AccountAble™

Debit and Credit — **Issue # 77; March-02**; Released July-02

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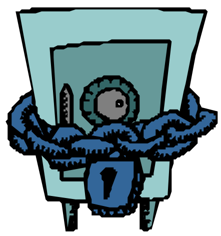
Overview

Most of accounting can be summed up in two words: Debit and Credit. What do these words mean?

Debit and credit is supposed to very boring and tedious for human beings. For accountants, this is the very essence of life.

Debit & Credit: Left or Right



You may heard the following story about an accounting wizard:

> A wealthy Wall Street banker was famous for his numerical skills - he could take in the most complicated balance sheet at one glance. Trained as an accountant, he would come to his office every day, open a wall safe behind his desk, take out a small piece of tightly rolled paper, look at it, then place it back in the safe.
>
> When the banker died, his junior was naturally very interested to know what was written on that slip of paper. He gained access to the safe, took out the paper, and unrolled it. Written in the banker's own handwriting were these words: 'Debit is on the left, Credit is on the right.'

And thereby hangs another tale. Why is debit on the left and credit on the right? For finding an answer we have to go back in time to the middle ages. And look at the origins of word debit and credit. It turned out that debit is related to the word debtor and comes from the Latin word debere.

debt[1]

Debt originated as *debita*, the plural of Latin *debitum* 'that which is owed,' a noun formed from the past participle of the verb *debere*[2] 'owe.' In the 15th century English independently borrowed Latin *debitum* as debit. People who owed money to others were called 'debtors'.

Debtors in those times really had a tough time: prisons were full of them. And of course, we all know what Shylock would have done to Merchant of Venice, had Portia not been around. So owing money to someone was probably a bad thing.

[1] 13th Century

[2] Latin *debere* 'owe,' source also of English debenture, due and duty, was originally a compound verb formed from the prefix de- 'away' and *habere* 'have,' literally 'have away,' that is 'keep in one's possession what belongs to someone else.'

left[3]

So was being left-handed. People who were left-handed were considered evil and sometimes burned at the stake as witches or wizards. The left hand continues to be considered unclean even today in India, though for different reasons.

The Old English word for 'left', was *'winestra'*. Tracing the origin of this word, we find that originally it meant 'friendlier[4]'. Its polite application to 'left' is a reminder that historically the left-hand side of the body has been superstitiously regarded as of ill omen. To call it 'friendly[5]' was an attempt to placate the evil forces of the left[6].

Putting these two things together, it is logical that debit would have been put on the left. The logic of putting bad things on the left continued with the Balance Sheet also, where assets were put on the right and liabilities on the left.

Once we have got this far, working out the credit side is much easier. The word credit comes from the Latin word credere 'to believe, trust'. It has positive connotations (creditable, creditworthy, credible). The word 'right; similarly has positivism (doing the right thing). So credit entries were put on the right.

Yes, but what does all this lead to?

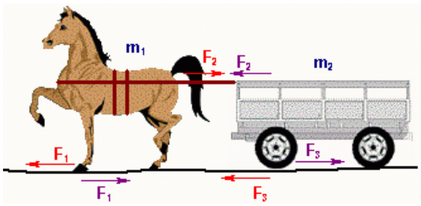
In the world, there are two forces at work, good and evil. A coin has two sides, heads and tails. Numbers can be of two types, either positive or negative. A person has two hands, left and right.

Accountants recognised this simple truth long ago, and adapted it to their purposes. According to them, every transaction involves two parties, a giver and receiver. If you receive something, then someone, somewhere must have given it to you.

If you receive something, you become a debtor. Receiving is therefore considered to be a debit activity.

On the other hand, if you give something to a person, you become his (or her) creditor. Giving is therefore 'credit'.

Accountants also say that debits and credits must always be equal to each other in any transaction. Or whenever, there is a debit, there will always be an equal and opposite credit. Sounds familiar?



A gentleman named Isaac Newton recognised[7] this truth and applied it to Physics in 1687. The Third Law of Motion (Every action has an equal and opposite reaction) was thus born.

Debit and Credit are, therefore, two sides of a transaction. Each accompanies the other.

The three rules of Debit & Credit

In order to make simple things complicated, accountants say that there are three types of accounts: Real, Personal and Nominal. If you know which type of account you are dealing with, you can apply the correct rule. Of course, identifying the type of account is not an easy thing. Still let us give it a try.

[3] 13th Century
[4] It is related to Swedish vän 'friend'
[5] A usage which survives in Swedish vänster and Danish venstre 'left'.
[6] No pun intended!
[7] It is not clear whether Sir Isaac Newton had taken accounting classes during college…

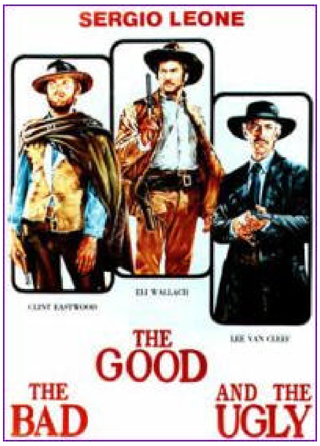
1. **Real Accounts** are tangible, physical things. For example, a building, cash, vehicle. For these accounts, the rule is ‘Debit what comes in, Credit what goes out.’

2. **Personal Accounts** are, well, accounts of persons. The definition of person includes organisations also. Here the rule is very simple: ‘Debit the Receiver, Credit the Giver.’ This doesn’t need much explanation.

3. Then comes the masterstroke of double entry accounting: Nominal Accounts. **Nominal Accounts** are actually a figment of accounting imagination. You can never touch, see or smell them. Accounts of income (sale, fees, interest earned) and of expenses (traveling, printing, rent etc.) are nominal accounts. The word nominal comes ultimately from the Latin word nomen, (name). Hence the meaning: existing in name only.

   The rule for nominal accounts is also rather simple: Debit all expenses and losses. Why? Because expenses are bad things, they should be kept on left. On the other hand (i.e. The right hand), income is good. Therefore, credit all incomes and gains! Simple, isn’t it?

A simpler Alternative



If these rules sound complicated then here’s a simpler[8] way:

The Good and the Bad

Keep in mind only two things:

1. Receiving is bad (because ultimately you have to repay it). Keep the Receivers on the left.

2. Giving is good (doesn’t every system of belief say that?). Keep the Givers on the right.

The Humanisation Process

If you are comfortable with that, proceed as follows:

- First give a personality to each account. Treat them like human beings. ‘Cash’ will become ‘Mr. Cashier’. Bank will become ‘Ms. Banker’.
- Similarly, when you look at tangible things, go behind them to the persons. For example, if you have bought a vehicle, think that Ms. Banker has paid money to Maruti Udyog Ltd.
- If you have incurred expenses, once again give them a personality. Your train fare has been paid to Indian Railways.
- If you receive money from a donor, give the donor a personality. Say that Mrs. Donor has given you the money.

Only one rule for everyone

Now apply the basic rule:

Transaction	Receiver	Giver	Entry
Withdrew cash from bank	Mr. Cashier	Ms. Banker	Dr. Mr. Cashier Cr. Ms. Banker
Bought a Maruti Gypsy	Maruti Udyog Ltd.	Ms. Banker	Dr. Maruti Udyog Ltd. Cr. Ms. Banker
Spent money on rail fare	Indian Railways	Mr. Cashier	Dr. Indian Railways Cr. Mr. Cashier

[8] This simple method has been known to cause serious confusion amongst trained accountants. Accountants are requested *not to pay* attention.

Transaction	Receiver	Giver	Entry
Received a donation	Ms. Banker	Mrs. Donor	Dr. Ms. Banker Cr. Mrs. Donor

Back to square one

Now swing your magic wand and turn them back into mice and pumpkins.

Entry	First Swing	Second Swing
Dr. Mr. Cashier **Cr. Ms. Banker**	Dr. ~~Mr. Cashier~~ Cash Cr. ~~Ms. Banker~~ Bank	Dr. Cash Account Cr. Bank Account
Dr. Maruti Udyog Ltd. **Cr. Ms. Banker**	Dr. ~~Maruti Udyog Ltd.~~ Gypsy Cr. ~~Ms. Banker~~ Bank	Dr. ~~Gypsy~~ Vehicles Account Cr. Bank Account
Dr. Indian Railways **Cr. Mr. Cashier**	Dr. ~~Indian Railways~~ Railway Ticket Cr. ~~Mr. Cashier~~ Cash	Dr. ~~Railway Ticket~~ Travel Account Cr. Cash Account
Dr. Ms. Banker **Cr. Mrs. Donor**	Dr. ~~Ms. Banker~~ Bank Cr. ~~Mrs. Donor~~ Donors	Dr. Bank Account Cr. ~~Donors~~ Donations Account

Checking back…

Let us now go back and see whether our results match with accounting rules.

Final Entry	Type of Account	Transaction Analysis	Rule Applicable
Dr. Cash Account **Cr. Bank Account**	Real Personal	Cash came in. Bank gave the money.	Debit what comes in. Credit the giver.
Dr. Vehicles **Cr. Bank Account**	Real Personal	Vehicle came in. Bank gave the money.	Debit what comes in. Credit the giver.
Dr. Travel **Cr. Cash Account**	Nominal Real	Travel is an expense. Cash went out.	Debit all expenses and losses. Credit what goes out.
Dr. Bank Account **Cr. Donations**	Personal Nominal	Bank received the money. Donation is an income.	Debit the receiver. Credit all income and gains.

Moral of the exercise?

You can break the rules and get away with it.

Sometimes.

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