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# Front Office News

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## Debits and Credits - By Diane DeClercq

### Debits and Credits

Do the words "debits" and "credits" sound like a foreign language to you? How do you know which account to debit and which to credit to increase or decrease their balance? Why is an accounting credit the opposite of what my bank calls a credit?

Under the double-entry system of accounting, every business transaction is recorded in at least two different accounts. One account will receive a debit entry, meaning the amount will be entered on the left side of its ledger. Another account will receive a credit entry, meaning the amount will be entered on the right side of that account's ledger. The initial challenge with double entry is to know which account should be debited and which account should be credited .

### What is an Account?

To keep a company's financial data organized, accountants developed a system that sorts transactions into records called accounts. When an accounting system is set up, the accounts most likely to be affected by the company's transactions are identified and listed. This list is referred to as the company's **chart of accounts**. Depending on the size, complexity and type of ownership the chart of accounts may be as few as thirty accounts or many thousands. Income and expense accounts can be customized to track types of income and expenses that are relevant o your business.

Within the chart of accounts the balance sheet accounts are listed first, followed by the income statement accounts. The accounts are organized as follows: Assets, Liabilities, Owner (Shareholders') Equity, Revenues or Income, Expenses, Gains/Losses.

### Double Entry Accounting

Our accounting system is known as a double-entry system. Every transaction affects at least two accounts. For example, if a company buys supplies for cash, the Supplies Expense account and the Cash account will be affected. If the company buys supplies on credit the Supplies Expense account and Accounts Payable will be affected. Lastly, if the supplies were purchased with an American Express card the accounts affected would be Supplies Expense account and American Express Credit Card account.

Although the system is referred to as double-entry, a transaction may involve more than two accounts. An example of a transaction that involves three accounts is a company's loan payment to its bank. This transaction will involve Cash account, Notes Payable Liability account and Interest Expense account.

After you have identified which accounts are involved in the transaction, you must decide which ones to debit and credit. To debit an account means to enter an amount on the left side of your journal entry and to credit means to enter an amount on the right side of the journal entry.

**The DEBIT - CREDIT rule**

| Debit | Credit |
|---|---|
| Left | Right |

**Generally these types of accounts are increased with a debit and decreased with a credit:** Assets, (including Cash & Bank Accounts), Expenses, Shareholder Draws. **These accounts are generally increased with a credit and decreased with a debit:** Revenue/Income, Liabilities, Shareholder Earnings.

For example, if you are going to deposit a check into your bank for sales revenue received, you would debit the Asset (Bank Account) which increases the balance in your account. Then you would credit Revenue/ Income which increases the amount of your sales. Purchasing supplies with cash you would debit Supplies Expense to increase the amount you have spent on supplies and credit Asset (Bank Account) which decreases the amount of cash in your bank.

**Summarized Debit and Credit Rules**

| Account Type | To Increase | To Decrease |
|---|---|---|
| Asset | Debit | Credit |
| Liability | Credit | Debit |
| Equity | Credit | Debit |
| Revenue | Credit | Debit |
| Expense | Debit | Credit |