

Accounting Equation

The accounting equation is the basic identity underlying the accounting process. The accounting equation says that the assets of a firm must equal the liabilities incurred to finance those assets and the amount of equity contributed by owners of that firm.

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Every transaction must satisfy this equation. If ever this equation is not in balance, it is an indication that a mistake has been made in the accounting process.

Satisfying this equation is the essence of double-entry bookkeeping, and it is what allows bookkeepers and accountants to discover mistakes relatively quickly before they compound, proliferate, and become much more difficult to sort out, track down, and correct. Bookkeeping and accounting became much more accurate with the invention of double-entry bookkeeping.