Accounting Basics

A complete last-minute revision map: the accounting equation, the five elements of financial statements, double-entry rules, and the core accounting concepts — exactly as tested in PRC-1.

Accounting Equation | Five Elements | Double-Entry DR/CR Rules | Accounting Concepts

1 CORE CONCEPT

> *Every transaction that affects assets, liabilities, capital, income or expenses must have an offsetting effect to maintain the accounting equation — this is the principle behind double-entry book-keeping.*

THE ACCOUNTING EQUATION

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Assets = Liabilities + Equity
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2 KEY DEFINITIONS — THE FIVE ELEMENTS

ASSET
A present economic resource controlled by the entity as a result of past events.

LIABILITY
A present obligation to transfer an economic resource as a result of past events.

EQUITY
The owner's residual interest in the assets after deducting liabilities.

INCOME
Increase in assets or decrease in liabilities, increasing equity, other than owner contributions.

EXPENSE
Decrease in assets or increase in liabilities, decreasing equity, other than distributions to owners.

3 IMPORTANT ACCOUNTING RULES — ASSET & LIABILITY CLASSIFICATION

✓ Current

Current assets
Provide economic benefits in the short term, usually one year — e.g. cash, trade receivables

Current liabilities
Payable within 12 months — e.g. trade payables, utility bills payable

✗ Non-Current

Non-current assets
Long useful life, benefits over several years — e.g. buildings, plant & machinery

Non-current liabilities
Payable more than 12 months after the reporting date — e.g. long term bank loan

4 FORMULAS

CAPITAL VS REVENUE

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Capital Exp. = Acquire / improve long-term assets
Revenue Exp. = Day-to-day operating costs
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"Capitalised" = treated as an asset, not an expense.

5 ACCOUNTING TREATMENT — DOUBLE-ENTRY RULES

Account Type	Increase	Decrease
Assets, Expenses & Drawings	**Debit**	**Credit**
Liabilities, Income & Capital	**Credit**	**Debit**

Total debit entries must always equal total credit entries — this maintains the accounting equation.

6 STEP-BY-STEP ROADMAP — ANALYSING A TRANSACTION

1. **Identify the two accounts affected**
   Every transaction touches at least two accounts.
2. **Classify each account's type**
   Asset, liability, equity, income, or expense.
3. **Decide increase or decrease**
   Apply the DR/CR rule table for each account.
4. **Check the equation still balances**
   Assets = Liabilities + Equity must always hold.

9 CORE ACCOUNTING CONCEPTS — EFFECT ON THE FINANCIAL STATEMENTS

Business Entity
Owner's personal transactions are kept separate from the business's records.

Going Concern
Statements assume the entity continues operating for the foreseeable future.

Realisation
Revenue is recognised when earned, not when cash is received.

Prudence
Income/assets not overstated; expenses/liabilities not understated.

Money Measurement
Only transactions quantifiable in money are recorded.

Consistency
Chosen accounting methods are applied the same way period to period.

10 COMMON EXAM CASES — DECISION TREE

IF acquiring/improving an asset	→ Capital expenditure — capitalised
IF a day-to-day cost	→ Revenue expenditure — expensed
IF owner pays business expense personally	→ Kept separate — business entity concept
IF collection is uncertain	→ Apply prudence — do not overstate the asset

11 COMMON MISTAKES / EXAM TRAPS

Trap: Reversing the DR/CR rule table
Assets, expenses and drawings increase with a DEBIT — students often reverse this for liabilities, income and capital.

Trap: Confusing consistency with comparability
Consistency is using the SAME method period to period; comparability is the broader GOAL this helps achieve — they are related but not identical.

Trap: Mixing owner and business transactions
Under the business entity concept, only the business's own transactions belong in its financial records — even for sole traders and partnerships.

★ QUICK EXAMPLE

SCENARIO

A company acquires an office and pays one year's rent in advance, Rs. 120,000, starting 1 September, for a financial year ending 31 December.

APPLYING THE MATCHING / ACCRUAL CONCEPT

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Expense for the year = Rs. 120,000 × 4/12 = Rs. 40,000
Prepayment carried forward = Rs. 80,000
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RESULT

Only the 4 months' rent relating to THIS period (Rs. 40,000) is expensed; the remaining Rs. 80,000 is a prepayment for the next financial period.

THE EQUATION
Assets = Liabilities + Equity — must always balance after every transaction.

FIVE ELEMENTS
Assets, liabilities, equity, income, and expenses — the building blocks of the financial statements.

DR/CR RULE
Assets/expenses/drawings: Dr = increase. Liabilities/income/capital: Cr = increase.

CORE CONCEPTS
Business entity, going concern, realisation, prudence, money measurement, consistency all shape how transactions are recorded.