

Accounting Principles 2 (Speedy Study Guides)

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ACCOUNTING PRINCIPLES II

How Transactions Impact The Accounting Equation

The preceding balance sheet for Edelweiss represented the financial condition at the noted date. But, each new transaction brings about a change in financial condition. Business activity will impact various asset, liability, and/or equity accounts without disturbing the equality of the accounting equation. How does this happen? To reveal the answer to this question, look at four specific cases for Edelweiss. See how each impacts the balance sheet without upsetting the basic equality.

CASE A: COLLECT AN ACCOUNT RECEIVABLE

If Edelweiss Corporation collected \$16,000 from a customer on an existing account receivable (i.e., not a new sale, just the collection of an amount that is due from some previous transactions), then the balance sheet would be revised to show that cash (an asset) increased from \$25,000 to \$35,000, and accounts receivable (an asset) decreased from \$50,000 to \$34,000. As a result total assets did not change, and liabilities and equity accounts were unaffected, as shown in the following illustration.

Assets		Assets	
Cash	\$ 25,000	Cash	\$ 35,000
Accounts receivable	50,000	Accounts receivable	34,000
Inventories	35,000	Inventories	35,000
Land	125,000	Land	125,000
Building	400,000	Building	400,000
Equipment	250,000	Equipment	250,000
Other assets	10,000	Other assets	10,000
Total assets	885,000	Total assets	885,000
Liabilities		Liabilities	
Accounts payable	\$ 30,000	Accounts payable	\$ 30,000
Loans payable	125,000	Loans payable	125,000
Total liabilities	155,000	Total liabilities	155,000
Stockholders' equity		Stockholders' equity	
Capital stock	\$120,000	Capital stock	\$120,000
Retained earnings	605,000	Retained earnings	605,000
Total stockholders' equity	730,000	Total stockholders' equity	730,000
Total liabilities and equity	885,000	Total liabilities and equity	885,000

CASE B: BUY EQUIPMENT VIA LOAN

If Edelweiss Corporation purchased \$30,000 of equipment, agreeing to pay for it later (i.e. taking out a loan), then the balance sheet would be further revised. The Case B illustration shows that equipment (an asset) increased from \$250,000 to \$280,000, and loans payable (a liability) increased from \$125,000 to \$155,000. As a result, both total assets and total liabilities increased by \$30,000.

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