SOLUTIONS Learning Goal 21

Discussion Questions and Brief Exercises for Learning Goals 20–21

1. An account is a detailed historical record that shows all the increases, decreases, and balance of a specific item in the accounting equation.
2. a. Asset: left side
   b. Liability: right side
   c. Owner's equity: right side
   d. Revenue: right side
   e. Expense: left side
3. Increases are recorded on the "normal" (the positive) side of an account. Examples: Cash is increased with a left-side entry. Accounts Payable is increased with a right-side entry. Expenses are increased with a left-side entry.
4. Decreases are recorded on the opposite side from increases. Examples: Cash is decreased with a right-side entry. Accounts Payable is decreased with a left-side entry. Expenses are decreased with a right-side entry.
5. The rules for increase and decrease state that any item on the left side of the equation is increased with a left-side entry, and any item on the right side of the equation is increased with a right-side entry. Decreases are simply the opposite. Therefore, whether a right-side or left-side entry increases or decreases an item **depends on the side of the equation where the item is located.** Assets are on the left side of the equation, so right-side entries decrease assets. Liabilities are on the right side of the equation, so right-side entries increase liabilities. Likewise, because assets are on the left of the equation, left-side entries increase assets. Because liabilities are on the right side of the equation, left-side entries decrease liabilities.
6.

Cash

Beginning balance	7,000	
	750	200
	2,000	
Ending balance	9,550	

(Notice that $ signs are not used.)

7.

Accounts Payable

Beginning balance		3,400
	2,900	1,500
Ending balance		2,000

8. There are two reasons for recording revenues and expenses in their own accounts, separate from the owner's capital account. First, it simply becomes too crowded and unmanageable to record all revenue and expense transactions in a single account. Second, recording in separate accounts makes it possible to see and analyze each separate item. In this way, the accounts provide a better understanding of what is happening with revenues and expenses.
9. Expense increases are recorded on the left of side of accounts (the normal side for an expense account) because an expense is really a decrease in owner's equity. All decreases in owner's equity are recorded with left-side entries. Revenue increases are recorded on the right side of accounts (the normal side for a revenue account) because revenues are increases in owner's equity. All increases in owner's equity are recorded with right-side entries.

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10. These accounts are the owner's capital account, revenue accounts, expense accounts, and the drawing (withdrawals) account. The capital account shows the cumulative balance of owner's equity, except for the current period revenues and expenses and withdrawals. Revenue accounts show the current period increase in owner's equity that result from making sales of services or merchandise. Expense accounts show the current period decrease in owner's equity as a result of consuming resources to operate the business and make sales. The drawing account records the value of the assets that the owner has withdrawn from the business in the current period. (Owner investments are recorded directly into the capital account.)

11.
- Capital account: normally right side, but can have a left-side balance if the business has had greater cumulative net losses than net income.
- Revenue account: right side
- Expense account: left side
- Drawing account: left side

12. $10,000 + $2,700 − $1,800 − $1,000 = $9,900

13. Owner investments are recorded directly into the capital account. This is a right-side entry because an owner investment increases the owner's equity.

Reinforcement Problems

LG 21-1.

a. Accountants use the accounting equation as a reference to decide which side of an account will be the natural positive side. Because the owner's capital is on the right side of the equation, the natural positive side of the owner's capital account is its right side.

b. Revenues, expenses, and owner withdrawals are all types of changes in the owner's capital. Because these changes are numerous and frequent, and because they have a powerful effect on the success or failure of a business, they must be monitored very closely. To follow these changes carefully, they are assigned individual accounts. This permits more accurate observation than simply recording them all together in the owner's capital account.

c. Decreases in the owner's capital account are recorded on the left side of the account. So, if the decreases in the owner's capital are subdivided into expense and drawing accounts, these "decrease accounts" should have left natural positive sides because the amounts recorded are decreases in the owner's capital.

d. Expenses and owner drawings decrease the owner's capital.

e. Revenues are sales transactions that cause the owner's capital to increase. Increases to owner's capital are recorded on the right side of the account. Therefore, because revenues increase owner's capital, revenue increases should be recorded on the right side of an individual revenue account.

LG 21-2. Yes. The owner's capital account can have a negative balance. This happens when liabilities exceed assets. This situation happens when a business consumes resources in a way that does not add enough value, so not enough assets are received from customers to replace the value of resources used up. A negative balance in a capital account is the amount of money an owner must invest so the business will have enough assets to pay off all the debts.

SOLUTIONS

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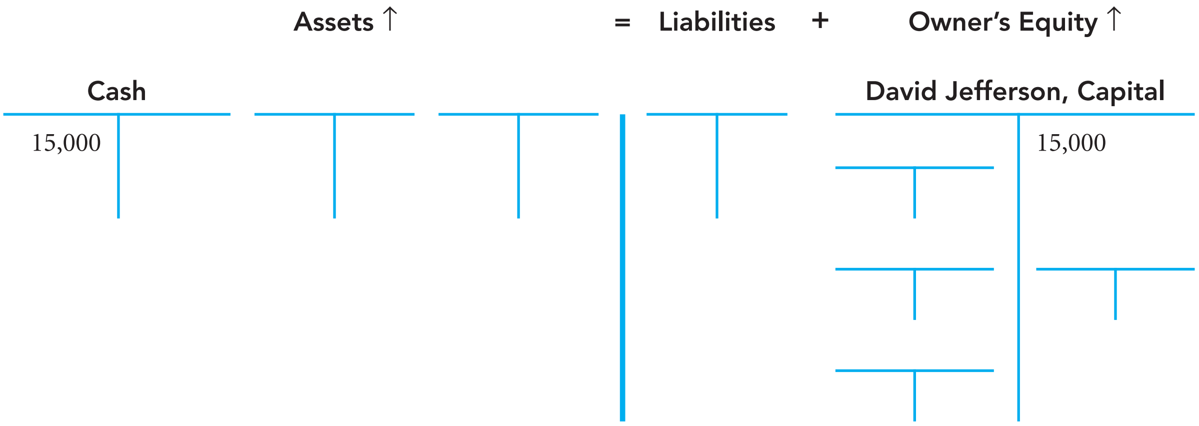
LG 21-3. *Note:* To help you remember the previous changes, the prior transactions are recorded in black.

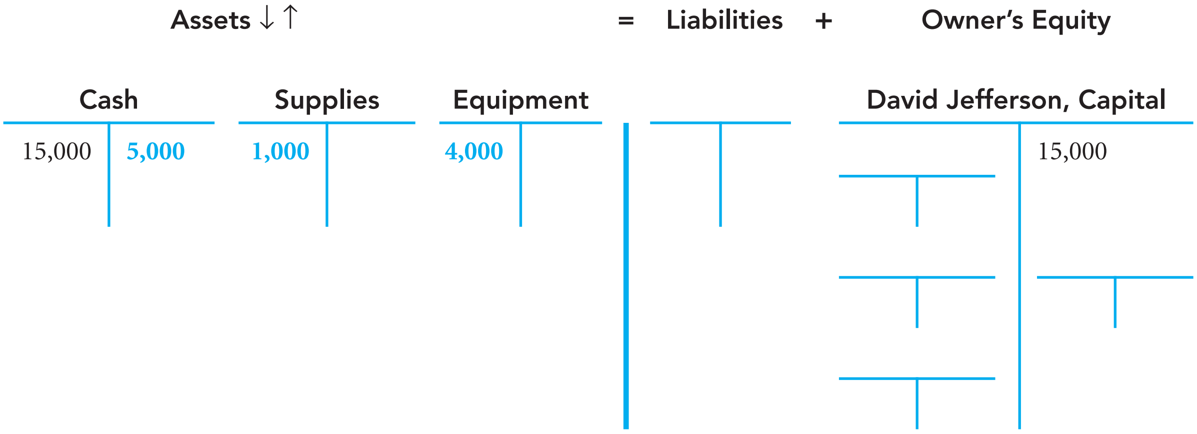
a.

On October 1, David Jefferson invests $15,000 to start a new business called Reliable Real Estate Appraisal Company.



b.

On October 5, the business spends $5,000 cash to purchase $4,000 of computer equipment and $1,000 of office supplies from a vendor.

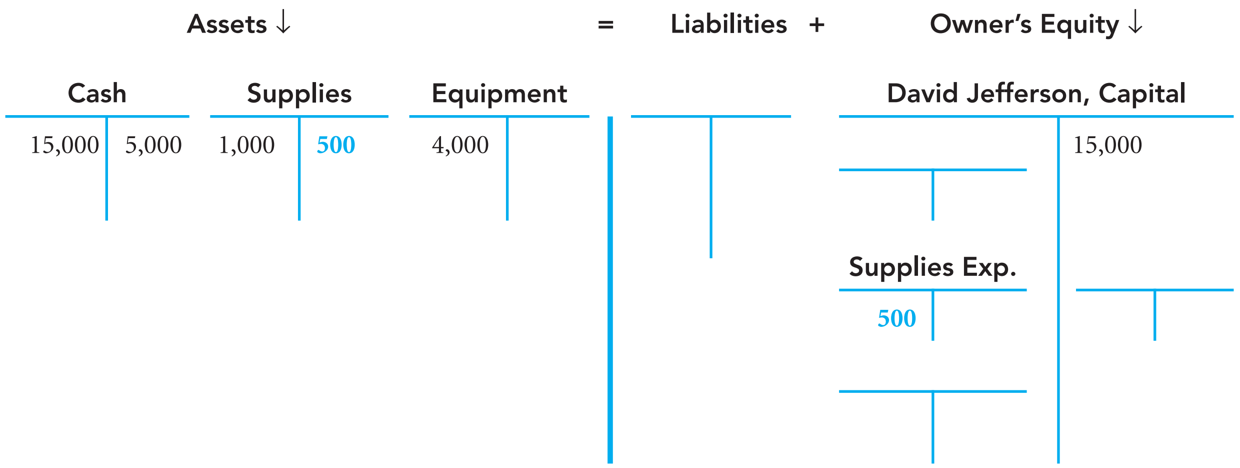


SOLUTIONS Learning Goal 21, continued

LG 21-3, *continued*

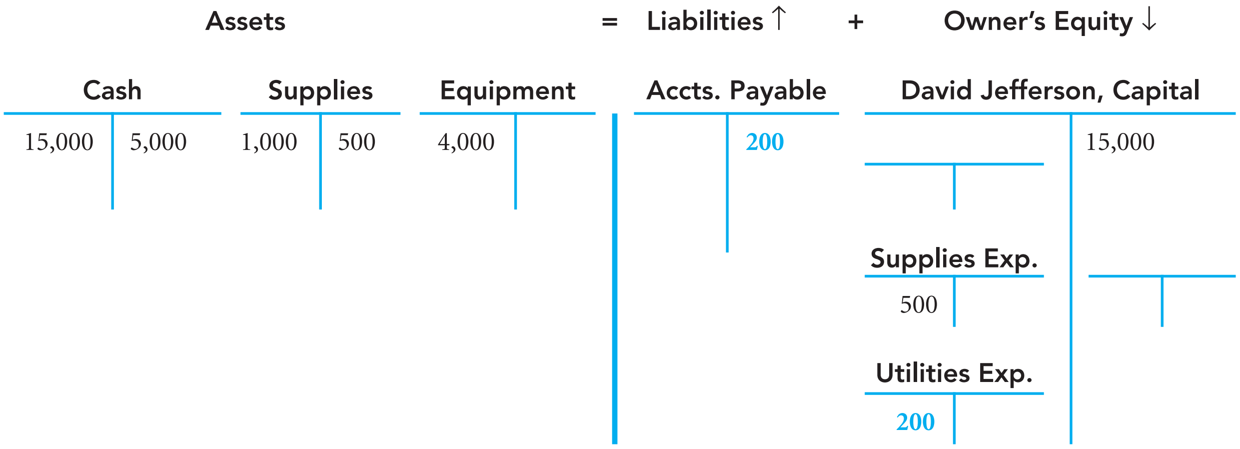
c.

On October 7, the business uses up $500 of supplies in performing a consulting job for a client.



d.

On October 20, the business receives a $200 bill from the electric company. The bill will be paid early next month.



SOLUTIONS

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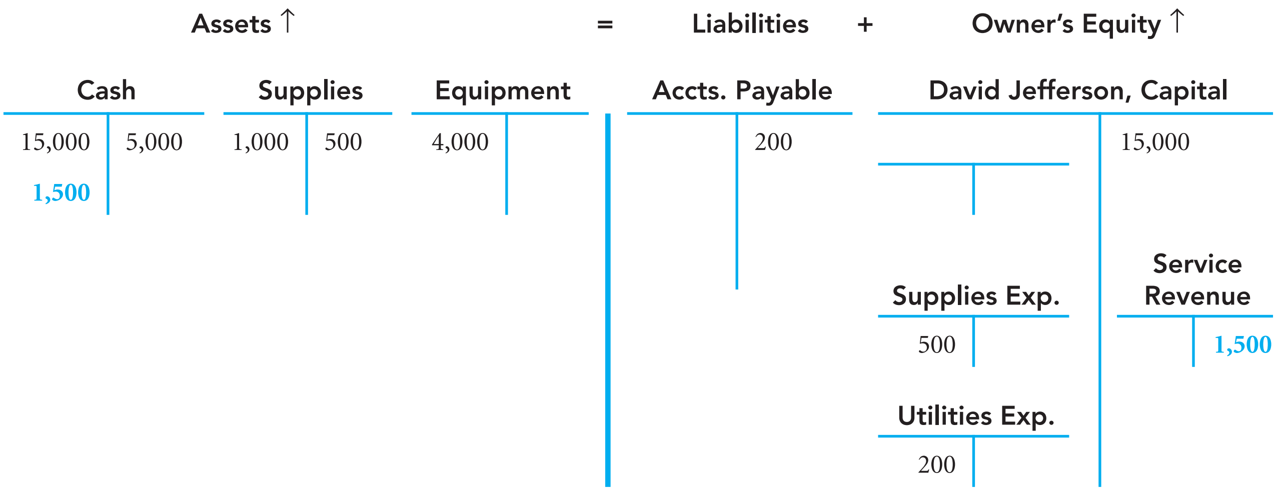
LG 21-3, *continued*

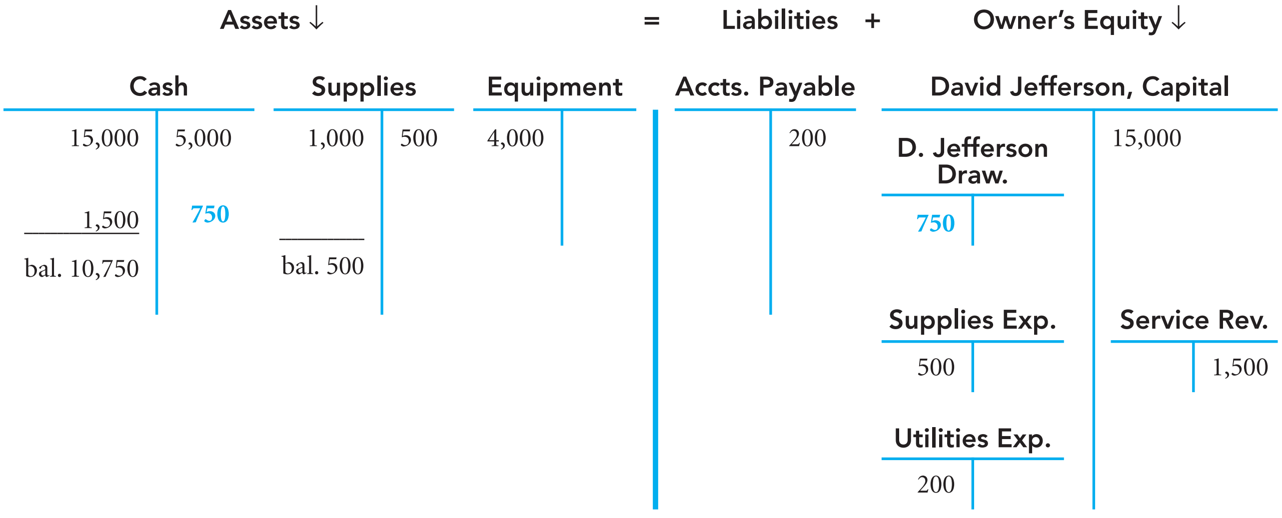
e.

On October 28, the business completes a consulting job, and the client pays $1,500 cash.



f.

On October 31, David Jefferson withdraws $750 cash from his business.



SOLUTIONS

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LG 21-4.

Cash

(a) 10,000	(b) 2,000
(g) 1,500	(i) 1,600
	(j) 1,000
6,900	

Accounts Receivable

(e) 3,900	

Supplies

(d) 300	(f) 150
150	

Accounts Payable

	(c) 700
	(d) 300
	(h) 90
	1,090

Howard Laguna, Capital

	(a) 10,000

Wages Expense

(i) 1,600	

Supplies Expense

(f) 150	

Advertising Expense

(c) 700	

Service Revenue

	(e) 3,900
	(g) 1,500
	5,400

Utilities Expense

(h) 90	

Rent Expense

(b) 2,000	

Howard Laguna, Withdrawals

(j) 1,000	

Total revenues are $5,400 and total expenses are $4,540, thus net income is $860.

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LG 21-5.

Cash

(a) 20,000	(b) 3,500
(c) 5,000	(h) 3,000
(f) 900	(k) 5,000
14,100	(m) 300

Accounts Receivable

(d) 1,300	

Supplies

(a) 500	(i) 400
(e) 700	
800	

Accounts Payable

	(e) 700
	(g) 375
	(l) 500
	1,575

Unearned Revenue

(j) 3,000	(c) 5,000
	2,000

Anne Quincy, Capital

	(a) 20,500

Wages Expense

(h) 3,000	

Supplies Expense

(i) 400	

Advertising Expense

(b) 3,500	

Service Revenue

	(d) 1,300
	(f) 900
	(j) 3,000
	5,200

Utilities Expense

(l) 500	

Repairs Expense

(g) 375	
(m) 300	
675	

Anne Quincy, Withdrawals

(k) 5,000	

This business has a net loss of $2,875 because total expenses of $8,075 exceed total revenues of $5,200.