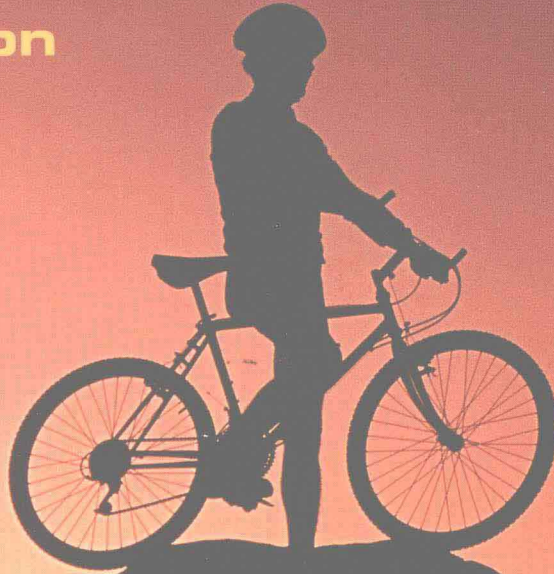


ESSENTIALS OF ACCOUNTING

Seventh Edition



Robert N. Anthony
Leslie K. Pearlman

Essentials of Accounting

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Robert N. Anthony and Leslie K. Pearlman

Harvard Business School

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for Katherine (RNA)
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Introduction

This book will help you teach yourself the essential ideas of accounting. You will learn what accounting information can—and cannot—tell you about an organization.

Accounting is the principal way of organizing and reporting financial information. Although there are differences in detail, the general structure and rules are similar in most countries and in most types of organizations.

Accounting has been called the language of business. Learning this language is complicated by the fact that many words used in accounting do not mean quite the same thing as they mean in everyday life. When using accounting words, it is important that you understand their accounting meaning.

As in any language, some accounting rules and terms have a single correct meaning, and others are like dialects in that their meaning varies with different users. You will learn to understand and allow for these differences.

HOW TO USE THIS PROGRAM

This program consists of “frames.” Each frame asks you to DO something: answer a question, make a calculation, fill in blanks. But these frames are NOT tests. As in most learning experiences, you learn by doing. You should be able to complete most frames without difficulty.

Procedures

- Read each frame in the left-hand column, while covering the right-hand column with the mask provided.
- *Write* your response in the space provided. Experience has shown that if you don’t write your response, you will not retain nearly as much information.
- Check your response by moving the mask so as to uncover the correct response in the right-hand column.
- If your response is correct, go to the next frame. Otherwise, study the frame again and try to understand why you were wrong.
- Some frames refer you to *Exhibits*. These are in a separate booklet. Remove it and use it when you are asked to do so.
- At the end of each part, there is a post test; you will find it in the separate booklet. When you have completed a part, complete the post test. If you have difficulty with it, review the frames on this topic.

- Do not skip frames. If you have difficulty with a particular point, go back to the frame in which it was first mentioned and review it from there.
- NOTE: Halfway through the book, the pages reverse so that the response column will always be on the right-hand side of the page.

Technical Conventions

_____ = Fill in the one word that is missing.

..... = Fill in the one *or more* words that are missing.

— — — — — = Fill in the letters that are missing, one to each underline.

. . . [Yes / No] = Underline or circle the correct alternative.

INSTRUCTOR'S GUIDE

An Instructor's Guide is available. It contains an overview of the text, instructions on how to use *Essentials of Accounting*, and quiz and examination material. This manual is provided free upon adoption.

The Instructor's Guide may be obtained by contacting your local sales representative, by calling the Prentice Hall Accounting and Tax Hotline at 1-800-227-1816, or by writing to:

Melissa Hayes
Business and Economics
Higher Education Publishing Group
Prentice Hall
1 Lake Street
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The following is in a separate booklet attached to the back of the book.

<i>Exhibits</i>	<i>1</i>
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Basic Concepts and the Balance Sheet

Learning Objectives

In this part you will learn:

- The nature of the balance sheet.
- The accounting meaning of assets, liabilities, and equity.
- The first three of the nine concepts that govern all accounting:
 - The dual-aspect concept.
 - The money-measurement concept.
 - The entity concept.

1-1. Accounting is a language. The purpose of any language is to convey information. Accounting information is provided by reports called **financial statements**. This program helps you understand what the numbers in the financial statements mean and how they can be used. Please tear out Exhibit 1 (in the separate booklet) to see one of these financial statements. As indicated by the title at the top of the page, this report is called a _____ **sheet**.

On an item like this, fill in one letter for each underline and then compare it with the correct answer, found here.

Balance

NOTE: Be sure to cover up the answers with the mask provided.

ELEMENTS OF THE BALANCE SHEET

1-2. A balance sheet gives financial information about an **entity**. The name of the entity that this balance sheet refers to is _____.

Garsden
Company

1-3. An entity is any organization for which financial statements are prepared. A business is an _____; a college, a government, a church, and a synagogue are also _____.

entity
entities

1-4. The balance sheet is a snapshot of the financial position of the entity as of one moment in time. As indicated by the heading in Exhibit 1, the balance sheet for Garsden Company reports its financial position as of December 31, _____.

2000

1-5. The date December 31, 2000, means [circle A or B]:

- A. it was prepared on December 31, 2000.
- B. it reports the entity’s financial position as of December 31, 2000.

B
(Probably, it was prepared early in 2001.)

1-6. Thus, the heading tells three things: (1) the fact that the report is a b____ s____, (2) the name of the _____, and (3) the “as of ” date.

balance sheet
entity

1-7. The Garsden Company balance sheet has two sides. The heading of the left side is A____, and the heading of the right side is L_____ and E_____. We shall describe the meaning of each side.

Assets
Liabilities Equity

ASSETS

1-8. Assets are valuable resources owned by the entity. An entity needs cash, equipment, and other resources in order to operate. These resources are its a____. The balance sheet shows the amounts of each of these assets as of a certain date.

assets

\$1,449,000
(Note that numbers on the Exhibit 1
balance sheet omit 000.)

are not
(*No one owns humans since the abolition of slavery.*)

On an item like this, circle the answer of your choice.

LIABILITIES AND EQUITY

1-11. The right side of the balance sheet shows the funding sources that provided the entity's assets. As the heading indicates, there are two general types of sources, L_____ and E_____.

Liabilities
Equity

1-12. Liabilities are the entity's obligations to outside parties who have furnished resources. These parties are generally called **creditors** because they have extended credit to the entity. As Exhibit 1 indicates, suppliers have extended credit in the amount of \$5,602,000 as indicated by the item A _____ p_____.

Accounts payable

1-13. Creditors have a **claim** against the assets in the amount shown as the liability. For example, a bank has loaned \$1,000,000 to Garsden Company, and therefore has a claim of this amount, as indicated by the item, _____.

Bank loan payable

1-14. Because an entity will use its assets to pay its claims, the claims are claims against _____. They are claims against all the assets, not any particular asset.

assets

1-15. The other source of the funds that an entity uses to acquire its assets is called **Equity**. In Garsden Company, equity investors provided funds for which they received common stock. The total amount supplied by equity investors is called **Total paid-in capital**. In Garsden Company, it was \$_____,_____,000. (We shall describe the details in a later part.)

\$12,256,000

NOTE: The term is Equity (singular) not Equities (plural) even though there are several sources of equity.

1-16. Equity funds also come from a second source, the profits or **earnings** generated by the entity. The amount of these earnings that has not been paid to equity investors in the form of dividends is retained in the entity, and therefore is called _____ earnings. In Garsden Company, the amount was \$_____,_____,000.

Retained
\$13,640,000

1-17. Thus, there are two sources of equity funds: (1) the amount provided directly by equity investors, which is called _____ - _____, and (2) the amount retained from profits (or earnings), which is called _____.

Paid-in
capital
Retained earnings

1-18. Creditors can sue the entity if the amounts due them are not paid. Equity investors have only a *residual claim*; if the entity is dissolved, they get whatever is left after the liabilities have been paid, which may be nothing. Liabilities therefore are a . . . [stronger / weaker] claim against the assets, and equity is a . . . [stronger / weaker] claim.

stronger
weaker

1-19. Thus, the right-hand side of the balance sheet reports two types of claims: (1) the claims of creditors, which are _____, and (2) the residual claim of equity investors, which is _____.

liabilities
equity

NOTE: We have described the right-hand side of the balance sheet in two somewhat different ways: (1) as the amount of funds supplied by creditors and equity investors, and (2) as the claims of these parties against the assets. Both are correct.

DUAL-ASPECT CONCEPT

1-20. Whatever assets remain after the liabilities are taken into account will be claimed by the equity investors. Consider the case of an entity whose assets total \$10,000, and whose liabilities total \$4,000. Its equity must be \$_____.

\$6,000 (= \$10,000 – \$4,000)

A single blank indicates that the answer is one word or, when preceded by the dollar sign as it is here, one amount.

1-21. (1) Any assets not claimed by creditors will be claimed by equity investors, and (2) the total amount of claims (liabilities + equity) cannot exceed what there is to be claimed. Therefore, the total amount of assets will always be . . . [greater than / equal to / less than] the total amount of liabilities plus equity.

equal to

1-22. Here is the balance sheet of Garsden Company, greatly condensed so as to focus on the main elements, and disregarding the thousands:

GARSDEN COMPANY			
Balance Sheet as of December 31, 2000			
(000 omitted)			
Assets		Liabilities & Equity	
Cash	\$ 1,449	Liabilities	\$12,343
Other assets	36,790	Equity	25,896
Total	\$38,239	Total	\$38,239

The total of the left side is \$_____,_____,000, and the total of the right side is \$_____,_____,000.

38,239,000
38,239,000

1-23. As shown by the Garsden Company balance sheet given in frame 1-22:

- 1. \$38,239,000 of these funds were supplied to the entity from sources listed on the . . . [left / right] side.
- 2. They are invested in assets listed on the . . . [left / right] side.
- 3. The total amount of assets must be the same as the amount of the sources of these assets. The amount of these assets therefore must be \$ __ __ , __ __ __ , 000.

right
left

38,239,000

1-24. This is another way of saying that total assets must always equal total __ __ __ __ __ plus __ __ __ __ __.

liabilities equity

- 1-25. If the total assets are less than the total liabilities plus equity, the reason may be (circle one):
- A. Assets have been lost or stolen.
 - B. The accountant has made an error.

B
(When correctly done, the two sides are always equal.)

1-26. The fact that total assets must equal, or **balance**, total liabilities plus equity is why the statement is called a __ __ __ __ __. This equality tells nothing about the entity's financial condition; it always exists unless the accountant has made a mistake.

balance
sheet

1-27. This equality leads to what is called the **dual-aspect concept**. The two aspects to which this concept refers are (1) __ __ __ __ __ and (2) __ __ __ __ __ plus __ __ __ __ __, and the concept states that these two aspects are always __ __ __ __ __. (In what relation to each other?)

assets
liabilities equity
equal

1-28. This equality exists even if liabilities are greater than assets. For example, if in an unprofitable business assets were \$100,000 and liabilities were \$120,000, equity would be a [positive / negative] amount of \$ __ __ __ __ __.

negative
\$20,000

1-29. The dual-aspect concept is the first of nine fundamental accounting concepts we shall describe in this program. The concept can be written as an equation; that is, a statement that something is equal to something else. Write this equation, using the words Assets, Liabilities, and Equity:

_____ = _____ + _____

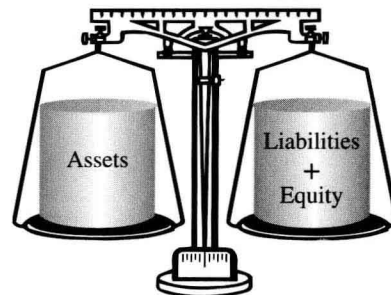
1-30. This equation is fundamental. It governs all accounting. Write a similar equation in a form that emphasizes the fact that equity is a residual interest:

_____ - _____ = Equity

1-31. The liabilities of Violet Company total \$3,000. Its equity totals \$16,000. The company must have assets that total \$_____.

1-32. Suppose a business had assets totaling \$20,000 and liabilities totaling \$18,000. Evidently, its equity was \$_____.

1-33. Suppose a business has \$30,000 in assets. Between the claims of the creditors (the _____) and those of equity investors, which have the first, or priority, claim? _____.



Assets = Liabilities + Equity

Assets - Liabilities

\$19,000 (= \$3,000 + \$16,000)

\$2,000 = (\$20,000 - \$18,000)



Always equal!
The two sides **balance**.

liabilities
creditors (liabilities)

1-34. As a review of terms we have discussed so far, here is a list of ordinary terms. In the right-hand column, write the accounting term for each.

Ordinary Term	Accounting Term
things of value	_____
one who lends money	_____
creditors' claims	_____
investors' claims	_____

assets
creditor
liabilities
equity

1-35. At the close of business on December 31, 1999, Dowling Company had \$2,000 in its bank account. It owned other assets totaling \$24,000. The company owed \$10,000 to creditors. Its equity was \$16,000. Complete the balance sheet for Dowling Company:

DOWLING COMPANY			
Balance Sheet as of _____			
Assets		Liabilities and Equity	
Cash	\$ <input type="text"/>	Liabilities	\$ <input type="text"/>
Other assets	<input type="text"/>	Equity	<input type="text"/>
Total	\$ <input type="text"/>	Total	\$ <input type="text"/>

December 31, 1999

\$ 2,000	\$10,000
24,000	16,000
\$26,000	\$26,000

1-36. One year later, on December 31, 2000, Dowling Company owed \$8,000 to creditors and had \$3,000 in its bank account. Other assets totaled \$25,000.

One item is missing. Calculate the amount of this item so that the balance sheet will balance. Prepare a balance sheet as of December 31, 2000, on a separate piece of paper.

DOWLING COMPANY			
Balance Sheet as of December 31, 2000			
Assets		Liabilities & Equity	
Cash	\$ 3,000	Liabilities	\$ 8,000
Other assets...	25,000	Equity.....	20,000
Total.....	\$28,000	Total	\$28,000

1-37. If Dowling Company prepared a balance sheet as of the beginning of business the next day, January 1, 2001, would it be different from the one you prepared above? . . . [Yes / No]

1-38. The term “Net assets” is sometimes used instead of “equity.” It refers to the fact that equity is always the difference between A_____ and L_____.

NOTE: You will see the term “Net Assets” instead of “Equity” on some balance sheets.

MONEY-MEASUREMENT CONCEPT

1-39. If a fruit store owned \$200 in cash, 100 dozen oranges, and 200 apples, could you add up its total assets from this information? . . . [Yes / No]

1-40. If you knew that the 100 dozen oranges cost \$5 a dozen and the 200 apples cost \$0.40 each, you could then add these amounts to the \$200 cash, and find the total assets to be \$_____.





NOTE: We use “*” to mean “multiply by.” Some people use “x.”





1-41. To add together objects as different as apples, oranges, automobiles, shoes, cash, supplies, etc., they must be stated in . . . [different / similar] units.

No (because nothing changes between the close of business on one day and the beginning of business on the next day)

Assets
Liabilities

No (because you can't add apples and oranges)

Cash	\$200	
 	100 dozen	
 	200	
	_____	Can't add

	\$780	
Cash	\$200	\$200
 	500	(= 5 * 100)
 	80	(= 0.40 * 200)
	_____	_____
	\$780	\$780

similar

1-42. Can you add the amounts of apples and oranges if they are stated in terms of money? . . . [Yes / No]

Yes (*You could also add them to get “pieces of fruit” but this is not a useful number for accounting purposes.*)

1-43. The facts that appear in an accounting report are stated in units of money; that is, dollars and cents. This is the **money-measurement concept**. By converting different facts to monetary amounts, we can deal with them . . . [verbally / arithmetically]; that is, we can add one item to another, or we can _____ one item from another.

arithmetically
subtract

1-44. The money-measurement concept states that accounting reports only those facts that can be stated as m_____ a_____.

monetary amounts

1-45. If facts cannot be expressed in monetary terms, they cannot be reported on a balance sheet. Which of the following facts could be learned by reading a balance sheet of Able Company?

- A. How much cash Able Company has.
- B. The health of the president of Able Company.
- C. How much money Able Company owes.
- D. A strike is beginning at Able Company.
- E. How many automobiles Able Company owns.

A and C
(*Not E because the number of automobiles is not a monetary amount.*)

1-46. Because accounting reports include only facts that can be stated in monetary amounts, accounting is necessarily a(n) . . . [complete / incomplete] record of the status of a business and . . . [does / does not] always give the most important facts about a business.

incomplete
does not

1-47. Some people believe that accounting reports tell everything important that one needs to know about a business. Such a belief is . . . [correct / wrong].

wrong

1-48. The **money-measurement concept** is the second of the nine major accounting concepts to be explained in this program. The first one was the **dual-aspect concept**. What is the meaning of each of these concepts? (Write your answer on a separate piece of paper.)

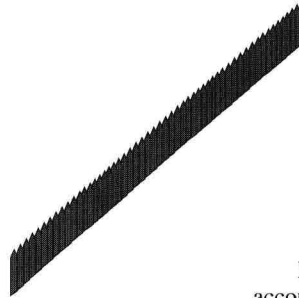
Dual-aspect concept:
 $\text{Assets} = \text{Liabilities} + \text{Equity}$
Money-measurement concept:
Accounting reports show only facts that can be expressed in monetary amounts.

ENTITY CONCEPT

1-49. Accounts are kept for **entities**, rather than for the persons who own, operate, or otherwise are associated with those entities. For example, suppose Green Company is a business entity, and Sue Smith is its owner. Sue Smith withdraws \$100 from the business. In preparing financial accounts for Green Company, we should record the effect of this withdrawal on the accounts of . . . [Sue Smith / the entity].



The accounting entity



Owner



NOT the
accounting entity

1-50. Sue Smith withdraws \$100 from Green Company, of which she is the sole owner. Smith now has \$100 more cash, but she has \$100 less equity in Green Company. Smith is . . . [better off / worse off / no better or worse off] than she was before.

1-51. If Smith withdraws \$100 from Green Company, of which she is the sole owner, she is just as well off after this withdrawal as before. What about Green Company? It now has . . . [\$100 more / the same amount / \$100 less] in assets.

1-52. Evidently, an event can affect the owner in one way and the entity in another way. Financial statements of Green Company report the effect that the event has:

- A. only on the owner.
- B. only on the entity.
- C. on both the owner and the entity.

the entity

no better or worse off

\$100 less

B

(Sue Smith can, of course, have her own personal financial statements.)