

MODULE 1 Communication and Terminology for the
Workplace

TOPIC 1 Preparing Balance Sheets and Writing
Letters to Clients

LEARNING OUTCOMES:

By the end of this lesson, participants will be able to:

- ◆ prepare a formatted or classified Balance Sheet
- ◆ write a standard business letter advising a client on a purchase

ACCOUNTING TERMINOLOGY WORKSHOP

TOPIC	SKILLS	CLB COMPETENCE AREAS	COMPETENCIES	PRE-TASKS	TASKS	POST TASK
<ul style="list-style-type: none"> ◆ Preparing Balance Sheets and Writing Letters to Clients 	<ul style="list-style-type: none"> ◆ Reading ◆ Writing ◆ Listening/ speaking 	<ul style="list-style-type: none"> ◆ formatted text ◆ exchanging information 	<ul style="list-style-type: none"> ◆ categorize accounts on a Balance Sheet ◆ identify different forms of Balance Sheets ◆ analyze accounting information on Balance Sheet ◆ evaluate the financial situation of companies using information on a Balance Sheet ◆ understand and use format and standard language of a business letter 	<ul style="list-style-type: none"> ◆ define terms related to Balance Sheets ◆ match terminology associated with Balance Sheets ◆ categorize accounts into Balance Sheets or income statement ◆ classify assets and liabilities in a formatted or classified Balance Sheet ◆ label parts of a business letter 	<ul style="list-style-type: none"> ◆ prepare a Balance Sheet based on a given situation ◆ make recommendations to a client about purchasing a particular business in a standard business letter form 	<ul style="list-style-type: none"> ◆ compare own business letter with a model and note suggestions for improvement

Facilitator's Guide for Module 1
Topic 1: Preparing Balance Sheets and Writing Letters to Clients

FACILITATOR PREPARATION

Content

For the three topics in Module 1, facilitators should know the following:

- ◆ how to read and interpret instructions in accounting cases, problems, and exercises
- ◆ how to analyze accounting information and provide solutions
- ◆ how to prepare accounting records and reports
- ◆ how to write accounting descriptions for journal entries and records

In addition, familiarity with standard business letters (i.e., format, punctuation, style, etc.) is required.

Delivery

Make as many copies as necessary of the following handouts:

- ◆ Introductory Handout 1
- ◆ Introductory Handout 2
- ◆ Handout 1 Matching Terms with Definitions
- ◆ Handout 2 More Definitions
- ◆ Handout 3 Additional Terminology
- ◆ Handout 4 Additional Terminology
- ◆ Handout 5 Format of a Business Letter
- ◆ Handout 6 Case Study
- ◆ Handout 7 Some Standard Phrases for Business Letters
- ◆ Handout 8 Model letter (two pages)

Terminology List (optional)

Materials needed: overhead projector (OHP), OHT (overhead transparency) 1-5, chart paper and markers.

Write a list of parts of a letter on chart paper (see pre-task #11).

Methodology

Course Introduction

- (15 minutes)** 1. Because this is the first class of the terminology workshop, participants may have some preconceived ideas and expectations about learning new terminology. For example, they may assume that a large portion of class time may be spent looking up words in the dictionary. It is important that participants get a clear idea of the way the course will be delivered and of the role of terminology within a task-based curriculum. For this reason, a workshop outline and two introductory handouts have been prepared for the participants. Before distributing the information, summarize it for the participants. Specifically, ask what they think it means to know a word and give them our definition, perhaps using an example. Also, make sure participants understand that their participation and involvement is critical to the success of the workshop - after all, they are the experts. Distribute Introductory Handouts 1 and 2 as one stapled handout. Go over the outline as a whole class with the participants reading the introduction and the facilitator checking for understanding/answering questions.

Introduction

Note: Please remind participants to bring calculators to class for this module.

- (15 minutes)** 1. Group participants into groups of three and ask them to brainstorm (for five minutes) different types of accounting statements, reports, and related vocabulary; have each group write their thoughts on a sheet of chart paper and share with class.
- (5 minutes)** 2. Explain to the class that in today's lesson, participants will have two tasks. The first is writing a classified or formatted Balance Sheet and computing the current ratio and working capital position of an engineering company. Afterwards participants will be asked to write a letter to the client as if they were the advising accountants.

Pre-Tasks

- (10 minutes)** 1. Have pairs discuss these questions, written on the board:
(Optional)
 What parts/accounts does a Balance Sheet consist of?
 How do you present it?
 Discuss answers with the class.
- (15 minutes)** 2. Distribute Handout 1. To make the activity more
(Optional) challenging, have the participants not use the word bank at the bottom of the page by folding the handout along the dotted line. Participants work in pairs to fill in the blanks. If it is too difficult, then the word bank can be used. Have the participants compare answers with another pair.
- (30 minutes)** 3. Show the participants OHT 1 and ask them to categorize
(Optional) accounts in Ex. 1 as those belonging to Balance Sheet or Income Statement. Then ask them to prepare a Balance Sheet in Ex. 2. Discuss verbally and on the board. Have volunteers explain how they calculated Net Income for October, 200X.
- (15 minutes)** 4. Elicit from participants types of assets, liabilities, and
 types of Balance Sheet forms.
 Elicit the answers:
 1. What is a formatted or classified Balance Sheet?
 2. What is liquidity order?
 3. What kind of accounts is on the Balance Sheet? Are they permanent or temporary accounts?**Note:** For examples and answers, refer to OHT 2, OHT 3, OHT 4, and Facilitator’s Answer Sheet for Handouts 3 and 4.

- (20 minutes)** 5. Ask participants to match terms with explanations in Ex. 3 on Handout 2 (pair work) and write a few accounts for each category (2-5). Review on the board or OHP and verify against OHT 2 [for types of accounts on Balance Sheet, and for categories (two to five accounts)].

Answers to Handout 2:

- | | | |
|---------|---------|---------|
| 1. – c) | 3. – d) | 5. – e) |
| 2. – a) | 4. – b) | |

Account examples are on OHT 4.

- (20 minutes)** 6. Discuss with class:
- Why are accounts on a Balance Sheet in this particular form?
 - What kind of information does this sequence give us?

Answers: *Re. 1)* the categories and layout follow the accounting equation (i.e., Assets = Liabilities + Owner's Equity)

Re. 2) The classified or formatted Balance Sheet example on OHT 4 gives the following information, in addition to the account balances:

- ◆ Which debts must be paid within a year?
- ◆ Is there enough cash (or assets) on hand to pay debts?
- ◆ Which debts must be paid in future years?
- ◆ Which assets of the business cannot be used easily to pay debts?

- (15 minutes)** 7. Have the whole class discuss the following questions:
- What is the connection between Balance Sheet and income statement?
 - What are the usual balances of asset, liability, or owner's equity? (in terms of debits/credits)

Review orally or on the board (volunteers give answers).

Answers: 1) Net Income closed to capital
 2) Assets: Debits (Dr)
 Liabilities (Cr)
 Owner's Equity: Credits (Cr)

- (25 minutes)** 8. Distribute Handout 3 and ask participants to fold it along the dotted line and then negotiate the term for each definition. If the activity is too difficult, ask participants to unfold the paper and match given terms with definitions. Partners negotiate the meaning of unfamiliar words and explanations can be elicited from the class.
- (15 minutes)** 9. Distribute Handout 4 and have participants work in pairs to negotiate the matching terms and definitions. Review orally with the class.
(Optional)
- (10 minutes)** 10. Explain that the task for this lesson consists of two parts. Based on a case study, participants will be asked to prepare a formatted or classified Balance Sheet and compute the current ratio and working capital position of the Northern Engineering Company after purchase of the business. Afterwards, participants will be asked to write a letter to the client as if they were the advising accountants. In order to do the second task, participants need to review the format of a business letter and some standard phrases.
- (10 minutes)** 11. Distribute Handout 5 and ask participants to label the ten parts of a typical business letter. Have the following parts listed (without numbers) on chart paper:
- ◆ reference initials ⑨
 - ◆ attention line ④
 - ◆ letterhead ①
 - ◆ salutation ⑤
 - ◆ carbon copies ⑪
 - ◆ enclosures ⑩
 - ◆ inside address ③
 - ◆ date ②
 - ◆ complimentary closing ⑦
 - ◆ signature, title, address ⑧
 - ◆ body ⑥

Take up as a whole-class activity by using OHT 5.

Task**(45 minutes)**

Distribute Handout 6, the Case Study, and have the participants work in pairs on the tasks. For task #3 (on Handout 6), distribute Handout 7 as a reference sheet for some standard phrases to begin and end the letter as well as to advise. The Balance Sheet should be enclosed with the letter. Assist the participants as necessary with the letter writing. Explain that the letter should be as detailed as possible and that they should come to agreement with their partner as to what they recommend to Ms Baker and why.

Post-Task**(20 minutes)**

Have participants share their letters and Balance Sheets with another pair. Use the facilitator's notes to correct and review all of the tasks. Distribute Handout 8 as a model of a business letter for the participants to keep for future reference. How does the letter compare with their own? How would they improve it?

Introductory Handout 1

Outline of Accounting Terminology Workshop

Welcome to the Accounting Terminology Workshop. The terminology workshop is divided into three modules. Within each module you will study three to five topics. This is the outline for the workshop:

Module 1 *Communication and Terminology for the Workplace*

- Topic 1 Preparing Balance Sheets and Writing a Letter to a Client
- Topic 2 Letters of Request and Income Statements
- Topic 3 The Accounting Cycle and Accounting Reports

Module 2 *Communication and Terminology for Licensing*

- Topic 4 Requesting Clarification for Obtaining a CGA Designation
- Topic 5A Obtaining a CA Designation
- Topic 5B Accounting Positions not Requiring a Designation
- Topic 6A Obtaining a CMA Designation
- Topic 6B Specific Accounting Skills: A Self Assessment

Module 3 *Communication and Terminology for Work Search*

- Topic 7 Understanding Job Ads: Skills and Personal Attributes
- Topic 8 Job Ads: Recruitment Terminology
- Topic 9 Accounting Résumés
- Topic 10 Accounting Employment Interviews

Introductory Handout 2

Introduction to Accounting Terminology Workshops

The workshop classes have been organized so that you will have many opportunities to perform oral and written language tasks using new terminology. You may find that you are familiar with some of the terminology in some topics. However, it is important to remember that knowing a word in English is much more than being able to recognize it or translate it into your own language. In order to know a word completely, you should be able to use it in six different ways. You should be able to pronounce it, spell it, know what it means in a particular context, and understand its indirect meanings. Also, you should be able to use it in grammatically correct sentences, and know with which other words it is commonly used or associated.

Because of the short length of the workshop, it is impossible to practise and know each new word in all six different ways. However, the class activities will give you opportunities to use accounting terminology and other language skills in different ways that will broaden and deepen your understanding and use of this terminology in the English language.

In each topic, terminology will be presented in context, meaning that words will be presented as they are actually used in the real world. For example, accounting statements and job ads contain terms and expressions that are commonly used in those contexts. Other activities will give you opportunities to analyze the language in different ways. For example, putting words in categories helps you remember them and finding synonyms expands your vocabulary knowledge and choice of words.

Each topic also contains a task. A task is a real-world communicative act that is similar to those you will likely have to do outside of the class as part of your professional development. In the tasks, you will be given opportunities to use terminology as you would in the real world. For example, being familiar with terminology used by the Certified General Accountants of Ontario (CGA) is important when filling out an application for Advanced Standing with the accounting body, and being responsible for income statements means understanding and using terminology related to those kinds of financial reports.

This workshop focuses on generic (or general) accounting terminology, although there will be opportunities for CA-, CMA-, and CGA-specific terminology to be explored.

In designing this workshop, we have tried to keep in mind that you, as accountants, are experts in your occupation. Remember that the facilitator is here to help you express your ideas more clearly, but the success of the workshop depends on everyone sharing their professional accounting expertise.

At the end of some of the modules or lessons, you may be asked to complete a questionnaire. Your feedback will help us improve the workshop. Thank you in advance for taking the time to complete the questionnaires.

Enjoy the terminology workshop!

Handout 1

Match the terms below with their definitions:

1. _____ Assets equal liabilities plus owner's equity. $A = L + OE$
2. _____ A financial information system that includes accounting forms, records, instruction manuals, flow charts, programs, and reports to fit the particular need of the business.
3. _____ Economic resources (things of value) owned by a business that are expected to benefit future operations.
4. _____ A record used to summarize all increases and decreases in a particular asset, such as cash, or any other type of asset, liability, owner's equity, revenue, or expense.
5. _____ The difference in dollars between the total debits and total credits in an account.
6. _____ A financial statement that shows the financial position of a business entity by summarizing the assets, liabilities, and owner's equity at a specific date.
7. _____ A listing of the ledger account titles and numbers being used by a given business.
8. _____ An amount entered on the right-hand side of an account. It is used to record a decrease in an asset or to record an increase in a liability or owner's equity.
9. _____ The balance of an account in which the total amount of credits exceeds the total amount of debits.
10. _____ An amount entered on the left-hand side of an account. It is used to record an increase in an asset or to record a decrease in a liability or owner's equity.
11. _____ The balance of an account in which the total amount of debits exceeds the total amount of credits.
12. _____ An accounting system in which every transaction is recorded in two or more accounts with debits and credits of equal amount.
13. _____ Debts or obligations of a business. The claims of creditors against the assets of a business.
14. _____ Liabilities evidenced by a formal written promise to pay a certain amount of money plus interest at a future date. Usually arise from borrowing.
15. _____ The excess of assets over liabilities. The amount of an owner's net investment in a business plus profits from successful operations that have been retained in the business.

Fold along dotted line

Owners' equity	Accounting system	Account balance	Accounting equation
Notes Payable	Double-entry system	Credit	Liabilities
Debit balance	Chart of Accounts	Assets	Balance Sheet
Credit balance	Account	Debit	

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

KEY TERMS

1. Accounting equation ⇔ Assets equal liabilities plus owner's equity.
 $A = L + OE$
2. Accounting system ⇔ A financial information system that includes accounting forms, records, instruction manuals, flow charts, programs, and reports to fit the particular need of the business.
3. Assets ⇔ Economic resources (things of value) owned by a business that are expected to benefit future operations.
4. Account ⇔ A record used to summarize all increases and decreases in a particular asset, such as Cash, or any other type of asset, liability, owner's equity, revenue, or expense.
5. Account balance ⇔ The difference in dollars between the total debits and total credits in an account.
6. Balance Sheet ⇔ A financial statement that shows the financial position of a business entity by summarizing the assets, liabilities, and owner's equity at a specific date.
7. Chart of accounts ⇔ A listing of the ledger account titles and numbers being used by a given business.
8. Credit ⇔ An amount entered on the right-hand side of an account. It is used to record a decrease in an asset or to record an increase in a liability or owner's equity.
9. Credit balance ⇔ The balance of an account in which the total amount of credits exceeds the total amount of debits.
10. Debit ⇔ An amount entered on the left-hand side of an account. It is used to record an increase in an asset or to record a decrease in a liability or owner's equity.
11. Debit balance ⇔ The balance of an account in which the total amount of debits exceeds the total amount of credits.
12. Double-entry system ⇔ An accounting system in which every transaction is recorded in two or more accounts with debits and credits of equal amount.
13. Liabilities ⇔ Debts or obligations of a business. The claims of creditors against the assets of a business.
14. Notes payable ⇔ Liabilities evidenced by a formal written promise to pay a certain amount of money plus interest at a future date. Usually arise from borrowing.
15. Owner's equity ⇔ The excess of assets over liabilities. The amount of an owner's net investment in a business plus profits from successful operations that have been retained in the business.

OHT 1

Ex. 1 Categorize the following accounts as belonging to the Balance Sheet statement or the income statement.

	\$	\$
General Expense	180	
Cash	2,555	
Equipment Expense	765	
Accounts Receivable	3,700	
T. Mott, Capital		18,735
T. Mott, Drawings	9,500	
Fees Earned		29,990
Office Supplies	284	
Prepaid Insurance	1,000	
Tapes	3,000	
Car	12,300	
Equipment	30,000	
Repairs Expense	1,876	
Telephone Expense	220	
Advertising Expense	2,880	
Revenue from Repairs		10,235
Accounts Payable		1,600
Bank Loan		7,700
	<u>\$68,260</u>	<u>\$68,260</u>

Ex. 2 Prepare a Balance Sheet for T. Mott for October 31, 200X.

FACILITATOR'S ANSWER SHEET FOR OHT 1

1)

**T. Mott, DJ
Trial Balance
October 31, 200X**

Cash	\$2,555		} Balance Sheet Accounts
Accounts Receivable	3,700		
Office Supplies	284		
Prepaid Insurance	1,000		
Tapes	3,000		
Car	12,300		
Equipment	30,000		
Accounts Payable		1,600	
Bank Loan		7,700	
T. Mott, Capital		18,735	
T. Mott, Drawings	9,500		} Income Statement Accounts
Fees Earned		29,990	
Revenue from Repairs		10,235	
Advertising Expense	2,880		
Telephone Expense	220		
Repairs Expense	1,876		
Equipment Expense	765		
General Expense	<u>180</u>	<u> </u>	
	<u>\$68,260</u>	<u>\$68,260</u>	

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. *Accounting: The Basis for Business Decisions*. Toronto: John Deyell Co., 1985.

FACILITATOR'S ANSWER SHEET FOR OHT 1

2)

**T. Mott, DJ
Balance Sheet
as at
October 31, 200X**

Assets		Liabilities and Owner's Equity	
Cash	\$2,555	Liabilities:	
Accounts Receivable	3,700	Accounts Payable	\$1,600
Office Supplies	284	Bank Loan	7,700
Prepaid Insurance	1,000	Total Liabilities	<u>9,300</u>
Tapes	3,000	Owner's Equity	
Car	12,300	T.Mott, Capital, Oct. 1, 200X	\$18,735
Equipment	<u>30,000</u>	Net Income for October	<u>34,304</u>
Total Assets	<u><u>\$52,839</u></u>	Subtotal	53,039
		Less: T. Mott, Drawings	<u>9,500</u>
		T.Mott, Capital, Oct. 31, 1997	<u>43,539</u>
		Total Liabilities and Owner's Equity	<u><u>\$52,839</u></u>

Note: Net Income for October:

Total Revenues – Total Expenses = Net Income

Total Revenue = \$29,990 + \$10,235

Total Expenses = \$2,880 + 220 + 1,876 + 765 + 180

OHT 2

Accounts in Financial Statements:

Balance Sheet Accounts

Assets:

- Cash
- Marketable securities
- Notes receivable
- Accounts receivable
- Inventory
- Office supplies (and unexpired insurance, prepaid rent, and other prepaid expenses)
- Land
- Buildings
- Equipment
- Other assets

Liabilities:

- Notes payable
- Accounts payable
- Salaries payable (and other short-term liabilities)

Owner's equity:

- John Smith, capital
- John Smith, drawing

Income Statement Accounts

Revenue:

Commissions earned (fees earned, rent earned, sales, etc.)

Expenses (no standard sequence of listing exists for expense account):

- Advertising
- Salaries
- Rent
- Telephone
- Depreciation
- Various other expenses

Note: Asset, liability, and owner's capital accounts are **permanent accounts**
Revenue and expense accounts are **temporary accounts**

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

OHT 3

Classified Financial Statements:

REPORT FORM of Balance Sheet:

**The Toronto Hotel
Balance Sheet
as at
October 31, 200X**

Assets

Current Assets

Cash	\$9 300	
Accounts Receivable	2 000	
Supplies	6 000	
Total Current Assets		\$17,300

Property, Plant and Equipment

Land	50 000	
Building	500 000	
Room Furniture	110 000	
Office Equipment	5 000	
Total Fixed Assets		665 000
Total Assets		\$682 300

Liabilities and Owner's Equity

Current Liabilities

Accounts Payable		\$24 000
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Long-Term Liabilities

Bank Loan	\$15 000	
Mortgage Payable	100 000	
Total Long-Term Liabilities		115 000
Total Liabilities		139 000

Owner's Equity

Smith, Capital Oct. 1	536 000	
Add: Net Income for October	\$8 200	
Less: Smith, Drawings	900	
Increase in Capital		7 300
Smith, Capital Oct. 31		543 300
Total Liabilities and Owner's Equity		\$682 300

Handout 2

Ex . 3 Match the following descriptions from a classified or formatted Balance Sheet with their explanations. Give examples of each type for 2-5.

1. _____ is the order in which assets may be converted into cash.
2. _____ are those which can be converted into cash within one year.
3. _____ are the operating assets that have a useful life of more than one year.
4. _____ are liabilities due to be paid within a year.
5. _____ are liabilities that are not due to be paid for at least a year.

- a) current assets
- b) current liabilities
- c) liquidity order
- d) fixed assets
- e) long-term liabilities

Handout 3 - Match the following terms with their definitions

◆ order of liquidity	◆ current liabilities	◆ drawing account
◆ cost price of assets	◆ report form of the Balance Sheet	◆ change in capital
◆ long-term liabilities	◆ withdrawal by owner	◆ fixed assets
◆ a current asset	◆ account form of the Balance Sheet	◆ owner's equity section
◆ drawings		◆ formatted or classified Balance Sheet
◆ depreciation		

1. _____ When fixed assets are purchased they are recorded in the journal at their cost price. The figure is never changed in the accounting records over time, even though the assets may have increased or decreased in value.
2. _____ The systematic allocation of the cost of an asset to expense during the periods of its useful life.
3. _____ The account used to record the withdrawals of cash or other assets by the owner. Closed at the end of the period by transferring its balance to the owner's capital account.
4. _____ It is the owner's equity account used when the owner withdraws cash or other assets from the business for personal use. It is also used to record any salary paid to the owner.
5. _____ Amounts of cash or other assets removed from the business by the owner. Cause a decrease in owner's equity.
6. _____ At the end of the accounting period the capital account must be updated to reflect operations for the fiscal period just ended. Depending on the amount of net income, or net loss, and the drawings taken by the owner, there will be either an increase or a decrease in capital.
7. _____ This is the section of the Balance Sheet where the owner's capital account is updated with the net income or net loss for the period, and the drawings taken by the owner during that time.
8. _____ This is a Balance Sheet that classifies assets as current or fixed, and liabilities as current or long-term.
9. _____ This is a Balance Sheet prepared horizontally, in the form of the fundamental accounting equation.
10. _____ This is a Balance Sheet prepared vertically, so that it is easy to compare figures from several years side by side.
11. _____ is one that will be used or realized within the current accounting period, usually one year.
12. _____ are debts which must be paid within the current accounting period.
13. _____ give a business benefits for more than one year.
14. _____ are debts that are not due until after the current accounting period.
15. _____ This refers to the order of assets on the Balance Sheet. Assets are listed in order of how easily and quickly they can be converted to cash.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 3

1. **Cost price of assets** When fixed assets are purchased they are recorded in the journal at their cost price. The figure is never changed in the accounting records over time, even though the assets may have increased or decreased in value.
2. **Depreciation** The systematic allocation of the cost of an asset to expense during the periods of its useful life.
3. **Drawing account** The account used to record the withdrawals of cash or other assets by the owner. Closed at the end of the period by transferring its balance to the owner's capital account.
4. **Drawings** It is the owner's equity account used when the owner withdraws cash or other assets from the business for personal use. It is also used to record any salary paid to the owner.
5. **Withdrawals by owner** Amounts of cash or other assets removed from the business by the owner. Cause a decrease in owner's equity.
6. **Change in capital** At the end of the accounting period the Capital account must be updated to reflect operations for the fiscal period just ended. Depending on the amount of net income, or net loss, and the drawings taken by the owner, there will be either an increase or a decrease in Capital.
7. **Owner's equity section** This is the section of the Balance Sheet where the owner's capital account is updated with the net income or net loss for the period, and the drawings taken by the owner during that time.
8. **Formatted or Classified Balance Sheet** This is a Balance Sheet that classifies assets as current or fixed, and liabilities as current or long-term.
9. **Account form of the B/S** This is a Balance Sheet prepared horizontally, in the form of the fundamental accounting equation.
10. **Report form of the B/S** This is a Balance Sheet prepared vertically, so that it is easy to compare figures from several years side by side.
11. **A current asset** is one that will be used or realized within the current accounting period, usually one year.
12. **Current liabilities** are debts which must be paid within the current accounting period.
13. **Fixed assets** give a business benefits for more than one year.
14. **Long-term liabilities** are debts that are not due until after the current accounting period.
15. **Order of liquidity** This refers to the order of assets on the Balance Sheet. Assets are listed in order of how easily and quickly they can be converted to cash.

Handout 4

Match each of the items in the left-hand column with the appropriate item in the right-hand column.

- | | |
|--|---|
| 1. proprietorship | a) _____ asset |
| 2. purchase of office furniture | b) _____ internal transaction |
| 3. owner's equity | c) _____ increases owner's equity |
| 4. transfer of merchandise from storage to salesroom | d) _____ liabilities |
| 5. prepaid insurance | e) _____ up-to-date actual cost of the use of an asset |
| 6. money order | f) _____ cash |
| 7. net book value | g) _____ payment of current liability |
| 8. corporation | h) _____ acquisition of a fixed asset |
| 9. accumulated depreciation | i) _____ a connection between an income statement and a Balance Sheet |
| 10. annual net profit | j) _____ distinct legal entity |
| 11. assets equal | k) _____ cost of asset net of accumulated depreciation |
| 12. depreciation | l) _____ negotiable instrument |
| 13. current asset | m) _____ decrease in long-term liability |
| 14. withdrawals | n) _____ liabilities plus owners' equity |
| 15. a net loss for a fiscal period | o) _____ allocation of the cost of an asset over its useful life |
| 16. assets minus owners' equity equal | p) _____ buildings and machinery |
| 17. mortgage payable payment | q) _____ reduces a capital |
| 18. fixed assets | r) _____ owner's equity |
| 19. capital | s) _____ reduces owner's equity |
| 20. settling of outstanding accounts payable | t) _____ affected by withdrawals and annual net income |

Adapted from: Costinett, S. The Language of Accounting in English. Inglewood Cliffs: Prentice Hall Regents, 1977.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 4

1 - r)

2 - h)

3 - i) or t)

4 - b)

5 - a)

6 - l)

7 - k)

8 - j)

9 - e)

10 - c)

11 - n)

12 - o)

13 - f)

14 - q)

15 - s)

16 - d)

17 - m)

18 - p)

19 - t) or i)

20 - g)

Handout 5 /OHT 5



1

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3

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2

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4

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5

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6

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AP/cl

9

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7

Encl.

10

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8

cc.DDube

11

Handout 6

Case Study

Ann Baker, an experienced engineer, is considering buying the Northern Engineering Company in December from its current owner, Tom Watson. Northern Engineering Company has been a profitable business, earning about \$55,000 each year. Ann Baker is positive she could operate the business just as profitably. The main activities of the business have been engineering studies for government agencies interested in the development of air- and water-pollution control programs. Ann Baker presents you with the Balance Sheet of Northern Engineering Company shown below and asks you to advise her about buying the business.

NORTHERN ENGINEERING COMPANY
Balance Sheet
as at
December 31, 200X

Assets		Liabilities & Owner's Equity	
Cash	\$ 38,000	Notes payable	\$ 52,800
Government contract Receivable	89,000	Accounts payable	18,300
Other contracts receivable	26,100	Wages payable	5,000
Equipment (net of depreciation)..	80,000	T. Watson, capital	214,000
Patents	57,000		
	<u>\$290,100</u>		<u>\$290,100</u>

Baker immediately points out, as evidence of the firm's solvency, that the current ratio for Northern Engineering is 2 to 1. In discussing the specific items on the Balance Sheet, you find that the patents were recently purchased by Northern, and Baker believes them to be worth their \$57,000 cost. The notes payable liability consists of one note to the manufacturer of the equipment owned by Northern, which Watson had incurred six years ago to finance the purchase of the equipment. The note becomes payable, however, in March of the coming year. The accounts payable all will become due within 60 to 90 days.

Since Baker does not have enough cash to buy Watson's equity in the business, she is considering the following terms of purchase: (1) Watson will withdraw all the cash from the business, thus reducing his equity to \$176,000; (2) Watson will also keep the \$89,000 receivable from the government, leaving his equity in the business at 87,000; and (3) by borrowing heavily, Baker thinks she can raise \$87,000 in cash, which she will pay to Watson for his remaining equity. Baker will assume the existing liabilities of the business.

Tasks

1. Prepare a classified or formatted Balance Sheet for Northern Engineering Company as it would appear immediately after Baker acquired the business, assuming that the purchase is carried out immediately on the proposed terms.
2. Compute the current ratio and the working capital position of Northern Engineering Company after Baker's purchase of the business
3. Write a letter to Baker explaining what problems she might encounter if she purchases the business as planned.

Adapted from: Meigs, W.B., R.F. Heigs, and W.P. Lam. Accounting: The Basis for Business Decisions. Toronto: John Deyell Co., 1985.

FACILITATOR'S ANSWER SHEET FOR HANDOUT 6: CASE STUDY

Note #1) could be elicited from students and written on the board):

◆ current ratio = $\frac{\text{current assets}}{\text{current liabilities}} = \frac{\$26,100}{\$76,100} = .34 \sim \underline{1:3}$

(current ratio is an indication of business solvency)

◆ solvency = ability to meet debts as they fall due

◆ working capital = current assets – current liabilities

(working capital is an indication of short-term financial strength)

working capital = \$26,100 - \$76,100 = \$(50,000)

Note #2) current ratio prior to a purchase ⇔ 2:1

working capital prior to a purchase ⇔ \$153,100 - \$76,100 = \$77,000

Handout 7

Some Standard Phrases for Business Letters

Beginning Sentences

This is to inform you that...	Attached is...
I am writing with regard to...	I refer to your letter/fax/e-mail...
As you may recall...	Thank you for...
I am writing this letter in order to...	In reference to...

Closing Sentences

- Should you have any questions, feel free to contact me at...
- Please do not hesitate to write if you require additional information.
- If you require further information, please do not hesitate to contact me.
- I hope that this information will be of some assistance to you.

Advising

We/I recommend that...	We/I would suggest...
We/I advise (against verb + ing)...	We/I would urge...
It would be advisable...	

Conditional Sentences

If you purchased... you would require...

Verbs and related nouns

to request	-	a request
to investigate	-	an investigation
to analyze	-	an analysis
to respond	-	a response
to inquire	-	an inquiry
to complete	-	a completion
to provide	-	a provision
to conclude	-	a conclusion

Handout 8 Model Letter



IMS Engineering Ltd.
230 Yonge St.
Toronto, Ontario
M5B 2SX

January 30, 200X

Attention: Ann Baker

Dear Ms. Baker:

Thank you for your letter dated January 1, 200X requesting our recommendation on the purchase of Northern Engineering Company.

After analyzing the original balance of Northern Engineering Company and after considering the terms of purchase, we have arrived at the following recommendations and remarks:

- 1) For the classified Balance Sheet for Northern Engineering company, after the purchase and considering the purchase terms, please refer to Section a) on the attached page two.
- 2) Prior to the purchase, the current ratio of the Northern Engineering Company (NEC) is 2:1, which is evidence of the firm's strong solvency. The working capital is \$77,000 (i.e. \$153,000 - \$76,100) and is an indication of the firm's short-term financial strength. (i.e. The firm is able to pay its current liabilities as they fall due.)
- 3) Under the proposed terms of purchase, your working capital will become negative (i.e. \$26,100 - \$76,100 = \$(50,000)) and the current ratio will be 1:3 $\left(\text{i.e. } \frac{\$26,100}{\$76,100} = 1:3 \right)$

The after-purchase working capital and current ratio indicate that after the purchase of the firm, you will not have enough money in the business to pay current liabilities when they fall due. Given the fact that the due date for liabilities payment is within three months of the purchase date of the business, it is unlikely that you will be able to make enough profit in the business within three months' period, even if the prior annual profitability of \$55,000 will be maintained (i.e., \$55,000: 4 = \$13,750 = the estimated profit for January to March, 200X; the amount that would not be sufficient to cover \$50,000 of outstanding accounts payable.)

In light of the above, we do not recommend that you purchase Northern Engineering Company, unless you change the terms of purchase and manage to raise enough cash to buy the company as it is represented by the Balance Sheet on December 31, 200X.

If you need further clarification, please do not hesitate to contact us at our office.

Yours Sincerely,

Jose Gonzalez, CGA
PBS Accounting Services
7000 Wilton Ave.
Toronto, Ontario
M0A 2A5

JG/jm

Encl.

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NORTHERN ENGINEERING COMPANY
Balance Sheet
as at
January 1, 200X

Assets		Liabilities & Owner's Equity	
Current Assets		Current Liabilities	
Other contracts receivable	\$26,100	Notes payable ...	\$ 52,800
		Accounts payable.	18,300
		Wages payable ...	<u>5,000</u> \$76,100
Fixed Assets		Owner's Equity	
Equipment (net of depreciation)	\$80,000	A. Baker, Capital	<u>87,000</u>
Patents.....	<u>57,000</u>		
Total Fixed Assets.....	<u>137,000</u>	Total Liabilities and	
Total Assets	<u>\$163,100</u>	Owner's Equity	<u>\$163,100</u>

Terminology List

- ◆ an accounting equation
- ◆ an accounting system
- ◆ an account
- ◆ an account balance
- ◆ a Balance Sheet
- ◆ a chart of accounts
- ◆ a credit balance
- ◆ a debit balance
- ◆ a double-entry system
- ◆ notes payable
- ◆ owner's equity
- ◆ an income statement
- ◆ current assets
- ◆ fixed assets
- ◆ current liabilities
- ◆ long-term liabilities
- ◆ formatted or classified Financial Statements
- ◆ formatted or classified Balance Sheet
- ◆ revenues
- ◆ net income
- ◆ net loss
- ◆ the Balance Sheet equation
- ◆ drawings
- ◆ owner's investment
- ◆ mortgage payable
- ◆ depreciation
- ◆ drawing account
- ◆ withdrawals by owner
- ◆ change in capital
- ◆ owner's equity section
- ◆ account form of the Balance Sheet
- ◆ report form of the Balance Sheet
- ◆ order of liquidity
- ◆ a current market value
- ◆ a transaction
- ◆ an internal transaction
- ◆ a distinct legal entity
- ◆ a negotiable instrument
- ◆ suppliers
- ◆ financed
- ◆ a legacy
- ◆ a creditor
- ◆ a T-account