

April 27	Commission			April 30	Closing Balance	
		2,75,000			1,05,000 1,70,000 2,75,000	

What has been done is place the increases in cash on the left hand side (*i.e.*, Receipts side or Debit side) and the decreases on the right hand side (*i.e.*, Payments side or Credit side). The closing balance is ascertained by deducting the total of payments, ₹ 1,05,000 from the total of the left hand side, ₹ 2,75,000.

MEANING OF DEBIT AND CREDIT

Debit refers to the left side of an account and credit refers to the right side of an account. In the abbreviated form Dr. stands for debit and Cr. stands for credit. An item recorded on the debit side of an account is said to be debited to the account. An item recorded on the credit side of an account is said to be credited to the account.

Both debit and credit may represent either increase or decrease depending upon the nature of an account. The rules of debit and credit depend on the nature of account.

RULES OF DEBIT AND CREDIT

Under Double Entry System of accounting each transaction has two aspects. One aspect is debit, *i.e.*, receiving or incoming aspect. Another aspect is credit, *i.e.*, giving or outgoing aspect. *Debit and credit aspects of a transaction form the basis of Double Entry System*

Rules of Double Entry or Rules of Debit and Credit are formed on the basis of these two aspects in each of the business transactions. There are two approaches for deciding when to write on the debit side of account and when to write on the credit side of an account, i.e., which account is to be debited and which account is to be credited. The rules on the basis of which such decision is taken are called **Rules of Debit and Credit**.

CLASSIFICATION OF ACCOUNTS

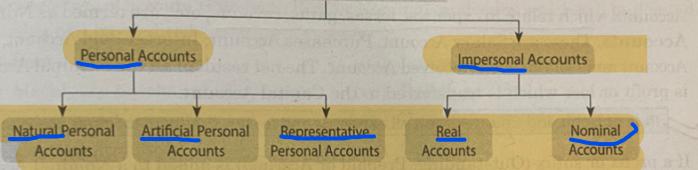
Accounts can be classified in two ways:

- A. Traditional Classification; and
- B. Modern Classification.

A. Traditional Classification

Under this classification, accounts are classified into two groups as shown below:

Traditional Classification of Accounts



Personal Accounts

1. Personal Accounts

Accounts which relate to persons, i.e., individuals, firms, companies, debtors or creditors etc., are Personal Accounts. Examples of Personal Accounts are the account of Ram & Co., a customer (Debtor), or the account of Jhaveri & Co., a supplier of goods (Creditor). Capital Account and Drawings Account of the proprietor. The main purpose of preparing a Personal Account is to determine the balance due to or due from persons or organisations.

Personal Accounts can be classified into three categories:

(i) Natural Personal Accounts

The term 'Natural Persons' means persons who are creations of God. Therefore, these will include accounts in individual name. For example, Ram's Account, Asha's Account, etc.

(ii) Artificial Personal Accounts

These accounts include accounts of corporate bodies or institutions which are recognised as persons in business dealings. For example, the account of a limited company, the account of a club or a cooperative society, etc.

(iii) Representative Personal Accounts

These are accounts which represent a certain person or a group of persons. For example, if rent is due to the landlord, an Outstanding Rent Account will be opened in the books. The Outstanding Rent Account represents the amount of rent payable to the landlord. Other examples of the Representative Personal Accounts are Prepaid Rent Account, Accrued Commission Account, Unearned Interest Account, etc.

Rule of Debit and Credit—Debit the receiver, Credit the giver.

2. Impersonal Accounts

Accounts which are not personal such as Machinery Account, Cash Account, Rent Account, etc., are termed as Impersonal Accounts. These can be further sub-divided into two accounts:

(i) Real Accounts

Real Accounts are the accounts which relate to tangible or intangible assets of the firm (excluding debtors). Examples of tangible assets are: land, building, investments, plant and machinery, stock or cash in hand. Examples of intangible assets are: goodwill, patents and trademarks.

Rule of Debit and Credit—Debit what comes in, Credit what goes out.

(ii) Nominal (Revenue or Expense) Accounts

Accounts which relate to expenses, losses, gains, revenue, etc., are termed as Nominal Accounts. These are Salary Account, Purchases Account, Interest Paid Account, Sales Account and Commission Received Account. The net result of all the Nominal Accounts is profit or loss which is transferred to the Capital Account.

Rule of Debit and Credit—Debit all expenses and losses, Credit all incomes and gains.

If a prefix or suffix (Outstanding, Prepaid or Accrued) is added to a Nominal Account, it becomes a Personal Account. The table given below explains the above:

Nominal Account	Personal Account
1. Interest A/c	Outstanding Interest A/c, Interest Received in Advance A/c, Prepaid Interest A/c
2. Rent A/c	Outstanding Rent A/c, Prepaid Rent A/c
3. Salary A/c	Outstanding Salaries A/c, Prepaid Salaries A/c
4. Commission A/c	Outstanding Commission A/c, Prepaid Commission A/c

Rules of Debit and Credit (Traditional Classification) at a Glance

<u>Types of Account</u>	<u>Account to be Debited</u>	<u>Account to be Credited</u>
1. Personal Account	Receiver	Giver
2. Real Account	What comes in	What goes out
3. Nominal Account	Expense and Loss	Income and Gain

~~Illustration 1.~~

~~Classify the following accounts into P, C, Dr or Cr.~~

- | | | accounts into Personal, Real and Nominal Accounts: |
|----------------------------|--|--|
| (i) Cash | asset so Real Acc | personal use are from drawing account of the real asset account |
| (ii) Bank | banks have personal accounts of ppl | (vii) Drawings
discount is a profit so nominal |
| (iii) Outstanding Salaries | | (viii) Discount Received |
| (iv) Sales | generate rev thus, Nominal; | (ix) Bad Debts Written off
bad debt is not expected to be paid back hence so nominal |
| (v) Accrued Interest | interest is nominal but accrued keyword made it personal | (x) Purchases
cause expense so nominal |
| (vi) Leasehold Property | property is an asset so real account | (xi) Bad Debts Recovered
(xii) Plant and Machinery
profit - nominal
asset- real |
| | | (xiii) Capital
company/owner's personal/artificial account |
| | | (xiv) Interest (Paid)
expense - nominal |
| | | (xv) Bank Overdraft
bank personal |
| | | (xvi) Prepaid Rent
prepaid, personal |
| | | (xvii) Carriage Inwards |
| | | (xviii) Goodwill
intangible asset - real account |

property is an asset so real account

Solution:

Personal Accounts	Real Accounts	Nominal Accounts
(ii) Bank	(i) Cash	(iv) Sales
(iii) Outstanding Salaries (<i>Rep.</i>)	(vi) Leasehold Property	(viii) Discount Received
(v) Accrued Interest	(xii) Plant and Machinery	(ix) Bad Debts Written off
(vii) Drawings	(xvii) Goodwill	(x) Purchases
(xiii) Capital		(xi) Bad Debts Recovered
(xv) Bank Overdraft		(xiv) Interest (Paid)
(xvi) Prepaid Rent		(xvii) Carriage Inwards

Each transaction involves two or more accounts. After ascertaining the accounts involved, it is decided which account is to be debited and which account is to be credited.

Illustration 2. To Do

State the nature of account (Personal, Real or Nominal) and show which will be debited and which will be credited:

- | | |
|--------------------------|-------------------------|
| (i) Rent received | (vi) Interest received |
| (ii) Machinery purchased | (vii) Building sold |
| (iii) Goods purchased | (viii) Discount allowed |
| (iv) Capital introduced | (ix) Goods sold |
| (v) Rent paid | |

Solution:

Accounts	Nature of Accounts	Debited/Credited
(i) Rent Received A/c	Nominal	Credited
(ii) Machinery A/c	Real	Debited
(iii) Purchases A/c	Nominal	Debited
(iv) Capital A/c	Personal	Credited
(v) Rent Paid A/c	Nominal	Debited
(vi) Interest Received A/c	Nominal	Credited
(vii) Building A/c	Real	Credited
(viii) Discount Allowed A/c	Nominal	Debited
(ix) Sales A/c	Nominal	Credited

Illustration 3.

From the following transactions, state the nature of accounts and state which account will be debited and which account will be credited:

- | | |
|---------------------------------------|----------|
| 1. Mohan started business with cash | 5,00,000 |
| 2. Purchased goods for cash | 1,00,000 |
| 3. Sold goods for cash | 1,50,000 |
| 4. Received interest from Ram in cash | 500 |
| 5. Sold goods to Ashok | 60,000 |
| 6. Purchased furniture for cash | 50,000 |
| 7. Paid wages | 20,000 |

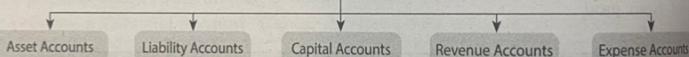
Solution:

ANALYSIS OF TRANSACTIONS					
Transactions	Accounts Involved	Nature of Account	Debit ₹	Credit ₹	Reason
1. Mohan started business with ₹ 5,00,000 in cash.	Cash Capital	Real Personal	5,00,000	5,00,000	Comes in Giver
2. Purchased goods for cash ₹ 1,00,000.	Purchases Cash	Nominal Real	1,00,000	1,00,000	Expenses Goes out
3. Sold goods for cash ₹ 1,50,000.	Cash Sales	Real Nominal	1,50,000	1,50,000	Comes in Income
4. Received interest from Ram in cash ₹ 500.	Cash Interest	Real Nominal	500	500	Comes in Income
5. Sold goods to Ashok for ₹ 60,000.	Ashok Sales	Personal Nominal	60,000	60,000	Receiver Income
6. Purchased furniture for cash ₹ 50,000.	Furniture Cash	Real Real	50,000	50,000	Comes in Goes out
7. Paid wages ₹ 20,000.	Wages Cash	Nominal Real	20,000	20,000	Expenses Goes out

B. Modern Classification

Under this classification, all the accounts are classified into the following five categories

Modern Classification of Accounts



1. Asset Accounts

Asset accounts are those accounts which relate to the economic resources of an enterprise such as Land and Building, Plant and Machinery, Furniture, Patents, Inventory, Bank and Cash, etc.

✓ Rule of Debit and Credit—Debit the increases and Credit the decreases.

2. Liability Accounts

Liability accounts are accounts of lenders, creditors for goods, outstanding expenses, etc.

✓ Rule of Debit and Credit—Debit the decreases and Credit the increases.

3. Capital Accounts

owner jo paisa laga raha hai

These are the accounts of proprietors/partners who have invested amount in the business. It includes both Capital and Drawings Account.

✓ Rule of Debit and Credit—Debit the decreases and Credit the increases.

4. Revenue Accounts

These are accounts of incomes and gains. Examples are: Sales, Discount received, Interest received, commission received, bad debts recovered, etc.

✓ Rule of Debit and Credit—Debit the decreases and Credit the increases.

5. Expense Accounts
These are the accounts of expenses. Examples are: Purchases, Rent Received, Salaries, etc.
✓ Rule of Debit and Credit—Debit the increases and Credit the decreases.

Another way to understand the classification:

Debit Increase (+)
Credit Decrease (-)

Debit Increase (+)
Credit Decrease (-)

Study the following accounts are debit or credit side:
Illustration 4.
On which side will the following accounts be debited or credited?
(i) Buildings
(ii) Purchases
(iii) Rent Received
(iv) Debitors

- Expense Accounts

These are the accounts of expenses or losses incurred in carrying the business. Examples are: Purchases, Wages, salaries, Depreciation, Discount allowed and Rent, etc.

Rule of Debit and Credit—Debit the increases and Credit the decreases.

Rules for Debit and Credit (Modern Classification) at a Glance

Types of Account	Accounts to be Debited	Accounts to be Credited
1. Asset Accounts	Increase	Decrease
2. Liability Accounts	Decrease	Increase
3. Capital Accounts	Decrease	Increase
4. Revenue Accounts	Decrease	Increase
5. Expense Accounts	Increase	Decrease

It should be noted that an increase in assets is favourable to the firm but an increase in expenses may not be so, even though in both the cases, increase will be recorded on the debit side. Similarly, increase in liabilities is, of course, not favourable but an increase in revenue is favourable. Nonetheless, both will be recorded on the credit side. Thus, the terms 'debit' and 'credit' should not be taken to mean respectively favourable and unfavourable—they merely describe the two sides of an account. In other words, *both debit and credit may represent either increase or decrease depending upon the nature of an account.*

Another way to understand the rules of debit and credit is as follows:

Rules of Debit and Credit			
Assets = Liabilities + Capital + Profits - Losses			
(1) Assets		(2) Liabilities	
Debit Increase (+)	Credit Decrease (-)	Debit Decrease (-)	Credit Increase (+)
(3) Capital		(4) Expense (Loss)	
Debit Decrease (-)		Credit Increase (+)	
(5) Revenue		(6) Income	
Debit Increase (+)	Credit Decrease (-)	Debit Decrease (-)	Credit Increase (+)

Study the following Illustrations and observe how increase and decrease in various accounts are debited and credited.

Illustration 4

On which side will the increase in following accounts be recorded? Also, mention the nature of the account on the basis of Modern Classification of Accounts:

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accou
1. A
2. D
3. V
4. W
5. R
6. D
7. P
8. P
9. P
10. P

Solut

Tra

Solution:

- | | | |
|----------------------|-------------------------|-----------------------|
| (i) Debit—Asset | (ii) Credit—Liability | (iii) Credit—Capital |
| (iv) Debit—Expense | (v) Debit—Expense | (vi) Debit—Asset |
| (vii) Credit—Revenue | (viii) Credit—Liability | (ix) Credit—Liability |
| (x) Debit—Asset | (xi) Debit—Asset | (xii) Debit—Asset |

Illustration 5.

Analyse the following transactions, state the nature of accounts and state which account will be debited and which account will be credited on the basis of Modern Classification of Accounts:

1. Dinesh started business with cash	5,00,000
2. Borrowed from Naresh	1,00,000
3. Purchased furniture for cash from Raj Furniture House	20,000
4. Purchased furniture from Delhi Safe	40,000
5. Purchased goods for cash	15,000
6. Purchased goods from Mahesh	30,000
7. Sold goods for cash to Karim	25,000
8. Sold goods to Shyam on credit	30,000
9. Cash received from Shyam	20,000
10. Cash paid to Mahesh	10,000

Solution:

ANALYSIS OF TRANSACTIONS

Transactions	Accounts Involved	Nature of Account	How Affected	Debit ₹	Credit ₹
1. Dinesh started business with cash ₹ 5,00,000.	Cash Capital	Asset Capital	Increased Increased	5,00,000	5,00,000
2. Borrowed from Naresh ₹ 1,00,000.	Cash Loan from Naresh	Asset Liability	Increased Increased	1,00,000	1,00,000
3. Purchased furniture for ₹ 20,000 in cash from Raj Furniture House.	Furniture Cash	Asset Asset	Increased Decreased	20,000	20,000
4. Purchased furniture from Delhi Safe for ₹ 40,000.	Furniture Delhi Safe	Asset Asset	Increased Increased	40,000	40,000
5. Purchased goods for cash ₹ 15,000.	Purchases Cash	Expense Asset	Increased Increased	15,000	15,000
6. Purchased goods from Mahesh ₹ 30,000.	Purchases Mahesh	Expense Liability	Increased Increased	30,000	30,000
7. Sold goods for cash to Karim ₹ 25,000.	Cash Sales	Asset Revenue	Increased Increased	25,000	25,000
8. Sold goods to Shyam on credit ₹ 30,000.	Shyam Sales	Asset Revenue	Increased Increased	30,000	30,000
9. Cash received from Shyam ₹ 20,000.	Cash Shyam	Asset Asset	Increased Decreased	20,000	20,000
10. Cash Paid to Mahesh ₹ 10,000.	Mahesh Cash	Liability Asset	Decreased Decreased	10,000	10,000

Illustration 6.

Analyse the following transactions, state the nature of accounts and state which account will be debited and which account will be credited:

1. Anuj started business with cash	1,00,000
2. Deposited cash into bank for opening an account	50,000
3. Withdrew cash for personal use	5,000
4. Withdrew cash from bank for office use	10,000
5. Received a cheque from debtor Shyam	5,000
6. Deposited Shyam's cheque next day.	
7. Paid to a creditor Mahesh by cheque	10,000
8. Paid salary to staff	20,000
9. Paid rent by cheque	6,000
10. Paid interest on loan	5,000

Solution:

ANALYSIS OF TRANSACTIONS

Transactions	Accounts Involved	Nature of Account	How Affected	Debit ₹	Credit ₹
1. Anuj started business with cash ₹ 1,00,000.	Cash Capital	Asset Capital	Increased Increased	1,00,000	1,00,000
2. Deposited cash into bank ₹ 50,000 for opening an account.	Bank Cash	Asset Asset	Increased Decreased	50,000	50,000
3. Withdrew cash for personal use ₹ 5,000.	Drawings Cash	Capital Asset	Decreased Decreased	5,000	5,000
4. Withdrew cash from bank for office use ₹ 10,000.	Cash Bank	Asset Asset	Increased Decreased	10,000	10,000
5. Received a cheque from debtor Shyam ₹ 5,000.	Cash/Cheque in Hand Shyam	Asset Asset	Increased Decreased	5,000	5,000
6. Deposited Shyam's cheque next day.	Bank Cash/Cheque in Hand	Asset Asset	Increased Decreased	5,000	5,000
7. Paid to a creditor Mahesh by cheque ₹ 10,000.	Mahesh Bank	Liability Asset	Decreased Decreased	10,000	10,000
8. Paid salary to staff ₹ 20,000.	Salary Cash	Expense Asset	Increased Decreased	20,000	20,000
9. Paid rent by cheque ₹ 6,000.	Rent Bank	Expense Asset	Increased Decreased	6,000	6,000
10. Paid interest on loan ₹ 5,000.	Interest Cash	Expense Asset	Increased Decreased	5,000	5,000