



# **Module-B Unit-1**

## **JAIIB PAPER-3**

### **Accounting & Financial Management for Bankers(AFM)**



## JAIIB AFM Module B Unit -1 Balance Sheet Equation

### Balance Sheet Equation

**An Accounting Equation is also called the Balance Sheet Equation.** We all know that we record all the business transactions using the Dual Aspect concept. This means that each debit has an equal credit and vice-versa.

- **Capital:** It means the amount which the owner of business has invested in the firm and can claim from the firm.
- **Liability:** It means the amount which the firm owes to outsiders. Long term liabilities are those liabilities which are payable after a long term. Current liabilities are those liabilities which are payable in near future (generally within one year).
- **Asset:** Assets are things of value owned. Fixed assets are those assets which are purchased for the purpose of operating the business but not for resale, e.g. Land, building, Plant and Machinery, etc. Current assets are those assets which are kept for short term for converting into cash or for resale, e.g. unsold goods, debtors, cash, bank balance, etc.

**Assets = Liabilities + Capital (Owner's Equity)**

**Liabilities = Assets - Capital or Capital = Assets - Liabilities**

#### Example:

ABC starts the food truck. He puts ₹ 50,000 as a capital fund. He further loans ₹ 25,000 from a local credit vendor. Now, he has a total of ₹ 75,000, he then purchases a fully furnished truck for ₹ 45,000.

Below is the ABC balance sheet for December 2017.

<b>Balance Sheet</b>			
<b>December 31, 2017</b>			
<b>Assets</b>		<b>Liabilities</b>	
Cash	30,000	Loan from credit union	25,000
Food truck	45,000	Owner's equity	50,000
<b>Total assets</b>	<b>75,000</b>	<b>Total Liabilities and Owner's equity</b>	<b>75,000</b>

### Computation Of Balance Sheet Equation

If there is any change in the amount of the assets or the liabilities, the owners' claim or the capital is bound to change correspondingly. If assets increase and liabilities do not, the capital will increase; a reduction in the amount of assets or an increase in the amount of liabilities will mean a reduction in the amount of capital. Such balance sheet equations will be clearer by the various transactions given below:

<i>Assets</i>	<i>Capital + Liabilities</i>
Cash	Capital + reserves and surplus Creditors Bills payable Outstanding expenses Bank Overdraft
Bank	
Bills Receivable	
Debtors	
Stock in trade	
Furniture	
Machinery	
Building	



1. He commences his business with ₹ 20,000 as capital.

This means that the firm has assets totalling ₹ 20,000 in the form of cash and claims against the firm are also ₹ 20,000 in the form of capital. The balance sheet stands as follows:

#### Balance Sheet 1

<i>Liabilities</i>	₹	<i>Assets</i>	₹
R's Capital	20,000	Cash	20,000

2. The business purchased a machinery of ₹ 1,000. The effect of this transaction is that amount of cash in hand is lower by ₹ 1,000, but a new asset (machinery) has been acquired leaving the total assets unchanged. The balance sheet after this transaction will appear as follows:

#### Balance Sheet 2

<i>Liabilities</i>	₹	<i>Assets</i>	₹
R's Capital	20,000	Cash (20,000 – 1,000)	19,000
		Machinery (0 + 1,000)	1,000
<b>Total</b>	<b>20,000</b>	<b>Total</b>	<b>20,000</b>

3. The business purchases goods for ₹ 2,000 for cash.

The effect of this transaction is that amount of cash in hand is lower by ₹ 2,000, but a new asset (stock of goods) has been acquired leaving the total assets unchanged. The balance sheet after this transaction will appear as follows:

#### Balance Sheet 3

<i>Liabilities</i>	₹	<i>Assets</i>	₹
R's Capital	20,000	Cash (19,000 – 2,000)	17,000
		Machinery (1,000 + 0)	1,000
		Goods (0 + 2,000)	2,000
<b>Total</b>	<b>20,000</b>	<b>Total</b>	<b>20,000</b>

4. The business purchases goods for ₹ 5,000 on credit. Because of this transaction, the stock of goods increased by ₹ 5,000 making the total assets ₹ 25,000. Now ₹ 5,000 is payable to the supplier of goods (creditor).

The balance sheet after this transaction will appear as follows:

#### Balance Sheet 4

<i>Liabilities</i>	₹	<i>Assets</i>	₹
R's Capital	20,000	Cash (17,000 – 0)	17,000
Creditor (0 + 5,000)	5,000	Machinery (1,000 + 0)	1,000
		Goods (2,000 + 5,000)	7,000
<b>Total</b>	<b>25,000</b>	<b>Total</b>	<b>25,000</b>

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