

Rules of debit & credit

- Any account that obtains a benefit is Debit. And
- Anything that will provide benefit to the business is Credit.
- Both these statements may look different but in fact if we consider that whenever an account benefits as a result of a transaction it will have to return that benefit to the business then both the statements will look like different sides of the same picture.

Rules of debit & credits can also be explained like:

- **EXPENDITURE**
 - Increase in Expenditure is Debit
 - Decrease in Expenditure is Credit
- **INCOME**
 - Increase in Income is Credit
 - Decrease in Income is Debit
- **ASSETS**
 - Increase in Asset is Debit
 - Decrease in Asset is Credit
- **LIABILITY**
 - Increase in Liability is Credit
 - Decrease in Liability is Debit

Now we will explain these rules with the help of the following illustration:

No.	Date	Particulars
01	Jan 01	Mr. Rizwan invests Rs. 100,000 to commence his business.
02	Jan 03	He opened an account with bank & deposited Rs. 30,000.
03	Jan 050	HE borrows Rs. 50,000 from Mr. Saleem at 12% per annum.
04	Jan 07	He purchased furniture worth Rs. 20,000 for cash.
05	Jan 09	He purchased goods(for resale) worth of Rs. 10,000 from Mr. Afzal on credit .
06	Jan 10	HE sold goods for cash Rs. 5,000
07	Jan 12	HE sold goods for Rs. 5,000 to Mr. Naeem on credit basis.
08	Jan 15	Cash deposited in bank Rs. 5,000
09	Jan 16	HE purchased stationery fore Rs. 3,000.
10	Jan 18	HE purchased office equipment for Rs. 10,000 and paid by cheque.
11	Jan 19	He returned defective goods to Mr. Afzal worth Rs. 1,000.
12	Jan 25	Goods are returned by Mr. Naeem Rs. 500 to the business.
13	Jan 30	Cash paid to Mr. Afzal Rs. 9,000 in full settlement of his claim.
14	Jan 31	Cash received from Mr. Naeem Rs. 4,500 in full settlement of his account.
15	Jan 31	Cash withdrawn from the bank Rs. 500.

FINANCIAL ACCOUNTING (LECTURE # 10)

Now first document that we prepare in accounting is the voucher. We will book first entry in voucher, i-e.

Name Of Company			
Type Of Voucher			
Date: <u>1-1-02--</u>		No: <u>01</u>	
Description	Code #	Debit Amount	Credit Amount
Cash	01	100,000	
Capital	02		100,000
Total:		100,000	100,000
Narration:	Capital Introduced in Cash by Mr. Rizwan.		
Prepared By:	Checked by:		

Same entry is presented in simpler form:

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
01-01-2002	Cash A/c	01	100,000	
	Capital A/c	02		100,000
	Capital Introduced in Cash by Mr. Rizwan			

In this case, cash account is debited because cash account has obtained benefit and Capital account is credited because business has obtained benefit because of capital account.

This statement can also be interpreted like this:

As cash is an asset and it is increased in this case, so cash is debited. Capital is a liability and increase in liability is credit. In this case capital is increased, hence it is credited.

ENTRY # 2

First, we will book this entry in voucher.

Name Of Company			
Type Of Voucher			
Date: 3-1-02--		No: 01	
Description	Code #	Debit Amount	Credit Amount
Bank	03	30,000	
Cash	01		30,000
Total:		30,000	30,000
Narration:	Deposited cash in bank.		
Prepared By:	Checked by:		

Again, the same entry in simple form

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
03-01-2002	Bank A/c	03	30,000	
	Cash A/c	01		30,000
	Deposited cash in bank.			

Again, bank account is debited because bank account has obtained benefit and Cash account is credited because business has obtained benefit because of cash account.

This statement can also be interpreted like this:

As bank is an asset and it is increased in this case, so bank is debited. Cash is an asset and decrease in asset is credit. In this case cash is decreased, hence it is credited

From now onward, we will present entry in simple form.

ENTRY # 3

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
05-01-2002	Cash A/c	01	50,000	
	Loan A/c	04		50,000
	Obtained loan from Mr. Saleem.			

Cash account is debited because cash account has obtained benefit and Loan account is credited because business has obtained benefit because of Loan account.

This statement can also be interpreted like this:

As cash is an asset and it is increased in this case, so cash is debited. Loan is a liability and increase in liability is credit. In this case Loan is increased, hence it is credited

ENTRY # 4

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
07-01-2002	Furniture A/c	05	20,000	
	Cash A/c	01		20,000
	Purchased furniture for cash			

ENTRY # 5

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
09-01-2002	Purchases A/c	06	10,000	
	Mr. Afzal(Creditors) A/c	07		10,000
	Purchased goods from Mr. Afzal on credit			

Purchase account is debited because purchase account has obtained benefit and Creditors account is credited because business has obtained benefit because of Creditors account.

This statement can also be interpreted like this:

As purchase is an expense and it is increased in this case, so purchases is debited. Creditors is a liability and increase in liability is credit. In this case Creditors is increased, hence it is credited

Creditors is any third person or organization, to whom business has to pay in future.

ENTRY # 6

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
10-01-2002	Cash A/c	01	5,000	
	Sale A/c	08		5,000
	Sold goods for cash			

Cash account is debited because cash account has obtained benefit and Sale account is credited because business has obtained benefit because of Sale account.

This statement can also be interpreted like this:

As cash is an asset and it is increased in this case, so cash is debited. Sale is an income and increase in income is credit. In this case income is increased, hence it is credited

ENTRY # 7

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
12-01-2002	Mr. Naeem(Debtors) A/c	09	5,000	5,000
	Sale A/c	08		
	Sold goods to Mr. Naeem on credit			

Debtors account is debited because Debtors account has obtained benefit and Sale account is credited because business has obtained benefit because of Sale account.

This statement can also be interpreted like this:

As Debtors is an asset and it is increased in this case, so debtors is debited. Sale is an income and increase in income is credit. In this case income is increased, hence it is credited

Debtors is any third person or organization, from whom cash is receivable by the business.

ENTRY # 8

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
15-01-2002	Bank A/c	03	5,000	5,000
	Cash A/c	01		
	Cash deposited in bank			

ENTRY # 9

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
16-01-2002	Stationery A/c	10	3,000	3,000
	Cash A/c	01		
	Stationery purchased for cash			

Stationery account is debited because stationery account has obtained benefit and Cash account is credited because business has obtained benefit because of Cash account.

This statement can also be interpreted like this:

As stationery is an expense and it is increased in this case, so stationery is debited. Cash is an asset and decrease in asset is credit. In this case Cash is decreased, hence it is credited

ENTRY # 10

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
18-01-2002	Office Equipment A/c	11	10,000	
	Bank A/c	03		10,000
	Office equipment purchased by cheque			

Office Equipment account is debited because Office Equipment account has obtained benefit and Bank account is credited because business has obtained benefit because of Bank account.

This statement can also be interpreted like this:

As Office Equipment is an asset and it is increased in this case, so Office Equipment is debited. Bank is an asset and decrease in asset is credit. In this case bank account is decreased, hence it is credited

ENTRY # 11

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
19-01-2002	Mr. Afzal(Creditors) A/C	07	1,000	
	Purchase return A/C	12		1,000

Creditors account is debited because Creditors account has obtained benefit and Purchase return account is credited because business has obtained benefit because of Purchase return account.

This statement can also be interpreted like this:

As Creditors is a liability and it is decreased in this case, so Creditors is debited. Purchase return is decrease in expense and decrease in expense is credit, So it is credited.

ENTRY # 12

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
25-01-2002	Sales return A/C	13	500	
	Mr. Naeem(Debtors) A/C	09		500
	Goods returned by Mr. Naeem(Debtors)			

Sales return account is debited because Sales return account has obtained benefit and Debtors is credited because business has obtained benefit because of Debtors account.

This statement can also be interpreted like this:

As sales return is decrease in income and decrease in income is debit, so it is debited. Debtors is decrease in asset and decrease in asset is credit, so it is credited.

ENTRY # 13

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
30-01-2002	Mr. Afzal(Creditors) A/C	07	9,000	
	Cash A/C	01		9,000
	Cash paid to Mr. Afzal(Creditors)			

ENTRY # 14

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
31-01-2002	Cash A/C	01	4,500	
	Mr. Naeem(Debtors) A/C	09		4,500
	Cash received from Mr. Naeem(Debtors)			

ENTRY # 15

Date	Particulars	Code #	Amount(Dr.) Rs.	Amount(Cr.) Rs.
31-01-2002	Cash A/C	01	500	
	Bank A/C	03		500
	Cash withdrawn from bank			

CASH AND BANK BOOK

- Ledger is a book that keeps separate record for each account;
- The Account or Head of Account is a systematic record of transactions of one type; and
- Like other things a separate account is also required to record the movements in cash (usually called cash in hand) and bank account (usually called cash at bank).
- If the volume of transactions is high then we can separate books for cash and bank account.
- These separate books for cash and bank account are called cash book and bank book respectively.
- The Cash Book records all the movements in the cash account.
- A cash book would be look like one of the two samples shown here

Cash Book Account Code 01									
Receipt Side					Payment Side				
Date	No.	Narration / Particulars	Ledger Code	Receipt Amount	Date	No.	Narration / Particulars	Ledger Code	Payment Amount

OR

Cash Book Account Code 01						
Date	Voucher Number	Narration / Particulars	Ledger Code	Receipt Amount	Payment Amount	Balance Dr/(Cr)

THE CASH BOOK

- In the first format / presentation receipts (Debits) are written on left hand side page and payments (Credits) on the right hand side.
- In the second presentation instead of using two pages we use two columns on the same page.
- Both these presentations are correct.
- In the second format we have an additional facility of knowing the balance of the account after every transaction.
- Whereas in the first one we have to add up the receipts and payments every time we need to know the balance.
- Moreover the second format utilizes less space, therefore **we will use this format in our future discussions**

THE BANK BOOK

- The Bank book records all the movements in the bank account.
- The format of the bank book is the same as that of cash book except for an additional column for Cheque Number.
- Again we can use either two pages OR two columns to present the bank book.

FINANCIAL ACCOUNTING (LECTURE # 10)

Same record will be presented in two column cash book now

Date	Voucher Number	Narration / Particulars	Ledger Code	Receipt Amount	Payment Amount	Balance Dr/(Cr)
Jan-1		Capital introduced	02	100,000		100,000
Jan-3		Deposited in bank	03		(30,000)	70,000
Jan-5		Loan received	04	50,000		120,000
Jan-7		Furniture purchased	05		(20,000)	100,000
Jan-10		Goods sold	08	5,000		105,000
Jan-15		Deposited in bank	03		(5,000)	100,000
Jan-16		Stationery purchased	10		(3,000)	97,000
Jan-30		Paid to creditors	07		(9,000)	88,000
Jan-31		Received from debtors	09	4,500		92,500
Jan-31		Cash drawn from bank	03	500		93,000

Now, we will present Bank entries in bank book.

Bank Book (Bank Account # xxx)				Account Code 02			
Date	Voucher Number	Chq . No.	Narration / Particulars	Ledger Code	Receipt Amount	Payment Amount	Balance Dr/(Cr)
Jan-3			Cash deposited	01	30,000		30,000
Jan-15			Cash deposited	01	5,000		35,000
Jan-18			Off. Equip. purchased	11		(10,000)	25,000
Jan-31			Cash drawn	01		(500)	24,500

RECOMMENDED READING

After reading this lecture, you will be able to read

- Chapter # 2 of business accounting by Frank Woods
- Chapter # 2, 3 of accounting by M. Arif & Sohail Afzal.