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While learning accountancy a student is taught to

■ Debit all expenses, credit all income.

■ Debit all assets, credit all liabilities.

■ Debit the receiver, credit the giver.

Why is it so?

Let us find out the rationale behind three golden rules of accounts. ■■ (1/n)

'Balance Sheet' and 'Profit & Loss Account' are two important aspects to learn accountancy.

Let us first understand how to interpret a Balance Sheet. (2/n)

Balance sheet is a simple snapshot of 'Sources of funds' ('Liabilities') and 'Application of funds' ('Assets') as on a 'particular' day. (3/n)

**Where did money
come from?**



**Where did money
go?**



LIABILITIES	ASSETS

It is important to note that the Balance sheet may change every day. That's because the liabilities side and the assets side may change frequently.

Example: The customer from whom the amount was receivable (Debtor) will get converted into Cash the moment he pays money. (4/n)

Suppose a businessman starts a business with his own money (equity/owner's fund) and uses this money to buy various assets. (5/n)

LIABILITIES	ASSETS
Equity	Assets

He earns good amount of profit from his business operations which is reinvested in the business (Profit/ Reserves and Surplus).

Also, the businessman decides to take loan (Outsider's money) to expand his business. So, the Balance Sheet will look something like this, (6/n)

LIABILITIES	ASSETS
Equity Reserves and Surplus Debt and other liabilities	Assets

So, we now have a simple equation:

$$\text{Equity} + \text{Reserves} + \text{Other liabilities} = \text{Assets}$$

(7/n)

Also, 'Reserves' is nothing but profit and profit figure is taken from 'Profit and Loss Account'.

Profit is calculated as 'Income – Expenses'.

So, we now have,

Equity + Income – Expenses + Other liabilities = Assets

(8/n)

Or, we can rearrange this as,

Equity + Income + Other liabilities = Assets + Expenses

This is a beautiful equation.

LHS shows us all the sources of money and RHS shows us its application. (9/n)

LHS shows us all the credits and RHS represents the debits. (10/n)

ALL CREDITS	ALL DEBITS
Equity Income Debt and other liabilities	Assets Expenses

Hence, we

■ Debit all expenses, credit all income.

■ Debit all assets, credit all liabilities.

■ Debit the receiver, credit the giver. (11/n)

Accounts is super interesting when you know the rationale behind everything. (12/n)

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