## Accounting Standards

2.4

In performing their work, accountants throughout the world follow sets of rules or standards. Historically, the Canadian Institute of Chartered Accountants (CICA) has established the standards for Canadian accountants. These standards are made available in the *CICA Handbook*, a publication that is updated regularly so that it reflects current accounting opinions and decisions. The most significant sections of the handbook contained the **Canadian Generally Accepted Accounting Principles (Canadian GAAP)**. Some GAAPs were formal regulations and others described what has become common practice over the years.

Originally, CICA committees were created to oversee Canadian accounting practice. Eventually these committees combined to form one separate governing body called the **Accounting Standards Board (AcSB)**. The board makes its decisions independently after consulting with many organizations and like-minded boards, including the **International Accounting Standards Board (IASB)**.

In 2006, the AcSB announced a process to replace the Canadian GAAP with the **International Financial Reporting Standards (IFRS)**, which are set by the IASB. The move to these international standards will help Canadian businesses communicate globally. The number of countries that have adopted or permitted IFRS is well over 100 with more joining this globalization trend.

The start date for moving to IFRS was January 1, 2011. This requirement was for public companies only. Public companies are those listed on stock exchanges.

Private businesses are not listed on stock exchanges. To help these organizations make the transition to global standards, the AcSB developed a separate set of guidelines called the **Accounting Standards for Private Enterprises (ASPE)**.

As of January 1, 2011, private businesses may choose IFRS or ASPE to govern their accounting practices. Since ASPE was developed from traditional Canadian standards, its guidelines force fewer changes in accounting procedures than the guidelines in IFRS. Therefore, most private enterprises will initially adopt ASPE, while holding on to the option of using IFRS in the future.

**Business Entity Concept**

The heading of the balance sheet indicates the name of the business, what the financial statement is, and when it applies. Therefore, the subject matter of this statement is the financial position of Pacioli Designs on December 31, 20–. Even though we see the name of the owner, Grace Cho, on the balance sheet, we know nothing about her financial position. No extra data is given about her personal assets and liabilities. All that is known is that she has a claim on the assets of Pacioli Designs in the amount of $34 165.

The **business entity concept** is a long-standing principle that keeps the accounting for a business organization separate from the personal affairs of its owner, or from any other business or organization.

This means that the owner of the business should not place any personal assets, such as the family home, on the business balance sheet. The balance sheet of the business must reflect the financial position of the business alone. The business entity concept is important in ASPE and IFRS, just as it was in Canadian GAAP.

- Business is a seperate entity from the owner.

**The Cost Principle and The Continuing Concern Concept**

Other interesting accounting principles can be seen on the Pacioli Designs balance sheet. Look at the value for supplies. Pacioli Designs originally paid $1750.50 for the supplies. The ASPE uphold the traditional **cost principle**, which requires accountants to record the value of assets at their historical cost price. (what you paid for them)

Readers of Pacioli's balance sheet are not concerned about the market value of the supplies because they know their original cost. They assume the business will continue operating and that the supplies will be eventually used. This is known as the **continuing concern concept.** It is also related to the cost principle and balance sheet interpretation.

The continuing concern concept assumes that a business will continue to operate unless it is known that it will not. This assumption frees the reader of a balance sheet from worrying about the market values of assets and whether debts will have to be paid before they are due.

① Assets are listed at their cost value

② The business will continue to run as usual

### The Revaluation Model

The revaluation model contained in IFRS allows for modifications to the cost principle. The **revaluation model** outlines an accounting procedure that allows accountants to change the value of particular assets based on market conditions.

For example, suppose the automobile in Figure 2.10 ($21 850) is a custom sports car that was purchased to add to the business's designer image. The market value of the sports car has risen to $30 000. If Grace Cho chooses to use IFRS for Pacioli Designs, she could change the value of the automobile to $30 000, based on the current market conditions.

If Grace chose IFRS and revalued the automobile to $30 000, the total assets of Pacioli Designs would increase by $8150. What else would change by $8150? If you said equity—the owner's claim on assets—then you are applying your understanding of accounting theory to new situations.

- Asset values can change based on market conditions

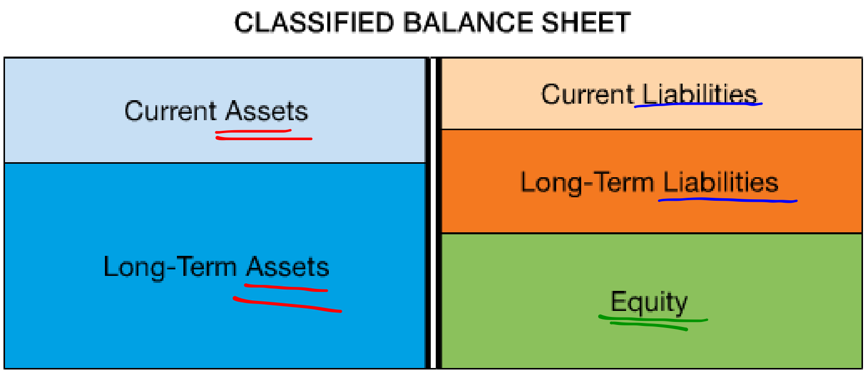



**Figure 2.11**

Balance sheet classifications

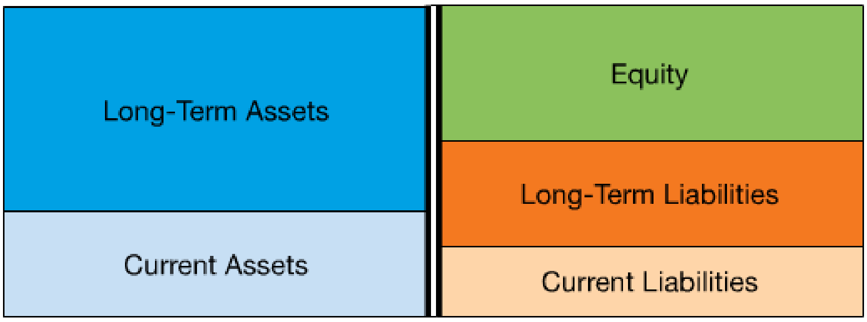
The pattern shown in Figure 2.11 follows the order of liquidity you learned in Section 2.2. It is also the pattern used by Pacioli Designs in Figure 2.10. New terms are listed below.

1. **Current assets** are cash and assets that will be converted into cash within one year, such as accounts receivable. Current assets also include assets that will be used up within a year, like supplies.
2. **Long-term assets** are items like land, buildings, and equipment (sometimes called property, plant, and equipment). These assets last longer than one year.
3. **Current liabilities** are those that are due within a year, such as accounts payable.
4. **Long-term liabilities** take more than a year to pay off. A mortgage is a common example.

Organizing the balance sheet into classifications helps the reader gain meaning and insight. Current assets are easily compared to the creditor's claims against them (current liabilities). Long-term assets, like a building, are shown with the mortgages against them.

Businesses in many countries using IFRS invert the order as shown in Figure 2.11. A typical structure under IFRS would look similar to Figure 2.12.

STATEMENT OF FINANCIAL POSITION




The order of both sides of the balance sheet has turned upside down. On the asset side, this inverted order reflects an emphasis on the long-term productive assets of a business, such as property, buildings, and equipment. On the right side, the order stresses the sources of the funds that were used to purchase the assets. The sources of funds begins with the owner(s), followed by the creditors.

Under IFRS, the name of the statement changes from balance sheet to **statement of financial position**.

Presently, most private businesses in Canada choose ASPE rather than IFRS. Therefore, if you see the inverted order in Figure 2.12, you are likely examining the financial position of a public company.

Recall that a private company has the right to choose IFRS. Suppose Grace Cho did just that for Pacioli Designs. The balance sheet you saw in Figure 2.10 might look similar to Figure 2.13.

PACIOLI DESIGNS
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 20–

| | | | | | |
|---|---|---|---|---|---|
| ***Assets*** | | | ***Equity and Liabilities*** | | |
| *Long-Term Assets* | | | *Equity* | | |
| Automobile | $21 850.00 | | Grace Cho, Capital | | $34 165.00 |
| Equipment | 16 000.00 | | | | |
| Furniture | 4 702.00 | | *Current Liabilities* | | |
| | | $42 552.00 | Bank Loan | $9 000.00 | |
| *Current Assets* | | | Accounts Payable | | |
| Supplies | $ 1 750.50 | | —CMYK Supplies | 1 905.15 | |
| Accounts Receivable | | | —Golden Art Store | 2 299.90 | |
| —J. Tenney | 1 350.00 | | —Premium Printing | 1 750.95 | |
| —V. Weiss | 1 850.50 | | | | 14 956.00 |
| Cash | 1 618.00 | | | | |
| | | 6 569.00 | | | |
| Total Assets | | $49 121.00 | Total Equity and Liabilities | | $49 121.00 |

**Figure 2.13**

The statement of financial position for Pacioli Designs under IFRS

# Homework

Page 37

Review Questions #1-17

**SECTION 2.4 REVIEW QUESTIONS** (page 37)

1. *Over the years, the Canadian Institute of Chartered Accountants has established the standards of practice for all Canadian accountants.*
2. *Most of the rules of accounting are found in the CICA Handbook.*
3. *The AcSB stands for Accounting Standards Board.*
4. *IFRS stands for International Financial Reporting Standards. The International Accounting Standards Board (IASB) sets the IFRS.*
5. *Canadian public companies started using IFRS on January 1, 2011.*
6. *ASPE stands for Accounting Standards for Private Enterprises.*
7. *Private businesses may use ASPE. They started using ASPE on January 1, 2011. They use them instead of IFRS because ASPE involve fewer changes for private businesses than adopting IFRS.*
8. *The business entity concept states that the accounting for a business should be kept separate from the accounting for the owner or another business.*
9. *The cost principle states that assets should be valued at their historic cost price.*
10. *The continuing concern concept assumes the company will keep operating and will use all of its short-term assets. This means that assets can be valued at their cost price rather than current market value because the company will use them up and does not need to sell them*
11. *The revaluation model is the IFRS procedure that gives a new perspective on the cost principle. The revaluation model allows accountants to value some assets at market value rather than historical cost price.*
12. *A current asset is an asset that can be converted to cash within a year, such as accounts receivable, or an asset that will be used up within a year, such as supplies.*
13. *A current liability is a liability that is due within a year, such as an account payable.*
14. *Property, plant and equipment are classified as long-term assets because they last longer than one year.*
15. *An example of a long-term liability is a liability that takes more than a year to pay off, such as a mortgage.*
16. *Traditionally, and under the Accounting Standards for Private Enterprises (ASPE), cash is listed first on the balance sheet because it is the most liquid asset. The International Financial Reporting Standards, however, invert the liquidity order of the traditional balance sheet. Long-term assets are listed first; liquid assets, like cash, are listed last.*
17. *Under IFRS, the balance sheet is called the statement of financial position.*

**SECTION 2.4 EXERCISES** (page 38)

**Exercise 1, p. 38**

**A.**

*ARNOLD'S LANDSCAPING*

*BALANCE SHEET*

*OCTOBER 31, 20–*

| Assets | | | Liabilities | | |
|---|---|---|---|---|---|
| *Current Assets* | | | *Current Liabilities* | | |
| *Cash* | $ 8 200.45 | | *Accounts Payable* | | |
| *Accounts Receivable* | | | —*Bev's Seed and Supply* | $1 515.88 | |
| —*P. Cannon* | 3 050.– | | —*Peter Power Equipment* | 3 356.– | |
| —*T. Horvath* | 890.30 | | —*ToughTurf Supplies* | 950.05 | |
| *Supplies* | 850.– | | *Loan Payable* | 6 000.– | |
| | | $12 990.75 | | | $11 821.93 |
| *Long-Term Assets* | | | *Long-Term Liabilities* | | |
| *Furniture* | $ 512.75 | | *Mortgage Payable* | | 24 000.– |
| *Equipment* | 42 900.25 | | | | |
| *Truck* | 32 160.50 | | *Owner's Equity* | | |
| | | 75 573.50 | *A. Vroom, Capital* | | 52 742.32 |
| *Total Assets* | | $88 564.25 | *Total Liabilities and Equity* | | $88 564.25 |

**B.** *The totals for current assets and current liabilities are very similar ($12 990.75 and $11 821.93). Therefore, Arnold's Landscaping should be able to pay its short-term liabilities with little difficulty. The cost value of the equipment is almost twice as much as the mortgage against it, which is also a healthy sign.*

**C.**

*ARNOLD'S LANDSCAPING*

*STATEMENT OF FINANCIAL POSITION*

*DECEMBER 31, 20–*

| Assets | | | Equity and Liabilities | | |
|---|---|---|---|---|---|
| Long-Term Assets | | | Equity | | |
| Furniture | $ 512.75 | | A. Vroom, Capital | | $52 742.32 |
| Equipment | 42 900.25 | | | | |
| Truck | 32 160.50 | | Long-Term Liabilities | | |
| | | $75 573.50 | Mortgage Payable | | 24 000.– |
| | | | | | |
| Current Assets | | | Current Liabilities | | |
| Supplies | $ 850.– | | Loan Payable | $6 000.00 | |
| Accounts Receivable | | | Accounts Payable | | |
| —P. Cannon | 3 050.– | | —Bev's Seed and Supply | 1 515.88 | |
| —T. Horvath | 890.30 | | —Peter Power Equipment | 3 356.– | |
| Cash | 8 200.45 | | —ToughTurf Supplies | 950.05 | |
| | | 12 990.75 | | | 11 821.93 |
| Total Assets | | $88 564.25 | Total Equity and Liabilities | | $88 564.25 |

**D.** *The business has long-term assets of $75 573.50, which is over three times the total of long-term liabilities. The business and the owner provided most of the funds for these important assets, not outside creditors.*

Homework

Work on Chapter 2 Review pg. 47-50

## CHAPTER 2 REVIEW EXERCISES (page 47)

**Using Your Knowledge**

**Exercise 1, p. 47**

Circle the best answer to each question.

**A.** The financial position of a business is
- **a.** the difference between total assets and total liabilities.
- **b.** represented by the assets, the liabilities, and the capital.
- **c.** the same as the net worth of the business.

**B.** If the total assets increase by $10 000 and the total liabilities decrease by $10 000, the capital will
- **a.** increase by $20 000.
- **b.** be unchanged.
- **c.** decrease by $20 000.

**C.** Which one of the following is not true?
- **a.** A – E = L
- **b.** A – L = E
- **c.** A + L = E
- **d.** A = L + E

**D.** A balance sheet shows
- **a.** all of the owner's assets and liabilities.
- **b.** a financial picture of the business on a certain date.
- **c.** the progress of the business over a period of time.

**E.** Which one of the following is not true?
- **a.** The heading of a balance sheet shows the date as of which it was prepared.
- **b.** Assets are listed in the order of their liquidity (under ASPE).
- **c.** Accounts receivable are considered to be a liquid asset.
- **d.** Personal assets have no place on the business balance sheet.
- **e.** A truck that cost $10 000 and for which $6000 is owed is listed on the balance sheet at $4000.

**F.** Abbreviations may be used on financial statements
- **a.** when it is necessary to crowd things to conserve space.
- **b.** to save time in preparing the statements.
- **c.** in a company name if the abbreviation is a formal part of the name.

**G.** Which one of the following is not true? Ruled lines are
- **a.** used to underline headings.
- **b.** used to indicate that columns of numbers are to be totalled.
- **c.** necessary to separate sections of the balance sheet.
- **d.** doubled to indicate a final total.

**H.** Before a business is closed down, the equation for it is

Assets ($125 000) = Liabilities ($37 000) + Equity ($88 000)

If assets of $70 000 are sold for $20 000, assets of $50 000 are sold for $90 000, and the remaining assets stay the same, the equation will become
- **a.** $55 000 = $37 000 + $18 000
- **b.** $115 000 = $37 000 + $78 000
- **c.** $75 000 = $37 000 + $38 000
- **d.** $135 000 = $47 000 + $88 000
- **e.** $115 000 = $27 000 + $88 000

**I.** Which of the following is not true?
- **a.** In the liability section on a balance sheet, accounts payable may be listed first.
- **b.** On a balance sheet, there are three main totals.
- **c.** On a balance sheet, the owner's name appears only in the heading.
- **d.** On a balance sheet, the final totals are always on the same line.

**J.** Which of the following is true?
- **a.** IFRS must be used by all businesses in Canada.
- **b.** In many countries using IFRS, the liquidity order of assets is inverted.
- **c.** Canadian GAAP has replaced ASPE.
- **d.** The IASB controls the AcSB.

**Exercise 2, p. 48**

*Jason's liabilities decreased by $16 000. (+26 000 = –16 000 + 42 000)*

**Exercise 3, p. 48**

*Fatima's liabilities increased by $7000. (+10 000 = +7000 + 3000)*

**Exercise 4, p. 48**

*Ravi's assets increased by $10 000. (+10 000 = +15 000 – 5000)*

**Exercise 5, p. 49**

**A.**

1. *In the heading, the order of the second and third rows is wrong. It should be "Who, What, and When."*
2. *The sub-heading Assets is missing.*
3. *Cash should be listed first in the Assets section (liquidity).*
4. *No need to underline Accounts Receivable.*
5. *The accounts receivable customers should be listed in alphabetical order.*
6. *Supplies should be listed before Equipment.*
7. *Equipment and Supplies should be capitalized.*
8. *The single rule in the Assets section should be just above the Total Assets amount.*
9. *Accounts Payable title is missing.*
10. *The presentation of the vendors should be consistent with the presentation of the customers—indent and precede with a dash.*
11. *The Total Liabilities amount should not be double-underlined.*
12. *For consistency, underline Owner's Equity.*
13. *In the Owner's Equity section, capital should be represented by C. Ing, Capital instead of Carmen's Web Creations.*
14. *The final totals of the balance sheet should be on the same line.*
15. *Columnar paper should be used and decimal points omitted.*

**CHAPTER 2 REVIEW EXERCISES** (continued)

**Exercise 5, p. 49** (continued)

**B.**

*CARMEN'S WEB CREATIONS*

*BALANCE SHEET*

*SEPTEMBER 30, 20–*

| *Assets* | | | *Liabilities* | | |
|---|---|---|---|---|---|
| *Cash* | *$ 3 652* | *80* | *Accounts Payable* | | |
| *Accounts Receivable* | | | *—Drive Computer Co.* | *$ 676* | *98* |
| *—Nina's Creations* | *460* | *50* | *—Wilson's Supply* | *100* | *90* |
| *—Tse Networks* | *1 780* | *–* | *—Zip Software* | *412* | *–* |
| *Supplies* | *900* | *25* | *Bank Loan* | *3 500* | *–* |
| *Equipment* | *6 500* | *30* | *Total Liabilities* | *$ 4 689* | *88* |
| | | | | | |
| | | | *Owner's Equity* | | |
| | | | *C. Ing, Capital* | *8 603* | *97* |
| *Total Assets* | *$13 293* | *85* | *Total Liabilities and Equity* | *$13 293* | *85* |

**Exercise 6, p. 49**

**A.**

*SMA CONSULTANTS*

*BALANCE SHEET*

*SEPTEMBER 30, 20–*

| *Assets* | | | *Liabilities* | | |
|---|---|---|---|---|---|
| *Current Assets* | | | *Current Liabilities* | | |
| *Cash* | *$ 6 000 –* | | *Accounts Payable* | *$ 35 000 –* | |
| *Accounts Receivable* | *14 000 –* | | | | |
| | | *$ 20 000 –* | *Long-Term Liabilities* | | |
| *Long-Term Assets* | | | *Mortgage Payable* | *160 000 –* | |
| *Land* | *$240 850 –* | | *Total Liabilities* | | *$195 000 –* |
| *Buildings* | *195 000 –* | | | | |
| *Equipment* | *25 000 –* | | *Owner's Equity* | | |
| | | *460 000 –* | *S. Magbool, Capital* | | *285 000 –* |
| *Total Assets* | | *$480 000 –* | *Total Liabilities and Equity* | | *$480 800 –* |

**B.** *Magbool does have a financial problem. The business is in a poor position to pay its debts. As shown by the balance sheet, the business had cash of $6000 and accounts receivable (near cash) of $14 000 for a current asset total of $20 000. This is considerably less than the accounts payable figure of $35 000, which is likely due in 30 days. In addition, there is a monthly installment of the mortgage to be paid.*

**Exercise 7, p. 49**

A. *The bank manager would probably grant the loan for two reasons. First, the profit record of the business is good. Second, the company does have sufficient cash and near cash to pay its immediate debts, even after deducting the value of the overdue accounts.*

B. *The manager would be concerned about the overdue accounts receivable. Such a high proportion of overdue accounts indicates that credit is being granted much too easily.*

**Exercise 8, p. 50**

*Statement headings will vary. Students will discover variations in statement headings. For example, they may encounter terms like Consolidated Statement of Financial Position, Non-Current Assets, Intangible Assets, Non-Current Liabilities, Shareholders' Equity, Capital and Reserves, and so on.*

**Questions for Further Thought, p. 50**

1. *The balance sheet is thought of as being a snapshot of the business because it shows the financial position of the business at a point in time.*
2. *Equity is the difference between assets and liabilities. It is a number that is the result of a calculation and is therefore not a physical thing that can be seen or touched.*
3. *The number of sales a business can make increases if it sells on credit. Knowing this, businesses are willing to take the risk that the increased sales will be greater than any bad debts.*
4. *Another definition for a balance sheet is a document displaying the assets, liabilities, and equity of a person, group, or company at a certain point in time.*
5. *The information contained in the heading of the balance sheet can be described as who, what, and when.*
6. *Secured creditors have a better chance of getting their money back if the borrowing company goes out of business. The bank becomes a secured creditor by receiving a signed document that gives it specific, legal claims on the borrowing company's cash or other assets (buildings, equipment, etc.). The legal document puts the bank at the front of the line when it comes time for the borrowing company to settle debts with creditors. Other creditors, such as suppliers, are competing with each other and get business by offering favourable, unsecured credit terms.*
7. *If the owner did not contribute or withdraw funds or other assets from the business, then the earnings of the business could be determined by finding the difference in the owner's equity on the balance sheets from two consecutive years.*