



Simon Porter/Getty Images

The Purpose and Use of Financial Statements

Feature Story

Trading on a Long Tradition The North West Company Inc. is one of the world's longest-running retail enterprises. It was established in Montreal in 1668 by European fur traders who helped map Canada's North. It was merged with the rival Hudson's Bay Company in 1821 and became the Northern Stores Division. A group of investors purchased the division in 1987 and, in 1992, the company began trading on the Toronto Stock Exchange as The North West Company Inc.

The North West Company is still a fixture in Canada's North. It is the largest private employer of Indigenous peoples in Canada and serves communities ranging from 300 to 8,000 people—many of them former trading posts. Its stores carry food, clothing, housewares, appliances, and outdoor gear. Many of the stores also provide services such as fuel, a post office, pharmacy, and income tax return preparation. The challenges and costs of operating in the far North are significant, including the fact that about 95% of the company's 117 Canadian stores cannot be accessed by all-weather roads. The company owns and operates its own airline, North Star Air Ltd., as well as 50% of Transport Nanuk Inc., a shipping company. Both of these help North West transport passengers, cargo, and fuel to communities in northern Canada, Alaska, and the eastern Arctic.

In 1992, North West began operating internationally when it acquired stores in Alaska. This was followed by a 2007 acquisition of stores in the South Pacific and Caribbean. As at January 31, 2022, North West operated 161 stores in Canada, 34 in Alaska, and 21 in the South Pacific and Caribbean. These stores are operated under a number of banners, including Northern, NorthMart, Quickstop, Giant Tiger, Alaska Commercial, Riteway, and Cost-U-Less. Staying true to its roots, North West still has operations that purchase furs from trappers. For the fiscal year ending January 31, 2022, North West had sales of more than \$2.2 billion and profits of about \$157 million. The company's international operations generated 43% of its total revenues.

The *Feature Story* helps you picture how the chapter relates to the real world of accounting and business. You will find references to the story throughout the chapter.

How does a company like The North West Company decide whether to expand into a new market, change its product categories, or operate as a franchise? How are decisions made regarding what types and quantities of inventory should be carried at each store? How are pricing decisions made, given the significance of transportation costs and changing foreign currency values? How does the company track consumer demands in the disparate markets it serves? Management relies on accounting as its key decision-making tool. And it's not just the company that needs financial information for making decisions. External audiences, such as banks, potential shareholders, and suppliers, also need to see the company's financial information before deciding whether to lend to, invest in, or sell to the retailer. The way The North West Company and other businesses communicate their financial information is through financial statements.¹

The Chapter Preview describes the purpose of the chapter and highlights major topics.

The Chapter Outline presents the chapter's learning objectives, topics, and practice opportunities to give you a framework for learning the specific concepts covered in the chapter.

Chapter Preview

To be successful in business, countless decisions must be made—and many decisions require accounting information. The purpose of this chapter is to show you accounting's role in providing useful financial information for decision-making. The material in this chapter will help you answer many questions, including: Who uses accounting information and how do they use it? How are businesses formed? What are the main types of business activities and how are they reported in a business's financial statements? How can you begin to interpret the information in the financial statements and use it to make decisions?

Chapter Outline

LEARNING OBJECTIVES

READ

PRACTICE

1. Identify the uses and users of accounting information.

Uses and Users of Accounting Information

- Internal users
- External users
- Ethics in financial reporting
- Data analytics

DO IT! 1.1 Users of accounting information

2. Describe the primary forms of business organization.

Forms of Business Organization

- Proprietorships
- Partnerships
- Corporations
- Generally accepted accounting principles for business organizations

DO IT! 1.2 Business organizations

3. Explain the three main types of business activity.

Types of Business Activity

- Financing activities
- Investing activities
- Operating activities
- Summary of business activities

DO IT! 1.3 Business activities

4. Describe the purpose and content of each of the financial statements.

Financial Statements

- The financial statements
- North West's financial statements
- Elements of an annual report

DO IT! 1.4a Accounting equation

DO IT! 1.4b Financial statement relationships

DO IT! 1.4c Preparing financial statements

Go to the **Review and Practice** section at the end of the chapter for a targeted summary and practice questions with solutions. Visit Wiley's course resources for more practice opportunities.

1.1 Uses and Users of Accounting Information

LEARNING OBJECTIVE 1

Identify the uses and users of accounting information.

Accounting is the information system that identifies and records the economic events of an organization, and then communicates them to a wide variety of interested users. Why does accounting matter to these users? The world's economic systems depend on highly transparent, reliable, and accurate financial reporting. Because of this, accounting has long been labelled “the language of business.”

That's one of the reasons why many Canadians, even those who do not plan on becoming accountants, study accounting. For example, Mike Cassidy, president of **Maritime Bus**; Sabrina Geremia, VP & Country Manager Canada of **Google Canada**; Monique Leroux, a member of the board of **Alimentation Couche-Tard Inc.** and **BCE Inc.**; Craig Reynolds, CEO of the **Saskatchewan Roughriders**; Elizabeth Marshall, a senator; George Melville, chair and owner of **Boston Pizza International**; Terry Goodtrack, CEO of **AFOA (Aboriginal Financial Officers Association) Canada**; and Joe Resnick, NHL hockey player agent, have all studied accounting in depth.

Whether you plan to become an accountant or not, a working knowledge of accounting will be relevant and useful in whatever role you assume as a user of accounting information—as an owner of your own business, working for someone else in their business, investing in a business, or simply understanding your own personal finances.

Users of accounting information can be divided broadly into two types: internal users and external users.

Internal Users

Internal users of accounting information manage companies, whether for-profit or not-for-profit, or government organizations. Company officers (senior management), as well as managers and directors in finance, marketing, human resources, production, and other functional areas within a company, are all internal users.

- As managers, **internal users** have access to internal accounting information to help them make the decisions required to run the company. This information is much more detailed than the information available to external users.
- Internal users are also able to access this information as required, whereas external users receive accounting information only when it is periodically made publicly available.

As shown in **Illustration 1.1**, internal users must answer many important questions as part of managing a company.

accounting The information system that identifies, records, and communicates the economic events of an organization to users interested in that information.

The names of real companies are shown in red when first referenced in the chapter and end-of-chapter material.

Key terms are printed in blue when they first appear. They are defined at the end of each chapter. There are many new terms in the first few chapters of the book to help you learn common business terminology.

internal users Users of accounting information, including company officers, managers, and directors, who have access to an organization's internal accounting information.



ILLUSTRATION 1.1 Questions asked by internal users

Alternative Terminology notes give synonyms for key terms that you may hear or see in the real world, as well as in this text.

For internal users, accounting provides a variety of internal reports, such as financial comparisons of operating alternatives, projections of income from new sales campaigns, analyses of sales costs, and forecasts of cash needs. In addition, companies present summarized financial information in the form of financial statements for both internal and external use.

ALTERNATIVE TERMINOLOGY

Investors are also known as shareholders. Creditors are also known as lenders.

External Users

External users are not involved in managing a company and do not have access to accounting information other than that which is available to the general public. There are several types of external users of accounting information, but the primary external users are as follows:

external users Users of accounting information that are not involved in managing the organization and do not have access to accounting information other than that which is publicly available, including investors, lenders, and other creditors.

investors Users of accounting information that have an ownership interest (own debt or equity securities) in the organization.

creditors Users of accounting information, including suppliers, that grant credit (sell on account) to a customer.

lenders Users of accounting information, including bankers, that extend credit to borrowers.

- **Investors** (owners) use accounting information to make decisions to buy, hold, or sell their ownership interest (see **Alternative Terminology**).
- **Creditors**, such as bankers (also known as **lenders**) and suppliers, use accounting information to evaluate the risks of lending money or of selling on credit.

Some questions that external users, such as investors and creditors, may ask about a company are shown in **Illustration 1.2**.

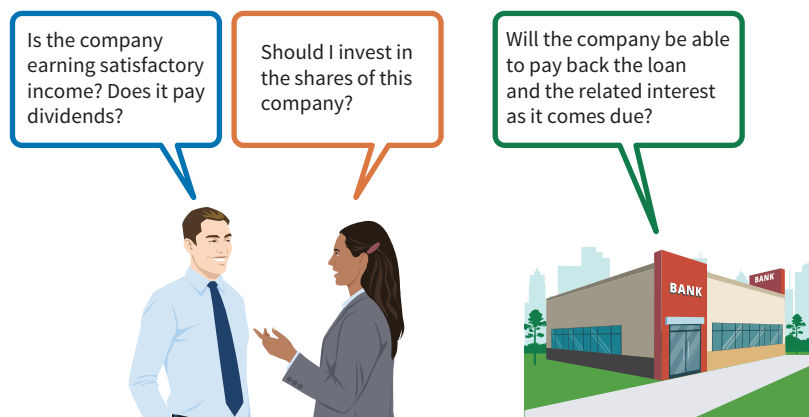


ILLUSTRATION 1.2 Questions asked by external users

In addition to investors and creditors, there are many other external users with a variety of information needs and questions. These include the following:

- Non-management employees (and any union that represents them)—Use financial information to bargain for better salaries and benefits.
- Potential employees—Use both financial and non-financial information to learn about the company and evaluate job prospects.
- Taxing authorities (such as the Canada Revenue Agency)—Use information from a company's financial statements in assessing its income tax return.
- Regulatory authorities (such as the Ontario Securities Commission)—Use financial statements to ensure compliance with regulations.
- Customers—Use financial statements to assess the company's ability to honour product warranties.

The Indigenous Perspectives features will give you a glimpse into the knowledge and world views of some of the diverse Indigenous populations of Canada as they relate to content covered in this course.

Indigenous Perspectives

Introduction

Our world views, experiences, and perspectives shape how we view and understand knowledge. The diversity of Indigenous peoples in Canada is vast. Three groups make up the Indigenous population: Inuit, Métis, and First Nations, each with many tribes, nations, traditions, and differing cultures. Indigenous perspectives are based on the distinct world view of Indigenous cultures. This textbook incorporates Indigenous knowledge by featuring individuals, organizations, and nations across Canada as a means of exploring their diverse experiences, perspectives, and ways of being and knowing.

Accounting can play a pivotal role in reconciliation. The Truth and Reconciliation Commission of Canada identified 94 calls to action to assist and advance the process of reconciliation. Though the role accountants and accounting practices play

is not explicitly called upon as an action, accounting does play a vital role in reconciliation and can assist the implementation of the calls to action, specifically Calls 44 (Canadian Governments and the *United Nations Declaration on the Rights of Indigenous People*), 62i (Education and Reconciliation), and 92 (Business and Reconciliation), and the *United Nations Declaration on the Rights of Indigenous People*.

The features in the textbook serve as a starting point; each feature has links to additional information to deepen your learning experience of the topic. We invite you to read further on the feature topic and share what you have learned to enrich your learning and continue together on the journey of truth and reconciliation. Broadening our perspectives will benefit the greater good. *Huy ch q' u* (thank you) for reading them with an open heart and an open mind.²

—Tasha Brooks

In Canada, women hold 36% of senior leadership roles in management.³ The Indigenous Perspectives feature shows how Indigenous women are once again at the forefront of Indigenous societies and businesses after barriers introduced by colonization were removed.

Indigenous Perspectives

Women in Leadership



Source: Helen Bobiwash

Many Indigenous traditions lift women up as the matriarchs of their societies and have done so for centuries. In traditional Indigenous societies, women were integral to government, family, and ceremony and honoured for their wisdom and contributions. Women maintained these vital roles until colonization. The absence of women in leadership roles today can be linked to colonization. The Indian Act, implemented in 1876, was disproportionately discriminatory toward First Nations women, ultimately abolishing their ability to participate in society as they had done historically. Throughout the various iterations of the Indian Act, First Nations women were not allowed to vote or participate in the band council system and lost their Indian status if they married non-First Nations men; the Act privileged the male birth line of descendants.

There has been a resurgence of Indigenous women reclaiming leadership roles. Since 2008, the proportion of women on First Nations band councils has increased by 31%, and there has been a slow and steady increase in the number of women chiefs since 1992. In 2016, 22,245 Indigenous women were self-employed. In 2022, the Government of Canada made significant contributions to remove barriers that Indigenous women face and support projects aiming to increase Indigenous women in senior leadership positions.

Often Indigenous women seek employment opportunities that enable them to contribute to the larger Indigenous community. Helen Bobiwash has done precisely that. She is Anishinabekwe from the Thessalon First Nation. She is a Chartered Professional Accountant working with Indigenous communities. She was honoured with a Fellow designation (FCPA) in 2019 by CPA Ontario for her exceptional leadership in business and in the communities she serves. She has made significant contributions to her community as the Fiscal Negotiator for the Kinooaadziwin Education Body, supporting the

largest self-government agreement in Canada: the Anishinabek Nation Education Agreement. Bobiwash's deep understanding of financial accounting and her understanding of First Nations communities have been vital to this work.

In addition to her FCPA designation, Bobiwash is also a Certified Aboriginal Financial Manager (CAFM). The CAFM designation is granted by AFOA Canada. AFOA's mission is to build a community of professionals by respecting and supporting individuals, organizations, and communities on their journey to management proficiency, professional certification, and self-reliance. AFOA focuses on building capacity in Indigenous communities by awarding designations, including CAFM, Certified Aboriginal Professional Administrator, Certified Indigenous Leadership, and Certified Indigenous Human Resource Professional. As of 2022, AFOA has awarded nearly 1,000 professional designations. Eighty percent of AFOA board members and staff are women leaders.⁴

Miigwetch, Anushiik, Wela'lin, Nia:wen Nakurmiik Marsi (Thank you) —Tasha Brooks

Ethics in Financial Reporting

In order for financial information to have value to its users, whether internal or external, it must be prepared by individuals with high standards of ethical behaviour. Ethical decision-making is critical in the preparation of accounting information and to the decision-makers who rely on this information.

Fortunately, most individuals in business are ethical. Their actions are both legal and responsible. They consider the organization's interests when they make decisions. Accountants and other professionals have extensive rules of professional conduct to guide their behaviour with each other and the public. In addition, most companies are required to have codes of conduct and ethics that outline their commitment to ethical behaviour in their internal and external relationships.

Data Analytics

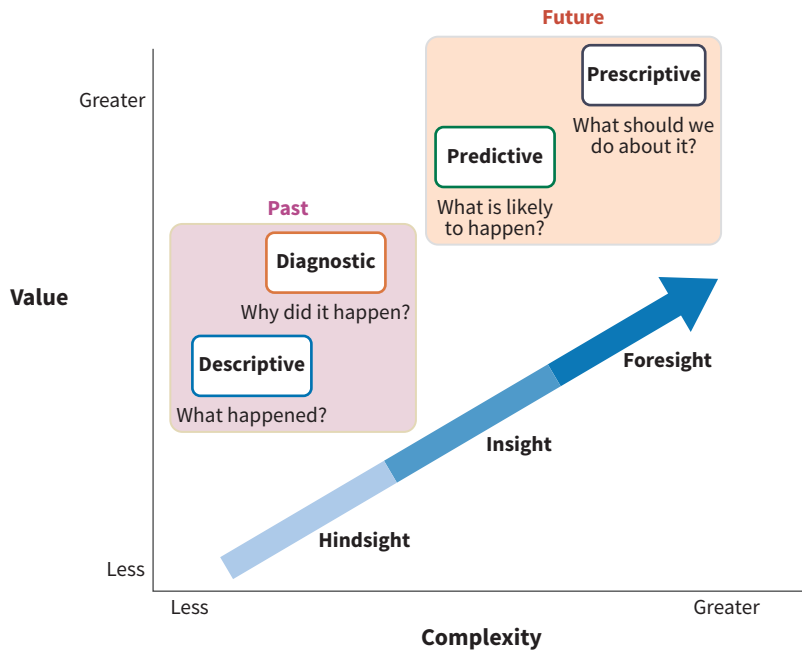
Accounting systems collect vast amounts of data about the economic events experienced by a company and about the users with whom the company engages, such as suppliers and customers. Business decision-makers take advantage of this wealth of data by using data analytics to make more informed business decisions.

data analytics The process of analyzing data to find patterns and correlations, trends, and other valuable insights to enhance decision-making.

- **Data analytics** involves analyzing data, often employing both software and statistics, to draw inferences.
- As both data access and analytical software improve, the use of data analytics to support decisions is becoming increasingly common at virtually all types of companies.

Illustration 1.3 shows the four most common types of data analytics that help answer questions ranging from what happened (descriptive) and why it happened (diagnostic), to what is likely to happen (predictive) and what we should do about it (prescriptive). Analytics range from simple analyses that can be performed using spreadsheets with tools like pivot tables and graphs, to complex statistical software and even artificial intelligence. More complex analysis provides greater value to the business.

ILLUSTRATION 1.3
Four types of data analytics



DO IT! 1.1 Users of Accounting Information

The following is a list of questions that may be asked by different users of accounting information:

1. Will I be able to obtain enough cash to finance this month's cash shortfall?
2. Will the company be able to repay the money we lend it when the loan comes due?
3. What was the labour cost for the production of 1,000 board feet of lumber?
4. Will the company stay in business long enough to service the products I buy from it?
5. Will the company's share price go up or down in the near future?
6. In which geographical areas and age demographics are our sales increasing?
 - a. Identify the type of user who would most likely ask each of the above questions from the following list of possible users: chief financial officer, customers, investors, creditors, production manager, or marketing manager.
 - b. Indicate whether the user you chose is an internal or external user.

ACTION PLAN

- Understand the difference between internal and external users: Internal users work for the company at a management level and require access to internal accounting information to help manage and operate the company. External users are not involved in running the company and do not have access to accounting information other than that which is available to the general public.
- Understand the types of information internal and external users require to make decisions.

Solution

(a) Type of User	(b) Internal or External User
1. Chief financial officer	Internal
2. Creditors	External
3. Production manager	Internal
4. Customers	External
5. Investors	External
6. Marketing manager	Internal

DO IT! exercises prompt you to stop and practise the key points you have just studied. The Action Plan offers you tips on how to approach the exercise. Attempt the exercise, then review the solution.

1.2 Forms of Business Organization

LEARNING OBJECTIVE 2

Describe the primary forms of business organization.

Businesses can be organized in different ways and the accounting standards they use can vary depending on the type of organization. There are three common forms of business organization: proprietorships, partnerships, and corporations.

Proprietorships

proprietorship A business owned by one person.

A **proprietorship** is a business owned by one person, known as a proprietor. It is often called a “sole” proprietorship because there is a single owner.

- Proprietorships are simple to set up and give the owner control over the business. Often only a relatively small amount of money (capital) is needed to start in business.
- The owner receives any income and suffers any losses from the business. The owner is personally liable (responsible) for all debts of the business. This is known as unlimited liability.
- There is no legal distinction between the business as an economic unit and the owner, so the life of the proprietorship is limited to the life of the owner and the business income is reported and taxed on the owner’s personal income tax return.

reporting entity concept The concept that economic activity that can be identified with a particular company must be kept separate and distinct from the activities of the owner(s) and of all other economic entities.

For accounting purposes, the business records of the proprietorship must be kept separate from those related to the owner’s personal activities. The separation of business and personal records is the simplest form of the reporting entity concept. The **reporting entity concept** requires that the economic activity that can be identified with a particular business be kept separate and distinct from the personal or non-business activities of the owner and of all other economic entities. The objective of the reporting entity concept is to ensure that the entity’s financial statements faithfully represent only its economic activities. This enables the profitability and financial position of just that entity to be assessed. This concept applies not only to proprietorships but also to partnerships and corporations, which are discussed in the next sections.

Small owner-operated businesses such as hair salons, plumbers, and mechanics are often proprietorships, as are many small-scale farms and small retail stores.

Partnerships

partnership A business owned by more than one person that is not incorporated.

A **partnership** is a business owned by more than one person. In most respects, a partnership is similar to a proprietorship except that there is more than one owner. Partnerships are often formed because one person does not have enough economic resources to start or expand the business, or because partners bring unique skills or other resources to the partnership.

- Partnerships are normally formalized in a written partnership agreement that outlines the formation of the partnership, partners’ contributions, how net income and losses are shared, provisions for withdrawals of assets and/or partners, dispute resolution, and partnership liquidation. The need to develop a partnership agreement makes establishing a partnership more complex and costly than establishing a proprietorship.
- Each partner generally has unlimited liability for all debts of the partnership, even if one of the other partners created the debt. There are certain situations where partnerships can be formed with limited liability for selected partners.
- Similar to a proprietorship, the portion of income that each partner is entitled to of the total partnership income is reported and taxed on each partner’s personal income tax return.
- The reporting entity concept requires that partnership records be kept separate from each partner’s personal activities.

Partnerships are typically used to organize professional service businesses, such as the practices of lawyers, doctors, architects, engineers, and accountants.

Corporations

A **corporation** is a business organized as a separate legal entity owned by shareholders and is the most complex and costly form of business to establish. The **North West Company** in our opening feature story is a corporation. Investors in a corporation such as The North West Company receive shares (normally in electronic form) to indicate their ownership claim (see **Alternative Terminology**). It is often possible for individuals to become owners of shares (shareholders) by investing relatively small amounts of money.

- Unlike unincorporated businesses, a corporation is a legal entity separate from its shareholders, and consequently the life of a corporation is indefinite. That means it continues on regardless of who owns its shares. It is not affected by the withdrawal, death, or incapacity of an owner, as is the case in a proprietorship or partnership. In fact, North America's oldest corporation, the **Hudson's Bay Company**, was formed in 1670.
- The ownership of a corporation may be easily transferred through the sale of shares, depending on its size, whereas selling a proprietorship or partnership can be more complicated.
- Shareholders of corporations typically have limited liability as they are not responsible for corporate debts. This means that the risk of loss for shareholders is limited to the amount they have invested in the company's shares. This limited liability is a significant advantage for the corporate form of organization. However, it is possible that shareholders have provided personal guarantees to lenders for the debts of a corporation, which would mean their liability would extend beyond the amount of their investment.
- Similar to proprietorships and partnerships, the company is a separate reporting entity under the reporting entity concept.

All of these advantages taken together—indefinite life, ease of transferring ownership when selling shares, and limited liability—can make it easier for corporations, especially large corporations, to raise capital (cash) compared with proprietorships and partnerships. Another potential advantage is that corporations may receive a more favourable income tax treatment than other forms of business organization such as proprietorships and partnerships. Because of the wide variety of income tax issues that apply to different companies in different jurisdictions, you would be wise to seek professional advice on taxation matters before choosing any form of business organization.

Although the combined number of proprietorships and partnerships in Canada is more than the number of corporations, the revenue produced by corporations is far greater. Most of the largest businesses in Canada—for example, **Alimentation Couche-Tard**, **Royal Bank of Canada**, **Power Corporation of Canada**, **Loblaw Companies**, **Great-West Life**, **Suncor**, **Imperial Oil**, and **Empire Company**—are corporations. Recently, the top 15 of Canada's largest corporations each reported annual revenues ranging from \$26.6 billion to \$82.1 billion.⁵

Corporations such as the large corporations mentioned above are known as **public corporations** because their shares are publicly traded on stock exchanges such as the Toronto Stock Exchange (TSX). Smaller emerging public companies in Canada list their shares on the TSX Venture Exchange (TSXV).

- Large public companies have thousands of shareholders and, as such, their shares are said to be “widely held.” For example, shareholders have purchased more than 1.4 billion shares of Royal Bank of Canada, while Alimentation Couche-Tard has issued 815 million shares. As a result, public corporations are able to raise large amounts of capital. Millions of shares are also bought and sold on stock exchanges each day, meaning that ownership of these companies is constantly changing. These transactions are between the shareholders that are selling and purchasing these shares. They do not involve the corporation or impact its financial statements.
- Shareholders who invest in public corporations are not involved in the management of the company. Instead, they manage it indirectly through a board of directors they elect.

corporation A company organized as a separate legal entity, with most of the rights and privileges of a person. Shares are evidence of ownership.

ALTERNATIVE TERMINOLOGY

Shares are also known as stock.

public corporation A corporation whose shares are publicly traded on a stock exchange.

The board, in turn, sets the broad strategic objectives for the company and hires the company's officers, such as the chief executive officer (CEO), to execute policy and perform the daily management functions.

- Public corporations are required to make their financial statements available to the public on a quarterly (every three months) and annual basis. These are published on their own websites, as well as that of the System for Electronic Document Analysis and Retrieval (SEDAR), which posts financial statements for all public corporations in Canada. While you could access North West's financial statements on SEDAR, we have reproduced them in Appendix A. The appendix can also be found in Wiley's course resources.

private corporation A corporation whose shares are not traded on a public stock exchange.

In addition to public corporations like North West, there are private corporations. A **private corporation** also issues shares, but they are not traded on a public stock exchange. There are some very large private corporations, however, such as the **Irving Group of Companies**, the **Jim Pattison Group**, and **McCain Foods**. Some of these private corporations are equal in size to or larger than many public corporations. For example, the Pattison Group reported annual revenue of \$12.7 billion in 2020, which would have put it in the top 50 of Canada's largest public corporations by annual revenue.⁶

- Private corporations normally have a limited number of shareholders, and their shares are said to be "closely held." Consequently, many private corporations, especially small ones, do not have the same advantages of raising capital as do large corporations. For example, a small, local incorporated business with a few family shareholders would likely have as much difficulty raising funds as a proprietorship or partnership would.
- Unlike public corporations, private corporations are under no obligation to distribute their financial statements publicly. Most private corporations do not wish to disclose financial information to their competitors and the public.

The form used to initially organize a business is not permanent and can be changed as the needs of the business and its owners change. Many businesses start as proprietorships or partnerships and eventually incorporate. Some major Canadian companies, including **George Weston**, **Sobeys**, **Bombardier**, and **Dollarama**, started as proprietorships and eventually incorporated as the businesses grew.

Because most Canadian business is transacted by corporations, this book focuses on the corporate form of organization. We will discuss the accounting for both publicly traded and private corporations in this textbook.

Illustration 1.4 provides a summary of the important characteristics of each organizational form a business can take.

ILLUSTRATION 1.4
Characteristics of business organizations

Characteristic	Proprietorship	Partnership	Corporation
Owners	Proprietor: one	Partners: two or more	Shareholders: one or more
Owner's liability	Unlimited	Unlimited	Limited
Separate legal entity	No	No	Yes
Taxation of profits	Paid by the owner	Paid by the partners	Paid by the corporation
Life of organization	Limited	Limited	Unlimited

Generally Accepted Accounting Principles for Business Organizations

How do businesses decide on the amount of financial information to disclose? In what format should financial information be presented? The answers to these questions can be found in accounting rules and practices that are recognized as a general guide for financial reporting purposes.

These rules and practices are called **generally accepted accounting principles (GAAP)** (see **Alternative Terminology**), commonly abbreviated as GAAP. GAAP includes broad policies and practices as well as rules and procedures that have substantive authoritative support and agreement about how to record and report economic events.

Generally accepted accounting principles can differ depending on the form of business organization.

- Publicly traded corporations must use International Financial Reporting Standards (IFRS), a set of global accounting standards developed by the International Accounting Standards Board.
- ASPE** Private corporations have a choice between using IFRS or Accounting Standards for Private Enterprises (ASPE), developed by the Canadian Accounting Standards Board. ASPE were developed to reduce the complexity and cost of financial reporting for private companies, recognizing that there are normally fewer users of private company financial statements. Generally, the users of private company financial statements also have access to financial information beyond that available to the users of public company financial statements.

Most private corporations choose to use ASPE, although there are exceptions. There are a number of reasons that a private company may adopt IFRS. These include:

- it is considering accessing public debt or equity (stock) markets in the future,
- it wants to be able to compare its financial results with competitors that use IFRS, or
- it has foreign subsidiaries (other companies that it controls) that are required to use IFRS and it wants a common set of accounting standards across the company.

We will learn more about IFRS and ASPE for corporations in Chapter 2.

Because proprietorships and partnerships are privately owned (even though they are not private *corporations*), these businesses generally follow ASPE for external financial reporting purposes. However, proprietorships and partnerships often prepare financial statements only for the internal use of the owner(s), in which case they don't have to follow any particular set of accounting standards.

generally accepted accounting principles (GAAP) A general guide, having substantial authoritative support, that describes how economic events should be recorded and reported for financial reporting purposes.

ALTERNATIVE TERMINOLOGY

Accounting principles are also commonly known as accounting standards or accounting policies.

The Accounting Matters boxes give examples of how accounting is used in various business situations.

Accounting Matters

What's in a Company Name?

How can you tell whether a company is a corporation or not? Corporations in Canada and the United States are identified by “Ltd.” (“Ltée” in French), “Inc.,” “Corp.,” or in some cases, “Co.” following their names. These abbreviations can also be spelled out. In Brazil and France, the letters used are “SA” (Sôciiedade Anonima, Société Anonyme); in Japan, “KK” (Kabushiki Kaisha); in the Netherlands, “NV” (Naamloze

Vennootschap); in Italy, “SpA” (Società per Azioni); and in Sweden, “AB” (Aktiebolag).

In the United Kingdom, public corporations are identified by “plc” (public limited company), while private corporations are denoted by “Ltd.” The same designations in Germany are “AG” (Aktiengesellschaft) for public corporations and “GmbH” (Gesellschaft mit beschränkter Haftung) for private corporations. There are no name distinctions between public and private corporations in Canada.

DO IT! 1.2 Business Organizations

In choosing the right organizational form for your business, you must consider the characteristics of each. Choose from the characteristics listed below for each of ownership, complexity, liability, life, and income tax, and match the characteristic with the form of business organization—proprietorship, partnership, or corporation—they are normally associated with:

- Ownership: Choose among “one individual,” “two or more individuals,” or “many shareholders.”
- Complexity: Choose among “simple,” “moderate,” or “complex.”
- Liability: Choose between “limited” or “unlimited.”
- Life: Choose between “limited” or “unlimited.”
- Income tax: Choose between “paid by individual(s)” or “paid by entity.”

ACTION PLAN

- Understand the characteristics of each type of business organization.

Solution

	<u>Proprietorship</u>	<u>Partnership</u>	<u>Corporation</u>
a. Ownership	One individual	Two or more individuals	Many shareholders
b. Complexity	Simple	Moderate	Complex
c. Liability	Unlimited	Unlimited	Limited
d. Life	Limited	Limited	Unlimited
e. Income tax	Paid by individual	Paid by individuals (partners)	Paid by entity (corporation)

1.3 Types of Business Activity

LEARNING OBJECTIVE 3

Explain the three main types of business activity.

financing activities

Activities that report the cash effects of debt or equity financing. These include borrowing or repaying cash from (to) lenders, and issuing or reacquiring shares or paying dividends to investors.

investing activities Activities that report the cash effects of purchasing and disposing of long-lived assets such as property, plant, and equipment and investments not held for trading.

operating activities Activities that result from day-to-day operations. They report the cash effects of transactions that create revenues and expenses.

share capital Shares representing the ownership interest in a corporation. If only one class of shares exists, it is known as common shares.

dividends The distribution of retained earnings from a corporation to its shareholders, normally in the form of cash.

All businesses are involved in three types of activity: financing, investing, and operating. Each of these activities can result in inflows of cash (cash flowing into the company) or outflows of cash (cash flowing out of the company). **Financing activities** are related to the cash flows from debt or equity financing, including issuing or repurchasing shares, paying dividends, or borrowing or repaying debt. **Investing activities** are related to the purchase or sale of long-lived assets such as land, buildings, or equipment. **Operating activities** result from a company's day-to-day operations, including the cash flows related to its revenues and expenses.

We will explain each of these three types of business activity in the sections that follow.

Financing Activities

Capital (money) is required to start any business. The two primary sources of capital for corporations are:

- Equity financing—issuing (selling) shares in exchange for cash (or other assets)
- Debt financing—borrowing money

When a corporation is established, common shares must be issued to shareholders in exchange for cash or other assets. Shareholders are also known as investors. These shares represent the shareholders' ownership in a company. Common shares are just one class or type of shares, known as **share capital**, that a company can issue. A corporation may subsequently obtain additional equity financing by selling additional shares to investors. The issue of shares for cash results in an inflow of cash. North West first issued common shares to the general public in 1992 when it became a publicly traded corporation.

Shareholders seldom provide all the financing required by a company. Often significant debt financing is provided by borrowing funds from creditors. If funds have been borrowed, shareholders have only a residual claim on the assets of the corporation. This means that, if a corporation was wound up (ceased operations), all debt financing would have to be repaid before shareholders had any legal right to a return of the capital they invested. In other words, debt obligations must eventually be repaid, while companies have no obligation to repurchase shares and return capital to shareholders, although they may choose to do so (unless they have committed to creditors not to).

Provided they are profitable and able to meet their obligations to creditors, many companies pay shareholders a regular return on their investment. Payments that distribute a portion of income to shareholders are called **dividends**. They are normally cash payments, but can also take other forms. Dividends are declared by a company's board of directors. For the year

ended January 31, 2022 (which we will call fiscal 2021 or just 2021 in this textbook), North West declared and paid dividends of \$70,420 thousand to its shareholders. An accounting time period that is one year in length is called a **fiscal year**. North West's fiscal year ending on January 31, 2022, is referred to as 2021 since 11 months of that year fell within the calendar year 2021.

Corporations can also repurchase shares that have been previously issued. This decision would be made by the board of directors with shareholder approval. Any share repurchases would result in an outflow of cash. North West paid \$28,064 thousand to repurchase shares in fiscal 2021.

Corporations also access funds using debt financing, which involves borrowing money. The persons or companies that a corporation borrows from are called creditors. Amounts owed to creditors—in the form of debt and other obligations—are called **liabilities** as they are a present obligation to transfer economic resources as a result of a past transaction. The claims of creditors differ from those of shareholders. Amounts owed to creditors must eventually be repaid with interest. The creditor and the company will agree to a repayment schedule at the time of borrowing. A creditor has a legal right to be paid at the agreed time. In the event of nonpayment, a creditor may force the company to sell assets to pay its debts.

Specific names are given to different types of liabilities, depending on their source. For instance, a corporation may have an operating line of credit with its bank. An operating line of credit is a pre-arranged bank loan for a maximum amount that allows a company to draw more money than it has on deposit in its bank account. When a company uses its operating line of credit to cover cash shortfalls and overdraws its bank account, it results in a liability called bank indebtedness.

Corporations may borrow using a short-term **bank loan payable** (also known as a note payable) or using **long-term debt** (see **Alternative Terminology**). Long-term debt can include **mortgages payable, bonds payable, finance lease obligations**, and other types of debt securities borrowed for longer periods of time.

When funds are borrowed, the result is an inflow of cash from these financing activities. Conversely, the repayment of debt results in an outflow of cash. In 2021, North West received \$44,071 thousand during the year from increasing long-term debt, but also used \$85,393 thousand to repay long-term debt during the same period.

The payment of interest on borrowed funds may be treated as a financing activity or as an operating activity under IFRS. In either case, it will be an outflow of cash. The payment of dividends may also be treated as a financing activity or as an operating activity under IFRS. In this text, the payment of interest will be treated as an operating activity, while the payment of dividends will be treated as a financing activity. This is done because interest factors into the determination of net income, while dividends do not. North West paid interest of \$8,944 thousand in fiscal 2021 and elected to report this as a financing activity.

Investing Activities

After a company raises money through financing activities, it often uses that money for investing activities. Investing activities involve the purchase (or sale) of long-lived assets that a company needs in order to operate. **Assets** are resources that a company owns or controls. Every asset is capable of providing future economic benefits that can be short- or long-lived. Investing activities generally involve long-lived assets. For example, purchases of long-lived assets such as furniture, equipment, computers, vehicles, buildings, and land are all examples of investing activities. Together, these assets are called **property, plant, and equipment**, or “property and equipment,” as North West calls this asset category (see **Alternative Terminology**).

Other examples of long-lived assets include goodwill and intangible assets. **Goodwill** results when a company acquires another company, paying a price that is higher than the value of the purchased company's net identifiable assets. **Intangible assets** are assets that do not have any physical substance themselves but represent a privilege or a right granted to, or held by, a company. Examples of intangible assets include patents, copyrights, and trademarks.

For most companies, investing activities normally result in an outflow of cash as companies must continuously invest in long-term assets to grow or even to maintain their operations. Companies also dispose of long-term assets when they have finished using them. The sale of long-term assets results in an inflow of cash, though this is generally much less than

fiscal year An accounting period that is one year long.

liabilities The debts and obligations of a business. Liabilities are claims of lenders and other creditors on the assets of a business.

ALTERNATIVE TERMINOLOGY

Long-term debt is also known as non-current debt or non-current liabilities.

assets The resources owned or controlled by a business that are expected to provide future economic benefits.

ALTERNATIVE TERMINOLOGY

Property, plant, and equipment are also known as capital assets; land, buildings, and equipment; or fixed assets.

the outflow of cash related to asset purchases. For example, in fiscal 2021, North West had cash outflows of \$87,341 thousand related to the purchase of property and equipment, while inflows of only \$85 thousand resulted from the sale of property and equipment.

Companies can also have investing activities related to the purchase (outflow) or sale (inflow) of shares or debt securities (such as bonds) of other companies. These **investments** may be related to generating returns (such as dividends or interest) in the short term or may be long-term strategic investments that enable the company to have a degree of influence or control over the other company. Many students misunderstand the term *investing activities*, thinking the term means “investments” only. For most companies, the vast majority of investing activities are normally related to the purchase and sale of long-term assets, rather than investments in the shares or debt securities of other companies.

Operating Activities

Once a business has raised the necessary financing and invested in the long-term assets it needs to get started, it can begin its operations. For example, North West sells food, clothing, housewares, appliances, and outdoor products in its retail locations. The company also provides services to its customers, including income tax preparation, cheque cashing, money transfers, and postal services. We call the amounts earned from the sale of these goods and services **income**. Income results from increases in economic resources—normally an increase in an asset but sometimes a decrease in a liability—that result from the sale of a product or service in the normal course of business.

Income comes from different sources and can be identified by various names. As we will learn in later chapters, some of these sources of income are referred to as **revenue** (such as from sales or services) and some as income (such as from interest and dividends). For instance, North West refers to the revenues it generates from the sale of goods and services as “sales.” However, companies may also earn interest income on excess cash held as investments and rental revenue from unused space. Sources of revenue or income that are common to many businesses are **sales revenue, service revenue, interest income** (see **Alternative Terminology**), and **rent income**. In this text, we will use the term *revenue* when recording sales of goods or services and *income* when recording the receipt of interest, rents, dividends, and other forms of income that are not part of the entity’s principal operations.

Some of North West’s sales do not result in an immediate receipt of cash. Instead, credit is extended to its customers. This means they will pay their accounts in the future. This right to receive money in the future is called an **account receivable**. Accounts receivable are assets because they represent an economic resource—the right to receive the cash that will eventually be collected from these customers.

We first mentioned the term *assets* in the investing activities section above. A company’s long-lived assets, such as property, plant, and equipment, are purchased through investing activities. Other assets—typically with shorter lives—result from operating activities, such as accounts receivable. Companies also have other types of receivables, such as interest receivable, rent receivable, and deferred tax assets that result from differences in how items are recorded for accounting and tax purposes.

Supplies are another example of a short-term asset used in day-to-day operations. These include items such as office and cleaning supplies, but do not include any items that are purchased to be resold to customers. Items that are held for future sale to customers are called **inventory** or merchandise inventory. When the goods (inventory) are sold, they are no longer an asset with future benefits, but are an expense. More specifically, the cost of the inventory sold is an expense called cost of goods sold. **Expenses** are decreases in economic resources, normally the costs of assets that are consumed or services that are used in the process of generating revenues. As we will learn in Chapter 4, expenses are related to assets and liabilities. When an expense is incurred, an asset will decrease or a liability will increase.

There are many kinds of expenses and they are identified by various names, depending on the type of asset consumed or service used. For example, North West reports a number of types of expenses: **cost of goods sold** (which it calls “cost of sales”); **selling, operating, and administrative expenses**; **interest expense** (see **Alternative Terminology**); and **income**

income The increase in economic benefits that result from the activities of a business, rather than from transactions with shareholders. Income includes revenues and gains.

revenue The increase in economic benefits that result from the normal operating activities of a business, such as the sale of a product or provision of a service.

ALTERNATIVE TERMINOLOGY

Interest income is also known as *finance income*.

expenses The decreases in economic benefits that result from the costs of assets consumed or services used in ongoing operations to generate revenue.

ALTERNATIVE TERMINOLOGY

Interest expense is commonly known as *finance costs*.

tax expense. North West’s selling, operating, and administrative expenses item is a summary of individual expense accounts such as salaries, advertising, utilities, professional fees, rent, depreciation (the allocation of the cost of property and equipment), amortization (the allocation of the cost of intangible assets), and other costs associated with running the business.

Short-term liabilities may result from some of these expenses. This occurs, for example, when a company purchases inventory or supplies on credit (on account) from suppliers. The obligations to pay for these goods are called **accounts payable**. A company may also have **interest payable** on the outstanding (unpaid) liability amounts owed to creditors, **salaries payable** to employees, **property tax payable** to the municipal and/or provincial governments, and **sales tax payable** and **income tax payable** to the provincial and federal governments. Deferred tax liabilities are another example of a liability. They result from differences in how items are recorded for accounting and tax purposes.

The goal of every business is to sell a good or service for a price that is greater than the cost of producing or purchasing the good or providing the service, plus the cost of operating the business. This means that revenues should, normally, be greater than the expenses incurred to generate the revenues. When revenues exceed expenses, the result is **net income**, as shown in **Illustration 1.5**. Net income is also commonly known as *net earnings* or *profit*.

net income The amount by which revenues exceed expenses.

$$\boxed{\text{Revenues}} - \boxed{\text{Expenses}} = \boxed{\text{Net Income (Loss)}}$$

ILLUSTRATION 1.5 Determination of net income (loss)

North West’s revenues exceeded its expenses and it reported net income (which it calls “net earnings”) of \$157,451 thousand for the year ended January 31, 2022. When the opposite happens—that is, when expenses exceed revenues—a **net loss** (also known as just a loss) results.

net loss The amount by which expenses exceed revenues.

Summary of Business Activities

To summarize our discussion in this section, there are three types of business activities that companies engage in: (1) financing, (2) investing, and (3) operating, as shown in **Illustration 1.6**.




Financing Activities	Investing Activities	Operating Activities
 <p>Inflows: Issuing shares, taking out a loan</p> <p>Outflows: Paying dividends, repurchasing shares, repaying loans</p>	 <p>Inflows: Proceeds from selling long-lived assets, proceeds from selling shares of other companies</p> <p>Outflows: Buying long-lived assets, buying shares of other companies</p>	 <p>Inflows: Revenues, collection of receivables, sale of services or goods</p> <p>Outflows: Expenses, payment of payables, purchase of inventory and supplies</p>

ILLUSTRATION 1.6 Business activities and examples

- Financing activities** involve either equity or debt financing. Activities related to equity financing include issuing shares to shareholders, paying dividends to shareholders, or repurchasing shares. Activities related to debt financing include borrowing cash from creditors by issuing debt, or conversely, using cash to repay debt.

2. **Investing activities** include purchasing and disposing of long-lived assets such as property, plant, and equipment and long-term investments.
3. **Operating activities** result from day-to-day operations and include revenues and expenses and changes in related accounts, including receivables, supplies, inventory, and payables accounts.

DO IT! 1.3 Business Activities

For each of the following items, **(a)** classify it as a financing, investing, or operating activity; **(b)** determine whether it resulted in an inflow, outflow, or no change of cash; and **(c)** classify it as an asset, liability, share capital, revenue, or expense.

1. An amount is paid to an employee for work performed
2. An amount is earned and received from providing a service
3. Common shares are issued
4. A vehicle is purchased
5. A sale is made to a customer who will pay next month
6. Supplies are purchased with cash
7. A bank loan is taken from the bank
8. An amount is paid for utilities used

ACTION PLAN

- **Classify each item based on its economic characteristics.**
- **Understand the differences among financing, investing, and operating activities.**
- **Consider whether cash flowed into or out of the company as a result of the transaction.**
- **Understand the distinctions among assets, liabilities, share capital, revenues, and expenses.**

Solution

(a)	(b)	(c)
1. Operating activity	Outflow	Expense (salary expense)
2. Operating activity	Inflow	Revenue (service revenue)
3. Financing activity	Inflow	Share capital (common shares)
4. Investing activity	Outflow	Asset (vehicles—property, plant, and equipment)
5. Operating activity	No change	Asset (accounts receivable)
6. Operating activity	Outflow	Asset (supplies)
7. Financing activity	Inflow	Liability (bank loan payable)
8. Operating activity	Outflow	Expense (utilities expense)

1.4 Financial Statements

LEARNING OBJECTIVE 4

Describe the purpose and content of each of the financial statements.

You will recall that we learned about internal and external users of accounting information earlier in this chapter. Users, especially external users, are interested in a company's financial position (including assets, liabilities, and shareholders' equity, as well as its cash flow) in addition to the company's financial performance (such as revenues and expenses) and capital structure (components of liabilities and shareholders' equity). For external reporting

purposes, it is customary to arrange this information in four different financial statements that are the backbone of financial reporting.

1. **Statement of income:** A statement of income reports revenues and expenses, showing how a company's operations performed during a period of time.
2. **Statement of changes in equity:** A statement of changes in equity shows the changes in each component of shareholders' equity (including common shares and retained earnings), as well as total equity, during a period of time.
3. **Statement of financial position:** A statement of financial position reports what a company owns (its assets), what it owes (its liabilities), and the resulting difference (its shareholders' equity) at a specific point in time.
4. **Statement of cash flows:** A statement of cash flows shows where a company obtained cash during a period of time and how that cash was used.

Additional information is reported in **notes to the financial statements** that are cross-referenced to these four statements. These explanatory notes clarify information presented in the financial statements and provide additional detail. They are essential to understanding a company's financial performance and position.

While the above four financial statements are the statements most commonly provided by publicly traded companies, there are other financial statements. For example, a statement of comprehensive income must be prepared when a publicly traded company reports other comprehensive income earned from certain items. In addition, private corporations prepare a statement of retained earnings instead of a statement of changes in equity. We will wait until later chapters to illustrate these statements.

As mentioned earlier, public companies must make financial statements available on an annual and quarterly basis, but these companies will usually produce monthly financial statements for internal use (see **Alternative Terminology**).

statement of income

A financial statement that reports a company's financial performance during the period.

statement of changes in equity

A financial statement that summarizes the changes in total shareholders' equity, as well as each component of shareholders' equity, for a specific period of time.

statement of financial position

A financial statement that reports the assets, liabilities, and shareholders' equity at a specific date.

statement of cash flows

A financial statement that provides information about the cash inflows (receipts) and cash outflows (payments) for a specific period of time.

ALTERNATIVE TERMINOLOGY

Quarterly financial statements are also called *interim* financial statements.

Accounting Matters



alexsl/Getty Images

Fiscal Year Ends

While some companies choose to use December 31 for their fiscal year end, others do not. Many companies choose to end their accounting year

when their inventory or operations are at a low. This is advantageous because gathering accounting information requires a lot of time and effort from managers. They would rather do it when business is slow. For some retailers, for example, a slow period is after

the Christmas/New Year's holiday period. Also, inventory can be more easily counted when it is low, reducing the cost of counting. Some companies whose year ends differ from December 31 are North West Company (January 31), **lululemon** (Sunday closest to January 31), **Canadian Tire** (Saturday closest to December 31), **Lions Gate Entertainment** (March 31), **Shaw Communications** (August 31), and **Metro Inc.** (the last Saturday in September). Most governments and government-related entities use March 31 for their fiscal year end.

The Financial Statements

We will now look at the financial statements of a fictitious service company, called Sierra Corporation, to introduce you to the four primary financial statements: the statement of income, statement of changes in equity, statement of financial position, and statement of cash flows. In Chapters 3 and 4, we will learn how these statements are prepared but for now, we simply show the end result—the financial statements.

Statement of Income The **statement of income** reports the success or failure of the company's operations for a period of time—annually, quarterly, and/or monthly, as we mentioned in the previous section (see **Alternative Terminology**). In our example, Sierra was incorporated (established) on October 1, 2024. It has been in operation for only one month, the month ended October 31, 2024, and prepares financial statements monthly. To

ALTERNATIVE TERMINOLOGY

The *statement of income* is also commonly known as the *income statement*, *statement of earnings*, or *statement of profit and loss*.

indicate that Sierra's statement of income reports the results of operations for a period of one month, the statement is dated "Month Ended October 31, 2024."

The statement of income lists the company's revenues first and then its expenses. We will learn about the order in which expenses can be listed in later chapters. For now, we have simply listed expenses in order of magnitude—that is, from the largest to the smallest. Expenses are deducted from revenues to determine income (or loss) before income tax. Income tax expense is shown separately, immediately following the income (or loss) before income tax line. Finally, net income (or net loss) is determined by deducting the income tax expense.

A sample statement of income for Sierra Corporation is shown in **Illustration 1.7** (see **Helpful Hint**).

ILLUSTRATION 1.7
Statement of income

Helpful hints further clarify concepts or items being discussed.

HELPFUL HINT

The heading of every statement identifies the company, the type of statement, and the time period covered by the statement. Sometimes another line is added to indicate the unit of measure. When it is used, this fourth line usually indicates that the amounts presented are in thousands or millions of dollars.

Decision Tools that are useful for decision-making are highlighted throughout the text. A review of the Decision Tools is also summarized in the Review and Practice section of each chapter.

DECISION TOOL

Users can use the statement of income to determine if a company was profitable, which occurs when its revenues exceed its expenses; in other words, when it has net income rather than a net loss.

Sierra Corporation		
Statement of Income		
Month Ended October 31, 2024		
Revenues		
Service revenue		\$20,600
Expenses		
Salaries expense	\$5,600	
Supplies expense	1,500	
Rent expense	900	
Depreciation expense	83	
Insurance expense	50	
Interest expense	25	8,158
Income before income tax		12,442
Income tax expense		1,800
Net income		<u>\$10,642</u>

Note that cents are not included in the dollar figures recorded in financial statements. It is important to understand, however, that cents should be and are used in recording transactions in a company's internal accounting records. It is only for financial reporting purposes that financial statement amounts are normally rounded to the nearest dollar, thousand dollars, or million dollars, depending on the size of the company. For example, North West rounds amounts in its financial statements to the nearest thousand dollars. External reporting condenses and simplifies information so that it is easier for the reader to understand.

It also does not matter whether the data in the statements are listed in two columns, as they are for Sierra Corporation, or in one column. Companies use a variety of presentation formats, depending on their preference and what they think is easiest for the reader to understand.

Why are financial statement users interested in net income?

- **Investors are interested in a company's past income because these numbers provide information that may help predict future income** (see **Decision Tool**). Income is required to generate cash to fund growth, repay debt, and pay dividends. Investors buy and sell shares based on their expectations about the future income or performance of a company. If investors expect that Sierra will be even more successful in the future, and that this success will translate into a higher share price, they will buy its shares.
- **Creditors use the statement of income to predict the future.** When a bank lends money to a company, it believes it will be repaid in the future. If it didn't think it would be repaid, it would not lend the money. Thus, before making the loan, the bank's loan officer uses the statement of income as one source of information for predicting whether the company will be profitable enough to be able to repay the loan and the related interest.

Thus, reporting recurring and increasing income amounts will make it easier for Sierra to raise additional cash either by borrowing or by issuing shares.

Statement of Changes in Equity The **statement of changes in equity** shows the changes in total shareholders' equity for the period, as well as the changes in each component of shareholders' equity. The time period is the same as for the statement of income—for the year, quarter, or month.

Shareholders' equity represents the shareholders' ownership interest in the company—their claim on the company's assets. In its simplest form, total shareholders' equity includes (1) share capital and (2) retained earnings. It can also include other types of accounts, such as accumulated other comprehensive income, that we will discuss later in this and other chapters.

Share capital represents amounts received from the shareholders when the shares were initially issued by the company. Companies can have different classes of shares. All companies have common shares. In Chapter 11, we will learn that many companies also have preferred shares. These two classes of shares—common and preferred—are combined to form the company's share capital.

The statement of changes in equity starts with the beginning balance of share capital—common shares, in Sierra's case. This is zero for Sierra because it just began operations at the beginning of the month, October 1. The statement then goes on to add any amounts received due to new shares being issued (or to deduct any amounts paid to repurchase shares) during the period to arrive at the ending balance of share capital, as shown in equation format in **Illustration 1.8**. Note that the dollar amounts received or paid are reported rather than the number of shares issued or repurchased.

$$\boxed{\text{Common shares, beginning of period}} + \boxed{\text{Common shares issued (sold)}} - \boxed{\text{Common shares repurchased}} = \boxed{\text{Common shares, end of period}}$$

ILLUSTRATION 1.8 Calculation of changes in common shares

Retained earnings represents the cumulative amounts of net income that have been retained in the corporation. In other words, it is the net income, or earnings, that has not been declared as dividends to shareholders that has accumulated since the company was incorporated. If the amount of retained earnings is negative—that is, cumulative net losses and dividends have exceeded cumulative net income—it is known as a **deficit**.

In addition to showing the changes in share capital during the period, the statement of changes in equity also shows the amounts and nature of changes in retained earnings. The column for retained earnings starts with the beginning balance of retained earnings. Sierra's beginning retained earnings balance is nil because it only began operations on October 1. The net income for the period is added and dividends declared (if any) are deducted from the beginning balance to calculate the retained earnings at the end of the period, as shown in equation format in **Illustration 1.9**.

$$\begin{array}{c} \boxed{\text{Revenues}} \\ - \\ \boxed{\text{Expenses}} \\ = \\ \boxed{\text{Net income (or - loss)}} \end{array} + \boxed{\text{Retained earnings, beginning of period}} - \boxed{\text{Dividends declared}} = \boxed{\text{Retained earnings, end of period}}$$

ILLUSTRATION 1.9 Calculation of changes in retained earnings

If a company reports a net loss, it is deducted (rather than added) to arrive at the ending balance of retained earnings. It is important to understand that dividends declared are not reported as an expense in the statement of income because they were not incurred to generate revenue. Instead, dividends are a distribution of retained earnings (or a distribution of accumulated net income) to shareholders and are reported in the statement of changes in equity. Furthermore, dividends declared, which are reported on this statement, may differ from dividends paid.

shareholders' equity The shareholders' claim on total assets, represented by the investments of the shareholders (share capital) and undistributed earnings (retained earnings) generated by the company.

retained earnings The amount of accumulated net income (less net losses, if any) from the prior and current periods that has been retained and reinvested in the corporation for future use and not distributed to shareholders as dividends.

deficit A negative balance in retained earnings resulting from cumulative net losses exceeding cumulative net income.

Illustration 1.10 presents Sierra's statement of changes in equity. Note that, when there is only one class of shares—common—the statement often just uses common shares rather than share capital as the title of the first column.

ILLUSTRATION 1.10**Statement of changes in equity**

Sierra Corporation			
Statement of Changes in Equity			
Month Ended October 31, 2024			
	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Total Equity</u>
Balance, October 1	\$ 0	\$ 0	\$ 0
Net income		10,642	10,642
Dividends declared		(500)	(500)
Issued common shares	<u>10,000</u>		<u>10,000</u>
Balance, October 31	<u>\$10,000</u>	<u>\$10,142</u>	<u>\$20,142</u>

Note that this statement adds both vertically (down; see “Total Equity” column) and horizontally (across; see “Balance, October 31” row). Also note that, because Sierra is a new company, all its opening balances are zero. While the order of items presented in the statement of changes in equity varies in public company financial statements, when preparing a statement of changes in equity in this text, use the order in Illustration 1.10.

Users can use the statement of changes in equity to determine:

- The company's dividend declaration practices, such as whether it pays a high percentage of net income as dividends or whether it focuses on growth by reinvesting net income instead of paying dividends (see **Decision Tool**). Lenders can also monitor dividend payments because they reduce the cash the company has available to repay debt.
- Whether the company issued or repurchased shares during the period. The issue of shares is one way a company obtains funds to expand or to repay debt, while share repurchases generally indicate that the company has surplus cash that it can return to shareholders.

ASPE Private companies reporting under ASPE prepare a statement of retained earnings rather than a statement of changes in equity. As its name implies, the statement of retained earnings is focused on the changes in only retained earnings, rather than presenting all the changes that affected shareholders' equity during the period.

Statement of Financial Position The **statement of financial position** (see **Alternative Terminology**) reports assets and claims to those assets at a specific point in time.

Claims to assets are subdivided into two categories: claims of creditors and claims of shareholders. As noted earlier, claims of creditors are called *liabilities*. Claims of shareholders, the owners of the company, are called *shareholders' equity*.

This relationship is shown in equation format in **Illustration 1.11**.

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

ILLUSTRATION 1.11 Basic accounting equation

- This equation is known as the basic **accounting equation**.
- This relationship is where the name *balance sheet* comes from. Assets must be in balance with the claims to those assets by both creditors (liabilities) and shareholders (shareholders' equity).
- The right-hand side of the equation—the liabilities and equity—also shows how the assets have been financed. The financing could have occurred through debt by borrowing from creditors or through equity by investments from shareholders (share capital) or net income retained in the company (retained earnings).

DECISION TOOL

Users can use the statement of changes in equity to determine how much of the company's retained earnings was declared as dividends. Companies that are growing, or have debt to repay, normally preserve the cash they generate and pay little or no dividends. Users can also use the statement of changes in equity to determine the extent to which the company has issued or repurchased shares during the period.

ALTERNATIVE TERMINOLOGY

The *statement of financial position* is also commonly known as the *balance sheet*, especially for companies following ASPE, and we will use these two terms interchangeably in this textbook.

accounting equation The equation that states that Assets = Liabilities + Shareholders' Equity.

DO IT! 1.4a Accounting Equation

Answer each of the following using the accounting equation:

- The liabilities of Gillis Ltd. are \$625,000, while its share capital is \$250,000 and its retained earnings are \$360,000. What is the amount of Gillis's total assets?
- Clegg Ltd.'s share capital is \$315,000 and its retained earnings are \$525,000. If Clegg's total liabilities are \$460,000, what is the amount of the company's total assets?
- The total assets of Mustafa Ltd. are \$1.2 million, while its liabilities are \$690,000 and its share capital is \$150,000. What is the amount of Mustafa's retained earnings?
- Egeland Ltd.'s assets increased by \$410,000 during the year, while its liabilities increased by \$220,000. By what amount did Egeland's shareholders' equity change during the year?
- During the year, Haime Ltd.'s liabilities increased by \$660,000, its share capital remained unchanged, and its retained earnings increased by \$380,000. By what amount did Haime's assets change?

ACTION PLAN

- Use the basic accounting, changes in common shares, and changes in retained earnings equations to solve each question.
- Understand that total assets must always equal total liabilities plus total shareholders' equity.
- Remember that shareholders' equity is made up of share capital and retained earnings.

Solution

- \$1,235,000 ($\$1,235,000 = \$625,000 + \$250,000 + \$360,000$)
- \$1,300,000 ($\$1,300,000 = \$460,000 + \$315,000 + \$525,000$)
- \$360,000 ($\$1,200,000 = \$690,000 + \$150,000 + \$360,000$)
- Increased by \$190,000 (Increased by \$410,000 = Increased by \$220,000 + Increased by \$190,000)
- Increased by \$1,040,000 (Increased by \$1,040,000 = Increased by \$660,000 + No change + Increased by \$380,000)

Sierra's statement of financial position is shown in **Illustration 1.12** (see **Helpful Hint**).

Sierra Corporation Statement of Financial Position October 31, 2024

<u>Assets</u>	
Cash	\$11,400
Accounts receivable	11,200
Supplies	1,000
Prepaid insurance	550
Equipment	<u>4,917</u>
Total assets	<u>\$29,067</u>
 <u>Liabilities and Shareholders' Equity</u>	
Liabilities	
Accounts payable	\$ 1,500
Salaries payable	1,600
Interest payable	25
Deferred revenue	800
Bank loan payable	<u>5,000</u>
Total liabilities	<u>8,925</u>
Shareholders' equity	
Common shares	10,000
Retained earnings	<u>10,142</u>
Total shareholders' equity	<u>20,142</u>
Total liabilities and shareholders' equity	<u>\$29,067</u>

ILLUSTRATION 1.12

Statement of financial position

HELPFUL HINT

The statement of financial position is dated at a *specific point in time*. The statement of income, statement of changes in equity, and statement of cash flows cover a *period of time*.

As you can see in Illustration 1.12, Sierra's assets are listed first, followed by liabilities and shareholders' equity. Sierra's assets total \$29,067 and include cash, accounts receivable, supplies, prepaid insurance (premiums paid in advance for insurance coverage in future periods), and equipment. Note that equipment is presented net of any related depreciation expense (which is \$83 in Sierra's case—see Illustration 1.7). We will learn about depreciation in later chapters.

Sierra's liabilities total \$8,925 and consist of accounts payable, salaries payable, interest payable, deferred revenue (cash received in advance from customers for which the service has not yet been provided and is therefore still owed), and a bank loan payable.

Sierra's shareholders' equity consists of common shares of \$10,000 and retained earnings of \$10,142, for total shareholders' equity of \$20,142. Note that Sierra's total liabilities and total shareholders' equity equal its total assets of \$29,067.

The items listed in the statement of financial position can be ordered in different ways. For example, Sierra presents its assets first, followed by liabilities and shareholders' equity. Some companies present these items in a different order, to better represent the nature of their business. We will learn more about how to order items within the statement of financial position in Chapter 2. For now, follow the order used in the Sierra example.

Users analyze the statement of financial position to assess several things:

DECISION TOOL

Users can use the statement of financial position to evaluate the percentage of a company's assets that have been financed by liabilities and the percentage that have been financed using shareholders' equity. This gives the user perspective on whether the company relies more on its creditors or investors to finance its assets.

- External users such as creditors analyze a company's statement of financial position to determine the likelihood that they will be repaid. They carefully evaluate the nature of the company's assets and liabilities. For example, does the company have assets that could easily be sold, if required, to repay its debts (liabilities)? Do the company's assets exceed its liabilities in both the short and long term?
- Internal users such as managers use the statement of financial position to determine whether inventory is adequate to support future sales and whether cash on hand is sufficient for immediate cash needs.
- Both external and internal users look at the relationship between total liabilities and shareholders' equity to determine the relative proportions of debt and equity financing (see **Decision Tool**).

Statement of Cash Flows The main function of a **statement of cash flows** is to provide financial information about the cash receipts and cash payments of a business for a specific period of time. To help investors, creditors, and others in their analysis of a company's cash position, the statement of cash flows reports the effects on cash of a company's:

- **Operating activities**—these result from transactions that create revenues and expenses.
- **Investing activities**—these involve the purchase or sale of long-lived resources such as property, plant, and equipment that a company needs to operate and the purchase or sale of investments in long-term securities.
- **Financing activities**—these involve borrowing (or repaying) long-term debt from (to) lenders and issuing (or repurchasing) shares or distributing dividends to shareholders.

Operating activities are normally presented first in the statement of cash flows, followed by investing and financing activities. In addition, the statement shows the net increase or decrease in cash during the period, and the cash amount at the end of the period.

Users analyze the statement of cash flows because they want to know what is happening to a company's most important resource (see **Decision Tool**). The statement of cash flows provides answers to these simple but important questions:

DECISION TOOL

Users can use the statement of cash flows to evaluate the amount of cash provided by a company's operating activities and compare this with the amount of cash required for its investing and financing activities.

- Where did cash come from during the period? How much came from operating activities?
- How was cash used during the period?
- What was the change in the cash balance during the period?

The statement of cash flows for Sierra is shown in **Illustration 1.13**. Note that it is prepared for the same time period as the statement of income and the statement of changes in equity. Also note that the positive numbers in the illustration indicate cash inflows, while the negative numbers in parentheses indicate cash outflows.

Sierra Corporation
Statement of Cash Flows
Month Ended October 31, 2024

Operating activities		
Cash receipts from operating activities	\$10,200	
Cash payments for operating activities	<u>(8,300)</u>	
Net cash provided by operating activities		\$ 1,900
Investing activities		
Purchase of equipment	<u>\$(5,000)</u>	
Net cash used by investing activities		(5,000)
Financing activities		
Issue of common shares	\$10,000	
Borrowing of bank loan	5,000	
Payment of dividends	<u>(500)</u>	
Net cash provided by financing activities		<u>14,500</u>
Net increase in cash		11,400
Cash, October 1		<u>0</u>
Cash, October 31		<u><u>\$11,400</u></u>

ILLUSTRATION 1.13**Statement of cash flows**

In the above illustration, Sierra's statement of cash flows shows that overall cash increased by \$11,400 during the month. Operating activities generated \$1,900 in cash during the month, but this was not enough cash to fund the investing activities of \$5,000 during the month. To help offset this shortfall, the company was able to generate \$14,500 in cash from its financing activities. As a result, the company's cash inflows for the period exceeded its outflows, resulting in a net increase of \$11,400.

For now, you should not worry too much about where the numbers came from. Our intention is to introduce this statement briefly at this point. We will learn more about the preparation of the statement of cash flows in Chapter 13.

The Keeping an Eye on Cash boxes help you understand the importance of cash in business decision-making.

Keeping an Eye on Cash

Understanding where its cash comes from and where it goes is critical for a company.

The statement of cash flows summarizes the company's cash flows from operating, investing, and financing activities. A user of this statement can then determine the amount of cash provided (or used) by operating activities, the amount of cash provided (or used) by investing activities, and the amount of cash provided (or used) by financing activities.

Operating activities are activities the company performs to generate net income. It is desirable for operating activities to provide cash (positive balance) rather than use cash (negative balance). A positive source of cash from operating activities can help fund the investment in additional assets to grow the business and/or fund debt repayments or dividend payments.

Investing activities include the purchase or sale of long-lived assets used in operating the business, or the purchase or sale of long-term investment securities. For most growing companies, investing activities use cash (negative balance) rather than provide cash (positive balance), because growing companies spend more cash to purchase or replace assets than they receive as proceeds from disposing of assets they have finished using.

Financing activities include borrowing or repaying money, issuing or repurchasing shares, and paying dividends. For most growing companies, financing activities provide cash (positive balance) rather than use cash (negative balance). Most growing companies have to borrow money or issue shares rather than being able to repay financing. As companies mature, they are able to repay financing, and this balance becomes negative (cash used) more often than positive.

Relationships between the Statements Illustration 1.14 highlights the interrelationships in Sierra's financial statements. Because the results on some statements are used as data for other statements, the statements are said to be interrelated (related to each other). These interrelationships are evident in Sierra's financial statements, as follows:

- 1. The statement of changes in equity depends, in part, on the results of the statement of income.** Sierra reported net income of \$10,642 for the month. This amount is added to the beginning amount of retained earnings as part of determining ending retained earnings—one of the components of total shareholders' equity shown in the statement of changes in equity.

ILLUSTRATION 1.14**Sierra's financial statements**

Sierra Corporation			
Statement of Income			
Month Ended October 31, 2024			
Revenues			
Service revenue			\$20,600
Expenses			
Salaries expense	\$5,600		
Supplies expense	1,500		
Rent expense	900		
Depreciation expense	83		
Insurance expense	50		
Interest expense	25		8,158
Income before income tax			<u>12,442</u>
Income tax expense			<u>1,800</u>
Net income			<u>\$10,642</u>

Sierra Corporation			
Statement of Changes in Equity			
Month Ended October 31, 2024			
	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Total Equity</u>
Balance, October 1	\$ 0	\$ 0	\$ 0
Net income		10,642	10,642
Dividends declared		(500)	(500)
Issued common shares	<u>10,000</u>		<u>10,000</u>
Balance, October 31	<u>\$10,000</u>	<u>\$10,142</u>	<u>\$20,142</u>

Sierra Corporation	
Statement of Financial Position	
October 31, 2024	
<u>Assets</u>	
Cash	\$11,400
Accounts receivable	11,200
Supplies	1,000
Prepaid insurance	550
Equipment	<u>4,917</u>
Total assets	<u>\$29,067</u>
<u>Liabilities and Shareholders' Equity</u>	
Liabilities	
Accounts payable	\$ 1,500
Salaries payable	1,600
Interest payable	25
Deferred revenue	800
Bank loan payable	<u>5,000</u>
Total liabilities	<u>8,925</u>
Shareholders' equity	
Common shares	10,000
Retained earnings	<u>10,142</u>
Total shareholders' equity	<u>20,142</u>
Total liabilities and shareholders' equity	<u>\$29,067</u>

Sierra Corporation			
Statement of Cash Flows			
Month Ended October 31, 2024			
Operating activities			
Cash receipts from operating activities	\$10,200		
Cash payments for operating activities	<u>(8,300)</u>		
Net cash provided by operating activities			\$ 1,900
Investing activities			
Purchase of equipment	<u>\$(5,000)</u>		
Net cash used by investing activities			(5,000)
Financing activities			
Issue of common shares	\$10,000		
Borrowing of bank loan	5,000		
Payment of dividends	<u>(500)</u>		
Net cash provided by financing activities			<u>14,500</u>
Net increase in cash			11,400
Cash, October 1			0
Cash, October 31			<u>\$11,400</u>

- The statement of financial position and statement of changes in equity are interrelated.** Note that the ending balances of each component reported on the statement of changes in equity—common shares, \$10,000, and retained earnings, \$10,142—as well as total shareholders' equity of \$20,142 at the end of the month are also reported in the shareholders' equity section of the statement of financial position.
- The statement of cash flows and the statement of financial position are also interrelated.** The statement of cash flows shows how the cash account changed during the period. It states the amount of cash at the beginning of the period, the sources and uses of cash during the month, and the amount of cash at the end of the period, \$11,400. The ending amount of cash must agree with the amount of cash shown in the assets section of the statement of financial position.

Study the relationships identified in Illustration 1.14 carefully. **To prepare financial statements, you must understand the sequence in which these amounts are determined and how each statement affects the next.** Because each financial statement depends on information contained in another statement, financial statements must be prepared in the following order: (1) statement of income; (2) statement of changes in equity; (3) statement of financial position; and (4) statement of cash flows, as illustrated in **Illustration 1.15**.

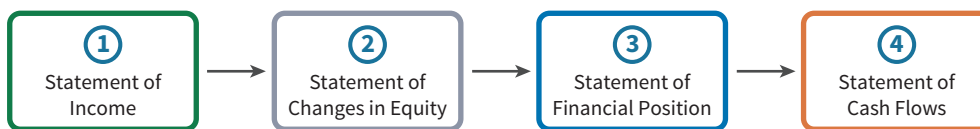


ILLUSTRATION 1.15
Financial statement preparation order

DO IT! 1.4b Financial Statement Relationships

Using your understanding of the relationship within and between the financial statements, determine the seven missing amounts.

Statement of Income	
Total revenues	\$2,360,000
Total expenses	<u>1,810,000</u>
Net income	(a)
Statement of Changes in Equity	
Total shareholders' equity, beginning of year	<u>980,000</u>
Common shares, beginning of year	350,000
Issue of shares	<u>(b)</u>
Common shares, end of year	<u>500,000</u>
Retained earnings, beginning of year	630,000
Net income	(c)
Dividends declared	<u>(d)</u>
Retained earnings, end of year	<u>890,000</u>
Total shareholders' equity, end of year	(e)
Statement of Financial Position	
Total assets	3,420,000
Total liabilities	(f)
Total shareholders' equity	(g)

ACTION PLAN

- Remember the order in which the financial statements are prepared.
- Certain amounts, such as net income, appear on more than one financial statement.
- Remember that the accounting equation, which is the basis for the statement of financial position, must balance.

Solution

Statement of Income	
Total revenues	\$2,360,000
Total expenses	<u>1,810,000</u>
Net income	(a) 550,000

Statement of Changes in Equity	
Total shareholders' equity, beginning of year	980,000
Common shares, beginning of year	350,000
Issue of shares	(b) 150,000
Common shares, end of year	500,000
Retained earnings, beginning of year	630,000
Net income	(c) 550,000
Dividends declared	(d) 290,000
Retained earnings, end of year	890,000
Total shareholders' equity, end of year	(e) 1,390,000
Statement of Financial Position	
Total assets	3,420,000
Total liabilities	(f) 2,030,000
Total shareholders' equity	(g) 1,390,000

- a. \$2,360,000 – \$1,810,000
- b. \$500,000 – \$350,000
- c. See Item (a)
- d. \$890,000 – \$630,000 – \$550,000
- e. \$500,000 + \$890,000
- f. \$3,420,000 – Item (g)
- g. See Item (e)

North West's Financial Statements

The same relationships that you observed among the financial statements of Sierra Corporation in Illustration 1.14 can be seen in the January 31, 2022 (fiscal 2021) simplified financial statements of The North West Company Inc., presented in **Illustration 1.16**.

ILLUSTRATION 1.16
North West's financial statements

The North West Company Inc.	
Statement of Earnings	
Year Ended January 31, 2022	
(\$ in thousands)	

Sales	\$2,248,796
Cost of sales	<u>1,511,045</u>
Gross profit	737,751
Selling, operating and administrative expenses	<u>517,326</u>
Earnings from operations	220,425
Interest expense	<u>13,058</u>
Earnings before income taxes	207,367
Income taxes	<u>49,916</u>
Net earnings	<u>\$ 157,451</u>

The North West Company Inc.					
Statement of Changes in Shareholders' Equity					
Year Ended January 31, 2022					
(\$ in thousands)					

	Share Capital	Retained Earnings	Accumulated Other Comprehensive Income	Other	Total Equity
Balance, January 31	\$174,213	\$282,088	\$21,605	\$27,325	\$505,231
Net earnings		154,802		2,649	157,451
Dividends declared		(70,420)			(70,420)
Repurchase of common shares	(2,892)	(25,172)			(28,064)
Issue of common shares	1,789			(944)	845
Other comprehensive income		14,376	745	(11)	15,110
Other changes to equity	(29)			80	51
Balance, January 31	<u>\$173,081</u>	<u>\$355,674</u>	<u>\$22,350</u>	<u>\$29,099</u>	<u>\$580,204</u>



ILLUSTRATION 1.16

(continued)

The North West Company Inc.

Balance Sheet
January 31, 2022
(\$ in thousands)

<u>Assets</u>		
Cash		\$ 49,426
Accounts receivable		99,241
Inventory		247,988
Prepaid expenses		6,703
Property and equipment		554,457
Right-of-use assets		100,844
Goodwill		48,502
Intangible assets		34,094
Other assets		<u>78,018</u>
Total assets		<u>\$1,219,273</u>
<u>Liabilities and Shareholders' Equity</u>		
Liabilities		
Accounts payable and accrued liabilities	\$221,319	
Income taxes payable	8,854	
Long-term debt	235,640	
Lease liabilities	114,070	
Other liabilities	<u>59,186</u>	
Total liabilities		\$ 639,069
Shareholders' equity		
Share capital	\$173,081	
Retained earnings	355,674	
Accumulated other comprehensive income	22,350	
Other equity items	<u>29,099</u>	
Total shareholders' equity		<u>580,204</u>
Total liabilities and shareholders' equity		<u>\$1,219,273</u>

3

The North West Company Inc.

Statement of Cash Flows
Year Ended January 31, 2022
(\$ in thousands)

Operating activities		
Cash receipts from operating activities	\$2,240,998	
Cash payments for operating activities	<u>(2,016,863)</u>	
Cash from operating activities		\$224,135
Investing activities		
Purchase of property and equipment	\$ (87,341)	
Goodwill and intangible asset additions	(6,729)	
Proceeds from disposal of property and equipment	<u>18,209</u>	
Cash used in investing activities		(75,861)
Financing activities		
Repayment of long-term debt	\$ (41,322)	
Payment of dividends	(70,420)	
Issue of common shares	845	
Repurchase of common shares	(28,064)	
Payment of lease liabilities (principal)	(18,003)	
Payment of interest	<u>(13,232)</u>	
Cash used in financing activities		(170,196)
Net decrease in cash		(21,922)
Effects of changes in foreign exchange rates on cash		<u>(188)</u>
Net decrease in cash including effects of changes in foreign exchange rates		(22,110)
Cash, beginning of year		<u>71,536</u>
Cash, end of year		<u>\$ 49,426</u>

North West's actual financial statements are presented in Appendix A. *The appendix can also be found in Wiley's course resources.* If you compare North West's actual financial statements with those presented in Illustration 1.16, you will notice some similarities and differences that we will clarify below.

- 1. Statement titles.** North West uses different titles in some of its actual financial statements than we have used in this textbook. As explained earlier in this chapter, there are a number of statement titles that mean the same thing: “statement of earnings” is how North West refers to its statement of income, “statement of changes in shareholders' equity” is how North West refers to its statement of changes in equity, and “balance sheet” is how North West refers to its statement of financial position. In Illustration 1.16, we used the account titles that North West used in its financial statements.
- 2. Consolidated financial statements.** North West presents consolidated financial statements. This means that the financial results include not only North West but also all the companies it owns or controls, which are called subsidiaries. Although the financial results of these companies are consolidated (combined) for reporting purposes, individual accounting records and financial statements are also produced for each specific company. In order to accurately assess each company's performance and financial position, it has to be possible to distinguish its activities from the transactions of any other company, even if the companies are related. This is another application of the reporting entity concept.
- 3. Comparative statements.** Public corporations are required to present their financial statements for at least two fiscal years. Financial statements that cover more than one period are called “comparative statements” and help users compare the financial position and performance of one accounting period with that of the prior period(s).
- 4. Unit of measure.** The numbers are reported in thousands of Canadian dollars on North West's financial statements; that is, the last three zeros (000) are omitted in both Illustration 1.16 and North West's actual financial statements.
- 5. Condensed statements.** The statements included in Illustration 1.16 have been condensed and simplified to assist your learning—but they may look complicated to you anyway. Do not be alarmed by this. By the end of the course, you will have a lot of experience in reading and understanding financial statements such as these, and they will no longer look as complicated.

Statement of Income Take a look at the simplified version of North West's statement of income, which it calls the statement of earnings, presented in Illustration 1.16. While Sierra is a service company, providing services to earn its revenue, North West is a retail company. It sells products to earn its revenue, although it also provides some services from which it earns revenue.

For the year ended January 31, 2022, North West reported:

- Sales revenue was \$2,248,796 thousand.
- Cost of sales (which is another term for cost of goods sold) of \$1,511,045 thousand is then subtracted to determine gross profit (\$737,751 thousand).
- Then a variety of expenses related to operating the business are subtracted.
- The resulting balance is income before income tax (which it calls “earnings before income taxes”) of \$207,367 thousand.
- Income tax expense of \$49,916 thousand is then deducted to determine net income (which it calls “net earnings”). Net income was \$157,451 thousand for the year ended January 31, 2022.

Statement of Changes in Equity North West presents information next about its shareholders' equity in the simplified statement of changes in equity (which the company calls “statement of changes in shareholders' equity”) in Illustration 1.16. This statement shows the changes in North West's shareholders' equity accounts, including share capital and retained earnings.

- During the year, North West issued shares for \$1,789 thousand and repurchased shares for \$2,892 thousand. These activities, together with some other minor adjustments, resulted in share capital decreasing during the year.

- North West’s opening retained earnings was increased by net income of \$154,802 thousand (see statement of income) and decreased by the declaration of dividends of \$70,420 thousand. Retained earnings was also reduced as a result of share repurchases during the year. We will learn why this was the case later in the text. Note that the net income figure in the net earnings row is the same as the net income reported on the statement of income. No matter what order the financial statements are presented in, the statement of income must be prepared first, because the net income (or loss) for the period is needed to prepare the statement of changes in equity.
- North West’s statement of changes in equity also includes a column for accumulated other comprehensive income (abbreviated as “AOCI” in its actual financial statements). Companies reporting under IFRS may have complex items that are similar to revenues and expenses but, due to their nature, are not used to determine net income. Rather, they are included in **other comprehensive income**. If a company has other comprehensive income (or loss) during the period, it is added to (or in the case of a loss, deducted from) a shareholders’ equity account called **accumulated other comprehensive income**. Similar to the retained earnings account, which accumulates net income over time, the accumulated other comprehensive income account is also a shareholders’ equity account that accumulates other comprehensive income over time.

We will learn more about other comprehensive income and accumulated other comprehensive income in Chapters 5 and 11. We will also learn in Chapter 11 about differences in how changes that influence shareholders’ equity, including other comprehensive income, affect public and private corporations.

Statement of Financial Position North West’s statement of financial position (which it calls “balance sheet”) shown in Illustration 1.16 includes the types of assets mentioned in this chapter: cash, accounts receivable, inventory, prepaid expenses, property and equipment, goodwill, intangible assets, and other types of assets. Similarly, its liabilities include accounts payable and accrued liabilities (we will learn about accrued liabilities in Chapter 2), income tax payable, and long-term debt, as well as other types of liabilities.

- Total assets equal \$1,219,273 thousand.
- Total liabilities equal \$639,069 thousand.
- The ending balances of North West’s share capital, retained earnings, accumulated other comprehensive income, and other shareholders’ equity items agree to (are equal to) the balances reported in the statement of changes in equity. Follow the arrow marked with a ② in Illustration 1.16 to confirm that the total shareholders’ equity of \$580,204 thousand reported in the statement of changes in equity for the year ended January 31, 2022, agrees to the total shareholders’ equity presented in the statement of financial position at the same date.
- Finally, note also that total liabilities and total shareholders’ equity equal total assets of \$1,219,273 thousand. The accounting equation is in balance.

You can see that North West relies on debt financing more than equity. It has used debt to finance 52.4% ($\$639,069 \div \$1,219,273$) of its assets, while equity financing was only 47.6% ($\$580,204 \div \$1,219,273$) of its assets. As you learn more about financial statements, we will discuss how to interpret the relationships and changes in financial statement items.

Statement of Cash Flows North West’s cash decreased by \$22,110 thousand in 2021. The reasons for the decrease in cash can be determined by examining the statement of cash flows in Illustration 1.16.

- North West’s operating activities, those related to the company’s revenues and expenses, generated significant cash flows of \$224,135 thousand during the year. These cash flows were used to support the company’s investing and financing activities.
- North West opened new stores, renovated existing stores, and replaced equipment during the year. This resulted in the company spending considerable cash—\$75,861 thousand—on investing activities.
- The company repaid \$41,322 in debt and \$18,003 thousand in lease liabilities as part of its financing activities. North West also distributed \$70,420 thousand in dividends, paid

\$28,064 thousand to repurchase common shares, and paid \$13,232 thousand in interest. These activities resulted in a total outflow of \$170,196 thousand from financing activities.

- The net result of these activities was a decrease in cash of \$22,110 thousand during the year.

These activities reduced the company's cash balance at the beginning of the year of \$71,536 thousand to \$49,426 thousand at the end of the year. Trace the ending balance of cash reported in the statement of cash flows to the ending balance reported in the statement of financial position, as indicated by the arrow marked with a ③ in Illustration 1.16.

Elements of an Annual Report

Public corporations must produce an **annual report** each year. The annual report includes the financial statements introduced in this chapter, together with a statement of management's responsibility for the statements. It also includes other important information such as a management discussion and analysis, an independent auditor's report, the notes to the financial statements, and a historical summary of key financial ratios and indicators. No analysis of a company's financial situation is complete without a review of these items. In the following sections, we will briefly elaborate about three of these key items: the management discussion and analysis, auditor's report, and notes to the financial statements.

Management Discussion and Analysis A management discussion and analysis (MD&A) must accompany the financial statements released by public companies. The MD&A provides management's perspective on the financial performance during the period covered by the financial statements and provides important context for interpreting them. It must also include a discussion of the company's financial condition and cash flows. In the MD&A, management also provides a forward-looking perspective (how the company's operations and results are expected to change in the future, including the expected impacts of industry and economic factors).

The MD&A often includes a discussion about the company's initiatives in relation to corporate social responsibility and sustainable development. This information is usually a brief summary of the information included in the company's sustainability report, which is prepared in addition to the annual report.

Auditor's Report The auditor's report is prepared by an independent auditor who is appointed by the shareholders on the recommendation by the board of directors. The auditor's report provides shareholders with an opinion on whether the company's financial statements are fairly presented in accordance with the applicable accounting principles (IFRS for public companies). For public companies, the auditor's report will also identify key audit matters, which are the matters that the auditor concluded were of most significance in the audit of the financial statements. These include:

- Areas involving significant risks of misstatement that have been identified by the auditor.
- Financial statement items involving significant management estimates.
- The effect on the audit of significant events or transactions that have taken place.

Reading the auditor's report before reviewing a company's financial statements will provide users with important additional context.

Notes to the Financial Statements Explanatory notes and supporting schedules accompany every set of financial statements and are an integral part of the statements. The notes to the financial statements clarify the statements and provide additional detail. Information in the notes does not have to be quantifiable (numerical). Examples of notes include the following:

- Descriptions of the significant accounting policies and methods used in preparing the statements.
- Explanations of risks, uncertainties, and contingencies.
- Various statistics and details too voluminous to be included in the statements.

The notes are essential to understanding a company's operating performance and financial position.

DO IT! 1.4c Preparing Financial Statements

CSU Corporation began operations on January 1, 2024. The following account information is available for CSU Corporation on December 31, 2024: service revenue \$22,200, accounts receivable \$4,000, accounts payable \$2,000, rent expense \$9,000, bank loan payable \$5,000, common shares \$10,000, equipment \$16,000, insurance expense \$1,000, supplies \$1,800, interest expense \$200, cash \$4,800, income tax expense \$1,800, and dividends declared \$600.

Using this information, prepare a statement of income, statement of changes in equity, statement of financial position, and statement of cash flows for the year.

For the operating activities section of the statement of cash flows, cash receipts from operating activities were \$18,200 and cash payments for operating activities were \$11,800. For the investing activities section, cash of \$16,000 was paid for the purchase of the equipment. For the financing activities section, cash of \$5,000 was received from the bank loan and \$10,000 from the issue of common shares. Cash of \$600 was paid for dividends.

ACTION PLAN

- Classify each account into the following categories: revenues, expenses, dividends, assets, liabilities, and shareholders' equity.
- Report revenues and expenses for the period in the statement of income and determine the amount of net income or loss.
- When preparing the statement of changes in equity, start with opening balances and show the amounts and causes of the changes in share capital and retained earnings for the period to determine ending balances. Ensure that net income or loss is included in retained earnings.
- List all assets and claims to those assets (liabilities and shareholders' equity) at a specific point in time in the statement of financial position. Ensure that the share capital and retained earnings balances agree to the amounts reported on the statement of changes in equity.
- Show the changes in cash for the period, classified as operating, investing, or financing activities in the statement of cash flows. Ensure that the ending cash balance agrees with the amount of cash reported on the statement of financial position.
- Remember that the statement of income, statement of changes in equity, and statement of cash flows cover a period of time, while the statement of financial position is reported at a specific point in time.

Solution

CSU Corporation Statement of Income Year Ended December 31, 2024		
Revenues		
Service revenue		\$22,200
Expenses		
Rent expense	\$9,000	
Insurance expense	1,000	
Interest expense	<u>200</u>	
Total expenses		<u>10,200</u>
Income before income tax		12,000
Income tax expense		<u>1,800</u>
Net income		<u>\$10,200</u>

CSU Corporation Statement of Changes in Equity Year Ended December 31, 2024			
	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Total Equity</u>
Balance, January 1	\$ 0	\$ 0	\$ 0
Issued common shares	10,000		10,000
Net income		10,200	10,200
Dividends declared		<u>(600)</u>	<u>(600)</u>
Balance, December 31	<u>\$10,000</u>	<u>\$ 9,600</u>	<u>\$19,600</u>

CSU Corporation
Statement of Financial Position
December 31, 2024

<u>Assets</u>	
Cash	\$ 4,800
Accounts receivable	4,000
Supplies	1,800
Equipment	<u>16,000</u>
Total assets	<u>\$26,600</u>
<u>Liabilities and Shareholders' Equity</u>	
Liabilities	
Accounts payable	\$ 2,000
Bank loan payable	<u>5,000</u>
Total liabilities	<u>7,000</u>
Shareholders' equity	
Common shares	10,000
Retained earnings	<u>9,600</u>
Total shareholders' equity	<u>19,600</u>
Total liabilities and shareholders' equity	<u>\$26,600</u>

CSU Corporation
Statement of Cash Flows
Year Ended December 31, 2024

Operating activities		
Cash receipts from operating activities	\$ 18,200	
Cash payments for operating activities	<u>(11,800)</u>	
Net cash provided by operating activities		\$ 6,400
Investing activities		
Purchase of equipment	<u>\$(16,000)</u>	
Net cash used by investing activities		(16,000)
Financing activities		
Issue of bank loan payable	\$ 5,000	
Issue of common shares	10,000	
Payment of dividends	<u>(600)</u>	
Net cash provided by financing activities		<u>14,400</u>
Net increase in cash		4,800
Cash, January 1		0
Cash, December 31		<u>\$ 4,800</u>

The Review and Practice section presents a summary of learning objectives, key terms, IFRS and ASPE differences, and decision tools. This section also provides opportunities for students to complete a Practice Using the Decision Tools case, a Practice Comprehensive DO IT! problem, and Practice Objective-Format Questions. Detailed solutions to these problems and questions are included at the end of the chapter.

Review and Practice

Review of Learning Objectives

1. Identify the uses and users of accounting information.

The purpose of accounting is to provide useful information for decision-making. There are two types of decision-makers who use accounting information: internal users and external users. The primary internal users are managers, who work for the business and need internal accounting information to manage and run its operations. The primary external users are investors and creditors.

Investors (existing and potential shareholders) use accounting information to help decide whether to buy, hold, or sell shares. Creditors, which include lenders such as bankers and suppliers, use accounting information to evaluate the risk of lending money or granting credit to a business. Other external users include non-management employees, potential employees, customers, regulators, and taxing authorities.

2. Describe the primary forms of business organization. There are three types of business organizations: proprietorships, partnerships, and corporations. A proprietorship is a business owned by one person. A partnership is a business owned by two or more people. A corporation is a separate legal entity whose shares provide evidence of ownership. Corporations can be public, which means their shares trade on a stock exchange, or private, which means their shares are closely held and do not trade on a stock exchange.

Generally accepted accounting principles are a common set of guidelines that are used to record and report economic events. These can differ depending on the form of business organization. Public corporations follow International Financial Reporting Standards (IFRS) and private corporations have the choice of using Accounting Standards for Private Enterprises (ASPE) or IFRS. Proprietorships and partnerships generally use ASPE.

3. Explain the three main types of business activity. Financing activities involve obtaining the necessary funds (through the issue of equity or the assumption of debt) to support the business. Repayments of debt, the declaration and payment of dividends, and share repurchases are also financing activities. Investing activities primarily

involve purchasing the long-term assets (such as property, plant, and equipment) that are needed to run the business, but also include the disposition of these items. Operating activities involve putting the resources of the business into action to generate net income. These involve the day-to-day activities of the business as it earns revenues and incurs expenses doing so.

4. Describe the purpose and content of each of the financial statements. The statement of income presents the revenues and expenses of a company for a specific period of time. The statement of changes in equity summarizes the changes in shareholders' equity that have occurred for a specific period of time, including those related to the issue of shares, generation of net income, and declaration of dividends. The statement of financial position reports the assets, liabilities, and shareholders' equity of a business at a specific date. The statement of cash flows summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time. Notes to the financial statements add explanatory detail where required. The financial statements are included in an annual report, along with the management discussion and analysis (MD&A), the auditor's report, and the notes to the financial statements.

Review of Key Terms

accounting The information system that identifies, records, and communicates the economic events of an organization to users interested in that information.

accounting equation The equation that states that Assets = Liabilities + Shareholders' Equity.

assets The resources owned or controlled by a business that are expected to provide future economic benefits.

corporation A company organized as a separate legal entity, with most of the rights and privileges of a person. Shares are evidence of ownership.

creditors Users of accounting information, including suppliers, that grant credit (sell on account) to a customer.

data analytics The process of analyzing data to find patterns and correlations, trends, and other valuable insights to enhance decision-making.

deficit A negative balance in retained earnings resulting from cumulative net losses exceeding cumulative net income.

dividends The distribution of retained earnings from a corporation to its shareholders, normally in the form of cash.

expenses The decreases in economic benefits that result from the costs of assets consumed or services used in ongoing operations to generate revenue.

external users Users of accounting information that are not involved in managing the organization and do not have access to accounting information other than that which is publicly available, including investors, lenders, and other creditors.

financing activities Activities that report the cash effects of debt or equity financing. These include borrowing or repaying cash from (to) lenders, and issuing or reacquiring shares or paying dividends to investors.

fiscal year An accounting period that is one year long.

generally accepted accounting principles (GAAP) A general guide, having substantial authoritative support, that describes how economic events should be recorded and reported for financial reporting purposes.

income The increase in economic benefits that result from the activities of a business, rather than from transactions with shareholders. Income includes revenues and gains.

internal users Users of accounting information, including company officers, managers, and directors, who have access to an organization's internal accounting information.

investing activities Activities that report the cash effects of purchasing and disposing of long-lived assets such as property, plant, and equipment and investments not held for trading.

investors Users of accounting information that have an ownership interest (own debt or equity securities) in the organization.

lenders Users of accounting information, including bankers, that extend credit to borrowers.

liabilities The debts and obligations of a business. Liabilities are claims of lenders and other creditors on the assets of a business.

net income The amount by which revenues exceed expenses.

net loss The amount by which expenses exceed revenues.

operating activities Activities that result from day-to-day operations. They report the cash effects of transactions that create revenues and expenses.

partnership A business owned by more than one person that is not incorporated.

private corporation A corporation whose shares are not traded on a public stock exchange.

proprietorship A business owned by one person.

public corporation A corporation whose shares are publicly traded on a stock exchange.

reporting entity concept The concept that economic activity that can be identified with a particular company must be kept separate and distinct from the activities of the owner(s) and of all other economic entities.

retained earnings The amount of accumulated net income (less net losses, if any) from the prior and current periods that has been retained and reinvested in the corporation for future use and not distributed to shareholders as dividends.

revenue The increase in economic benefits that result from the normal operating activities of a business, such as the sale of a product or provision of a service.

share capital Shares representing the ownership interest in a corporation. If only one class of shares exists, it is known as common shares.

shareholders' equity The shareholders' claim on total assets, represented by the investments of the shareholders (share capital) and undistributed earnings (retained earnings) generated by the company.

statement of cash flows A financial statement that provides information about the cash inflows (receipts) and cash outflows (payments) for a specific period of time.

statement of changes in equity A financial statement that summarizes the changes in total

shareholders' equity, as well as each component of shareholders' equity, for a specific period of time.

statement of financial position A financial statement that reports the assets, liabilities, and shareholders' equity at a specific date.

statement of income A financial statement that reports a company's financial performance during the period.

Review of IFRS and ASPE

Key Standard Differences	International Financial Reporting Standards (IFRS)	Accounting Standards for Private Enterprises (ASPE)
Accounting standards	Publicly traded corporations must use IFRS; private corporations normally use ASPE but can choose to use IFRS.	Private corporations normally use ASPE but can choose to use IFRS. Once the choice is made, it must be applied consistently. Proprietorships and partnerships generally follow ASPE.
Statement of changes in equity vs. statement of retained earnings	A statement of changes in equity must be presented that shows the changes in all components of shareholders' equity (for example, share capital and retained earnings).	A statement of retained earnings is presented that shows the change in only one component of shareholders' equity: retained earnings.

Review of Decision Tools

Decision Checkpoints	Info Needed for Decision	Tools to Use for Decision	How to Evaluate Results
Are the company's operations profitable?	Statement of income	The statement of income indicates the success or failure of the company's operating activities by reporting its revenues and expenses.	If the company's revenues exceed its expenses, it will report net income; otherwise it will report a net loss.
Is the company expanding or contracting its share capital?	Statement of changes in equity	Did the company issue or repurchase shares?	If share capital is increasing, the company may be gathering funds for future expansion plans or to repay debt. If share capital is decreasing, the company has surplus cash and is returning it to shareholders by repurchasing some of their shares.
What is the company's policy on dividends and growth?	Statement of changes in equity	How much of the company's retained earnings was paid out in dividends to shareholders?	A company needing to finance growth or the repayment of debt will preserve the cash it generates from its operations and pay little or nothing in dividends.
Does the company rely mainly on debt or on equity to finance its assets?	Statement of financial position	The statement of financial position reports the company's resources and claims to those resources. There are two types of claims: liabilities and shareholders' equity.	Compare the amount of liabilities as a percentage of total assets with the amount of shareholders' equity as a percentage of total assets to determine whether the company relies more on creditors or on shareholders for its financing.
Does the company generate enough cash from operating activities to fund its investing activities?	Statement of cash flows	The statement of cash flows shows the amount of cash provided or used by operating activities, investing activities, and financing activities.	Compare the amount of cash provided by operating activities with the amount of cash used by investing activities. Any deficiency in cash from operating activities must be made up with cash provided by financing activities.

Practice Using the Decision Tools

Answers are at the end of the chapter.

Loblaw Companies Limited operates more than 2,400 stores across Canada. Just like North West, Loblaw has a long tradition—with portions of the company's operations dating back to before 1900. While Loblaw's stores can be found in towns and cities across Canada, North West's stores are located in remote communities, including in Canada's far North, Alaska, and the Caribbean. Although the two companies do not compete in the same markets, they are in a similar industry. Assume that you are reviewing the financial information of each company to determine if you should invest in North West or Loblaw.

Instructions

- Which financial statements should you review before you invest?
- What should each of these financial statements tell you? Which financial statement will you likely be most interested in?
- Loblaw's fiscal year end is the Saturday closest to December 31. North West's fiscal year end is January 31. Do you believe it is possible to compare these companies' financial statements since they have different fiscal year ends?
- Simplified financial statements for Loblaw follow. More detailed financial statements are available on the System for Electronic Document Analysis and Retrieval (SEDAR) found at <https://www.sedar.com>. What broad comparisons can you make between North West and Loblaw by reviewing their financial statements?
- How did the amount of cash generated by each company from operating activities compare with the amount of cash used for its investing activities? How did this relate to the cash flows each had from its financing activities?

Loblaw Companies Limited

Statement of Earnings Year Ended January 1, 2022 (\$ in millions)

Sales	\$53,170
Cost of sales	<u>36,436</u>
Gross profit	16,734
Selling, operating and administrative expenses	<u>13,797</u>
Earnings from operations	2,937
Interest expense	<u>495</u>
Earnings before income taxes	2,442
Income taxes	<u>466</u>
Net earnings	<u>\$ 1,976</u>

Loblaw Companies Limited

Statement of Changes in Equity Year ended January 1, 2022 (\$ in millions)

	Share Capital	Retained Earnings	Accumulated Other Comprehensive Income	Other	Total Equity
Balance, January 2, 2021	\$7,045	\$3,813	\$21	\$240	\$11,119
Net earnings		1,875		101	1,976
Dividends declared		(484)			(484)
Repurchase of common shares	(310)	(890)			(1,200)
Other comprehensive income		282	5		287
Other changes to equity	<u>117</u>	<u>(5)</u>	<u>(12)</u>	<u>(61)</u>	<u>39</u>
Balance, January 1, 2022	<u>\$6,852</u>	<u>\$4,591</u>	<u>\$14</u>	<u>\$280</u>	<u>\$11,737</u>

Loblaw Companies Limited

Statement of Financial Position

As at January 1, 2022

(\$ in millions)

<u>Assets</u>		
Cash		\$ 1,976
Short term investments		464
Accounts receivable		947
Inventory		5,166
Prepaid expenses		249
Property and equipment		5,447
Right-of-use assets		7,175
Intangible assets		6,402
Goodwill		3,949
Other assets		<u>4,839</u>
Total assets		<u>\$36,614</u>
 <u>Liabilities and Shareholders' Equity</u> 		
Liabilities		
Accounts payable and other liabilities	\$5,433	
Income taxes payable	153	
Long-term debt	7,213	
Lease liabilities	8,839	
Other liabilities	<u>3,239</u>	
Total liabilities		\$24,877
Shareholders' equity		
Share capital	\$6,852	
Retained earnings	4,591	
Accumulated other comprehensive income	14	
Other equity items	<u>280</u>	
Total shareholders' equity		<u>11,737</u>
Total liabilities and shareholders' equity		<u>\$36,614</u>

Loblaw Companies Limited

Statement of Cash Flows

Year Ended January 1, 2022

(\$ in millions)

Operating activities		
Cash receipts from operating activities	\$ 52,866	
Cash payments for operating activities	<u>(48,039)</u>	
Cash from operating activities		\$4,827
Investing activities		
Purchase of property and equipment	\$ (803)	
Goodwill and intangible asset additions	(379)	
Proceeds from disposal of property and equipment	80	
Other outflows from investing activities	<u>(169)</u>	
Cash used in investing activities		(1,271)
Financing activities		
Repayment of short-term and long-term debt	\$ (762)	
Proceeds from issuing long-term debt	772	
Payment of dividends	(484)	
Issue of common shares	102	
Repurchase of common shares	(1,250)	
Payment of lease liabilities (principal)	(1,360)	
Payment of interest	(339)	
Other inflows from financing activities	<u>72</u>	
Cash used in financing activities		<u>(3,249)</u>

Net increase in cash	307
Effects of changes in foreign exchange rates on cash	<u>1</u>
Net increase in cash including effects of changes in foreign exchange rates	308
Cash, beginning of year	<u>1,668</u>
Cash, end of year	<u>\$ 1,976</u>

Practice Comprehensive DO IT!

Answers are at the end of the chapter.

Jeff Andringa, a former university hockey player, started Ice Camp Ltd., a hockey camp for children from ages 6 to 16. Eventually he would like to expand and open hockey camps across the country. Jeff has asked you to help him prepare financial statements at the end of his first year of operations. He tells you the following facts about his business activities.

In order to get the business started, he decided to incorporate. On January 3, 2024, he incorporated Ice Camp Ltd., paying \$5,000 in exchange for 500 common shares. The company subsequently borrowed \$10,000 from a local bank. A used bus for transporting kids was purchased for \$12,000 cash. Hockey nets and other miscellaneous equipment were purchased with \$1,500 cash. The company earned camp tuition of \$100,000 during the year but has collected only \$90,000 of this amount so far. Thus, at the end of the year, the company was still owed \$10,000 by some of its clients. The company rents time at a local rink. Total ice rental costs during the year were \$14,000, insurance was \$6,000, salaries were \$20,000, and administrative expenses totalled \$7,000—all of which were paid in cash. The company incurred \$800 in interest expense on the bank loan, which it still owed at the end of the year. The company also owes \$10,440 in income tax. The company paid Jeff dividends of \$35,000 rather than salary during the year.

The balance in the corporate bank account at December 31, 2024, was \$9,500 (\$5,000 + \$10,000 – \$12,000 – \$1,500 + \$90,000 – \$14,000 – \$6,000 – \$20,000 – \$7,000 – \$35,000).

Instructions

Prepare a statement of income, statement of changes in equity, and statement of financial position for the year assuming Ice Camp uses IFRS. Note that, while it is unlikely that Ice Camp would follow IFRS, the resulting financial statements would not be very different from those that would be reported under ASPE.

Practice Objective-Format Questions

Answers are at the end of the chapter.

- For each of the following financial statement users, indicate whether they would be an “internal” or “external” user:
 - Bank (lender)
 - Shareholders
 - Employees (non-management)
 - Suppliers
 - Labour union
 - Canada Revenue Agency
 - Management
- For each of the following questions that could be asked by a financial statement user, indicate which user (select from management, shareholder, potential shareholder, supplier, labour union, and bank) would be most likely to ask it and whether they would be considered an “internal” or “external” user.
 - How do production costs compare across our two manufacturing plants?
 - If we lend the company money, will it be able to repay the loan, together with interest?
 - Should we allow the company to purchase materials on account?
 - Do the company’s financial results justify the price I would have to pay to purchase shares in it?
 - If we demand a 2% salary increase, would it make the company unprofitable?
 - Should we purchase or rent the new equipment we require?
 - If the company maintains its dividend policy (declares and pays the same dividends as it did in the previous year), what would be the dividend I would receive on the 100 shares I own?

3. Indicate which of the following statements is (are) correct. (Select as many as are appropriate.)
- A corporation is a separate legal entity and pays income tax on its net income.
 - In a partnership, there is a legal distinction between the business and the partners.
 - Shareholders are responsible for the debts of the corporation because they are the owners of the company.
 - The net income of a proprietorship is taxed on the owner's personal income tax return.
 - Forming a corporation is the most complex way to structure a business.
 - Each partner in a partnership generally has unlimited liability for all of the debts of the partnership.
 - The reporting entity concept applies regardless of whether a business is organized as a proprietorship, partnership, or corporation.
4. Indicate which of the following statements is (are) correct. (Select as many as are appropriate.)
- Public corporations are companies whose shares trade on a public stock exchange.
 - Once the form of business is established (as a proprietorship, partnership, or corporation), it cannot be changed.
 - Private companies can use either IFRS or ASPE to prepare their financial statements.
 - It is normally easier for a proprietorship to raise capital than it is for a corporation.
 - Private companies do not have to make their financial results public.
 - The personal liability of shareholders in both private and public corporations is normally limited to the extent of their investment in shares of the corporation.
 - Public companies can use either IFRS or ASPE to prepare their financial statements.
5. For each of the following, indicate what type of activity it is (financing, investing, or operating) and whether it would result in an inflow or outflow of cash.
- Paying dividends
 - Collecting an account receivable from a customer
 - Purchasing new equipment
 - Issuing common shares
 - Paying employee salaries
 - Repaying a bank loan
 - Selling equipment that the company has finished using
6. For each of the following, indicate what type of activity (financing, investing, or operating) it is related to.
- Property, plant, and equipment
 - Dividends declared
 - Intangible assets
 - Accounts payable
 - Loan payable
 - Common shares
 - Supplies
7. Indicate on which financial statement(s) (statement of income, statement of changes in equity, statement of financial position, or statement of cash flows) each of the following would be reported. (Select as many as are appropriate.)
- Cash
 - Deferred revenue
 - Net income
 - Cost of goods sold
 - Dividends declared and paid
 - Prepaid insurance
 - Service revenue
8. Indicate which of the following statements is (are) correct. (Select as many as are appropriate.)
- Total assets less total liabilities should be equal to shareholders' equity.
 - The statement of income is normally prepared before the statement of financial position.
 - The declaration and payment of dividends would affect the statement of income, statement of changes in equity, and statement of cash flows.
 - A company's cash balance at the end of an accounting period is found on both the statement of financial position and the statement of cash flows.
 - If a company received a new bank loan, it would affect both the statement of financial position and the statement of cash flows.
 - The statement of financial position is normally prepared before the statement of changes in equity.
 - The issue of common shares would affect all four of the financial statements.
9. Indicate which financial statement(s) (statement of income, statement of changes in equity, statement of financial position, or statement of cash flows) would have to be consulted to answer each of the following questions.
- Did the company declare dividends during the period?
 - How did the company's salaries expense compare with its revenues?
 - What was the company's income before income taxes?
 - How much does the company owe its suppliers?
 - Did the company issue shares during the period?
 - Were the company's cash flows from operating activities sufficient to cover the cash required to purchase long-term assets?
 - What amount was owed to the company by its customers?
10. For each lettered item below, indicate which of the following amounts it would be used to calculate: total assets, total liabilities, total shareholders' equity, net income, or retained earnings.
- Deferred revenue
 - Common shares
 - Cost of goods sold
 - Bank indebtedness
 - Dividends declared
 - Goodwill
 - Interest expense

Selected Brief Exercises, Exercises, and many additional resources are available for practice in Wiley's course resources.

End-of-Chapter Assessment

Questions

- (LO 1)** What is accounting?
- (LO 1) (a)** Distinguish between internal and external users of accounting information. **(b)** Why are some people who work for a company considered to be internal users while others are considered to be external users?
- (LO 1)** What kinds of questions might internal users of accounting information want answered? External users?
- (LO 1)** Why are investors and creditors considered to be the primary users of accounting information? Are these users considered to be internal or external users?
- (LO 1)** Why is ethical decision-making important to the preparation of accounting information and to the decision-makers who rely on this information?
- (LO 1)** What is the difference between descriptive and predictive data analytics? Which is likely to be of greater use to management?
- (LO 2)** Identify the advantages and disadvantages of each of the following forms of business organization: **(a)** proprietorship, **(b)** partnership, **(c)** private corporation, and **(d)** public corporation.
- (LO 2)** Identify the similarities and differences between a public corporation and a private corporation.
- (LO 2)** Are the shareholders of public corporations normally involved in managing these companies? If not, explain who is.
- (LO 2) (a)** Identify the financial reporting standards a public and a private corporation may use. **(b)** Why do you think they differ?
- (LO 2)** Why might a private corporation opt to prepare its financial statements using IFRS?
- (LO 2)** Explain how the reporting entity concept applies to business organizations.
- (LO 3)** Explain the following terms and give an example of each: **(a)** asset, **(b)** liability, **(c)** shareholders' equity, **(d)** revenues, and **(e)** expenses.
- (LO 3)** Distinguish among operating, investing, and financing activities.
- (LO 3)** Give two examples of each kind of business activity: **(a)** operating, **(b)** investing, and **(c)** financing. For each type of activity, identify at least one example that would result in a cash inflow and one that would result in a cash outflow.
- (LO 3)** Why would a bank want to monitor the dividend payment practices of the corporations to which it lends money?
- (LO 3)** "A company's net income appears directly on both the statement of income and statement of changes in equity." Do you agree? Explain.
- (LO 3)** What is retained earnings? What increases the balance in retained earnings? What items decrease the balance in retained earnings?
- (LO 4)** What is a fiscal year end? Why does a company's fiscal year not always end on December 31?
- (LO 4)** André is puzzled reading **Air Canada's** financial statements. He notices that the numbers have all been rounded to the nearest million. He thought financial statements were supposed to be accurate and wonders what happened to the rest of the money. Respond to André's concern.
- (LO 4)** The basic accounting equation is $\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$. Replacing words with dollar amounts, what is **The North West Company's** accounting equation at January 31, 2022? North West's simplified financial statements can be found in Illustration 1.16 in this chapter.
- (LO 4)** What are the primary components explained in a statement of changes in equity? What types of items generally increase each component? What types of items generally decrease each component?
- (LO 4) (a)** What is the purpose of the statement of cash flows? **(b)** What are the three main categories of activities included in the statement?
- (LO 4)** Explain whether cash flows from operating activities would normally be expected to be positive or negative in the early years of a company's life. What about cash flows from investing activities? Why is this the case?
- (LO 4)** Why is a statement of financial position prepared as at a specific point in time, while the other financial statements cover a period of time?
- (LO 4)** How are each of the following pairs of financial statements related?
 - Statement of income and statement of changes in equity
 - Statement of changes in equity and statement of financial position
 - Statement of financial position and statement of cash flows
- (LO 4)** Identify the four financial statements prepared by corporations using **(a)** IFRS and **(b)** ASPE.
- (LO 4)** What is the purpose of the management discussion and analysis (MD&A) section of the annual report?
- (LO 4)** What information can be obtained from reading the auditor's report?
- (LO 4)** What types of information are presented in the notes to the financial statements?

Brief Exercises

BE1.1 (LO 1) (*Identify users of accounting information.*) The following list presents different types of evaluations made by various users of accounting information:

1. Determining if the company can pay for purchases made on account
2. Determining if the company has complied with income tax regulations
3. Determining if the company could afford a 1% salary increase
4. Determining if an advertising campaign was cost-effective
5. Determining if the company's net income may result in a share price increase
6. Determining if the company should use debt or equity financing
 - a. Beside each user of accounting information listed in the left-hand column of the table that follows, write the number of the evaluation above (1 to 6) that the user would most likely make.
 - b. Indicate if the user is internal or external. The first item has been done for you as an example.

	<u>(a) Type of Evaluation</u>	<u>(b) Type of User</u>
Investor	5	External
Marketing manager	_____	_____
Creditor	_____	_____
Chief financial officer	_____	_____
Canada Revenue Agency	_____	_____
Labour union	_____	_____

BE1.2 (LO 1) (*Identify types of data analytics*) (a) Match each of the following questions with the type of data analytics—(1) descriptive, (2) diagnostic, or (3) predictive—that will help answer it. (b) For each type, also indicate whether its perspective is hindsight, insight, or foresight.

	<u>(a) Type of Data Analytic</u>	<u>(b) Perspective</u>
1. What happened to sales revenue?	_____	_____
2. Why did cost of goods sold increase?	_____	_____
3. How much is salaries expense expected to increase next period?	_____	_____

BE1.3 (LO 2) (*Identify forms of business organization.*) Match each of the following forms of business organization—(1) proprietorship, (2) partnership, (3) public corporation, or (4) private corporation—with the set of characteristics that best describes it.

- a. _____ Simple to set up; founder retains control
- b. _____ Separate legal entity; shares closely held
- c. _____ Easier to transfer ownership and raise funds; no personal liability
- d. _____ Shared control; increased skills and resources
- e. _____ Issues shares; can choose to follow IFRS or ASPE accounting standards

BE1.4 (LO 3) (*Identify business activities and cash impact.*) Classify each item by type of business activity—operating (O), investing (I), or financing (F). Also indicate whether it results in an inflow or outflow of cash.

- a. _____ / _____ Loan taken out from a bank
- b. _____ / _____ Cash received from customers
- c. _____ / _____ Sale of office equipment the company is done using
- d. _____ / _____ Dividends paid to shareholders
- e. _____ / _____ Common shares issued to investors
- f. _____ / _____ Loan repayment
- g. _____ / _____ Payment to supplier for inventory
- h. _____ / _____ Purchase of an office building
- i. _____ / _____ Salaries paid

BE1.5 (LO 3) (Identify business activity and effect on cash.) For each of the following items, indicate (a) the type of business activity—operating (O), investing (I), or financing (F)—and (b) whether it increased (+), decreased (−), or had no effect (NE) on cash. The first one has been done for you as an example.

	<u>(a) Type of Activity</u>	<u>(b) Cash Effect</u>
1. Sold goods on account.	O	NE
2. Borrowed money from a bank.	_____	_____
3. Purchased inventory for cash.	_____	_____
4. Provided a service for cash.	_____	_____
5. Purchased supplies on account.	_____	_____
6. Paid salaries in cash.	_____	_____
7. Paid dividends.	_____	_____
8. Purchased a delivery truck for cash.	_____	_____

BE1.6 (LO 4) (Use accounting equation.) Use the accounting equation to answer these independent questions:

- The shareholders' equity of Sansom Corporation is \$120,000. Its total liabilities are \$55,000. What is the amount of Sansom's total assets?
- The liabilities of Houle Corporation are \$170,000. Houle's share capital is \$100,000 and its retained earnings are \$90,000. What is the amount of Houle's total assets?
- The total assets of Pitre Limited are \$150,000. Its share capital is \$50,000 and its retained earnings are \$25,000. What is the amount of its total liabilities?
- The total assets of Budovitch Inc. are \$500,000 and its liabilities are equal to half its total assets. What is the amount of Budovitch's shareholders' equity?

BE1.7 (LO 4) (Use accounting equation.) At the beginning of the year, Xul Ltd. had total assets of \$720,000 and total liabilities of \$420,000. Use this information to answer each of the following independent questions.

- If Xul's total assets increased by \$250,000 during the year and total liabilities decreased by \$80,000, what is the amount of shareholders' equity at the end of the year?
- During the year, Xul's total liabilities decreased by \$100,000. The company reported net income of \$90,000, sold additional shares for \$125,000, and did not declare any dividends during the year. What is the amount of total assets at the end of the year?
- If Xul's total assets decreased by \$90,000 during the year and shareholders' equity increased by \$120,000, what is the amount of total liabilities at the end of the year?

BE1.8 (LO 4) (Identify financial statement.) Indicate which statement—statement of income (SI), statement of financial position (SFP), statement of changes in equity (SCE), or statement of cash flows (SCF)—you would examine to find each of the following items:

- | | |
|--|---|
| a. _____ Service revenue | e. _____ Total liabilities |
| b. _____ Supplies | f. _____ Cash used for financing activities |
| c. _____ Dividends declared | g. _____ Salaries expense |
| d. _____ Cash provided by operating activities | h. _____ Common shares issued during the year |

BE1.9 (LO 4) (Identify assets, liabilities, and shareholders' equity.) Indicate whether each of these items is an asset (A), a liability (L), or shareholders' equity (SE):

- | | |
|------------------------------|----------------------------|
| a. _____ Bank indebtedness | g. _____ Goodwill |
| b. _____ Accounts receivable | h. _____ Common shares |
| c. _____ Salaries payable | i. _____ Bank loan payable |
| d. _____ Accounts payable | j. _____ Retained earnings |
| e. _____ Inventory | k. _____ Cash |
| f. _____ Equipment | |

BE1.10 (LO 4) (*Determine effect of transactions on shareholders' equity.*) Determine whether each transaction would increase (+), decrease (–), or have no effect (NE) on each of the following components found in the statement of changes in equity: share capital, retained earnings, and total shareholders' equity. The first one has been done for you as an example.

	<u>Share Capital</u>	<u>Retained Earnings</u>	<u>Total Shareholders' Equity</u>
a. Net income	NE	+	+
b. Repayment of bank loan	_____	_____	_____
c. Declaration of dividends	_____	_____	_____
d. Issue of common shares	_____	_____	_____
e. Cash purchase of supplies	_____	_____	_____
f. Repurchase of common shares	_____	_____	_____
g. Net loss	_____	_____	_____
h. Issue of long-term debt	_____	_____	_____

BE1.11 (LO 4) (*Calculate ending equity balances.*) Go-Ahead Limited began the year with common shares of \$100,000 and retained earnings of \$475,000. During the year, it issued an additional \$50,000 of common shares, reported net income of \$75,000, and declared dividends of \$15,000. **(a)** Calculate the ending balances of **(1)** common shares, **(2)** retained earnings, and **(3)** total shareholders' equity. **(b)** Explain how your answer would change if the company had reported a net loss of \$75,000 rather than net income and had not declared any dividends.

Exercises

E1.1 (LO 1) (*Identify users of accounting information.*) **Meta Platforms, Inc.** is a public corporation and has been one of the world's most active social networking sites. Its revenue is generated primarily from advertising.

Instructions

- Identify two internal users of Meta's accounting information. Write a question that each user might try to answer by using accounting information.
- Identify two external users of Meta's accounting information. Write a question that each user might try to answer by using accounting information.

E1.2 (LO 2) (*Identify forms of business organization.*) Consider the following statements.

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

Instructions

Indicate if each of the statements listed in the left-hand column of the table above is normally true (T) or false (F) for each of the following types of business organization: proprietorship, partnership, public corporation, and private corporation. The first one has been done for you as an example.

E1.3 (LO 3) (Identify business activities.) Consider the following business activities.

- | | |
|---|-------|
| 1. Cash receipts from customers paying for daily ski passes | O |
| 2. Payments made to purchase additional snow-making equipment | _____ |
| 3. Payments made to repair the grooming machines | _____ |
| 4. Receipt of funds from the bank to finance the purchase of the additional snow-making equipment | _____ |
| 5. Issue of shares to raise funds for a planned expansion | _____ |
| 6. Repayment of a portion of the loan from the bank (see #4) | _____ |
| 7. Payment of interest on the bank loan | _____ |
| 8. Payment of salaries to the employees who operate the ski lifts | _____ |
| 9. Receipt of a grant from the government for training a group of skiers with disabilities | _____ |
| 10. Payment of dividend to shareholders | _____ |

Instructions

Classify each of the above items by type of business activity: operating (O), investing (I), or financing (F). The first one has been done for you as an example.

E1.4 (LO 3) (Identify business activity and effect on cash.) Consider the following business activities.

	<u>(a) Type of Activity</u>	<u>(b) Cash Effect</u>
1. Purchase of goods for resale	O	—
2. Issue of common shares	_____	_____
3. Sale of equipment that the company has finished using	_____	_____
4. Receipt of bank loan	_____	_____
5. Purchase of long-term investment	_____	_____
6. Purchase of equipment	_____	_____
7. Sale of merchandise to customers	_____	_____
8. Payment of salaries to employees	_____	_____
9. Sale of long-term investment	_____	_____
10. Repayment of loan owed to bank	_____	_____
11. Payment of dividends	_____	_____
12. Payment of interest on money borrowed from bank	_____	_____

Instructions

- For each of the above items, indicate the type of business activity—operating (O), investing (I), or financing (F).
- Indicate whether each of the above items would increase (+) or decrease (–) cash. Assume all items are cash transactions. The first one has been done for you as an example.

E1.5 (LO 4) (Identify financial statement.) Consider the following typical accounts and statement items.

- | | |
|--|---|
| 1. _____ Interest income | 9. _____ Inventory |
| 2. _____ Cash | 10. _____ Income tax expense |
| 3. _____ Cash provided by operating activities | 11. _____ Interest expense |
| 4. _____ Service revenue | 12. _____ Cash used by investing activities |
| 5. _____ Common shares | 13. _____ Equipment |
| 6. _____ Dividends declared | 14. _____ Retained earnings |
| 7. _____ Net income | 15. _____ Bank loan payable |
| 8. _____ Accounts receivable | |

Instructions

Indicate on which statement(s)—statement of income (SI), statement of financial position (SFP), statement of changes in equity (SCE), and/or statement of cash flows (SCF)—you would find each of the above accounts or items. Note that there may be more than one correct statement for some of the above.

E1.6 (LO 4) (Use accounting equation.) K-Os Corporation reported the following selected information for two years ended December 31:

	<u>2024</u>	<u>2023</u>
Total assets	\$630,000	\$550,000
Total liabilities	420,000	400,000

Instructions

- Calculate total shareholders' equity at December 31, 2023 and 2024.
- Calculate the change in total shareholders' equity for the year ended December 31, 2024.
- K-Os's shareholders' equity consists only of common shares and retained earnings. Using the change in total shareholders' equity calculated in part (b) above, calculate the net income or loss for the year ended December 31, 2024, assuming each of the following independent scenarios:
 - K-Os issued no common shares during the year and did not declare any dividends.
 - K-Os issued no common shares during the year and declared and paid dividends of \$10,000.
 - K-Os issued \$30,000 of additional common shares during the year and did not declare any dividends.
 - K-Os issued \$20,000 of additional common shares during the year and declared and paid dividends of \$10,000.

E1.7 (LO 4) (Determine missing amounts.) Summaries of selected data from the financial statements of two corporations follow. Both companies have just completed their first year of operations.

	<u>Lumber Inc.</u>	<u>Trucking Inc.</u>
Statement of income		
Total revenues	\$1,000,000	\$ [7]
Total expenses	[1]	250,000
Net income	150,000	50,000
Statement of changes in equity		
Total shareholders' equity, beginning of year	0	0
Common shares, beginning of year	0	0
Issue of shares	100,000	[8]
Common shares, end of year	[2]	20,000
Retained earnings, beginning of year	0	0
Net income	[3]	[9]
Dividends declared	[4]	10,000
Retained earnings, end of year	100,000	40,000
Total shareholders' equity, end of year	[5]	[10]
Statement of financial position		
Total assets	1,050,000	[11]
Total liabilities	850,000	150,000
Total shareholders' equity	[6]	[12]

Instructions

Determine the missing amounts for [1] to [12]. Note that you may not be able to solve the items in numerical order.

E1.8 (LO 4) (Determine missing amounts.) Summaries of selected data from the financial statements of two corporations follow. Both companies have just completed their first year of operations.

	<u>Heavy Lift Ltd.</u>	<u>Transport Ltd.</u>
Statement of income		
Total revenues	\$ [1]	\$3,200,000
Total expenses	1,700,000	[7]
Net income	1,100,000	1,500,000
Statement of changes in equity		
Total shareholders' equity, beginning of year	0	0
Common shares, beginning of year	0	0
Issue of shares	[2]	500,000
Common shares, end of year	200,000	[8]
Retained earnings, beginning of year	0	0
Net income	[3]	[9]
Dividends declared	300,000	[10]
Retained earnings, end of year	800,000	1,200,000
Total shareholders' equity, end of year	[4]	[11]

Statement of financial position		
Total assets	[5]	3,100,000
Total liabilities	1,600,000	[12]
Total shareholders' equity	[6]	1,700,000

Instructions

Determine the missing amounts for [1] to [12]. Note that you may not be able to solve the items in numerical order.

E1.9 (LO 4) (Use accounting equation.) The following amounts (in thousands) were taken from the December 31 statements of financial position of **Maple Leaf Foods Inc.**:

	2021	2020
Total assets	\$4,385,806	\$3,860,205
Total liabilities	2,349,880	1,927,741

Instructions

- How much was Maple Leaf Foods' shareholders' equity at December 31, 2021 and 2020?
- Write Maple Leaf Foods' accounting equation for each year.
- Calculate the change in total shareholders' equity for the year ended December 31, 2021.
- Assume that Maple Leaf Foods had the following changes to its shareholders' equity in 2021: dividends declared of \$89,054 thousand and other shareholders' equity items decreased by \$89,693 thousand. How much net income did the company report in 2021?

E1.10 (LO 4) (Classify accounts and prepare statement of financial position.) The following list of accounts, in alphabetical order, is for Aventura Inc. at November 30, 2024:

_____ Accounts payable	\$ 26,200
_____ Accounts receivable	19,500
_____ Bank loan payable	34,000
_____ Buildings	100,000
_____ Cash	20,000
_____ Common shares	20,000
_____ Equipment	30,000
_____ Income tax payable	6,000
_____ Inventory	18,000
_____ Land	44,000
_____ Mortgage payable	97,500
_____ Retained earnings	48,500
_____ Supplies	700

Instructions

- For each of the above accounts, identify whether it is an asset (A), liability (L), or shareholders' equity (SE) item.
- Prepare a statement of financial position at November 30.

E1.11 (LO 4) (Classify accounts and prepare statement of income.) The following selected accounts and amounts (in thousands) were taken from the December 31, 2021, financial statements of **Leon's Furniture Limited**.

_____ Selling, general and administrative expenses	\$ 819,091
_____ Cost of goods sold	1,404,446
_____ Dividends declared	146,092
_____ Finance expenses	20,752
_____ Finance income	5,767
_____ Income tax expense	69,221
_____ Inventories	395,646
_____ Sales	2,512,670

Instructions

- For each of the above accounts, identify whether it is a revenue (R) or expense (E) account or an account that is not reported on the statement of income (NR).
- Prepare a statement of income for the year.

E1.12 (LO 4) (Prepare statements of income and changes in equity.) The following information is for Kon Inc. for the year ended December 31, 2024:

Common shares, Jan. 1	\$20,000	Rent expense	\$12,400
Common shares issued during year	10,000	Service revenue	61,000
Retained earnings, Jan. 1	58,000	Utilities expense	2,400
Office expense	1,600	Salaries expense	30,000
Dividends declared	5,000	Income tax expense	3,000

Instructions

Prepare a statement of income and statement of changes in equity for the year.

E1.13 (LO 4) (Calculate net income and prepare statements of changes in equity and financial position.)

Sea Surf Resorts Inc. has the following financial information as at December 31, 2024:

Camping revenue	\$283,000	Dividends declared	\$ 12,000
Cash	19,000	Operating expenses	245,000
Equipment	124,000	Supplies	2,500
Accounts payable	16,500	Common shares, Jan. 1	30,000
Bank loan payable	50,000	Common shares issued during year	15,000
Income tax expense	10,000	Retained earnings, Jan. 1	18,000

Instructions

- Determine net income for the year.
- Prepare a statement of changes in equity and a statement of financial position for the year.

E1.14 (LO 4) (Interpret financial information.) Consider each of the following independent situations:

- The statement of changes in equity of Yu Corporation shows dividends declared of \$70,000, while net income for the year was \$75,000.
- The statement of cash flows for Surya Corporation shows that cash provided by operating activities was \$10,000; cash used by investing activities was \$100,000; and cash provided by financing activities was \$120,000.
- Naguib Ltd.'s statement of financial position reports \$200,000 of total liabilities and \$250,000 of shareholders' equity.
- Rijo Inc. has total assets of \$100,000 and no liabilities.

Instructions

For each company, write a brief interpretation of these financial facts. For example, you might discuss the company's financial health or what seems to be its growth philosophy.

Problems: Set A

P1.1A (LO 1, 4) (Identify users of accounting information.) Financial decisions made by users often depend on one financial statement more than the others. Consider each of the following independent, hypothetical situations:

- The South Face Inc. is considering extending credit to a new customer. The credit terms would require the customer to pay within 30 days of receiving goods.
- An investor is considering purchasing the common shares of Orbite Online Inc. The investor plans on holding the investment for at least five years.
- Caisse d'Économie Base Montréal is thinking about extending a loan to a small company. The company would be required to make interest payments at the end of each month for three years, and to repay the loan at the end of the third year.
- The chief financial officer of Tech Toy Limited is trying to determine whether the company is generating enough cash to increase the amount of dividends paid to shareholders in this and future years. He needs to be sure that Tech Toy will still have enough cash to expand operations when needed.

Instructions

- Identify the key user(s) in each situation and determine whether they are internal or external users.
- State whether the user(s) you identified in part (a) would be most interested in the statement of income, statement of financial position, or statement of cash flows to make their decision. Choose only one financial statement in each case, and briefly give reasons for your choice.

P1.2A (LO 2) (*Determine forms of business organization and accounting standards.*) Five independent situations follow:

1. Randi Nelson wants to build carports that can be rented to customers for winter storage of recreational vehicles (RV). Her idea is for customers to rent outdoor storage space and as an add-on rent a carport, which Randi would provide to protect their RV from the winter elements. This would require Randi to market her carport rental business through companies that sell new and used RVs.
2. Three graduate students, working in collaboration, discovered a way to use biotechnology to target cancer cells in mice. They believe their discovery could be used on humans and want to create a start-up company that will be able to raise funding to conduct clinical trials while protecting the intellectual property. Each will contribute an equal amount of knowledge to the venture and seek their initial share of the investment from family members.
3. Stella, a culinary art student, always had an interest in homemade ice cream. She opened a mobile ice cream cart, which she takes to special events such as weddings and carnivals over the summer months.
4. Giuseppe Palmieri, a recent graduate from the University of Ottawa, decided to become a gondolier. He started a tourist attraction providing gondola rides on the Rideau Canal in Ottawa. He hires and trains university students to work for him as gondoliers over the summer. In the winter, he rents sleighs that skaters can pull behind them on the frozen canal.
5. Alexandro and Alexis recently passed the bar after articling with Case & Case law firm. They became good friends while working at Case & Case and found they worked well together, so they decide to branch out and open their own law firm.

Instructions

- a. In each of the above situations, explain what form of organization the business is likely to take: proprietorship, partnership, public corporation, or private corporation. Give reasons for your choice.
- b. Indicate which type of accounting standards—IFRS or ASPE—each of the business organizations you identified in part (a) is most likely to use for external reporting purposes.

P1.3A (LO 3) (*Identify business activities.*) All companies are involved in three types of activities: operating, investing, and financing. The names and descriptions of organizations in several different industries follow:

- Indigo Books & Music**—book, gift, and specialty toy retailer
High Liner Foods—processor and distributor of seafood products
Mountain Equipment Co-op—outdoor equipment retailer
Ganong Bros.—chocolate and candy manufacturer
Royal Bank—banking and financial service provider

Instructions

- a. For each of the above organizations, provide a likely example of (1) one of its operating activities, (2) one of its investing activities, and (3) one of its financing activities.
- b. Which of the activities that you identified in part (a) are common to most organizations? Which activities are not?

P1.4A (LO 4) (*Classify accounts.*) Starweb Ltd. reports the following list of accounts, in alphabetical order:

	(a)	(b)
Accounts payable	L	SFP
Building	_____	_____
Cash	_____	_____
Common shares	_____	_____
Deferred revenue	_____	_____
Depreciation expense	_____	_____
Dividends payable	_____	_____
Intangible assets	_____	_____
Interest expense	_____	_____
Interest payable	_____	_____
Inventory	_____	_____
Land	_____	_____
Long-term debt	_____	_____
Prepaid rent	_____	_____

Repairs and maintenance expense	_____	_____
Rent expense	_____	_____
Retained earnings	_____	_____
Salaries expense	_____	_____
Supplies expense	_____	_____

Instructions

- Classify each account as an asset (A), liability (L), shareholders' equity (SE), revenue (R), or expense (E) item. The first one has been done for you as an example.
- Identify on which financial statement(s)—statement of income (SI), statement of changes in equity (SCE), and/or statement of financial position (SFP)—each account would be reported. Note that there may be more than one correct statement for some of the above. The first one has been done for you as an example.

P1.5A (LO 4) (*Prepare accounting equation.*) Craft Carpentry Limited reports the following selected asset, liability, and shareholders' equity accounts, in alphabetical order:

Accounts payable	\$15,600	Intangible assets	\$ 5,000
Accounts receivable	13,100	Interest payable	300
Bank loan payable	32,000	Inventory	9,200
Cash	9,350	Prepaid insurance	1,000
Common shares	20,000	Retained earnings	21,250
Deferred revenue	1,800	Salaries payable	700
Equipment	30,500	Supplies	2,800
Income tax payable	1,800	Vehicles	22,500

Instructions

- Classify each account as an asset (A), liability (L), or shareholders' equity (SE) item.
- Calculate total assets, total liabilities, and total shareholders' equity and prepare Craft Carpentry's accounting equation.
- Craft Carpentry's retained earnings were \$18,000 at the beginning of the year. The company reported revenues of \$296,750, expenses of \$278,500, and dividends declared of \$15,000 during the year. Prepare a calculation that proves how retained earnings of \$21,250 at the end of the year was determined.

P1.6A (LO 4) (*Determine missing amounts; answer questions.*) Selected information (in millions) is available for **The Home Depot, Inc.** and **Canadian Tire Corporation, Limited** for a recent fiscal year:

	<u>Home Depot (U.S. \$)</u>	<u>Canadian Tire (C\$)</u>
Beginning of year		
Total assets	\$ [1]	\$20,377.1
Total liabilities	67,282	[4]
Total shareholders' equity	3,299	5,834.7
End of year		
Total assets	71,876	[5]
Total liabilities	[2]	15,291.4
Total shareholders' equity (deficit)	(1,696)	[6]
Changes during year in shareholders' equity		
Repurchase of shares	15,001	131.1
Dividends declared	6,985	291.2
Total revenues	151,157	16,292.1
Total expenses	[3]	15,031.4
Other increases (decreases) in shareholders' equity	558	(162.3)

Instructions

- Determine the missing amounts for [1] to [6].
- Which company has a higher proportion of debt financing at the end of its fiscal year? Of equity financing?
- Home Depot's year end is the Sunday closest to January 31. Canadian Tire's year end is the last Saturday in December. How might these differing year-end dates affect your comparison in part (b)?

P1.7A (LO 4) (Prepare financial statements.) On October 1, 2024, One Thingamajig Corp. was formed. Its assets, liabilities, share capital, revenues, expenses, and dividends as at October 31 follow:

Utilities expense	\$ 2,000	Supplies	\$ 4,000
Service revenue	34,500	Dividends declared	7,000
Accounts receivable	8,500	Common shares	40,000
Interest expense	3,000	Cash	20,000
Salaries expense	4,000	Bank loan payable	24,500
Vehicles	50,000	Repair and maintenance expense	5,700
Accounts payable	8,000	Supplies expense	2,000
Income tax expense	1,700		

Instructions

- Prepare a statement of income, statement of changes in equity, and statement of financial position for the month.
- Explain why it is necessary to prepare the financial statements in the order listed in part (a).

P1.8A (LO 4) (Prepare statement of cash flows; comment on adequacy of cash.) Selected financial information follows for Maison Corporation for the year ended December 31, 2024:

Cash, Jan. 1	\$ 12,000
Cash dividends paid	10,000
Cash paid to purchase equipment	35,000
Cash payments for operating activities	120,000
Cash receipts from operating activities	140,000
Cash received from issue of long-term debt	20,000
Cash received from issue of shares	20,000

Instructions

- Classify each of the above items, except for cash at the beginning of the year, as an operating, investing, or financing activity.
- Prepare a statement of cash flows for Maison Corporation for the year.
- Comment on the adequacy of cash provided by operating activities to fund the company's investing activities.

P1.9A (LO 4) (Calculate missing amounts; explain statement interrelationships.) Incomplete financial statements for Dexter Inc. follow.

Dexter Inc.
Statement of Income
Year Ended April 30, 2024

Service revenue	\$450,000
Operating expenses	<u>[1]</u>
Income before income tax	240,000
Income tax expense	<u>[2]</u>
Net income	<u>\$ [3]</u>

Dexter Inc.
Statement of Changes in Equity
Year Ended April 30, 2024

	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Total Equity</u>
Balance, May 1, 2023	\$ 25,000	\$ 0	\$ 25,000
Issued common shares	275,000		275,000
Net income		[4]	[7]
Dividends declared		<u>[5]</u>	<u>(10,000)</u>
Balance, April 30, 2024	<u>\$300,000</u>	<u>\$[6]</u>	<u>\$515,000</u>

Dexter Inc.
Statement of Financial Position
April 30, 2024

<u>Assets</u>		<u>Liabilities and Shareholders' Equity</u>	
Cash	\$ 25,000	Liabilities	
Accounts receivable	50,000	Accounts payable	\$ 80,000
Land	280,000	Bank loan payable	[9]
Buildings	[8]	Total liabilities	<u>380,000</u>
Equipment	<u>215,000</u>	Shareholders' equity	
Total assets	<u>\$895,000</u>	Common shares	[10]
		Retained earnings	<u>[11]</u>
		Total shareholders' equity	<u>[12]</u>
		Total liabilities and shareholders' equity	<u>\$ [13]</u>

Instructions

- a. Calculate the missing amounts for [1] to [13]. Note that you may not be able to solve the items in numerical order.
- b. Explain (1) the sequence for preparing the financial statements, and (2) the interrelationships among the statement of income, statement of changes in equity, and statement of financial position.

P1.10A (LO 4) *(Prepare corrected statement of financial position; identify financial statements for ASPE.)* GG Corporation, a private corporation, was formed on July 1, 2024. On July 31, Guy Gélinas, the company's president, asked the accountant to prepare a statement of financial position at the end of the first month of operations.

GG Corporation
Statement of Financial Position
July 31, 2024

<u>Assets</u>		<u>Liabilities and Shareholders' Equity</u>	
Cash	\$ 20,000	Accounts payable	\$ 34,000
Accounts receivable	50,000	Boat loan payable	40,000
Inventory	36,000	Common shares	50,000
Boat	<u>24,000</u>	Retained earnings	<u>6,000</u>
	<u>\$130,000</u>		<u>\$130,000</u>

Guy admits that his knowledge of accounting is somewhat limited and is concerned that his statement of financial position might not be correct. He gives you the following additional information:

1. The boat actually belongs to Guy Gélinas, not to GG Corporation. However, because Guy thinks he might take customers out on the boat occasionally, he told the accountant to list it as an asset of the company. To be consistent, the accountant also included as a liability of the company the personal bank loan that Guy took out to buy the boat.
2. Included in the accounts receivable balance is \$10,000 that Guy personally loaned to his brother five years ago. It was included in the receivables of GG Corporation at Guy's request so that he wouldn't forget that his brother owes him money.
3. The financial statements didn't balance originally. To make them balance, the accountant adjusted the Common Shares account until assets equalled liabilities and shareholders' equity.

Instructions

- a. Identify any corrections that should be made to the statement of financial position and explain why.
- b. Prepare a corrected statement of financial position. (*Hint:* To get the statement of financial position to balance, adjust Common Shares.)
- c. What other financial statements should GG Corporation prepare, assuming it follows Accounting Standards for Private Enterprises?

Problems: Set B

P1.1B (LO 1, 4) (*Identify users of accounting information.*) Financial decisions made by users often depend on one financial statement more than the others. Consider each of the following independent, hypothetical situations:

1. An Ontario investor is considering purchasing the common shares of Fight Fat Ltd., which operates a number of fitness centres in the Toronto area. The investor plans on holding the investment for at least three years.
2. Comeau Ltée is considering extending credit to a new customer. The terms of the credit would require the customer to pay within 45 days of receipt of the goods.
3. The chief financial officer of Private Label Corporation is trying to determine whether the company is generating enough cash to increase the amount of dividends paid to shareholders in this, and future, years. She needs to ensure that there will still be enough cash to expand operations when needed.
4. Drummond Bank is considering extending a loan to a small company. The company would be required to make interest payments at the end of each month for five years, and to repay the loan at the end of the fifth year.

Instructions

- a. Identify the key user(s) in each situation and determine whether they are internal or external users.
- b. State whether the user(s) you identified in part (a) would be most interested in the statement of income, statement of financial position, or statement of cash flows. Choose only one financial statement in each case, and briefly give reasons for your choice.

P1.2B (LO 2) (*Determine forms of business organization and accounting standards.*) Five independent situations follow:

1. Dawn Addington, a student looking for summer work, has opened a pop-up vegetable stand along a busy local highway. Each morning, she buys produce from local farmers, then sells it in the afternoon as people return home from work.
2. Joseph Counsell and Sabra Surkis each own a bike shop. They have decided to combine their businesses and try to expand their operations to include skateboards, skis, and snowboards. They expect that in the coming year they will need funds to expand their operations.
3. Three chemistry professors have formed a business that uses bacteria to clean up toxic waste sites. Each has contributed an equal amount of cash and knowledge to the venture. The use of bacteria in this situation is experimental, and legal obligations could result.
4. Abdul Rahim has run a successful but small co-operative health and organic food store for over five years. The increased sales at his store have made him believe that the time is right to open a chain of health and organic food stores across the country. Of course, this will require a substantial investment for inventory and property, plant, and equipment, as well as for employees and other resources. Abdul has no savings or personal assets.
5. Mary Emery, Richard Goedde, and Jigme Tshering recently graduated with law degrees. They have decided to start a law practice in their hometown.

Instructions

- a. In each of the above situations, explain what form of organization the business is likely to take: proprietorship, partnership, public corporation, or private corporation. Give reasons for your choice.
- b. Indicate which type of accounting standards—IFRS or ASPE—each of the business organizations you identified in part (a) is most likely to use for external reporting purposes.

P1.3B (LO 3) (*Identify business activities.*) All companies are involved in three types of activities: operating, investing, and financing. The names and descriptions of organizations in several different industries follow:

Cargojet—airline

University of Calgary Students' Union—university student union

GlaxoSmithKline—pharmaceutical manufacturer

Maple Leaf Sports & Entertainment—professional sports company (including ownership of the Toronto Maple Leafs hockey team and Toronto Raptors basketball team)

Loblaw Companies—food retailer and real estate investments

Instructions

- For each of the above organizations, provide a likely example of (1) one of its operating activities, (2) one of its investing activities, and (3) one of its financing activities.
- Which of the activities that you identified in part (a) are common to most organizations? Which activities are not?

P1.4B (LO 4) (Classify accounts.) Gulfstream Inc. reports the following list of accounts, in alphabetical order:

	(a)	(b)
Accounts payable	L	SFP
Accounts receivable		
Bank loan payable		
Buildings		
Cash		
Common shares		
Deferred revenue		
Equipment		
Income tax expense		
Income tax payable		
Intangible assets		
Interest expense		
Land		
Mortgage payable		
Office expense		
Prepaid insurance		
Retained earnings		
Salaries payable		
Service revenue		

Instructions

- Classify each account as an asset (A), liability (L), shareholders' equity (SE), revenue (R), or expense (E) item. The first one has been done for you as an example.
- Identify on which financial statement(s)—statement of income (SI), statement of changes in equity (SCE), and/or statement of financial position (SFP)—each account would be reported. Note that there may be more than one correct statement for some of the above. The first one has been done for you as an example.

P1.5B (LO 4) (Prepare accounting equation.) D&K Delivery Limited reports the following selected asset, liability, and shareholders' equity accounts, in alphabetical order:

Accounts payable	\$23,100	Income tax payable	\$ 1,900
Accounts receivable	6,950	Interest payable	500
Bank loan payable	25,000	Inventory	21,300
Cash	17,750	Prepaid insurance	950
Common shares	20,000	Retained earnings	39,850
Deferred revenue	3,500	Salaries payable	3,050
Equipment	66,200	Supplies	3,750

Instructions

- Classify each account as an asset (A), liability (L), or shareholders' equity (SE) item.
- Calculate total assets, total liabilities, and total shareholders' equity and prepare D&K Delivery's accounting equation.
- D&K Delivery's retained earnings were \$8,850 at the beginning of the year. The company reported revenues of \$365,000, expenses of \$333,000, and dividends declared of \$1,000 during the year. Prepare a calculation that proves how retained earnings of \$39,850 at the end of the year were determined.

P1.6B (LO 4) (Determine missing amounts; answer questions.) Selected information is available for **Restaurant Brands International**, which owns or franchises more than 29,000 Tim Hortons, Burger King, Popeyes, and Firehouse Subs restaurants around the world, and **Starbucks Corporation**, which owns or licenses more than 33,800 stores around the world, for a recent fiscal year:

	Restaurant Brands International (in U.S. \$ millions)	Starbucks (in U.S. \$ millions)
Beginning of year		
Total assets	\$22,777	\$ [4]
Total liabilities	[1]	37,173.9
Total shareholders' equity (deficit)	3,721	(7,799.4)
End of year		
Total assets	23,246	[5]
Total liabilities	19,393	36,707.1
Total shareholders' equity (deficit)	[2]	[6]
Changes during year in shareholders' equity		
Issuance of shares	12	42.4
Repurchase of shares	551	-
Dividends declared	[3]	2,697.2
Total revenues	5,739	24,607.0
Total expenses	4,486	20,406.7
Other increases (decreases) in shareholders' equity	76	939.4

Instructions

- Determine the missing amounts for [1] to [6].
- Which company has the higher proportion of debt financing at the end of its fiscal year? Of equity financing?
- Restaurant Brands' year end is December 31. Starbucks' year end is the last Sunday in September. Is it appropriate to compare these two companies in part (b)?

P1.7B (LO 4) (Prepare financial statements.) On May 1, 2024, Aero Flying School Ltd. was formed. Its assets, liabilities, share capital, revenues, expenses, and dividends as at May 31 follow:

Cash	\$ 26,900	Interest expense	\$12,500
Accounts receivable	22,600	Rent expense	12,100
Supplies	15,000	Repairs and maintenance expense	40,900
Equipment	372,500	Fuel expense	85,400
Accounts payable	6,400	Office expense	12,700
Bank loan payable	241,000	Salaries expense	36,600
Common shares	180,000	Income tax expense	2,800
Service revenue	215,300	Dividends declared	2,700

Instructions

- Prepare a statement of income, statement of changes in equity, and statement of financial position for the month of May.
- Explain why it is necessary to prepare the financial statements in the order listed in part (a).

P1.8B (LO 4) (Prepare statement of cash flows; comment on adequacy of cash.) Selected financial information follows for Furlotte Corporation for the year ended June 30, 2024:

Cash, July 1	\$ 40,000
Cash payments for operating activities	109,000
Cash paid for equipment	40,000
Repayment of long-term debt	15,000
Cash dividends paid	13,000
Cash receipts from operating activities	158,000

Instructions

- Classify each of the above items, except for cash at the beginning of the year, as an operating, investing, or financing activity.
- Prepare a statement of cash flows for Furlotte Corporation for the year.
- Comment on the adequacy of cash provided by operating activities to fund the company's investing activities.

P1.9B (LO 4) (Calculate missing amounts; explain statement interrelationships.) Incomplete financial statements for Wu Inc. follow:

Wu Inc. Statement of income Year Ended August 31, 2024			
Service revenue		\$325,000	
Operating expenses		[1]	
Income before income tax		116,000	
Income tax expense		23,000	
Net income		\$ [2]	

Wu Inc. Statement of Changes in Equity Year Ended August 31, 2024			
	Common Shares	Retained Earnings	Total Equity
Balance, September 1, 2023	\$250,000	\$440,000	\$[5]
Issued common shares	60,000		[6]
Net income		[3]	[7]
Dividends declared		[4]	[8]
Balance, August 31, 2024	\$310,000	\$521,000	\$[9]

Wu Inc. Statement of Financial Position August 31, 2024			
Assets		Liabilities and Shareholders' Equity	
Cash	\$ [10]	Liabilities	
Accounts receivable	34,000	Accounts payable	\$ 67,000
Equipment	364,000	Loan payable	453,000
Buildings	616,000	Shareholders' equity	
Land	310,000	Common shares	[12]
Total assets	\$ [11]	Retained earnings	[13]
		Total liabilities and shareholders' equity	\$1,351,000

Instructions

- a. Calculate the missing amounts [1] to [13]. Note that you may not be able to solve the items in numerical order.
- b. Explain (1) the sequence for preparing and presenting the financial statements, and (2) the interrelationships among the statement of income, statement of changes in equity, and statement of financial position.

P1.10B (LO 4) (Prepare corrected statement of income; identify financial statements for ASPE.) The Independent Book Shop Ltd. was formed on April 1, 2023. It is a small private corporation run by Joanna Kay. On March 31, 2024, Joanna prepared the following statement of income:

Independent Book Shop Ltd. Statement of Income Year Ended March 31, 2024		
Revenues		
Accounts receivable		\$23,000
Service revenue		41,000
Total revenues		\$64,000
Expenses		
Rent expense		\$12,000
Office expense		5,000
Vacation expense		4,000
Total expenses		21,000
Income before income tax		85,000
Income tax expense		5,000
Net income		\$90,000

Joanna admits that her knowledge of accounting is somewhat limited and is concerned that the statement of income might not be correct. She gives you the following additional information:

1. Included in the Service Revenue account is \$3,000 of revenue that the company expects to earn in April 2024. Joanna included it in this year's statement so she wouldn't forget about it.
2. Joanna operates her business in a converted carriage house attached to her parents' downtown home. They do not charge her anything for the use of this building, but she thinks that if she paid rent it would have cost her about \$12,000 a year. She included this amount in the statement of income as Rent Expense because of the "opportunity cost."
3. To reward herself after a year of hard work, Joanna took a vacation to Greece. She used personal funds to pay for the trip, but she reported it as an expense on the statement of income since it was her job that made her need the vacation.

Instructions

- a. Identify any corrections that should be made to the statement of income and explain why.
- b. Prepare a corrected statement of income.
- c. What other financial statements should the Independent Book Shop prepare, assuming it follows Accounting Standards for Private Enterprises?

Expand Your Critical Thinking

Financial Statement Impact

CT1.1 (LO 3, 4) Shown below are some items commonly found in the financial statements of public companies.

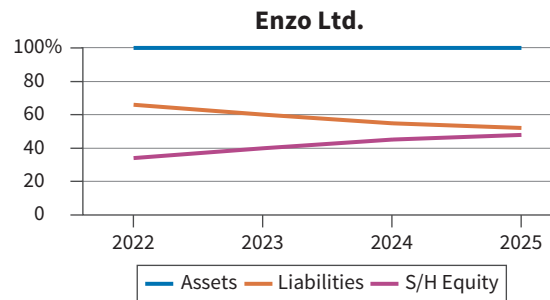
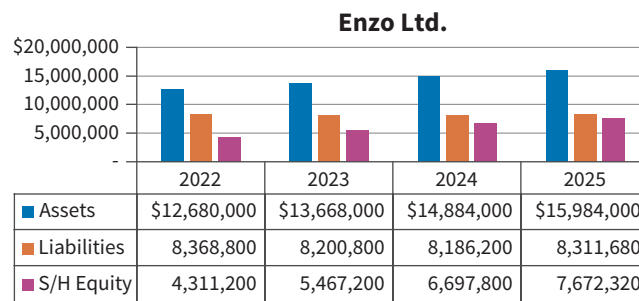
Item	Statement of Income	Statement of Changes in Equity	Statement of Financial Position	Statement of Cash Flows
Common shares				
Service revenue				
Retained earnings				
Deferred revenue				
Cash payments for operating activities				
Dividends declared				
Cash				
Prepaid insurance				
Salaries expense				
Cash payments to purchase equipment				
Accounts payable				
Net income				

Instructions

For each transaction, identify in which financial statement(s) it would be reported by indicating a "Y" in that column.

Data Visualization Case

CT1.2 (LO 1) The following two data visualizations were included in a recent report prepared by Enzo Ltd. The aim of the visualizations was to help the reports users understand the extent to which the company's assets have been financed using debt or equity.



Instructions

- Review both visualizations and comment on which one would be more useful to users of the report in understanding the extent to which assets are financed with debt or equity. Explain why this would be the case.
- Which of the two visualizations is an example of a descriptive analytic and which one may be more useful to users from a predictive perspective? Explain why this is the case.

Financial Reporting Case

CT1.3 (LO 4) Actual financial statements (rather than the simplified financial statements presented in the chapter) for **The North West Company Inc.** are presented in Appendix A. *The appendix can be found in Wiley's course resources; the financial statements can also be found on www.sedar.com.*

Instructions

- What are the five financial statements that North West includes in its financial statement package? Which ones were discussed in this chapter?
- Look at North West's statement of income (which it calls "statement of earnings"). Did its sales increase or decrease between January 31, 2021 and 2022? Did its net income (which it calls "net earnings") increase or decrease over the two years? Are its sales and net income moving in the same direction (that is, both increasing or both decreasing)? If not, explain why not.
- Look at North West's statement of financial position (which it calls "balance sheet"). Identify its total assets, total liabilities, and total shareholders' equity as at (1) January 31, 2022, and (2) January 31, 2021.
- Look at North West's statement of changes in equity (which it calls "statement of changes in shareholders' equity"). What were the balances in its share capital and retained earnings accounts at January 31, 2022? At January 31, 2021? Do these amounts agree to the same balances reported in the shareholders' equity section of the statement of financial position?
- How much cash did North West have at January 31, 2022? At January 31, 2021? Which financial statement(s) did you look at to answer this question?

Financial Analysis Case

CT1.4 (LO 4) The financial statements of The North West Company Inc. are presented in Appendix A followed by the financial statements for **Sobeys Inc.** in Appendix B. *The appendices can be found in Wiley's course resources; the financial statements can also be found on www.sedar.com.*

Instructions

- a. Based on the information in these financial statements, determine the following for each company:
 1. Total assets, liabilities, and shareholders' equity at the end of the current and prior fiscal years
 2. Sales and net income (loss) for the current and prior fiscal years
- b. Calculate the percentage change between the current and prior fiscal years for each company for the assets, liabilities, shareholders' equity, sales, and net income amounts determined in part (a).
- c. What conclusions about the two companies can you draw from the data you determined in part (b)?
- d. Sobeys' fiscal year end is the first Saturday in May. North West's fiscal year end is January 31. Knowing that the year ends of Sobeys and North West are not the same, do you have any concerns about the comparisons you made in part (c)? If so, why?

Financial Analysis Case

CT1.5 (LO 3, 4) The financial statements of The North West Company Inc. are presented in Appendix A, followed by the financial statements for Sobeys Inc. in Appendix B. *The appendices can be found in Wiley's course resources; the financial statements can also be found on www.sedar.com.*

Instructions

Based on the information in these financial statements, answer the following questions:

- a. Did both companies declare dividends during the current fiscal year? If yes, how much did each company declare?
- b. Did each company generate positive cash flows from its operating activities? How much cash did each company generate from its operating activities? How did these amounts compare with the amount of cash each company required for its investing activities?
- c. How much, if any, long-term debt did each company repay during the year?

Professional Judgement Case

CT1.6 (LO 1, 2) In Canada, public corporations are required to adopt International Financial Reporting Standards (IFRS) as accounting standards. Private corporations are given a choice and must decide between two sets of accounting standards: Accounting Standards for Private Enterprises (ASPE) or IFRS.

Instructions

- a. What is the key difference between public and private companies when it comes to their financial reporting?
- b. Who are the key users of public company financial statements? Who are the key users of private company financial statements?
- c. What is the difference between users of public company financial statements and users of private company financial statements?
- d. Why do you think public companies do not have a choice regarding which accounting standards they use?
- e. Why do you think private companies do have a choice regarding the accounting standards they use?

Financial Analysis Case

CT1.7 (LO 4) *This case can be assigned as a group activity. Additional instructions and material for this activity can be found in Wiley's course resources.*

Industrial Maids Service Ltd. (IMS) is a corporation based in Sarnia, Ontario, that focuses on cleaning commercial properties, which is a very competitive business. Although IMS tries to recruit highly trained employees, it is not able to pay a very high hourly wage. Cleaning services are charged to clients by the hour and the average rate is \$22 per hour. Some of the cleaning done by this company is performed with larger equipment that is repaired by the company. The average employee will work an entire shift at one client's premises.

Prestige Cleaning Services Inc. (PCS) also operates a cleaning service in Sarnia but this company focuses on residential cleaning and targets large homes in high-income areas. The company is owned by a former NHL star who is very effective at securing cleaning contracts. Most of the cleaning work done by this company occurs during the day, and the company is able to attract experienced cleaning staff and pay them a high wage. Cleaning services are charged to clients by the hour and the average rate is \$30 per hour. The equipment used by this company is inexpensive. Most employees will clean two or three houses during a single shift. The company owns several vehicles.

Optional collaborative learning activities in each chapter allow you to practise solving cases with classmates.

Listed below are condensed statements of income of the two corporations:

	<u>IMS</u>	<u>PCS</u>
Service revenue	\$1,320,000	\$900,000
Salaries expense	900,000	480,000
Rent expense	42,000	23,000
Other operating expenses	4,000	14,000
Interest expense	<u>25,000</u>	<u>13,000</u>
Income before income tax	349,000	370,000
Income tax expense	<u>87,250</u>	<u>92,500</u>
Net income	<u>\$ 261,750</u>	<u>\$277,500</u>

Instructions

- How many hours of cleaning service did each company provide to its clients?
- What is the average rate of pay per hour that each company pays its employees?
- Which company do you think uses larger facilities? Why do you think this is?
- Why does PCS likely have higher “other operating expenses” than IMS?
- One of the companies financed its start-up by taking out a higher amount of bank loan than the other company. Which company do you think this was? Both companies are charged the same rate of interest by their banks.
- What is the most significant factor that makes PCS more profitable than IMS?

Ethics Case

CT1.8 (LO 1) Chief executive officers (CEOs) and chief financial officers (CFOs) of publicly traded companies are required to personally certify that their companies’ financial statements and other financial information contain no untrue statements and do not leave out any important facts. Khan Corporation just hired a new management team, and its members say they are too new to the company to know whether the most recent financial reports are accurate or not. They refuse to sign the certification.

Instructions

- Who are the stakeholders in this situation?
- Should the CEO and CFO sign the certification? Explain why or why not.
- What are the CEO’s and CFO’s alternatives?

Serial Case

CT1.9 (LO 1, 3) As part of the requirements of her university entrepreneurship program, Emily Anthony had been operating Compu-Tech Consulting, a proprietorship, on a part-time basis. The purpose of Compu-Tech Consulting was to provide training and technical support to seniors who wished to learn how to use a computer, tablet, or smartphone, as well as to fix hardware or software issues. As Emily approaches her graduation from university, she is considering other opportunities in addition to continuing to operate Compu-Tech Consulting.

Emily’s parents, Doug and Bev Anthony, have been operating Anthony Business Company Ltd. (ABC), a private corporation, for a number of years. ABC provides end-to-end computer business solutions. The company has been overwhelmed with the demand for its services and has recently negotiated a number of new contracts.

In anticipation of Emily graduating, and in the hope of spending a little more time away from the business, Doug and Bev have discussed with Emily the possibility of her moving back to her home province to assume a full-time responsibility as administrator. Emily could continue to provide computer training and technical support; however, that would be done through ABC in future rather than through Compu-Tech Consulting.

Instructions

- Discuss the advantages and disadvantages of each of these two forms of business organization: Compu-Tech Consulting, a proprietorship, and Anthony Business Company Ltd., a private corporation.
- What form of generally accepted accounting principles do you anticipate each of these business organizations is using? Explain.
- As ABC begins to meet the demands of its new contractual commitments, what accounting information will Emily need if she accepts the position with ABC as administrator, and why? How often will she need this information?

This serial case starts in this chapter and continues in each chapter of the book.

- d. What types of users do you anticipate will use ABC's accounting information? What information will these users require?
- e. Identify two examples each of operating activities, investing activities, and financing activities that ABC would likely be engaged in. For each type of activity, identify at least one example that would result in a cash inflow and one that would result in a cash outflow.

Solution to Practice Using the Decision Tools

- a. Before you invest, you should investigate the most recent statement of income, statement of changes in equity, statement of financial position, and statement of cash flows for each company. In addition, you should carefully review the notes to the financial statements.
- b. The statement of income shows a company's revenues and expenses and overall profitability for the current period. The statement of changes in equity shows any changes in share capital as well as the impact that the current period's net income and dividends declared have on the company's retained earnings. The statement of financial position reveals the company's financial position and the relationship among assets, liabilities, and shareholders' equity. Finally, the statement of cash flows reveals where the company is getting and spending its cash. This is especially important for a company that wants to grow.

Investors would probably be most interested in the statement of income because it shows past performance and this can give an indication of future performance.

- c. North West's fiscal year overlaps Loblaw's for 11 months (February 1, 2021, through January 1, 2022). If there have been no substantial changes to the economy that would affect their business during the one-month period (January 2022) that North West's financial results cover but Loblaw's do not (or vice versa), it really does not matter when each company's fiscal year ends. It is more important that we compare what each company was able to achieve within an equivalent period of time—whether it be one year, six months, or one quarter. If, however, a major economic change did occur in the intervening period (the period when the statements do not overlap), such a change would likely reduce the usefulness of a comparison of the two companies' financial statements.
- d. Many interesting comparisons can be made between the two companies in spite of their being different sizes. Loblaw is much larger than North West, with 30 times the assets and 24 times the revenues. It is interesting to note that North West's cost of sales as a percentage of sales was 67%, compared with 69% for Loblaw. This means that both companies make about the same on each dollar of sales (that each marks up its retail prices by about the same amount). In addition, North West's selling, operating, and administrative expenses as a percentage of sales was 23%, a slightly lower percentage than that of Loblaw at 26%.

North West issued a small amount of shares during the year, while Loblaw did not. Both companies declared dividends to their shareholders and both repurchased shares from shareholders during the year. Property and equipment is the largest type of asset for North West, while right-of-use assets are the largest asset for Loblaw. Both companies also rely more on debt than equity to finance these assets, though Loblaw has a much larger reliance on debt financing.

While these comparisons are useful, these basic measures are not enough to determine whether one company will be a better investment than the other. In later chapters, you will acquire more tools to help you compare the relative profitability and financial health of these, and other, companies.

- e. North West generated \$224 million cash from its operating activities, while Loblaw generated \$4,827 million. Both companies generated significant cash from their operating activities. In North West's case, these cash flows were sufficient to cover the company's investing activities, but were not sufficient to cover the company's financing activities as well. This resulted in an overall decrease in cash. Loblaw generated sufficient cash flows from operating activities to cover the outflows from both its investing and financing activities. Importantly, both companies did generate significantly more cash from their operating activities than was required to fund their investing activities.

Loblaw used \$1,271 million for investing activities and \$3,249 million for financing activities during the current fiscal year. Together, Loblaw's use of cash for investing and financing activities was less than the receipt of cash from its operating activities, resulting in a net increase of \$308 million in overall cash and cash equivalents for the year. In comparison, North West used \$76 million for investing activities and \$170 million for financing activities during the current fiscal year. Its cash provided by operating activities was insufficient to offset the cash used by investing and financing activities, resulting in a net decrease of \$22 million cash for the year.

Solution to Practice Comprehensive DO IT!

Ice Camp Ltd.
Statement of Income
Year Ended December 31, 2024

Revenues		
Camp tuition revenue		\$100,000
Expenses		
Salaries expense	\$20,000	
Ice rental expense	14,000	
Administrative expense	7,000	
Insurance expense	6,000	
Interest expense	<u>800</u>	
Total expenses		<u>47,800</u>
Income before income tax		52,200
Income tax expense		<u>10,440</u>
Net income		<u>\$ 41,760</u>

Ice Camp Ltd.
Statement of Changes in Equity
Year Ended December 31, 2024

	<u>Common Shares</u>	<u>Retained Earnings</u>	<u>Total Equity</u>
Balance, January 1	\$ 0	\$ 0	\$ 0
Issued common shares	5,000		5,000
Net income		41,760	41,760
Dividends declared		<u>(35,000)</u>	<u>(35,000)</u>
Balance, December 31	<u>\$5,000</u>	<u>\$ 6,760</u>	<u>\$ 11,760</u>

Ice Camp Ltd.
Statement of Financial Position
December 31, 2024

<u>Assets</u>	
Cash	\$ 9,500
Accounts receivable	10,000
Bus	12,000
Equipment	<u>1,500</u>
Total assets	<u>\$33,000</u>
<u>Liabilities and Shareholders' Equity</u>	
Liabilities	
Interest payable	\$ 800
Income tax payable	10,440
Bank loan payable	<u>10,000</u>
Total liabilities	<u>21,240</u>
Shareholders' equity	
Common shares	5,000
Retained earnings	<u>6,760</u>
Total shareholders' equity	<u>11,760</u>
Total liabilities and shareholders' equity	<u>\$33,000</u>

Answers to Practice Objective-Format Questions

1. a. External c. External e. External g. Internal
 b. External d. External f. External
2. a. Management/Internal
 b. Bank/External e. Labour union/External
 c. Supplier/External f. Management/Internal
 d. Potential shareholder/External g. Shareholder/External
3. a., d., e., f., and g. are correct

Feedback

- b. Incorrect. A partnership does not establish a separate legal entity and there is no legal distinction between the business and the partners.
- c. Incorrect. Shareholders of a corporation are not responsible for the debts of the company unless they have personally guaranteed them with the lender.
4. a., c., e., and f. are correct

Feedback

- b. Incorrect. The form of a business can be changed and many businesses initially established as proprietorships are eventually incorporated as the business grows.
- d. Incorrect. It is generally more difficult for a proprietorship to raise capital than it is for a corporation. Corporations can access the capital markets by issuing shares and/or debt, whereas proprietorships are limited to the capital of the owner and amounts that can be borrowed from lenders.
- g. Incorrect. Public companies must use IFRS to prepare their financial statements. The use of ASPE is not an option.

5. a. Financing/Outflow e. Operating/Outflow
 b. Operating/Inflow f. Financing/Outflow
 c. Investing/Outflow g. Investing/Inflow
 d. Financing/Inflow
6. a. Investing e. Financing
 b. Financing f. Financing
 c. Investing g. Operating
 d. Operating
7. a. Statement of financial position (assets section)/Statement of cash flows
 b. Statement of financial position (liabilities section)
 c. Statement of income/Statement of changes in equity
 d. Statement of income
 e. Statement of changes in equity/Statement of cash flows
 f. Statement of financial position (assets section)
 g. Statement of income
8. a., b., d., and e. are correct

Feedback

- c. Incorrect. The declaration and payment of dividends would have no impact on the statement of income, but would affect the statement of changes in equity (dividends declared) and the statement of cash flows (dividends paid).
- f. Incorrect. The statement of changes in equity is normally prepared before the statement of financial position because the ending equity balances are required in order to prepare the statement of financial position.
- g. Incorrect. The issue of common shares would have no impact on the statement of income, but would affect the other three financial statements.

- | | |
|---|--|
| <p>9. a. Statement of changes in equity
b. Statement of income
c. Statement of income
d. Statement of financial position</p> <p>10. a. Total liabilities
b. Total shareholders' equity
c. Net income
d. Total liabilities</p> | <p>e. Statement of changes in equity/Statement of cash flows
f. Statement of cash flows
g. Statement of financial position</p> <p>e. Retained earnings
f. Total assets
g. Net income</p> |
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Endnotes

¹ The North West Company 2021 annual report. The North West Company 2021 annual information form.

² Truth and Reconciliation Commission of Canada, *Calls to Action*, Winnipeg: Truth and Reconciliation Commission of Canada, 2015. Department of Justice Canada, *United Nations Declaration on the Rights of Indigenous Peoples*, Ottawa: Department of Justice Canada, 2020.

³ "Women in Business 2021: A Window of Opportunity," Grant Thornton, <https://www.grantthornton.ca/insights/2021-women-in-business-report>; accessed July 22, 2022.

⁴ Statistics Canada, "Gender Results Framework: Data Table on the Representation of Men and Women in First Nations Band Councils and Chiefs in First Nations Communities in Canada, 2019," March 13,

2021. Statistics Canada, "Aboriginal Population Profile." 2016 Census, Statistics Canada Catalogue no. 98-510-X2016001, Ottawa, released July 18, 2018. Employment and Social Development Canada, "Government of Canada Highlights Projects to Help Break Down Barriers to Employment for Indigenous Women," March 8, 2022. AFOA Canada website, "About Us," 1999–2021. AFOA Canada, Annual Report 2020–2021.

⁵ "The FP500: Canada's Largest Corporations by Revenue," *Financial Post*, <https://financialpost.com/financial-post-magazine/fp500/fp500-the-premier-ranking-of-corporate-canada-2>; accessed May 2, 2022.

⁶ The Jim Pattison Group, "About Us," <https://www.jimpattison.com/about/our-story/>; accessed May 4, 2022.