CHAPTER 5

Accounting Equation

LEARNING OBJECTIVES

This chapter would enable students to understand:

- ❑ Meaning of an Accounting Equation
- ❑ Effect of Transactions on Accounting Equation
- ❑ Process of Preparing Accounting Equation
- ❑ Rules for Accounting Equations
- ❑ Effect of Adjustment Transactions on Accounting Equation

MEANING OF AN ACCOUNTING EQUATION

Accounting Equation is a mathematical expression based on Dual Aspect Concept of Accounting.

Accounting Equation is based on the *Dual Aspect Concept* of accounting. It means every transaction has dual aspect or two aspects—debit and credit. It holds that for every debit there is a credit of equal amount and *vice versa*. It means, total claims (those of outsiders and of the proprietors) will always be equal to the total assets of the firm. The claims, also known as **equities**, are of two types:

1. Owner's equity or capital and
2. Liabilities or amounts due to outsiders (*i.e.*, Outsiders' Equity).

We can express it mathematically as follows:

Assets = Equities (Total Claims) *Or* Assets = Liabilities + Capital

Or Liabilities = Assets – Capital *Or* Capital = Assets – Liabilities

The above relationship is known as the **Accounting Equation** or the **Balance Sheet Equation**.

An Accounting Equation always holds true with every change that occurs due to a transaction entered into. It is because of the reason that it is based on the Dual Aspect Concept of accounting.

EFFECT OF TRANSACTIONS ON ACCOUNTING EQUATION

A transaction may affect either both sides of the equation by the same amount or one side of the equation only, by both increasing or decreasing it by equal amounts.

Transactions from the Accounting Equation viewpoint, can be divided into two, *i.e.*,

1. Transactions Affecting Two Items, and
2. Transactions Affecting More Than Two Items.

Let us discuss them in detail.

1. Transactions Affecting Two Items

As the title suggests, these are those transactions that affect two items of the accounting equation or Balance Sheet.

Transactions affecting opposite sides are:

(i) Increase in Asset, Increase in Liability

Transaction such as credit purchases increase asset (stock) and also increase liability (creditor). Similarly, Loan from bank increases asset (cash or bank) and also increases liability (Bank Loan).

(ii) Decrease in Liability, Decrease in Asset

Transaction of payment to a creditor decreases liability (creditor) and also reduces asset (cash or bank).

(iii) Increase in Asset, Increase in Owner's Capital

Introduction of capital by the proprietor increases asset (cash or bank) and also liability (owner's capital).

(iv) Decrease in Owner's Capital, Decrease in Asset

Drawings by the proprietor decrease liability (owner's capital) and also asset (cash or bank).

Transactions affecting same side but in opposite direction are:

(i) Increase in Asset, Decrease in Another Asset

Transactions such as cash purchases or receipt from debtors increase one asset (goods and cash or bank, respectively) and decrease another asset (cash or bank and debtors).

(ii) Decrease in Liability, Increase in Another Liability

Settlement of creditor by issue of Bill of Exchange decreases a liability (creditor) and increases another liability (Bill of Exchange).

2. Transactions Affecting More Than Two Items

Some transactions affect more than two items of the accounting equation or a Balance Sheet. For example, when a sale is made in cash for ₹ 30,000, it is made at cost (₹ 25,000) *plus* profit (₹ 5,000). Cost of goods (₹ 25,000) reduces asset (stock of goods); cash increases by ₹ 30,000 and the owner's capital increases by the profit (₹ 5,000). It should be noted that profit increases the owner's capital and loss decreases it.

PROCESS OF PREPARING ACCOUNTING EQUATION

The process of Accounting Equations begins with:

1. Ascertaining Assets, Liabilities or Capital effected by a transaction.
2. Deciding the effect (in terms of increase or decrease) of a transaction on Assets, Liabilities or Capital.
3. Recording the effect on the relevant side of the equation.

Let us take few transactions to understand the accounting equation.

Suppose, Rakesh starts business and the following successive transactions are entered into:

(1) He commences his business with ₹ 20,000 as Capital.

Effect: It means that the firm has assets totalling ₹ 20,000 in the form of cash and claims against the firm are also ₹ 20,000 in the form of capital.

The equation stands as follows:

	Assets	=	Liabilities	+	Capital
	Cash				Rakesh's
	₹		₹		₹
Capital Introduced	20,000	=	0	+	20,000

(2) Purchases furniture for ₹ 500 in cash.

Effect: It means cash in hand is reduced by ₹ 500 but a new asset (furniture) of the same amount has been purchased. Thus, total of assets remains unchanged.

The equation will now appear as follows:

	Assets			=	Liabilities	+	Capital
	Cash	+	Furniture				Rakesh's
	₹		₹		₹		₹
Old Balance	20,000	+	0	=	0	+	20,000
New Transaction	– 500	+	500	=	0	+	0
New Balance	19,500	+	500	=	0	+	20,000

It may be noted that the total assets remain equal to liabilities *plus* capital.

(3) Purchases goods for ₹ 1,000 in cash.

Effect: It means cash in hand is reduced by ₹ 1,000 and another asset, *i.e.*, stock has come into existence. However, total of assets remains unchanged.

The equation now will be as follows:

	Assets					=	Liabilities	+	Capital
	Cash	+	Furniture	+	Stock				Rakesh's
	₹		₹		₹		₹		₹
Old Balance	19,500	+	500	+	0	=	0	+	20,000
New Transaction	–1,000	+	0	+	1,000	=	0	+	0
New Balance	18,500	+	500	+	1,000	=	0	+	20,000

(4) Purchases goods for ₹ 2,000 on credit.

Effect: It means the stock has increased by ₹ 2,000 increasing the total assets to ₹ 22,000. A liability of ₹2,000 to the supplier of the goods (creditor) has arisen. The equation now will be as follows:

	Assets					=	Liabilities	+	Capital
	Cash	+	Furniture	+	Stock		Creditors	+	Rakesh's
	₹		₹		₹		₹		₹
Old Balance	18,500	+	500	+	1,000	=	0	+	20,000
New Transaction	0	+	0	+	2,000	=	2,000	+	0
New Balance	18,500	+	500	+	3,000	=	2,000	+	20,000

(5) Sold goods costing ₹ 2,500 on credit for ₹ 4,000.

Effect: It means a debtor has come into existence to the extent of ₹ 4,000. The stock is reduced only by ₹ 2,500, being the cost of goods sold. Net increase in assets, ₹ 1,500 (*i.e.*, ₹ 4,000 – ₹ 2,500) (profit) will be added to the capital.

The equation now will appear as follows:

	Assets							=	Liabilities	+	Capital
	Cash	+	Furniture	+	Stock	+	Debtors	=	Creditors	+	Rakesh's
	₹		₹		₹		₹		₹		₹
Old Balance	18,500	+	500	+	3,000	+	0	=	2,000	+	20,000
New Transaction	0	+	0	–	2,500	+	4,000	=	0	+	1,500
New Balance	18,500	+	500	+	500	+	4,000	=	2,000	+	21,500

(6) Paid ₹ 1,000 for rent and ₹ 5,000 for salaries.

Effect: It means cash in hand has reduced by ₹ 6,000; these are expenses and no asset comes into existence. Hence, capital will be reduced by this amount, as shown below:

	Assets							=	Liabilities	+	Capital
	Cash	+	Furniture	+	Stock	+	Debtors	=	Creditors	+	Rakesh's
	₹		₹		₹		₹		₹		₹
Old Balance	18,500	+	500	+	500	+	4,000	=	2,000	+	21,500
New Transaction	– 6,000	+	0	+	0	+	0	=	0	–	6,000
New Balance	12,500	+	500	+	500	+	4,000	=	2,000	+	15,000

(7) Rakesh withdraws ₹ 2,000 for his personal use.

Effect: Cash in hand is reduced by ₹ 2,000 and capital will also reduce by the same amount. The new Accounting Equation will be as follows:

	Assets							=	Liabilities	+	Capital
	Cash	+	Furniture	+	Stock	+	Debtors	=	Creditors	+	Rakesh's
	₹		₹		₹		₹		₹		₹
Old Balance	12,500	+	500	+	500	+	4,000	=	2,000	+	15,500
New Transaction	– 2,000	+	0	+	0	+	0	=	0	–	2,000
New Balance	10,500	+	500	+	500	+	4,000	=	2,000	+	13,500

It will be observed from above that the total of assets will always be equal to the total of liabilities and the capital. The last equation stated above can also be presented in the form of a statement, *i.e.*, **Balance Sheet** as given below:

BALANCE SHEET OF RAKESH *as at ...*

Liabilities		₹	Assets	₹
Creditors		2,000	Cash	10,500
Capital	15,500		Stock	500
Less: Drawings	2,000	13,500	Debtors	4,000
			Furniture	500
		15,500		15,500

The Balance Sheet shows the sources from which funds have been obtained—the left hand side does that; in the above case, ₹ 2,000 have been obtained from outsiders and ₹ 13,500 have been contributed by the proprietor. The other side known as **assets side** shows how the funds stand invested.

A conclusion apparent from the transactions given above is that every transaction has two sided effect. In other words, the Dual Aspect Concept will always hold good. A reduction or increase in an asset will have a corresponding effect on liabilities or capital. This is because of the rule that every receiver is a giver and every giver is a receiver.

Illustration 1.

Show Accounting Equation on the basis of the following transactions:

1. Sunil started business with cash ₹ 1,00,000.
2. Purchased goods in cash ₹ 50,000.
3. Purchased furniture from M/s Samrat Furnitures ₹ 20,000.
4. Sold goods costing ₹ 25,000 for ₹ 35,000 against cash.
5. M/s Samrat Furnitures was paid in cash.

Solution:

S. No.	Transactions	Assets ₹	=	Liabilities ₹	+	Capital ₹
1.	Sachin started business with cash	1,00,000	=	0	+	1,00,000
2.	Purchased goods in cash	+ 50,000				
		- 50,000				
	New Equation	1,00,000	=	0	+	1,00,000
3.	Purchased furniture from M/s Samrat Furnitures (Note 1)	+ 20,000	=	20,000	+	0
	New Equation	1,20,000	=	20,000	+	1,00,000
4.	Sold goods costing ₹ 25,000	- 25,000				
	for ₹ 35,000 (Note 2)	+35,000	=	0	+	10,000
	New Equation	1,30,000	=	20,000	+	1,10,000
5.	Paid to M/s Samrat Furnitures	- 20,000	=	- 20,000	+	0
	New Equation	1,10,000	=	0	+	1,10,000

Notes: 1. The transaction with M/s Samrat Furnitures (₹ 20,000) is a credit transaction since it is not stated to be cash payment.

2. Sale of goods has resulted in a profit of ₹ 10,000. It has been added to capital because net profit at the year end is transferred to Capital Account.

Illustration 2.

Prepare the Accounting Equation on the basis of the following:

1. Started business with cash ₹ 70,000.
2. Credit purchases of goods ₹ 18,000.
3. Payment made to creditors in full settlement ₹ 17,500.
4. Purchase of machinery for cash ₹ 20,000.

(KVS)

Solution:

S. No.	Transactions	Assets					=	Liabilities	+	Capital
		Cash (₹)	+	Stock (₹)	+	Machinery (₹)	=	Creditors (₹)	+	Capital (₹)
1.	Started business with cash ₹ 70,000	70,000	+	0	+	0	=	0	+	70,000
2.	Credit Purchases of goods ₹ 18,000	0	+	18,000	+	0	=	18,000	+	0
	New Equation	70,000	+	18,000	+	0	=	18,000	+	70,000
3.	Payment made to creditors in full settlement	-17,500	+	0	+	0	=	-18,000	+	500
	New Equation	52,500	+	18,000	+	0	=	0	+	70,500
4.	Purchase of machinery for cash	-20,000	+	0	+	20,000	=	0	+	0
	New Equation	32,500	+	18,000	+	20,000	=	0	+	70,500

Illustration 3.

Prepare the Accounting Equation on the basis of the following:

		₹
1.	Rakesh commenced business with cash.	1,50,000
2.	Furniture purchased for cash.	20,000
3.	Purchased goods from Mahesh on credit.	25,000
4.	Sold goods (costing ₹ 10,000) to Mohan for cash.	14,000
5.	Additional capital introduced.	20,000
6.	Commission received in advance.	2,000
7.	Paid to creditor (Mahesh) in full settlement.	22,500
8.	Sold goods (costing ₹ 15,000) for ₹ 18,000 out of which ₹ 5,000 received in cash.	
9.	Depreciation on furniture provided @ 10%.	

Solution:

S. No.	Transactions	Assets: Cash ₹	+ Furniture ₹	+ Stock ₹	+ Debtors ₹	= Liabilities: Creditors ₹	+ Commin. Recd. in Advance ₹	+ Capital: Capital ₹
1.	Rakesh Commenced business with cash	1,50,000	0	0	0	0	0	1,50,000
2.	Furntiure purchased for cash	–20,000	20,000	0	0	0	0	0
	New Equation	1,30,000	20,000	0	0	0	0	1,50,000
3.	Purchased goods from Mahesh	0	0	25,000	0	25,000	0	0
	New Equation	1,30,000	20,000	25,000	0	25,000	0	1,50,000
4.	Cash Sales (Profit ₹ 14,000 – ₹ 10,000)	14,000	0	– 10,000	0	0	0	4,000
	New Equation	1,44,000	20,000	15,000	0	25,000	0	1,54,000
5.	Additional capital introduced	20,000	0	0	0	0	0	20,000
	New Equation	1,64,000	20,000	15,000	0	25,000	0	1,74,000
6.	Commission received in advance	2,000	0	0	0	0	2,000	0
	New Equation	1,66,000	20,000	15,000	0	25,000	2,000	1,74,000
7.	Paid to creditor Mahesh ₹ 22,500 in full settlement	–22,500	0	0	0	–25,000	0	2,500
	New Equation	1,43,500	20,000	15,000	0	0	2,000	1,76,500
8.	Sold goods (costing ₹ 15,000) for ₹ 18,000 out which ₹ 5,000 received in cash	5,000	0	– 15,000	13,000	0	0	3,000
	New Equation	1,48,500	20,000	0	13,000	0	2,000	1,79,500
9.	Depreciation on furniture @ 10% on ₹ 20,000	0	– 2,000	0	0	0	0	– 2,000
	New Equation	1,48,500	18,000	0	13,000	0	2,000	1,77,500

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Illustration 4.

Present the following transactions in the Accounting Equation:

		₹			₹
1.	Ram started business with cash ₹ 25,000 and cheque of ₹ 25,000 to open a Bank Account		6.	Paid rent	200
2.	Purchased goods on credit	4,000	7.	Received interest from Bank	100
3.	Purchased goods for cash	1,000	8.	Sold goods on credit (cost ₹ 500)	700
4.	Purchased furniture for cash	500	9.	Paid to creditors	400
5.	Withdrew cash for personal use from Bank	700	10.	Paid Petty Expenses	200

Solution:

S. No.	Transactions	Assets									=	Capital	+	Liabilities
		Cash ₹	+	Bank ₹	+	Stock ₹	+	Furniture ₹	+	Debtors ₹	=	Capital ₹	+	Creditors ₹
1.	Ram started business with cash ₹ 25,000 and cheque of ₹ 25,000	25,000	+	25,000	+	0	+	0	+	0	=	50,000	+	0
2.	Purchased goods on credit for ₹ 4,000	0	+	0	+	4,000	+	0	+	0	=	0	+	4,000
	New Equation	25,000	+	25,000	+	4,000	+	0	+	0	=	50,000	+	4,000
3.	Purchased goods for cash for ₹ 1,000	−1,000	+	0	+	1,000	+	0	+	0	=	0	+	0
	New Equation	24,000	+	25,000	+	5,000	+	0	+	0	=	50,000	+	4,000
4.	Purchased furniture for cash for ₹ 500	−500	+	0	+	0	+	500	+	0	=	0	+	0
	New Equation	23,500	+	25,000	+	5,000	+	500	+	0	=	50,000	+	4,000
5.	Withdrew cash for personal use ₹ 700 from Bank	0	−	700	+	0	+	0	+	0	=	−700	+	0
	New Equation	23,500	+	24,300	+	5,000	+	500	+	0	=	49,300	+	4,000
6.	Paid rent ₹ 200 (Note 1)	−200	+	0	+	0	+	0	+	0	=	−200	+	0
	New Equation	23,300	+	24,300	+	5,000	+	500	+	0	=	49,100	+	4,000
7.	Received interest ₹ 100 (Note 2)	0	+	100	+	0	+	0	+	0	=	100	+	0
	New Equation	23,300	+	24,400	+	5,000	+	500	+	0	=	49,200	+	4,000
8.	Sold goods costing ₹ 500 for ₹ 700 on credit (Note 3)	0	+	0	−	500	+	0	+	700	=	200	+	0
	New Equation	23,300	+	24,400	+	4,500	+	500	+	700	=	49,400	+	4,000
9.	Paid to creditors ₹ 400	−400	+	0	+	0	+	0	+	0	=	0	−	400
	New Equation	22,900	+	24,400	+	4,500	+	500	+	700	=	49,400	+	3,600
10.	Paid Petty Expenses ₹ 200 (Note 4)	−200	+	0	+	0	+	0	+	0	=	−200	+	0
	New Equation	22,700	+	24,400	+	4,500	+	500	+	700	=	49,200	+	3,600

April	1	[illegible]							1,05,000
					April	30	Closing Balance		1,70,000
				2,75,000					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

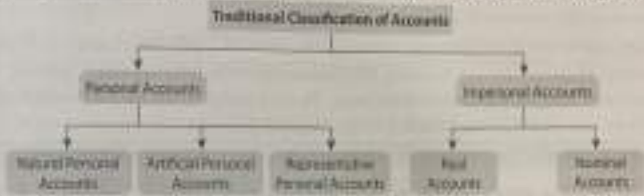
Accounts can be classified in two ways:

A. Traditional Classification; and

B. Modern Classification.

A. Traditional Classification

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



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, Expense 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

Types of Account	Account to be Debited	Account to be Credited
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 Personal, Real and Nominal Accounts:

(i) Cash
(ii) Bank
(iii) Outstanding Salaries
(iv) Sales
(v) Accrued Interest
(vi) Leasehold Property
(vii) Drawings
(viii) Discount Received
(ix) Bad Debts Written off
(x) Purchases
(xi) Bad Debts Recovered
(xii) Plant and Machinery
(xiii) Capital
(xiv) Interest (Paid)
(xv) Bank Overdraft
(xvi) Prepaid Rent
(xvii) Carriage Inward
(xviii) Goodwill

Solution:

Personal Accounts	Real Accounts	Nominal Accounts
(ii) Bank	(i) Cash	(iii) Sales
(iv) Outstanding Salaries [illegible]	(vi) Leasehold Property	(viii) Discount Received
(v) [illegible]	(xiii) Plant and Machinery	(ix) Bad Debts Written off
(xi) Drawings	(xviii) Goodwill	(x) Purchases
(xii) Capital		(xi) Bad Debts Recovered
(xiv) Bank Overdraft		(xvi) Interest Paid
(xv) [illegible]		(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.

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

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

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 ₹ 3,00,000 in cash.	Cash Capital	Real Personal	3,00,000	3,00,000	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 firm 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

- Asset Accounts
- Liability Accounts
- Capital Accounts
- Revenue Accounts
- Expense 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

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 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	
Debit Decrease (−)	Credit Increase (+)

(4) Expense (Loss)		(5) Revenue	
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:

(i) Buildings A/c (ii) Creditor's A/c (iii) Abhishek (Proprietor)
(iv) Purchases A/c (v) Carriage Inwards A/c (vi) Cash A/c
(vii) Rent Received A/c (viii) Interest Payable A/c (ix) Bills Payable A/c
(x) Debtors A/c (xi) Accrued Commission A/c (xii) Bills Receivable A/c

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 Liability	Increased Increased	40,000	40,000
5. Purchased goods for cash ₹ 15,000	Purchases Cash	Expense Asset	Increased Decreased	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

SIGNIFICANCE OF DEBIT AND CREDIT BALANCE IN ACCOUNTS

Some accounts show debit balances and some credit balances. These balances are as follows:

1. *Credit* balance in the *Capital Account* means amount due to the owner of the business. In other words, the amount invested in the business by the owner.
2. *Credit* balance in Bank Loan Account, Suppliers Account, etc., means amount payable by the business, *i.e.*, liability of the business.
3. *Debit* balance in Cash Account, Bank Account, Debtor's Account, means Cash in Hand, Cash at Bank, and amount receivable against sale respectively.
4. *Credit* balance in Discount Received Account, Interest Received Account, etc., means income earned by the business.
5. *Debit* balance in Discount Allowed Account, Salary Account, Rent Account, Interest Paid Account, etc., means expenses incurred by the business.

So, we can briefly say that:

(*a*) A debit balance is either an asset (cash, bank, etc.) or an expense (salary, rent, etc.); and

(*b*) A credit balance shows the income earned or liability or the amount invested by the proprietor.

Balancing an account is necessary to ascertain the net effect of all transactions posted to that account during a given period.

Illustration 7.

Prepare a 'T' shape account of furniture and enter the following transactions:

	₹		₹
1. Furniture purchased	50,000	2. Furniture sold—costing	10,000
3. Furniture purchased	15,000	4. Old furniture discarded	5,000
5. Depreciation on furniture	3,000		

Solution:

Furniture is an Asset Account, an increase in the amount of furniture is recorded on the debit side, while a decrease on the credit side.

Dr. FURNITURE ACCOUNT Cr.

Increase (+)	₹	Decrease (–)	₹
1. Cash—Furniture Purchased	50,000	2. Cash—Sale of Furniture	10,000
3. Cash—Furniture Purchased	15,000	4. Furniture Discarded	5,000
		5. Depreciation on Furniture*	3,000
		6. Balance	47,000
	65,000		65,000

*Depreciation is a permanent and continuous decrease in the book value of fixed assets due to use, effluxion of time, obsolescence, etc.

Illustration 8.

Open a 'T' shape account of a creditor, Mohan, and write the following transactions on the proper side:

	₹
1. Purchased goods from Mohan on credit	50,000
2. Paid to Mohan	30,000
3. Goods returned to Mohan	3,000
4. Again purchased goods from Mohan on credit	10,000

Solution:

Mohan's Account (Creditor) is a Liability Account, an increase is recorded on the credit side while a decrease is recorded on the debit side.

Dr. MOHAN'S (CREDITOR) ACCOUNT Cr.

Decrease (–)	₹	Increase (+)	₹
2. Cash Paid	30,000	1. Purchases	50,000
3. Goods Returned (Returns Outward)	3,000	4. Purchases	10,000
5. Balance	27,000		
	60,000		60,000

Illustration 9.

Write up a 'T' shape Account of Gaurav, a debtor, from the following transactions:

	₹
1. Goods sold to Gaurav	80,000
2. Cash received from Gaurav	30,000
3. Discount allowed to Gaurav	2,000
4. Goods sold for Cash to Gaurav	10,000
5. Cheque received from Gaurav	20,000
6. Sales Return by Gaurav	5,000

Solution:

Gaurav's Account (Debtor) is an Asset Account, an increase is recorded on the debit side, while a decrease is recorded on the credit side.

Dr. GAURAV'S ACCOUNT Cr.

Particulars	₹	Particulars	₹
1. Sales	80,000	2. Cash	30,000
		3. Discount Allowed	2,000
		5. Bank (Cheque Received)	20,000
		6. Sales Return	5,000
		7. Balance	23,000
	80,000		80,000

Note: 4th transaction will not be recorded in Gaurav's Account as goods have been sold in cash.

Illustration 10.

Write the following transactions in Debtor's Account, Creditor's Account and Cash Account:

	₹		₹
1. Cash sales	50,000	2. Sold goods to X on credit	80,000
3. Cash received from X	56,000	4. Purchased goods from Y on credit	44,000
5. Paid to Y	30,000	6. Cash purchases from Y	16,000

Solution:

Dr. CASH ACCOUNT Cr.

Particulars	₹	Particulars	₹
1. Sales	50,000	5. *Y* (Creditor)	30,000
3. *X* (Debtor)	56,000	6. Purchases	16,000
		Balance	60,000
	1,06,000		1,06,000

Dr. *X*'S (DEBTOR) ACCOUNT Cr.

Particulars	₹	Particulars	₹
2. Sales	80,000	3. Cash Received	56,000
		Balance	24,000
	80,000		80,000

Dr. *Y*'S (CREDITOR) ACCOUNT Cr.

Particulars	₹	Particulars	₹
5. Cash Paid	30,000	4. Purchases	44,000
Balance	14,000		
	44,000		44,000

Illustration 11.

From the following particulars, prepare the account of Devender, the proprietor of a business:

	₹
(*i*) Capital introduced	30,000
(*ii*) Drawings made by him	6,500
(*iii*) Further Capital introduced	22,000
(*iv*) Profit for the period	7,500

Balance the same and explain what the closing balance indicates.

Solution:

Devender's Capital Account is a Capital Account, an increase is recorded on the Credit side, while a decrease is recorded on the debit side.

Dr. DEVENDER'S CAPITAL ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Drawings A/c	6,500	By Cash A/c—Capital	30,000
To Balance *c/d*	53,000	By Cash A/c—Capital	22,000
		By Profit & Loss A/c	7,500
	59,500		59,500
		By Balance *b/d*	53,000

Note: Proprietor's Capital Account has a credit balance of ₹ 53,000 which indicates that the business owes him this amount.

Business transactions that can be measured in terms of money are recorded in the books of account on the basis of evidences such as bills of purchases, invoices for sales, agreements, debit and credit notes which are known as **source documents**. These books of account are broadly divided into two, *i.e.*, (1) Journal and (2) Ledger.

Journal is a book in which transactions are recorded in the order in which they are entered, *i.e.*, in a chronological order. Journal is called the **Book of Original Entry** since all transactions are initially recorded in it. Rules of debit and credit are applied to each transaction at the time of recording in the books of account. The transactions recorded in the Journal are transferred (posted) in Ledger Accounts.

Ledger is called **Principal Book** of accounts as any accounting information can be extracted from it.

Both Journal and Ledger are essential to complete a system of accounting.

JOURNAL

Meaning

Journal is a book of primary entry or a book of original entry in which transactions are first recorded in a chronological order from the accounting vouchers that are prepared on the basis of source documents, *i.e.*, cash memo, invoices, purchase bills, etc.

The transactions can be recorded in one Journal. Alternatively, separate Journals may be maintained to record particular type of transactions, *e.g.*, credit purchases may be recorded in Purchases Journal; credit sales in Sales Journal, purchases return in Purchases Return Journal, and so on. These separate Journals are called **Special Journals** or **Special Purpose Books** and often called as **Subsidiary Books**.

Definitions

"*The basic book of accounting is called* ***Journal****. Precisely it is the book of prime entry which means—Day Book. Trader records his total daily transactions in it. The process of recording the transactions into Journal is called* ***Journalising****.*" —**Rowland**

"*A Journal is a chronological record of financial transactions of a business.*" —**M.J. Keeler**

Terms or Expressions Used for Journal

1. *Book of Original Entry*

Journal is called a **Book of Original Entry** (also called **Book of Primary Entry**) because a transaction is first recorded or written in this book and thereafter transferred, *i.e.*, posted in the Ledger Accounts.

2. *Journal Entry*

An entry recorded in the Journal is called a **Journal Entry**.

3. *Journalising*

The process of recording a transaction in a Journal is known as **Journalising**.

4. *Posting*

The transfer of Journal entry to Ledger Accounts is called **Posting**.

Functions of Journal

1. *Maintaining Chronological Record of Transactions*

Transactions are recorded in the Journal in the order they take place on day-to-day basis.

2. *Analysing the Transaction*

Each transaction is analysed and it is determined which account or accounts are to be debited and credited. Accounts debited and credited are recorded in the Journal. It is called **Journal entry**.

3. *Basis for Ledger Posting*

Journal entry recorded in the Journal Book is posted in relevant Ledger Account.

Characteristics or Features of Journal

1. Day-to-day transactions are recorded in a Journal in a chronological order, *i.e.*, in the order or sequence they are entered.

2. It is a book of original entry in which transactions are written before they are posted in the ledger accounts.
3. It records both aspects of a transaction, *i.e.*, debit and credit using rules of debit and credit under Double Entry System of Book Keeping.
4. After the Journal entry, narration is given which is a description of the entry.
5. Journal is a record of transactions which shows complete detail of a transaction in one entry.
6. Journalising is a process of recording a transaction in the Journal and the form in which it is recorded is known as a **Journal Entry**.

Advantages of Journal

1. *Provides Accounting Data in Chronological Order*

Transactions in the Journal are recorded in the sequence or order they are entered. Thus, it is datewise accounting record in chronological order.

2. *Possibility of Error Reduces*

Possibility of error is reduced as the amounts to be debited and credited are written side by side and the two can be compared to verify whether they are equal or not. If the accounts are written up directly in the ledger account, there is a possibility of wrong amount being written or the amount written on the debit side may be more or less than on the credit side.

3. *Explanation of the Transaction*

Along with the entry in the Journal, narration is written explaining the entry for understanding the entry later.

4. *Ledger Posting of Transactions*

Journal is the basis for posting of transactions in ledger accounts. Debit and Credit aspects of transactions are marked as *Debit* and *Credit*, making posting of transactions in ledger accounts easy.

5. *Locating Errors*

Locating errors becomes easy if the Trial Balance does not match.

Limitations of Journal

1. *Not suitable for Large Volume of Transactions*

Recording all transactions in a Journal is feasible if the number of transactions are not many. In case, the number of transactions is large, it becomes inconvenient to maintain one Journal to record all the transactions because the Journal Book will become voluminous. This limitation can be overcome by maintaining Subsidiary Books such as Purchases Journal, Sales Journal, etc. Subsidiary Books are discussed in a later chapter.

2. *Cash Balance is not Revealed*

Recording of all transactions in Journal means cash balance can be known after posting of cash transactions in Cash Account, which is a lengthy process. However, this limitation can be overcome by maintaining Special Journal for cash transactions, *i.e.*, Cash Book.

3. *Not a Substitute of Ledger*

Information relating to a particular head is known after posting of transactions in ledger accounts. Journal, thus, is not a substitute of ledger.

Format of Journal

The format of Journal is as follows:

JOURNAL

Date (1)	Particulars (2)	L.F. (4)	Dr. Amount (₹) (5)	Cr. Amount (₹) (6)
	....Dr. To .... (...(3)...)			

1. *Date*

In this column, the transaction date is written.

2. *Particulars*

According to Dual Aspect Concept of accounting, both debit and credit aspects of a transaction are recorded. Name of the account to be debited is written first followed by the word 'Dr.' written close to the Right-hand margin line, while the name of the account to be credited is written in the next line preceded by the word 'To'.

3. *Narration*

A brief description of the transaction is also written after the entry.

4. *Ledger Folio (L.F.)*

In this column the number of Ledger page is written to which the debit and credit aspects of the transaction is posted.

5. *Debit Amount*

In this column, the amount debited is written.

6. *Credit Amount*

In this column, the amount credited is written.

Note: All the columns, except the Ledger Folio (L.F.) column, are completed at the time of Journalising. The Ledger Folio (L.F.) is written at the time of posting the transaction in Ledger Accounts.

C C D
L C D
A D C
E D C
R C D

Personal: Debit the receiver and Credit the giver.
Real: Debit what comes in and Credit what goes out.
Nominal: Debit all expenses and losses and Credit all incomes and gains.

Modern Classification of Accounts

Capital: *Increase* in capital is credited and *Decrease* is debited.
Liabilities: *Increase* in liabilities is credited and *Decrease* is debited.
Assets: *Increase* in assets is debited and *Decrease* is credited.
Losses and Expenses: *Increase* in losses and expenses is debited and *Decrease* is credited.
Revenue and Income: *Increase* in revenue and income is credited and *Decrease* is debited.

Let us take few simple examples to understand how a transaction is recorded in a Journal.

Examples:

1. Dutta started business and introduced capital of ₹ 1,00,000.
   The transaction is recorded by passing the following Journal entry:

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bank or Cash A/c	...Dr.		1,00,000	
	To Capital A/c				1,00,000
	(Amount invested in business)				

Reason for Debit and Credit:

(i) *First aspect of the transaction is cheque or cash brought by Dutta. Bank/Cash Account is debited because the firm has received cheque or cash. Bank Account is debited, it being a Personal Account (Under Traditional Classification), and the rule 'Debit the Receiver and Credit the Giver' is applied.*

Cash Account is debited, it being a Real Account (Under Traditional Classification), and the rule 'Debit what comes in and Credit what goes out' is applied. Bank/Cash Account being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.

(ii) *Second aspect of the transaction is introduction of capital by Dutta. Capital Account is credited because Dutta has brought capital. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. It is a Capital Account (Under Modern Classification), the rule 'Increase in capital is credited and decrease debited' is applied.*

2. Purchased furniture for office from Raj Furniture for ₹ 10,000, paid by cheque or in cash.
   The transaction is recorded by passing the following Journal entry:

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Furniture A/c	...Dr.		10,000	
	To Bank or Cash A/c				10,000
	(Furniture purchased against cheque/cash)				

Reason for Debit and Credit:

(i) *First aspect of the transaction is purchase of furniture. Furniture Account is debited because the firm has purchased furniture, i.e., an asset is purchased. It is a Real Account (Under Traditional Classification), the rule 'Debit what comes in and Credit what goes out' is applied. It being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

(ii) *Second aspect of the transaction is payment for furniture by cheque or in cash. Bank or Cash Account is credited because the firm has paid by cheque or in cash for the furniture. If Bank Account is credited, it being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. If Cash Account is credited, it being a Real Account (Under Traditional Classification), the rule 'Debit what comes in and Credit what goes out' is applied. Bank/Cash Account being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

Meaning of Goods

Goods means the items that are purchased for manufacture, *i.e.*, raw materials or items for the purpose of resale. For example, T.V., Mobile Phones, Computers, etc., purchased for resale, is termed as **goods** and is debited to Purchases Account. On the other hand, if computer is purchased to be used in business, it will be debited to 'Computer Account' as an asset and not to Purchases Account.

Following accounts are associated with the purchase and sale of goods:

1. ***Purchases Account:*** At the time of purchase of goods 'Purchases Account' is debited following the rule for Expense Accounts, *i.e.*, Increase in expense is debited and Decrease credited.
2. ***Sales Account:*** At the time of sale of goods 'Sales Account' is credited following the rule for Revenue Accounts, *i.e.*, Increase in revenue is credited and Decrease debited.
3. ***Purchases Return Account:*** At the time of purchases being returned 'Purchases Return Account' is credited and not 'Purchases Account'. It is credited with a purpose to know total value of goods returned by the firm.
   At the time of preparing the Profit & Loss Account (discussed in a later chapter), Purchases Return Account is deducted from Purchases Account to show the purchases at net amount.
   It is credited following the rule for Expense Accounts, *i.e.*, Increase in Expenses is debited and Decrease credited.
4. ***Sales Return Account:*** At the time of goods sold being returned, 'Sales Return Account' is debited and not 'Sales Account'. It is credited with a purpose to know total value of goods sold having been returned to the firm.
   At the time of preparing Profit & Loss Account, Sales Return Account is deducted from Sales Account to show Sales at net amount.
   It is debited following the rule for Revenue Accounts, *i.e.*, Increase in revenue is credited and Decrease debited.
5. ***Closing Stock Account:*** It is the value of stock remaining unsold.
   It is valued at Cost or Net Realisable Value (Market Value), whichever is less.

3. Purchased goods for ₹ 50,000 against cheque.

The transaction is recorded by passing the following Journal entry:

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Purchases A/c	...Dr.		50,000	
	To Bank A/c				50,000
	(Goods purchased and cheque issued)				

Reason for Debit and Credit:

(i) *First aspect of the transaction is purchase of goods. Purchases Account is debited because the firm has purchased goods. It being a Nominal Account (Under Traditional Classification), the rule 'Debit all expenses and losses, Credit all incomes and gains' is applied. It being an Expense Account (Under Modern Classification), the rule 'Increase in expenses is debited and decrease credited' is applied.*

(ii) *Second aspect of the transaction is payment of goods purchased by cheque. Bank Account is credited because the firm has paid by cheque for purchases of goods. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. It being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

4. Sold goods for ₹ 25,000 against cheque.

The transaction is recorded by passing the following Journal entry:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c ...Dr.		25,000	
	To Sales A/c			25,000
	(Goods sold and cheque received)			

Reason for Debit and Credit:

(i) *First aspect of the transaction is receiving cheque of ₹ 25,000 against sale. Bank Account is debited because the firm has received cheque against the sale. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. It being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

(ii) *Second aspect of the transaction is sales having been made. Sales Account is credited because the firm has sold goods. It being a Nominal Account (Under Traditional Classification), the rule 'Debit all expenses and losses and Credit all incomes and gains' is applied. It being a Revenue Account (Under Modern Classification), the rule 'Increase in revenue is credited and decrease debited' is applied.*

5. Paid salary ₹ 50,000 for the month of December, 2021 to staff by cheque.

The transaction is recorded by passing the following Journal entry:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Salaries A/c ...Dr.		50,000	
	To Bank A/c			50,000
	(Salary paid to staff by cheque for the month of December, 2021)			

Reason for Debit and Credit:

(i) *First aspect of the transaction is that expense (salaries) is incurred. Salaries Account is debited because the firm has paid for an expense (salaries). It being a Nominal Account (Under Traditional Classification), the rule 'Debit all expenses and losses and Credit all incomes and gains' is applied. It being an Expense Account (Under Modern Classification), the rule 'Increase in expenses is debited and decrease credited' is applied.*

(ii) *Second aspect of the transaction is that salary is paid to staff by cheque. Bank Account is credited because the firm has paid salaries by cheque. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver', is applied. Bank being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

6. Received ₹ 10,000 from Amit (Debtor).

The transaction is recorded by passing the following Journal entry:

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bank or Cash A/c	...Dr.		10,000	
	To Amit's (Debtor) A/c				10,000
	(Cash received from Amit)				

Reason for Debit and Credit:

(i) *First aspect of the transaction is receipt of ₹ 10,000 from Amit. Bank or Cash Account is debited because the firm has received the amount. If Bank Account is debited, it being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver', is applied. If Cash Account is debited, it being a Real Account (Under Traditional Classification), the rule 'Debit what comes in and Credit what goes out', is applied. Bank/Cash Account is an Asset Account (Under Modern Classification), the rule 'Increase in asset is debited and decrease credited' is applied.*

(ii) *Second aspect of the transaction is that Amit (Debtor) has paid the amount. Amit's Account is credited because the firm has received cash from Amit which is an asset. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. It being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*

7. Paid cash to Sujit (Creditor) ₹ 5,000.

The transaction is recorded by passing the following Journal entry:

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Sujit's (Creditor) A/c	...Dr.		5,000	
	To Cash A/c				5,000
	(Cash paid to Sujit, a creditor)				

Reason for Debit and Credit:

(i) *First aspect of the transaction is reduction in liability towards creditor. Creditor's Account is debited because the firm has paid the liability to a creditor. It being a Personal Account (Under Traditional Classification), the rule 'Debit the Receiver and Credit the Giver' is applied. It being a Liability Account (Under Modern Classification), the rule 'Increase in liability is credited and decrease debited' is applied.*

(ii) *Second aspect of the transaction is payment of ₹ 5,000 in cash to Sujit (Creditor). Cash Account is credited because the firm has paid cash to a creditor. It being a Real Account (Under Traditional Classification), the rule 'Debit what comes in, Credit what goes out' is applied. It being an Asset Account (Under Modern Classification), the rule 'Increase in assets is debited and decrease credited' is applied.*