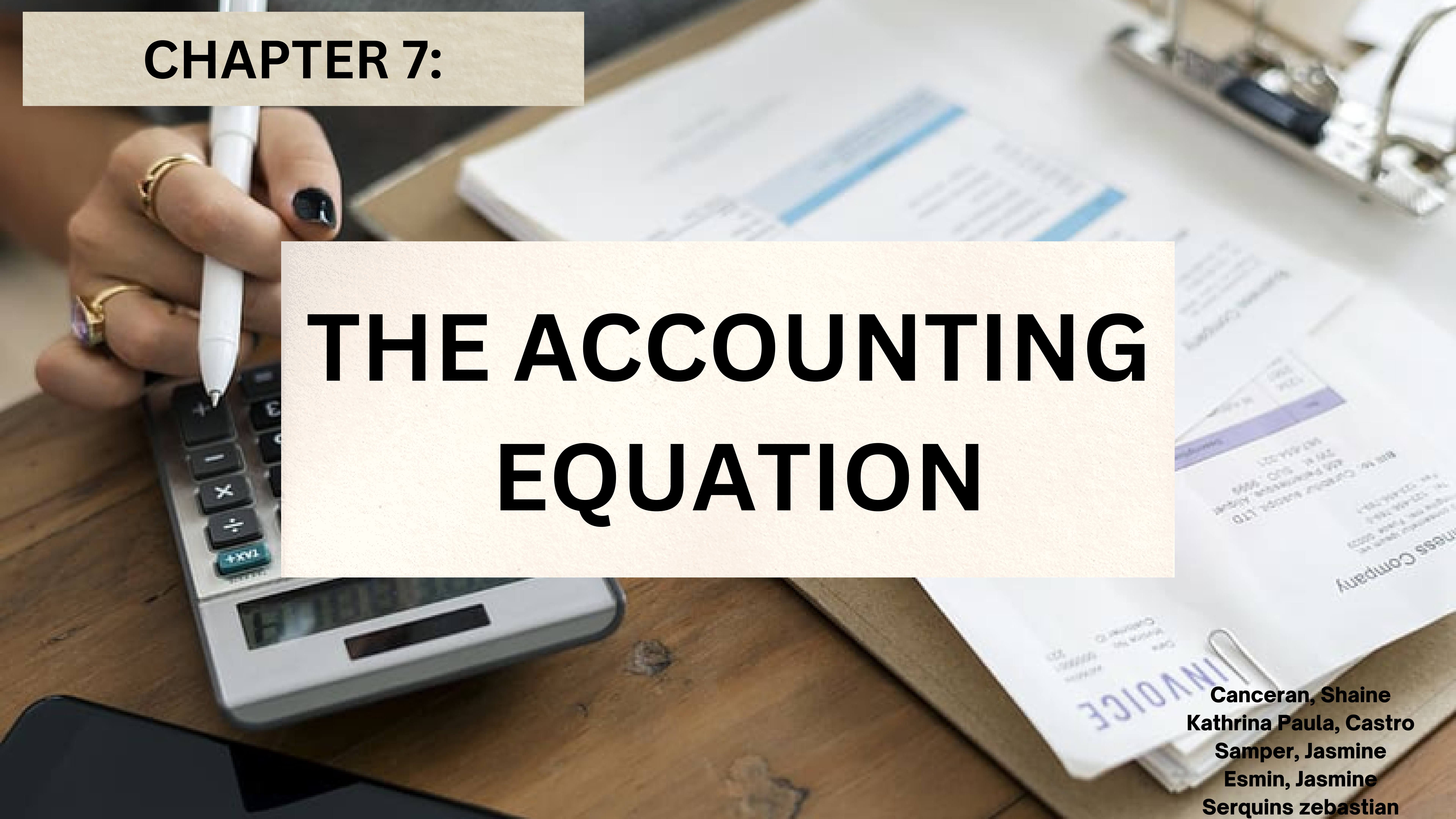

CHAPTER 7:

THE ACCOUNTING EQUATION

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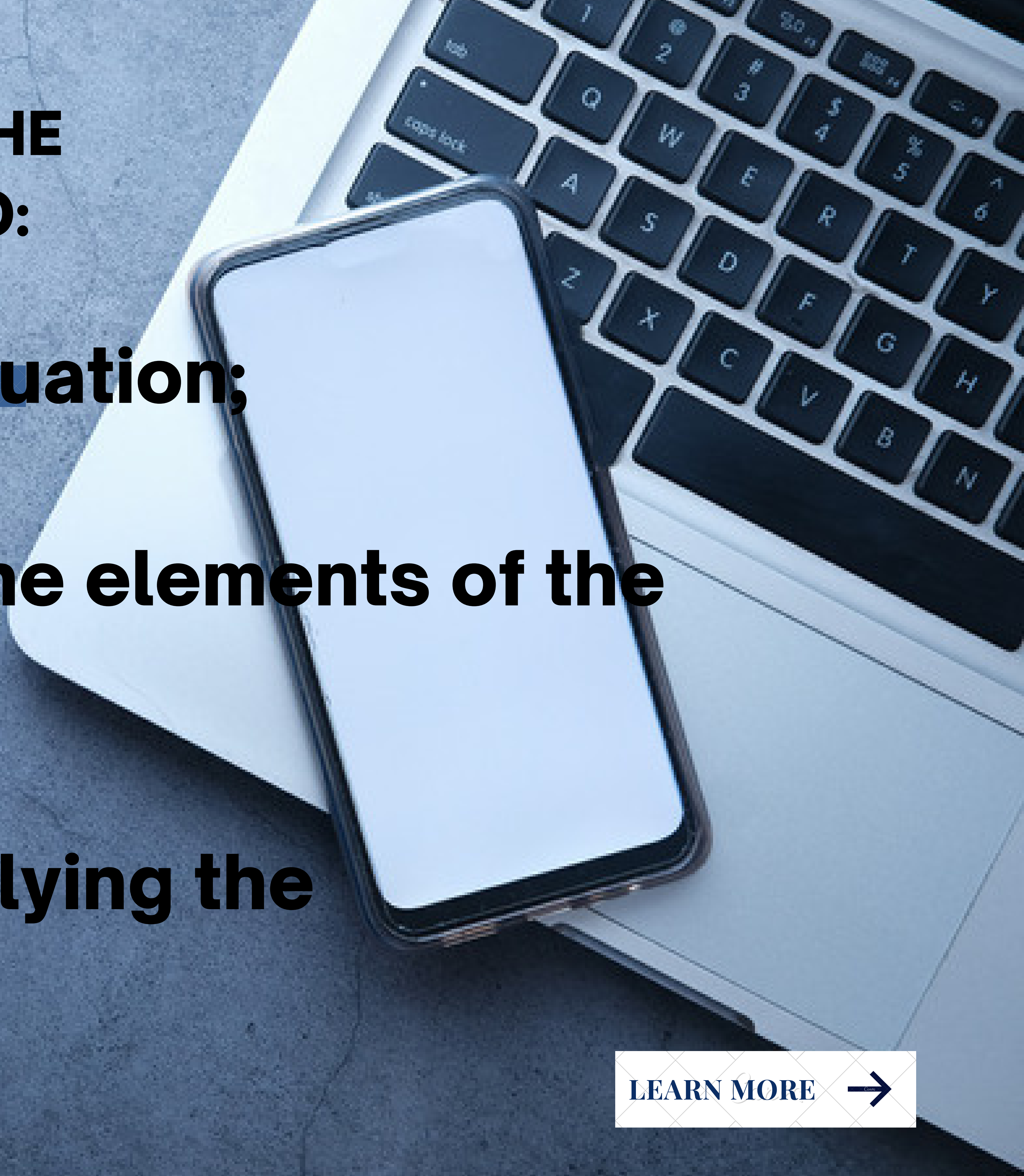

AT THE END OF THIS CHAPTER, THE LEARNERS SHOULD BE ABLE TO:

1. **Define the accounting equation;**

2. **Enumerate and explain the elements of the accounting equation and**

3. **Solve basic problem applying the accounting equation**

LEARN MORE →

The Statement of Assets, Liabilities, and Net Worth

We always hear about the Statement of Assets, Liabilities, and Net Worth (SALN) of our public officials. Almost every year, we always hear how Senator A increased his or her net worth by a certain amount, or how Senator B becomes the richest senator in the Philippines, while Senator C is the poorest. Generally, through this public document, we can see and monitor the changes in the net worth of each of these officials of our country. Understanding a SALN is quite straightforward as it is just an information sheet enumerating the properties and debts of a public official. The document can be generally divided into three parts: (1) the official's personal information, (2) the listing of his or her assets and liabilities, and (3) the official's sworn statement. (See sample of SALN).

However, have you ever wondered how the net worth of each official is computed? Basically, we can determine anyone's net worth by just deducting the individual's liabilities (what the individual owes) to his or her assets (what he or she owns). The result will equate to the net worth of the individual which, in a sense, measures his or her value in money.

It may be quite a simple process, but it is an effective tool to actually see if whether or not that particular official can justify his or her wealth. For example, if you compare the SALN of Senator A from 2009 to 2010, the increase in the net worth of this senator should have been evidenced by his or her earnings. But when the increase is substantially greater than his or her compensation as a senator, there might be something suspicious going on.

This computation of net worth of an individual is derived from one of the most fundamental concepts in the study of accounting-the accounting equation. This equation applies to all business organizations regardless of its size and form.

Revised as of January 2015
Per CSC Resolution No. 1500088
Promulgated on January 23, 2015

SWORN STATEMENT OF ASSETS, LIABILITIES AND NET WORTH

As of ______________________________

(Required by R.A. 6713)

Note: *Husband and wife who are both public officials and employees may file the required statements jointly or separately.*

❑ *Joint Filing* ❑ *Separate Filing* ❑ *Not Applicable*

DECLARANT: ______________________________ **POSITION:** ______________________
(Family Name) (First Name) (M.I.) **AGENCY/OFFICE:** ______________________
ADDRESS: ______________________________ **OFFICE ADDRESS:** ______________________
______________________________ ______________________

SPOUSE: ______________________________ **POSITION:** ______________________
(Family Name) (First Name) (M.I.) **AGENCY/OFFICE:** ______________________
OFFICE ADDRESS: ______________________
____

UNMARRIED CHILDREN BELOW EIGHTEEN (18) YEARS OF AGE LIVING IN DECLARANT'S HOUSEHOLD

NAME	DATE OF BIRTH	AGE

Basic Accounting Equation

Let us continue our study through the introduction of the fundamental concept of the accounting equation. The equation has two elements which equally divide the entity into two parts. The left side of the equation represents what the entity owns. On the other hand, the right side represents those that the company owes.

Assets = Liabilities + Equity

The left side of the equation represents what the company owns. These are resources that the entity controls in order to attain future benefits. On the other hand, the right side represents the claims of the different parties to the company's assets. Liabilities represent the claims of the entity's creditors while equity represents the residual interest of the owners of the entity.

Also, remember that just like in any equation, the two sides of the equation shou always be balanced, Hence, what the company owns should always equal what it c its owners

ELEMENTS OF THE ACCOUNTING EQUATION

- **ASSETS**

As we have learned earlier, assets are resources that an entity owns in order to derive some future benefits. These assets are used by the company in its normal operations such as the manufacture of goods or delivery of services. The main feature of these assets is the capability to give benefits to the entity. These benefits are usually in the form of their ability to directly or indirectly increase the inflow of cash to the entity or a reduction of its outflows.

Some examples of these assets are the following:

1. CASH

Generally, it is the money that we use comprising of the bills and coins w use in our everyday lives in order to buy the goods that we want and also avail the services that we need. However, when accounting for cash, we also consider ca as the money that is deposited in the banks and even undeposited checks from customers.

2. ACCOUNTS RECEIVABLE

This represents amounts that are collectible from customers. They are when a business sells its goods or services on account or on credit.

3. INVENTORIES

When going to a sari-sari store, you would notice piles of assorted product being offered to be sold. One can easily find various items such as food and household items to satisfy whatever he or she needs.

4. EQUIPMENT

Pandesal shops would need ovens and furnaces in order to properly and actually create their goods. The product of these ovens is the pandesals which would be sold later on and eventually increase the cash of the shop.

5. LAND AND BUILDING

In most businesses, a physical store is necessary for them to operate. For example, how can a local carenderia function without an actual store? Where wil a barber shop operate without its building? Such buildings are also assets of the businesses.

These buildings are owned by the company so that they can use them fo their business to operate normally.

6.INTANGIBLE ASSETS

When we think of the things we can own, we normally think of tangible things or those that can be seen and touched. However, assets also encompass intangible things that can neither be seen nor touched.

- **LIABILITIES**

Liabilities are one of the claims of external parties from the entity. Basically, they are the debts of the entity to external creditors. These debts do not always have to be paid in money. Some of these liabilities are in the form of obligations to do some service or even give something. These liabilities can take form in the following:

1. ACCOUNTS PAYABLE

When a local supermarket or convenience store like 7-Eleven buys its goods, it is unusual for it to immediately pay cash for such goods. Normally, it would only incur an obligation to pay its supplier after a certain number of days.

2. UNEARNED REVENUE

Telecommunication companies such as Globe and Smart normally offer prepaid load to customers. load credits can be later on used by customers for text messages or to call other people. On the other hand, when Globe or Smart receive payments from customers, it creates an obligation for them to actually deliver their services. Such obligations to give their service are recorded as liabilities.

- **EQUITY**

The equity reflects the residual claims or net assets of the owners of an entity. This is similar to the net worth part of the SALN of our public servants. Take note that these are only residual claims of the owners since the creditors get their share of the entity first before the owners are given their share. This is also why the net worth of individuals is computed by subtracting their liabilities from their assets.

Generally, equity comes from two sources. The first one comes directly from the owners in the form of investments of capital. The other comes from the income of the business from its normal operations. The net income or net loss of the business from its operations can be determined by using the following equation:

Revenues - Expenses = Net income / (Net loss)

A business will have a net income if its revenues exceed expenses and will have a r loss if its revenues are less than its expenses.

1. REVENUES

A business earns revenue when it sells its products or its services. When you go to a store and buy a phone, the store earns revenue. When you get a haircut from a barber shop, the shop also earns revenue. Generally, we can say that business earns revenue when it expects to earn an economic benefit in the form of an increase in assets such as cash or a decrease in liabilities. Other terms used for revenue are sales, rent, fees, etc.

2. EXPENSES

Matching principle states that no revenue can be earned without incurring corresponding expenditures. As such, when a store sells a phone, aside from getting cash for the phone, it also incurs costs for the goods it has sold. On the other hand, such is also true when services are rendered. In the barber shop, when someone gets a haircut, the barber shop incurs costs in the form of salary for its employees.

3. CAPITAL

The capital account of the equity represents the net investments of the business. This means that any contribution of the owner which increases the assets of the business or decreases its liabilities will increase the capital account. For example, when creating a business, an owner normally contributes a significant amount of cash to kickstart the business.

Such transaction increases the capital account of the business. Note that it does not only have to be cash to increase the capital account. An owner may even contribute equipment or land to increase his or her capital.

Using the Accounting Equation

When using the accounting equation, one must remember the accounting identity which means that the equality must be maintained throughout all transactions. The reason for this is because the assets of the entity will always be claimed by another party.

Also, another way to explain this is because of the identity property in mathematics which states that both sides of an equation should be equal to each other at all times.

As such, to maintain this identity, transactions always have a dual effect on the accounting equation. Otherwise stated, each transaction of the entity would have to affect at least two accounts in order for the equation to remain in balance. Such accounts may be on the same side, that is, (+ Asset & - Asset) or on both sides of the equation, that is, (+Asset & +Equity) or (+Asset & +Liability)

THANK YOU !!!

NAKINIG KA BA?
BAHALA KA JAN