DEBITS
AND
CREDITS

For every item which appears in the income statement or balance sheet an account (the form or record for each item) is kept. The accounts are designed so that increases in the account are recorded separately from decreases. Each account has a left side and a right side. The left side of the account is known as the debit side and the right side is known as the credit side.

Debiting an account means recording an amount on the left or debit side of the account; crediting an account means recording an amount on the right or credit side.

The words debit and credit do not imply increase or decrease until they are associated with particular accounts. The rules for increasing and decreasing a liability or owner equity account are just the reverse of those for the asset accounts.

\[
\text{DEBITS} = \text{CREDITS}
\]

\[
\text{Assets} = \text{Liabilities} + \text{Owner's Equity}
\]

| Debit Record Increases (+) | Credit Record Decreases (-) | Debit Record Decreases (-) | Credit Record Increases (+) | Debit Record Decreases (-) | Credit Record Increases (+) |

Note: For illustrative purposes the "T" account format is used rather than the formal account format found in an accounting system.
Revenue and expense transactions cause changes in the owner's equity of an organization. While these transactions could be recorded directly in the owner's equity account, the usual process is to record the revenues and expenses in separate accounts. If the revenues and expenses were recorded directly in the owner's equity account, it would be difficult to produce an income statement because the revenue and expense items would be mixed with those of the investments and withdrawals of the owner. In order to produce an income statement a detailed analysis of the owner's equity account would be required.

When separate revenue and expense accounts are used, the rules of debit and credit are derived from the rules used to increase or decrease the owner's equity account.

\[
\begin{align*}
\text{DEBITS} & = \text{CREDITS} \\
\text{Assets} & = \text{Liabilities} + \text{Owner's Equity}
\end{align*}
\]
Revenues increase owner's equity; owner's equity is increased by crediting the account. Therefore, revenue accounts are increased with credits and decreased with debits.

Expenses decrease owner's equity; owner's equity is decreased by debiting the account. Therefore, expense accounts are increased with debits (increasing an expense decreases owner's equity) and decreased with credits.

The Effect Of Transactions On The Accounts

1. Increase an asset; increase owner's equity

   Steve Molloy decides to start a television repair business. He begins the business by investing $10,000 in cash.

   \[
   \begin{array}{c|c|c}
   \hline
   \text{ASSETS} & \text{LIABILITIES} & \text{OWNER'S EQUITY} \\
   \hline
   \text{Cash} & \text{Debit} & \text{Credit} \\
   \text{Steve Molloy Capital} & \text{Debit} & \text{Credit} \\
   \hline
   \$10,000 & \text{Debit} & \text{Credit} \\
   \text{\$10,000 (1)} & \text{Decr.} & \text{Cr.} \\
   \hline
   \end{array}
   \]

   The cash account was increased (debits increase assets)
   The owner's equity account was increased (credits increase owner's equity)

2. Increase an asset; decrease an asset

   Molloy purchases $6,000 of equipment paying cash

   \[
   \begin{array}{c|c|c}
   \hline
   \text{ASSETS} & \text{LIABILITIES} & \text{OWNER'S EQUITY} \\
   \hline
   \text{Cash} & \text{Debit} & \text{Credit} \\
   \text{Equipment} & \text{Debit} & \text{Credit} \\
   \text{Steve Molloy Capital} & \text{Debit} & \text{Credit} \\
   \hline
   \$10,000 & \text{Decr.} & \text{Cr.} \\
   \$6,000 (2) & \text{Cr.} & \text{Decr.} \\
   \$10,000 (1) & \text{Debit} & \text{Credit} \\
   \hline
   \end{array}
   \]

   The cash account was decreased (credits decrease assets)
   The equipment account was increased (debits increase assets)

3. Increase an asset; increase a liability

   Molloy purchases $1,000 of parts on credit from Peterson Electronic Supply.

   \[
   \begin{array}{c|c|c}
   \hline
   \text{ASSETS} & \text{LIABILITIES} & \text{OWNER'S EQUITY} \\
   \hline
   \text{Cash} & \text{Debit} & \text{Credit} \\
   \text{Parts} & \text{Debit} & \text{Credit} \\
   \text{Equipment} & \text{Debit} & \text{Credit} \\
   \text{Accounts Payable} & \text{Debit} & \text{Credit} \\
   \text{Steve Molloy Capital} & \text{Debit} & \text{Credit} \\
   \hline
   \$10,000 & \text{Decr.} & \text{Cr.} \\
   \$6,000 (2) & \text{Cr.} & \text{Decr.} \\
   \$5,000 & \text{Decr.} & \text{Cr.} \\
   \$3,000 (1) & \text{Cr.} & \text{Decr.} \\
   \$10,000 (1) & \text{Debit} & \text{Credit} \\
   \hline
   \end{array}
   \]

   The parts account was increased (debits increase assets)
   The accounts payable account was increased (credits increase liabilities)
4. Increase an asset, increase owner's equity

Molloy performed services for customers receiving a payment of $1,000 in cash.

<table>
<thead>
<tr>
<th>Cash</th>
<th>Revenue</th>
<th>Parts</th>
<th>Equipment</th>
<th>Accounts Payable</th>
<th>Owner's Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>10,000</td>
<td>(1)</td>
<td>6,000</td>
<td>(2)</td>
<td>6,000</td>
<td>(2)</td>
</tr>
</tbody>
</table>

5. Decrease an asset, decrease a liability

Molloy paid $1,700 to Petersen Electronic Supply against the liability of $3,000

<table>
<thead>
<tr>
<th>Cash</th>
<th>Owner's Equity</th>
<th>Parts</th>
<th>Equipment</th>
<th>Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
</tr>
<tr>
<td>10,000</td>
<td>(1)</td>
<td>6,000</td>
<td>(2)</td>
<td>6,000</td>
</tr>
<tr>
<td>1,000</td>
<td>(5)</td>
<td>1,700</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The cash account was decreased (credits decrease assets)
The accounts payable account was decreased (debits decrease liabilities)

6. Decrease an asset, decrease owner's equity

Molloy paid one month's rent of $200

<table>
<thead>
<tr>
<th>Cash</th>
<th>Revenue</th>
<th>Parts</th>
<th>Equipment</th>
<th>Accounts Payable</th>
<th>Owner's Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
<td>Credit</td>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>10,000</td>
<td>(1)</td>
<td>6,000</td>
<td>(2)</td>
<td>6,000</td>
<td>(2)</td>
</tr>
<tr>
<td>1,000</td>
<td>(5)</td>
<td>1,700</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1,700</td>
<td>(6)</td>
<td>200</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The cash account was decreased (credits decrease assets)
The expense account was increased (debits decrease owner's equity; expenses decrease owner's equity; therefore, debits increase expense accounts)