

SOLUTIONS

Learning Goal 2

Reinforcement Problems

LG 2-1. An asset is property that is owned by a business. Every asset must be able to provide a future benefit to the business to which it belongs. The asset must be owned by the business as a result of a past event.

LG 2-2. The everyday, nontechnical meaning of the word “asset” is anything that has a beneficial quality or trait.

LG 2-3. The two essential qualities of a business asset are: (a) It must provide future benefits to a business, and (b) it must be owned as a result of a past event.

LG 2-4. Your answer will be different from this answer. Nevertheless, notice how the everyday example of an asset excludes some of the necessary qualities of a business asset, and the business example includes all of the necessary qualities. You should look for this in your own examples.

Everyday Asset: “I love my bicycle! I found it sometime last summer in a park (a past event), so I did not pay anything for it, and I’m not even sure what it would cost. It looks old, is rusting, is slow, and has only one speed, but people like to look at it and ask questions because it’s an antique! That’s how they become my friends. And the bike gives me pleasure because while I *sloooowwwly* pedal it, I notice more flowers and trees. And by doing all this pedaling, I have lost eight pounds.”

In this story, the bicycle provides the benefits of pleasure and a way to make new friends, but these are not business benefits. Also, we cannot be certain of who really owns the bicycle. There was never any kind of dollar value transaction that took place to acquire it, nor do we know what date it was acquired.

Business Asset: “We use a bicycle in our business to provide fast, inner-city delivery of documents. Our business bought the bicycle on August 10 for \$800. The employee assigned to use the bicycle can make deliveries in half the time of a professional courier service.”

In this story, both qualities of a business asset are set forth: the business benefits it provides (speedy delivery); it is owned by the business as the result of a past event. Notice also that there will be objective evidence and an identifiable historical cost.

LG 2-5.

Business item	It is . . .		Missing quality	
	an asset	not an asset	Future benefits	Owned as a result of a past event
a. The supervisors of a business		✓		✓
b. Office supplies	✓			
c. Cash in the checking account	✓			

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LG 2-5, continued

Business item	It is . . .		Missing quality	
	an asset	not an asset	Future benefits	Owned as a result of a past event
d. The legal right to collect \$500 that customers owe the business	✓			
e. The new airport to be built next year, five miles from your business		✓	✓	✓
f. A 12-year-old computer that is no longer functional		✓	✓	
g. An expensive French impressionist painting purchased to hang in the lobby of your office	✓			
h. A building that your company rents from Multnomah Company		✓		✓
i. A prepaid \$700 fire insurance policy	✓			
j. The business owner's master's degree <i>Note: this is not something owned by the business</i>		✓		✓
k. The computer that your business rents and uses to produce marketing brochures		✓		✓
l. A promise by a good customer to buy \$10,000 of merchandise from your business <i>Note: not a past event; certain legal details aside, your company has nothing but a promise</i>		✓	✓	✓
m. The \$5,000 increase in value of the French painting your business bought six years ago. <i>Note: any "increase" in value is only an estimate, so future benefits are not really measurable</i>		✓	✓	✓
n. A mission statement explaining company goals that managers prepared		✓	✓	✓
o. The employees of a business		✓		✓
p. A budgeted amount to buy office equipment		✓	✓	✓
q. Money that your business owes to vendors <i>Note: This is DEBT, which is the claim of someone else on the business assets! Were you fooled? Don't worry, we discuss more about debts and assets in the next learning goal.</i>		✓		

LG 2-6. Asset value is determined by using historical cost. This is the asset value at the time the asset was acquired. Historical cost is the value maintained in the accounting records unless Generally Accepted Accounting Principles permit a change in the value. Asset valuation is an extensive subject, and we will have more to say about this in later learning goals.

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LG 2-7.

Item	Property	Service
a. The aircraft of a commercial airline company	✓	
b. A medical examination by your doctor		✓
c. The medical equipment in the doctor's office	✓	
d. The gasoline in your car	✓	
e. The cash in a savings account	✓	
f. The classroom lecture from your accounting instructor		✓
g. The rental of a computer to a business that does not own one		✓
h. A six-month fire insurance policy paid in advance	✓	

Note: Anything prepaid is property, even prepayment of a service as in this case. A prepayment is owned by whomever made the prepayment, and the benefit is the right to receive future fire insurance coverage. We will talk more about prepaid items in later sections of this volume and in Volume 2.

LG 2-8.

- Because the machine has a market value and can be sold for \$250, it is still an asset—the \$250 represents potential future benefits that can be received.
- Because the machine is still functional and is able to provide operational benefits, it is still an asset to the business that is using it—despite the fact that no one would buy it. The historical cost of the item will be the dollar amount used to keep the item in the accounting records.
- No, it is not an asset. The equipment no longer provides any kind of benefits—either future sales price or operational cash flow. When property loses all future benefits to a business, the item is no longer an asset, even if it has some kind of functionality.
- Yes, an item can be an asset even though it is acquired at no cost—for example, a donation of land by a local city to attract a new business. However, the item must have some measurable value or it cannot be recorded, even if it otherwise would qualify as an asset. In the case of an asset acquired at no cost, the usual method is to use its appraised value. The best approach would be to use one or more certified appraisers. Another example: A business locates an old machine that no one wants and obtains it without cost. The machine is in some particular way useful to the operations of the business, so it provides some future benefits. The business would record the machine at its appraised value.

Summary: In addition to being owned as the result of a past event, an item must provide some kind of future benefits to qualify as an asset. As well, for the asset to be recorded it must also be able to be valued at some measurable amount—either at historical cost, appraised value, or some other reliable valuation.

Comment: Valuation issues are among the most tricky and difficult issues in accounting. How to determine the “best” valuation is the subject of frequent debate and controversy among professional accountants and academics. We return to the subject of valuation again in other learning goals.