WHY ARE ACCOUNTING EQUATIONS IMPORTANT?

BY: AZAILY VELAZQUEZ, TATIANA IBARRA
Key terms

**Assets** - are resources a company owns or controls. These resources are expected to yield better benefits.

**Liabilities** - are creditors’ claims on assets. These claims are obligations to provide assets, products, or services to others.

**Equity** - is the owner’s claim on assets minus liabilities. Equity is also called net assets or residual equity.
Examples

**Assets** - include cash, supplies, equipment, land, and accounts receivable.

**Liabilities** - include wages payable to workers, accounts payable to suppliers, notes (loans) payable to banks, and taxes payable.

**Equity** - includes owner's capital, owner's withdrawal, Revenues, Expenses.
**EQUITY BREAKDOWN**

- **Expense**: decreases equity (via net income) from costs of providing products and services to customers.

- **Owner’s withdrawal**: are outflows of cash and other assets to owners for personal use, which reduces equity.

- **Revenue**: increases equity (via net income) from sales of products and services to customers.

- **Owner's capital**: are inflows of cash and other assets for owner's contributions, which increase equity.
THE ACCOUNTING EQUATION

Assets = Liabilities + Owner, Capital - Owner, Withdrawals + Revenues - Expenses
CORRECT ACCOUNTING EQUATION

<table>
<thead>
<tr>
<th>Assets</th>
<th>=</th>
<th>Liabilities</th>
<th>+</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>+</td>
<td>Supplies</td>
<td>+</td>
<td>Equipment</td>
</tr>
<tr>
<td>Old Bal. $1,500</td>
<td>+</td>
<td>$2,500</td>
<td>+</td>
<td>$26,000</td>
</tr>
<tr>
<td>(4)</td>
<td></td>
<td>+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Bal. $1,500</td>
<td>+</td>
<td>$9,600</td>
<td>+</td>
<td>$26,000</td>
</tr>
</tbody>
</table>

- Will always be balanced: Asset equals liabilities plus equity
- Both sides are being affected.
- Both assets and liabilities were affected because supplies is an asset. Liabilities as well because it is being put on credit.

Taylor wants to purchase more supplies for her business and has arranged them to be purchased on credit.
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- The accounting equation is not equal. Asset should always equal liabilities plus equity.
- What is accounted for on one side, you must account for on the other side.
- Forgot to add $7,100 into Asset (supplies).
Making an accounting equation true

Bose: $150 = $30 + __ → $150 = $30 + $120 TRUE

By subtracting $150 (Assets) and $30 (Liabilities) we get $120. Which make the accounting balance and makes it the correct amount for equity.

Vogue: __ = $100 + $300 → $400 = $100 + $300 TRUE

By adding $100 (liabilities) and $300 (equity) we get a amount of $400 for (Assets). Which make the accounting balance and makes it the correct amount for Assets.
Summary

• The accounting equation is important because it applies to all transactions and events, to all companies and organizations, and to all points in time.

• To determine if an accounting equation is true, it must balance.