DUALITY OF TRANSACTIONS

A business owns assets and owes liabilities.

Assets are items belonging to a business and used in the running of the business. They may be **non-current** (machinery, office premises) or **current** (inventory, receivables, cash).
Liabilities are sums of money owed by a business to outsiders such as a bank or a supplier.
Capital – anything introduced by the owner of the business.

Assets
Assets can be long term (non-current assets, which are expected to be used in the business for more than one year) and short term (current assets which are expected to be consumed or used within one year by the business).

Liabilities
Liabilities can be long term (non -current liabilities which are expected to be settled in a date which is more than 12 months forward) or short term (current liabilities which are expected to be settled within twelve months).

Capital
This is the residual interest of in the business by the owner after all liabilities have been paid. That which belongs to the owner of the business.

INCOME - This is the act of generating funds that will increase the profits of the business. For example doing a sale is an income.

Expenses – This is any activity that is incurred to support generation of income e.g. paying or rent, salaries, purchase of goods for resale etc.

Drawings – this are amounts of money or goods that are taken out of the business by the owner.

The Accounting equation.

This is the fundamental equation that guides the preparation of financial statements and the concept of double entry.

What the business owns equals to what the business owes

The business owns Assets (A)

The business owes capital(C) and Liabilities

Thus
ASSETS (A) = CAPITALA(C) + LIABILITIES (L) ---------------- The accounting equation

i. *e.g a Business has assets of 50,000 and liabilities of 30,000 what is the capital.*
ii. *A business has liabilities of 40,000 and capital of 25,000 what's the value of assets*

The accounting equation can be rearranged as follows

ASSETS - LIABILITES= CAPITAL (A-L=C)
CAPITAL = NET ASSETS OF THE BUSINESS.

The net assets of a business change in total because of the following three aspects

i. ***Profit (P)*** *- profits made by a business increase the net assets of a business however if there is a loss, it decreases the net assets*
ii. ***Additional Capital (AC)*** *- Additional capital injected into the business by the owner increase the net assets of a business.*
iii. ***Drawings*** *- Drawings done by the owner reduce the net assets of a business.*

Thus any change in net assets of a business can be written as follows

Change in net assets = Profit for the period + Additional capital injected during the period – Drawings during the period.

Examples

1 On 1st Jan 2019, a business had net assets of 60,000 while on 31st Jan 2019, the net assets were 72,000. The owner made an additional capital of 8, 000 during the month of January and also did drawings of 6,400. What was the profit for January 2019?

2. The net assets of a business at the start of a period were 7,400, and at the end of the period they were 6800, the business made a loss of 2,600 and the owner did drawings of 1,500. How much additional capital did the owner introduce during the period?

3. At the start of a period, a business has Assets of 48000 and liabilities of 7,600. At the end of the period, the assets are 64,000 and liabilities of 12,500. During the period, the owner introduced additional capital of 14,000 and made drawings of 5,800. What was the profit or loss for the period?

DOUBLE ENTRY CONCEPT (DUALITY OF TRANSACTIONS)

In accounting every transaction has two effects (Debit entry and credit entry). We know that, since the total of liabilities plus capital is always equal to total assets, any transaction has a dual effect ***– if it changes the amount of total assets it also changes the total liabilities plus capital****, and vice versa*

Every financial transaction affects the entity in two ways and gives rise to two accounting entries, one a debit and the other a credit. The total value of debit entries is therefore always equal at any time to the total value of credit entries. Double entry takes place in ledgers accounts which resemble a capital (T). The left hand side is the debit side while the right hand side is the credit side.

A Ledger account

Debit side	*Credit side*

This ledger accounts are named depending on the elements of the financial statements (Assets, capital, liabilities, income and expenses). To know when to debit or credit which ledger account, depends on the nature of the transaction and the type of elements being affected by the transaction.

The table below summarizes the rules of when to credit or debit a ledger account

ELEMENT	EFFECT OF TRANSACTION ON THE ELEMENT	
	INCREASING	**DECREASING**
ASSETS	*DEBIT*	*CREDIT*
LIABILITIES	*CREDIT*	*DEBIT*
CAPITAL	*CREDIT*	
INCOME	*CREDIT*	*DEBIT*
EXPENSES	*DEBIT*	*CREDIT*
DRAWINGS	DEBIT	-

Show the double journal entry for the following transactions, and draw the ledger accounts to post the transactions.

- Owner introduces 60,000 cash into the business
- The business receives a bank loan of 50,000 from KCB bank
- The business pays 6,000 for rent expense
- The business sells goods for 12,000 cash.
- The business buys goods that are for resale worthy 8,000 cash.
- The owner withdraws cash of 4,000 from the business
- Purchase of motor vehicle for use in the business for 40,000

Balancing a ledger account

At the end of each period, individual ledger accounts are balanced and the remaining balances are taken to the trial balance in preparation of the financial statements.
Steps in balancing a ledger account

1. Add the totals of each side (credit and debit) separately.
2. Record the higher total on both sides
3. Introduce a figure on the lower side,(the balance c/d, or c/f) to balance to the total)
4. Finish the double entry by entering a balance b/d on the opposite side below the equal signs.

E.g. the cash ledger account has the following fiqures
Debit side------- 40, 60,90, 860, 340,
Credit side ------ 210, 75, 180.
Required: Draw the cash ledger account and balance it to find the balance c/d.

Comprehensive Illustration

Enter the following transactions of a sole trader in the **journal accounts, post the transactions to ledger accounts and extract a trial balance** as at 31 March 2009.

March

1 Started in business with Kshs.800,000 in the bank and Ksh. 500,00 in cash

2 Bought goods for sale Ksh. 145,000 paying by a cheque.

5 Cash sales Kshs.500,000

6 Paid wages in cash Kshs.100,000

7 Sold goods by cheque Kshs 400,000.

9 Bought goods for cash Kshs.120, 000

10 Bought goods on credit Ksh. 200,000 from Victoria Furnitures

12 Paid wages in cash Kshs.50, 000

13 Sold goods on credit Kshs.80,000 to Lions investment

15 Bought shop fixtures on credit from Mbao Ltd Kshs.74,000

17 Paid Victoria Furnitures by cheque Kshs.150,000

21 Paid Mbao Ltd Kshs.74, 000 in cash

24 Lions Investment paid us his account by cheque Kshs.64,500

30 Pauline lent us Kshs.100,000 by cash

31 Bought a motor van paying by cheque Kshs.625,000