CHAPTER 2

Analyzing Transactions and Their Effects on Financial Statements

Learning Objectives

1. Identify the accounting standards used by Canadian companies.
2. Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
3. Explain the difference between the cash basis of accounting and the accrual basis of accounting.
4. Explain the accounting equation template approach to recording transactions.
5. Analyze basic transactions and record their effects on the accounting equation.
6. Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
7. Calculate and interpret three ratios used to assess the profitability of a company.

Summary of Questions by Learning Objectives and Bloom's Taxonomy

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
Discussion Questions														
1.	1	C	7.	2	C	13.	5	C	19.	5	C	25.	6	K
2.	2	C	8.	3	C	14.	4	C	20.	5	C	26.	6	K
3.	2	C	9.	3	K	15.	5	C	21.	5	C	27.	6	C
4.	2	C	10.	3	C	16.	5	C	22.	6	C			
5	2	C	11.	3	C	17.	5	C	23.	6	K			
6.	2	C	12.	3	C	18.	5	C	24.	6	K			
Application Problems														
1.	2	K	4.	5	AP	7.	5	AP	10.	6	AP	13.	6	AP
2.	3	AP	5.	5	AP	8.	5	AP	11.	6	AP	14.	5,6	AP
3.	5	AP	6.	5	AP	9.	5	AP	12.	6	AP	15.	5,6,7	AP
User Perspective Problems														
1.	1	C	3.	2	C	5.	3	C	7.	3	C	9.	6	C
2.	1	C	4.	3	C	6.	3	C	8.	6	C			
Work in Process														
1.	3	C	2.	4	C	3.	4	C	4.	7	AN			
Reading and Interpreting Published Financial Statements														
1.	7	AN	3.	7	AN	5.	7	AN	7.	7	AN			
2.	4,7	AN	4.	4,7	AN	6.	4,7	AN						
Cases														
1.	5,6,7	AN	2.	5,6	C	3.	7	AN	4.	5,6	C			

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

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

SOLUTIONS TO DISCUSSION QUESTIONS

DQ2-1 Advantages of using IFRS for interlisted public companies

- Financial statement prepared using IFRS are accepted on many stock exchanges: NYSE, LSE, ASE, OMX Nordic Exchange and JSE. This saves these companies from having to prepare different financial statements for each exchange.
- The SEC allows companies to submit IFRS statements rather than those prepared using US GAAP.

LO 1 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-2 The two fundamental qualitative characteristics are relevance and representational faithfulness. These fundamental characteristics ensure that information reported in financial statements is useful.

The four enhancing qualitative characteristics are comparability, verifiability, timeliness, and understandability. These characteristics further enhance useful information; however, they cannot make useless information useful.

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

DQ2-3 The value of the land is reported at its original purchase price, or its historical cost. This is representationally faithful, verifiable, accurate and free from error. However, historical cost may not be relevant if the market value of the land has increased significantly since it was purchased. Some users may find it more useful to know the current market value of the land.

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

DQ2-4 The conceptual framework provides guidance by focusing the financial statement preparer on presenting information that is relevant and faithfully represented. Even in highly unique situations for which there is no specific accounting standard, accountants must think about accounting for a transaction in a manner that provides information that is predictive or enables users to confirm their previous assessments as well as provide information that is complete, neutral, and free from error. The conceptual framework also directs the accountant to consider qualities like comparability, verifiability, timeliness, and understandably. Finally, the conceptual framework considers the cost and benefit of reporting information, to ensure that the efforts spent obtaining information is warranted, considering the benefits the information provides to the financial statement users.

In short, the conceptual framework provides accountants with a basis for determining how to treat the item or transaction in a way that results in useful financial information in the absence of any specific standard.

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

DQ2-5 Material information is information that is useful and matters to decision makers. Information is material when it influences the user of the information. Therefore, it is associated with the qualitative characteristic of relevance. It is information that, if known, would make a difference in the decisions that are made about investments in, or investments made by, a company. Normally, the greater the dollar value of an item, the more material it is. However, some small dollar items can be qualitatively material due to particular situations (i.e. even a small dollar fraud by senior management could be considered material).

LO 2 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-6 The cost constraint is applied by companies when deciding what financial information should be reported. The benefits of reporting the information must exceed the cost involved in its preparation. If the benefit doesn't exceed the cost, that information should not be captured and reported on the financial statements.

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

DQ2-7 The going concern assumption is a basic assumption in accounting that the business is going to continue to operate in the foreseeable future. A company can rely that it is going to realize its assets and discharge its liabilities through the normal course of operations. If this assumption were not present, the company would need to report its assets and liabilities at the amounts expected to result from the liquidation process.

LO 2 BT: C Difficulty: S Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-8 Under the accrual basis of accounting, transactions are recorded in the period in which they occur (i.e. revenues when earned and expenses when incurred) regardless of when the cash related to these transactions flowed into or out of the company. Under the cash basis of accounting, transactions are only recorded when the cash is actually received or paid by the company.

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

DQ2-9 Advantages of using the accrual basis:

1. Revenue is recognized when earned which is more meaningful to users. Under the cash basis, the revenue is recognized when the cash is received, even if the work associated with has been done previously or may not be completed for several periods.
2. It results in statements of income that reflect the revenues and expenses of the period more accurately.
3. It increases the comparability of financial statements from one period to another.

Disadvantages of using the accrual basis:

1. It is more complicated for unsophisticated users to prepare or interpret.
2. Creates uncertainty regarding the collectability of future cash flows. Under the accrual basis, some of the revenues recognized may never be collected. This is a non-issue under the cash basis.
3. Net income determined under the accrual basis does not give a clear view of the amount of cash that an organization has generated in a given time period.

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

DQ2-10 Since revenue is only recorded when cash is received, management could require customers to pay before providing the product or service to show revenue before it is earned and therefore increasing net income. Management could also delay paying for expenses to increase net income as well.

The accrual basis of accounting prevents both these manipulations by only recording revenue when it is earned, when the product or service is provided to the customer and expenses are recorded when they are incurred.

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

DQ2-11 Under the accrual basis of accounting, revenues are recorded when they have been earned regardless of whether the related cash has been received by the company. When a university bookstore sells a textbook, it ‘earns’ the revenue when the textbook is sold and delivered to the student. In this case, most students pay for textbooks at the same time as receiving them, therefore the cash basis and the accrual basis would be the same for the sale of textbooks.

The revenue earned from the parking would be recognized throughout the semester, as the student uses the parking space. The university would recognize a portion of the parking revenue each month throughout the semester. Under the cash basis of accounting, the full amount of the parking pass would have been recognized as revenue in the month the cash was received.

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

DQ2-12 Under accrual-basis accounting, a prepaid expense is recorded as an asset on the statement of financial position and expensed as the related benefits are realized. For example, if rent is paid for future months, no expense is recognized immediately even though cash is paid. The prepaid expense is then expensed over the months that benefit from the advance payment (i.e. rent expense would be recognized in each month covered by the prepaid rent).

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

DQ2-13 Under accrual-basis accounting, an accrued expense (such as interest) is one that is recognized on the statement of income as an expense before any cash is paid out. In this case, a liability is also set up on the statement of financial position, that will be eliminated once the cash has been paid to settle the liability.

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

DQ2-14 When transactions are recorded in the accounting system, the equality of the basic accounting equation (or statement of financial position equation), Assets = Liabilities + Shareholders' Equity, must be maintained. This implies that all transactions must affect at least two accounts in the financial statements to maintain the equality, although the effects may be within the same category of accounts. For example, the collection of cash on account from customers both increases an asset (Cash) and decreases another asset (Accounts Receivable).

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

DQ2-15 Dividends are not expenses. They are a distribution of profits to shareholders and not an expense incurred to generate revenues. Dividend payments involve an outflow of cash and are therefore recorded on the statement of cash flows and the statement of changes in equity.

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

DQ2-16 Revenue is recorded as an increase to retained earnings in the template system as the template is based on the accounting equation: Assets = Liabilities + Shareholder's Equity. Within Shareholder's equity is Retained earnings, which captures net income and revenue is part of net income. Revenue increases net income and therefore, also increases retained earnings.

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

DQ2-17 At the date the loan is taken out, no interest has been incurred, but with each day that passes, interest expense is being incurred. Interest expense is based on the time the loan has been held and typically interest expense is recorded at the end of each month.

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

DQ2-18 Prepaid insurance is a benefit over the life of the policy and, since it has an economic benefit, it is considered an asset. Over time, this benefit is used up and should be expensed as time passes. Typically, insurance expense is recorded at the end of each month and the amount of prepaid insurance is reduced.

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

DQ2-19 Depreciation is a method of allocating the cost of property, plant and equipment to each of the years in which these assets are expected to help generate revenues (i.e. its estimated useful life). Using the straight-line method, depreciation is calculated as (the total cost of the asset less its estimated residual value, if any) divided by the estimated useful life. It results in an equal portion of the asset's cost being allocated each period.

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

DQ2-20 Accrual accounting requires that revenue be recognized when it is earned, and that expenses be recognized in the period they are used to earn revenue. Buildings and equipment are often paid for when they are acquired, and then are used for generating revenue over many years. Depreciation enables the cost of the assets to be allocated to the periods in which they are used.

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

DQ2-21 The estimated residual value of an asset is the amount the company estimates to recover from the disposal of the asset when the company is finished using it. The purpose of depreciation is to allocate the net cash spent on the asset to the periods of its use. Since some of the purchase price will be recovered through the eventual disposal of the asset, that portion of the cost should not be allocated as an expense during the period of use. Therefore, residual value is subtracted from the asset's cost when calculating depreciation.

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

DQ2-22 The statement of changes in shareholders' equity includes changes in retained earnings. Retained earnings are increased or decreased by the net income or loss for the period, therefore the statement of income must be completed first to know how much change to record in retained earnings. Then, the rest of the statement of changes in shareholders' equity can be completed.

LO 6 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-23 The three major sections in the cash flow statement are:

1. Operating Activities: Includes transactions involving cash received from the sale of goods/services and cash paid for expenses incurred in generating the sales.
2. Investing Activities: Includes transactions involved with the buying and selling of assets such as property, plant, and equipment, long-term investments, etc.
3. Financing Activities: Includes transactions regarding the inflow and outflow of cash obtained from creditors or from shareholders necessary to finance the investment plans of the business. Financing activities include the issuance of shares, payment of dividends, proceeds from new loans and the repayment of loan principal, etc.

LO 6 BT: K Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-24 The repayment of loan principal is an example of a cash outflow from financing activity. The sale of property, plant and equipment such as land or equipment held by a company for use is an example of a cash inflow from investing activity.

LO 6 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-25 The issuance of shares is an example of a cash inflow from financing activity. The purchase of property, plant, and equipment is an example of a cash outflow from investing activity.

LO 6 BT: K Difficulty: S Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-26

a. T
b. T
c. F
d. F
e. F
f. T
g. F
h. T

LO 3,5,6 BT: C Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

DQ2-27 Operating activities are normally expected to have a positive net cash flow, as cash collected from sales is expected to be greater than the cash spent to generate the sales.

Investing activities are normally expected to have a negative net cash flow, as more cash is spent on acquiring property, plant and equipment than is received from selling them once the company has finished using them.

Financing activities normally result in net cash inflow because companies generally borrow money and issue shares to finance their growth.

LO 6 BT: C Difficulty: C Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

SOLUTIONS TO APPLICATION PROBLEMS

AP2-1A

a. E
b. F
c. E
d. E
e. E
f. F

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

AP2-2A

i. (a) No effect on the statement of income
(b) No effect on the statement of income

ii. (a) No effect on the statement of income
(b) Revenue recorded $56,000 and an increase to net income of $56,000

iii. (a) Expenses recorded $18,000 and a decrease to net income of $18,000
(b)Expenses recorded $18,000 and a decrease to net income of $18,000

iv. (a) Revenue recorded $41,000 and an increase to net income of $41,000
(b) No effect on the statement of income

v. (a) No effect on the statement of income
(b) Expenses recorded $3,800 and a decrease to net income of $3,800

vi. (a) Expenses recorded $19,000 and a decrease to net income of $19,000
(b) No effect on the statement of income

vii.(a) Revenue recorded $2,200 and an increase to net income of $2,200
(b) No effect on the statement of income

Summary of results on the next page

AP2-2A (Continued)

Summary of results:

	(a) Cash Basis			(b) Accrual Basis	
	Revenue	Expenses		Revenue	Expenses
i.			i.		
ii.			ii.	$56,000	
iii.		$18,000	iii.		$18,000
iv.	$41,000		iv.		
v.			v.		3,800
vi.		19,000	vi.		
vii.	2,200		vii.		
	$43,200	$37,000		$56,000	$21,800
Net income		$6,200	Net income		$34,200

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

AP2-3A

a. Increase assets (cash) and increase shareholders' equity (common shares)
b. Decrease assets (cash) and increase assets (land)
c. Increase assets (accounts receivable) and increase shareholders' equity (sales revenue increases, which increases retained earnings)
d. Increase assets (cash) and decrease assets (accounts receivable)
e. Decrease assets (cash) and decrease shareholders' equity (dividends declared increases, which decreases retained earnings)
f. Increase assets (cash) and increase liabilities (bank loan payable)
g. Decrease assets (cash) and decrease shareholders' equity (interest expense increases, which decreases retained earnings)
h. Increase assets (inventory) and increase liabilities (accounts payable)
i. Decrease assets (cash) and decrease liabilities (accounts payable)
j. Decrease assets (cash) and decrease shareholders' equity (delivery expense increases, which decreases retained earnings)
k. Decrease assets (cash) and increase in assets (prepaid insurance) when payment is made. As insurance is used, decrease in assets (prepaid insurance) and a decrease shareholders' equity (insurance expense increases, which decreases retained earnings)
l. Decrease assets (increases accumulated depreciation, which is a contra asset) and decreases shareholders' equity (increases depreciation expense, which decreases retained earnings)

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

AP2-4A

Account	Increase/Decrease
a. Cash (A)	Increase
Common Shares (SE)	Increase*
b. Cash (A)	Increase
Bank Loan Payable (L)	Increase
c. Equipment (A)	Increase
Accounts Payable (L)	Increase
d. Inventory (A)	Increase
Cash (A)	Decrease
Accounts Payable (L)	Increase
e. Accounts Receivable (A)	Increase
Sales Revenue (SE)	Increase*
Cost of Goods Sold (SE)	Increase**
Inventory (A)	Decrease
f. Accounts Payable (L)	Decrease
Cash (A)	Decrease
g. Cash (A)	Increase
Accounts Receivable (A)	Decrease
h. Supplies (A)	Increase
Cash (A)	Decrease
i. Dividends Declared (SE)	Increase**
Cash (A)	Decrease
j. Interest Expense (SE)	Increase**
Interest Payable (L)	Increase
k. Accounts Payable (L)	Decrease
Cash (A)	Decrease
l. Supplies Expense (SE)	Increase**
Supplies (A)	Decrease

* Increase in Shareholders' Equity
** Decrease in Shareholders' Equity

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

AP2-5A

	Assets				Liabilities				S/H Equity	
Date Sept.	Cash	A/R	Inv.	Inflatable Equip.	A/P	Deferred Revenue	Loan Payable	Common Shares	R/E	R/E/DD
1	260,000							260,000		
1	160,000						160,000			
3	(100,000)			140,000	40,000					
8			6,600		6,600					
11	2,500					2,500				
15:1	4,300	4,300							8,600	R
15:2			(5,700)						(5,700)	E
19	(1,700)				(1,700)					
23	3,400	(3,400)								
30:1	(3,000)						(3,000)			
30:2	(800)*								(800)	E

*$160,000 x 6% x 1/12 = $800 Interest expense

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

AP2-6A

	Assets				Liabilities			S/H Equity	
Date Jan	Cash	A/R	Inv.	Prepaid Ins.	A/P	Deferred Revenue	Loan Payable	R/E	R/E/DD
1	20,000						20,000		
1	(3,300)			3,300					
4			36,000		36,000				
10.1	11,100	11,100						22,200	R
10.2			(15,600)					(15,600)	E
19	(5,000)				(5,000)				
27	(5,100)							(5,100)	E
29	5,000					5,000			
30				(275)				(275)	E
30	(1,550)						(1,500)	(50)	E

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

AP2-7A

Trans-action	(i) Effect on Net Earnings	(ii) Effect on cash flows
i.	No effect	Increase of $60,000
ii.	No effect	No effect
iii.	No effect	Decrease of $500
vi.	Net increase of $200 (Sales of $500 less Cost of goods sold of $300)	No effect (sold on account, inventory already owned)
v.	No effect	Decrease of $10,000
vi.	No effect	Decrease of $1,000
vii.	Decrease of $300 (Supplies expense)	No effect
viii.	No effect	Increase of $700
ix.	No effect	No effect
x.	No effect	Decrease of $2,000
xi.	Decrease of $500 (Depreciation expense)	No effect

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

AP2-8A

	Assets					Liabilities		S/H Equity		
#	Cash	A/R	Inv.	Supplies	Equip.	A/P	Loan Payable	Common Shares	R/E	Rev/ Exp/DD
a	150,000							150,000		
b	(25,000)				50,000	25,000				
c			45,000			45,000				
d:1		52,000							52,000	Rev
d:2			(35,000)						(35,000)	Exp
e	(1,000)					(1,000)				
f	25,000						25,000			
g					(1,200)				(1,200)	Exp
h	(750)			750						
i	(250)								(250)	Exp
j	(8,000)								(8,000)	DD

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

AP2-9A

	Assets				Liabilities			S/H Equity		
Date Jan	Cash	A/R	Inv.	Equip.	A/P	Wages Payable	Loan Payable	Common Shares	R/E	Rev/Exp/ DD
1a.	75,000							75,000		
1b.	60,000						60,000			
1c.	(10,000)			10,000						
d.			87,500		87,500					
e.	17,500	130,000							147,500	Rev
f.			(85,000)						(85,000)	Exp
g.	(73,000)				(73,000)					
h.	116,000	(116,000)								
i.	(47,200)					1,200			(48,400)	Exp
j.	(3,600)*								(3,600)	Exp
k.	(1,000)								(1,000)	DD
l.				(1,500)**					(1,500)	Exp

* 60,000 x 6% = 3,600 Interest expense **(10,000 -1,000)/6 = 1,500 Depreciation expense

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

AP2-10A

Case 1

A Revenue – Expenses = Net Income, Revenue – $510,000 = $215,000, Revenue = $510,000 +$215,000 = $725,000

B Retained earnings, end of year = Retained earnings, beginning of the year + Net Income – Dividends declared = $850,000 + $215,000 – $100,000 = $965,000

C Total assets, end of the year = Total Liabilities, end of the year + Total Common Shares, beginning of the year + Total Retained Earnings, beginning of the year = $860,000 + $350,000 + $965,000 = $2,175,000

D Total Liabilities, beginning of year = Total Assets, beginning of year (given $1,890,000) – Total common shares, beginning of year (calculated in E) – Total retained earnings, beginning of year (calculated in B) = $1,890,000 - $250,000 - $850,000 = $790,000

E Common shares, beginning of the year = Common shares, end of the year - Additional common shares issued during the year = $350,000 - $100,000 = $250,000

Case 2

A Net Income = Revenue – Expenses = $850,000 - $550,000 = $300,000

B Total Retained Earnings, end of the year $965,000 - Retained Earnings, beginning of the year $780,000 (item C) less Net Income for the year $300,000 (item A) equals Dividends Declared of $115,000

C Total assets, beginning of year $1,880,000 - Total liabilities, beginning of year $850,000 - Total common shares, beginning of year $250,000 = Total retained earnings, beginning of year = $780,000

D Total liabilities, end of year = Total assets, end of year - Total common shares, end of year - Total retained earnings, end of year = $2,20,000 - $350,000 - 965,000 = $885,000

E Proceeds from issuing Common shares during the year = Common shares, end of year – Common shares at beginning of the year = $350,000 – 250,000 = $100,000

LO 6 BT: AP Difficulty: C Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-11A **a.** Total revenues: $448,800 + $4,800 + $2,200 = $455,800

b. Total expenses: $272,000 + $63,300 + $38,800 + $1,200 + $26,400 = $401,700

c. Net earnings: $455,800 - $401,700 = $54,100

d. Dividends declared: $96,000 + $54,100 - $105,600 = $44,500

Alternate:

Beg. R/E + net income – dividends declared = End R/E
$96,000 + $54,100 - ? (div. decl.) = $105,600
$150,100 - ? (div. decl.) = $105,600
? (div. decl.) = $150,100 - $105,600

Therefore, dividends declared = $44,500

LO 6 BT: AP Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-12A

a.

i. Sales revenue = $48,000 (#5)

ii. Cost of goods sold = $22,000 (#6)

iii. Total expenses other than cost of good sold = $7,000 (#7) + $2,200 (#8) + $600 (#9) = $9,800

iv. Net income = $48,000 - $22,000 - $9,800 = $16,200

b.

i. Cash on hand: $100,000 (#1) + $22,000 (#2) - $25,000 (#3) - $6,000 (#4) + $10,000 (#5) - $7,000 (#7) - $2,200 (#8) - $1,000 (#10) = $90,800

ii. Total assets other than cash: $25,000 (#3) + $36,000 (#4) + $38,000 (#5) - $22,000 (#6) - $600 (#9= $76,400

Alternate:

Equipment = $36,000 - $600 = $35,400

Inventory = $25,000 - $22,000 = $3,000

Accounts receivable = $38,000 (#5)

Total assets other than cash = $35,400 + $3,000 + $38,000 = $76,400

iii. Total liabilities: $22,000 (#2) + $30,000 (#4) = $52,000

iv. Share capital: $100,000

v. Retained earnings: $0 + $16,200 - $1,000 (#10) = $15,200

LO 6 BT: AP Difficulty: C Time: 25 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-13A

a.

The Wizard's Corner
Statement of Income
For the year ended June 30, 2024

Sales revenue		$190,000
Less expenses:		
Cost of goods sold	$103,000	
Wages expense	36,000	
Rent expense	12,000	
Advertising expense	6,000	
Depreciation expense	2,000	
Total expenses		159,000
Net income		$ 31,000

b.

Retained earnings at July 1, 2023	$21,000
Plus: Net income	31,000
Less: dividends declared	3,000
Retained earnings at June 30, 2024	$49,000

AP8-13A (Continued)

c.

The Wizard's Corner
Statement of Financial Position
As at June 30, 2024

ASSETS	
Current assets	
Cash	$ 40,000
Accounts receivable	15,000
Inventory	28,000
Prepaid rent	1,000
	84,000
Non-current assets	
Equipment	11,000
Total Assets	$ 95,000
LIABILITIES & SHAREHOLDERS' EQUITY	
Current liabilities	
Accounts payable	$11,000
Wages payable	2,000
	13,000
Total liabilities	13,000
Shareholders' equity	
Common shares	33,000
Retained earnings	49,000
Total Shareholders' Equity	82,000
Total Liabilities and Shareholders' Equity	$ 95,000

LO 6 BT: AP Difficulty: M Time: 45 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-14A

a.

	Assets					Liabilities					S/H Equity		
Date/ Ref.	Cash	A/R	Inv.	Buildings	Land	A/P	Wages Payable	Interest Payable	Dividends Payable	Loan Payable	Common Shares	R/E	Rev/ Exp/DD
Jan.1	250,000										250,000		
Jan.2	50,000									50,000			
Jan.3	(200,000)			140,000	60,000								
4			130,000			130,000							
5	30,000	175,000										205,000	Rev
6			(120,000)									(120,000)	Exp
7	(115,000)					(115,000)							
8	155,000	(155,000)											
9	(55,000)						2,000					(57,000)	Exp
10								3,000*				(3,000)	Exp
11				(4,000)**								(4,000)	Exp
Dec.15									7,000			(7,000)	DD
Totals	115,000	20,000	10,000	136,000	60,000	15,000	2,000	3,000	7,000	50,000	250,000	14,000	

***$50,000 x 6% = $3,000**
**** ($140,000 - $ 20,000) ÷ 30 = $4,000**

AP2-14A (Continued)

b.

Singh Company
Statement of Income
For the Year Ending December 31, 2024

Revenues		
Sales revenue		$205,000
Expenses		
Cost of goods sold	$120,000	
Wages expense	57,000	
Interest expense	3,000	
Depreciation expense	4,000	184,000
Net income		$ 21,000

Singh Company Statement of Changes in Equity For the year ended December 31, 2024				
	Number of Common Shares	Share Capital - Common Shares	Retained Earnings	Total
Balance, Beginning of Year			$0	$0
Net Income			21,000	21,000
Declaration of Dividends			(7,000)	(7,000)
Issuance of Common Shares	10,000	$250,000		250,000
Balance, End of Year	10,000	$250,000	$14,000	$264,000

AP2-14A (Continued)

Singh Company
Statement of Financial Position
As at December 31, 2024

ASSETS	
Cash	$115,000
Accounts Receivable	20,000
Inventory	10,000
Land	60,000
Buildings	136,000
TOTAL ASSETS	$341,000
LIABILITIES	
Accounts Payable	$ 15,000
Wages Payable	2,000
Interest Payable	3,000
Dividends Payable	7,000
Loan Payable	50,000
TOTAL LIABILITIES	77,000
SHAREHOLDERS' EQUITY	
Common Shares	250,000
Retained Earnings	14,000
TOTAL SHAREHOLDERS' EQUITY	264,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$341,000

AP2-14A (Continued)

Singh Company
Statement of Cash Flows
For the Year Ending December 31, 2024

Cash Flow from Operating Activities:	
Cash collections from customers	$185,000
Cash payments to suppliers	(115,000)
Cash payments for wages	(55,000)
Cash flows from operating activities	15,000
Cash Flow from Investing Activities:	
Purchase of land and building	(200,000)
Cash used in investing activities	(200,000)
Cash Flow from Financing Activities:	
Cash proceeds from issuance of shares	$ 250,000
Cash proceeds from bank loan	50,000
Cash from financing activities	300,000
Increase in cash	115,000
Cash, beginning of year	0
Cash, end of year	$115,000

LO 5,6 BT: AP Difficulty: M Time: 60 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-15A

a.

	Assets					Liabilities		S/H Equity		
Date/ Ref.	Cash	A/R	Prepaid Rent	Inv.	Equip-ment	A/P	Notes Payable	Common Shares	R/E	Rev/ Exp/DD
Oct. 1	175,000							175,000		
Oct. 1	225,000						225,000			
Oct. 1	(75,000)		75,000							
3			(60,000)						(60,000)	Exp
4	(220,000)				220,000					
5	(90,000)			90,000						
6				570,000		570,000				
7	80,000	720,000							800,000	Rev
8	650,000	(650,000)								
9	(510,000)					(510,000)				
10				(560,000)					(560,000)	Exp
11	(82,500)					4,000			(86,500)	Exp
12	(47,500)						(25,000)		(22,500)*	Exp
13					(20,000)				(20,000)**	Exp
14	(7,000)								(7,000)	DD
Totals	98,000	70,000	15,000	100,000	200,000	64,000	200,000	175,000	44,000	

*$225,000 x 10% = $22,500

** ($220,000 - $20,000) ÷ 10 = $20,000

AP8-15A (Continued)

b.

Hughes Tools Company
Statement of Income
For the year ended September 30, 2024

Sales revenue		$800,000
Expenses		
Cost of goods sold	$560,000	
Rent expense	60,000	
Depreciation expense	20,000	
Interest expense	22,500	
Selling and administrative	86,500	749,000
Net income		$ 51,000

The Hughes Tool Company
Statement of Changes in Equity
For the year ended September 30, 2024

	Number of Common Shares	Share Capital - Common Shares	Retained Earnings	Total
Balance, Beginning of Year			$0	$0
Net income			51,000	51,000
Declaration of dividends			(7,000)	(7,000)
Issuance of common shares	10,000	$175,000		175,000
Balance, End of Year	10,000	$175,000	$44,000	$219,000

AP8-15A (Continued)

Hughes Tools Company
Statement of Financial Position
As at September 30, 2024

Assets	
Cash	$ 98,000
Accounts receivable	70,000
Inventory	100,000
Prepaid rent	15,000
Equipment	200,000
Total assets	$483,000
Liabilities	
Accounts payable	$ 64,000
Notes payable	200,000
Total liabilities	264,000
Shareholders' equity	
Common shares	175,000
Retained earnings	44,000 *
Total shareholders' equity	219,000
Total liabilities and shareholders' equity	$483,000

*Net income – dividends declared = $51,000 – $7,000 = $44,000

AP2-15A (Continued)

Hughes Tools Company
Statement of Cash Flows
For the year ended September 30, 2024

Cash flows from operating activities		
Cash receipts from customers	$730,000	
Cash paid for inventory	(600,000)	
Cash paid for interest	(22,500)	
Cash paid for selling and administrative expenses	(82,500)	
Cash paid for rent	(75,000)	
Cash used in operating activities		$(50,000)
Cash flows from investing activities		
Purchase of equipment		(220,000)
Cash flows from financing activities		
Issuance of shares	175,000	
Issuance of note payable	225,000	
Repayment of note payable	(25,000)	
Payment of dividends	(7,000)	
Cash from financing activities		368,000
Increase in cash		98,000
Cash, beginning of the year		0
Cash, end of the year		$98,000

c. The results of the first year of operations are generally very good. The sales are excellent, with a healthy profit margin ($51,000/$800,000) 6.4%, and the business has a very substantial cash balance. However, cash flow from operations is negative, which may be a cause for concern.

The company's return on assets measures 10.6% ($51,000/$483,000) and their return on equity comes in at 23.3% ($51,000/$219,000). As it is their first year of operations, we will want to compare these results to industry averages to have a better understanding of this company's performance.

LO 5,6,7 BT: AP Difficulty: M Time: 60 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

AP2-1B

a. R
b. F
c. F
d. R
e. R
f. F

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

AP2-2B

i. (a) No effect on the statement of income
(b) No effect on the statement of income

ii. (a) Revenue recorded $80,000 ($100,000 x 80%) and an increase to net income of $80,000
(b) Revenue recorded $100,000, Cost of Goods Sold recorded $60,000 and an increase to net income of $40,000

iii. (a) Revenue recorded $20,000 and an increase to net income of $20,000
(b) No effect on the statement of income

iv. (a) Expenses recorded $13,000 and a decrease to net income of $13,000
(b) Expenses recorded $12,000 and a decrease to net income of $12,000

v. (a) Expenses recorded $5,500 and a decrease to net income of $5,500
(b) Expenses recorded $5,000 and a decrease to net income of $5,000

vi. (a) Expenses recorded $37,500 and a decrease to net income of $37,500
(b) Expenses recorded $38,000 and a decrease to net income of $38,000

Summary of results on the next page

AP8-2B (Continued)

Summary of results:

	(a) Cash Basis				(b) Accrual Basis	
	Revenue		Expenses		Revenue	Expenses
i.				i.		
ii.	$80,000	*		ii.	$100,000	$60,000
iii.	20,000			iii.		
iv.			$ 13,000	iv.		12,000
v.			5,500	v.		5,000
vi.			37,500	vi.		38,000
	$100,000		$56,000		$100,000	$115,000
Net income			$44,000	Loss		($15,000)

*($100,000 x 80%) = $80,000

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

AP2-3B

a. Increase assets (equipment) and decrease assets (cash)
b. Increase assets (cash) and increase liabilities (bank loan payable)
c. Increase assets (inventory) and increase liabilities (accounts payable)
d. Increase assets (cash) and increase shareholders' equity (sales revenue increases, which increases retained earnings)
e. Decrease assets (cash) and decrease liabilities (accounts payable)
f. Increase liabilities (wages payable) and decrease shareholders' equity (wages expenses increases, which decreases retained earnings)
g. Decrease assets (cash) and decrease shareholders' equity (interest expense increases, which decreases retained earnings)
h. Decrease assets (cash) and decrease liabilities (bank loan payable)
i. Decrease assets (cash) and decrease liabilities (wages payable)
j. Increase assets (inventory) and increase liabilities (accounts payable)
k. Decrease assets (cash) and decrease in shareholders' equity (utilities expense increases, which decreases retained earnings)
l. Decrease assets (increases accumulated depreciation, which is a contra asset) and decrease shareholders' equity (increases depreciation expense, which decreases retained earnings)

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

AP2-4B

Account	**Increase/Decrease**
a. Cash (A)	Increase
Common Shares (SE)	Increase*
b. Land (A)	Increase
Cash (A)	Decrease
c. Inventory (A)	Increase
Accounts Payable (L)	Increase
d. Equipment (A)	Increase
Cash (A)	Decrease
e. Prepaid Insurance (A)	Increase
Cash (A)	Decrease
f. Advertising Expense (SE)	Increase**
Accounts Payable (L)	Increase
g. Accounts Receivable (A)	Increase
Sales Revenue (SE)	Increase*
Cost of Goods Sold (SE)	Increase**
Inventory (A)	Decrease
h. Accounts payable (L)	Decrease
Cash (A)	Decrease
i. Accounts Payable (L)	Decrease
Cash (A)	Decrease
j. Cash (A)	Increase
Accounts Receivable (A)	Decrease
k. Insurance Expense (SE)	Increase**
Prepaid Insurance (A)	Decrease
l. Depreciation Expense (SE)	Increase**
Accumulated Depreciation (CA)	Increase***

* Increase in Shareholders' Equity
** Decrease in Shareholders' Equity
*** Decrease in Assets

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

AP2-5B

	Assets					Liabilities		S/H Equity		
Date Sept	Cash	A/R	Inv.	Equip.	Delivery Van	A/P	Bank Loan Payable	Common Shares	R/E	R/E/ DD
1	20,000							20,000		
4	10,000						10,000			
7	(4,500)			4,500						
9			2,500			2,500				
15		4,000							4,000	R
19			2,100			2,100				
20	(2,700)					(2,700)				
21	(15,000)				15,000					
28			(1,800)						(1,800)	E
28	(700)								(700)	E
29						400			(400)	E
30	(150)								(150)	E
30	2,200	(2,200)								

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

AP2-6B

	Assets				Liabilities			S/H Equity		
Date Jan	Cash	A/R	Inv.	Prepaid Rent	A/P	Deferred Revenue	Loan Payable	Common Shares	R/E	R/ E/DD
1	150,000							150,000		
1	100,000						100,000			
2	(8,000)			5,000					(3,000)	E
8			26,200		26,200					
12	6,500					6,500				
16:1	9,100	9,100							18,200	R
16:2			(9,200)						(9,200)	E
19	(7,000)				(7,000)					
25	7,100	(7,100)								
31:1	(5,000)						(5,000)			
31:2	(750)*								(750)	E

*$100,000 x 9% x 1/12 = $750

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

AP2-7B

Transaction	Effect on Net Earnings (i)	Effect on cash flows (ii)
a.	No effect	Increase of $125,000
b.	No effect	Decrease of $40,000
c.	No effect	No effect
d.	Decrease of $1,200 (Advertising expense)	Decrease of $1,200
e.	Net increase of $26,300 (Sales of $38,200 less Cost of goods sold of $11,900)	No effect (sold on account, inventory already owned
f.	No effect	Decrease of $20,000
g.	Decrease of $5,000 (Wages expense)	Decrease of $5,000
h.	No effect	Increase of $26,400
i.	No effect	Decrease of $2,000
j.	Decrease of $900 (Interest expense)	Decrease of $2,900
k.	Decrease of $2,000 (Depreciation expense)	No effect
l.	Decrease of $300 (Interest expense)	No effect

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

AP2-8B

	Assets				Liabilities			S/H Equity		
Date/Ref.	Cash	A/R	Inv.	Equip.	A/P	Dividends Payable	Loan Payable	Common Shares	R/E	Rev/ Exp/DD
a	250,000							250,000		
b	100,000						100,000			
c	(178,000)			178,000						
d	(50,000)		75,000		25,000					
e:1	46,000	46,000							92,000	Rev
e:2			(49,000)						(49,000)	Exp
f	(20,000)				(20,000)					
g	(3,700)								(3,700)	Exp
h	(5,200)						(4,000)		(1,200)	Exp
i				(22,600)					(22,600)	Exp
j						8,000			(8,000)	DD

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

AP2-9B

	Assets					Liabilities		S/H Equity		
Date /Ref	Cash	A/R	Inv.	Prepaid Insurance	Equip.	A/P	Dividends Payable	Common Shares	R/E	Rev/ Exp/DD
a	(10,000)				10,000					
b			42,000			42,000				
c	24,000	36,000							60,000	Rev
d	34,000	(34,000)								
e	(36,000)					(36,000)				
f	(900)			900						
g			(39,000)						(39,000)	Exp
h	(7,000)								(7,000)	Exp
i				(675)*					(675)	Exp
j					(3,600)				(3,600)	Exp
k							1,600		(1,600)	DD
l	(1,200)						(1,200)			

* $900/12 = $75 per month; $75 x 9 months (i.e. Apr.-Dec.) = $675

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

AP2-10B

A Revenue – Net Earnings = Expenses $123,000 – $45,000 = $78,000

B Dividends declared = Retained earnings, beginning of the year + Net Earnings – Retained Earnings, end of year = $278,000 + $45,000 - $311,000 = $12,000

C Total assets, end of the year = Total Liabilities, end of the year + Total Common Shares, end of the year + Total Retained Earnings, end of the year = $408,000 + $150,000 + $311,000 = $869,000

D Proceeds from common shares issued during the year = Common shares, end of the year – Common shares, beginning of the year = $150,000 - $100,000 = $50,000

E Revenues = Net earnings + Expenses = $77,000 + $158,000 = $235,000

F Retained earnings, end of year = Retained earnings, beginning of the year + Net earnings – Dividends declared = $321,000 + $77,000 – $20,000 = $378,000

G Common shares, end of year = Assets, end of year – Liabilities, end of year – Retained earnings, end of year (solved in F) = $726,000 - $273,000 - $378,000 = $75,000

H Proceeds from common shares issued during the year = Common shares, end of the year (solved in G) – Common shares, beginning of the year = $75,000 - $50,000 = $25,000

LO 6 BT: AP Difficulty: C Time: 20 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-11B **a.** Total revenues: $510,000 + $1,800 + $2,600 = $514,400

b. Total expenses: $364,000 + $43,700 + $38,000 + $200 + $22,700 = $468,600

c. Net earnings: $514,400 - $468,600 = $45,800

d. Dividends declared: $145,000 + $45,800 - $185,500 = $5,300

Alternate:

Beg. R/E + net income – dividends declared = End R/E
$145,000 + $45,800 - ? (div. decl.) = $185,500
$190,800 - ? (div. decl.) = $185,500
? (div. decl.) = $190,800 - $185,500

Therefore, dividends declared = $5,300

LO 6 BT: AP Difficulty: M Time: 15 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-12B

a.

i. Sales revenue = $9,000 (#5)

ii. Cost of goods sold = $6,000 (#4)

iii. Total expenses other than cost of good sold = $100 (#6) + $200 (#7) + $1,900 (#8) = $2,200

iv. Net earnings = $9,000 - $6,000 - $2,200 = $800

b.

i. Cash on hand: $15,000 (#1) - $4,000 (#2) - $500 (#3) - $3,000 (#4) + $4,500 (#5) - $1,900 (#8) - $300 (#9) = $9,800

ii. Total assets other than cash: $12,000 (#1) + $4,000 (#2) + $500 (#3) + $6,000 (#4) - $6,000 (#5) + 4,500 (#5) - $100 (#6) - $200 (#7) = $20,700

Alternate:

Equipment = $12,000 + $4,000 - $200 = $15,800

Supplies = $500 - $100 (#6) = $400

Inventory = $6,000 - $6,000 = 0

Accounts receivable = $4,500 (#2)

Total assets other than cash = $15,800 + $300 + $4,500 = $20,700

iii. Total liabilities: $6,000 - $3,000 = $3,000

iv. Share capital: $15,000 + $12,000 = $27,000

v. Retained earnings: $0 + $800 - $300 = $500

LO 6 BT: AP Difficulty: C Time: 25 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-13B

a.

Insomniacs Coffee Ltd.
Statement of Income
For the year ended December 31, 2024

Sales revenue		$2,910,000
Less expenses:		
Cost of goods sold	$1,650,000	
Wages expense	510,000	
Rent expense	180,000	
Advertising expense	78,000	
Depreciation expense	82,000	
Interest expense	42,000	
Total expenses		2,542,000
Net Income		$ 368,000

b.

Retained Earnings at January 1, 2024	$410,000
Plus: Net Income	368,000
Less: dividends declared	180,000
Retained earnings at December 31, 2024	$598,000

AP2-13B (Continued)

c.

Insomniacs Coffee Ltd.
Statement of Financial Position
As at December 31, 2024

ASSETS		
Current assets		
Cash	$ 120,000	
Accounts receivable	185,000	
Inventory	305,000	
Prepaid Insurance	23,000	
		633,000
Non-current assets		
Equipment		1,240,000
Total Assets		$1,873,000
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$340,000	
Wages payable	45,000	
		385,000
Non current liabilities		
Loan Payable		790,000
Total liabilities		1,175,000
Shareholders' equity		
Common shares		$ 100,000
Retained earnings		598,000
Total Shareholders' Equity		698,000
Total Liabilities and Shareholders' Equity		$1,873,000

LO 6 BT: AP Difficulty: M Time: 45 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-14B
a.

	Assets					Liabilities				S/H Equity		
Date/ Ref.	Cash	A/R	Inv.	Buildings	Land	A/P	Wages Payable	Dividend Payable	Loan Payable	Common Shares	R/E	Rev/ Exp/ DD
Jan. 1	700,000									700,000		
Jan. 1	250,000								250,000			
Jan. 3	(700,000)			300,000	400,000							
4	(90,000)		190,000			100,000						
5	155,000	155,000									310,000	Rev
6			(128,000)								(128,000)	Exp
7	132,000	(132,000)										
8	(95,000)					(95,000)						
9	(91,800)						4,200				(96,000)	Exp
10	(15,000)*										(15,000)	Exp
11				(35,000)**							(35,000)	Exp
12	(7,500)							7,500			(15,000)	DD
Total	237,700	23,000	62,000	265,000	400,000	5,000	4,200	7,500	250,000	700,000	21,000	

***$250,000 x 6% = $15,000**
**** ($300,000 - $ 20,000) ÷ 8 = $35,000**

AP2-14B (Continued)

a.

Moksh Ltd.
Statement of Income
For the Year Ending December 31, 2024

Revenues		
Sales revenue		$310,000
Expenses		
Cost of goods sold	$128,000	
Wages expense	96,000	
Interest expense	15,000	
Depreciation expense	35,000	274,000
Net income		$ 36,000

Moksh Ltd.
Statement of Changes in Equity
For the year ended December 31, 2024

	Number of Common Shares	Share Capital - Common Shares	Retained Earnings	Total
Balance, Beginning of Year			$0	$0
Net Income			36,000	36,000
Declaration of Dividends			(15,000)	(15,000)
Issuance of Common Shares	10,000	$700,000		700,000
Balance, End of Year	10,000	$700,000	$21,000	$721,000

AP2-14B (Continued)

Moksh Ltd.
Statement of Financial Position
As at December 31, 2024

ASSETS	
Cash	$237,700
Accounts Receivable	23,000
Inventory	62,000
Land	400,000
Building	265,000
TOTAL ASSETS	$987,700
LIABILITIES	
Accounts Payable	$ 5,000
Wages Payable	4,200
Dividends Payable	7,500
Bank Loan Payable	250,000
TOTAL LIABILITIES	266,700
SHAREHOLDERS' EQUITY	
Common Shares	700,000
Retained Earnings	21,000
TOTAL SHAREHOLDERS' EQUITY	$721,000
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$987,700

AP2-14B (Continued)

Moksh Ltd
Statement of Cash Flows
For the Year Ending December 31, 2024

Cash Flow from Operating Activities:	
Cash collections from customers	$287,000
Cash payments to suppliers	(185,000)
Cash payments for wages	(91,800)
Cash payments for interest	(15,000)
Cash flows from operating activities	(4,800)
Cash Flow from Investing Activities:	
Purchase of land and building	(700,000)
Cash used in investing activities	(700,000)
Cash Flow from Financing Activities:	
Cash proceeds from issuance of shares	700,000
Cash proceeds from bank loan	250,000
Cash paid for dividends	(7,500)
Cash from financing activities	942,500
Increase in cash	237,700
Cash, beginning of year	0
Cash, end of year	$237,700

LO 5,6 BT: AP Difficulty: M Time: 60 min. AACSB: None CPA: cpa-t001 CM: Reporting

AP2-15B

a.

	Assets						Liabilities					S/H Equity		
Date/ Ref.	Cash	A/R	Inventory	Land	Building	Equip-ment	A/P	Deferred Revenue	Interest Payable	Dividends Payable	Notes Payable	Common Shares	R/E	R/E/DD
Jan.1[1]	300,000											300,000		
Jan.1[2]	(80,000)			57,500	172,500							150,000		
Item 3[3]	30,000							7,500					22,500	R
July 1	(60,000)					120,000					60,000			
Item 5			250,000				250,000							
Item 6	50,000	250,000											300,000	R
Item 7			(190,000)										(190,000)	E
Item 8	(205,000)						(205,000)							
Item 9	200,000	(200,000)												
Item 10	(50,000)												(50,000)	E
Item 11[4]					(7,125)								(7,125)	E
Item 12[5]						(5,750)							(5,750)	E
Item 13	(15,000)									5,000			(20,000)	DD
Item 14[6]									3,000				(3,000)	E
Totals	170,000	50,000	60,000	57,500	165,375	114,250	45,000	7,500	3,000	5,000	60,000	450,000	46,625	

[1] (12,000 x $25) = $300,000

[2] (6,000 x $25) = $150,000 + $80,000 = $230,000 x ¼ for land = $57,500

[3] (4 X $7,500) = $30,000

[4] ($172,500 – $30,000) ÷ 20 = $7,125

[5] ($120,000 – $5,000) ÷ 10 x 6/12 = $5,750

[6] $60,000 x 10% x 6/12 = $3,000

AP2-15B (Continued)

b.

A.J. Smith Company
Statement of Income
For the year ended December 31, 2024

Sales revenue		$300,000
Rent revenue		22,500
Total revenues		$322,500
Expenses		
Cost of goods sold	$190,000	
Depreciation expense	12,875	
Interest expense	3,000	
Operating expenses	50,000	255,875
Net income		$ 66,625

A. J. Smith Company
Statement of Changes in Equity
For the year ended December 31, 2024

	Number of Common Shares	Share Capital - Common Shares	Retained Earnings	Total
Balance, Beginning of Year			$0	$0
Net Income			66,625	66,625
Declaration of Dividends			(20,000)	(20,000)
Issuance of Common Shares	12,000	$300,000		300,000
Issuance of Common Shares	6,000	150,000		150,000
Balance, End of Year	18,000	$450,000	$46,625	$496,625

AP2-15B (Continued)

A.J. Smith Company
Statement of Financial Position
As at December 31, 2024

Assets	
Cash	$170,000
Accounts receivable	50,000
Inventory	60,000
Land	57,500
Buildings	165,375
Equipment	114,250
Total assets	$617,125
Liabilities	
Accounts payable	$ 45,000
Notes payable	60,000
Interest payable	3,000
Deferred revenue	7,500
Dividends payable	5,000
Total liabilities	120,500
Shareholders' Equity	
Common shares	$450,000
Retained earnings	46,625
Total retained earnings	496,625
Total liabilities and shareholders' equity	$617,125

AP2-15B (Continued)

A.J. Smith Company
Statement of Cash Flows
For the year ended December 31, 2024

Cash flows from operating activities	
Cash receipts from customers	$250,000
Cash receipts from rent revenue	30,000
Cash paid for inventory	(205,000)
Cash paid for operating expenses	(50,000)
Cash from operating activities	$25,000
Cash flows from investing activities	
Purchase of property, plant & equipment	(140,000)
Cash flows from financing activities	
Issuance of common shares	300,000
Payment of dividends	(15,000)
Cash from financing activities	285,000
Increase in cash	$170,000
Beginning cash balance	0
Ending cash balance	$170,000

c. Students should utilize the three performance measures introduced in the chapter:

Profit margin ratio (using total revenues): $66,625/$322,500 = 20.7%
Return on Assets: $66,625/$617,125 = 10.8%
Return on Equity: $66,625/$496,625 = 13.4%
Ideally, they should consider these numbers with respect to industry averages; however, these are not provided.
Students should also identify from the cash flow statement that positive cash flows were generated from operating activities, which is a good sign – especially in the company's first year of operations.

LO 5,6,7 BT: AP Difficulty: M Time: 60 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

USER PERSPECTIVE SOLUTIONS

UP 2-1 Most public companies operate internationally and a significant number of them are also cross-listed, meaning that they are listed on stock exchanges both inside and outside of Canada. IFRS, a common set of financial reporting standards, was developed to minimize the differences in financial reporting across countries and to reduce the need for companies to generate different sets of financial information in each country in which they operate or raise funds. ASPE, on the other hand, represents a set of simplified standards that Canadian standards setters have established to reduce the financial reporting burden for private companies.

The objective of both IFRS and ASPE is to produce financial reporting that is useful to the financial statement users. Both IFRS and ASPE focus on the needs of shareholders (current and potential) and creditors in determining the financial information that would be useful. Specifically, the standards' aim is to provide financial information that assists these two user groups in making decisions about providing resources to the reporting company, such as whether they should buy or sell the reporting company's shares, and whether they should extend credit to the reporting company. The needs of these two user groups often correspond with the needs of other users, such as employees, unions, and governments, but they may not completely overlap.

LO1 BT: C Difficulty: M Time: 20 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

UP2-2 Companies who are dual-listed on the TSX and NYSE have a choice to use IFRS or U.S. GAAP. It is likely that the company using IFRS is a Canadian-based company which is filing on both exchanges and doesn't want to prepare two different sets of financial statements. They may want to be able to compare their results with other companies using IFRS to prepare their financial statements. Conversely, it is likely that the company using U.S. GAAP is a company dealing mainly in Canada and in the U.S. with predominantly U.S. competitors against which it wants to benchmark against.

LO1 BT: C Difficulty: C Time: 10 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

UP2-3 Following are some suitable answers. There may be other valid responses.

I would like to know how the additional funds will be used by the borrower. If the business demonstrates that it will be able to increase profitability and cash flows from operations from the use of the additional funds, the request will be viewed in a positive light. I would want to know how much profit the company has made to date. I would look at retained earnings for this information. I would want to know if past sales levels and profits are sustainable in the future.

I would also look at the company's current and non-current liabilities to find out what other obligations the company currently has that require repayment. I would want to know whether the company was paying its current loan payments on schedule.

I would look at the mix between liabilities and equity to determine how the company has funded its operations so far. I would want to know how much was funded through debt and how much was funded through investments from shareholders.

I would want to know what capital assets the company owns, and the age and condition of those assets to determine whether they will need replacing in the near future. If they do, that could possibly compromise the company's ability to use them to generate revenue. I could determine the age of the assets by looking at their original cost vs. the amount of cost that has been depreciated to date.

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

UP2-4

a. From the perspective of a shareholder of the company, treating the cost of a piece of equipment as an expense at the date of purchase will misstate net income in the current period as well as in future periods. The current period's income would be understated because the full cost of the equipment would be deducted in the current period rather than being depreciated and allocated to each of the future periods in which it is expected to help generate revenue (i.e. the estimated useful life of the asset). Future periods' income will be overstated since there will be revenue shown in those periods, but no expense related to the cost of the equipment being used to generate the revenue. In addition, there would be no equipment on the statement of financial position.

b. From the perspective of a buyer, the concern would be the equipment would not be listed on the statement of financial position of the company (since it would already have been expensed). In attempting to value the assets of the company, the buyer would have to recognize that there are some assets that do not appear on the statement of financial position, but should be considered in valuing the company. In addition, the balance of retained earnings would be lower because the full cost of the equipment had been charged to an expense at its purchase.

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

UP2-5 When the cash is received in August, the university would record a liability, deferred revenue. As each month passes, a portion of the deferred revenue would be recognized as revenue, thus decreasing the liability and increasing retained earnings. The university would recognize the revenue evenly over the months of September through December, as the tuition would cover the December exam period.

LO 3 BT: C Difficulty: M Time: 5 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP2-6 The statement of income and the statement of financial position are both prepared using accrual accounting. These financial statements may show strong earnings, yet the company may have problems making loan payments if most of its sales were on credit, and if it then has problems collecting from its customers.

By comparing the current and previous statement of financial position, a user can see the change in cash from the beginning of the year to the end of the year. There may be a very small change; however there may be thousands of cash transactions during the year. The statement of cash flows categorizes all cash transactions into operating, investing, and financing activities. This allows the user to determine where cash is coming from and where it is going. It is particularly important to know whether the company can pay for its current obligations to vendors and employees through cash generated from operations. If the company has to sell its property, plant and equipment in order to pay for its operating expenses, then the company may be in serious jeopardy of not being able to continue.

LO 3 BT: C Difficulty: M Time: 15 min. AACSB: : Communication CPA: cpa-t001 CM: Reporting

UP2-7 Many businesses are required to sell on account, in order to remain competitive. If revenue were calculated from the cash flow inflows from sales revenue, a great deal of revenue still receivable would not be included, understating net income. Similarly, businesses deal with suppliers on account. If expenses were calculated based on the cash outflows related to expenses, several expenses would be omitted as they were incurred on account or require payment later than the date they are incurred. This would cause net income to be overstated. Overall, the cash basis is not a true reflection of the activities of the business for a given period of time. The best way to calculate net income is to use the accrual basis of accounting.

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

UP2-8 I would tell my friend NOT to invest in this company because it is not generating enough cash from operations (i.e. it has negative cash flows from operating activities) to cover its operating expenses. It appears that the company is selling its property, plant and equipment (i.e. it has positive cash flows from investing activities). The normal balance for investing should be negative, indicating that the company is using cash to acquire property, plant and equipment to grow its business and increase its operating profits. A company that sells its property, plant and equipment may soon have to go out of business as it has no means to generate income. Similarly, an increase in cash from financing activities indicates that the company is borrowing money or is obtaining financing from shareholders through the issuance of shares to generate enough cash to continue operations.

LO 6 BT: C Difficulty: M Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

UP2-9 This company is not generating enough cash from operations (i.e. it has negative cash flows from operating activities) to cover its operating expenses. It appears that the company is purchasing property, plant and equipment (i.e. it has negative cash flow from investing activities) which is a good thing as it indicates that the company is using cash to acquire property, plant and equipment to grow its business and increase its operating profits in the future. The purchases of this property required financing, which is confirmed by the increase in cash from financing activities. It appears that the company is either a new company in a growth phase and able to attract capital (in which case it may be a good time to accept the job), or it is an older company with declining operations that is still able to secure new financing (in which case you may want to consider the company's ability to turn its operations around and its ability to continue to secure additional financing before deciding whether to accept the job).

LO 6 BT: C Difficulty: C Time: 10 min. AACSB: None CPA: cpa-t001 CM: Reporting

Work in Progress

WIP2-1 “If the company followed the cash basis of accounting, it would recognize $500 after the initial meeting as the company has received the cash. The remaining $700 would be recognized when the cash is received from the client.”

“If the company followed the accrual basis of accounting, it would recognize $1,200 as revenue when the client is billed. At this point, the revenue has been earned.” The deposit of $500 would be recorded as deferred revenue until the will is satisfactory for the client.

LO 3 BT: C Difficulty: M Time: 15 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

WIP2-2 Shareholders’ equity is the residual amount that remains when total liabilities are subtracted from total assets. It represents a company’s net assets. It is the shareholder’s claim on the company. Shareholders’ equity is not money since money (cash) as it includes all of the various assets of a company (cash, accounts receivable, inventory, equipment etc.) If a company’s assets are liquidated, the cash received would likely be different than the amount that the assets are carried at on the statement of financial position.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

WIP2-3 The statement: “Companies that have a large amount of retained earnings have been profitable” is correct. The statement “They should distribute the retained earnings as dividends, or pay off any debt, or invest the amount to generate some extra income for the company” is incorrect. Retained earnings are not cash so it can’t be used to pay off debt and dividends can only be declared and paid if there is cash available. Retained earnings are earnings that have been retained in the company so they do represent a reinvestment of earnings into the company but again they do not represent cash, which is an asset.

LO 4 BT: C Difficulty: M Time: 10 min. AACSB: Communication CPA: cpa-t001 CM: Reporting

WIP2-4 Companies can generate cash to pay for purchases of land, building, equipment and inventory in two ways: borrow money or issue shares. So if the company has a low debt balance, it likely has issued shares for cash to finance its significant purchases or it used cash earnings from prior periods to fund the purchase.

LO 7 BT: AN Difficulty: M Time: 10 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

READING AND INTERPRETING PUBLISHED FINANCIAL STATEMENTS SOLUTIONS

RI2-1: Nutrien Ltd.

All dollar amounts are expressed in millions of US dollars.

a. Growth from fiscal year 2019 to 2020.

i.	Sales	+4.1%	($20,908 – $20,084) / $20,084
ii	Cost of goods sold	+7.2%	($14,814 – $13,814) / $13,814
iii.	Net earnings	-53.7%	($459 – $992) / $992
iv.	Total assets	+0.8%	($47,192 – $46,799) / $46,799
v.	Total share-holders' equity	-2.2%	($22,365 – $22,869) / $22,869

We would not generally expect all of these accounts to grow at the same rate for a variety of reasons. For example:

- Sales can increase from an aggressive pricing policy or as a result of increased spending on marketing and advertising, which would normally each lead to a higher profit as a percentage of sales.
- Cost of goods sold increased at a higher rate than sales, indicating that some cost savings or efficiencies were not achieved. Overall net earnings decreased by 53.7% because of increased cost of goods sold and expenses from operations.
- The increase in sales outpaced the increase in total assets.
- Equity balances are affected by the issuance or repurchase of shares, by the rate of profitability, and by the dividend policy, among other things. Nutrien bought back shares in 2020, decreasing the company's share capital by US$98 million ($15,771 – $15,673). Dividends declared were greater in amount than net earnings resulting in a decrease in retained earnings by US$495 million ($7,101 - $6,606), a 7.5% decrease.

RI2-1(Continued)

Nutrien is in a phase of modest growth. Additional information, especially in the Management Discussion and Analysis section of the annual report, should help to clarify the meaning of these changes and the prospects for further growth.

b.

	2020		2019	
Total liabilities	$24,827	52.6%	$23,930	51.1%
Total shareholders' equity	22,365	47.4%	22,869	48.9%
Total Assets	$47,192	100%	$46,799	100%

The equity investors financed less of the company in 2020 than they did in 2019. In 2019, equity investors had financed 48.9% of the company's assets. In 2020, this ratio decreased to 47.4%.

c. (Note: ratios are computed using ending equity and assets, and interest expense is not added back to income for the ROA calculation, as that concept has not been introduced in the text).

	2020	2019
Profit margin	$459/$20,908 = 2.2%	$992/$20,084 = 4.9%
ROA	$459/$47,192 = 1.0%	$992/$46,799 = 2.1%
ROE	$459/$22,365 = 2.1%	$992/$22,869 = 4.3%

These ratios each indicate a negative change in performance, with all ratios deteriorating significantly. The issue revolves around a substantial increase in cost of goods sold (7.2%) compared to a modest increase in sales (4.1%).

Comments could include:

- Pricing pressures could have been the cause of the decline in gross profit.
- Beyond the decline in gross profit there were substantial increases in operating expenses from 2019 to 2020.

RI2-1(Continued)

- Return on assets and return on equity align with the previous two indicators, reducing more than half from 2019 to 2020.
- The results from part (a) do help interpret the ratios in part (c) because where we see a decline in net earnings year over year we would expect to see a corresponding decreased ROA and ROE.

LO 7 BT: AN Difficulty: M Time: 50 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

RI2-2: High Liner Foods

All dollar amounts are expressed in thousands of US dollars.

a. The $112,739 in common shares represent the net proceeds received from shareholders at the time the shares were issued.

b. The $183,649 in retained earnings represents the cumulative lifetime income that the company has earned, less all dividends paid out during that period. In other words, it represents the company's cumulative earnings that have been retained and reinvested in the company, rather than being distributed to shareholders as dividends.

c. 2020: $485,556 / $776,558 = 62.5%
2019: $552,324 / $820,494 = 67.3%

There is a decrease in the percentage of High Liner's assets that were financed by creditors.

d. Total assets decreased slightly $776,558 in 2020 from $820,494 in 2019. This decrease of $43,936 (5.4%) comes largely from inventory and accounts receivable.

e. If High Liner were to pay the income taxes payable, both assets and liabilities would decrease by the same amount and shareholders' equity would not change. The expense related to these income taxes has already been recognized (i.e. it was recorded at the same time as the payable). The basic accounting equation would remain in balance.

RI2-2 (Continued)

f. Gross Profit Percent

2020 $177,924 / $827,453 = 21.5%
2019 $185,860 / $942,224 = 19.7%

High Liner's gross profit was higher in 2020 relative to 2019. Sales have decreased, however, cost of sales has decreased by a greater percentage. The company is making slightly more gross profit on each dollar of sales revenue.

g. Geographic information for sales:

Location	Sales 2020	Sales 2019	Decrease	As a %
Outside of Canada	$626.2	$712.4	$ 86.2	12.1%
Canada	201.3	229.8	28.5	12.4%
Total	$827.5	$942.2	$114.7	12.2%

As a percentage, High Liner's outside of Canada operations suffered a slightly reduced decline in sales compared to the operations in Canada. In dollars, the outside of Canada segment is more than three times the size of the Canadian segment.

LO 4,7 BT: AN Difficulty: M Time: 45 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

RI2-3: Maple Leaf Foods Inc.

All dollars amounts are expressed in thousands of Canadian dollars.

a. At December 31, 2020, Maple Leaf Foods Inc. had $100,828 cash and cash equivalents available to use.

b. 2020: $1,932,466 / $3,860,205 = 50.1%
2019: $1,949,870 / $3,514,035 = 55.5%

The percentage of Maple Leaf Food's assets financed by shareholders decreased by 5.4% in 2020. This trend means that the company's creditors financed a greater proportion of the company's assets than in the previous year.

c. Accounts receivable increased by ($159,750 - $154,969) $4,781 (3.1%). Sales increased by ($4,303,722 - $3,941,545) $362,177 or (9.2%). This may mean that credit sales have increased slower than sales, that customers are taking less time to pay, or that credit terms have changed.

d. Gross profit: 2020: $703,053 / $4,303,722 = 16.3%
2019: $590,979 / $3,941,545 = 15.0%

The gross profit has improved substantially in 2020. Increases in gross profit can be generated through increases is sales prices or through efficiency in the production of the meat products sold.

e. The financing section of the statement of cash flows shows $78,932 of dividends paid in 2020.

f. The company acquired $432,540 of long-term assets. The proceeds from the sale of long-term assets were in the amount of $37,373. The proceeds represent 8.6% of the amount of the purchases.

RI2-3 (Continued)

g.

i. Profit margin: 2020 $113,277 / $4,303,722 = 2.6%
2019 $74,628 / $3,941,545 = 1.9%

ii. ROA 2020 $113,277 / $3,860,205 = 2.9%
2019 $74,628 / $3,514,035 = 2.1%

iii. ROE 2020 $113,277 / $1,932,464 = 5.9%
2019 $74,628 / $1,949,870 = 3.8%

h. These ratios indicate major increases in the margins and returns realized, which is consistent with the increase in sales of 9.2% ($4,303,722 – $3,941,545) / $3,941,545 and the increase in gross profit discussed in d. above.

LO 7 BT: AN Difficulty: M Time: 45 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

RI2-4: Sleep Country Canada Holdings Inc.

All dollars amounts are express in thousands of Canadian dollars).

a. The amount of dividends *declared* during fiscal 2020, as shown in the statement of changes in shareholders' equity, was $13,627.

b. The declaration of dividends affects the accounting equation by reducing shareholders equity and increasing liabilities (i.e. dividends payable) by the amount of the dividends declared.

c. The amount of dividends actually *paid* during fiscal 2020 was $13,627, as shown on the statement of cash flows.

d. The payment of dividends affects the accounting equation by reducing cash by the amount paid and reducing the dividends payable liability by the same amount.

e. Gross profit margin on sales:

	2020	2019
Revenues	$757,699	$712,372
Cost of Sales	513,203	489,082
Gross Profit	$244,496	$223,290
	32.3%	31.3%

The gross profit margin increased by 1.0%, meaning that the company's gross margin on sales improved from 2019 to 2020. Based on these calculations, we see that the company's product costs represented about $0.68 for every $1 sales.

f. Sleep Country's cash flow pattern in 2020 was +/-/-, which fits the "normal" pattern discussed in the chapter for a company that pays dividends and is investing in property, plant and equipment.

LO 4,7 BT: AN Difficulty: M Time: 30 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

RI2-5

Answers to this question will depend on the company selected.

LO 7 BT: AN Difficulty: M Time: 50 min. AACSB: Analytic CPA: cpa-t001 CM: Reporting and Finance

CASE SOLUTIONS

C2-1a.

	Cash	A/R	Car	A/P	Interest Payable	Loan - Parents	Loan - Car	Common Shares	R/E	
1	1,800							1,800		
2	3,000					3,000				
3	(3,000)		8,000				5,000			
4	(623)						(500)		(123)	E - Int
5					60				(60)	E - Int
6	(6,000)								(6,000)	E - Wages
7	(9,600)			100					(9,700)	E - Op
8	19,200	300							19,500	R
9			(2,000)						(2,000)	E - Dep
Total	4,777	300	6,000	100	60	3,000	4,500	1,800	1,617	
					11,077				11,077	

Depreciation calculation: ($8,000 - $6,000)
Interest expense on loan from parents: $3,000 x 6% x 4 / 12 = $60

C2-1 (Continued)

Wroad Wrunner Ltd.
Statement of Income
For the four months ending August 31, 2XXX

Revenue		$ 19,500
Expenses:		
Interest expense – Loan from parents	$ 60	
Interest expense – Car loan	123	
Wages expense	6,000	
Operating expenses	9,700	
Depreciation expense	2,000	
		17,883
Net income		$ 1,617

Wroad Wrunner Ltd.
Statement of Financial Position
As at August 31, 2XXX

Assets:		
Cash	$ 4,777	
Accounts Receivable	300	
Car	6,000	
Total Assets		$11,077
Liabilities:		
Accounts Payable	$ 100	
Interest Payable	60	
Notes Payable	3,000	
Loan Payable – Car	4,500	
Total Liabilities		$ 7,660
Shareholder's Equity:		
Common Shares	1,800	
Retained Earnings	1,617	
Total Shareholder’s Equity		3,417
Total Liabilities and Shareholder’s Equity		$11,077

C2-1 (Continued)

b. Profit Margin = Net earnings / Total revenues
Profit margin = $1,617 / $19,500 = 8.3%

Wroad Wrunner Ltd. made $1,617 before income taxes in the first four months of operation, which is quite impressive – especially in light of the small amount she invested in the business. This profit is after Nola paying $6,000 in wages to herself.

c. Nola presently owes $7,660 as of August 31. If she sells the car for $6,000, collects the outstanding receivables and uses the existing cash of $4,777, Nola would have more than enough money to pay off all her liabilities. In fact, she would have $1,617 (the shareholder's equity) left over.

LO5,6,7 BT: AN Difficulty: M Time: 50 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

C2-2 Daisy-Fresh Dry Cleaning

1. The payment of the insurance policy should have been recorded as a prepaid expense when it was purchased. A prepaid expense is a current asset because there is a future benefit associated with the policy. As the year progresses, the benefits of the policy are used up because the company has been provided with insurance coverage for that time period. As the benefits of the policy expire, the related costs should be expensed. At the end of the first year, one-third of the three-year policy would have expired; therefore, one-third of the policy costs should be expensed. The remaining two-thirds should remain as a prepaid expense on the asset side of the statement of financial position.

2. The full amount of the cost of the new dry-cleaning machine ($10,000) should have been recorded as an asset when it was purchased. As time passes and the machine is used, it should be depreciated as an expense on the statement of income which would reduce the carrying value of the machine on the statement of financial position. The machine's depreciation expense should be reported in the same period in which it is used to help generate revenue. Using straight-line depreciation would result in an expense of $800 for the current year ([$10,000 - $2,000] / 5 * 6/12 = $800)

3. The company should report all future claims on its assets even when those claims don't become due for four years. The loan should be recorded as a long-term liability until the end of the third year, at which point it becomes a current liability, payable within the normal operating year of the company. Recording the loan on the books now provides a complete listing of total liabilities owed by the organization.

4. The interest on the loan to the bank should be recorded in the period in which it is incurred. Even though the owner did not yet pay any of the interest, there is an obligation to pay the interest in the near future, thus there is a claim on the assets of the company that should be recorded in the financial statements. The company should report an interest expense on the statement of income and an interest payable on the statement of financial position, as a current liability.

C2-2 (Continued)

5. Dividends represent a distribution of profits to the shareholders. Dividends are not recorded as an expense but rather directly reduce the retained earnings of the business. Because dividends are a distribution of profit and not an expense, their payment should not be reported on the statement of income. The payment of dividends appears on the statement of retained earnings (ASPE) or the statement of changes in equity (IFRS), and as a financing activity on the statement of cash flows.

LO 5,6 BT: C Difficulty: M Time: 25 min. AACSB: : Communication CPA: cpa-t001 CM: Reporting

C2-3 Mega Manufacturing

Mega Manufacturing appears to be improving its financial position to be more In line with the performance of other companies in the same industry.

Profit margin has decreased in the past year, which indicates that the level of profit generated by each dollar of sales revenue declined. The company remains well above the industry average.

Currently the company is able to generate a return of 10% on its assets. This means that for every $100 invested in assets the company is able to generate profits of $10. The company appears to be performing slightly below the average for companies in the industry, but has improved these results in the last year.

Finally, the return on equity ratio compares the profits earned in the business to the amount invested by shareholders. Shareholders will use this ratio to evaluate the ability of the business to provide them with an acceptable return on their investment. Investors will often compare the return on equity for businesses of similar risk to make decisions about buying new shares or selling their existing shares. With a return on shareholders' equity of 12%, Mega Manufacturing is providing investors with a return that is below the industry average. The 2% increase over the past year should make this company an attractive investment, especially if it continues to increase and it becomes closer to the industry average.

LO7 BT: AN Difficulty: C Time: 25 min. AACSB: Analytic CPA: cpa-t001, cpa-t005
CM: Reporting and Finance

C2-4 Canadian Cookies and Cakes Ltd.

	Assets			Liabilities			S/H Equity		
Date/ Ref.	Cash	Supplies	Equipment	A/P	Interest Payable	Bank Loan	Common Shares	R/E	R/E/ DD
1:1	30,000					30,000			
1:2	(10,000)					(10,000)			
1:3	30,000						30,000		
2:1		42,000		42,000					
2:2		(33,600)						(33,600)	E
2:3	(37,000)			(37,000)					
3:1	(12,000)							(12,000)	E
3:2	(46,000)		46,000						
4	(27,000)			3,000				(30,000)	E
5					1,600			(1,600)	E
6	(13,500)			1,500				(15,000)	E
7	98,000							98,000	R
Totals	12,500	8,400	46,000	9,500	1,600	20,000	30,000	5,800	
			66,900					66,900	

C2-4 (Continued)

a. Calculation of cash on hand at end of year:

See template, or…

Cash received:		
Bank loan	$ 30,000	
Shareholders' investment	30,000	
Sale of products	98,000	$158,000
Cash paid out:		
Purchase of baking supplies ($42,000 – $5,000)	$ 37,000	
Rent payments on ovens	12,000	
Payment on bank loan	10,000	
Payment of wages ($30,000 – $3,000)	27,000	
Payment of other expenses	13,500	
Purchase of ovens	46,000	(145,500)
		$ 12,500

Calculation of net income for the year:

See template, or…

Sales revenue		$98,000
Cost of goods sold ($42,000 x 80%)	$33,600	
Wages expense	30,000	
Rent expense	12,000	
Interest expense	1,600	
Other expenses	15,000	(92,200)
Net income		$ 5,800

C2-4 (Continued)

b. See template for calculations

Canadian Cookie and Cakes Ltd.
Statement of Financial Position
December 31, 20xx

Cash	$12,500	Accounts payable	$ 9,500
Baking supplies	8,400	Interest payable	1,600
Baking ovens	46,000	Bank loan payable	20,000
		Total liabilities	$31,100
		Common shares	$30,000
		Retained earnings	5,800
		Shareholders' equity	35,800
Total assets	$66,900	Total liabilities and shareholders' equity	$66,900

c. The shareholder's proportionate claim on the reported net assets (assets less liabilities) is $11,933 ($35,800 x 33.33%). In light of the profitable operations during the first year of operations, the company should be worth more than its book value and the shareholder should be able to sell her shares for more than this. On the other hand, if she is desperate to sell she may be willing to take less than the book value of her share of the company and accept something less than $11,933.

It is worth noting that the income tax expense was not taken into consideration in the calculation of the results and revisions would be required once the calculation of amounts owing are made.

LO 5,6 BT: C Difficulty: M Time: 45 min. AACSB: : None CPA: cpa-t001 CM: Reporting

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