

Name

Name

## 3 The Accounting equation

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### 3.1 Introduction

The primary aim of a business is to make a profit through buying and selling merchandise or to gain an income by rendering a service. By means of accounting the businessman can ascertain whether he/she has succeeded in realising that primary aim. The primary aim of accounting is therefore to determine the financial result (net profit or net loss) and the financial position of the enterprise as at a specific date. The financial position of the enterprise is measured by the accounting equation.

### 3.2 Accounting equation

The accounting equation basically states that: **ASSETS = EQUITY + LIABILITIES**.

*A feature of this equation is that the equation remains balanced after every transaction entry.*

#### Assets

- An entry on the left-hand (debit) side of an asset account creates or increases an asset value.
- An entry on the right-hand (credit) side of an asset account decreases the asset value.

#### Liabilities

- An entry on the credit side of a liability account creates or increases the liability.
- An entry on the debit side of a liability account decreases the liability.

#### Equity

- An entry on the credit side of an equity account creates or increases the equity.
- An entry on the debit side of an equity account decreases the equity.
- A nominal account indicating a loss or expense decreases equity.
- A nominal account indicating a profit or income increases equity.

### Activity 23 (AOL)

#### Required

Analyse the following transactions under the headings provided. Under account debited and account credited, you must indicate which accounts in the General ledger are debited and credited. In the accounting equation, indicate an increase with a "+", a decrease with a "-." before the amounts and no change with a "o". Assume throughout that the bank has a favourable bank balance.

#### Hints:

- Draw up T-accounts.
- Make sure the accounting equation ( $A = E + L$ ) remains balanced after every transaction entry.

#### Transactions

- 1 A statement of account was received from Kromhout Traders. It was decided to transfer the credit balance (R150) in the debtors' ledger to the account in the creditors' ledger.
- 2 The telephone bill was received from Telkom. Issue a cheque to pay the amount of R2 300.
- 3 Receive a cheque from R. Brown, the owner, to increase his capital contribution from R578 640 to R600 000.
- 4 Pay Santie Ltd. in payment of our account of R10 500 minus 5% discount.
- 5 Buy goods on credit from Mala Manufacturers for R2 300 minus 20% trade discount.
- 6 Brom Distributors charges our overdue account of R8 400 with 7% interest per annum for three months.

- 7 Credit sales of merchandise to L. Lona, R4 200. The cost price of the goods sold was R2 100.
- 8 L. Lona returned R300 worth of trading stock back. The cost price of the goods was R150.
- 9 Sent goods back to Mala Distributors (creditor) worth R450 minus 20% trade discount.
- 10 It was discovered that stationery bought on credit for R280 from Morne Traders was posted to the trading stock account. Correct the error.
- 11 Buy stationery from SNA Distributors for R80 and pay with petty cash.
- 12 Cash sales of merchandise, R9 600. The cost price of the goods sold was R4 800.
- 13 The owner took merchandise with a selling price of R600 for his own use. The cost price of the goods was R300.
- 14 R. Radebe (a debtor) is declared insolvent. Receive a first and final dividend of 20 cent in the Rand. R. Radebe owes the business R1 100.
- 15 Pay R400 taken from the petty cash for two days' wages to a worker who washed the windows.
- 16 Receive a cheque from S. Moaner on payment of his account of R2 000 minus 2½% discount.
- 17 Receive S. Moaner's cheque back from the bank with the remark "R/D insufficient funds". (Look at nr. 16)
- 18 Donate merchandise of R200 at cost price to the local children's home.
- 19 Charge G. Gifts (a debtor) overdue account of R4 800 with 2½% interest for two months.
- 20 Receive a cheque from G. Pillay for R400. It is for his account that has already been written off as bad debts.
- 21 Pay SA Deliveries with a cheque for delivery of goods bought on credit, R340.
- 22 The fixed deposit by AB Bank of R30 000 matured today. Received a cheque of R32 500. Included in the amount received is interest on fixed deposit.
- 23 Pay S. Moor's salary for the month, R8 000.
- 24 Pay SA Deliveries R140 with petty cash for delivering goods to L. Prinsloo (debtor). The amount must be levied against the debtors' account.
- 25 Receive the bank statement from Perm Bank, reflecting the following:
  - Service fees, R210
  - Credit card levies, R340
  - Interest on credit balance, R110

### *Answer sheet*