Financial Accounting
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Lecture - 36
3.4 Debit and Credit Balances

Alright, so now you know how to post the journal entries into the ledger and then, how to close these ledger accounts and find out the closing balance, the carried down balance in any ledger account. In this video, I am going to talk about two nomenclatures that we use for these account balances. There are different types of accounts and you saw in some cases the balance was written on the debit side, while in other cases the balance was written on the credit side. These are the specific names that are given to these two types of balances: that is what we are going to learn in this video.

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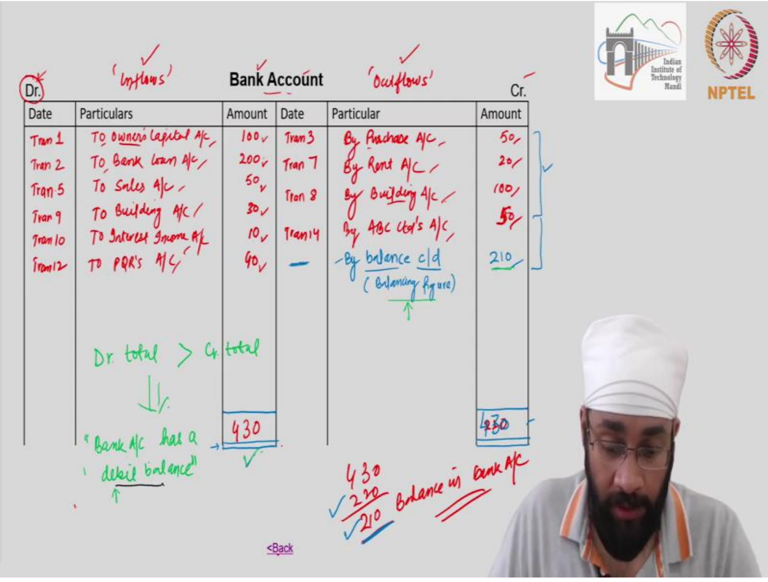

So, these were the accounts. Now, again let me take a different colour of pen, so that I can distinguish the work in this video. In the bank account, we saw that the total on the debit side was 430. Let me just say debit total, I can write it here, debit total was greater than the credit total. Now, in this case, the balance is written on the credit side. When this happens, we say, that bank account has a debit balance. One more time let me repeat this. The total on the debit side is higher than the total on the credit side. This phenomenon is called a debit balance.

We say bank account has a debit balance. To understand it more informally, you can think about it as follows: the bank account has a higher total on the debit side that is what it means. So, a bank account having a debit balance means that the bank account has a higher total on the debit side. Because the total on the debit side is higher, the resulting balance is written on the credit side. But as the balance is being written on the credit side, it does not make it credit balance, do not get confused there. I often see that happening. Do not get confused by looking at the balance on the credit side and saying *hey it is a credit balance*. No, if it is written on the credit side, it is actually because the total on the debit side was higher, and hence, the definition of debit balance says that the debit side total should be higher.

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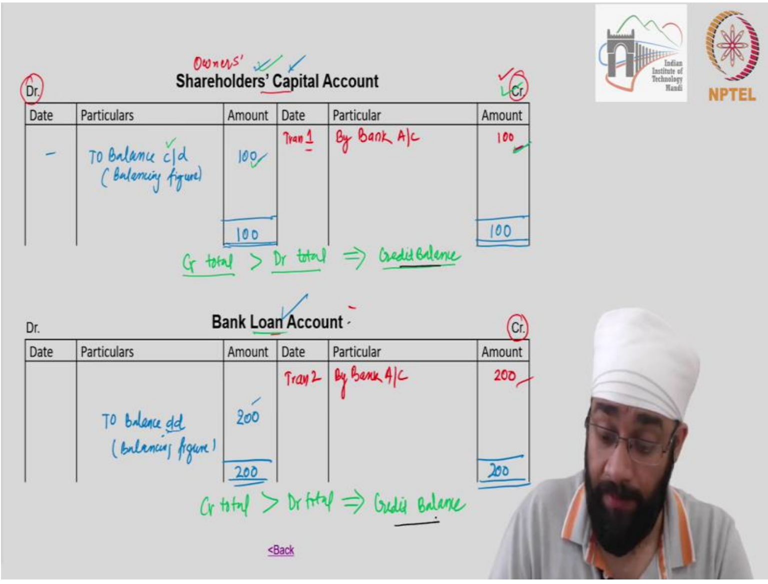

Let us do this for the rest of the accounts as well. Shareholders' capital, you see that the total is on the credit side. So, the credit side total is higher than the debit side total: there was actually nothing on the debit side. This means that the shareholders' capital account had a credit balance. One more time, the credit side total is higher than the debit side total. I am not regarding this balance here, the balance is not the total, total was 100, transactions were only on the credit side, this is a balancing figure. If credit total is higher than debit total, we say shareholders' capital account has a credit balance, and has a higher total on the credit side. As a result, you are going to write the carried down balance on the debit side. The bank account here has a credit total higher than the debit total. Therefore, the bank loan account has a credit balance.

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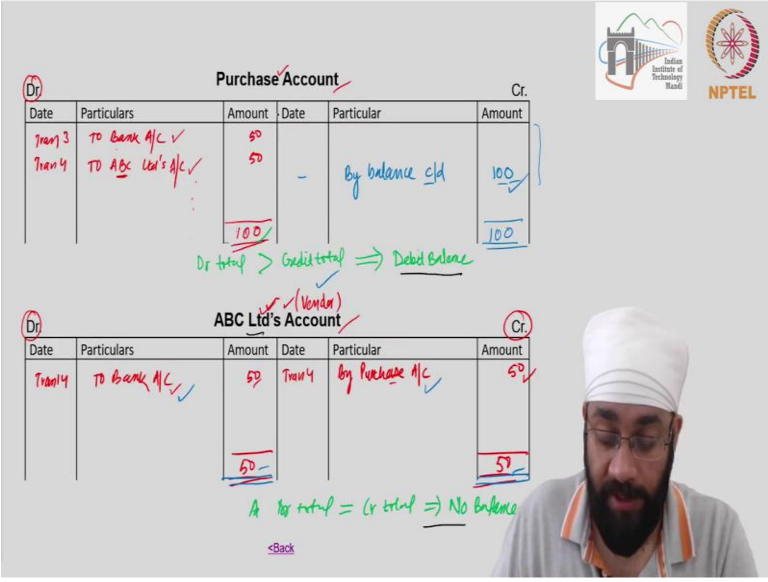

Let us go to the next slide. Here, we have a total on the debit side, 100 and no item on the credit side. So, the debit total is greater than the credit total, which leads us to conclude that the purchase account has a debit balance. ABC account has actually debit total equal to credit total. So, there is no balance, neither debit or credit: there is no balance in this account.

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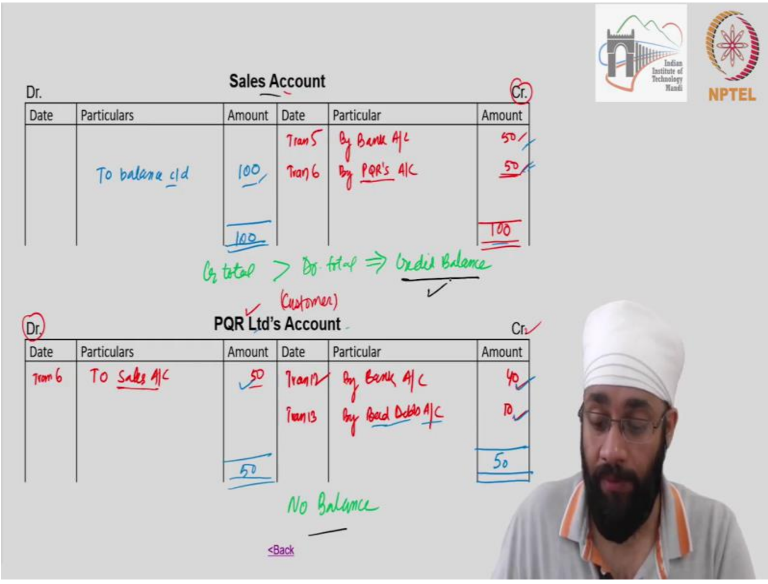

Sales account: you have a credit total which is higher than the debit total that leads us to conclude that there is a credit balance in the sales account. The PQR account has no balance. The total on the debit side is equal to total on the credit side, so no balance.

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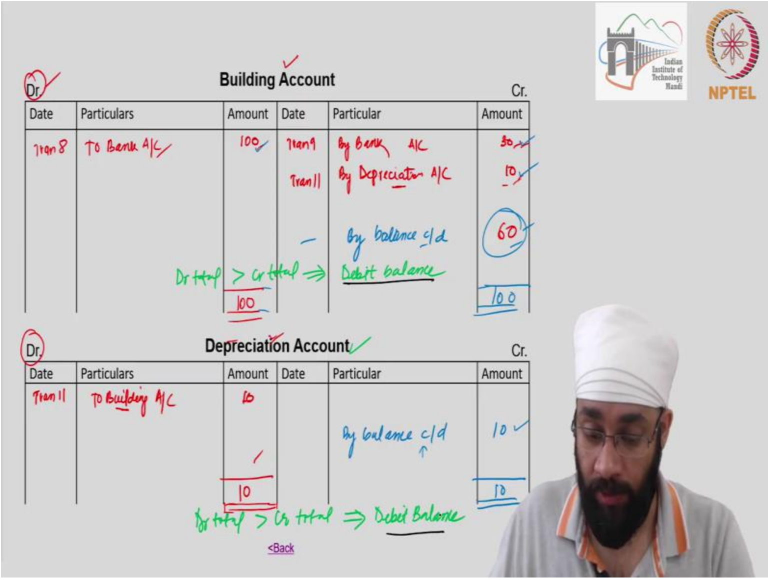

Building account has higher debit total. So, the debit total is greater than the credit total leading us to conclude that building account has a debit balance. Depreciation account again, debit total is higher than the credit total. Therefore, we conclude that the depreciation account has a debit balance here.

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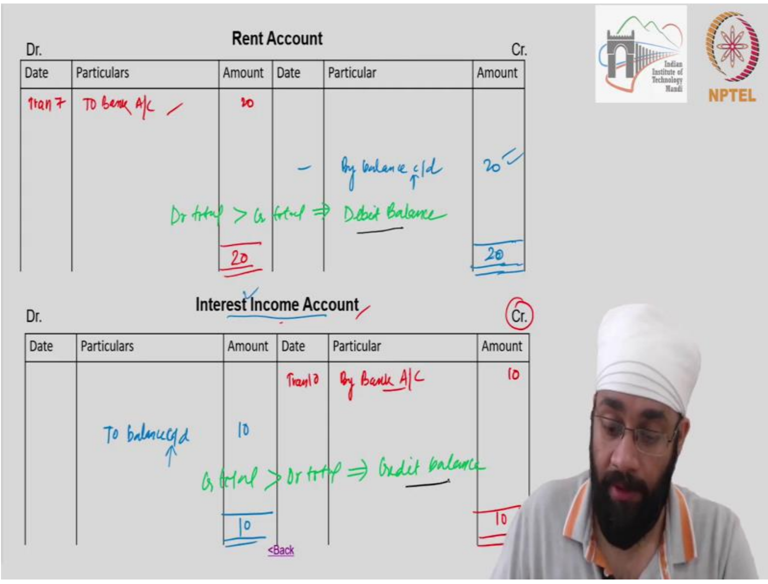

Next step is the rent account. Rent account, debit total is greater than the credit total. Therefore, the rent account has a debit balance and then, you have credit total for interest income which is greater than the debit total that leads us to conclude that interest income account has a credit balance.

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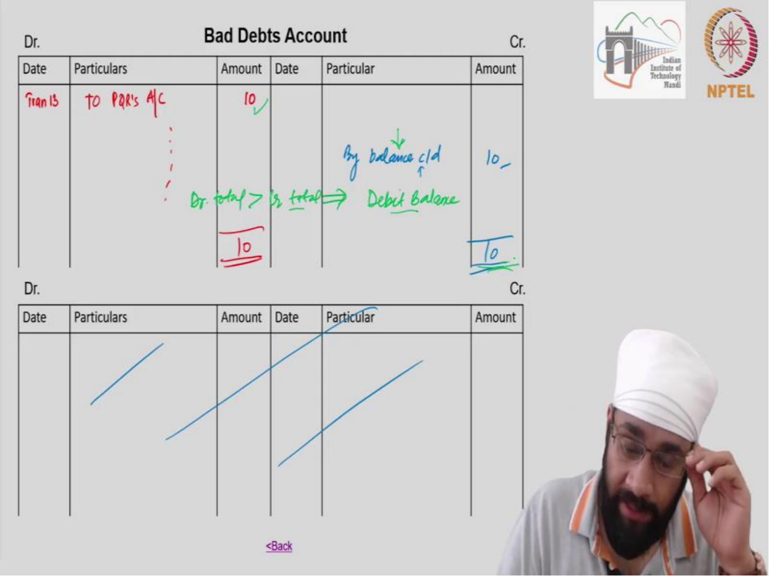

The last account is bad debts account. The bad debt account has a debit total which is greater than the credit total that leads us to conclude that the bad debts account has a debit balance. There you go. That is how you identify if a given account has a debit balance or a credit balance.

Word of caution again, please do not confuse the existence of this balance on the credit side and to conclude that it has a credit balance, that is not correct. You have to compare the total. The total on the debit side is higher than the credit side total therefore, it is a debit balance. As a result of this being a debit balance, then you write this balance on the other side, so that the total comes out to be equal, that is it.

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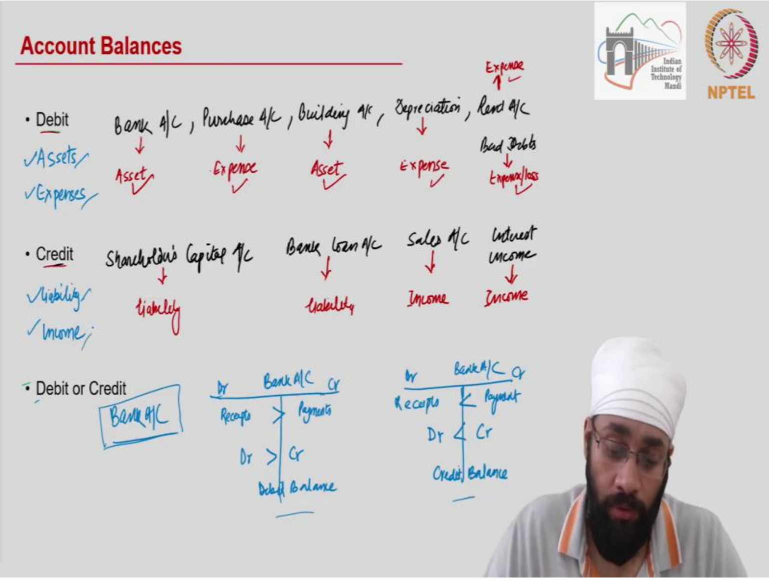

Now we know how to identify the debit or credit balances in these accounts. Let us take one more step and try to see if there is a pattern, is there a rule which can be followed to just verify if we are doing these things correctly and that can be done as follows.

We are going to list the names of the accounts which have debit balances here, and we are going to list names of accounts which have credit balance and then after we do this I will do this discussion. Let me get a different ink.

Now, I am going to start from the beginning, let us say, bank account. Bank account has a debit balance. So, I am going to this slide and I am going to write bank. So, bank account has a debit balance. Let me go back to the next account which was shareholders' capital account. Shareholders' capital account has a credit balance so, I will write shareholders' capital account under credit. Then, let us go to bank loan account; it has a credit balance. So, I am going to write a bank loan account here under credit. Next step you have purchase account. Purchase account has a debit balance and ABC limited has no balance. So, purchase account debit, and ABC limited does not have a balance so, I am going to ignore it for now. Sales account has a credit balance, PQR has no balance. So, sales account credit. Let us look at more accounts. You have a building account which has a debit balance. Depreciation also has a debit balance. So, building and depreciation, under debit. Next step, you have a rent account which has a debit balance. Interest income has a credit balance. So, the rent account debit and interest income has a credit balance here and finally, you have a bad debts account which has a debit balance.

So, bad debts is going to be written here under debit. So, what I have done is I have categorized all the balances into two, which are the accounts which have debit balances, which are the accounts which have credit balances, I have written them here. The objective is to see if there is a pattern. Let us identify if there is a pattern and we will do that in the following manner. What is a bank? An asset, liability, income or expense? The bank is an asset. I am going to write asset. The purchase account, purchases are our expenses. So, I am going to write expense here. The building is an asset, so let us write asset. Depreciation is an expense. Rent is also an expense and bad debts is also an expense/loss. So, we have identified the nature, the broad category where these items fall.

Let us look at the credit balance accounts as well. Shareholders' capital is a liability. Bank loan is a liability. Sales account is an income and interest income, of course, is also an income. These subcategories may vary, but the top level categorization stays.

Now, is there a pattern to it? Is there a pattern to which accounts have debit balances, which accounts have credit balances? Clearly there is asset and asset, there are expenses, expenses, expenses and expenses. So, in the debit balances, you see no liability and no income which means under the debit, the two heads which you can easily identify or the pattern that you see is that there are assets and there are expenses.

On the other hand, under the credit balance accounts, you see all the liability related accounts and you see all the income accounts: that is the pattern. And this pattern is not random, it is not by chance. That is the design of the double entry system. In the double entry system, when you follow the scientific method, you will realize that all assets and expenses are always going to have a debit balance and all liabilities and incomes are always going to have a credit balance: that is the rule and this is a way to check as well. If you have a building account which is giving you credit balance, you know there is something wrong. So, just relook at what you have done and correct your mistake. Now, there is this third category which says debit or credit. So, is there any account which could have a debit or credit account? The answer is yes, there is one account which is called bank account. Bank account could have a debit balance or it could have a credit balance as well.

Now, let me illustrate that here. So, this is the bank account for example, and I am just drawing a sample account format: you have a debit side, you have a credit side. You have three columns on both sides, but I am just trying to give you an example here. So, imagine three columns on both sides. In the bank account, you write all the receipts here. So, you are going to write all the receipts here and you are going to write all the payments here and can you have a case where receipts are more than payments of course, almost always. You are going to have cases where receipts are more than payments which means, debit total is going to be higher than the credit total which means it has a debit balance. Now, let us assume another scenario, where the payments can be more than the receipt, is that possible? Well, if you are talking about cash in hand, then you can certainly not pay more than what you have. However, when you have a bank account, for businesses, banks extend this facility, where you can actually pay more than what you have in the account. This is called a facility of overdraft. When you have an over drafting, over withdrawing facility at bank, you can make more payments. So, in such cases, the receipts can be less and the payments can be more, but there is a limit to it. There is a certain limit based upon the kind of business you do, the level of transactions you do, the businesses extend you some facility that up to 50,000 overdraft is allowed, but you have to bring that money back within 1 month, 2 months. The policies of banks can vary from business to business, but the possibility exists. So, there is just one account, bank account which could possibly have any of the two types of balances. But all the rest of the accounts, all assets and expenses are going to have a debit balance, all liabilities and incomes are going to have a credit balance that is the rule.

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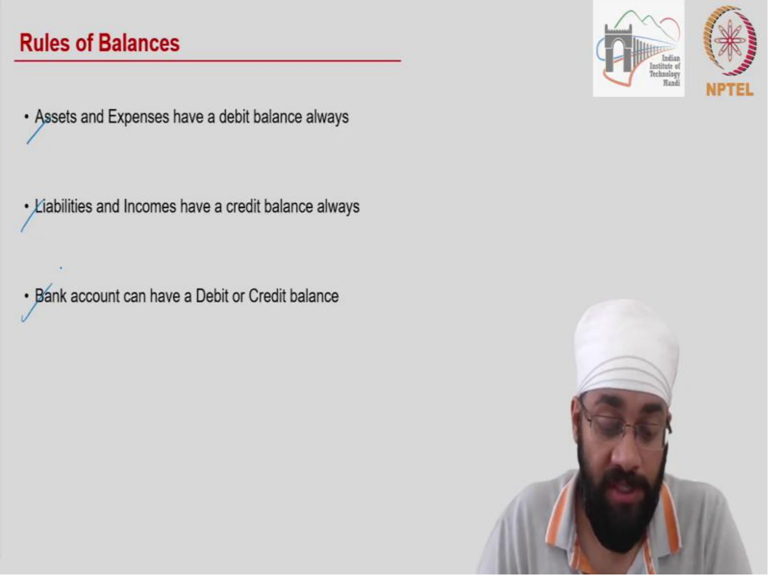

Alright, so this is what we have learnt in this video. These are the three rules which are going to be followed, they help us check, double check if we are doing the transactions, posting the transactions in the right manner. We stop here. We have learned the process of posting; we know how to balance the accounts and now we also know the nomenclature used for indicating debit balances or credit balances.