

The Accounting Equation

The resources owned by a business are its **ASSETS**. Examples of assets include cash, land, buildings, and equipment. The rights or claims to the properties are normally divided into two types: (1) the rights of creditors and (2) the rights of owners. The rights of creditors represent debts of the business and are called **LIABILITIES**. The rights of the owners are called **OWNER'S EQUITY**. The relationship between these terms can be stated in the form of an equation, as follows:

$$\mathbf{ASSETS = LIABILITIES + OWNER'S EQUITY}$$

This equation is known as the accounting equation. It is usual to place liabilities before owner's equity in the accounting equation, because creditors have first rights to the assets.

To illustrate, if the assets owned by a business amount to \$100,000 and the liabilities amount to \$30,000, the owner's equity is equal to \$70,000, as shown below.

Assets	=	Liabilities	+	Owner's Equity
\$100,000	=	\$30,000	+	\$70,000

The accounting equation provides a basic framework for recording the effects of transactions on companies of all sizes and types. This basic framework serves as the foundation for all accounting systems from the smallest local business to the largest businesses in the country. Some examples taken from recent financial reports of well-known companies are shown below.

Company	Assets	=	Liabilities	+	Owner's Equity	
Dell Computer	26,500	=	22,229	+	4,271	
McDonald's	28,462	=	15,079	+	13,383	
Microsoft	77,888	=	38,330	+	39,558	
Starbucks	5,673	=	3,182	+	2,491	
Wal-Mart	163,429	=	98,144	+	62,285	

all amounts are shown in millions of dollars

Problems

- The total assets and liabilities of Coca-Cola and PepsiCo are shown below. Determine the owner's equity of each company.

	Coca-Cola <i>(in millions)</i>	PepsiCo <i>(in millions)</i>
Assets	\$40,519	\$35,994
Liabilities	\$20,047	\$23,888

- The total assets and liabilities of GameStop and Best Buy are shown below. Determine the owner's equity of each company.

	GameStop <i>(in millions)</i>	Best Buy <i>(in millions)</i>
Assets	\$4,513	\$15,826
Liabilities	\$2,213	\$11,183

- Determine the missing amount for each of the following:

	Assets	=	Liabilities	+	Owner's Equity
a.	_____	=	\$25,000	+	\$71,500
b.	\$82,750	=	_____	+	\$15,000
c.	\$37,000	=	\$17,500	+	_____