

 Sixteenth Canadian Edition

# FUNDAMENTAL ACCOUNTING PRINCIPLES

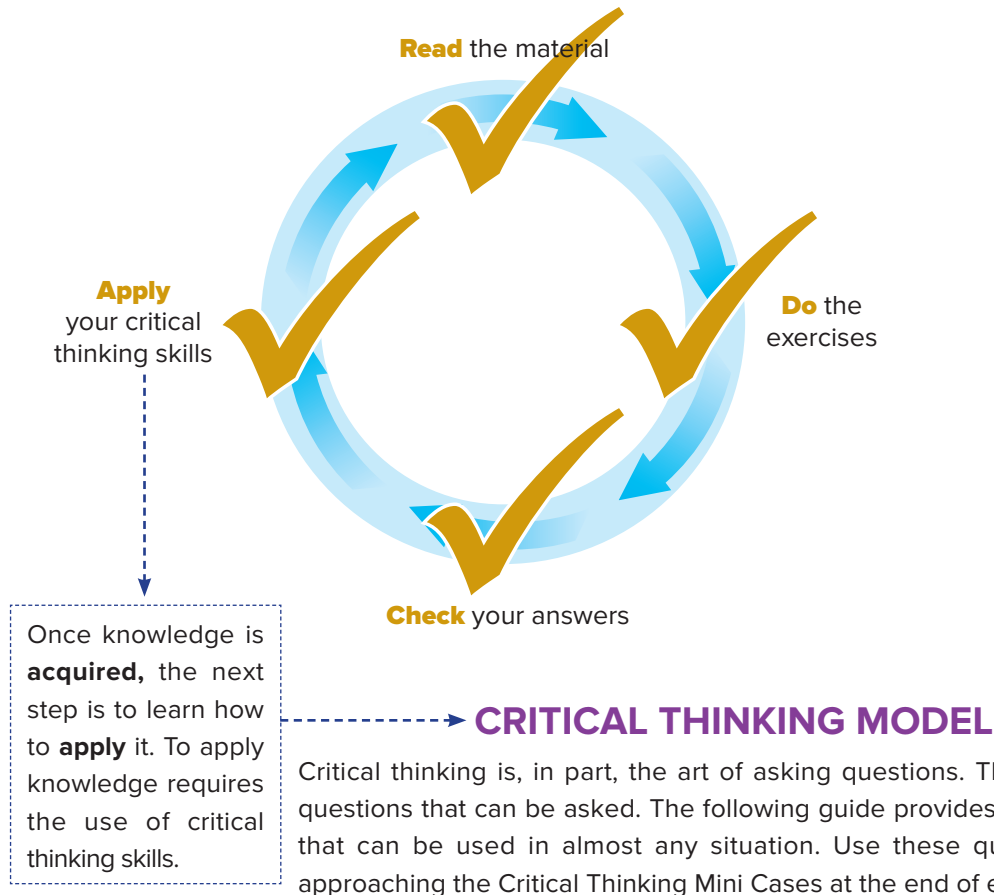
VOLUME 1



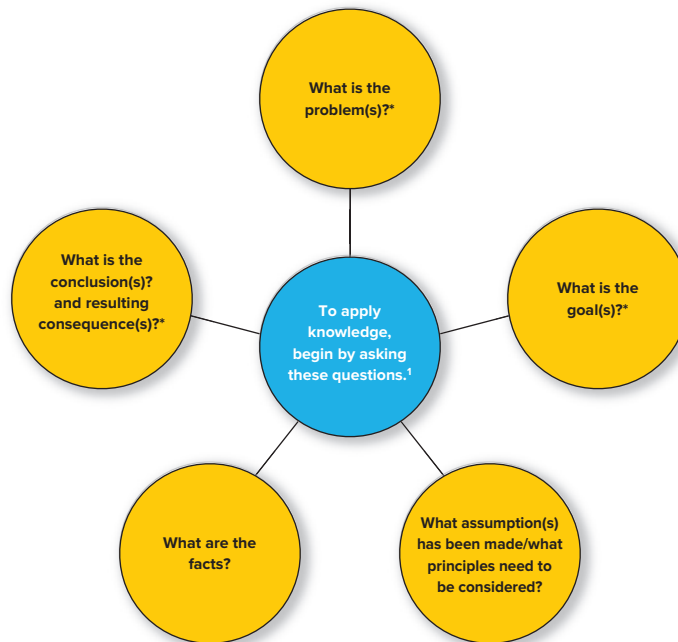
LARSON | DIECKMANN

## STUDENT SUCCESS CYCLE

Following the Student Success Cycle will help you **acquire** knowledge through **active** learning.



Critical thinking is, in part, the art of asking questions. There are many questions that can be asked. The following guide provides key questions that can be used in almost any situation. Use these questions when approaching the Critical Thinking Mini Cases at the end of each chapter.



\*These are highly dependent on perspective.

<sup>1</sup>R. Paul, L. Elder., & Foundation for Critical Thinking, *The Miniature Guide to Critical Thinking: Concepts & Tools*, 3rd ed. (Dillon Beach, Calif.: Foundation for Critical Thinking, 2003).



# Differentiating the Financial Statements

*Fundamental Accounting Principles* uses a colour scheme to help students differentiate among the four key financial statements.

Organico's Income Statement For Month Ended March 31, 2020		
Revenues:		
Food services revenue .....	\$3,800	
Teaching revenue .....	<u>300</u>	
Total revenues .....		\$4,100
Operating expenses:		
Rent expense .....	\$1,000	
Salaries expense .....	<u>700</u>	
Total operating expenses .....		<u>1,700</u>
Profit .....		<u>\$2,400</u>

Organico Statement of Changes in Equity For Month Ended March 31, 2020		
Hailey Walker, capital, March 1 .....		\$ -0-
Investments by owner .....	\$10,000	
Profit .....	<u>2,400</u>	<u>12,400</u>
Total .....		\$12,400
Less: Withdrawals by owner .....		<u>600</u>
Hailey Walker, capital, March 31 .....		<u>\$11,800</u>

Organico Balance Sheet March 31, 2020			
<b>Assets</b>		<b>Liabilities</b>	
Cash .....	\$ 8,400	Accounts payable .....	\$ 200
Supplies .....	3,600	Notes payable .....	<u>6,000</u>
Equipment .....	<u>6,000</u>	Total liabilities .....	\$ 6,200
Total assets .....	<u>\$18,000</u>	<b>Equity</b>	
		Hailey Walker, capital .....	<u>11,800</u>
		Total liabilities and equity .....	<u>\$18,000</u>

Organico Statement of Cash Flows For Month Ended March 31, 2020		
Cash flows from operating activities		
Cash received from clients .....	\$ 4,100	
Cash paid for supplies .....	(3,400)	
Cash paid for rent .....	(1,000)	
Cash paid to employee .....	<u>(700)</u>	
Net cash used by operating activities .....		\$(1,000)
Cash flows from investing activities .....		
		-0-
Cash flows from financing activities		
Investment by owner .....	\$10,000	
Withdrawal by owner .....	<u>(600)</u>	
Net cash provided by financing activities .....		<u>9,400</u>
Net increase in cash .....		\$ 8,400
Cash balance, March 1 .....		-0-
Cash balance, March 31 .....		<u>\$ 8,400</u>

The arrows are provided for education purposes only to emphasize the link between statements.



# FUNDAMENTAL ACCOUNTING PRINCIPLES

VOLUME 1

**Kermit D. Larson**

University of Texas—Austin

**Heidi Dieckmann**

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**Fundamental Accounting Principles  
Volume 1  
Sixteenth Canadian Edition**

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Kermit D. Larson is the Arthur Andersen & Co. Alumni Professor of Accounting Emeritus at the University of Texas at Austin. He served as chair of the University of Texas, Department of Accounting, and was visiting associate professor at Tulane University. His scholarly articles have been published in a variety of journals, including *The Accounting Review*, *Journal of Accountancy*, and *Abacus*. He is the author of several books, including *Financial Accounting* and *Fundamentals of Financial and Managerial Accounting*, both published by Irwin/McGraw-Hill.

Professor Larson is a member of the American Accounting Association, the Texas Society of CPAs, and the American Institute of CPAs. His positions with the AAA have included vice president, southwest regional service president, and chair of several committees, including the Committee of Concepts and Standards. He was a member of the committee that planned the first AAA doctoral consortium and served as its director.

## **HEIDI DIECKMANN, KWANTLEN POLYTECHNIC UNIVERSITY–BRITISH COLUMBIA**

Heidi Dieckmann graduated from Simon Fraser University in Burnaby, BC with a BBA in Accounting and carried on her studies in the Masters of Professional Accountancy Program at the University of Saskatchewan. Heidi attained her CA designation while working in public practice at KPMG in Burnaby before beginning her career in education as an accounting instructor at Kwantlen Polytechnic University. While at KPU, Heidi has served as Department Chair and has sat on several committees. Her major initiatives at KPU included spearheading the Accounting Society of Kwantlen, an impressive accounting student club that has created opportunities for students to network with professional accountants in industry and public practice. She was also actively involved in the redesign of KPU's new BBA program and managed the detailed competency mapping for the transition to the CPA designation. She is also currently involved as a CPA Mentor, coaching upcoming CPAs through the new CPA education and experience requirements.

Heidi has a keen interest in providing students with real-world relevance and preparing students for ethical issues they will come across in the workplace. She has a passion for maximizing student engagement and learning outcomes and is inspired by Eric Mazur's research on the Flipped Classroom and Peer Instruction, and Dee Fink's research in Creating Significant Learning Experiences. Heidi focusses her research on engagement and motivation strategies to reach today's generation of technology-immersed students. She has an interest in online student engagement with a focus on creating a seamless transition into online learning and providing resources to assist teams to collaborate in a virtual environment.

Heidi is a member of the Canadian Academic Accounting Association's Education Committee and has presented at the CAAA annual conference for her work in student engagement through online education and top strategies to reach millennial learners. She has been inspired to embrace international education through participating in the award-winning Canadian Academics Studying Europe conference led by Catherine Vertesi and Robert Buttery; visiting the European Union and the Council of Europe; and studying Swiss banking at the University of Zurich, and political and education systems at the University of Applied Sciences and Arts Northwestern Switzerland. In her spare time Heidi enjoys volunteering through teaching art and STEM classes at her children's school. She loves to explore nutrition through creating new flavours, travel, take art classes at a local gallery, analyze real estate investment opportunities, and most of all spend time with her husband Andrew, her two children Nolan and Hailey, and her close family and friends.

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## APPENDIX IV

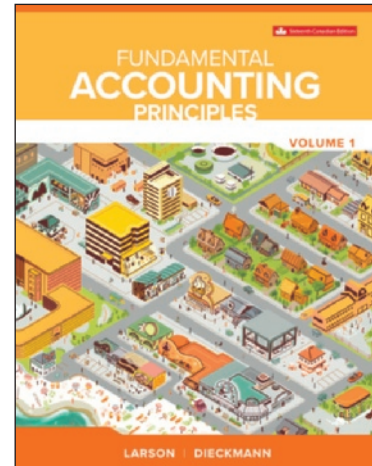
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# Preface

## A Note About Our Cover

The cover of the Sixteenth Canadian Edition is the work of Rachel Idzerda. Rachel's playful illustration spotlights many of the companies, entrepreneurs, and organizations featured in *Fundamental Accounting Principles'* chapter-opening vignettes. See if you can spot the images representing Zane Caplansky's Deli (Chapter 1), Amazon's drones (Chapter 6), Betterwith Ice Cream (Chapter 7), and the Vancouver Airport Authority (Chapter 9). Rachel is a freelance illustrator specializing in editorial illustration and portraiture. She works with her husband and lives with him and their two dogs just outside of Toronto.



## INSIDE THE CHAPTERS

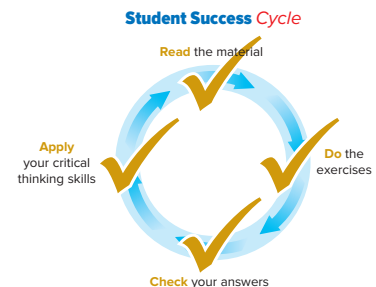
As educators, instructors strive to create an environment that fosters learning and provides students with the tools they need to succeed. The Sixteenth Canadian Edition continues to meet and surpass the high standards the market expects from *Fundamental Accounting Principles*. We continue to put learning first, with student-centred pedagogy and critical thinking lessons throughout the text.

All the pedagogical tools are carefully designed for ease of use and understanding, helping the instructor teach and giving the students what they need to succeed.

## PEDAGOGY

### Student Success Cycle

Student success at the post-secondary level is measured not by how much knowledge a student has acquired, but rather by how well a student can *use* knowledge. The Student Success Cycle, illustrated by a circular icon, reinforces decision-making skills by highlighting key steps toward understanding and critically evaluating the information the student has just read. **Read-Do-Check-Apply** reinforces active learning rather than passive learning. This tool is integrated throughout the text, including the chapter opening page, Checkpoint questions, Demonstration Problems, and end-of-chapter material.



### Critical Thinking Challenge

An essential element of critical thinking is the ability to ask questions while reading (or listening or speaking). These exercises are designed to help students develop the skills related to questioning. Suggested answers are posted on **Connect**.

#### CRITICAL THINKING CHALLENGE

Why is assessing customer credit critical to the overall success of businesses like WN Pharmaceuticals?



IFRS AND ASPE—THE DIFFERENCES		
Difference	International Financial Reporting Standards (IFRS)	Accounting Standards for Private Enterprises (ASPE)
Recording adjusting entries	<ul style="list-style-type: none"> <li>Requires that financial statements be presented at least annually<sup>a</sup>; therefore, adjustments would be prepared at least annually. However, for publicly listed companies, securities commissions law requires publicly listed companies to present quarterly financial statements, which in turn would require that adjusting entries be prepared at least quarterly.</li> </ul>	<ul style="list-style-type: none"> <li>Unlike IFRS, ASPE does not explicitly require that financial statements be presented at least annually although it is implied given that financial statements must be presented in a timely manner<sup>b</sup> and items must be presented consistently from period to period.<sup>c</sup> Financial statements are prepared at least annually for tax purposes and, for example, to meet any banking requirements.</li> </ul>
	<ul style="list-style-type: none"> <li>Both public and private enterprises may prepare adjusting entries more frequently, such as monthly, to enhance the accuracy of information required for decision making.</li> </ul>	
Depreciation vs. amortization	<ul style="list-style-type: none"> <li>Uses the term <i>depreciation</i><sup>d</sup> (although it uses <i>amortization</i> for intangible assets)<sup>e</sup></li> </ul>	<ul style="list-style-type: none"> <li>Uses the term <i>amortization</i>.<sup>f</sup></li> </ul>

a. IFRS 2018, IAS 1 para. 36.  
 b. ASPE, Accounting Standards, Section 1000.17(b).  
 c. ASPE, Accounting Standards, Section 1000.19-20.  
 d. IFRS 2018, IAS 16 para. 6.  
 e. IFRS 2018, IAS 38 para. 8.  
 f. ASPE, Accounting Standards, Section 3061.6.

## IFRS and ASPE—The Differences

This box appears at the end of every chapter to highlight any differences or important points about reporting and terminology as they relate to the financial accounting course. The chapter content is IFRS 2018 compliant for Volumes I and II; references are provided where appropriate.

## Real-World Focus

The Sixteenth Canadian Edition has increased the use of real business examples to reflect the most current information available. This continues the text’s strong ties to the real world of accounting, be it through detailed interviews with business-people for the chapter-opening vignettes, examples of ethical standards and treatments, or annual reports for both in-chapter example disclosures and end-of-chapter material. The first time an actual business is used, its name is highlighted in **bold magenta** for emphasis. This integration with real-world companies helps engage students while they read.

A **business** is an entity represented by one or more individuals selling products or services for profit. Products sold include anything from athletic apparel (**CCM, Bauer, Lululemon Athletica, Nike, Reebok**) to electronic devices (**Apple, Dell, Hewlett-Packard, Samsung**) and clothing (**Abercrombie & Fitch, The Gap, Zara**). Service providers such as data communication providers (**Bell, Rogers, Telus**), food services (**McDonald’s, Starbucks, Tim Hortons**), and Internet services (**Google, Twitter, Skype, Facebook, Instagram**) make our lives more connected. A business can be as small as an in-home tutoring business or as large as **George Weston Limited**, the food processing company known for its President’s Choice and No Name brands, owner of the clothing label Joe Fresh, and holder of a significant investment in the supermarket chain **Loblaw Companies Limited**. Nearly 100,000 new businesses are started in Canada each year, with most of them being founded by people who want freedom from ordinary jobs, a new challenge in life, or the potential of earning extra money.

### Food Truck Frenzy

Across the country, major urban centres are experiencing an industry trend to go to the street to entice customers with a wide range of fresh, made-to-order food options. In Canada, the street vendor industry is in the growth phase of its industry life cycle according to IBISWorld, a global market research firm. IBISWorld estimates the market for street vendors in Canada will continue to grow over the next five years. Revenues are expected to reach \$335 million with an expected annualized growth rate of 17% by 2023. The market is dominated by new market entrants—in most cases, individual owners operating as sole proprietors. The most successful street vendors will take advantage of effective marketing and branding toward health-conscious consumers looking for unique dining options.

Thunderin’ Thelma made her debut on CBC’s *Dragons’ Den* when owner Zane Caplansky decided to expand his famous downtown Toronto brick-and-mortar deli and enter the trendy urban food truck business. After being labelled “insane Zane” by Kevin O’Leary, and seeing the other *Dragons* balk at the 15% ownership interest at a proposed cost of \$350,000, Zane decided to continue his new business venture on his own. A year later, Caplansky returned to *Dragons’ Den* and boasted achieving profit margins between 30 and 40% and achieving \$110,000 in sales in his first six months of operation. Caplansky’s business continues to thrive, with its latest location at the Toronto Pearson International Airport. According to Zane, “persistence, hard work and integrity” are key to achieving success in new business initiatives.

Sources: <https://www.ibisworld.ca/industry/street-vendors.html>, accessed September 15, 2017; <http://www.torontofiles.com/daily-dish/people-dish/2017/11/03/zane-caplansky-on-dragons-den>, accessed April 15, 2016; <http://www.postcity.com/Eat-Shop-Do/Eat/November-2013/Weekly-Restaurant-Recap-Henriet-Kitchen/>; CBC *Dragons’ Den*, Season 7, Episode 11, aired January 7, 2013; On the Journey, Towards a Perfect Sandwich: Zane Caplansky at TEDxQueensU, [https://youtu.be/cN\\_BHMMnNFk](https://youtu.be/cN_BHMMnNFk), accessed September 14, 2017.

Video Links: <http://www.cbc.ca/dragonsden/pitches/caplansky-deli> and [https://youtu.be/cN\\_BHMMnNFk](https://youtu.be/cN_BHMMnNFk).

## Video Links

This text features interactive digital links directing students and instructors to helpful videos to provide students with real-world application of the chapter content and enhance student exposure to valuable online resources.

## A Look Back, A Look at This Chapter

In these brief paragraphs, students are directed to reflect on their learning from previous chapters and are provided with a high-level summary of the current chapter. These helpful learning summaries assist students in understanding how their chapter by chapter learning ties into the big-picture learning objectives.

# Receivables

### A Look Back

Chapter 7 provides an introduction to internal control and cash with a detailed analysis of internal control guidelines, banking activities, accounting for petty cash funds, and reconciling the differences between cash reported in the bank account and cash in the company’s accounting records.

### A Look at This Chapter

This chapter takes a look at accounting for customer accounts receivable and short-term notes receivable, specifically investigating tools such as initial recognition of the receivables and subsequent measurement at the end of the accounting period. Valuation is assessed through methods to estimate bad debts, including the benefits of an A/R aging report, and using the accounts receivable turnover ratio and days’ sales uncollected ratios to evaluate financial statements.

## Learning Objectives

Learning Objectives have long been a standard in the Larson textbook. By giving students a head start on what the following material encompasses, the text readies them for the work ahead.

## Checkpoints

This series of questions within the chapter reinforces the material presented immediately before it. These questions allow students to “Do” problem material by referencing what they have just learned. Answers at the end of each chapter will then allow them to “Check” their work, further supporting the Student Success Cycle. Under each set of Checkpoints is a reference to the Quick Study questions (single-topic exercises) available at the end of each chapter. Students can go ahead and try them at this point. Checkpoint solutions are at the end of the chapter. Quick Study solutions are available on **Connect**.

**CHECKPOINT**

5. What is the difference between private and public accountants?
6. What are the four broad fields of accounting?
7. What is the purpose of an audit?
8. Distinguish between managerial and financial accounting.
9. What is the difference between external and internal users of accounting information?
10. Why are internal controls important?

**Do Quick Study question: QS 1-5**

**Important Tip:**

Ensure you know the following rules as illustrated in Exhibit 2.7 before reading Chapter 3. For a helpful learning tool, review the following video by Colin Dodds, an educational music video enthusiast.

**Video Link:** <https://youtu.be/7EuxfW76BWU>

## Important Tips

Important tip boxes have been incorporated throughout the text to direct students’ attention to critical concepts that students often miss in their initial reading of the text.

## Ethical Impact

Ethics continues to be a critical foundation-level concern to prepare students to understand and apply ethical values in their day-to-day decisions. This new feature helps develop students to reach toward CPA-enabling competencies such as professional and ethical behaviour, problem solving and decision making, communication, self-management, teamwork, and leadership skills. It will be an excellent tool instructors can utilize to provide real-world relevance and develop these critical skills for students as they work toward developing professional competencies.

**ETHICAL IMPACT**

**\$18.7 Million Maple Syrup Theft**

On July 30, 2012, Micheal Gavreau arrived at a warehouse to audit \$30 million worth of inventory at the Global Strategic Maple Syrup Reserve. To his surprise, several of the barrels were discovered to be empty; others had their contents replaced with water. It was the “largest theft investigated by the Sûreté du Québec in its history.” The leader of the heist was found guilty of fraud, theft, and trafficking stolen goods and was sentenced to eight years in prison and fined \$9.4 million. This situation occurred because of inadequate internal controls. In Chapter 7 we will introduce you to the concept of internal controls and the critical role they play in maintaining corporate assets.

What would you do if you noticed unusual activities or discrepancies at your audit client or place of work, such as boxes that looked like they had been tampered with? Would you turn a blind eye or would you take the time to investigate?

**Video Link:** Follow this link to view a video summary of the full story of “The Sweetest Heist”: <https://youtu.be/adC09cvYA8o>.

Each scenario is designed to strengthen each student’s professional competencies as they approach ethical dilemmas that have been developed from current, real-world Canadian and global business scenarios. Each box is designed with a concise scenario and provides open-ended questions to enable effective classroom discussions. Encourage students to use the framework presented in Chapter 1 Decision Insight on Resolving Ethical Dilemmas to help them develop a compass to guide them through alternative courses of action.

**DECISION INSIGHT**

**Loblaws Companies Limited Converts from Periodic to Perpetual**

**Loblaws Companies Limited** began a process of converting its corporate-owned grocery stores from a periodic inventory system to a perpetual inventory system that was completed in 2014. The improved information is a result of an upgrade to its IT infrastructure, enabling the stores to integrate costing information more effectively for items held in inventory.


## Decision Insight

Social responsibility is a key concern for today’s generation of socially conscious students. Through the Decision Insight feature, accounting’s role in ethics and social responsibility is

described by both reporting and assessing its impact. Relating theory to a real-life situation piques interest and reinforces active learning.

## Decision Maker

This feature requires students to make accounting and business decisions by using role-playing to show the interaction of judgment and awareness, as well as the impact of decisions made. This feature works well to develop enabling professional competencies such as professional and ethical behaviour, problem solving and decision making, communication, self-management, teamwork, and leadership skills. These boxes work well in conjunction with the new Ethical Impact box. Guidance answers are available at the end of each chapter.

 **Guidance Answer to DECISION MAKER**

**Analyzing Results**  
Yes, you are concerned about the absence of a depreciation adjustment on the manufacturing equipment. Equipment does lose value as it is used in the business, and financial statements must recognize this occurrence. Its absence suggests an error or a misrepresentation (there is also the possibility that equipment is fully utilized and should have been completely depreciated or that it was scrapped).

**Analyst**  
A current ratio of 1.2 suggests that current assets are sufficient to cover current liabilities, but it implies a minimal buffer in case of errors in measuring current assets or current liabilities. Removing the past due receivable reduces the current ratio to 0.7. Your assessment is that the bakery will have some difficulty meeting its loan payments.

*For further study on some topics of relevance to this chapter, please see the following Extend Your Knowledge supplements:*

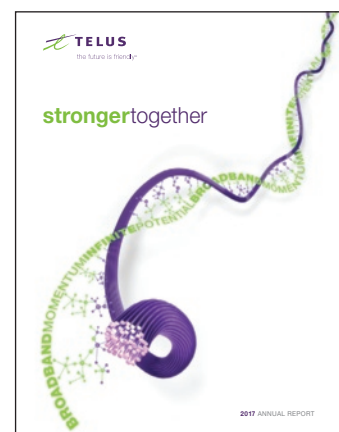
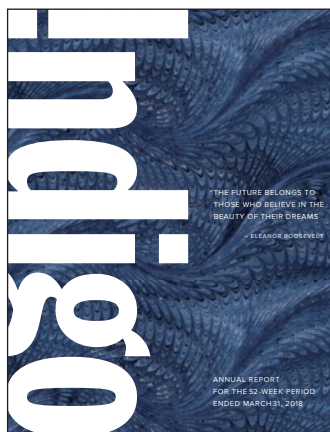
**EYK 4-1** Work Sheet Demonstration  
**EYK 4-2** Corporate Supplement  
**EYK 4-3** Summary of Business Activities  
**EYK 4-4** Examples of Classified Balance Sheets

## Extend Your Knowledge (EYK)

Supplementary material has been developed to explore some topics in more detail than the textbook can allow. A list of EYKs relevant to each chapter is presented at the end of the chapter, alerting students to visit **Connect** if they choose to delve deeper into the material.

## Financial Statements

Features and assignments that highlight companies such as **Spin Master** (a successful Canadian toy innovator and children’s entertainment company) and **WestJet** (a company that provides services) show accounting in a modern and global context. Because students go directly to the financial statements of real companies, they remain engaged in the active learning process. The audited annual financial statement section of these annual reports (with notes to the financial statements), as well as those of **Telus** and **Indigo Books & Music** (with weblinks provided to access the notes), are reproduced at the end of Volume 1. In Volume 2, the annual audited financial statements are presented without notes, and weblinks are provided for student access to the full set of Annual Reports.



# End-of-Chapter Material

*Fundamental Accounting Principles* sets the standard for quantity and quality of end-of-chapter material.

## Summary

Each chapter includes a Summary of the chapter by Learning Objective, to reinforce what students have just learned.

SUMMARY	
<p><b>LO1 Explain the accounting cycle.</b> The accounting cycle includes the steps in preparing financial statements for users that are repeated each reporting period.</p> <p><b>LO2 Describe an account, its use, and its relationship to the ledger.</b> An account is a detailed record of increases and decreases in a specific asset, liability, or</p>	<p>equity item. Information is taken from accounts, analyzed, summarized, and presented in useful reports and financial statements for users.</p> <p><b>LO3 Define debits and credits and explain their role in double-entry accounting.</b> Debit refers to left, and credit refers to right. The following table summarizes debit and credit effects by account type:</p>

**Guidance Answer to DECISION MAKER**

**Accounting Clerk**

The business entity principle is being violated because it requires that the owner's personal expenses be recorded separately from those of his business. By debiting the entire amount to Office Supplies, assets will be overstated on the balance sheet. By crediting Accounts Payable for the whole amount, liabilities will also be overstated. At the end of the accounting period when the amount of supplies used is recorded, Office Supplies Expense will be overstated on the income statement, causing profit to be understated. When profit is too low, equity is also understated.

## Guidance Answers to Decision Maker

These discuss the Decision Maker boxes presented earlier in the chapter, and reinforce the need for decision making and critical thinking skills. This feature fits into the Student Success Cycle by reinforcing the “Apply” step.

## Guidance Answers to Checkpoint

The Checkpoint material throughout the chapter allows students to pause and check their progress. This feature reinforces the “Do,” “Check,” and “Apply” steps of the Student Success Cycle.

**Guidance Answers to CHECKPOINT**

- Best Buy.
- Total cost is \$12,180, calculated as:  $\$11,400 + \$130 + \$150 + \$100 + \$400$ .
- The matching principle.
- Businesses that sell unique, high-dollar-value merchandise in relatively low volume levels might choose specific identification. Car dealerships are a good example because each car received as merchandise inventory is unique in terms of both features and identification number. Using specific identification allows the business to accurately tag each item coming in and going out.
- Moving weighted average gives a lower inventory figure on the balance sheet as compared to FIFO. FIFO's inventory amount will approximate current replacement costs. Moving weighted average costs increase but more slowly because of the effect of averaging.
- Because these units are the same ones that were originally written down, a reversal is appropriate and would be recorded as:

Merchandise Inventory.....	2,000	
Cost of Goods Sold.....		2,000
$\$1,800 - \$1,300 = \$500/\text{unit original write-down:}$		
$\$500 \times 4 = \$2,000 \text{ maximum reversal}$		

- The reported inventory amount is \$540, calculated as  $(20 \times \$5) + (40 \times \$8) + (10 \times \$12)$ .
- Cost of goods sold is understated by \$10,000 in 2020 and overstated by \$10,000 in 2021.
- The estimated ending inventory (at cost) is \$327,000 and is calculated as:

Step 1:  $(\$530,000 + \$335,000) - \$320,000 = \$545,000$

Step 2:  $\frac{\$324,000 + \$195,000}{\$530,000 + \$335,000} = 60\%$

Step 3:  $\$545,000 \times 60\% = \$327,000$

- Company B is more efficient at selling its inventory because it has higher merchandise turnover.

**GLOSSARY**

**Consignee** One who receives and holds goods owned by another party for the purpose of acting as an agent and selling the goods for the owner. The consignee gets paid a fee from the consignor for finding a buyer.

**Consignor** An owner of inventory goods who ships them to another party who will then find a buyer and sell the goods for the owner. The consignor retains title to the goods while they are held offsite by the consignee.

**Consistency principle** The accounting requirement that a company use the same accounting policies period after period so that the financial statements of succeeding periods will be comparable.

**Days' sales in inventory** A financial analysis tool used to estimate how many days it will take to convert the inventory on hand into accounts receivable or cash; calculated by dividing the ending inventory by cost of goods sold and multiplying the result by 365.

**Faithful representation** The accounting principle that requires information to be complete, neutral, unbiased, and free from error.

## Glossary

All terms highlighted in the chapter are included.

## PROBLEM MATERIAL

### Demonstration Problems

These problems reinforce the chapter material and further bolster the Student Success Cycle.

**Demonstration Problem**

*This Demonstration Problem is based on the same facts as the Demonstration Problem at the end of Chapter 1 except for two additional items: (b) August 1 and (k) August 18.*

The following activities occurred during the first month of Joanne Cardinal's new haircutting business called The Cutlery:

- On August 1, Cardinal put \$16,000 cash into a chequing account in the name of The Cutlery. She also invested \$10,000 of equipment that she already owned.
- On August 1, Cardinal paid \$2,400 for six months of insurance effective immediately.
- On August 2, she paid \$2,000 cash for furniture for the shop.
- On August 3, she paid \$3,200 cash to rent space in a strip mall for August.
- On August 4, she furnished the shop by installing the old equipment and some new equipment that she bought on credit for \$21,000. This amount is to be repaid in three equal payments at the end of August, September, and October.

## PREFACE

### Analysis Component

An analysis component is included in each Mid- and End-of-Chapter Demonstration Problem, as well as several Exercises, Problems, and Focus on Financial Statements questions. These promote critical thinking and give students opportunities to practise their analytical skills.

#### Analysis Component:

Refer to The Cutlery's August 31, 2020, financial statements. What do each of *equity* and *liabilities* represent?

### CONCEPT REVIEW QUESTIONS

1. What tasks are performed with the work sheet?
2. What two purposes are accomplished by recording closing entries?
3. What are the four closing entries?
4. Daniel is having trouble determining whether withdrawals, owner's capital, interest income, and prepaid insurance are temporary or permanent accounts. Explain to him the difference between a temporary and a permanent account in accounting and classify the accounts into each category.
5. Alexis believes that temporary account information is deleted through the closing entries. Do you agree or disagree? Explain. What is the relationship between temporary and permanent accounts?
6. Describe the similarities and differences between adjusting and closing entries.
7. What is the purpose of the Income Summary account? How is it different from the Income Statement?
8. Explain whether an error has occurred if a post-closing trial balance includes a Depreciation Expense, Building account.
9. Refer to **Spin Master's** income statement in Appendix III at the end of the book. What journal entry was recorded as of December 31, 2017 to close the revenue account?
10. What is a company's operating cycle?
11. Why is a classified balance sheet more useful to financial statement users than a non-classified balance sheet?
12. What classes of assets and liabilities are shown on a typical classified balance sheet?

### Concept Review Questions

These short-answer questions reinforce the chapter content by Learning Objective.

### Quick Study

These single-topic exercises give students a quick test of each key element in the chapter and are referenced to Learning Objectives. Answers to these items are available on **Connect**.

### QUICK STUDY

#### QS 6-1 Inventory ownership LO1

1. At year-end Carefree Company has shipped, FOB destination, \$500 of merchandise that is still in transit to Stark Company. Which company should include the \$500 as part of inventory at year-end?
2. Carefree Company has shipped goods to Stark and has an arrangement that Stark will sell the goods for Carefree. Identify the consignor and the consignee. Which company should include any unsold goods as part of inventory?

#### Exercise 6-3 Specific identification cost flow assumption LO2


**CHECK FIGURES:** COGS = \$9,427; Gross profit = \$15,073

Refer to the data in Exercise 6-2. Assume that Urban Glam Cosmetics uses the specific identification method to cost inventory. The 700 units were specifically sold as follows:

Jan. 10:	70	units from beginning inventory
Mar. 15:	3	units from beginning inventory, and 177 units from the March 14 purchase
Oct. 5:	50	units from the March 14 purchase, and 400 units from the July 30 purchase

Calculate cost of goods sold and the gross profit.

### Exercises

Exercises provide students with an additional opportunity to reinforce basic chapter concepts by Learning Objective. **Note:** Selected end-of-chapter exercises and problems are marked with this icon: . These have Excel templates located on **Connect**.

### Problems

Problems typically incorporate two or more concepts. There are two groups of problems: A problems and Alternate or B problems. B Problems mirror the A problems to help improve understanding through repetition.

### PROBLEMS

#### Problem 1-1A Identifying type of business organization LO2

Complete the chart below by placing a check mark in the appropriate column.

Characteristic	Type of Business Organization		
	Sole Proprietorship	Partnership	Corporation
Limited liability			
Unlimited liability			
Owners are shareholders			
Owners are partners			
Taxed as a separate legal entity			



**ETHICS CHALLENGE**

**EC 5-1**

Claire Phelps is a popular high school student who attends approximately four dances a year at her high school. Each dance requires a new dress and accessories that necessitate a financial outlay of \$100 to \$200 per event. Claire's parents inform her that she is on her own with respect to financing the dresses. After incurring a major hit to her savings for the first dance in her second year, Claire developed a different approach. She buys the dress on credit the week before the dance, wears it to the dance, and returns the dress the next week to the store for a full refund on her charge card.

**Required**

1. Comment on the ethics exhibited by Claire and possible consequences of her actions.
2. How does the store account for the dresses that Claire returns?

**Ethics Challenge**

Each chapter includes at least one Ethics Challenge to reinforce critical thinking skills for students and open up discussion about various ethical topics.

**Focus on Financial Statements**

Each chapter includes two technical and analytical questions that incorporate into the financial statements all major topics covered up to that point. Additional questions are available online on **Connect**.

**FOCUS ON FINANCIAL STATEMENTS**

**FFS 2-1**

Travis McAllister operates a surveying company. For the first few months of the company's life (through April), the accounting records were maintained by an outside bookkeeping service. According to those records, McAllister's equity balance was \$75,000 as of April 30. To save on expenses, McAllister decided to keep the records himself. He managed to record May's transactions properly, but was a bit rusty when the time came to prepare the financial statements. His first versions of the balance sheet and income statement follow. McAllister is bothered that the company apparently operated at a loss during the month, even though he was very busy.

McAllister Surveying Income Statement For Month Ended May 31, 2020	
Revenue:	
Investments by owner .....	\$ 3,000
Unearned surveying fees .....	<u>6,000</u>
Total revenues .....	\$ 9,000

**CRITICAL THINKING MINI CASE**

Prairie Insurance sells life insurance, disability insurance, vehicle insurance, crop insurance, and homeowners' insurance. You are employed by Prairie Insurance and have been promoted to sales division manager for the Western Canadian division. You will be supervising approximately 25 salespeople, along with five administrative assistants at various locations. The salespeople travel extensively and submit expense reports along with sales information monthly. A sample expense report for September shows:

Prairie Insurance—Western Canadian Division Sales Report: John Bishop Month Ended September 30, 2020	
Sales revenue*	\$56,000
Expenses**	34,000

\*Sales invoices attached  
\*\*Receipts attached

**Critical Thinking Mini Cases**

These cases give students the opportunity to apply critical thinking skills to concepts learned in the chapter, thus further reinforcing the "Apply" step of the Student Success Cycle.

**Help Me Solve It**

New *Help Me Solve It* tutorials are available on **Connect** for Larson's *Fundamental Accounting Principles*. The tutorials guide students through one or two of the more challenging end-of-chapter problems per chapter, providing them with an engaging visual and audio walk-through of the problem.



# What's New

## The Accounting Standard

We listened! Through extensive reviewing and consultations with the market, we have heard the issues and concerns instructors like you have about the materials you use to teach introductory financial accounting. Here you will find a list of new changes to specific chapters that our author has made to ensure the content of Larson's *Fundamental Accounting Principles* remains current and fresh. Whether you are new to using *Fundamental Accounting Principles* or new to this edition, you can see that McGraw-Hill Education and Larson/Dieckmann are setting the accounting standard in *Fundamental Accounting Principles*. We know you'll like what you see.

### GENERAL UPDATES

- Larson continues to strive to achieve the ultimate balance between the preparer focus and user focus in its delivery of financial accounting to meet the current needs of today's diverse range of students. A strong preparer focus provides students with the tools to understand what is happening at the individual transaction level to the financial statements, providing a strong foundation for a career in accounting, as an entrepreneur, or as a savvy business professional. These skills are essential for students to develop to accurately understand the numbers behind key decisions they will face in their careers. In addition, each chapter provides several real-world company business scenarios, an increased focus on ethical issues, financial statement excerpts, and financial statement analysis tools to prepare students to be an effective decision maker in any career path they choose.
- Increased emphasis on global perspectives, bringing ethical issues and examples to students from around the world.
- New Knowledge Check-Up (KCU) questions are ten single-topic, multiple-choice questions designed to assess initial comprehension of the key chapter learning objectives. These reading readiness assessments have been written by the author to provide students with a quick and easy test as to whether they achieved the critical comprehension concepts in each chapter before moving on to more comprehensive review problems. These can be used as a quick mini quiz at the beginning of each lecture to encourage students to complete chapter readings before class. Answers are provided on **Connect** under the instructor resources tab.
- Appendix III for Volume 1 includes the complete annual audited financial statements, including notes to the financial statements, for Spin Master and WestJet, as well as the audited financial statements *without* the notes for Telus and Indigo Books & Music. Appendix II for Volume 2 includes the annual audited financial statements, **excluding** notes to the financial statements, for Spin Master, WestJet, Telus, and Indigo.
- Throughout each chapter in both Volumes 1 and 2, new end-of-chapter practice questions have been added in targeted areas, based on feedback from the market, where students would benefit from additional practice opportunities. Approximately 25% of the exercises and problems have been refreshed in terms of numbers and/or business scenarios. Existing company scenarios have been expanded and updated to provide students with more information and updated examples to enhance student engagement. Volume 1 and 2 end-of-chapter content was revised by Laura Dallas of Kwantlen Polytechnic University.
- The chapter content is IFRS 2018 compliant throughout Volume 1 and Volume 2; references are included where appropriate. New updates include coverage of IFRS 16 Leases in Chapter 14 and conceptual framework integrated throughout. IFRS and ASPE differences are identified at the end of each chapter.

- The Sixteenth Canadian Edition includes three exciting *new* chapter-opening vignettes, and significant updates to the remaining 14 featuring a range of engaging topics and including inspiring stories from company startups to success stories of well-known businesses and not-for-profit organizations. Nearly all of the vignettes include relevant video links for students to broaden their real-world exposure to critical business decisions.
- Seventeen new *Ethical Impact* boxes have been crafted to highlight an ethical dilemma for each chapter based on a real-world example linked directly to issues within the chapter learning objectives. Instructors can take a moment to help students develop these critical professional skills.
- Real-world relevance is provided with actual businesses used as examples with several financial statement excerpts throughout Volumes 1 and 2, including issues relating to financial statement presentation and disclosure. These real company names are bolded and highlighted in magenta at first mention to emphasize integration of accounting concepts with actual business practice.
- New important tip boxes have been added and are incorporated throughout the text to direct students' attention to critical concepts that students often miss in their initial reading of the text.
- Chapter 9 on property, plant, and equipment is now included in both Volume 1 and Volume 2 to offer flexibility to instructors, depending on institutional course design.
- Chapter 14 includes a more integrated approach to bond pricing that includes instructional tips on how to use a financial calculator, with helpful hints and examples provided for students to follow along during their chapter reading.
- “Thunderin’ Thelma” as featured on CBC’s *Dragons’ Den*.
- New *Ethical Impact* box on an \$18.7 million maple syrup heist that helps students to assess how they would handle identified irregularities.
- Updated Exhibit 1.5 charting average annual salaries for accounting positions.
- Updated section on professional certification in Canada.
- New *Ethical Impact* box on resolving ethical dilemmas.
- New *Decision Insight* on evaluating charitable organizations.
- Updated section on the measurement principle, highlighting current cost, fair value, and value in use terminology
- Updated Exhibit 1.12 summarizing the elements of financial statements, including updating the definition of an asset and a liability.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

## Chapter 2

## CHAPTER-BY-CHAPTER UPDATES

### Chapter 1

- Updated chapter-opening vignette “Food Truck Frenzy” featuring entrepreneur Zane Caplansky, founder of Caplansky’s Deli and the food truck

- New *Important Tips* boxes added to provide extra support in topic areas where students typically struggle; new box on unearned revenue to emphasize this common learning hurdle for students.
- New *Decision Insight* on Cara Operations to help students understand the real-world applicability of this chapter’s concepts relating to financial reporting.
- Updated presentation and approach to mid-chapter demonstration problem makes the transaction analysis section easier to follow.
- Updated Exhibit 2.8 presentation of revenue and expenses in relation to equity.
- New presentation of recording and posting transactions, based on reviewer feedback to improve student connections of material.
- New *Ethical Impact* box on International Ethics: Corporate Corruption vs. Cross Cultural Management to expose students to real-world issues relating to factors impacting their decision making.

## PREFACE

- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

### Chapter 3

- Exciting new chapter-opening vignette featuring a project run by Cities Foundation called *Wasted* that provides digital coins to incentivize its residents in Amsterdam’s Noord district to recycle. Includes an engaging new video link to help students understand the program.
- New vignette also introduces students to the concept of cryptocurrencies and provides an overview of the organization Recereum, which is a blockchain-based platform that aims to provide money in the form of cryptocurrency coins for “every single recycled bottle.”
- Updated wording to introduction to the purpose of adjusting to help students understand the purpose of the adjusting process.
- New *Ethical Impact* box for MagnaChip, which is a South Korea–based semiconductor company that is publicly traded in the United States and was recently under investigation by the SEC for engaging in unethical/improper conduct. MagnaChip was charged by the SEC with artificially increasing revenue, delaying or avoiding expenses, avoiding reductions in revenue, smoothing gross margins, and hiding delays in receivables collections.
- Updated *Decision Maker* box with a focus on revenue recognition. Students assume a small publishing company signed basketball superstar LeBron James to write a book. The company paid LeBron \$500,000 today and will pay future book royalties.
- Updated Exhibit 3.20, Summary of Adjustments and Financial Statement Impact, to clarify “need to know” journal entries for students.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

### Chapter 4

- Updated chapter-opening vignette featuring founders of the BC startup Cupcakes, as featured

on their reality series *The Cupcake Girls* on W, We TV, and the Oprah Network (OWN).

- Expanded *Decision Maker* on a vitamin manufacturing company with a concern over its depreciation expense adjustment.
- Updated Exhibit 4.15 featuring example presentation of current assets for Apple Inc.
- New *Ethical Impact* box putting students in the role of a junior accountant working for a local building supply store. The CFO asks them to capitalize a number of small items for which they do not understand the long-term future benefit.
- New *Decision Insight* highlighting examples of how companies are maintaining high levels of their most liquid asset—cash.
- Updated *Decision Maker* regarding a commercial loan manager’s analysis of a local bakery’s current ratio.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

### Chapter 5

- Updated chapter-opening vignette featuring Mountain Equipment Co-op (MEC), including a new video link to review MEC’s financial results.
- New chapter feature company Lifetime Equipment Co-op to help students understand typical journal entries in a merchandising business.
- New *Ethical Impact* box relating to the role of marketing manager and a concern over revenue recognition and channel stuffing.
- Updated Exhibit 5.18 providing a gross margin snapshot for a number of different types of businesses to help students understand the financial statement user perspective.
- Updated Appendix 5B discussion on PST, GST, and HST.
- Updated Exhibit 5B.1 summarizing zero-rated and exempt products for GST/HST.
- Updated Exhibit 5B.2 organizing sales tax rates for rate changes and restructured into a more student-friendly format.

- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

## Chapter 6

- Updated chapter-opening vignette featuring inventory innovation at Amazon.com, including video links outlining Amazon’s warehouse operations and demonstrating its Kiva robots.
- New *Important Tip* box summarizing the incidental costs that are to be added to inventory.
- New chapter demonstration company, Lifetime Equipment Co-op, continued from Chapter 5.
- Updated real-world examples providing accounting policy disclosures for Amazon.com Inc., Lululemon Athletica, Procter & Gamble Co., and Tiffany & Co., illustrating examples of companies that use the various inventory costing alternatives.
- New *Ethical Impact* box featuring the example of Fair Beans Coffee, an ethical roaster that obtains organic beans from Nicaragua. Students, in the role of manager of accounting, consider how they would handle a concern over inventory valuation.
- Updated note disclosure for TJX Companies Inc. illustrating both the retail method of inventory and disclosure over inventory shrinkage.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

## Chapter 7

- Exciting new chapter-opening vignette featuring Lori Joyce, founder of Betterwith Foods—a new Vancouver-based ice cream brand with a focus on delivering high-quality, clean and simple ice cream from farm-fresh traceable dairy. A video link is included providing Lori’s perspective on the business.
- Updated section on the fraud triangle and the drivers of fraud (includes two new exhibits).
- New *Ethical Impact* box, involving a manager, the director of finance, demonstrating some warning signs of fraud, including modifying the

control environment and making significant lifestyle changes. Students are asked if they have any concerns and what they would do.

- Two new *Important Tip* boxes have been added to the chapter to simplify adjustments to the book balance and adjustments to the bank balance for students when preparing a bank reconciliation.
- Additional new *Important Tip* box on types of adjusting entries required after preparing a bank reconciliation.
- New *Decision Insight* developed from a previous chapter-opening vignette, featuring an analysis of “What Is Cash?” investigating today’s payment options in Canada, and outlining the important role of the Canadian Payments Association. A video link is provided for students who want to learn more about how the complex payment system functions in Canada.
- Updates in the Financial Statement Analysis section for the quick ratio highlight differences with current ratio for WestJet.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

## Chapter 8

- Updated chapter-opening vignette discussing BC-based WN Pharmaceuticals, providing a valuable perspective to students in understanding a risk-based approach to the management of customer receivables.
- Updated Exhibit 8.1, Accounts Receivable Analysis for Selected Companies as a Percentage of Total Assets.
- Updated *Decision Insight* box covers a recent application from Rogers Communications and the development of a wholly owned subsidiary, Rogers Bank.
- New *Ethical Impact* box featuring a real-world example from an organization that discovered millions in fraudulent loans in a subsidiary company. The box asks students what they would do if they were asked to falsify invoices to help their business obtain a bank loan.



## PREFACE

- Updated control considerations for customer payments.
- New *Decision Insight* providing students with an understanding of payment securities; this feature is linked directly to learning concepts highlighted in the chapter-opening vignette.
- New *Important Tip* box highlighting the logic behind recording only the note receivable and not the interest income on a dishonoured note.
- Updated Exhibit 8.21, Comparison of Accounts Receivable Turnover and Days' Sales Uncollected for High Liner Foods Inc. and Maple Leaf Foods Inc.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.
- Updated financial statement excerpts featuring presentation of Indigo Books & Music Inc.'s accounting policy and depreciation schedule for property, plant, and equipment and Microsoft's presentation and disclosure over intangible assets.
- New *Decision Insight* identifying fixed asset tracking and the related depreciation of the underlying assets as a critical role in business.
- New Exhibit 9.23, World's Most Valuable Brands, presented in an easy to understand and engaging display.
- Ten new *Knowledge Check-Up* questions to help students assess their reading readiness and to identify any initial learning hurdles.

## Chapter 9

- Updated chapter-opening vignette featuring Vancouver International Airport and its latest collaborative innovation CHECKiTXPRESS, which is an innovative and user-friendly bag drop for travellers.
- This chapter has a number of up-to-date examples of PPE items drawn from a variety of public companies.
- Updated language under Cost of PPE to refer to capital expenditures as betterments and revenue expenditure as repairs and maintenance expense to align more closely with industry practice.
- Updated presentation under Cost of PPE of types of expenses that can be capitalized are summarized now in bulleted form to assist in student comprehension and retention.
- New *Ethical Impact* box on a fictitious scenario involving an ethical issue that a junior accountant comes across in their new role managing the property, plant, and equipment subledger for the Bermuda Airport Authority.

## Appendix I

- All rates (i.e., EI, CPP, provincial tax, federal tax) updated to 2018.

## Appendix II

- Responding to reviewer feedback this former online appendix, Accounting Information Systems, is now included in the body of the textbook.

## Appendix III

- Volume 1 includes annual audited financial statements (including notes to the financial statements) for Spin Master and WestJet and annual audited financial statements (excluding notes to the financial statements) for Telus Corporation and Indigo Books & Music.
- Volume 2 includes annual audited financial statements (**excluding** notes to the financial statements) for Spin Master, WestJet, Telus Corporation, and Indigo Books & Music.

## Appendix IV

- Sample chart of accounts updated to reflect textbook content.

# Market Leading Technology



## LEARN WITHOUT LIMITS

McGraw-Hill Connect® is an award-winning digital teaching and learning platform that gives students the means to better connect with their coursework, with their instructors, and with the important concepts that they will need to know for success now and in the future. With Connect, instructors can take advantage of McGraw-Hill's trusted content to seamlessly deliver assignments, quizzes and tests online. McGraw-Hill Connect is the only learning platform that continually adapts to each student, delivering precisely what they need, when they need it, so class time is more engaging and effective. Connect makes teaching and learning personal, easy, and proven.

## CONNECT KEY FEATURES:

### Smartbook®

As the first and only adaptive reading experience, SmartBook is changing the way students read and learn. SmartBook creates a personalized reading experience by highlighting the most important concepts a student needs to learn at that moment in time. As a student engages with SmartBook, the reading experience continuously adapts by highlighting content based on what each student knows and doesn't know. This ensures that he or she is focused on the content needed to close specific knowledge gaps, while it simultaneously promotes long-term learning.

### Connect Insight®

Connect Insight is Connect's one-of-a-kind visual analytics dashboard—available for instructors—that provides at-a-glance information regarding student performance, which is immediately actionable. By presenting assignment, assessment, and topical performance results together with a time metric that is easily visible for aggregate or individual results, Connect Insight gives the instructor the ability to take a just-in-time approach to teaching and learning, which was never before available. Connect Insight presents data that helps instructors improve class performance in a way that is efficient and effective.

### Simple Assignment Management

With Connect, creating assignments is easier than ever, so instructors can spend more time teaching and less time managing.

- Assign SmartBook learning modules
- Instructors can edit existing questions and create their own questions
- Draw from a variety of text specific questions, resources, and test bank material to assign online
- Streamline lesson planning, student progress reporting, and assignment grading to make classroom management more efficient than ever

### Smart Grading

When it comes to studying, time is precious. Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it.

- Automatically score assignments, providing students immediate feedback on their work and comparisons with correct answers
- Access and review each response, manually change grades, or leave comments for students to review

## PREFACE

- Track individual student performance—by question or assignment, or in relation to the class overall—with detailed grade reports.
- Reinforce classroom concepts with practice tests and instant quizzes.
- Integrate grade reports easily with Learning Management Systems including Blackboard, D2L, and Moodle.

### Mobile Access

Connect makes it easy for students to read and learn using their smartphones and tablets. With the mobile app, students can study on the go—including reading and listening using the audio functionality—without constant need for Internet access.

### Instructor Library

The Connect Instructor Library is a repository for additional resources to improve student engagement in and out of the class. It provides all the critical resources instructors need to build their course. Instructors can

- Access Instructor resources
- View assignments and resources created for past sections
- Post their own resources for students to use

## Instructor Resources

Instructor supplements are available within **Connect**.

### Solutions Manual

*Fundamental Accounting Principles* continues to set the standard for accuracy of its problem material. The Solutions Manual has been revised by Laura Dallas, Kwantlen Polytechnic University. Additional accuracy check was conducted by Rhonda Heninger, SAIT Polytechnic. Available in both Microsoft Word and PDF format, solutions for all problem material are included.

### Computerized Test Bank

The test bank has been revised and technically checked for accuracy to reflect the changes in the Sixteenth Canadian Edition. Sarah Magdalinski, Northern Alberta Institute of Technology, revised the test bank for this edition. Grouped according to Learning Objective, difficulty level, and by level of Bloom's Taxonomy, the questions in the computerized test bank include true/false, multiple choice, matching, short essay, and problem material.

### PowerPoint® Presentations

These presentation slides, revised by Lise Wall, Red River College, are fully integrated with the text to visually present chapter concepts.

### Instructor's Manual

The Instructor's Manual, revised by Milena Ceglie, Durham College, cross-references assignment materials by Learning Objective and also provides a convenient chapter outline.

### Focus on Financial Statements

These include technical and analytical questions that incorporate major topics covered. These, and accompanying solutions, have been revised by Laura Dallas, Kwantlen Polytechnic University. Additional Focus on Financial Statement exercises for each chapter are included on **Connect**.

### Extend Your Knowledge

This supplemental material has been developed to delve into more detail for specific topics.

### Excel Template Solutions

Solutions to the problems using Excel templates are available for instructors. These have been revised by Heather Cornish, Northern Alberta Institute of Technology.

### Image Bank

All exhibits and tables displayed in the text are available for your use, whether for creating transparencies or handouts, or customizing your own PowerPoint presentations.

## Other Supplements for Students

### Working Papers

Available for purchase by students, printed Working Papers for Volumes 1 and 2 match the end-of-chapter material. They include papers that can be used to solve all of the Quick Study questions, Exercises, and A and B Problem sets. The Working Papers for the Sixteenth Canadian Edition have been revised by Laura Dallas, Kwantlen Polytechnic University. Additional technical checking was completed by Rhonda Heninger, Southern Alberta Institute of Technology.

## Superior Learning Solutions and Support

The McGraw-Hill Education team is ready to help instructors assess and integrate any of our products, technology, and services into your course for optimal teaching and learning performance. Whether it's helping your students improve their grades, or putting your entire course online, the McGraw-Hill Education team is here to help you do it. Contact your Learning Solutions Consultant today to learn how to maximize all of McGraw-Hill Education's resources.

For more information, please visit us online: <http://www.mheducation.ca/he/solutions>.

## Developing a Market-Driven Text

The success of this text is the result of an exhaustive process, which has gone beyond the scope of a single edition. Hundreds of instructors and educators across the country have been involved in giving their feedback to help develop the most successful accounting fundamentals text in the country. We owe thanks to all of those who took the time to evaluate this textbook and its supplemental products. *In preparation for the 16th edition, the following reviewers provided us with invaluable feedback based on the 15th edition:*

### REVIEWERS

Treena Burns	Seneca College	Darlene Lowe	MacEwan University
Milena Celgie	Durham College	Heather Martin	Nova Scotia Community College
Barb Chapple	St. Clair College	Michelle Nicholson	Okanagan College
Heather Cornish	Northern Alberta Institute of Technology	Dal Pirot	MacEwan University
John Currie	Humber College	James Reimer	Lethbridge College
Samuel Kiragu	Nova Scotia Community College	Joe Toste	Centennial College
		Shawn West	Mount Saint Vincent University

## PREFACE

*Fundamental Accounting Principles* continues to set the bar in terms of its leading-edge approach to educating today's students to both excel as users of financial accounting as well as having outstanding technical understanding through a commitment to relevance, quality, accuracy, and state-of-the-art supplemental resources.

This has been possible only because of the outstanding efforts and contributions of a dedicated team of exceptional individuals. I owe many thanks to their expertise and commitment as it was extensively drawn upon during the process of writing this textbook. Particular thanks go out to Maria Belanger, Shannon Butler, Cheryl Wilson, Sarah Magdalinski, Rhonda Heninger, Milena Ceglie, Lise Wall, Heather Cornish, and Amy Hoggard. A big thanks to the many entrepreneurs, financial experts, and business owners that devoted their precious time to making our chapter opening-vignettes compelling and captivating. Thanks also to our brilliant illustrator, Rachel Idzerda ([www.rachelidzerda.com](http://www.rachelidzerda.com)), for sharing our vision and for her tireless efforts in crafting our cover illustration with creativity and vibrant energy. A special thanks to my close friend and colleague Laura Dallas for committing to developing a leading-edge product that is technically strong, relevant, and an effective learning tool for introductory accounting students. Laura's outstanding dedication ensured the end-of-chapter questions are accurate, logical, and easy for students to understand. I am thankful to McGraw-Hill Ryerson's exceptional team, including Rhondda McNabb, Joy Armitage Taylor, Loula March, Alwynn Pinard, Jessica Barnoski, Kelli Howey, Karen Hunter, and Shalini Khanna, who have been exceptionally responsive, supportive, and dedicated to producing a top-tier product.

I am incredibly appreciative to my colleagues, passionate and forward thinking educators, current and past students, the phenomenal group of entrepreneurs and outstanding professional accountants across Canada who have inspired enhancements for this edition. Their knowledge and expertise in identifying student learning hurdles in the classroom and suggestions for enhancing student comprehension are invaluable in our continuous improvement initiative to maintain this textbook as the industry standard.

With heartfelt appreciation,  
Heidi Dieckmann

## CHAPTER 1

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# Accounting in Business

### A Look at This Chapter

Whether you are embarking on a new career, are managing an investment account, or have an entrepreneurial spirit like Zane Caplansky from our opening vignette, a clear understanding of accounting will provide you with the tools to make effective decisions. Accounting is the system of recording and interpreting financial information to make relevant decisions. In this chapter, we discuss the significant role of accounting in organizations today and describe its many users and uses.



Andrew Francis Wallace/Toronto Star/Getty Images

### LEARNING OBJECTIVES

- LO1** Describe the purpose and importance of accounting.
- LO2** Describe forms of business organization.
- LO3** Identify users and uses of accounting and opportunities in accounting.
- LO4** Identify and explain why ethics and social responsibility are crucial to accounting.
- LO5** Identify, explain, and apply accounting principles.
- LO6** Identify and explain the content and reporting aims of financial statements.
- LO7** Analyze business transactions by applying the accounting equation.
- LO8** Prepare financial statements reflecting business transactions.



## Food Truck Frenzy

Across the country, major urban centres are experiencing an industry trend to go to the street to entice customers with a wide range of fresh, made-to-order food options. In Canada, the street vendor industry is in the growth phase of its industry life cycle according to IBISWorld, a global market research firm. IBISWorld estimates the market for street vendors in Canada will continue to grow over the next five years. Revenues are expected to reach \$335 million with an expected annualized growth rate of 1.7% by 2023. The market is dominated by new market entrants—in most cases, individual owners operating as sole proprietors. The most successful street vendors will take advantage of effective marketing and branding toward health-conscious consumers looking for unique dining options.

Thunderin' Thelma made her debut on CBC's *Dragons' Den* when owner Zane Caplansky decided to expand his famous downtown Toronto brick-and-mortar deli and enter the trendy urban food truck business. After being labelled "insane Zane" by Kevin O'Leary, and seeing the other *Dragons* balk at the 15% ownership interest at a proposed cost of \$350,000, Zane decided to continue his new business venture on his own. A year later, Caplansky returned to *Dragons' Den* and boasted achieving profit margins between 30 and 40% and achieving \$110,000 in sales in his first six months of operation. Caplansky's business continues to thrive, with its latest location at the Toronto Pearson International Airport. According to Zane, "persistence, hard work and integrity" are key to achieving success in new business initiatives.

**Sources:** <https://www.ibisworld.ca/industry/street-vendors.html>, accessed September 15, 2017; <http://www.torontolife.com/daily-dish/people-dish/2011/11/03/zane-caplansky-on-dragons-den>, accessed April 15, 2014; <http://www.postcity.com/Eat-Shop-Do/Eat/November-2013/Weekly-Restaurant-Recap-Harvest-Kitchen/>; CBC *Dragons' Den*, Season 7, Episode 11, aired January 7, 2013; On the Journey Towards a Perfect Sandwich: Zane Caplansky at TEDxQueensU, [https://youtu.be/cN\\_8HMMnNFk](https://youtu.be/cN_8HMMnNFk), accessed September 14, 2017.

**Video Links:** <http://www.cbc.ca/dragonsden/pitches/caplanskys-deli> and [https://youtu.be/cN\\_8HMMnNFk](https://youtu.be/cN_8HMMnNFk).

### CRITICAL THINKING CHALLENGE

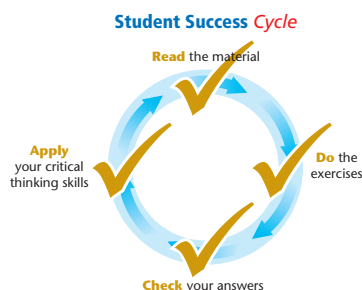
What questions might Zane Caplansky need to answer in order to get a loan from a bank? Who else might require accounting information from Caplansky's business?

↑ An essential element of critical thinking is the ability to ask questions while reading (or listening or speaking). This exercise is designed to help students develop the skills related to questioning. Suggested answers are available on Connect.

## CHAPTER PREVIEW

↑ A chapter preview introduces the importance and relevance of the material, and also links these materials to the opening article to help you understand how what you are learning in the chapter relates to the real world through practical examples.

Accounting information pulsates throughout an organization, feeding decision makers with key details needed to make important decisions and navigate through today's competitive business environment. Whether your future role is in accounting, human resources, finance, operations, marketing, or strategy, you will find the study of financial accounting integral to your ability to make relevant decisions. Understanding accounting terms such as revenue, expenses, assets, liabilities, and profitability is critical to effectively analyzing the financial performance of any business. Through your study of this book, you will learn key accounting concepts and develop an ability to interpret financial information that is essential for making sound business decisions.



This first chapter accomplishes three goals in your journey toward understanding financial accounting. First, it introduces the subject of accounting and helps you to deepen your understanding of the role of accounting in business, including the importance of ethics and social responsibility in producing trustworthy financial reports.

Second, it demonstrates how accounting information is created and communicated in the form of *financial statements*, which report on the financial performance and condition of an organization. Chapter concepts are illustrated through an in-depth demonstration of how a young entrepreneur, Hailey Walker, handles financial information as she pursues the initial start-up phase in her new food truck business, Organico. Her goal is to capitalize on the increasing consumer demand for healthier options in the fast food market by specializing in fresh, organic, Mexican burritos. The illustration begins with Walker registering her business name and commencing her first month of operations on March 1, 2020.



Third, this chapter introduces you to each of the learning features found in most chapters. For example, a note above explains the purpose of the chapter preview, and three additional features—learning objectives, boldfaced key terms, and real company names—are described below. Some of the features refer to Connect, located on the Web. Take the time in this chapter to explore and learn the value of these additional resources.

## What Is Accounting?

**LO1** Describe the purpose and importance of accounting.

↑ Each chapter is separated into chunks of information called learning objectives (LO). Each LO tells you what needs to be mastered in that section of reading.

Accounting knowledge is a powerful tool; it provides you with essential information to make critical business decisions. How does accounting knowledge give you power? What exactly is the focus of accounting? This section answers these fundamental questions.

### POWER OF ACCOUNTING

**Accounting** is an information system that identifies, measures, records, and communicates *relevant* information that *objectively and correctly represents* an organization's economic activities,<sup>1</sup> as shown in Exhibit 1.1. Its objective is to help people make better decisions. It also helps people better assess opportunities, products,

#### EXHIBIT 1.1

##### Accounting Activities



(left) © Diane Diederich/istockphoto.com; (centre) © JGI/Tom Gril/Blend Images LLC; (right) © shironosov/istockphoto.com

<sup>1</sup> When information makes a difference in the decisions made by users, it is *relevant*. For information to possess the quality of *faithful representation*, it must be complete, neutral, and free from error (IFRS 2018, “The conceptual framework for financial reporting,” para. QC5-QC6, QC 12). These primary qualitative characteristics of useful accounting information will be discussed in more detail later in this chapter.

investments, and social and community responsibilities. In addition to reporting on the performance of a business, what the business owns, and what it owes, accounting opens our eyes to new and exciting possibilities. Put more simply, accounting involves collecting relevant information, recording it, and then reporting it to various decision makers. In the chapter-opening story, for example, **Caplansky's Deli** collects and records accounting information so that it can be reported to Zane Caplansky, the business owner, and other investors, to help them make important decisions—such as those involved in setting selling prices for his deli sandwiches, and developing an effective expansion strategy.

↑ Boldfaced words or phrases represent new terminology that is explained here and defined in the glossary at the end of the chapter.

Real company names are printed in **bold magenta** the first time they are mentioned in each chapter.

## FOCUS OF ACCOUNTING

Accounting for our personal finances enables us to better manage and plan for our future. Examples of common personal points of contact with financial accounting include applying for credit approvals, opening bank accounts, filling out student loan forms, and making decisions regarding whether to purchase a new or a used car. These experiences often focus on the *recordkeeping* (or *bookkeeping*) parts of accounting. **Recordkeeping**, or **bookkeeping**, is the recording of financial transactions, either manually or electronically, for the purpose of creating a bank of data that is complete, neutral, and free from error. Accounting *involves* the recordkeeping process but *is* much more.

Accounting also involves designing information systems to provide useful reports that provide relevant information in monitoring and controlling an organization's activities. In order to use the reports effectively, decision makers must be able to interpret the information. The skills needed to understand and interpret accounting information are developed through building a foundation in accounting concepts and developing an understanding of recording transactions through the recordkeeping process. The use of technology in recordkeeping reduces the time, effort, and cost of accounting while improving accuracy. As technology has changed the way we store, process, and summarize masses of data, financial analysis tools have improved, resulting in improved decision making. Consulting, planning, and other financial services are now closely linked to accounting. These services require sorting through data, interpreting their meaning, identifying key factors, and analyzing their implications. Because accounting is part of so much that we do in business and our everyday lives, you can enjoy greater opportunities if you understand and are able to use accounting information effectively.



### CHECKPOINT

1. What is the major objective of accounting?
2. Distinguish between accounting and recordkeeping.

**Do Quick Study questions: QS 1-1, QS 1-2**

↑ A series of Checkpoint questions in the chapter reinforce the immediately preceding materials. These questions give you feedback on your comprehension before you go on to new topics. Answers to these Checkpoint questions are available for you at the end of each chapter.

↑ Answers to the Quick Study (QS) questions are available on Connect.

# Forms of Organization

**LO2** Describe forms of business organization.

A **business** is an entity represented by one or more individuals selling products or services for profit. Products sold include anything from athletic apparel (**CCM, Bauer, Lululemon Athletica, Nike, Reebok**) to electronic devices (**Apple, Dell, Hewlett-Packard, Samsung**) and clothing (**Abercrombie & Fitch, The Gap, Zara**). Service providers such as data communication providers (**Bell, Rogers, Telus**), food services (**McDonald's, Starbucks, Tim Hortons**), and Internet services (**Google, Twitter, Skype, Facebook, Instagram**) make our lives more connected. A business can be as small as an in-home tutoring business or as large as **George Weston Limited**, the food processing company known for its President's Choice and No Name brands, owner of the clothing label Joe Fresh, and holder of a significant investment in the supermarket chain **Loblaws Companies Limited**. Nearly 100,000 new businesses are started in Canada each year, with most of them being founded by people who want freedom from ordinary jobs, a new challenge in life, or the potential of earning extra money.

Most organizations engage in economic activities such as the business activities of purchasing materials and labour, and selling products and services. They can also involve activities for non-business organizations, more commonly referred to as not-for-profit organizations, such as government, schools, and health care and charities. Non-business organizations do not plan and operate for profit, but rather for other goals such as health, education, and cultural and social activities. A common feature in all organizations, both business and non-business, is the reliance on reported financial information to successfully run the organization.

## BUSINESS ORGANIZATIONS

When a business is initially established, the owner(s) need to select one of the three legal business structures: sole proprietorship, partnership, or corporation.

### Sole Proprietorship

A **sole proprietorship**, or *single proprietorship*, is a business owned by one person. Initial setup of a sole proprietorship is relatively easy and inexpensive. No special legal requirements must be met in order to start this form of business, other than to file for a business licence and register the business name. While it is a separate entity<sup>2</sup> for accounting purposes, it is *not* a separate legal entity from its owner. This means, for example, that a court can order an owner to sell personal belongings to pay a proprietorship's debt. An owner is even responsible for debts that are greater than the resources of the proprietorship; this is known as **unlimited liability**. This unlimited liability is a clear disadvantage of a sole proprietorship, because tax authorities do not separate a proprietorship from its owner; the profits of the business are reported and taxed on the owner's personal income tax return. Small retail stores and service businesses often are organized as proprietorships.

### Partnership

A **partnership**<sup>3</sup> is owned by two or more persons called *partners*. Similar to a proprietorship, no special legal requirements must be met in order to start a partnership, other than to register the business name and obtain a business licence. To run the business together, the partners need an oral or written agreement that usually

<sup>2</sup> The *business entity principle* is one of a group of accounting rules, the *generally accepted accounting principles (GAAP)*, which are discussed later in this chapter. This principle states that each economic entity or business of the owner must keep accounting records and reports separate from the owner and any other economic entity of the owner.

<sup>3</sup> Partnerships are discussed in greater detail in Chapter 11 in Volume 2 of the textbook.

indicates how profits and losses are to be shared, referred to as a partnership agreement. A partnership, like a proprietorship, is not legally separate from its owners; therefore, each partner's share of profits is reported and taxed on that partner's tax return. Partners are usually subject to *unlimited liability*, meaning they are personally responsible for the debts of the business.

### Corporation

A **corporation**<sup>4</sup> is a business that is set up as a separate legal entity chartered (or *incorporated*) under provincial or federal laws. A corporation is responsible for its actions and any debts incurred. It can enter into its own contracts, and it can buy, own, and sell property. It can also sue and be sued. Separate legal status not only gives a corporation an unlimited life, but also entitles the corporation to conduct business with the rights, duties, and responsibilities of a person. As a result, a corporation files a tax return and pays tax on its profits. A corporation acts through its managers, who are its legal agents. Separate legal status also means that the shareholders are not personally liable for corporate acts and debts. Shareholders are legally distinct from the business and their loss is limited to whatever resources they have invested. This **limited liability** is a key to why corporations can raise resources from shareholders who are not active in managing the business. Ownership, or equity, of all corporations is divided into units called **shares**. Owners of shares are called **shareholders** (another term for shares is *stock* and for shareholders, *stockholders*). A shareholder can sell or transfer shares to another person without affecting the operations of a corporation. When a corporation issues (or sells) only one class of shares, we call them **common shares**. A corporation that sells its shares to the public is called a **publicly accountable enterprise (PAE)**. The **public sale of shares** refers to the trading of shares in an organized stock market such as the Montreal or Toronto stock exchanges. A **private enterprise (PE)** is a corporation that does not offer its shares for public sale. **Canadian Tire Corporation** is an example of a publicly accountable enterprise. Its shares are available on the Toronto Stock Exchange, and as of December 31, 2016, Canadian Tire had issued a total of 68.51 million common shares to the public. This means that Canadian Tire Corporation's ownership is divided into 68.51 million units. **McCain Foods** is a Canadian corporation that is a private enterprise. McCain's shares are held by a small group of individuals and are not for sale to the public.

Exhibit 1.2 lists some of the characteristics of each business form.

#### EXHIBIT 1.2

##### Characteristics of Business Organizations

	Sole Proprietorship	Partnership	Corporation
Separate business entity	yes	yes	yes
Separate legal entity	no	no	yes
Limited owner liability	no	no	yes
Unlimited life	no	no	yes
Business profit is taxed separate from owner(s)	no	no	yes
One owner allowed	yes	no	yes

<sup>4</sup> Corporations are discussed in greater detail in Chapter 12 in Volume 2 of the textbook.



## CHECKPOINT

1. Identify examples of non-business organizations.
2. What are the three common forms of business organization?

**Do Quick Study questions: QS 1-3, QS 1-4**

## Users of Accounting Information

**LO3** Identify users and uses of accounting and opportunities in accounting.

Accounting is a service activity that serves the decision-making needs of *external* and *internal* users, as shown in Exhibit 1.3.

### EXTERNAL INFORMATION USERS

**External users** of accounting information are any party outside the company that relies on the company's reported accounting information to make financial decisions. These users often hold a financial interest in the company but are not involved in day-to-day operations. They include existing and potential shareholders, lenders such as banks, and other creditors such as suppliers and bondholders. Each external user has special information needs that depend on the kind of decisions to be made. To make decisions, these individuals do not have access to internal records of the company but rely on information presented in financial reports, known widely as financial statements.

#### External Reporting

**Financial accounting** is the area of accounting aimed at providing information to external users. Its primary objective is to provide external reports called *financial statements* to help users analyze an organization's operations and assess performance. Because external users have limited access to an organization's information, their own success depends on getting external reports that communicate relevant information that is truthfully represented. Some governmental and regulatory agencies have the power to get reports in specific forms,

#### EXHIBIT 1.3

##### Users of Accounting Information

###### External users



- Lenders
- Shareholders
- Governments
- Consumer groups
- External auditors
- Customers

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###### Internal users



- Officers
- Managers
- Internal auditors
- Sales staff
- Budget officers
- Controllers

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but most external users must rely on *general purpose financial statements*. The term “general purpose” refers to the broad range of purposes for which external users rely on these statements. *Generally accepted accounting principles (GAAP)* are important in increasing the usefulness of financial statements to users. GAAP are the underlying concepts that make up acceptable accounting practices. GAAP for public companies in Canada follow International Financial Reporting Standards (IFRS). IFRS are the “accounting laws” that must be applied by accountants to public companies in Canada when recording and reporting accounting information. We discuss GAAP and IFRS along with the financial statements in more detail later.

## INTERNAL INFORMATION USERS

**Internal users** of accounting information are those individuals directly involved in making decisions in an organization’s day-to-day activities. The internal role of accounting is to provide information to help internal users improve the efficiency and effectiveness of an organization in delivering products or services.

### Internal Reporting

**Managerial accounting** is the area of accounting aimed at serving the decision-making needs of internal users. Managerial accounting provides special-purpose reports customized to meet the information needs of internal users. An example of such a report is a monthly sales report for each **David’s Tea** location to be used to monitor performance of the store’s managers in leading their team. Another example would be a report showing a detailed listing of suppliers owed money by David’s Tea for food purchases. Internal reports aim to answer questions such as

- What are the manufacturing expenses per unit of product?
- What is the most profitable mix of goods and/or services?
- What level of revenues is necessary to show profit income?
- Which expenses increase with an increase in revenues?

This book will help you to learn the skills needed to record accounting information effectively to provide answers to questions like these and others.

### Internal Operating Functions

The responsibilities and duties of internal users extend to every function of an organization including human resources, sales, marketing, purchasing, production, distribution, and research and development. Accounting is essential to the smooth operation of each aspect of an organization.



## ETHICAL IMPACT

### \$18.7 Million Maple Syrup Theft

On July 30, 2012, Micheal Gavreau arrived at a warehouse to audit \$30 million worth of inventory at the Global Strategic Maple Syrup Reserve. To his surprise, several of the barrels were discovered to be empty; others had their contents replaced with water. It was the “largest theft investigated by the Sûreté du Québec in its history.” The leader of the heist was found guilty of fraud, theft, and trafficking stolen goods and was sentenced to eight years in prison and fined \$9.4 million. This situation occurred because of inadequate internal controls. In Chapter 7 we will introduce you to the concept of internal controls and the critical role they play in maintaining corporate assets.

What would you do if you noticed unusual activities or discrepancies at your audit client or place of work, such as boxes that looked like they had been tampered with? Would you turn a blind eye or would you take the time to investigate?

**Video Link:** Follow this link to view a video summary of the full story of “The Sweetest Heist”: <https://youtu.be/adCQ9cwYA8o>.

To monitor operating functions, managers rely on **internal controls**—procedures set up to protect assets (like cash, equipment, and buildings); ensure that accounting reports are free from error, neutral, and complete; promote efficiency; and ensure that company policies are followed. For example, certain actions require verification, such as a manager’s approval before materials enter production. Internal controls are crucial if accounting reports are to provide relevant and trustworthy information.

## Accounting Opportunities

Exhibit 1.4 identifies some of the countless job opportunities in accounting by classifying accountants according to the kind of work that they perform. In general, accountants work in four broad fields:

- Financial
- Managerial
- Taxation
- Accounting related

Another way to classify accountants is to identify the kinds of organizations in which they work. Most accountants are **private accountants** and work for a single employer, which is often a business. **Public accountants** are licensed and regulated by their professional accounting bodies in the provinces in which they work. For example, the Chartered Professional Accountants of Ontario provides licensing and regulation over CPAs working in Ontario. Exhibit 1.5 shows the average annual salaries for various accounting groups.

## FINANCIAL ACCOUNTING

Financial accounting serves the needs of external users by providing standardized financial reports referred to as financial statements. Public companies are required to issue annual financial reports that are audited by a professional accountant. An **audit** is an independent review of an organization’s accounting systems and records; it is performed to add credibility to the financial statements. **External auditors** perform the audit at the request of the board of directors to protect investor interests.

### EXHIBIT 1.4

#### Opportunities in Practice

