

The Accounting Equation

QuickBooks Pro is a *double-entry* accounting system. This ensures that your books are always in balance, and is dictated by generally accepted accounting principles. The double-entry system is exemplified in the basic accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Although you will not work directly with the accounting equation when you use QuickBooks Pro, a basic grasp of the equation is necessary to understand other accounting principles.

The accounting equation states that total assets equal the amounts claimed by creditors, owners, and shareholders. In other words, what an organization has (assets) is either owned by creditors (liabilities) or by investors (equity).

Earnings (profits) are reflected in the equity part of the equation. Earnings can be defined as the difference between *income* and *expenses*. Without changing the validity of the accounting equation, we can revise it to:

$$\text{Assets} = \text{Liabilities} + \text{Income} - \text{Expenses} + \text{Equity}$$

If proper accounting procedures are followed, the accounting equation will hold true before and after you record each financial transaction. However, if it were necessary to go to all the trouble to prepare the accounting equation after recording each financial transaction, few transactions would ever take place. *Accounts* (asset, liability, equity, income, and expense) were devised as an efficient means to record financial transactions.

The following table may help you remember to normal types of transactions and usual account balances for each type of account.

Type of Account	Increase with a:	Decrease with a:	Normal Balance is a:
Asset	Debit	Credit	Debit
Liability	Credit	Debit	Credit
Equity	Credit	Debit	Credit
Income	Credit	Debit	Credit
Expense	Debit	Credit	Debit