

INTERMEDIATE ACCOUNTING

FOURTH
EDITION

KIN LO

University of British Columbia

**GEORGE
FISHER**

Douglas College

WITH CONTRIBUTIONS BY

KIM TROTTIER

Simon Fraser University

DESMOND TSANG

McGill University

VOLUME

1

Brief Contents



Preface	xix
CHAPTER 1 Fundamentals of Financial Accounting Theory	1
CHAPTER 2 Conceptual Frameworks for Financial Reporting	26
CHAPTER 3 Accrual Accounting	71
CHAPTER 4 Revenue Recognition	146
CHAPTER 5 Cash and Receivables	202
CHAPTER 6 Inventories	250
CHAPTER 7 Financial Assets	303
CHAPTER 8 Property, Plant, and Equipment	348
CHAPTER 9 Intangible Assets, Goodwill, Mineral Resources, and Government Grants	407
CHAPTER 10 Applications of Fair Value to Non-Current Assets	457
APPENDIX A Statement of Cash Flows	A1
APPENDIX B Time Value of Money and Simple Valuation Techniques	B1
APPENDIX C Case Solving and Comprehensive Cases	C2
APPENDIX D Canadian Tire Corporation 2016 Consolidated Financial Statements	D2
Glossary	G2
Index	I2

Contents



Preface

xix

CHAPTER 1	Fundamentals of Financial Accounting Theory	1
A.	Uncertainty and Information Asymmetries	4
1.	Adverse selection example	5
2.	Moral hazard example	6
3.	Adverse selection and moral hazard defined	7
4.	Application of adverse selection and moral hazard to accounting	7
5.	Moral hazard in action: The financial crisis of 2008	8
B.	Desirable Characteristics of Accounting Information and Trade-Offs	9
C.	Economic Consequences of Accounting Choice and Earnings Management	10
D.	Accounting and Securities Markets	11
1.	Accounting information in securities markets	11
2.	Using information from securities markets in accounting	14
E.	Summary	14
F.	Answers to Checkpoint Questions	15
G.	Glossary	15
H.	References	16
I.	Problems	16
J.	Mini-Cases	22
CHAPTER 2	Conceptual Frameworks for Financial Reporting	26
A.	Conceptual Frameworks for Financial Accounting as Strategies to meet Market Demands for Information	28
1.	Sketch of a business plan for a carmaker	28
2.	Outline of a conceptual framework for financial reporting	29
B.	Components of the IFRS Conceptual Framework	30
1.	Users and their needs	30
2.	Objectives of financial reporting	31
3.	Qualitative characteristics	33
4.	Elements of financial statements	35
5.	Recognition	37
6.	Measurement	37
7.	Constraints	38
8.	Assumptions	38
9.	Example for illustrating the application of the IFRS Framework	40
10.	Financial information prepared on other bases	41
C.	Other Conceptual Frameworks	41
D.	Standard Setting: Internationally and in Canada	43
1.	Standards internationally	43
2.	Standards in Canada	43
3.	Organization and authority for setting accounting and auditing standards in Canada	44
4.	Globalization of standard setting	47
E.	Standards in Transition	50
F.	Appendix: Illustration of Capital Maintenance Concepts	50
G.	Summary	53

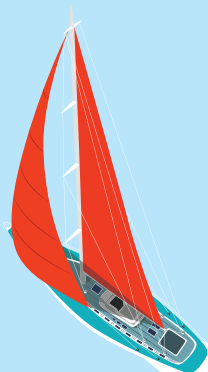
H. Answers to Checkpoint Questions	53
I. Glossary	54
J. References	55
K. Problems	56
L. Mini-Cases	66

CHAPTER 3 Accrual Accounting 71

A. Demand for Periodic Reporting and the Need for Accrual Accounting	73
B. Accrual Versus Cash Accounting	76
C. Uncertainty and the Essential Role of Estimates in Accrual Accounting	78
D. Quality of Earnings and Earnings Management	79
E. Periodicity, Cut-Off, and Subsequent Events	81
1. Periodicity	81
2. Cut-off	81
F. Accounting Changes: Errors, Changes in Accounting Policy, and Changes in Estimates	83
1. Correction of errors	83
2. Changes in accounting policy	83
3. Changes in accounting estimates	85
4. Illustrative example for practice	85
5. Summary	87
G. The Structure of Financial Reports and their Relationships	88
1. Overview of financial statement presentation and interrelationships	88
2. Balance sheet (statement of financial position)	91
3. Statement of changes in equity	95
4. Statement of comprehensive income	97
5. Statement of cash flows	98
6. Note disclosures	100
7. Discontinued operations and other non-current assets held for sale	100
8. Comparative figures	101
9. Putting it all together: An illustrative example	102
10. A practical illustration: Canadian Tire Corporation	102
H. Substantive Differences Between Relevant IFRS and ASPE	109
I. Appendix: Review of the Accounting Cycle	109
1. Journalizing	111
2. Posting	111
3. Adjustments	113
4. Preparing the financial statements	114
5. Journalizing closing entries	114
6. Posting of closing entries	115
7. Summary	115
J. Summary	116
K. Answers to Checkpoint Questions	117
L. Glossary	117
M. For Further Reading	118
N. References	119
O. Problems	119
P. Mini-Cases	144

CHAPTER 4 Revenue Recognition 146

A. Range of Conceptual Alternatives for Revenue Recognition	148
B. An Overview of Revenue Recognition Criteria	149
C. Revenue Recognition Criteria: A More Detailed Look	151
1. Identify the contract	151
2. Identify the performance obligation	151
3. Determine the transaction price	153



4. Allocate the transaction price to performance obligations	155
5. Recognize revenue in accordance with performance	156
6. Examples of multiple performance obligations, allocation, and recognition: Franchise fees	157
D. Other Related Issues	158
1. Expense recognition	158
2. Contract costs	159
3. Warranties	159
4. Onerous contracts	160
E. Specific Revenue Recognition Situations	160
1. Consignment sales	160
2. Installment sales	161
3. Bill-and-hold arrangements	162
F. Accounting for Long-Term Contracts	162
1. Revenue recognition for cost-plus contracts	163
2. Revenue recognition for fixed-price contracts: Application of changes in estimates	163
3. Revenue recognition for fixed-price contracts: The cost-to-cost approach	165
4. Accounting cycle for long-term contracts	167
5. Onerous contracts	169
6. Revenue recognition when outcome of a contract is uncertain: Cost recovery method	171
7. Alternative in ASPE: Completed contract method	171
G. Risk of Earnings Overstatement in Long-Term Contracts	172
1. Intentional overstatement: Earnings management	172
2. Unintentional overstatement: The winner's curse	173
H. Presentation and Disclosure	174
1. General presentation and disclosure requirements	174
2. Presentation and disclosure for long-term contracts	174
I. Substantive Differences Between IFRS and ASPE	174
J. Summary	175
K. Answers to Checkpoint Questions	176
L. Glossary	176
M. References	177
N. Problems	177
O. Mini-Cases	196
CHAPTER 5 Cash and Receivables	202
A. Cash and Cash Equivalents	204
1. Inclusions in cash and cash equivalents	204
2. Exclusions from cash and cash equivalents	204
3. Cash held in foreign currencies	205
4. Negative balances	206
5. Implications for the cash flow statement	206
B. Bank Reconciliations	206
C. Cash Management, Internal Controls, and Fraud Prevention	208
1. Segregation of duties	208
2. Monitoring by staff and customers	209
3. Implications for internal controls of other areas	209
D. Overview of Accounting for Non-Cash Assets	211
1. Initial recognition and measurement: Asset or expense?	211
2. Asset valuation on the balance sheet	212
3. Derecognition: Removal of an asset from the balance sheet	212
E. Trade Receivables: Initial Classification, Recognition, and Measurement	212
F. Subsequent Measurement of Trade Receivables: Accounting for Bad Debts	214
1. Percentage of sales method (income statement approach)	215
2. Aging of accounts method (balance sheet approach)	216



G. Derecognition of Receivables: Collection, Write-Offs, and Disposals	217
1. Collection	217
2. Write-offs	218
3. Transfer of receivables (factoring)	218
4. Transfer of receivables (securitization)	221
H. Comprehensive Illustration of Initial Recognition, Subsequent Measurement, and Derecognition of Accounts Receivable	222
I. Non-Trade Receivables	224
J. Accounting for Restructured Loans (from the Lender's Perspective)	225
K. Potential Earnings Management Using Receivables	226
1. Revenue recognition policy	226
2. Change in credit policy without change in allowance	226
3. Channel stuffing	226
4. Change in the calculation of net realizable value	226
5. Sale of receivables	227
L. Practical Illustration: Canadian Tire Corporation, Limited	227
M. Summary	229
N. Answers to Checkpoint Questions	229
O. Glossary	230
P. For Further Reading	231
Q. References	231
R. Problems	231
S. Mini-Cases	246

CHAPTER 6 Inventories 250

A. Information Systems for Inventory Control	252
1. Perpetual system	252
2. Periodic system	252
3. Comparison and illustration	252
B. Initial Recognition and Measurement	254
1. Purchased goods	254
2. Manufactured goods	255
3. Manufactured goods with abnormal production levels	256
C. Subsequent Measurement and Derecognition: Cost Allocation Between the Balance Sheet and Income Statement	257
1. Specific identification	258
2. Cost flow assumptions	258
3. Retail inventory method	262
D. Subsequent Measurement: Interaction of Cost Flow Assumptions and Information Systems for Inventory Control	265
E. Subsequent Measurement: Avoiding Overvaluation of Inventories	267
1. Meaning of "market"	267
2. Unit of evaluation	268
F. Accounting for Inventory Errors	269
G. Presentation and Disclosure	271
H. A Practical Illustration: Canadian Tire Corporation, Limited	271
I. Potential Earnings Management Using Inventories	272
1. Overproduction	272
2. Including non-production costs in inventory	272
3. Not identifying impaired or discounted items	272
J. Summary	273
K. Answers to Checkpoint Questions	273
L. Glossary	274
M. References	275
N. Appendix: Usage of Last-In, First-Out (LIFO) in The United States	275
1. Balance sheet effect and the LIFO reserve	275
2. Income effect and LIFO liquidation	275
3. Distortion of turnover ratio	276



O. Problems	277
P. Mini-Cases	297
CHAPTER 7 Financial Assets	303
A. Introduction	304
B. Overview of Financial Asset Classification	306
C. Strategic Equity Investments	307
1. Subsidiaries	307
2. Joint operations	309
3. Joint ventures	310
4. Associates	311
D. Non-Strategic Investments	313
1. Fair value through profit or loss (FVPL)	314
2. Fair value through other comprehensive income (FVOCI)	316
3. Amortized cost	316
4. Exception for equity investments with an irrevocable election	316
5. Reclassifications from one category to another	318
6. Example: A debt investment to illustrate the differences among FVPL, FVOCI, and amortized cost	319
E. Amortization of Debt Investments	322
1. The effective interest method	322
2. Using amortized cost in the accounting for financial assets	325
F. Impairment of Investments in Debt	328
G. Substantive Differences Between Relevant IFRS and ASPE	328
H. Summary	329
I. Answers to Checkpoint Questions	330
J. Glossary	330
K. References	331
L. Problems	331
M. Mini-Cases	346
CHAPTER 8 Property, Plant, and Equipment	348
A. Initial Recognition and Measurement	350
1. What should an enterprise capitalize?	350
2. How should enterprises categorize costs capitalized into property, plant, and equipment?	358
B. Subsequent Measurement	360
1. Basis of measurement: Historical cost versus current value	360
2. Impairment	361
3. Depreciation under the historical cost basis	361
C. Derecognition	367
D. Non-Monetary Transactions	370
1. Classification of non-monetary exchanges	370
2. Recognition of non-monetary exchanges	371
E. Potential Earnings Management Using Property, Plant, and Equipment	372
1. Including operating expenses in PPE	372
2. Interest capitalization	372
3. Depreciation parameters	373
4. Opportunistic disposals of PPE	373
F. Presentation and Disclosure of Property, Plant, and Equipment	373
G. Substantive Differences Between IFRS and ASPE	375
H. Summary	376
I. Answers to Checkpoint Questions	376
J. Glossary	377
K. References	378
L. Problems	378
M. Mini-Cases	399



CHAPTER 9	Intangible Assets, Goodwill, Mineral Resources, and Government Grants	407
A.	Intangible Assets—Initial Recognition and Measurement	409
1.	What qualifies as an intangible asset?	409
2.	What amounts should an enterprise capitalize as intangible assets?	411
B.	Intangible Assets—Subsequent Measurement	415
1.	Intangible assets with indefinite useful lives	415
2.	Intangible assets with finite useful lives	415
C.	Intangible Assets—Derecognition	416
D.	Goodwill	416
E.	Presentation and Disclosure	417
F.	Mineral Resources	419
1.	Three phases in mineral activities: Exploration, development, and extraction	419
2.	Full cost alternative under ASPE	420
3.	Other aspects of accounting for mineral exploration costs	422
4.	Example to illustrate the accounting for mineral resources	422
G.	Government Grants	423
1.	How should enterprises recognize government grants—as equity capital or income?	423
2.	When should enterprises recognize government grants?	424
3.	How should enterprises present government grants?	425
4.	Repayment of government grants	427
H.	Potential Earnings Management	428
1.	Capitalization of development costs	428
2.	Estimated useful lives of intangible assets	429
3.	Determination of exploration success or failure	429
I.	Substantive Differences Between IFRS and ASPE	429
J.	Summary	429
K.	Answers to Checkpoint Questions	430
L.	Glossary	431
M.	References	431
N.	Problems	432
O.	Mini-Cases	448
CHAPTER 10	Applications of Fair Value to Non-Current Assets	457
A.	Revaluation Model of Measuring Carrying Values Subsequent to Initial Acquisition	459
1.	Adjusting asset values for revaluation	460
2.	Accounting for the effect of revaluation on equity	462
3.	Adjusting depreciation in periods subsequent to revaluation	463
B.	Impairment	464
1.	Preliminary steps: What to test for impairment	465
2.	Impairment test	467
3.	Recognition of impairment	470
4.	Differences between impairment and revaluation	474
5.	Impairment standards in ASPE	475
6.	Economic roles of impairments	475
C.	Investment Property	477
1.	Definition of investment property and scope of IAS 40	477
2.	Subsequent measurement	477
3.	Transfers into and out of investment property	480
D.	Agriculture	483
1.	Definition of agricultural activity and scope of IAS 41	483
2.	Accounting for biological assets and agricultural produce	483
E.	Non-Current Assets Held for Sale and Discontinued Operations	487
F.	A Practical Illustration: Canadian Tire Corporation	489
G.	Substantive Differences Between IFRS and ASPE	491
H.	Summary	491



I. Answers to Checkpoint Questions	493
J. Glossary	493
K. References	494
L. Problems	495
M. Mini-Cases	511
APPENDIX A Statement of Cash Flows	A1
APPENDIX B Time Value of Money and Simple Valuation Techniques	B1
APPENDIX C Case Solving and Comprehensive Cases	C2
APPENDIX D Canadian Tire Corporation 2016 Consolidated Financial Statements	D2
Glossary	G2
Index	I2

