

CHAPTER 1

OVERVIEW OF CORPORATE FINANCIAL REPORTING

Learning Objectives

1. Define financial accounting and understand its relationship to economic decision-making.
2. Identify the main users of financial accounting information and explain how they use this information.
3. Describe the major forms of business organization and explain the key distinctions between them.
4. Explain the three categories of business activities and identify examples of transactions related to each category.
5. Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

Summary of Questions by Learning Objectives and Bloom's Taxonomy

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
Discussion Questions														
1.	1	K	6.	2	C	11.	4	C	16.	4	C	21.	5	C
2.	3	K	7.	2	C	12.	4	C	17.	5	C	22.	5	C
3.	3	C	8.	2	C	13.	4	C	18.	5	C			
4.	3	C	9.	4	C	14.	4	C	19.	5	C			
5.	2	C	10.	5	C	15.	4	C	20.	5	C			
Application Problems														
1.	4	C	4.	5	C	7.	5	AP	10.	5	AP	13.	5	AP
2.	4	C	5.	5	AP	8.	5	AP	11.	5	AP	14.	5	AP
3.	4	AP	6.	5	AP	9.	5	AP	12.	5	AP			
User Perspective Problems														
1.	2	C	2.	2	C	3.	3	C	4.	2	C	5.	2	C
Work in Process														
1.	5	C	2.	5	C	3.	5	C	4.	5	C			
Reading and Interpreting Published Financial Statements														
1.	5	AN	3.	5	AN	5.	2,5	C						
2.	5	AN	4.	5	AN	6.	5	AN						
Cases														
1.	2	C												

Legend: The following abbreviations will appear throughout the solutions manual file.

LO	Learning objective	
BT	Bloom's Taxonomy	
	K	Knowledge
	C	Comprehension
	AP	Application
	AN	Analysis
	S	Synthesis
	E	Evaluation
Difficulty:	Level of difficulty	
	E	Easy
	M	Medium
	H	Hard
Time:	Estimated time to complete in minutes	
AACSB	Association to Advance Collegiate Schools of Business	
	Communication	Communication
	Ethics	Ethics
	Analytic	Analytic
	Tech.	Technology
	Diversity	Diversity
	Reflec. Thinking	Reflective Thinking
CPA CM	CPA Canada Competency Map	
	Ethics	Professional and Ethical Behaviour
	PS and DM	Problem-Solving and Decision-Making
	Comm.	Communication
	Self-Mgt.	Self-Management
	Team & Lead	Teamwork and Leadership
	Reporting	Financial Reporting
	Stat. & Gov.	Strategy and Governance
	Mgt. Accounting	Management Accounting
	Audit	Audit and Assurance
	Finance	Finance
	Tax	Taxation

SOLUTIONS TO DISCUSSION QUESTIONS

DQ1-1 Accounting, as an information system, provides economic information to users to allow them to determine whether the entity is operating effectively and efficiently. In addition, accounting facilitates the making of important decisions in the management of the entity, such as whether new assets should be purchased or leased, or whether equity financing should be used as opposed to debt financing.

LO 1 BT: K Difficulty: E Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-2 The owner's legal liability is as follows for each form of business:

Proprietorship: The owner (or proprietor) is responsible for the debts of the business. His or her personal assets are at risk in the event of legal action.

Partnership: The owners (or partners) are responsible for the debts of the business. Their personal assets are at risk in event of legal action.

Corporation: The owners (or shareholders) are only responsible for the debts of the corporation to the extent of their investment in the company's shares. Any debts in excess of this amount are not their responsibility.

The taxation of income is as follows for each form of business:

Proprietorship: The income of a proprietorship is taxed in the hands of the owner (i.e. the proprietor).

Partnership: The income of a partnership is taxed in the hands of the owners (i.e. the partners).

Corporation: The income of a corporation is taxed separately (i.e. the corporation files its own tax return). Any income distributed to the shareholders (i.e. dividends) is then taxed in the hands of the owners (i.e. the shareholders).

LO 3 BT: K Difficulty: E Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-3 If an entrepreneur has a relatively simple business with low liability risk, it may be better to operate the business as a proprietorship. If the entrepreneur is not looking to borrow any money he or she will not assume the personal risk. Proprietorships are easy to form and do not have any organizational costs. If the entrepreneur has no intention of expanding the business or selling the business, a proprietorship makes sense.

LO 3 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-4 A private corporation is one whose shares are held by a small number of individuals. This makes the transfer of ownership more difficult, as the shares do not trade on a public stock exchange. A public corporation has shares held by a larger number of individuals or entities and these shares are bought and sold on a public stock exchange (such as the Toronto Stock Exchange).

LO 3 BT: C Difficulty: E Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-5 **Shareholders** – These users are interested in the performance of their investment in the company. They will use the financial statements to evaluate how well management is handling their investment. Individual shareholders may also use the financial statements in assessing whether to continue to hold the shares, purchase more or sell the shares they have.

Creditors (i.e. Financial Institutions) – These users are interested in evaluating the company to decide whether to lend money to it. They will use the statements to evaluate the risk that will be taken in making the loan. This includes assessing the company's ability to service the debt (i.e. pay interest and repay principal).

Taxing Authorities – These users establish the rules for how taxable income will be measured. They are interested in the fair measurement of the financial performance of the company so that the appropriate tax will be paid. Note, however, that income taxes are not paid based on the net earnings reported in the financial statements; rather, income taxes are based on taxable income. In preparing the tax return, the financial statements' net income is the starting point and is then adjusted to arrive at taxable income.

DQ1-5 (Continued)

Financial Analysts – These users provide investment advice to their customers. They are interested in evaluating the investment potential of various companies. They will want to evaluate not only individual companies, but also make comparisons between companies, likely in the same industry.

(Note: there are other users discussed in the chapter that would be equally acceptable answers to this question.)

LO 2 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ -6 Shareholders invest in the shares of a company. They may expect to receive dividends, which are a distribution of past profits to shareholders. They also expect to eventually sell their shares at a higher price than they paid for them, due to capital appreciation.

LO 2 BT: C Difficulty: E Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-7 Capital appreciation is an increase in the market value of the shares of a company. Investors realize this type of return by purchasing shares in a company, and then later selling the shares at a higher market price than they had originally paid. Capital appreciation often results from a company's growth (i.e. increased revenues and increased profits).

LO 2 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-8 When creditors loan money to a company, they expect to receive their money back. That is one cash stream, called return of principal. The other cash stream is periodic interest that creditors receive for time they have allowed the company to use their money.

LO 2 BT: C Difficulty: E Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-9 The three major types of activities in which all companies engage are financing, investing, and operating activities.

Financing refers to the activity of obtaining funds for the company to operate. Two primary sources of funds are owners and creditors. Some typical financing activities are: short- and long-term borrowing, repayment of debt, dividend payments, and the issuance of additional shares.

Investing refers to the activity of using funds generated by financing activities to acquire assets that will generate profits in the future. Investments include the purchase of property, plant, and equipment and the purchase and sale of investments in other companies.

Operating activities are associated with developing, producing, marketing, and selling the products and/or services of the company. Operating activities are mainly concerned with the day-to-day activities of the company.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-10 The three major categories of items that appear in a typical statement of financial position (balance sheet) are assets, liabilities, and shareholders' equity.

Assets are resources owned by a company that will be used or sold for its the future economic benefit. In order to have an asset, the event that gave the company the control of the resource must have already happened. The company is able to perform its activities and thereby generate profits with the help of its assets. This means that they are income earning. Assets may be current or non-current. Current assets will be used or converted into cash within the next year or operating cycle. Examples include cash, inventory, and accounts receivable. Non-current assets are those assets whose benefits may be realized over a period longer than one year or operating cycle. Examples include property, plant, and equipment, patents, trademarks, etc.

DQ1-10 (Continued)

Liabilities are the amounts that the company owes to others and which require a probable future outflow or sacrifice of resources to settle an obligation that exists as a result of a transaction that has already taken place. Liabilities may be classified as current and non-current. Current liabilities include notes payable due within one year, accounts payable, accrued expenses, and dividends payable. Non-current liabilities include long-term debt, long-term warranties payable, and pension liabilities.

Shareholders' Equity represents the wealth or the ownership interest of the owners. Shareholders' equity may also be defined as the difference between the assets and liabilities of a company:

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

There are two major shareholders' equity accounts: share capital and retained earnings. Share capital represents the amount that investors originally paid for the shares that the company issued. Retained earnings consist of the cumulative earnings of the company less the dividends distributed to shareholders.

LO 5 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-11 Operating activities relate to the day to day activities of a company. This includes generating revenues and incurring expenses, which are the most crucial activities in relation to the long-term sustainability of a company. Investing activities occur on a more sporadic basis and includes the purchase or disposal of property, plant, and equipment as well as the purchase and resale of shares in other companies.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-12 Operating activities relate to the day to day activities of a company. This includes generating revenue and incurring expenses, which are the most crucial to the long-term sustainability of a company. Financing activities are those actions taken by a company to obtain the funding necessary to purchase assets such as buildings and equipment and investments. Financing activities also include the repayment of loan principal and payment of dividends. Financing activities are required in order to start a business. Without financing, most businesses would not be able to begin to engage in operating activities. Financing needs generally continue throughout the life of a company as it grows and expands.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-13 Costs relating to hiring and training a company's employees are considered an operating activity. The employees will perform and maintain operations so all costs related to them will be operating activities. Investing activities are related to the purchase or sale of property, plant, and equipment and shares in other companies.

LO 4 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-14 We would normally expect a company to have an overall inflow of cash from its operating activities. Unless a company is successful at generating positive cash inflows from its operations, it will ultimately run out of cash. Financing sources will dry up because the company will be unable to attract new investors or lenders. Eventually it will have to sell the property, plant, and equipment it uses to generate revenue.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-15 We would normally expect a company to have an overall cash outflow from its investing activities. These activities include the purchase of property, plant, and equipment that are purchased to generate operating revenue. Cash inflows from investing activities require the sale of investments or property, plant and equipment. Companies that are financially healthy and growing typically spend more cash on acquiring new assets than the proceeds they generate from selling the property, plant and equipment they have finished using.

LO 4 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-16 The statement of income describes the results of the operating activities from the beginning of the current period to its end. Net income is defined as revenues less expenses. Revenues are cash or resources that flow into the company from operating activities. Expenses are cash or resources that flow out of company from operating activities. Investing and financing activities are typically depicted on statement of financial position.

LO 4 BT: C Difficulty: H Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-17 The purpose of the statement of income is to measure the company's performance by the results of its operating activities for a month, a quarter, or a year. The sum of these operating activities is known as the company's profit, which is revenue less expenses. The purpose of a statement of cash flows is to present the cash related to the three categories of business activities and its objective is to enable financial statement users to assess the company's inflows and outflows relative to each of these activities. The statement of income allows users to assess how well management has operated its business and if it is profitable where as the statement of cash flows allows users to assess how well management has managed its cash and whether they will have enough cash in the future to run the business effectively.

LO 5 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ 1-18 The statement of changes in equity provides details on how each component of shareholders' equity changed during the period. Retained earnings, a component of shareholders' equity, changes each period by the net income reported on the statement of income, less any dividends that were declared by the board of directors during the period. As a result, the statement of income must be prepared first.

LO 5 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-19 The accounting equation is $\text{Assets} = \text{Liabilities} + \text{Shareholder's Equity}$. Shareholder's Equity does represent the interests of the owners or residual value left in the business after the external claims or liabilities have been paid. This is supported by the reorganization of the accounting equation: $\text{Shareholder's Equity} = \text{Assets} - \text{Liabilities}$.

LO 5 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-20 The four main financial statements contained in all annual reports are the statement of income, the statement of changes in equity, the statement of financial position, and the statement of cash flows.

Statement of Income: The statement of income records the inflow of revenues and gains and the outflow of expenses and losses over the year. The statement helps investors evaluate the performance of the company during the period and it is useful in forecasting the future results of the company.

Statement of Changes in Equity: The statement of changes in equity provides details on how each component of shareholders' equity changed during the period. This includes any changes in share capital, and any income generated by the company less amounts distributed to shareholders as dividends.

Statement of Financial Position: The statement of financial position gives the financial status of the company at a particular point in time. Since it presents the details of assets, liabilities, and shareholders' equity, it gives users a fair idea of the riskiness of the mix of assets and liabilities of the company.

DQ1-20 (Continued)

Statement of Cash Flows: This statement measures the inflow and outflow of cash during a specific period of time. It is very useful in measuring the performance of the company as well as predicting future cash flows since it gives details about the inflow and outflow of cash broken down into operating, investing, and financing activities. It explains the change in cash between the beginning and the end of the period.

LO 5 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-21 The notes to the financial statements provide more detailed information on items in the financial statements and are cross-referenced. The first, second or sometimes third note to the financial statements often discusses the Summary of Significant Accounting Policies, which describes the choices made by management from among the possible choices and judgments acceptable under accounting standards. The notes help keep the financial statements free of excessive detail, while providing meaning information to financial statement users.

LO 5 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ1-22 The management discussion and analysis (MD&A) section of the annual report provides an overview of the previous year, a discussion of the risks facing the company, and some information about business plans for the future. Many companies use this part of the report to make more extensive, detailed comments on the company and its operating results. Often the information is presented from the company's perspective.

LO 5 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

SOLUTIONS TO APPLICATION PROBLEMS

AP1-1A Examples of Canadian Tire's financing transactions:

1. Share issuance to raise capital for purchasing property, plant & equipment
2. Issuance of long-term debt to raise capital

Examples of Canadian Tire's investing transactions:

1. Purchase of buildings to house their retail stores
2. Purchase of shelving racks and other displays

Examples of Canadian Tire's operating transactions:

1. Purchase of inventory from suppliers
2. Sale of goods and services

LO 4 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-2A Examples of Bank of Nova Scotia's financing transactions:

1. Issuance of shares to investors to raise capital to lend money to customers
2. Issuance of long-term debt to raise necessary capital to have funds available to lend money (provide mortgages and loans) to customers

Examples of Bank of Nova Scotia's investing transactions:

1. Purchase of buildings and equipment for in branch operations
2. Purchase of information technology equipment and software to maintain the banking transactions and provide online access for customers

Examples of Bank of Nova Scotia's operating transactions:

1. Sale of services (interest revenue, service charges, etc.) to customers
2. Payment of wages to employees

LO 4 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-3A**
- a. O
 - b. O
 - c. F
 - d. I
 - e. F
 - f. I
 - g. O
 - h. F

LO 4 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-4A

- a. Sales revenue is found on the statement of income and represents the amounts charged to customers for the sale of goods and services.
- b. Accounts receivable appears on the statement of financial position and represents claims to cash, for the sale of goods and services, that have not yet been collected from the customer. Accounts receivable represents an asset of the company.
- c. The connection between these two accounts is that accounts receivable are created when sales have been made on credit.

LO 5 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-5A

- a. CL
- b. SI
- c. CL
- d. NCA
- e. CA
- f. SI
- g. SCF
- h. SI
- i. SC
- j. CA
- k. NCL

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-6A**
- a. NCA
 - b. SI
 - c. SCF
 - d. SI
 - e. RE and SCE
 - f. SI
 - g. SCE and SCF
 - h. SCF
 - i. SI
 - j. NCA
 - k. SCE and SCF

LO 5 BT: AP Difficulty: H Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-7A**
- a. SFP
 - b. SFP
 - c. SFP
 - d. SI
 - e. SI
 - f. N
 - g. SI
 - h. N
 - i. N
 - j. SFP

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-8A**
- a. SFP
 - b. N
 - c. SFP
 - d. SI
 - e. SFP
 - f. SFP
 - g. SI
 - h. N
 - i. SI
 - j. SI

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-9A

	A	B	C	D
Current Assets	\$570,000¹	\$600,000	\$180,000	\$990,000
Non-current Assets	780,000	735,000²	390,000	660,000³
Total Assets	1,350,000⁴	1,335,000	570,000⁵	1,650,000
Current Liabilities	375,000	345,000	135,000	390,000
Non-current Liabilities	337,000⁶	330,000	105,000⁷	225,000
Shareholders' Equity	638,000	660,000⁸	330,000	1,035,000⁹
Total Liabilities and Shareholders' Equity	1,350,000	1,335,000¹⁰	570,000¹¹	1,650,000¹²

$$^1 \$1,350,000 - \$780,000 = \$570,000$$

$$^2 \$1,335,000 - \$600,000 = \$735,000$$

$$^3 \$1,650,000 - \$990,000 = \$660,000$$

$$^4 \$1,350,000 = \text{Total Liabilities and Shareholders' Equity}$$

$$^5 \$180,000 + \$390,000 = \$570,000$$

$$^6 \$1,350,000 - \$638,000 - \$375,000 = \$337,000$$

$$^7 \$570,000^5 - \$330,000 - \$135,000 = \$105,000$$

$$^8 \$1,335,000^{10} (\text{total assets}) - \$345,000 - \$330,000 = \$660,000$$

$$^9 \$1,650,000^{12} (\text{total assets}) - \$390,000 - \$225,000 = \$1,035,000$$

$$^{10} \$1,335,000 = \text{Total Assets}$$

$$^{11} \$570,000^5 = \text{Total Assets}$$

$$^{12} \$1,650,000 = \text{Total Assets}$$

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: : Analytic CPA: cpa-t001 CM: Reporting

AP1-10A

	A	B	C	D
Retained Earnings				
Dec. 31, 2019	\$100,000	\$420,000	\$1,475,000¹	\$930,000
Net Earnings	40,000	160,000²	550,000	290,000
Dividends declared and paid	10,000	50,000	225,000	140,000³
Retained Earnings				
Dec. 31, 2020	130,000⁴	530,000	1,800,000	1,080,000

$$^1 \$1,800,000 - \$550,000 + \$225,000 = \$1,475,000$$

$$^2 \$530,000 - \$420,000 + \$50,000 = \$160,000$$

$$^3 \$930,000 + \$290,000 - \$1,080,000 = \$140,000$$

$$^4 \$100,000 + \$40,000 - \$10,000 = \$130,000$$

LO 5 BT: AP Difficulty: M Time: 15 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting

AP1-11A

a.

**A Slice of Life Ltd.
Statement of Income
For the month of November, 2xxx**

Sales Revenue		\$23,870
Cost of goods sold	\$7,130	
Wages expense	5,120	
Rent expense	1,200	
Utilities expense	1,090	
Telephone expense	<u>220</u>	
Total expenses		<u>14,760</u>
Net income		<u><u>\$ 9,110</u></u>

b. Other costs that Jason might have incurred in November not listed above include:

1. Depreciation expense for kitchen facilities and equipment
2. Income tax expense
3. Operating expenses such as gas and insurance for pizza delivery vehicles
4. Other employee benefit costs such as employer portion of CPP and EI
5. Interest expense on any bank loans owing
6. Insurance expense

LO 5 BT: AP Difficulty: E Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-12A

a.

**Call of the Wild Ltd.
Statement of Income
For the month of July, 2xxx**

Service revenue		\$ 171,430
Wages expense	\$ 49,860	
Advertising expense	14,610	
Supplies expense	25,629	
Operating expenses	3,460	
Utilities expense	<u>1,532</u>	
Total expenses		<u>95,091</u>
Net income		<u>\$ 76,339</u>

b. Other costs Michelle might have incurred in July that were not listed above include:

1. Depreciation expense of tents and rafting equipment
2. Income tax expenses
3. Interest expense on any outstanding loans
4. Insurance expense
5. Other employee benefit costs such as employer portion of CPP and EI

LO 5 BT: AP Difficulty: E Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-13A

a.	<u>Item</u>	<u>Classification</u>
	Supply of ingredients	Asset
	Wages owed to employees	Liability
	Loan owed to the bank	Liability
	Cash held in chequing account	Asset
	Cost of ovens & refrigerators	Asset
	Prepaid rent for December	Asset
	Common shares	Shareholders' equity
	Retained Earnings	Shareholders' equity

b.

A Slice of Life Ltd.
Statement of Financial Position
Nov. 30, 2xxx

Cash	\$ 3,490	Wages payable	\$ 1,460
Supplies	670	Bank loan payable	11,000
Prepaid rent	1,200	Common shares	5,000
Equipment	<u>14,300</u>	Retained earnings	<u>2,200</u>
		Total Liabilities and	
Total Assets	<u>\$ 19,660</u>	Shareholders' Equity	<u>\$19,660</u>

- c. It is unlikely that Jason will have an account called 'accounts receivable' since most of his sales will be on a cash basis. If customers purchased pizza and other food items on credit, then Jason would have accounts receivable on his statement of financial position that would represent the amount that he is owed from his customers. However, pizza parlours sell products that are relatively inexpensive, therefore most customers, if not all, will have enough funds to pay cash or use debit cards for their purchase, which is why it is unlikely that Jason will have an account called "accounts receivable". It may be necessary for him to have an accounts receivable account if he has customers that purchase frequently and/or in large quantities, such as a school. In that case, it would be appropriate to ship a large order of pizzas along with an invoice. Until the invoice is paid (by the school for example), the amount owing would be "accounts receivable".

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-14A

a.	<u>Item</u>	<u>Classification</u>
	Loan owed to bank	Liability
	Supplies on hand	Asset
	Cash in bank accounts	Asset
	Common shares	Shareholders' equity
	Cost of tents and rafts	Asset
	Retained earnings	Shareholders' equity
	Amount prepaid by customers for August trips	Liability
	Vehicles	Asset

b.

Call of the Wild Ltd.
Statement of Financial Position
As at July 31, 2xxx

Cash	\$33,670	Unearned revenue	\$19,140
Supplies	13,420	Bank loan payable	24,000
Equipment	34,100	Common shares	20,000
Vehicles	<u>38,400</u>	Retained earnings	<u>56,450</u>
	<u>\$ 119,590</u>		<u>\$ 119,590</u>

- c.** Inventory refers to products that have been purchased for resale to customers. Michelle's business does not have any products for resale to customers, but instead it provides a service, rafting excursions. Thus, the real product is not inventory but a service.
- d.** Michelle's business does not produce a product for which customers would be extended credit. Michelle would want her customers to pay in advance. Unlike a car dealership where the company can repossess the car if the customer does not pay, it would not be possible for Michelle to repossess a rafting excursion once it is complete. Furthermore, the cost for the service is likely not too high for customers to pay right away. Thus, Michelle's business is not likely to have an accounts receivable account. If Michelle provided rafting excursions to a company for several people, it is possible that she would invoice the customer and allow them to pay after the event. In this case, Michelle would have an account receivable.

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-1B** Examples of Hudson Bay Company's financing transactions:
1. Issuance of shares to investors to raise capital for the purchasing of property, plant and equipment
 2. Issuance of long-term debt to raise necessary capital to build new stores or invest in new retail technologies (such as online shopping)

- Examples of Hudson Bay Company's investing transactions:
1. Purchase of buildings and equipment for retail operations
 2. Purchase of building and vehicles for a distribution network to move inventory between warehouses and retail stores

- Examples of Hudson Bay Company's operating transactions:
1. Sale of retail inventory to customers
 2. Payment of wages to employees

LO 4 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-2B** Examples of Blackberry Limited's financing transactions:
1. Issuance of shares to investors to raise capital for the purchasing of property, plant and equipment and research and development.
 2. Issuance of long-term debt to raise necessary capital invest in new technologies (such as new versions of the Blackberry)

- Examples of Blackberry Limited's investing transactions:
1. Purchase of equipment for manufacturing operations
 2. Selling of equipment used for manufacturing operations.

- Examples of Blackberry Limited's operating transactions:
1. Sale of inventory to customers
 2. Payment of wages to employees

LO 4 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-3B**
- a. I
 - b. I
 - c. O
 - d. F
 - e. O
 - f. I
 - g. F

LO 4 BT: AP Difficulty: H Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-4B

- a. Wages payable is found on the statement of financial position and represents the amount that the company owes to the employees for time worked but not yet paid to the employees.
- b. Wages expense is found on the on the statement of income and represents the amount of wages incurred (earned by the employees) during the period, whether paid or unpaid. Wages payable represents a liability of the company and wages expense represents a use of the resources of the company.
- c. The connection between these two accounts is that wages payable is created from wages expense for time that has been worked by the employees but has not yet been paid.

LO 5 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-5B**
- a. CL
 - b. CA
 - c. SI
 - d. SCF
 - e. CA
 - f. SI and SCE
 - g. SCF
 - h. SCF
 - i. SI
 - j. SI
 - k. SCE and SCF

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-6B**
- a. NCA
 - b. SI
 - c. SCF
 - d. CA
 - e. SCE
 - f. SI
 - g. CL
 - h. SI
 - i. SI
 - j. CL
 - k. SI

LO 5 BT: AP Difficulty: H Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-7B**
- a. SFP
 - b. SI
 - c. SFP
 - d. SFP
 - e. N
 - f. SI
 - g. SI
 - h. SFP
 - i. SI
 - j. SFP

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

- AP1-8B**
- a. SFP
 - b. SI
 - c. N
 - d. SFP
 - e. SI
 - f. SFP
 - g. SFP
 - h. SFP
 - i. SI
 - j. SFP

LO 5 BT: AP Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-9B

	A	B	C	D
Current Assets	\$ 650,000	\$420,000¹	\$150,000	\$ 320,000
Non-current Assets	1,150,000²	380,000	210,000³	760,000
Total Assets	1,800,000	800,000⁴	360,000	1,080,000⁵
Current Liabilities	750,000	170,000	50,000	410,000
Non-current Liab.	500,000	205,000⁶	120,000	270,000⁷
Shareholders' Equity	550,000⁸	425,000	190,000⁹	400,000
Total Liabilities and Shareholders' Equity	1,800,000¹⁰	800,000	360,000¹¹	1,080,000¹²

¹ \$800,000⁴ - \$380,000 = \$420,000

² \$1,800,000 - \$650,000 = \$1,150,000

³ \$360,000 - \$150,000 = \$210,000

⁴ \$800,000 = Total Liabilities and Shareholders' Equity

⁵ \$320,000 + \$760,000 = \$1,080,000

⁶ \$800,000 - \$425,000 - \$170,000 = \$205,000

⁷ \$1,080,000⁵ - \$400,000 - \$410,000 = \$270,000

⁸ \$1,800,000¹⁰ (total assets) - \$750,000 - \$500,000 = \$550,000

⁹ \$360,000¹¹ (total assets) - \$50,000 - \$120,000 = \$190,000

¹⁰ \$1,800,000 = Total Assets

¹¹ \$360,000 = Total Assets

¹² \$1,080,000⁵ = Total Assets

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: : Analytic CPA: cpa-t001 CM: Reporting

AP1-10B

	A	B	C	D
Retained Earnings Dec. 31, 2019	\$70,000¹	\$350,000	\$2,400,000	\$540,000
Net Earnings (Loss)	30,000	400,000	(900,000)²	190,000
Dividends declared and paid	5,000	150,000³	200,000	340,000
Retained Earnings Dec. 31, 2020	95,000	600,000	1,300,000	390,000⁴

¹ \$95,000 - \$30,000 + \$5,000 = \$70,000

² \$1,300,000 - \$2,400,000 + \$200,000 = \$(900,000)

³ \$400,000 - \$350,000 - \$600,000 = \$150,000

⁴ \$540,000 + \$190,000 - \$340,000 = \$390,000

LO 5 BT: AP Difficulty: M Time: 15 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting

AP1-11B

a.

**Scents Unlimited Ltd.
Statement of Income
For the month of May, 2xxx**

Sales Revenue		\$24,730
Cost of goods sold	\$10,733	
Wages expense	7,000	
Telephone expense	160	
Utilities expense	370	
Rent expense	1,500	
Operating expenses	<u>329</u>	
Total expenses		<u>20,092</u>
Net income		<u>\$ 4,638</u>

b. Other costs that Lydia might have incurred in May not listed above include:

1. Depreciation expense for vehicles and equipment
2. Income tax expense
3. Cost of advertising
4. Other employee benefit costs such as employer portion of CPP and EI
5. Interest expense on any bank loans owing
6. Insurance expense

LO 5 BT: AP Difficulty: E Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-12B

a.

**Slip and Slide Ltd.
Statement of Income
For the month of July, 2xxx**

Service revenue		\$ 200,650
Parking revenue		<u>6,000</u>
Total revenues		206,650
Wages expense	\$ 25,000	
Advertising expense	5,430	
Supplies expense	15,469	
Water expense	6,153	
Utilities expense	<u>8,756</u>	
Total expenses		<u>60,808</u>
Net income		<u><u>\$ 145,842</u></u>

b. Other costs Josephine might have incurred in July that were not listed above include:

1. Depreciation expense of water park equipment
2. Income tax expenses
3. Interest expense on any outstanding loans
4. Insurance expense
5. Other employee benefit costs such as employer portion of CPP and EI

LO 5 BT: AP Difficulty: E Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-13B

a.	<u>Item</u>	<u>Classification</u>
	Inventory	Asset
	Wages owed to employees	Liability
	Loan owed to the bank	Liability
	Cash held in chequing account	Asset
	Cost of refrigerator	Asset
	Prepaid rent for June	Asset
	Common shares	Shareholders' equity
	Retained Earnings	Shareholders' equity

b.

Scents Unlimited
Statement of financial position
May 31, 2xxx

Cash	\$ 8,361	Wages payable	\$ 950
Inventory	1,100	Bank loan payable	8,000
Prepaid rent	1,500		
		Common shares	18,000
Equipment	<u>18,695</u>	Retained earnings	<u>2,706</u>
Total Assets	<u>\$ 29,656</u>	Total Liabilities and	
		Shareholders' Equity	<u>\$29,656</u>

- c.** It is unlikely that Lydia will have an account called 'accounts receivable' since most of her sales will be on a cash basis. If customers purchased flowers and other items on credit, then Lydia would have accounts receivable on her statement of financial position that would represent the amount that she is owed from her customers. However, florist shops sell products that are relatively inexpensive, therefore most customers, if not all, will have enough funds to pay cash for their purchase, which is why it is unlikely that Lydia will have an account called "accounts receivable". It may be necessary for her to have an accounts receivable account if she has customers that purchase frequently and/or in large quantities, such as an event planner. In that case, it would be appropriate to ship a large order of flowers along with an invoice. Until the invoice is paid (by the event planner for example), the amount owing would be "accounts receivable".

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP1-14B

a.	<u>Item</u>	<u>Classification</u>
	Cash in bank accounts	Asset
	Chemical supplies on hand	Asset
	Loans owed to an investor	Liability
	Retained earnings	Shareholders' equity
	Spare parts	Asset
	Common shares	Shareholders' equity
	Amount prepaid by customers to access park in August	Liability
	Cost of kayaks and pedal boats	Asset

b.

Slip and Slide Ltd.
Statement of Financial Position
As at July 31, 2xxx

Cash	\$15,000	Unearned revenue	\$35,000
Supplies	12,620	Loan payable	22,500
Spare parts	15,000	Common shares	30,000
Equipment	<u>65,000</u>	Retained earnings	<u>20,120</u>
	<u>\$ 107,620</u>		<u>\$107,620</u>

- c.** Inventory refers to products that have been purchased for resale to customers. Josephine's business does not have any products for resale to customers, but instead it provides a service, water park.
- d.** Josephine's business does not produce a product for which customers would be extended credit. Josephine would want her customers to pay in advance. Unlike a car dealership where the company can repossess the car if the customer does not pay, it would not be possible for Josephine to repossess a day at the water park once it is complete. Furthermore, the cost for the service is likely not too high for customers to pay right away. Thus, Josephine's business is not likely to have an accounts receivable account. If Josephine provided water park usage to a company for several people, it is possible that she would invoice the customer and allow them to pay after the event. In this case, Josephine would have an accounts receivable.

LO 5 BT: AP Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

USER PERSPECTIVE SOLUTIONS

UP1-1

- Selling price of each model of laptop computer
- Cost of each model of laptop computer
- Selling price of assembly services
- Cost of assembly services
- Wages paid to any employees
- Costs of parts inventory that would be required
- Information on customers, as in name, model purchased, account balance
- Information on suppliers such as time to delivery and payment policy
- Warranty information on laptops sold
- Return policy for products sold

An accounting software package could reliably keep track of the above information, as well as other relevant information for running the business.

A bank would want assurance that the loan will be repaid. This might include information about past sales and further sales prospects, as well as the cost of goods and services provided. A bank would also want to know about other current financial obligations of the business, and what the loan would be used for. It would be of particular interest whether the loan would be used to cover operating expenses or used for expansion. The bank would also be interested in any other assets you may have that could be used as security for the loan.

LO 2 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP1-2

a.

The loan officer would be interested in your company's ability to repay the loan and thus would look at net income and cash flows. The loan officer would also need to consider a backup plan in the event your company does not make the required loan payments. For example, which assets of your company could be given to the bank in lieu of repayment, or sold to provide cash for repayment? The loan officer would also look at your statement of financial position to identify the assets owned by your company, but would prefer up-to-date market values for these assets rather than the historical costs listed on the statement of financial position. Any other current or non-current liabilities would be of interest to the loan officer, as they may indicate previous obligations that could compromise the ability to repay a new loan.

b.

1. Is your net income sufficient to repay a loan?
2. Is your net income sustainable?
3. Do you have assets that could be liquidated if your cash flows are insufficient?
4. Do you have currently existing debt that will make it difficult to repay new loans?

*Other answers may also be accepted.

LO 2 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP1-3

- a. The advantages of operating the business as a proprietorship are that it is simple and inexpensive to establish and maintain.
- b. The advantages of operating the business as a corporation are that Taylor's personal assets would not be at risk in the event the company was unsuccessful. This form of business would also enable the company to raise funds by issuing shares, which is not an option if the business operated as a proprietorship. If the business proves to be success, there can be tax advantages from operating it as a corporation.
- c. Customers would likely prefer that he operates as a corporation. This gives the appearance that the business is more than a single individual.
- d. Creditors would likely prefer that he operate as a proprietorship as they would be able to access any personal assets Taylor might have in the event the business is not successful. They may be able to do this anyway, by requiring personal guarantees from Taylor for any debts.
- e. The corporate form of business would be more advantageous if Taylor expects the business to grow rapidly. Rapid growth would require additional financing, and this is easier to obtain as a corporation. As the company grew Taylor would see a related increase in the value of his shares in the company. Taylor would also have the option of selling some of his shares (for personal gain) or having the company issue additional shares to raise additional capital to fund the company's growth. There may also be tax advantages associated with organizing the business as a corporation if profits increase as a result of the growth.

LO 3 BT: C Difficulty: M Time: 30 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP1-4 Funds can be raised from several sources, but the two primary sources are from lenders and shareholders.

The advantage of borrowing from a lender is that your friend would retain complete ownership of the business and would not be required to share the decision-making and the profit of the company with anyone else. Bringing in another shareholder may result in a loss of control over the company and would also mean giving up some share of the future profits.

The disadvantage of borrowing from a lender is that loan contracts require repayment of the amount on a set schedule. This increases the risk to the company that it will not be able to make payments on a timely basis. There could be significant consequences for not making payments, including losing ownership of the company. A new shareholder would not have this same type of contractual arrangement and would be at risk in the same way as your friend. However, the new shareholder would probably expect a higher return from her/his investment than would a lender. Your friend would be giving up more potential profit to a new shareholder than lender.

Another disadvantage to borrowing is that interest must be paid on the loan. It is not optional but is tax deductible. Dividends, on the other hand, are optional and would normally only be declared by the company's board if the company was profitable.

LO 2 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP1-5 The board should consider the number of shares outstanding and the proposed dividend per share, which will determine the total cash requirements. They must also consider whether the available cash in the company is sufficient to make the dividend payment without disturbing the overall liquidity of the business in its day to day operations. If not, they may have to delay payment of the dividend, or look for ways to generate additional cash.

The dividend declaration will reduce retained earnings, so the retained earnings amount must be larger than the proposed dividend. The board should also consider the company's future plans. The retained earnings account represents the cumulative profits of the business that are kept within the company to fund future expansion plans. Dividends are declared and paid when the company has no plans to use the accumulated profits to fund future expansion. Thus, the declaration and payment of dividends only makes sense if the company does not need the cash for future expansion plans.

LO 2 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

WORK IN PROGRESS

WIP1-1

Correct elements:

- To determine if the dividends have been paid, we could review the statement of financial position, if they have been paid there will be no dividends payable account balance, if they still need to be paid there will be a dividends payable account in current liabilities. We could also look at the statement of cash flows to see if there are any dividend payments reported on under cash flows from financing activities.

Incorrect elements:

- Dividends declared are not found on the statement of income. Instead, they are found on the statement of changes in equity.
- The amount of dividends declared are not equal to the company's earnings per share (EPS). EPS is based on the net income, preferred dividends and the number of shares outstanding, whereas dividends declared is an amount determined by the Board of Directors, based on the profit for the year, cash available for the year and the strategic and operational goals of the organization. It would be very unusual for a company to distribute all of its earnings as dividends. Normally at least some portion of earnings is used to pay down liabilities or is reinvested in the company to purchase new property, plant, and equipment or other growth activities.

LO 5 BT: C Difficulty: M Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

WIP1-2

Correct elements:

- Dividends can be viewed as extra, or surplus cash flow as company boards do not declare dividends unless the company does not require these funds.

Incorrect elements:

- A company will not declare a dividend if they do not have cash to do so (cash available in their cash account) not an overall positive cash flow.
- A company will also not declare dividends unless they are profitable or have retained earnings from prior periods.
- To determine the amount of a dividend the company declared during the year, you should look at the statement of changes in shareholders' equity for the year.

LO 5 BT: C Difficulty: H Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

WIP1-3

Incorrect elements:

- Shareholder's equity is comprised of share capital (the amount of cash (or value of asset/service) received when a company issued the shares to the initial shareholders) and retained earnings (the net profits of the company from inception, less any dividends declared over the life of the company). The market price of the shares is not reflected in the shareholder's equity section of the company's statement of financial position.

LO 5 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

WIP1-4

Correct elements:

- Shareholder's equity is comprised of two parts. The first part is the amounts contributed by the shareholders and the second is the company's subsequent net earnings (net of dividends declared).
- If the company reports a profit, the retained earnings (part of shareholder's equity) will increase

Incorrect elements:

- The increase to retained earnings for the year is made up of the profit for the year less of any dividends declared by the company during the year. Profit less dividends declared = the increase or decrease in retained earnings in shareholder's equity.
- Shareholders equity is reduced by dividends declared, not dividends paid.

LO 5 BT: C Difficulty: H Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

READING AND INTERPRETING PUBLISHED FINANCIAL STATEMENTS SOLUTIONS

RI1-1

- a. Dividends declared in 2016 are \$28,691. This amount is included in the consolidated statement of changes in shareholders' equity. The actual amount paid for dividends was (\$28,649) as shown on the consolidated statement of cash flows.
- b. All amounts are in thousands of Canadian dollars.
- i. Revenues in 2016: \$2,143,736.
 - ii. Cost of sales in 2016: \$1,228,499
 - iii. Gross profit in 2016: \$915,237 or 42.7%.
 - iv. Selling, general and administrative expenses in 2016: \$786,568
 - v. Net finance costs in 2016: \$14,481
 - vi. Income tax expense in 2016: \$30,597
 - vii. Net income in 2015: \$76,629.
 - viii. Inventories at the end of 2016: \$308,801.
 - ix. Trade payables and other payables at the beginning of 2016 fiscal year: \$206,076.
 - x. Retained earnings at the end of 2016: \$613,426 (from the consolidated statement of changes in shareholders' equity or the statement of financial position).
 - xi. Loans and borrowings at the beginning of 2016: \$287,357 (\$237,257 + \$50,000)
 - xii. Cash flows provided from operating activities in 2016: \$164,648
 - xiii. Cash payments to purchase property, plant, and equipment and investment properties in 2016: (\$25,689).
 - xiv. Cash payments for dividends in 2016: \$(28,649).
 - xv. Cash flows used for financing activities in 2015: (\$72,015).
 - xvi. Cash payments to repay term loans in 2016: (\$50,000).
- c. The largest sources of cash are \$164,640 from operating activities, and \$16,184 from proceeds on sale of available-for-sale financial assets.

The largest uses of cash are (\$50,000) for repayment of term loan and (\$29,981) for purchase of available-for-sale assets.

RI1-1 (Continued)

- d. To compute cash flow from operations, net earnings are increased by the non-cash items including depreciation and amortization expense, and further adjusted by changes in working capital items such as inventory and accounts payable. Also, cash was received from warranty plan sales, which would not have been included in revenue yet, since it has not been earned.
- e. Cost of goods sold increased by \$86,793 (\$1,228,499 - \$1,141,706). General, administrative and store operating expenses increased by \$15,602 (\$786,568 - \$770,966). Income tax expense increased by \$5,807 (\$30,597 - \$24,790). Together, this helps explain “where the additional revenue went.”

LO 5 BT: AN Difficulty: M Time: 40 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

RI1-2

- a. The use of the term “consolidated” means that the company has, at a minimum, a parent company and a subsidiary – a company that is controlled by the parent company generally through holding voting shares.
- b. Amounts are in thousands of Canadian dollars

Year	<u>Current assets</u>	<u>Current liabilities</u>	<u>Working capital</u>
2017	\$16,080,182	\$11,140,597	\$4,939,585
2016	10,216,245	6,854,613	<u>3,361,632</u>
Increase in working capital			\$ <u>1,577,953</u>

The working capital did improve from 2016 to 2017, it increased by \$1,577,953. This represents a increase of approximately 47% in the ability to cover current liabilities with current assets.

RI-2 (Continued)

- c.** All amounts are in Canadian dollars.
- i. Revenues in 2017: \$45,176,380.
 - ii. Cost of sales in 2017: \$29,464,917.
 - iii. Gross profit in 2017: \$15,711,463 or 34.8%
 - iv. Selling, marketing, and administrative expenses in 2016: \$7,367,411
 - v. Income tax expense in 2016: \$658,392
 - vi. Net income in 2017: \$3,996,812.
 - vii. Intangible assets at the end of 2017: \$15,499,186
 - viii. Accounts receivable at the beginning of 2017: \$6,176,421.
 - ix. Share capital at the end of 2017: \$39,651,096.
 - x. Property, plant, and equipment at the end of 2017: \$21,709,425.
 - xi. Cash flows from in operating activities in 2017: \$9,768,209
 - xii. Cash payments to purchase property, plant, and equipment in 2017: (\$2,578,913).
 - xiii. Cash used for the payment of dividends in 2017: \$1,822,177
- d.** In 2017, 32.1% (\$17,915,020/\$55,751,121) of The Brick's assets were financed with debt, while 67.9% (\$37,836,101/\$55,751,121) were financed by equity.
- e.** The two largest sources of cash were operating activities of \$9,768,209 and the issuance of long-term debt of \$2,000,000. The two largest uses of cash were the purchase of property, plant and equipment (\$2,578,913) and the construction deposit paid of (\$2,462,328).
- f.** The income of \$3,996,812 included non-cash depreciation and amortization of \$2,875,958 and non-cash income tax expense of \$1,345,158. These are the most significant differences between the net income on the consolidated statement of income and the cash flows from operations.

LO 5 BT: AN Difficulty: M Time: 35 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

RI1-3

- a.** All amounts in thousands of Canadian dollars:
- i. Total revenues in 2016: \$81,927.
 - ii. Cost of sales in 2016: \$69,877.
 - iii. Sales and marketing expenses for 2015: \$2,341.
 - iv. Administration expenses for 2016: \$4,499
 - v. Income tax expense for 2015: \$533.
 - vi. Net income for 2016: \$4,149.
 - vii. Inventories at the end of 2016: \$11,574
 - viii. Accounts payable at the beginning of 2016: \$1,722.
 - ix. Shareholders' equity at the end of 2016: \$44,335.
 - x. Retained earnings at the end of 2016: \$357.
 - xi. Cash provided from operating activities in 2016: \$9,156.
 - xii. Cash payments to acquire plant and equipment in 2016: \$5,293.
 - xiii. Cash used to purchase short-term investments in 2016: \$12,700.
 - xiv. Cash used to pay dividends in 2016: \$2,256.
- b.** At December 31, 2016, Ten Peaks' total assets of \$67,899 were financed by liabilities of \$23,564 and equity of \$44,335. Approximately 65.3% of Peaks' assets were financed by shareholders, while 34.7% were financed using debt.
- c.** In 2016, Ten Peaks had a net cash inflow of \$12,271 from financing activities (the company paid dividends and issues convertible debentures) and a net cash outflow of \$17,993 for investing activities (the company purchased plant and equipment and short-term investments).
- d.** A classified statement of financial position presents information in order of liquidity. This is how Ten Peaks structures its consolidated statement of financial position, by separating current from non-current assets and liabilities. Current assets are reported according to liquidity, with least liquid first and most liquid last.

LO 5 BT: AN Difficulty: M Time: 35 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

RI-4

- a. All amounts are in thousands of U.S. dollars
 - i. Net sales in 2016 - \$2,585,070
 - ii. Total selling, general, and administrative expenses in 2016 – \$336,433
 - iii. Income tax expense in 2015 - \$4,526
 - iv. Net income (earnings) in 2016 - \$346,638
 - v. Inventories in the beginning of 2016 - \$851,033
 - vi. Trade accounts receivable at the end of 2016 - \$277,733
 - vii. Retained earnings at the end of 2016 - \$1,903,525
 - viii. Long-term debt at the end of 2015 - \$375,000
 - ix. Cash flows from operating activities in 2016 - \$537,898
 - x. Cash payments to acquire property, plant, and equipment in 2016 - \$129,408
 - xi. Dividends paid in 2016 - \$74,382
 - xii. Cash (used) for investing activities in 2015 - (\$425,256).

- b. At September 29, 2015, Gildan's total assets of \$2,990,144 were financed by liabilities of \$870,497 and equity of \$2,119,647. Approximately 70.9% of Gildan's assets were financed by shareholders, while only 29.1% were financed using debt.

- c. The two largest sources of cash in 2016 were cash flows from operating activities of \$537,898 and proceeds from issuance of a term loan and issuance of notes both for \$300,000 each. The two largest uses of cash in 2016 were a repurchase and cancellation of shares of \$394,451 and principal repayments of a revolving long-term bank credit facility, of \$375,000.

- d. Gildan Activewear prepared a classified statement of financial position that presents information in order of liquidity. The presence of sub-totals for current assets and current liabilities shows that the statement is a classified statement of financial position. Gildan separates current from non-current assets and liabilities. Current assets are reported according to liquidity, with most liquid first and least liquid last.

RI-4 (Continued)

e.	Year	Current assets	Current liabilities	Working capital
	Jan. 1, 2016	\$1,340,525	\$235,928	\$ 1,104,597
	Jan. 3, 2015	1,253,614	233,221	<u>1,020,393</u>
			Increase in working capital	<u><u>84,204</u></u>

Gildan's working capital increased by \$84,204,000 in fiscal year 2016. This is approximately 8% higher than working capital in fiscal year 2015.

LO 5 BT: AN Difficulty: M Time: 35 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

RI1-5 Answers to this question will depend on the company selected.

LO 2,5 BT: C Difficulty: H Time: 120 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting

RI1-6 Answers to this question will depend on the company selected.

LO 5 BT: AN Difficulty: M Time: 60 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

CASE SOLUTIONS

C1-1 Enticing Fashions Ltd.

Memorandum

To: CEO, Enticing Fashions Ltd.
From: Accountant
Re: Bank's Use of Financial Statements

As the company is seeking financing from its bank to support its expansion plans, it is understandable that the bank will be taking a greater interest in the company's financial reporting. Prior to approving any loan, the bank will use Enticing's financial statements to assess the following:

- (i) The company's ability to service a loan

The bank will use the financial statements to determine if Enticing has the earnings and cash flow to service the loan (i.e. pay interest on the loan and repay the loan principal).

Specifically, the bank will review the statement of income to assess the profitability of the company's operations. If the company does not have a track record of profits, then it unlikely a loan will be granted. If the company is not profitable, it will not be able to pay interest or repay loan principal.

The bank will use the statement of cash flows to evaluate the amount of cash the company is generating from its operating activities. It will be these cash flows that Enticing will use to pay interest and repay principal. While it will look at the company's financing and investing cash flows, the bank's primary focus will be on those generated from operations.

C1-1 (Continued)

- (ii) The extent of assets that the company has available that could be provided as security in the event of loan default

The bank will also want to ensure that it has adequate loan security. This will normally involve them taking a charge over some of the borrower's assets. For example, they may want a charge over the Enticing's accounts receivable and inventory, meaning these assets would revert to the bank for collection or sale to repay the loan if Enticing defaulted. They may also wish to use the property, plant and equipment of the company as security. This would involve the bank having a charge over Enticing's equipment, buildings, land, etc. The bank could then seize and sell these assets to repay the loan in the event of default.

The bank will use the statement of financial position to determine what assets the company could provide as security. The bank would know that, for many assets, the values on the statement of financial position represent their historic cost rather than their fair values. As such, the bank may ask Enticing to obtain appraisals for these assets prior to agreeing to accept the assets as loan security.

I hope that this enhances your understanding of how the bank may use Enticing's financial statements in the context of approving the company's loan application. Please don't hesitate to contact me if you wish to discuss this matter in greater detail.

Sincerely,

Accountant

LO 2 BT: C Difficulty: M Time: 35 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

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