SOLUTIONS Learning Goal 22

Multiple Choice

1. c
2. d. The words "debit" and "credit" refer *only* to location. "Debit" means "left" and "credit" means "right." They have no other meaning. Whether or not "debit" and "credit" is an increase or decrease depends entirely on which account in the equation is affected. That is the reason why it is so important to first remember the basic rule:

   Accounts on the left side of the equation are increased with left-side (debit) entries, and accounts on the right side of the equation are increased with right-side (credit) entries. Then record decreases on the opposite sides from increases.

   Another common mistake with the words "debit" and "credit" is trying to give them meanings such as "favorable" or "unfavorable" or "give" and "take."

3. b
4. a
5. b. This is giving up one asset (Accounts Receivable) for another asset (Cash).
6. c
7. d
8. d. Debits (left-side entry) decrease liabilities.
9. a
10. b
11. d. Net income (or loss) is simply revenues – expenses: ($44,200 – $37,100 = $7,100)
12. c
13. b, because Accounts Payable decreased and Cash decreased.
14. a, because Cash decreased and Supplies increased.
15. c, because Cash increased and Unearned Revenue increased.
16. a, because Cash increased and Accounts Receivable decreased.
17. d. Equipment increased and Notes Payable increased, so the company purchased equipment and signed a note payable.

SOLUTIONS Learning Goal 22, continued

Reinforcement Problems

LG 22-1.

Account	Natural Positive Side	
	Dr.	Cr.
a. Supplies	✓	
b. Accounts Payable		✓
c. Service Revenue		✓
d. Cash	✓	
e. R. Penland, Drawing	✓	
f. R. Penland, Capital		✓
g. Accounts Receivable	✓	
h. Rent Expense	✓	
i. Prepaid Rent	✓	
j. Equipment	✓	
k. Unearned Revenue		✓
l. Notes Payable		✓

LG 22-2.

a. . . . when a debit is to item on the left side of the equation (assets).
b. . . . when a debit is to an item on the right side of the equation (liabilities and owner's equity). (*Note:* expenses and withdrawals decrease owner's equity, so expenses and withdrawals are recorded with debits.)
c. . . . when a credit is to an item on the right side of the equation (liabilities and owner's equity).
d. . . . when a credit is to an item on the left side of the equation (assets).

LG 22-3.

	Assets	Liabilities	Owner's Capital	Revenue	Expense	Drawing
Debit	Increase	Decrease	Decrease	Decrease	Increase	Increase
Credit	Decrease	Increase	Increase	Increase	Decrease	Decrease
Natural Positive Balance?	Dr.	Cr.	Cr.	Cr.	Dr.	Dr.

* *Note:* Natural positive balances ("normal balances") are always on the increase side.

SOLUTIONS Learning Goal 22, continued

LG 22-4.

a. The word "debit" refers to location—specifically, left side—but not increase or decrease. "Debit" has nothing to do with knowing how to increase or decrease accounts. Knowing how to increase or decrease accounts is a completely separate rule. The word "debit" is only used *after* the rule is applied.

b. The word "credit" refers to location—specifically, right side—but not increase or decrease. "Credit" has nothing to do with knowing how to increase or decrease accounts. Knowing how to increase or decrease accounts is a completely separate rule. The word "credit" is only used *after* the rule is applied.

c. The **rule for increasing and decreasing accounts** is this: Any item on the left side of the accounting equation (assets) is increased with a left-side entry, and any item on the right side of the accounting equation (liabilities and owner's equity) is increased with a right-side entry. To do decreases, just do the opposite of increases.

   The result: An asset is on the left side, so it is increased with a left-side entry, which we call a "debit." We know that an expense is part of owner's equity, and owner's equity is on the right side of the equation, so owner's equity should be increased with a right-side entry (which we call a "credit"). However, an expense is a *decrease* to owner's equity, so we just do the opposite of an increase. We make a left-side entry, called a "debit." As expenses increase, owner's equity decreases.

d. Do not think about "debits" or "credits" first. **Apply the RULE FIRST!** The rule is: Any item on the left side of the accounting equation (assets) is increased with a left-side entry, and any item on the right side of the accounting equation (liabilities and owner's equity) is increased with a right-side entry. To do decreases, just do the opposite of increases. After you apply the rule, you can use the words "debit" and "credit."

LG 22-5.

a. Essex Company receives $1,000 from a customer before the services are provided.

Analysis:
The *asset Cash increases* by $1,000. The *liability Unearned Revenue increases* by $1,000.

Apply the rule:
Assets are increased with debits: debit Cash $1,000.
Liabilities are increased with credits: credit Unearned Revenue $1,000.

Record in T account:

		Cash		Unearned Revenue	
		1,000			1,000

SOLUTIONS Learning Goal 22, continued

LG 22-5, *continued*

b. Montgomery Enterprises receives a $200 electric bill. The bill is not paid immediately.

Analysis:
The *expense Utility Expense increases* by $200. The *liability Accounts Payable increases* by $200.

Apply the rule:
Expenses are increased with debits: debit Utility Expense $200.
Liabilities are increased with credits: credit Accounts Payable $200.

Record in T account:

Utility Expense	
200	

Accounts Payable	
	200

c. Prince Georges Company finishes consulting services for a client and sends the client a bill for $5,000.

Analysis:
The *asset Accounts Receivable increases* by $5,000. The *revenue Fees Earned* (or similar name, such as Service Revenue, etc.) *increases* by $5,000.

Apply the rule:
Assets are increased with debits: debit Accounts Receivable $5,000.
Revenues are increased with credits: credit Fees Earned $5,000.

Record in T account:

Accounts Receivable	
5,000	

Fees Earned	
	5,000

d. Cecil Company prepays six months of fire insurance for $2,500.

Analysis:
The *asset Prepaid Insurance increases* by $2,500. The *asset Cash decreases* by $2,500.

Apply the rule:
Assets are increased with debits: debit Prepaid Insurance $2,500.
Assets are decreased with credits: credit Cash $2,500.

Record in T account:

Prepaid Insurance	
2,500	

Cash	
	2,500

SOLUTIONS Learning Goal 22, continued

LG 22-5, *continued*

e. James Lafayette, owner of Anchorage Company, invests $9,000 in his business.

Analysis:
The *asset Cash increases* by $9,000. The *owner's equity James Lafayette, Capital increases* by $9,000.

Apply the rule:
Assets are increased with debits: debit Cash $9,000.
Owner's equity is increased with credits: credit James Lafayette, Capital $9,000.

Record in T account:

Account	Debit	Credit
Cash	9,000	
James Lafayette, Capital		9,000

f. Soldotna Company pays a $1,000 account payable.

Analysis:
The *asset Cash decreases* by $1,000. The *liability Accounts Payable decreases* by $1,000.

Apply the rule:
Assets are decreased with credits: credit Cash $1,000.
Liabilities are decreased with debits: debit Accounts Payable $1,000.

Record in T account:

Account	Debit	Credit
Cash		1,000
Accounts Payable	1,000	

g. Nome Commercial Company purchases $10,000 of equipment, paying $3,000 cash and signing a note payable for the balance.

Analysis:
The *asset Equipment increases* by $10,000. The *asset Cash decreases* by $3,000. The *liability Notes Payable increases* by $7,000.

Apply the rule:
Assets are increased with debits: debit Equipment $10,000.
Assets are decreased with credits: credit Cash $3,000.
Liabilities are increased with credits: credit Notes Payable $7,000.

Record in T account:

Account	Debit	Credit
Equipment	10,000	
Cash		3,000
Notes Payable		7,000

SOLUTIONS

Learning Goal 22, continued

LG 22-6.

Cash	
(a) 12,000	
	(b) 5,500
(d) 350	
(e) 500	
	(g) 200
	(i) 800
(j) 750	
	(k) 1,000
(l) 250	
6,350	

Accounts Receivable	
(e) 2,000	
	(j) 750
1,250	

Supplies	
(c) 200	
	(h) 150
50	

Equipment	
(b) 5,500	
5,500	

Accounts Payable	
	(c) 200
	(f) 170
(g) 200	
	170

Unearned Revenue	
	(l) 250
(m) 50	
	200

Jack Davis, Drawing	
(k) 1,000	
1,000	

Jack Davis, Capital	
	(a) 12,000
	12,000

Teaching Revenue	
	(d) 350
	(e) 2,500
	(m) 50
	2,900

Utilities Expense	
(f) 100	
100	

Telephone Expense	
(f) 70	
70	

Supplies Expense	
(h) 150	
150	

Rent Expense	
(i) 800	
800	

Note: Account balances are always entered on the positive sides of the accounts.

SOLUTIONS

Learning Goal 22, continued

LG 22-7.

A = L + OE

A

Cash	
(a) 35,000	(c) 4,500
(f) 5,000	(e) 2,400
(h) 3,000	(j) 2,500
(l) 1,200	(k) 250
	(n) 2,500
	(o) 1,000
31,050	

Accounts Receivable	
(d) 3,900	(l) 1,200
(h) 1,100	
3,800	

Supplies	
(b) 460	

Office Equipment	
(c) 4,500	

Land	
(j) 11,000	

L

Accounts Payable	
(k) 250	(b) 460
	(g) 510
	(i) 190
	910

Unearned Revenue	
(m) 2,000	(f) 5,000
	3,000

Notes Payable	
	(j) 8,500

OE

A. Alvarez, Withdrawals	
(n) 2,500	

A. Alvarez, Capital	
	(a) 35,000

Rent Expense	
(e) 2,400	

Commission Revenue	
	(d) 3,900
	(h) 4,100
	(m) 2,000
	10,000

Advertising Expense	
(g) 510	
(o) 1,000	
1,510	

Telephone Expense	
(i) 190	

Net Income: $5,900