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Accounting in Action

The **Chapter Preview** outlines the major topics and subtopics you will see in the chapter.

Chapter Preview

The feature story about Canada Goose Holdings Inc. highlights the importance of having good financial information to make good business decisions. This applies not just to companies but also to individuals. You cannot earn a living, spend money, buy on credit, make an investment, or pay taxes without receiving, using, or giving financial information. Good decision-making for companies and individuals depends on good information.

This chapter shows you that accounting is the system that produces useful financial information for decision-making.

The **Feature Story** helps you see how the chapter topic fits with the real world of accounting and business. The story will be mentioned throughout the chapter.

Feature Story

Canada Goose: Keeping Generations of Canadians Warm

TORONTO, ON—If you ever operated a babysitting or lawn-mowing service, you probably tried to make more money by finding as many customers as possible and keeping expenses down. You were using the same principles that businesses use to maximize profit.

Enterprises need a successful business model—a way of generating regular sales that over the long run exceed expenses, which results in profit. Companies use accounting to record financial information, which they report in financial statements that internal users (such as management) and external users (such as shareholders and banks) use to make decisions. For example, internal users need to know how much to charge for products or services to maximize profits without losing sales to competitors. External users need to decide if the company is worth investing in or lending money to.

Take as an example Canada Goose Holdings Inc., one of the world's leading manufacturers of performance luxury apparel. It designs, manufactures, and sells performance apparel for everyone. Canada Goose has 51 retail operations in North America, Europe, and Asia Pacific, and 57 national e-commerce markets. In 2023, the company launched its e-commerce platform called "Generations," where consumers can shop and trade in used Canada Goose products, underlining the company's dedication to sustainability and quality products.

The company was founded as Metro Sportwear Ltd. in 1957 by Sam Tick, who immigrated to Canada from Poland following World War II. Almost seven decades later, the company is now known as Canada Goose and is run by Sam's grandson, Dani Reiss. Mr. Reiss became CEO in 2000 and embarked on a mission to see their lone manufacturing facility in Toronto operating at capacity and generating more profit. Today, the company operates seven manufacturing facilities across Canada.

Over the next 13 years, the company grew globally. The Canada Goose brand is recognized throughout the world as performance luxury apparel. The "Made in Canada" moniker makes the products a sought-after status symbol. Because of the product's design and quality performance in extreme temperatures, they are also the choice of many who work in extreme climates, such as the kind Canadians experience every year. Canada Goose is the go-to for winter apparel for those employed in industries ranging from emergency services to the film industry. With rapid growth came a need for increased capital (investment). In 2018, Mr. Reiss took the company public and raised over $255 million to continue growing the company.

What kinds of things does Canada Goose need to keep track of in its accounts? Like any company, Canada Goose records revenues (sales), which totalled $1,217 million in 2023, and expenses, which were $1,148 million, resulting in a profit of $69 million. It also records assets (the value of what it owns at a certain point in time) and liabilities (the value of what it owes to others).

Canada Goose's stated growth strategies are to expand their customer base by growing both their direct-to-customer sales and expanding their product line. These strategies require investment in the internal operations of the organization—that is, investing in their brand. The company is working hard to attain environmental, social, and governance (ESG) goals. In 2023, Canada Goose issued their first sustainability report. In the report, they cited their commitment to slowing climate change, producing fur-free and ethically sourced materials, and contributing to the communities in which they work and sell their products. With each of these initiatives, costs incurred are closely monitored to ensure the continued profitability of the organization.

All of these activities are recorded by accounting—a crucial business tool that ensures Canada Goose will continue to keep Canadians warm for generations to come.

Sources: Canada Goose, *Humanature: Keep the Planet Cold and the People on It Warm,* Environmental, Social and Governance Report FY 23, https://investor.canadagoose.com/files/doc_sustainability/FY23-Sustainability-Report.pdf; Lauren Debter, "The Golden Goose: How Dani Reiss Became a Billionaire Turning Canada Goose into a Luxury Brand Powerhouse," *Forbes*, April 18, 2019; CNBC Make It, "How I Transformed Canada Goose into a Billion-Dollar Brand," YouTube, November 10, 2023, https://www.youtube.com/watch?v=pw7iJKJlsWg; Canada Goose Management Discussion and Analysis Report, April 2, 2023; Canada Goose Holdings Inc. Consolidated Financial Statements, April 2, 2023.

Learning Objectives show what you should be able to do after learning the specific concepts presented in the chapter.

Chapter Outline

LEARNING OBJECTIVES

LO 1 Identify the uses and users of accounting and the objective of financial reporting.	**Why Is Accounting Important?** • Accounting activities • Using accounting information • Objective of financial reporting	**DO IT! 1.1** Users of accounting information
LO 2 Compare the different forms of business organization.	**Forms of Business Organization** • Proprietorship • Partnership • Corporation	**DO IT! 1.2** Types of business organization
LO 3 Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.	**Generally Accepted Accounting Principles** • Ethics in financial reporting • Conceptual framework • Accounting standards	**DO IT! 1.3** Building blocks of accounting

LO 4 Describe the elements of the financial statements and explain the accounting equation.	**The Accounting Model** • Financial statements • The expanded accounting equation	**DO IT! 1.4** The accounting equation
LO 5 Analyze the effects of business transactions on the accounting equation.	**Transaction Analysis**	**DO IT! 1.5** Tabular analysis
LO 6 Prepare financial statements.	**Preparing Financial Statements** • Income statement • Statement of owner's equity • Balance sheet • Cash flow statement • Understanding the information in the financial statements	**DO IT! 1.6** Financial statements

1.1 Why Is Accounting Important?

LEARNING OBJECTIVE 1

Identify the uses and users of accounting and the objective of financial reporting.

Accounting consistently ranks as one of the top career opportunities in business. Students looking for these opportunities find that the best path into the world of finance and business is to pursue a professional accounting credential. Why? Accountants work in every industry and level of business and their skills in accounting and management make them highly attractive to employers and recruiters. Accountants can be CEOs, CFOs, managers, and entrepreneurs, to name a few. Accountants also hold high-level positions in governments and not-for-profit organizations. So, what is accounting?

Accounting is the system that **identifies, records, and communicates** the economic events of an organization to a wide variety of interested users. The world's economic systems depend on highly transparent and relevant financial reporting that provides a true representation of economic events. Accounting is the system that provides relevant, reliable financial information. Let's examine accounting activities in more detail.

Essential (key) terms are printed in blue when they first appear, and are defined in the end-of-chapter glossary.

Accounting Activities

As a starting point to the accounting process, a company **identifies** the economic events relevant to its business. Examples of economic events are the sale of apparel and accessories by Canada Goose, the sale of coffee and doughnuts by Tim Hortons, and the payment of wages by Rogers Communications.

Once a company like Canada Goose identifies economic events, it records those events in order to provide a history of its financial activities. **Recording** consists of keeping a systematic, chronological diary of events, measured in dollars and cents.

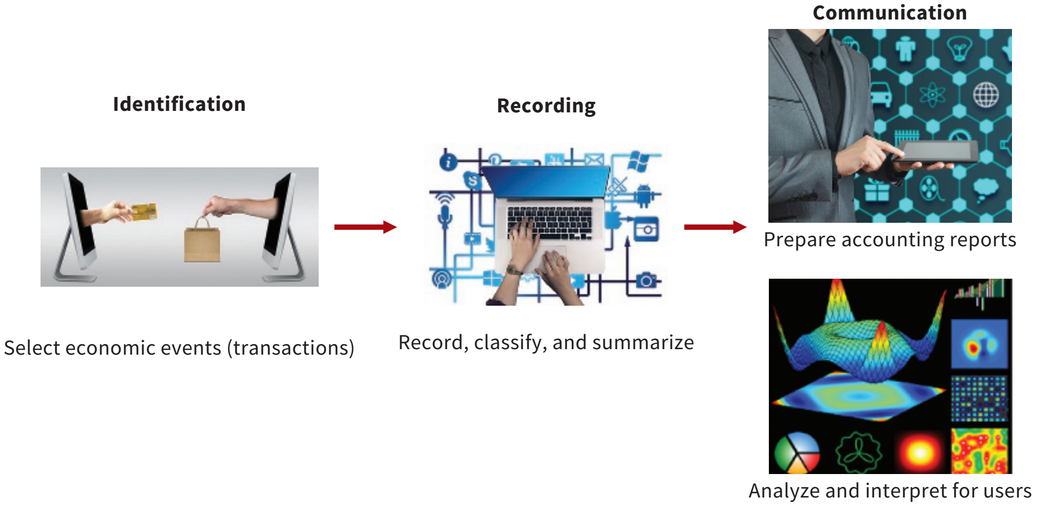
The systematic collection of these data allows Canada Goose to prepare financial statements that are then used to **communicate** financial information to interested users. Financial statements report the recorded data in a standardized way to make the information meaningful. For example, Canada Goose accumulates all sales transactions over a certain period of time and reports the data as a single amount in the company's financial statements. Such data are said to be reported in the *aggregate*. By presenting the recorded data in the aggregate, the accounting process simplifies the multitude of transactions and makes a series of economic events understandable and meaningful. Appendix A at the end of this text shows the financial statements of Canada Goose Holdings Inc. We refer to these statements at various places throughout the textbook. At this point, these financial statements probably strike you as complex and confusing. By the end of this course, you'll be surprised at your ability to understand, analyze, and interpret them.

A vital element in communicating economic events is the accountant's ability to **analyze and interpret** the reported information.

- **Analysis** involves using ratios, percentages, and data visualization (graphs and charts) to highlight significant financial trends and relationships.
- **Interpretation** involves explaining the uses, meaning, and limitations of reported data.

Illustration 1.1 summarizes the activities of the accounting process.

ILLUSTRATION 1.1 **The activities of the accounting process**



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The accounting process includes the bookkeeping function. Bookkeeping usually involves only the recording of economic events. It is therefore just one part of the accounting process. In total, accounting involves the entire process of identifying, recording, and communicating economic events.

You might think this is all well and good for students who want to become accountants, but what about someone who has plans to be anything *but* an accountant?

Understanding the basics of accounting is helpful for almost every endeavour you can think of. Whether you plan to own your own business in the future, work for someone else in their business, or invest in a business, learning how to read and interpret financial information is a valuable set of skills.

When you study accounting, you will also learn a lot about management, finance, and marketing, which will give you a solid foundation for your future studies. For example, you will learn how making a sale is meaningless unless it is a profitable sale and the money can eventually be collected from the customer. Marketing managers must also be able to decide pricing strategies based on costs. Accounting is what quantifies these costs and explains why a product or service costs what it does. So think of this textbook as your introduction to accounting across the organization.

It doesn't matter if you plan to become a doctor, lawyer, social worker, teacher, engineer, architect, or entrepreneur—whatever you choose, a working knowledge of accounting will be relevant and useful. Make the most of this course—it will serve you for a lifetime in ways you cannot now imagine.

Accounting in Action Insight features give examples of accounting situations from different perspectives: All About You, Across the Organization, and in terms of Business Insight, and Ethics Insight.

All About You

Fotografias de Rodolfo Velasco/ Getty Images

We all know the importance of literacy. But what about financial literacy—the ability to understand and manage your finances? It seems Canadians don't place the same importance on financial literacy—but with rising household debt levels, falling savings levels, increasing personal bankruptcies, and continuing economic uncertainty, they should. According to the Canadian Financial Capability Survey, in 2019, 17% of adult Canadians say their monthly spending exceeds their income and 31% believe they have too much debt.

There is movement on several fronts to improve financial literacy. For example, the federal government in 2021 launched an updated national financial literacy strategy with a goal of building financial resilience among Canadians in the age of exponential technological growth. The COVID pandemic from 2020 to 2022 exposed financial vulnerabilities across the country, hence the focus on financial resilience. Still, Canada has been ranked third (tied with Norway) internationally on overall financial literacy by the Organisation for Economic Co-Operation and Development. Globally Canadians are doing well, but nationally, many still feel their financial knowledge is only average and could be improved.

One of the strategy's activities was partnering in a pilot project with the United Way of Ottawa to create an app to encourage people to save. More than 1,000 signed up for the Small Change app. Over four months in 2016, they saved a total of $46,716 by doing things such as bringing their lunch to work and brewing their own coffee. Financial literacy experts point out that making the right financial decisions can have a major impact on an individual's financial well-being, health, and happiness. Financial Consumer Agency of Canada offers many resources and tools to improve financial literacy and target specific areas, like debt management.

Learning the basics of accounting will help you make the right financial decisions. Accounting will help you make investment decisions, determine how much interest you are paying on your student loan or credit cards, and prepare your personal budget. To demonstrate the value of accounting to you, included in each chapter is an "All About You" feature and a related activity at the end of the chapter (BYP.5) that links accounting to your life as a student or to a situation you are likely to face.

Sources: "Mark Change that Counts: National Financial Literacy Strategy 2021-2026", Financial Consumer Agency of Canada, 2021; "Implementing the National Strategy for Financial Literacy – Count me in, Canada: Progress report 2015-2019", Financial Consumer Agency of Canada, 2019; "Improving Financial Literacy through Mobile Technology: Small Change Pilot Program Outcomes," Financial Consumer Agency of Canada, January 2018; "Canadians and their Money: Key Findings from the 2019 Canadian Financial Capability Survey", Financial Consumer Agency of Canada, 2019; *Money and finances* (2024, April 25). canada.ca. Retrieved April 20, 2024, from https://www.canada.ca/en/services/finance.html

How might learning accounting help you make sure that your employer or bank hasn't made an error with your paycheque or bank account?

Using Accounting Information

There are two broad groups of users of accounting information: internal users and external users.

Internal Users

Internal users of accounting information plan, organize, and run companies. They work for the company. They include finance directors, marketing managers, human resources personnel, production supervisors, and company officers. In running a business, internal users must answer many important questions, as shown in **Illustration 1.2**.

ILLUSTRATION 1.2
Questions asked by internal users

To answer these and other questions, users need detailed information on a timely basis; that is, it must be available when needed. Some examples of information that internal users need include:

- forecasts of cash flows for the next year,
- projections of profit from new sales campaigns,
- analyses of salary costs, and
- budgeted financial statements.

Internal users generally have direct access to the business's accounting information and are able to request a wide variety of custom reports designed for their specific needs.

External Users

External users are individuals or organizations outside of a company who want financial information about the company. There are several types of external users of accounting information, but the two most common are:

1. **Investors**, who are owners (or potential owners) of the business, use accounting information to make decisions to buy, hold, or sell their ownership interest.
2. **Creditors**—persons or other businesses that are owed money by the business, such as suppliers and bankers—use accounting information to evaluate the risks of granting credit or lending money.

Investors and creditors are the main external users of accounting information, but there are also many other external users with a large variety of information needs and questions. Some examples of other external users and their information needs are the following:

- Labour unions want to know whether the owners can afford to pay increased salaries and benefits to their members.
- Customers are interested in whether a company will continue to honour its product warranties and support its product lines.
- Taxing authorities, such as the Canada Revenue Agency, want to know whether the company respects the tax laws.

- Regulatory agencies, such as provincial securities commissions that regulate companies that sell shares to the public, want to know whether the company is respecting established rules.
- Economic planners use accounting information to forecast economic activity.

Some questions that external users may ask about a company are shown in **Illustration 1.3**.

ILLUSTRATION 1.3
Questions asked by external users

Unlike internal users, external users have access to only the accounting information available publicly or provided to them by the business. Determining what information should be provided to external users, and how, is the focus of financial accounting.

Computerized accounting information systems collect vast amounts of data about the economic events in a company and about the parties 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 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 decision-making is becoming increasingly common at virtually all types of companies (see **Helpful Hint**).

Helpful hints help clarify concepts or items that are being discussed.

HELPFUL HINT

Throughout the text, we will highlight examples where accounting information is used to support business decisions using *data analytics*.

Data Analytics Insight

Bogdan Glisik/
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Using Data Science to Create Art

Technology provides decision-makers and problem-solvers with access to a large volume of information called "big data." And **Netflix**, the world's leading subscription streaming entertainment service, is tapping into this big data as part of its efforts to ramp up its original content production.

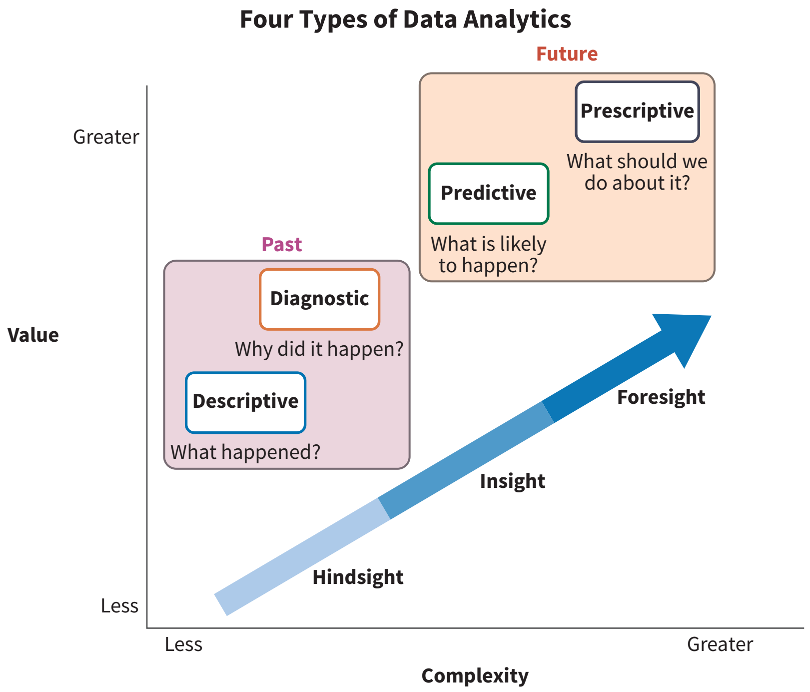
In a recent year, Netflix planned to spend \$8 billion on content creation. Producing content involves a blend of creativity, technology, and business decisions, all of which result in costs. And by analyzing the large amounts of data from past productions, such as filming locations and production schedules, Netflix can more precisely estimate costs for future productions. Further, consider that the production of a TV show or film involves hundreds of tasks. Here again, Netflix uses data science, in this case to visualize where bottlenecks might occur or where opportunities might exist to increase the efficiency of the production process.

Source: Adapted from Ritwik Kumar et al., "Data Science and the Art of Producing Entertainment at Netflix," *The Netflix Tech Blog,* March 26, 2018.

How can "big data" improve decision-making?

Illustration 1.4 shows the four most common types of data analytics that help answer questions ranging from what happened and why did it happen, to what is likely to happen and what should we do about it? Analytics range from simple analysis 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 1.4
Four types of data analytics



Objective of Financial Reporting

As stated, accounting information is communicated in financial reports, and the most common reports are financial statements. **The main objective of financial reporting is to provide useful information to existing and potential investors and creditors (external users) to make decisions about providing resources to a business.** This information is most commonly supplied in general purpose financial statements, which we will discuss later in the chapter. Recall that internal users have access to a broader range of accounting information and do not necessarily need general purpose financial statements to make informed decisions, although they can be used by internal users as well.

To make the decision to invest in a business or to lend to a business, users need information about the business's ability to earn a profit and generate cash. Consequently, financial statements must give information about the following:

1. The business's economic resources. What resources does the business have that it can use to carry out its business activities?
2. The claims to the business's economic resources. What are the amounts owed by the business and the owner's rights to the business's resources?
3. Economic performance. Is the business generating a profit and enough cash to pay its debts, and provide a return to its owners?
4. Management's stewardship. Is management using the economic resources efficiently and effectively in order to provide future net cash flows?

We will learn more about financial statements in the following sections.

DO IT! 1.1 | Users of Accounting Information

The following is a list of some users of accounting information. For each user indicate:

a. whether they are an internal or external user, and

b. an example of a question that might be asked by that user.

1. Creditor
2. Canada Revenue Agency
3. Investor
4. General manager of the production department
5. Manager of the human resources department

ACTION PLAN

- Understand that internal users work for the company and have direct access to the business's accounting information.
- Understand that external users are users who do not work for the company and have access to only the accounting information available publicly or provided to them by the company.
- Understand that users require information to make decisions.

Solution

User	(a) Internal or External	(b) Question
1. Creditor	External	Will the business be able to pay back the loan?
2. Canada Revenue Agency	External	Is the company following the tax laws?
3. Investor	External	Should I invest money in the company?
4. General manager of the production department	Internal	How much will it cost to produce the product?
5. Manager of the human resources department	Internal	Can the company afford to give the employees raises?

Related exercise material: **BE1.1**, **E1.1**, and **E1.2**.

1.2 Forms of Business Organization

LEARNING OBJECTIVE 2

Compare the different forms of business organization.

DO IT! exercises like the one here ask you to put your new knowledge to work. They also outline an Action Plan you need to follow to do the exercise. *Related exercise material* tells you which Brief Exercises (BE) and Exercises (E) at the end of the chapter have similar study objectives.

Now that we understand that accounting information is prepared to convey financial information to various users, it is important to note that how the financial statements are prepared depends on the form and nature of the business organization. Therefore, let's explore the different organizational forms a business can take. The most common forms of business organization are the proprietorship, partnership, and corporation.

Proprietorship

A business owned by one person is a **proprietorship**. The owner is usually the operator of the business. Small service businesses (hair stylists, plumbers, and mechanics), farms, and small retail stores (antique shops, corner grocery stores, and independent bookstores) are often proprietorships.

- Often only a relatively small amount of money (capital) is needed to start in business as a proprietorship.
- The owner (the proprietor) receives any profits, suffers any losses, and 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. Thus the life of a proprietorship is limited to the life of the owner. This also means that the profits of the business are reported and taxed on the owner's personal income tax return.
- For accounting purposes, the records of the proprietorship's business activities are kept separate from the personal records and activities of the owner.

Many businesses in Canada are proprietorships, but they earn only a small percentage of the revenue earned by Canadian businesses as a whole. In this textbook, we start with proprietorships because many students organize their first business this way.

Partnership

A business owned by two or more persons who are associated as partners is a **partnership**. In most aspects, a partnership is similar to a proprietorship, except that there is more than one owner. Partnerships are often used to organize service-type businesses, including professional practices (lawyers, doctors, architects, and accountants).

- Typically, a partnership agreement (written or oral) defines the initial investments of each partner, the duties of each partner, how profit (or loss) will be divided, and what the settlement will be if a partner dies or withdraws.
- As in a proprietorship, for accounting purposes a partnership's business activities must be kept separate from the personal activities of each partner.
- The partners' share of the profit must be reported and taxed on the partners' personal income tax returns.
- Each partner generally has unlimited liability for all debts of the partnership, even if one of the other partners created the debt. This means that any of the partners can be forced to give up their personal assets in order to repay the partnership debt, just as can happen to an owner in a proprietorship.

We will learn more about partnerships in Chapter 12.

Corporation

A business that is organized (incorporated) as a separate legal entity under federal, provincial, or territorial corporate law is a **corporation** (see **Helpful Hint**).

HELPFUL HINT

You can usually tell if a company is a corporation by looking at its name. The words *Limited (Ltd.)*, *Incorporated (Inc.)*, or *Corporation (Corp.)* usually follow its name.

- A corporation can have one owner or many owners. A corporation's ownership is divided into transferable shares. Shareholders, also known as investors, may sell all or part of their shares to other investors at any time. Easy changes of ownership are part of what makes it attractive to invest in a corporation.
- A corporation enjoys an unlimited life, because ownership can be transferred through the sale of shares and without dissolving the corporation.
- The corporation's separate legal status provides the owners of the shares (shareholders) with **limited liability**. Limited liability mean shareholders are not personally liable for the debts of the corporation and they risk losing only the amount that they have invested in the company's shares.
- A corporation is responsible for its own debts and for paying taxes on its profit.

Although there are many more proprietorships and partnerships than corporations in Canada, the revenue produced by corporations is far greater. Most of the largest companies in Canada—for example, Royal Bank of Canada, Canadian National Railway Company, Roots Corporation, and Suncor Inc.—are corporations. Corporations such as these are publicly traded. That is, their shares are listed on Canadian stock exchanges and the public can buy the shares.

Public corporations commonly distribute their financial statements to shareholders, creditors, other interested parties, and the general public upon request. Canada Goose Holdings Inc. is a public corporation, whose shares are traded on the Toronto Stock Exchange (TSX). You can access Canada Goose's financial statements on its website, and selected statements are also presented in Appendix A at the back of this textbook.

Private corporations do not issue publicly traded shares. Some of the largest private corporations in Canada include Moosehead Brewery, James Richardson & Sons Ltd., McCain Foods Limited, and GoodLife Fitness Centres Inc. Like proprietorships and partnerships, these corporations almost never distribute their financial statements publicly. We will discuss the corporate form of organization in Chapters 13 and 14.

Illustration 1.5 provides a summary of the important characteristics of each organizational form a business can take.

ILLUSTRATION 1.5
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
Private or public	Private	Usually private	Private or public
Taxation of profits	Paid by the owner	Paid by the partners	Paid by the corporation
Life of organization	Limited	Limited	Unlimited

DO IT! 1.2 | Types of Business Organization

For each type of organization (proprietorship, partnership, and corporation) indicate:

1. Number and type of owners.
2. If it has limited or unlimited liability.
3. If it is a separate legal entity from its owners.

ACTION PLAN

- Understand the characteristics of the most common forms of business organization.

Solution

	Proprietorship	Partnership	Corporation
1.	Proprietor: one	Partners: two or more	Shareholders: one or more
2.	Unlimited	Unlimited	Limited
3.	Not a separate legal entity from its owner	Not a separate legal entity from the partners	Separate legal entity from the shareholders

Related exercise material: **BE1.2** and **E1.3**.

1.3 Generally Accepted Accounting Principles

LEARNING OBJECTIVE 3

Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

In order to prepare useful financial information, the accounting profession has developed standards that are generally accepted and universally practised. This common set of standards is called **generally accepted accounting principles (GAAP)**. Generally accepted accounting principles:

- represent broad principles, procedures, concepts, and standards that act as guidelines for accountants.
- guide the reporting of economic events.

However, for these standards to be meaningful, a fundamental business concept must be present—ethical behaviour.

Ethics in Financial Reporting

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. The standards of conduct by which actions are judged as right or wrong, honest or dishonest, fair or not fair are **ethics**.

- Ethics in accounting is of the utmost importance to accountants and decision-makers who rely on the financial information they produce.
- Effective financial reporting depends on sound ethical behaviour.

Fortunately, most individuals in business are ethical, that is:

- 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 conduct to guide their behaviour with each other and the public. In addition, many companies today have codes of conduct, or statements of corporate values, that outline their commitment to ethical behaviour in their internal and external relationships, as shown in **Illustration 1.6** for Canada Goose.

ILLUSTRATION 1.6
Canada Goose Code of Conduct

Excerpt from the Canada Goose Code of Conduct

Fair Dealing

Company Personnel should endeavour to deal fairly with the Company's customers, suppliers, competitors and employees. No one should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair-dealing practice.

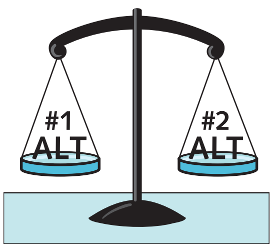
Canada Goose fosters a work environment in which all individuals are treated with respect and dignity. The Company is an equal opportunity employer and does not discriminate against Company Personnel, on the basis of race, color, religion, sex, national origin, age, sexual orientation or disability. The Company is committed to actions and policies to assure fair employment, including equal treatment in hiring, promotion, training, compensation, termination and corrective action. The Company does not tolerate discrimination by any member of its Company Personnel and does not tolerate harassment of its employees, customers and suppliers in any form.

Source: Canada Goose Holdings Inc., *Code of Business Conduct and Ethics*, CP03-02-22.

Throughout this textbook, ethical considerations will be presented to highlight the importance of ethics in financial reporting. Every chapter includes an Accounting in Action Ethics Insight case that simulates a business situation and asks you to put yourself in the position of a key decision-maker.

When you analyze these ethical situations, you should follow the steps outlined in **Illustration 1.7**.

ILLUSTRATION 1.7 **Steps used to analyze ethics cases and situations**



1. Identify the ethical issues involved.
- Use your personal ethics or an organization's code of ethics to identify ethical situations and issues.
- Some business and professional organizations provide written codes of ethics for guidance in common business situations.

2. Identify the stakeholders—the persons or groups that may benefit or face harm.
- Ask the questions: Who are the impacted parties? What are their responsibilities and obligations?

3. Consider the alternative courses of action and the consequences of each for the various stakeholders.
- There may not always be one right answer. Some situations require an evaluation of the alternatives and the impact of each alternative on the identified stakeholders.
- Select the most ethical alternative, considering all the consequences.

Indigenous Perspective (LO 1.2 – Forms of Business)

Two-Eyed Seeing

Etuaptmumk, or "Two-Eyed Seeing," is an action-oriented conceptual framework introduced by Mi'kmaq elder Alfred Marshall in 2012. It is about learning to see from one eye with the strengths of Indigenous ways of knowing, and from the other with the strengths of traditional Western ways of knowing. The action of seeing through both eyes integrates the strengths of each knowledge system. Western knowledge systems often give credibility to objectivity and favour a capitalistic model. The Western capitalistic model is centred on profitability and accumulation, which differs greatly from an Indigenous model. Indigenous knowledge is shared through teachings from a variety of sources, including ceremonies, living things, dreams, and the cosmos. The re-emergence of Indigenous knowledge systems and frameworks is challenging mainstream economic models to take into account diverse Indigenous needs and value systems and become more holistic in nature. An Indigenous approach to the economy is often collective, aiming to benefit a communal purpose rather than individual gains. This approach can positively influence the serious socioeconomic conditions experienced by many Indigenous people in Canada by recognizing the importance of social, cultural, environmental, and economic contributions to the economy. Typically, Indigenous communities have Indigenous Economic Development Corporations to support their Nation's economic objectives.

An Indigenous Economic Development Corporation is the economic and business development arm of a First Nation, Métis, or Inuit government and is a significant economic driver for an Indigenous community. These corporations engage in business activities and support business ventures to benefit their communities. The Nisga'a Economic Development Corporation is an example of a successful Indigenous Economic Development Corporation.

In 2000, the Nisga'a treaty was signed between the Nisga'a Nation, the Government of British Columbia, and the Government of Canada. The Nisga'a treaty opened the door for economic development, giving rise to the Nisga'a Business Development Fund. The Fund's purpose is to foster a process that creates wealth, prosperity, and cultural well-being for the Nisga'a Nation and Nisga'a citizens, by promoting business development and entrepreneurship by, and employment of, Nisga'a citizens. As of 2022, the Fund has invested over $3 million in over 40 business initiatives. Nisga'a entrepreneurs have received support for multiple businesses, creating local jobs and infrastructure and, in some cases, preserving culture. The Fund has now expanded to include an Indigenous business incubator. The process for selecting the businesses that will be supported honours the diverse values and needs of Nisga'a entrepreneurs, focusing on not only their potential profitability but also their potential social, environmental, and cultural impacts. Bert Mercer, the Manager of the Nisga'a Development Fund, is optimistic about the future of the Nisga'a Nation's Business Incubator. Mercer says, "this is a natural extension of the Nisga'a Business Development Fund. With multiple supports in place, I am hopeful entrepreneurs will succeed by utilizing the incubator and improve the quality of life for all people in all walks of life."

Understanding how others view the world is integral to working together. Cross-cultural understanding can benefit how we relate to each other in the world. Reviewing the resources on two-eyed seeing is a recommended step on the path of reconciliation.[*]

T'ooyaks̲im̓ n̓isim̓ (Thank you)—*Tasha Brooks*

* Nisga'a Lisims Government website, "Understanding the Treaty," https://www.nisgaanation.ca/understanding-treaty. Nisga'a Lisims Government, Nisga'a Business Development Fund Act, 2008. Albert Marshall, "Two-Eyed Seeing," 2019 Global Symposium: Reimagining Community in the 21st Century, https://www.youtube.com/watch?v=DTJtAdH9_mk. "Two-Eyed Seeing—Elder Albert Marshall's Guiding Principle for Inter-Cultural Collaboration," Thinkers Lodge, Pugwash, NS: Climate Change, Drawdown & the Human Prospect: A Retreat for Empowering our Climate Future for Rural Communities, September 28–October 1, 2017.

Ethics Insight

TriggerPhoto/Getty Images

What would you do if you suspected a co-worker was stealing? Would you confront them or tell your employer or the authorities? Would you keep quiet if you feared losing your job? What to do about suspected fraud is an ethical question facing not just those working in the accounting field, but employees in any role. Workplace fraud can take many forms. It could be an employee forging a cheque or stealing inventory. But it could also be an executive who falsifies financial information to make their department's sales figure look better, to meet company targets and collect a bonus, or to keep their job. According to the Association of Certified Fraud Examiners, the average occupational fraud committed worldwide in 2019 caused a median loss of US$125,000.

Organizations need to send a strong message that they won't tolerate fraud. One way of doing that is to protect and encourage employees who suspect fraud and report it to their employers. The federal government and most provinces in Canada have enacted their own public employee protection legislation. Another way to discourage fraud is to set up an internal crime hotline for employees to report suspected wrongdoing. When fraud is not reported, everyone is potentially harmed, not just the employer. Colleagues may lose jobs, customers may be misled, and shareholders and the public will lose trust in the accuracy of financial information.

Consider the following scenario: Jennifer is an accountant who works for Currie Financial Services Company. Currie has recently been given the opportunity to provide financial services to a large transportation company but Currie must compete against other financial service companies. Jennifer's boss has instructed her to prepare a presentation for the transportation company and include some performance statistics that he created. The potential client wants reassurance that whichever financial services provider it chooses will be in business a long time to serve its needs. Consequently, it wants to see financial figures from bidders that show they have been profitable over several years. Jennifer knows that the financial figures her boss wants her to show the potential client do not reflect Currie's actual performance but her boss told her they must "get that contract at all costs." He also said that those statistics are "likely to reflect actual performance in the future."

Sources: Association of Certified Fraud Examiners, "Report to the Nations: 2020 Global Study on Occupational Fraud and Abuse," 2020; David Malamed, "Whistle Where You Work?", *CA Magazine*, January/February 2012.

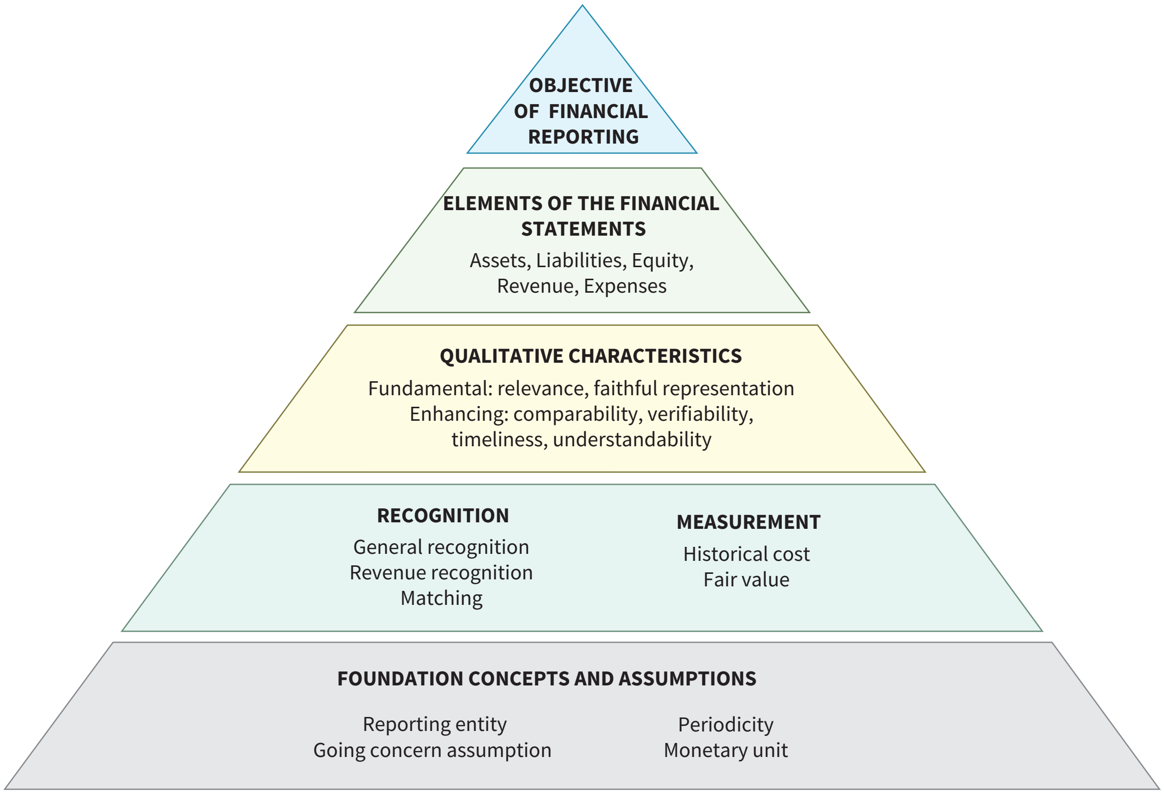
Who are the stakeholders in this situation? How would they be impacted by this situation?

Conceptual Framework

Some GAAP are so fundamental that we begin the study of them in introductory courses because they help us understand why we prepare and report accounting information in the manner we do.

As previously discussed in this chapter, the objective of financial reporting is to provide information to assist users in making decisions. **Illustration 1.8** is a representation of the **conceptual framework of accounting**, which is a coherent system that guides the development and application of accounting principles and standards and leads to the objective of financial reporting. In this chapter, we introduce some of the central concepts contained in the conceptual framework. The entire framework will be covered in more detail in Chapter 11.

ILLUSTRATION 1.8 **The conceptual framework of accounting**



Qualitative Characteristics

Fundamental qualitative characteristics include relevance and faithful representation.

- Accounting information has **relevance** if it would make a difference in a business decision.
- **Faithful representation** means that information accurately depicts what really happened. To provide a faithful representation, information must be:
  - **complete** (nothing important has been omitted),
  - **neutral** (it is not biased toward one position or another), and
  - **free from error**.

Enhancing qualitative characteristics include comparability, verifiability, timeliness, and understandability.

- In accounting, **comparability** results when different companies use the same accounting principles.
  - Comparability also implies that the accounting information should be consistent.
  - **Consistency** means that a company uses the same accounting principles and methods from year to year.
- Information has the quality of **verifiability** if independent observers, using the same methods, obtain similar results.

- For accounting information to have relevance, it must be timely. This is referred to as **timeliness** and it means information must be available to decision-makers before it loses its capacity to influence decisions. For example, public companies like Canada Goose, Apple, and Best Buy provide their annual financial statements to investors within 60 days of their year end.
- Information has the quality of **understandability** if it is presented in a clear and concise fashion, so that reasonably informed users of that information can interpret it and comprehend its meaning.

Recognition

Not all events are recorded and reported in the financial statements. For example, suppose a new employee is hired. Should this event be recorded in the company's accounting records? The answer is no. Why? Only events that cause changes in the business's economic resources or changes to the claims on those resources are recorded and reported. These events are called **accounting transactions**. While the hiring of an employee will lead to future accounting transactions (for example, the payment of a salary after the work has been completed), an accounting transaction has not occurred at the time of hiring.

Recognition is the process of recording transactions in the accounting records. Once a transaction has been recognized or recorded, it will be included in the financial statements.

A key recognition principle is the **revenue recognition principle**, which we introduce here and cover in more depth in Chapter 3. Revenue (discussed in more detail later in this chapter) is one of the elements used to determine economic performance.

- When a company agrees to perform a service or sell a product to a customer, it has a **performance obligation**.
- When the company meets this performance obligation, it recognizes revenue.

Therefore, companies **recognize revenue in the accounting period in which the performance obligation is satisfied,** not when cash is exchanged.

To illustrate, assume Landon's Laundry cleans clothing on June 30 but customers do not claim and pay for their clothes until the first week of July. When should Landon's recognize the revenue? Landon's should recognize the revenue and record the transaction in June when it performed the service (satisfied the performance obligation), rather than in July when it received the cash.

This then gives rise to what is traditionally known as the **matching concept**, which often drives when we recognize certain costs incurred to operate the business (known as expenses and discussed later in the chapter). Generally, when there is a direct association between the costs incurred and the completion of a performance obligation, accounting attempts to match these costs and revenues.

To illustrate using the Landon's Laundry example above, Landon's would recognize wage costs incurred in performing the June 30 cleaning service in the same period in which it recognizes the service revenue.

Measurement

Measurement is the process of determining the *amount* that should be recognized. At the time something is acquired, the transaction is first measured at the amount of cash that was paid or will be paid or at the value exchanged. For example, Echo Company purchased land for $100,000. The land will be recorded in Echo's accounting records at its cost of $100,000. The land is an economic resource of the business and $100,000 is referred to as the land's historical cost. But what should Echo Company do if, by the end of the next year, the land's value has increased to $120,000? Historical cost is the primary basis of measurement used in financial statements, which means that Echo Company would continue to report the land at its historical cost of $100,000. This is often called the **historical cost** measurement method (see **Alternative Terminology**).

Historical cost has important advantages over other measurement methods:

- It is definite and verifiable. The values exchanged at the time something is acquired can be objectively measured.
- Users can rely on the information that is supplied, because they know it is based on fact.

Alternative Terminology notes give synonyms that you may hear or see in the workplace, in companies' financial statements, and occasionally in this textbook.

ALTERNATIVE TERMINOLOGY

The historical cost measurement method is also known as the *cost measurement method.*

- Historical cost is relevant if a business is going to operate into the foreseeable future and the resource will continue to be used in the business. We can ask the question, "what did the company give up to acquire the resource to use in the business?"

However, historical cost may not always be the most relevant measure of certain types of resources. Fair value may provide more useful information in such cases. For example, with an investment purchased for the purpose of trading to make a gain, the current value or market value of the investment provides more relevant information to the user. **Fair value** generally would be the amount the resource could be sold for in the market.

Fundamental to this discussion is that **only transactions that can be reliably expressed as an amount of money can be included in the accounting records**. This is traditionally known as the **monetary unit concept**. This concept makes it possible for accounting to quantify (measure) economic events. In Canada, we mainly use the Canadian dollar to record these transactions. However, some companies report their results in U.S. dollars. In Europe, the euro (€) is used; in China, the yuan (CNY) is used; and so on. The monetary unit concept does prevent some relevant information from being included in the accounting records. For example, the health of the owner, the quality of service, and the morale of employees would not be included, because they cannot be reliably quantified in monetary amounts.

In summary, a transaction is recognized in the accounting records if there is a change in the business's economic resources or a change to the claims on those resources and the change can be reliably measured in monetary terms.

Illustration 1.9 summarizes the process that is used to decide whether or not to record an event.

ILLUSTRATION 1.9
Transaction identification process

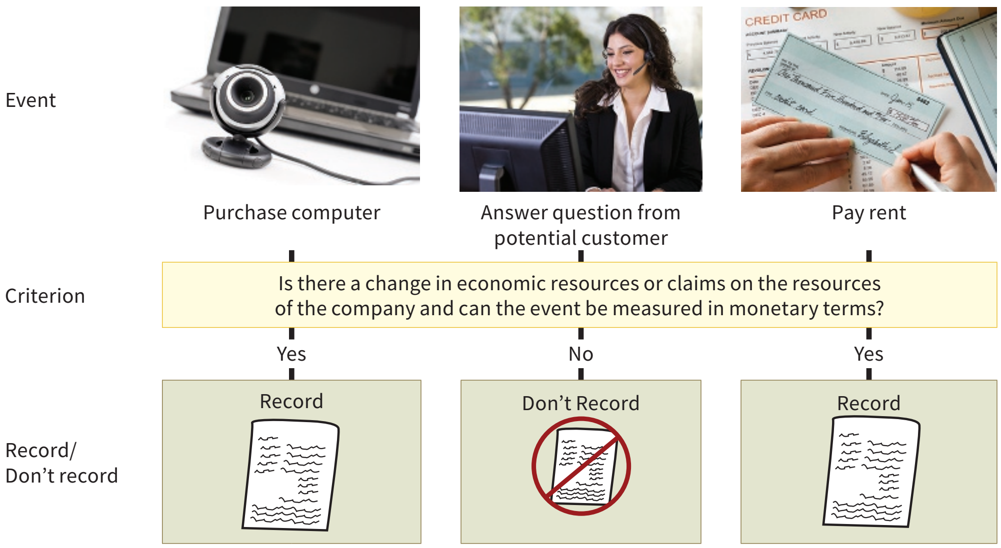


Photo Credits: jcjgphotography/Shutterstock.com; courtneyk/Getty Images; YinYang/Getty Images

Reporting Entity Concept

ALTERNATIVE TERMINOLOGY

A reporting entity is also referred to as an *economic entity*.

A reporting entity (see **Alternative Terminology**) is defined as an entity that is required, or chooses, to prepare financial statements. The **reporting entity concept** contains a couple of key components:

- **A reporting entity can be any organization or unit in society, that is, it does not have to be a legal entity.**
- **Financial statements should include information that is both relevant and faithfully represented.**

Recall that proprietorships and partnerships are not separate legal entities from their owners. However, records of their business activities are kept separate from their owners' personal records because only financial information related to the economic activities of the entity is relevant to users' needs and properly represents the results of operations and financial position of the business.

In practice, this concept guides businesses to **record and report a business's economic activities separate and apart from the economic activities of its owner(s) and all other reporting entities.**

A corporation (such as Canada Goose) is considered a reporting entity for financial statement purposes. Other examples of reporting entities are a governmental unit (such as the Province of Manitoba), a municipality (such as the Ville de Montréal), an Indigenous band council (such as the Kingsclear First Nation), a school board (such as the Burnaby Board of Education), and a club (such as the Rotary Club of Melfort).

Going Concern Assumption

The **going concern assumption** (see **Alternative Terminology**) is the assumption that the reporting entity will continue to operate in the foreseeable future. Although some businesses fail, many companies continue operating for a long time. **The going concern assumption presumes that the company will operate long enough to use its resources for their intended purpose and to complete the company's commitments.**

This assumption is one of the most important assumptions in GAAP because:

- it has implications regarding what information is useful for decision-makers, and
- it affects many of the accounting standards you will learn.

To illustrate:

- If a company *is* a going concern, then financial statement users will find it useful for the company to report certain resources, such as land, at their cost. Land is acquired so a company can use it, not so it can be resold. Therefore, what matters is the amount the company gave up to acquire the land, not an estimate of its current value.
- If a company *is not* a going concern, and the land is going to be sold, then financial statement users will be more interested in the land's current value.

If a company is not regarded as a going concern, or if there are significant doubts about its ability to continue as a going concern, then this must be stated in the financial statements, along with the reason why the company is not regarded as a going concern. Otherwise, you can assume that the company is a going concern—even though this is not explicitly stated.

ALTERNATIVE TERMINOLOGY

The going concern assumption is also referred to as the *continuity assumption.*

Periodicity Concept

Financial statements provide information to users for a specified period of time. The **periodicity concept** (see **Alternative Terminology**) **guides businesses in dividing up their economic activities into distinct time periods**. The most common time periods are months, quarters, and years.

ALTERNATIVE TERMINOLOGY

The periodicity concept is also referred to as the *time period concept* or the reporting period concept.

Accounting Standards

To make the information in financial statements meaningful, accountants have to prepare the reports in a standardized way. As mentioned in the previous section, standards are developed from the guiding principles, assumptions, and concepts. Standards specify how to report **economic events** (see **Helpful Hint**). Business transactions can be complex and it is up to the professional accountant to ensure that transactions are correctly recorded and relevant. Accounting standards are part of the body of knowledge known as generally accepted accounting principles (GAAP).

HELPFUL HINT

In accounting, there are two types of economic events: (1) external events are transactions with another company; and (2) internal events occur within a company, such as the use of equipment in operations.

In Canada, the Accounting Standards Board (AcSB), an independent standard-setting body, has the main responsibility for developing GAAP. **The AcSB's most important criterion for accounting standards is this: the standard should lead to external users having the most useful financial information possible when they are making business decisions.**

In Canada, accounting professionals follow different accounting standards (see **Alternative Terminology**) depending on the type of entity they work for. For-profit entities report their financial statements using either (1) International Financial Reporting Standards (IFRS) or (2) Accounting Standards for Private Enterprises (ASPE).

ALTERNATIVE TERMINOLOGY

The terms *standard* and *principle* are often used interchangeably in accounting.

International Financial Reporting Standards (IFRS) are a set of global standards developed by the International Accounting Standards Board (IASB) and adopted for use in

HELPFUL HINT

Accounting standards use the word "enterprise" because it is a broader term than "company" or "business." The word "enterprise" means that the accounting standard applies to the different forms of business organization, as well as specific projects. Throughout this text, instead of using the word "enterprise," we will frequently use the words "company" or "business," because they are more common terms.

Canada by the AcSB. The IASB is charged with the responsibility to develop International Financial Reporting Standards that bring transparency, accountability, and efficiency to financial markets around the world. IFRS makes it easier for users to compare financial information prepared across the globe. As markets become more global, it is often desirable to compare the results of companies from different countries. That is more difficult when different companies use different accounting standards. Therefore, in order to increase comparability, in recent years, more and more countries are adopting IFRS. IFRS is the main basis of financial reporting in more than 130 countries, including Canada, Australia, Brazil, Russia, members of the European Union, China, India, Japan, and Mexico. At the time this textbook was being written, the United States had not yet agreed to adopt IFRS (in totality).

In Canada, IFRS standards must be followed by publicly accountable enterprises (see **Helpful Hint**). **Publicly accountable enterprises** include publicly traded corporations, as well as securities brokers and dealers, banks, and credit unions whose role is to hold assets for the public as part of their primary businesses. In this textbook, we will discuss publicly traded corporations. Discussion of the other types of businesses will be covered in more advanced courses. Canada Goose is a publicly traded company and therefore it is required to follow IFRS.

The AcSB recognized that, for most private companies in Canada, users can generally obtain additional information from the company if required. Therefore, these users typically require less information in the financial statements. As a result, the AcSB developed **Accounting Standards for Private Enterprises (ASPE)**. Non-publicly traded companies can choose to use ASPE instead of IFRS. ASPE requires considerably less information in financial statements than is required by IFRS. Canadian private companies, such as McCain Foods and EllisDon Inc., have the choice to report under ASPE or IFRS. Because proprietorships and partnerships are private companies, these entities will generally follow ASPE for financial reporting.

The **ASPE word mark** indicates where differences between IFRS and ASPE are explained. These differences are also summarized at the end of each chapter.

ASPE While both IFRS and ASPE are "principle based" (designed to encourage the use of professional judgement in applying basic accounting principles), there are differences. Therefore, financial statement users will need to know which standards the company is following. Companies are required to report this in their financial statements. In this textbook, as we proceed through the material, we will point out where there are differences in the two sets of standards. However, the two sets of standards have a great deal in common regarding the type of material covered in an introductory accounting textbook. The authoritative source of all accounting standards is the handbook produced by Chartered Professional Accountants Canada (CPA Canada), the main professional accounting body in Canada, called the *CPA Canada Handbook*.

Regardless of the financial reporting framework, it is important to understand that GAAP is not static and that it changes over time. Standard setters continue to develop new GAAP and modify existing GAAP. Changes to GAAP may take a long time before being finalized. Therefore, the length of time involved in changing existing accounting standards or adding new ones can make it difficult to determine what information we should include in this textbook. Should we cover the currently approved standard or the proposed new standard? Normally the textbook will cover only the currently approved standards, which include standards that are approved and not yet effective. But where we believe it is important to do so, we will discuss new standards that were proposed at the time the textbook was written.

ACTION PLAN

- **Review the discussion of generally accepted accounting principles.**
- **Develop an understanding of the key terms used.**

DO IT! 1.3 | Building Blocks of Accounting

Indicate whether each of the five statements presented below is true or false.

1. The historical cost principle dictates that companies record economic resources at their cost. In later periods, however, the fair value of the resource must be used if fair value is higher than its cost.
2. Relevance means that financial information matches what really happened; the information is factual.
3. A business owner's personal expenses must be separated from expenses of the business to comply with accounting's reporting entity concept.
4. All events are recorded in the financial statements.
5. All companies in Canada must report their financial statements using IFRS.

Solution

1. False. The historical cost principle dictates that companies record economic resources at their cost. Under the historical cost principle, the company must also use cost in later periods.
2. False. Faithful representation, not relevance, means that financial information matches what really happened; the information is factual.
3. True.
4. False. Not all events are recorded and reported in the financial statements; only accounting transactions are recorded as business transactions. Accounting transactions are events that change the business's economic resources or claims on those resources.
5. False. In Canada, publicly accountable entities must use IFRS, while private entities may report using ASPE.

Related exercise material: **BE1.4** and **BE1.5.**

1.4 The Accounting Model

LEARNING OBJECTIVE 4

Describe the elements of the financial statements and explain the accounting equation.

The accounting model can be described as a structure that is used to prepare financial statements. The model includes:

- the elements of the financial statements, and
- the accounting equation.

Financial Statements

Recall that financial statements are prepared mainly to provide information to external users. There are four financial statements that are prepared for most businesses:

- Balance sheet
- Income statement
- Statement of owner's equity
- Cash flow statement

Later in this chapter, we will illustrate how to prepare these statements.

The specific financial statements prepared differ depending on the nature of the business organization; however, all businesses prepare a balance sheet and income statement.

As you go through this section, we recommend that you refer to Canada Goose's financial statements for the year ended April 2, 2023, in Appendix A of this textbook. We will refer to these statements often throughout the textbook.

Before we begin our discussion about the financial statements and the financial statement elements, one specific term needs to be defined and explained: accounts. Accounting records are made up of several accounts that group similar transactions, each one given a title such as Owner's Capital or Utilities Expense. **An account is an individual accounting record of increases and decreases in a specific asset, liability, or owner's equity item.** You might think of an account as one of the tools accountants use to build the financial statements.

Balance Sheet

ALTERNATIVE TERMINOLOGY

The balance sheet is sometimes called the *statement of financial position.*

The balance sheet is like a snapshot of the company's financial condition at a specific point in time (usually the end of a month, quarter, or year) (see **Alternative Terminology**). This statement provides users with information on the economic resources that the business can use to carry out its business activities and the claims on these economic resources. Let's look at the elements reported on the balance sheet.

Assets **Assets** are present economic resources controlled by a business as a result of past events and have the potential to produce economic benefit. In a business, economic benefits generally refer to cash inflows (receipts) but can include other assets.

Assets are used to carry out activities, such as the production and distribution of merchandise. For example, imagine that a local pizza restaurant, called Campus Pizza, owns a delivery truck. The truck provides economic benefits because it is used to deliver pizzas. Campus Pizza also owns other assets, such as tables, chairs, a sound system, a cash register, an oven, dishes, supplies, and, of course, cash.

Other common assets include the following:

- **Accounts receivable** is the asset created when a company sells goods or services to customers who promise to pay cash in the future
- **Prepaid expense** is the asset created when a business pays cash in advance for goods or services that will be used over time. Common types of prepaid expenses are insurance, rent, and supplies
- Merchandise held for resale (commonly referred to as merchandise inventory)
- Investments
- Land
- Buildings
- Patents
- Copyrights

Liabilities **Liabilities** are claims to economic resources and are defined as present obligations, arising from past events, the settlement of which will include the transfer of economic resources. An economic resource here generally refers to cash outflows (payments) but can also include other assets or services. An obligation is a duty or responsibility that a company has no practical ability to avoid. Common liability accounts include the following:

- **Accounts payable** is an obligation to pay cash to suppliers in the future.
- **Notes payable** arise when a business borrows money to purchase equipment, for instance. A note payable is supported by a written promise to pay a specific amount, at a specific time, in the future.
- **Unearned revenue** arises when a customer pays a business in advance of being provided with a service or product. This advance by the customer is a liability because the business has an obligation to provide the service or product in the future.
- Salaries or wages payable to employees.
- Goods and Services Tax or Harmonized Sales Tax (GST/HST) payable and Provincial Sales Tax (PST) payable are obligations to the federal and provincial governments, respectively.
- Property taxes payable is an obligation to the municipality.

Persons or other businesses that are owed money by the business, such as suppliers and bankers, are called "creditors." The law requires that creditor claims be paid before ownership claims are paid.

Owner's Equity The owner's claim on the assets of the company is known as **owner's equity**.

- It is equal to total assets minus total liabilities.
- Claims of creditors must be paid before ownership claims; consequently, the owner's equity is often called "residual equity."
- If the equity is negative—that is, if total liabilities are more than total assets—the term "owner's deficiency" (or deficit) describes the shortage.

Owner's equity is a general accounting term that could be used for any type of organization. It is used most frequently for proprietorships. Partnerships use the term "partners' equity"; corporations, such as Canada Goose, use "shareholders' equity."

A summary of the balance sheet elements—assets, liabilities, and owner's equity—is presented in **Illustration 1.10**.

ILLUSTRATION 1.10
The balance sheet: A snapshot in time

The Balance Sheet—A Snapshot in Time		
Element	**Definition**	**Examples**
Assets	Present economic resources controlled by the business that have the potential to produce economic benefits	Accounts receivable Merchandise inventory Vehicles Buildings
Liabilities	Present obligations to transfer an economic resource	Accounts payable Notes payable Salaries payable or Wages payable
Owner's Equity	The owner's claim on the assets after deducting the liabilities	Owner's capital

ALTERNATIVE TERMINOLOGY
The accounting equation is sometimes referred to as the *balance sheet equation.*

The Accounting Equation The relationship between assets, liabilities, and owner's equity is expressed as an equation, called the **accounting equation** (see **Alternative Terminology**) as shown in **Illustration 1.11**.

ILLUSTRATION 1.11
Accounting equation

Economic Resources		Claims to Economic Resources		
Assets	=	Liabilities	+	Owner's Equity

This relationship shows the *basic* accounting equation and there are a few observations we can make:

- Assets must equal the sum of liabilities and owner's equity.
- Liabilities are shown before owner's equity in the accounting equation because creditors have the right to receive payment before owners.

The accounting equation is the same for all businesses regardless of size, nature of business, or form of business organization. It applies to a small proprietorship such as a corner grocery store as much as it does to a large corporation such as Canada Goose. The equation provides the underlying framework for recording and summarizing accounting transactions. Later in this section, we will return to the accounting equation. Let's discuss the remaining financial statements and elements of the financial statements first.

Income Statement

ALTERNATIVE TERMINOLOGY
The income statement is sometimes called the *statement of earnings* or *statement of operations.*

The main purpose of the **income statement** (see **Alternative Terminology**) is to report the economic performance of the business's operations over a specified period of time (a month, quarter, or year). Economic performance is indicated by determining the company's profit or loss.

ALTERNATIVE TERMINOLOGY
Profit is sometimes called *net income* or *earnings* or *net earnings.*

- **Profit** or **loss** is measured by the difference between revenues and expenses (see **Alternative Terminology**).
- Profit results when revenues are greater than expenses.
- Loss results when expenses are greater than revenues.
- Revenues and expenses are elements of the financial statements and are reported in the income statement along with profit or loss.

Revenues **Revenues** result from business activities that are undertaken to earn profit, such as performing services, selling merchandise inventory, renting property, and lending money. Revenues result in an increase in an asset or a decrease in a liability *and* an increase in owner's equity. They come from different sources and are given different names, depending on the type of business. Campus Pizza, for instance, has two categories of revenue: food sales and beverage sales. Common types of revenue include:

- Sales revenue
- Service revenue
- Commissions revenue
- Interest revenue
- Rental revenue

Expenses **Expenses** are the costs of assets that are consumed and services that are used in a company's business activities. Expenses are decreases in assets or increases in liabilities *and* result in a decrease in owner's equity. Like revenues, 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, Campus Pizza reports the following expenses: cost of ingredients (such as meat, flour, cheese, tomato paste, and mushrooms); cost of beverages; salaries expense; utilities expense (electric, gas, and water); telephone expense; repairs expense; fuel expense; supplies expense (such as napkins, detergents, and aprons); rent expense; insurance expense; and interest expense.

Illustration 1.12 shows the elements reported on the income statement for a particular period of time.

ILLUSTRATION 1.12
The income statement for a period of time

The Income Statement—A Period of Time		
Element	**Definition**	**Examples**
Revenues	Result from business activities that are undertaken to earn profit. Revenues increase assets or decrease liabilities *and* increase owner's equity.	Sales revenue Service revenue Rental revenue
Expenses	Costs of assets that are consumed and services that are used in a company's business activities. Expenses decrease assets or increase liabilities *and* decrease owner's equity.	Bank charges expense Supplies expense Cellphone expense

The balance sheet and income statement report balances for all of the elements of the financial statements: assets, liabilities, equity, revenue, and expense. The next financial statement that is prepared—the statement of owner's equity—reports the change in equity from the beginning of the period to the end of the period.

Statement of Owner's Equity

The **statement of owner's equity** reports the changes in owner's equity for the same period of time as the income statement.

- In a proprietorship, owner's equity is increased by investments made by the owner and decreased by withdrawals made by the owner.
- Owner's equity is also increased when a business generates a profit from business activities or decreased if the business has a loss.

Let's look at each of these in more detail.

Investments **Investments by the owner** are contributions of cash or other assets (for example, a vehicle or computer) made by the owner to the business. In a proprietorship, investments are recorded as increases to what is known as the Owner's Capital account.

- Investments by owners result in an increase in an asset and an increase in owner's equity.

Drawings An owner may withdraw cash (or other assets) for personal use. In a proprietorship, these withdrawals could be recorded as a direct decrease to the Owner's Capital account. However, it is generally considered better to use a separate account called Drawings so that the total withdrawals for a specific period can be determined.

- **Drawings** result in a decrease in an asset and a decrease in owner's equity.

Profit As previously explained, revenues increase owner's equity and expenses decrease owner's equity. We also learned that profit results from revenues being greater than expenses and a loss results if expenses are greater than revenues. Therefore, profit increases owner's equity and losses decrease owner's equity.

Illustration 1.13 summarizes the transactions that change owner's equity.

ILLUSTRATION 1.13
Transactions that increase and decrease owner's equity

Summary of Changes to Owner's Equity	
Increases in owner's equity	**Decreases in owner's equity**
Investments by the owner	Drawings by the owner
Revenues	Expenses

Cash Flow Statement

Investors and creditors need information on the business's ability to generate cash from its business activities and how the business uses cash. The **cash flow statement** (see **Alternative Terminology**) gives information about the cash receipts and cash payments for a specific period of time.

ALTERNATIVE TERMINOLOGY

The cash flow statement is sometimes called the *statement of cash flows.*

The cash flow statement gives answers to the following simple but important questions:

1. Where did the cash come from during the period?
2. What was the cash used for during the period?
3. What was the change in the cash balance during the period?

To help investors, creditors, and others analyze a company's cash, the cash flow statement reports the following:

1. the cash inflows and outflows as a result of the company's operating activities during a period;
2. the cash inflows and outflows from investing transactions (for example, the purchase and sale of land, buildings, and equipment);
3. the cash inflows and outflows from financing transactions (for example, borrowing and repayments of debt, and investments and withdrawals by the owner);
4. the net increase or decrease in cash during the period; and
5. the cash amount at the end of the period.

Accounting for and Reporting Equity: Differences by Form of Organization

Earlier in the chapter, you were introduced to different forms of business organization: the proprietorship, partnership, and corporation. Accounting for assets, liabilities, revenues, and expenses is the same, regardless of the form of business organization.

The main distinction between the forms of organizations is found in:

- the terminology that is used to name the equity section,
- the accounting for the owner's investments and withdrawals, and
- the name of the statement showing the changes in owner's equity.

In a proprietorship, equity is summarized and reported as one line item on the balance sheet called "capital" and prefaced by the owner's name.

In a partnership, equity is summarized and reported as one line item for each partner and each account is referred to as "capital" prefaced by the individual partner's name.

Later in the chapter, the presentation of the balance sheet for a proprietorship will be illustrated. Chapter 12 will illustrate the balance sheet for a partnership and Chapter 13 will show the balance sheet for a corporation. For now, note that account and statement names in a corporation are different from those in proprietorships and partnerships.

Illustration 1.14 summarizes the differences.

ILLUSTRATION 1.14
Equity differences by form of organization

Accounting for and Reporting Equity—Differences by Form of Organization

	Proprietorship	**Partnership**	**Corporation (reporting under IFRS)**
Equity section	Owner's equity	Partners' equity	Shareholders' equity
Investments by owners	↑ Owner's capital	↑ Partners' capital	↑ Share capital
Profits	↑ Owner's capital	↑ Partners' capital	↑ Retained earnings
Withdrawals	↑ Drawings account and ↓ Owner's capital	↑ Drawings account and ↓ Partners' capital	↑ Dividends account and ↓ Retained earnings
Statement	Statement of Owner's Equity	Statement of Partners' Equity	Statement of Changes in Equity

↑ means the account is increased or added to.
↓ means the account is decreased or subtracted from.

The Expanded Accounting Equation

The basic accounting equation in Illustration 1.11 shows that assets are equal to liabilities plus owner's equity. The basic equation is the underlying framework showing the relationship between assets, liabilities, and owner's equity. We now know that it is necessary to report on revenues, expenses, and other changes in owner's equity. In **Illustration 1.15**, the basic accounting equation is expanded to show the different components of owner's equity and the relationship between revenues, expenses, profit (or loss), and owner's equity.

ILLUSTRATION 1.15
Expanded accounting equation

Assets = Liabilities + Owner's Equity

Owner's Capital (Investments) − Drawings + Profit (or − Loss)

Revenues − Expenses

The expanded equation provides the framework to complete the income statement and statement of owner's equity, as well as the balance sheet.

Here are some key concepts of the expanded accounting equation:

- Assets must equal liabilities plus owner's equity.
- If revenue increases, owner's equity increases and either assets increase or liabilities decrease to keep the equation balanced.
- If expenses increase, owner's equity decreases and either assets decrease or liabilities increase to keep the equation balanced.

In the next section of the chapter, we will use the expanded equation to record and summarize the accounting transactions for the fictitious company Softbyte.

DO IT! 1.4 | The Accounting Model

The following are a few of the accounts that are reported in financial statements: (1) cash, (2) service revenue, (3) drawings, (4) accounts receivable, (5) accounts payable, and (6) salaries expense.

a. Classify the accounts as assets, liabilities, or owner's equity. If the account affects owner's equity, indicate whether these accounts increase or decrease equity.

b. Indicate which financial statement the account is reported in.

Solution

	(a) Element	(b) Financial Statement
1. Cash	Asset	Balance sheet
2. Service revenue	Owner's equity—increase	Income statement
3. Drawings	Owner's equity—decrease	Statement of owner's equity
4. Accounts receivable	Asset	Balance sheet
5. Accounts payable	Liability	Balance sheet
6. Salaries expense	Owner's equity—decrease	Income statement

Related exercise material: **BE1.7** and **E1.8.**

ACTION PLAN

- **Understand that assets are resources controlled by a business that have the potential to produce economic benefit.**
- **Understand that liabilities are obligations to transfer economic resources.**
- **Review which transactions affect owner's equity.**
- **Recall what information is included in each of the financial statements.**

1.5 Transaction Analysis

LEARNING OBJECTIVE 5

Analyze the effects of business transactions on the accounting equation.

The system of collecting and processing transaction data and communicating financial information to decision-makers is known as the **accounting information system**. Factors that shape an accounting information system include the nature of the company's business, the types of transactions, the size of the company, the volume of data, and the information demands of management and others.

Most businesses use computerized accounting systems. These systems handle all the steps involved in the recording process, from initial data entry to preparation of the financial statements. In addition, companies are increasingly utilizing new technologies such as cloud-based storage, which permits employees to access records from different locations, and data automation and analytics tools, which help companies interpret large volumes of data to support enhanced decision-making and automate routine processes.

In this text, in order to emphasize the underlying concepts and principles, we focus on a manual accounting system. The accounting concepts and principles do not change whether a system is computerized or manual.

Under Learning Objective 3 of this chapter, we covered the concept of recognition and measurement of accounting transactions and the concept is summarized in Illustration 1.9. Once it has been determined that an event or transaction should be recognized, it must be analyzed for its effect on the elements of the accounting equation before it can be recorded.

This analysis:

- identifies the specific accounts that are affected, and
- identifies the amount of change in each account.

Each transaction must have a dual effect on the equation for the two sides of the accounting equation to remain equal. For example, if an asset is increased, there must be a corresponding

- decrease in another asset, *or*
- increase in a liability, *or*
- increase in owner's equity.

Two or more accounts could be affected by a transaction. For example, an asset (equipment) could increase by $10,000, a different asset (cash) could decrease by $6,000, and a liability (notes payable) could increase by $4,000. Any change in a liability or ownership claim is subject to similar analysis.

To demonstrate how to analyze transactions in terms of the accounting equation, we will review the business activities of Softbyte, a fictitious software development business, during its first month of operations. You should study these transactions until you are sure you understand them. They are not difficult, but they are important to your success in this course. Being able to analyze how transactions affect the accounting equation is essential for understanding accounting.

To facilitate learning, we will not include cents in the dollar amounts we record in the following analysis of Softbyte's transactions. In reality, it is important to understand that cents should be, and are, used when transactions are recorded in a company's accounting records.

Transaction (1): Investment by Owner Andrew Leonid decides to open a software development business, which he names Softbyte. On September 1, 2028, he invests $15,000 cash in the business, which he deposits in a bank account opened under the name of Softbyte. This transaction results in an equal increase in both assets and owner's equity for Softbyte, as shown in **Illustration 1.16**.

ILLUSTRATION 1.16
Investment of cash by owner

Basic Analysis: The asset Cash is increased by $15,000 and the owner's equity account, A. Leonid, Capital is increased by $15,000.

Equation Analysis:

	Assets	=	Liabilities	+	Owner's Equity	
	Cash	=			A. Leonid, Capital	
(1)	+$15,000	=			+$15,000	Initial Investment

The increase in owner's equity is specifically identified to differentiate it from other transactions affecting equity. Notice that the two sides of the basic equation remain equal. Note also that investments by an owner are **not** revenues and are not included in calculating profit. The increase therefore has to be recorded as an investment in the Owner's Capital account rather than as revenue from operations.

Transaction (2): Purchase of Equipment for Cash Softbyte purchases computer equipment for $7,000 cash. This transaction results in an equal increase and decrease in total assets, though the composition of the assets changes. The specific effect of this transaction and the cumulative effect of the first two transactions are demonstrated in **Illustration 1.17**.

ILLUSTRATION 1.17
Purchase of equipment for cash

Basic Analysis: The asset Cash is decreased by $7,000 and the asset Equipment is increased by $7,000.

Equation Analysis:

	Assets			=	Liabilities	+	Owner's Equity	
	Cash	+	Equipment	=			A. Leonid, Capital	
	$15,000						$15,000	Old Balances
(2)	−7,000		+$7,000					
	$ 8,000	+	$7,000	=			$15,000	New Balances
	$15,000				$15,000			

Notice that total assets are still $15,000, and that Leonid's equity also remains at $15,000, the amount of his original investment.

Transaction (3): Purchase of Supplies on Credit Softbyte purchases $1,600 of printer paper and other supplies that are expected to last several months from Alpha Supply Company. Alpha Supply will allow Softbyte to pay this bill next month (in October). This transaction is referred to as a purchase on account, or a credit purchase. Assets are increased because the use of the paper and supplies is capable of producing economic benefits. Liabilities are increased by the amount that is due to Alpha Supply. **Illustration 1.18** shows the equation analysis for this transaction.

ILLUSTRATION 1.18 **Purchase of supplies on credit**

Basic Analysis: The asset Supplies is increased by $1,600 and the liability Accounts Payable is increased by the same amount.

Equation Analysis:

	Assets					=	Liabilities	+	Owner's Equity	
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	
	$8,000	+		+	$7,000	=			$15,000	Old Balances
(3)			+$1,600				+$1,600			
	$8,000	+	$1,600	+	$7,000	=	$1,600	+	$15,000	New Balances
	$16,600						$16,600			

Total assets are now $16,600. This total is matched by a $1,600 creditor's claim and a $15,000 ownership claim.

Transaction (4): Services Provided for Cash Softbyte receives $1,200 cash from customers for software development services it has provided. This transaction is Softbyte's main revenue-producing activity. Remember that revenue increases profit, which then increases owner's equity. **Illustration 1.19** shows the equation analysis for this transaction.

ILLUSTRATION 1.19 Services provided for cash

Basic Analysis	The asset Cash is increased by $1,200 and the owner's equity account Service Revenue is increased by $1,200.

Equation Analysis

	Assets					=	Liabilities	+	Owner's Equity			
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	
	$8,000	+	$1,600	+	$7,000	=	$1,600	+	$15,000			Old Balances
(4)	+1,200										+$1,200	Service Revenue
	$9,200	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$1,200	New Balances
	$17,800						$17,800					

The two sides of the equation still balance at $17,800.

Note that, in the far right column of the illustration, the account title Service Revenue is included. It is important to keep track of the account titles for revenues and expenses that are affected, because they will be needed when the income statement is prepared in the next section.

Transaction (5): Purchase of Advertising on Credit Softbyte receives a bill for $250 from the local newspaper for advertising the opening of its business. It postpones payment of the bill until a later date. The cost of advertising is an expense, and not an asset, because the benefits have already been used. Owner's equity decreases because an expense is incurred. Expenses reduce profit and owner's equity. **Illustration 1.20** shows the equation analysis for this transaction.

ILLUSTRATION 1.20 Purchase of advertising on credit

Basic Analysis	The liability Accounts Payable is increased by $250 and the owner's equity account Advertising Expense is increased by $250.

Equation Analysis

	Assets					=	Liabilities	+	Owner's Equity					
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$9,200	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$1,200			Old Balances
(5)							+250						−$250	Advertising Expense
	$9,200	+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$1,200	−	$250	New Balances
	$17,800						$17,800							

The two sides of the equation still balance at $17,800. Note that, although the expense increases, this is shown as a negative number because expenses reduce owner's equity.

Expenses do not have to be paid in cash at the time they are incurred. When payment is made on the later date, the liability Accounts Payable will be decreased and the asset Cash will also be decreased [see transaction (8)].

Transaction (6): Services Provided for Cash and Credit Softbyte provides $3,500 of software development services for customers. Cash of $1,500 is received from customers, and the balance of $2,000 is billed to customers on account. This transaction results in an equal increase in assets and owner's equity, as shown in **Illustration 1.21**.

ILLUSTRATION 1.21 Services provided for cash and credit

Basic Analysis	Three specific accounts are affected: the asset Cash is increased by $1,500; the asset Accounts Receivable is increased by $2,000; and the owner's equity account Service Revenue is increased by $3,500.

Equation Analysis

	Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$ 9,200			+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$1,200	−	$250	Old Balances
(6)	+1,500		+$2,000										+3,500			Service Revenue
	$10,700	+	$2,000	+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$4,700	−	$250	New Balances
	$21,300								$21,300							

You might wonder why owner's equity is increased by $3,500 when only $1,500 has been collected. The reason is that the assets from earning revenues do not have to be in cash. Owner's equity is increased when revenues are recognized. In Softbyte's case, revenues are recognized when the service (performance obligation) is provided and complete. When collections on account are received at a later date, Cash will be increased and Accounts Receivable will be decreased [see transaction (9)].

Transaction (7): Payment of Expenses The expenses paid in cash for September are store rent, $600; salaries of employees, $900; and utilities, $200. These payments result in an equal decrease in assets and owner's equity, as shown in **Illustration 1.22**.

ILLUSTRATION 1.22 Payment of expenses

Basic Analysis	The asset Cash is decreased by $1,700 in total ($600 + $900 + $200) and owner's equity expense accounts are increased by the same amount, which then decreases owner's equity.

Equation Analysis

	Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$10,700	+	$2,000	+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$4,700	−	$ 250	Old Balances
(7)	−600														−600	Rent Expense
	−900														−900	Salaries Expense
	−200														−200	Utilities Expense
	$ 9,000	+	$2,000	+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$4,700	−	$1,950	New Balances
	$19,600								$19,600							

The two sides of the equation now balance at $19,600. Three lines are needed in the analysis in order to show the different types of expenses that have been paid. Note that total expenses increase but, as explained in transaction (5), it is shown as a negative number because expenses decrease owner's equity.

Transaction (8): Payment of Accounts Payable Softbyte pays its $250 advertising bill in cash. Remember that the bill was previously recorded in transaction (5) as an increase in Accounts Payable and a decrease in owner's equity. **Illustration 1.23** shows the equation analysis for this transaction.

ILLUSTRATION 1.23 **Payment of accounts payable**

Basic Analysis: The asset Cash is decreased by $250 and the liability Accounts Payable is decreased by $250.

Equation Analysis

	Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$9,000	+	$2,000	+	$1,600	+	$7,000	=	$1,850	+	$15,000	+	$4,700	−	$1,950	Old Balances
(8)	−250								−250							
	$8,750	+	$2,000	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$4,700	−	$1,950	New Balances
	$19,350								$19,350							

Notice that the payment of a liability for an expense that has previously been recorded does not affect owner's equity. The expense was recorded in transaction (5) and should not be recorded again.

Transaction (9): Receipt of Cash on Account The sum of $600 in cash is received from some customers who were billed for services in transaction (6). This transaction does not change total assets, but it does change the composition of those assets, as shown in **Illustration 1.24**.

ILLUSTRATION 1.24 **Receipt of cash on account**

Basic Analysis: The asset Cash is increased by $600 and the asset Accounts Receivable is decreased by $600.

Equation Analysis

	Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$8,750	+	$2,000	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$4,700	−	$1,950	Old Balances
(9)	+600		−600													
	$9,350	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$4,700	−	$1,950	New Balances
	$19,350								$19,350							

Note that a collection of an account receivable for services that were billed and recorded earlier does not affect owner's equity. Revenue was already recorded in transaction (6) and should not be recorded again.

Transaction (10): Signed Contract to Rent Equipment in October Andrew Leonid and an equipment supplier sign a contract for Softbyte to rent equipment for the months of October and November at the rate of $250 per month. Softbyte is to pay each month's rent at the start of the month. There is no effect on the accounting equation because the assets, liabilities, and owner's equity have not been changed by the signing of the contract. An accounting transaction has not occurred. At this point, Softbyte has not paid for anything, nor has it used the equipment, and therefore it has not incurred any expenses. **Illustration 1.25** shows the equation analysis for this transaction.

ILLUSTRATION 1.25 **Signed contract to rent equipment in October**

	Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	+	Revenues	−	Expenses	
	$9,350	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$4,700	−	$1,950	Old Balances
(10)																No entry
	$9,350	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000	+	$4,700	−	$1,950	New Balances
	$19,350								$19,350							

Note that the new balances are all identical to the old balances because nothing has changed.

Transaction (11): Withdrawal of Cash by Owner Andrew Leonid withdraws $1,300 in cash from the business for his personal use. This transaction results in an equal decrease in assets and owner's equity, as shown in **Illustration 1.26**.

ILLUSTRATION 1.26 Withdrawal of cash by owner

Basic Analysis	The asset Cash is decreased by $1,300, and the owner's equity account Drawings is increased by $1,300, which then decreases owner's equity, as follows:

Equation Analysis

	Assets							=	Liabilities	+	Owner's Equity								
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	−	A. Leonid, Drawings	+	Revenues	−	Expenses	
	$9,350	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000			+	$4,700	−	$1,950	Old Balances
(11)	−1,300												−$1,300					Drawings
	$8,050	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000	−	$1,300	+	$4,700	−	$1,950	New Balances
	$18,050								$18,050									

Note that both drawings and expenses reduce owner's equity, as shown in the accounting equation above. However, **owner's drawings are not expenses.** Expenses are incurred for the purpose of earning revenue and are reported in the income statement. Drawings do not generate revenue. They are a *disinvestment*; that is, the effect of an owner's cash withdrawal is the opposite of the effect of an owner's investment. Like owner's investments, drawings are not included in the determination of profit.

Summary of Transactions

Softbyte's transactions are summarized in **Illustration 1.27** to show their cumulative effect on the accounting equation. The transaction number and the specific effects of each transaction are indicated.

ILLUSTRATION 1.27 Tabular summary of Softbyte transactions

	Assets							=	Liabilities	+	Owner's Equity							
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	A. Leonid, Capital	−	A. Leonid, Drawings	+	Revenues	−	Expenses	
(1)	+$15,000										+$15,000							Initial Investment
(2)	−7,000						+$7,000											
(3)					+$1,600				+$1,600									
(4)	+1,200														+$1,200			Service Revenue
(5)									+250								−$ 250	Advertising Expense
(6)	+1,500		+$2,000												+3,500			Service Revenue
(7)	−600																−600	Rent Expense
	−900																−900	Salaries Expense
	−200																−200	Utilities Expense
(8)	−250								−250									
(9)	+600		−600															
(10)	No entry																	
(11)	−1,300												−$1,300					Drawings
	$ 8,050	+	$1,400	+	$1,600	+	$7,000	=	$1,600	+	$15,000	−	−$1,300	+	$4,700	−	$1,950	
	$18,050								$18,050									

The illustration demonstrates some significant facts:

1. Each transaction must be analyzed for its effects on:
   a. the three elements (assets, liabilities, and owner's equity) of the accounting equation, and
   b. specific accounts within each element.
2. The two sides of the equation must always be equal.

This section on transaction analysis does not show the formal method of recording transactions. We will start illustrating that in Chapter 2. But understanding how transactions change assets, liabilities, and owner's equity is fundamental to understanding accounting and also business in general.

ACTION PLAN

- Analyze the effects of each transaction on the accounting equation.
- Use appropriate account names for the account titles (not descriptions).
- Keep the accounting equation in balance.

DO IT! 1.5 | Tabular Analysis

Transactions for the month of August by Dawd & Co., a public accounting firm, are shown below. Make a table that shows the effects of these transactions on the accounting equation, like the tabular analysis shown in Illustration 1.27.

1. The owner, John Dawd, invested $25,000 of cash in the business.
2. Equipment was purchased on credit, $7,000.
3. Services were performed for customers for $8,000. Of this amount, $2,000 was received in cash and $6,000 is due on account.
4. Rent of $850 was paid for the month.
5. Customers paid $4,000 on account (see transaction 3).
6. The owner withdrew $1,000 of cash for personal use.

Solution

	Assets					=	Liabilities	+	Owner's Equity						
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	J. Dawd, Capital	−	J. Dawd, Drawings	+	Revenues	−	Expenses
1.	+$25,000								+$25,000						
2.					+$7,000		+$7,000								
3.	+2,000		+$6,000										+$8,000		
4.	−850														−$850
5.	+4,000		−4,000												
6.	−1,000										−$1,000				
	$29,150	+	$2,000	+	$7,000	=	$7,000	+	$25,000	−	$1,000	+	$8,000	−	$850
			$38,150								$38,150				

Related exercise material: **BE1.12** and **E1.12.**

1.6 Preparing Financial Statements

HELPFUL HINT

The income statement, statement of owner's equity, and cash flow statement all report information for a period of time. The balance sheet reports information at a point in time.

LEARNING OBJECTIVE 6

Prepare financial statements.

Once all transactions for the month have been recognized, financial statements can be prepared. You will recall that these include the balance sheet, income statement, statement of owner's equity, and cash flow statement (see **Helpful Hint**).

Illustration 1.28 shows Softbyte's statements prepared from the transaction analysis in Illustration 1.27 and how the statements are interrelated. It is important to note that, because

ILLUSTRATION 1.28
Financial statements and their interrelationships (see Helpful Hint)

SOFTBYTE
Income Statement
Month Ended September 30, 2028

Revenues		
Service revenue		$4,700
Expenses		
Advertising expense	$250	
Rent expense	600	
Salaries expense	900	
Utilities expense	200	
Total expenses		1,950
Profit for the month		$2,750

①

SOFTBYTE
Statement of Owner's Equity
Month Ended September 30, 2028

A. Leonid, capital, September 1, 2028		$ 0
Add: Investments	$15,000	
Profit for the month	2,750	17,750
		17,750
Less: Drawings		1,300
A. Leonid, capital, September 30, 2028		$16,450

②

SOFTBYTE
Balance Sheet
September 30, 2028

Assets	
Cash	$ 8,050
Accounts receivable	1,400
Supplies	1,600
Equipment	7,000
Total assets	$18,050
Liabilities and Owner's Equity	
Liabilities	
Accounts payable	$ 1,600
Owner's equity	
A. Leonid, capital	16,450
Total liabilities and owner's equity	$18,050

③

SOFTBYTE
Cash Flow Statement
Month Ended September 30, 2028

Operating activities		
Cash receipts from customers	$ 3,300	
Cash payments for operating expenses	(1,950)	
Net cash provided by operating activities		$ 1,350
Investing activities		
Purchase of equipment	(7,000)	
Net cash used by investing activities		(7,000)
Financing activities		
Investments by owner	15,000	
Drawings by owner	(1,300)	
Net cash provided by financing activities		13,700
Net increase in cash		8,050
Cash, September 1, 2028		0
Cash, September 30, 2028		$ 8,050

HELPFUL HINT
The heading of each statement identifies the company, the type of statement, and the specific date or period of time covered by the statement.

HELPFUL HINT
If a section has two or more amounts, a subtotal to the left may be included.

HELPFUL HINT
Note that the final sums are double-underlined.

HELPFUL HINT
The arrows in this illustration show the relationships between the four statements.

of the interrelationships of the financial statements, they are always prepared in the following order:

1. income statement,
2. statement of owner's equity,
3. balance sheet, and
4. cash flow statement.

The essential features of Softbyte's four financial statements, and their interrelationships, are described in the following sections.

Income Statement

The income statement is prepared from the data appearing in the revenue and expense columns of the tabular summary of Illustration 1.27.

- The statement's heading names the company and type of statement, and shows the time period covered by the statement.
  - For Softbyte, this appears as Month Ended September 30, 2028, which means the statement is for a one-month period—September 1 to 30, 2028.
- On the income statement, revenues of $4,700 appear first, followed by a list of the expenses totalling $1,950. Finally, profit of $2,750 is determined.
- The income statement is always prepared first in order to determine the amount of profit or loss to be used in the statement of owner's equity.

Statement of Owner's Equity

The statement of owner's equity is prepared from the data in the owner's equity columns, specifically the A. Leonid, Capital and A. Leonid, Drawings columns of the tabular summary of Illustration 1.27 and from the income statement.

- The statement's heading names the company and type of statement, and shows the time period covered by the statement.
  - Because the time period is the same as it is for the income statement, it is also dated Month Ended September 30, 2028.
- The beginning owner's equity amount is shown on the first line of the statement. In this example, it is a zero balance because it is Softbyte's first period of operations.
  - If monthly financial statements are again prepared for Softbyte on October 31, 2028, the beginning owner's equity amount will be $16,450, which is the ending balance on September 30, 2028.
  - For a company that is continuing its operations, the beginning balance is equal to the ending balance from the previous period.

What if Softbyte reported a loss in its first month? The loss would reduce owner's capital. Instead of adding profit for the month, the loss would be deducted in the same section as owner's drawings.

Balance Sheet

The balance sheet is prepared from the assets and liabilities columns of the tabular summary and the month-end data shown in the last line of Illustration 1.27, and from the statement of owner's equity. Owner's capital of $16,450 on September 30, 2028, in the statement of owner's equity is also reported on the balance sheet.

- The statement's heading names the company and type of statement and date. Recall that the balance sheet is a snapshot of assets, liabilities, and owner's equity at a point in time; therefore, the date only mentions the point in time.
  - For Softbyte, the date is September 30, 2028.

- Notice that the assets are listed at the top, followed by liabilities and owner's equity. This presentation is a common convention used in Canada but other orders of presentation are possible.
  - Regardless of the order of presentation, total assets must equal total liabilities and owner's equity.

Cash Flow Statement

Softbyte's cash flow statement, shown in Illustration 1.28, is for the same period of time as the income statement and the statement of owner's equity.

- The positive numbers indicate cash inflows or increases.
- Numbers in parentheses indicate cash outflows or decreases. At this time, you do not need to know how these amounts are determined.

In Chapter 17, we will look at the cash flow statement in detail. But you should note that Cash of $8,050 on the September 30, 2028, balance sheet is also reported at the bottom of the cash flow statement.

The order of preparation and interrelationships among the statements are shown in **Illustration 1.29**.

ILLUSTRATION 1.29 **Summary of financial statement order of preparation and interrelationships**

Financial Statement	Income Statement	Statement of Owner's Equity	Balance Sheet	Cash Flow Statement
Timeframe	Period of time	Period of time	Point in time	Period of time
Format	Revenue − Expenses Profit (loss) for the month (or quarter or year)	Beginning Owner's Capital + Investments +/− Profit (loss) − Drawings Ending Owner's Capital	Assets = Liabilities + Owner's Equity	+/− Operating cash flows +/− Investing cash flows +/− Financing cash flows Net incr./(decr.) in cash Beginning cash Ending cash

Understanding the Information in the Financial Statements

Along with a balance sheet, income statement, statement of owner's equity, and statement of cash flows, every set of financial statements will include explanatory notes and supporting schedules that are an essential part of the statements. For example, at the very least, a company will have to indicate if it is following IFRS or ASPE.

Appendix A contains the financial statements for Canada Goose Holdings Inc. for the year ended April 2, 2023. From these statements, we can make a few important observations:

- Canada Goose's transactions have been accumulated for the year ended April 2, 2023, and grouped together in categories. When similar transactions are grouped together, they are being reported in aggregate. By presenting recorded data in aggregate, the company makes its activities easier to understand and more meaningful, and it avoids revealing significant details to competitors.
- The financial statement amounts are normally rounded to the nearest dollar, thousand dollars, or million dollars, depending on the size of the company. Canada Goose rounds its numbers to the nearest million dollars. This is done to remove unnecessary detail and make the information easier for readers to understand.

- Public company financial statements are audited and include the auditor's report (page A-x). There is also a statement of management responsibility (not included in the Appendix).
- Canada Goose provides extensive explanatory notes and supporting schedules beginning on page A-x.

Public corporations issue their financial statements and supplementary materials in an **annual report**. The annual report is a document that includes useful non-financial information about the company, as well as financial information. Canada Goose's supplementary materials are not included in the Appendix but are accessible online. To access the information, go to Sedar+ (https://www.sedarplus.ca), click "Search Sedar +," type in "Canada Goose Holdings Inc." into the "Select profile(s) to search on" box, select "Canada Goose Holdings Inc." from the list that appears, scroll down and click the "Search" button. A list of all filings and documents appears, which can then be downloaded.

Non-financial information may include:

- management's discussion of the company's mission, goals, and objectives;
- the company's market position; and
- the people involved in the company.

Compare Canada Goose's financial statements with Softbyte's financial statements in Illustration 1.28. What similarities can you find?

ACTION PLAN

- **The following instructions apply to all the statements. A single underline symbolizes an equal (=) sign. A double underline signifies a final or total amount. Include a dollar sign on the first and last numbers in a column of numbers. Head each statement with the company name, title of the statement, and period of time (or point in time for the balance sheet).**
- **Prepare the income statement by locating the account balances for all revenue and expense accounts and listing them; revenues are listed first and then expenses. Complete the statement by calculating profit for the month (revenues minus expenses).**
- **Prepare the statement of owner's equity by locating the account balances for beginning capital and drawings. The statement lists the following: (1) Beginning capital (beginning of the time period); (2) Add:**

DO IT! 1.6 | Financial Statements

Listed below, in alphabetical order, are the accounts for Park Accounting Services. Prepare an income statement, statement of owner's equity, and balance sheet for the month ended January 31, 2028.

Accounts payable	$ 5,000	M. Park, capital, January 1, 2028	$10,350
Accounts receivable	2,500	M. Park, drawings	3,000
Advertising expense	500	Prepaid rent	1,300
Cash	8,200	Rent expense	850
Equipment	10,000	Service revenue	11,000

Solution

PARK ACCOUNTING SERVICES
Income Statement
Month Ended January 31, 2028

Revenues		
Service revenue		$11,000
Expenses		
Advertising expense	$500	
Rent expense	850	
Total expenses		1,350
Profit for the month		$ 9,650

PARK ACCOUNTING SERVICES
Statement of Owner's Equity
Month Ended January 31, 2028

M. Park, capital, January 1, 2028	$10,350
Add: Profit for the month	9,650
	20,000

Less: Drawings	3,000
M. Park, capital, January 31, 2028	$17,000

PARK ACCOUNTING SERVICES
Balance Sheet
January 31, 2028

Assets	
Cash	$ 8,200
Accounts receivable	2,500
Prepaid rent	1,300
Equipment	10,000
Total assets	$22,000
Liabilities and Owner's Equity	
Liabilities	
Accounts payable	$ 5,000
Total liabilities	5,000
Owner's equity	
M. Park, capital	17,000
Total liabilities and owner's equity	$22,000

Related exercise material: **BE1.16, BE1.17, BE1.18, E1.14, E1.15, E1.16,** and **E1.17.**

Profit for the month (from the income statement); (3) Deduct: Drawings. Complete the statement by calculating ending capital (end of the period).

- **Prepare the balance sheet by locating the account balances for all asset and liability accounts. List the assets first under the subheading "Assets," add balances, and label the total as Total Assets. List the liabilities second under the subheading "Liabilities and Owner's Equity," and then the ending balance in the capital account (from the statement of owner's equity). Add all liabilities and owner's equity amounts and label the total as Total Liabilities and Owner's Equity.**

Review and Practice

Comparing IFRS and ASPE

Key Differences	International Financial Reporting Standards (IFRS)	Accounting Standards for Private Enterprises (ASPE)
Accounting standards	Required for publicly accountable enterprises and optional for private enterprises	Private enterprises only
Level of accounting information required	Users require extensive detailed information	Users require less information
Equity reporting	Statement of changes in equity	• Proprietorships: Statement of owner's equity • Partnerships: Statement of partners' equity • Corporation: Statement of retained earnings

The **Demonstration Problem** is a final review before you work on the assignment material.
The Action Plan strategies give you tips about how to approach the problem.
The solution shows both the form and the content of complete answers.

Demonstration Problem

Adina Falk opened her own law office on July 1, 2028. During the first month of operations, the following transactions occurred:

1. Invested $15,000 in cash in the law practice.
2. Hired a legal assistant to work part-time for $1,500 per month.

3. Paid $1,800 for July rent on office space.
4. Purchased equipment on account, $3,000.
5. Provided legal services to clients for cash, $2,500.
6. Borrowed $7,000 cash from a bank on a note payable.
7. Provided legal services to a client on account, $4,000.
8. Collected $1,200 of the amount owed by a client on account (see transaction 7).
9. Paid monthly expenses: salaries, $1,500; telephone, $200; and utilities, $300.
10. Withdrew $2,000 cash for personal use.

Instructions

a. Prepare a tabular analysis of the transactions.

b. Prepare the income statement, statement of owner's equity, and balance sheet for Adina Falk, Barrister & Solicitor.

ACTION PLAN

- **Make sure that assets equal liabilities plus owner's equity in each transaction.**
- **Investments and revenues increase owner's equity. Withdrawals and expenses decrease owner's equity.**
- **Prepare the financial statements in the order listed.**
- **The income statement shows revenues and expenses for a period of time.**
- **Profit (or loss) is calculated on the income statement and carried forward to the statement of owner's equity.**
- **The statement of owner's equity shows the changes in owner's equity for the same period of time as the income statement.**
- **The owner's capital at the end of the period is carried forward from the statement of owner's equity to the balance sheet.**
- **The balance sheet reports assets, liabilities, and owner's equity at a specific date.**

Solution to Demonstration Problem

a.

	Assets				Liabilities		Owner's Equity			
Transaction	**Cash**	+ **Accounts Receivable**	+ **Equipment**	=	**Notes Payable**	+ **Accounts Payable**	+ **A. Falk, Capital**	− **A. Falk, Drawings**	+ **Revenues**	− **Expenses**
(1)	+$15,000						+$15,000			
(2) No Entry										
(3)	−1,800									−$1,800
(4)			+$3,000			+$3,000				
(5)	+2,500								+$2,500	
(6)	+7,000				+$7,000					
(7)		+$4,000							+4,000	
(8)	+1,200	−1,200								
(9)	−1,500									−1,500
	−200									−200
	−300									−300
(10)	−2,000							−$2,000		
	$19,900 +	$2,800 +	$3,000	=	$7,000 +	$3,000 +	$15,000 −	$2,000 +	$6,500 −	$3,800
		$25,700						$25,700		

b.

ADINA FALK, BARRISTER & SOLICITOR
Income Statement
Month Ended July 31, 2028

Revenue		
Service revenue		$6,500
Expenses		
Rent expense	$1,800	
Salaries expense	1,500	
Telephone expense	200	
Utilities expense	300	
Total expenses		3,800
Profit for the month		$2,700

ADINA FALK, BARRISTER & SOLICITOR
Statement of Owner's Equity
Month Ended July 31, 2028

A. Falk, capital, July 1, 2028		$ 0
Add: Investments	$15,000	
Profit for the month	2,700	17,700
		17,700
Less: Drawings		2,000
A. Falk, capital, July 31, 2028		$15,700

ADINA FALK, BARRISTER & SOLICITOR
Balance Sheet
July 31, 2028

Assets	
Cash	$19,900
Accounts receivable	2,800
Equipment	3,000
Total assets	$25,700
Liabilities and Owner's Equity	
Liabilities	
Notes payable	$ 7,000
Accounts payable	3,000
Total liabilities	10,000
Owner's equity	
A. Falk, capital	15,700
Total liabilities and owner's equity	$25,700

Summary of Learning Objectives

1 Identify the uses and users of accounting and the objective of financial reporting.

Accounting is the information system that identifies, records, and communicates the economic events of an organization to a wide variety of interested users. Good accounting is important to people both inside and outside the organization. Internal users, such as management, use accounting information to plan, control, and evaluate business operations. External users include investors and creditors, among others. Accounting data are used by investors (owners or potential owners) to decide whether to buy, hold, or sell their financial interests. Creditors (suppliers and bankers) evaluate the risks of granting credit or lending money based on the accounting information. The objective of financial reporting is to provide useful information to investors and creditors to make these decisions. Users need information about the business's ability to earn a profit and generate cash. For our economic system to function smoothly, reliable and ethical accounting and financial reporting are critical.

2 Compare the different forms of business organization.

The most common examples of business organization are proprietorships, partnerships, and corporations. Proprietorships and partnerships are not separate legal entities but are separate entities for accounting purposes; income taxes are paid by the owners and owners have unlimited liability. Corporations are separate legal entities as well as separate entities for accounting purposes; income taxes are paid by the corporation and owners of the corporation have limited liability.

3 Explain the building blocks of accounting: ethics and the concepts included in the conceptual framework.

Generally accepted accounting principles are a common set of guidelines that are used to prepare and report accounting information. The conceptual framework outlines some of the body of theory used by accountants to fulfill their goal of providing useful accounting information to users. Ethical behaviour is fundamental to fulfilling the objective of financial accounting. The reporting entity concept requires the business activities of each reporting entity to be kept separate from the activities of its owner and other economic entities. The going concern assumption presumes that a business will continue operations for enough time to use its assets for their intended purpose and to fulfill its commitments. The periodicity concept requires businesses to divide up economic activities into distinct periods of time. Qualitative characteristics include fundamental and enhancing characteristics that help to ensure accounting information is useful.

Only events that cause changes in the business's economic resources or changes to the claims on those resources are recorded. Recognition is the process of recording transactions and measurement is the process of determining the amount that should be recognized. The historical cost concept states that economic resources should be recorded at their historical (original) cost. Fair value may be a more appropriate measure for certain types of resources. Generally, fair value is the amount the resource could be sold for in the market. The monetary unit concept requires that only transactions that can be expressed as an amount of money be included in the accounting records, and it assumes that the monetary unit is stable.

The revenue recognition principle requires companies to recognize revenue when a performance obligation(s) is satisfied. The matching concept requires that costs be recognized as expenses in the same period as revenue is recognized when there is a direct association between the cost incurred and revenue recognized.

In Canada, there are two sets of standards for profit-oriented businesses. Publicly accountable enterprises must follow International Financial Reporting Standards (IFRS) and private enterprises have the choice of following IFRS or Accounting Standards for Private Enterprises (ASPE).

4 Describe the elements of the financial statements and explain the accounting equation.

Assets, liabilities, and owner's equity are reported on the balance sheet. Assets are present economic resources controlled by the business as a result of past events and have the potential to produce economic benefits. Liabilities are present obligations of a business to transfer an economic resource as a result of past events. Owner's equity is the owner's claim on the company's assets and is equal to total assets minus total liabilities. The balance sheet is based on the accounting equation: Assets = Liabilities + Owner's equity.

The income statement reports the profit or loss for a specified period of time. Profit is equal to revenues minus expenses. Revenues are the increases in assets, or decreases in liabilities, that result from business activities that are undertaken to earn profit. Expenses are the cost of assets consumed or services used in a company's business activities. They are decreases in assets or increases in liabilities, excluding withdrawals made by the owners, and result in a decrease to owner's equity.

The statement of owner's equity summarizes the changes in owner's equity during the period. Owner's equity is increased by investments by the owner and profits. It is decreased by drawings and losses. Investments are contributions of cash or other assets by owners. Drawings are withdrawals of cash or other assets from the business for the owner's personal use. Owner's equity in a partnership is referred to as partners' equity, and in a corporation it is called shareholders' equity.

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

5 Analyze the effects of business transactions on the accounting equation.

Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (1) decrease in another asset, (2) increase in a liability, and/or (3) increase in owner's equity.

6 Prepare financial statements.

The income statement is prepared first. Expenses are deducted from revenues to calculate the profit or loss for a specific period of time. Then the statement of owner's equity is prepared using the profit or loss reported in the income statement. The profit is added to (losses are deducted from) the owner's equity at the beginning of the period. Drawings are then deducted to calculate owner's equity at the end of the period. A balance sheet reports the assets, liabilities, and owner's equity of a business as at the end of the accounting period. The owner's equity at the end of the period, as calculated in the statement of owner's equity, is reported on the balance sheet in the owner's equity section.

Glossary

Account An individual accounting record of increases and decreases in a specific asset, liability, or owner's equity item. (p. 1-19)

Accounting The information system that identifies, records, and communicates the economic events of an organization to a wide variety of interested users. (p. 1-3)

Accounting equation Assets = Liabilities + Owner's equity. (p. 1-21)

Accounting information system The system of collecting and processing transaction data and communicating financial information to decision-makers. (p. 1-25)

Accounting Standards for Private Enterprises (ASPE) A set of standards developed by the Accounting Standards Board (AcSB) that may be used for financial reporting by private enterprises in Canada. (p. 1-18)

Accounting transaction An economic event that results in a measurable change in a company's assets, liabilities, or owner's equity. (p. 1-15)

Accounts payable A liability created by buying services or products on credit. It is an obligation to pay cash to a supplier in the future. (p. 1-20)

Accounts receivable An asset created when selling services or products to customers who promise to pay cash in the future. (p. 1-20)

Annual report Information that a company provides each year to its shareholders and other interested parties about its operations and financial position. It includes the financial statements and auditors' report, in addition to information and reports by management. (p. 1-36)

Assets Economic resources controlled by a business as a result of past events that have the potential to produce economic benefit. (p. 1-20)

Balance sheet A financial statement that reports the assets, liabilities, and owner's equity at a specific date. (p. 1-20)

Cash flow statement A financial statement that provides information about the cash receipts and cash payments for a specific period of time. (p. 1-23)

Comparability An enhancing qualitative characteristic that accounting information has if it can be compared with the accounting information of other companies because the companies all use the same accounting principles. (p. 1-14)

Conceptual framework of accounting A coherent system that guides the development and application of accounting principles. (p. 1-13)

Consistency The use of the same accounting policies from year to year. Consistency is part of the comparability enhancing qualitative characteristic of accounting information. (p. 1-14)

Corporation A business organized as a separate legal entity under corporation law, with ownership divided into transferable shares. (p. 1-10)

Creditors All of the persons or entities that a company owes money to. (p. 1-6)

Data analytics The use of software and statistics to draw inferences from data. (p. 1-7)

Drawings Withdrawals of cash or other assets from an unincorporated business for the owner's personal use. Drawings result in a decrease in an asset and a decrease in owner's equity. (p. 1-23)

Ethics The standards of conduct by which actions are judged as right or wrong, honest or dishonest, fair or not fair. (p. 1-12)

Expenses The cost of assets consumed or services used in a company's ordinary business activities. Expenses are decreases in assets or increases in liabilities, excluding withdrawals made by the owners, and result in a decrease to owner's equity. (p. 1-22)

Fair value The price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. (p. 1-16)

Faithful representation A fundamental qualitative characteristic of accounting information meaning information accurately depicts what really happened. (p. 1-14)

Generally accepted accounting principles (GAAP) An accepted set of accounting standards that includes broad principles, procedures, concepts, and standards. GAAP guide the reporting of economic events. (p. 1-12)

Going concern assumption An assumption that a company will continue to operate in the foreseeable future. (p. 1-17)

Historical cost An accounting concept that states that assets should be recorded at their historical (original) cost. (p. 1-15)

Income statement A financial statement that presents the revenues and expenses and resulting profit (or loss) for a specific period of time. (p. 1-21)

International Financial Reporting Standards (IFRS) A set of global standards developed by the International Accounting Standards Board (IASB) used for financial reporting, mostly by publicly accountable enterprises but also by certain private entities. (p. 1-17)

Investments by the owner The increase in owner's equity that results from assets put into the business by the owner. (p. 1-23)

Investors Owners or potential owners of a business. (p. 1-6)

Liabilities Present obligations, arising from past events, the settlement of which will include an outflow of economic resources. (p. 1-20)

Limited liability The legal principle that the owners' liability for the debts of the business is limited to the amount they invested in the business. (p. 1-10)

Loss The amount by which expenses are greater than revenues. A loss decreases owner's equity. (p. 1-21)

Matching concept The accounting concept that prescribes when a cost incurred by a business should be recognized as an expense. The general concept states cost should be recognized as an expense in the same period as the revenue is recognized. (p. 1-15)

Measurement The process of determining the amount that should be recognized. (p. 1-15)

Monetary unit concept A concept that states that only transaction data that can be expressed as an amount of money may be included in the accounting records. It is also assumed that the monetary unit is stable. (p. 1-16)

Neutral The characteristic of accounting information when it is not biased toward one position or another. Neutrality is part of the faithful representation fundamental qualitative characteristic of accounting information. (p. 1-14)

Note payable A liability supported by a written promise to pay a specific amount, at a specific time, in the future. (p. 1-20)

Objective of financial reporting The goal of providing useful information to investors and creditors (external users) to make decisions about providing resources to a business. (p. 1-8)

Owner's equity The owner's claim on the assets of the company, which is equal to total assets minus total liabilities. (p. 1-20)

Partnership An association of two or more persons to carry on as co-owners of a business for profit. (p. 1-10)

Performance obligation The obligation of a business to perform a service or deliver goods to a customer. (p. 1-15)

Periodicity concept The accounting concept that guides organizations in dividing up their economic activities into distinct time periods. The most common time periods are months, quarters, and years. (p. 1-17)

Prepaid expense The asset created when a business pays cash for costs incurred in advance of being used or consumed. (p. 1-20)

Profit The amount by which revenues are greater than expenses. Profit increases owner's equity. (p. 1-21)

Proprietorship A small business owned by one person. (p. 1-9)

Publicly accountable enterprises Publicly traded companies, as well as securities brokers and dealers, banks, and credit unions, whose role is to hold assets for the public as part of their primary business. (p. 1-18)

Recognition The process of recording a transaction in the accounting records. (p. 1-15)

Relevance A fundamental qualitative characteristic that accounting information has if it makes a difference in a decision. The information should have predictive and feedback value and be material. (p. 1-14)

Reporting entity concept The concept that the accounting for a reporting entity's activities should be kept separate and distinct from the accounting for the activities of its owner and all other reporting entities. (p. 1-16)

Revenue recognition principle The principle that guides the recognition of revenue when a performance obligation is satisfied, not when cash is exchanged. (p. 1-15)

Revenues The result of business activities that are undertaken to earn profit, such as performing services, selling merchandise inventory, renting property, and lending money. Revenues result in an increase in assets, or decrease in liabilities, and an increase in owner's equity. (p. 1-22)

Statement of owner's equity A financial statement that summarizes the changes in owner's equity for a specific period of time. (p. 1-22)

Timeliness An enhancing qualitative characteristic that accounting information has if information is made available to decision-makers before it loses its capacity to influence decisions. (p. 1-14)

Understandability An enhancing qualitative characteristic that requires information to be presented in a clear and concise fashion, so that reasonably informed users of that information can interpret it and comprehend its meaning. (p. 1-14)

Unearned revenue The liability created when a customer pays in advance of being provided with a service or product. (p. 1-20)

Unlimited liability The principle that the owners of a business are personally liable (responsible) for all debts of the business. (p. 1-9)

Verifiability An enhancing qualitative characteristic that information has if independent observers, using the same methods, obtain similar results. (p. 1-14)

Self-Study Questions

Answers are at the end of the chapter.

1. **(LO 1) K** The main objective of the financial statements is to provide useful information to:
   - **a.** government in deciding if the company is respecting tax laws.
   - **b.** increase the value of the company.
   - **c.** investors and creditors that is useful when they are making decisions about the business.
   - **d.** management that is useful when they are making decisions about the business.

2. **(LO 1) K** Which of the following statements about users of accounting information is incorrect?
   - **a.** Management is an internal user.
   - **b.** Taxing authorities are external users.
   - **c.** Present creditors are external users.
   - **d.** Regulatory authorities are internal users.

3. **(LO 2) K** The three types of business organization forms are:
   - **a.** proprietorships, small businesses, and partnerships.
   - **b.** proprietorships, partnerships, and corporations.
   - **c.** proprietorships, partnerships, and large businesses.
   - **d.** financial, manufacturing, and service companies.

4. **(LO 3) K** Which of the following statements about International Financial Reporting Standards (IFRS) is correct?
   - **a.** All Canadian enterprises must follow IFRS.
   - **b.** Under IFRS, companies that operate in more than one country must produce separate financial statements for each of those countries.
   - **c.** All Canadian publicly accountable enterprises must use IFRS.
   - **d.** Canadian private enterprises are not allowed to use IFRS. They must use ASPE.

5. **(LO 3) C** Which of the following statements about the going concern assumption is correct?
   - **a.** The going concern assumption is the assumption that the reporting entity will continue to operate in the future.
   - **b.** Under the going concern assumption, all of the business's assets must be reported at their fair value.
   - **c.** The financial statements must report whether or not a company is a going concern.
   - **d.** The going concern assumption is not followed under ASPE.

6. **(LO 3) K** Which of the following best describes when an event should be recognized in the accounting records?
   - **a.** An event should be recognized in the accounting records if there is a change in assets, liabilities, or owner's equity and the change can be measured in monetary terms.
   - **b.** An event should be recognized in the accounting records if it involves an interaction between the company and another external entity.
   - **c.** Where there is uncertainty about a future event occurring or not, it should not be recognized.
   - **d.** Accountants use tradition to determine which events to recognize.

7. **(LO 4) AP** As at December 31, its year end, Bruske Company has assets of $12,500; revenues of $10,000; expenses of $5,500; beginning owner's capital of $8,000; and drawings of $1,500. What are the liabilities for Bruske Company as at December 31?
   - **a.** $1,500
   - **b.** $2,500
   - **c.** $500
   - **d.** $3,500

8. **(LO 5) AP** Performing services on account will have the following effects on the elements of the basic accounting equation:
   - **a.** increase assets and decrease owner's equity.
   - **b.** increase assets and increase owner's equity.
   - **c.** increase assets and increase liabilities.
   - **d.** increase liabilities and increase owner's equity.

9. **(LO 5) AP** Bing Company pays $700 for store rent for the month. The basic analysis of this transaction on the accounting records is:
   - **a.** the asset Cash is increased by $700 and the expense Rent Expense is increased by $700.
   - **b.** the asset Cash is decreased by $700 and the expense Rent Expense is increased by $700.
   - **c.** the asset Cash is decreased by $700 and the liability Rent Payable is increased by $700.
   - **d.** the asset Cash is increased by $700 and the liability Rent Payable is decreased by $700.

10. **(LO 6) C** Which of the following statements is true?
    - **a.** An income statement presents the revenues, expenses, and changes in owner's equity for a specific period of time.
    - **b.** The income statement shows information as at a specific point in time; the balance sheet shows information for a specified time period.
    - **c.** The statement of cash flows summarizes cash inflows (receipts) and outflows (payments) as at a specific point in time.
    - **d.** The income statement shows information for a specified time period; the balance sheet shows information as at a specific point in time.

Questions

1. **(LO 1) C** "Accounting is ingrained in our society and it is vital to our economic system." Do you agree? Explain.
2. **(LO 1) C** Distinguish between internal and external users of accounting information. Include in your answer what kinds of questions both internal and external users might want answered.
3. **(LO 1) K** What is the main objective of financial reporting?
4. **(LO 2) C** Explain the differences between the following forms of business organization: (a) proprietorship, (b) partnership, and (c) corporation.
5. **(LO 3) C** Why is ethics important to the accounting profession? To statement users?
6. **(LO 3) K** Why are there two sets of accounting standards for profit-oriented enterprises in Canada?
7. **(LO 3) K** What is the reporting entity concept?
8. **(LO 3) C** Describe the fundamental qualitative characteristics of relevance and faithful representation.
9. **(LO 3) C** What is the difference between historical cost and fair value measurements?
10. **(LO 3) C** What criteria must be fulfilled for an event to be recognized in the accounting records? Give two examples of events that would not be recognized.
11. **(LO 3) C** Explain the monetary unit concept.
12. **(LO 4) K** What is the accounting equation and what is its purpose?
13. **(LO 4) K** (a) Define assets, liabilities, and owner's equity. (b) What causes an increase or decrease in owner's equity?
14. **(LO 4) K** What is the difference between Accounts Payable and Accounts Receivable?
15. **(LO 4) C** How is profit or loss determined?
16. **(LO 4) K** List the types of accounts that are reported on (a) the balance sheet and (b) the income statement.
17. **(LO 5) C** Can a business have a transaction in which only the left (assets) side of the accounting equation is affected? If yes, give an example.
18. **(LO 5) AP** Alessandro Bega withdrew $8,000 from his business, Bega Pharmacy, which is organized as a proprietorship. Bega's accountant recorded this withdrawal as an increase in an expense and a decrease in cash. Is this treatment correct? Why or why not?
19. **(LO 6) K** In what order should the financial statements be prepared? Why?
20. **(LO 6) C** James is puzzled as he reads **Canada Goose Holdings Inc.**'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 he is now wondering what happened to the rest of the money. Respond to James's concern.

When the financial results of **real companies** are used in the end-of-chapter material, the company's name is shown in red.

Brief Exercises

BE1.1 (LO 1) K A list of decisions made by different users of accounting information follows:

Identify users of accounting information.

1. Decide whether the company pays fair salaries.
2. Decide whether the company can pay its obligations.
3. Decide whether a marketing proposal will be cost-effective.
4. Decide whether the company's profit will permit an increase in drawings.
5. Decide how the company should finance its operations.

The different users are identified in the table that follows. (a) Insert the number (1–5) of the kind of decision described above that each user would likely make. (b) Indicate whether the user is internal or external.

User	(a) Kind of Decision	(b) Internal or External User
Owner		
Marketing manager		
Creditor		
Chief financial officer		
Labour union		

BE1.2 (LO 2) C Match each of the following forms of business organization with the correct set of characteristics: proprietorship (PP), partnership (P), or corporation (C).

Identify forms of business organization.

a. ________ Shared control; combined skills and resources
b. ________ Easier to transfer ownership and raise funds; no personal liability; entity pays income tax
c. ________ Simple to set up; owner pays income tax

Discuss ethical issues.

BE1.3 (LO 3) AN Describe an ethical dilemma that each of the following individuals might encounter:

a. A student in an introductory accounting course
b. A production supervisor
c. A banker

Identify application of concepts.

BE1.4 (LO 3) C Indicate whether each of the following statements is true or false by placing a T or an F in the blank at the start of each statement.

a. _______ Relevance is an enhancing qualitative characteristic.
b. _______ Timeliness is enhanced when a business uses the same accounting methods from year to year.
c. _______ Understandability is an enhancing qualitative characteristic that requires accounting information to be clear and concise.
d. _______ Information is verifiable if two independent people, using similar methods, achieve similar results.
e. _______ Information is neutral when it is unbiased.

Identify application of IFRS and ASPE.

BE1.5 (LO 3) C Indicate whether each of the following statements is true or false by placing a T or an F in the blank at the start of each statement.

a. _______ Canadian publicly accountable enterprises have the choice to report under IFRS or ASPE.
b. _______ All private enterprises must follow ASPE.
c. _______ Companies are required to include a note in their financial statements stating if they are using IFRS or ASPE.
d. _______ Using IFRS may help Canadian public companies attract investors from around the globe.

Identify GAAP concepts.

BE1.6 (LO 3) C Match each of the following terms with the best description below:

1. Historical cost
2. Revenue recognition
3. Going concern assumption
4. Reporting entity concept
5. Monetary unit concept

a. _______ Transactions are recorded in terms of units of money.
b. _______ Transactions are recorded based on the actual amount received or paid.
c. _______ Indicates that personal and business record keeping should be kept separate.
d. _______ Performance obligation has been satisfied.
e. _______ Businesses are expected to continue operating indefinitely.

Identify the elements of the financial statements.

BE1.7 (LO 4) C Match the following elements with the best description below and indicate if the element is reported on the balance sheet (BS) or income statement (IS).

1. Assets
2. Liabilities
3. Owner's equity
4. Revenues
5. Expenses
6. Profit

Description	Element	Balance Sheet or Income Statement
a. The increase in assets, or decrease in liabilities, resulting from business activities carried out to earn profit.		
b. Resources controlled by a business that have the potential to produce economic benefits.		
c. The owner's claim on the residual assets of the company.		
d. Present obligations that are expected to result in an outflow of economic resources as a result of a past transaction.		
e. The cost of resources consumed or services used in the company's business activities.		

BE1.8 **(LO 4) AP** Presented below is the accounting equation. Determine the missing amounts:

Solve accounting equation.

Assets	=	Liabilities	+	Owner's Equity
$75,000		$24,000		(a)
(b)		$150,000		$91,000
$89,000		(c)		$52,000

BE1.9 **(LO 4) AP** Use the accounting equation to answer each of the following questions:

Solve accounting equation.

a. The liabilities of Weber Company are $120,000 and the owner's equity is $232,000. What is the amount of Weber Company's total assets?

b. The total assets of King Company are $190,000 and its owner's equity is $91,000. What is the amount of its total liabilities?

c. The total assets of Smith Company are $800,000 and its liabilities are equal to one-half of its total assets. What is the amount of Smith Company's owner's equity?

BE1.10 **(LO 4) AP** **Video** Butler Company is owned by Rachel Butler. The company had total assets of $850,000 and total liabilities of $550,000 at the beginning of the year. Answer each of the following independent questions:

Solve accounting equation.

Solution Walkthrough Videos walk students through the approach and solution to selected questions.

a. During the year, total assets increased by $130,000 and total liabilities decreased by $80,000. What is the amount of owner's equity at the end of the year?

b. Total liabilities decreased by $95,000 during the year. The company incurred a loss of $40,000. R. Butler made an additional investment of $100,000 and made no withdrawals. What is the amount of total assets at the end of the year?

c. Total assets increased by $45,000 and total liabilities decreased by $50,000. There were no additional owner's investments, and R. Butler withdrew $40,000. What is the amount of profit or loss for the year?

BE1.11 **(LO 4) K** Indicate whether each of the following accounts is an asset (A), liability (L), or part of owner's equity (OE).

Identify assets, liabilities, and owner's equity.

_______ 1. Accounts receivable

_______ 2. Salaries payable

_______ 3. Equipment

_______ 4. Supplies

_______ 5. Owner's capital

_______ 6. Notes payable

BE1.12 **(LO 5) AP** Presented below are nine business transactions. Indicate whether the transactions increased (+), decreased (−), or had no effect (NE) on each element of the accounting equation.

Determine effects of transactions on accounting equation.

a. Purchased $250 of supplies on account.

b. Performed $500 of services on account.

c. Paid $300 of operating expenses.

d. Paid $250 cash on account for the supplies purchased in item (a) above.

e. Invested $1,000 cash in the business.

f. Owner withdrew $400 cash.

g. Hired an employee to start working the following month.

h. Received $500 from a customer who had been billed previously in item (b) above.

i. Purchased $450 of equipment in exchange for a note payable.

Use the following format, in which the first one has been done for you as an example:

			Owner's Equity			
Transaction	**Assets**	**Liabilities**	**Capital**	**Drawings**	**Revenues**	**Expenses**
a	+$250	+$250	NE	NE	NE	NE

BE1.13 **(LO 5) AP** Match the following basic transaction analysis with the best description of the economic event.

Match basic transaction analysis with transaction description.

1. Cash is increased by $9,000 and the owner's equity account M. Vijayakumar, Capital is increased by $9,000.

2. Cash is decreased by $6,000 and the asset account Prepaid Rent is increased.

3. Supplies is increased by $1,000 and the liability account Accounts Payable is increased by $1,000.

4. Accounts Receivable is increased by $900 and the revenue account Service Revenue is increased by $900.

Description	Transaction Analysis
a. Cash paid in advance for rent.	_______
b. Owner invests cash in the business.	_______
c. Supplies are purchased on account.	_______
d. Company provides service on account.	_______

Determine effects of transactions on owner's equity.

BE1.14 (LO 4, 5) AP Classify each of the following as owner's investments (I), drawings (D), revenue (R), expenses (E), or as having no effect on owner's equity (NE):

a. _______ Advertising expense
b. _______ Commission fees earned
c. _______ Cash received from the company's owner
d. _______ Amounts paid to employees
e. _______ Services performed on account
f. _______ Utilities incurred
g. _______ Cash distributed to company owner

Determine missing amounts in owner's equity.

BE1.15 (LO 4, 6) AP Video Presented below is information from the statements of owner's equity for Kerkan Consulting for the first three years of operation. Determine the missing amounts:

	2026	2027	2028
J. Kerkan, capital, January 1	$ 0	$68,000	$ (c)
Investment in the year	50,000	0	20,000
Profit (loss) for the year	25,000	(b)	17,000
Drawings in the year	(a)	33,000	12,000
J. Kerkan, capital, December 31	68,000	65,000	(d)

Prepare an income statement.

BE1.16 (LO 6) AP Prairie Company is owned and operated by Natasha Woods. In alphabetical order below are the financial statement accounts for Prairie Company. Using the appropriate accounts, prepare an income statement for the month ended October 31, 2028.

Accounts payable	$90,000	N. Woods, capital, October 1, 2028	$36,000
Accounts receivable	77,500	N. Woods, drawings	6,000
Advertising expense	3,600	Rent expense	2,600
Cash	59,300	Service revenue	23,000

Prepare a statement of owner's equity.

BE1.17 (LO 6) AP Refer to the data in BE1.16. Using these data and the information from Prairie's income statement, prepare a statement of owner's equity.

Prepare a balance sheet.

BE1.18 (LO 6) AP Refer to the data in BE1.16. Using these data and the information from Prairie's statement of owner's equity prepared in BE1.17, prepare a balance sheet for Prairie Company.

Exercises

Identify users of accounting information.

E1.1 (LO 1) C 1. The following are users of financial information:

_______ Customers	_______ Store manager
_______ Canada Revenue Agency	_______ Supplier
_______ Labour unions	_______ Chief Financial Officer
_______ Marketing manager	_______ Loan officer

2. The following questions could be asked by an internal user or an external user.

_______ Can the company afford to give our members a pay raise?
_______ How does the company's profitability compare with other companies in the industry?
_______ Do we need to borrow money in the near future?
_______ What does it cost to manufacture each unit produced?
_______ Has the company paid all income tax amounts owing?
_______ Which product should we emphasize?

Instructions

a. In part 1, identify the users as being either external users (E) or internal users (I).

b. In part 2, identify each of the questions as being more likely asked by an internal user (I) or an external user (E).

E1.2 (LO 1) C lululemon athletica inc., a public company, is known around the world for its clothing and accessories. It has more than 400 stores in 17 countries.

Identify users and uses of accounting information.

Instructions

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

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

E1.3 (LO 2, 3) C Video Listed below are several statements regarding different forms of business organization.

Relate concepts to forms of business organization.

Instructions

For each statement, indicate if that statement is true or false for each of the forms of business organization by placing a T or an F in each column.

	Proprietorship	Partnership	Publicly Traded Corporation
a. Owners have limited liability.	______	______	______
b. Records of the business are combined with the personal records of the owner or owners.	______	______	______
c. Required to follow IFRS.	______	______	______
d. Pays income taxes on its profits.	______	______	______
e. Owners are called "shareholders."	______	______	______
f. Will have more than one owner.	______	______	______
g. Has a limited life.	______	______	______
h. Has a separate legal existence from its owners.	______	______	______

E1.4 (LO 3) C Below is a list of accounting concepts:

Match accounting concepts with descriptions.

1. Relevance
2. Faithful representation
3. Comparability
4. Verifiability
5. Neutrality
6. Understandability

Instructions

Match each concept with the best description that follows:

a. ______ An economic event is reported so it represents what actually happened.

b. ______ Users find the information in the financial statements helps them to make decisions.

c. ______ The accounting information shows the profit of a business without consideration of what the owner may want to report.

d. ______ Financial statements make sense to business people.

e. ______ Henry is able to confirm the information presented in the financial statements.

f. ______ Très Chic Boutique uses the same accounting methods as other similar boutiques.

E1.5 (LO 1, 3, 5) K Here are some terms from the chapter:

Match words with descriptions.

1. Accounts payable
2. Expenses
3. Creditor
4. International Financial Reporting Standards (IFRS)
5. Prepaid expense
6. Profit
7. Assets
8. Corporation
9. Unearned revenue
10. Generally accepted accounting principles (GAAP)
11. Accounts receivable
12. Owner's equity

Instructions

Match each term with the best description that follows:

a. ________ A company that raises money by issuing shares

b. ________ An accepted set of accounting standards that includes broad principles, procedures, and concepts

c. ________ Obligations to suppliers of goods

d. ________ Amounts due from customers

e. ________ Owner's claims against the company's residual resources

f. ________ Payment of cash for costs incurred in advance of being used

g. ________ A party that a company owes money to

h. ________ Resources owned by a business that have the potential to provide economic benefit

i. ________ The set of accounting standards that all publicly traded enterprises in Canada must follow

j. ________ Results when revenues exceed expenses

k. ________ The cost of assets consumed or services used in a company's ordinary business activities

l. ________ A liability arising when a customer pays in advance of receiving service

Determine missing amounts.

E1.6 (LO 4) AP Below is a partially completed income statement and statement of owner's equity for Gary Dickson Engineering Company:

Consulting revenue		$18,000
Expenses		
Advertising expense	$ 400	
Rent expense	(a)	
Utilities expense	900	
Salaries expense	3,500	6,800
Profit (loss)		$ (b)
G. Dickson, capital, August 1		$ 5,000
Add: Investment	(e)	
Profit	(c)	21,200
		26,200
Less: Drawings		(d)
G. Dickson, capital, July 31		$21,700

Instructions

Fill in the missing amounts.

Calculate profit (or loss).

E1.7 (LO 4) AP **Video** Shane Cooke began a business, Cooke Company, on January 1, 2028, with an investment of $100,000. The company had the following assets and liabilities on the dates indicated:

December 31	Total Assets	Total Liabilities
2028	$370,000	$210,000
2029	440,000	290,000
2030	525,000	355,000

Instructions

Use the accounting equation and the change in owner's equity during the year to calculate the profit (or loss) for:

a. 2028, assuming Shane Cooke's drawings were $50,000 for the year.

b. 2029, assuming Shane Cooke made an additional investment of $40,000 and had no drawings in 2029.

c. 2030, assuming Shane Cooke made an additional investment of $10,000 and his drawings were $60,000 for the year.

Classify accounts.

E1.8 (LO 4) C Below are some accounts found in the financial statements of Petra Zizler, Orthodontist.

	(a)	(b)
1. Accounts payable	L	BS
2. Accounts receivable	________	________
3. Cash	________	________

	(a)	(b)
4. Equipment	________	________
5. Interest payable	________	________
6. Interest revenue	________	________
7. Interest expense	________	________
8. Investment by the owner	________	________
9. Service revenue	________	________
10. Prepaid rent	________	________
11. P. Zizler, capital (opening balance)	________	________
12. P. Zizler, drawings	________	________
13. Salaries expense	________	________
14. Supplies	________	________
15. Supplies expense	________	________
16. Unearned revenue	________	________

Instructions

Indicate:

a. whether each of the above accounts is an asset (A), liability (L), or part of owner's equity (OE); and

b. which financial statement—income statement (IS), statement of owner's equity (OE), or balance sheet (BS)—it would be reported on. The first one has been done for you as an example.

E1.9 (LO 3, 5, 6) C James Company, a proprietorship, had the following selected business transactions during the year:

Identify GAAP.

1. Land with a cost of $415,000 was recorded at its fair value of $465,000.
2. A lease agreement to rent equipment from an equipment supplier starting next year was signed. The rent is $500 per month and the lease is for two years. Payments are due at the start of each month. Nothing was recorded in James Company's accounting records when the lease was signed.
3. James paid the rent for an apartment for the owner's personal use and charged it to Rent Expense.
4. James prepaid for a one-year insurance policy for $1,200. The amount was charged to Insurance Expense.
5. James included a note in its financial statements stating the company is a going concern.
6. James included a note in its financial statements stating the company is following ASPE.

Instructions

a. In each situation, identify whether the accounting treatment is correct or not, and why.

b. If it is incorrect, state what should have been done.

E1.10 (LO 3, 5) C Video The following is a list of independent events:

Determine events to be recognized.

1. A company pays $10,000 cash to purchase equipment at a bankruptcy sale. The equipment's fair value is $15,000.
2. A Canadian company purchases equipment from a company in the United States and pays US$5,000 cash. It cost the company $6,900 Canadian to purchase the U.S. dollars from its bank.
3. A company provides $4,000 of services to a customer on account.
4. A company hires a new chief executive officer, who will bring significant economic benefit to the company. The company agrees to pay the new executive officer $500,000 per year.
5. A company signs a contract to provide $10,000 of services to a customer. The customer pays the company $4,000 cash at the time the contract is signed. The performance obligation required by the company has not been completed.

Instructions

a. Should the transaction be recorded in the accounting records? Explain why or why not.

b. If the transaction should be recorded, indicate the amount. Explain.

E1.11 (LO 5) C A list of effects on the accounting equation follows:

Give examples of transactions.

1. Increases an asset and increases a liability.
2. Increases an asset and increases owner's equity.

3. Decreases an asset and decreases a liability.
4. Decreases owner's equity and decreases an asset.
5. Increases a liability and decreases owner's equity.
6. Increases one asset and decreases another asset.

Instructions

For each effect, give an example of a transaction that would cause it.

Analyze effects of transactions for existing company.

E1.12 **(LO 5) AP** **Video** At the beginning of March, Brister Software Company had Cash of $12,000, Accounts Receivable of $18,000, Accounts Payable of $4,000, and G. Brister, Capital of $26,000. During the month of March, the following transactions occurred:

1. Purchased equipment for $23,000 from Digital Equipment. Paid $3,000 cash and signed a note payable for the balance.
2. Received $12,000 from customers for contracts billed in February.
3. Paid $3,000 for March rent of office space.
4. Paid $2,500 of the amounts owed to suppliers at the beginning of March.
5. Provided software services to Kwon Construction Company for $7,000 cash.
6. Paid BC Hydro $1,000 for energy used in March.
7. G. Brister withdrew $5,000 cash from the business.
8. Paid Digital Equipment $2,100 on account of the note payable issued for the equipment purchased in transaction 1. Of this, $100 was for interest expense.
9. Hired an employee to start working in April.
10. Incurred advertising expense on account for March, $1,500.

Instructions

Prepare a tabular analysis of the above transactions, as shown in Illustration 1.27 in the text. The first row should contain the amounts the company had at the beginning of March.

Analyze transactions. Calculate profit and increase in owner's equity.

E1.13 **(LO 4, 5) AP** **Video** A tabular summary of the transactions for Star & Co., an accounting firm, for its first month of operations, July 2028, follows:

	Cash	+	Accounts Receivable	+	Prepaid Insurance	+	Equipment	=	Accounts Payable	+	B. Star, Capital	−	B. Star, Drawings	+	Revenues	−	Expenses
1	$18,000						$6,000				$24,000						
2	−4,000						8,000		$ 4,000								
3	−750				$750												
4	3,500		$4,800												$8,300		
5	−2,000								−2,000								
6	−3,300												−3,300				
7	−800																−$800 Rent
8	1,350		−1,350														
9	−2,700																−2,700 Salaries
10									420								−420 Utilities

Instructions

a. Describe each transaction that occurred in the month.
b. Calculate the amount of profit for the month.
c. Calculate the increase in owner's equity for the month.

Prepare financial statements.

E1.14 **(LO 6) AP** An analysis of transactions for Star & Co. for July 2028 was presented in E1.13.

Instructions

Prepare an income statement and statement of owner's equity for July and a balance sheet at July 31.

E1.15 **(LO 6) AP** Atlantic Cruise Co. is owned by Irina Temelkova. The following information is an alphabetical listing of financial statement accounts for the company for the year ended May 31, 2028:

Prepare income statement and statement of owner's equity.

Accounts payable	$ 47,750	Interest expense	$ 20,960
Accounts receivable	42,950	Investments by owner	5,847
Advertising expense	3,640	Maintenance expense	82,870
Building	122,570	Notes payable	379,000
Cash	20,080	Other expenses	66,500
Equipment	553,300	Prepaid insurance	1,283
I. Temelkova, capital, June 1, 2027	311,182	Revenue	350,640
I. Temelkova, drawings	33,950	Salaries expense	126,950
Insurance expense	2,566	Supplies	16,800

Instructions

Prepare an income statement and a statement of owner's equity for the year.

E1.16 **(LO 6) AP** Refer to the financial information in E1.15 for Atlantic Cruise Co. at May 31, 2028.

Prepare balance sheet.

Instructions

Prepare the balance sheet.

E1.17 **(LO 6) AP** **Video** Judy Cumby is the sole owner of Deer Park Campground near Gros Morne National Park. Judy has gathered the following financial information for the year ended March 31, 2028:

Calculate profit and owner's equity and prepare balance sheet.

Revenues—camping fees	$150,000	Revenues—general store	$ 40,000
Operating expenses	150,000	Cash on hand	9,400
Supplies on hand	2,500	Original cost of equipment	110,000
Fair value of equipment	125,000	Notes payable	70,000
Accounts payable	11,500	J. Cumby, capital, April 1, 2027	17,000
Accounts receivable	21,000	J. Cumby, drawings	5,000
Camping fees collected for April	10,000	Insurance paid for in advance for April to June 2028	600

Instructions

a. Calculate Deer Park's profit for the year.

b. Calculate Judy's owner's equity as at March 31, 2028.

c. Prepare a balance sheet at March 31, 2028.

Problems: Set A

P1.1A **(LO 1) S** Specific financial decisions often depend more on one type of accounting information than another. Consider the following independent, hypothetical situations:

Identify users and uses of accounting information.

1. Pierson Industries is thinking about extending credit to a new customer. The terms of credit would require the customer to pay within 45 days of receipt of the goods.
2. Dean Gunnerson owns Toys and Sports Co., a manufacturer of quality toys and sports equipment. The company manufactures a line of mountain bikes and a line of treadmills. Dean wants to know which line is more profitable.
3. The president of Hi-tech Adventure is trying to determine whether the company has enough cash to buy additional equipment.
4. Standen Bank is thinking about extending a loan to a small company. The company would be required to make interest payments at the end of each year for five years, and to repay the loan at the end of the fifth year.

Instructions

a. Identify the type of user of accounting information in each situation and indicate if they are external or internal.

b. For each situation, state whether the user making the decision would depend mostly on information about (1) the business's economic resources and claims to the resources, or (2) the economic performance of the business. Justify your choice.

Taking It Further is an extra question at the end of each problem designed to challenge you to think beyond the basic concepts covered in the problem and to provide written explanations. Your instructor may assign problems with or without this extra element.

Taking It Further Why is it important to users of financial statements to know that the statements have been prepared by individuals who have high standards of ethical behaviour?

Determine forms of business organization and type of accounting standards.

P1.2A (LO 2, 3) AP Four independent situations follow:

1. Tom Courtney, a student looking for summer employment, started a dog-walking service. He picks up the dog while its owner is at work and returns it after a walk.
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 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. Abdur Rahim has run a successful but small organic food store for over five years. The increased sales at his store have made him believe the time is right to open a chain of organic food stores across the country. Of course, this will require a substantial investment for inventory and equipment, as well as for employees and other resources. Abdur has minimal personal savings.

Instructions

a. In each case, explain what form of organization the business is likely to take: proprietorship, partnership, or corporation. Give reasons for your choice.

b. In each case, indicate what accounting standards, IFRS or ASPE, the business is likely to use in its financial statements. Give reasons for your choice.

Taking It Further Frequently, individuals start a business as a proprietorship and later incorporate the business. What are some of the advantages of doing this?

Determine missing amounts.

P1.3A (LO 4) AP The following selected data are for Carducci Importers for its first three years of operations:

	2026	2027	2028
January 1:			
Total assets	$ 40,000	$ (f)	$ (j)
Total liabilities	0	50,000	(k)
Total owner's equity	(a)	75,000	(l)
December 31:			
Total assets	(b)	140,000	172,000
Total liabilities	50,000	(g)	65,000
Total owner's equity	(c)	97,000	(m)
Changes during year in owner's equity:			
Investments by owner during the year	7,000	0	(n)
Drawings by owner during the year	15,000	(h)	36,000
Profit or loss for the year	(d)	40,000	(o)
Total revenues for the year	132,000	(i)	157,000
Total expenses for the year	(e)	95,000	126,000

Instructions

Determine the missing amounts.

Taking It Further What information does the owner of a company need in order to decide whether they are able to withdraw cash from the business?

Classify accounts and prepare accounting equation.

P1.4A (LO 4) AP Listed in alphabetical order, the following selected accounts (in thousands) were taken from Parker Information Technology Company's December 31, 2028, financial statements:

1.	L	BS	Accounts payable	$ 810	7.	____	____	Rent expense	$4,800
2.	____	____	Accounts receivable	900	8.	____	____	S. Parker, capital, Jan. 1	6,600
3.	____	____	Cash	3,500	9.	____	____	S. Parker, drawings	3,900
4.	____	____	Consulting revenue	15,730	10.	____	____	Salaries expense	3,200
5.	____	____	Equipment	5,700	11.	____	____	Utilities expense	350
6.	____	____	Interest expense	790					

Instructions

a. In each case, identify on the blank line in the first column whether the account is an asset (A), liability (L), capital (C), drawings (D), revenue (R), or expense (E) element. The first one has been done for you as an example.

b. Indicate on the blank line in the second column which financial statement—income statement (IS), statement of owner's equity (OE), or balance sheet (BS)—each account would be reported on. The first one has been done for you as an example.

c. Calculate the company's profit or loss for the year ended December 31, 2028.

Taking It Further Is it important for Parker Information Technology Company to keep track of its different types of expenses as separate accounts? Explain.

P1.5A (LO 3, 5) C Four independent situations follow:

Assess accounting treatment.

1. Human Solutions Incorporated believes its people are its most significant asset. It estimates and records their value on its balance sheet.
2. Sharon Barton, president and owner of Barton Industries, has instructed the accountant to report the company's land and buildings at their current value of $500,000 instead of their cost of $350,000. "Reporting the land and buildings at $500,000 will make it easier to get a loan from the bank next month," Sharon states.
3. Will Viceira, owner of Music To You Company, bought an electric guitar for his personal use. He paid for the guitar with company funds and increased the Equipment account.
4. West Spirit Oil Corp. is a very small oil and gas company that is listed on the Toronto Stock Exchange. The president asked each of the shareholders to approve using ASPE instead of IFRS to reduce expenses for accounting services. He received unanimous approval and has advised the company accountant to prepare the 2028 financial statements accordingly.

Instructions

a. For each of the above situations, determine if the accounting treatment of the situation is correct or incorrect. Explain why.

b. If the accounting treatment is incorrect, explain what should be done.

Taking It Further Why is it important for companies to follow generally accepted accounting principles when preparing their financial statements?

P1.6A (LO 4, 5, 6) AP Frank Petronick decided to start an accounting practice after graduation from university. The following is a list of events that occurred concerning Frank's practice during June 2028, the first month of operations.

Analyze transactions and calculate owner's equity.

June	1	After shopping around, Frank found an office to lease and signed a lease agreement. The lease calls for a payment of $1,050 rent per month.
	4	Borrowed $3,900 from his grandmother to assist in starting up his new business.
	4	Deposited the $3,900 plus $530 of his own cash in a new bank account at the Bank of Montreal under the name Petronick Accounting Services.
	6	Paid the landlord the first month's rent.
	8	Purchased furniture for $3,160 on account.
	11	Moved into the office and obtained the first assignment from a client to prepare year-end financial statements for $1,865.
	15	Performed the work on the assignment and sent an invoice to the client for $1,865.
	15	Paid half of the amount of the June 8 purchase of furniture.
	18	Purchased supplies on account for $344.
	26	Paid for internet services, $49 cash.
	28	Collected $900 of the June 15 billing to the client.
	30	Withdrew cash from the business of $128 for personal expenses.

Instructions

a. Prepare a tabular analysis of the effects of the above transactions on the accounting equation.

b. From an analysis of the owner's equity, calculate the account balance in F. Petronick, Capital, at June 30.

Taking It Further Assume that on June 30 there was $144 of supplies on hand and $200 of supplies had been used during June. What amount should be reported as an asset, Supplies, on the June 30 balance sheet? What amount should be reported as Supplies Expense?

P1.7A (LO 3, 4, 5, 6) AP The following events concern Anita LeTourneau, a Manitoba law school graduate, for March 2028:

Analyze transactions and prepare balance sheet.

1. On March 4, she spent $20 on a lottery ticket.
2. On March 7, she won $250,000 in the lottery and immediately quit her job as a junior lawyer.

3. On March 10, she decided to open her own law practice, and deposited $50,000 of her winnings in a business chequing account, LeTourneau Legal Services.
4. On March 14, she purchased a new luxury condominium with a down payment of $150,000 from her personal funds plus a home mortgage of $200,000.
5. On March 15, Anita signed a rental agreement for her law office space for $2,500 a month, starting March 15. She paid the first month's rent, as it is due on the 15th of each month.
6. On March 19, she hired a receptionist. He will be paid $500 a week and will begin working on March 24.
7. On March 20, she purchased equipment for her law practice from a company that had just declared bankruptcy. The equipment was worth at least $15,000 but Anita was able to buy it for only $10,000.
8. On March 21, she purchased $400 of supplies on account.
9. On March 24, she purchased an additional $6,500 of equipment for her law practice for $3,000 plus a $3,500 note payable due in six months.
10. On March 31, she had performed $3,500 of legal services on account.
11. On March 31, she received $2,500 cash for legal services to be provided in April.
12. On March 31, she paid her receptionist $500 for the week.
13. On March 31, she paid $400 for the supplies purchased on account on March 21.

Instructions

a. Prepare a tabular analysis of the effects of the above transactions on the accounting equation.
b. Calculate profit and owner's equity for the month ended March 31.
c. Prepare a balance sheet at March 31.

Taking It Further How should Anita determine which transactions should be recorded and which ones should not be recorded?

Analyze transactions and prepare financial statements.

P1.8A (LO 4, 5, 6) AP Izabela Jach opened a medical office under the name Izabela Jach, MD, on August 1, 2028. On August 31, the balance sheet showed Cash $3,000; Accounts Receivable $1,500; Supplies $600; Equipment $7,500; Accounts Payable $5,500; Note Payable $3,000; and I. Jach, Capital, $4,100. During September, the following transactions occurred:

Sept.	4	Collected $800 of accounts receivable.
	5	Provided services of $10,500, of which $7,700 was collected from patients and the remainder was on account.
	7	Paid $2,900 on accounts payable.
	12	Purchased additional equipment for $2,300, paying $800 cash and leaving the balance on account.
	15	Paid salaries, $2,800; rent for September, $1,900; and advertising expenses, $275.
	18	Collected the balance of the accounts receivable from August 31.
	20	Withdrew $1,000 for personal use.
	26	Borrowed $3,000 from the Bank of Montreal on a note payable.
	28	Signed a contract to provide medical services, not covered under the government health plan, to employees of CRS Corp. in October for $5,700. CRS Corp. will pay the amount owing after the medical services have been provided.
	29	Received the telephone bill for September, $325.
	30	Billed the government $10,000 for services provided to patients in September.

Instructions

a. Beginning with the August 31 balances, prepare a tabular analysis of the effects of the September transactions on the accounting equation.
b. Prepare an income statement and statement of owner's equity for September, and a balance sheet at September 30.

Taking It Further What are the differences between purchasing an item on account and signing a note payable for the amount owing?

Prepare financial statements.

P1.9A (LO 6) AP Pavlov's Home Renovations was started in 2008 by Jim Pavlov. Jim operates the business from an office in his home. Listed below, in alphabetical order, are the company's assets and liabilities as at December 31, 2028, and the revenues, expenses, and drawings for the year ended December 31, 2028:

Accounts payable	$ 7,850	Operating expenses	$ 3,545
Accounts receivable	10,080	Prepaid insurance	1,685
Cash	8,250	Salaries expense	88,230
Equipment	29,400	Service revenue	153,750
Insurance expense	3,375	Supplies	595
Interest expense	1,195	Supplies expense	20,095
J. Pavlov, drawings	44,800	Unearned revenue	15,000
Notes payable	30,800	Vehicles	42,000

Jim's capital at the beginning of 2028 was $45,850. He made no investments during the year.

Instructions

Prepare an income statement, statement of owner's equity, and balance sheet.

Taking It Further Why is it necessary to prepare the income statement first, then the statement of owner's equity, and the balance sheet last?

P1.10A (LO 6) AN Here are incomplete financial statements for Lee Company:

Determine missing amounts, and comment.

LEE COMPANY
Balance Sheet
February 29, 2028

Assets		Liabilities and Owner's Equity	
Cash	$ 9,500	Liabilities	
Accounts receivable	5,300	Notes payable	$26,000
Land	(a)	Accounts payable	(c)
Building and equipment	41,500	Total liabilities	43,800
		M. Lee, Capital	(d)
Total assets	$ (b)	Total liabilities and owner's equity	$91,300

LEE COMPANY
Income Statement
Year Ended February 29, 2028

Revenues		
Service revenue		$95,000
Expenses		
Salaries expense	$32,000	
Other expenses	(e)	
Supplies expense	1,500	
Total expenses		59,500
Profit for the year		(f)

LEE COMPANY
Statement of Owner's Equity
Year Ended February 29, 2028

M. Lee, capital, March 1, 2027	$22,000
Add: Investments	(g)
Profit for the year	(h)
	62,500
Less: M. Lee, drawings	(i)
M. Lee, capital, February 29, 2028	(j)

Instructions

a. Calculate the missing amounts (a) to (j).

b. Write a memo explaining (1) the sequence for preparing the financial statements, and (2) the interrelationships between the income statement, statement of owner's equity, and balance sheet.

Taking It Further Why isn't the balance sheet dated the same way as the income statement and statement of owner's equity: "Year Ended February 29, 2028"?

Discuss errors and prepare corrected balance sheet.

P1.11A (LO 3, 4, 5, 6) AP The balance sheet of Reflections Book Shop at April 30, 2028, is as follows:

REFLECTIONS BOOK SHOP
Balance Sheet
April 30, 2028

Assets		Liabilities and Owner's Equity	
Building	$110,000	Accounts payable	$ 15,000
Accounts receivable	37,000	Equipment	58,000
C. Dryfuss, capital	85,000	Supplies	1,000
Cash	10,000	"Plug"	338,000
Land	50,000		
Notes payable	120,000		
	$412,000		$412,000

Charles Dryfuss, the owner of the book shop, admits that he is not an accountant. In fact, he couldn't get the balance sheet to balance without "plugging" the numbers (making up numbers to give the desired result). He gives you the following additional information:

1. A professional real estate appraiser estimated the value of the land at $50,000. The actual cost of the land was $36,000.
2. Accounts receivable include amounts due from customers in China for 35,000 yuan, which is about $5,000 Canadian. Dryfuss didn't know how to convert the currency for reporting purposes so he added the 35,000 yuan to the $2,000 due from Canadian customers. He thought it more important to know how much he was owed by each customer in the currency they would likely pay him with anyway.
3. Dryfuss reasons that equipment is a liability because it will cost him money in the future to maintain these items.
4. Dryfuss reasons that the note payable must be an asset because getting the loan was good for the business. If he had not obtained the loan, he would not have been able to purchase the land and buildings.
5. Dryfuss believes that his capital account is also an asset. He has invested in the business, and investments are assets; therefore, his capital account is an asset.

Instructions

a. Identify any corrections that should be made to the balance sheet, and explain why by referring to the appropriate accounting principle, assumption, or concept.

b. Prepare a corrected balance sheet for Reflections Book Shop at April 30. (*Hint:* The capital account may need to be adjusted in order to balance.)

Taking It Further Explain to Dryfuss why all transactions affect at least two financial statement elements.

Problems: Set B

Identify users and uses of accounting information.

P1.1B (LO 1) S Specific financial decisions often depend more on one type of accounting information than another. Consider the following independent, hypothetical situations:

1. Samuel Colt owns a company called Organics To You, which operates a chain of 20 organic food stores across Canada. Samuel wants to determine which brand of pasta is the most profitable for the store.
2. The Backroads Company is considering extending credit to a new customer—Europe Tours Company. The terms of credit would require the customer to pay within 45 days of receipt of the goods.
3. The senior partner of Accountants R Us is trying to determine if the partnership is generating enough cash to increase the partners' drawings and still ensure the partnership has enough cash to expand its operations.

Instructions

a. Identify the type of user of accounting information in each situation and indicate if they are external or internal.

b. For each situation, state whether the user making the decision would depend mostly on information about (1) the business's economic resources and claims to the resources, or (2) the economic performance of the business. Justify your choice.

Taking It Further Why is it important to users of financial statements to know that the statements have been prepared by individuals who have high standards of ethical behaviour?

P1.2B (LO 2, 3) AP Four independent situations follow:

Determine forms of business organization and types of accounting standards.

1. Three computer science students have formed a business to develop a new social media application (app) for the internet. Each has contributed an equal amount of cash and knowledge to the venture. While their app looks promising, they are concerned about the legal liabilities that their business might confront.
2. Shamira Hatami, a student looking for summer employment, opened a small cupcake shop out of her summer vacation home.
3. Robert Steven and Tom Cheng each own a snowboard manufacturing business and have now decided to combine their businesses. They expect that in the next year they will need funds to expand their operations.
4. Darcy Becker, Ellen Leboeuf, and Meg Dwyer recently graduated with marketing degrees. Friends since childhood, they have decided to start a consulting business that focuses on branding strategies for small and medium-sized businesses.

Instructions

a. In each case, explain what form of organization the business is likely to take: proprietorship, partnership, or corporation. Give reasons for your choice.

b. In each case, indicate what accounting standards, IFRS or ASPE, the business is likely to use in its financial statements. Give reasons for your choice.

Taking It Further What are the advantages of two individuals first forming a partnership to run a business, and later incorporating?

P1.3B (LO 4) AP The following selected data are for Alexei Imports for its first three years of operations.

Determine missing amounts.

	2026	2027	2028
January 1:			
Total assets	(a)	$75,000	$127,000
Total liabilities	0	(e)	(k)
Total owner's equity	60,000	(f)	(l)
December 31:			
Total assets	75,000	(g)	170,000
Total liabilities	(b)	45,000	(m)
Total owner's equity	45,000	(h)	100,000
Changes during year in owner's equity:			
Investments by owner during the year	5,000	(i)	0
Drawings by owner during the year	0	10,000	(n)
Profit or loss for the year	(c)	35,000	30,000
Total revenues for the year	(d)	(j)	160,000
Total expenses for the year	120,000	95,000	(o)

Instructions

Determine the missing amounts.

Taking It Further What information does the owner of a company need in order to decide whether they need to invest additional cash in the business?

P1.4B (LO 4) AP Listed in alphabetical order, the following selected accounts (in thousands) were taken from Paradise Mountain Family Resort's December 31, 2028, financial statements:

Classify accounts and prepare accounting equation.

1.	L	BS	Accounts payable	$ 195	10.	______	______	Operating expenses	$ 871
2.	______	______	Accounts receivable	160	11.	______	______	Other assets	615
3.	______	______	Cash	120	12.	______	______	Other liabilities	396
4.	______	______	Equipment	600	13.	______	______	Other revenue	52
5.	______	______	Insurance expense	15	14.	______	______	Rent revenues	1,295
6.	______	______	Interest expense	45	15.	______	______	Salaries payable	125
7.	______	______	Land	1,495	16.	______	______	T. Yuen, capital, January 1	934
8.	______	______	Notes payable	950	17.	______	______	T. Yuen, drawings	20
9.	______	______	Prepaid insurance	30	18.	______	______	Unearned rent revenue	24

Instructions

a. In each case, identify on the blank line in the first column whether the account is an asset (A), liability (L), capital (C), drawings (D), revenue (R), or expense (E) element. The first one has been done for you as an example.

b. Indicate on the blank line in the second column which financial statement—income statement (IS), statement of owner's equity (OE), or balance sheet (BS)—each account would be reported on. The first one has been done for you as an example.

c. Calculate the company's profit or loss for the year ended December 31, 2028.

Taking It Further Is it important for Paradise Mountain Family Resort to keep track of its different types of expenses as separate accounts? Explain.

Assess accounting treatment.

P1.5B (LO 3, 5) C Three independent situations follow:

1. In preparing its financial statements, Karim Company estimated and recorded the impact of the recent death of its president.
2. Because of a "flood sale," equipment worth $300,000 was purchased by Montigny Company for only $200,000. The equipment was recorded at $300,000 on Montigny's books.
3. Vertical Lines Company was on the verge of filing for bankruptcy, but a turnaround in the economy has resulted in the company being very healthy financially. The company president insists that the accountant put a note in the financial statements that states the company is a real going concern now.

Instructions

a. For each of the above situations, determine if the accounting treatment of the situation is correct or incorrect. Explain why.

b. If the accounting treatment is incorrect, explain what should be done.

Taking It Further Why is it important for companies to follow generally accepted accounting principles when preparing their financial statements?

Analyze transactions and calculate owner's equity.

P1.6B (LO 4, 5, 6) AP Kensington Bike Repair Shop was started on April 1 by L. Depres. A summary of the April transactions follows:

April	1	Invested $21,000 to start the repair shop.
	2	Purchased equipment for $9,000, paying $3,000 cash and signing a note payable for the balance.
	5	Paid rent for the month, $1,050.
	7	Purchased $975 of supplies on account.
	9	Received $3,200 in cash from customers for repair services.
	16	Provided repair services on account to customers, $2,900.
	26	Collected $1,200 on account for services billed on April 16.
	27	Paid for supplies purchased on April 7.
	28	Paid $290 for advertising.
	29	Withdrew $1,300 for personal use.
	30	Received April utility bill, $200.
	30	Paid part-time employee salaries, $1,400.
	30	Billed a customer $750 for repair services.
	30	Received an advance from a customer for repairs to be performed in May, $2,100.

Instructions

a. Prepare a tabular analysis of the effects of the above transactions on the accounting equation.

b. From an analysis of the owner's equity, calculate the account balance in L. Depres, Capital at April 30.

Taking It Further Assume that on April 30 there was $500 of supplies on hand and $475 of supplies had been used during April. What amount should be reported as an asset, Supplies, on the April 30 balance sheet? What amount should be reported as Supplies Expense?

Analyze transactions and prepare balance sheet.

P1.7B (LO 3, 4, 5, 6) AP Lynn Barry started her own consulting firm, Barry Consulting, on June 1, 2028. The following transactions occurred during the month of June:

June	1	Sold her shares in Big Country Airlines for $7,000, which she deposited in her personal bank account.
	1	Transferred $6,000 from her personal account to a business account in the name of Barry Consulting.

2 Paid $900 for office rent for the month.
3 Purchased $545 of supplies on account.
5 Paid $95 to advertise in the *County News*.
9 Received $3,275 for services provided.
12 Withdrew $600 for personal use.
15 Performed $5,000 of services on account.
17 Paid $1,800 for employee salaries.
21 Received $3,000 for services provided on account on June 15.
22 Paid for the supplies purchased on account on June 3.
25 Signed a contract to provide consulting services to a client for $5,500. Services will be performed and paid for in July.
26 Borrowed $5,500 from the bank and signed a note payable.
29 Used part of the cash borrowed from the bank on June 26 to purchase equipment for $2,150.
30 Paid $150 for telephone service for the month.
30 Received $2,500 from client for consulting to be provided in July.

Instructions

a. Prepare a tabular analysis of the effects of the above transactions on the accounting equation.

b. Calculate profit and owner's equity for the month ended June 30.

c. Prepare a balance sheet at June 30.

Taking It Further How should Lynn determine which transactions should be recorded and which ones should not be recorded?

Analyze transactions and prepare financial statements.

P1.8B (LO 4, 5, 6) AP Fraser Baker opened Baker's Media Consulting in Winnipeg on September 1, 2028. On September 30, the balance sheet showed Cash $5,700; Accounts Receivable $2,100; Supplies $350; Equipment $7,600; Accounts Payable $4,300; and F. Baker, Capital $11,450. During October, the following transactions occurred:

Oct. 1 Paid $3,800 of the accounts payable.
1 Paid $900 rent for October.
4 Collected $1,550 of the accounts receivable.
5 Hired a part-time office assistant at $80 per day to start work the following week.
8 Purchased additional equipment for $4,000, paying $500 cash and signing a note payable for the balance.
14 Performed $900 of consulting work on account.
15 Paid $300 for advertising.
18 Collected $400 from customers who received services on October 14.
20 Paid $500 for family dinner celebrating Fraser's son's university graduation.
25 Borrowed $8,000 from the Manitoba Bank on a note payable.
26 Sent a statement reminding a customer that he still owed the company money from September.
28 Earned revenue of $5,400, of which $3,100 was paid in cash and the balance was due in November.
29 Paid the part-time office assistant $720 for working nine days in October.
29 Received $2,800 cash for consulting work to be performed in November.
30 Received the telephone bill for the month, $205.
30 Withdrew $1,200 cash for personal expenses.

Instructions

a. Beginning with the September 30 balances, prepare a tabular analysis of the effects of the October transactions on the accounting equation.

b. Prepare an income statement and statement of owner's equity for October, and a balance sheet at October 31.

Taking It Further Fraser is confused about the accounting treatment of the October 20 transaction. Explain the reason for this treatment.

Prepare financial statements.

P1.9B (LO 6) AP Judy Johansen operates an interior design business, Johansen Designs. Listed below, in alphabetical order, are the company's assets and liabilities as at December 31, 2028, and the revenues, expenses, and drawings for the year ended December 31, 2028:

Accounts payable	$ 6,590	Prepaid insurance	$ 600
Accounts receivable	6,745	Rent expense	18,000
Cash	11,895	Salaries expense	70,500
Equipment	9,850	Service revenue	132,900
Furniture	15,750	Supplies	675
Insurance expense	1,800	Supplies expense	3,225
Interest expense	350	Telephone expense	3,000
J. Johansen, drawings	40,000	Unearned revenue	2,500
Notes payable	7,000	Utilities expense	2,400

Judy's capital at the beginning of 2028 was $35,800. She made no investments during the year.

Instructions

Prepare an income statement, statement of owner's equity, and balance sheet.

Taking It Further Why is the balance sheet prepared after the statement of owner's equity?

Determine missing amounts, and comment.

P1.10B (LO 6) AN Here are incomplete financial statements for Deol Company:

DEOL COMPANY
Balance Sheet
October 31, 2028

Assets		**Liabilities and Owner's Equity**	
Cash	$ 5,000	Liabilities	
Accounts receivable	10,000	Notes payable	$59,600
Land	(a)	Accounts payable	(b)
Building and equipment	45,000	Total liabilities	66,500
		Owner's equity	
		B. Deol, capital	(c)
Total assets	$110,000	Total liabilities and owner's equity	$ (d)

DEOL COMPANY
Income Statement
Year Ended October 31, 2028

Revenues		
Service revenue		$80,000
Expenses		
Salaries expense	$37,500	
Other expenses	(e)	
Supplies expense	6,000	
Total expenses		62,500
Profit for the year		$ (f)

DEOL COMPANY
Statement of Owner's Equity
Year Ended October 31, 2028

B. Deol, capital, November 1, 2027	$35,000
Add: Investments	(g)
Profit for the year	(h)
	57,500
Less: B. Deol, drawings	(i)
B. Deol, capital, October 31, 2028	$ (j)

Instructions

a. Calculate the missing amounts (i) to (x).

b. Write a memo explaining (1) the sequence for preparing the financial statements, and (2) the interrelationships between the income statement, statement of owner's equity, and balance sheet.

Taking It Further Why aren't the income statement and the statement of owner's equity dated the same way as the balance sheet: "October 31, 2028"?

Discuss errors and prepare corrected balance sheet.

P1.11B (LO 3, 4, 5, 6) AP GG Company was formed on January 1, 2028. On December 31, Gil Goodman, the owner, prepared a balance sheet:

GG COMPANY
Balance Sheet
December 31, 2028

Assets		Liabilities and Owner's Equity	
Cash	$ 15,000	Accounts payable	$ 45,000
Accounts receivable	55,000	Boat loan payable	13,000
Supplies	20,000	G. Goodman, capital	25,000
Boat	18,000	Profit for 2028	25,000
	$108,000		$108,000

Gil willingly admits that he is not an accountant. He is concerned that his balance sheet might not be correct. He gives you the following additional information:

1. The boat actually belongs to Gil Goodman, not to GG Company. However, because he thinks he might take customers out on the boat occasionally, he decided to list it as an asset of the company. To be consistent, he also listed as a liability of the company the personal bank loan that he took out to buy the boat.
2. Gil spent $15,000 to purchase more supplies than he usually does, because he heard that the price of the supplies was expected to increase. It did, and the supplies are now worth $20,000. He thought it best to record the supplies at $20,000, as that is what it would have cost him to buy them today.
3. Gil has signed a contract to purchase equipment in January 2029. The company will have to pay $5,000 cash for the equipment when it arrives and the balance will be payable in 30 days. Gil has already reduced Cash by $5,000 because he is committed to paying this amount.
4. The balance in G. Goodman, Capital is equal to the amount Gil originally invested in the company when he started it on January 1, 2028.
5. Gil paid $1,200 for a one-year insurance policy on December 31. He did not include it in the balance sheet because the insurance is for 2029 and not 2028.
6. Gil knows that a balance sheet needs to balance but on his first attempt he had $108,000 of assets and $83,000 of liabilities and owner's equity. He reasoned that the difference was the amount of profit the company earned this year and added that to the balance sheet as part of owner's equity.

Instructions

a. Identify any corrections that should be made to the balance sheet, and explain why by referring to the appropriate accounting concept, assumption, or principle.
b. Prepare a corrected balance sheet for GG Company at December 31. (*Hint:* To get the balance sheet to balance, adjust owner's equity.)

Taking It Further Assume that Gil did not make any withdrawals from the company in 2028, nor any investments other than his initial investment of $25,000. What was the actual profit for the year?

Chapter 1: Broadening Your Perspective

Financial Reporting and Analysis

Financial Reporting Problem

BYP1.1 Canada Goose Holdings Inc.'s financial statements have been reproduced in Appendix A at the back of the textbook.

Instructions

a. Many companies use a calendar year for their financial statements. What does Canada Goose use?
b. Where in the financial statements does it indicate that Canada Goose's statements have been prepared using IFRS?
c. What five financial statements has Canada Goose presented?
d. Where in the financial statements does it indicate that Canada Goose reports the financial amounts in millions of Canadian dollars?
e. What were Canada Goose's total assets as at March 31, 2024? As at April 2, 2023?
f. What were Canada Goose's total liabilities as at March 31, 2024? As at April 2, 2023?
g. What is the amount of change in Canada Goose's profit (Canada Goose calls this "net income") from 2023 to 2024?

Interpreting Financial Statements

BYP1.2 Apple Inc. is an international corporation that designs, manufactures, and markets smartphones, personal computers, tablets, wearables, and accessories, and sells a variety of related services. In the assets section of its 2023 balance sheet, the following data were presented:

APPLE INC.
Balance Sheets (partial)
(in U.S. millions)

Assets	September 30, 2023	September 24, 2022
Cash and cash equivalents	$ 29,965	$ 23,646
Short-term marketable securities	31,590	24,658
Accounts receivable, net	29,508	28,184
Inventories	6,331	4,946
Vendor non-trade receivables	31,477	32,748
Other current assets	14,695	21,223
Long-term marketable securities	100,544	120,805
Property, plant and equipment, net	43,715	42,117
Other non-current assets	64,758	54,428
Total assets	$352,583	$352,755

Instructions

a. For a company such as Apple, what do you think its most important economic resource is? Where is this recorded on the balance sheet? At what value (if any) should it be shown?

b. Do the assets reported on the balance sheet above tell you what Apple is worth? What information does the balance sheet give you about the company's value?

Critical Thinking

Collaborative Learning Activity

Note to instructor: Additional instructions and material for this group activity can be found on the Instructor Resource Site and in Wiley's course resources.

BYP1.3 In this group activity, students will be asked to identify (or determine) the information they would require if they were making a decision whether or not to lend money or to invest in a company.

Communication Activity

BYP1.4 Robert Joote is the owner of Peak Company. Robert has prepared the following balance sheet:

PEAK COMPANY
Balance Sheet
Month Ended December 31, 2028

Assets	
Equipment	$20,500
Cash	10,500
Supplies	2,000
Accounts payable	(5,000)
Total assets	$28,000
Liabilities and Owner's Equity	
R. Joote, capital	$23,500
Accounts receivable	(3,000)
R. Joote, drawings	(2,000)
Prepaid insurance	(2,500)
Notes payable	12,000
Total liabilities and owner's equity	$28,000

Robert didn't know how to determine the balance for his capital account so he just "plugged" the number. (He made up a number that would give him the result that he wanted.) He had heard somewhere that assets had to equal the total of liabilities and owner's equity, so he made up a number for capital so that these would be equal.

Instructions

In a memo, explain to Robert (a) how to determine the balance for his capital account, (b) why his balance sheet is incorrect, and (c) what he should do to correct it. Include in your explanation how the financial statements are interrelated, and why the order of preparation is important.

"All About You" Activity

BYP1.5 In the "All About You" feature, we introduced the idea that being financially literate has a major impact on our ability to meet our financial goals and even on our health and happiness. We all face financial decisions each day. Some of these decisions are small and others are critical. Making the right financial decisions is important to your well-being. Following are three financial decisions that you as a student will likely have to make.

1. You have to pay for your tuition, books, and spending money during college. You are trying to decide what kind of summer job you should apply for and whether or not you need to work part-time during the school year.
2. You need to have transportation to get back and forth to college each day. You are trying to decide if you can afford to buy a second-hand car and pay for parking or whether you should use public transport. You will have to borrow money to purchase the car.
3. You will be graduating this year and have received job offers from two different companies. You are deciding which company you should work for, and you want to accept a position in a company that is financially stable and has growth potential.

Instructions

a. For each decision, indicate what financial information you would want to have in order to make an optimal decision.

b. Based on what you have learned in Chapter 1, how will learning about accounting help you with the above decisions?

The **Santé Smoothies Saga** starts in this chapter and continues in every chapter. This feature chronicles the growth of a hypothetical small business to show how the concepts you learn in each chapter can be applied in the real world.

Santé Smoothies Saga

BYP1.6 Natalie Koebel spent much of her youth playing sports. She passed many hours on the soccer field and in the dance studio. As Natalie grew older, her passion for healthy living continued as she started practising yoga. Now, at the start of her second year in college, Natalie is investigating various possibilities for starting her own business as part of the requirements of the Entrepreneurship program she is taking. A long-time friend insists that Natalie has to somehow include healthy living in her business plan and, after a series of brainstorming sessions, Natalie settles on the idea of operating a smoothie business. She will start on a part-time basis. She will make the product at home, bottle it, and take it to the yoga studio where she exercises because they have agreed to purchase it on a regular basis. Now that she has started thinking about it, the possibilities seem endless. During the summer, she will concentrate on fresh fruit and vegetable smoothies. The first difficult decision is coming up with the perfect name for her business. In the end, she settles on "Santé Smoothies Saga" and then moves on to more important issues.

Instructions

a. What form of business organization—proprietorship, partnership, or corporation—do you recommend that Natalie use for her business? Discuss the benefits and weaknesses of each form and give the reasons for your choice.

b. Will Natalie need accounting information? If yes, what information will she need and why? How often will she need this information?

c. In addition to Natalie, who do you anticipate to be the users of Natalie's accounting information? What information will these identified users need and why?

d. Identify specific asset, liability, and equity accounts that Santé Smoothies will likely use to record its business transactions.

e. Should Natalie open a separate bank account for the business? Why or why not?

Answers to Self-Study Questions

1. c **2.** d **3.** b **4.** c **5.** a **6.** a **7.** a **8.** b **9.** b **10.** d