

SOLUTIONS

Learning Goal 8

Reinforcement Problems

LG 8-1. No. Paying a liability reduces a creditor's claim, never the owner's claim. An expense is a reduction in the owner's claim because of consuming resources to add value and make sales (operations). It has nothing to do with paying liabilities.

LG 8-2.

1. An increase in owner's equity caused by either an increase in assets or a decrease in liabilities as a result of performing services or selling products is called (i) Revenue.
 2. Items such as paper, pencils, binders, staples, solvents, and paper towels are called (b) Supplies.
 3. An asset created when a sale is made to a customer "on account" (that is, no cash is received at the time of sale) is (c) Accounts Receivable.
 4. A liability that is created on the books of the seller when a customer prepays before the service or product is provided to the customer is called (h) Unearned Revenue.
 5. An asset that is created for the recipient when a formal written promise to pay a certain amount is signed is called a (d) Note Receivable.
 6. A liability that is created for the payor when a formal written promise to pay a certain amount is prepared and signed is called a (g) Note Payable.
 7. The owner transferring personal assets into a business is called (l) Owner Investment.
 8. A decrease in owner's equity caused by a decrease in assets or an increase in liabilities resulting from the process of operating the business is an (m) Expense.
 9. An obligation to pay money (normally in 30–90 days) to a supplier is an (f) Account Payable.
 10. Currency that a business has on hand and the amounts in the checking and savings accounts that can be withdrawn on demand is called (a) Cash.
 11. A short-term asset created when a business pays for goods or services before it receives them or uses them up is a (e) Prepaid Expense.
 12. The owner's withdrawal of assets from the business for personal use is called a (k) Withdrawal.
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SOLUTIONS

Learning Goal 8, continued

LG 8-3.

Transaction	Assets increased or liabilities decreased?	Revenue?	Why is it a revenue or not a revenue?	A	=	L	+	OE
a. An accountant performs \$2,000 of accounting services and is paid in cash.	Yes (The asset Cash increases.)	Yes	Assets increase because services are performed for a customer, so it is a revenue transaction.	↑				↑
b. The accountant borrows \$2,000 from her bank.	Yes (The asset Cash increases.)	No	Assets increase because of a loan, so it is not a revenue transaction.	↑		↑		
c. An accountant receives a \$2,000 cash advance from a client as a prepayment for future services.	Yes (The asset Cash increases.)	No	Assets increase as a result of a liability, so it is not a revenue (revenue not earned yet).	↑		↑		
d. The accountant fully performs all the services for the client who prepaid her in (c) above.	Yes (The liability Unearned Revenue decreases.)	Yes	Services were performed, so revenue was earned.			↓		↑
e. The accountant invests an additional \$5,000 in her business.	Yes (The asset Cash increases.)	No	Owner's equity increases, but not because of a sale of services or goods. Investment is not revenue.	↑				↑
f. In September, the accountant performs \$2,500 of services "on account."	Yes (The asset Accounts Receivable increases.)	Yes	Accounting services were performed.	↑				↑

SOLUTIONS

Learning Goal 8, continued

LG 8-3, continued

Transaction	Assets increased or liabilities decreased?	Revenue?	Why is it a revenue or not a revenue?	A	=	L	+	OE
g. The accountant collects \$2,000 cash from the accounts receivable.	Yes (The asset Cash increases and the asset Accounts Receivable decreases.)	No	Simply an exchange of one kind of asset for another kind of asset.	↑ ↓				
h. A magazine publisher mails magazines to its subscribers who prepaid subscriptions.	Yes (The liability Unearned Revenue decreases.)	Yes	Merchandise is delivered when the magazines are mailed out to customers.			↓		↑
i. A computer consultant is paid \$1,000 immediately after finishing a job.	Yes (The asset Cash increases.)	Yes	Assets increased because services were performed.	↑				↑

LG 8-4. No sale has been made. A revenue must meet two requirements: (1) it must *increase owner's equity*, and (2) it must be *caused by making a sale of services or goods*. None of the examples meet both requirements. Except for owner's investment, none of the transactions affect owner's equity. The investment increases owner's equity but not because of a sale being made.

LG 8-5. None of the transactions involve operations. An expense must meet two requirements: (1) it must *decrease owner's equity*, and (2) it must be *caused by operations*. None of the examples meet both requirements. Except for owner's drawing, none of the transactions affect owner's equity. The withdrawal does decrease owner's equity but not because of operations.

SOLUTIONS**Learning Goal 8, continued****LG 8-6.**

Transaction	Assets decreased or liabilities increased?	Expense?	Why is it an expense or not an expense?	A	=	L	+	OE
a. The business pays off a loan of \$10,000.	Yes (The asset Cash decreases.)	No	Only creditors' equity is affected, not the owner's.	↓		↓		
b. \$1,500 of supplies are used up.	Yes (The asset Supplies is used up.)	Yes	A direct using up of resources in operations.	↓				↓
c. A business pays off an account payable of \$1,500.	Yes (The asset Cash decreases.)	No	Paying a liability is never an expense; it affects the creditor's equity, not the owner's.	↓		↓		
d. A business pays employees \$1,500 in wages as soon as they are earned.	Yes (The asset Cash decreases.)	Yes	Asset used up in operations to pay for employee services.	↓				↓
e. A business receives a \$750 repair bill for this month's computer repair services. The bill is not paid immediately.	Yes (The liability Accounts Payable increases.)	Yes	A new claim is placed on existing assets because of a service consumed and not paid for.			↑		↓

SOLUTIONS

Learning Goal 8, continued

LG 8-6, continued

Transaction	Assets decreased or liabilities increased?	Expense?	Why is it an expense or not an expense?	A	=	L	+	OE
f. The owner pays himself a "salary" and withdraws \$1,000 in cash.	Yes (The asset Cash decreases.)	No	Drawing is never an expense; it is not part of business operations.	↓				↓
g. A business pays this month's telephone bill of \$300 as soon as it is received.	Yes (The asset Cash decreases.)	Yes	Cash decreases immediately as a result of operations.	↓				↓
h. A business owes its employees \$15,000 in wages but will not pay them until next Monday.	Yes (The liability Wages Payable increases.)	Yes	A new claim is placed on existing assets because of a service consumed and not paid for.			↑		↓
i. Next Monday, the business pays the wages owing to the employees.	Yes (The asset Cash decreases.)	No	Payment of debt is never an expense.	↓		↓		

SOLUTIONS**Learning Goal 8, continued****LG 8-7.**

Transaction	Expense?	Liabilities increased?	Did event happen as part of revenue-earning operations?
a. The business borrows \$10,000 and records a liability to Fifth National Bank.	No	Yes (The liability Notes Payable increases.)	No (Borrowing money is not part of revenue-earning operations.)
b. The business owes its employees \$8,500 for this week's wages and records it as a new liability by classifying it as Wages Payable.	Yes	Yes (The liability Wages Payable increases.)	Yes (Employee services were used.)
c. The business receives a bill for this month's utilities.	Yes	Yes (The liability Accounts Payable increases.)	Yes (Utility services were consumed.)
d. The business receives a bill for this month's accounting services.	Yes	Yes (The liability Accounts Payable increases.)	Yes (Accounting services were consumed.)
e. The business purchases \$700 of supplies "on account."	No	Yes (The liability Accounts Payable increases.)	No (A resource has not been consumed in operations.)
f. The \$700 of supplies is consumed.	Yes	No (Liabilities are not affected.)	Yes (This is to remind you that the expense occurs when the supplies are consumed, even though the \$700 liability for the purchase of the supplies happened in example f.)
g. The business purchases \$4,000 of equipment on account.	No	Yes (The liability Accounts Payable increases.)	No (A resource has not been consumed in operations.)
h. The business receives a \$1,000 bill for this month's computer repair services.	Yes	Yes (The liability Accounts Payable increases.)	Yes (Repair services were consumed.)
i. The business receives a \$500 prepayment from a customer for services to be performed next month.	No	Yes (The liability Unearned Revenue increases.)	No (A resource has not been consumed in operations.)

SOLUTIONS**Learning Goal 8, continued****LG 8-8.**

Transaction affecting owner's equity	Type of change to owner's equity	Owner's equity increase or decrease?	Asset or liability affected?	Increase or decrease?
a. An accountant prepares a tax return and collects \$500 from a client.	Revenue	Increase	Asset (Cash)	Increase
b. An owner invests \$10,000 cash in her business.	Owner's investment	Increase	Asset (Cash)	Increase
c. Office supplies are used up.	Expense	Decrease	Asset (Supplies)	Decrease
d. A business receives a bill for consulting services payable on account.	Expense	Decrease	Liability (Accounts Payable)	Increase
e. The same accountant as in (a) above prepares another tax return for \$400 and sends the bill to the client.	Revenue	Increase	Asset (Accounts Receivable)	Increase
f. A real estate company receives and pays its current bill for advertising.	Expense	Decrease	Asset (Cash)	Decrease
g. A law firm receives its current bill from the telephone company but does not immediately pay it.	Expense	Decrease	Liability (Accounts Payable)	Increase
h. An owner withdraws \$500 worth of supplies from his business.	Owner's drawing	Decrease	Asset (Supplies)	Decrease
i. An airline company provides a flight to a customer who purchased the ticket three months ago.	Revenue	Increase	Liability (Unearned Revenue)	Decrease
j. The accountant receives a bill for computer repair services for this month for \$950.	Expense	Decrease	Liability (Accounts Payable)	Increase
k. An owner pays a debt of his business by writing a check on his personal checking account (not a good business practice).	Owner's investment	Increase	Liability (Debt decreased)	Decrease

SOLUTIONS**Learning Goal 8, continued****LG 8-9.**

- a. Assets increase, but not as a result of revenue-earning operations. Only creditors' equity is affected.
 - b. The advance payment is not the result of a sale, so owner's equity is not affected.
 - c. Again, only creditors' equity is affected. Paying a debt is never an expense.
 - d. Assets increase, but not as a result of revenue-earning operations or owner's investment. Only creditors' equity is affected.
 - e. There is no change in total assets. Cash increases but accounts receivable decrease. Collection of a receivable is not part of revenue-earning operations. (The revenue was earned previously, when the receivable was created.)
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