

ACCOUNTING EQUATION

- ❖ Double entry bookkeeping states that for every debit entry there should be pass a credit entry. Every transaction has twofold effect; this concept has a result of Accounting Equation or Balance Sheet Equation or Fundamental Equation

Resources

=

Source

Or

Assets

=

Equities / Claims (Claims may be internal or external)

Or

Asset

=

Liabilities + Owner Equity

Or

Left hand side

=

Right hand side

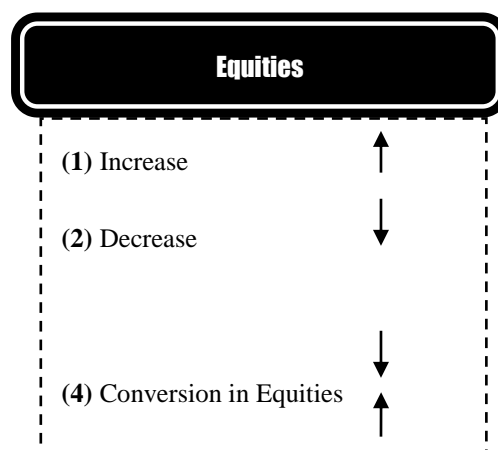
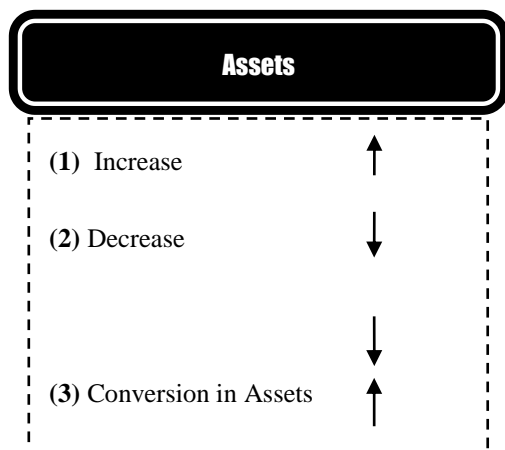


Which of the following is correct form of Equation?

Assets	=	Liabilities	+	Owner's Equity	
Assets	-	Liabilities	=	Owner's Equity	
Liabilities	=	Assets	-	Owner's Equity	
Asset	-	Liabilities	-	Owner's Equity	= 0

- ❖ At any point of time total assets must be equal to total equities. In other words we can say that left hand side which is resource side must be equal to right hand side which is of course source side

4.1 Four Effects





Example # 4.1: For each of the following transactions indicate the effects on the Accounting Equation of the Company i.e. (Increase, Decrease, Conversion or No Effect)?

(1) The owner invests personal cash in the company?

Assets	Liabilities	Owner's Equity

(2) The owner withdraws company's assets for personal use?

Assets	Liabilities	Owner's Equity

(3) The company purchases equipment with its cash?

Assets	Liabilities	Owner's Equity

(4) The company repays the bank loan by introducing reinvestment of owner in the company?

Assets	Liabilities	Owner's Equity

Example # 4.2: From the list of accounts below, determine which assets are and which equities are. List the assets under the Asset Column and the equities under the equities Column. Then add each column and complete the Fundamental Accounting Equation?

Accounts		Asset	Equities
Cash	Rs. 5,000		
Accounts Receivable	10, 600		
Building	35,000		
Accounts Payable	5,000		
Inventory	200		
Computer Equipment	18,000		
Bank Loan	6,000		
Mortgage Payable	10,000		
Owner Equity	47,800		
TOTAL	Rs. 137,600		

Example # 4.3: For each of the following equations, a figure is missing. In the space provided, please supply the missing figure that will balance the equation.

Assets	Liabilities	Owner's Equity
100	20.00	
	720	70
2,000		1,600
11,218	10,000	
	25	985
340		328
8793	0	
	1,501	499

Example # 4.4: Prepare Accounting Equation on the basis of following transactions?

1. Arush Khan and Company started business with cash Rs. 100,000
2. She purchased Furniture for cash Rs. 2,000
3. Purchases Machinery on credit from Umer Abbasi Rs.10,000
4. Cash withdraw by owner Rs. 20,000
5. Cash Sales of Rs. 6,000
6. Credit sales to Ayesha Iqbal Rs.2,000
7. Paid rent Rs. 2,500 and wages Rs. 1,500

S. No	Assets				Equities	
	Cash	Furniture	Machinery	A/C Receivables	A/C Payable	O.E
1						
Bal						
2						
Bal						
3						
Bal						
4						
Bal						
5						
Bal						
6						
Bal						
7						
Bal						
Total						

Example # 4.5: On 1st January, 2016 the balances of Muhammad Danish & Bros. are as follows?

Assets		Equities	
Cash	25,000	Creditor	40,000
Debtor	17,000	Capital	94,000
Inventory.....	22,000		
Building	70,000		
Total	Rs. 134,000		Rs. 134,000

Transaction during the January was

January

- 1) Purchase inventory for cash Rs. 3,600
- 5) Sold inventory for cash Rs. 12,000 costing Rs. 10,500
- 7) Cash paid to creditor Rs. 25,000
- 9) Sold inventory for cash Rs. 5,000 and on credit Rs. 3,000 costing Rs. 6,000
- 11) Inventory returned by a cash customer Rs. 2,000 costing Rs. 1,900
- 15) Cash received from debtors Rs. 14,000
- 18) Cash paid for furniture purchased for owner domestic use Rs. 1,000
- 20) Paid salaries Rs. 1,400

Requirement: Show the effects of above transaction on the accounting equation:

S. No	Assets				Equities	
	Cash	Debtor	Inventory	Building	Creditor	Capital
Bal						
1						
Bal						
5						
Bal						
7						
Bal						
9						
Bal						
11						
Bal						
15						
Bal						
18						
Bal						
20						
Bal						
Total						

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