

SUBJECT- FINANCIAL ACCOUNTING

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PREPARATION OF FINANCIAL STATEMENTS

* DEBITS AND CREDITS

Every account has two sides left and right. The left side (or column) is referred to as the debit side and the right side (or column) as the credit side. (for purposes of instruction, we will use "T-accounts" such as Accounts receivable account. Business typically use "balance column accounts". Both are used in the same manner - only the physical appearance of the account is different.)

The following rules govern the recording of transactions in the debit and credit system:

- An increase in an asset is a debit and is recorded on the left side of the asset account.
- An increase in a liability or owner's equity is a credit and is recorded on the right side of the liability or owner's equity account.
- A decrease in an asset is a credit and is recorded on the right side of the asset account.
- A decrease in a liability or owner's equity is a debit and is recorded on the left side of the liability or owner's equity account.

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- Because an expense decreases owner's equity, it is a debit and is recorded on the left side of the expense account.

- Because a revenue increases owner's equity, it is a credit and is recorded on the right side of the revenue account.

* Four basic rules govern the recording of transactions:

1. Each transaction must be recorded separately.

2. The transaction must be recorded so that $Assets = Liabilities + Owner's Equity$. For example if transaction includes an increase in an asset, it must also include a corresponding decrease in some other asset or a corresponding increase in a liability or owner's equity.

3. Each transaction will affect at least two accounts. Because of this, the system is referred to as dual-entry accounting. The transaction may affect more than two accounts, but it must always affect at least two.

4. Every transaction must be recorded such that debits equal credits.

Accounts Receivable P/c		Accounts Receivable			
		DATE	DEBIT	CREDIT	BALANCE
425	250	6-20	425	-	425
	125	6-22	150	-	575
150		6-27	-	250	325
<u>200</u>		6-30	-	125	200