

MEANING OF KEY TERMS USED IN THE CHAPTER

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| 1. Accounting Equation | Accounting Equation shows the relationship between capital, liabilities and assets. Total assets are equal to the sum of capital and liabilities.

Mathematical Expression of Accounting Equation:

(i) Assets = Liabilities + Capital; or
(ii) Capital = Assets – Liabilities; or
(iii) Liabilities = Assets – Capital. |
| 2. Assets | Assets are the resources that the business owns. They refer to property or legal rights owned by the business, which can be measured in terms of money. |
| 3. Liabilities | Liabilities are the financial obligations of an enterprise other than owner's fund or capital. |
| 4. Capital | Capital is the amount invested by the owner in the business.

Or

Capital is the excess of assets over external liabilities. |

CHAPTER SUMMARY

- **Accounting Equation** is the basis for Double Entry System of Book Keeping. Total assets of the business firm are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of a business are equal to its total liabilities (those of outsiders and of the proprietors). Liabilities to the outsiders are known as '**liabilities**' but liability to the owners, in accounting is referred to as '**capital**'.

We can express the relationship that exists among assets, liabilities and capital in the form of an accounting equation as follows:

$$\text{Total Assets} = \text{Total Liabilities}$$

Or

$$\text{Total Assets} = \text{Liabilities} + \text{Capital}$$

Or

$$\text{Capital} = \text{Total Assets} - \text{Liabilities}$$

- A transaction may affect either both sides of the equation by the same amount or on one side of the equation only, by both increasing or decreasing it by the equal amounts.
- *An increase in an asset, without a corresponding increase in liability or corresponding decrease in another asset, must represent an increase in capital.*

Conversely, an increase in liability without a corresponding increase in asset or a corresponding decrease in another liability, will indicate a decrease in capital.