Single Platinum Rule of Accounts - "Asset is a prepayment"

Accounting

KEYWORDS : Debit, Credit, Assets, Liability and Prepaid Expense.

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ABSTRACT

Background- To decide what to be debited and what to be credited, first he had to classify the accounts into three viz. Real, Personal and Nominal. And there are three traditional rules each of these three accounts respectively, to record transaction by debiting one account and crediting another account, known as three golden rules of accounts.
This review paper aims to provide a simple explanation of the cornerstone of the Accounts "Debit and Credit" for the new learners of Accounts, without the use of traditional three golden rules of Accounts.
Conclusion- Single Platinum rule: - Credit is addition and Debit is deletion while considering all Assets (including cash) of the company as prepaid expenses. This rule can be applied in all transactions unconditionally, which always stands true as the traditional three golden rules.

INTRODUCTION

Credit and Debit:

Credit is the word used as the praise you get when you are responsible for something good that has happened. When the amount of money is added in a bank account, the account is being **credited**. If you or your bank account is in **Credit**, there is money in your account. The money that you borrow from a bank is known as **Credit**. An arrangement that you make with a shop/store to pay later for something you buy is also known as **Credit**. Even for successfully completing a unit of study at a college or university is also known as **Credit**. For a layman Credit means "+" adding or getting and Debit means "-"deletion. But in accounting debit and credit do not have any value connotations such as bad or good and unfavourable or favourable. They are simply the accountant's terms for left or right and nothing more. But this simple definition is just the tip of the iceberg. But which transaction is to be recorded on the left (debit) and which one on the right (credit) of a Ledger or 'T' account is decided according to the three golden rules of accounts. Before knowing the three golden rules of accounts, one has to understand three different types of accounts viz. Real, Personal and Nominal. Though in practice, Accountants don't think about these rules because of being used to of recording transaction but for new learners, it's quite perplexing.

History:

Luca Pacioli (pronounced pot-chee-oh-lee), an Italian Monk, best friend and teacher of Leonardo da Vinci (the renowned painter, scientist and inventor), first articulated the double entry system (every debit transaction must have a corresponding credit transaction(s) and vice versa) in 1494 in his book titled Summa de Arithmetica, Geometria, Proportioni et Proportionalita (which means "Everything about Arithmetic, Geometry and Proportions"). He is also known as father of accounts. To decide what to be debited and what to be credited, first he had to classify the accounts into three viz. Real, Personal and Nominal.

Real accounts are assets.

Personal Accounts are liabilities and owner's equity, which represent people and entities that have invested in the business.

Nominal Accounts are revenues, expenses, gains and losses. Accountants close nominal accounts at the end of each accounting period.

And then there are three rules each of these three accounts respectively, to record transaction by debiting one account and crediting another account, known as three golden rules of accounts.

Real account: Debit what comes in and Credit what goes out.

Personal Account: Debit who receives and Credit who gives.

Nominal Account: Debit all expenses and losses and Credit all income and gains.

Double entry system was a great invention in accounting but the explanation for what to debit and what to credit became complex to understand for new learners of accounts. There could be much simple explanation for Debit and Credit transaction.

Simple Explanation for the Debit and Credit:

Expense is an outflow of the assets and Assets are actually the application of funds as a "Prepaid Expense". Cost of an asset is a long term prepayment to reap the benefits from the assets and Depreciation is the portion of the asset's cost allocated to an accounting period or in other words gradual conversion of the cost of an asset into expense. Also total depreciation can't exceed its cost. Therefore we can say that all Assets are prepaid expenses and in the operation of the company while expending out of the company, the value of prepaid expenses (assets) is transferred to expense account by crediting the prepaid expense (assets) & debiting the expense account. Cash and Bank accounts are the primary prepaid expenses. Other prepaid expenses are just transferred from these primary prepaid expenses. Though under Asset Category in the balance sheet, prepaid expense is a usual separate asset account e.g. Rent, insurance, newspaper subscription and property taxes but if we contemplate, all assets are prepaid expenses, required for the usual operation of the company and all prepayments are assets. The prepaid expense accounts records all such amounts to the extent the related benefits have not been expired. The obsolete machine or any such assets, those benefits have expired are not recorded. Even Acquisition and Improvement of Asset is known as Capital Expenditure. One prepaid expense is also transferred to another prepaid expense e.g. debiting machine account and crediting cash account while buying a machine by cash payment.

Debit and Credit are either transfer of value from one asset to another asset or Expense of Assets in the usual operation of the company. This expense can be in the form of cash (asset) flowing out of the company or in the form of Depreciation i.e. gradual conversion of the cost of an asset in to expense. Cash and Bank accounts are the primary prepaid expense or primary asset accounts. Other prepaid expenses (assets) like land, building, machines, inventories etc. are secondary prepaid expenses which are actually the value transferred from the primary prepaid expense (cash/bank).

Banking: - All the customers are the Creditors (liability) of the bank. The Bank's Pass Book (Bank's Statement) is a particular customer's (creditor's) account. Bank's Cash Book is different from the customer's bank statement. When an amount of money is deposited by a customer, Bank records this transaction into two accounts by double entry system. In their cash book (cash account), the value is debited as cash is an asset to the bank and bank expends it as a prepayment in their banking business. Simultaneously in the creditor's account (Customer's Pass Book/ Bank's Statement), which is a liability to the Bank; value is simply added as credit.

As Credit represents Receiving Aspect, Creditors are liability but an addition to the business and Debtors are assets i.e. prepaid expense therefore debited.

Conclusion:

Single Platinum rule: - Credit is addition and Debit is deletion while considering all Assets (including cash) of the company as prepaid expenses. This rule can be applied in all transactions unconditionally, which always stands true as the traditional three golden rules.

REFERENCE

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