Hello! My name is Alyceson-Grace Eke from the UNT Learning Center, and today we will be covering the Accounting Equation.

**Defining the Accounting Equation**

So, what is the Accounting Equation? The Accounting Equation is the base for double-entry accounting, and it shows that a company's assets must equal the sum of their liabilities and owner's equity.

In other words, Assets = Liabilities + Owner's Equity. To remember, you can use the abbreviation "ALOE" as a memory cue.

**Problem #1:**

Total Assets: $200 million  
Total Liabilities: $125 million  
*Calculate how much Owner's Equity should be.*

**Solution #1:**

To calculate Owner's Equity, use the equation. Assets, $200 million, is the same as $125 million + a number. The unknown number can be called "x," and just like in algebra, we can isolate X to figure out how much Owner's Equity is. 200 - 125 = 75. Therefore, Owner's Equity must be $75 million.

You can use the same method regardless of which piece of the accounting equation is missing. The next step, then, is to define what assets, liabilities, and owner's equity are.

**Assets**

An asset is a resource owned by a business. These can be converted into cash, which is something everyone wants. Some examples of Assets include:

- Cash and Cash Equivalents
- Accounts Receivable
- Equipment
- Inventory
- Buildings

**Problem #2:**

Bottle Corporation has $600 in cash, $1,000 in equipment, and $500 in accounts payable. How much
do they have in assets?

Solution #2:

Cash and Equipment are both assets. $600 + $1000 = $1,600. Therefore, Bottle Corporation has $1,600 in assets.

But what about accounts payable? Isn't that the same as accounts receivable? No! Accounts receivable is what is owed to the company. Accounts payable is what the company owes to someone else. It is a liability, which is what we are about to cover next.

Liabilities

Liabilities are debts owed and required to be paid in order to keep the company functioning. Almost all liabilities will have the word "payable" in them. It means the item is "to be paid."

Problem #3:

Which one of these items is not a liability?
  a) Accounts Payable
  b) Notes Payable
  c) Salaries Payable
  d) Dividends Expense

Solution #3:

Answers a-c have "payable" in the name. That means the company has debts in those categories. Expenses are not liabilities, even if they are items that have incurred a cost.

So, what about the things that aren't "to be paid" or that we own? Where do they go? That's where Owner's Equity comes in.

Owner's Equity

Owner's Equity is the amount shareholders (the owners of the company) would receive if all debts were paid and all assets were liquidated. Some items that fall under Owner's Equity are:

  • Retained Earnings
    – Net Income (increase retained earnings)
      * Revenues (increase net income)
      * Expenses (decrease net income)
    – Dividends (decrease retained earnings)
Now, let's try a problem that includes all the materials we've learned so far:

**Scenario:** King Crimson Incorporated is trying to analyze their accounts. The following is a summary of their financial statements:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$700 million</td>
</tr>
<tr>
<td>Notes Payable -</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable -</td>
<td>$200 million</td>
</tr>
<tr>
<td>Salaries Expense -</td>
<td>$450 million</td>
</tr>
<tr>
<td>Accounts Receivable -</td>
<td>$300 million</td>
</tr>
<tr>
<td>Common Stock -</td>
<td>$250 million</td>
</tr>
<tr>
<td>Salaries Payable -</td>
<td>$250 million</td>
</tr>
<tr>
<td>Service Revenue -</td>
<td>$700 million</td>
</tr>
<tr>
<td>Inventory -</td>
<td>$500 million</td>
</tr>
</tbody>
</table>

- Which accounts are assets?
- Which accounts are liabilities?
- Which accounts are owner's equity?
- How much is the Notes Payable account?
- Which number is the greatest? Assets, Liabilities, or Owner's Equity?

**Answers:**

- Cash, Accounts Receivable, and Inventory are Assets. Those were mentioned earlier as assets.
- Accounts Payable, Notes Payable, and Salaries Payable are Liabilities. They all include "payable," which is the giveaway that they are debts.
- Salaries Expense, Common Stock, and Service Revenue are Owner's Equity. They were all mentioned earlier as owner's equity.
- Since (in millions) Cash = $700, Accounts Receivable = $300, and Inventory = $500, Assets are $1,500.
  - Revenue - Expenses = Net Income, which increases owner's equity, would be $700 - 450 = $250. Add Common Stock ($250), and Owner's Equity is $500.
  - Assets = Liabilities + Owner's Equity. $1,500 = x + $500.
  - When we isolate "x," we find that Liabilities equal $1,000. Accounts Payable is $200, Salaries Payable is $250, and the rest is the Notes Payable.
  - $1,000 = 200 + 250 + x. Solve for X, and **Notes Payable is $550**.
- Assets will always be the greatest number because it is the sum of Liabilities and Owner's Equity. Unless either Liabilities or Owner's Equity is ever zero, neither will ever be greater than Assets.

With this, you have everything you need to understand the Accounting Equation and its components. I
hope this helps, and I can't wait to go on more accounting adventures with you in the future! Bye for now!