Effects of business transactions on the Accounting equation

- Business transactions are financial events, which affects the assets, capital and liabilities of a business.
- Each transaction has two aspects and both will affect the accounting equation.
- Regardless of the nature of the specific transaction, the accounting equation must stay in balance at all times.
- The transactions are classified as follows:
    - A transaction that **increases the total assets** must also **increase total liabilities or owner's equity.**
    - A transaction that **decreases total assets** must also **decrease the total liabilities or owner's equity.**
    - Some transactions may **increase one account and decrease another on the same side of the equation**, i.e, one asset increases and another decreases.

Analysing the effects of transactions

Step 1: Identify the items affected.

Step 2: Classify the items as assets, liabilities or owner's equity.

Step 3: Determine whether the items have increased or decreased.

Step 4: Ensure accounting equation remains in balance.

Note: The effects of each transaction are analyzed to show how the different elements in the equation are affected.

Must remember:

Assets = Owner's equity + Liabilities

Example:

Transaction	Effect on		
	Assets	**Liabilites**	**Capital**
Sold a vehicle for cash ₹ 3000	Vehicle (- 3000) Cash (+ 3000)		

Example:

Show the effects by a positive sign for an increase and a negative sign for a decrease of the following transactions on the elements of accounting equation.

Transactions		Effects Upon		
		Assets	**Liabilities**	**Capital**
A	Owner commenced business with machinery $60000 and cash in bank ₹5000			
B	Bought goods worth ₹ 2,200 on credit			
C	Sold goods worth ₹ 3oo for cash			
D	Repaid loan taken from bank ₹ 4,000 with cheque			
E	Owner took cash worth ₹ 3,000 for personal use.			
F	Paid trade payables ₹ 500 by cheque.			
G	Took ₹ 2,500 from bank for office use			
H	Brought personal computer valued ₹2400 into the business for office use.			

Exercise 1

The following transactions occurred during the first month of operations for Sally Trading, a retailer in electrical goods. For each transaction, show the effect on the elements of the accounting equation.

Transactions		**Effects upon**		
		Assets	Liabilities	Capital
A	Proprietor invested ₹2,000 cash as capital for the business			
B	Borrowed ₹10,000 cash from Sam Finance			
C	Purchased furniture on credit ₹5,500			
D	Proprietor brought his own vehicle for business use ₹14,000			
E	Paid trade payables ₹4,500 by cheque, for amount owing			
F	Purchased a computer for cash ₹8, 200			

Each transaction has **two aspects and both will affect the accounting equation.**

Exercise 2

Show the effects of the following transactions on the elements of the accounting equation.

Transactions		Effects upoon		
		Assets	Liabilities	Capital
A	Purchased stock of goods ₹2,000 on credit.			
B	A trade receivable paid ₹450 by cheque			
C	Owner invested a further ₹8,000 cash in the business			
D	Furniture were brought on credit ₹1,200			
E	Nimal lends the business ₹2000 by cheque			
F	Paid a trade receivable ₹300 in cash			
G	Owner brought his motor vehicle ₹2000 to the business for office use.			
H	Goods costing ₹50 were returned to supplier			
I	Owner took furniture worth ₹3,000 for own use			

Exercise 3

Show the effects of the following transactions on the elements of the accounting equation.

Transactions		Effects upon		
		Assets	Liabilities	Capital
A	Started business with ₹6,000 cash			
B	Bought motor van paying by cheque ₹2,000			
C	Sold goods ₹500 on credit to Salim			
D	Withdrew ₹200 from bank account and put it into the cash			
E	Salim paid ₹500 by cheque			
F	A loan of ₹1,000 cash is received from Jay			
G	Paid ₹800 cash into the business bank account			
H	Bought stationary paying in cash ₹400			

Exercise 4

Show the effects of the following transactions on the elementts of the accounting equation.

Transactions		Effects upon		
		Assets	Liabilities	Capital
A	Owner deposited his own cash ₹4, 000 into the business bank account			
B	Obtained ₹10,000 loan from HDC bank in cash			
C	Bought goods costing ₹ 3000 from Giant Traders			
D	Sold a used vehicle and deposited the proceeds ₹ 3,000 in the business bank account			
E	Paid Petals Co. ₹ 2000 by cheque			
F	Repaid part of loan taken from HDC Bank ₹5,000 by using a cheque			
G	Received ₹500 cash from a trade receivable to settle his account			
H	An old equipment worth ₹ 300 was sold to Zander on credit			

Exercise 5

Show the effects of the following transactions on the elements of the accounting equation.

Transactions		Effects upon		
		Assets	Liabilities	Capital
A	Commenced business with cash ₹ 20,000, motor vehicles ₹ 40,000			
B	Purchased a computer on credit for ₹ 5,600, from Dell computers.			
C	Paid Dell computers ₹ 4,000 by cheque			
D	A loan of ₹ 30,000 was received in cash from WCM Finance			
E	Issued a cheque of ₹3,000 as a part repayment of the loan from WCM Finance			
F	Sold a goods of ₹300 on credit to Candy Supplies			
G	Candy Supplies returned faulty goods costing ₹ 60			
H	Issued a cheque to Yan to settle det of ₹3,500			
I	Goods costing ₹200 were returned to a credit supplier			

Exercise 6

The balance sheet of Mona on 1 November 2013 is shown below.

Mona

Balance sheet as at 1 November 2013

Assets	₹	Liabilities and capital	₹
Premises	100,000	Capital	170,000
Fixtures	32,000	Trade payables	15,500
Inventory	19,500		
Trade receivables	13,500		
Cash equivalent	20,500		
	185,500		185,500

On 2 November 2013, the following transactions took place.

	Assets	**Liabilities**	**Capital**
a) Bought inventory ₹ 1,500 on credit			
b) A trade receivable paid ₹ 500 by cheque.			
c) Mary invested a further ₹ 10,000 by cheque.			
d) Additional fixtures ₹ 1,000 were bought on credit			

Required:

Prepare the Balance sheet of Mona on 2 November 2013 after the above transactions have taken place.

Exercise 7

Jason is a trader. On 30 November 2013 his balance sheet was as follows.

Jason

Balance sheet as at 30 November 2013

Assets	**₹**	**Liabilities and capital**	**₹**
Machinery	55,000	Capital	80,000
Equipment	18,000	Loan	30,000
Motor vehicle	25,000	Trade payables	7,100
Inventory	11,000		
Trade receivables	6,400		
Cash equivalent	1,600		
Cash	100		
	117,100		**117,100**

On 1 December 2013, the following transactions took place.

a) Paid a trade payable ₹2,100 by cheque
b) A trade receivable paid ₹ 100 in cash
c) Purchased inventory ₹ 1,500 and paid by cheque
d) Borrowed a further ₹10,000 and purchased an additional motor vehicle

Required:

Prepare the balance sheet of Jason on 1 December 2013 after the above transactions take place.

Must remember

Every transaction has two effects

Exercise 8

Mahesh is a trader who owns a general store. He had the following assets and liabilities as on 1 January 2014.

	₹
Trade payables	2800
Equipment	6200
Motor vehicle	7300
Inventory	8100
Trade receivables	4050
Cash equivalent	9100
Cash	200

You are not given the capital amount at that date.

During the first week of January 2014:

a) Mahesh bought extra equipment on credit for ₹ 110
b) Bought extra inventory by cheque ₹ 380
c) Paid trade payable by cheque ₹ 1,150
d) Trade receivables paid ₹ 640 by cheque and ₹ 90 by cash
e) Mahesh put in an extra ₹1,500 into the business, ₹ 1,300 by cheque and ₹ 200 in cash.

Required:

Prepare the balance sheet of Mahesh on 7 January 2014 after the above transactions have been completed.

Remember to write the title and the date when preparing the balance sheet.

TYPES OF ASSETS AND LIABILITIES

What are assets???

Assets are resources owned by a business that have monetary values.

Assets are classified into:

Assets

Non-Current assets

Land and Building	Plant & Machinery
Motor vehicles	Furniture & Fixtures
Equipment	Goodwill, Patent, etc.

- Acquired for operation of business, not for sale
- High values and physical substance
- Useful life > 1 accounting period

Current Assets

Inventory Trade receivables Cash Bank, Prepaid Expenses, Accrued Income

- Cash or can be easily converted into cash
- Include inventory (stock) bought for resale
- Useful life < 1 accounting period

What are Liabilities????

Liabilities are debts that a business owed to external parties other than owners.

Classified into

Liabilities

Non Current Liabilities	
Long term Loan Debentures	Mortgage Loan
Debts owed for > 1 accounting period	

Current Liabilities	
Trade payables Loan (short-term) Etc.	Bank Overdraft Outstanding Expenses,
Debts which must be paid in the next accounting period	

TEST YOUR UNDERSTANDING

1. State whether each of the following is a non current asset, current asset, current liability or non-current liability
   - Land and building
   - Inventory
   - Trade payable
   - Trade receivable
   - Loan from bank (long term)
   - Cash
   - Bank over draft
   - Furniture

2. Classify the following items into **non-current assets, current assets, current liabilities and non- current liabilities**

   a. Fixtures and fittings
   b. Premises
   c. Trade payables
   d. Inventory
   e. Trade receivables
   f. Loan from Jim (repayable in Jan2021)
   g. Bank overdraft
   h. Cash
   i. Bank loan(repayable in 2025)
   j. Machinery
   k. Premises
   l. Cash equivalent

Non-current assets	**Current assets**	**Current Liabilities**	**Non-current liabilities**