



# learnkwniy

## Chapter – 7

### Double Entry System

## **MEANING OF DOUBLE ENTRY SYSTEM**

The method of recording of two-fold aspects (or both the aspects) of each transaction is known as Double Entry System. The fundamental principle in double entry system is for every debit, there is a corresponding credit.

According to this system every business transaction affects at least two accounts in opposite directions. For example, if the furniture is purchased in the business, furniture is increased whereas the cash is decreased. There can be no transaction in the business which affects only one account or which has only one aspect. As such, both the aspects of every transaction are recorded under this system.

Double Entry System is the most scientific, complete and perfect system of keeping records. According to this system, every business transaction involves two accounts, one receiving the benefit and the other giving the benefit. The party receiving the benefit is called, Receiver; the party giving the benefit is called as the "Giver."

## **DEFINITIONS OF DOUBLE ENTRY SYSTEM**

Some important definitions of Double Entry System are as follows:

1. According to J. R. Batlibes. Every business transaction has a two-fold effect and that it affects two accounts in opposite directions and if a complete record were to be made of each such transaction, it would be necessary to debit one account and credit another account. It is this recording of the two fold effect of every transaction that has given rise to the term Double Entry System
2. According to William Pickles, Double Entry System seeks to record every transaction in its double aspect the one aspect is receiver and the other is giver the account of the receiver is debited and that of the giver is credited."

## **FEATURES OR CHARACTERISTICS OF DOUBLE ENTRY SYSTEM**

The following are the important features or essentials of the double entry system:

### **1. Every Business Transaction affects Two**

**Accounts:** Every business transaction has two-fold effect. One account receives the benefit and the other gives the benefit. Of the two accounts, one account is given 'debit' while the other account is given 'credit' with an equal amount.

### **2. Recording of Both Personal and Impersonal**

**Aspects:** Both personal and impersonal aspects of a transaction are recorded in Double Entry.

**3. Every Account has Two Sides:** On left hand side, we have 'debit side' and on the right hand, we have credit side.

**4. Recording according to Certain Rules:** In double entry system recording is made according to certain specified rules. There are certain rules for debiting and crediting.

**5 Arithmetical Accuracy (Trial Balance):** Since one account is debited and the other is credited total of all debits is always equal to the total of all Credits. This helps in finding out arithmetical accuracy of the accounting records. This is done by preparing a Trial Balance.

## **ADVANTAGES OF DOUBLE ENTRY SYSTEM**

The following are the main advantages of Double Entry System:

**1. Scientific System:** Under double entry system the

transactions are recorded according to certain specified rules. As such the system is considered to be the most scientific and perfect system.

**2. Full Accounting Information:** This system gives full accounting information about the business transactions, as it records both the aspects of each and every transaction.

**3. Verification of Arithmetical Accuracy:** The accuracy of accounting records can be verified by preparing a Trial Balance at the end.

**4. Lesser Possibility of Fraud:** It minimises the possibility of errors and fraud. It also assists in detecting and rectifying the errors, if occurred.

**5. Personal and Impersonal Accounts:** It provides a complete record of every transaction whether it relates to the personal or impersonal account.

**6. Preparation of Trading and Profit & Loss**

**Account:** This system helps in the preparation of Trading Account to find out 'Gross Profit or Gross Loss. Under this system, it is easy to find out Net Profit' or 'Net Loss for a particular period by preparing Profit & Loss Account.

**7. Knowledge of Financial Position:** This system helps to prepare the Balance Sheet. The Balance Sheet shows the financial position of the business.

**(8) Comparative Study:** Under this system, separate recording is made for each item of expenditure and income. As such, the management can compare the expenditure of the current year with those of the previous years and can know on what head of expenditure the money spent is unreasonable and can take steps to check the unnecessary expenditure. Similarly,

the profit and loss account and Balance Sheet of one year may be compared with those of the previous years and reasons for the change may be ascertained.

**9. Knowledge of Various Information:** This system provides various information, such as

- (i) What amount is due to be received from customers or debtors.
- (ii) What amount is due to be paid to suppliers or creditors?
- (iii) What is the value of closing stock?
- (iv) What is the amount of purchases and sales? etc.

**10. Legal Approval:** The books maintained under Double Entry System are complete, accurate, reliable and scientific. They can be produced before the Court. The Court of Law, accepts accounting records as documentary evidence. Tax authorities also rely on the books maintained under this system.

### **DISADVANTAGES OF DOUBLE ENTRY SYSTEM**

- (1) A number of books are to be kept under this system, as such, the system is quite expensive.
- (2) It is quite difficult to apply the rules of debit and credit. Proper education, practical knowledge and training is required in order to have command over the rules of double entry system.
- (3) Only the arithmetical accuracy of the accounts is checked by preparing a trial balance under the double entry system.

Following types of errors are not disclosed under the system:-

- (1) Errors of Omission:-** If a transaction remains altogether unrecorded in the books of original entry.

**(ii) Errors of Commission:-** If wrong amount is recorded in the books of original entry.

**(iii) Errors of Principle:-** If the amount is recorded on the correct side though in a wrong account. For example, if purchase of machinery is debited to purchase account instead of machinery account.

**(iv) Compensating Errors:** - If the effect of one error is cancelled by the effect of some other errors.

## **CLASSIFICATION OF ACCOUNTS**

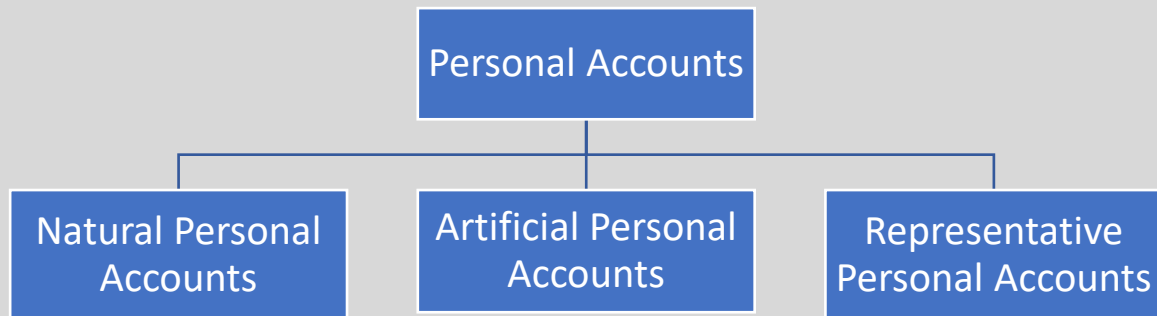
### **(1) Personal Accounts**

The accounts which relate to an individual, firm company or an institution are called personal accounts.

Rule: - Rule for recording a transaction in personal accounts in simple words is 'Debit the receiver and credit the giver'.

### **Types or Classification of Personal Accounts**

Personal accounts can be classified into the following three categories:



**(A) Natural Personal Accounts:-** Accounts of 'Natural Persons' means the accounts of human beings. For example, Mohan's Account, Sohan's Account, Seema's Account, Nirmla's Account etc. Proprietor's Capital Account, Proprietor's Drawings Account, Debtors Accounts and Creditors Accounts are also included in this category.

**(B) Artificial Personal Accounts:-** These accounts do not have physical existence as human beings but they work as personal accounts. For example, any Firm's account, any limited company's account, any institution's account and any bank's account. These accounts also include the accounts of Clubs, Insurance Companies and the accounts of Government Departments which are recognised as 'persons in the business dealings.

**(C) Representative Personal Accounts: -** When an account represents a particular person or group of persons, it is termed as a representative personal account For example Prepaid Insurance Account, Accrued Interest Account and Unearned Commission Account, Outstanding salary or rent etc.

## **(2) Real Accounts**

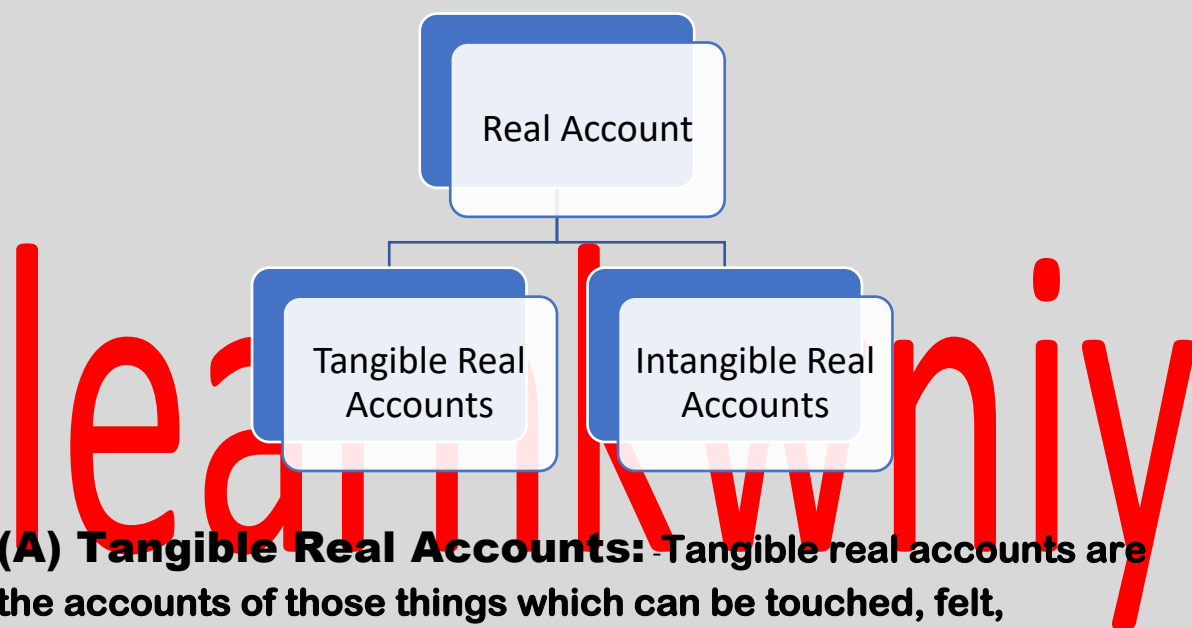
The accounts of all those things whose value can be measured in terms of money and which are the properties of the business are

termed as Real Accounts. Such as, Cash Account, Furniture Account, Machinery Account, Building Account, Goodwill Account etc.

**Rule:** - Rule for recording a transaction in real account is 'Debit what comes in and credit what goes out'.

## **Types or Classification of Real Accounts**

Real accounts can be classified in the following two categories:-



**(A) Tangible Real Accounts:** Tangible real accounts are the accounts of those things which can be touched, felt, measured, purchased, sold etc. Examples of such accounts are Cash account, Stock account, Furniture account, Land account, Building account etc.

**(B) Intangible Real Accounts:** - These accounts represent such things which cannot be touched, but, of course, their value can be measured in terms of money. Examples are: Goodwill account, Patents account, Trade Marks account, Copyrights account etc.

### **(3) Nominal Accounts**

These accounts include the accounts of all expenses and incomes.

The examples of nominal accounts relating to expenses are

Salaries paid, Rent paid, Discount allowed, Bad Debts etc. The examples of nominal accounts relating to incomes are Commission received, Interest received, Discount received etc.

**Rule:** - Rule for recording in nominal accounts is. "Debit the expenses and losses and Credit incomes and gains".

**Stages or Parts of Double Entry System Accounting process can be divided into three stages under the double entry system :-**

**(1) Original Record:** All the transactions are first recorded in a primary book called Journal. When the business is a big one and the number of transactions is large, Journal is divided into various books which are called 'Sub-division of Journal or Subsidiary Books'. This stage is also known as original record stage.

**(2) Classification:** In this stage, all the transactions recorded in the Journal or its subsidiary books are transferred (posted) in a classified form to another book which is called 'Ledger'. Posting in ledger is also known as classification stage.

**(3) Summary:** In this stage, all the accounts in the ledger are balanced off and are put in a list, debit balances on one side and credit balances on the other side. The list so prepared is called a Trial Balance. With the help of the trial balance a Trading and Profit & Loss account is prepared to ascertain the profit earned or loss suffered during a particular period and a Balance Sheet is prepared to show the financial position of the business.