The accounting equation grid discussed in Section 1.4 displays the transactions in an easy-to-read format in terms of the accounts impacted and the related amounts. However, this layout becomes a bit cumbersome when a large number of transactions are involved. The accounting process is streamlined by instead using two record keeping processes for analyzing, classifying and recording transactions. These are the **journal** and the **ledger**.

Financial transactions are written down throughout the accounting period as they happen in a record book called the **journal.**

This is a sample of a few rows in a journal. It has four columns:*Date, Account, Debit, Credit.*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | | | |
| **Date** | **Account** |  | **Debit** | **Credit** |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |

[Notes Box]

*“In the journal, the column heading* ***Debit*** *means “left” and* ***Credit*** *means “right” in terms of the column where an account’s dollar amount should be entered.”*

## Rules of Debit and Credit

Whether an account’s amount should be entered in the debit column or the credit column is based on (1) the type of account it is and (2) whether the account is increasing or decreasing. The following table summarizes the rules of debit and credit for commonly used accounts.



|  |  |  |  |
| --- | --- | --- | --- |
| ACCOUNT  TYPE | ACCOUNTS | DEBIT | CREDIT |
| **Asset** | Cash Accounts Receivable  Equipment Building Land | ↑ | ↓ |
| **Contra Asset** | Accumulated Depreciation | ↓ | ↑ |
| **Liability** | Accounts Payable Note Payable | ↓ | ↑ |
| **Stockholders’ Equity** | Common Stock  Retained Earnings | ↓ | ↑ |
| **Revenue** | Fees Earned | ↓ | ↑ |
| **Expense** | Wages Expense Rent Expense Utilities Expense Supplies Expense  Insurance Expense Advertising Expense Maintenance Expense Miscellaneous Expense | ↑ | ↓ |

## Interactive Exercise 3 – Account classifications and behaviors

***Instruction*:** For each account listed, select its corresponding account type and whether it would increase with either a debit or a credit.

|  |  |  |
| --- | --- | --- |
| **ACCOUNTS** | **ACCOUNT TYPE** | **TO INCREASE** |
| Fees Earned |  |  |
| Retained Earnings |  |  |
| Insurance Expense |  |  |
| Accounts Payable |  |  |
| Accounts Receivable |  |  |

*[Hint:* Assets are items of value to a business. Liabilities are debts. Stockholders’ equity is the worth of the corporate owners in the business. Revenue represents income, and expenses are costs of generating revenue.*]*

*[ANSWER KEY]*

|  |  |  |
| --- | --- | --- |
| **ACCOUNTS** | **ACCOUNT TYPE** | **TO INCREASE** |
| Fees Earned | Revenue | credit |
| Retained Earnings | Stockholders’ Equity | credit |
| Insurance Expense | Expense | debit |
| Accounts Payable | Liability | credit |
| Accounts Receivable | Asset | debit |