

HORNGREN'S

10TH CANADIAN
EDITION

ACCOUNTING

MILLER-NOBLES MATTISON MATSUMURA MEISSNER JOHNSTON NORWOOD



VOLUME ONE

HORNGREN'S 10TH CANADIAN EDITION **ACCOUNTING**

TRACIE L. MILLER-NOBLES

Austin Community College

BRENDA MATTISON

Tri-County Technical College

ELLA MAE MATSUMURA

University of Wisconsin—Madison

CAROL A. MEISSNER

Georgian College

JO-ANN L. JOHNSTON

British Columbia Institute of Technology

PETER R. NORWOOD

Langara College

VOLUME ONE

PEARSON

Toronto

In memory of Charles T. Horngren 1926–2011

Whose vast contributions to the teaching and learning of accounting impacted and will continue to impact generations of accounting students and professionals.

I would like to thank my students for keeping me on my toes. Hearing their new ideas and how they think about accounting makes teaching such a wonderful job.

Carol A. Meissner

I would like to thank my husband, Bill, and my family for their encouragement and support.

Jo-Ann L. Johnston

I would like to thank my wife, Helen, and my family very much for their support and encouragement.

Peter R. Norwood

Editorial Director: Claudine O'Donnell
Senior Acquisitions Editor: Megan Farrell
Senior Marketing Manager: Loula March
Program Manager: Patricia Ciardullo
Project Manager: Sarah Lukaweski
Manager of Content Development: Suzanne Schaan
Developmental Editor: Suzanne Simpson Millar
Production Editor: Leanne Rancourt
Media Editor: Anita Smale
Media Developer: Olga Avdyeyeva

Copyeditor: Leanne Rancourt
Proofreaders: Susan Broadhurst and
Bradley T. Smith
Permissions Project Manager: Joanne Tang
Photo and Text Permissions Research: Integra
Publishing Services
Compositor: Cenveo® Publisher Service
Interior and Cover Designer: Anthony Leung
Cover Image: © John Kuczala / Getty Images

Vice-President, Cross Media and Publishing Services: Gary Bennett

Credits and acknowledgments for material borrowed from other sources and reproduced, with permission, in this textbook appear on the appropriate page within the text.

Copyright © 2017, 2014, 2011, 2007, 2005, 2002, 1999, 1996, 1993, 1991 Pearson Canada Inc. All rights reserved.
Original edition published by Pearson Education, Inc., Upper Saddle River, New Jersey, USA. Copyright
© 2014, 2012, 2009 by Pearson Education, Inc.

This edition is authorized for sale only in Canada.

Copyright © 2017 Pearson Canada Inc. All rights reserved. Manufactured in the United States of America. This publication is protected by copyright and permission should be obtained from the publisher prior to any prohibited reproduction, storage in a retrieval system, or transmission in any form or by any means, electronic, mechanical, photocopying, recording, or likewise. To obtain permission(s) to use material from this work, please submit a written request to Pearson Canada Inc., Permissions Department, 26 Prince Andrew Place, Don Mills, Ontario, M3C 2T8, or fax your request to 416-447-3126, or submit a request to Permissions Requests at www.pearsoncanada.ca.

10 9 8 7 6 5 4 3 2 1 [V0TX]

Library and Archives Canada Cataloguing in Publication

Miller-Nobles, Tracie L., author

Horngren's accounting / Tracie Nobles (Texas State University-San Marcos), Brenda Mattison (Tri-County Technical College), Ella Mae Matsumura (University of Wisconsin-Madison), Carol A. Meissner (Georgian College), Jo-Ann L. Johnston (British Columbia Institute of Technology), Peter R. Norwood (Langara College). -- Tenth Canadian edition.

Includes indexes.

Issued in print and electronic formats.

ISBN 978-0-13-385537-1 (volume 1 : paperback).—ISBN 978-0-13-414064-3 (volume 1 : loose leaf). ISBN 978-0-13-418033-5 (volume 1 : html)

1. Accounting—Textbooks. I. Norwood, Peter R., author
II. Matsumura, Ella Mae, 1952-, author III. Johnston, Jo-Ann L., author
IV. Mattison, Brenda, author V. Meissner, Carol A., author VI. Title.
VII. Title: Accounting.

HF5636.M54 2016 657 C2015-904630-0
C2015-904631-9

PEARSON

ISBN 978-0-13-385537-1

BRIEF CONTENTS

Part 1 The Basic Structure of Accounting

- 1 Accounting and the Business Environment 2
- 2 Recording Business Transactions 58
- 3 Measuring Business Income: The Adjusting Process 116
- 4 Completing the Accounting Cycle 174
- 5 Merchandising Operations 244
- 6 Accounting for Merchandise Inventory 324
- 7 Accounting Information Systems 376

Part 2 Accounting for Assets and Liabilities

- 8 Internal Control and Cash 444
- 9 Receivables 504
- 10 Property, Plant, and Equipment; and Goodwill and Intangible Assets 558
- 11 Current Liabilities and Payroll 612

Part 3 Accounting for Partnerships and Corporate Transactions

- 12 Partnerships
- 13 Corporations: Share Capital and the Balance sheet
- 14 Corporations: Retained Earnings and the Income Statement
- 15 Long-Term Liabilities
- 16 Investments and International Operations

Part 4 Analysis of Accounting Information

- 17 The Cash Flow Statement
- 18 Financial Statement Analysis

CONTENTS

Part 1 The Basic Structure of Accounting 2

1 Accounting and the Business Environment 2

Accounting: The Language of Business 4

Forms of Business Organizations 7

Accounting Concepts 9

The Accounting Equation 12

The Financial Statements 21

ASPE vs. IFRS 25

Summary Problem for Your Review 26

Summary 28

Assignment Material 33

Extending Your Knowledge 54

2 Recording Business Transactions 58

The Accounting Cycle 60

Chart of Accounts 61

Double-Entry Accounting 63

Source Documents—The Origin of Transactions 67

Recording Transactions in the Journal 67

Posting (Transferring Information) from the Journal to the Ledger 69

Accounting for Business Transactions 70

The Trial Balance 80

Summary Problem for Your Review 82

Summary 86

Assignment Material 89

Extending Your Knowledge 111

3 Measuring Business Income: The Adjusting Process 116

Time Period Assumption 119

Recognition Criteria for Revenues and Expenses 119

Accrual-Basis Accounting versus Cash-Basis Accounting 121

Adjusting the Accounts 122

The Adjusted Trial Balance 134

Preparing the Financial Statements from the Adjusted Trial Balance 134

Ethical Considerations in Accrual Accounting 136

Adjusting-Process Implications of IFRS 137

Summary Problem for Your Review 138

Chapter 3 Appendix: Alternative Treatment of Accounting for Prepaid Expenses and Unearned Revenues 142

Summary 144

Assignment Material 147

Extending Your Knowledge 171

4 Completing the Accounting Cycle 174

The Accounting Cycle 176

The Worksheet 177

Working through the Accounting Cycle 181

Closing the Accounts 185

Correcting Journal Entries 189

Classifying Assets and Liabilities 190

Accounting Ratios 194

Accounting Cycle and Financial Reporting Implications of IFRS 195

Summary Problem for Your Review 196

Chapter 4 Appendix: Reversing Entries: An Optional Step 202

Summary 205

Assignment Material 208

Extending Your Knowledge 236

5

Merchandising Operations 244

- What Are Merchandising Operations? 247
- Inventory Systems: Perpetual and Periodic 249
- Accounting for Inventory Purchases in the Perpetual Inventory System 251
- Selling Inventory and Recording Cost of Goods Sold 257
- Adjusting and Closing the Accounts of a Merchandising Business 260
- Preparing a Merchandiser's Financial Statements 264
- Two Ratios for Decision Making 268
- The Effect of IFRS on Merchandising Operations 270
 - Summary Problem for Your Review 270
- Chapter 5 Appendix A: Accounting for Merchandise in a Periodic Inventory System 273
 - Summary Problem for Your Review: Chapter 5 Appendix A 281
- Chapter 5 Appendix B: Comparing the Perpetual and Periodic Inventory Systems 283
 - Summary 285
 - Assignment Material 289
 - Extending Your Knowledge 319

6

Accounting for Merchandise Inventory 324

- Inventory Costing Methods 326
- Inventory Costing in a Perpetual System 329
- Comparing FIFO and Moving-Weighted-Average Cost 333
- Inventory Costing in a Periodic System 334
- Accounting Concepts and Inventories 336
- Other Inventory Issues 337
- Effects of Inventory Errors 339
- Estimating Ending Inventory 342
 - Summary Problem for Your Review 344
 - Summary 345
 - Assignment Material 349
 - Extending Your Knowledge 370

7

Accounting Information Systems 376

- Effective Accounting Information Systems 378
- How Accounting Systems Work 380
- Special Journals 385
- The Role of the General Journal 397
 - Chapter 7 Appendix: Special Journals and Sales Taxes (available online)
 - Summary Problem for Your Review 401
 - Summary 405
 - Assignment Material 408
 - Extending Your Knowledge 436

Comprehensive Problem for Part 1 440

Part 2 Accounting for Assets and Liabilities 444

8

Internal Control and Cash 444

- Internal Control 446
- The Components of Internal Control 448
- The Bank Account as a Control Device 454
- Internal Control over Cash Receipts 463
- Internal Control over Cash Payments 465
- Internal Control over Petty Cash 467
- Ethics and Accounting 470
 - Summary Problem for Your Review 472
 - Summary 474
 - Assignment Material 478
 - Extending Your Knowledge 501

9 Receivables 504

- Receivables: An Introduction 506
- Accounting for Uncollectible Accounts 508
- The Direct Write-Off Method 515
- Other Payment Methods 516
- Accounting for Notes Receivable 518
- Using Accounting Information for Decision Making 523
- The Impact of IFRS on Accounts Receivable 525
 - Summary Problem for Your Review 526
- Chapter 9 Appendix: Discounting (Selling) a Note Receivable 527
- Summary 528
- Assignment Material 532
- Extending Your Knowledge 554

10 Property, Plant, and Equipment; and Goodwill and Intangible Assets 558

- Measuring the Cost of PPE 560
- Lump-Sum Purchase of Assets 562
- Betterments versus Repairs 563
- Ethical Issues 564
- Amortization 565
- Other Issues in Accounting for PPE 571
- Disposing of PPE 573
- Accounting for Natural Resources 577
- Intangible Assets and Goodwill 578
- The Impact of IFRS on PPE, Intangibles, and Goodwill 582
 - Summary Problems for Your Review 583
 - Summary 584
 - Assignment Material 588
 - Extending Your Knowledge 607

11 Current Liabilities and Payroll 612

- Current Liabilities of a Known Amount 614
- Current Liabilities That Must Be Estimated 622
- Contingent Liabilities 624
- Ethical Issues in Accounting for Current and Contingent Liabilities 626
- Accounting for Payroll 627
- Payroll Entries 633
- The Payroll System 635
- Reporting Current Liabilities 641
- The Impact of IFRS on Current Liabilities 642
 - Summary Problem for Your Review 642
 - Summary 644
 - Assignment Material 648
 - Extending Your Knowledge 666

Comprehensive Problem for Part 2 670

- Appendix A: Indigo Books and Music Inc. 2014 Annual Report A-1
- Appendix B: Typical Chart of Accounts for Service Proprietorships (ASPE) A-37

Glossary G-1 Index I-1

ABOUT THE AUTHORS

TRACIE L. MILLER-NOBLES, CPA, received her bachelor's and master's degrees in accounting from Texas A&M University. She is an associate professor at Austin Community College. Previously she served as a senior lecturer at Texas State University, San Marcos, Texas, and has served as department chair of the Accounting, Business, Computer Information Systems, and Marketing/Management Department at Aims Community College, Greeley, Colorado. In addition, Tracie has taught as an adjunct professor at University of Texas and has public accounting experience with Deloitte Tax LLP and Sample & Bailey, CPAs.

Tracie is a recipient of the Texas Society of CPAs Outstanding Accounting Educator Award, NISOD Teaching Excellence Award, and the Aims Community College Excellence in Teaching Award. She is a member of the Teachers of Accounting at Two Year Colleges, the American Accounting Association, the American Institute of Certified Public Accountants, and the Texas State Society of Certified Public Accountants. She is currently serving on the board of directors as secretary/webmaster of Teachers of Accounting at Two Year Colleges, as chair of the American Institute of Certified Public Accountants Pre-certification Executive Education committee, and as program chair for the Teaching, Learning and Curriculum section of the American Accounting Association. In addition, Tracie served on the Commission on Accounting Higher Education: Pathways to a Profession.

Tracie has spoken on such topics as using technology in the classroom, motivating nonbusiness majors to learn accounting, and incorporating active learning in the classroom at numerous conferences. In her spare time she enjoys spending time with her friends and family, and camping, fishing, and quilting.

BRENDA L. MATTISON has a bachelor's degree in education and a master's degree in accounting, both from Clemson University. She is currently an accounting instructor at Tri-County Technical College (TCTC) in Pendleton, South Carolina. Brenda previously served as Accounting Program Coordinator at TCTC and has prior experience teaching accounting at Robeson Community College, Lumberton, North Carolina; University of South Carolina Upstate, Spartanburg, South Carolina; and Rasmussen Business College, Eagan, Minnesota. She also has accounting work experience in retail and manufacturing businesses.

Brenda is a member of Teachers of Accounting at Two Year Colleges and the American Accounting Association. She is currently serving on the board of directors as vice-president of registration of Teachers of Accounting at Two Year Colleges.

Brenda engages in the scholarship of teaching and learning (SOTL). While serving as Faculty Fellow at TCTC, her research project was Using Applied Linguistics in Teaching Accounting, the Language of Business. Brenda has presented her research findings. Other presentations include using active learning and manipulatives, such as building blocks and poker chips, in teaching accounting concepts.

In her spare time, Brenda enjoys reading and spending time with her family, especially touring the United States in their motorhome. She is also an active volunteer in the community, serving her church, local Girl Scouts, and other organizations.

ELLA MAE MATSUMURA is a professor in the Department of Accounting and Information Systems in the School of Business at the University of Wisconsin—Madison, and is affiliated with the university's Center for Quick Response Manufacturing. She received a Bachelor of Arts degree in mathematics from the University of California, Berkeley, and a Master of Science and PhD degree from the University of British Columbia. Ella Mae has won two teaching excellence awards at the University of Wisconsin—Madison and was elected as a lifetime fellow of the university's Teaching Academy, formed to promote effective teaching. She is a member of the university team awarded an IBM Total Quality Management Partnership grant to develop curriculum for total quality management education.

Ella Mae was a co-winner of the 2010 Notable Contributions to Management Accounting Literature Award. She has served in numerous leadership positions in the American Accounting Association (AAA). She was co-editor of *Accounting Horizons* and has chaired and served on numerous AAA committees. She has been secretary-treasurer and president of the AAA's Management Accounting Section. Her past and current research articles focus on decision making, performance evaluation, compensation, supply chain relationships, and sustainability. She co-authored a monograph on customer profitability analysis in credit unions.

CAROL A. MEISSNER is a professor in both the School of Business and the Automotive Business School of Canada at Georgian College in Barrie, Ontario. She teaches in the Accounting Diploma,

Automotive Business Diploma, and Bachelor of Business (Automotive Management) programs. Her favourite courses are introductory financial accounting and dealership financial statement analysis.

In 2014, Carol was awarded the Georgian College Board of Governors' Award of Excellence Academic for outstanding contributions to the college and an ongoing commitment to excellence.

Carol has broad experience in curriculum development. She has been a curriculum chair, program coordinator, member of several curriculum committees, and has been involved in writing and renewing degree, diploma, and graduate certificate programs. She is currently helping to launch the new Automotive Dealership Management graduate certificate program for automotive industry executives.

A self-professed "learning junkie," Carol holds a Bachelor of Commerce degree, a Master of Business Administration degree, a Master of Arts degree in Education (Community College concentration), and a CPA designation. She has also earned Georgian College's Professional Development Teaching Practice Credential and is a graduate of Georgian's Aspiring Leaders program. She is a regular attendee at conferences related to teaching, accounting, and the automotive industry.

Carol has always been a teacher. She started as a part-time college instructor when she completed her first degree and has taught full time since 2005. Her "real world" experience includes car dealership controllership and self-employment as a part-time controller and consultant for a wide variety of businesses. Carol recently worked on several online projects for publishers and OMVIC as a subject matter expert. She is a trustee for OPSEU Local 35 and a member of the Secretary Treasurers Association of Ontario.

JO-ANN JOHNSTON is an instructor in the Accounting, Finance and Insurance Department at the British Columbia Institute of Technology (BCIT). She obtained her Diploma of Technology

in Financial Management from BCIT, her Bachelor in Administrative Studies degree from British Columbia Open University, and her Master of Business Administration degree from Simon Fraser University. She is also a certified general accountant and completed the Canadian securities course.

Prior to entering the field of education, Jo-Ann worked in public practice and industry for over 10 years. She is a past member of the board of governors of the Certified General Accountants Association of British Columbia and has served on various committees for the association. She was also a member of the board of directors for the BCIT Faculty and Staff Association, and served as treasurer during that tenure.

In addition to teaching duties and committee work for BCIT, Jo-Ann is the financial officer for a family-owned business.

PETER R. NORWOOD is an instructor in accounting and coordinator of the Accounting program at Langara College in Vancouver. A graduate of the University of Alberta, he received his Master of Business Administration from the University of Western Ontario. He is a CPA, a fellow of the Institute of Chartered Accountants of British Columbia, a certified management accountant, and a fellow of the Society of Management Accountants of Canada.

Before entering the academic community, Peter worked in public practice and industry for over 15 years. He is a past president of the Institute of Chartered Accountants of British Columbia and chair of the Chartered Accountants School of Business (CASB). He is also the chair of the Chartered Accountants Education Foundation for the British Columbia Institute of Chartered Accountants and has been active on many provincial and national committees, including the Board of Evaluators of the Canadian Institute of Chartered Accountants. Peter is also a sessional lecturer in the Sauder School of Business at the University of British Columbia.

HORNGREN'S ACCOUNTING ... REDEFINING TRADITION

MAKING CONNECTIONS

CONNECTING CHAPTER boxes appear at the beginning of each chapter. These features combine the chapter outline with the learning objectives, key questions, and page references.

4 COMPLETING THE ACCOUNTING CYCLE

CONNECTING CHAPTER 4

LEARNING OBJECTIVE 1 Prepare an accounting worksheet
How can we summarize data to prepare the financial statements?
The Worksheet, page 177

LEARNING OBJECTIVE 2 Completing the accounting cycle
Remind me: How does this all fit together?
Working Through the Accounting Cycle, page 181
Preparing the Financial Statements
Recording the Adjusting Entries

LEARNING OBJECTIVE 3 Close the revenue, expense, and withdrawal accounts
What are closing entries, and how do we record them?
Closing the Accounts, page 185
Post-Closing Trial Balance

LEARNING OBJECTIVE 4 Correct typical accounting errors
How do we fix accounting errors?
Correcting Journal Entries, page 189

LEARNING OBJECTIVE 5 Classify assets and liabilities as current or long term, and prepare a classified balance sheet
How can assets and liabilities be classified for a more informative balance sheet?
Classifying Assets and Liabilities, page 190
Assets
Liabilities
The Classified Balance Sheet

LEARNING OBJECTIVE 6 Use the current ratio and the debt ratio to evaluate a company
How do decision makers evaluate a company using the current ratio and debt ratio?
Accounting Ratios, page 194
Current Ratio
Debt Ratio
Interpreting Ratios

LEARNING OBJECTIVE 7 Describe the accounting cycle and financial reporting implications of International Financial Reporting Standards (IFRS)
How does IFRS apply to the accounting cycle and financial reporting?
Accounting Cycle and Financial Reporting Implications of IFRS, page 195

LEARNING OBJECTIVE 8 Describe and prepare reversing entries
What are reversing entries, and how do we record them?
Reversing Entries: An Optional Step, page 202

MyAccountingLab The Summary for Chapter 4 appears on page 205. This lists all of the MyAccountingLab resources. **Accounting Vocabulary** with definitions for this chapter's material appears on page 206.

174

LEARNING OBJECTIVES provide a roadmap showing what will be covered and what is especially important in each chapter.

PAGE REFERENCES give students the ability to quickly connect to the topic they are seeking within the chapter.

KEY QUESTIONS are questions about the important concepts in the chapter, expressed in everyday language.

CHAPTER OPENERS set up the concepts to be covered in the chapter using stories students can relate to. They show why the topics in the chapter are important in the business world. These vignettes are now 100 percent Canadian content.

NEW INSTRUCTOR TIPS RIGHT IN THE CHAPTER

Found throughout the text, these handwritten notes mimic the experience of having an experienced teacher walk a student through concepts on the board. Many include mnemonic devices or examples to help students remember the rules of accounting.

The entry to record each year's amortization is:

Dec. 31	Amortization Expense—Delivery Truck	12,000	
	Accumulated Amortization—Delivery Truck		12,000

Assume that this truck was purchased on January 1, 2017, and the business's fiscal year ends on December 31. A *straight-line amortization schedule* is presented in Exhibit 10-5. Spreadsheets are usually used to prepare these schedules.

Notice that when there is more than one asset being amortized in a business, we update the account names to include the specific asset information.



Kowartha Dairy Limited is a 100% Canadian-owned ice cream and dairy processor located in Bobcaygeon, Ontario, and is still operated by the same family that started it back in 1937. As a business, it is different from many in the food industry because it not only operates its own production facility, but also runs a chain of eight of its own retail stores. It also wholesales its Kowartha Dairy-branded products to other businesses, who in turn offer the products in their own stores. In addition to ice cream and milk, it produces specialized products like buttermilk for the baking industry and private-label items for other companies.

A firm like this has a huge investment in assets. Kowartha Dairy owns buildings, land, production equipment, and office furniture that it uses to run the business. It also has a fleet of trucks to deliver its goods to its own retail outlets, independent specialty shops, grocery stores, and institutional customers.

How does the company record the purchase of these trucks in their accounting records? Do they expense them or set them up as assets? Because they help the company earn revenue over several periods, they are reported as assets.

How should Kowartha Dairy account for the use of the trucks? They record amortization over each truck's useful life. Managers estimate how long they can use the truck and how much they can sell it for when it is taken out of service. They don't amortize this last amount because they get it back when they sell the truck or trade it in for a new one.

Because most companies keep assets for as long as they can, they also need to make repairs and maintain the trucks. *How do you decide when work done on the truck is part of the cost or considered a repair? Professional judgment is just as important in these decisions as are the generally accepted accounting principles.* Managers at Kowartha and other companies need to know how to account for these assets.

This chapter covers these and other matters about property, plant, and equipment, the long-term tangible assets that a business uses to operate, such as airplanes for Air Canada and automobiles for Discount Car and Truck Rentals. It also looks at *intangibles*—those assets with no physical form, such as trademarks and copyrights, and finally, this chapter shows how to account for natural resources such as oil and timber.

559

ADJUSTING-PROCESS IMPLICATIONS OF IFRS

ASPE **IFRS**

The concept of accrual accounting is accepted around the world. The accounting guidelines for all countries recommend the use of accrual accounting, so there are no process differences. There are differences in terminology, though.

Amortization is the term used for the allocation of the cost of plant and equipment over its estimated useful life:

- Amortization Expense
- Accumulated Amortization

Businesses may choose to use the term *depreciation* or *depletion* to be consistent with other companies in their industry.

Depreciation is the term used for amortization of tangible assets:

- Depreciation Expense
- Accumulated Depreciation

Amortization is the term used for intangible assets.

* This is the term used in Part II (ASPE), Section 3061, CPA Canada Handbook.

NEW IFRS/ASPE COMPARISON Each applicable chapter ends with a table comparing how concepts in that chapter are dealt with for those using IFRS and ASPE.

EXHIBIT 1-14 | Balance Sheet

HUNTER ENVIRONMENTAL CONSULTING
Balance Sheet
April 30, 2016

Assets		Liabilities	
Cash	\$172,000	Accounts payable	\$ 2,000
Accounts receivable	10,000		
Office supplies	7,000	Owner's Equity	
Land	100,000	Lisa Hunter, capital	287,000
Total assets	\$289,000	Total liabilities and owner's equity	\$289,000

Each asset account is listed separately and then totaled. Cash is always listed first. Pay attention to the order of the other accounts, too.

The heading again shows the name of the business and the title of the financial statement. Notice that the date is different. The balance sheet shows the date as a specific date, not a period of time.

Liabilities are listed separately and then totaled. Liabilities that are to be paid first are listed first.

The ending owner's capital is listed directly from the statement of owner's equity.

The balance sheet must always balance. Assets = Liabilities + Owner's Equity. Notice that the total of this document also shows assets on the left and liabilities and equity on the right. This is no coincidence.

NEW ANNOTATED EXHIBITS More annotated exhibits have been developed for this edition to improve clarity and reduce related explanations in the text.

Try It!

5. Check Yes or No in the following tables to indicate whether each of the accounts would usually require an adjusting entry to be made to the specific account listed.

Account	Yes	No	Account	Yes	No
Accounts Receivable			Supplies		
Building			Cash		
Interest Payable			Prepaid Insurance		

6. At the beginning of the month, Supplies were \$500. During the month, the company purchased \$600 of supplies. At month's end, November 30, \$400 of supplies were still on hand.

- What was the cost of supplies used during the month? Where is this item reported?
- What is the ending balance of Supplies? Where is this item reported?
- Make the adjusting entry to update the Supplies account at the end of the month.

Solutions appear at the end of this chapter and on MyAccountingLab

NEW TRY IT! BOXES Found at the end of each learning objective section in the text, **Try It!** features (formerly Just Checking) give students the opportunity to apply the concepts they just learned to an accounting problem. For this edition, care was taken to streamline this feature to include fewer questions to avoid interrupting the flow of student learning. Deep linking in the eText will allow students to practise in MyAccountingLab without interrupting their interaction with the eText. **Try It! Solutions** are provided at the end of each chapter.

> Why It's Done This Way



The top level of the accounting framework reminds us that financial statements are prepared to provide interested external users with information about the financial health of the company. These users have a variety of relationships with the company—some may be creditors who have lent money to the company, others may be shareholders or investors in the company. These groups want to

understand how well the company has done in the past year. As well, they may want to predict how the company will do in the future. The classified format of the balance sheet is an example of how liquidity information can be provided to help users get a better understanding about the financial condition of a business, which they can use as they calculate and interpret financial ratios.

••••• REVISED WHY IT'S DONE THIS WAY BOXES

Descriptions in these boxes have been shortened to focus on the key new points in the chapter, without referencing levels. For instructors who want longer and more technical notes, these are included in the instructor's material.

REVISED END-OF-CHAPTER MATERIAL

The number of Starters and Exercises provided in each chapter has been increased, while maintaining both A and B Problem sets.

All learning objectives now have consistent coverage in end-of-chapter questions.

There is now more variety of questions provided.

ENGAGING REDESIGN The redesign of this text throughout includes clean and consistent art for T-accounts, journal entries, financial statements, and the accounting equation.

New art types include clear explanations and connection arrows to help students follow the transaction process. Illustrations are updated to be more modern and clean.

Margins have been decluttered, ensuring a smoother, more open and approachable look, while keeping the most important content visible.

Closing entry **3** would then credit Income Summary to close its debit balance and transfer the net loss to Lisa Hunter, Capital:

3 May 31	Lisa Hunter, Capital	1,000	
	Income Summary		1,000
	To close the Income Summary account and transfer net loss to the Capital account.		

After posting, these two accounts would appear as follows:

Income Summary		Lisa Hunter, Capital	
Clo. 2 27,500	Clo. 1 26,500	Clo. 3 1,000	120,100
Bal. 1,000	Clo. 3 1,000	Bal.	119,100

Changes to the Tenth Canadian Edition

Additional Starters and Exercises have been added to *all* chapters in Volume 1. Instructors wanted more of these types of questions and more variety in the questions, so the Tenth Canadian Edition has been updated to reflect this.

Chapter 1—Accounting and the Business Environment

- Chapter 1 has been completely reworked and refreshed. The explanation of accounts has been moved from Chapter 2, thus removing duplication and ensuring students have all the information they need to create financial statements.
- Updates to this chapter include information reflecting the changing professional landscape of accountants in Canada, and the history of accounting material has been removed.
- Annotated exhibits for the balance sheet and income statement have been provided to strengthen explanations of the financial statements.

Chapter 2—Recording Business Transactions

- The introduction of the accounting cycle has been moved from Chapter 4 to the start of this chapter because this is where the topic is first introduced.
- The demonstration of posting to a T-account is now covered before introducing a more formal ledger account.
- Exhibits relating to the rules of debits and credits have been improved.
- The explanation of journal entries and calculating the balance of a T-account has been improved with new annotated exhibits.

Chapter 3—Measuring Business Income: The Adjusting Process

- The discussion on cash-basis versus accrual-basis accounting has been reduced since instructors told us that the accrual basis needed to be the focus of the lesson. We moved some cash-basis information to MyAccountingLab for those instructors who still want to cover this topic in more detail.
- There is an expanded alternative presentation example of property, plant, and equipment (where we show rather than tell).
- Again because of instructor requests, we added an additional example of partial pay periods to support student learning of a very difficult concept.
- The flow of the chapter has been improved by moving the order of adjusting entry topics so that they are in the same order as presented in the exhibit.
- The learning objective about using the worksheet to prepare the adjusted trial balance has been removed to make it easier for some schools to skip the topic of worksheets.

Chapter 4—Completing the Accounting Cycle

- Duplicate information about worksheets and the accounting cycle has been removed.
- The complexity of the classified balance sheet example has been reduced.

Chapter 5—Merchandising Operations

- The summary problem has been updated to cover more of the key learning objectives. The Ninth Canadian Edition solved problem, which included a merchandiser's worksheet and closing entries, has been moved to MyAccountingLab, so it is still available for those instructors who teach those topics.
- The information about sales taxes, which was included as Appendix C to this chapter, has been moved to Chapter 11 (Current Liabilities) to remove the additional complexity this adds to the chapter and avoid duplication of topics in the book.

Chapter 6—Accounting for Merchandise Inventory

- The main change to this chapter is the removal of the learning objective, chapter section, and problem material related to the assessment of the impact of IFRS on inventory recording and reporting.

Chapter 7—Accounting Information Systems

- The learning objective that covered special journals with sales taxes (Learning Objective 6 in the Ninth Canadian Edition) has been moved to MyAccountingLab to reduce complexity, since sales taxes are not covered in detail until Chapter 11. Instructors who cover this topic still have the information they need.
- Information has been added on the use of new technology and security, such as the cloud.

Chapter 8—Internal Control and Cash

- All of the internal control information has been merged into one learning objective to streamline the content and reduce duplication.
- The Sarbanes-Oxley Act (SOX) discussion has been updated to include the Frank Dodd Act.

Chapter 9—Receivables

- Duplication of statement presentation information has been removed.
- Online payments have been added to keep the text material current.
- Internal control topics have been removed to keep the chapter focus on the most important topics in the chapter.
- Annotated T-account explanations about how to calculate the Allowance for Doubtful Accounts balance have been added to clarify a difficult topic for students.

Chapter 10—Property, Plant, and Equipment; and Goodwill and Intangible Assets

- The discussions of “construction in progress” and internal control have been removed to focus on key chapter concepts.
- The discussion about operating leases has been removed because this topic is covered in Volume 2.

Chapter 11—Current Liabilities and Payroll

- In order to reduce duplication, information about the presentation of liabilities has been consolidated.
- Payroll and sales tax rates have been updated for consistency with legislation at the time of writing.
- The concept of crowdfunding has been introduced to keep the text current.
- Internal control topics have been removed to keep the chapter focus on the most important topics in the chapter.
- The flow of recording payroll journal entries has been reworked to reduce duplication and improve clarity.

Student and Instructor Resources

The primary goal of the supplements that accompany *Horngrén's Accounting*, Tenth Canadian Edition, is to help instructors deliver their course with ease using any delivery method—traditional, self-paced, or online—and for students to learn and practise accounting in a variety of ways that meet their learning needs and study preferences.

MyAccountingLab

MyAccountingLab delivers proven results in helping individual students succeed. It provides engaging experiences that personalize, stimulate, and measure learning for each student, including a personalized study plan, mini-cases, and videos. MyAccountingLab is the portal to an array of learning tools for all learning styles—algorithmic practice questions with guided solutions are only the beginning!

For Students

The following features are **NEW** to MyAccountingLab for the Tenth Canadian Edition:

NEW!

Assignable Accounting Cycle Tutorial—MyAccountingLab's new interactive tutorial helps students master the accounting cycle for early and continued success in the introduction to accounting course. The tutorial, accessed by computer, smartphone, or tablet, provides students with brief explanations of each concept of the accounting cycle through engaging videos and/or animations. Students are immediately assessed on their understanding, and their performance is recorded in the MyAccountingLab gradebook. Whether the Accounting Cycle Tutorial is used as a remediation self-study tool or course assignment, students have yet another resource within MyAccountingLab to help them be successful with the accounting cycle.

NEW!

Enhanced Pearson eText—The Enhanced eText keeps students engaged in learning on their own time, while helping them achieve greater conceptual understanding of course material. The worked examples bring learning to life, and algorithmic practice allows students to apply the concepts they are reading about. Combining resources that illuminate content with accessible self-assessment, MyAccountingLab with Enhanced eText provides students with a complete digital learning experience—all in one place.

The Pearson eText gives students access to the text whenever and wherever they have online access to the Internet. eText pages look exactly like the printed text, offering powerful new functionality for students and instructors. Users can create notes, highlight text in different colours, create bookmarks, zoom, click hyperlinked words and phrases to view definitions, and view in single-page or two-page view.

Dynamic Study Modules—Canadian study modules allow students to work through groups of questions and check their understanding of foundational accounting topics. As students work through questions, the Dynamic Study Modules assess their knowledge and only show questions that still require practice. Fully Assignable, flowing through the Gradebook, or Self-Directed Dynamic Study Modules can be completed online using a computer, tablet, or mobile device.



Learning Catalytics—A “bring your own device” assessment and classroom activity system that expands the possibilities for student engagement. Using Learning Catalytics, you can deliver a wide range of auto-gradable or open-ended questions that test content knowledge and build critical thinking skills. Eighteen different answer types provide great flexibility, including graphical, numerical, textual input, and more.



Audio Lecture Videos—These pre-class learning aids are available for every learning objective and are professor-narrated PowerPoint summaries that will help students prepare for class. These can be used in an online or flipped classroom experience or simply to get students ready for the lecture.



Adaptive Assessment—Integrated directly into the MyAccountingLab Study Plan, Pearson’s adaptive assessment is the latest technology for individualized learning and mastery. As students work through each question, they are provided with a custom learning path tailored specifically to the concepts they need to practice and master.



In addition, students will find the following assets to help improve their learning experience:

- Help Me Solve This Guides
- Worked Solutions
- Videos
- DemoDocs
- Check Figures
- Student PowerPoint Presentations
- Audio Chapter Summaries
- Accounting Cycle Tutorial Animations
- Excel Spreadsheet Templates
- General Ledger (NEW!)
- Open-Response Questions (NEW!)

For Instructors

The following resources are available for Instructors at the Instructor’s Resource Centre on the catalogue, at catalogue.pearsoned.ca:

- **Instructor’s Solutions Manual.** This manual provides instructors with a complete set of solutions to all the end-of-chapter material in the text. Available in both Word and PDF formats.
- **Computerized Testbank.** The Testbank for *Horngren’s Accounting* offers a comprehensive suite of tools for testing and assessment. TestGen allows educators to easily create and distribute tests for their courses, either by printing and distributing through traditional methods or by online delivery. The more than 100 questions per chapter can be sorted by the chapter’s Learning Objectives, difficulty ranking, Bloom’s Taxonomy, and—new to this edition—applicable Canadian Professional Accounting Standards. Types of questions included are Multiple Choice, True/False, Short Answer, and Essay. One NEW Essay question has been created for each chapter, building on cumulative learning across all previous chapters.

- **Test Item File.** All the test questions from the TestGen testbank are available in Microsoft Word format.
- **Instructor’s Teaching Tips in Digital eText Resource:** Instructors can easily locate useful teaching tips and resources throughout the eText, which is annotated by apple icons throughout the chapters. This eText is located in MyAccountingLab.
- **PowerPoint Presentations.** Prepared for each chapter of the text, these presentations offer helpful graphics that illustrate key figures and concepts from the text.
- **Image Library.** We are pleased to provide the exhibits from the text in .jpg format for use in the classroom or for building your own lectures or PowerPoint presentations.

Learning Solutions Managers

Pearson’s Learning Solutions Managers work with faculty and campus course designers to ensure that Pearson technology products, assessment tools, and online course materials are tailored to meet your specific needs. This highly qualified team is dedicated to helping schools take full advantage of a wide range of educational resources by assisting in the integration of a variety of instructional materials and media formats. Your local Pearson sales representative can provide you with more details on this service program.

Acknowledgements for *Horngren’s Accounting, Tenth Canadian Edition*

Horngren’s Accounting, Tenth Canadian Edition, is the product of a rigorous research process that included multiple reviews in the various stages of development to ensure the revision meets the needs of Canadian students and instructors. The extensive feedback from the following reviewers helped shape this edition into a clearer, more readable and streamlined textbook in both the chapter content and assignment material:

- Bharat Aggarwal, Seneca College
- Ionela Bacain, Humber College
- Maria Belanger, Algonquin College
- Robin Day, British Columbia Institute of Technology
- Meredith Delaney, Seneca College
- Denise Dodson, Nova Scotia Community College
- Stanley Faria, Humber College
- Carol Fearon, Seneca College
- Darla Lutness, Northern Alberta Institute of Technology
- Michael Malkoun, St. Clair College
- Vnit Nath, British Columbia Institute of Technology
- Dal Pirot, MacEwan University
- Raymond Sungaila, Humber College
- Selina Tang, Douglas College
- Dan Wong, Southern Alberta Institute of Technology

Special thanks to Brad Witt at Humber College for being a “super reviewer” of this manuscript—his comments helped us improve the end-of-chapter material.

We would also like to thank the late Charles Horngren and Tom Harrison for their support in writing the original material.

We would like to give special thanks to Chris Deresh, CPA, Manager, Curriculum Content, at Chartered Professional Accountants of Canada for his guidance and

technical support. His willingness to review and discuss portions of the manuscript was generous and insightful, and it is gratefully acknowledged.

The Chartered Professional Accountants, as the official administrator of generally accepted accounting principles in Canada, and the *CPA Canada Handbook*, are vital to the conduct of business and accounting in Canada. We have made every effort to incorporate the most current *Handbook* recommendations in this new edition of *Accounting* for both private enterprises (ASPE) and for publicly accountable enterprises subject to International Financial Reporting Standards (IFRS).

Thanks are extended to Indigo Books & Music Inc. and TELUS Corporation for permission to use their annual reports in Volumes I and II of this text and on MyAccountingLab. We acknowledge the support provided by the websites of various news organizations and by the annual reports of a large number of public companies.

We would like to acknowledge the people of Pearson Canada, in particular Senior Acquisitions Editor Megan Farrell, who put together a great team for this project, and Marketing Manager Loula March. Special thanks to Suzanne Simpson Millar, Queen Bee at Simpson Editorial Services, who was an awesome Developmental Editor on this edition. Leanne Rancourt as Production Editor also added her many talents as the project neared completion.

We would like to thank Media Editor Anita Smale for her excellent work on the MyAccountingLab that accompanies this textbook.

Our task is to provide educational material in the area of accounting to instructors and students to aid in the understanding of this subject area. We welcome your suggestions and comments on how to serve you better.

1 ACCOUNTING AND THE BUSINESS ENVIRONMENT

CONNECTING CHAPTER 1

Connecting Chapter "X" appears at the beginning of each chapter and gives a guide to the content of the chapter with page references.

Learning Objectives are a "roadmap" showing what will be covered and what is especially important in each chapter.

Key Questions are questions about the important concepts in the chapter expressed in everyday language.

LEARNING OBJECTIVE 1 Define accounting, and describe the users of accounting information

Why is accounting important, and who uses the information?

Accounting: The Language of Business, page 4
Users of Accounting Information
Financial Accounting and Management Accounting
Accountants
Ethics in Accounting and Business

LEARNING OBJECTIVE 2 Compare and contrast the forms of business organizations

In what form can we set up a company?

Forms of Business Organizations, page 7
Proprietorship
Partnership
Corporation

LEARNING OBJECTIVE 3 Describe some concepts and principles of accounting

What are some of the guidelines for accounting, and why do we need them?

Accounting Concepts, page 9
Framework for Financial Reporting

LEARNING OBJECTIVE 4 Use the accounting equation to analyze business transactions

How do business activities affect the accounting records of a company?

The Accounting Equation, page 12
Assets
Liabilities
Owner's Equity
Accounting for Business Transactions

LEARNING OBJECTIVE 5 Prepare financial statements

What financial statements are prepared by a company, and how do we create them?

The Financial Statements, page 21
Income Statement
Statement of Owner's Equity
Balance Sheet
Cash Flow Statement
Relationships among the Financial Statements

LEARNING OBJECTIVE 6 Briefly explain the different accounting standards

What are IFRS and ASPE?

ASPE vs. IFRS, page 25

MyAccountingLab The **Summary** for Chapter 1 appears on page 28. This lists all of the MyAccountingLab resources. **Accounting Vocabulary** with definitions for this chapter's material appears on page 29.



Lisa Hunter graduated from university with a degree in environmental studies. She then went to work with an environmental consulting company and gained extensive experience in the area of environmental sustainability. Lisa soon came to realize that many small businesses were starting to recognize the benefits of “going green.”

Lisa decided to start her own consulting firm, but she did not have a lot of knowledge about businesses or their record keeping. She had so many questions. What kind of business should she set up? How would she know if the business was making any money? How would she know how much money she could take out of her business? She took some night school courses in accounting and small business management before starting her business to make sure she could answer those questions.

She named her new company “Hunter Environmental Consulting.” She was now an entrepreneur! She realized she needed to develop a business plan, secure clients, set up an office, and hire staff.

Lisa’s first year in business was stressful and successful. Her work in the first year was in the area of energy efficiency and suggesting how her clients could reduce their energy consumption and their energy costs.

“My previous training and experience gave me the confidence to know that I could be successful in this field. However, I did not realize how carefully you have to watch the books—costs can get out of control in a hurry if you’re not careful!”

A chapter-opening story shows why the topics in the chapter are important to real companies and businesspeople. We refer to this story throughout the chapter.

> What

role does accounting play in Lisa Hunter's situation? Lisa had to decide how to organize her company. She set up her business as a proprietorship—a single-owner company—with herself as the owner. As her business grows, she may decide to expand it by taking on a partner. She might also choose to incorporate—that is, to form a corporation. In this chapter, we discuss all three forms of business organization: proprietorships, partnerships, and corporations.

You may already know various accounting terms and relationships, because accounting affects people's lives in many ways. This first accounting course will help you see this by explaining how accounting works. As you progress through this course, you will see how accounting helps people like Lisa Hunter—and you—achieve business goals.

LO 1

Why is accounting important, and who uses the information?

Learning objectives in the margin signal the beginning of the section that covers the learning-objective topic.

Boldfaced words are new terms that are explained here and defined in the Accounting Vocabulary section at the end of this chapter and the Glossary at the end of the book.

ACCOUNTING: THE LANGUAGE OF BUSINESS

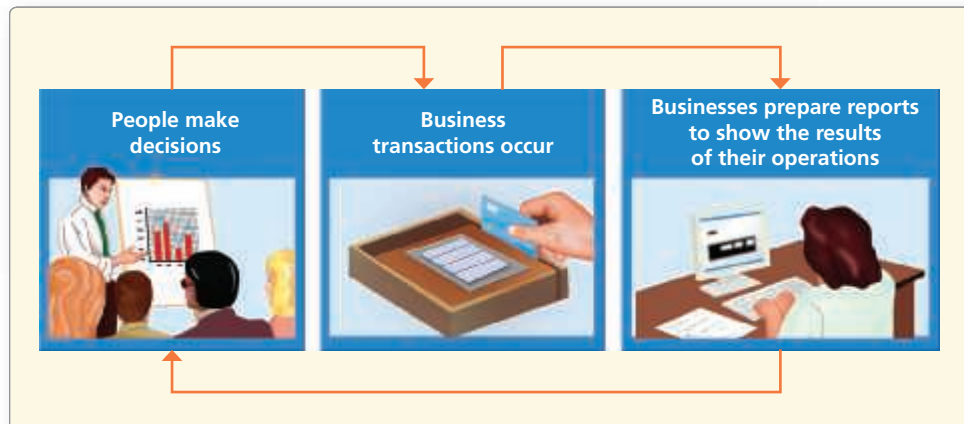
Accounting is the information system that measures **business** financial activities, processes that information into reports, and communicates the results to decision makers. For this reason it is called “the language of business.” The better you understand the language, the better your decisions will be, and the better you can manage financial information. And as with any language, there is unique terminology that takes practice to learn. Students must practise using this new language as much as possible. Many business managers believe it is more important for students to learn accounting than any other business subject.

Financial statements are a key product of an accounting system and provide information that helps people make informed business decisions. Financial statements report on a business in monetary terms and help you answer questions such as, Is my business making a **profit**? Should I hire assistants? Who owes me money? Am I earning enough money to expand my business?

Students sometimes mistake bookkeeping for accounting. **Bookkeeping** is a procedural element of accounting, just as arithmetic is a step used when solving a mathematical problem (or just as skating is an important part of hockey). There are many accounting software packages that will handle detailed bookkeeping. Recording the information is important, but understanding what it all means and how it helps you make better decisions is even more important. Exhibit 1–1 illustrates the role of accounting in business.

Exhibits summarize key ideas in a visual way.

EXHIBIT 1–1 | The Accounting System: The Flow of Information



Users of Accounting Information

It seems that almost everyone uses financial information to make decisions.

Individuals People use accounting information in day-to-day affairs to manage bank accounts, evaluate job prospects, make investments, and decide whether to lease or buy a new car.

Businesses Business owners and managers use accounting information to set goals for their organizations. They evaluate their progress toward those goals, and they make changes when necessary. For example, Lisa Hunter makes decisions based on accounting information. She knows the amount of money that will be earned, since she and her client will agree on a fee for the consulting work she will perform. She needs to determine the scope of the work, how many consultants she will require, and how many hours it will take to complete the project. She needs to make sure that her costs do not exceed the fee she will receive from her client if she wants to make sure that she maintains a profitable business.

Investors and Creditors Investors and creditors provide the money to finance business activities. To decide whether to invest, **investors** predict the amount of income that will be earned on their investment. Before lending money, **creditors** such as banks and suppliers evaluate the borrower's ability to pay them back.

Government and Regulatory Bodies Provincial and federal governments levy taxes on individuals and businesses. Income tax is calculated by using accounting information as a starting point. A business's accounting system is required to keep track of provincial sales tax, goods and services tax, and harmonized sales tax that a business collects from its customers and pays to its suppliers. In addition, some companies are regulated by provincial securities commissions, such as the British Columbia Securities Commission or the Ontario Securities Commission, which dictate that businesses selling their shares to and borrowing money from the public disclose certain financial information.

Not-for-Profit Organizations Organizations such as churches, hospitals, government agencies, universities, and colleges, which operate for purposes other than to earn a profit, use accounting information to make decisions related to the organization in much the same way that profit-oriented businesses do.

Other Users Employees and labour unions may make wage demands based on the accounting information that shows their employer's reported income. Consumer groups and the general public are also interested in the amount of income that businesses earn.

Financial Accounting and Management Accounting

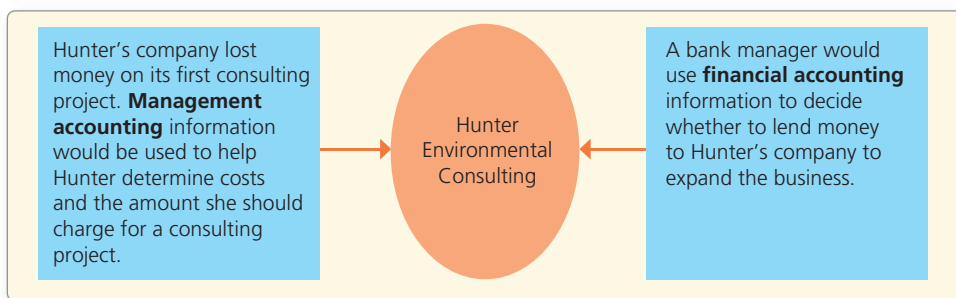
Users of accounting information may be grouped as external users or internal users. This distinction allows us to classify accounting into two fields—financial accounting and management accounting.

Financial accounting provides information primarily to people outside the company. Creditors and outside investors, for example, are not part of the day-to-day management of the company. Likewise, government agencies and the general public are **external users** of a company's accounting information. This book deals primarily with financial accounting.

Management accounting generates information for internal decision makers, such as company executives, department managers, and hospital administrators. **Internal users** ask questions such as, What price should we set for our product in order to make the most money? How much of a raise can we afford to give our employees?

Exhibit 1–2 shows how financial accounting and management accounting are used by Hunter Environmental Consulting's internal and external decision makers.

EXHIBIT 1-2 | How Financial Accounting and Management Accounting Are Used



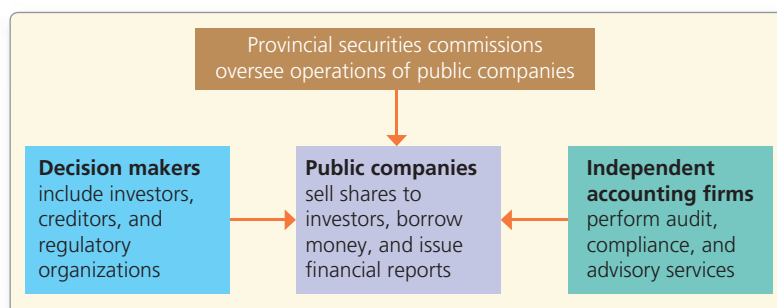
Accountants

Canadian accountants have been going through a period of transition. The largest organization of designated accountants in Canada is now the **Chartered Professional Accountants (CPAs)**. Until recently, there were three **professional designations** for accountants in Canada—Chartered Accountants (CAs), Certified General Accountants (CGAs), and Certified Management Accountants (CMAs). Those accountants who joined the CPA as a result of the merger of these organizations will retain their **legacy designation** on their business cards.

Professional Conduct Professional accountants are governed by standards of professional conduct. Many of these standards apply whether the members are **public accountants** who perform work for other businesses or **private accountants** who are employed by a particular business. These rules concern the confidentiality of information the accountant is privy to, maintenance of the profession's reputation, the need to work with integrity and due care, competence, refusal to be associated with false or misleading information, and compliance with professional standards. Other rules are applicable only to those members in public practice and deal with things like the need for **independence** and how to advertise, seek clients, and conduct a practice. This helps the public determine its expectations of members' behaviour. However, the rules of professional conduct should be considered a minimum standard of performance; ideally, the members should continually strive to exceed them.

Audits One type of work done by **designated accountants** is an **audit**. An audit is a financial examination. Audits are conducted by independent accountants who express an opinion on whether or not the financial statements fairly reflect the economic events that occurred during the accounting period. Companies and their auditors must behave in an ethical manner. Exhibit 1-3 illustrates the relationship among accounting and business entities that are public companies (companies that sell shares of stock to investors).

EXHIBIT 1-3 | Relationship among Accounting and Business Entities



CPA Canada Advanced Certificate in Accounting and Finance (ACAF) The ACAF certificate program prepares people for a career in accounting and finance as an alternative to pursuing a professional designation.

Ethics in Accounting and Business

We need to consider **ethics** in all areas of accounting and business. Investors, creditors, and regulatory bodies need reliable information about a company. Naturally, companies want to make themselves look as good as possible to attract investors, so there is a potential for conflict. Unfortunately for the accounting profession, accounting scandals involving both public companies and their auditors have made the headlines over the years. At the turn of this century, Enron Corporation, which was the seventh-largest company in the United States, issued misleading financial statements. Enron was forced into bankruptcy and its auditors' actions were questioned. The impact of the Enron bankruptcy was felt by many different parties, including Enron shareholders, who saw their investments become worthless; employees, who lost their jobs and their pensions; and the accounting profession, which lost some of its integrity and reputation as gatekeepers and stewards for the investing public. This situation shocked the business community and caused investors to question the reliability of financial information.

Since the financial health of a company is important to many different groups of users, these users must be confident that they can rely on the financial information they are given when they are making decisions. To increase users' confidence, the accounting profession and other interested stakeholder groups made important changes over the past decade to improve the quality of the financial information provided.

Try It! questions appear at the end of each learning-objective section, allowing you to test your mastery of the concepts in this learning objective before moving on to the next one. The solutions appear at the end of the chapter and on MyAccountingLab.

> Try It!

1. For each of the following users of accounting information, indicate if the user is an internal or external user.
 - a. Supplier
 - b. Owner
 - c. Marketing manager
 - d. Lender
 - e. Ontario Securities Commission

Solutions appear at the end of this chapter and on [MyAccountingLab](#)

FORMS OF BUSINESS ORGANIZATIONS

A business can be organized as a

- Proprietorship
- Partnership
- Corporation

Exhibit 1–4 summarizes some of the differences between the three forms of business organization.

Proprietorship

A **proprietorship** has a single owner, called the proprietor, who often manages the business. Proprietorships tend to be small retail stores, restaurants, and service businesses, but they can also be very large. From an accounting viewpoint, each proprietorship is distinct from its owner. Thus, the accounting records of

LO 2

In what form can we set up a company?

EXHIBIT 1-4 | Comparison of the Forms of Business Organization

	Proprietorship	Partnership	Corporation
Owner(s)	Proprietor—one owner	Partners—two or more owners	Shareholder(s)—one or many owners
Life of organization	Limited by owner's choice or death	Limited by owners' choices or death of one of the partners	Indefinite
Personal liability of owner(s) for business debts	Owner is personally liable	Partners are personally liable*	Shareholders are not personally liable
Legal status	The owner and the business are not legally separate	The partnership is the partners; they are not legally separate	The corporation is separate from the shareholders (owners).
Taxation	The owner pays tax on the proprietorship's earnings; income is added onto the owner's personal tax return	The owners each pay tax on their share of the partnership's earnings; income is added onto each partner's personal tax return	Separate taxable entity; the corporation pays tax on its earnings

*Unless it is a limited-liability partnership (LLP)

the proprietorship do not include the proprietor's personal accounting records. However, from a legal perspective, the business *is* the proprietor, so if the business cannot pay its debts, lenders can take the proprietor's personal assets (cash and belongings) to pay the proprietorship's debt.

Partnership

A **partnership** joins two or more individuals together as co-owners. Each owner is a partner. Many retail stores and professional organizations of physicians, lawyers, and accountants are partnerships. Accounting treats the partnership as a separate organization distinct from the personal affairs of each partner. From a legal perspective, though, a partnership *is* the partners in a manner similar to a proprietorship. If the partnership cannot pay its debts, lenders can take each partner's personal assets to pay the partnership's debts.

Limited-Liability Partnership (LLP) A **limited-liability partnership (LLP)** is a partnership in which one partner cannot create a large liability for the other partners. Each partner is liable only for his or her own actions and those actions under his or her control.

Corporation

A **corporation** is a business owned by **shareholders**. These are the people or other corporations who own shares of ownership in the business. Although proprietorships and partnerships are more numerous, corporations engage in more business and are generally larger in terms of total assets, income, and number of employees. In Canada, corporations generally have *Ltd.* or *Limited, Inc.* or *Incorporated*, or *Corp.* or *Corporation* in their legal name to indicate that they are incorporated. Corporations need not be large; a business with only one owner and only a few assets could be organized as a corporation.

From a legal perspective, a corporation is formed when the federal or provincial government approves its articles of incorporation. Unlike a proprietorship or a partnership, once a corporation is formed it is a legal entity separate and distinct from its owners. The corporation operates as an "artificial person" that exists apart from its owners and that conducts business in its own name. The corporation has

many of the rights that a person has. For example, a corporation may buy, own, and sell property; the corporation may enter into contracts and sue and be sued.

Corporations differ significantly from proprietorships and partnerships in another way. If a proprietorship or partnership cannot pay its debts, lenders can take the owners' personal assets to satisfy the business's obligations. But if a corporation goes bankrupt, lenders cannot take the personal assets of the shareholders. This **limited personal liability** of shareholders for corporate debts explains why corporations are so popular compared to proprietorships and partnerships, which have **unlimited personal liability**.

Corporations divide ownership into individual shares. Companies such as WestJet Airlines Ltd. and Canadian Tire Corporation, Limited, have issued millions of shares of stock and have tens of thousands of shareholders. An investor with no personal relationship either to the corporation or to any other shareholder can become an owner by buying 30, 100, 5,000, or any number of shares of its stock. For most corporations, the investor may sell the shares at any time. It is usually harder to sell one's investment in a proprietorship or a partnership than to sell one's investment in a corporation.

Accounting for corporations includes some unique complexities. For this reason, we initially focus on proprietorships. We cover partnerships in Chapter 12 and begin our discussion of corporations in Chapter 13.

> Try It!

2. For each of the following scenarios, indicate the applicable form of business in the space provided.

	Proprietorship	Partnership	Corporation
a. The business is not making enough money to pay its bills. The owners do not have to make up the difference with their personal funds.			
b. Anna and Sui have owned their business together for 5 years. Anna dies. The business must be closed if they chose this form of business.			
c. An unincorporated business with five owners is a ...			
d. The profits of Chi's business must be reported on her tax return.			
e. There is a lawsuit against a business and there is not enough money to pay the claim. The owners only lose the amount they have invested into the business.			

Solutions appear at the end of this chapter and on [MyAccountingLab](#)

ACCOUNTING CONCEPTS

Earlier in this chapter, we discussed the importance of financial information to various user groups. Users must be confident that they can rely on the financial information they are given when they are making decisions. To increase users' confidence, accounting practices need to follow certain guidelines that govern how accountants measure, process, and communicate financial information. They are known as **generally accepted accounting principles**, or **GAAP**.

Individual countries determine their own GAAP. In the past, the standards used around the world were very different. Over time, as more businesses operated in multiple countries, the preparation of different statements for each country became

LO 3

What are some of the guidelines for accounting, and why do we need them?