

CHAPTER 1

Accounting in Action

ASSIGNMENT CLASSIFICATION TABLE

<u>Study Objectives</u>	<u>Questions</u>	<u>Brief Exercises</u>	<u>Exercises</u>	<u>Problems Set A</u>
1. Identify the use and users of accounting and the objective of financial reporting.	1, 2, 3, 4, 5	1, 2	1, 3	1
2. Compare different forms of business organizations and explain how Canadian accounting standards apply to these organizations.	6, 7, 8	3, 4, 10	2, 3, 7	2, 5
3. Describe the components of the financial statements and explain the accounting equation.	9, 10, 11, 12, 13	5, 6, 7, 8, 9, 12, 14, 15	3, 4, 5, 6	3, 4, 6, 7
4. Determine what events are recognized in the financial statements and how the events are measured.	14, 15	10	7, 8	5, 7, 8
5. Analyze the effects of business transactions on the accounting equation.	16, 17	11, 12, 13, 14	9, 10, 11, 12	6, 7, 8
6. Prepare financial statements.	18, 19	15, 16, 17, 18, 19	13, 14, 15, 16	7, 8, 9, 10

ASSIGNMENT CHARACTERISTICS TABLE

<u>Problem Number</u>	<u>Description</u>	<u>Difficulty Level</u>	<u>Time Allotted (min.)</u>
1A	Identify users and use of accounting information.	Simple	15-20
2A	Determine forms of business organization and types of accounting standards.	Simple	15-20
3A	Determine missing items.	Moderate	20-25
4A	Classify accounts and prepare accounting equation.	Simple	20-30
5A	Assess accounting treatment.	Moderate	20-25
6A	Analyze transactions and calculate owner's equity.	Simple	35-45
7A	Analyze transactions and prepare balance sheet.	Simple	40-50
8A	Analyze transactions and prepare financial statements.	Moderate	40-50
9A	Prepare financial statements.	Simple	35-45
10A	Determine missing amounts, and comment.	Moderate	35-45

BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Material

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the use and users of accounting and the objective of financial reporting.	Q1-4 BE1-1 E1-3	Q1-1 Q1-2 Q1-3 Q1-5 E1-1		BE1-2	P1-1A	
2. Compare different forms of business organizations and explain how Canadian accounting standards apply to these organizations.	Q1-8 E1-3	Q1-6 Q1-7 BE1-3 BE1-4 BE1-10 E1-2 E1-7 P1-5A	P1-2A			
3. Describe the components of the financial statements and explain the accounting equation.	Q1-9 Q1-10 Q1-11 Q1-12 Q1-13 E1-3	BE1-5 E1-6	BE1-6 BE1-7 BE1-8 BE1-9 BE1-14 BE1-15 E1-4 E1-5 P1-3A P1-4A P1-6A P1-7A	BE1-2		
4. Determine what events are recognized in the financial statements and how the events are measured.		Q1-14 Q1-15 BE1-10 E1-7 E1-8 P1-5A	P1-7A P1-8A			
5. Analyze the effects of business transactions on the accounting equation.		Q1-16 E1-9	Q1-17 BE1-11 BE1-13 BE1-14 E1-10 E1-11 E1-12 P1-6A P1-7A P1-8A	BE1-12		

BLOOM'S TAXONOMY TABLE (Continued)

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
6. Prepare financial statements.		Q1-18 Q1-19	BE1-15 BE1-16 BE1-17 BE1-18 BE1-19 E1-13 E1-14 E1-15 E1-16 P1-7A P1-8A P1-9A	P1-10A		
Broadening Your Perspective		Continuing Cookie Chronicle	BYP1-1	BYP1-2	BYP1-3 BYP1-4	

ANSWERS TO QUESTIONS

1. Accounting is the financial information system that provides useful financial information to every person who owns and uses economic resources or otherwise engages in economic activity.
2. Understanding the basics of accounting is helpful for everyone. Studying accounting allows you to learn how the world of business actually works. Learning how to read and interpret financial information will provide you with a valuable set of skills.
3. Internal users are those who plan, organize, and run businesses and include managers, supervisors, directors, and company officers. External users work for other organizations but have reasons to be interested in the company's financial position and performance, and include current or potential investors (owners), and creditors.

Internal users may want answers to several types of questions. For example, the finance department wants to know if there is enough cash to pay the bills. The marketing department wants to know what price the business should use in selling its products to maximize profits. The human resources department wants to know how many people the business can afford to hire. The production department wants to know which product lines make the business the most profit.

External users may want answer to several types of questions. For example, investors want to know if the company is earning enough to give them a return on their investment. Creditors want to know if the company is able to pay its debts as they come due. Labour unions want to know whether the owners can afford to pay increased wages and benefits. Customers are interested in whether a company will continue to honour its product warranties and support its product lines. Taxing authorities want to know whether the company respects the tax laws. Regulatory agencies want to know whether the company is respecting established rules.

4. The main objective of financial reporting is to provide useful information to investors and creditors (external users) to make decisions about a business. Users may be potential investors who need to decide if they wish to invest in the business or they may be creditors deciding if they wish to lend money to the business. These users want to know if the business is running successfully and can generate cash and earn a profit.

QUESTIONS (Continued)

5. Ethics is a fundamental business concept. If accountants do not have a high ethical standard, the information they produce will not have any credibility.

Ethics are important to statement users because it provides them comfort that the financial information they are using is credible and reliable.

6. a) A proprietorship is a private business with one owner who has unlimited liability for the business. The proprietorship has a limited life tied to the life of the owner. Proprietorships do not pay tax, the owner does.
- b) A partnership has essentially the same characteristics as a proprietorship except that in a partnership, there is more than one owner. A partnership need not be a private business, although it usually is.
- c) For corporations, the owners are one or more shareholders who enjoy limited liability. The corporation pays income taxes and can have an indefinite live since its ownership units, in the form of shares, are easily transferred to other owners. Public corporations issue publicly traded shares. That is, their shares are listed on Canadian or other stock exchanges.
- d) Private corporations have essentially the same characteristics as public corporations except that they do not issue publicly traded shares.

QUESTIONS (Continued)

7. The users of financial information on public companies have different needs than the users of financial information on private companies. Public corporations need the opportunity to present financial information using accounting rules that are consistent with those used globally. To do this, public companies need to follow International Financial Reporting Standards (IFRS). Doing so helps Canadian companies compete in a global market. But following this set of policies and standards is often not essential or cost effective for privately owned businesses. The users of private company financial statements often do not require the extensive measurements and disclosures required by IFRS and thus private companies may report under Accounting Standards for Private Enterprises (ASPE).

Companies are required to disclose which Generally Accepted Accounting Principles (GAAP) they are following in the notes to their financial statements. Thus users should read the notes in order to determine which generally accepted accounting principles a business has followed.

8. The economic entity concept states that economic events can be identified with a particular unit of accountability. This concept requires that the activities of the entity be kept separate and distinct from the activities of its owners and all other economic entities.
9. The basic accounting equation is $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ and the expanded accounting equation is $\text{Assets} = \text{Liabilities} + \text{Owner's Capital} - \text{Owner's Drawings} + \text{Revenue} - \text{Expenses}$. The equation is the basis for recording and summarizing all of the economic events and transactions of a business.
10. (a) Assets are economic resources, owned by a business, that are capable of providing future services or benefits. Liabilities are current obligations, arising from past events, to make future payments of assets or services. Put more simply, liabilities are existing debts and obligations. Owner's equity is the ownership claim on the assets.
- (b) Revenues and investments by the owner increase owner's equity. Drawings and expenses decrease owner's equity.

QUESTIONS (Continued)

11. Accounts Receivable represent amounts owed to the business by its customers for services performed, but for which collection has not yet been received. Accounts Payable represent amounts owed by the business for services or goods received, but for which payment has not yet been made.
12. Revenues occur from providing services, selling merchandise inventory, renting property and lending money. Revenues increase profit. The result of a business realizing revenue is an increase in the business's assets or decrease in its liabilities. Revenues increase owner's equity. Expenses are costs incurred to earn revenue. Expenses are the cost of assets that are consumed and services that are used by a business in its activities. Expenses decrease profit. Expenses decrease a business's assets or increase its liabilities. Revenues minus expenses equals profit.
13. The balance sheet depicts the accounting equation and so it reports the assets, liabilities and owner's equity of a business at a point in time. The income statement is a summary of the results of the business's operating activities aimed to increase profit. The income statement reports the revenues and the expenses for a period in time.
14. Wayne is incorrect. Not all events are transactions recognized in the accounting records. Only events that cause changes in assets, liabilities, or owner's equity and can be reliably measured in monetary terms should be recorded. For example, a business might sign a lease for a store. Although this event obligates the business for the payment of rent in the future, it is not yet a transaction as no assets have been exchanged by the business and its landlord. Another example is when an employee is hired. No transaction has occurred, and nothing will be recorded until the employee has started working and earning wages.
15. The monetary unit assumption requires that only transaction data capable of being expressed in terms of money can be included in the accounting records of the economic entity. As a result, information that cannot be objectively measured in dollars cannot be included. For example, a skilled manager may add value to a company, but since that skill cannot be objectively measured in dollars, it is not included as an asset of the company. Another important part of the monetary unit assumption is that the unit of measure remains sufficiently constant over time. In other words, inflation is ignored.

QUESTIONS (Continued)

16. Yes, a business can enter into a transaction in which only the left side of the accounting equation is affected. An example would be a transaction where an increase in one asset is offset by a decrease in another asset, such as when equipment is purchased for cash (resulting in an increase in the equipment account which is offset by a decrease in the cash account).
17. No, this treatment is not proper. While the transaction does involve a disbursement of cash, it does not represent an expense. Expenses are decreases in owner's equity resulting from business activities entered into for the purpose of earning profit. This transaction is a withdrawal of capital from the business by the owner and should be recorded as a decrease in both cash and owner's equity.
18. Yes. Profit does appear on the income statement—it is the result of subtracting expenses from revenues. In addition, profit appears in the statement of owner's equity—it is shown as an addition to the beginning-of-period capital. Indirectly, the profit of a company is also included in the balance sheet, as it is included in the capital account, which appears in the owner's equity section of the balance sheet.
19. It is likely that the use of rounded figures would not change the decisions made by the users of the financial statements. As well, presenting the information in this manner make the statements easier to read and analyze, thereby increasing their usefulness to the users.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 1-1

User	(a) Kind of Decision	(b) Internal or External User
Owner	4	Internal
Marketing manager	3	Internal
Creditor	2	External
Chief financial officer	5	Internal
Labour union	1	External

BRIEF EXERCISE 1-2

- a. The student is provided with the opportunity to cheat on an exam.
- b. A production supervisor might become aware of a defect in a company's product that is ready to ship but his/her bonus is based on volume of shipments.
- c. A salesperson might be provided with the opportunity to not report cash sales and pocket the cash instead.
- d. A banker is able to approve a loan for an unqualified family member.
- e. The prime minister of Canada interferes in a political inquiry of a political friend.

BRIEF EXERCISE 1-3

- (a) P
- (b) C
- (c) PP

BRIEF EXERCISE 1-4

- (a) F
- (b) F
- (c) F
- (d) T
- (e) T

BRIEF EXERCISE 1-5

	<u>Component</u>	<u>Balance Sheet or Income Statement</u>
(a)	Revenues	Income Statement
(b)	Assets	Balance Sheet
(c)	Owner's Equity	Balance Sheet
(d)	Liabilities	Balance Sheet
(e)	Expenses	Income Statement

BRIEF EXERCISE 1-6

- (a) $\$75,000 - \$24,000 = \$51,000$ (Owner's Equity)
- (b) $\$150,000 + \$91,000 = \$241,000$ (Assets)
- (c) $\$89,000 - \$52,000 = \$37,000$ (Liabilities)

BRIEF EXERCISE 1-7

- (a) $\$600,000 - (\$600,000 \times \frac{1}{3}) = \$400,000$ (Liabilities)
- (b) $\$280,000 + \$130,000 - \$40,000 + \$440,000 - \$330,000$
 $= \$480,000$ (Total assets)
- (c) $\$90,000 - (\$35,000 - \$7,000 + \$55,000 - \$45,000)$
 $= \$52,000$ (Total liabilities)

BRIEF EXERCISE 1-8

Assets = Liabilities + Owner's Equity
 $\$850,000 = \$550,000 + X$

Owner's Equity = Assets - Liabilities
 $\$300,000 = \$850,000 - \$550,000$

- (a) $(\$850,000 + \$130,000) - (\$550,000 - \$80,000)$
 $= \$510,000$ (Owner's equity)
- (b) $(\$550,000 - \$95,000) + (\$300,000 - \$40,000 + \$100,000)$
 $= \$815,000$ (Assets)
- (c) $(\$850,000 + \$100,000) - (\$300,000 + \$185,000 - \$50,000)$
 $= \$515,000$ (Liabilities)
- (d) $(\$850,000 + \$45,000) - (\$550,000 - \$50,000) = \$395,000$
ending balance Owner's equity
 $\$395,000 + \$40,000 - \$300,000 = \$135,000$ Profit

BRIEF EXERCISE 1-9

	(a)	(b)
1. Accounts receivable	<u>A</u>	<u>BS</u>
2. Salaries payable	<u>L</u>	<u>BS</u>
3. Salaries expense	<u>SOE</u>	<u>IS</u>
4. Supplies	<u>A</u>	<u>BS</u>
5. Supplies expense	<u>SOE</u>	<u>IS</u>
6. S. Knoler, capital	<u>SOE</u>	<u>SOE & BS</u>
7. Service revenue	<u>SOE</u>	<u>IS</u>
8. Equipment	<u>A</u>	<u>BS</u>
9. Notes payable	<u>L</u>	<u>BS</u>
10. Cash	<u>A</u>	<u>BS</u>
11. Prepaid expense	<u>A</u>	<u>BS</u>
12. S. Knoler, drawings	<u>SOE</u>	<u>SOE</u>

BRIEF EXERCISE 1-10

- (a) 5. Monetary unit assumption
- (b) 1. Cost principle
- (c) 4. Economic entity assumption
- (d) 2. Generally accepted accounting principles
- (e) 3. Going concern assumption

BRIEF EXERCISE 1-11

Trans- action	Assets	Liabilities	Owner's Equity			
			Capital	Drawings	Revenues	Expenses
(a)	+\$250	+\$250	NE	NE	NE	NE
(b)	+500	NE	NE	NE	+\$500	NE
(c)	−300	NE	NE	NE	NE	−\$300
(d)	−250	−250	NE	NE	NE	NE
(e)	+1,000	NE	+\$1,000	NE	NE	NE
(f)	−400	NE	NE	−\$400	NE	NE
(g)	NE	NE	NE	NE	NE	NE
(h)	+500 / −500	NE	NE	NE	NE	NE
(i)	+450	+450	NE	NE	NE	NE

BRIEF EXERCISE 1-12

Expenses only	1, 4
Drawings only	2
Both (intersection of Venn diagram)	3, 5

BRIEF EXERCISE 1-13

<u>Description</u>	<u>Transaction Analysis</u>
(a) Cash collected on account.	6
(b) Owner invests cash in the business.	1
(c) Supplies are purchased on account.	3
(d) Company provides service on account.	4
(e) Payment on account made to supplier.	5
(f) Company purchases an insurance policy.	

BRIEF EXERCISE 1-14

<u>E</u>	(a) Cost incurred for advertising
<u>R</u>	(b) Commission earnings
<u>I</u>	(c) Equipment received from company owner
<u>E</u>	(d) Amounts paid to employees
<u>NE</u>	(e) Cash paid to purchase equipment
<u>R</u>	(f) Services performed on account
<u>R</u>	(g) Rent received
<u>E</u>	(h) Utilities incurred
<u>D</u>	(i) Cash withdrawn by company owner
<u>NE</u>	(j) Collection of an account receivable
<u>NE</u>	(k) Cash collected in advance of providing service

BRIEF EXERCISE 1-15

- (a) $\$68,000 - \$25,000 - \$50,000 = \text{drawings } \$7,000$
 (b) $\$65,000 + \$33,000 - \$68,000 = \text{profit } \$30,000$
 (c) $\$65,000 \text{ Ending balance 2014} = \text{Opening balance 2015}$
 (d) $\$65,000 + \$20,000 + 17,000 - \$12,000 = \$90,000$

BRIEF EXERCISE 1-16

**Beginning capital + Investments + Profit (or – Loss) – Drawings
= Ending capital**

(a)	Ending capital balance	\$260,000
	Beginning capital balance	<u>225,000</u>
	Profit	<u>\$ 35,000</u>
(b)	Ending capital balance	\$260,000
	Beginning capital balance	<u>225,000</u>
	Increase in capital	35,000
	Deduct: Portion of increase arising from investment	<u>(10,000)</u>
	Profit	<u>\$ 25,000</u>
(c)	Ending capital balance	\$260,000
	Beginning capital balance	<u>225,000</u>
	Increase in capital	35,000
	Deduct: Portion of increase arising from investment	(5,000)
	Add: Portion of decrease arising from withdrawal	<u>7,000</u>
	Profit	<u>\$ 37,000</u>

BRIEF EXERCISE 1-17

PRAIRIE COMPANY Income Statement Month Ended October 31, 2014

Revenues		
Service revenue		\$23,000
Expenses		
Advertising expense.....	\$3,600	
Rent expense	<u>2,600</u>	
Total expenses		<u>6,200</u>
Profit.....		<u><u>\$16,800</u></u>

BRIEF EXERCISE 1-18

PRAIRIE COMPANY Statement of Owner's Equity Month Ended October 31, 2014

N. Woods, Capital, October 1	\$36,000
Add: Profit	<u>16,800</u>
	52,800
Less: Drawings.....	<u>6,000</u>
N. Woods, Capital, October 31	<u><u>\$46,800</u></u>

BRIEF EXERCISE 1-19

PRAIRIE COMPANY Balance Sheet October 31, 2014

Assets	
Cash	\$ 59,300
Accounts receivable	<u>77,500</u>
Total assets	<u>\$136,800</u>
Liabilities and Owner's Equity	
Liabilities	
Accounts payable	\$ 90,000
Owner's equity	
N. Woods, capital	<u>46,800</u>
Total liabilities and owner's equity	<u>\$136,800</u>

SOLUTIONS TO EXERCISES

EXERCISE 1-1

- (a) **Chief Financial Officer — Does Roots Canada Ltd. generate enough cash to expand its product line?**

Human Resource Manager — What is Roots Canada Ltd.'s annual salary expense?

- (b) **Creditor — Does Roots Canada have enough cash available to make its monthly debt payments?**

Investor — How much did Roots Canada pay in dividends last year?

EXERCISE 1-2

	<u>Proprietorship</u>	<u>Partnership</u>	<u>Publicly Traded Corporation</u>
(a)F	F	T	
(b)F	F	F	
(c)F	F	T	
(d)F	F	T	
(e)F	F	T	
(f) F	T	T	
(g)T	T	F	
(h)F	F	T	

EXERCISE 1-3

- | | | |
|------------|-----------|---|
| (a) | 8 | Corporation |
| (b) | 10 | Generally accepted accounting principles (GAAP) |
| (c) | 1 | Accounts payable |
| (d) | 11 | Accounts receivable |
| (e) | 12 | Owner's equity |
| (f) | 5 | Prepaid expense |
| (g) | 3 | Creditor |
| (h) | 7 | Assets |
| (i) | 4 | International Financial Reporting Standards (IFRS) |
| (j) | 6 | Profit |
| (k) | 2 | Expenses |
| (l) | 9 | Unearned revenue |

EXERCISE 1-4

(a)	Total assets (beginning of year).....	\$95,000
	Total liabilities (beginning of year).....	<u>72,000</u>
	Total owner's equity (beginning of year)	<u>\$23,000</u>
 (b)	Total assets (end of year)	\$110,000
	Total owner's equity (end of year).....	<u>37,000</u>
	Total liabilities (end of year)	<u>\$ 73,000</u>
 (c)	Total owner's equity (end of year).....	\$37,000
	Total owner's equity (beginning of year)	<u>23,000</u>
	Increase in owner's equity	<u>\$14,000</u>
	 Total revenues	\$179,000
	Total expenses.....	<u>150,000</u>
	Profit	<u>\$ 29,000</u>
	 Increase in owner's equity	\$14,000
	Less: Profit.....	(29,000)
	Add: Drawings.....	<u>22,000</u>
	Investments by owner	<u>\$ 7,000</u>

Alternatively:

Owner's equity (beginning of year)	\$23,000
Add: Profit	29,000
Investments by owner ¹	<u>7,000</u>
	59,000
Deduct: drawings	<u>(22,000)</u>
Owner's equity (end of year)	<u>\$37,000</u>

$$\begin{aligned}
 &^1 \$23,000 + \$29,000 + x - \$22,000 = \$37,000 \\
 &= x + \$30,000 = \$37,000 \\
 &= \$37,000 - \$30,000 \\
 &= \$7,000
 \end{aligned}$$

(d)	Total assets (beginning of year).....	\$162,000
	Total owner's equity (beginning of year)	<u>85,000</u>
	Total liabilities (beginning of year).....	<u>\$ 77,000</u>

EXERCISE 1-4 (Continued)

(e)	Total liabilities (end of year)	\$61,000
	Total owner's equity (end of year)	<u>98,000</u>
	Total assets (end of year).....	<u>\$159,000</u>

(f)	Total owner's equity (end of year).....	\$ 98,000
	Total owner's equity (beginning of year)	<u>85,000</u>
	Increase in owner's equity	<u>\$ 13,000</u>

Total revenues	\$ 99,000
Total expenses	<u>48,000</u>
Profit.....	<u>\$ 51,000</u>

Add: Profit.....	\$ 51,000
Investments.....	<u>0</u>
.....	51,000
Deduct: Increase in owner's equity	<u>(13,000)</u>
Drawings.....	<u>\$ 38,000</u>

Alternatively:

Owner's equity(beginning of year)	\$ 85,000
Add: profit	51,000
Investments by owner	<u>0</u>
	136,000
Deduct: drawings ¹	<u>(38,000)</u>
Owner's equity (end of year)	<u>\$ 98,000</u>

$$^1 \$85,000 + \$51,000 + \$0 - x = \$98,000$$

$$= \$136,000 - \$98,000 = \$38,000$$

(g)	Total liabilities (beginning of year)	\$ 30,000
	Total owner's equity (beginning of year)	<u>33,000</u>
	Total assets (beginning of year).....	<u>\$ 63,000</u>

(h)	Total assets (end of year)	\$ 79,000
	Total liabilities (end of year)	<u>42,000</u>
	Total owner's equity (end of year).....	<u>\$ 37,000</u>

EXERCISE 1-4 (Continued)

(i)	Total owner's equity (end of year).....	\$ 37,000
	Total owner's equity (beginning of year).....	<u>33,000</u>
	Increase in owner's equity.....	<u>\$ 4,000</u>
	 Increase in owner's equity.....	 \$ 4,000
	Less: Investments.....	\$(5,000)
	Plus: Drawings.....	<u>25,000</u>
	Profit.....	<u>20,000</u>
		<u>\$24,000</u>
	 Total revenues.....	 \$85,000
	Less: Profit	<u>24,000</u>
	Total expenses	<u>\$61,000</u>

EXERCISE 1-5

(a)	Owner's equity—12/31/2012 (\$370,000–\$210,000)	\$160,000
	Owner's equity—1/1/2012	<u>0</u>
	Increase in owner's equity	160,000
	Less: Owner's investment	<u>100,000</u>
		60,000
	Add: Drawings	<u>50,000</u>
	Profit for 2012	<u><u>\$110,000</u></u>
(b)	Owner's equity—12/31/2013 (\$440,000–\$290,000)	\$150,000
	Owner's equity—12/31/2012—see (a)	<u>160,000</u>
	Decrease in owner's equity	(10,000)
	Less: Owner's investment	<u>40,000</u>
	Loss for 2013	<u><u>\$(50,000)</u></u>
(c)	Owner's equity—12/31/2014 (\$525,000–\$355,000)	\$170,000
	Owner's equity—12/31/2013—see (b)	<u>150,000</u>
	Increase in owner's equity	20,000
	Less: Owner's investment	(10,000)
	Add: Drawings	<u>60,000</u>
	Profit for 2014	<u><u>\$ 70,000</u></u>

EXERCISE 1-6

	(a)	(b)
1. Accounts payable	<u>L</u>	<u>BS</u>
2. Accounts receivable	<u>A</u>	<u>BS</u>
3. Cash	<u>A</u>	<u>BS</u>
4. Equipment	<u>A</u>	<u>BS</u>
5. Interest payable	<u>L</u>	<u>BS</u>
6. Interest revenue	<u>OE</u>	<u>IS</u>
7. Interest expense	<u>OE</u>	<u>IS</u>
8. Investment by the owner	<u>OE</u>	<u>SOE</u>
9. Service revenue	<u>OE</u>	<u>IS</u>
10. Prepaid rent	<u>A</u>	<u>BS</u>
11. P. Zizler, capital (opening balance)	<u>OE</u>	<u>SOE</u>
12. P. Zizler, drawings	<u>OE</u>	<u>SOE</u>
13. Salaries expense	<u>OE</u>	<u>IS</u>
14. Supplies	<u>A</u>	<u>BS</u>
15. Supplies expense	<u>OE</u>	<u>IS</u>
16. Unearned revenue	<u>L</u>	<u>BS</u>

EXERCISE 1-7

(a) and (b)

- 1. This accounting treatment is incorrect, as it violates the cost principle. Land was reported at its market value, when it should have been recorded and reported at cost.**
- 2. This accounting treatment is correct. Although a commitment for future payments is put into place when the lease is signed, an exchange has not yet taken place so there is no transaction that needs to be recorded. At this time, all that is required concerning this lease is to disclose the details of the commitment in the notes to the financial statements.**
- 3. This accounting treatment is incorrect, as it violates the economic entity assumption. An owner's personal transactions should be kept separate from those of the business. Instead of being charged as an expense to the business, the transaction should be recorded as drawings taken by the owner.**
- 4. This accounting treatment is incorrect, as it violates the monetary unit assumption. An important part of the monetary unit assumption is the stability of the monetary unit (the dollar) over time. Inflation is considered a non-issue for accounting purposes in Canada and is ignored.**
- 5. This accounting treatment is partially correct. It is assumed that a company is a going concern, unless the notes state otherwise. Consequently, the statement in the notes that the company is a going concern need not be added. On the other hand, the company is required to make the disclosure that it is following ASPE.**

EXERCISE 1-8

(a) and (b)

- 1. This is a transaction that should be recorded in the accounts as there has been an exchange of assets. Cash was reduced and equipment was increased. The historical cost of \$10,000 should be used in when recording this transaction.**
- 2. This is a transaction that should be recorded in the accounts as there has been an exchange of assets. Cash was reduced and equipment was increased. The transaction is to be recorded in Canadian funds in order to follow the monetary unit assumption, so the amount that should be used when recording this transaction is \$5,200.**
- 3. This is a transaction that should be recorded in the accounts because revenue has been earned from providing services and accounts receivable have been increased. The amount of \$4,000 should be used in when recording this transaction.**
- 4. This is not a transaction as an exchange has not yet occurred.**
- 5. This is a transaction that should be recorded in the accounts because an asset, cash has increased and a liability has been created to deliver services to the customer at a future date. The amount of \$4,000 should be used in when recording this transaction.**

EXERCISE 1-9

- 1. Purchase inventory on credit.**
Increases an asset (inventory) and increases a liability (accounts payable).
- 2. Investment made by owner.**
Increases an asset (cash) and increases owner's equity (owner's capital).
- 3. Payment of accounts payable.**
Decreases an asset (cash) and decreases a liability (accounts payable).
- 4. Withdrawal of cash by the owner or payment of an expense.**
Decreases an asset (cash) and decreases owner's equity (drawings or expense).
- 5. Record salaries due to employees.**
Increases a liability (salaries payable) and decreases owner's equity (expense).
- 6. Collect an accounts receivable.**
Increases one asset (cash) and decreases another asset (accounts receivable).

Note: These are examples. There are other correct responses.

EXERCISE 1-10

Assets	=	Liabilities	+	Owner's Equity
---------------	---	--------------------	---	-----------------------

Trans.	Cash	+ Accounts Rec.	+ Prepaid Ins.	+ Equip- ment
1	+\$25,000			
2	-2,000			+\$7,000
3				
4		+\$3,200		
5	-2,000			
6	+2,100	-2,100		
7	+3,000			
8	+1,000			
9	-250			
10	-700		+\$700	
Total	\$26,150	+\$1,100	+\$700	+\$7,000

+ Accounts Payable	+ Unearned Revenue	+ Note Payable
		+\$5,000
+\$250		
	+\$3,000	
-250		
\$0	+\$3,000	+\$5,000

+ H.Seigny Capital	- H.Seigny Drawings	+ Reve- nues	- Expenses
+\$25,000			
			-\$250
		+\$3,200	
	-\$2,000		
		+1,000	
+\$25,000	-\$2,000	+\$4,200	-\$250

\$34,950 = \$34,950

EXERCISE 1-11

Assets				=	Liabilities		+	Owner's Equity			
Trans.	Cash	+ Accounts Rec.	+ Equip- ment		+ Accounts Payable	+ Note Payable		+ G. Brister Capital	- G. Brister Drawings	+ Revenues	- Expenses
Bal.	\$12,000	\$18,000			\$4,000			\$26,000			
1	-3,000		+\$23,000			+\$20,000					
2	+12,000	-12,000									
3	-3,000										-\$3,000
4	-2,500				-2,500						
5	+7,000									+\$7,000	
6	-1,000										-1,000
7	-5,000								-\$5,000		
8	-2,100					-2,000					-100
9	No entry										
10					+1,500						-1,500
Total	\$14,400	+\$6,000	+\$23,000		+\$3,000	+\$18,000		+\$26,000	-\$5,000	+\$7,000	-\$5,600

\$43,400 = \$ 43,400

EXERCISE 1-12

- (a)
1. Owner invested \$18,000 cash and equipment with the fair value of \$6,000 in the business.
 2. Purchased equipment for \$8,000, paying \$4,000 in cash with the balance of \$4,000 on account.
 3. Paid for insurance for \$750 cash.
 4. Earned \$8,300 in service revenue, receiving \$3,500 cash with the remaining \$4,800 on account.
 5. Paid \$2,000 cash on accounts payable.
 6. B. Star withdrew \$3,300 cash for personal use.
 7. Paid \$800 cash for rent.
 8. Collected \$1,350 cash from customers on account.
 9. Paid salaries of \$2,700.
 10. Incurred \$420 of utilities expense on account.

(b) Revenues	\$8,300
Rent expense	(800)
Salaries expense.....	(2,700)
Utilities expense	<u>(420)</u>
Profit.....	<u>\$4,380</u>

(c) Investment	\$24,000
Profit.....	4,380
Drawings	<u>(3,300)</u>
Increase in owner's equity	<u>\$25,080</u>

EXERCISE 1-13

STAR & CO. Income Statement Month Ended July 31, 2014

Revenues		
Service revenue		\$8,300
Expenses		
Salaries expense.....	\$2,700	
Rent expense	800	
Utilities expense	<u>420</u>	
Total expenses		<u>3,920</u>
Profit.....		<u><u>\$4,380</u></u>

EXERCISE 1-13 (Continued)

STAR & CO.
Statement of Owner's Equity
Month Ended July 31, 2014

B. Star, Capital, July 1	\$ 0
Add: Investments	\$24,000
Profit	<u>4,380</u>
	28,380
	28,380
Less: Drawings	<u>3,300</u>
B. Star, Capital, July 31	<u>\$25,080</u>

STAR & CO.
Balance Sheet
July 31, 2014

Assets

Cash	\$ 9,300
Accounts receivable	3,450
Prepaid insurance	750
Equipment	<u>14,000</u>
Total assets	<u>\$27,500</u>

Liabilities and Owner's Equity

Liabilities	
Accounts payable	\$ 2,420
Owner's equity	
B. Star, Capital	<u>25,080</u>
Total liabilities and owner's equity	<u>\$27,500</u>

EXERCISE 1-14

ATLANTIC CRUISE CO.
Income Statement
Year Ended May 31, 2014

Revenues		
Ticket revenue		\$355,000
Expenses		
Salaries expense.....	\$128,000	
Maintenance expense.....	83,000	
Food, fuel and other expenses	65,500	
Interest expense	20,000	
Advertising expense.....	3,500	
Insurance expense	<u>2,400</u>	
Total expenses		<u>302,400</u>
Profit.....		<u>\$ 52,600</u>

ATLANTIC CRUISE CO.
Statement of Owner's Equity
Year Ended May 31, 2014

I. Temelkova, Capital, June 1, 2013.....		\$275,000
Add: Investments.....	\$6,000	
Profit	<u>52,600</u>	<u>58,600</u>
		333,600
Less: Drawings.....		<u>35,000</u>
I. Temelkova, Capital, May 31, 2014		<u>\$298,600</u>

EXERCISE 1-15

ATLANTIC CRUISE CO.
Balance Sheet
May 31, 2014

Assets	
Cash	\$ 19,400
Accounts receivable	42,000
Supplies	15,000
Prepaid insurance	1,200
Equipment.....	120,000
Ships	<u>550,000</u>
Total assets	<u>\$747,600</u>

Liabilities and Owner's Equity	
Liabilities	
Notes payable	\$400,000
Accounts payable	<u>49,000</u>
Total liabilities	449,000
Owner's equity	
I. Temelkova, Capital	<u>298,600</u>
Total liabilities and owner's equity	<u>\$747,600</u>

EXERCISE 1-16

(a)	Revenues—camping fees	\$150,000
	Revenues—general store	<u>40,000</u>
	Total revenue	190,000
	Operating expenses	<u>150,000</u>
	Profit	<u>\$ 40,000</u>

(b)	J. Cumby, Capital, April 1, 2013	\$17,000
	Add: Profit	<u>40,000</u>
		57,000
	Less: J. Cumby, Drawings	<u>5,000</u>
	J. Cumby, Capital, March 31, 2014	<u>\$52,000</u>

EXERCISE 1-16 (Continued)**(c)**

**DEER PARK
Balance Sheet
March 31, 2014**

Assets

Cash	\$ 9,400
Accounts receivable	21,000
Supplies	2,500
Prepaid insurance	600
Equipment.....	<u>110,000</u>
Total assets.....	<u>\$143,500</u>

Liabilities and Owner's Equity

Liabilities

Notes payable	\$ 70,000
Accounts payable	11,500
Unearned revenue	<u>10,000</u>
Total liabilities	91,500

Owner's equity

J. Cumby, Capital.....	<u>52,000</u>
Total liabilities and owner's equity	<u>\$143,500</u>

SOLUTIONS TO PROBLEMS

PROBLEM 1-1A

1. (a) In deciding to extend credit to a new customer, Pearson Industries is an external user of the accounting information of its customers.
(b) Pearson Industries would focus its attention on the information about the customer's economic resources and claims to those resources. The terms of credit they are extending require collection in a short period of time. Funds used to pay Pearson Industries would come from cash on hand. The balance sheet will show if the new customer has enough cash to meet its obligations, including those to Pearson Industries.
2. (a) The investor is the external user of the accounting information of Organic Food Solutions Ltd.
(b) When purchasing a business, the information that will be most relevant to the investor will be on the economic performance of the business as shown on the income statement. The income statement reports the past performance of the business in terms of its revenue, expenses and profit. This is the best indicator of the company's future potential and return on the investment.
3. (a) The president of Hi-tech Adventure Limited is an internal user of the accounting information.
(b) In order to determine if Hi-tech Adventure Limited is holding enough cash to increase the amount of dividends paid to shareholders and still have enough cash to buy additional equipment, the president should examine the business's economic resources and claims to those resources in order to determine if the necessary cash is available to meet obligations and address the dividend and equipment purchase plans.

PROBLEM 1-1A (Continued)

- 4. (a) Standen Bank is an external user of the accounting information of the small business that is the loan applicant.**
- (b) In deciding whether to extend a loan, Standen Bank is interested in two things—the ability of the company to make interest payments on an annual basis for the next five years and the ability to repay the principal amount at the end of five years. In order to evaluate both of these factors, the focus should be on business's economic resources and claims to those resources in order to determine if the necessary cash is available to meet obligations. As well, Standen Bank will look at the economic performance of the business that should generate the necessary cash from its operations on an ongoing basis. This will be the most important factor in determining if the company will survive and be able to repay the loan.**

Taking It Further:

When making decisions based on the financial statements of a business, users need to rely on the accuracy of the financial statements. The individual preparing the financial statements must adhere to the highest standards of ethical behaviour to ensure that the decision maker is not hurt by false or misleading financial information.

PROBLEM 1-2A

- 1. (a) Tom will likely operate his walking business as a proprietorship because he is planning on operating it for a short time period and a proprietorship is the simplest and least costly business organization to form and dissolve.**

(b) ASPE will likely be the accounting standards followed as they are simplest to follow.
- 2. (a) Joseph and Sabra might form a partnership as it is a small operation and would be easy to set up. However, a corporation may offer benefits that the partnership will not offer. The corporation will give them limited liability. Also a corporation may be the best form of business for them because they plan to raise funds in the coming year. It is easier to raise funds in a corporation. A corporation may also receive more favourable income tax treatment.**

(b) ASPE will likely be the accounting standards followed as they are simplest to follow. The business would not be a publicly traded corporation requiring the use of IFRS.
- 3. (a) The professors should incorporate their business because of their concerns about the legal liabilities. A corporation is the only form of business that provides limited liability to its owners.**

(b) ASPE will likely be the accounting standards followed as they are simplest to follow. The business would not be a publicly traded corporation requiring the use of IFRS.

PROBLEM 1-2A (Continued)

4. (a) Abdur would likely form a corporation because he needs to raise funds to invest in inventories and equipment. He has no savings or personal assets and it is normally easier to raise funds through a corporation than through a proprietorship or partnership.
- (b) ASPE will likely be the accounting standards followed as they are simplest to follow. The business would not be a publicly traded corporation requiring the use of IFRS.
5. (a) A partnership would be the most likely form of business for Evelyn, Amaan and Brenda to choose. A partnership is simpler to form than a corporation and less costly.
- (b) ASPE will likely be the accounting standards followed as they are simplest to follow.

Taking It Further:

The advantages of starting a business as a proprietorship and later incorporating the business include: the ease of formation, simplicity and reduced costs. As the business grows and the additional costs and administration that are required of corporations are justified, incorporating the business provides additional advantages.

PROBLEM 1-3A

(a)	Total assets (Jan. 1, 2013)	\$40,000
	Total liabilities (Jan. 1, 2013)	<u>0</u>
	Total owner's equity (Jan. 1, 2013)	<u>\$40,000</u>
(b)	Total liabilities (Dec. 31, 2013)	\$50,000
	Total owner's equity (Dec. 31, 2013) (c) below	<u>75,000</u>
	Total assets (Dec. 31, 2013)	<u>\$125,000</u>
(c)	Total owner's equity (Dec. 31, 2013)	\$75,000
	Equal to owner's equity (Jan. 1, 2014) given	
(d)	Total owner's equity (Dec. 31, 2013)	\$75,000
	Total owner's equity (Jan. 1, 2013)	<u>40,000</u>
	Increase in owner's equity	<u>\$35,000</u>
	Increase in owner's equity	\$35,000
	Less: Investments	(7,000)
	Add: Drawings	<u>15,000</u>
	Profit	<u>\$43,000</u>
(e)	Total revenues	\$132,000
	Less: Profit (d) above	<u>(43,000)</u>
	Total expenses	<u>\$ 89,000</u>
(f)	Total liabilities (Jan. 1, 2014)	\$50,000
	Total owner's equity (Jan. 1, 2014)	<u>75,000</u>
	Total assets (Jan. 1, 2014)	<u>\$125,000</u>
	Also same as (b) above	
(g)	Total assets (Dec. 31, 2014)	\$140,000
	Total owner's equity (Dec. 31, 2014)	<u>97,000</u>
	Total liabilities (Dec. 31, 2014)	<u>\$ 43,000</u>

PROBLEM 1-3A (Continued)

(h)	Total owner's equity (Dec. 31, 2014)	\$97,000
	Total owner's equity (Jan. 1, 2014) (c) above	<u>75,000</u>
	Increase in owner's equity	<u>\$22,000</u>
	Increase in owner's equity	\$22,000
	Less: Profit	\$40,000
	Investments	<u>0</u>
	Drawings	<u>\$18,000</u>
(i)	Profit	\$40,000
	Total expenses	<u>95,000</u>
	Total revenues	<u>\$135,000</u>
(j)	Total assets (Jan. 1, 2015)	\$140,000
	Equal to total assets (Dec. 31, 2014) given	
(k)	Total liabilities (Jan. 1, 2015)	\$43,000
	Equal to total liabilities (Dec. 31, 2014) (g) above	
(l)	Total owner's equity (Jan. 1, 2015)	\$97,000
	Equal to total owner's equity (Dec. 31, 2014) given	
(m)	Total assets (Dec. 31, 2015)	\$172,000
	Total liabilities (Dec. 31, 2015)	<u>65,000</u>
	Total owner's equity (Dec. 31, 2015)	<u>\$107,000</u>
(n)	Total owner's equity (Dec. 31, 2015)	\$107,000
	Total owner's equity (Jan. 1, 2015) (l) above	<u>97,000</u>
	Increase in owner's equity	<u>\$ 10,000</u>
	Increase in owner's equity	\$10,000
	Less: Profit (o) below	(\$31,000)
	Add: Drawings	<u>36,000</u>
	Investments	<u>\$15,000</u>

PROBLEM 1-3A (Continued)

(o) Total revenues	\$157,000
Less: Total expenses	<u>126,000</u>
Profit.....	<u>\$ 31,000</u>

Taking It Further:

In order to decide if an owner is able to withdraw cash from the business, the owner needs to find out if his capital account is sufficiently high to cover the drawings charge. He also needs to know that there is sufficient cash available in business to make the withdrawal and still have enough cash to meet the obligations of the business.

PROBLEM 1-4A

(a) and (b)

(\$ in thousands)

1.	<u>L</u>	<u>BS</u>	Accounts payable	\$ 2,598
2.	<u>A</u>	<u>BS</u>	Accounts receivable	869
3.	<u>A</u>	<u>BS</u>	Cash	1,700
4.	<u>A</u>	<u>BS</u>	Equipment	26,785
5.	<u>R</u>	<u>IS</u>	Food service revenues	5,500
6.	<u>E</u>	<u>IS</u>	Fuel expense	1,750
7.	<u>C</u>	<u>SOE</u>	G. Hirsch, capital, January 1	2,738
8.	<u>D</u>	<u>SOE</u>	G. Hirsch, drawings	2,500
9.	<u>E</u>	<u>IS</u>	Interest expense	675
10.	<u>E</u>	<u>IS</u>	Maintenance expense	1,578
11.	<u>L</u>	<u>BS</u>	Notes payable	13,500
12.	<u>A</u>	<u>BS</u>	Other assets	905
13.	<u>E</u>	<u>IS</u>	Other expenses	4,650
14.	<u>L</u>	<u>BS</u>	Other liabilities	1,735
15.	<u>R</u>	<u>IS</u>	Other revenue	230
16.	<u>R</u>	<u>IS</u>	Passenger revenues	19,765
17.	<u>E</u>	<u>IS</u>	Port fee expenses	429
18.	<u>E</u>	<u>IS</u>	Salaries expense	5,675
19.	<u>A</u>	<u>BS</u>	Supplies	550
20.	<u>L</u>	<u>BS</u>	Unearned passenger revenues	2,000

(c) (\$ in thousands)

$$\begin{aligned}
 &\text{Assets} = \text{Liabilities} + \text{Owner's Equity} \\
 &(\$869 + \$1,700 + \$26,785 + \$905 + \$550) = (\$2,598 + \$13,500 \\
 &+ \$1,735 + \$2,000) + (\$2,738 + \$230 + \$19,765 + \$5,500 - \\
 &\$1,750 - \$2,500 - \$675 - \$1,578 - \$4,650 - \$429 - \$5,675) \\
 &\$30,809 = \$19,833 + \$10,976
 \end{aligned}$$

PROBLEM 1-4A (Continued)

Taking It Further:

It is important for Sunrise Cruise Ltd. to keep track of its different types of revenues to ensure that management is able to get the necessary information to make decisions concerning where improvements in performance can be made. As well, separate revenues can be compared with their related expenses to determine the amount of profit from the different sources of revenue activity for Sunrise Cruise Ltd.

PROBLEM 1-5A

1. (a) This accounting treatment is incorrect as people involved with the organization are not an asset of the business to be placed on the balance sheet.
(b) The entries to record people as assets should be removed from the accounting records.
2. (a) This accounting treatment is incorrect as it violates the cost principle. The land and building should be recorded at the amount paid on purchase of \$350,000.
(b) The entry to increase the carrying value of the land and building from \$350,000 to \$500,000 should be removed from the accounting records of Barton Industries.
3. (a) This accounting treatment is incorrect as it violates the economic entity assumption. The electric guitar is a personal asset, and not an asset of the business.
(b) The entry to record the purchase of the guitar should be removed from the accounting records. Instead this should be recorded as a drawing by Will Viceira.
4. (a) The accountant's treatment is correct as the business can no longer be assumed to be a going concern.
(b) No change required.

PROBLEM 1-5A (Continued)

Taking It Further:

It is important for private and public companies to follow generally accepted accounting principles (GAAP) because a common set of standards, applied by all businesses and entities, provides financial statements which are reasonably comparable. Without a common set of standards, each enterprise could, develop its own theory structure and set of practices, resulting in non-comparability among enterprises, to the detriment of financial statement users.

PROBLEM 1-6A

(a) LEANNE'S TRAVEL AGENCY

	Cash	+	Acc. Rec.	+	Sup- plies	+	Pre- paid Ins.	+	Equip- ment	=	Account s Payable	+	Note Payable	+	L. Aiken, Capital	-	L. Aiken, Drawings	+	Reve- nues	-	Ex- penses
June 1	+\$23,000														+\$23,000						
2	-3,000								+\$6,800				+\$3,800								
3	-2,500																				-\$2,500
7	-675				+\$675																
8											+\$300										-300
15	+3,500		+\$7,500																+\$11,000		
22	-1,500																-\$1,500				
25	-300										-300										
30	-5,750																				-5,750
30											+300										-300
30	+6,000		-6,000																		
30	-2,400								+\$2,400												
	<u>\$16,375</u>	+	<u>\$ 1,500</u>	+	<u>\$675</u>	+	<u>\$2,400</u>	+	<u>\$6,800</u>	=	<u>\$300</u>	+	<u>\$3,800</u>	+	<u>\$23,000</u>	-	<u>\$1,500</u>	+	<u>\$11,000</u>	-	<u>\$8,850</u>
	\$27,750 = \$27,750																				

PROBLEM 1-6A (Continued)

(b) Capital Investment	\$23,000
Less: Drawings.....	<u>1,500</u>
	21,500
Add: Revenue	11,000
Less: Expenses	<u>(8,850)</u>
L. Aiken, Capital, June 30	<u>\$23,650</u>

Taking It Further:

\$300 should be reported as an asset, Supplies, on the June 30 balance sheet. This is the amount of supplies on hand. \$375 should be reported as an expense. This is the amount of supplies that were actually used in the month of June.

PROBLEM 1-7A

(a) ANITA LETOURNEAU, LAWYER

Assets					=	Liabilities			+	Owner's Equity			
Tran- sac- tion	Cash	+	+	+		+	+	+		+	-	+	-
		Acc. Rec.	Sup- plies	Equip- ment		Acc. Payable	Un- earned Rev- enue	Note Payable		A. LeTour- neau Capital	A. LeTour- neau Drawings	Rev- enues	Exp- enses
1													
2													
3	+\$50,000									+\$50,000			
4													
5	-2,500												-\$2,500
6													
7	-10,000			+10,000									
8			+\$400			+400							
9	-3,000			+\$6,500				+\$3,500					
10		+\$3,500										+\$3,500	
11	+2,500						+\$2,500						
12	-500												-500
12	-400					-400							
Total	\$36,100	\$3,500	\$400	\$16,500		\$0	\$2,500	\$3,500		\$50,000	0	\$3,500	-\$3,000

\$56,500 = \$56,500

PROBLEM 1-7A (Continued)

(a) (Continued)

Notes: Items 1 (March 4), 2 (March 7), and 4 (March 14) are not relevant to the business entity. They are personal transactions.

Item 6 (March 20) is not recorded, because the transaction has not yet been completed. There is no expense, nor liability, until he begins working.

(b) Profit = Revenues – Expenses = (\$3,500 – \$3,000) = \$500

**Owner's Equity = Investment – Drawings + Profit =
(\$50,000 – \$0 + \$500) = \$50,500**

PROBLEM 1-7A (Continued)**(c)**

ANITA LETOURNEAU, LAWYER
Balance Sheet
March 31, 2014

Assets	
Cash	\$36,100
Accounts receivable	3,500
Supplies	400
Equipment.....	<u>16,500</u>
Total assets.....	<u>\$56,500</u>
Liabilities and Owner's Equity	
Note payable.....	\$ 3,500
Unearned revenue	<u>2,500</u>
Total liabilities.....	6,000
Owner's Equity	
A. LeTourneau, Capital.....	<u>50,500</u>
Total liabilities and owner's equity	<u>\$56,500</u>

Taking It Further:

A good rule of thumb to determine whether or not a transaction should be recorded, is to test if an exchange has taken place. Only when the event represents an exchange should a transaction be recorded. As well, personal transactions must be excluded, to comply with the economic entity assumption.

[illegible]

Note that the September 28 transaction is not recorded, because the work will not commence until September.

PROBLEM 1-8A (Continued)

(b)

LISE ANDERSON MD Income Statement Month Ended September 30, 2014

Revenues	
Service revenue.....	\$20,500
Expenses	
Advertising expense	\$ 275
Rent expense	1,900
Salaries expense	2,800
Utilities expense	<u>325</u>
Total expenses.....	<u>5,300</u>
Profit	<u><u>\$15,200</u></u>

LISE ANDERSON MD Statement of Owner's Equity Month Ended September 30, 2014

L. Anderson, Capital, September 1	\$4,100
Add: Profit.....	<u>15,200</u>
	19,300
Less: Drawings	<u>1,000</u>
L. Anderson, Capital, September 30.....	<u><u>\$18,300</u></u>

PROBLEM 1-8A (Continued)**(b) (Continued)**

LISE ANDERSON MD
Balance Sheet
September 30, 2014

Assets	
Cash.....	\$ 5,525
Accounts receivable	12,800
Supplies on hand	600
Equipment	<u>9,800</u>
Total assets	<u>\$28,725</u>
Liabilities and Owner's Equity	
Liabilities	
Notes payable	\$ 6,000
Accounts payable.....	<u>4,425</u>
Total liabilities.....	10,425
Owner's Equity	
L. Anderson, Capital	<u>18,300</u>
Total liabilities and owner's equity	<u>\$28,725</u>

Taking It Further:

When an item is purchased on account, payment usually must be made in 30 days. If a note payable is used, payment will be delayed until the maturity date of the note, which is typically longer than 30 days. Although this will likely mean that interest will also have to be paid, the cash remains in the business longer than if the item had been purchased on account.

PROBLEM 1-9A

**BENNETT'S HOME RENOVATIONS
Income Statement
Year Ended December 31, 2014**

Revenues		
Service revenue.....		\$153,750
Expenses		
Interest expense.....	\$ 1,195	
Insurance expense.....	3,375	
Supplies expense.....	20,095	
Salaries expense.....	88,230	
Vehicle operating expenses.....	<u>3,545</u>	
Total expenses.....		<u>116,440</u>
Profit		<u>\$ 37,310</u>

**BENNETT'S HOME RENOVATIONS
Statement of Owner's Equity
Year Ended December 31, 2014**

J. Bennett, Capital, January 1	\$45,850
Add: Profit	<u>37,310</u>
	83,160
Less: J. Bennett, Drawings	<u>44,800</u>
J. Bennett, Capital, December 31.....	<u>\$38,360</u>

PROBLEM 1-9A (Continued)

BENNETT'S HOME RENOVATIONS
Balance Sheet
December 31, 2014

Assets	
Cash.....	\$ 8,250
Accounts receivable.....	10,080
Supplies.....	595
Prepaid insurance.....	1,685
Equipment.....	29,400
Vehicles.....	<u>42,000</u>
 Total assets	 <u><u>\$92,010</u></u>
 Liabilities and Owner's Equity	
Liabilities	
Notes payable.....	\$30,800
Accounts payable.....	7,850
Unearned revenue.....	<u>15,000</u>
Total liabilities.....	53,650
 Owner's equity	
J. Bennett, Capital.....	<u>38,360</u>
 Total liabilities and owner's equity.....	 <u><u>\$92,010</u></u>

Taking It Further:

In order to prepare the statement of owner's equity, you need to have the amount of the profit or loss for the year. This is why the income statement is prepared first. The statement of owner's equity is prepared next in order to have the ending capital balance for the balance sheet.

PROBLEM 1-10A

- (a) (i) $\$91,300 \text{ (from ii)} - \$9,500 - \$5,300 - \$41,500 = \$35,000$
 (ii) Total liabilities and owner's equity = $\$91,300$
 (iii) $\$43,800 - \$26,000 = \$17,800$
 (iv) $\$91,300 - \$43,800 = \$47,500$
 (v) $\$59,500 - \$32,000 - \$1,500 = \$26,000$
 (vi) $\$95,000 - \$59,500 = \$35,500$
 (vii) $\$62,500 - \$22,000 - \$35,500 \text{ (from viii)} = \$5,000$
 (viii) $\$35,500$ from income statement (from vi)
 (ix) $\$62,500 - \$47,500 \text{ (from x)} = \$15,000$
 (x) $\$47,500$ from the balance sheet (from iv)
- (b) In preparing the financial statements, the first statement to be prepared is the income statement. The profit figure is used in the statement of owner's equity to calculate the ending balance of capital. The balance sheet is then completed using the balance of capital as calculated in the statement of owner's equity.

Taking It Further:

The balance sheet, which is sometimes referred to as the statement of financial position, reports balances at a point in time, at the end of a reporting period. The income statement on the other hand, reports the results of revenue and expense business transactions for a period of time, whether it is a month, a quarter or a fiscal year. The statement of owner's equity also reports for the period of time, those items that have increased or decreased capital. Consequently, the income statement and the statement of owner's equity are for the period of time ending at a specific date and the balance sheet is at that specific date.

CONTINUING COOKIE CHRONICLE

- (a) Natalie has a choice between a sole proprietorship and a corporation. A partnership is not an option since she is the sole owner of the business.

A proprietorship is the easiest to create and operate because there are no formal procedures involved in creating the proprietorship. However, if she operates the business as a proprietorship she will personally have unlimited liability for the debts of the business. Operating the business as a corporation could limit her liability to her investment in the business. Natalie will in all likelihood require the services of a lawyer to incorporate. Costs to incorporate as well as additional ongoing costs to administrate and operate the business as a corporation could be more costly than a proprietorship.¹ The corporation would pay income taxes on its profits, instead of Natalie personally paying taxes on the income of the proprietorship. The amount of taxes that would be paid could be higher with the corporation.¹

My recommendation is that Natalie choose the proprietorship form of business organization. This is a very small business where the cost of incorporating outweighs the benefits of incorporating at this point in time. Furthermore, it will be easier to stop operating the business if Natalie decides not to continue with it once she is finished college.

- ¹ Additional comments that are not specifically covered in the text that some students may identify or the instructor may wish to discuss with the students.

CONTINUING COOKIE CHRONICLE (Continued)

- (b) Natalie will need information on her cash balance on a daily or weekly basis to help her determine if she can pay her bills. She will need to know the cost of her services so she can establish what to charge for her services. She will need to know the company's revenues and expenses so she can report her profit for personal income tax reporting purposes on an annual basis. If she borrows money, she will need financial statements so lenders can assess the company's ability to pay a interest and pay back a loan. Natalie would also find financial statements useful to better understand her business and identify any financial issues as early as possible. Monthly financial statements would be best because accounting information is needed on a timely basis.**

- (c) If Natalie needs to borrow money from a relative or from the bank or needs to establish credit with some suppliers, she will need to be able to present these creditors with some financial information to obtain credit and to demonstrate her ability to repay loans, plus any interest.**

The Canada Revenue Agency (CRA) is another user of the financial information Natalie will present in reporting the profit of her business on her personal income tax return. CRA will want to make sure that Natalie is reporting all of the profits properly and that the expenses of the business are in fact deductible.

CONTINUING COOKIE CHRONICLE (Continued)

- (d) **Natalie will have a choice of adopting IFRS or Accounting Standards for Private Enterprises (ASPE) because Cookie Creations is a private company. Natalie will likely use ASPE as this set of standards will meet her company's needs. As a very small private company it will not need the extra disclosure that is required by IFRS.**

- (e) **Assets: Cash, Accounts Receivable, Supplies, Equipment**

Liabilities: Accounts Payable, Unearned Revenue, Notes Payable

Owner's Equity: N. Koebel, Capital, N. Koebel, Drawings

Revenue: Fees Earned

Expenses: Advertising Expense, Interest Expense, Supplies Expense, Telephone Expense

- (f) **Natalie should have a separate bank account used solely by Cookie Creations. This will make it easier to prepare financial statements for her business. The business is a separate entity from Natalie and must be accounted for separately.**

BYP 1-1 COLLABORATIVE LEARNING ACTIVITY

All of the material supplementing the collaborative learning activity, including a suggested solution, can be found in the Collaborative Learning section of the Instructor Resources site accompanying this textbook.

BYP 1-2 COMMUNICATION ACTIVITY

Date:

To: Robert Joote

From: Student

Subject: Balance Sheet Correction

I have reviewed the balance sheet of Peak Company as at December 31, 2014 and offer the following comments for your review and consideration:

- (a) The balance in your capital account should be the accumulation of all investments, either in cash or other assets, contributed by you to the company, less any drawings, in either cash or other assets, you have made for personal use, plus profit and less losses over time.**

The purpose of a balance sheet is to present the financial position of the company at a point in time. The balance sheet lists the company's assets, liabilities and equities.

- (b) A number of items in your balance sheet are not properly reported as indicated below:**

- 1. The balance sheet should be dated as of a specific date, not for a period of time such as the month ended December 31, 2014. Rather, it should be dated "December 31, 2014."**
- 2. Assets on the balance sheet are normally ordered in order of liquidity.**
- 3. Assets include Accounts Receivable and Prepaid Insurance, which should be included in the assets section rather than as deductions to liabilities and owner's equity.**

BYP 1- 2 (Continued)

(b) (Continued)

- 4. The bottom portion of the balance sheet, headed "Liabilities and Owner's Equity", should be sub-divided into two sections: one for Liabilities and one for Owner's Equity. Liabilities accounts would include Notes Payable and Accounts Payable. The owner's equity section would include the capital account.**
- 5. Accounts Payable should be reported in the liability section, rather than as a deduction in the assets section of the balance sheet.**
- 6. R. Joote, Drawings should not be reported separately on the balance sheet but rather should be subtracted from R. Joote, Capital to arrive at owner's equity at the end of the period.**

In order to be able to prepare the statement of owner's equity, you need to have the amount of the profit or loss for the year. This is why the income statement is prepared first. In order to determine the ending balance in capital for the balance sheet, you need to prepare the statement of owner's equity second, before preparing the balance sheet.

BYP 1-2 (Continued)**(c) A correct balance sheet follows:**

PEAK COMPANY
Balance Sheet
December 31, 2014

Assets	
Cash	\$10,500
Accounts receivable	3,000
Supplies	2,000
Prepaid insurance	2,500
Equipment.....	<u>20,500</u>
 Total assets.....	<u>\$38,500</u>
Liabilities and Owner's Equity	
Liabilities	
Notes payable	\$12,000
Accounts payable	<u>5,000</u>
Total liabilities	17,000
Owner's equity	
R. Joote, Capital.....	<u>21,500</u>
Total liabilities and owner's equity	<u>\$38,500</u>

R. Joote, Capital = \$38,500 – \$17,000 = \$21,500.

BYP 1-3 ETHICS CASE

- (a) The stakeholders in this situation are the new CEO and CFO, and the creditors and investors who rely on the financial statements to make business decisions.**
- (b) The CEO and CFO should not sign the certification until they have taken steps to assure themselves that the most recent reports accurately reflect the activities of the business. However, as the current management of the company, they cannot refuse to sign the certification just because they are new. They are the management team now and must accept the responsibility that goes with these positions. When they were hired or appointed to their positions, they were aware of this requirement. Consequently, they must dedicate the necessary effort and time to become aware and familiar with the information, to allow them to sign the certification.**
- (c) The CEO and CFO have no alternative other than to take the steps necessary to assure themselves of the accuracy of the financial information, and, if accurate, sign the certification. If the information is not accurate, they need to make the required corrections to the financial information.**

BYP 1-4 “PERSONAL FINANCIAL LITERACY” ACTIVITY

- (a) 1. When deciding what kind of summer job I should apply for and whether or not I need to work part time during the school year, I need to know exactly what amounts I will have to pay for tuition, books, living expenses, and spending money during university. The rate of pay I can expect to earn is also relevant in my decision, as well as the number of weeks of work I can expect over the summer months. Finally, I would like to assess the financial stability of my employer to ensure continued employment, particularly if I am expecting to continue part-time employment beyond the summer months.
2. In order to decide whether I can afford to buy a second hand car and pay for parking or if I will need to use public transit to get back and forth to university each day, I would need several pieces of financial information to make my comparisons of costs. The relevant information in the purchase and financing of a second hand car include: the actual cost of the car, the insurance costs, the maintenance costs, the price of gas, the value of the car at the end of the school term and the price of parking. Concerning the loan I would have to negotiate to purchase the car, I would need to know the maximum amount I could borrow compared to the cost of the car, the interest rate and the amount of the payments I would need to make after I had obtained the loan. I would also have to consider the financial demands of any other debt I owe when I applied for the car loan. As for the alternative, which is to use public transit, I would need to know the cost of a transit pass for the term I am at university.

BYP 1-4 (Continued)

(a) (Continued)

3. When looking for an employer that is financially stable and has growth potential, it will be useful to have financial information. If the two are public companies, audited financial statements would be a good source of information about the companies' financial stability and growth potential.

(b) By understanding the financial statements of a business, I will be in a better position to reduce the risks involved in choosing between employers, whether this decision is for after graduation or for summer employment. By studying accounting, I will learn several skills that are relevant in making other financial decisions and making comparisons of costs for alternatives concerning my travel costs while at college.

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