

## When to Debit and Credit in Accounting

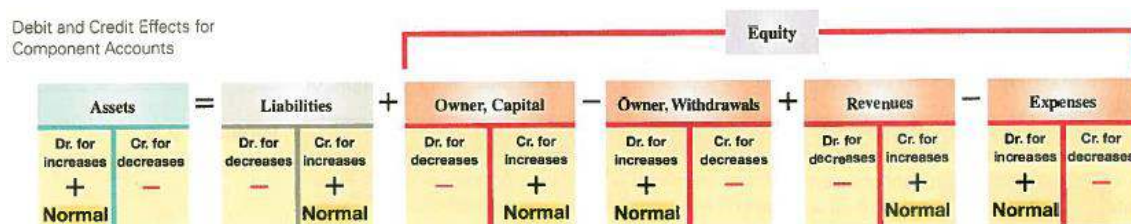
Journal entries show a firm's transactions throughout a period of time; for example, when a company purchases supplies a journal entry will show the amount of supplies bought and money spent.

According to the practice of double-entry accounting, every journal entry must:

- Include at least two distinct accounts with at least one debit and one credit.
- Have the total monetary amount of debits equal to the total monetary amount of credits.
- Be consistent with the accounting equation,  $\text{Assets} = \text{Liabilities} + \text{Equity}$ . (Wild, Shaw, and Chiappetta, 55)

An *asset* is loosely defined as a resource with economic value that a particular firm has, and includes accounts such as cash, accounts receivable, and office supplies. *Liabilities* are the debts and obligations a company accumulates in operating the business; it includes accounts such as accounts payable, wages payable, and interest payable. *Equity* represents the amount of ownership in an asset that is not financed through debt. Equity begins with the owner's capital, which are personal investments of assets by the owner, and grows as revenues are accrued over the course of business operations. Equity shrinks when the owner withdrawals capital and/or expenses are incurred. Thus the accounting equation,  $\text{Assets} = \text{Liabilities} + \text{Equity}$ , can be roughly translated as, "things we have are backed by things we owe and things we own." A chart of accounts, which list commonly used accounts and their type, is included as an appendix in most accounting text books.

The following diagram depicts the accounting equation such that equity is broken down into the component accounts of Capital, Withdrawals, Revenue, and Expenses, and illustrates how each type of account reacts to debits and credits.





Generally speaking, accounts that are categorized as assets on the left side of the accounting equation are debited to increase their value, while accounts on the right side of the equation, which are categorized as liability or equity accounts, are credited to increase their value. The owner's withdrawals and expenses are the only exception to this rule, as they are on the right side of the equation but are debited to increase their value; this is because both withdrawals and expenses serve to lower the total value of equity in the accounting equation. If equity is thought of as its own unique account such that it increases when it is credited and decreases when it is debited, then increasing an expense or withdrawal with a debit can be thought of as decreasing the total amount of equity.

Listed below are the only possible ways a company's assets, liabilities, or equity could be affected by a single transaction:

1. An equal rise/decrease on the same side of the equation:
  - a.  $\uparrow\downarrow\text{Assets}=\text{Liabilities}+\text{Equity}$
  - b.  $\text{Assets}=(\text{Liabilities}+\text{Equity})\uparrow\downarrow$
2. Equal increases on opposite sides of the equation:
  - a.  $\uparrow\text{Assets}=(\text{Liabilities} + \text{Equity})\uparrow$
3. Equal decrease on opposite sides of the equation:
  - a.  $\downarrow\text{Assets}=(\text{Liabilities} + \text{Equity})\downarrow$

Journal Entries are comprised of three parts: the transaction date, account names and numbers used in the transaction, the resulting debits and credits. The journal entry's debits and credits must equal each other. There could be many accounts debited and just one account credited, but the total monetary amounts of debits and credits must equal one another.

**Example 1:**

On December 1<sup>st</sup> an Owner invests 10,000 dollars in cash, equipment valued at 20,000 dollars, and a building valued at 50,000 dollars. Create the journal entry for this transaction.

**Solution:**

Because the Owner invested cash, equipment, and a building into the company, the value of these accounts are increasing; because these accounts are all asset accounts, an increase in their



value must be recorded as a debit. Likewise, because the Owner’s Capital is increasing and has a normal credit balance, the account will be credited for 80,000 dollars. This transaction is illustrated with the accounting equation as such:

$$+\$80,000 \uparrow \text{Assets} = \text{Liabilities} + (\text{Equity}) \uparrow +\$80,000$$

The resulting journal entry for this transaction is as follows: (next page)

Date	Account Name	Debit	Credit
Dec 1 <sup>st</sup>	Cash	10,000	
	Equipment	20,000	
	Building	50,000	
	Owner’s Capital		80,000

Note that there is an 80,000 dollar increase on both sides of the accounting equation, even though three accounts were debited and only one account credited in the journal entry.

When creating a journal entry, all debited accounts have to be listed before any credited accounts, and the credited account needs to be indented to the right in order to distinguish it from debited accounts. Furthermore, it is customary to provide a space between each entry in the journal.

The above entry is correct in that it meets all the requirements of the double-entry method in accounting. It includes at least two distinct accounts with at least one debit and one credit, and the total monetary amount of debits equal the total monetary amount of credits and is consistent with the accounting equation,  $\text{Assets} = \text{Liabilities} + \text{Equity}$ . (Wild, Shaw, and Chiappetta, 55).



**Example 2**

The Owner of a business paid 300 dollars for December rent on December 31<sup>st</sup>. Record the resulting journal entry.

**Solution:**

This is a typical example of information given to a student to record into a journal entry. This transaction involves two accounts: cash and rent expense. In this transaction, cash was used to pay for the rent. Following the double-entry method, the journal entry will look like this:

Date	Account Name	Debit	Credit
Dec 31 <sup>st</sup>	Rent Expense	300	
	Cash		300

Using the accounting equation, the transaction is illustrated as:

$$-\$300 \downarrow \text{Assets} = \text{Liabilities} + (\text{Equity}) \downarrow -\$300$$

Note that a debit is used to increase the amount of an expense; however, this results in an overall decrease in Equity because:

$$\text{Equity} = \text{Capital} - \text{Withdrawals} + \text{Revenue} - \text{Expenses}$$

Therefore, this transaction is consistent with the accounting equation.



Try creating journal entries from the following transactions. The answers are on the following page.

Sample Problems: Walter's Consulting and Cleaning Company

- Dec 1) Walter invested equipment valued at \$20,000 into his company and \$45,000 cash.
- Dec 2) Walter paid \$550 cash for supplies.
- Dec 3) Walter paid \$22,000 cash for equipment.
- Dec 4) Walter's Consulting and Cleaning Company paid \$15,000 in cash for equipment and paid \$3,000 cash for additional supplies.
- Dec 5) Walter purchased \$400 of supplies on credit from a supplier.
- Dec 6) Walter performed consulting services of \$6,000. The customer paid with cash.
- Dec 7) Walter's Consulting and Cleaning Company paid \$440 cash for employee salary.
- Dec 8) Walter's Consulting and Cleaning Company completed consulting services of \$2,500. The customer is billed for these services.
- Dec 9) Walter paid \$400 cash to settle the accounts payable created in transaction 5.
- Dec 10) Walter's Consulting and Cleaning Company recieved payment from example 8.
- Dec 11) Walter withdrew \$1,000 cash from the company for personal use.
- Dec 12) Walter paid \$2,000 cash for 12 months of insurance.
- Dec 13) Walter's Consulting and Cleaning Company provided consulting services of \$2,000 and cleaning services of \$200. The customer is billed \$2,200 for these services.
- Dec 14) Walter recieved cash for services rendered on December 13.



Transaction Date	Account Name	Debit	Credit
Dec-1	Equipment	20,000	
	Cash	45,000	
	Walter's Capital		65,000
2	Supplies	550	
	Cash		550
3	Equipment	22,000	
	Cash		22,000
4	Equipment	15,000	
	Supplies	3,000	
	Cash		18,000
5	Supplies	400	
	Accounts Payable		400
6	Cash	6,000	
	Consulting Revenue		6,000
7	Salary Expense	440	
	Cash		440



8	Accounts Receivable	2,500	
	Consulting Revenue		2,500
9	Accounts Payable	400	
	Cash		400
10	Cash	2,500	
	Accounts Receivable		2,500
11	Walter's Withdrawal	1,000	
	Cash		1,000
12	Prepaid Insurance	2,000	
	Cash		2,000
13	Accounts receivable	2,200	
	Consulting Revenue		2,000
	Cleaning Revenue		200
14	Cash	2,200	
	Accounts receivable		2,200



References

Wild, J., Shaw, K., & Chiappetta, B. (2011). *Fundamental accounting principles*. (20th ed., p. 55-56). New York, NY: McGraw-Hill/Irwin.