STUDY UNIT 2 – CONTENT EXPLANATION

In this study unit you learn the basic elements of the statement of financial position. The financial position of the entity is described in terms of assets, equity and liabilities at a given time.

On page 5 of Study unit 2 there is a simplified example of the statement of financial position of Business Traders according to the basic accounting equation. Here you will see that:

ASSETS	=	EQUITY	+	LIABILITIES
Tools and equipment, R88 800 + Bank, R8 200	=	Capital, R40 000	+	Trade payables, R7 000 + Long-term loan, R50 000
R97 000	=	R40 000	+	R57 000
Dr	=	Cr		

Why do we say **Dr** = **Cr**:
That is: **ASSETS** **= EQUITY + LIABILITIES**

Here we need to look at the T-accounts. For each of the assets, equity and liabilities a T-account will be opened in the general ledger of Business Traders (See study unit 2 page 8). The balances of all the asset accounts (Tools and equipment and Bank) will be on the debit side.

Dr **Tools and equipment** **Cr**

	R		R
Balance b/d	88 800		

Dr **Bank** **Cr**

	R		R
Balance b/d	8 200		

The balances of the equity account (capital) and liability accounts (Creditors/Trade payables and Long-term loan) will be on the credit side.

Dr Capital **Cr**

	R		R
		Balance b/d	40 000

Dr Trade payables **Cr**

	R		R
		Balance b/d	7 000

Dr Long-term loan **Cr**

	R		R
		Balance b/d	50 000

The very important rules are therefore:

All assets have **debit balances** if you want to **add** something you will **debit** the asset accounts. For example, if you receive an additional R5 000 from the owner the bank account will be debited.

Dr		Bank	Cr		
		R			R
Balance	b/d	8 200			
Capital		5 000			
		13 200			

You will now have R8 200 + R5 000 = R13 200 in the Bank. The name of the account credited, Capital will be entered next to the amount.

The other account is the owner's account that is capital. The business will then owe the owner R5 000 extra. Therefore R40 000 + R5 000 = R45 000. The name of the account debited; Bank will be entered next to the amount of R5 000. The equity account (capital) has a **credit balance** if you want to **add** something you will **credit** the equity account (The same rule will be applied for liability accounts (Creditors/Trade payables and Long-term loan) – all liability accounts have **credit balances** if you want to **add** something you will **credit** the liability accounts.

Dr		Capital	Cr		
	R				R
			Balance	b/d	40 000
			Bank		5 000
					45 000

You will see that the debit side as well as the credit side of the simplified statement of financial position of Business Traders according to the basic accounting equation has increased with R5 000.

ASSETS	**=**	**EQUITY**	**+**	**LIABILITIES**
Tools and equipment, R88 800 + Bank, R13 200	=	Capital, R45 000	+	Trade payables, R7 000 + Long-term loan, R50 000
R102 000	=	R45 000	+	R57 000
Dr	=		**Cr**	

Therefore, another rule in accounting is that **for each debit entry there must be a credit entry** to make sure the **debits is equal to the credits**.

We can also **decrease accounts** (subtract from accounts), the following rules will then be applied:

All asset accounts have **debit balances** if you want to **subtract** something you will **credit** the asset account. For example, if the entity paid back an amount of R2 000 of the capital originally invested in the entity to the owner, the bank account will be credited.

Dr **Bank** **Cr**

		R			R
Balance	b/d	8 200	Capital		2 000
Capital		5 000	Balance	c/d	11 200
		13 200			13 200
Balance………………………	b/d	11 200			

The name of the account debited, Capital will be entered next to the amount. You must have now R8 200 + R5 000 = R13 200 less R2 000 = R11 200 in the Bank.

The **calculation of the balance** is done as follows:

Add the debit side of the account: R8 200 + R5 000 = R13 200
Add the credit side of the account: R2 000
The biggest total is the debit side total of R13 200. This total is then entered in the total columns on both sides of the account.
Now calculate the difference between the bigger side (debit side) and the smaller side (credit side): R13 200 – R2 000 = R11 200. This is the balance carried down.
The credit side was only used to calculate the balance. The real balance is brought down on the debit side of the account. This is correct because the entity has R11 200 in the bank.

The other account is the owner's account that is capital. The business will then owe the owner R2 000 less. Therefore R40 000 + R5 000 = R45 000 – R2 000 = R43 000. The name of the account credited; Bank will be entered next to the amount. The equity account (capital) has a **credit balance** if you want to **subtract** something you will **debit** the equity account (The same rule will be applied for liability accounts (Creditors/Trade payables and Long-term loan) – all liability accounts have **credit balances** if you want to **subtract** something you will **debit** the liability accounts).

Dr Capital **Cr**

		R			R
Bank		2 000	Balance	b/d	40 000
Balance	c/d	43 000	Bank		5 000
		45 000			45 000
			Balance	b/d	43 000

The **calculation of the balance** is done as follows:

Add the debit side of the account: R2 000
Add the credit side of the account: R40 000 + R5 000 = R45 000
The biggest total is the credit side total of R45 000. This total is then entered in the total columns on both sides of the account.
Now calculate the difference between the bigger side (credit side) and the smaller side (debit side): R45 000 – R2 000 = R43 000. This is the balance carried down.
The debit side was only used to calculate the balance. The real balance is brought down on the credit side of the account. This is correct because the entity still owes the owner R43 000.

You will see that the debit side as well as the credit side of the simplified statement of financial position of Business Traders according to the basic accounting equation has decreased with R2 000.

ASSETS	=	EQUITY	+	LIABILITIES
Tools and equipment, R88 800 + Bank, R11 200	=	Capital, R43 000	+	Trade payables, R7 000 + Long-term loan, R50 000
R100 000	=	R43 000	+	R57 000
Dr	=	**Cr**		

Therefore, another rule in accounting is that **for each debit entry there must be a credit entry** to make sure the debits is equal to the credits.

Steps necessary to do the T-accounts:

- First determine the two accounts involved in the transaction. In our example Bank and Capital.
- Then decide whether the accounts are assets, equity or liabilities.
- Then decide if the accounts must be increased or decreased.
- Then decide whether the account must be debited or credited by applying the rules applicable to assets, equity or liabilities.

The following rules can be applied:

Dr (Debit side) **Asset accounts** **(Credit side) Cr**

Balance b/d + (increase)	- (decrease)

Dr (Debit side) **Equity accounts** **(Credit side) Cr**

- (decrease)	Balance b/d + (increase)

Dr (Debit side) **Liability accounts** **(Credit side) Cr**

- (decrease)	Balance b/d + (increase)

For you as a learner of financial accounting the reality is that the double-entry rules are not one of those concepts that you can try to understand – you have to learn them!