TT TEXTBOOK TESTBANKS

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Artificial Intelligence Activities

Prepared by Mfon Akpan, DBA, CGMA, Methodist University
Modified by Anu Goel, CA, CPA, MBA, Seneca Polytechnic

Chapter 1: The Environment and Conceptual Framework of Financial Reporting

Disclaimer: Artificial intelligence platforms continuously change with frequent and often unexpected updates. The AI prompts and content in this book were designed and tested with the most current models available at the time of writing. However, as technology advances, instructors are encouraged to verify the accuracy and functionality of the sample prompts with the latest AI tools they are using. This book offers adaptable prompts that can be customized to fit the latest AI capabilities, ensuring a cutting-edge learning experience. For those new to AI, step-by-step guides and support are available to help effectively implement these activities in your classroom. Whether or not you are familiar with AI, these prompts and exercises are designed to be engaging and educational, providing flexibility and enhancing your teaching strategies. By experimenting with these tools, you can discover new ways to enrich your student's learning experience and stay aligned with the latest developments in the field.

Activity 1: Understanding the Financial Reporting Environment

Learning Objective: Students will describe the financial reporting environment, major standard-setting bodies, and the meaning of generally accepted accounting principles (GAAP), aligning with LO 1.1 (Understand the financial reporting environment.) LO 1.3 (Explain the meaning of generally accepted accounting principles (GAAP) and the significance of professional judgement in applying GAAP.).

Instructions for Instructors:

1. **Scenario Context:**
    - Imagine your students are financial analysts tasked with explaining the financial reporting environment to new interns at a financial firm. This exercise will help them understand the major standard-setting bodies and the significance of GAAP.
    - **Data Provided:**
        - Major standard-setting bodies: Canadian Accounting Standards Board (AcSB) and IASB..
        - Key concepts: GAAP, due process in standard setting, and the role of the AcSb and IASB.
    - **Steps to Follow:**
        - Explain the roles of the AcSB and IASB in setting accounting standards.
        - Describe the process through which the AcSB and IASB sets standards.
        - Discuss the importance of GAAP in ensuring comparability and transparency in financial reporting.
2. **What Students Should Work Out Themselves:**
    - Summarize the roles of each standard-setting body.
    - Explain the due process in setting standards.
3. **What Students Should Use AI For:**
    - Generate explanations and descriptions of the roles of the AcSb and IASB.

- Provide examples of how GAAP ensures comparability and transparency in financial reporting.

4. **Sample Prompt for AI Model:**
   Succinctly, explain the roles of the Canadian Accounting Standards Board (AcSB) and International Accounting Standards Board (IASB) in setting accounting standards. Describe the process the AcSb and IASB follows to set standards and discuss the importance of GAAP in financial reporting.

Answer Key:

Roles of AcSB and IASB

- **AcSB**: Establishes accounting standards for Canadian private sector entities to ensure high-quality financial reporting.
- **IASB**: Develops and promotes International Financial Reporting Standards (IFRS) for global consistency and transparency in financial reporting.

Standard-Setting Process

AcSB:

1. Identify priorities based on user needs and economic changes.
2. Develop and approve a project proposal.
3. Issue a consultation paper for feedback.
4. Publish an exposure draft for public comment.
5. Finalize the standard after considering feedback.

IASB:

1. Conduct research and stakeholder consultation.
2. Publish a discussion paper outlining issues and solutions.
3. Issue an exposure draft for public comment.
4. Gather and analyze feedback.
5. Finalize the standard with board approval.

Importance of GAAP

- **Standardization**: Ensures consistency and comparability across companies.
- **Transparency**: Enhances the clarity of financial statements for stakeholders.
- **Reliability**: Provides accurate reflection of a company's financial performance.
- **Regulatory Compliance**: Meets legal and financial reporting obligations

VOLUME 1 APPENDIX C

THE ACCOUNTING INFORMATION SYSTEM

APPENDIX OBJECTIVES

This Appendix is intended to present a concise yet thorough review of the accounting process. Other objectives are to identify and explain the basic procedures of the accounting process and describe the way these procedures are combined in completing the accounting cycle.

Without doubt, this is the most procedural (bookkeeping) section of the text. Its importance, however, cannot be underestimated. A strong command of the material in this Appendix is essential to knowing the language and process of accounting, which is used extensively in the remainder of the book.

LEARNING OBJECTIVES

1. Understand basic accounting terminology, double-entry rules and the accounting equation.

2. Identify the steps in the accounting cycle and the steps in the recording process.

3. Explain the reasons for, and prepare, adjusting entries.

4. Explain how the type of ownership structure affects the financial statements.

5. Prepare closing entries and consider other matters relating to the closing process.

6. Prepare a 10-column work sheet and financial statements

APPENDIX REVIEW

1. The accounting process can be described as a set of procedures used in **identifying, recording, classifying**, and **interpreting** information related to the transactions and other events of a business enterprise. To understand the accounting process, it is important for an individual to be aware of the basic terminology employed in the process. The basic terminology includes: **events, transactions, permanent (real) accounts, temporary (nominal) accounts, ledger, journal, posting, trial balance, adjusting entries, financial statements, closing entries, and reversing entries**. These terms refer to the various activities that make up the **accounting cycle**. As we review the steps in the accounting cycle, the individual terms will be defined.

LOC.1 – Accounting System Overview

Basic Terminology and Double-Entry Rules

2. Once a transaction or other event has been identified as satisfying the criteria for recognition and measurement (step one), it must be recorded in the accounts (step two). **Double-entry accounting** refers to the process used in recording transactions. The terms **debit** and **credit** are used in the accounting process to indicate the effect a transaction has on account balances. The debit side of any account is the left side, and the right side is the credit side. Assets and expenses are increased by debits and decreased by credits. Liabilities, equity, and revenues are decreased by debits and increased by credits.

3. In a double-entry system, for every debit there must be a credit and vice-versa. This leads us to the accounting equation: Assets = Liabilities + Shareholders' Equity.

4. The equity section of the Statement of Financial Position reports the owners' interest in the assets of the company. A corporation uses Share Capital, Contributed Surplus, Dividends, and Retained Earnings. A sole proprietorship or a partnership uses a Capital account and a Drawings account (one for each partner or owner).

5. In a corporation, dividends, revenues, and expenses are transferred to retained earnings at the end of a period, so a change in any one of these three accounts affects equity.

LOC.2 – The Accounting Cycle and the Recording process

Identifying and Recording Transactions and Other Events

6. The first step in the accounting cycle is **analysis of transactions and selected other events.** The purpose of this analysis is to determine which events should be recorded and, if recorded, at what amount (measurement). To be included (recognized) in the accounting process, a transaction or other economic event must **affect an element of the financial statements and be reasonably (reliably) measurable.**

7. Events can be classified as **external** or **internal**. External events are those between the entity and its environment, whereas internal events relate to the accounting for activities totally within the entity. A transaction can have both external and internal elements. In recent years, the accounting profession has been looking at ways of reporting events that were previously not reported because they were considered too complex or hard to measure.

Journalizing

8. Transactions are initially recorded in a **journal**, sometimes referred to as **the book of original entry.** A **general journal** is a chronological listing of transactions expressed in

terms of debits and credits to particular accounts. No distinction is made in a general journal concerning the type of transaction involved. In addition to a general journal, **specialized journals** are used to accumulate transactions possessing common characteristics. Special journals benefit the accounting process by summarizing similar transactions, such as sales on account, cash receipts, and cash payments, thus reducing the efforts associated with the posting process. Specialized journals are not examined in the text.

Posting

9. The next step in the accounting cycle involves transferring amounts entered in the journal into the **general ledger.** The general ledger is a book (or computer file) that usually contains a separate page for each account. Transferring amounts from a journal to the ledger is called **posting**. Transactions recorded in a general journal must be posted individually, while entries made in special journals (sales, cash receipts, purchases, cash payments) are generally posted in total.

10. The general ledger contains information related to the balance of accounts included therein. Many of the accounts listed in a general ledger are supported by **subsidiary ledgers**. Accounts such as accounts receivable and accounts payable represent an accumulation of many individual customer or supplier balances. An accounts receivable subledger contains a detailed listing of the individual customer account balances. The use of subsidiary ledgers frees the general ledger from details concerning numerous individual balances.

Preparing the Trial Balance

11. The next step in the accounting cycle is the preparation of a **trial balance.** A trial balance is a list of all open accounts in the general ledger and their balances. An entity may prepare a trial balance at any time in the accounting cycle. A trial balance prepared after posting has been completed serves to check the mechanical accuracy of the journalizing and posting processes and provides a listing of accounts to be considered in making adjustments and preparing financial statements. While total debits may equal total credits, errors may still exist (e.g. entries posted to the wrong account, omission or duplication of a complete entry).

LOC.3 – Adjusting Entries

12. Preparation of **adjusting journal entries** is the next step in the accounting cycle. Adjusting entries are entries made at the end of an accounting period to bring all accounts up to date on an accrual accounting basis so that financial statements can be prepared. Adjusting entries are necessary to achieve appropriate matching of revenues and expenses in determining net income for a period and to achieve an accurate statement of assets, liabilities, and equities existing at the end of the period. One common characteristic of adjusting entries is that they affect at least **one permanent (real) account** (asset, liability, or equity account) and **one nominal (temporary) account** (revenue or expense account).

Adjusting entries are usually made for items classified as **prepaid expenses, unearned revenues, accrued expenses, accrued revenues,** and **estimated items.** An adjusting entry will never affect cash, although a correcting entry may affect cash.

Adjusting Entries for Prepayments

13. Prepaid expenses and unearned revenues refer to situations where cash has been paid or received BEFORE any goods or services have changed hands, so therefore the corresponding expense or revenue will not be recognized until a future period.

Adjusting Entries for Accruals

14. Accrued revenues (assets) and accrued expenses (liabilities) refer to revenues and expenses recognized in the current period, with the corresponding payment or receipt of cash to occur in a future period. In these cases, goods and services have changed hands but cash will be received or be paid AFTERWARDS. In all four cases, assets, liabilities, revenues and expenses are recognized when the goods and services change hands, not when the cash does – that can happen earlier or later. Estimated items are expenses such as bad debts and depreciation whose amounts are a function of future events and developments.

Adjusting Entries for Estimated Items

15. The third category of adjusting entries is **estimated items**. Adjusting entries for estimated items are required in order to record expenses, gains, and losses incurred in the current accounting period that have not been recognized through daily entries. If an estimated adjustment is needed for anticipated bad debts, the expense account is understated. So, the adjusting entry will often increase both a contra account on the statement of financial position and an income statement account. Similarly, an adjusting entry for fair value through net income investments for an unrealized gain would increase an investment account and affect unrealized gains on the statement of comprehensive income.

Unrealized Holding Gains and Losses (FV-NI and FV-OCI)

16. An unrealized gain or loss must be recorded in the statement of comprehensive income at the end of the reporting period. This is done to adjust FV-NI and FV-OCI investments to their fair values. At the end of each period, an estimate is made of the fair value of investments held in the fair value through net income (FV-NI) and fair value through other comprehensive income (FV-OCI) categories. FV-NI investments could include equity investments or investments in debt securities

Adjusted Trial Balance

17. After adjusting entries are recorded and posted, an **adjusted trial balance** is prepared. This trial balance serves as a basis for the preparation of the financial statements discussed later in the textbook. Preparation of the adjusted trial balance and financial statements represents steps six and seven in the accounting cycle.

18. When inventory records are maintained on a periodic (not perpetual) basis, an adjustment is usually needed to reflect the difference between the beginning and ending inventory. An adjusting/closing entry eliminates all temporary accounts related to the purchase of inventory by transferring them to Cost of Goods Sold and also adjusts the inventory account by crediting it for the beginning inventory amount and debiting the inventory account for the ending inventory amount. The ending amount is determined by a **physical count** and is the amount to be included on the Statement of Financial Position (balance sheet).

    A typical inventory adjusting/closing entry would include debits and credits to the following accounts:

	Dr.	Cr.
Inventory (ending)	XX,XXX	
Purchase Discounts	X,XXX	
Purchase Allowances	XXX	
Returned Purchases	X,XXX	
Cost of Goods Sold	XXX,XXX	
Inventory (beginning)		XX,XXX
Purchases		XXX,XXX
Transportation-In		X,XXX

LOC.4 – Financial Statements and Ownership Structure

19. The type of ownership structure that a business enterprise uses determines the types of accounts that are part of the equity section or that affect it. In a **corporation**, **Common Shares**, **Contributed Surplus**, **Dividends**, **Retained Earnings**, and **Accumulated Other Comprehensive Income** are commonly used accounts.[7] In a **proprietorship** or **partnership**, an **Owners' Capital** account is used to indicate the investment in the company by the owner(s). An **Owners' Drawings** or withdrawal account may be used to indicate withdrawals by the partners. These two accounts are grouped or netted under **Owners' Equity**. We focus on the corporate organization structure in this text. Companies may use a work sheet to facilitate the preparation of financial statements.

LOC.5 - Closing Entries

20. After financial statements have been prepared, nominal/temporary accounts (revenues and expenses) should be reduced to zero in preparation for recording the events and transactions of the next period. The **closing process** requires recording and posting of **closing entries.** All temporary accounts are reduced to zero by closing them through an **Income Summary** account. The net balance in the Income Summary account after closing is equal to net income or net loss for the period. The net income or net loss for the period is then transferred to an equity account by closing the Income Summary account to the

appropriate equity account. For a corporation, the equity account is Retained Earnings; for proprietorships and partnerships, it is a capital account. Dividends (for a corporation) and Drawings (for a sole proprietorship or partnership) are closed directly to Retained Earnings or Capital as appropriate, as they are not part of income.

Post-Closing Trial Balance

21. A third trial balance may be prepared after the closing entries are recorded and posted. This **Post-Closing Trial Balance** serves to show that equal debits and credits have been posted through Income Summary and that the company has properly journalized and posted the closing entries. This trial balance would consist of only permanent (real) accounts.

Reversing Entries

22. Preparation and posting of **reversing entries** is the final step in the accounting cycle. The entries subject to reversal are the adjusting entries for accrued assets, accrued liabilities, and prepaid expenses and unearned revenues initially entered in expense and revenue accounts. Reversing entries are **optional.**

Accounting Cycle Summary

23. The steps in the accounting cycle performed in every fiscal period may be summarized as follows:
    a) Analyze transactions and other events, which will result in identification and measurement decisions.
    b) Enter the transactions of the period in appropriate journals.
    c) Post from the journals to the ledger.
    d) Prepare a trial balance (unadjusted trial balance).
    e) Prepare adjusting journal entries, and post them to the ledger.
    f) Prepare a trial balance after adjusting (adjusted trial balance).
    g) Prepare the financial statements from the adjusted trial balance.
    h) Prepare closing journal entries and post them to the ledger.
    i) Prepare a post-closing trial balance (after closing trial balance).
    j) Optionally, prepare reversing entries and post them to the ledger.

24. The method used to process accounting information does not alter the steps in the accounting cycle. When computerized systems are used, the accounting records may change in appearance, but the steps performed are the same as those in a manual system.

LOC.6 – Using a Work Sheet

25. A multicolumn (8, 10, 12, etc.) **work sheet** serves as an aid to the accountant in adjusting the account balances and preparing the financial statements. The work sheet provides an orderly format for the accumulation of information necessary for the preparation of

financial statements. Use of a work sheet does not replace any financial statements, nor does it alter any of the steps in the accounting cycle.

LECTURE OUTLINE

TEACHING TIP

The Appendix provides a review of the procedures employed in carrying out the steps in the accounting cycle. Depending on time constraints and students' accounting course backgrounds, it can be approached in several different ways: (1) Spend 2–3 class sessions reviewing the material. (2) Spend 1–2 class sessions reviewing selected portions only. (3) Omit the material entirely and have students review it on their own as needed.

It is assumed that all students have completed at least one course in financial accounting, learning fundamental accounting principles. Therefore, students should already be familiar with the mechanics of journalizing, posting, and preparing adjusting entries and financial statements, etc. An important objective of a review of these procedural details is to prepare students:

a) to progress from mere memorization of required journal entries to understanding the effect of a journal entry on the financial statements, and
b) to visualize the effect of errors (both the failure to record transactions and the improper recording of transactions) on the financial statements.

The following topics covered in the Appendix may warrant special emphasis because students' grasp of them may be weak and because understanding of them is particularly important in mastering other chapters of the text:

1. Transactions affecting equity—helpful in understanding adjustments or prior periods and error analysis and the statement of changes in shareholders' equity (statement of retained earnings in ASPE).
2. Year end procedure for inventory and related accounts—helpful in understanding the effect of inventory errors.
3. Reversing entries—an understanding of reversing entries is assumed when accounting for accruals.

The following lecture outline can be expanded upon or reduced to suit your needs.

A. Basic Terminology. Review the terms defined in the "Basic Terminology" section presented in the beginning of the Appendix.

B. Double-Entry Rules.
   - Review the mechanics of debits and credits.

TEACHING TIP

Use **Illustration C.1 in the text** in reviewing double-entry rules for increasing and decreasing accounts. Debits increase assets and expenses while credits increase liabilities, owners' equity, and revenues. The normal balance of an account is the same as the increase side.

Illustration C.2 in the text shows the basic accounting equation.

Illustration C.3 in the text shows the expanded accounting equation. The table that follows provides examples of transactions affecting the equity accounts. Emphasize the difference between temporary (nominal) and permanent (real) accounts.

C. The Accounting Cycle.

TEACHING TIP

Present an overview of the accounting cycle by using **Illustration C.4 in the text**.

1. Journalizing (general journal and special journals)

2. Posting to the Ledger

3. Trial Balance

TEACHING TIP

Now would be a good time to review the **cash basis versus accrual basis accounting**. Under the **strict cash basis**, revenues are recognized only when the cash is received, and expenses are recorded only when the cash is paid. The **accrual basis of accounting** recognizes revenues when they are realized (earned) and expenses when incurred to earn related revenues (matching), regardless of when the cash is paid or received.

TEACHING TIP

Use **Illustration C.5 in the text** to demonstrate an unadjusted trial balance.

4. Adjusting Entries:
   a) prepaid expenses
   b) unearned revenues

c) accrued liabilities (expenses)
d) accrued assets (revenues)
e) estimated items

TEACHING TIP

Use **Illustration C.6 in the text** in discussing adjusting entries. Provide examples of each type and discuss the effect on the financial statements of failure to make each type of entry.

Illustration C.7 in the text shows the adjusting entries for prepayments.
Illustration C.8 shows the adjusting entries for accruals.
Illustration C.9 shows the adjusting entries for estimated items.

TEACHING TIP

You might digress from the accounting process at this point to use **Illustration C.10** to review the structure of the equity accounts in a corporation's financial statements.

5. Year-End Procedure for Inventory and Related Accounts.

6. The Closing Process and Preparation of a Post-Closing Trial Balance.
All temporary (nominal) accounts are closed out to permanent (real) accounts. The Post-Closing Trial Balance should mirror the Statement of Financial Position (Balance Sheet).

TEACHING TIP

Review the adjusting and closing process using the tables in the LO 5 section of the book. There is no specific Illustration in the text that shows this graphically.

In addition, review the text discussion of the adjusting and closing entries for inventory and related accounts when a periodic system is usded. Again, there is no specific Illustration in the text that shows this graphically.

7. Reversing Entries.

TEACHING TIP

Use **PiP C.12 in the text** to demonstrate the journal entries to be made when reversing entries **are** made and when reversing entries **are not** made.

Emphasize that reversing entries are optional and that the financial statement amounts are identical whether or not reversing entries are used.

a) Use of reversing entries is optional.
b) an accounting system that uses reversing entries, the following types of adjusting entries would be reversed:
   i) adjusting entries for unearned and prepaid items where the original amount was entered in a revenue or expense account (i.e., the adjusting entry "created" a liability or asset account).
   ii) adjusting entries for all accrued items (again, the adjusting entry "creates" an asset or a liability account).

8. Use of a Work Sheet to Prepare Financial Statements.
   The work sheet does not replace the financial statements. Use of a work sheet is optional. The work sheet format varies. The format used in the text may be different from the one students used in elementary accounting but the basic rules are the same. Work through the example in the text, or one of the exercises, to give hands on practice in completing a worksheet, paying particular attention to the work sheet columns required, the preparation of the work sheet, and preparing the financial statements from the work sheet.

TEACHING TIP

Use **Illustration C.11 in the text** to demonstrate the work sheet.

ILLUSTRATION 1

DOUBLE-ENTRY ACCOUNTING FOR CORPORATIONS

Permanent Accounts | **Temporary Accounts**

ASSETS AND LIABILITIES | **SHAREHOLDERS' EQUITY** | **REVENUES AND EXPENSES**

ASSETS		COMMON SHARES and RELATED ACCOUNTS		REVENUES (and GAINS)	
Debit	Credit	Debit	Credit	Debit	Credit
+(increase)	–(decrease)	–(decrease)	+(increase)	-(decrease)	+(increase)

LIABILITIES		RETAINED EARNINGS		EXPENSES (and LOSSES)	
Debit	Credit	Debit	Credit	Debit	Credit
–(decrease)	+(increase)	–(decrease)	+(increase)	+(increase)	–(decrease)

TEACHING TIP

Rules of Thumb

- If the "normal balance" for an account is a debit, then the account is increased by a debit and decreased by a credit.
- If the "normal balance" for an account is a credit, then the account is increased by a credit and decreased by a debit.
- Contra accounts have "normal balances" that are the opposite of their "parent" accounts.