

RULES OF ACCOUNTING

7.1 INTRODUCTION

You are expected to prepare the different books of accounts. These books of accounts can be prepared if you have thorough knowledge of the rules of accounting. The knowledge of the rules of accounting may be facilitated by the earlier lessons that you have studied so far, viz. the accounting assumption, accounting concepts, conventions, terms and accounting equation. This lesson focuses on the meaning of account and the rules of accounting.

7.2 OBJECTIVES

After studying this lesson, you will be able to

- give the meaning of an account and its format;
 - recognize the five types of accounts viz. assets, liabilities, capital, revenue and expense accounts;
 - identify the effect of each transaction in terms of increase or decrease in the two aspects,
 - translate the increase or decrease in the two aspects into debit and credit;
 - debit or credit the different types of accounts on the basis of accounting rules.
-

7.3 MEANING AND FEATURES OF ACCOUNT

You have already studied the meaning of 'Dual Aspect'. It implies that each accounting transaction has two aspects. For example, goods sold to Shyam on credit for Rs. 20,000. In this transaction, the two aspects are - Shyam and Sales account. Records of these two aspects, i.e., Shyam on one hand and sales account on the other should be kept. Many more transactions pertaining to these two aspects may take place during the course of business operations. It will be better if all the transactions of Shyam are recorded at one place under the heading Shyam. Similarly, all the transactions pertaining to sales should be placed under the heading 'Sales'. Like "Shyam" and "Sales", there are many other aspects of various business transactions e.g. cash, furniture, purchases, buildings, rent, etc. At any point of time, *any heading pertaining to particular item or person* may be seen and the *financial position* of that item or person may be assessed. This classified and consolidated record of a particular type of transactions under a head is known as 'Account'. Thus an account is a systematic record of transactions pertaining to a particular item or person, which can be measured in terms of money during a particular period. The abbreviation for the word 'account' is *A/c*. In simplest form an account consists of three parts:

- (i) Title i.e. the name of the person, company, etc.
- (ii) Debit side i.e. the left hand side of the account.
- (iii) Credit side i.e. the Right hand side of the account.

A simplified form of an account called T-account is given below:

Dr.	Names of Account	Cr.
(Left) Dr.		(Right) Cr.

The detailed ruling of a specimen of account is as:

Dr.				Cr.			
Amount				Amount			
Date	Particulars	F	Amount	Date	Particulars	F	Amount
A	B	C	D	E	F	G	H

Notes:

- (i) The name of the person or object is written at the top of the account.
- (ii) The word 'Dr.' on left hand side (columns A to D) denotes Debit Side while the word 'Cr.' on right hand side (columns E to H) denotes credit side.
- (iii) Column A is meant to record the data of each transaction with month and year.
- (iv) Column B is designed to record the details of the transaction.
- (v) Column C is headed as 'F' which means Folio.
- (iv) Column D is meant to record the amount in Rupees.

Note: (i) Similarly, Columns E to H can be explained.

- (ii) In this lesson, we are using simplified form of an account as and when required.

Each account shows what has been received and what has been paid. For example, goods have been sold to Amit on credit for Rs.2,000. This shows that Amit has become the debtor of the business (i.e. the person who will pay in future). He will be shown as a debtor in the books of accounts in the following way:

Dr.	Amit		Cr.
	Rs.		
To Sales A/c	2,000		

Whenever, due to a transaction, a person becomes debtor of the business he is shown in the books of accounts in the same way as Amit has been shown in the books. The above account shows that Amit has been debited and he is a debtor of the business, i.e., he owes Rs.2,000 to the business. Suppose, at a later date, Amit pays Rs.1,500 on account. Now the two aspects are Amit and cash. As Amit is the giver, Rs.1,500 will be shown on the right hand side or credit side (Cr.side) of the account. Now, the additional record in his account will be shown in the following manner:

Dr.	Amit		Cr.
	Rs.		
To Sales A/c	2000	By Cash A/c	1,500

Amit, in the above example, has been credited with Rs.1,500. The net effect of this account is that he is now the debtor of the business to the extent of Rs.500 only. In this way the financial position of each account may be ascertained at any point of time.

Now the businessman, in order to systematise his recording of transactions reserves pages in his register for different accounts, e.g., from page No.1 to 5 for Sales A/c; from 6 to 10 for Cash A/c; from 11 to 13 for Amit A/c and so on. If he/she wants to know the financial position of any account, he can do so by finding out the difference of totals of the two sides.

FEATURES OF ACCOUNT

If you study the above description carefully, you will be able to derive the following features of an account:

- (i) Each account resembles the shape of English alphabet. "T"

- (ii) Each account has two sides — left and right.
- (iii) The left side of an account is known as “debit” (Dr.) and the right side as “Credit” (Cr.)
- (iv) Each account has a title.
- (v) The entries recorded in an account help in ascertaining the financial position of that account on a particular date.

There are certain rules which help us in debiting and crediting different kinds of accounts. We shall learn these rules later in the next section.

INTEXT QUESTIONS 7.1

- 1 Which English alphabet is similar to the shape of an account?
 - (a) I
 - (b) T
 - (c) H
- 2 How many sides does an account have?
 - (a) One
 - (b) Two
 - (c) Three
3. Where are all the transactions of a particular account recorded?
 - (a) Under the particular account
 - (b) Under any account
 - (c) Under more than two accounts.

7.4 KINDS OF ACCOUNTS

If you observe the transactions of a business, you may be able to generate many transactions. Further, you may be able to recognise

various accounts pertaining to those transactions. Observe the following transactions and label the accounts contained in each transaction.

- (i) Started business with cash.
- (ii) Bought goods for cash.
- (iii) Bought goods on credit.
- (iv) Sold goods for cash.
- (v) Sold goods on credit.
- (vi) Paid wages.
- (vi) Received commission.

Each Transaction will simultaneously affect two accounts.

The two accounts contained in each of the above transactions are:

- | | | | | | |
|----|------------|-----|-----|----------|-----|
| 1. | Capital | A/c | and | Cash | A/c |
| 2. | Purchases | A/c | and | Cash | A/c |
| 3. | Purchases | A/c | and | Supplier | A/c |
| 4. | Sales | A/c | and | Cash | A/c |
| 5. | Sales | A/c | and | Customer | A/c |
| 6. | Wages | A/c | and | Cash | A/c |
| 7. | Commission | A/c | and | Cash | A/c |

Like the above sets of accounts, there are endless accounts in each business unit. Seeing the nature of these accounts, they may be grouped under the following heads:

1. Assets	2. Liabilities	3. Capital
4. Expenses	5. Revenue	

The above terms have already been explained in lesson on Accounting Terms. Some important examples of each of the above *kinds of accounts* are given below:

(i) Assets

Examples of Assets are:

Cash in hand, cash at bank, land and building, furniture, machinery, stock, debtors, bills receivable, prepaid expenses, investments, etc.

(ii) Liabilities

Examples are:

Creditors, short term loans, long term loans, bills payable outstanding expenses, Bank overdraft, salaries received in advance etc.

(iii) Expenses

Examples of expenses are:

Payment of wages, salaries, rent, commission, carriage, carriage, insurance, discount, freight, interest, etc.

(iv) Revenue

Examples are:

Receipt of interest, commission, discount, dividend, rent etc.

(v) Capital

Examples are:

Owner's investments in his Business and owner's withdrawals (drawings)

In order to have a solid base of accounting, you must have thorough knowledge of the kinds of accounts. The knowledge of rules of accounting may be attained only after learning the different kinds of accounts. The next section focuses on the rules of accounting.

INTEXT QUESTIONS 7.2

A list of the accounts is given below. Tick the (✓) category in which each account falls:

Name of account	Kinds of Accounts				
	Asset	Liability	Capital	Revenue	Expense
(i) Salaries					
(ii) Rent received					
(iii) Machinery					
(iv) Bank Overdraft					
(v) Cash					
(vi) Rajat (Supplier)					
(vii) Mukesh (Owner)					
(viii) Usha Saini (customer)					

7.5 RULES APPLIED TO VARIOUS ACCOUNTS

There are five rules corresponding to the five kinds of accounts:

i) Rule Applied to Asset Accounts

Whenever transaction pertaining to an asset takes place, ascertain whether that asset is being increased or decreased. If there is an increase in the asset, record the amount on the Dr. side of that account and any decrease in that asset should be recorded on the Cr. side of the account. Thus, the rule is 'Debit an increase in assets and credit any decrease in them'.

Example:

Akshay purchased a machinery for Rs.2,00,000. In this transaction, the affected accounts are Cash A/c and Machinery A/c. Cash of the business is decreasing and Machinery A/c as an asset is increasing. Applying

the above rule, Cash A/c will be credited and Machine A/c will be debited. These two accounts will be prepared in the following manner:

Dr.	Cash A/c	Cr.	Dr.Machinery A/c		Cr.
	By Machinery A/c	2,00,000 (Decrease)	To Cash A/c	2,00,000 (Increase)	

Note: 'To' and 'By' have no significance, it is just a customary to write these two prepositions. 'To' is always written on the debit side and 'By' is always on the credit side.

(ii) Rules Applied to Liabilities Accounts

Liabilities are the amount which the business has to pay to the outsiders. An increase in liability is recorded on the credit side of the liability A/c and decrease on the debit side of that liability A/c. Thus the rule is "Credit an increase in liabilities and Debit any decrease in them".

Example :

Purchased goods from Ahmed for Rs.30,000

The two affected accounts in the above transaction are Purchases account and Ahmed account. Ahmed's account in the above transaction is liability account as the business has to make payment to him for the goods purchased on credit. There is an increase in this liability A/c and hence the amount will be written on credit side. This A/C will be shown in the following manner:

Dr.	Ahmed's A/c	Cr.
	By Purchases A/c	30,000 (Increase)

Note: Since Purchases A/c is not liability A/c, it has not been shown. It will be prepared as per the rules of Asset A.c.

(iii) Rule Applied to Capital Account

Capital is the liability of the business towards its owner, i.e., the owner

is the creditor of the business for the amount he has put in the business. Capital gets increased whenever the businessmen introduces additional money or whenever there are profits in the business. Similarly the amount of capital gets decreased whenever there are some losses in business. An increase in capital is recorded on the credit side and a decrease in capital is recorded on the debit side of capital account. The rule, therefore, is "debit a decrease in capital and credit an increase in it".

Example:

Harbans brought Rs.2,00,000 as capital into the business. In this transaction, the two affected accounts are Cash A/c and Capital A/c. The rule stated above will be applied to Capital A/c. Since there is increase in capital, this account will be credited. The Capital will, thus be shown in the following manner

Dr.	Harbans Capital A/c	Cr.
	By Cash A/c	2,00,000 (Increase)

Note: Since Cash A/c is an Asset A/c, it has not been shown here, it will be prepared as per the rules of Asset A/c.

iv) Rule applied to Revenue Account

Revenue increases when it is received, it is decreased, when it is given out of the business. The rule applied to revenue account is "debit decrease in revenue and credit increase in revenue".

Example:

Received rent Rs. 1,000

The two affected accounts in the above transactions are Cash A/c and Rent A/c. Since rent received is a revenue account, it will be credited in the following manner:

Dr.	Rent A/c	Cr.
	By Cash A/c	1,000
		(Increase)

Note: Since Cash A/c is an asset A/c, it has not been shown here. It will be prepared as per the rules of Asset A/c

v) Rule applied to Expense Accounts

Whenever some amount is spent on a particular expense, there is an increase in expenses. Whenever some amount of expenses paid is returned due to some reason, there is a decrease in expenses like excess Rent, tax paid, etc. is returned.

An increase in expenses is recorded on the Debit side and a decrease in expenses is recorded on the credit side of that expense account. Therefore, the rule is "debit any increase in expenses and credit any decrease in them".

Example:

Salaries paid Rs.3,000 by cheque.

The two affected accounts are — Cash A/c and Salaries A/c. Since Salaries A/c is an expense account, the above rule will be applied in the following manner:

Dr.	Salaries A/c	Cr.
To Bank A/c	3,000	

Note: Since Bank A/c is an asset account it will be prepared as per the rules of Asset Account

The rules applicable to the five kinds of accounts have been summarised in the following chart:

Rules of Accounting

Dr.	Asset A/c.	Cr.
Increase (+)		Decrease (-)

Dr.	Liability A/c	Cr.
	Decrease (-)	Increase (+)

Dr.	Capital A/c.	Cr.
Decrease (-)		Increase (+)

Dr.	Revenue A/c	Cr.
	Decrease (-)	Increase (+)

Dr.	Expenses A/c.	Cr.
Increase (+)		Decrease (-)

The above rules have been summarised in the following table:

Summarised Table of the rules of Accounting

The rules given above are summarised below:

- (i) Increase in Assets are debits; decreases are credits;
- (ii) Increase in liabilities are credits; decreases are debits;
- (iii) Increases in owner's capital are credits; decreases are debits;
- (iv) Increases in expenses are debits; decreases are credits;
- and
- (v) Increases in revenues or Incomes are credits; decreases are debits.

Illustration 1

From the following transactions, state the titles of the accounts to be affected, types of the accounts and the account to be debited and the account to be credited:

	Rs.
1. Ram started business with cash	2 00 000
2. He purchased goods for cash	30 000
3. He paid salaries	5,000
4. He sold goods to Mukesh on credit	20,000
5. Furniture purchased for cash	10,000
6. He took loan from Bank	20,000
7. He received commission	1,000
8. Postage paid	1,000
9. He paid rent	3,000
10. He received cash from Mukesh	20,000

Solution

Trans- action No	Names of accounts		Type of accounts		Rules applicable to A/cs in Debit/Credit items of Increase/Decrease	
	(1)	(2)	(1)	(2)	(1)	(2)
1	Cash	Capital	Asset	Capital	Cash (Increase)	Capital Increase
2	Purchases	Cash	Expense	Asset	Purchase (,)	Cash (decrease)
3	Salaries	Cash	Expense	Asset	Salaries (,)	Cash (decrease)
4	Mukesh	Sales	Asset Debtor	Revenue	Mukesh (,)	Sales (Increase)
5	Furniture	Cash	Asset	Asset	Furniture (,)	Cash (Increase)
6	Cash	Bank loan	Asset	Liability	Cash (Increase)	Bank loan (Increase)
7	Cash	Commis- sion	Asset	Revenue	Cash (Increase)	Commission (Increase)
8	Postage	Cash	Expense	Asset	Printing and Stationery (Increase)	Cash (decrease)
9	Rent	Cash	Expense	Asset	Rent (Increase)	Cash (decrease)
10	Cash	Mukesh	Asset	Asset	Cash (Increase)	Mukesh (decrease) Debtor

Illustration 2

Show how the different accounts will appear in the above illustration No. 1

Solution

Dr.	Cash	A/c	Cr.
	(Rs.)		(Rs.)
To Capital	2,00,000	By Purchases	30,000
to Bank loan	20,000	By Salaries	5,000
To Commission	1,000	By Furniture	10,000
To Mukesh	20,000	By Printing & Stationery	1,000
		By Rent	3,000
Dr.	Capital	A/c	Cr.
		By Cash A/c	2,00,000
Dr.	Purchases	A/c	Cr.
	(Rs.)		
To Cash	30,000		
Dr.	Salaries	A/c	Cr.
	(Rs.)		
To Cash A/c	5,000		
Dr.	Mukesh	A/c	Cr.
	(Rs.)		
To Cash A/c	20,000	By Cash A/c	20,000
Dr.	Sales	A/c	Cr.
	(Rs.)		
By Mukesh A/c	20,000		
Dr.	Commission	A/c	Cr.
			(Rs.)
		By Cash A/c	1,000

Dr.	Furniture	A/c	Cr.
		Rs.	
To Cash A/c	10,000		
Dr.	Bank Loan	A/c	Cr.
		Rs.	
		By Cash A/c	20,000
Dr.	Printing & Stationary	A/c	Cr.
		(Rs.)	
To Cash A/c	1,000		
Dr.	Rent	A/c	Cr.
		(Rs.)	
To Cash A/c	3,000		

INTEXT QUESTIONS 7.3

1. The names of some accounts are written under the first column. Identify the accounts and state the rules to be applied against each.

Account	Type	Rules to be applied
Cash A/c		
Sales A/c		
Furniture A/c		
Capital A/c		
Rent A/c		
(Rent has been paid)		

2. Increases or decreases in the different types of accounts have been mentioned in the first column. Write whether each increase or decrease will be debited or credited to the account mentioned in the second column.

	Increase or decrease	Debit or Credit
(i)	Increase in revenue	Revenue A/c
(ii)	Increase in an expense	Expense A/c
(iii)	Withdrawals of a portion of Capital	Capital A/c
(iv)	Purchases of furniture	Furniture A/c
(v)	Receipt of a part of debt from a debtor	Debtors A/c

7.6 WHAT YOU HAVE LEARNT

1. Meaning of an account — An account is a systematic record of transactions which can be measured in terms of money and related to business during a particular period.
2. Kinds of accounts — These are (a) Assets, (b) Liabilities (c) Capital, (d) Revenue, (e) Expenses.
3. Rules of accounting:
 - (a) Debit an increase in assets and credit a decrease in assets.
 - (b) Debit a decrease in liability and credit an increases in liability.
 - (c) Debit a decrease in Capital and credit an increase in capital.
 - (d) Debit an increase in expenses and credit a decrease in expenses.
 - (e) Debit a decrease in revenue and credit an increase in revenue.

7.7 TERMINAL QUESTIONS

1. Answer the following questions in 1-10 words:
 - (i) How does the format of an account look like?
 - (ii) Name the two sides of an account.
 - (iii) Which accounting rule is applied to Assets accounts?
2. Answer the following in 30-50 words (Approx)
 - (i) What is an account?
 - (ii) Enumerate the rules of accounting
3. Enter the amount of each of the following transactions in cash account:
 - (a) Started business with cash Rs.50,000
 - (b) Paid Wages Rs.2,000
 - (c) Received commission Rs. 3 000
 - (d) Paid salaries Rs. 5,000
 - (e) Took loan from bank Rs. 4,000
4. For each of the following items, indicate whether the amount should be entered on the debit or credit side of the account:
 - (i) increase in cash;
 - (ii) decrease in machinery;
 - (iii) increase in wages;
 - (iv) decrease in interest received;
 - (v) decrease in capital
 - (vi) increase in furniture

5 Prepare "T" accounts and enter the following amounts in these accounts:

- (i) Mohini started business with Rs.65,000
- (ii) She purchased goods for cash Rs.19,000
- (iii) She deposited into bank Rs.15,000
- (iv) She sold goods for cash Rs.5,000
- (v) She sold goods on credit to Janak Rs.5,000
- (vi) She paid wages Rs.2,000
- (vii) She received rent Rs.2,000
- (viii) She paid salaries Rs.3,000

7.8 ANSWERS TO INTEXT QUESTIONS

- 7.1 1 (b)
- 2. (b)
- 3 (a)

Name of account	Kinds of Accounts				
	Asset	Liability	Capital	Revenue	Expense
(i) Salaries	—	—	—	—	√
(ii) Rent received	—	—	—	√	—
(iii) Machinery	√	—	—	—	—
(iv) Bank Overdraft	—	√	—	—	—
(v) Cash	√	—	—	—	—
(vi) Rajat (Supplier)	—	√	—	—	—
(vii) Mukesh (Owner)	—	—	√	—	—
(viii) Usha Saini (customer)	√	—	—	—	—

7.3 (1)

Account	Type	Rules to be applied
(i) Cash A/c	Asset A/c	Increase to be debited and decrease to be credited.
(ii) Sales A/c	Revenue A/c	Increase to be credited and decrease to be debited.
(iii) Furniture A/c	Asset A/c	Increase to be debited and decrease to be credited.
(iv) Capital A/c	Liability A/c	Increase to be credited and decrease to be debited.
(v) Rent A/c	Expense A/c	Increase to be debited and decrease to be credited.

- 2) i) credited
ii) debited
iii) debited
iv) debited
v) credited