Financial Accounting
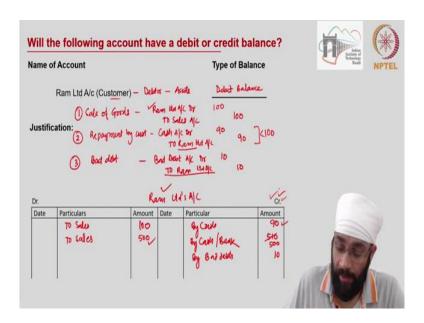**Dr. Puran Singh**
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Lecture – 38
3.5 Tutorial-Identifying Balances (Part-2)

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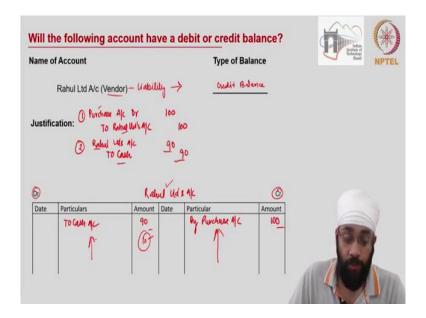

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The next account is Ram Limited's account and this is a customer. Customer is a debtor. And, debtors are assets. All assets have a debit balance: that is the explanation, debit balance. Now, let us try to justify this. Let us look at various kinds of transactions that a business could have

with its customers. Typically, the first transaction would be a sale being made. So, let us say, sale of goods, and this sale is going to be on credit: that is how a customer becomes a debtor. So, the transaction is Ram Limited's A/c (Dr.), To Sales A/c. This is the transaction for a credit sale. You are selling on credit and you are making Ram a debtor by giving him a debit. Let us say the amount is 100. You could recover this money by repayment from Ram Limited: so repayment by customer. And when you receive the payment, you will say Cash A/c (Dr.), To Ram Limited's A/c. Let us say, you received 90 out of that, you could also receive full money, but he is not going to pay you more than 100, of course. Now if you post these two transactions in Ram Limited's account: Ram Limited's account the first transaction- you will write To sales, credit sales taking place 100- and then the second transaction you write on the credit side By Cash A/c 90. Now, in this case, if these were the only two transactions you will have a debit balance total of the debit side is higher than the total of the credit side. And, I just said the customer is at best going to pay you 100, he will not pay you more than 100 of course. So, you will never have a credit balance, you will never have more on the credit side. You could argue that there can be multiple transactions. Well, you can do multiple transactions. You sold more goods to Ram. So, another sale of 500 and then what is going to happen? He is going to pay you back. When he pays you back, you are going to write By Cash A/c. What if he pays you through the bank? Then you write By Bank. And how much is he going to pay, he is going to pay you 500. At best he will pay the previous 10 as well and you will write 510. Still, there is no credit balance. You can have no balance in this account. Of course, any account can have no balance, but the debtors account here cannot have a credit balance. The total of the credit side cannot be higher than the total of the debit side for an asset account, for a debtor account, that is my point.

Let us say the customer does not pay you 510. The customer only pays you 500, and then says I cannot pay you the remaining 10, it becomes a bad debt. What happens in that case? When there is a bad debt, the journal entry is Bad Debt A/c (Dr.). This is a loss: all expenses and losses are debit. So, Bad Debt A/c (Dr.), To Debtors A/c, and debtors name is Ram Limited account. Now, what do you do? You go to the credit side because Ram Limited's account is being credited; and you write By Bad Debts, and you write 10. Now, again there is zero balance in this account, but you can never have the total of the credit side going higher than the total of the debit side. So, again I have tried to provide you justification on why a debtor's account cannot have a credit balance. It will always have a debit balance or at best there will be no balance.

Let us look at another account which is a vendor's account. All vendors are liabilities. This is the liability account and all liability accounts have a credit balance. This is the exact opposite of the debtor's account. And, I am going to show you how. So, let us say this is Rahul Limited's account. What is the journal entry when you purchase from a vendor? When you purchase from the vendor, the journal entry is Purchase A/c (Dr.), To Vendor's A/c. Vendor's name is Rahul Limited, so To Rahul Limited's account 100. Now, what is the next transaction? You could purchase more; you could pay back. Let us say you will pay back. When you pay to the vendor, then the vendor is the receiver. So, you debit the vendor's account; Rahul Limited's A/c (Dr.), To Cash; cash is being paid to the vendor. How much are you going to pay? You will pay 50; you will pay 90; you will pay 100, but not more than 100. Let us say again you pay 90. And, now let me bring these two transactions into the ledger account. So, purchase debit to Rahul, so we are going to write By purchase account here 100, and the second transaction Rahul A/c (Dr.), To cash, so To cash account 90. What is the balance? Credit total is higher than the debit total 100 is greater than 90. This account has a credit balance, alright. Now, you could say that you paid 100 in which case the account balance will be nil.
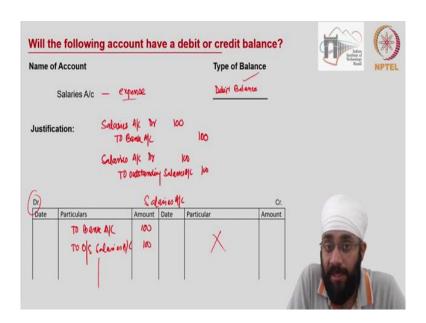
Will you pay more than 100? You will not pay more than 100. You could argue saying we could pay more than 100, and then in the next purchase that we do the vendor can adjust the account. Well, if you pay more than 100, then that amount is not shown here. That amount is an advance given to a vendor and is an asset, so that is not shown in a liability account. So, that is all together a separate transaction. When you hand out an advance to your vendor that is your

asset that is not shown under the liability. That is not the actual payment which is shown here. So, let us say even if you pay 100, you will have a higher balance on this side. So, all the purchases are going to keep accumulated on the credit side, and all the payments are going to accumulate on the debit side. So, this is what is going to happen at the best.

Now, one more transaction which could possibly be here is that you decide that you are not going to pay to the vendor in which case you do not necessarily do anything the payment of remaining 10, you know it will keep standing in your balance sheet as an outstanding you know as a liability as a creditor, but the bad debts adjustment is done in the books of you know Rahul Limited.

So, you do not have to worry about that side. So, as far as your company is concerned you only do purchase transactions here and the cash received on the other side.
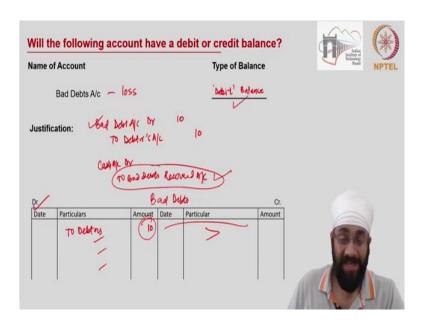
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Let us move on to another account. This is a salary account. Salaries account is an expense and all expenses have a debit balance. Why would this happen? Now, what is the transaction relating to salary that happens in a business? Business pays salaries that is all. Business does not receive any salaries. The only transaction that happens is business has paid salaries, or business has not paid the salaries which have become due. Let me write the journal entries for those two. When you pay salaries, the transaction is Salaries A/c (Dr.), To Bank A/c. And, if you do not pay, you still recognize this as an expense, but rather than accounting it in the bank account you say outstanding salaries account. So, 100 and 100, these are the two possible

transactions relating to salaries. And, when we pay salaries, we are going to write on the debit side To bank A/c, you paid 100. And To outstanding salaries A/c 100: you did not pay in cash, but it is a liability. So, both the transactions are going to be recorded on the debit side. There is going to be actually nothing on the opposite side. So, the account is always going to have a debit balance. The total on the debit side is going to be higher than the total on the credit side. And, this is going to be true for all the expenses. Therefore, there should not be any doubt going further that the expenses are always going to have a debit balance in the ledger account.

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Let us look at bad debt. Bad debt is a loss. All expenses and losses are going to have a debit balance. We did not talk about losses having a debit balance, but that is going to be addressed now. So, when a bad debt takes place the journal entry is Bad Debt A/c (Dr.), To Debtors A/c. Let us say this is the amount, it is debited, you are going to write this on the debit side, To Debtors A/c 10.

Now, at best what could happen is you could recover the bad debts in which case you are going to say Cash A/c (Dr.), To Bad Debts Recovered A/c. But mind you this is a separate, this is a new account. This is not the same as the bad debts account. So, the bads debts recovered is going to be a new account. The only transaction that is going to be in the bad debts account is going to be on the debit side. Whenever somebody does not pay you, you transfer it here. And, the total on the debit side is going to be higher than the total on the credit side, so always a debit balance. So, all expenses and losses are going to have a debit balance.