

# CHAPTER 1

## ACCOUNTING IN ACTION

### SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
<b>Exercises</b>														
1.	1	C	10.	3	K	19.	3	K	28.	5	C	37.	6	AP
2.	1	C	11.	3	K	20.	3	AP	29.	5	C	38.	6	AP
3.	1	K	12.	3	K	21.	3	K	30.	5	C	39.	6	AP
4.	2	N	13.	3	AP	22.	3	AP	31.	5	C	40.	6	AP
5.	2	C	14.	3	AP	23.	3,5	AN	32.	5	C	41.	6	AP
6.	2	C	15.	3	AP	24.	4	K	33.	5	K			
7.	2	C	16.	3	AP	25.	4	C	34.	5	C			
8.	2	K	17.	3	AP	26.	4	C	35.	5	AP			
9.	2	K	18.	3	C	27.	4	K	36.	6	AP			

Note: K = Knowledge    C = Comprehension    AN = Analysis    AP = Application

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## SUMMARY OF QUESTIONS BY LEVEL OF DIFFICULTY (LOD)

Item	SO	LOD	Item	SO	LOD	Item	SO	LOD	Item	SO	LOD	Item	SO	LOD
<b>Exercises</b>														
1.	1	H	10.	3	E	19.	3	E	28.	5	M	37.	6	E
2.	1	M	11.	3	E	20.	3	H	29.	5	M	38.	6	M
3.	1	E	12.	3	E	21.	3	E	30.	5	M	39.	6	H
4.	2	E	13.	3	M	22.	3,6	M	31.	5	H	40.	6	M
5.	2	M	14.	3	E	23.	3,5	H	32.	5	H	41.	6	M
6.	2	M	15.	3	E	24.	4	M	33.	5	E			
7.	2	E	16.	3	M	25.	4	M	34.	5	M			
8.	2	M	17.	3	H	26.	4	E	35.	5	H			
9.	2	E	18.	3	M	27.	4	E	36.	6	M			

Note:      E = Easy                  M = Medium                  H=Hard

## CHAPTER STUDY OBJECTIVES

1. **Identify the use and users of accounting and the objective of financial reporting.**

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

2. **Compare different forms of business organizations and explain how Canadian accounting standards apply to these organizations.**

The most common examples of business organizations are proprietorships, partnerships, and corporations. Generally accepted accounting principles are a common set of guidelines that are used to prepare and report accounting information. In Canada, there are two sets of standards for profit-oriented businesses. Publicly accountable enterprises follow International Financial Reporting Standards (IFRS) and private enterprises have the choice of following IFRS or Accounting Standards for Private Enterprises (ASPE).

The economic entity concept requires the business activities of each economic entity to be kept separate from the activities of its owner and other economic entities. The going concern assumption presumes that a business will continue operations for enough time to use its assets for their intended purpose and to fulfill its commitments.

3. **Describe the components of the financial statements and explain the accounting equation.**

Assets, liabilities, and owner's equity are reported in the balance sheet. Assets are resources owned or controlled by a business that are expected to provide future services or benefits. Liabilities are current obligations arising from past events to make future payments of assets or services. Owner's equity is the owner's claim on the company's assets and is equal to total assets minus total liabilities. The balance sheet is based on the accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ .

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

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

A cash flow statement summarizes information about the cash inflows (receipts) and

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outflows (payments) for a specific period of time.

4. ***Determine what events are recognized in the financial statements and how the events are measured.*** Only events that cause changes in assets, liabilities, or owner's equity are recorded. Recognition is the process of recording items and measurement is the process of determining the amount that should be recognized. The cost principle states that assets should be recorded at their historical (original) cost. Fair value may be a more appropriate measure for certain types of assets. Generally fair value is the amount the asset could be sold for in the market. The monetary unit assumption requires that only transaction data that can be expressed as an amount of money be included in the accounting records, and it assumes that the monetary unit is stable.
  
5. ***Analyze the effects of business transactions on the accounting equation.*** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (1) decrease in another asset, (2) increase in a liability, and/or (3) increase in owner's equity.
  
6. ***Prepare financial statements.*** The income statement is prepared first. Expenses are deducted from revenues to calculate the profit or loss for a specific period of time. Then the statement of owner's equity is prepared using the profit or loss reported in the income statement. The profit is added to (losses are deducted from) the owner's equity at the beginning of the period. Drawings are then deducted to calculate owner's equity at the end of the period. A balance sheet reports the assets, liabilities, and owner's equity of a business as at the end of the accounting period. The owner's equity at the end of period, as calculated in the statement of owner's equity, is reported in the balance sheet in the owner's equity section.

# EXERCISES

## Exercise 1

Ogilvie Homes is a business owned by Joe Ogilvie. The accounting for this business is done by Joe's sister Leigh. Leigh is currently preparing the 2013 year end financial statements which Joe will use for three purposes:

1. to submit with his tax returns;
2. to support a loan application; and
3. to help him evaluate the success of the business.

### Instructions

- a. For each of the three purposes identified, describe the information needs the user will fulfill based on Ogilvie Home's financial statements.
- b. Leigh has suggested that she can help Joe out by recording some January 2014 revenue in December 2013. She feels this is reasonable because it is just a slight timing difference and so "not really dishonest". Comment on the ethical implications of this suggestion and explain how each of the three users' needs may be affected if Leigh implements her suggestion.

### Solution Exercise 1 (10 min)

- a. Information needs for each of the three users:
  1. The tax department will want to know whether the company respects tax laws.
  2. The bank's loans officer will evaluate the risk of granting credit or lending money.
  3. Joe will be able to assess whether the business is earning him the amount of profit he is expecting in comparison with other similar businesses.
- b. Leigh's action would be unethical because it would be misrepresenting the true results of the business operations for 2013. It would violate the trust each financial statement user places in the accounting information. The effect on each of the needs identified in part a. would be:
  1. The tax department might assess higher taxes than are really warranted.
  2. The bank might lend more money to Joe than they would otherwise, based on expectations of higher future profits than can actually be achieved because the bank's projections are based on incorrect historical information.
  3. Joe might assume that past projects were more profitable than they really were. He might therefore reject new projects based on the assumption that he does not need to increase his sales above current levels in order to earn target profit levels.

## Exercise 2

The following are six questions that users of accounting information might ask about Redpath Auto Towing (Redpath).

### Instructions

For each question, indicate who the decision maker is and whether it is an external or internal user.

	Decision	Decision maker	External or internal
a.	Can Redpath's operations generate sufficient cash to make payments on a term loan?		
b.	Does Redpath have sufficient assets to provide		

	security for a mortgage loan?		
c.	Should Redpath continue its current business, or look for more profitable opportunities in a different line of business?		
d.	Were the profit sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract?		
e.	Was the amount of goods and services taxes (GST) that Redpath remitted to the tax department equal to 5% of its revenue, as required by law?		
f.	Does Redpath have enough money in the bank to pay out drawings to the owner?		

**Solution Exercise 2** (10 min)

	<b>Decision</b>	<b>Decision maker</b>	<b>External or internal</b>
a.	Can Redpath's operations generate sufficient cash to make payments on a term loan?	Banker	External
b.	Does Redpath have sufficient assets to provide security for a mortgage loan?	Banker/lender	External
c.	Should Redpath continue its current business, or look for more profitable opportunities in a different line of business?	Management	Internal
d.	Were the profit sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract?	Employee union	External
e.	Was the amount of goods and services taxes (GST) that Redpath remitted to the tax department equal to 5% of its revenue, as required by law?	Tax assessor (Canada Revenue Agency)	External
f.	Does Redpath have enough money in the bank to pay out drawings to the owner?	Owner	Internal

**Exercise 3**

Jamenac Company recently released its first set of financial statements. Below is a list of potential users of the financial statements.

1. Labour Union
2. Employees
3. Canadian Imperial Bank of Commerce
4. CRA
5. Potential shareholders/ investors
6. Sales Manager
7. Marketing Manager
8. Economic planners
9. Provincial Securities Commission
10. Human Resource Director
11. Customers

**Instructions**

- a. For each user identify whether the user is an external or internal user.
- b. Provide a brief explanation as to the difference between external and internal users.

### **Solution Exercise 3**

- a.
  1. External
  2. Internal
  3. External
  4. External
  5. External
  6. Internal
  7. Internal
  8. External
  9. External
  10. Internal
  11. External
- b. External users do not work for the company and may use the information to base future decisions about the company (ie, loans, invest or future profitability) or in the case of governments and regulators whether the company is respecting laws and regulations. Internal users plan, organize and run the company. They use the information to create or alter future budgets, projects or for detailed comparisons.

### **Exercise 4**

Each of the following independent situations represents a violation of accounting assumptions.

1. It is now the end of 2012 and Catherine Co. is preparing its annual financial statements. The company has been experiencing severe financial difficulties and management anticipates that the company will cease operations in 2013 but this is not disclosed in the financial statements.
2. Jeff Connors runs a small business. All receipts from the business are deposited into Jeff's personal bank account and all Jeff's expenses, both personal and business, are paid out of this same account. Jeff makes no attempt to maintain separate records for the business.
3. Dean has a mining company which is very profitable. Over the past few years Dean has been very good at maintaining his business records and books. However, Dean's wife has recently been using the company account to pay for her personal expenses. She informed Dean that since he owns the company all the money earned will go to him anyways therefore using the company account or their personal bank account makes no difference.

### **Instructions**

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For each of the situations listed above, fill in the appropriate letter to indicate which of the following accounting assumptions has been violated:

- a. Going Concern Assumption
- b. Economic Entity Concept

**Solution Exercise 4 (5 min)**

1. a.
2. b.
3. b

**Exercise 5**

1. Explain the going concern assumption. How is it relevant in accounting for a business that may be going through temporary financial difficulties?
2. Explain how the economic entity concept applies when a business is owned and operated by a sole proprietor.

**Solution Exercise 5 (10 min)**

1. The going concern assumption states that one assumes that the business will continue its operations for the foreseeable future. This means that even though the business may be experiencing financial difficulties, one continues to present its assets and liabilities as though the assets will continue to be used in the business and liabilities will be able to be honoured. If it becomes apparent that the business will discontinue operations, it is necessary to report in the financial statements that the company is not a going concern.
2. The economic entity concept requires that only the events and transactions of a business be reported in the financial statements of a business. Therefore, although an unincorporated business is not a separate legal entity in the same sense that a corporation is, the accountant must still ensure that personal transactions, assets, and liabilities of the business owner are not reported in the business financial statements.

**Exercise 6**

Each of the following independent situations represents a departure from generally accepted accounting principles.

1. Strad Music Supplies is a proprietorship owned and operated by Giuseppe Amati. Giuseppe started the business with funds given to him by his uncle. He gives his uncle a copy of Strad's financial statements each year so that his uncle will see this was a good investment. In 2011 both Giuseppe and his uncle were disappointed that sales had decreased from the prior year. When Giuseppe wins \$50,000 in a lottery during 2013, he decides to record the amount as revenue in the financial statements of the business to avoid disappointing his uncle even further.
2. Xavier Quinn, the owner of Quinn's Travel is thinking of retiring in two years time because the business is not as successful as he had hoped. Xavier has always been very careful to ensure that all assets and liabilities are recorded correctly. However, since he is thinking of retiring, Xavier decides that generally accepted accounting principles are no longer relevant, so he does not double check his work as carefully as he did previously.

**Instructions**



For each situation listed above:

- a. identify which principle has been violated
- b. describe what the correct accounting treatment would be, and
- c. why the correct treatment provides better information.

### **Solution Exercise 6 (10 min)**

1. The economic entity concept has been violated. Giuseppe should record only transactions related to the business in Strad's financial statements. By including personal income, a correct evaluation of the business's performance cannot be made.
2. The going concern assumption is violated. The assets and liabilities should be accounted for as though the business were going to continue, so the accuracy of all amounts continues to be as relevant as they were before.

### **Exercise 7**

In each of the following situations, the accountant for Sydney Design Services (Sydney) must decide how to record the information in the financial statements. Sydney is a proprietorship owned and operated by Gloria Steinwald.

1. Gloria would like to borrow money from the bank to expand the business. Since she owns a house that can be pledged as security for a bank loan, she asks the accountant to ensure that the house is shown on Sydney's balance sheet.
2. The accountant is confident that with the new contract that was signed, Sydney will be a successful business for many years to come. However, before that was finalized, he was curious whether there would be any effect on accounting for the assets and liabilities of the business if its ongoing viability had been in doubt.

### **Instructions**

For each of the situations, identify which generally accepted accounting principle would guide the accountant in deciding how to report the situation, and describe the correct treatment.

### **Solution Exercise 7 (5 min)**

1. The economic entity concept requires that no personal assets are recorded in the records of the business, therefore the house should not be included on Sydney's balance sheet.
2. The going concern assumption applies. In accordance with this assumption, accounting for the business should be based on the assumption that it will continue for the foreseeable future, so there is no difference in the accounting in this situation.

### **Exercise 8**

Listed below are various types of business organizations.

1. Three individuals created a law practice.
2. Two individuals bought shares of company as an investment.
3. A single mother opens her own hair salon.
4. Husband and wife decide to open a daycare business. The wife will operate and maintain the daycare while the husband works his normal full time job. The daycare income will be reported solely on the wife's personal tax return.
5. A public company with 100 shareholders.
6. Two friends create a chocolate company business. All profits will be on their personal returns.

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**Instructions**

- a. For each of the six situations identify the type of business organization.
- b. For each of the six situations identify the owner's liability

**Solution Exercise 8**

a.	b.
1. Partnership	Unlimited
2. Corporation	Limited
3. Proprietorship	Unlimited
4. Proprietorship	Unlimited
5. Corporation	Limited
6. Partnership	Unlimited

**Exercise 9**

Listed below are various types of organizations.

1. publicly accountable enterprise
2. bank or credit unions
3. private corporation
4. security broker
5. Canadian partnership

**Instructions**

- a. For each organization, identify the appropriate accounting standards the organization should follow. (ASPE or IFRS).
- b. If applicable, identify if any organization has the option to follow both standards.

**Solution Exercise 9**

- a.
  1. IFRS
  2. IFRS
  3. ASPE
  4. IFRS
  5. ASPE
- b. Canadian private companies including corporations have the option to adopt IFRS or ASPE. Therefore 3. and 5. can adopt either set of standards.

**Exercise 10**

For the items listed below, fill in the appropriate code letter to indicate whether the item is an asset, liability, or owner's equity item.

	<u>Code</u>
Asset	A
Liability	L
Owner's Equity	OE

- |                             |                              |
|-----------------------------|------------------------------|
| _____ 1. Rent Expense       | _____ 6. Cash                |
| _____ 2. Office Equipment   | _____ 7. Accounts Receivable |
| _____ 3. Accounts Payable   | _____ 8. L. Landry, Drawings |
| _____ 4. L. Landry, Capital | _____ 9. Service Revenue     |
| _____ 5. Insurance Expense  | _____ 10. Notes Payable      |

**Solution Exercise 10** (5 min.)

1. OE
2. A
3. L
4. OE
5. OE
6. A
7. A
8. OE
9. OE
10. L

**Exercise 11**

From the following list of selected accounts taken from the records of Miller Clinic, Identify which would appear on the balance sheet.

- |                         |                      |
|-------------------------|----------------------|
| a. Jane Miller, Capital | f. Accounts Payable  |
| b. Patient Revenue      | g. Cash              |
| c. Land                 | h. Rent Expense      |
| d. Wages Expense        | i. Medical Supplies  |
| e. Notes Payable        | j. Utilities Expense |

**Solution Exercise 11** (5 min.)

- a. Jane Miller, Capital
- c. Land
- e. Notes Payable
- f. Accounts Payable

- g. Cash
- i. Medical Supplies

**Exercise 12**

Carrie's Carpet Cleaning has the following balance sheet items:

Van	Notes Payable
Accounts Payable	T. Carrie, Capital
Cash	T. Carrie, Drawings
Cleaning Supplies	Equipment
Accounts Receivable	

**Instructions**

Identify which items are

- a. Assets
- b. Liabilities
- c. Owner's Equity

**Solution Exercise 12** (5 min.)

- a. Assets—Van, Cash, Cleaning Supplies, Accounts Receivable, Equipment
- b. Liabilities—Accounts Payable, Notes Payable
- c. Owner's Equity—T. Carrie, Capital, T. Carrie, Drawings

**Exercise 13**

The following amounts are the ending balances that form the accounting equation of Anna's Consulting Services.

Accounts payable.....	\$ 2,100
Accounts receivable .....	1,900
Bank loan payable.....	60,000
Cash .....	3,000
A. Mercer, Drawings.....	12,000
Equipment.....	6,000
Expenses .....	23,800
Land and building.....	100,000
A. Mercer, Capital, beginning of year	25,000
Revenues.....	60,000
Supplies .....	400

**Instructions**

- a. For each amount, indicate whether it is classified as an Asset (A), Liability (L) or Owner Equity (OE).
- b. Calculate total assets, total liabilities, and total owner equity. Use these amounts to show that the accounting equation is in balance.

**Solution Exercise 13** (10 min)

a.

Accounts payable	2,100	L
Accounts receivable	1,900	A
Bank loan payable	60,000	L
Cash	3,000	A
A Mercer, Drawings	12,000	OE
Equipment	6,000	A
Expenses	23,800	OE
Land and building	100,000	A
A. Mercer, Capital, beginning of year	25,000	OE
Revenues	60,000	OE
Supplies	400	A

- b. Total assets = \$1,900 + \$3,000 + \$6,000 + \$100,000 + \$400 = \$111,300  
 Total liabilities = \$2,100 + \$60,000 = \$62,100  
 Total owner equity = \$25,000 + \$60,000 – \$23,800 – \$12,000 = \$49,200

$$\text{Assets } (\$111,300) = \text{Liabilities } (\$62,100) + \text{Owner equity } (\$49,200)$$

**Exercise 14**

At the beginning of the year, Diskman Company had total assets of \$700,000 and total liabilities of \$300,000.

**Instructions**

Answer the following questions viewing each situation as being independent of the others.

- If total assets increased \$250,000 during the year, and total liabilities decreased \$100,000, what is the amount of owner's equity at the end of the year?
- During the year, total liabilities increased \$340,000 and owner's equity decreased \$130,000. What is the amount of total assets at the end of the year?
- If total assets decreased \$60,000 and owner's equity increased \$190,000 during the year, what is the amount of total liabilities at the end of the year?

**Solution Exercise 14** (5 min.)

1.

	<u>Total Assets</u>		<u>Total Liabilities</u>		<u>Owner's Equity</u>
Beginning	\$700,000		\$300,000		\$400,000
Change	<u>250,000</u>		<u>(100,000)</u>		
Ending	\$950,000	–	\$200,000	=	<u>\$750,000</u>

2.

	<u>Total Assets</u>		<u>Total Liabilities</u>		<u>Owner's Equity</u>
Beginning	\$700,000		\$300,000		\$400,000
Change			<u>340,000</u>		<u>(130,000)</u>
Ending	<u>\$910,000</u>	=	\$640,000	+	\$270,000

3.

	<u>Total Assets</u>		<u>Total Liabilities</u>		<u>Owner's Equity</u>
Beginning	\$700,000		\$300,000		\$400,000
Change	<u>(60,000)</u>				<u>190,000</u>

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Ending            \$640,000            =            \$ 50,000            +            \$590,000

**Exercise 15**

Calculate the missing amount in each category of the accounting equation.

	<u>Assets</u>	<u>Liabilities</u>	<u>Owner's Equity</u>
1.	\$280,000	<u>\$ ?</u>	\$ 98,000
2.	\$178,000	\$ 63,000	<u>\$ ?</u>
3.	<u>\$ ?</u>	\$202,000	\$300,000

**Solution Exercise 15** (5 min.)

- \$182,000 (\$280,000 – \$98,000 = \$182,000).
- \$115,000 (\$178,000 – \$63,000 = \$115,000).
- \$502,000 (\$202,000 + \$300,000 = \$502,000).

**Exercise 16**

Below are three lists of accounting information with missing amounts. Each list is independent of the others.

Cash	\$ 2,100	\$ 550	\$ 1,800
Accounts receivable	1.	100	1,200
Equipment	5,000	2,500	10,000
Bank loan payable	2,000	0	5.
Accounts payable	750	3.	1,500
J. Rodriguez, Capital, beginning of year	3,000	900	5,000
J. Rodriguez, Drawings	1,200	350	3,500
Revenues	10,000	6,000	15,000
Expenses	7,000	4,000	6.
J. Rodriguez, Capital, end of year	2.	4.	2,500

**Instructions**

Use the accounting equation to determine the missing amounts.

**Solution Exercise 16** (10 min)

- \$450
- \$4,800
- \$600
- \$2,550
- \$9,000
- \$14,000

**Exercise 17**

Summaries of information from the balance sheets and income statements for four different proprietorships are provided below, with several amounts missing.

	<u>Jordan Installations</u>	<u>Campus Cleaning</u>	<u>Millenium Sales</u>	<u>Ferrier Enterprises</u>
Beginning of year				
Total assets	\$ 50,000	\$ 8,500	\$124,000	\$ 15,600
Total liabilities	24,300	3.	63,900	9,900
Total owner's equity	25,700	4,300	5.	5,700
End of year:				
Total assets	62,400	10,000	165,000	21,000
Total liabilities	25,900	5,600	69,900	7.
Total owner's equity	1.	4,400	95,100	8.
Changes in owner's equity:				
Investments	5,000	4.	10,000	1,000
Drawings	18,000	12,000	60,000	24,000
Total revenues	151,700	51,000	6.	140,000
Total expenses	2.	41,800	215,000	115,000

**Instructions**

Determine the missing amounts.

**Solution Exercise 17 (10 min)**

1. 36,500
2. 127,900
3. 4,200
4. 2,900
5. 60,100
6. 300,000
7. 13,300
8. 7,700

**Exercise 18**

The following are six questions that users of accounting information might ask about Redpath Auto Towing (Redpath).

**Instructions**

For each question determine which part of the financial statements (income statement, balance sheet, or cash flow statement) would provide the information required.

	<b>Decision</b>	<b>Financial statement used</b>
1.	Can Redpath's operations generate sufficient cash to make payments on a term loan?	
2.	Does Redpath have sufficient assets to provide security for a mortgage loan?	
3.	Should Redpath continue its current business, or look for more profitable opportunities in a different line of business?	
4.	Were the profit sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract?	
5.	Was the amount of goods and services taxes (GST) that Redpath remitted to the tax department equal to 5% of its revenue, as required by law?	
6.	Does Redpath have enough money in the bank to pay out drawings to the owner?	

### **Solution Exercise 18**

	<b>Decision</b>	<b>Financial statement used</b>
1.	Can Redpath's operations generate sufficient cash to make payments on a term loan?	Statement of cash flow
2.	Does Redpath have sufficient assets to provide security for a mortgage loan?	Balance sheet
3.	Should Redpath continue its current business, or look for more profitable opportunities in a different line of business?	Income statement
4.	Were the profit sharing bonuses paid to unionized employees equal to the percentage of profit stated in the employment contract?	Income statement
5.	Was the amount of goods and services taxes (GST) that Redpath remitted to the tax department equal to 5% of its revenue, as required by law?	Income statement
6.	Does Redpath have enough money in the bank to pay out drawings to the owner?	Balance sheet

### **Exercise 19**

Listed below are various accounts which can be found on the financial statements.

1. Cash
2. Unearned Revenue
3. Delivery Truck
4. Accounts Receivable
5. Prepaid expenses
6. Rental Income
7. Accounts Payable
8. Consulting fees earned
9. Telephone expense



10. Bank loan payable
11. Supplies expense
12. Interest Revenue
13. Sales
14. Salaries payable
15. Building
16. Note payable
17. Insurance expense
18. Owners investment
19. Commission revenue
20. Owners drawings

**Instructions**

For each account listed, identify the applicable financial statement on which the account will be presented (Balance Sheet, Income Statement or Statement of Owner's Equity).

**Solution Exercise 19**

1. Balance Sheet
2. Balance Sheet
3. Balance Sheet
4. Balance Sheet
5. Balance Sheet
6. Income Statement
7. Balance Sheet
8. Income Statement
9. Income Statement
10. Balance Sheet
11. Income Statement
12. Income Statement
13. Income Statement
14. Balance Sheet
15. Balance Sheet
16. Balance Sheet
17. Income Statement

18. Statement of Owner's Equity
19. Income Statement
20. Statement of Owner's Equity

**Exercise 20**

One item is omitted in each of the following summaries of balance sheet and income statement data for three different sole proprietorships, A, B, and C.

	Proprietorship		
	A	B	C
Beginning of the Year:			
Assets	\$400,000	\$150,000	\$199,000
Liabilities	250,000	105,000	168,000
End of the Year:			
Assets	450,000	195,000	195,000
Liabilities	280,000	95,000	169,000
During the Year:			
Additional Investment by the owner	?	79,000	80,000
Withdrawals by the owner	90,000	83,000	?
Revenue	195,000	?	187,000
Expenses	170,000	113,000	185,000

**Instructions**

Determine the amounts of the missing items, identifying each proprietorship by letter.

**Solution Exercise 20** (10 min.)

Proprietorship A (\$85,000)

Beginning Capital balance (\$400,000 – \$250,000) .....	\$150,000
Additional investments (\$260,000 – \$150,000 – \$25,000) ....	85,000
Profit for year (\$195,000 – \$170,000) .....	<u>25,000</u>
.....	260,000
Less withdrawals .....	<u>90,000</u>
Ending Capital balance (\$450,000 – \$280,000) .....	<u>\$170,000</u>

Proprietorship B (\$172,000)

Beginning Capital balance (\$150,000 – \$105,000) .....	\$ 45,000
Additional investments .....	79,000
Profit for year .....	<u>59,000</u>
[Revenue = \$172,000 (\$113,000 + \$59,000)] .....	183,000
Less withdrawals .....	<u>83,000</u>
Ending Capital balance (\$195,000 – \$95,000) .....	<u>\$100,000</u>

Proprietorship C (\$87,000)

Beginning Capital balance (\$199,000 – \$168,000) .....	\$ 31,000
Additional investments .....	80,000
Profit for year (\$187,000 – \$185,000) .....	<u>2,000</u>
.....	113,000
Less withdrawals (\$113,000 – \$26,000) .....	<u>87,000</u>
Ending Capital balance (\$195,000 – \$169,000) .....	<u>\$ 26,000</u>

**Exercise 21**

Indicate in the space provided by each item whether it would appear on the Income Statement (IS), Balance Sheet (BS), or Statement of Owner's Equity (OE):

- |          |                   |           |                     |
|----------|-------------------|-----------|---------------------|
| 1. _____ | Service Revenue   | 7. _____  | Accounts Receivable |
| 2. _____ | Utilities Expense | 8. _____  | K. Brown, Capital   |
| 3. _____ | Cash              | 9. _____  | Equipment           |
| 4. _____ | Accounts Payable  | 10. _____ | Advertising Expense |
| 5. _____ | Office Supplies   | 11. _____ | K. Brown, Drawings  |
| 6. _____ | Wage Expense      | 12. _____ | Notes Payable       |

**Solution Exercise 21** (5 min.)

1. IS
2. IS
3. BS
4. BS
5. BS
6. IS
7. BS
8. OE, BS
9. BS
10. IS
11. OE
12. BS

**Exercise 22**

The following items are taken from the December 31 financial statements of Scotia Rental Properties, an unincorporated business owned by Leo DeRosier.

		a.	b.
Accounts payable	\$ 9,320		
Accounts receivable	8,600		
Building and equipment	246,000		
Cash	15,000		
L. DeRosier, drawings	12,000		
Insurance expense	3,450		
Interest expense	5,905		
Interest payable	420		
Investments, L. DeRosier	8,000		

L. DeRosier, capital, beginning of year	40,695		
Mortgage payable	210,000		
Other assets	4,500		
Prepaid insurance	510		
Rental revenue	36,000		
Repair expenses	2,300		
Telephone expense	680		
Wages expense	5,490		

### Instructions

- For each of the above items indicate in column a. whether the item is an asset (A), liability (L), capital (C), drawings (D), revenue (R), or expense (E) item.
- For each of the above items indicate on which financial statement – income statement (IS), statement of owner's equity (OE), or balance sheet (BS) – each item would be reported.
- Calculate total assets.
- Calculate total liabilities.
- Calculate profit.
- Calculate total owner's equity.
- Demonstrate that the accounting equation is in balance.

### Solution Exercise 22 (20 min)

		a.	b.
Accounts payable	\$ 9,320	L	BS
Accounts receivable	8,600	A	BS
Building and equipment	246,000	A	BS
Cash	15,000	A	BS
L. DeRosier, Drawings	12,000	D	OE
Insurance expense	3,450	E	IS
Interest expense	5,905	E	IS
Interest payable	420	L	BS
Investments, L. DeRosier	8,000	C	OE
L DeRosier, capital, beginning of year	40,695	C	OE
Mortgage payable	210,000	L	BS
Other assets	4,500	A	BS
Prepaid insurance	510	A	BS
Rental revenue	36,000	R	IS
Repair expenses	2,300	E	IS
Telephone expense	680	E	IS
Wages expense	5,490	E	IS

- Total assets:  $(8,600 + 246,000 + 15,000 + 4,500 + 510) = 274,610$
- Calculate total liabilities:  $(9,320 + 420 + 210,000) = 219,740$
- Calculate profit:  $(36,000 - 3,450 - 5,905 - 2,300 - 680 - 5,490) = 18,175$
- Calculate total owner's equity:  $(40,695 + 8,000 + 18,175 - 12,000) = 54,870$

g. Accounting equation:  $274,610 = 219,740 + 54,870$

**Exercise 23**

Analyze the transactions described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (–) to indicate a decrease.

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
1. Received cash for services performed.	_____		_____		_____
2. Purchased office equipment on credit.	_____		_____		_____
3. Paid employees' salaries.	_____		_____		_____
4. Received cash from customer in payment on account.	_____		_____		_____
5. Paid telephone bill for the month.	_____		_____		_____
6. Paid for office equipment purchased in transaction 2.	_____		_____		_____
7. Purchased office supplies on credit.	_____		_____		_____
8. Proprietor withdrew cash for personal expenses.	_____		_____		_____
9. Obtained a loan from the bank.	_____		_____		_____
10. Billed customers for services performed.	_____		_____		_____

**Solution Exercise 23** (10 min.)

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
1. Received cash for services performed.	+				+
2. Purchased office equipment on credit.	+		+		
3. Paid employees' salaries.	–				–
4. Received cash from customer in payment on account.	+,-				
5. Paid telephone bill for the month.	–				–
6. Paid for office equipment purchased in transaction 2.	–		–		
7. Purchased office supplies on credit.	+		+		
8. Proprietor withdrew cash for personal expenses.	–				–
9. Obtained a loan from the bank.	+		+		
10. Billed customers for services performed.	+				+

**Exercise 24**

- 
1. What is meant by the cost principle? Explain why the principle is used primarily when accounting for assets used in a business.
  2. Explain the monetary unit assumption of accounting. Explain how a business may have competitive advantage(s) that are not reported in the financial statements due to this principle, and provide an example

**Solution Exercise 24**

1. Cost is the amount paid for the asset. Cost is definite and verifiable as it can be measured by fact. Users will be more comfortable with this measurement as it is objective.
2. The monetary unit assumption states that only events that can be measured in a monetary unit are reported in the financial statements, and that the same monetary unit should be used to report all transactions. However, the business may have a particularly talented work force in comparison to competitors'. Because the value of this extra talent cannot be measured in monetary terms, it is not recorded as an asset in the financial statements. [Other examples might include inventions or internally developed technology.]

**Exercise 25**

Each of the following independent situations represents a departure from generally accepted accounting principles:

1. Value Properties owns a number of apartment buildings. In April 2013 a new building was purchased for \$1,000,000. Because of the rapid increase in real estate prices, by the time Value's accountant recorded the purchase in July 2013, the estimated value of the property had increased to \$1,200,000. The accountant decided to record the new building at \$1,200,000.
2. Expat Imports International purchases products in the United States for resale in Canada. The goods they buy in the US are paid for in US dollars. In Expat's financial statements, each amount is identified as being in either US or Canadian dollars, for example as follows:

Sales .....	\$40,000	(Canadian \$)
Cost of goods sold.....	(25,000)	(US \$)
Wages expense.....	(7,000)	(Canadian \$)
Freight expense.....	<u>(2,000)</u>	(US \$)
Profit.....	<u>\$ 6,000</u>	

**Instructions**

For each situation, (i) identify which principle has been violated, (ii) describe what the correct accounting treatment would be, and (iii) why the correct treatment provides better information.

**Solution Exercise 25**

1. The cost principle has been violated. The accountant should have recorded the building at \$1,000,000. Cost is more verifiable than estimated fair values. Fair values are not relevant because the building is not being sold.
2. The monetary unit principle has been violated. The transactions should all be recorded in the equivalent Canadian dollars. By combining different currencies, the amount of profit is not meaningful.

**Exercise 26**

In each of the following situations, the accountant for Sydney Design Services (Sydney) must

decide how to record the information in the financial statements. Sydney is a proprietorship owned and operated by Gloria Steinwald.

1. In April, Sydney purchased some furniture that will be used in a client's newly designed office. Sydney paid \$4,000 for the furniture, and the client will pay Sydney \$5,600 when it is delivered and assembled in May. The accountant wants to know at which amount the furniture should be reported on the April 30 balance sheet.
2. In June, Sydney signed a long-term contract with a hotel chain to review all of their hotels' décor annually and recommend updates as fashions change. The fees will be based on the amount of time spent on the annual review. The first location will be evaluated starting in September. The accountant believes this contract is of great value to Sydney even though no money has changed hands yet, and wonders how it can be shown in the June 30 financial statements.

### **Instructions**

For each of the situations, identify which generally accepted accounting principle would guide the accountant in deciding how to report the situation, and describe the correct treatment.

### **Solution Exercise 26**

1. The cost principle states that the transaction should be reported at its cost, which is \$4,000.
2. The monetary unit assumption states that only transactions that can be measured in monetary terms should be recorded. Since no funds have changed hands, and the benefit cannot be measured until it is known how many hours are to be spent, there is no transaction that can be measured in monetary terms.

### **Exercise 27**

For each of the assumptions listed below, fill in the appropriate letter to indicate which of the following accounting assumptions have been violated.

- a) Monetary Unit Assumption
- b) Cost Principle

1. Harvester International revalues its financial statements each year to take into consideration the effects of inflation. The company justifies its decision by stating the "inflation adjusted statements more fully reflect the purchasing power of the company's earnings."
2. Ernie began operations 11 years ago and purchased land for \$200,000. Ernie has since built a manufacturing plant on this land to use in daily operations. Today Ernie has appraised the value of his land to be \$1.5 million. He would like the increase in the value of his land to be reported on the financial statements at \$1.5 million.

### **Solution Exercise 27**

1. Monetary Unit Assumption
2. Cost Principle

### **Exercise 28**

For each of the following, describe a transaction that will have the stated effect on the elements of the accounting equation.

1. Increase one asset and decrease another asset.
2. Increase an asset and increase a liability.
3. Decrease an asset and decrease a liability.

- 
4. Increase an asset and increase owner's equity.
  5. Increase one asset, decrease another asset, and increase a liability.

**Solution Exercise 28** (5 min.)

1. Receive cash from customers on account.  
Purchase supplies for cash.  
Purchase equipment for cash.
2. Purchase supplies on account.  
Purchase equipment and sign a note payable.  
Borrow money from bank.
3. Pay cash to reduce accounts payable.  
Pay cash to reduce a note payable.
4. Initial contribution by an owner  
Additional contributions by an owner  
Render services on account.  
Render services for cash.
5. Buy equipment with a cash down payment with the remainder financed by a note payable.

**Exercise 29**

The following transactions represent part of the activities of Lewis Company for the first month of its existence. Indicate the effect of each transaction upon the total assets of the business by one of the following phrases: increased total assets, decreased total assets, or no change in total assets.

1. The owner invested cash to start the business.
2. Purchased a computer for cash.
3. Purchased office equipment with money borrowed from the bank.
4. Paid the first month's utility bill.
5. Collected an accounts receivable.
6. Owner withdrew cash from the business.

**Solution Exercise 29** (5 min.)

1. Increased total assets.
2. No change in total assets.
3. Increased total assets.
4. Decreased total assets.
5. No change in total assets.
6. Decreased total assets.

**Exercise 30**

Selected transactions for the Barkley Company are listed below:

1. Paid monthly utility bill.



2. Purchased new display case for cash.
3. Paid cash for repair work on security system.
4. Billed customers for services performed.
5. Received cash from customers billed in 4.
6. Withdrew cash for owner's personal use.
7. Incurred advertising expenses on account.
8. Paid monthly rent.
9. Received cash from customers when service was provided.

### **Instructions**

List the number of the transaction and then describe the effect of each transaction on assets, liabilities, and owner's equity.

Sample: Made initial cash investment in the business. The answer would be: Increase in assets and increase in owner's equity.

### **Solution Exercise 30 (5 min.)**

1. Decrease in assets and decrease in owner's equity.
2. No net change in assets.
3. Decrease in assets and decrease in owner's equity.
4. Increase in assets and increase in owner's equity.
5. No net change in assets.
6. Decrease in assets and decrease in owner's equity.
7. Increase in liabilities and decrease in owner's equity.
8. Decrease in assets and decrease in owner's equity.
9. Increase in assets and increase in owner's equity.

### **Exercise 31**

There are ten transactions listed below:

1. Receive cash from customers on account.
2. Initial cash contribution by an owner.
3. Pay cash to reduce an accounts payable.
4. Purchase supplies for cash.
5. Pay cash to reduce a notes payable.
6. Purchase supplies on account.
7. Customers pay cash for services rendered.
8. Purchase equipment with a note payable.
9. Pay utilities with cash.
10. Owner withdraws money from the business for personal use.

### **Instructions**

Match the transactions that have the identical effect on the accounting equation. You should end

---

up with 5 matches. The first one has been completed for you with an explanation.  
Example: 1. and 4. are a match because both of them include one increase in assets and one decrease in assets, so there is no effect on the accounting equation.

**Solution Exercise 31** (10 min.)

Match #1 = 1, 4

Match #2 = 3, 5

Match #3 = 6, 8

Match #4 = 2, 7

Match #5 = 9, 10

**Exercise 32**

Selected transactions for Givens Lawn Services are listed below:

1. Purchased a new lawn mower for \$2,000, making a 10% down payment in cash, the remainder is on account.
2. Purchased \$350 supplies for cash.
3. Billed customers \$1,500 for lawn services completed.
4. Purchased used truck for \$6,500, fully financed by a bank loan.
5. Collected \$800 from customers for services previously billed.
6. Paid balance owing on lawn mower.
7. Incurred telephone expenses of \$85 on account.
8. Completed services for customers who pay \$440 cash.
9. William Givens, the owner, invests \$7,000 of additional funds in the business.
10. Part of the funds invested is used to repay the full balance of the bank loan plus \$65 in interest expense.
11. \$1,250 in wages is paid to employees.
12. William withdrew \$1,000 cash for personal use.

**Instructions**

For each transaction, state whether the transaction increases or decreases assets, liabilities and/or owner's equity, and by what amount(s).

**Solution Exercise 32** (10 min)

1. Increases assets and liabilities by \$1,800 each.
2. No effect – increase and decrease in assets offset.
3. Assets and owner's equity are each increased by \$1,500.
4. Assets and liabilities each increase by \$6,500.
5. No effect – increase and decrease in assets offset.
6. Assets and liabilities are each decreased by \$1,800.
7. Liabilities are increased by \$85 and owner's equity decreased by the same amount.

8. Assets and owner's equity are each increased by \$440.
9. Assets and owner's equity are each increased by \$7,000.
10. Assets are decreased by \$6,565, liabilities decreased by \$6,500 and owner's equity decreased by \$65.
11. Assets and owner's equity are each decreased by \$1,250.
12. Assets and owner's equity are each decreased by \$1,000.

**Exercise 33**

A service proprietorship shows five transactions summarized below. The effect of each transaction on the accounting equation is shown.

	Cash	+ Accounts Rec.	Equip- + ment	+Land	+Building	=Accounts Payable	+ Capital	- Drawings	+ Revenues	- Expenses
	\$5,000	\$6,500	\$10,000	\$7,500	\$50,000	\$3,000	\$66,000	\$20,000	\$35,000	\$5,000
1.	-2,000					-2,000				
2.	+1,000	-1,000								
3.			+5,000			+5,000				
4.	+2,500								+2,500	
5.		+3,000							+3,000	
Totals	<u>\$6,500</u>	<u>\$8,500</u>	<u>\$15,000</u>	<u>\$7,500</u>	<u>\$50,000</u>	<u>\$6,000</u>	<u>\$66,000</u>	<u>\$20,000</u>	<u>\$40,500</u>	<u>\$5,000</u>

**Instructions**

For each transaction, write an explanation of the nature of the transaction.

**Solution Exercise 33 (5 min.)**

1. Paid cash to creditors.
2. Received cash from customers on account.
3. Bought equipment on account.
4. Services provided to customers for cash.
5. Services provided on account.

**Exercise 34**

Ken Serratore decides to open a cleaning and laundry service near the local college campus that will operate as a proprietorship. The transactions for the month of June are listed below:

1. Ken Serratore invests \$20,000 in cash to start a cleaning and laundry business on June 1.
2. Purchased laundry equipment for \$5,000 paying \$3,000 in cash and the remainder due in 30 days.
3. Purchased laundry supplies for \$1,200 cash.
4. Received a bill from Campus News for \$300 for advertising in the campus newspaper.
5. Cash revenue from customers for cleaning and laundry amounted to \$1,500.
6. Paid salaries of \$200 to student workers.

7. Billed the Tiger Football Team \$100 for cleaning and laundry services.
8. Paid \$300 to Campus News for advertising that was previously billed in Transaction 4.
9. Ken Serratore withdrew \$700 from the business for living expenses.
10. Incurred utility expenses for month on account, \$400.

**Instructions**

Analyze the transactions above in terms of their effect on the basic accounting equation. Record each transaction by increasing (+) or decreasing (–) the dollar amount of each item affected. Total and balance the equation at the end of the month.

Trans- action	Cash	+ Accounts Rec.	+ Laundry Supplies	+ Laundry Equip.	=	Accounts Payable	+ K. Serratore, Capital	– K. Serratore, Drawings	+ Revenues	– Expenses
1.										
2.										
3.										
4.										
5.										
6.										
7.										
8.										
9.										
10.										
<hr/>										
Totals										

**Solution Exercise 34 (20 min.)**

Trans- action	Cash	+ Accounts Rec.	+ Laundry Supplies	+ Laundry Equip.	=	Accounts Payable	+ K. Serratore, Capital	– K. Serratore, Drawings	+ Revenues	– Expenses
1.	+\$20,000						+\$20,000			
2.	–3,000			+\$5,000	+\$2,000					
3.	–1,200		+\$1,200							
4.					+\$300					–\$300
5.	+1,500								+\$1,500	
6.	–200									–200
7.		+\$100							+\$100	
8.	–300				–300					
9.	–700							–\$700		
10.					+\$400					–400
Totals	\$16,100	\$100	\$1,200	\$5,000	\$2,400	\$20,000	–\$700	\$1,600	–\$900	

**Exercise 35**

Amanda Maynes recently started a business, Mayne Events, that will provide promotion and advertising for fund raising events hosted by charities. She will operate the business as a proprietorship. The first month’s transactions are listed below:

1. Amanda invests \$5,000 in the business out of her personal savings.
2. Amanda transfers a computer valued at \$3,000 to the business.
3. Purchases computer supplies for \$400 cash.
4. Pays \$550 for wages to an assistant.

5. Completes advertising brochures for a client, who pays \$700 for the service.
6. Advertisements for Mayne Events are run in the local newspaper at a cost of \$600 on account.
7. Provides services totaling \$1,200 for several clients – one client whose bill is \$200 pays cash, the remainder are on account.
8. Pays the amount owing to the newspaper for the advertisements described in 6.
9. Half the amount receivable from customers is collected.
10. Purchases additional computer equipment for \$450, cash.
11. Amanda withdraws \$300 for personal use.

**Instructions**

- a. For each of the above items, determine the accounts that will be affected and, in the table provided, set up the headings in the order of the accounting equation.
- b. For each of the above items, record each transaction in the table provided.
- c. Calculate total assets.
- d. Calculate total liabilities.
- e. Calculate profit.
- f. Calculate owner’s equity.
- g. Demonstrate that the accounting equation is in balance.

Trans- action									
1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									
10.									
11.									
Totals									

**Solution Exercise 35 (20 min)**

a. and b.

Trans- action	Cash	A/R	Supplies	Computer equipment	Accounts payable	A. Maynes, Capital	A. Maynes, Drawings	Revenue	Expenses
1.	+\$5,000					+\$5,000			
2.				+\$3,000		+3,000			
3.	-400		+\$400						
4.	-550								-\$550
5.	+700							+\$700	
6.					+\$600				-600
7.	+200	+\$1,000						+1,200	
8.	-600				-600				
9.	+500	-500							

10.	-450			+450					
11.	-300								
Totals	\$4,100	\$500	\$400	\$3,450	\$0	\$8,000	\$-300	\$1,900	-\$1,150

- c. Total assets = \$4,100 + \$500 + \$400 + \$3,450 = \$8,450
- d. Total liabilities = -0-
- e. Profit = \$1,900 – \$1,150 = \$750
- f. Owner's equity = \$8,000 + \$750 – \$300 = \$8,450
- g. The accounting equation \$8,450 = \$0 + \$8,450

**Exercise 36**

Presented below is a balance sheet for the Marks Lawn Service at December 31, 2013.

**MARKS LAWN SERVICE**  
Balance Sheet  
December 31, 2013

<u>Assets</u>		<u>Liabilities and Owner's Equity</u>	
Cash	\$12,000	Liabilities	
Accounts receivable	7,000	Accounts payable	\$ 8,000
Supplies	9,000	Notes payable	15,000
Equipment	11,000	Owner's equity	
		B. Marks, Capital	<u>16,000</u>
Total assets	<u>\$39,000</u>	Total liabilities & owner's equity	<u>\$39,000</u>

The following additional data are available for the year which began on January 1, 2013: All expenses (excluding supplies expense) total \$6,000. Supplies on January 1, were \$11,000 and \$3,000 of supplies were purchased during the year. Profit for the year was \$8,000 and drawings were \$5,000.

**Instructions**

Determine the following: (Show all calculations.)

- a. Supplies used during the year.
- b. Total expenses for the year.
- c. Service revenues for the year.
- d. Bill Marks' capital balance on January 1.

**Solution Exercise 36** (10 min.)

- a. Calculation of Supplies Used:

Beginning Supplies, Jan. 1 .....	\$11,000
Add: Purchases .....	3,000
Less: Ending Supplies, Dec. 31 .....	<u>(9,000)</u>
Equals: Supplies Used .....	<u>\$ 5,000</u>
  
- b. Calculation of Total Expenses:

All Expenses (excluding supplies expense) .....	\$ 6,000
Plus: Supplies Used .....	<u>5,000</u>

Total Expenses.....	<u>\$11,000</u>
c. Calculation of Revenues:	
Profit .....	\$ 8,000
Plus: Total Expenses.....	<u>11,000</u>
Total Revenues .....	<u>\$19,000</u>
d. Calculation of Bill Marks, Capital on January 1:	
Capital, December 31.....	\$16,000
Plus: Drawings .....	5,000
Less: Profit .....	<u>(8,000)</u>
Capital, January 1 .....	<u>\$13,000</u>

**Exercise 37**

Greg Stewart was reviewing his business activities at the end of the year (February 28, 2013) and decided to prepare a Statement of Owner's Equity. At the beginning of the year, his assets were \$500,000 and his liabilities were \$150,000. At the end of the year the assets had grown to \$950,000 but liabilities had also increased to \$300,000. The profit for the year was \$420,000. Greg had withdrawn \$120,000 during the year for his personal use.

**Instructions**

Prepare a Statement of Owner's Equity in good form.

**Solution Exercise 37 (5 min.)**

GREG STEWART  
Statement of Owner's Equity  
Year Ended February 28, 2013

G. Stewart, Capital March 1, 2012.....	\$350,000
Add: Profit .....	<u>420,000</u>
.....	770,000
Less: Drawings.....	<u>120,000</u>
G. Stewart, Capital February 28, 2013.....	<u>\$650,000</u>

**Exercise 38**

At September 1, 2013, the balance sheet accounts for Roxanne's Restaurant were as follows:

Accounts Payable.....	\$ 3,800	Land .....	\$33,000
Accounts Receivable .....	1,600	R. Roy, Capital .....	?
Building .....	68,000	Notes Payable .....	48,000
Cash.....	5,000	Supplies .....	6,600
Furniture.....	18,700		

The following transactions occurred during the next two days:  
Roxanne invested an additional \$22,000 cash in the business. The accounts payable were paid in full. (No payment was made on the notes payable.)

**Instructions**

Prepare a Balance Sheet at September 3, 2013.

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**Solution Exercise 38** (10 min.)

ROXANNE'S RESTAURANT  
Balance Sheet  
September 3, 2013

ASSETS

Cash .....	\$ 23,200
Accounts receivable .....	1,600
Supplies .....	6,600
Furniture.....	18,700
Building .....	68,000
Land .....	<u>33,000</u>
Total assets .....	<u>\$151,100</u>

LIABILITIES

Notes payable .....	\$ 48,000
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OWNER'S EQUITY

R. Roy, Capital .....	<u>103,100</u>
Total liabilities and owner's equity.....	<u>\$151,100</u>

Cash ( $\$5,000 + \$22,000 - \$3,800$ ) = \$23,200

Accounts Payable ( $\$3,800 - \$3,800$ ) = \$0. Note that nil balances are not normally reported in the financial statements.

R. Roy, Capital:	Beginning balance .....	\$ 81,100
	Additional investment.....	<u>22,000</u>
	Ending balance.....	<u>\$103,100</u>

**Exercise 39**

The dental practice of Pamela Bell, DDS, has the following items for the month of September, 2013.

P. Bell, Capital (September 1) .....	\$42,000
Accounts payable .....	7,000
Equipment.....	30,000
Service revenue .....	25,000
P. Bell, Drawings.....	6,000
Dental supplies expense .....	3,500
Cash.....	8,000
Utilities expense .....	700
Dental supplies.....	2,800
Salaries expense.....	7,000
Accounts receivable .....	14,000
Rent expense .....	2,000

**Instructions**

Prepare an income statement, a statement of owner's equity, and a balance sheet for the dental



practice in the following formats:

PAMELA BELL, DDS  
Income Statement  
Month Ended September 30, 2013

---

Revenues		\$
Expenses		
	\$	
Total expenses		\$ _____
Profit		\$ _____

PAMELA BELL, DDS  
Statement of Owner's Equity  
Month Ended September 30, 2013

---

P. Bell, Capital, September 1	\$
Add:	\$ _____
Less:	\$ _____
P. Bell, Capital, September 30	\$ _____

PAMELA BELL, DDS  
Balance Sheet  
September 30, 2013

---

ASSETS		\$
Total Assets		\$ _____
LIABILITIES AND OWNER'S EQUITY		
Liabilities		\$ _____
Owner's Equity		\$ _____
Total liabilities and owner's equity		\$ _____

**Solution Exercise 39** (15 min.)

PAMELA BELL, DDS  
Income Statement  
Month Ended September 30, 2013

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---

Revenues		
Service revenue .....		\$25,000
Expenses		
Salaries expense .....	\$7,000	
Dental supplies expense.....	3,500	
Rent expense .....	2,000	
Utilities expense .....	<u>700</u>	
Total expenses .....		<u>13,200</u>
Profit .....		<u>\$11,800</u>

PAMELA BELL, DDS  
Statement of Owner's Equity  
Month Ended September 30, 2013

P. Bell, capital, September 1 .....	\$42,000
Add: Profit .....	<u>11,800</u>
	53,800
Less: Drawings.....	<u>6,000</u>
P. Bell, capital, September 30 .....	<u>\$47,800</u>

PAMELA BELL, DDS  
Balance Sheet  
September 30, 2013

---

ASSETS	
Cash .....	\$ 8,000
Accounts receivable .....	14,000
Dental supplies.....	2,800
Equipment.....	<u>30,000</u>
Total assets.....	<u>\$54,800</u>

LIABILITIES AND OWNER'S EQUITY	
Liabilities	
Accounts payable .....	\$ 7,000
Owner's Equity	
P. Bell, capital.....	<u>47,800</u>
Total liabilities and owner's equity.....	<u>\$54,800</u>

**Exercise 40**

Listed below, in alphabetical order, are the balance sheet items of Sing Company at December 31, 2013.

Accounts Payable.....	\$ 9,000
Accounts Receivable .....	15,000
Building .....	46,000
Cash.....	12,000
Land .....	52,000
Office Equipment.....	4,000

S. Sing, Capital..... 120,000

**Instructions**

Prepare a balance sheet and include a complete heading.

**Solution Exercise 40** (5 min.)

SING COMPANY  
Balance Sheet  
December 31, 2013

ASSETS	
Cash .....	\$ 12,000
Accounts receivable .....	15,000
Office equipment .....	4,000
Building .....	46,000
Land .....	<u>52,000</u>
Total assets .....	<u>\$129,000</u>
LIABILITIES	
Accounts payable .....	\$ 9,000
OWNER'S EQUITY	
S. Sing, capital .....	<u>120,000</u>
Total liabilities and owner's equity .....	<u>\$129,000</u>

**Exercise 41**

William Calvin owns and operates Sales Consulting, an unincorporated consulting firm. The following information is based on December 31, 2014 year end ending balances for the firm. (All amounts are in 000's).

	\$
Accounts payable	1,860
Accounts receivable	3,340
Cash	1,705
Drawings, W. Calvin	4,800
Fees earned	10,600
Insurance expense	900
Investments, W. Calvin	1,500
Prepaid insurance	80
Supplies	120
Telephone expense	480
W. Calvin, capital, beginning of year	3,755
Wages expense	6,890
Wages payable	600

**Instructions**

- a. Prepare the income statement for Sales Consulting.
- b. Prepare the statement of owner's equity.
- c. Prepare the balance sheet.

**Solution Exercise 41** (20 min)

a.

Sales Consulting  
Income Statement  
Year Ended December 31, 2014

Revenue		
Fees earned		\$ 10,600
Expenses		
Insurance expense	\$ 900	
Telephone expense	480	
Wages expense	<u>6,890</u>	<u>8,270</u>
Profit		<u>\$ 2,330</u>

b.

Sales Consulting  
Statement of Owner's Equity  
Year ended December 31, 2014

W. Calvin, January 1		\$ 3,755
Add: Investments	\$ 1,500	
Profit	<u>2,330</u>	<u>3,830</u>
		7,585
Less: W. Calvin, Drawings		<u>4,800</u>
W. Calvin, December 31		<u>\$ 2,785</u>

c.

Sales Consulting  
Balance Sheet  
December 31, 2014

ASSETS		
Cash		\$ 1,705
Accounts receivable		3,340
Supplies		120
Prepaid insurance		<u>80</u>
Total assets		<u>\$5,245</u>
LIABILITIES AND OWNER'S EQUITY		
Liabilities		
Accounts payable		\$ 1,860
Wages payable		<u>600</u>
Total liabilities		<u>2,460</u>
Owner's equity		
W. Calvin, capital		<u>2,785</u>
Total liabilities and owner's equity		<u>\$ 5,245</u>

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# CHAPTER 1

## ACCOUNTING IN ACTION

### SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
<b>True-False Statements</b>														
1.	1	K	11.	2	K	21.	2	K	31.	3	K	41.	3	K
2.	1	K	12.	2	K	22.	2	K	32.	3	K	42.	3	K
3.	1	K	13.	2	K	23.	2	K	33.	3	K	43.	4	K
4.	1	K	14.	2	C	24.	2	C	34.	3	C	44.	4	K
5.	1	K	15.	2	C	25.	2	K	35.	3	K	45.	4	C
6.	1	K	16.	2	C	26.	2	C	36.	3	K	46.	4	C
7.	1	K	17.	2	K	27.	2	K	37.	3	C	47.	4	C
8.	1	C	18.	2	K	28.	2	C	38.	3	K	48.	4	K
9.	1	C	19.	2	K	29.	3	C	39.	3	K	49.	5	C
10.	2	K	20.	2	C	30.	3	K	40.	3	K			
<b>Multiple Choice Questions</b>														
50.	1	K	66.	2	C	82.	3	K	98.	4	K	114.	5	K
51.	1	K	67.	2	K	83.	3	K	99.	4	C	115.	5	C
52.	1	K	68.	2	K	84.	3	K	100.	5	C	116.	5	C
53.	1	C	69.	2,4	K	85.	3	C	101.	5	C	117.	5	K
54.	1	K	70.	2,4	C	86.	3	K	102.	5	C	118.	6	C
55.	2	K	71.	2,4	C	87.	3	C	103.	5	C	119.	6	C
56.	2	K	72.	3	C	88.	3	C	104.	5	C	120.	6	K
57.	2	K	73.	3	C	89.	3	C	105.	5	C	121.	6	AP
58.	2	C	74.	3	K	90.	3	C	106.	5	AP	122.	6	AP
59.	2	C	75.	3	C	91.	3	C	107.	5	AP	123.	6	AP
60.	2	K	76.	3	C	92.	3	K	108.	5	C	124.	6	K
61.	2	K	77.	3	K	93.	3	C	109.	5	C	125.	6	C
62.	2	C	78.	3	AP	94.	3	K	110.	5	C	126.	6	K
63.	2	C	79.	3	K	95.	3	K	111.	5	C	127.	6	C
64.	2	K	80.	3	C	96.	3,6	C	112.	5	C	128.	6	K
65.	2	K	81.	3	C	97.	4	K	113.	5	C			
<b>Matching Questions</b>														
129.	1,2,3,5	K												

Note: K = Knowledge

C = Comprehension

AP = Application

## SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
<b>Study Objective 1</b>													
1.	TF	4.	TF	7.	TF	50.	MC	53.	MC				
2.	TF	5.	TF	8.	TF	51.	MC	54.	MC				
3.	TF	6.	TF	9.	TF	52.	MC	129.	Ma				
<b>Study Objective 2</b>													
10.	TF	16.	TF	22.	TF	28.	TF	60.	MC	66.	MC	129.	Ma
11.	TF	17.	TF	23.	TF	55.	MC	61.	MC	67.	MC		
12.	TF	18.	TF	24.	TF	56.	MC	62.	MC	68.	MC		
13.	TF	19.	TF	25.	TF	57.	MC	63.	MC	69.	MC		
14.	TF	20.	TF	26.	TF	58.	MC	64.	MC	70.	MC		
15.	TF	21.	TF	27.	TF	59.	MC	65.	MC	71.	MC		
<b>Study Objective 3</b>													
29.	TF	35.	TF	41.	TF	76.	MC	82.	MC	88.	MC	94.	MC
30.	TF	36.	TF	42.	TF	77.	MC	83.	MC	89.	MC	95.	MC
31.	TF	37.	TF	72.	MC	78.	MC	84.	MC	90.	MC	96.	MC
32.	TF	38.	TF	73.	MC	79.	MC	85.	MC	91.	MC	129.	Ma
33.	TF	39.	TF	74.	MC	80.	MC	86.	MC	92.	MC		
34.	TF	40.	TF	75.	MC	81.	MC	87.	MC	93.	MC		
<b>Study Objective 4</b>													
43.	TF	45.	TF	47.	TF	69.	MC	71.	MC	98.	MC		
44.	TF	46.	TF	48.	TF	70.	MC	97.	MC	99.	MC		
<b>Study Objective 5</b>													
49.	TF	102.	MC	105.	MC	108.	MC	111.	MC	114.	MC	117.	MC
100.	MC	103.	MC	106.	MC	109.	MC	112.	MC	115.	MC	129.	Ma
101.	MC	104.	MC	107.	MC	110.	MC	113.	MC	116.	MC		
<b>Study Objective 6</b>													
118.	MC	120.	MC	122.	MC	124.	MC	126.	MC	128.	MC		
119.	MC	121.	MC	123.	MC	125.	MC	127.	MC				

Note: TF = True-False MC = Multiple Choice Ma = Matching

## SUMMARY OF QUESTIONS BY LEVEL OF DIFFICULTY (LOD)

Item	SO	LOD	Item	SO	LOD	Item	SO	LOD	Item	SO	LOD	Item	SO	LOD
<b>True-False Statements</b>														
1.	1	E	11.	2	E	21.	2	E	31.	3	E	41.	3	E
2.	1	E	12.	2	E	22.	2	E	32.	3	E	42.	3	E
3.	1	E	13.	2	E	23.	2	E	33.	3	E	43.	4	E
4.	1	E	14.	2	M	24.	2	M	34.	3	M	44.	4	E
5.	1	E	15.	2	M	25.	2	E	35.	3	E	45.	4	M
6.	1	E	16.	2	M	26.	2	E	36.	3	E	46.	4	E
7.	1	E	17.	2	E	27.	2	E	37.	3	M	47.	4	M
8.	1	E	18.	2	E	28.	2	E	38.	3	E	48.	4	E
9.	1	M	19.	2	M	29.	3	E	39.	3	E	49.	5	M
10.	2	E	20.	2	M	30.	3	E	40.	3	E			
<b>Multiple Choice Questions</b>														
50.	1	E	66.	2	E	82.	3	E	98.	4	E	114.	5	E
51.	1	E	67.	2	E	83.	3	M	99.	4	E	115.	5	E
52.	1	E	68.	2	E	84.	3	E	100.	5	E	116.	5	M
53.	1	E	69.	2,4	M	85.	3	E	101.	5	E	117.	5	E
54.	1	E	70.	2,4	E	86.	3	M	102.	5	E	118.	6	M
55.	2	E	71.	2,4	E	87.	3	M	103.	5	M	119.	6	M
56.	2	E	72.	3	M	88.	3	E	104.	5	E	120.	6	M
57.	2	M	73.	3	M	89.	3	E	105.	5	E	121.	6	E
58.	2	M	74.	3	E	90.	3	E	106.	5	M	122.	6	E
59.	2	E	75.	3	M	91.	3	E	107.	5	E	123.	6	E
60.	2	E	76.	3	M	92.	3	E	108.	5	M	124.	6	E
61.	2	E	77.	3	E	93.	3	E	109.	5	E	125.	6	E
62.	2	M	78.	3	E	94.	3	E	110.	5	E	126.	6	E
63.	2	M	79.	3	E	95.	3	E	111.	5	E	127.	6	M
64.	2	E	80.	3	M	96.	3,6	E	112.	5	M	128.	6	E
65.	2	E	81.	3	E	97.	4	E	113.	5	M			
<b>Matching Questions</b>														
129.	1,2,3,5	E												

Note:                    E = Easy                    M = Medium                    H=Hard



## CHAPTER STUDY OBJECTIVES

- 1. *Identify the use and users of accounting and the objective of financial reporting.*** Accounting is the information system that identifies, records, and communicates the economic events of an organization to a wide variety of interested users. Good accounting is important to people both inside and outside the organization. Internal users, such as management, use accounting information to plan, control, and evaluate business operations. External users include investors and creditors, among others. Accounting data are used by investors (owners or potential owners) to decide whether to buy, hold, or sell their financial interests. Creditors (suppliers and bankers) evaluate the risks of granting credit or lending money based on the accounting information. The objective of financial reporting is to provide useful information to the investors and creditors who make these decisions. Users need information about the business's ability to earn a profit and generate cash. For our economic system to function smoothly, reliable and ethical accounting and financial reporting are critical.
- 2. *Compare different forms of business organizations and explain how Canadian accounting standards apply to these organizations.*** The most common examples of business organizations are proprietorships, partnerships, and corporations. Generally accepted accounting principles are a common set of guidelines that are used to prepare and report accounting information. In Canada, there are two sets of standards for profit-oriented businesses. Publicly accountable enterprises follow International Financial Reporting Standards (IFRS) and private enterprises have the choice of following IFRS or Accounting Standards for Private Enterprises (ASPE). The economic entity concept requires the business activities of each economic entity to be kept separate from the activities of its owner and other economic entities. The going concern assumption presumes that a business will continue operations for enough time to use its assets for their intended purpose and to fulfill its commitments.
- 3. *Describe the components of the financial statements and explain the accounting equation.*** Assets, liabilities, and owner's equity are reported in the balance sheet. Assets are resources owned or controlled by a business that are expected to provide future services or benefits. Liabilities are current obligations arising from past events to make future payments of assets or services. Owner's equity is the owner's claim on the company's assets and is equal to total assets minus total liabilities. The balance sheet is based on the accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ . The income statement reports the profit or loss for a specified period of time. Profit is equal to revenues minus expenses. Revenues are the increase in assets, or decrease in liabilities, that result from business activities that are done to earn profit. Expenses are the cost of assets consumed or services used in a company's ordinary business activities. They are decreases in assets or increases in liabilities, excluding withdrawals made by the owners, and result in a decrease to owner's equity. The statement of owner's equity summarizes the changes in owner's equity during the period. Owner's equity is increased by investments by the owner and profits. It is decreased by drawings and losses. Investments are contributions of cash or other assets by owners. Drawings are withdrawals of cash or other assets from the business for the owner's personal use. Owner's equity in a partnership is referred to as partners'

equity and in a corporation as shareholders' equity.

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

4. **Determine what events are recognized in the financial statements and how the events are measured.** Only events that cause changes in assets, liabilities, or owner's equity are recorded. Recognition is the process of recording items and measurement is the process of determining the amount that should be recognized. The cost principle states that assets should be recorded at their historical (original) cost. Fair value may be a more appropriate measure for certain types of assets. Generally fair value is the amount the asset could be sold for in the market. The monetary unit assumption requires that only transaction data that can be expressed as an amount of money be included in the accounting records, and it assumes that the monetary unit is stable.
5. **Analyze the effects of business transactions on the accounting equation.** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (1) decrease in another asset, (2) increase in a liability, and/or (3) increase in owner's equity.
6. **Prepare financial statements.** The income statement is prepared first. Expenses are deducted from revenues to calculate the profit or loss for a specific period of time. Then the statement of owner's equity is prepared using the profit or loss reported in the income statement. The profit is added to (losses are deducted from) the owner's equity at the beginning of the period. Drawings are then deducted to calculate owner's equity at the end of the period. A balance sheet reports the assets, liabilities, and owner's equity of a business as at the end of the accounting period. The owner's equity at the end of period, as calculated in the statement of owner's equity, is reported in the balance sheet in the owner's equity section.

## TRUE-FALSE STATEMENTS

1. Accounting is the information system that identifies, records, and communicates the economic events of an organization to a wide variety of interested users.
2. A working knowledge of accounting can be useful to doctors or lawyers.
3. The main objective of financial statements is to provide useful information to management.
4. Employees are an example of an external user.
5. Creditors are an example of an internal user of accounting information.
6. Accounting information is used only by external users with a direct financial interest in a company.
7. Ethics are critical in the preparation of accounting information.
8. Only the accountants should be concerned with ethics when the financial statements are being prepared.
9. In a situation with an ethical consideration, there is only one ethical course of action which can be followed.
10. In a proprietorship, there may be 2 or more owners.
11. One of the disadvantages of a proprietorship is that there is unlimited liability for the owner.
12. Under the proprietorship form of business organization, no distinction is made between the business as an economic unit and its owner.
13. A partnership must have at least 2 people in the partnership.
14. In a partnership, all of the partners will generally have unlimited liability for the debts of the partnerships.

15. A corporation may only be formed under the federal legislation.
16. A corporation is only subject to the federal laws of corporations.
17. A corporation may be formed under either the provincial legislation or the federal legislation.
18. A corporation's ownership is divided into transferable shares.
19. One of the main advantages of a corporation is the limit of liability for the shareholders of the company.
20. An advantage of the corporation is that the shares of the corporation are easily transferable.
21. A private company is one that issues shares to the public.
22. GAAP stands for Generally Accepted Accounting Principles.
23. In Canada, the main standard setting board is the Accounting Standards Board.
24. Companies incorporated under provincial legislation report under ASPE and companies incorporated under federal legislation report under IFRS.
25. Publicly Traded Corporations can choose to report under either ASPE or IFRS.
26. Both IFRS and ASPE are considered "principles-based" as opposed to "rules-based" standards.
27. The going concern assumption is the assumption that a company will continue to operate in the foreseeable future.
28. The economic entity concept requires that an entity's business activities be combined with the activities of its owner for financial reporting purposes.
29. Assets are current obligations, arising from past events, to make a future payment or to provide services.

30. Liabilities are the resources owned by a business that are expected to provide future services or benefits.

31. Accounts payable is the asset created when a company sells services or products to customers who promise to pay cash in the future.

32. An obligation to pay cash to a supplier in the future is called accounts payable.

33. The owner's claim on the assets of the company is known as owner's equity.

34. Owner's claims to total business assets take precedence over the claims of creditors because owners invest assets in the business and are liable for losses.

35. Expenses are the costs of assets that are consumed or services used in the ordinary business activities.

36. A balance sheet presents the revenues and expenses, and the resulting profit or loss for a specific period of time.

37. Profit results when a company's expenses are higher than its revenues.

38. A balance sheet reports the assets, liabilities, and owner's equity at a specific date.

39. An income statement will give the answer to the question – "where did all the cash get used during this month?"

40. A cash flow statement is organized into three categories, operating, financing and investing activities of the company.

41. Revenues decrease owner's equity and expenses increase owner's equity.

42. A Balance Sheet can also be called a Statement of Financial Position.

43. Recognition is the process of recording a transaction in the accounting records.

44. Measurement is the process of determining the amount that should be recognized.

45. Cost value is the amount of the consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act.

46. The cost and fair value of an asset are the same at the time of acquisition and in all subsequent periods.

47. The monetary unit assumption assumes that all transactions will take place in Canadian dollars.

48. Sometimes Canadian companies will report their results in U.S. dollars.

49. An accounting transaction occurs when assets, liabilities, or owner's equity items change as the result of some economic event.

## ANSWERS TO TRUE- FALSE STATEMENTS

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	11.	T	21.	F	31.	F	41.	F
2.	T	12.	F	22.	T	32.	T	42.	T
3.	F	13.	T	23.	T	33.	T	43.	T
4.	F	14.	T	24.	F	34.	F	44.	T
5.	F	15.	F	25.	F	35.	T	45.	F
6.	F	16.	F	26.	T	36.	F	46.	F
7.	T	17.	T	27.	T	37.	F	47.	F
8.	F	18.	T	28.	F	38.	T	48.	T
9.	F	19.	T	29.	F	39.	F	49.	T
10.	F	20.	T	30.	F	40.	T		

## MULTIPLE CHOICE QUESTIONS

50. An external user could be

- employees.
- management.
- Canada Revenue Agency.
- the human resource director.

51. An external user would NOT include

- A creditor of the company.
- Canada Revenue Agency.
- An employee.
- The company's bank.

52. Which of the following would NOT be considered an internal user of accounting data for the ABC Company?

- President of the company
- Production manager
- Merchandise inventory clerk
- President of the employees' labour union

53. All of the following are steps used to analyze ethical dilemmas EXCEPT

- using the organization's code of ethics to identify ethical situations.
- using personal ethics to identify ethical situations.
- identifying potential stakeholders.
- discussing the ethical dilemma with co-workers.

54. The main objective of the financial statements is

- to show the profit of a company.
- to allow customers to determine whether a company will honour its product warranties.
- to provide useful information to investors and creditors to make decisions about a business.
- to determine how many employees the company can afford to hire each year.

55. The proprietorship form of business organization

- must have at least three owners in most provinces.
- represents the largest number of businesses in Canada.
- combines the records of the business with the personal records of the owner.
- is characterized by a legal distinction between the business as an economic unit and the owner.

56. A business organized as a corporation

- is not a separate legal entity in most provinces.
- requires that shareholders be personally liable for the debts of the business.



- c. is owned by its shareholders.
- d. terminates when one of its original shareholders dies.

57. The partnership form of business organization
- a. is a separate legal entity.
  - b. is a common form of organization for service-type businesses.
  - c. enjoys an unlimited life.
  - d. has limited liability.

58. Which of the following is NOT an advantage of the corporate form of business organization?
- a. limited liability of shareholders
  - b. transferability of ownership
  - c. unlimited personal liability for shareholders
  - d. unlimited life

59. Judy and Marilyn met at law school and decide to start a small law practice after graduation. They agree to split revenues and expenses evenly. The most common form of business organization for a business such as this would be a(n)
- a. non profit organization.
  - b. partnership.
  - c. corporation.
  - d. proprietorship.

60. Which of the following forms of business organizations typically have their shares listed on the Toronto Stock Exchange?
- a. Proprietorships
  - b. Private companies
  - c. Public companies
  - d. Partnerships

61. Which of the following is true regarding the corporate form of business organization?
- a. Corporations are the most prevalent form of business organization.
  - b. Corporate businesses are generally smaller in size than partnerships and proprietor-ships.
  - c. The revenues of corporations are greater than the combined revenues of partnerships and proprietorships.
  - d. Corporations are separate legal entities organized exclusively under federal law.

62. Canadian Accounting Standards allow a choice of whether or not to use International Financial Reporting Standards for which type of company?
- a. Public companies
  - b. Only small private companies
  - c. Banks
  - d. All private companies in Canada

63. ASPE requires less information on the financial statements of private companies than IFRS requires because

- a. private companies are smaller than public companies.
- b. users of private company financial statements have the ability to obtain additional information from the company if required.
- c. public companies have their information available on the internet.
- d. public companies may report in different foreign currencies.

64. Generally accepted accounting principles are

- a. income tax regulations.
- b. standards that indicate how to report economic events.
- c. theories that are based on physical laws of the universe.
- d. principles that have been proven correct by academic researchers.

65. GAAP stands for

- a. Generally Accepted Auditing Procedures.
- b. Generally Accepted Accounting Principles.
- c. Generally Accepted Auditing Principles.
- d. Generally Accepted Accounting Procedures.

66. Which of the following would violate the economic entity concept?

- a. reporting amounts owed to the company's suppliers as a liability on the balance sheet.
- b. reporting equipment owned and used in the business as an asset in the balance sheet.
- c. reporting withdrawals by the owner as a drawing in the statement of owner's equity.
- d. reporting the owner's personal sailboat as an asset on the balance sheet.

67. The International Accounting Standards Board

- a. works to reduce differences in accounting practices across countries.
- b. promotes unique accounting applications.
- c. works to increase differences in accounting practices across countries.
- d. only operates in countries which speak English.

68. The going concern assumption

- a. states that a company will not operate long enough to utilize assets and fulfill obligations.
- b. assumes the company will continue to operate in the foreseeable future.
- c. is inconsistent with the cost principle.
- d. states that net worth is the most appropriate value at which to record assets.

69. Which of the following principles or assumptions requires that the activities of a business be kept distinct from those of its owner(s)?

- a. economic entity concept
- b. going concern assumption
- c. monetary unit assumption
- d. cost principle

70. Mel Green is the proprietor (owner) of Green's, a retailer of athletic apparel. When recording the financial transactions of Green's, Mel does not record an entry for a car he purchased for personal use. Mel took out a personal loan to pay for the car. What accounting assumption guides Mel's behaviour in this situation?

- a. going concern assumption
- b. economic entity concept
- c. time period assumption
- d. monetary unit assumption

71. Emily Hogan recently opened a new business. The business has been very successful and as a reward for all her hard work Emily spent a day at the local spa. Emily paid for the spa using a company credit card and charged the amount to the expense account called Repairs and Maintenance expense. Emily's actions violated which of the following?

- a. The going concern assumption
- b. The monetary unit assumption
- c. The cost principle
- d. The economic entity concept

72. Withdrawal of cash from a business by the owner for personal reasons will NOT affect which financial statement?

- a. Balance Sheet
- b. Income Statement
- c. Statement of Owner's Equity
- d. Cash Flow Statement

73. Which of the following is true when considering the accounting equation?

- a. An increase in an asset must always equal a decrease in a liability.
- b. For every transaction an asset and a liability must be affected.
- c. An increase in a liability must equal a decrease in owner's equity.
- d. An increase in an asset may result in a decrease in another asset.

74. The common characteristic possessed by all assets is

- a. long life.
- b. great monetary value.
- c. tangible nature.
- d. future economic benefit.

75. The accounting equation, for a proprietorship, may be expressed as

- a.  $\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$ .
- b.  $\text{Assets} - \text{Liabilities} = \text{Partners' Equity}$ .
- c.  $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ .
- d. all of these.

76. The accounting equation, for a corporation, is best expressed as

- a. Assets = Liabilities + Shareholders' Equity.
- b. Assets – Liabilities = Partner's Equity.
- c. Assets = Liabilities + Owner's Equity.
- d. all of these.

77. An account receivable is recorded in the accounting records as a(n)

- a. liability.
- b. expense.
- c. asset.
- d. revenue.

78. Bing Company has total liabilities of \$10,000 and total assets of \$15,000. Based on this information, Bing Company's owner's equity must be

- a. \$10,000.
- b. \$ 0.
- c. \$5,000.
- d. \$15,000.

79. Liabilities

- a. are future economic benefits.
- b. are current or long term obligations arising from past events.
- c. possess service potential.
- d. are things of value used by the business in its operation.

80. Which of the following would best be described as an ownership claim on a company's assets?

- a. expenses
- b. account receivable from the owner
- c. owner's equity
- d. liabilities

81. Evan Guanzon owns and operates Guanzon's Pizza Express. Evan should record the cost of wages paid to store employees as a (an)

- a. revenue.
- b. expense.
- c. liability.
- d. asset.

82. Owner's equity is often referred to as

- a. residual equity.
- b. leftovers.
- c. spoils.
- d. a second equity.

83. In a proprietorship, owner's equity is affected by all of the following EXCEPT

- the investment of cash by the owners.
- the purchase of a personal automobile by the owner using personal funds.
- the purchase of a computer for the owner's son using cash generated by the business.
- the sale of goods by the business.

84. When an owner, in a proprietorship or partnership, withdraws cash or other assets from a business for personal use, these withdrawals are termed

- expenses.
- salary.
- drawings.
- a credit line.

85. Revenues would NOT result from

- sale of merchandise.
- initial investment of cash by owner.
- performance of services.
- rental of property to a tenant.

86. Sources of increases to owner's equity, in a proprietorship, are

- additional investments by owners.
- purchases of merchandise.
- withdrawals by the owner.
- sale of share capital.

87. The basic accounting equation, in a proprietorship, CANNOT be restated as

- $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$ .
- $\text{Assets} - \text{Owner's Equity} = \text{Liabilities}$ .
- $\text{Owner's Equity} + \text{Liabilities} = \text{Assets}$ .
- $\text{Assets} + \text{Liabilities} = \text{Owner's Equity}$ .

88. Owner's equity, in a proprietorship, is increased by

- drawings.
- revenues.
- expenses.
- liabilities.

89. Owner's equity, in a proprietorship, is decreased by

- assets.
- revenues.
- expenses.
- liabilities.

90. Revenues, in a proprietorship, are

- a. the cost of assets consumed during the period.
- b. the gross increases in owner's equity resulting from business activities.
- c. the cost of services used during the period.
- d. actual or expected cash outflows.

91. Profit results when

- a. Assets > Liabilities.
- b. Revenues = Expenses.
- c. Revenues > Expenses.
- d. Revenues < Expenses.

92. A balance sheet, in a proprietorship, shows

- a. revenues, liabilities, and owner's equity.
- b. expenses, drawings, and owner's equity.
- c. revenues, expenses, and drawings.
- d. assets, liabilities, and owner's equity.

93. An Income Statement

- a. summarizes the changes in owner's equity for a specific period of time.
- b. reports the changes in assets, liabilities, and owner's equity over a period of time.
- c. reports the assets, liabilities, and owner's equity at a specific date.
- d. presents the revenues and expenses for a specific period of time.

94. The Income Statement is sometimes referred to as

- a. a Statement of Earnings.
- b. the Statement of Financial Position.
- c. the Cash Flow Statement.
- d. the Statement of Owner's Equity.

95. The primary purpose of the Cash Flow Statement is to report

- a. a company's investing transactions.
- b. a company's financing transactions.
- c. information about cash inflows and cash outflows of a company.
- d. the net increase or decrease in cash.

96. Which of the following accounts would NOT be found on the Balance Sheet?

- a. Cash
- b. Drawings
- c. Equipment
- d. Accounts Payable.

97. The cost principle requires that when assets are acquired, they be recorded at

- a. appraisal value.
- b. the amount paid.

- c. the amount the asset could be sold for.
- d. list price.

98. A basic assumption of accounting assumes that the dollar is

- a. unrelated to business transactions.
- b. a poor measure of economic activities.
- c. the common unit of measure for all business transactions.
- d. useless in measuring an economic event.

99. Recognition in the accounting terminology means

- a. recognizing the difference between assets and liabilities.
- b. recognizing the difference between income and expenses.
- c. recognizing that initially transactions are recorded at fair value.
- d. the process of recording a transaction in the accounting records.

100. Which of the following would NOT affect owner's equity?

- a. a cash receipt from a customer in payment of account
- b. payment of an expense
- c. services provided for cash
- d. withdrawal of funds for personal use

101. Which of the following is an example of an economic event that should be recorded as an accounting transaction?

- a. the purchase of supplies
- b. the signing of a contract to build a new corporate headquarters
- c. the appointment of a new Chief Executive Officer
- d. the launch of a new marketing strategy

102. Which of the following transactions would NOT affect Cash?

- a. payment to a supplier on account
- b. purchase of supplies on account
- c. payment of salaries for the week
- d. prepaying an insurance premium

103. An investment by a company's owner increases a company's cash and

- a. reduces its liabilities.
- b. reduces a company's total assets.
- c. increases owner's equity.
- d. increases the company's net earnings in the year in which the investment is made.

104. Partners' equity, in a partnership, is decreased by

- a. payment of dividends.
- b. drawings.
- c. owner's investments.
- d. revenues.

105. Shareholders' equity, in a corporation, is increased by

- a. an expense.
- b. shareholder purchase of common shares.
- c. payment of dividends.
- d. liabilities.

106. If total liabilities increased by \$5,000, then

- a. assets must have decreased by \$5,000.
- b. owner's equity must have increased by \$5,000.
- c. assets must have increased by \$5,000, or owner's equity must have decreased by \$5,000.
- d. assets and owner's equity each increased by \$2,500.

107. Collection of a \$600 Accounts Receivable

- a. increases an asset \$600; decreases an asset \$600.
- b. increases an asset \$600; decreases a liability \$600.
- c. decreases a liability \$600; increases owner's equity \$600.
- d. decreases an asset \$600; decreases a liability \$600.

108. If an individual asset, in a proprietorship, is increased, then

- a. there may be an equal decrease in a specific liability.
- b. there may be an equal decrease in owner's equity.
- c. there may be an equal decrease in another asset.
- d. none of these is possible.

109. If services are provided for credit, in a proprietorship, then

- a. assets will decrease.
- b. liabilities will increase.
- c. owner's equity will increase.
- d. liabilities will decrease.

110. If expenses, in a proprietorship, are paid in cash, then

- a. assets will increase.
- b. liabilities will decrease.
- c. owner's equity will increase.
- d. assets will decrease.

111. If an owner makes a withdrawal of cash from a proprietorship, then

- a. there has been a violation of accounting principles.
- b. assets will decrease and owner's equity will increase.
- c. assets will decrease and owner's equity will decrease.
- d. assets will decrease and liabilities will increase.



112. If supplies that have been purchased are used in the course of business, then

- a. a liability will increase.
- b. an asset will increase.
- c. owner's equity will decrease.
- d. owner's equity will increase.

113. Two or more items could be affected by a transaction. Which of the following statements is INCORRECT?

- a. An increase in an asset may result in a decrease in another asset.
- b. An increase in an asset may result in a decrease in an asset and increase in a liability.
- c. An increase in a liability may result in a decrease in an asset.
- d. An increase in a liability may result in a decrease in owner's equity.

114. The cost of advertising purchased for the month is considered an expense, not an asset because

- a. the expense will generate future benefits.
- b. the advertising will generate future cash inflows.
- c. the benefits of the expense have already been used.
- d. the expense has not yet been used.

115. Expenses do not have to be paid in cash at the time they are incurred. When payment is made on the later date, the liability accounts payable account will decrease and the asset

- a. cash will increase.
- b. cash will decrease.
- c. will not be affected.
- d. accounts receivable will increase.

116. Payment of a liability for an expense that has been previously recorded

- a. does not affect the owner's equity account.
- b. only affects the liability accounts.
- c. does not affect the asset accounts.
- d. only affects the asset accounts.

117. Ingrid Ltd and Bulgar Equipment rentals company sign a contract to rent equipment in the next two years. What is the impact on the accounting equation?

- a. Assets increase and liabilities increase.
- b. Assets decrease and liabilities decrease.
- c. No impact on the accounting equation.
- d. Owner's equity increases and assets decrease.

118. Owner's equity, in a proprietorship, at the end of the period is equal to

- a. owner's capital at the beginning of the period plus profit minus liabilities.
- b. owner's capital at the beginning of the period plus profit minus drawings.
- c. profit.
- d. assets plus liabilities.

119. Shareholders' equity, in a corporation, at the end of the period is equal to

- shareholders' equity at the beginning of the period plus profit minus liabilities.
- share capital plus retained earnings.
- share capital plus dividends.
- share capital plus this year's profit.

120. If the owner's equity account increases from the beginning of the year to the end of the year, the best explanation for this change is

- profit is less than owner drawings.
- a loss is less than owner drawings.
- additional owner investments are less than a loss.
- profit is greater than owner drawings.

121. Jackson's Small Engine Repair Shop, a proprietorship, started the year with total assets of \$60,000 and total liabilities of \$40,000. During the year, the business recorded \$100,000 in repair revenues, \$55,000 in expenses, and Mike Jackson, the owner, withdrew \$10,000. Jackson's Capital balance at the end of the year was

- \$55,000.
- \$35,000.
- \$65,000.
- \$45,000.

122. Jackson's Small Engine Repair Shop, a proprietorship, started the year with total assets of \$60,000 and total liabilities of \$40,000. During the year, the business recorded \$100,000 in repair revenues, \$55,000 in expenses, and Mike Jackson, the owner, withdrew \$10,000. The profit reported by Jackson's Small Engine Repair Shop for the year was

- \$35,000.
- \$45,000.
- \$20,000.
- \$90,000.

123. Jackson's Small Engine Repair Shop, a proprietorship, started the year with total assets of \$60,000 and total liabilities of \$40,000. During the year, the business recorded \$100,000 in repair revenues, \$55,000 in expenses, and Mike Jackson, the owner, withdrew \$10,000. Jackson's Capital balance changed by what amount from the beginning of the year to the end of the year?

- \$10,000.
- \$45,000.
- \$20,000.
- \$35,000.

124. The income statement is prepared from the data in the

- assets column.
- liabilities column.

- c. owner's equity column.
- d. liabilities and owner's equity column.

125. Which of the following statements is correct in regards to the order of preparing financial statements?

- a. Income statement, Balance sheet, Statement of changes in owner's equity, Cash flow statement
- b. Balance sheet, Income statement, Cash flow statement, Statement of changes in owner's equity
- c. Income statement, Statement of changes in owner's equity, Balance sheet, Cash flow statement
- d. Income statement, Statement of changes in owner's equity, Cash flow statement, Balance sheet

126. The income statement is always prepared first in order to determine

- a. the total assets to be reported on the balance sheet.
- b. the cash outflow of the company.
- c. the profit or loss used in the statement of changes in owner's equity.
- d. the amount of investments or withdrawals used in the statement of changes in owner's equity.

127. If a company reported a loss in the first month of operations, the loss would reduce owner's capital and would be

- a. added in the same section as owner's investments.
- b. deducted in the same section as owner's investments.
- c. deducted in the same section as owner's drawings.
- d. added in the same section as owner's drawings.

128. The heading of a balance sheet must identify the

- a. company, statement and time period.
- b. statement and date.
- c. company, statement and date.
- d. company and date.

## ANSWERS TO MULTIPLE CHOICE QUESTIONS

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
50.	c	66.	d	82.	a	98.	c	114.	c
51.	c	67.	a	83.	b	99.	d	115.	b
52.	d	68.	b	84.	c	100.	a	116.	a
53.	d	69.	a	85.	b	101.	a	117.	c
54.	c	70.	b	86.	a	102.	b	118.	b
55.	b	71.	d	87.	d	103.	c	119.	b
56.	c	72.	b	88.	b	104.	b	120.	d
57.	b	73.	d	89.	c	105.	b	121.	a
58.	c	74.	d	90.	b	106.	c	122.	b
59.	b	75.	c	91.	c	107.	a	123.	d
60.	c	76.	a	92.	d	108.	c	124.	c
61.	a	77.	c	93.	d	109.	c	125.	c
62.	d	78.	c	94.	a	110.	d	126.	c
63.	b	79.	b	95.	c	111.	c	127.	c
64.	b	80.	c	96.	b	112.	c	128.	c
65.	b	81.	b	97.	b	113.	c		

## MATCHING

129. Match the items below by entering the appropriate code letter in the space provided.

- |                               |                 |
|-------------------------------|-----------------|
| A. Codes of conduct           | F. Corporation  |
| B. Profit                     | G. Assets       |
| C. Partnership                | H. Equities     |
| D. Proprietorship             | I. Expenses     |
| E. Economic Entity Assumption | J. Transactions |

- \_\_\_ 1. Ownership is limited to one person.
- \_\_\_ 2. Rules for ethical business practices
- \_\_\_ 3. A separate legal entity under federal or provincial laws
- \_\_\_ 4. Reflective of two or more owners
- \_\_\_ 5. Economic events can be identified with a particular unit of accountability.
- \_\_\_ 6. Consumed assets or services
- \_\_\_ 7. Ownership claims against the assets of the business
- \_\_\_ 8. Results when revenues exceed expenses.
- \_\_\_ 9. Future economic benefits
- \_\_\_ 10. Economic events recorded by accountants.

## ANSWERS TO MATCHING

- 1. D
- 2. A
- 3. F
- 4. C
- 5. E
- 6. I
- 7. H
- 8. B
- 9. G
- 10. J

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