3.3 RULES OF DEBIT AND CREDIT

The transactions in the Journal are recorded on the basis of the rules of debit and credit. For this purpose business transactions have been classified into three categories:

(i) Transactions relating to persons
(ii) Transactions relating to properties and assets
(iii) Transactions relating to incomes and expenses

On this basis, it becomes necessary for the business to keep an account of:

(i) Each person with whom it deals
(ii) Each property or asset which the business owns
(iii) Each item of income or expense

The accounts falling under the first heading are called 'Personal Accounts'. The accounts falling under the second heading are termed 'Real Accounts'. The accounts falling under the third heading are termed 'Nominal Accounts'. The classification of the accounts, as explained above, can be put in the form of the following chart:
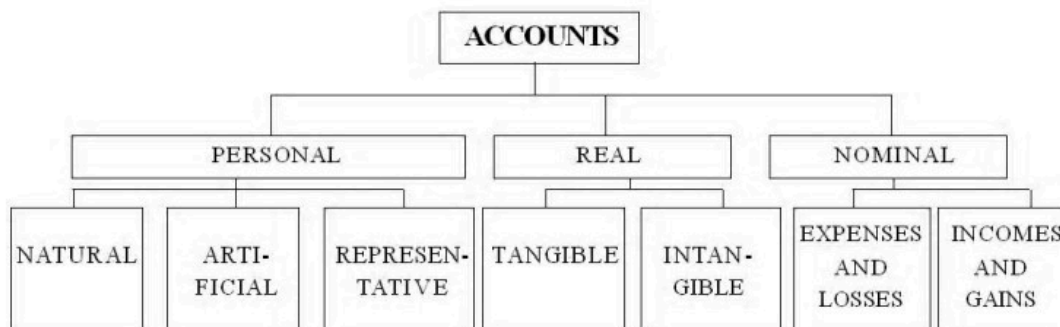

Fig. 3.2 Classification of Accounts

Each of the above categories of accounts and the relevant rule for 'debit and credit' have been explained in detail in the following pages:

Personal accounts. Personal accounts include the accounts of persons with whom the business deals. These accounts can be classified into three categories:

1. *Natural Personal Accounts.* The term 'Natural Persons' means persons who are the creation of God. For example, Mohan's Account, Sohan's Account, Abha's Account, etc.

2. *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 Co-operative Society, the account of a Club, the account of Government, the account of an Insurance Company etc.

3. *Representative Personal Accounts.* These are accounts which represent a certain person or group of persons. For example, if the rent is due to the landlord, an outstanding rent account will be opened in the books. Similarly, for salaries due to the employees (not paid), an outstanding salaries account will be opened. The outstanding rent account represents the account of the landlord to whom the rent is to be paid while the outstanding salaries account represents the accounts of the persons to whom the salaries have to be paid. All such accounts are therefore termed as 'Representative Personal Accounts'.

The rule is:

> DEBIT THE RECEIVER
> CREDIT THE GIVER

For example, if cash has been paid to Ram, the account of Ram will have to be debited. Similarly, if cash has been received from Keshav, the account of Keshav will have to be credited.

Real accounts. Real accounts may be of the following types:

1. *Tangible Real Accounts.* Tangible Real Accounts are those which relate to such things which can be touched, felt, measured etc. Examples of such accounts are cash account, building account, furniture account, stock account, etc. It should be noted that a bank account is a personal account; since it represents the account of the banking company—an artificial person.

2. *Intangible Real Accounts.* These accounts represent such things which cannot be touched. Of course, they can be measured in terms of money. For example, patents account, goodwill account, etc.

The rule is:

> DEBIT IS WHAT COMES IN
> CREDIT IS WHAT GOES OUT

For example, if a building has been purchased for cash, the building account should be debited (since it is coming in the business), while the cash account should be credited (since cash is going out the business). Similarly when furniture is purchased for cash, the furniture account should be debited while the cash account should be credited.

Nominal accounts. These accounts are opened in the books to simply explain the nature of the transactions. They do not really exist. For example, in a business, salary is paid to the manager, rent is paid to the landlord, commission is paid to the salesman, cash goes out of the business and it is something real; while salary, rent or commission as such do not exist. The accounts of these items are opened simply to explain how the cash has been spent. In the absence of such information, it may difficult for the person concerned to explain how the cash at his disposal was utilised.

Nominal Accounts include accounts of all expenses, losses, incomes and gains. The examples of such accounts are rent, rates lighting, insurance, dividends, loss by fire, etc.

The rule is:

> DEBIT ALL EXPENSES AND LOSSES
> CREDIT ALL GAINS AND INCOMES

Tutorial Note. Both Real Accounts and Nominal Accounts come in the category of Impersonal Accounts. The student should note that when some prefix or suffix is added to a Nominal Account, it becomes a Personal Account. A table is being given to explain the above rule:

Table 3.1 Nominal and Personal Accounts

Nominal Account	Personal Account
1. Rent account	Rent prepaid account, Outstanding rent account.
2. Interest account	Outstanding interest account, Interest received in advance account, Prepaid interest account.
3. Salary account	Outstanding salaries account, Prepaid salaries account.
4. Insurance account	Outstanding insurance account, Prepaid insurance account.
5. Commission account	Outstanding commission account, Prepaid commission account.

Illustration 3.1. From the following transactions find out the nature of account and also state which account should be debited and which account should be credited.

(a) Rent paid
(b) Salaries paid
(c) Interest received
(d) Dividends received
(e) Furniture purchased for cash
(f) Machinery sold
(g) Outstanding for salaries
(h) Telephone charges paid
(i) Paid to Suresh
(j) Received from Mohan (the proprietor)
(k) Lighting

Solution:

	Transaction	Accounts involved	Nature of Accounts	Debit/Credit
(a)	Rent paid	Rent A/c	Nominal A/c	Debit
		Cash A/c	Real A/c	Credit
(b)	Salaries paid	Salaries A/c	Nominal A/c	Debit
		Cash A/c	Real A/c	Credit
(c)	Interest received	Cash A/c	Real A/c	Debit
		Interest A/c	Nominal A/c	Credit
(d)	Dividends received	Cash A/c	Real A/c	Debit
		Interest A/c	Nominal A/c	Credit
(e)	Furniture purchased	Furniture A/c	Real A/c	Debit
		Cash A/c	Real A/c	Credit
(f)	Machinery sold	Cash A/c	Real A/c	Debit
		Interest A/c	Real A/c	Credit