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Robert N. Anthony

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Essentials of Accounting

Fourth Edition

Robert N. Anthony

*Ross Graham Walker Professor of Management Control, Emeritus
Harvard Business School*



Addison-Wesley Publishing Company

*Reading, Massachusetts • Menlo Park, California
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Amsterdam • Bonn • Sydney • Singapore • Tokyo • Madrid • San Juan*

Sponsoring Editor: Herbert Smith
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Manufacturing Supervisor: Roy Logan

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Library of Congress Cataloging-in-Publication Data

Anthony, Robert Newton

Essentials of accounting / Robert N. Anthony.—4th ed.

p. cm.

ISBN 0-201-00017-2

1. Accounting. I. Title

HF5635.A6879 1988

657' .07—dc19

87-21944

CIP

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Acknowledgments

Dr. Matthew Israel developed the program for the First Edition.

Dr. Philip E. Meyers, Boston University, developed the Glossary.

Illustrations were developed by C. Stewart Anthony, Phil Carver, Jerrold E. Moore, and Carol Flaherty. Jerry Moore also made helpful comments on the substance.

Student testing and surveys were conducted by Prof. Julie H. Hertenstein, Harvard Business School; Prof. Susan Haas, Simmons College; Peter Yu and Lisa Martin, Harvard Extension Program, and Dr. Robert N. Anthony, Jr.

Frank J. Burns, Herbert Smith and Jane Tamlyn were my editors at Addison-Wesley. Others who participated in the editorial and production process at Addison-Wesley were Mary Eagleson, Sarah Hallet, Doris L. Machado, Linda O'Brien, and Mona Zeffel.

Nancy Anthony edited the manuscript.

My secretaries who worked on this project included Sandra Bardwell, Ann T. Carter, Judith Grady, Emily C. Hood, Elizabeth Keyes, and Patricia Lougee.

I am grateful for all this help and for the comments of many users whose ideas have led to improvements in this edition.

Introduction

This book is designed to help you teach yourself the basic concepts of accounting. It leads you to an understanding of what accounting statements can and cannot tell you about a business.

Accounting has been called the language of business and, like any language, it can never express ideas with perfect precision and clarity. The task of learning this language is complicated by the fact that many of the words used in accounting do not mean the same things as they mean in everyday life. You must learn to think of words in their accounting, rather than their popular, meaning. In this program, we have used a standard set of accounting terms. Frequent repetition and writing of these terms reinforces your basic grasp of the accounting language.

In any language there are some rules or principles that are *definite* and some others that are *not definite*. The latter are a matter of opinion or style. Accountants have different opinions, just as people speak in different dialects. In this program we have tried to describe the elements of good accounting practice, and to indicate some of the areas where there are differences of opinion as to what constitutes good practice. As language changes to meet the needs of communication in a society, so accounting changes to meet the needs of business. We have presented what is currently good practice in accounting.

How to Use This Program

General Instructions

1. Read each item or “frame” in the left-hand column, while covering the right-hand column with the mask provided.
2. *Write* your answer in the space provided or, where necessary, on a separate piece of scratch paper. (It is essential that you write rather than think your response.)
3. Check your response by moving the mask down the page to uncover the correct answer in the right-hand column.
4. If your answer is correct, go on to the next frame.
5. If your answer is *not* correct, read the frame again and try to understand why you were wrong.
6. Many of the frames refer to panel displays called *Exhibits*. These will be found in a separate booklet at the end of this book. When it becomes necessary to look at a given exhibit, tear it out along the perforation and place it beside your work, where you can refer to it as needed. Exhibits which have thus been removed and used should afterwards be clipped or otherwise secured to the inside cover of your book for further use.
7. Following the exhibits you will find a series of *Post Tests*, one for each part of the program. Do not look at any of these tests until you are instructed to do so. When you are ready to take a given test, tear it out along the perforation, then set aside the book and all exhibits (unless other instructions are given), and proceed as directed.

This programmed text has a proven format which involves a unique reversal of pages in the later chapters. This design allows the answer column always to appear in the right margin.

SEQUENCE

Each frame should be answered in turn. Do not skip frames unless directed to do so. If you have difficulty with a particular point, you should go back to the place where it first appeared and review those frames.

Avoid careless answers. If you begin to make mistakes because you are tired, take a rest.

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.

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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 accounting meaning of assets, liabilities, equities, and the balance sheet.
- 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 provide information. Accounting information is provided by reports that are called **financial statements**. The objective of this program is to help you understand what the numbers in the financial statements mean and how they can be used. Please turn to 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 or other unit for which financial statements are prepared. A business is an _____; so is a college, a government, a church, a synagogue or other nonprofit organization.

entity

1-4. The balance sheet reports 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, _____.

1986

1-5. The date December 31, 1986, means [circle A or B]:

A. it was prepared on December 31, 1986.

B. it reports the entity's financial position as of December 31, 1986.

B

(probably it was prepared early in 1987)

1-6. Thus, the heading tells three things: (1) the fact that the report is a balance sheet, (2) the name of the entity, and (3) the date.

balance sheet

1-7. The balance sheet has two sides. The heading of the left side is called Assets, and the heading of the right side is Liabilities and Equities. We shall describe the meaning of each side.

Assets; Liabilities
Equities

ASSETS

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

assets

1-9. For example, the amount of Cash that Garsden Company owned on December 31, 1986 was \$ _ , _ _ _ , 000.

\$1,449,000

(Note that numbers on this balance sheet omit 000.)

1-10. Assets are resources **owned** by Garsden Company. Its employees, although perhaps its most valuable resource, . . . [are / are not] accounting assets.

are not

(No one owns humans since the abolition of slavery.)

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

LIABILITIES AND EQUITIES

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

Liabilities; Equities

1-12. **Liabilities** are amounts provided by outside parties. 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 off 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 **Equities**. 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

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 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 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.

stronger

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 are _____ .

liabilities
equities

1-20. 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. Use whichever of these is more meaningful to you.

(No answer required.)

DUAL-ASPECT CONCEPT

1-21. 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.

1-22. (1) Any assets not claimed by creditors will be claimed by equity investors, and (2) The total amount of claims (liabilities + equities) cannot exceed what there is to be claimed.

It follows from statements (1) and (2) that the total amount of assets will always be ... [greater than / equal to / less than] the total amount of liabilities plus equities.

equal to

1-23. Here is the balance sheet of Garsden Company, greatly condensed so as to focus on the main elements, and disregarding thousands:

Garsden Company
Balance Sheet as of December 31, 1986

Assets		Liabilities & Equities	
Cash	\$ 1,449	Liabilities	\$12,343
Other assets	36,790	Equity	25,896
Total	<u>\$38,239</u>	Total	<u>\$38,239</u>

- (1) \$38,239 of funds were supplied to the entity from sources listed on the ... [left / right] side.
- (2) They are represented by assets listed on the ... [left / right] side.
- (3) The amount of assets can be neither more nor less than the amount of sources of these assets. The amount must be \$38,239.

right

left

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

liabilities; equities

1-25. If the total assets are less than the total liabilities plus equities, the reason may be (circle one):

- A. Assets have been lost or stolen.
- B. The record keeper 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 equities is why the statement we have been studying is called a _____ . This equality tells nothing about the entity's financial condition; it always exists unless the accountant has made a mistake.

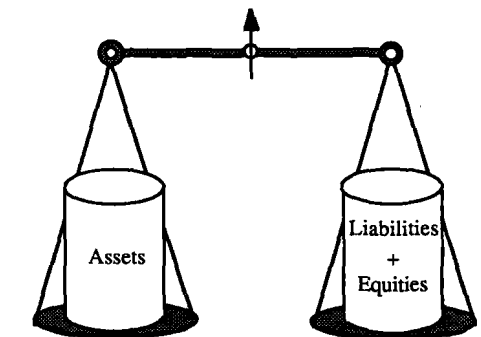
balance
sheet

1-27. This fact leads to what is called the dual-aspect concept. Evidently the two aspects that this concept refers to are _____ and _____ plus _____, and the concept states that these two aspects are always _____. (In what relation to each other?)

assets
liabilities; equities
equal

1-28. 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 just the words assets, liabilities, and equities:

_____ = _____ + _____



assets = liabilities + equities

1-29. 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:

_____ - _____ = Equities

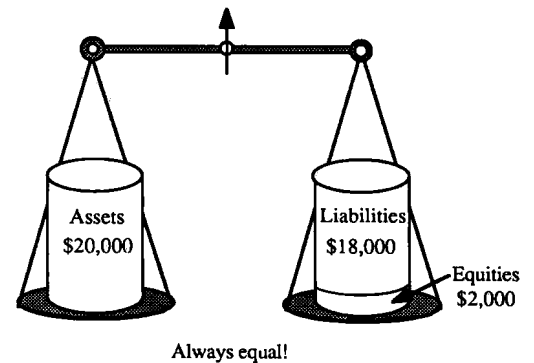
Assets - Liabilities

1-30. The liabilities of Violet Company total \$3,000. Its equities total \$16,000. The company must have assets that total \$ _____.

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

1-31. Suppose a business has assets totaling \$20,000 and liabilities totaling \$18,000. Evidently, its equities are \$ _____.

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



1-32. Suppose a business has \$30,000 in assets. Between the claims of the creditors (the _____) and those of equity investors, which have priority—that is, which have the first claim? _____.

liabilities
Creditors (liabilities)

1-33. 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' claim	_____
investors' claim	_____

assets
creditor
liabilities
equities