Walter B. Meigs & Robert F. Meigs

Study Guide for use with

FINANCIAL ACCOUNTING

Fifth Edition

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FINANCIAL ACCOUNTING

FIFTH EDITION

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TO THE STUDENT

This self-study guide is designed for your use as a student taking your first course in accounting at either the undergraduate or the graduate level. It is prepared to accompany ***Financial Accounting,*** fifth edition, by Meigs and Meigs. However, it can be used effectively with other introductory accounting texts. The key purposes of this study guide are:

1 To help you in ***mastering the material*** as you initially study each chapter.

2 To ***summarize the essential points*** in each chapter and to ***test your knowledge*** with a series of objective questions and exercises, thus making it possible for you to ***review the material quickly*** from time to time, particularly before examinations.

3 To make the study of accounting ***more enjoyable and more efficient*** for you. This is accomplished by presenting an informal and concise summary of each chapter, followed by three groups of objective questions and some short exercises. The answers to these questions and exercises are provided at the back of the study guide ***in order to give you immediate feedback and to point out areas that need additional attention.***

The manner in which each student uses this study guide may differ. However, we recommend the following approach:

1 Study the chapter in your textbook.

2 Read the ***Highlights of the Chapter*** section of the study guide. If you encounter any statements that you do not understand, refer to the textbook for a more detailed discussion of the topic.

3 Work the questions and exercises in the ***Test Yourself*** section of the study guide, and compare your answers and solutions with those provided in the back of the guide. This will show you how well you really understand the material contained in the related chapter of your textbook. Again, if you find something you do not understand, refer to your text for a thorough discussion of the subject.

4 Work the problems assigned as homework in your text.

Once you have mastered the material in this manner, rereading the ***Highlights of the Chapter*** section of the study guide will assist you in quickly reviewing the material before examinations.

Walter B. Meigs
Robert F. Meigs

CONTENTS

1 ACCOUNTING: THE LANGUAGE OF BUSINESS

HIGHLIGHTS OF THE CHAPTER

1 The basic purpose of accounting is to provide financial information about a business enterprise or any other economic entity. This information is needed internally by managers and also by outsiders such as bankers, other creditors, investors, and certain government agencies. In short, anyone who must make ***decisions*** regarding a business enterprise has need of ***accounting information.***

2 Most businesses enter into so many different transactions every year that a complete list of these transactions would be too long to be useful to decision makers. An accounting system creates ***useful*** information by (a) ***recording*** business events as they occur, (b) ***classifying*** these events into related groups, and (c) ***summarizing*** this information into accounting reports designed to meet the information needs of decision makers.

3 The major types of accounting reports include (a) financial statements, (b) tax returns, (c) specialized reports to management, and (d) reports to governmental regulatory agencies. In this accounting course, we shall emphasize the information contained in financial statements.

4 Financial statements are useful to management and also the primary source of accounting information to persons outside the business enterprise. These statements show the financial position of the business at a given date and also the operating results which caused it to arrive at this position.

5 The accounting concepts, measurement techniques, and standards of presentation used in the preparation of financial statements are called ***generally accepted accounting principles.*** Developing accounting information in conformity with generally accepted accounting principles is often termed ***financial accounting.*** Developing accounting information to fill the specialized needs of management, on the other hand, is called ***managerial accounting.***

6 ***Bookkeeping*** refers to the mechanical aspects of recording and classifying transactions, and is but a small part of the field of accounting. ***Accounting*** includes the design of the financial information system, preparation of financial statements, development of forecasts, cost studies, tax consulting, and the ***analysis*** and ***interpretation*** of accounting information to assist decision makers in making ***informed*** decisions.

7 Careers in accounting may be divided into three broad areas: (a) the public accounting profession, (b) private accounting, and (c) governmental accounting.

8 Public accounting is practiced by ***certified public accountants,*** called CPAs. CPAs are granted a license to practice by the state, and perform professional accounting services for clients for a fee. These services include:

a ***Auditing*** An audit is an investigation of a company's accounting system to determine that the financial statements ***present fairly*** its financial position and operating results. All large corporations and many small companies are audited annually by a CPA firm.

b ***Tax services*** Taxes often play an important role in financial decisions. CPA firms offer "tax planning" services to minimize the impact of taxes on their clients, and also assist in the preparation of their clients' income tax returns.

c ***Management advisory services*** CPA firms may become familiar with their clients' problems and be able to recommend corrective action. This service is actually ***management consulting.***

9 ***Private accounting*** refers to the work of accountants employed directly by private industry. The functions of accountants in private industry include:

a ***Design of accounting systems*** Although most business concerns follow the same basic accounting principles, each firm will require its own individually tailored accounting system.

b ***Cost accounting*** This is the specialized field of determining the cost of manufacturing a product or performing a specific process.

c ***Financial forecasting*** A financial ***forecast (budget) is a plan*** of financial operations for the future. The forecast helps management to set goals, and then to measure actual performance relative to these goals.

d ***Tax accounting*** Tax specialists play as important a role in private accounting as they do in public accounting.

e ***Internal auditing*** Internal auditors are responsible for seeing that the objectives of a company are being carried out efficiently in all departments. Unlike CPAs, internal auditors are ***not*** responsible for determining the fairness of annual financial statements.

10 ***Governmental accounting*** includes many specialized areas such as monitoring regulated industries, auditing tax returns, and preparing budgets for governmental agencies. Two important governmental agencies using accounting information are:

a ***Internal Revenue Service*** The IRS processes the federal income tax returns filed by individuals and corporations.

b ***Securities and Exchange Commission*** The SEC reviews and approves the financial disclosure by corporations which offer their securities for sale to the public.

11 In the United States, four groups which have been influential in improving accounting principles and practices are the ***American Institute of Certified Public Accountants*** (AICPA), the ***Securities and Exchange Commission*** (SEC), the ***American Accounting Association*** (AAA), and the ***Financial Accounting Standards Board*** (FASB). The FASB conducts research and issues Statements of Financial Accounting Standards which represent authoritative expressions of generally accepted accounting principles.

12 Two primary objectives of most business concerns are to make a profit and remain solvent. Being ***solvent*** means having the cash to pay debts on time. The accounting system is the means by which profitability and solvency are measured.

13 Steps taken to ensure the reliability of accounting information and to safeguard the resources of a business against waste, fraud, or inefficient use are called the system of ***internal control.***

14 Accounting information is gathered for specific business entities. A business ***entity*** is any economic unit which enters into business transactions. The business entity is regarded as separate from its owners; the entity owns its own property and has its own debts.

15 The three most common forms of business entities are single proprietorships, partnerships, and corporations. Accounting principles and concepts apply to all three forms of organization.

a A single proprietorship is a business owned by one individual.

b A partnership is a business owned by two or more people who have agreed to act as partners.

c A corporation is a business granted a charter by the state and owned by ***stockholders.*** Ownership is evidenced by shares of capital stock which may be sold by one investor to another. The stockholders elect a ***board of directors*** to oversee the operation of the business; the directors, in turn, appoint officers and managers of the business.

16 A corporation is legally an entity separate from its owners. Thus, the stockholders' liability for the losses incurred by an unsuccessful corporation is limited to the amount they have invested in the business. Nearly all large businesses and many small ones are organized as corporations.

17 The two most widely used financial statements are the ***balance sheet*** and the ***income statement.*** A balance sheet shows the financial position of a business at a particular date. It consists of a list of the company's assets, liabilities, and owners' equity. (The income statement will be discussed in Chapter 3.)

18 Assets are economic resources owned by a business, such as land, buildings, and cash. Assets are valued on a balance sheet at their ***cost***, rather than at current market prices, because cost is more factual and can be more ***objectively determined*** than current market value. Another reason for valuing assets at cost is that a business is assumed to be a ***going concern*** that will keep and use such assets as land and buildings rather than sell them.

19 The validity of the ***cost principle*** is weakened by inflation. Inflation has caused many accountants to recommend valuing assets at appraised value or replacement cost rather than at original (historical) cost. In Great Britain, for example, current values are used in accounting for assets. The problem of asset valuation is complex and will be given much attention in later chapters.

20 Liabilities are debts. Either borrowing money or buying on credit will create a liability. Liabilities represent the claims of ***creditors*** to the resources of the business. Examples of liabilities are accounts payable and notes payable.

21 Owners' equity represents the owners' investment in the business; it is equal to total assets minus liabilities. Owners' equity in a corporation is called ***stockholders' equity***. The equity of the owners is a residual amount. It is the claim to all resources (assets) of the business ***after*** the claims of the creditors have been satisfied. If a loss occurs, it is the owners' equity rather than the creditors' claims which must absorb the loss. Thus, creditors view the owners' equity as a "buffer" which protects the safety of their claims to the resources of the business.

22 Increases in stockholders' equity result from (a) the owners investing cash or other assets in the business in exchange for capital stock and (b) profitable operation of the business. Stockholders' equity is decreased by (a) the payment of ***dividends*** to stockholders and (b) unprofitable operation of the business.

23 In the balance sheet of a corporation, stockholders' equity is presented in two parts: capital stock and retained earnings. ***Captial stock*** represents the owners' equity resulting from the owners investing assets in the business. ***Retained earnings*** represents the increase in owners' equity resulting from profitable operation of the business. The term retained earnings describes only those earnings which were ***not*** paid out as dividends to stockholders.

24 The "accounting equation" is ***Assets = Liabilities + Owners' Equity***. The listing of assets shows us what things the business owns; the listing of liabilities and owners' equity tells us who supplied these resources to the business and how much each group supplied.

25 You should become familiar with the effects of various transactions upon a balance sheet.

a Purchasing an asset for cash is merely trading one kind of asset for another. Total assets will not change.

b Purchasing an asset on credit will cause total assets to increase because additional resources are being acquired, and none is being given up. However, total liabilities will increase by the same amount.

c Paying a liability with cash will cause both total assets and total liabilities to decrease.

TEST YOURSELF ON THIS INTRODUCTORY CHAPTER

True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

T F 1 The basic purpose of accounting is to provide financial information to economic decision makers.

T F 2 Bookkeeping is only a small part of the field of accounting and probably the simplest part.

T F 3 The most useful financial statement would be a detailed list of every business transaction in which the business enterprise has been involved.

T F 4 Financial statements are confidential documents made available only to the top management of a business enterprise.

T F 5 A basic principle of internal control is that one person should handle all phases of a transaction from beginning to end.

T F 6 The chief accounting officer of a corporation is usually called the controller.

T F 7 A forecast for a business enterprise is always prepared by the CPA firm conducting the annual audit.

T F 8 The Financial Accounting Standards Board is an authoritative source of generally accepted accounting principles in the United States.

T F 9 A business may be profitable, but not solvent.

T F 10 A business may be solvent, but not profitable.

T F 11 A comprehensive list of all generally accepted accounting principles (GAAP) is available for accountants and users of financial statements.

T F 12 One characteristic of a corporation is that its owners are personally liable for any losses incurred by the business.

T F 13 Assets are valued on the balance sheet at current liquidation values to show how much cash would be realized if the business went broke.

T F 14 The cost principle of asset valuation is no longer widely used in the U.S.

T F 15 Losses from unprofitable operations cause the owners' equity in a business enterprise to decrease.

T F 16 The purchase of a building for cash will cause total assets to increase.

T F 17 The payment of a liability will not affect total assets, but will cause total liabilities to decrease.

T F 18 In the balance sheet of a single proprietorship, any increase in capital earned through profitable operations and retained in the business is added to the capital originally invested, and a single figure is shown for the owners' capital.

T F 19 State laws require corporations to show capital stock and retained earnings separately in the balance sheet.

Completion Statements

Fill in the necessary words or amounts to complete the following statements:

1 Two major financial statements are the ________ ________ and the ________ ________.

2 The three basic steps in the accounting process are (a) ________ transaction, (b) ________ these events into groups, and (c) ________ the information in accounting reports.

3 The accounting concepts, measurement techniques, and standards of presentation used in the preparation of financial statements are called ________ ________ ________ ________.

4 An investigation of the accounting system of a business to determine the fairness of the firm's financial statements is called an ________.

5 The governmental agency which reviews and approves the financial disclosure by companies which offer their securities to the public is the ________ ________ ________ ________.

6 *Statements of Financial Accounting Standards* are authoritative expressions of generally accepted accounting principles issued by the ________ ________ ________ ________.

7 Two primary objectives of most business concerns are (a) making a ________ and (b) remaining ________.

8 The steps taken to ensure the reliability of the accounting information and to safeguard the assets of the firm against waste, fraud, or inefficient use make up the system of ________ ________.

9 The three common forms of business organizations are (a) ________ ________, (b) ________, and (c) ________.

10 The heading of a balance sheet should include (a) ________ __ __ ________, (b) ________ __ __ ________, and (c) ________.

11 Two reasons supporting the cost principle of asset valuation are the "________" assumption and the ________ principle. Some accountants, however, suggest that assets should be valued at appraisal value or ________ cost rather than at ________ cost.

12 Since the claims of ________ have priority over those of the ________ of a business, the owners' equity is called a ________ claim.

13 The accounting equation states that ______ = ____________ + _______ ____________.

14 Land advertised for sale at $90,000 was purchased for $80,000 cash by a development company. For property tax purposes, the property was assessed by the county at $25,000. The development firm intended to sell the property in parcels for a total of $150,000. The land would appear on the balance sheet of the development company among the ________ at a value of $ ______.

15 On December 15, Shadow Mountain Golf Course had a contractor install a $90,000 sprinkler system. Since no payment to the contractor was required until the following month, the transaction was not recorded in December and was not reflected in any way in the December 31 balance sheet. Indicate for each of the following elements of the balance sheet whether the amounts were overstated, understand, or correct. Total assets ________________, total liabilities ________________________________, owners' equity ______________________.

16 The owners' equity in a business comes from two sources: (a) ____________________ and (b) ______________.

17 A transaction which causes total liabilities to increase but which has no effect on owners' equity must cause total assets to ______________________.

18 Retained earnings represent the total earnings (profits) of a business which have not been paid out as ____________________ to the ________________.

Multiple Choice

Choose the best answer for each of the following questions and enter the indentifying letter in the space provided.

_____ 1 Which of the following best describes the nature of an asset?
a Something with a ready market value.
b An economic resource, which will provide some future benefits, owned by a business.
c Tangible property (something with physical form) owned by a business.
d The amount of the owners' investment in a business.

_____ 2 The principal reason for annual audit of a business corporation by a firm of certified public accountants (CPAs) is:
a To obtain an independent expert opinion on the fairness and dependability of the financial statements prepared by the company and distributed to stockholders, bankers, and other outsiders.
b To detect fraud on the part of company personnel.
c To assist the accounting department of the company in handling the heavy year-end work of preparing financial statements.
d To relieve management of the responsibility for financial reporting to stockholders and other outsiders.

_____ 3 The primary objective of the internal auditor is to:
a Conduct an annual audit of a company's accounting system to determine that the financial statements present fairly its financial position and operating results.
b Observe the business transactions of the firm to be sure the annual tax returns are accurately prepared.
c Aid management by investigating and reporting on accounting, financial, and other operations of the company.
d Render a professional opinion as to the fairness and accuracy of the budget.

_____ 4 Which of the following equations ***cannot*** be derived from the basic accounting equation (Assets = liabilities + owners' equity)?
a Assest − Liabilities = Owners' Equity.
b Liabilities = Assets − Owners' Equity.
c Owners' Equity = Liabilities − Assets.
d Assets − Owners' Equity = Liabilities.

_____ 5 The balance sheet item, Retained Earnings:
a Appears in the stockholders' equity section for a corporation in which earnings have exceeded dividends.
b Is always equal to the amount of cash owned.
c Appears on the balance sheet of a single proprietorship if the earnings of the business have exceeded the withdrawls by the proprietor.
d Appears among the assets of any form of business organization in which earnings have exceeded amounts distributed to owners.

_____ 6 Magic Forest Land Development Company sold a parcel of land at a profit. This will cause:
a A decrease in assets and liabilities.
b An increase in assets and owners' equity.
c An increase in assets and liabilities.
d A decrease in liabilities and owners' equity.

_____ 7 Lake Arrowhead Boat Shop bought a $700 electric hoist to lift engines out of boats. The boat shop paid $200 in cash for the hoist and signed a note to pay the balance in 60 days. This transaction will cause:

a The boat shop's assets to increase by $700 and liabilities to increase by $500.
b Assets to increase to $500 and owners' equity to decrease.
c No change in total assets, but a $500 increase in liabilities and a similar decrease in owners' equity.
d No change in owners' equity, but a $500 increase in both assets and liabilities.

Exercises

1 In the space provided below, prepare a balance sheet for the Titan Corporation at December 31, 19__, from the following alphabetical list of accounts:

Accounts payable	$ 28,000
Accounts receivable	37,000
Automobiles	8,000
Buildings	60,000
Capital stock	100,000
Cash	14,000
Income taxes payable	12,000
Land	35,000
Office equipment	16,000
Retained earnings	30,000

TITAN CORPORATION
Balance Sheet
December 31, 19__

Assets		Liabilities & Stockholders' Equity	
	$	Liabilities:	
			$
	$		$

2 Use the following information to complete the balance sheet of the Unitrex Corporation on December 31, 19__.
a The corporation was organized on January 1, 19__, and has operated for the full year 19__.
b Earnings have amounted to $100,000, and dividends of $20,000 have been paid to stockholders.
c Cash and Accounts Receivable together amount to three times as much as Accounts Payable.

UNITREX CORPORATION
Balance Sheet
December 31, 19__

Assets	
Cash	$ 42,000
Accounts receivable	
Land	90,000
Building	260,000
Office equipment	56,000
Total assets	$

Liabilities & Stockholders' Equity		
Liabilities:		
Notes payable		$
Accounts payable		
Income taxes payable		40,000
Total liabilities		$112,000
Stockholders' equity:		
Capital stock	$	
Retained earnings		
Total liabilities & stockholders' equity		$592,000

3 The Billiard Den was organized by Robert Neal on July 1 of the current year. In the space below, indicate the effect of each of the following transactions on the various balance sheet items of the Billiard Den. Indicate the new balance for every item after the July 3 transaction and each subsequent transaction. The effects of the July 1 transaction are already filled in to provide you with an example.

July 1 Issued capital stock to Robert Neal in exchange for $20,000 cash invested in the business.

3 Purchased an existing pool hall at a price of $21,000 for the land and $30,000 for the building. Neal paid the former owner $10,000 in cash and issued a short-term note payable for the balance of the purchase price.

10 Purchase 10 pool tables for $1,000 each, paying $6,000 cash and agreeing to pay the balance due in 30 days.

14 Sold one pool table to a friend for $1,000. The friend paid $500 cash to the Billiard Den and promised to pay the balance within 30 days.

20 Paid $2,000 of the amount owed on the pool tables.

24 Collected $200 from the friend who has bought the pool table.

30 Purchased one used pool table from another pool hall, paying $600 cash.

	Assets					= Liabilities		+ Owners' Equity
	Cash	Accounts Receivable	Land	Building	Pool Tables	Notes Payable	Accounts Payable	Capital Stock
July 1	+$20,000							+$20,000
3								
Balances								
10								
Balances								
14								
Balances								
20								
Balances								
24								
Balances								
30								
Balances								

2

RECORDING CHANGES IN FINANCIAL POSITION

HIGHLIGHTS OF THE CHAPTER

1 Many businesses engage in hundreds or even thousands of business transactions every day. Obviously, it would be too costly and time-consuming to prepare a new balance sheet after each transaction. Instead, the effects of these transactions are stored in the ***ledger*** until the end of a month or year, when new financial statements are prepared.

2 A ***ledger account*** is maintained for every item on the balance sheet. Thus, we have a ledger account for each type of asset (such as Cash), for each type of liability (such as Accounts Payable), and for each element of owners' equity (such as Capital Stock).

3 Each ledger account occupies a separate page in a loose-leaf book called a ***ledger.*** The ledger is a permanent, important, and basic accounting record. For example, the first page in a ledger might be the ledger account entitled ***Cash.*** It would show increases and decreases in cash, resulting from the many transactions in which cash is received or paid.

4 A balance sheet is usually prepared at the end of each month by listing the cumulative balances of accounts contained in the ledger.

5 A ledger page is divided into two sections by a verticle line drawn down the center of the page. The left half of the page is called the ***debit*** side; the right half of the page is the ***credit*** side.

6 An amount recorded on the left side of a ledger page is called a ***debit entry;*** an amount recorded on the right side is called a ***credit entry.***

7 Asset accounts normally have debit balances; that is, the amounts entered on the debit (or left) side are larger than the amounts entered on the credit (or right) side. For example, Cash is an asset account and has a debit balance.

8 Liability accounts and owners' equity accounts normally have credit balances because the amounts entered on the credit (right-hand) side of such accounts are greater than the amounts entered on the debit (left-hand) side.

9 For all ***asset*** accounts, increases are recorded by debits, and decreases are recorded by credits.

10 For all ***liability*** accounts and ***owners' equity*** accounts, increases are recorded by credits, and decreases are recorded by debits.

11 The double-entry system of accounting (which is almost universally used) requires that ***equal debits and credits*** be recorded for ***every*** transaction.

12 Most ledger accounts are actually designed in a ***running balance*** form. This means there is a third column, on the extreme right side of the account, which shows the ***balance*** (the amount by which the debits exceed the credits, or vice versa) of the account.

13 Since every transaction results in recording equal dollar amounts of debits and credits (double entry), it follows that the total of the debit entries in the ledger must equal the total of the credit entries. It also follows that the total of the debit balance accounts must equal the total of the credit balance accounts. When this equality of debits and credits exists, we say the ledger is ***in balance.*** Otherwise, one or more errors must have been made in recording transactions.

14 Accounts are arranged in the ledger in the same sequence as they appear on the balance sheet: asset accounts first, then liabilities, and finally owners' equity. Each account has a number, but many numbers are skipped, so that later a new account may be inserted in the ledger if the business acquires a new type of asset, liability, or owners' equity.

15 A very small business could record transactions directly in the ledger as they occurred. However, this procedure would be inefficient and it would be difficult to locate errors because you could not locate all the parts of one transaction. Therefore, virtually every business also maintains a ***journal***, or ***book of original entry***. A journal is a chronological record listing the transactions in the order they occur.

16 The journal shows all information about one transaction in one place. It shows (a) the date of transaction, (b) the account(s) debited, (c) the account(s) credited, and (d) a written explanation of the transaction.

17 After a transaction has first been recorded in the journal, each debit and credit is later transferred to the proper ledger accounts. This transfer is called ***posting***.

18 At month-end, when all entries in the journal have been posted to the ledger, the debit or credit balance of each account is computed (unless running balance form ledger accounts are maintained). These balances are listed in a ***trial balance***. The trial balance is a two-column schedule listing the names and balances of all accounts in the order they appear in the ledger. Debit balances are listed in the left-hand column of the trial balance, and credit balances are listed in the right-hand column. Since the total of the debit balances should equal the total of the credit balances, the totals of the two columns of the trial balance ***should be equal***, if the ledger is in balance.

19 The trial balance proves that an equal number of debits and credits were posted to the ledger, and also that the arithmetic in determining the account balances was correct. However, it does not prove that all transactions were correctly recorded in the journal. For example, the trial balance would not disclose the omission of an entire transaction (both the debit and credit parts) from the journal. Also if the ***right amount*** of debits or credits was entered in the ledger but the entry was made to the ***wrong account***, the trial balance would not reveal the error.

20 The trial balance is not a formal financial statement, but merely a preliminary step to preparing financial statements.

21 The balance sheet is prepared from the trial balance.

22 The sequence of accounting procedures used to record, classify, and summarize accounting information is often termed the ***accounting cycle***. The accounting cycle to prepare a balance sheet is (1) record transactions in the journal, (2) post to ledger accounts, (3) prepare a trial balance, and (4) prepare financial statements.

23 In a computer-based accounting system, transaction data may be initially entered into a ***data base***, instead of a journal. A data-base is a warehouse of information stored within the computer. The data originally entered into the computer is the same as contained in a journal entry: the date, the accounts to be debited and credited, and an explanation of the transaction. The computer operator will only have to enter the data once; from then on the computer can arrange this information into any desired format, such as journal entries, ledger accounts, and financial statements.

TEST YOURSELF ON RECORDING CHANGES IN FINANCIAL POSITION

True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

T F **1** In a prosperous and solvent business the accounts with credit balances will normally exceed in total dollar amount the accounts with debit balances.

T F **2** The term ***debit*** may signify either an increase or a decrease; the same is true of the term ***credit***.

T F **3** All transactions are recorded in the journal and in ledger accounts by equal amounts of debit and credits.

T F **4** A business transaction is always recorded in the ledger by entries to two or more different ledger accounts.

T F **5** An entry on the left side of a ledger account is called a debit entry, and an entry on the right side is called a credit entry, regardless of whether the account represents an asset, a liability, or owners' equity.

T F 6 Accounts representing items which appear on the left-hand side of the balance sheet usually have credit balances.

T F 7 Decreases in a ledger account are recorded by debits and increases are recorded by credits, regardless of whether the account represents an asset, a liability, or owners' equity.

T F 8 The balance of a T account is entered in small pencil figures opposite the last entry on the side having the larger column total.

T F 9 A trial balance with equal debit and credit totals proves that all transactions have been correctly journalized and posted to the proper accounts.

T F 10 The sequence of the account titles in a trial balance depends upon the size of the account balances.

T F 11 A journal entry may include debits to more than one account and credits to more than one account, but the total of the debits must always equal the total of the credits.

T F 12 One advantage of using a journal and a ledger rather than recording transactions directly in the ledger accounts is that the journal provides all information about a particular transaction in one place.

T F 13 The purchase of a typewriter on account would be recorded as a debit to Accounts Payable and a credit to Office Equipment.

T F 14 Of the following 11 accounts, six normally have debit balances and five have credit balances: Accounts Receivable, Accounts Payable, Buildings, Capital Stock, Cash, Land, Machinery, Mortgage Payable, Notes Payable, Notes Receivable, Retained Earnings.

T F 15 A transposition error means a posting of a journal entry to the wrong ledger account.

T F 16 The footings, or memoranda totals of the entries in a ledger account, do not relate to a specific transaction, but are merely a step in determining the balance of the account.

T F 17 If a business transaction is recorded correctly, it cannot possibly upset the equality of debits and credits in the ledger.

T F 18 More knowledge of accounting is required to post amounts from the journal to the ledger than is required to record transactions in journal entry form.

T F 19 In a journal entry recording the purchase of a desk for $275.80, both debit and credit were recorded and posted as $257.80. This ***transposition error*** would ***not*** be disclosed by the preparation of a trial balance.

T F 20 The double-entry accounting system means that transactions are recorded both in the journal and in the ledger.

T F 21 The accounting cycle begins with recording transactions in the journal and ends with the preparation of financial statements.

T F 22 A limitation of a computer-based accounting system is that computers do not know which transactions should be recorded, or how to record them properly.

Completion Statements

Fill in the necessary words to complete the following statements:

1 In accounting, the term ***debit*** refers to the ______ side of a ______________________, while the term ***credit*** refers to the __________ side.

2 The unit of organization for a journal is the ______________________ and the unit of organization for the ledger is the ________.

3 A T account is a simplified model of a formal ledger account and consists of only three elements: (a) an account___________, (b) a ________ ______________, and (c) a ________ ______________.

4 Increases in assets are recorded by ________ and decreases in assets are recorded by credits; increases in accounts appearing on the right side of a balance sheet are recorded by ________________, while decreases in those accounts are recorded by ______________.

5 Asset accounts appear on the ____________ side of the balance sheet and normally have ________________ balances. Liability and owners' equity accounts appear on the ______________ side of a balance sheet and normally have ________________ balances.

6 When a company borrows from a bank, two accounts immediately affected are ________ and ________ ________.
The journal entry to record the transaction requires a ________ to the first account and a ________ to the second one.

7 If you charge a sweater at a clothing store where you have an account, the store will ________ your account for the amount of your purchase.

8 A journal entry shows (a) the ________ ________ of the transaction, (b) the ________ ________ to be ________, (c) the ________ to be ________, and also (d) an ________ of the transaction.

9 When making a journal entry the ________ ________ column just to the left of the debit column remains blank. When the debits and credits are later ________ to the ledger, the ________ of the ledger accounts are listed in this column to provide a convenient ________ ________ with the ledger.

10 A ________ ________ is prepared from the ledger accounts at the end of the month (or other accounting period) in order to prove that the total of accounts with ________ ________ is equal to the total of accounts with ________ ________.

11 The journal may also be called the ________ ________ ________ ________.

12 With respect to (a) posting, (b) journalizing, (c) preparation of a balance sheet, (d) preparation of a trial balance, and (e) occurrence of a business transaction, the normal sequence of these events is denoted by the following list of letters ________ ________.

Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

____ **1** Mohawk Company completed a transaction which caused both its total assets and its total liabilities to increase by $6,000. The transaction could have been:
- **a** Purchase of a fork lift by paying $4,000 cash and issuing a note payable for $6,000.
- **b** Purchase of a drill press by a payment of $2,000 in cash and issuance of a $4,000 note payable.
- **c** Sale of land costing $6,000 for $6,000 in cash.
- **d** None of the above.

____ **2** Red Hill Vineyards completes a transaction which causes an asset account to decrease. Which of the following related effects may also occur?
- **a** An increase of an equal amount in a liability account.
- **b** An increase of an equal amount in owners' equity.
- **c** An increase of an equal amount in another asset account.
- **d** None of the above.

____ **3** The term ***posting*** means:
- **a** Entering transactions in a book of original entry.
- **b** Transferring debit and credit amounts from the journal to the ledger.
- **c** Proving the equality of debits and credits in the ledger.
- **d** Determining the balances of individual ledger accounts.

____ **4** If a computer is acquired by paying $10,000 in cash and signing a note payable for $40,000:
- **a** Total assets are increased and total owners' equity is increased.
- **b** Total liabilities are increased and total owners' equity decreased.
- **c** Total assets are decreased and total liabilities are increased.
- **d** Total assets are increased and total liabilities are increased.

____ **5** Which of the following errors would ***not*** be disclosed by the trial balance?
- **a** The collection of a $520 account receivable was journalized as a $520 debit to Cash and a $502 credit to Accounts Receivable.
- **b** The collection of a $200 account receivable was journalized as a $200 debit to Cash and a $200 debit to Accounts Receivable.
- **c** The collection of a $1,000 account receivable was journalized correctly, but the debit was posted to the Land account instead of Cash.
- **d** None of the above.

____ **6** The accountant of the Midas Company made an error in posting from the journal to the ledger accounts. He posted a debit to Office Equipment as a debit to Accounts Receivable. The procedure which is most likely to disclose this error is:

a Refooting all the accounts in the ledger.
b Sending month-end bills to all customers.
c Taking a trial balance.
d Comparing the written explanation of the journal entry with the accounts mentioned in the journal.

_____ **7** If a trial balance is out of balance, a possible cause is:

a A transaction calling for a debit to an asset account and a credit to a liability account was entered in the journal as a debit to a liability account and a credit to an asset account.
b A transaction was entirely omitted from the records.
c An error was made in determining the balance of the Cash account.
d The balances of the Cash account and the Accounts Receivable account were switched in the preparation of the trial balance.

_____ **8** Peckham Investment Company entered into a transaction which did not change total assets, total liabilities, or total owners' equity. The transaction could have been:

a The sale of land for cash at a price equal to the cost of the land.
b An investment of cash in the business by stockholders.
c The settlement of a liability by paying the creditor some asset other than cash.
d None of the above.

_____ **9** The third step in the accounting cycle is to:

a Prepare financial statements
b Post to ledger accounts
c Record transactions in the journal
d Prepare a trial balance

Exercises

1 Show the change in total assets, total liabilities, and total owners' equity that will be caused by posting each amount in the following journal entries. In the ***effect of transaction*** row, show the total change in assets, liabilities, and owners' equity that has occurred after all parts of the transaction have been posted. ***Hint:*** The effect of each transaction should be that the total change on the left side of the balance sheet (change in assets) should equal the change on the right side (change in liabilities + change in owners' equity). Explanations have been omitted from journal entries to conserve space.

Journal Entry	Dr	Cr	Assets	=	Liabilities	+	Owners' Equity
Example:							
Office Equipment	600		+600		–		–
Cash		150	–150		–		–
Accounts Payable		450	–		+450		–
Effect of transaction			+450	=	+450	+	–
a Accounts Receivable	230						
Cash		230					
Effect of transaction				=		+	
b Cash	5,000						
Capital Stock		5,000					
Effect of transactions				=		+	
c Cash	800						
Notes Payable		800					
Effect of transaction				=		+	