investment decision-making process. While IFRS standards do not make specific mention of climate-related issues, climate change is something that the preparers of financial statements have to consider when applying a number of standards.

Climate-related financial reporting, together with other ESG disclosures, is an area undergoing significant change. In March 2021, the IFRS Foundation announced that it planned to establish a Sustainability Standards Board that will set sustainability reporting standards. The Foundation noted that, given the urgent need for better information about climate-related matters, these standards will initially focus on climate-related reporting. The goal is to provide a single set of global sustainability reporting standards, much like IFRS are for financial reporting, which will result in more consistent and comparable sustainability reporting.

A study by the Chartered Professional Accountants of Canada that looked at the financial statements and other public disclosures of 75 Canadian public companies found that 79% of them had some form of the climate-related disclosures, while 21% of them did not make any climate-related disclosures. Of the companies with climate-related disclosures, only 14% had climate-related disclosures reported in the financial statements. The study also found that there were "significant inconsistencies" in terms of the climate-related disclosures, "making it difficult for users to compare companies and analyze trends. Users [were] also challenged to locate relevant information" as there were no consistent practices in terms of where the information was being presented. These are exactly the issues that it is hoped the Sustainability Standards Board will address.

Climate change impact features have been added throughout the text to identify areas of the financial statements impacted by climate-related reporting issues. Having this increased awareness is key to understanding how these issues may impact the decisions of financial statement users. It is also a starting point for thinking more deeply about what ESG information should be reported by companies and how this could be done.⁶

While not part of the financial statements, all publicly traded companies are required to include a management discussion and analysis (MD&A) section in their annual reports. The MD&A section provides readers with senior management's perspective on the information contained in the financial statements. It provides very useful context for users of the financial statements.

In addition to management’s perspectives on the company’s financial results for the prior year, the MD&A provides a discussion of the risks facing the company and information about future plans. Often information is presented from the perspective of the company’s various divisions. It also includes information on significant events and about sales, profits, and cash flow during the year. The discussion focuses on the financial aspects of the business, including pricing strategies, expenses, earnings, liquidity, environmental and corporate social responsibility, expansion and future development, taxes, events after the end of the current year, and executive compensation policies.

Ethics in Accounting



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The role of accountants is expected to continue to evolve and expand in the areas of environmental and social reporting. Company managers, investors, and creditors are considering an increasing number of issues in their decision-making, including climate change, employment and pay equity, water and energy usage, ecological impacts, and employee health. In January 2021, the Chartered Professional Accountants of Ontario issued a paper titled *CPAs and the New Social Contract: The Rise of the Warrior Accountant*. The term *warrior accountant* was coined in 2020 by *Financial Times* columnist Gillian Tett, who wrote that “the Warrior Accountant will do more to change the world on green issues than activists.” The expertise that accountants have in measurement, disclosure, and auditing is viewed as being critical to ensuring that ESG reporting is rigorous, consistent, and comparable between companies and across periods.

Some companies are already reporting ESG information. To give you an example of the types of sustainability standards that are currently being reported by some companies, let’s look at a sample of some of the standards that the Sustainability Accounting Standards Board has developed for a number of different industries:

Industry	Sustainability Standard
Hotels and lodging	Total energy consumed and percentage of renewable energy Total water usage

Restaurants	Average hourly wage and percentage of employees earning minimum wage, by region Total amount of waste, percentage of food waste, and percentage diverted from landfills Total percentage of packaging made from recycled and/or renewable materials
Agricultural products	Number of incidents of non-compliance associated with water quality and/or standards and regulations Number of recall issues and total amount of food product recalled
Food retailers	Fleet fuel consumed and percentage renewable Revenue from products labelled and/or marketed to promote health and nutrition Percentage of refrigerants consumed with zero ozone-depleting potential

Maple Leaf Foods Inc. reports some of these items in its annual sustainability reports, including energy and water consumption, landfill diversion, and packaging recycling. Canadian companies are also reporting other social metrics. For example, in its *2020 Environmental, Social and Governance Report*, **The Toronto-Dominion Bank** reports on the number of mortgages issued to low-income people, accessibility services provided for people with disabilities, LGBTQ2+ programs, and initiatives to serve Indigenous peoples.

In its paper, CPA Ontario concluded that “CPAs, armed with the information and tools to make sense of the changes taking place, should embrace the warrior accountant mission.” This is an exciting area, especially for students beginning their accounting studies, and one that continues to evolve together with the traditional financial reporting that is currently the focus of the profession (and this text). This area may provide the next generation of accountants with a real opportunity to make an impact on sustainability and social justice issues.⁷

Now that you know what corporate financial reporting involves and what the main financial statements contain, in the next chapter we’ll look at how users can analyze them.

Ethics in Accounting

Shareholders hire an independent external **auditor** to review the financial statements presented to them by the company’s management. The auditor must maintain their independence from the

company’s management team throughout the audit. In order to ensure their independence and encourage ethical behaviour, the accounting profession has developed codes of professional conduct.

Assess Your Understanding

Attempt the following problems and review the solutions provided:

- Chapter End Review Problem 1-4
- Demonstration Problems 1-3 and 1-4 in Wiley's course resources

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Review and Practice

Summary

1 Define financial accounting and understand its relationship to economic decision-making.

- Financial accounting is the process by which information on the transactions of an organization is captured, analyzed, and reported to external decision makers.
- These decision makers are referred to as *financial statement users* and include investors and creditors.
- The primary purpose of financial accounting information is to aid these users in making economic decisions related to the reporting organization, such as whether to invest in it or lend it money.

2 Identify the main users of financial accounting information and explain how they use this information.

- The main users of financial accounting information include shareholders, the board of directors, potential investors, creditors (bankers and suppliers), regulators (stock exchanges), taxing authorities (governments), securities analysts, and others.
- Shareholders, the board of directors, and potential investors will use financial accounting information to enable them to assess how well management has run the company; determine whether they should buy, sell, or continue to hold shares in the company; assess the company's share price relative to the financial accounting information; and so on.
- Creditors will use financial accounting information to determine whether they should lend funds to the company, establish credit terms for it, assess a company's ability to meet its obligations, and so on.
- Regulators will use financial accounting information to determine whether a company has met its listing requirements.
- Taxing authorities will use this information in assessing the taxes owed by the organization.

3 Describe the major forms of business organization and explain the key distinctions between them.

- There are three major forms of business organization: (1) proprietorships, (2) partnerships, and (3) corporations.

- There are public corporations (whose shares trade on a public stock exchange and are widely held) and private corporations (whose shares do not trade on a public exchange and are generally owned by a small number of people).
- Corporations are separate legal entities, whereas proprietorships and partnerships are not. This means the personal assets of owners are protected in the event of legal action against corporations, whereas they are at risk in the case of proprietorships and partnerships. It also means corporations file separate tax returns, whereas the income from proprietorships and partnerships is reported on the personal tax returns of their owners.

4 Explain the three categories of business activities and identify examples of transactions related to each category.

- The three categories of business activities are: (1) operating, (2) investing, and (3) financing activities.
- Operating activities are related to the company's revenues and expenses, such as sales to customers, collections from customers, purchases of inventory, and payments of wages and other expenses.
- Investing activities include buying and selling property, plant, and equipment and buying and selling the shares of other companies.
- Financing activities include borrowing money, issuing shares, repaying loan principal, and paying dividends.

5 Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

- There are four basic financial statements: (1) the statement of income, (2) the statement of changes in equity, (3) the statement of financial position, and (4) the statement of cash flows.
- The objective of the statement of income is to measure the company's operating performance (its profit) for a period of time. This is measured by subtracting the expenses incurred during the period from the income earned (revenues) in the same period.
- The objective of the statement of changes in equity is to provide details on how each component of shareholders' equity changed during the period. The components of shareholders' equity

include share capital (the shares issued by the company) and retained earnings (the company's earnings that have been kept and not distributed as dividends).

- The objective of the statement of financial position is to present information on a company's assets, liabilities, and shareholders' equity at a specific date. Assets must be controlled by the company and embody a future benefit. Examples include cash; accounts receivable; inventory; property, plant, and equipment; land; and so on. Liabilities are obligations of a company that will result in an outflow of resources. Examples include accounts payable, deferred revenue, long-term debt, and so on.
- Shareholders' equity represents the shareholders' interest in the assets of the company and is referred to as *net assets*. Examples include common shares and retained earnings.
- The objective of the statement of cash flows is to enable financial statement users to assess the company's inflows and outflows of cash related to its operating, investing, and financial activities for a period of time.
- The notes to a company's financial statements are used to provide additional detail and context for items in the financial statements. They enable the financial statements themselves to remain uncluttered, while increasing their usefulness.

Key Terms

Accounting equation 1-19	Financial accounting 1-3	Net earnings 1-14
Annual report 1-3	Financial statement users 1-3	Net income 1-14
Assets 1-19	Financial statements 1-3	Net loss 1-14
Auditor 1-26	Financing activities 1-10	Non-current 1-18
Board of directors 1-6	Fiscal year 1-14	Notes to the financial statements 1-25
Canada Revenue Agency (CRA) 1-8	Gains 1-14	Operating activities 1-10
Capital appreciation 1-11	Gross profit 1-16	Parent company 1-14
Classified statement of financial position 1-18	Income 1-14	Principal 1-7
Common shares 1-9	Interest 1-7	Private company 1-6
Comparative information 1-14	International Financial Reporting Standards (IFRS) 1-25	Profit 1-14
Consolidated financial statement 1-14	Investing activities 1-10	Public company 1-6
Creditors 1-3	Investors 1-3	Retained earnings 1-11
Current 1-18	Liabilities 1-19	Revenues 1-14
Current assets 1-19	Liquidity 1-18	Share capital 1-17
Current liabilities 1-19	Losses 1-14	Shareholders 1-6
Dividends 1-11	Management 1-3	Shareholders' equity 1-11
Earnings 1-14	Management discussion and analysis (MD&A) 1-3	Statement of cash flows 1-23
Earnings management 1-17	Managerial accounting 1-3	Statement of changes in equity 1-17
Earnings per share 1-16	Market value 1-22	Statement of financial position 1-18
Equity 1-17	Net assets 1-21	Statement of income 1-14
Expenses 1-14		Subsidiary companies 1-14
		Working capital 1-19

Abbreviations Used

CRA	Canada Revenue Agency
IFRS	International Financial Reporting Standards
MD&A	Management discussion and analysis
TSX	Toronto Stock Exchange

Synonyms

Accounts payable | Trade payables
 Depreciation | Amortization
 Gross profit | Gross margin
 Income | Revenues
 Liabilities | Debt | Obligations
 Net earnings | Net income | Profit
 Property, plant, and equipment | Capital assets

Share capital | Common shares

Shareholders | Investors

Shareholders' equity | Net assets

Statement of cash flows | Cash flow statement

Statement of changes in shareholders' equity | Statement of shareholders' equity | Statement of changes in equity | Statement of equity

Statement of income | Statement of operations | Statement of net earnings | Statement of earnings | Statement of profit or loss | Statement of comprehensive income

Statement of financial position | Balance sheet

Deferred revenue | Unearned revenue | Deposits

The Chapter End Review Problems reinforce your understanding of major sections in the chapter. One or more questions have been created to illustrate the topics and demonstrate how you can use the information. Answers are provided so that you can check your knowledge. You can use these questions as examples when working on other questions assigned by your instructor.

Chapter End Review Problem 1-1

Use the following abbreviations to answer this question:

O	Operating activities item
I	Investing activities item
F	Financing activities item

Required

Classify each of the following transactions according to whether they are operating, financing, or investing activities:

- Purchase of manufacturing equipment
- Payments to suppliers
- Collection of amounts owed by customers
- Proceeds from issuing common shares
- Payment of dividends
- Payments of rent for leased store locations

- Proceeds from new bank loan
- Payment of employee bonuses

STRATEGIES FOR SUCCESS

- Remember that there are only four main financing activities, two inflows (proceeds from issuing shares and from taking out a loan) and two outflows (paying dividends and repaying loan principal).
- Remember that there are only four main investing activities, two inflows (proceeds from selling long-term assets, like equipment, or the shares of other companies) and two outflows (purchasing long-term assets, like equipment, and the shares of other companies).
- All other activities are operating activities.

Chapter End Review Problem 1-2

Use the following abbreviations to answer this question:

CA	Current assets
NCA	Non-current assets
CL	Current liabilities
NCL	Non-current liabilities
SC	Share capital
RE	Retained earnings
SI	Statement of income item
SCF	Statement of cash flows item
SCE	Statement of changes in equity item

Required

Classify the following items according to where they would appear in the financial statements:

- Accounts receivable
- Bank indebtedness
- Declaration of dividends, which will be paid in the next period
- Goodwill

- Purchase of a forklift for use in the warehouse
- Deferred revenue
- Payment of loan interest
- Dividends payable
- Cost of goods sold
- Income taxes payable
- Loan payable (due in five years)

STRATEGIES FOR SUCCESS

- Remember that revenues and expenses are found on the statement of income. Assets, liabilities, and shareholders' equity items are found on the statement of financial position. The statement of changes in equity includes changes in share capital and retained earnings, while the statement of cash flows presents the inflows and outflows of cash from operating, investing, and financing activities.

Chapter End Review Problem 1-3

Determine the four missing amounts (A, B, C, and D) using financial statement relationships.

Revenues	A
Expenses	668,000
Net income	194,000
Dividends declared during the year	65,000
Retained earnings	
Beginning	686,000
Ending	815,000
Total assets	
Beginning	B
Ending	3,426,000
Total liabilities	
Beginning	428,000
Ending	C

Common shares	
Beginning	D
Ending	300,000
Proceeds from issuing additional common shares during the year	100,000

STRATEGIES FOR SUCCESS

- Remember the order in which the financial statements are prepared (see Exhibit 1.23) and determine the missing amounts by following that order. Note that this may be different from the sequence of the letters.
- Remember that Revenues – Expenses = Net Income.
- Remember that Assets = Liabilities + Shareholders' Equity
- Remember that Shareholders' Equity = Common Shares + Retained Earnings

Chapter End Review Problem 1-4

The major financial statements of **High Liner Foods Incorporated** from its 2020 annual report are included in Exhibits 1.26A, 1.26B, and 1.26C. Nova Scotia-based High Liner is a leading processor and marketer of frozen seafood. Note

that its fiscal year is a 52-week period ended January 2, 2021. We will refer to these as the 2020 financial statements and use them to answer a series of questions.

EXHIBIT 1.26A High Liner Foods Incorporated's 2020 Consolidated Statement of Income

Financial Statements

HIGH LINER FOODS INCORPORATED

Consolidated Statement of Income

(in thousands of United States dollars, except per share amounts)

	Notes	Fifty-three weeks ended January 2, 2021	Fifty-two weeks ended December 28, 2019
Sales	24	\$ 827,453	\$ 942,224
Cost of sales		649,529	756,364
Gross profit		177,924	185,860
Distribution expenses		45,076	45,759
Selling, general and administrative expenses		73,736	90,019
Impairment of property, plant and equipment	8	—	974
Business acquisition, integration and other expense		2,957	1,572
Results from operating activities		56,155	47,536
Finance costs	28	19,483	33,012
Income before income taxes		36,672	14,524

Income taxes			
Current	18	6,535	3,356
Deferred	18	1,335	879
Income tax expense	18	7,870	4,235
Net income		\$ 28,802	\$ 10,289
Earnings per common share			
Basic	20	\$ 0.85	\$ 0.31
Diluted	20	\$ 0.83	\$ 0.30
Weighted average number of shares outstanding			
Basic	20	33,853,881	33,801,217
Diluted	20	34,519,305	34,195,365

HIGH LINER FOODS INCORPORATED

Consolidated Statement of Financial Position
(in thousands of United States dollars)

	Notes	January 2, 2021	December 28, 2019
Assets			
Current assets			
Cash		\$ 32,935	\$ 3,144
Accounts receivable	6	60,927	85,089
Income taxes receivable		2,609	3,494
Other financial assets	25	211	236
Inventories	7	250,861	294,913
Prepaid expenses		4,176	4,322
Total current assets		351,719	391,198
Non-current assets			
Property, plant and equipment	8	107,221	108,986
Right-of-use assets	9	15,018	11,792
Deferred finance costs	11	287	—
Deferred income taxes	18	2,401	2,134
Other receivables and assets	25	47	34
Intangible assets	10	142,168	148,893
Goodwill	10	157,697	157,457
Total non-current assets		424,839	429,296
Total assets	11, 14	\$776,558	\$820,494
Liabilities and shareholders' equity			
Current liabilities			
Bank loans	11	\$ —	\$ 37,546
Accounts payable and accrued liabilities	12	114,326	141,238
Contract liability	19	4,351	3,581
Provisions	13	3,327	329

(continued)

EXHIBIT 1.26B High Liner
Foods Incorporated's 2020
Consolidated Statement of
Financial Position

Financial Statements

EXHIBIT 1.26B High Liner Foods Incorporated's 2020 Consolidated Statement of Financial Position (continued)

	Notes	January 2, 2021	December 28, 2019
Other current financial liabilities	25	2,735	861
Other current liabilities	17	2,731	4,881
Income taxes payable		41	2,102
Current portion of long-term debt	14	20,185	14,511
Current portion of lease liabilities	9	4,866	4,582
Total current liabilities		152,562	209,631
Non-current liabilities			
Long-term debt	14	268,048	289,020
Other long-term financial liabilities	25	329	292
Other long-term liabilities	17	6,510	3,031
Long-term lease liabilities	9	10,722	7,198
Deferred income taxes	18	31,071	30,182
Future employee benefits	15	16,314	12,970
Total non-current liabilities		332,994	342,693
Total liabilities		485,556	552,324
Shareholders' equity			
Common shares	16	112,739	112,887
Contributed surplus		16,551	16,028
Retained earnings		183,649	162,773
Accumulated other comprehensive loss		(21,937)	(23,518)
Total shareholders' equity		291,002	268,170
Total liabilities and shareholders' equity		\$776,558	\$820,494

EXHIBIT 1.26C High Liner Foods Incorporated's 2020 Consolidated Statement of Cash Flows

Financial Statements

HIGH LINER FOODS INCORPORATED

Consolidated Statement of Cash Flows

(in thousands of United States dollars)

	Notes	Fifty-three weeks ended January 2, 2021	Fifty-two weeks ended December 28, 2019
Cash flows provided by (used in): Operating activities			
Net income		\$28,802	\$10,289
Adjustments to net income not involving cash from operations:			
Depreciation and amortization	28	23,228	22,455
Share-based compensation expense	17	5,861	7,124
Loss on asset disposals and impairment	8	135	1,292
Future employee benefits contribution, net of expense		363	(25)
Finance costs	28	19,483	33,012
Income tax expense	18	7,870	4,235
Unrealized foreign exchange loss		1,234	1,020
Cash flows provided by operations before changes in non-cash working capital, interest and income taxes refunded (paid)		86,976	79,402

(continued)

EXHIBIT 1.26C High Liner Foods Incorporated's 2020 Consolidated Statement of Cash Flows (continued)

Changes in non-cash working capital balances:		
Accounts receivable		212
Inventories	24,325	10,095
Prepaid expenses	45,871	95
Accounts payable and accrued liabilities	256	(18,388)
Provisions	(30,970)	(1,158)
Net change in non-cash working capital balances	2,994	(9,144)
Interest paid	42,476	(20,173)
Income taxes (paid) refunded	(19,271)	1,521
Net cash flows provided by operating activities	102,997	51,606
Financing activities		
(Decrease) increase in bank loans	21 (37,745)	6,638
Repayment of lease liabilities	21 (5,568)	(5,649)
Repayment of long-term debt	14 (14,685)	(37,926)
Deferred finance costs	21 (54)	(6,344)
Common share dividends paid		(7,424)
Common shares repurchased for cancellation		—
Net cash flows used in financing activities	(63,859)	(50,705)
Investing activities		
Purchase of property, plant and equipment, net of investment tax credits, and intangible assets		(6,569)
Net cash flows used in investing activities	(8,952)	(6,569)
Foreign exchange decrease on cash	(395)	(756)
Net change in cash during the period	29,791	(6,424)
Cash, beginning of period	3,144	9,568
Cash, end of period	\$32,935	\$ 3,144

Required

- a. Find the following amounts in the statements:
 - i. Total revenues for fiscal year 2020
 - ii. Total cost of sales for fiscal year 2020
 - iii. Total selling, general, and administrative expenses for fiscal year 2020
 - iv. Finance costs for fiscal year 2020
 - v. Income tax expense (current and deferred) for fiscal year 2020
 - vi. Net income for fiscal year 2020
 - vii. Inventories at the end of fiscal year 2020
 - viii. Accounts payable and accrued liabilities at the beginning of fiscal year 2020
 - ix. Shareholders' equity at the end of fiscal year 2020
 - x. Retained earnings at the beginning of fiscal year 2020
 - xi. Cash provided from operating activities in fiscal year 2020
 - xii. Cash payments, net of investment tax credits, to acquire property, plant, and equipment and intangible assets in fiscal year 2020
 - xiii. Cash used in the repayment of long-term debt in fiscal year 2020
 - xiv. Cash used in the payment of dividends in fiscal year 2020
 - xv. Cash provided from (used in) investing activities in fiscal year 2020

- b. Does High Liner Foods finance its business primarily with debt or with shareholders' equity? Support your answer with appropriate data.
- c. Does High Liner Foods use a classified statement of financial position? Explain.

STRATEGIES FOR SUCCESS

- Start by reviewing High Liner's three financial statements. Refresh your understanding of the kinds of information found in each statement.
- As you work through the list of items in question 1, try to remember which financial statement to look at by linking in your mind the name of the item identified and the financial statement on which it is included. As you work through more problems like this, you will become more familiar with what is on each statement.
- To answer question 2, first reread the section in the statement of financial position discussion in this chapter that explains shareholders' equity. The discussion of Dollarama's use of liabilities and shareholders' equity to finance its operations should be helpful.

Solutions to Chapter End Review Problems

Suggested Solution to Chapter End Review Problem 1-1

Use the following abbreviations to answer this question:

O	Operating activities item
I	Investing activities item
F	Financing activities item

Required

Classify each of the following transactions according to whether they are operating, financing, or investing activities:

- a. I – Investing activity
- b. O – Operating activity
- c. O – Operating activity
- d. F – Financing activity
- e. F – Financing activity
- f. O – Operating activity
- g. F – Financing activity
- h. O – Operating activity

Suggested Solution to Chapter End Review Problem 1-2

Use the following abbreviations to answer this question:

CA	Current assets
NCA	Non-current assets
CL	Current liabilities
NCL	Non-current liabilities
SC	Share capital
RE	Retained earnings
SI	Statement of income item
SCF	Statement of cash flows item
SCE	Statement of changes in equity item

Required

Classify the following items according to where they would appear in the financial statements:

- a. CA (as receivables from customers are normally collected within one year)
- b. CL (as this represents amounts owing to the bank that will be repaid within one year)

- c. SCE (as the dividends have not yet been paid, they will not appear on the statement of cash flows) and CL (as these dividends will also be a current liability)
- d. NCA (as goodwill embodies future economic benefits that will be realized over multiple future periods)
- e. SCF (as this will be an investing activity)
- f. CL (as customers don't normally prepay for goods or services more than one year in advance)
- g. SCF (as this will be an operating activity)
- h. CL (as the dividends will normally be paid to shareholders within one year)
- i. SI (as this is an expense)
- j. CL (as these will be payable to the government within one year)
- k. NCL (as this won't be paid within the next year)

Suggested Solution to Chapter End Review Problem 1-3

- a. Solve first: \$862,000 (Revenues = Expenses + Net Income; \$194,000 + \$668,000)
- b. Solve third: \$1,314,000 (Beginning Assets = Beginning Liabilities + Beginning Common Shares + Beginning Retained Earnings; \$428,000 + \$200,000 + \$686,000)
- c. Solve fourth: \$2,311,000 (Ending Liabilities = Ending Assets – Ending Common Shares – Ending Retained Earnings)
- d. Solve second: \$200,000 (Beginning Common Shares = Ending Common Shares – Proceeds from Issuing Additional Common Shares During the Year; \$300,000 – \$100,000)

Suggested Solution to Chapter End Review Problem 1-4

To find the answers to the above questions, you will need to examine closely the three financial statements that have been provided.

- a. The following answers are found on the financial statements included in **Exhibits 1.26A, 1.26B, and 1.26C**:
 - i. Total revenues in 2020: \$827,453 thousand. Revenues are reported on the statement of income.
 - ii. Total cost of sales in 2020: \$649,529 thousand. The cost of sales is a type of expense. Expenses are reported on the statement of income.
 - iii. Total selling, general, and administrative expenses in 2020: \$73,736 thousand. Expenses are reported on the statement of income.
 - iv. Finance costs in 2020: \$19,483 thousand. Expenses are reported on the statement of income.
 - v. Income tax expense (current and deferred) in 2020: \$7,870 thousand (\$6,535 + \$1,335). Expenses are reported on the statement of income.
 - vi. Net income in 2020: \$28,802 thousand. Net income is reported on the statement of income.
 - vii. Inventories at the end of 2020: \$250,861 thousand. Inventories are assets, which are reported on the statement of financial position.
 - viii. Accounts payable and accrued liabilities at the beginning of 2020: \$141,238 thousand (the end of 2019 is the same as the beginning of 2020). Liabilities are reported on the statement of financial position.
 - ix. Shareholders' equity at the end of 2020: \$291,002 thousand. Shareholders' equity is reported on the statement of financial position.
 - x. Retained earnings at the beginning of 2020: \$162,773 thousand. (Again, you need to look to the end of 2019 to find the beginning of 2020.) The retained earnings are a part of shareholders' equity that is reported on the statement of financial position.
 - xi. Cash provided from operating activities in 2020: \$102,997 thousand. The cash provided by various business activities is reported on the statement of cash flows. Operating activities are shown in the first section of this statement.
 - xii. Cash payments, net of investment tax credits, to acquire property, plant, and equipment and intangible assets in 2020: (\$8,952 thousand). The net addition of capital assets is reported under the investing section on the statement of cash flows. Putting the amount in parentheses indicates that it is a negative number. In other words, cash was used.
 - xiii. Cash used in the repayment of long-term debt in fiscal year 2020: (\$14,685 thousand). The cash used for various business activities is reported on the statement of cash flows. The repayment of debt is a financing activity.

- xiv. Cash used in the payment of dividends in 2020: (\$5,518 thousand). The cash used for various business activities is reported on the statement of cash flows. Paying dividends is a financing activity.
 - xv. Cash provided from (used for) investing activities in 2020: (\$8,952 thousand). The cash provided by various business activities is reported on the statement of cash flows. Investing activities are one of the three main sections on this statement.
- b. High Liner uses substantially more liabilities than shareholders' equity to finance its business. You can see this when you compare the total liabilities with the total liabilities plus shareholders' equity (on the statement of financial position as at January 2, 2021) as follows:

Total liabilities: \$485,556 thousand
 Total shareholders' equity: \$291,002 thousand
 Total liabilities and shareholders' equity: \$776,558 thousand

Total liabilities are, therefore, 63% ($(\$485,556 \div \$776,558) \times 100$) of High Liner's total sources of financing. Because debt must be repaid, it is important for users to understand how much of the company's activities are being financed by debt. The greater the percentage of debt to total liabilities and shareholders' equity, the more risk there is that the company may not be able to repay its debt when it comes due. At January 2, 2021, 63% of High Liner's financing was debt financing.

- c. High Liner does use a classified statement of financial position. It has labelled sections for current assets and current liabilities and for non-current assets and non-current liabilities. It has included the non-current assets and non-current liabilities in separate sections after the totals of the current assets and current liabilities. It has also given you separate totals for the non-current assets and non-current liabilities.

Assignment Material

Discussion Questions

DQ1-1 Describe the role that accounting plays in the management of a business.

DQ1-2 Describe the owner's legal liability and the taxation of income in the following forms of business: corporation, proprietorship, and partnership.

DQ1-3 Describe the circumstances in which it may make sense for an entrepreneur to operate their business as a proprietorship rather than as a corporation.

DQ1-4 Explain the difference between a public corporation and a private corporation.

DQ1-5 Explain why public companies are required to publicly disclose their financial statements, while private companies are not.

DQ1-6 Identify at least three major users of corporate financial statements, and briefly state how these users might use the information from the statements.

DQ1-7 Explain how investors expect to receive a return on the investment they make in a corporation.

DQ1-8 What is capital appreciation and how can an investor realize this type of return?

DQ1-9 Creditors are ultimately concerned with receiving two streams of cash in relation to the loans they make. Explain each of them.

DQ1-10 Describe and illustrate the three major types of activities in which all companies engage.

DQ1-11 Describe and illustrate the three major categories of items that appear in a typical statement of financial position.

DQ1-12 How do the activities that are considered to be operating activities differ from those considered to be investing activities?

DQ1-13 How do the activities that are considered to be operating activities differ from those considered to be financing activities?

DQ1-14 Explain whether the costs related to hiring and training a company's employees are considered to be an operating or investing activity.

DQ1-15 Would we normally expect a company to have an overall inflow or an overall outflow of cash from its operating activities? Explain why.

DQ1-16 Would we normally expect a company to have an overall inflow or an overall outflow of cash from its investing activities? Explain why.

DQ1-17 How is the statement of income related to the three major types of business activities?

DQ1-18 Compare and contrast the purpose of the statement of income and the statement of cash flows.

DQ1-19 How does the statement of changes in equity relate to the statement of income? Which of these statements would need to be prepared first?

DQ1-20 Explain whether or not shareholders' equity represents the interests of owners after external claims have been satisfied.

DQ1-21 Describe the purpose of the four main financial statements that are contained in annual reports.

DQ1-23 What role does the management discussion and analysis section of an annual report play in informing users about a company?

DQ1-22 Explain the purpose of the notes to the financial statements.

Application Problems Set A

API-1A (Identifying financing, investing, and operating transactions)

Required

For a company like **Canadian Tire Corporation**, provide two examples of transactions that you would classify as financing, investing, and operating activities.

API-2A (Identifying financing, investing, and operating transactions)

Required

For a company like **Bank of Nova Scotia**, provide two examples of transactions that you would classify as financing, investing, and operating activities.

API-3A (Classifying items on statement of cash flows) Use the following abbreviations to answer this question:

- O Operating activities item
- I Investing activities item
- F Financing activities item

Required

Classify each of the following transactions according to whether they are operating, financing, or investing activities:

- a. Purchase of manufacturing equipment
- b. Issuance of long-term debt
- c. Payment of property tax for office building
- d. Sale of goods sold for cash
- e. Interest paid on long-term debt
- f. Proceeds from the sale of land
- g. Payment of insurance premium
- h. Purchase of shares of another company

API-4A (Comparing statement of income and statement of financial position accounts)

Required

- a. On what financial statement would you expect to find sales revenue, and what does it represent?
- b. On what financial statement would you expect to find accounts receivable, and what does it represent?
- c. What is the connection between sales revenue and accounts receivable?

API-5A (Classifying items on financial statements) Use the following abbreviations to answer this question:

- CA Current assets
- NCA Non-current assets
- CL Current liabilities
- NCL Non-current liabilities
- SC Share capital
- RE Retained earnings
- SI Statement of income item
- SCF Statement of cash flows item
- SCE Statement of changes in equity item

Required

Classify the following items according to where they would appear in the financial statements:

- a. Wages payable
- b. Prepaid rent
- c. Dividends payable
- d. Inventory
- e. Net increase in cash
- f. Cost of goods sold
- g. Dividends declared
- h. Patents
- i. Acquisition of bank loan with a five-year term
- j. Deferred revenue
- k. Common shares

API-6A (Classifying items on financial statements) Use the same abbreviations as in AP1-5A to answer the following question.

Required

Classify the following items according to where they would appear in the financial statements:

- a. Intangible assets
- b. Interest revenue
- c. Cash collections from amounts owed by customers on account
- d. Cost of developing a new advertising campaign
- e. Earnings over the years that have not been paid to shareholders as dividends
- f. Revenue from the provision of services to customers
- g. Dividends paid
- h. Increase in a bank loan (additional borrowings)
- i. Supplies used this year
- j. An investment in the shares of another corporation (the intent is not to sell the investment in the near future)
- k. Amounts paid to repurchase shares from shareholders

API-7A (Identifying items on statement of financial position and statement of income)

Required

Indicate whether each of the following items will be reported on the statement of financial position (SFP), statement of income (SI), both the statement of financial position and statement of income (B), or neither statement (N)—for example, it might appear only on the statement of cash flows.

- a. Cash
- b. Land acquired four years ago
- c. Prepaid rent
- d. Interest revenue
- e. Sales of goods and services
- f. Dividends paid to shareholders
- g. Rent expense
- h. Sales anticipated next period
- i. Payment made to reduce the principal amount of a bank loan
- j. Common shares issued when the company was organized five years ago

API-8A (Identifying items on statement of financial position and statement of income)

Required

Indicate whether each of the following items will be reported on the statement of financial position (SFP), statement of income (SI), both the statement of financial position and statement of income (B), or neither statement (N)—for example, it might appear only on the statement of cash flows.

- a. Temporary investments
- b. Repurchase of shares issued 10 years ago
- c. Goodwill
- d. Rent revenue
- e. Goods held for resale to customers
- f. Retained earnings
- g. Interest expense
- h. Increase in accounts receivable
- i. Depreciation expense
- j. Gain on sale of equipment

API-9A (Determining missing statement of financial position amounts)

Required

Calculate the missing statement of financial position amounts in each of the following independent situations:

	A	B	C	D
Current assets	\$ (1)	\$ 600,000	\$180,000	\$ 990,000
Non-current assets	780,000	(2)	390,000	(3)
Total assets	(4)	1,335,000	(5)	1,650,000
Current liabilities	375,000	345,000	135,000	390,000
Non-current liabilities	(6)	330,000	(7)	225,000
Shareholders' equity	638,000	(8)	330,000	(9)
Total liabilities and shareholders' equity	1,350,000	(10)	(11)	(12)

API-10A (Determining missing statement of changes in equity amounts of retained earnings) The change in retained earnings from the beginning of the year to the end of the year is the result of net earnings minus dividends for the year. These changes are part of the information presented on the statement of changes in equity.

Required

Calculate the missing amounts in the reconciliation of retained earnings in each of the following independent situations:

	A	B	C	D
Retained earnings, Dec. 31, 2023	\$100,000	\$420,000	\$ (1)	\$ 930,000
Net earnings	40,000	(2)	550,000	290,000
Dividends declared and paid	10,000	50,000	225,000	(3)
Retained earnings, Dec. 31, 2024	(4)	530,000	1,800,000	1,080,000

API-11A (Determining missing financial statement information)

Required

Determine the four missing amounts using financial statement relationships.

Revenues	862,000
Expenses	A
Net income	194,000
Dividends declared during the year	65,000
Retained earnings	
Beginning	686,000
Ending	815,000

(continued)

(continued)

Total assets	
Beginning	B
Ending	3,426,000
Total liabilities	
Beginning	428,000
Ending	C
Common shares	
Beginning	D
Ending	300,000
Proceeds from issuing additional common shares during the year	100,000

API-12A (Preparing simple statement of income) Friedrich Burgel runs a ski school and excursion company called Easy Peasy Ltd. His busiest months are December through February, although, if the weather holds, he extends his school and excursions into March. For the month of January, he recorded the following items:

1. He spent \$1,465 on the utilities for the office and \$6,450 on gas and repairs for the vehicles.
2. He used supplies that cost \$16,465.
3. Customers paid him \$237,570 for excursions that took place in January and \$65,500 in deposits for trips scheduled in February.
4. He paid \$35,791 for employee wages and he spent \$10,000 to an influencer for advertising the company.

Required

- a. Prepare a statement of income to determine how much Easy Peasy Ltd. earned in January.
- b. Are there any other costs that might have been incurred in January but were not listed?

API-13A (Preparing simple statement of income) Michelle Fontaine runs an outdoor adventure company called Call of the Wild Ltd. Her busiest months are June through September, although, if the weather holds, she extends her excursions into October and November. For the month of July, she recorded the following items:

1. She paid \$49,860 for employee wages and spent \$14,610 on advertising.
2. Customers paid her \$171,430 for excursions that took place in July and \$21,000 in deposits for trips scheduled in August and September.
3. She used supplies in July that cost \$25,629.
4. She spent \$1,532 on the utilities for the office and \$3,460 on gas and repairs on the vehicles.

Required

- a. Prepare a statement of income to determine how much Call of the Wild Ltd. earned in July.
- b. Are there any other costs that might have been incurred in July but were not listed?

API-14A (Preparing simple statement of financial position) API-12A introduced Friedrich Burgel and his ski school and excursion company, Easy Peasy Ltd. At the end of January, the following items were in his records:

Loan owed to the bank	\$60,000
Common shares	41,000
Vehicles	65,000
Ski equipment	22,000
Amounts prepaid by customers for trips to be taken in February	95,000
Retained earnings	26,000
Amounts prepaid by Easy Peasy to secure accommodations in February	60,000
Cash in bank accounts	75,000

Required

- Identify each of the items in his records as an asset, liability, or shareholders' equity item.
- Prepare a statement of financial position for Easy Peasy Ltd. at the end of January.
- Does Friedrich Burgel have any inventory? Explain.
- Friedrich Burgel does not have accounts receivable in his records. Explain why it is unlikely that he will record accounts receivable. Under what business circumstances would it be necessary for him to record accounts receivable?

AP1-15A (Preparing statement of financial position) AP1-13A introduced Michelle Fontaine and her outdoor adventure company, Call of the Wild Ltd. At the end of July, the following items were in her records:

Loan owed to the bank	\$24,000
Supplies on hand to be used in August	13,420
Cash in bank accounts	33,670
Common shares	20,000
Cost of tents and rafts	34,100
Retained earnings	56,450
Amounts prepaid by customers for trips to be taken in August	19,140
Vehicles	38,400

Required

- Identify each of the items in her records as an asset, liability, or shareholders' equity item.
- Prepare a statement of financial position for Call of the Wild Ltd. at the end of July.
- Does Michelle Fontaine have any inventory? Explain.
- Michelle Fontaine does not have accounts receivable in her records. Explain why it is unlikely that she will record accounts receivable. Under what business circumstances would it be necessary for her to record accounts receivable?

Application Problems Set B

AP1-1B (Identifying financing, investing, and operating transactions)**Required**

For a company like **Aritzia Inc.** provide two examples of transactions that you would classify as financing, investing, and operating activities.

AP1-2B (Identifying financing, investing, and operating transactions)**Required**

For a company like **Telus Corporation**, provide two examples of transactions that you would classify as financing, investing, and operating activities.

AP1-3B (Classifying items on statement of cash flows)**Required**

Use the same abbreviations as in AP1-3A to classify each of the following transactions according to whether they are operating, financing, or investing activities:

- Proceeds from the sale of an investment in another company's shares
- Acquisition of a business
- Cash paid to suppliers of inventory
- Acquisition of a long-term bank loan
- Payment of advertising costs
- Purchase of a truck used for deliveries
- Payment of dividends

AP1-4B (Comparing statement of income and statement of financial position accounts)**Required**

- a. On what financial statement would you expect to find wages payable, and what does it represent?
- b. On what financial statement would you expect to find wages expense, and what does it represent?
- c. What is the connection between wages payable and wages expense?

AP1-5B (Classifying items on financial statements) Use the same abbreviations as in AP1-5A to answer the following question.

Required

Classify the following items according to where they would appear in the financial statements:

- a. Rent payable
- b. Amounts owed by customers of the company
- c. Administrative expense
- d. Proceeds received from taking out a long-term bank loan
- e. Office supplies
- f. Net earnings for the year
- g. Cash proceeds from the sale of old equipment
- h. Increase in the cash balance for the year
- i. Income tax expense
- j. Cost to the company of inventory sold to customers this year
- k. Proceeds from issuing common shares during the year

AP1-6B (Classifying items on financial statements) Use the same abbreviations as in AP1-5A to answer the following question.

Required

Classify the following items according to where they would appear in the financial statements:

- a. Goodwill arising from the acquisition of another company
- b. Payment of a utility bill
- c. Cash collections from loan receivable
- d. Short-term investments
- e. Dividends declared
- f. Cost for renting equipment
- g. Amounts owed to customers for advance payments
- h. Insurance costs for the period
- i. Inventory sold during the year
- j. Dividends declared by the board of directors but not yet paid
- k. Revenue from software licensing

AP1-7B (Identifying items on statement of financial position and statement of income)**Required**

Indicate whether each of the following items will be reported on the statement of financial position (SFP), statement of income (SI), both the statement of financial position and statement of income (B), or neither statement (N)—for example, it might appear only on the statement of cash flows.

- a. Notes receivable
- b. Interest revenue from a short-term investment
- c. Common shares
- d. Accounts payable
- e. Depreciation expense on a building

- f. Interest expense
- g. Cash from the issuance of shares
- h. Wages payable
- i. Interest expense on a bank loan
- j. Retained earnings

API-8B (Identifying items on statement of financial position and statement of income)

Required

Indicate whether each of the following items will be reported on the statement of financial position (SFP), statement of income (SI), both the statement of financial position and statement of income (B), or neither statement (N)—for example, it might appear only on the statement of cash flows.

- a. Current portion of long-term debt
- b. Gain on disposal of asset
- c. Repayment of long-term debt
- d. Deferred revenue
- e. Amortization of an intangible asset
- f. Rent paid in advance
- g. Wages owed to employees
- h. Dividend payable
- i. Income tax expense
- j. Retained earnings

API-9B (Determining missing statement of financial position amounts)

Required

Calculate the missing statement of financial position amounts in each of the following independent situations:

	A	B	C	D
Current assets	\$ 650,000	\$ (1)	\$150,000	\$320,000
Non-current assets	(2)	380,000	(3)	760,000
Total assets	1,800,000	(4)	360,000	(5)
Current liabilities	750,000	170,000	50,000	410,000
Non-current liabilities	500,000	(6)	120,000	(7)
Shareholders' equity	(8)	425,000	(9)	400,000
Total liabilities and shareholders' equity	(10)	800,000	(11)	(12)

API-10B (Determining missing statement of changes in equity amounts of retained earnings) The change in retained earnings from the beginning of the year to the end of the year is the result of net earnings minus dividends for the year. These changes are part of the information presented on the statement of changes in equity.

Required

Calculate the missing amounts in the reconciliation of retained earnings in each of the following independent situations:

	A	B	C	D
Retained earnings, Dec. 31, 2023	\$ (1)	\$350,000	\$2,400,000	\$540,000
Net earnings (loss)	30,000	400,000	(2)	190,000
Dividends declared and paid	5,000	(3)	200,000	340,000
Retained earnings, Dec. 31, 2024	95,000	600,000	\$2,700,000	(4)

API-11B (Determining missing financial statement information)**Required**

Determine the four missing amounts using financial statement relationships.

Revenues	A
Expenses	<u>2,687,000</u>
Net income	792,000
Dividends declared during the year	137,000
Retained earnings	
Beginning	1,120,000
Ending	1,775,000
Total assets	
Beginning	4,252,000
Ending	B
Total liabilities	
Beginning	C
Ending	2,564,000
Common shares	
Beginning	450,000
Ending	D
Proceeds from issuing additional common shares during the year	100,000

API-12B (Preparing simple statement of income) Lydia Cravette operates a florist shop called Scents Unlimited Ltd. During the month of May, the following things occurred:

1. She spent \$160 on the telephone system, \$370 on utilities, and \$1,500 on rent.
2. She took in \$24,730 from selling flowers and plants. All of the shop's sales were cash sales.
3. She spent \$10,733 for the cost of the flowers sold, she paid \$329 for gas and repairs to the delivery vehicle, and she paid her employees \$7,000 for wages earned during the month.

Required

- a. Prepare a statement of income to determine how much Scents Unlimited Ltd. earned in May.
- b. Are there any other costs that might have been incurred in May but are not listed?

API-13B (Preparing simple statement of income) Josephine D'eau operates a water park called Slip and Slide Ltd. Her busiest months are April through September, although, if the weather holds, she extends park access into October. For the month of July, she recorded the following items:

1. She paid \$25,000 for employee wages and spent \$5,430 on promotional material.
2. Customers paid her \$200,650 to access the water park in July and \$6,000 to park their cars. She enticed customers to purchase advance tickets for the month of August and collected \$35,000 for these advance ticket sales in the month of July.
3. She used chemical supplies to purify the water in July that cost \$15,469.
4. She spent \$6,153 for the use of water and \$8,756 on electricity as the water park extended operating hours until midnight for the month of July.

Required

- Prepare a statement of income to determine how much Slip and Slide Ltd. earned in July.
- Are there any other costs that might have been incurred in July but were not listed?

AP1-14B (Preparing simple statement of financial position) AP1-12B introduced Lydia Cravette and her florist shop, Scents Unlimited Ltd. At the end of May, the following items were in her records:

Inventory	\$ 1,100
Wages owed to employees	950
Loan owed to the bank	8,000
Cash held in a chequing account	8,361
Cost of refrigerator used to store the flowers	18,695
Prepaid rent for June	1,500
Common shares	18,000
Retained earnings	2,706

Required

- Identify each of the items in her records as an asset, liability, or shareholders' equity item.
- Prepare a statement of financial position for Scents Unlimited Ltd. at the end of May.
- Lydia Cravette does not have accounts receivable in her records. Explain why it is unlikely that she will record accounts receivable. Under what business circumstances would it be necessary for her to record accounts receivable?

AP1-15B (Preparing statement of financial position) AP1-13B introduced Josephine D'eau and her water park company, Slip and Slide Ltd. At the end of July, the following items were in her records:

Cash in bank accounts	\$15,000
Chemical supplies on hand	12,620
Loan owed to an investor	22,500
Retained earnings	20,120
Spare parts	15,000
Common shares	30,000
Amounts prepaid by customers to access the park in August	35,000
Cost of kayaks and pedal boats	65,000

Required

- Identify each of the items in her records as an asset, liability, or shareholders' equity item.
- Prepare a statement of financial position for Slip and Slide Ltd. at the end of July.
- Does Josephine D'eau have any inventory? Explain.
- Josephine D'eau does not have accounts receivable in her records. Explain why it is unlikely that she will record accounts receivable. Under what business circumstances would she need to record accounts receivable?

User Perspective Problems

UPI-1 (Information for decision-making) Suppose that you started your own company that assembles and sells laptop computers. You do not manufacture any of the parts yourself. The computers are sold through orders received over the Internet and through mail orders.

Required

Make a list of the information that would be relevant to running this business. Then discuss the information you would need to gather if you were going to approach a bank for a small business loan.

UP1-2 (Information for decision-making) Suppose that you own and operate a company. You need to raise money to expand your operation, so you approach a bank for a loan. The loan officer has asked you for your company's financial statements.

Required

- What items on your financial statements would be of the most interest to the loan officer?
- Develop four questions that you think the loan officer would be trying to answer by looking at your financial statements.

UP1-3 (Form of business) Taylor Leblond just graduated from university and is planning to start a software development company to develop and market a mapping program he has created. He is debating whether to operate the business as a proprietorship or corporation.

Required

- What advantages are there to operating as a proprietorship?
- What advantages are there to operating as a corporation?
- Which form of business organization would his customers likely prefer? Why?
- Which form of business organization would his creditors likely prefer? Why?
- Which form of business will be more advantageous to Taylor if he expects the business to grow rapidly? Why?

UP1-4 (Raising new capital) Suppose that your best friend wants to start a new company that provides website development services to customers. Your friend has some savings to start the company but not enough to buy all the equipment that she thinks she needs. She has asked you for some advice about how to raise additional funds.

Required

Give your friend at least two alternatives and provide the pros and cons for each one.

UP1-5 (Distribution of dividends to shareholders) The board of directors of a public company is having its monthly meeting. One of the items on the agenda is the possible distribution of a cash dividend to shareholders. If the board decides to issue a cash dividend, the decision obliges the company to issue cash to shareholders based on the number of shares each shareholder owns.

Required

Before making its decision, what information about the company should the board consider? Think of the items on the financial statements that you saw in this chapter.

Work in Progress

WIP1-1 (Dividends) You are part of a group of students analyzing a company's financial statements as part of a class project. At a team meeting, one of your group members makes the following statement:

“If we are trying to determine the dividends that the company has declared, then we should see it reflected on the statement of income. If we want to determine if these dividends have been paid or not, then we should review the statement of financial position. Normally, the amount of dividends declared will be equal to a company's earnings per share.”

Required

Evaluate your group member's response. Identify the elements that are correct and incorrect. For any elements that are incorrect, explain why.

WIP1-2 (Dividends) While preparing for an upcoming exam, you are studying with some classmates when one of them states the following:

“Dividends are extra cash flow to the company. Companies do not declare dividends unless they have an overall positive cash flow. To determine the amount of dividends a company declared during the year, you should look at the statement of income for the year.”

Required

Evaluate your classmate's response. Identify the elements that are correct and incorrect. For any elements that are incorrect, explain why.

WIP1-3 (Dividends) While studying with a classmate, you are discussing a question about which of the financial statements you would look to in order to determine the amount of dividends that a company declared during the year. Your classmate states:

“The amount of dividends that have been declared can be seen on the statement of income. This statement tells users how much profit the company makes after expenses and dividends declared have been deducted from the revenues earned during the period.”

Required

Evaluate your classmate’s response. Identify the elements that are correct and incorrect. For any elements that are incorrect, explain why.

WIP1-4 (Shareholders’ equity) A friend from your accounting class asks you for some help. She asks:

“Am I correct in thinking that shareholders’ equity is equal to the amount shareholders paid for their shares when they purchased them in the market? If not, can you please explain what it represents?”

Required

Evaluate your friend’s response. Identify the elements that are correct and incorrect. For any elements that are incorrect, explain why.

WIP1-5 (Shareholders’ equity) You are part of a group of students analyzing the financial statements of a public company as part of a class project. At a team meeting, one of your group members makes the following statement:

“Shareholders’ equity is really composed of two parts. The first part is the amounts contributed by shareholders, and the second is the company’s subsequent earnings. If a company reports a profit for the year, then shareholders’ equity increases by the same amount. On the other hand, shareholders’ equity is reduced by the amount of any dividends paid during the year.”

Required

Evaluate your friend’s response. Identify the elements that are correct and incorrect. For any elements that are incorrect, explain why.

WIP1-6 (Statement of cash flows) A member of your study group stated the following:

“The costs related to hiring and training a company’s employees would be considered to be an investing activity because the company is investing in its employees, an important asset to the company.”

Required

Evaluate your friend’s response and explain any deficiencies.

Reading and Interpreting Published Financial Statements

RI1-1 (Financial statements of Leon’s Furniture Limited/Meubles Léon Ltée) Base your answers to the following questions on the financial statements for **Leon’s Furniture Limited/Meubles Léon Ltée** in **Exhibits 1.27A to 1.27D**.

LEON’S FURNITURE LIMITED

Consolidated Statement of Financial Position
(C\$ in thousands)

	Notes	As at December 31, 2020	As at December 31, 2019
Assets			
Current assets			
Cash and cash equivalents	5	\$ 368,635	\$ 89,032
Restricted marketable securities		2,451	5,777
Debt securities		73,565	65,859

(continued)

EXHIBIT 1.27A Leon’s
Furniture Limited’s 2020
Consolidated Statements of
Financial Position

EXHIBIT 1.27A Leon's
Furniture Limited's 2020
Consolidated Statements of
Financial Position (*continued*)

	Notes	As at December 31, 2020	As at December 31, 2019
Equity securities		48,634	42,286
Trade receivables		130,582	140,535
Income taxes receivable		4,266	3,578
Inventories	6	332,072	334,443
Deferred acquisition costs	7	10,725	10,994
Prepaid expenses and other assets		11,095	9,273
Other assets	22	—	625
Total current assets		982,025	702,402
Non-current assets			
Deferred acquisition costs	7	17,614	16,870
Loan receivable	15	12,721	13,053
Property, plant and equipment	8	714,423	720,794
Investment properties	9	16,212	16,633
Intangible assets	10	270,481	271,810
Goodwill	10	390,120	390,120
Deferred income tax assets	20	14,993	14,779
Total non-current assets		1,436,564	1,444,059
Total assets		\$ 2,418,589	\$ 2,146,461
Liabilities			
Current liabilities			
Trade and other payables	11	\$ 304,844	\$ 256,539
Provisions	12	25,608	23,274
Income taxes payable	20	15,479	6,505
Customers' deposits	17	305,460	151,817
Lease liability	13	73,476	70,601
Dividends payable	16	36,163	10,822
Deferred warranty plan revenue	17	55,733	57,638
Loans and borrowings	14	—	25,000
Other liabilities	22	3,976	—
Total current liabilities		820,739	602,196
Non-current liabilities			
Loans and borrowings	14	90,000	70,000
Convertible debentures	14	441	48,788
Lease liability	13	327,227	342,093
Deferred warranty plan revenue	17	88,604	85,305
Redeemable share liability	15	13	13
Deferred income tax liabilities	20	75,562	82,302
Total non-current liabilities		581,847	628,501
Total liabilities		1,402,586	1,230,697
Equity			
Common shares	16	164,669	115,728
Equity component of convertible debentures	14	31	3,542
Retained earnings		842,604	793,116
Accumulated other comprehensive income		8,699	3,378
Total shareholders' equity		1,016,003	915,764
Total liabilities and shareholders' equity		\$ 2,418,589	\$ 2,146,461

LEON'S FURNITURE LIMITED

Consolidated Statement of Income
(C\$ in thousands except share and share amounts)

For the	Notes	Year ended	
		December 31, 2020	December 31, 2019
Revenue	17	\$ 2,220,180	\$ 2,283,411
Cost of sales	6	1,236,258	1,284,826
Gross profit		983,922	998,585
Operating expenses			
Selling, general and administration expenses	18	750,951	830,495
Operating profit		232,971	168,090
Finance costs	19	(22,413)	(28,689)
Finance income	19	4,526	3,505
Change in fair value of derivative instruments		(4,599)	140
Net income before income tax		210,485	143,046
Income tax expense	20	47,235	36,117
Net income for the year		\$ 163,250	\$ 106,929

EXHIBIT 1.27B Leon's
Furniture Limited's 2020
Consolidated Statements of
Income

LEON'S FURNITURE LIMITED

Consolidated Statement of Cash Flows
(C\$ in thousands except share and share amounts)

For the	Notes	Year ended	
		December 31, 2020	December 31, 2019
Operating activities			
Net income before income tax		\$ 210,485	\$ 143,046
Add (deduct) items not involving an outlay of cash:			
Depreciation of property, plant and equipment and investment properties		108,970	118,775
Amortization of intangible assets		2,319	3,920
Amortization of deferred warranty plan revenue	17	(64,736)	(71,449)
Amortization of premium		222	144
Net finance costs		18,050	25,472
Gain on sale of property, plant and equipment and investment properties		(831)	(424)
Fair value gain on loan receivable	15	(714)	(528)
Gain (loss) on sale of debt and equity instruments		(139)	5
		273,626	218,961
Change in operating working capital	26	217,674	(11,627)
Cash received on warranty plan sales		66,130	66,086
Income taxes paid		(46,006)	(38,806)
Cash provided by operating activities		511,424	234,614

(continued)

EXHIBIT 1.27C Leon's
Furniture Limited's 2020
Consolidated Statements of
Cash Flows

EXHIBIT 1.27C Leon's
Furniture Limited's 2020
Consolidated Statements of
Cash Flows (continued)

For the	Notes	Year ended	
		December 31, 2020	December 31, 2019
Investing activities			
Purchase of property, plant and equipment	8	(43,493)	(32,931)
Purchase of intangible assets	10	(995)	(1,236)
Proceeds on sale of property, plant and equipment		1,298	1,004
Purchase of debt and equity instruments		(36,038)	(36,497)
Proceeds on sale of debt and equity instruments		30,586	22,097
Repayment of loan receivable		1,046	666
Interest received		4,526	3,505
Cash used in investing activities		(43,070)	(43,392)
Financing activities			
Payment of lease liability	13	(71,076)	(66,149)
Dividends paid		(44,636)	(43,313)
Decrease of employee loans—redeemable shares	15	2,499	5,063
Repurchase of common shares	16	(48,202)	(10,158)
Repayment of term loan	14	(5,000)	(50,000)
Interest paid		(22,336)	(27,900)
Cash used in financing activities		(188,751)	(192,457)
Net increase (decrease) in cash and cash equivalents during the year		279,603	(1,235)
Cash and cash equivalents, beginning of year		89,032	90,267
Cash and cash equivalents, end of year		\$ 368,635	\$ 89,032

EXHIBIT 1.27D Leon's Furniture Limited's 2020 Consolidated Statements of Changes in Shareholders' Equity

LEON'S FURNITURE LIMITED

Consolidated Statements of Changes in Shareholders' Equity
(C\$ in thousands)

	Equity component of convertible debentures	Common shares	Accumulated other comprehensive income	Retained earnings	Total
As at December 31, 2019	\$ 3,542	\$ 115,728	\$ 3,378	\$ 793,116	\$ 915,764
Comprehensive income					
Net income for the year	—	—	—	163,250	163,250
Other comprehensive income for the year	—	—	5,321	—	5,321
Total comprehensive income	—	—	5,321	163,250	168,571
Transactions with shareholders					
Dividends declared	—	—	—	(69,977)	(69,977)
Management share purchase plan [note 15]	—	2,499	—	—	2,499
Convertible debentures [note 14]	(3,511)	51,859	—	—	48,348
Treasury shares [note 16]	—	(6)	—	(59)	(65)
Share repurchase commitment [note 16]	—	(159)	—	(841)	(1,000)
Repurchase of common shares [note 16]	—	(5,252)	—	(42,885)	(48,137)
Total transactions with shareholders	(3,511)	48,941	—	(113,762)	(68,332)
As at December 31, 2020	\$ 31	\$ 164,669	\$ 8,699	\$ 842,604	\$ 1,016,003

(continued)

EXHIBIT 1.27D Leon's Furniture Limited's 2020 Consolidated Statements of Changes in Shareholders' Equity (*continued*)

	Equity component of convertible debentures	Common shares	Accumulated other comprehensive income (loss)	Retained earnings	Total
As at December 31, 2018	\$ 3,546	\$ 111,956	\$ (1,539)	\$ 743,399	\$ 857,362
Comprehensive income					
Net income for the year	—	—	—	106,929	106,929
Other comprehensive income for the year	—	—	4,917	—	4,917
Total comprehensive income	—	—	4,917	106,929	111,846
Transactions with shareholders					
Dividends declared	—	—	—	(43,445)	(43,445)
Management share purchase plan [note 15]	—	5,063	—	—	5,063
Convertible debentures [note 14]	(4)	100	—	—	96
Share repurchase commitment [note 16]	—	(443)	—	(4,557)	(5,000)
Repurchase of common shares [note 16]	—	(948)	—	(9,210)	(10,158)
Total transactions with shareholders	(4)	3,772	—	(57,212)	(53,444)
As at December 31, 2019	\$ 3,542	\$ 115,728	\$ 3,378	\$ 793,116	\$ 915,764

In the questions below, the year 2020 refers to Leon's fiscal year that ends December 31, 2020, and the year 2019 refers to the prior fiscal year ended December 31, 2019.

Required

- a. Determine the amount of dividends that Leon's declared in 2020. On which financial statement(s) did you find this information?
- b. Find the following amounts in the statements:
 - i. Revenue in 2020
 - ii. Cost of sales in 2020
 - iii. Gross profit (as a dollar amount and as a percentage) in 2020
 - iv. Selling, general, and administrative expenses in 2020
 - v. Income tax expense in 2020
 - vi. Net income in 2019
 - vii. Trade receivables at the end of 2019
 - viii. Inventories at the end of 2020
 - ix. Trade and other payables at the beginning of the 2020 fiscal year
 - x. Retained earnings at the end of 2020
 - xi. Loans and borrowings at the beginning of 2020 (include the current portion)
 - xii. Cash flows provided by operating activities in 2020
 - xiii. Cash payments to purchase property, plant, and equipment in 2020
 - xiv. Cash payments for dividends in 2020
 - xv. Cash flows generated by (used in) financing activities in 2019
 - xvi. Cash payments to repurchase common shares in 2020
- c. List the two largest sources of cash and the two largest uses of cash in 2020. (Consider operating activities to be a single source or use of cash.)
- d. Suggest two reasons why net income was \$163,250 thousand in 2020, yet cash provided by operating activities was \$511,424 thousand.
- e. During 2020, total revenue was approximately \$63,231 thousand lower than in 2019. However, net income in 2020 was \$56,321 thousand higher than in 2019. Examine the consolidated statements of income and explain how this was possible.

R11-2 (Financial statements of Waterloo Brewing Ltd.) Base your answers to the following questions on the 2021 financial statements for **Waterloo Brewing Ltd.** in Exhibits 1.28A to 1.28C.

EXHIBIT 1.28A Waterloo
 Brewing Ltd.'s 2021 Statements
 of Financial Position

WATERLOO BREWING LTD.

Statements of Financial Position

As at January 31, 2021 and January 31, 2020	Notes	January 31, 2021	January 31, 2020
Assets			[recast – note 3.6]
Current assets			
Accounts receivable	6	\$ 9,871,061	\$ 4,976,226
Inventories	7	14,344,496	10,482,912
Prepaid expenses		729,260	787,448
		24,944,817	16,246,586
Non-current assets			
Property, plant and equipment	8	46,630,107	32,808,678
Right-of-use assets	9	26,936,861	27,840,996
Intangible assets	10	15,002,826	15,184,333
Construction deposits		1,949,074	1,050,425
		90,518,868	76,884,432
Total Assets		\$115,463,685	\$93,131,018
Liabilities and Equity			
Current liabilities			
Bank indebtedness	11	\$ 3,366,489	\$ 783,077
Accounts payable and accrued liabilities	12	21,341,335	12,909,771
Current portion of lease liabilities	13	3,282,080	2,869,733
Non-revolving demand loans	14	25,896,379	13,748,967
Current portion of long-term debt	15	510,275	687,836
		54,396,558	30,999,384
Non-current liabilities			
Provisions	16	1,019,962	958,025
Lease liabilities	13	21,522,379	23,226,137
Long-term debt	15	1,367,930	1,852,023
Deferred income tax liability	17	3,462,495	2,208,947
		27,372,766	28,245,132
Total Liabilities		81,769,324	59,244,516
Equity			
Share capital	18	39,546,216	39,126,283
Share-based payments reserves	19	2,245,415	2,108,671
Deficit		(8,097,270)	(7,348,452)
Total Equity		33,694,361	33,886,502
Commitments	26		
Total Liabilities and Equity		\$115,463,685	\$93,131,018

EXHIBIT 1.28B Waterloo Brewing Ltd.'s 2021 Statements of Comprehensive Income**WATERLOO BREWING LTD.**

Statements of Comprehensive Income

Years ended January 31, 2021 and 2020

	Notes	January 31, 2021	January 31, 2020
Revenue	20	\$86,699,345	\$60,333,417
Cost of sales	13, 21	66,000,997	42,483,862
Gross profit		20,698,348	17,849,555
Selling, marketing and administration expenses	13, 21	11,853,169	11,842,088
Other expenses	13, 21, 22	2,268,499	1,616,977
Finance costs	13, 23	2,107,363	1,500,682
Loss on misappropriated funds, net	12	—	1,869,595
Loss (gain) on disposal of property, plant and equipment and right-of-use assets		215,756	(15,168)
Income before tax		4,253,561	1,035,381
Income tax expense	17	1,253,548	537,779
Net income and comprehensive income for the year		\$ 3,000,013	\$ 497,602

EXHIBIT 1.28C Waterloo Brewing Ltd.'s 2021 Statements of Cash Flows**WATERLOO BREWING LTD.**

Statements of Cash Flow

Years ended January 31, 2021 and 2020

	Notes	January 31, 2021	January 31, 2020
			[recast – note 3.6]
Operating activities			
Net income		\$ 3,000,013	\$ 497,602
Adjustments for:			
Income tax expense	17	1,253,548	537,779
Finance costs	23	2,107,363	1,500,682
Depreciation and amortization of property, plant and equipment, right-of-use assets and intangibles	8, 9, 10, 21, 22	7,810,676	6,334,179
Loss (gain) on disposal of property, plant and equipment and right-of-use assets		215,756	(15,168)
Share-based payments	19	792,327	892,360
Change in non-cash working capital	28	(442,761)	5,036,143
Less:			
Interest paid		(1,859,817)	(1,373,019)
Cash provided by operating activities		12,877,105	13,410,558
Investing activities			
Purchase of property and equipment	8	(18,407,338)	(11,013,763)
Construction deposit paid	8	(1,949,074)	(1,050,425)
Proceeds from sale of property, plant and equipment, net		9,555	18,656
Purchase of intangible assets	10	(25,659)	(134,624)
Cash used in investing activities		(20,372,516)	(12,180,156)

(continued)

EXHIBIT 1.28C Waterloo Brewing Ltd.'s 2021 Statements of Cash Flows (*continued*)

	Notes	January 31, 2021	January 31, 2020
Financing activities			
Increase (decrease) in bank indebtedness	11	2,583,412	(1,104,176)
Issuance of non-revolving demand loans	14	14,505,315	7,961,780
Repayment of non-revolving demand loans	14	(2,357,903)	(1,292,639)
Repayment of long-term debt	15	(671,169)	(672,193)
Repayment of lease liabilities	13	(2,579,763)	(1,563,059)
Dividends paid	18	(3,748,831)	(3,576,462)
Issuance of shares, net of fees	19	29,368	96,722
Shares repurchased and cancelled, including fees	18	(377,058)	(1,125,484)
Stock option costs	19	—	(17,169)
Proceeds from stock option exercise	19	112,040	62,278
Cash generated from (used in) financing activities		7,495,411	(1,230,402)
Net increase/(decrease) in cash		—	—
Cash, beginning of year		—	—
Cash, end of year		\$ —	\$ —
Non-cash investing activities:			
Acquisition of assets under lease	9, 13	\$ 1,311,281	\$13,822,240

In the questions below, the year 2021 refers to Waterloo Brewing's fiscal year ended January 31, 2021, and the year 2020 refers to the prior year ended January 31, 2020.

Required

- a. Waterloo Brewing's financial statements do not include the word "consolidated" in their title. What does this tell you about the company's structure?
- b. Waterloo Brewing prepared a classified statement of financial position. Calculate the difference between current assets and current liabilities at the end of 2021, and at the end of 2020. This amount is referred to as *working capital*. Did the company's working capital improve in 2021? Explain.
- c. Find the following amounts in Waterloo Brewing's statements:
 - i. Revenues in 2021
 - ii. Cost of sales in 2021
 - iii. Gross profit (as a dollar amount and as a percentage) in 2021
 - iv. Selling, marketing, and administration expenses in 2020
 - v. Income tax expense in 2020
 - vi. Net income in 2021
 - vii. Intangible assets at the end of 2021
 - viii. Accounts receivable at the beginning of 2021
 - ix. Share capital at the end of 2021
 - x. Property, plant, and equipment at the end of 2021
 - xi. Cash flows from operating activities in 2021
 - xii. Cash payments to purchase property, plant, and equipment in 2021
 - xiii. Cash used for the payment of dividends in 2021
- d. Did Waterloo Brewing finance the company's assets mainly from creditors (total liabilities) or from shareholders (shareholders' equity) in 2021? Support your answer with appropriate calculations.

- e. List the two largest sources of cash and the two largest uses of cash in 2021. (Consider cash generated from operating activities to be a single source or use of cash.)
- f. Suggest some reasons why Waterloo Brewing's net income was \$3,000,013 in 2021, yet cash provided by operating activities was \$12,877,105.

RI1-3 (Financial statements of Roots Corporation) The major financial statements of **Roots Corporation** for the year ended January 30, 2021, are included in **Exhibits 1.29A** to **1.29C**.

EXHIBIT 1.29A Roots Corporation's 2021 Consolidated Statement of Financial Position

ROOTS CORPORATION

Consolidated Statement of Financial Position

As at January 30, 2021 and February 1, 2020

(in thousands of Canadian dollars)

	Note	January 30, 2021	February 1, 2020
Assets			
Current assets			
Cash	19	\$ 9,166	\$ 949
Accounts receivable	4, 14	7,165	7,158
Inventories	5, 19	42,401	40,152
Prepaid expenses		3,137	5,418
Total current assets		61,869	53,677
Non-current assets			
Loan receivable	14, 18	608	585
Lease receivable	9, 14	1,187	1,511
Fixed assets	6, 19	47,981	55,694
Right-of-use assets	9, 19	79,995	128,322
Intangible assets	7	190,777	193,079
Goodwill	7	7,906	7,906
Total non-current assets		328,454	387,097
Total assets		\$390,323	\$440,774
Liabilities and shareholders' equity			
Current liabilities			
Bank indebtedness		\$ —	\$ 7,226
Accounts payable and accrued liabilities	14, 19	25,850	20,252
Deferred revenue		5,759	6,011
Income taxes payable	15	5,955	2,008
Current portion of lease liabilities	9, 14, 19	22,197	26,569
Current portion of long-term debt	10, 14	4,984	4,984
Derivative obligations	8, 14	418	158
Total current liabilities		65,163	67,208
Non-current liabilities			
Deferred tax liabilities	15	15,891	13,942
Long-term portion of lease liabilities	9, 14, 19	78,989	124,590
Long-term debt	10, 14	66,100	84,528
Total non-current liabilities		160,980	223,060
Total liabilities		226,143	290,268

(continued)

EXHIBIT 1.29A Roots Corporation's 2021 Consolidated Statement of Financial Position (*continued*)

	Note	January 30, 2021	February 1, 2020
Shareholders' equity:			
Share capital	11	197,333	196,903
Contributed surplus	13	3,682	3,407
Accumulated other comprehensive income (loss)		(227)	(116)
Retained earnings (deficit)		(36,608)	(49,688)
Total shareholders' equity		164,180	150,506
Total liabilities and shareholders' equity		\$390,323	\$440,774

EXHIBIT 1.29B Roots Corporation's 2021 Consolidated Statement of Net Income (Loss)

ROOTS CORPORATION

Consolidated Statement of Net Income (Loss)

For the 52-week periods ending January 30, 2021 and February 1, 2020

(in thousands of Canadian dollars, except per share amounts)

	Note	January 30, 2021	February 1, 2020
Sales		\$240,506	\$329,865
Cost of goods sold	5	100,767	153,676
Gross profit		139,739	176,189
Selling, general and administrative expenses	20	114,807	188,308
Goodwill impairment	7	—	44,799
Gain from deconsolidation of RTS USA Corp.	19	4,774	—
Income (loss) before interest expense and income taxes expense (recovery)		29,706	(56,918)
Interest expense	10	11,741	15,567
Income (loss) before income taxes		17,965	(72,485)
Income taxes expense (recovery)	15	4,885	(10,456)
Net income (loss)		\$ 13,080	\$ (62,029)

EXHIBIT 1.29C Roots Corporation's 2021 Consolidated Statement of Cash Flows

ROOTS CORPORATION

Consolidated Statement of Cash Flows

For the 52-week periods ended January 30, 2021 and February 1, 2020

(in thousands of Canadian dollars)

	Note	January 30, 2021	February 1, 2020
Cash provided by (used in):			
Operating activities:			
Net income (loss)		\$ 13,080	\$(62,029)
Items not involving cash:			
Depreciation and amortization	6, 7, 9	33,325	39,606
Share-based compensation expense (recovery)	13	705	(518)
Impairment of fixed assets and right-of-use assets	6, 9	2,048	22,398
Impairment of goodwill	7	—	44,799

(continued)

EXHIBIT 1.29C Roots
 Corporation's 2021
 Consolidated Statement of
 Cash Flows (*continued*)

Gain from deconsolidation of RTS USA Corp.	19	(4,774)	—
Unrealized losses on forward contracts	8	105	—
Gain on lease modification	9	(310)	(520)
Rent concessions related to practical expedient	9	(3,525)	—
Interest expense	10	11,741	15,567
Income taxes expense (recovery)	15	4,885	(10,456)
Interest paid		(4,337)	(5,904)
Payment of interest on lease liabilities	9	(6,724)	(9,048)
Taxes refunded (paid)		1,056	(2,200)
Change in non-cash operating working capital:			
Accounts receivable	4	(7)	(531)
Inventories	5	(4,540)	9,381
Prepaid expenses		2,281	1,025
Accounts payable and accrued liabilities		6,165	(2,039)
Deferred revenue		(252)	513
		50,922	40,044
Financing activities			
Issuance (repayment) of long-term debt	10	(14,000)	9,000
Long-term debt financing costs	10	(148)	(163)
Repayment of Term Credit Facility	10	(4,984)	(4,984)
Payment of principal on lease liabilities, net of tenant allowance	9	(12,383)	(17,436)
		(31,515)	(13,583)
Investing activities:			
Additions to fixed assets	6	(3,423)	(22,320)
Deconsolidation of RTS USA Corp.	19	(541)	—
		(3,964)	(22,320)
Increase in cash		15,443	4,141
Cash and bank indebtedness, beginning of period		(6,277)	(10,418)
Cash and bank indebtedness, end of period		\$ 9,166	\$ (6,277)

Required

- a. Find the following amounts in the statements:
 - i. Total sales for fiscal year 2021
 - ii. Total cost of goods sold for fiscal year 2021
 - iii. Selling, general, and administrative expenses for fiscal year 2020
 - iv. Interest expense for fiscal year 2020
 - v. Income tax expense for fiscal year 2021
 - vi. Net income for fiscal year 2021
 - vii. Inventories at the end of fiscal year 2021
 - viii. Accounts payable and accrued liabilities at the beginning of fiscal year 2021
 - ix. Shareholders' equity at the end of fiscal year 2021
 - x. Retained earnings (deficit) at the end of fiscal year 2021
 - xi. Cash provided from operating activities in fiscal year 2021
 - xii. Cash payments to acquire fixed assets in fiscal year 2021
 - xiii. Cash used to repay long-term debt in fiscal year 2021
 - xiv. Cash used to pay dividends in fiscal year 2021

- b. Does Roots finance its business primarily with debt or with shareholders' equity? Support your answer with appropriate data.
- c. Did Roots have a net inflow or a net outflow of cash from financing activities in 2021? What about from its investing activities?
- d. Does Roots use a classified statement of financial position? Explain.

RII-4 (Financial statements of Gildan Activewear Inc.) Excerpts from the 2020 financial statements of **Gildan Activewear Inc.** are in **Exhibits 1.30A** to **1.30C**.

EXHIBIT 1.30A Gildan Activewear Inc.'s 2020 Consolidated Statements of Earnings and Comprehensive Income

GILDAN ACTIVEWEAR INC.

Consolidated Statements of Earnings and Comprehensive Income

Fiscal years ended January 3, 2021 and December 29, 2019

(in thousands of U.S. dollars)

	2020	2019
Net sales (note 25)	\$1,981,276	\$2,823,901
Cost of sales (note 16(c))	1,732,217	2,119,440
Gross profit	249,059	704,461
Selling, general and administrative expenses (note 16(a))	272,306	340,487
Impairment of trade accounts receivable (note 6)	15,453	27,652
Restructuring and acquisition-related costs (note 17)	48,154	47,329
Impairment of goodwill and intangible assets	93,989	—
Operating income (loss)	(180,843)	288,993
Financial expenses, net (note 14(c))	48,530	39,168
Earnings (loss) before income taxes	(229,373)	249,825
Income tax recovery (note 18)	(4,091)	(9,984)
Net earnings (loss)	(225,282)	259,809
Other comprehensive income (loss), net of related income taxes:		
Cash flow hedges (note 14(d))	(8,503)	(3,917)
Actuarial gain (loss) on employee benefit obligations (note 12(a))	12,142	(1,296)
	3,639	(5,213)
Comprehensive income (loss)	\$ (221,643)	\$ 254,596

EXHIBIT 1.30B Gildan Activewear Inc.'s 2020 Consolidated Statements of Financial Position

GILDAN ACTIVEWEAR INC.

Consolidated Statements of Financial Position

(in thousands of U.S. dollars)

	January 3, 2021	December 29, 2019
Current assets:		
Cash and cash equivalents (note 5)	\$ 505,264	\$ 64,126
Trade accounts receivable (note 6)	196,480	320,931
Income taxes receivable	4,632	—
Inventories (note 7)	727,992	1,052,052
Prepaid expenses deposits and other current assets	110,105	77,064
Total current assets	1,544,473	1,514,173

(continued)

EXHIBIT 1.30B Gilman
 Activewear Inc.'s 2020
 Consolidated Statements of
 Financial Position (continued)

Non-current assets		
Property, plant and equipment (note 8)	896,800	994,980
Right-of-use assets (note 9(a))	59,445	73,539
Intangible assets (note 10)	289,901	383,864
Goodwill (note 10)	206,636	227,865
Deferred income taxes (note 18)	17,689	9,917
Other non-current assets	6,004	6,732
Total non-current assets	1,476,475	1,696,897
Total assets	\$3,020,948	\$3,211,070
Current liabilities:		
Accounts payable and accrued liabilities	\$ 343,722	\$ 406,631
Income taxes payable	—	1,255
Current portion of lease obligations (note 9(b))	15,884	14,518
Total current liabilities	359,606	422,404
Non-current liabilities		
Long-term debt (note 11)	1,000,000	845,000
Lease obligations (note 9(b))	66,580	66,982
Other non-current liabilities (note 12)	35,865	42,190
Total non-current liabilities	1,102,445	954,172
Total liabilities	1,462,051	1,376,576
Commitments, guarantees and contingent liabilities (note 23)		
Equity (note 13)		
Share capital	183,938	174,218
Contributed surplus	24,936	32,769
Retained earnings	1,359,061	1,628,042
Accumulated other comprehensive income	(9,038)	(535)
Total equity attributable to shareholders of the Company	1,558,897	1,834,494
Total liabilities and equity	\$3,020,948	\$3,211,070

GILDAN ACTIVEWEAR INC.

Consolidated Statements of Cash Flows

Fiscal years ended January 3, 2021 and December 29, 2019

(in thousands of U.S. dollars)

	2020	2019
Cash flows from (used in) operating activities:		
Net earnings (loss)	\$(225,282)	\$ 259,809
Adjustments to reconcile net earnings to cash flows from operating activities (note 21(a))	297,802	175,548
	72,520	435,357
Changes in non-cash working capital balances:		
Trade accounts receivable	125,150	(3,515)
Income taxes	(5,747)	2,969
Inventories	320,384	(115,082)

(continued)

EXHIBIT 1.30C Gilman
 Activewear Inc.'s 2020
 Consolidated Statements of
 Cash Flows

EXHIBIT 1.30C Gildan
Activewear Inc.'s 2020
Consolidated Statements of
Cash Flows (continued)

	2020	2019
Prepaid expenses, deposits and other current assets	(34,801)	(8,320)
Accounts payable and accrued liabilities	(62,476)	49,621
Cash flows from operating activities	415,030	361,030
Cash flows from (used in) investing activities:		
Purchase of property, plant and equipment	(50,670)	(128,676)
Purchase of intangible assets	(7,670)	(11,558)
Business acquisitions	—	(1,300)
Proceeds on disposal of property, plant and equipment	830	5,783
Cash flows used in investing activities	(57,510)	(135,751)
Cash flows from (used in) financing activities:		
(Decrease) increase in amounts drawn under revolving long-term bank credit facility	(245,000)	176,000
Proceeds from term loan	400,000	—
Payment of lease obligations	(15,418)	(13,534)
Dividends paid	(30,553)	(110,346)
Proceeds from issuance of shares	2,854	10,318
Repurchase and cancellation of shares (note 13(d))	(23,216)	(257,233)
Share repurchases for settlement of non-Treasury RSUs	(2,558)	(7,008)
Withholding taxes paid pursuant to the settlement of non-Treasury RSUs	(2,571)	(6,001)
Cash flows (used in) from financing activities	83,538	(207,804)
Effect of exchange rate changes on cash and cash equivalents denominated in foreign currencies	80	(6)
Net increase in cash and cash equivalents during the fiscal year	441,138	17,469
Cash and cash equivalents, beginning of fiscal year	64,126	46,657
Cash and cash equivalents, end of fiscal year	\$ 505,264	\$ 64,126

In the questions below, the year 2020 refers to Gildan's fiscal year ended January 3, 2021, and the year 2019 refers to the prior year ended December 29, 2019.

Required

- a. Find the following amounts in the statements:
 - i. Net sales in 2020
 - ii. Gross profit in 2020
 - iii. Total selling, general, and administrative expenses in 2019
 - iv. Net earnings (loss) in 2020
 - v. Inventories at the beginning of 2020
 - vi. Trade accounts receivable at the end of 2020
 - vii. Retained earnings at the end of 2020
 - viii. Long-term debt at the end of 2019
 - ix. Cash flows from operating activities in 2020
 - x. Cash payments to acquire property, plant, and equipment in 2020
 - xi. Dividends paid in 2020
 - xii. Cash produced or used for investing activities in 2019
- b. Did Gildan Activewear finance its business primarily from creditors (total liabilities) or from shareholders (shareholders' equity) in 2020? Support your answer with appropriate calculations.
- c. List the two largest sources of cash and the two largest uses of cash in 2020. (Consider operating activities to be a single source or use of cash.)

- d. Did Gildan Activewear prepare a classified statement of financial position? How can you tell?
- e. Calculate the difference between the current assets and current liabilities at the end of 2020, and at the end of 2019. This amount is referred to as *working capital*. Did the company's working capital improve in 2020? Explain.

RI1-5 (Using sources other than the textbook to find company information) The SEDAR website (www.sedar.com) contains most securities-related information required by the Canadian securities regulatory authorities. It is probably your best source for financial statements of Canadian companies on the Internet. In addition, most companies that have a website have a section on investor information. In this section, they often include their most recent financial reports and news releases.

Required

Choose a Canadian publicly traded company. Collect several articles about the company that cover the most recent two-year period. Try to find at least three longer articles. If the company has a website (most companies do), it will probably have useful news releases there. Finally, go to the SEDAR website and find the company's most recent financial statements filed there.

Answer the following questions:

- a. What are the products (or product lines) and/or services that it sells? Be as specific as possible.
- b. Who are the company's customers?
- c. In what markets, domestic and global, does the company sell its products and/or services?
- d. Who are the company's major competitors?
- e. What are the major inputs that the company needs in order to produce its product? Who are the suppliers of these inputs?
- f. Are any of the items listed in the questions above changing substantially? Use a two-year time span to answer this question.

RI1-6 (Using sources other than the textbook to find company information)

Required

Go to a publicly traded company's website and find the company's most recent annual report. Answer the following questions:

- a. What are the major sections of the annual report?
- b. What are the three most important points in the letter to the shareholders?
- c. What are the titles of the major financial statements in the report?
- d. What are the company's total assets, total liabilities, and total shareholders' equity? What percentage of the company's total assets is financed through liabilities?
- e. Is the statement of financial position classified or unclassified? If it is classified, what are the major categories?
- f. What are the net sales in the most recent year? Are they up or down from the previous year? (Answer in both dollar and percentage amounts.)
- g. What is the net income and earnings per share in the most recent year? Are these amounts up or down from the previous year? (Answer in both dollar and percentage amounts.)
- h. What is the net cash provided (used) by operating, financing, and investing activities for the most recent year?
- i. What is the last day of the company's fiscal year?

Cases

C1-1 Enticing Fashions Ltd.

Enticing Fashions Ltd. designs and manufactures upscale women's clothing. The company's early customers were small boutiques in Toronto, Montreal, and Vancouver. Customers liked the colours and fabrics used and enjoyed the unique styling of the garments. Demand for the company's clothing rose to the point where it is looking at opening a number of its own stores in various retail locations across Canada. The company has approached its bank seeking additional financing so that it can proceed with its plan to develop retail locations and hire more people to assist with various aspects of the business. The bank wants to see the company's financial statements.

You are an accountant employed by a local accounting firm, and Enticing Fashions Ltd. has been your client for several years. In previous years, you have prepared the company's financial statements and corporate tax returns. Enticing Fashions' CEO has approached you because he wants to have an understanding about how the bank may use the company's financial statements in determining whether or not to grant the loan.

Required

Prepare a memo to Enticing Fashions' CEO addressing his question regarding how banks use financial statements to determine whether or not to grant loans to companies.

Endnotes

¹Dollarama, *2021 Annual Report*; Dollarama corporate website, <https://www.dollarama.com>.

²Wildflower Brands Inc., "Wildflower Brands Cease Trade Order," Press release, February 23, 2021; "Cease Trade Orders: Wildflower Brands Inc." British Columbia Securities Commission, February 3, 2021, <https://www.bsc.bc.ca/enforcement/early-intervention/cease-trade-orders/2021/wildflower-brands-cease-trade-order>; Wildflower Brands Inc., *Financial Statements for the Year Ended June 30, 2019*.

³"Canadian Business Counts, with employees," Statistics Canada, *June 2020*, <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3310026701>; "Business Startup Statistics Canada (2021 Update)," Fundsquire Limited, accessed April 10, 2021, <https://fundsquire.ca/startup-statistics-canada/>; TSX, *Inter-listed Companies*, accessed January 15, 2021, <https://www.tsx.com/trading/market-data-and-statistics/market-statistics-and-reports/interlisted-companies>.

⁴Sam Bourgi, "5 Canadian Companies That Have Paid a Dividend for Over 100 Years," Dividend Investing Ideas Center, <https://dividend.com/how-to-invest/over-100-years-of-dividends-for-5-canadian-companies/>.

⁵Canada Goose Holdings, *2020 Annual Report*.

⁶"CPA Canada Study of Climate-Related Disclosures by Canadian Public Companies," CPA Canada, accessed 2017, <https://cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/sustainability-environmental-and-social-reporting/publications/climate-related-disclosure-study>; IFRS Foundation, *Effects of Climate-Related Matters on Financial Statements*, November 2020, <https://ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf>; Sebastien Betermier, "Are University Pension Plans the Next Battleground in the Climate Debate?" *The Globe and Mail*, December, 20, 2019, <https://theglobeandmail.com/business/commentary/article-are-university-pension-plans-the-next-battleground-in-the-climate/>; ICAEW Insights, "Beyond Financial Reporting to Sustainability Reporting," ICAEW, March 16, 2021, <https://www.icaew.com/insights/viewpoints-on-the-news/2021/mar-2021/beyond-financial-reporting-to-sustainability-reporting>.

⁷"CPAs and the New Social Contract: The Rise of the Warrior Accountant," Chartered Professional Accountants of Ontario, January 2021, <https://cpaontario.ca/insights/esg-thought-leadership>; Sustainability Accounting Standards Board, *Hotels & Lodging Sustainability Accounting Standard 2018-10*, *Restaurants Sustainability Accounting Standard 2018-10*, *Agricultural Products Sustainability Accounting Standard 2018-10*, *Food Retailers & Distributors Sustainability Accounting Standard 2018-10*; Maple Leaf Foods Inc., *2019 Sustainability Report*; The Toronto-Dominion Bank, *2020 Environmental, Social and Governance Report*.