Principles of Accounting Help Lesson #3

Debits and Credits

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Debits and Credits

Use this presentation to help you learn about <u>debits</u> and <u>credits</u>.

Foundation

The prerequisite for this tutorial is a thorough understanding of analyzing transactions.

See Help Lesson #2 – Analyzing Transactions

Analyzing a Transaction

In the previous tutorial, you learned to analyze transactions by asking the following three questions:

ü What **accounts** are involved in the transaction?
ü What is the **classification** of each account?
ü What is **happening** to each account—is it **increasing** or **decreasing**?

In this lesson, you will add a fourth question to this list.

Analyzing a Transaction

From this point on, when analyzing a transaction, ask yourself the following *four* questions.

1. What **accounts** are involved in the transaction?
2. What is the **classification** of each account?
3. What is **happening** to each account—is it **increasing** or **decreasing**?
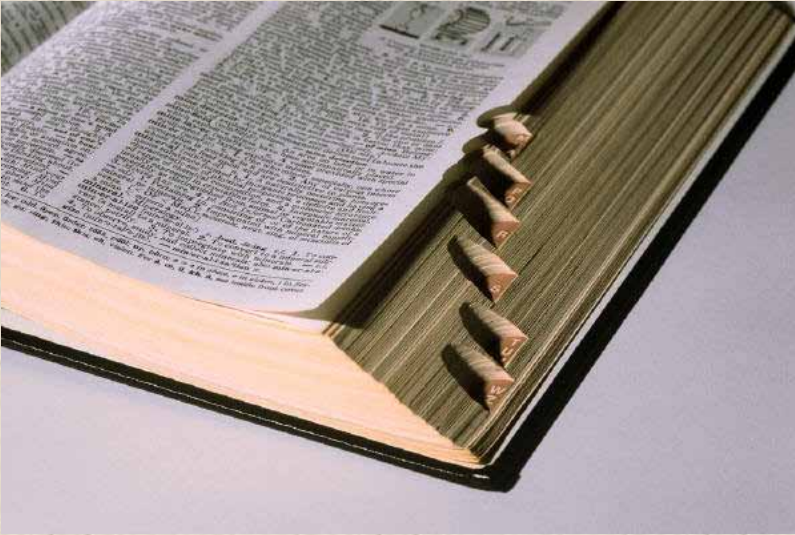4. **How** is this accomplished—with a **debit** or **credit**?

T-Accounts

Transactions can be analyzed using a tool known as a T-account.

Cash
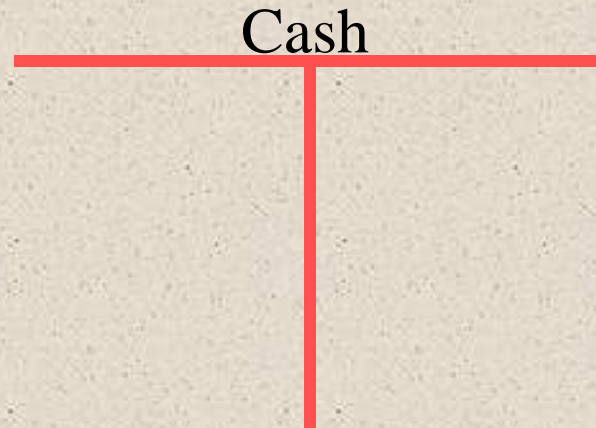
The account name is written at the top of the T. Increases and decreases are entered on each side of the T.

Debits and Credits:
A Definition

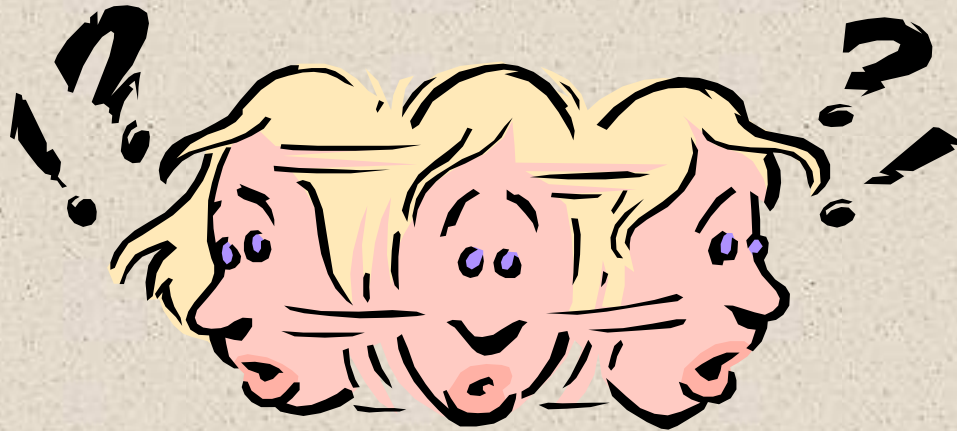Debit (abbreviated DR) simply means the left-hand side of an account and credit (abbreviated CR) means the right-hand side of an account.

Debit and Credit Identified on a T-Account

Cash
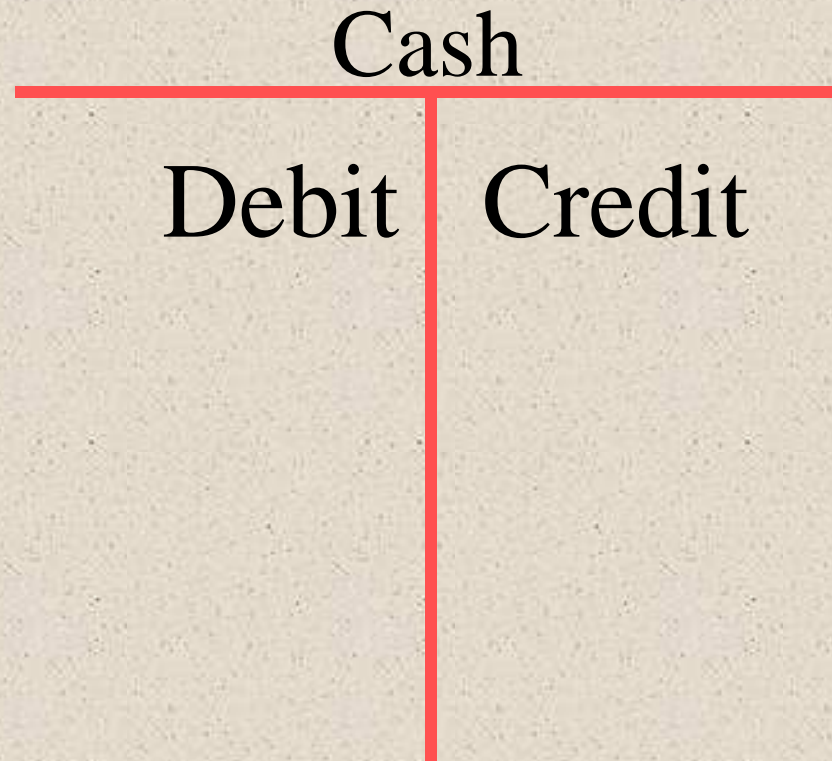
Debit | Credit

Debit and Credit

Although debit and credit mean the left and right sides of an account, they represent different effects for different types of accounts.

Increases with Debits
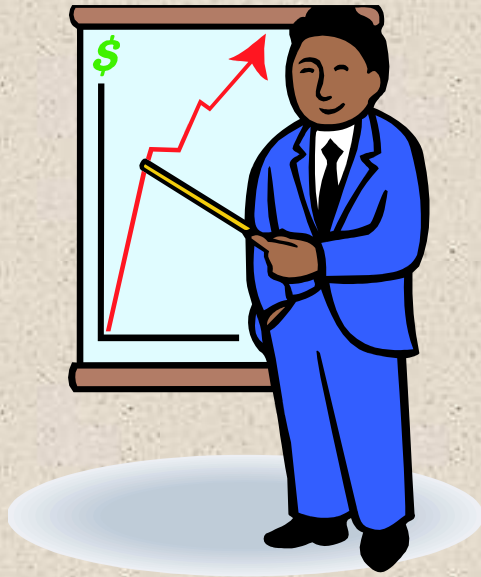
The **Debit** side of an account represents <u>increases</u> in <u>asset</u> accounts, <u>expense</u> accounts, and <u>Drawing</u>.

Increases with Credits

The **Credit** side of an account represents <u>increases</u> in <u>liability</u> accounts, <u>revenue</u> accounts, and <u>Capital</u>.

Decreases with Credits

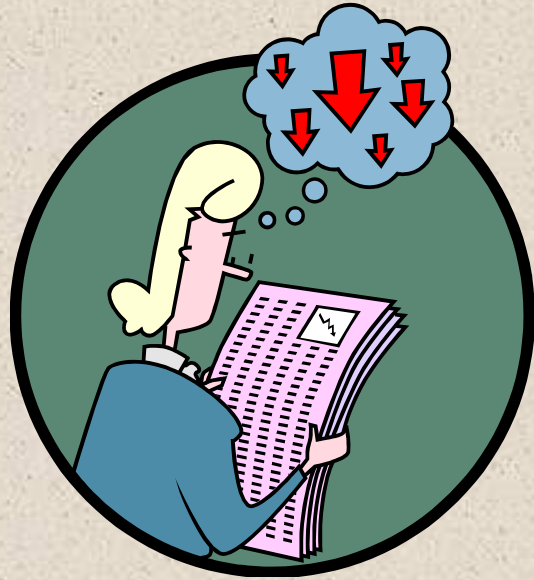Since *debits* represent increases in <u>asset</u> accounts, <u>expense</u> accounts, and <u>Drawing</u>, then **credits** must represent <u>decreases</u> in these accounts.

Decreases with Debits

Since *credits* represent increases in <u>liability</u> accounts, <u>revenue</u> accounts, and <u>Capital</u>, then **debits** must represent <u>decreases</u> in these accounts.

Try It

See if you can identify the increase and decrease sides of the following accounts using the T-account.

Acct Rec (Asset)	
DR	CR
+	-

Acct Pbl (Liab)	
DR	CR
-	+

Consult Fees (Rev)	
DR	CR
-	+

Rent Exp (Exp)	
DR	CR
+	-

M. Brady, Capital	
DR	CR
-	+

M. Brady, Drawing	
DR	CR
+	-

Normal Balance

The increase side of an account is known as its **normal balance**.

For assets, expenses, and drawing, the normal balance is debit, while revenues, liabilities, and capital have normal credit balances.

Using The Transaction Analysis Sheet

Once you understand the effect of debit and credit on each type of account, you may use the Transaction Analysis Sheet to analyze transactions and answer the four questions previously discussed.

	Account	Classification	Effect	How

Transaction Analysis Sheet

Use the Transaction Analysis Sheet to analyze the following transactions.

Transaction Analysis Sheet

1. *Jones Career Consulting purchased* supplies *for* cash*, $88.*

	Account	Classification	Effect	How
1.	Supplies	Asset	Increase	DR
	Cash	Asset	Decrease	CR

Transaction Analysis Sheet

2. *Jones Career Consulting* paid *a* creditor on account, *$350*.

	Account	Classification	Effect	How
2.	Accounts Pbl	Liability	Decrease	DR
	Cash	Asset	Decrease	CR

Transaction Analysis Sheet

3. Jones Career Consulting provided consulting *to a client* on account, *$500*.

	Account	Classification	Effect	How
3.	Accounts Rec	Asset	Increase	DR
	Consulting Income	Revenue	Increase	CR

A Rule

While transactions may involve any combination of accounts and effects, **for each transaction there must always be at least one debit and at least one credit.**

Review the Previous Transactions

Review the analysis of the previous transactions. Notice the various accounts and effects recorded. Also notice that for each transaction one debit and one credit was entered.

	Account	Classification	Effect	How
1.	Supplies	Asset	Increase	**DR**
	Cash	Asset	Decrease	**CR**
2.	Accounts Pbl	Liability	Decrease	**DR**
	Cash	Asset	Decrease	**CR**
3.	Acct Rec	Asset	Increase	**DR**
	Consulting Income	Revenue	Increase	**CR**

Next Step

Now that you understand how to analyze transactions with the effects of debit and credit, you should begin to record transactions in a General Journal.

Choose Help Lesson #4 – Recording Transactions in a Journal.