

# Types of Accounts and Rules of Debit & Credit

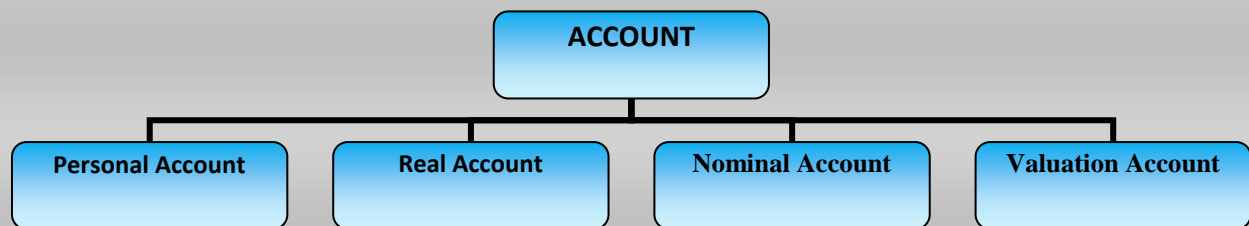
**Account:** A summarized record of transactions in a classified manner is known as account. For example, Cash account, Machinery account etc. In Cash account all transactions relating to cash are to be posted whereas in Machinery account, all transactions relating to machinery are to be posted. The same classified procedure is to be applied for other accounts.

**Classification of Accounts:** There are two main approaches for discussing types of accounts.

- Traditional or British Approach
- Modern or American Approach

## **Traditional Classification of Accounts (British Approach)**

According to this approach, accounts are to be classified into four main categories. These are shown in a chart given below:



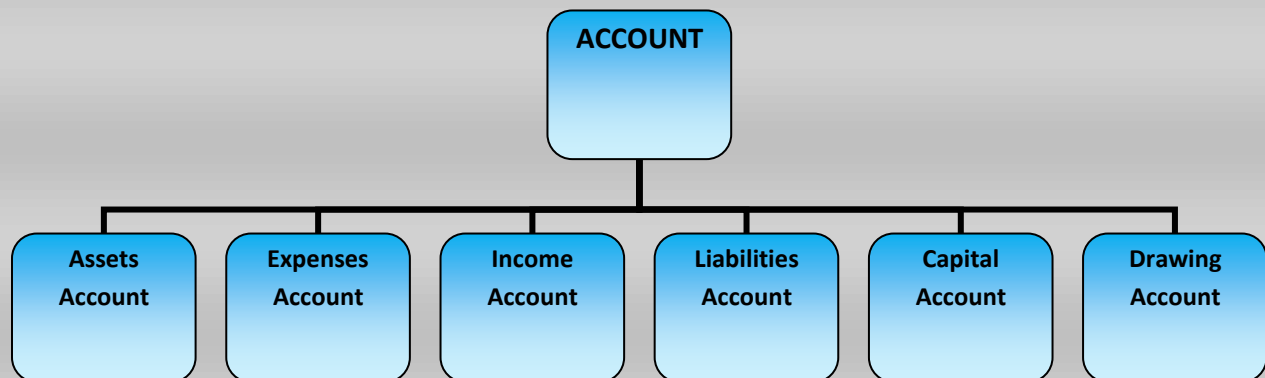
Detail of these accounts is given below:

- Personal Account:** All accounts relating to the name of individuals and firms are known as personal accounts like Anwar's account and Ali & Son's account etc. These accounts are maintained for knowing the "balance due to" or "balance due from" individual or organizations like investors, customers, sellers, banks or financial institutions etc.
- Real Account:** All accounts relating to asset or property are known as real accounts. These accounts are permanent in nature so balances of these accounts are to be transferred to next accounting period. These accounts are used in the preparation of balance sheet for knowing the financial position of business. For example Cash account, Machinery account and Furniture account etc.
- Nominal Account:** All accounts relating to income or gain and expenses or losses are known as nominal accounts. These accounts are temporary in nature so balances of these accounts cannot be transferred to next accounting period. So these accounts are used in the preparation of Income statement for knowing the performance of business. For example Sales account, Purchases account and Rent account etc.

- iv. **Valuation Account:** These are contra asset or contra liability accounts. These accounts reduce the balance of particular asset or liability to represent their true & fair value in balance sheet. Like,
- Accumulated depreciation of machinery (Deducted from machinery)
  - Provision for doubtful debts (Deducted from Sundry Debtors/ Accounts Receivable account)

### **Modern Classification of Account (American Approach)**

According to this approach, accounts are to be classified into six main categories. These are shown in a chart given below:

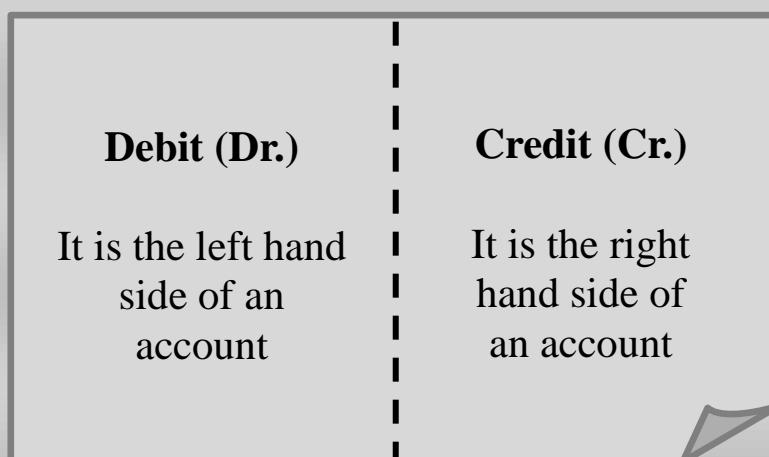


Detail of these accounts is given below:

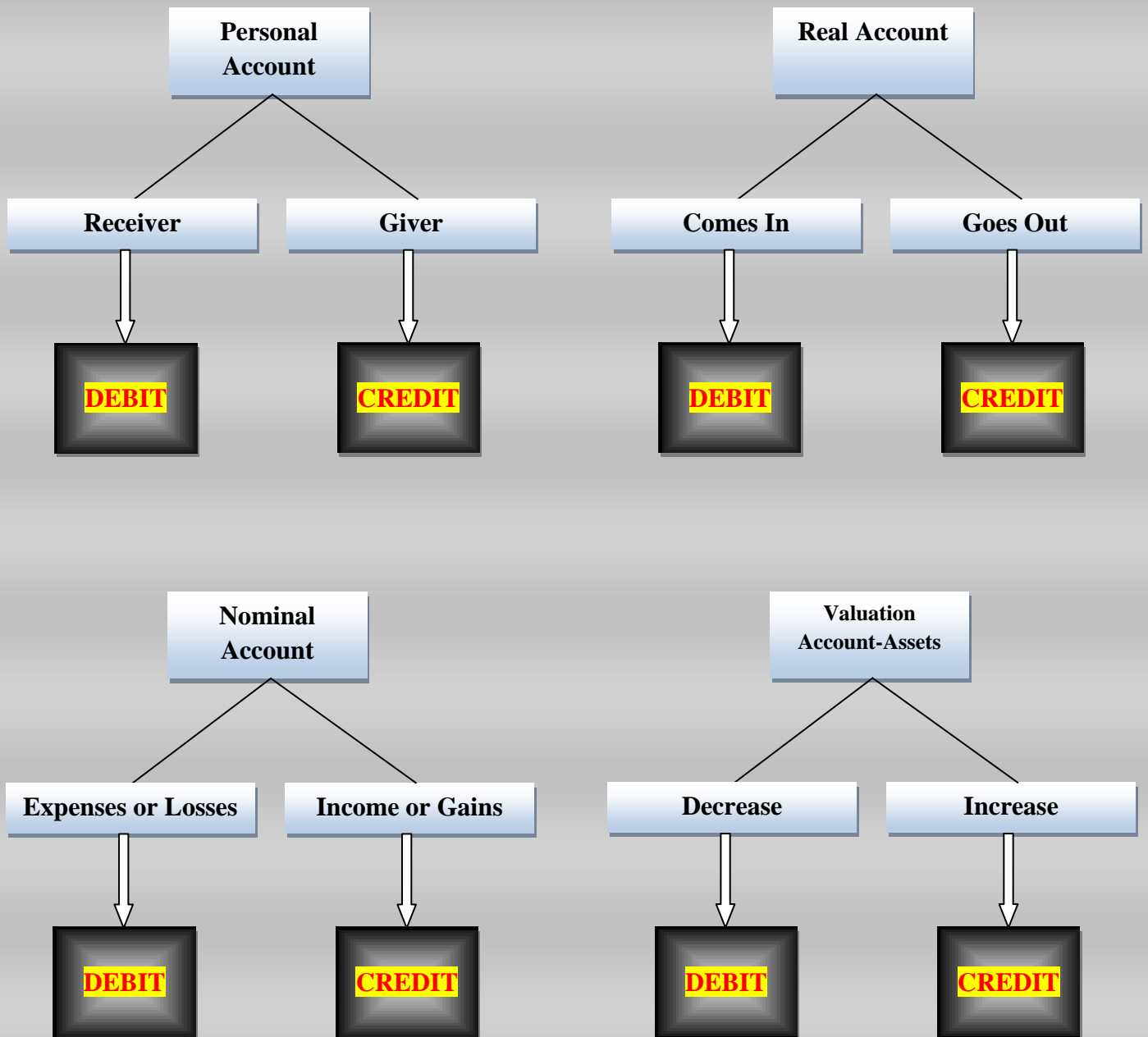
- Assets Account:** Anything which is owned by a business is known as asset like cash, furniture, machinery etc. and ledger accounts of assets are known as assets account.
- Income/Revenue Account:** It is the price of goods sold or services provided by a business to its customers/clients like Commission received, Sales revenue, Service revenue etc. and ledger account of any income or revenue is called revenue account.
- Expenses Account:** Expenses are the cost of goods and services used up during the process of generating revenue like selling expenses and administration expenses etc. and ledger account of any expense is known as expense account.
- Liabilities Account:** Liabilities are the payable or due amount of the business like loan taken from bank and sundry creditors etc. and the ledger account of any liability is called liability account
- Capital or Owners equity Account:** Capital is the investment in business made by the owner and its ledger account is called capital account.
- Drawings or Withdrawals Account:** Amount or things withdrawn by the owner from business for his personal or household use is called drawing and its ledger account is called drawing account.

## Introduction of Debit and Credit

The most famous Italian mathematician Luca Pacioli generally known as “The Father Of Accounting and Book Keeping” describes the concept of double entry system i.e., every transaction has two aspects. He used the Latin words “debitum or debere” and “creditum or credere” to describe the two aspect of business transaction. Debere means “to owe” and credere means “to trust or believe”. When Luca Pacioli’s work was translated in English then debere and credere were called as Debit and Credit respectively. Every transaction has twofold aspect so one is to be recorded in the left hand side of an account called as “Debit” and other is to be recorded in the right hand side of an account called as “Credit”. Debit is abbreviated with “DR” and Credit is abbreviated with “CR”. There are different theories regarding these abbreviations. One theory calls that these abbreviations are derived from debitum/debere and creditum/credere. Another theory argued that DR abbreviated from Debit Record and CR abbreviated from Credit Record. However, some believer states that DR is short for Debtor and CR is short for Creditor. For basic understanding, the concept is precisely described and presented below:



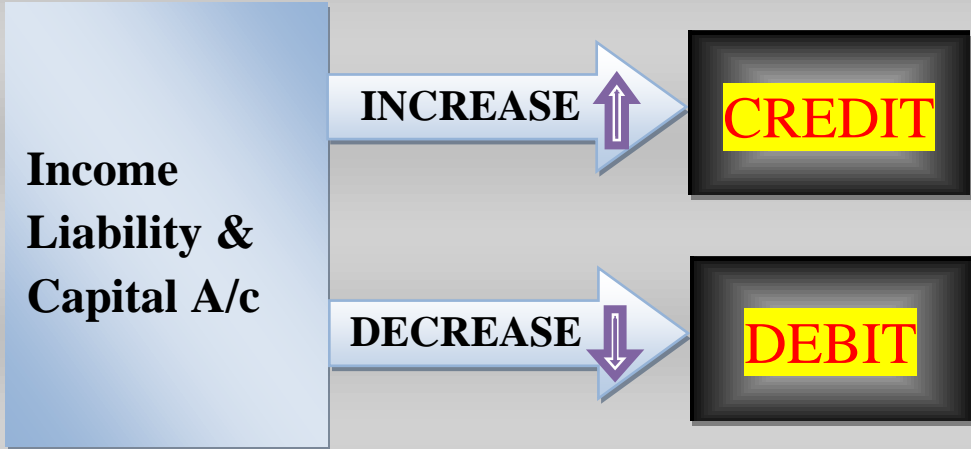
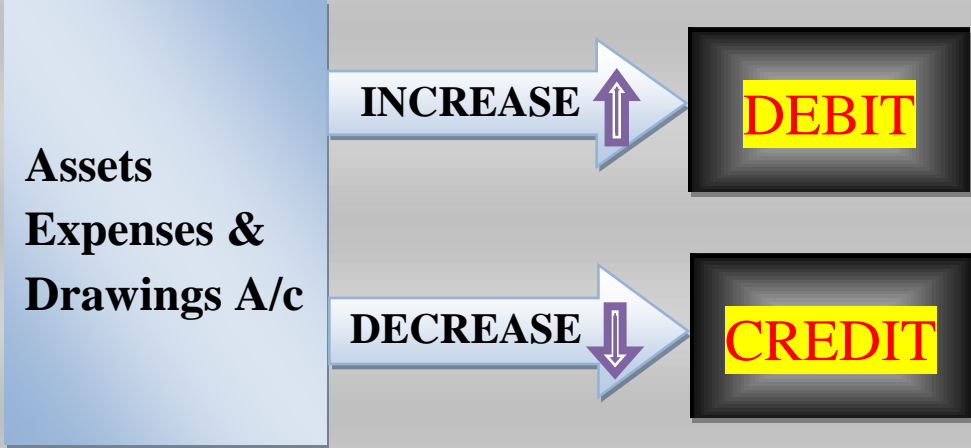
## Rules for Debit and Credit – Traditional/British Approach



Note: “Valuation Account-Liabilities” is the vice versa of “Valuation Account-Assets”

Note: Expenses or losses should be credited in case of reduction whereas income or gains should be debited in case of reduction.

# Rules for Debit and Credit – Modern/American Approach



## Practice Question

Date	Transactions	Rs.
2016		
Feb 01	Mr. Akram started his business with:	
	Cash	500,000
	Furniture	900,000
‘‘ 02	Purchased goods on cash	100,000
‘‘ 10	Goods bought on account from Mr. Tayyab.	80,000
‘‘ 12	Furniture sold for cash (Cost price is Rs. 400,000)	500,000
‘‘ 18	Sold goods on account to Mr. Hussain	150,000
‘‘ 20	Goods returned from customers	15,000
‘‘ 21	Goods returned to suppliers	20,000
‘‘ 25	Machinery purchased	300,000
‘‘ 27	Loan taken from Mr. Ali	50,000
‘‘ 28	Goods taken away from the business by the owner for his personal use	50,000
‘‘ 29	Paid rent for the month	10,000

### Required:

You are required to analyse the transactions given above and fill the appropriated boxes given below by following the classification of account and rules of debit and credit with respect to:

**A. Traditional/British Approach**

**B. Modern/American Approach**

Date	Account involved	Nature of account	Debit	Credit	Reason

## Solution

### A. Traditional/British Approach:

Date	Account involved	Nature of account	Debit	Credit	Reason
2016					
Feb 01	Cash account	Real a/c	500,000		Comes in
	Furniture account	Real a/c	900,000		Comes in
	Capital account	Personal a/c		1,400,000	Giver
Feb 02	Purchases account	Nominal a/c	100,000		Expenses
	Cash account	Real a/c		100,000	Goes out
Feb 10	Purchases account	Nominal a/c	80,000		Expense
	Accounts payable account- Mr. Tayyab.	Personal a/c		80,000	Giver
Feb 12	Cash account	Real a/c	500,000		Comes in
	Furniture account	Real a/c		400,000	Goes out
	Gain on sale of fixed asset account	Nominal a/c		100,000	Gain
Feb 18	Accounts Receivable account- Mr.Hussain	Personal a/c	150,000		Receiver
	Sales account	Nominal a/c		150,000	Income
Feb 20	Returns Inwards account	Nominal a/c	15,000		Income reduced
	Accounts Receivable account- Mr. Hussain	Personal a/c		15,000	Giver

<b>Date</b>	<b>Account involved</b>	<b>Nature of account</b>	<b>Debit</b>	<b>Credit</b>	<b>Reason</b>
2016					
Feb 21	Accounts Payable account- Mr. Tayyab	Personal a/c	20,000		Receiver
	Returns Outward account	Nominal a/c		20,000	Expenses reduced
Feb 25	Machinery account	Real a/c	300,000		Comes in
	Cash account	Real a/c		300,000	Goes out
Feb 27	Cash account	Real a/c	50,000		Comes in
	Loan-Mr. Ali	Personal a/c		50,000	Giver
Feb 28	Drawings account	Personal a/c	50,000		Receiver
	Purchases account	Nominal a/c		50,000	Expenses reduced
Feb 29	Rent account	Nominal a/c	10,000		Expense
	Cash account	Real a/c		10,000	Goes out



**B. Modern/American Approach:**

<b>Date</b>	<b>Account involved</b>	<b>Nature of account</b>	<b>Debit</b>	<b>Credit</b>	<b>Reason</b>
2016					
Feb 01	Cash account	Asset	500,000		Increase in asset
	Furniture account	Asset	900,000		Increase in asset
	Capital account	Capital		1400,000	Increase in capital
Feb 02	Purchases account	Expense	100,000		Increase in expense
	Cash account	Asset		100,000	Decrease in asset
Feb 10	Purchases account	Expense	80,000		Increase in expense
	Accounts payable account- Mr. Tayyab	Liability		80,000	Increase in liability
Feb 12	Cash account	Asset	500,000		Increase in asset
	Furniture account	Asset		400,000	Decrease in asset
	Gain on sale of fixed asset account	Income		100,000	Increase in income
Feb 18	Accounts Receivable account- Mr.Hussain	Asset	150,000		Increase in asset
	Sales account	Income		150,000	Increase in income
Feb 20	Returns Inwards account	Income	15,000		Decrease in income
	Accounts Receivable account-Mr. Hussain	Asset		15,000	Decrease in asset

Date	Account involved	Nature of account	Debit	Credit	Reason
2016					
Feb 21	Accounts Payable account- Mr. Tayyab	Liability	20,000		Decrease in liability
	Returns Outward account	Expense		20,000	Decrease in expense
Feb 25	Machinery account	Asset	300,000		Increase in asset
	Cash account	Asset		300,000	Decrease in asset
Feb 27	Cash account	Asset	50,000		Increase in asset
	Loan-Mr. Ali	Liability		50,000	Increase in liability
Feb 28	Drawings account	Drawings	50,000		Increase drawings
	Purchases account	Expense		50,000	Decrease in expense
Feb 29	Rent account	Expense	10,000		Increase in expense
	Cash account	Asset		10,000	Decrease in asset

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Note: Please consult recommended books mentioned in “books” Tab of VU-LMS for more practice.