

FINANCIAL FOUNDATIONS

An Educational Ebook Series for Small Business Owners

BOOK 01

Debits & Credits Explained

Mastering the language of business, one transaction at a time.



TLC Business Solutions · Expert Bookkeeping & Accounting Services

Debits & Credits Explained



A SMALL-BUSINESS ACCOUNTING EBOOK

Debits & Credits Explained

Mastering the Language of Business

A plain-English guide to the two words behind every financial report — built for small & mid-sized business owners who want to read their own books with confidence.

TLC Business Solutions · Accounting · Bookkeeping · Tax Consulting · Payroll · Financial Management

Debits & Credits Explained



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INTRODUCTION

Why Debits & Credits Matter

Every transaction your business makes tells a story — and **debits and credits are the grammar** of that story. They are the two words that make every other financial report possible.

If you own a small or mid-sized business, you don't need to become an accountant. But you do need to speak enough of the language to read your own books, catch problems early, and make confident decisions. When you understand debits and credits, a balance sheet stops looking like a foreign document and starts looking like a map of your company.

The payoff for business owners

- **Read your own books** — understand what's happening without waiting for your accountant to translate.
- **Spot errors early** — a balanced ledger is a self-checking system; mistakes surface fast.
- **Make better decisions** — when cash, inventory, and obligations are clear, choices get easier.
- **Talk to your accountant with confidence** — no more nodding along to terms you don't quite grasp.

Here's the good news: the core idea is simple. Debits and credits are not about "good" and "bad," and a debit is not automatically an increase any more than a credit is automatically a refund. They are **directions** — left and right — and they always work in pairs. Master that single idea and the rest of accounting starts to click into place.

This ebook breaks it down plainly, with real-world examples you'll recognize from running your business. Let's begin with the basics.

Debits & Credits Explained

THE BASICS

What Are Debits & Credits?

In bookkeeping, every account has two sides: a **left side** and a **right side**. A **debit** is simply an entry made on the **left**. A **credit** is an entry made on the **right**. That's the whole mechanical definition — left and right.

The "flow of value" mental model

Think of value flowing through your business like water through pipes. A **debit** marks the **destination** — where value flows *in*. A **credit** marks the **source** — where value flows *from*. Every transaction records both: the place value lands, and the place it left.

What a debit or credit does depends on the account

This is the part that trips people up. A debit doesn't always mean "increase." Whether a debit increases or decreases an account depends entirely on *what kind* of account it is:

- **Assets & Expenses** — a debit **increases** them.
- **Liabilities, Equity & Revenue** — a debit **decreases** them (and a credit increases them).

We'll lay out the full map a few pages ahead. First, the one rule that never bends.

The Golden Rule

Total Debits = Total Credits

Always. Every. Single. Time. Every transaction you record must have equal debits and credits. If the two sides don't match, something is wrong — an entry is missing, mistyped, or posted to the wrong account. The system is self-checking by design.

Picture a seesaw. When you add weight (value) to one side with a debit, the other side must adjust with an equal credit to keep it balanced. That balance is what keeps your books trustworthy and your financial statements accurate.

Debits & Credits Explained

THE FOUNDATION

The Accounting Equation, Revisited

Behind every debit and credit sits one equation that defines all of bookkeeping:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Assets

What the business **owns** — cash, inventory, equipment, accounts receivable, vehicles. These hold value for the company.

Liabilities

What the business **owes** — accounts payable, loans, credit cards, taxes payable. Obligations to outsiders.

Equity

The owner's **stake** — initial investment plus retained earnings (profits kept in the business). What's left after liabilities are paid.

How it stays balanced

Every transaction touches at least two accounts so the equation never breaks. Buy equipment with cash: one asset rises, another falls — net assets unchanged.

Why the equation is the backbone

Debits and credits are simply the tool that keeps this equation true after every single transaction. When the books balance, the equation holds; when the equation holds, your balance sheet tells a true story about what your business owns, owes, and is worth. Everything — from your profit-and-loss statement to your tax return — is built on this one relationship.

Debits & Credits Explained

THE MASTER MAP

How Debits & Credits Affect Each Account Type

This is the single most useful table in the whole ebook. Print it, bookmark it, tape it to your monitor. It tells you exactly what a debit or credit does to each kind of account.

Account Type	Debit	Credit	Normal Balance
Assets	Increases (+)	Decreases (-)	Debit
Liabilities	Decreases (-)	Increases (+)	Credit
Equity	Decreases (-)	Increases (+)	Credit
Revenue (Income)	Decreases (-)	Increases (+)	Credit
Expenses	Increases (+)	Decreases (-)	Debit

Read it the easy way

Notice the pattern. **Assets and Expenses behave the same** — a debit increases them. **Liabilities, Equity, and Revenue behave the opposite way** — a credit increases them. That's why each account type has a *normal balance*: the side it usually sits on. Assets and expenses normally carry a debit balance; the other three normally carry a credit balance.

Memory trick — "DEALER"

Dividend / Draw, Expense, Asset are increased by a Debit. Liability, Equity, Revenue are increased by a Credit. Six letters, one side each — the whole map on a sticky note.

Debits & Credits Explained

IN PRACTICE

Real-World Examples

Let's put the map to work with four everyday transactions. Notice how every entry has a debit and a credit of equal size — the Golden Rule in action.

1. Recording a Cash Sale

A customer pays \$1,000 cash for services. Cash rises; revenue rises.

ACCOUNT	DEBIT	CREDIT
Cash (Asset) ↑	\$1,000	
Sales Revenue ↑		\$1,000

2. Paying a Bill

You pay a \$500 supplier invoice already in Accounts Payable.

ACCOUNT	DEBIT	CREDIT
Accounts Payable ↓	\$500	
Cash (Asset) ↓		\$500

3. Taking Out a Loan

You borrow \$20,000 from the bank. Cash in; a liability is created.

ACCOUNT	DEBIT	CREDIT
Cash (Asset) ↑	\$20,000	
Loan Payable ↑		\$20,000

4. Buying Inventory

You buy \$3,000 of inventory on credit to pay the supplier later.

ACCOUNT	DEBIT	CREDIT
Inventory (Asset) ↑	\$3,000	
Accounts Payable ↑		\$3,000

The pattern

In every case the two sides are equal. Ask “where did the value come from, and where did it go?” and the entry almost writes itself.

Debits & Credits Explained

VISUAL TOOLS

T-Accounts & Double-Entry Bookkeeping

The T-account: a picture of any account

A T-account is simply a drawing of an account shaped like the letter **T**. The account name sits on top, debits go on the **left**, and credits go on the **right**. Accountants use them to visualize activity before posting it for real. Here's the Cash account after our \$1,000 sale and \$500 bill payment:

Cash (Asset)			
DEBITS (LEFT)		CREDITS (RIGHT)	
Sale — cash received	\$1,000	Paid supplier bill	\$500
Loan proceeds received	\$20,000		
Total debits: \$21,000		Total credits: \$500	
		Balance (debit): \$20,500	

Because Cash is an asset, its normal balance is a debit. Add up each side; the larger side is the account's balance.

Why every transaction has two sides

This is the heart of **double-entry bookkeeping**: every transaction affects at least two accounts, with equal debits and credits. It's not bookkeeping tradition — it's a built-in error detector.

- **Built-in accuracy.** If debits don't equal credits, the entry can't be posted. Mistakes are caught immediately, not months later.
- **A complete picture.** Recording both the source and destination of value means nothing slips through unnoticed — every dollar is tracked from where it came to where it went.
- **Trustworthy statements.** Because the books stay balanced, your profit-and-loss statement, balance sheet, and cash-flow report all reconcile to the same underlying numbers.

Single-entry vs. double-entry

A simple checkbook is single-entry — you track cash in and out, and that's it. It works for a lemonade stand, but it can't produce a balance sheet, can't catch most errors, and falls apart the moment you carry inventory or owe vendors. Double-entry is the standard because it's reliable, auditable, and scales with your business.

Debits & Credits Explained

AVOID & REFERENCE

Common Mistakes & How to Avoid Them

#	Mistake	How to Avoid It
1	"Debit always means increase"	A debit increases assets & expenses but <i>decreases</i> liabilities, equity & revenue. Check the account type first.
2	Swapping debit & credit sides	Debit = left, credit = right. Mixing them reverses the transaction. Slow down on the first entry of a new type.
3	Forgetting the second entry	A debit without a matching credit throws the books off. If it doesn't balance, it's not done — finish both sides.
4	Mixing personal & business funds	Commingling muddies equity and complicates taxes. Keep separate accounts, always.
5	Skipping bank reconciliation	Reconciling monthly catches missing entries, duplicates, and bank errors before they snowball.
6	Ignoring small rounding gaps	A few cents off means something's miscoded. Investigate every imbalance — small ones hide bigger ones.

Quick-Reference Cheat Sheet

To...	Debit	Credit
Increase cash / assets	Asset	—
Decrease cash / assets	—	Asset
Record a sale / income	Asset (cash or A/R)	Revenue
Record an expense	Expense	Asset (cash or A/P)
Borrow money	Asset (cash)	Liability (loan)
Pay a liability	Liability	Asset (cash)
Owner invests capital	Asset (cash)	Equity
Owner takes a draw	Equity	Asset (cash)

Remember the Golden Rule across every row: total debits always equal total credits.

Debits & Credits Explained

PUTTING IT TO WORK

How TLC Business Solutions Can Help

You've now got the foundation: debits and credits are left and right, they always balance, and their effect depends on the account type. That's the language your books are written in.

But knowing the language and keeping flawless books are two different things. Reconciling accounts, closing the month, classifying transactions correctly, and preparing clean statements — that's where the daily work adds up, and where small mistakes turn into costly surprises. You started your business to grow, not to wrestle with ledger entries every evening. That's where TLC Business Solutions comes in.

What we handle for you

- **Accurate bookkeeping** — every transaction posted and reconciled monthly.
- **Clean financial statements** — balance sheets, P&L, and cash flow you can read.
- **Tax consulting** — proactive planning that keeps more money in your business.
- **Payroll done right** — accurate, on time, and fully compliant.

We provide **accounting, bookkeeping, tax consulting, payroll, and financial management** services to small and mid-sized US businesses — so your debits and credits stay balanced, your reports are always ready, and you always know exactly where your business stands.

Ready to hand the books to a pro?

Let TLC Business Solutions keep your debits and credits — and your entire financial picture — perfectly balanced, so you can focus on running your business.

Contact TLC Business Solutions

Web: tlcbusinesssolutions.com

Services: Accounting · Bookkeeping · Tax Consulting · Payroll · Financial Management

Expert bookkeeping and accounting support for small & mid-sized US businesses.



Build Your Financial Foundations with TLC

TLC Business Solutions helps small business owners strengthen bookkeeping, accounting, payroll, tax consulting, financial management, and practical decision-making systems so the numbers are clean, useful, and ready for growth.

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