**CHAPTER 1**

THE PURPOSE AND USE OF FINANCIAL STATEMENTS

**1 MINUTE QUESTION**

The purpose of these short 1 minute questions is to encourage students to come to class prepared for the lesson, having read the chapter. One of these questions may be given at the beginning of the class and count for ½ to 1 mark.

Name two of the external users of accounting information.

Answer: External users: Investors, lenders, other creditors, regulators, customers, labour unions, potential employees, current employees not involved in managing a company, and the like.

**VOCABULARY QUIZ**

1. The amount by which expenses exceed revenues.

2. An association of two or more persons to carry on as co-owners of a business for profit.

3. A financial statement that reports the assets, liabilities, and shareholders’ equity at a specific date.

4. A business owned by one person.

5. Users of financial information that use the information to determine whether or not to lend money.

6. Assets = Liabilities + Shareholders’ equity.

7. Debts and obligations of a business.

8. A report prepared by management that presents financial and non-financial information about the company.

9. The amount of accumulated net income that has been retained in the corporation.

10. The cost of assets consumed or services used in ongoing operations to generate revenues.

**ANSWERS TO VOCABULARY QUIZ**

1. Loss (or net loss)

2. Partnership

3. Statement of financial position

4. Proprietorship

5. Lenders and other creditors

6. The accounting equation

7. Liabilities

8. Annual report

9. Retained earnings

10. Expenses

**MULTIPLE CHOICE QUIZ**

1. All of the following are characteristics of a sole proprietorship, *except*

a. a business owned by one person.

b. owner has control of the business.

c. a separate legal entity.

d. owner has unlimited legal liability.

e. none of the above

2. All of the following are characteristics of a corporation, *except*

a. a separate legal entity.

b. ownership evidenced by shares.

c. produce far more revenue than sole proprietorships and partnerships in Canada.

d. shareholders have unlimited liability.

e. none of the above

3. Corporations may issue several classes of shares, but the shares representing the primary ownership interest are

a. common shares.

b. retained earnings.

c. financing activity.

d. dividends declared.

4. Resources owned by a business and used in carrying out its operating activities are

a. liabilities.

b. shareholders’ equity.

c. revenues.

d. assets.

5. Acquiring property, plant, and equipment necessary to operate the business is called a(n)

a. financing activity.

b. operating activity.

c. revenue activity.

d. investing activity.

6. The term used to describe the amount that a company earns in exchange for its products is

a. cash.

b. revenue.

c. inventory.

1. accounts receivable.

7. The financial statement which presents a picture of what a business owns and owes at a point in time is a(n)

a. income statement.

b. statement of changes in equity.

c. statement of financial position.

d. statement of cash flows.

8. Net income shown on the income statement is added to the beginning balance of retained earnings in the

1. income statement.
2. statement of changes in equity.
3. statement of financial position.

d. statement of cash flows.

9. To report the success or failure of the company’s operations during the period is the purpose of the

a. income statement.

b. statement of changes in equity.

c. statement of financial position.

d. statement of cash flows.

10. Borrowing money is considered what type of business activity?

a. operating activity

b. financing activity

c. borrowing activity

d. investing activity

11. Paying dividends declared is considered what type of business activity?

a. operating activity

b. financing activity

c. payment activity

d. investing activity

12. Purchasing a building is considered what type of business activity?

a. operating activity

b. financing activity

c. buying activity

d. investing activity

13. A publicly traded corporation needs to follow which type of accounting standards?

a. International financial reporting standards

b. Accounting standards for private enterprises

c. Not-for-profit accounting standards

d. Public company standards

14. Which of the following variations of the accounting equation is *incorrect?*

a. Assets = Liabilities - Shareholders’ Equity

b. Assets - Liabilities = Shareholders’ Equity

c. Assets - Shareholders’ Equity = Liabilities

d. Assets - Shareholders’ Equity - Liabilities = 0

e. none of the above

15. The statement of financial position is also commonly called the

a. Income statement.

b. Statement of changes in financial position.

c. Balance sheet.

d. Statement of changes in equity.

**ANSWERS TO MULTIPLE CHOICE QUIZ**

1. c

2. d

3. a

4. d

5. d

6. b

7. c

8. b

9. a

10. b

11. b

12. d

13. a

14. a

15. c

20-MINUTE QUIZ #1

Circle the correct answer.

**True/False**

1. Accounting is an information system that identifies, True False

records, and communicates economic events of an

organization to interested users.

2. Internal users include investors, lenders, and creditors. True False

3. Issuing shares is considered an investing activity. True False

4. Private companies have a choice of whether to True False

follow ASPE or IFRS.

5. The statement of financial position covers a True False

period of time.

6. The reporting entity concept requires that True False

the activities of the entity be kept separate

and distinct from the activities of its owner

and all other economic entities.

7. The income statement can be prepared True False

monthly, quarterly, or annually.

8. The statement of financial position is also True False

known as the balance sheet.

9. Liabilities represent the ownership claim on True False

total assets.

10. A sale of a delivery truck previously used in True False

the company’s operations is an example of

an operating activity.

**Multiple Choice**

11. Which one of the following groups uses accounting information to determine whether the company’s net income will result in a share price increase?

a. investors

b. auditors

c. creditors

d. production managers

e. none of the above

12. A company’s earning of revenues is an example of a(n)

a. operating activity.

b. investing activity.

c. financing activity.

d. statement of financial position activity.

13. A business organized as a corporation

a. is not a separate legal entity in most provinces.

b. requires that shareholders be personally liable for the debts of the business.

c. is not owned by its shareholders.

d. has an indefinite life.

e. all of the above

14. Which of the following accounts would be found on an income statement?

a. Sales, Salary Expense, and Dividends Declared

b. Service Revenue and Salary Expense

c. Sales, Salary Expense, and Cash

d. Salary Expense, Dividends Declared, and Cash

15. The financial statement that reports the assets, liabilities, and shareholders’ equity at a specific date is the

a. income statement.

b. statement of changes in equity.

c. statement of financial position.

d. statement of cash flows.

ANSWERS TO 20-MINUTE QUIZ #1

**True/False**

1. True

2. False

3. False

4. True

5. False

6. True

7. True

8. True

9. False

10. False

**Multiple Choice**

11. a

12. a

13. d

14. b

15. c

20-MINUTE QUIZ #2

1. Identify the different forms of business organization.

2. Identify two internal users and two external users of the financial statements.

3. Classify each of the following items first as a financing, investing, or operating activity, and then indicate whether the transaction increases or decreases cash.

a. Inventory is purchased for cash.

b. A company sells services for cash.

c. A company buys equipment for cash.

d. A company sells equipment for cash.

e. Employees are paid.

f. A company borrows money from the bank.

g. A company issues shares.

h. A company repays a loan.

ANSWERS TO 20-MINUTE QUIZ #2

1. The three forms are business organization are:

1. Proprietorship

2. Partnership

3. Corporation (public and private)

2. Internal users could include:

* Finance directors
* Marketing managers
* Human resource personnel
* Production supervisors
* Company officers

External users could include:

* Investors
* Lenders
* Creditors
* Canada Revenue Agency (CRA)
* Government
* Union
* Potential employees
* Current employees not involved in managing the company

3. Classify each of the following items first as a financing, investing, or operating activity, and then indicate whether the transaction increases or decreases cash.

a. Operating activity; cash is decreased.

b. Operating activity; cash is increased.

c. Investing activity; cash is decreased.

d. Investing activity; cash is increased.

e. Operating activity; cash is decreased.

f. Financing activity; cash is increased.

g. Financing activity; cash is increased.

h. Financing activity; cash is decreased.