# **Chapter 1 Accounting in Business**

# Chapter Opening Vignette Critical Thinking Challenge Questions**\***

# **What questions might Zane need the answers to, to get a loan from a bank?**

The key question the bank wants answered is whether Zane can repay the loan. In order to assess this, they would ask questions such as:

* Financial Results: How much is the business earning per year? How profitable has the food truck been for the past year? How much are revenues and expenses? How are the results compared to the past year or couple of years? Where do you expect results to be in the next few years?
* Cash: How much cash does Zane currently have? How much does he want for the loan? What is his credit score?
* Debt: Are there any outstanding loans? If so, what is the balance outstanding, the term, the payments, and the interest rate?
* Assets: What personal or business assets does Zane have? The bank may want to take some of Zane’s assets as collateral.
* Customers: How many customers on average are served per day? How many customers are new or repeat customers?
* Employees: How many employees does he need to hire to serve his customers? Does Zane pay his employees a salary or a wage? How much does he pay them? Does he have the cash in the bank to pay his employees?
* Food Truck: Does Zane own his food trucks? If the trucks are purchased, did he pay cash or does he owe money on it? If he owes money, does he pay interest? Does he lease them? Does he have insurance?
* Toronto Pearson Airport Location: How much is the rent?
* Food (Inventory): How much food is purchased in advance? How does Zane manage his food to prevent spoilage? Does Zane need to pay his suppliers right away or can he pay on credit?
* Advertising: Does Zane advertise? If so, how much does he pay?
* Taxes: What is the amount of income tax he must pay?
* There are many other questions that could be asked.

# **Who else might require accounting information from Zane’s business?**

 Other stakeholders that might require accounting information from Zane’s business include Canada Revenue Agency (CRA), employees, and potential investors.

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# **\*The Chapter 1 Critical Thinking Challenge questions are asked at the beginning of this chapter. Students are reminded at the conclusion of the chapter to refer to the Critical Thinking Challenge questions at the beginning of the chapter. The solutions to the Critical Thinking Challenge questions are available here in the Solutions Manual and accessible to students at Connect.**

Knowledge Check-Up Questions

1. d) 2. a) 3. b) 4. b) 5. a)
2. c) 7. d) 8. a) 9. d) 10. c)

# Concept Review Questions

1. Accounting will provide Zane useful information to make good decisions. For instance, it is important for Zane to track his revenues and expenses to determine whether his business is profitable (his revenues are exceeding his expenses). Based on the accounting information, Zane can make decisions on how to price his food and where he can decrease expenses to improve his profits. Accounting will provide Zane important information on his business’ performance to make informed decisions on his expansion strategy.

 2. Businesses offering products include Spin Master Corp., Lululemon, NIKE, and Reebok which produce apparel; Dell, Hewlett-Packard, and Apple which produce computer equipment; and Abercrombie and Fitch, GAP, and Zara which produce clothing. Service business examples include: WestJet Airlines which provides airline services; Bell Canada, Rogers Communications, and Telus provide information communication services; and Google, Twitter, Skype, Facebook and Instagram which provide internet services.

 3. “Accounting is relevant to all students even if they do not plan on becoming an accountant. If you are pursuing a career in marketing, you will need to understand information such as sales volume, advertising costs, promotion costs, salaries of sales personnel, and sales commissions. If you are studying human resources, you will need to understand the financial position of your company to determine whether you have the resources to hire new employees or provide existing employees a pay increase. Even if you do not pursue a career in business, understanding the basics of accounting can help you better understand your own personal finances and the world around us. I am convinced that this course will be a good investment of our time.”

4. Answers will vary on what students would sell. Business organizations can be organized in one of three forms: sole proprietorship, partnership, or corporation. These forms have implications for legal liability, taxation, continuity, number of owners, and legal status as follows:

 Sole Proprietorship Partnership Corporation

 Legal entity no no yes

 Limited liability no no yes

 Unlimited life no no yes

 Business income taxed no no yes

 One owner allowed yes no yes

Answers and reasons will vary for the best form of business. Possible answers include: A sole proprietorship would be easiest to form for a student. A partnership would be helpful in bringing people with multiple skills and/or resources together. A corporation would be the easiest to obtain financing and to limit liability.

 5. The equity section of the balance sheet reports a Hailey Walker, Capital account. The presence of the owner’s capital account indicates that Organico has been organized as a sole proprietorship.

 6. The two organizations for which accounting information is available in Appendix III at the end of the book are WestJet Airlines, Spin Master Corp., Telus or Indigo.

 7. Hospitals, colleges, prisons, and bus lines are examples of organizations that can be formed as profit-oriented businesses, government units, or not-for-profit establishments.

 8. External users and their uses of accounting information include: (1) lenders for measuring the return of loans; (2) shareholders for assessing the acquisition of shares; (3) members of the board of directors for overseeing management; and (4) potential employees for judging employment opportunities. Other users are external auditors, consultants, regulators, unions, suppliers, and appraisers. Internal users and their uses of accounting information include: (1) management for overseeing performance, financial position, and cash flow; (2) current employees for generating special purpose reports to assist management; (3) internal auditors for identifying high-risk areas to audit; and (4) Sales staff to determine how to increase sales.

 9. The internal role of accounting is to serve the organization’s internal operating functions by providing useful information in completing their tasks more effectively and efficiently. By providing this information, accounting helps the organization reach its overall goals.

10. “Tyler, there are a number of areas you could pursue within accounting. There are also a number of opportunities within those accounting areas. I have put together some information to help with your decision.”

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| Accounting professionals practice in four broad fields including: | Accounting-related opportunities within each field are numerous and include: |
| Financial accounting | * Statement preparation
* Statement analysis
* Auditing
* Regulatory
* Consulting
* Planning
* Criminal investigation
 |
| Managerial accounting | * General accounting
* Cost accounting
* Budgeting
* Internal auditing
* Management advisory services
 |
| Taxation | * Preparation
* Planning
* Regulatory
* Investigations
* Consulting
 |
| Accounting-related | * Lenders
* Consultants
* Analysts
* Traders
* Managers
* Directors
* Underwriters
* Planners
* Appraisers
 |

11. The independent auditor for WestJet is KPMG LLP.

12. The purpose of accounting is to provide decision makers with information helping them make better decisions. Examples include information for people making investments, loans and similar decisions.

13. Accounting professionals deal with a variety of information about their employers and clients that is not generally available to the public. Ethical issues arise concerning the possibility that accounting professionals might personally benefit by using confidential information. There is also the possibility that their employers and clients might be harmed if certain information is not kept confidential.

14. An income statement user must know what time period is covered to judge whether the company’s performance is satisfactory. For example, a statement user would not be able to assess whether the amounts of revenue and profit are satisfactory without knowing whether they were earned over a week, a month, or a year.

15. The revenue recognition principle provides guidance that managers and auditors need for knowing when to recognize revenue. For example, if revenue is recognized too early, the income statement reports income earlier than it should and the business looks more profitable than it really is. On the other hand, if the revenue is not recognized on time, the income statement shows lower amounts of revenue and profit than it should and the business looks less profitable than it really is. Basically, this principle requires revenue to be recognized when it is earned and can be measured reliably. The amount of revenue should equal the value of the assets received from the customers.

16. The four financial statements are: the income statement, the balance sheet, the statement of changes in equity, and the statement of cash flows.

17. An income statement reports on the business’s performance during the period. It shows whether the business earned a profit (or loss). The statement does not simply report the amount of profit or loss but lists the types and amounts of the revenues and expenses.

 The balance sheet reports on the financial position of a business at a specific point in time. It is often called the statement of financial position. It provides information that helps users understand a company’s financial status. The balance sheet lists the types and dollar amounts of assets, liabilities, and equity of the business.

18. Cash has purchasing power and can be used to acquire other assets. A business that sells products to a customer and does not collect cash immediately has created an Accounts Receivable. This account represents a future collection of cash. Supplies are resources that will help a business carry on its operations.

19. I disagree with Rachel. While an accounts receivable and an accounts payable both show up on the balance sheet and in the accounting equation, an accounts receivable is an asset and an accounts payable is a liability. These two accounts