

SOLUTIONS

Learning Goal 21

Discussion Questions and Brief Exercises for Learning Goals 20–21

- An account is a detailed historical record that shows all the increases, decreases, and balance of a specific item in the accounting equation.
- Asset: left side
 - Liability: right side
 - Owner's equity: right side
 - Revenue: right side
 - Expense: left side
- 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.
- 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.
- 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	(Notice that \$ signs are not used.)
	750	
	2,000	
Ending balance	9,550	

7.

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

- 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.
- 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.

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LG 21-3, continued

c.

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

Assets ↓				=	Liabilities	+	Owner's Equity ↓	
Cash		Supplies		Equipment		David Jefferson, Capital		
15,000	5,000	1,000	500	4,000				15,000
						Supplies Exp.		
						500		

d.

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

Assets				=	Liabilities ↑	+	Owner's Equity ↓	
Cash		Supplies		Equipment		David Jefferson, Capital		
15,000	5,000	1,000	500	4,000		200		15,000
						Supplies Exp.		
						500		
						Utilities Exp.		
						200		

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e.

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

Assets ↑				=	Liabilities	+	Owner's Equity ↑		
Cash		Supplies		Equipment		Accts. Payable		David Jefferson, Capital	
15,000	5,000	1,000	500	4,000		200		15,000	
1,500									
								Supplies Exp.	Service Revenue
								500	1,500
								Utilities Exp.	
								200	

f.

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

Assets ↓				=	Liabilities	+	Owner's Equity ↓		
Cash		Supplies		Equipment		Accts. Payable		David Jefferson, Capital	
15,000	5,000	1,000	500	4,000		200	D. Jefferson Draw.	15,000	
1,500	750						750		
bal. 10,750		bal. 500					Supplies Exp.	Service Rev.	
							500	1,500	
							Utilities Exp.		
							200		

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LG 21-4.

Cash		Accounts Receivable	Supplies		Accounts Payable
(a) 10,000	(b) 2,000	(e) 3,900	(d) <u>300</u>	(f) 150	(c) 700
(g) 1,500	(i) 1,600		150		(d) 300
	(j) 1,000				(h) <u>90</u>
<u>6,900</u>					1,090

Howard Laguna, Capital

Howard Laguna, Capital			(a) 10,000
Wages Expense		Supplies Expense	Advertising Expense
(i) 1,600		(f) 150	(c) 700
Utilities Expense		Rent Expense	Howard Laguna, Withdrawals
(h) 90		(b) 2,000	(j) 1,000
			Service Revenue
			(e) 3,900
			(g) <u>1,500</u>
			5,400

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

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LG 21-5.

Cash		Accounts Receivable	Supplies		Accounts Payable	Unearned Revenue	
(a) 20,000	(b) 3,500	(d) 1,300	(a) 500	(i) 400	(e) 700	(j) 3,000	(c) <u>5,000</u>
(c) 5,000	(h) 3,000		(e) <u>700</u>		(g) 375		2,000
(f) 900	(k) 5,000		800		(l) <u>500</u>		
<u>14,100</u>	(m) 300				1,575		

Anne Quincy, Capital

Anne Quincy, Capital						(a) 20,500
Wages Expense		Supplies Expense		Advertising Expense		Service Revenue
(h) 3,000		(i) 400		(b) 3,500		(d) 1,300
						(f) 900
						(j) <u>3,000</u>
						5,200
Utilities Expense		Repairs Expense		Anne Quincy, Withdrawals		
(l) 500		(g) 375		(k) 5,000		
		(m) <u>300</u>				
		675				

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