

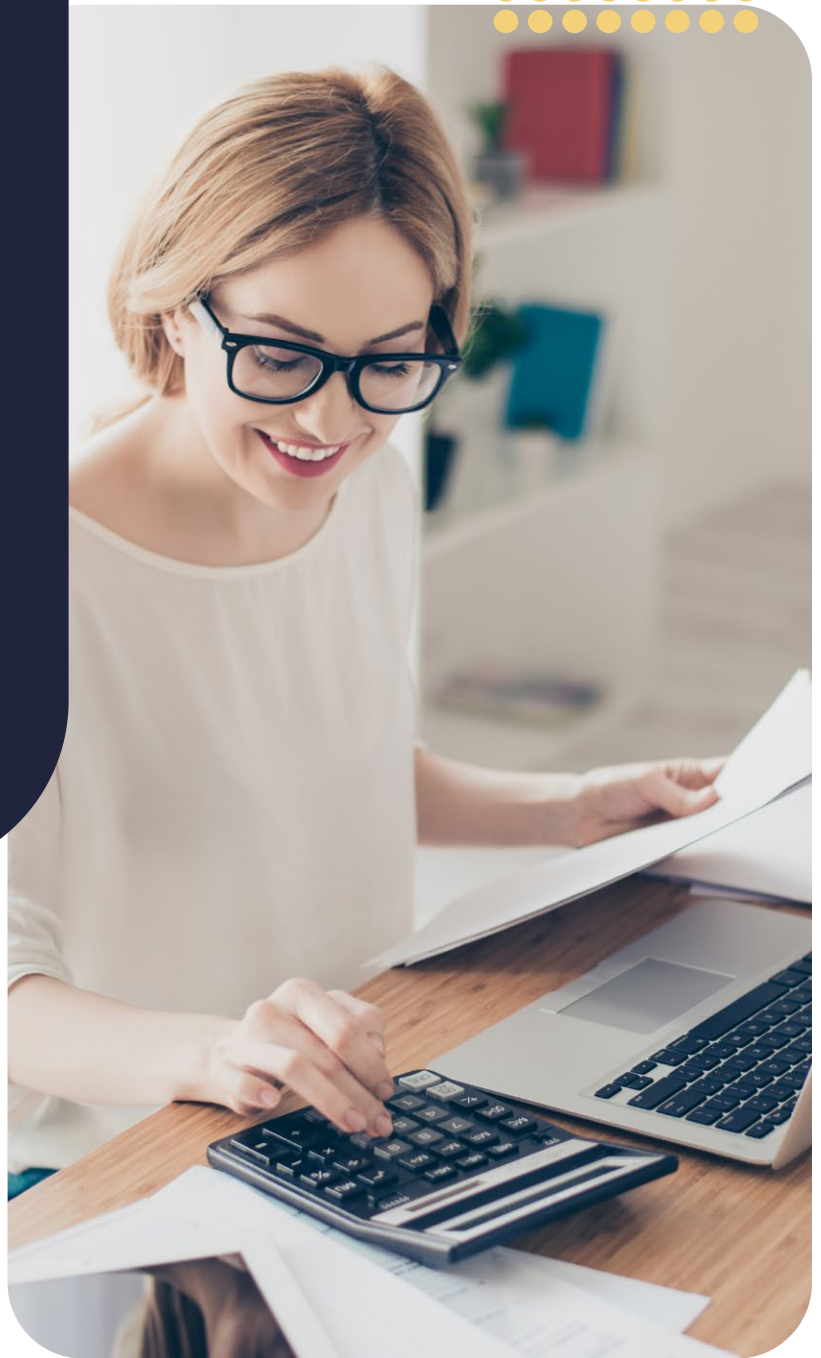
Diploma in Bookkeeping

The Accounting Equation



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Introduction

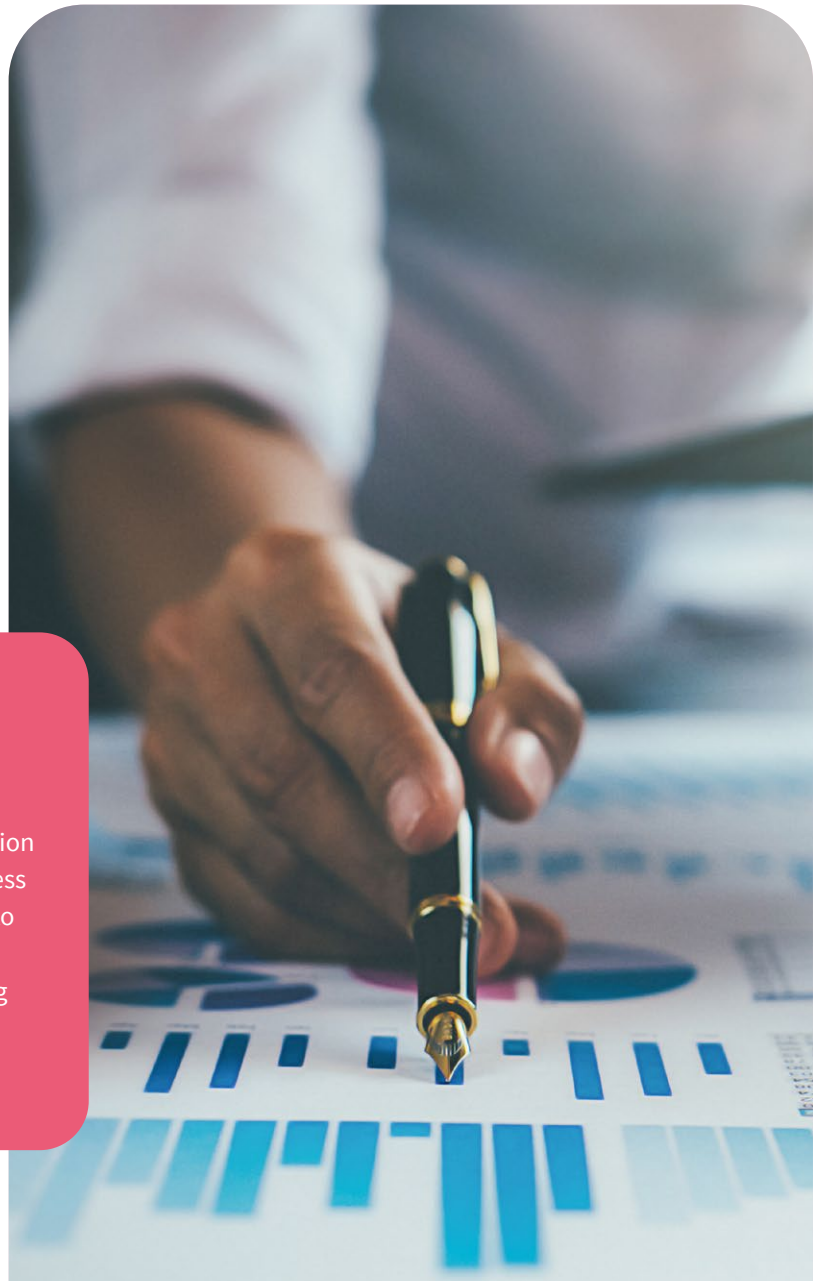
In exercise, it is important to balance cardio with stretching and toning. In your diet, it is important to balance your eating. In life, it is important to balance your time. Accounting is no different. The books must balance.

“Life is like accounting. Everything must balance.” – Anonymous

Lesson outcomes

By the end of the lesson, you will:

- Apply the accounting equation to any transaction whether it be in your personal life or your business
- Understand how the accounting equation links to the double-entry system
- Apply the double-entry system to the accounting equation
- Create general journals



Practical learning outcome

Use all the skills learnt to interpret transactions using the accounting equation and general journals.

Accounting equation



- The importance of the accounting equation surpasses all other bookkeeping concepts
- It is the basis for the principles of the double-entry system
- It is a focus on the balance sheet
- If the accounting equation balances, the balance sheet will balance
- This is a check to ensure the double-entry system has been appropriately applied



Another way to look at this equation is assets less liabilities equals equity
The value of assets will reflect the value of the resources controlled by a business
The liabilities reflect the debt of the business
The liabilities with equity indicates how the business is being financed
With this information, you can assess the financial performance as well as the affluence of the business

NOTES

Exercise 1:**Scenario 1 Joe's Business:**

List of Joe's assets, liabilities, and equity:

1. Industrial juicer \$ 500
2. Cash in the bank \$ 1 300
3. Receivables \$ 300
4. Payables \$ 550
5. Loan \$ 650
6. Own investment \$ 900

Can you insert these figures into the accounting equation? A hint is it must balance on both sides of the equals sign. In this example, you can assume that Joe has applied the accrual basis of accounting and we want to assess his financial position as at the end of June.

Scenario 2 Mary's Business:

List of Mary's assets, liabilities, and equity:

1. Delivery van \$ 1 600
2. Cash in the bank \$ 1 200
3. Receivables \$ 500
4. Payables \$ 800
5. Loan \$ 1 500
6. Own investment \$ 1 000

Can you complete the same exercise for Mary's accounting equation? Like Joe, she has adopted IFRS and therefore applies the accrual basis of accounting.

Solution 1:**Scenario 1 Joe's Business****Assets =**

Juicer \$ 500
 Cash \$ 1 300
 Owed \$ 300
TOTAL \$ 2 100

\$ 2 100 =

Liabilities +

Owing \$ 550
 Loan \$ 650
TOTAL \$ 1200

\$1200 + \$ 900 = \$ 2 100

Equity

Own investment
 \$ 900
TOTAL \$ 900

Solution 2:

Scenario 2 Mary's Business

Assets =	
Van	\$ 1 600
Owed	\$ 500
Cash	\$ 1 200
TOTAL	\$ 3 300

\$ 3 300 =

Liabilities +	
Owing	\$ 800
Loan	\$ 1 500
TOTAL	\$ 2 300

\$ 2 300 + \$ 1 000 = \$ 3 300

Equity	
Own investment	\$ 1 000
TOTAL	\$ 1 000



NOTES

Rules of the double-entry system

- What you do to the one side you must do to the other
- This same concept applies to the accounting equation
- It is similar to a give-and-take as for every debit there must be an equal credit
- Values can decrease or increase on the debit side, but they can also increase or decrease on the credit side
- You can have multiple debit accounts and multiple credit accounts as long as the total debits equal the total credits

Tips:

- Always work from the known to the unknown
- Use the chart of accounts to assist in determining the unknown account
- The word credit has the letter "R" and therefore is always on the right-hand side of a T-account



Cheat sheets





NOTES

Examples of Charts of Accounts

Chart of Accounts

Number	Account Description	Account Type	Statement
1010	Cash	Assets	Balance Sheet
1020	Accounts Receivable	Assets	Balance Sheet
1040	Lab Equipment	Assets	Balance Sheet
1050	Insurance	Assets	Balance Sheet
1070	Lab Computers	Assets	Balance Sheet
1090	Real Estate	Assets	Balance Sheet
2010	Accounts Payable	Liabilities	Balance Sheet
2030	Unearned Rent	Liabilities	Balance Sheet
3010	Doris Green, Equity	Equity	Balance Sheet
3020	Doris Green, Withdrawals	Equity	Balance Sheet
4010	Fees Earned	Revenues	Income Statement
5010	Wages	Expenses	Income Statement
5020	Rent	Expenses	Income Statement
5040	Utilities	Expenses	Income Statement
5090	Lab Supplies	Expenses	Income Statement
5100	Misc.	Expenses	Income Statement

Small Business Chart of Accounts

Account Name	Code	Financial Statement	Group	Sub-Group	Normality
1. Bank checking account	1000	Balance sheet	Current assets	Cash and cash equivalents	Debit
2. Bank savings account	1010	Balance sheet	Current assets	Cash and cash equivalents	Debit
3. Online savings account	1020	Balance sheet	Current assets	Cash and cash equivalents	Debit
4. Petty cash account	1030	Balance sheet	Current assets	Cash and cash equivalents	Debit
5. Payroll account	1040	Balance sheet	Current assets	Cash and cash equivalents	Debit
6. Accounts receivable	1050	Balance sheet	Current assets	Accounts receivable	Debit
7. Allowance for doubtful debts account	1015	Balance sheet	Current assets	Accounts receivable	Debit
8. Inventory	1060	Balance sheet	Current assets	Inventory	Debit
9. Prepayments	1070	Balance sheet	Current assets	Other current assets	Debit
10. Property	1080	Balance sheet	Long term assets	Property, plant and equipment	Debit
11. Property Depreciation	1015	Balance sheet	Long term assets	Property, plant and equipment	Debit
12. Plant	1020	Balance sheet	Long term assets	Property, plant and equipment	Debit
13. Plant Depreciation	1015	Balance sheet	Long term assets	Property, plant and equipment	Debit
14. Equipment	1030	Balance sheet	Long term assets	Property, plant and equipment	Debit
15. Equipment depreciation	1015	Balance sheet	Long term assets	Property, plant and equipment	Debit
16. Accounts payable	2000	Balance sheet	Current liabilities	Accounts payable	Debit
17. Payroll payable	2010	Balance sheet	Current liabilities	Other current liabilities	Debit
18. Interest payable	2015	Balance sheet	Current liabilities	Other current liabilities	Debit
19. Accrued expenses	2020	Balance sheet	Current liabilities	Other current liabilities	Debit
20. Unearned revenue	2030	Balance sheet	Current liabilities	Other current liabilities	Debit
21. Sales Tax payable	2040	Balance sheet	Current liabilities	Other current liabilities	Debit
22. Payroll Tax payable	2050	Balance sheet	Current liabilities	Other current liabilities	Debit
23. Interest payable	2060	Balance sheet	Current liabilities	Other current liabilities	Debit
24. Mortgage loan	2070	Balance sheet	Long term liabilities	Mortgages	Debit
25. Other loans	2080	Balance sheet	Long term liabilities	Loans	Debit
26. Owners contributions	3000	Balance sheet	Equity	Capital	Debit

- References:**
- Chart of Accounts (Zarzycki, 2018)
 - Small Business Chart of Accounts (Brown, n.d.)

Exercise 2:**Scenario 1 Joe's Business:**

1. Joe invests \$ 900 of his personal savings to start the business
2. Joe obtained a loan of \$ 650 to increase his cash flow
3. He then purchased an industrial juice on credit for \$ 500
4. He bought stationery to the value of \$ 250 to manually record his transactions

Draw up the T-accounts the above 4 transactions.

Scenario 2 Mary's Business:

1. Mary invests \$ 1 000 of her personal savings to start the business
2. She obtained a loan of \$ 1 500 to increase her cash flow
3. Then she purchased a delivery van for \$ 1 600 using \$ 830 of her cash and financing the balance with a further loan
4. She purchased more fuel to the value of \$ 470 for more deliveries

Draw up the T-accounts the above 4 transactions.

Solution 2:**Scenario 1 Joe's Business**

1. Debit ACC05 Cash account and credit ACC09 Owner's capital

Debit				Credit	
			ACC05	Investment	\$ 900
ACC09	Investment	\$ 900			

2. Debit ACC05 Cash account and credit ACC08 Loan account

Debit				Credit	
			ACC05	XYZ Lenders	\$ 650
ACC08	XYZ Lenders	\$ 650			

3. Debit ACC04 Equipment and credit ACC07 Creditors Scenario 1 Joe's Business

<i>Debit</i>			<i>Credit</i>		
ACC07	Juicer	\$ 500			
			ACC04	Juicer	\$ 500

4. Debit ACC03 Admin expense and credit ACC05 Cash

<i>Debit</i>			<i>Credit</i>		
ACC05	Stationery	\$ 250			
			ACC03	Stationery	\$ 250

Scenario 2 Mary's Business

1. Debit 300-01 Cash and credit 500-01 Owner's equity Debit ACC05 Cash account and credit ACC08 Loan account

<i>Debit</i>			<i>Credit</i>		
			300-01	Investment	\$ 1 000
500-01	Investment	\$ 1 000			

2. Debit 300-01 Cash and credit 450-01 Loans owing

<i>Debit</i>			<i>Credit</i>		
			300-01	ABC Lenders	\$ 1 500
450-01	ABC Lenders	\$ 1 500			

3. Debit 100-01 Vehicles and credit 300-01 Cash as well as 350-01 Payables

<i>Debit</i>			<i>Credit</i>		
300-01	Delivery van	\$ 830			
350-01	Delivery van	\$ 770			
			100-01	Delivery van	\$ 770
			100-01	Delivery van	\$ 830

4. Debit 850-01 Gas expenses and credit 300-01 Cash

<i>Debit</i>			<i>Credit</i>		
300-01	Gas	\$ 470			
			850-01	Gas	\$ 470



NOTES

General Journals

- Every transaction, after meeting the definition and recognition criteria must be recorded in the books
- This process is known as journalising
- It is the first point of entry into the records
- Journals are recorded into various ledgers and subsidiary ledgers called the books of first entry
- The frequency of journalising it entirely up to your needs and the needs of your business but consider the volume of transaction as to whether to capture transactions daily, weekly, or monthly
- You can also decide what is the trigger for commencing the journalising process
- You can capture when you receive an invoice, payment or use bank statements
- Small businesses, particularly those who adopt the cash basis of accounting, the bank statements will be used
- Keep track of your records using the T accounts or via journals
- T-accounts are trickier to maintain when the number of transactions increase
- Journals are known as general journals and they are later transposed into the general ledger
- Options for maintaining your records include physical books that you can purchase at a store or Excel
- These means are suitable if you have a small business with very few transactions
- If you prefer technology, there are various software options to choose from, which removes a lot of the manual tasks involved with bookkeeping

Details required to record a journal

- The date of the transaction: on the accrual basis this would be the date on the invoice and on the cash basis this would be the date of the payment
- A brief description of the transaction
- The debit or credit value with the credit being indented
- For purchases to include the name of the supplier as well as the invoice number
- Include the relevant account number that is being debited or credited, which you can select from the charts of accounts and this is called a folio number
- Include a narration or a comment to provide a bit more detail about the transaction

NOTES

Exercise 3:**Scenario 1 Joe's Business:**

Draw up the journal entries for the four transactions linked to Joe's business based as per exercise 2.

Scenario 2 Mary's Business:

Draw up the journal entries for the four transactions linked to Mary's business based as per exercise 2.

Solution 3:**Scenario 1 Joe's Business**

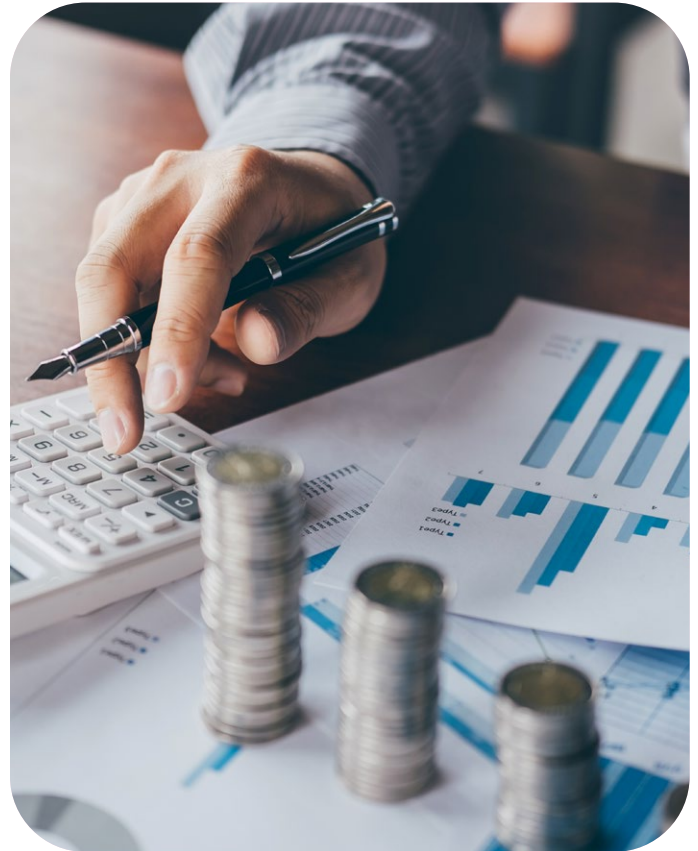
GJ001	Dr	ACC05 Cash	900	
	Cr	ACC09 Owner's Capital		900
		<i>Investment of savings to start up business</i>		
GJ002	Dr	ACC05 Cash	650	
	Cr	ACC08 Loan account		650
		<i>Loan obtained from XYZ Lenders</i>		
GJ003	Dr	ACC04 Equipment	500	
	Cr	ACC07 Creditors		500
		<i>Machinery purchased to create lemon juice</i>		
GJ004	Dr	ACC03 Admin expense	250	
	Cr	ACC05 Cash		250
		<i>Stationery purchased to use in the business</i>		

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Scenario 2 Mary's Business

GJ001	Dr	300-01 Cash	1 000	
	Cr	500-01 Owner's Capital		1 000
		Investment of savings to start up business		
GJ002	Dr	300-01 Cash	1 500	
	Cr	450-01 Loans owing		1 500
		Loan obtained from ABC Lenders		
GJ003	Dr	100-01 Vehicles	1 600	
	Cr	350-01 Payables		770
	Cr	300-01 Cash		830
		Delivery van purchased to make deliveries		
GJ004	Dr	850-01 Gas expense	470	
	Cr	300-01 Cash		470
		Gas purchased using cash in the bank		

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Additional resources

<https://www.myaccountingcourse.com/accounting-basics/double-entry-accounting>

<https://courses.lumenlearning.com/wm-accountingformanagers/chapter/double-entry-system/>

<https://www.money-zine.com/definitions/investing-dictionary/double-entry-accounting/>

References

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Available at: <https://www.double-entry-bookkeeping.com/coa/chart-of-accounts-for-small-business/>

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