CHAPTER 6

ACCOUNTING EQUATION

❖ **Accounting Equation**

It refers to the mathematical statement (or equation) that expresses the equality between assets and sum total of liabilities and capital of a business. Algebraically, it is expressed as:

Assets = Liabilities + Capital

As accounting equation shows the effect of transaction on the either side of the balance sheet, so it is also known as balance sheet equation.

❖ **Steps to Prepare an Accounting Equation**

(1) Analyse transaction in detail and identify how assets, liabilities and capital balances are affected by it.

(2) Effect in terms of increase or decrease in the balance of assets, liabilities or capital is identified.

(3) If there is an increase then it is added to and if there is a decrease then it is subtracted from the respective asset, liability or capital account.

(4) At last, ensure that *total of Left side* represented by Assets is always equal to *total of Right side* represented by the sum of Liabilities and Capital.

❖ **Effect of Transaction on the Accounting Equation**

As we consider all the transactions from the business point of view, so whenever we consider effects of any transaction on the assets, liabilities or capital, then we have to keep two things in mind.

(i) Measure effect of a transaction in terms of increase or decrease in the balance of asset, liabilities or capital.

(ii) Both sides of the equation should always be equal.

Note- If after taking any effect of a transaction, both sides of the equation mismatch or becomes unequal, then surely there is a mistake on your side in taking an effect of the transaction. In no case, both sides can get unequal

because in accounts we record all the transactions on the principle of duality. As per this principle, every transaction has a dual effect of debit and credit with the same amount or simply, there is an increase and decrease with same amount. Therefore, both the sides i.e. Assets (Left side) and sum of Capital and Liabilities (Right side) always stands equal.