

ACCOUNTING: DO YOU GUIDE OR DO YOU JUST TEACH?

Your role in the teaching of Accounting should be to *guide the learners to discover*. This is a much better option than to *teach the learners to do*. This is of especially important when dealing with the foundation of Accounting, the Accounting equation.

The end result of the accounting process is in the form of reports and financial statements. These show how a business or organisation has performed and provide the information required to plan for the future. The Balance sheet (Statement of financial position) is one of the relevant statements and shows the financial position of a business on a specific date. It shows what the business owns (assets), what they owe (liabilities) and the difference, known as equity or owner's equity. If we write these three items in the form of an equation we get: $\text{Assets} - \text{Liabilities} = \text{Owner's equity}$. However, we usually work with positive amounts in accounting. So the equation known as the basic accounting equation is written as: $\text{Assets} = \text{Owner's equity} + \text{Liabilities}$. Therefore, the accounting equation is a simplified Balance sheet.

As soon as a transaction takes place, it has an effect on the accounting equation. Note that the relevant effect takes place **before any entry has been made**. To record the relevant effect, an entry is made. The entry is therefore the **result** of the effect on the equation.

It makes sense to take the foundation of a subject – in this case the accounting equation – as starting point and then to build on the basic accounting principles and concepts throughout. Learners need to first consider the effect of **all new transactions** on the accounting equation and then reason about what entry should be made to record the relevant effect.

It is not only the effect of the transaction on the accounting equation that is important. Once learners have grasped this, they need to be aware that generally accepted accounting practice (GAAP) also determines how the entry is done. One such transaction is sales, another is the depreciation of a fixed asset and yet another is the purchase of merchandise when the periodic inventory system is in use. The bottom line however, is that the effect of a transaction on the accounting equation **always takes place before any entry is made**. The entry is **always the result** of the effect on the equation and where applicable, generally accepted accounting practice. This fact should be applied throughout where applicable.

Suggested point of departure for the elementary teaching of Accounting

Start by letting learners discover the accounting equation by discussing the effect of cash transactions of a service business on the elements of the equation. Take a step-by-step approach and start with only two elements of the equation, assets and owner's equity. Don't immediately refer to the term *accounting equation*. Guide learners to discover the accounting equation as they progress by letting them prepare a cumulative summary (simplified Balance sheet) after each transaction which shows how the financial position changes. The following three transactions of Rufus Plumbers can serve as an example:

1. Rufus started his business, Rufus Plumbers, by depositing a capital contribution of R80 000 in the current bank account of the business; receipt 001 was issued.
2. Bought a vehicle from Bingo Motors and paid by cheque 001, R25 000.
3. Issued cheque 002 for R15 000 to Coastal Stores for equipment.

Do not discuss the relevant documents in detail at this stage. Simply refer to the purpose of the documents in general. Emphasise that when you look at the effect of a transaction on assets and/or owner's equity, you must analyse the transaction **from the point of view of the business**. Guide the learners to read the transactions carefully and then ask themselves what happened. The answer to this question and the teacher's guidance regarding the cumulative summary after each transaction, will lead them to the following solution:

Effect on assets and owner's equity

No.	Assets		Owner's equity	
	Effect	Reason	Effect	Reason
1.	+80 000	Cash increases	+80 000	Owner's capital contribution
2.	-25 000 +25 000	Cash decreases Vehicles increases		
3.	-15 000 +15 000	Cash decreases Equipment increases		

Cumulative summary after each transaction

No.	Assets		Owner's equity	
	Effect	Reason	Effect	Reason
1.	Cash	R80 000	Capital contribution	R80 000
2.	Cash Vehicles	55 000 25 000 R80 000	Capital contribution	80 000 R80 000
3.	Cash Vehicles Equipment	40 000 25 000 15 000 R80 000	Capital contribution	80 000 R80 000

With the necessary guidance, learners have discovered that:

- Assets = Owner's equity (liabilities have not yet been discussed)
- Buying assets does not affect the owner's equity.
- Although buying assets for cash does not affect the owner's equity, it does affect the cash (financial) position of the business.
- Owner's equity does not (necessarily) equal cash.
- The money received from the owner (transaction 1) is called a receipt.
- The money paid for a vehicle and equipment (transactions 2 and 3) is called payments.

In addition to this, the cumulative summary will help learners to have a better understanding of the Balance sheet when the time comes. No reference is made to the term *Balance sheet* at this stage.

Learners can be introduced to expenses and income by determining the effect of the following three transactions of Rufus Plumbers on the accounting equation and continuing with the cumulative summary:

4. Paid the local newspaper, *Daily News*, for advertising, cheque 003, R400.
5. Rented a storeroom from First Street Properties; paid rent by cheque 004, R900.
6. Cash received for services rendered, cash register roll, R3 300.

Effect on assets and owner's equity

No.	Assets		Owner's equity	
	Effect	Reason	Effect	Reason
4.	-400	Cash decreases	-400	Advertising – expense
5.	-900	Cash decreases	-900	Rent – expense
6.	+3 300	Cash increases	+3 300	Income earned

Cumulative summary after each transaction

No.	Assets		Owner's equity	
4.	Cash	39 600	Owner's equity	79 600
	Vehicles	25 000		
	Equipment	15 000		
		<u>R79 600</u>		
5.	Cash	38 700	Owner's equity	78 700
	Vehicles	25 000		
	Equipment	15 000		
		<u>R78 700</u>		
6.	Cash	42 000	Owner's equity	82 000
	Vehicles	25 000		
	Equipment	15 000		
		<u>R82 000</u>		

With the necessary guidance, learners will learn that:

- Payments that have the effect of decreasing owner's equity are called expenses.
- A receipt that has the effect of increasing owner's equity is called an income.
- Assets = Owner's equity (liabilities have not been discussed yet)
- Profit = Income less Expenses [3 300 – (400+ 900) = 3 300 – 1 300 = R2 000]
- Owner's equity after transaction 1 (R80 000) + Profit (R2 000) = Owner's equity after transaction 6 (R82 000).
- Wealth does not (necessarily) mean lots of cash.

These are all important concepts that apply to all levels of accounting.

The only rules that learners need to know are the rules, applicable to all transactions, which allow us to apply logical reasoning in deciding which account to debit and which account to credit. These are:

Asset accounts	Dr.	ASSETS	Cr.
• increase with a debit entry	Increase with	Decrease with	
• decrease with a credit entry	a debit entry	a credit entry	

Liability accounts (after they have been discussed)	Dr.	LIABILITIES	Cr.
• increase with a credit entry	Decrease with	Increase with	
• decrease with a debit entry	a debit entry	a credit entry	

Owner's equity	Dr.	OWNER'S EQUITY	Cr.
• increases with a credit entry	Decreases with	Increases with	
• decreases with a debit entry	a debit entry	a credit entry	

The logical conclusion is that:

• We credit income accounts because income increases owner's equity.	Dr.	INCOME	Cr.
		Is credited	

• We debit expense accounts because expenses decrease owner's equity.	Dr.	EXPENSES	Cr.
	Are debited		

Record the transactions of Rufus Plumbers in simplified ledger accounts (T-accounts) by applying the rules for debiting and crediting ledger accounts. When completed, the solution would look like this:

General ledger of Rufus Plumbers

<i>Asset accounts</i>				<i>Accounts that affect owner's equity</i>				
Dr.	BANK		Cr.	Dr.	CAPITAL		Cr.	
1.	Capital	80 000	2.	Vehicles	25 000	1.	Bank	80 000
6.	Current Income	3 300	3.	Equipment	15 000	ADVERTISING		
			4.	Advertising	400	4.	Bank	400
			5.	Rent expense	900	RENT EXPENSE		
						5.	Bank	900
VEHICLES				CURRENT INCOME				
2.	Bank	25 000				6.	Bank	3 300
EQUIPMENT								
3.	Bank	15 000						

Learners can be guided to:

- answer how many accounts were opened
- name the asset accounts that were opened
- name the expense accounts that were opened
- name the income accounts that were opened
- answer how many entries were made in the Bank account.

It is important for learners to differentiate between the various accounts that appear in the General ledger and to understand the difference between the concepts 'accounts' and 'entries'.

These simplified ledger accounts can be used to introduce the learners to analysis and interpretation. This can be done by asking the learners the following questions and giving guidance regarding the answers where necessary:

Questions

1. How much money does the business have in the bank?
2. List all the accounts and their balances or totals and add the amounts.
3. Calculate the profit made.
4. What does the owner's equity amount to?
5. List the assets and add their balances.

Learners discover the following:

1. The balance in the Bank account shows how much money is in the bank.
2. If a list of accounts and balances is prepared, the total of the debit balances equals the total of the credit balances.
3. To calculate the profit, one has to identify the income and expense accounts. The actual calculation of profit is done in an Income statement.
4. The profit calculated is the net amount by which the owner's equity increased over a given period. The owner's equity consists of the original capital contribution plus the profit.
5. The total of the balances of the assets equals the owner's equity as calculated in 4. This can be compared to the cumulative summary after transaction 6.
Assets = Owner's equity (liabilities have not yet been discussed.)

The concept of analysis and interpretation is introduced here in a simplified manner and at a very basic level. Although the level is basic, the concepts have been introduced so that they can be extended further at a later stage.

When introducing a trading business, emphasise that everything that is discussed with regards to a service business also applies to a trading business. The only new transactions are the purchase and sales of trading stock. Purchasing trading stock is none other than purchasing an asset. Selling trading stock needs a bit more guidance.

As one progresses with the various transactions at elementary level, one must bear in mind that the aim of accounting is to supply financial information. Everything in an accounting system is done with this in mind.

If a firm sells stock (original cost price, R200) for R350 cash, the effect on the accounting equation is:

A	E	L
+350 (Cash increases)		
-200 (Stock decreases)	+150 (Profit)	0

Note once again that this effect has taken place before any entry has been made.

It is important for a business to know what the turnover (total sales) is and what the merchandise that was sold cost the business. This means that they do not make only one entry to record the net increase of owner's equity. They make two entries. One entry to show the sales amount (R350) and another to show the cost of the goods sold (R200). This is the first transaction where the effect of the transaction on the accounting equation as well as generally accepted accounting practice determines the entry.

Therefore Bank is debited (R350) and Sales credited (R350) and Cost of sales is debited (R200) and Trading stock credited (R200).

This **does not mean** that the effect under Equity is now +350 and -200. The effect under Equity is still +150 (Profit), because it is the result of the increase in cash (+R350) and the decrease in stock (-R200).

By this time learners are able to consider carefully the effect of a transaction on assets and equity. Introducing liabilities with a transaction such as buying a vehicle on credit, will be easy for them to grasp. With the necessary guidance, learners discover that an amount owed by the business creates a liability, the third element of the accounting equation.

Learners also have no problem with the next logical transaction, payment or part-payment of the relevant liability (creditor) and the resulting decrease in cash and liabilities. The accounting equation, Assets = Owner's equity + Liabilities, is now complete and the learners have experienced first hand where it originates from.

At this stage learners have an overall view of Accounting and the principles that have been discussed form the foundation for the work yet to be discussed. The effect of transactions on the accounting equation is an important accounting tool for logical reasoning in accounting and teachers will be well-advised to use the accounting equation as starting point for all new transactions.

It needs to be emphasised that, in addition to sales, there are more transactions where not only the effect of the transaction on the accounting equation, but also generally accepted accounting practice determines the entry. One such a transaction is the depreciation of a fixed asset and another is the purchase of merchandise when the periodic inventory system is in use.

When merchandise is bought, the asset Trading stock increases, no matter what inventory system is used. The fact that the Purchases account is debited when the periodic inventory system is in use, **does not change this**. So let it be emphasised once more: the entry does not affect the equation – the entry is a result of the effect of a transaction on the equation and, where applicable, generally accepted accounting practice.