# Accounting Equations in Business Transactions

**Almira Keumala Ulfah*, Arina Nurfaza, Ramadhan Razali, Heny Rofizar, Husna Hayati, Asmah Savitri**
IAIN LHOKSEUMAWE, Lhokseumawe, Indonesia
Corresponding Email: almirakeumalaulfah@iainlhokseumawe.ac.id

**ABSTRACT:**
This study intends to analyze comprehensively about accounting equations in business transactions. The accounting equation is the basis for understanding accounting records that use paired records so that the amount of debit is always balanced with credit and can know where the position of assets, debt position and capital position in each transaction. The basic accounting equation is an equation that shows the balance between assets, liabilities, and equity. The basic accounting equation is an equation that shows the balance between assets, liabilities, and equity. The accounting equation does not only record transactions that are directly related to assets, debt and capital. The accounting equation can also be used to see the effects of income, expenditure, expense, and transaction. Therefore, before making financial statements we must first have to understand the basic concept of accounting, the accounting equation. The basic equation in accounting is a basic concept in making financial statements.
**Keywords:** Accounting Equations, Balance, Assets, Transaction
*Article Received: 18 October 2020, Revised: 3 November 2020, Accepted: 24 December 2020*

## Introduction

Accounting has an important role in the business world, namely accounting provides financial information that can be used by economic actors. Accounting and bookkeeping systems play a role as a substitute tool that makes trust and as a means of coordination in economic activities . So the function and role of accounting in the accounting cycle is to record transactions and business activities, report the results of what is recorded and distribute accounting and financial information . Accounting is a business language where accounting is an information system that measures business activity, processes data into financial statements and communicates these financial statements to decision makers who will make decisions that can affect business activities .[1]

To show the relationship between assets, liabilities and equity there is a basic concept of accounting, the accounting equation. The wealth, debt, and capital of the company can be reflected in the accounting equation. Every transaction that occurs is analyzed in the accounting equation. The important thing held in the accounting equation is the principle of a balance between assets and assets. The accounting equation is the basis for understanding accounting records that use paired records so that the amount of debit is always balanced with credit and can know where the position of assets, debt position and capital position in each transaction. The basic accounting equation is an equation that shows the balance between assets, liabilities, and equity. Where the basic accounting equation is 'Assets = Liabilities + Equity'. The accounting equation does not only record transactions that are directly related to assets, debt and capital. The accounting equation can also be used to see the effects of income, expenditure, expense, and transaction transactions.

IFRS Framework states that the purpose of financial statements is to provide information about the financial position, performance, and changes in the financial position of an entity that is beneficial for many users when making economic decisions. Who are the users of financial statement information? Users of financial statements are divided into internal and external. Internal, namely managers, directors, and employees, while external, namely the government, society and investors. The IFRS Framework uses the term qualitative characteristics to describe the attributes that make the information available in financial statements useful for financial statement users. The four main qualitative characters are comprehensible, relevant, reliability and comparability. Financial statements are places where the company explains how the company is. How the company is run and how its position can be seen in the financial statements. The elements of financial statements consist of: assets, liabilities, equity, profits, expenses. Information about financial position such as assets, liabilities and equity is presented in the balance sheet. While information on financial performance including profit / loss, income and expenses is presented in the income statement.

To show the relationship between assets, liabilities and equity there is a basic concept of accounting, the accounting equation. The wealth, debt, and capital of the company can be reflected in the accounting equation. Every transaction that occurs is analyzed in the accounting equation. The important thing held in the accounting equation is the principle of a balance between assets, liabilities and equity . The accounting equation is the basis for understanding accounting records that use paired records so that the amount of debit is always balanced with credit and can know where the position of assets, debt position and capital position in each transaction. The basic accounting equation is an equation that shows the balance between assets, liabilities, and equity. Where the basic accounting equation is 'Assets = Liabilities + Equity'. The accounting equation does not only record transactions that are directly related to assets, debt and capital. The accounting equation can also be used to see the effects of income, expenditure, expense, and transaction transactions.

Therefore, before making financial statements we must first have to understand the basic concept of accounting, the accounting equation. The basic equation in accounting is a basic concept in making financial statements. Based on the above description, the authors are interested in describing "Accounting Equations in Business Transactions".

.

## Discussion

**Accounting Equation**

Resources owned or controlled by a company are called assets.[2] Examples of assets include cash, land, buildings and equipment. Rights or claims for assets are usually divided based on two types of owners, namely the rights of creditors and the rights of owners. Creditors' rights are called company debts or liabilities. Owner rights are called owner's equity. The relationship between the two forms an equation as follows :

**Assets = Liabilities + Equity**

The equation is called the accounting equation. This equation is generally written with the position of a liability or liability placed before the owner's equity. Because debts to creditors must be paid off before investors when the company goes bankrupt. In other words, liabilities are considered more current or liquid than equity. This has proven to be consistent with the example of financial reporting where current assets (Current Assets) and current liabilities (Current Liabilities) are always reported before fixed assets (PPE) and long-term liabilities (Long-Term Debt).[3]

This equation applies to all business activities and transactions. Assets will always be equivalent to liabilities and owner's equity. If assets increase, both liabilities or owner's equity must increase to balance the equation. Vice versa, if assets decline, liabilities and owner's equity also decline.

Understanding the basic accounting equation is a balance of two sides, namely between the left side (assets) and the right side (liabilities), so that changes arising from financial transactions and the balance will always be maintained. The Accounting Equation is the foundation for all accounting systems. In fact, all accounting concepts and frameworks are based on accounting equations. The accounting equation equates a company's assets with its liabilities and equity. This shows that all of the company's assets are obtained from funding from debt or equity.

For example when a new company is built, the first asset purchased comes from funds received from investors or from loans (debt). [4]

**Components in the Accounting Equation**

**a.Assets**

An asset is a resource that is owned or controlled by a business entity and is used for future benefits. Here are some examples of common assets :

1. Current assets
   - Cash
   - Receivables
   - Prepaid expenses
2. Fixed Assets
   - Vehicle
   - Buildings
3. Intangible Assets
   - Goodwill
   - Copyright
   - Patent

**b.The liability**

In the accounting equation there is a component of an obligation or a liability. Liability is the amount of money owed to other parties. Liabilities are also often referred to as creditor claims for company assets because they are considered assets that will be owned by creditors if the company experiences liquidation. An obligation, in the simplest terms, is the amount of money owed to another person or organization. In other words, a liability is a creditor's claim on a company's assets because this is the amount of assets that a creditor will have if the company is liquidated. [5]

A common form of obligation is debt. Debt is the opposite of receivables. When a company purchases goods or services from another company on credit, debt is recorded to show that the company promised to pay other companies for their assets. Here are some examples of some of the most common obligations:

1. Debt Account
2. Bank loans
3. Permanent credit (LOC)
4. Personal loans
5. Employee loans

**c.Equity**

Equity represents the portion of company assets owned by shareholders or partners. In other words, shareholders or partners have the remaining assets after all liabilities are paid. Owners can increase their share of ownership by donating money to the company or reducing equity by withdrawing company funds. Likewise, income increases equity while costs decrease equity. Here are some common equity accounts:

1. Owner's capital
2. Withdrawal of owner's funds
3. Employee loan
4. Prepaid income
5. Common stock
6. Paid-up capital

**Form of Basic Accounting Equations**

•Balance of Assets and Capital

Assets are assets owned by a company and are one of the sources for spending and for carrying out activities related to the company. Therefore, assets must be balanced with equity or expenditure sources. Source of expenditure obtained from the owner is called equity or capital.

**ASSETS = EQUITY**

•Liabilities Plus Equity Equals Liabilities

Assets owned by the company are assets that will be used as a source of expenditure in activities obtained through two sources, namely, the Owner and the Creditor. Resources used for spending from the owner are often referred to as equity. Source of expenditure that has been obtained from the creditor to the owner will be an obligation that will be returned, this is often referred to as an obligation or debt. So in this element the formula or equation is obtained namely:

**ASSETS = LIABILITIES + EQUITY**

In operating a business, it is clear that there are possibilities for income and expenses. Opinion is an increase in assets that will be obtained from the sale of an item or service. While the burden is a decrease in property, because it is one of the sacrifices that will earn income. Revenue also has the property to increase capital, while expenses will have the property of reducing capital. So that the existing income and expenses will affect the state of capital in the basic accounting equation, recorded in the capital component. However, to develop accounting, recording income and expenses can be separated from midal. So the form of the equation can be formulated as follows: [6]

**ASSETS = LIABILITIES + EQUITY + REVENUE – EXPENSES**

**Accounting Equation Function**

The accounting equation is very useful for knowing about changes in wealth in a company in every transaction that occurs. In addition, the function of the accounting equation is to find out some of the assets that have been used and spent in one accounting period. [7]

Analysis of the effect of transactions to the accounting equation in every transaction that occurs will affect the financial position of the company. Influence on these transactions can increase and also reduce the financial components of the company, namely: Assets, debt, and capital. Changes to these components of financial position in the basic accounting equation can also be grouped as follows:

- All transactions can affect assets and debts in the same amount.
- All transactions can affect property and capital in the same amount.
- All transactions can affect assets with the same changes in debt and capital.

**Accounting Equations in Business Transactions**

Economic activities or conditions that directly change the financial condition of an entity or directly affect operational results are called business transactions. All business transactions can be stated by changing elements in the accounting equation. Here are some of the applications of accounting equations in business transactions:

• Financial statements

The basic application of accounting that is never omitted is in the financial statements. This report covers many things and is not just a company report. The financial statements include the sum of incoming and outgoing balances. These two points must be the same so that they conform to the basic principles of accounting equations. The application of financial statements itself is used for various needs and by various groups such as schools, shops to households.

•Bookkeeping

The accounting equation is used in accounting. Bookkeeping itself is always owned by each company in order to get a balance of the company's account statements between expenses and income in a certain period. With proper bookkeeping, the company will know the details of the data that will be used to account for what the company has done in the intended period. Usually, this takes the form of a responsibility report to ensure clear credit debit.

• Income

The application of an accounting equation relates to the calculation of the profits generated by an entity during a financial period. Profit can be explained as income minus expenses. Profit earned by the company is awaited thing. It's just that calculating the company's total profits is not an easy matter. New company profits can be calculated using the service of applying accounting equations. This equation makes it easy for companies to calculate the total profits that should be obtained. If the amount of profit does not match the estimate then this is questionable. Is there a mistake in recording or bookkeeping, or even there are those who commit fraud.

•Investment

The accounting equation is also related in calculating the amount of profit from investment returns. Investment is a process for investing and obtaining profits within a certain period. In investing it is also very necessary to apply this basic equation to calculate the amount of profits from investment returns. The expected amount of profits can exceed the amount of capital invested when making investments. [8]

## Conclusion

Understanding accounting equation is a balance of two sides, namely between the left side (assets) and the right side (liabilities), so that changes arising from financial transactions and the balance will always be maintained. The Accounting Equation is the foundation for all accounting systems. In fact, all accounting concepts and frameworks are based on accounting equations. The accounting equation equates a company's assets with its liabilities and equity. This shows that all of the company's assets are obtained from funding from debt or equity. For example when a new company is built, the first asset purchased comes from funds received from investors or from loans (debt). Application of accounting equations in business transactions, namely in financial statements, bookkeeping, profit calculation and calculation of the amount of return on investment.

## References

[1] A. K. Ulfah *et al.*, “Analisis Kemampuan Pembiayaan Keuangan Pemerintah Provinsi Aceh Setelah Penerapan Revisi UU Tentang Otonomi Daerah,” *Semin. Nas. Teknol. Komput. Sains*, pp. 113–116, 2019.

[2] S. F. Ramadhan Razali, “Eksistensi Keadilan Sosial Dalam Keuangan Publik Islam (Kajian Terhadap Kitab Al-Amwal Karya Ad-Dawudi,” *Jeskape*, vol. 3, no. 2, pp. 40–56, 2019.

[3] H. R. Muhammad Arfan, “Nilai Perusahaan Dalam Kaitannya Dengan Arus Kas Bebas dan Pertumbuhan Perusahaan (Studi Pada Perusahaan Manufaktur Yang Terdaftar di Bursa Efek Indonesia),” *J. Telaah Ris. Akunt.*, vol. 06, no. 1, pp. 14–30, 2013.

[4] Harrison Jr Walter T., Horngren, C William Thomas, Suwardy T. (2013), Akuntansi Keuangan-Edisi IFRS, Edisi Kedelapan, Jilid 2. Erlangga, Jakarta..

[5] Kajiwara, T. (2012) Does Systematic Recordkeeping Contribute to Human Development, April 2012 SSRN´s eLibrary id No 1794824

[6] Kieso, Donald E. dan Jerry J. Weygandt. (2002). Akuntansi Intermediate. Jilid 1. Jakarta : Erlangga.H. R. Muhammad Arfan, “Nilai Perusahaan Dalam Kaitannya Dengan Arus Kas Bebas dan Pertumbuhan Perusahaan (Studi Pada Perusahaan Manufaktur Yang Terdaftar di Bursa Efek Indonesia),” *J. Telaah Ris. Akunt.*, vol. 06, no. 1, pp. 14–30, 2013.

[7] Warren, Carl S, Reeve, James M., Duchac, Jonathan E. (2015). Pengantar Akuntansi. Jakarta: Salemba Empat.

[8] Weygandt, J.J, Kimmel, P.D, and Kieso, D.E. (2010). Financial Accounting, 7th Edition, John Wiley & Sons, Inc. England