Classification of accounts

Accounts are classified using two approaches - traditional approach (also known as British approach) and modern approach (also known as American approach). On this page, we shall briefly discuss the classification of accounts under both the approaches.

Classification of accounts under traditional or British approach

According to traditional approach or British approach, the accounts are classified into three types - real accounts, nominal accounts and personal accounts. Because it is an old system of classifying accounts, its use is very rare in practice.

Personal accounts

Personal accounts are the accounts that are used to record transactions relating to individual persons, firms, companies or other organizations. Examples of such accounts include Mr. X account, modern enterprises account and city bank account etc.
Impersonal accounts

The accounts which are not relating to persons are called impersonal accounts. These are further divided into two accounts.

1. Real accounts
2. Nominal accounts

Real accounts

Real accounts (also termed as permanent accounts) are the accounts that have their existence even after the close of accounting period. In the next account period, these accounts start with a non-zero balance carried forward from the previous accounting period.

Examples of such accounts include machinery account, land account, furniture account, cash account and accounts payable account. Usually, real accounts are listed in the balance sheet of the business so they are sometimes referred to as balance sheet accounts.

Nominal accounts

Nominal accounts (also termed as temporary accounts) are the accounts that are closed at the end of accounting period. In the next account period, these accounts start with a zero balance. Accounts of income, gains, expenses and losses are nominal accounts.

Nominal accounts are normally used to accumulate income and expense data to be used for the preparation of income statement or trading and profit and loss account so they are sometimes referred to as income statement accounts. Examples of such accounts include sales, purchases, gain on sale of an asset, wages paid and rent paid etc.

Classification of accounts under modern or American approach

The modern approach has become a standard of classifying accounts in many
advanced countries. The types of accounts under this approach are mostly self-explanatory.

Under modern/American approach, the accounts are classified into the following five groups:

1. **Asset accounts:**
   Examples are land account, machinery account, accounts receivable account, prepaid rent account, cash account etc.

2. **Liability accounts:**
   Examples are loan account, accounts payable account, wages payable account, salaries payable account, rent payable etc.

3. **Revenue accounts:**
   Examples are sales account, service revenue account, rent revenue account, interest revenue account etc.

4. **Expense accounts:**
   Examples are wages expense account, commission expense account, salaries expense account, rent expense account etc.

5. **Capital/owner’s equity accounts:**
   Examples are John’s capital account etc.

**Example**

Classify the following accounts using traditional and modern approach:

1. Plant and machinery
2. Purchases
3. Sales
4. Rent expense
5. Land and building
6. Cash
7. Sam’s capital
8. Loan from City bank

**Traditional classification:**

1. Plant and machinery > Real account
2. Purchases > Nominal account
3. Sales > Nominal account
4. Rent expense > Nominal account
5. Land and building > Real account
6. Cash > Real account
7. Sam’s capital > Personal account
8. Loan from City bank > Personal account

**Modern classification:**

1. Plant and machinery > Asset account
2. Purchases > Expense account
3. Sales > Revenue account
4. Rent expense > Expense account
5. Land and building > Asset account
6. Cash > Asset account
7. Sam’s capital > Capital/Owner’s equity account
8. Loan from City bank > Liability account

**Exercise:**

- [Multiple choice questions](#)
- [Fill in the blanks quiz](#)
- [Short question with answers](#)