The accounting equation – lecture 2

- Assets – resources available to the business – produce wealth for the owner
- Liabilities – obligations of the business – to other parties (including owners)

Statement of financial position/balance sheet:

$$assets - liabilities = equities\ (ownership\ interest)$$
$$A - L = E$$

also can be viewed as:

$$assets = liabilities + equities$$
$$A = L + E$$

The liabilities and the equity are the obligations of the business.

Asset: a resource

- Controlled by the business. Can we restrict access?
- As a result of past events – some kind of transaction
- Future economic benefits will follow – will cash be generated in the future?
- Capable of reliable measurement – can we reliably estimate the future economic benefits?

Examples:

- Land and buildings
- Raw materials – what makes the product
- Cash balances held by business
- Cars and other vehicles used for the business
- Machinery and tools used in production
- Offices, computers, etc…

Recognition of an asset:

Recognised = included in balance sheet

ONLY IF it is possible to record the future possible economic benefits that will flow

AND the asset has a cost or value that can be measured reliably.

Workforce and advertising campaigns are not recognised as assets as the benefits are uncertain, and it's hard to measure the cash that will flow to the business in the future.

Liabilities:

- A present obligation of a business – legal or from commercial
- From past events – normally receiving G&S or borrowing money
- Outflow of resources (often cash) – cash or other resources leaving the business
- Capable of reliable measurement

If there is sufficient evidence of outflow likely, and it's recognised as a liability, it's included in the balance sheet.