REVISION NOTES ON ACCOUNTING EQUATION & THEORY OF DOUBLE ENTRY

The accounting equation is:-

Assets = Owner's Equity + Liabilities

- Assets are items of value owned by the business
- Liabilities are amounts owed by a business to external parties.
- Owner's equity is the owner's interest or claim on the business
- Owner's Equity=Assets-Liabilities (rearranging formula)

Salient Points On Accounting Equation:-

- The accounting equation is based on the business entity concept which assumes that the business, as a unit by itself, acquires its own assets through funds supplied by the owner or by external sources.
- Owner's equity can be increased through investment by the owner or as a result of profit earned from business operations
- Owner's equity can be decreased through withdrawals by the owner for personal use or as a result of losses made from business operations.
- The Balance Sheet is a statement listing all assets, owners's equity and liabilities AT A PARTICULAR DATE
- The balance sheet totals WILL ALWAYS BALANCE because the assets will always be equal to owner's equity plus liabilities
- The accounting equation and the Balance Sheet are two different ways of expressing the same idea.
- The equality of the accounting equation and the balance sheet totals are always maintained no matter what transactions take place in the business

Theory of Double Entry System:

1. Accounting transactions are recorded by using an accounting system.
2. Accounting systems are designed to show the increases and decreases in accounts in the financial statements.
3. There are five major accounts in financial statements:

- Assets
- Liabilities
- Owner's Equity namely Capital & Drawing
- Revenues
- Expenses

Also called the Dual Accounting Concept i.e. for every debit, there is an equivalent credit

Assets or any other item of the accounting equation can increase or decrease but assets will always be equal to capital + liabilities

Transactions which are related to a particular person or item which are of similar nature are grouped to form an "account" . Separate accounts are drawn for each asset, liabilities and one capital

A **T** account explains how an asset or liability is increasing or decreasing.
Dr is the left hand side of the **T** account
Cr is the right hand side of the **T** account
Remember the simple Rules of Dr and Cr.or the theory of Double entry:

	Assets	=	Capital	+	Liabilities
Increase	Dr	=	Cr	+	Cr
Decrease	Cr	=	Dr	+	Dr

WORKED EXAMPLES OF ACCOUNTING EQUATION

SAMPLE NO.1

1.0	Assets	Liabilties	Capital
a	40,000	10,000	?
b	15,000	?	11,000
c	?	5,000	10,000
d	11,000	8,000	

Answer:

1a $30,000 ($40,000-$10,000)

1b $4,000 ($15,000-$11,000)

1c $15,000 ($5,000+$10,000)

1d $3,000 ($11,000-$8,000)

SAMPLE NO.2

The following is the summary data of ABC Ltd for August presented in equation form. Describe each of the transactions that occurred during August.

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2.0	ASSET Cash	ASSETS Supplies	ASSETS Equipment	= LIABILITIES	+	
a	+$10,000				+$10,000	Capital
b	-$2,000		+$2,000			
c	-$200	+$200				
d			+$700	$700		
e	+$1,000				+$1,000	Income
f	-$600				-$600	Salaries
g	-$300			-$300		
h	-$100				-$100	Drawing
	$7,800	$200	$2,700	= $400 +	$10,300	

Answer:

2a The owner made an investment by injecting cash as capital

2b Equipment was bought and *paid for*

2c Supplies were bought and *paid for*

2d Additional equipment was *bought on account* creating a liability

2e The company recorded an income for work done for customers

2f The company *paid salaries* to the workers

2g Cash was paid to reduce amount owing to Accounts Payable(Liability)

2h Owner *withdrew* cash for her personal use.