

Nominal accounts mainly gains.

Golden Rule: Debit all Expenses or Losses,
Credit all Income or Gains.

4.1.3.2. Modern Classification of Accounts

The rule of debit and credit depend on the nature of an account. For this purpose all the accounts are classified into the following five categories:

- 1) Assets,
- 2) Liabilities,
- 3) Owner Equity,
- 4) Revenues, and
- 5) Expenses.

The above classification is derived from the accounting equation in the following manner:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity} + \text{Revenue}$$

Or, $\text{Assets} + \text{Expenses} = \text{Liabilities} + \text{Owner's Equity} + \text{Revenues}$

Or, $\text{Assets} = \text{Liabilities} + \text{Owner's Equity} + \text{Revenues} - \text{Expenses}$

The rule of debit and credit relating to all the above types of account are explained below:

| Types of Accounts | Rules for Debit | Rules for Credit |
|-----------------------------|--------------------|---------------------|
| 1) For Assets Accounts | Debit the increase | Credit the decrease |
| 2) For Liabilities Accounts | Debit the decrease | Credit the increase |
| 3) For Capital Accounts | Debit the decrease | Credit the increase |
| 4) For Revenue Accounts | Debit the decrease | Credit the increase |
| 5) For Expenses Accounts | Debit the increase | Credit the decrease |

Thus, all the transaction may be divided into the following five categories:

- 1) Transactions relating to assets (Assets Accounts).
- 2) Transactions relating to liabilities (Liabilities Accounts).
- 3) Transactions relating to capital (Capital Accounts).
- 4) Transactions relating to revenue (Revenue Accounts).
- 5) Transactions relating to expenses (Expenses Accounts).

4.1.4. Advantages of Double Entry System

The advantages of double entry system are as follows:

- 1) **Reliable Information at a Glance:** The system keeps complete records of business transactions in systematic and scientific way, so requisite information can be obtained at a glance. The information supplied by the system is also reliable.

- 2) **Scrutiny and Verification of Information:** The business can verify the value of assets and scrutinize the records, if necessary on the basis of documentary proof as vouchers.
- 3) **Knowledge of Gross Profit or Loss:** One can prepare trading account and find out gross profit or loss with this account.
- 4) **Knowledge of Net Profit or Loss:** Under the double entry system, one can prepare profit and loss account and ascertain net profit or net loss.
- 5) **Knowledge of Assets and Liabilities of the Business:** Position statement also known as **balance sheet** is prepared. It reflects the values of assets and liabilities of the business at the end of accounting year.
- 6) **Comparative Studies:** Financial statements prepared on the basis of double entry system can be compared with the statements of previous years.
- 7) **Detection of Fraud:** The systematic and scientific recording of business transaction on the basis of this system minimizes the chances of embezzlement and frauds. It can be easily detected by vouching, verification and auditing of accounts. This exerts a moral pressure on the accountant and his staff.
- 8) **Complete Record of Every Transaction:** Under this system both the aspects of each and every transaction are recorded. So, it is possible to keep complete account.
- 9) **Possible to Verify the Arithmetical Accuracy:** It is possible to verify the arithmetical accuracy of the books of account by ascertaining whether the two sides become equal or not through a process known as '**Trial Balance**'.

4.1.5. Disadvantages of Double Entry System

The disadvantages of double entry system are as follows:

- 1) **Costlier System:** In double entry system use of a number of accounting books such as Journal, Ledger, Cash Book, and Subsidiary Journals is needed. Therefore, the book-keeping under this system become costlier, especially for small traders.
- 2) **Need Practical Knowledge:** Different types of accounts have different rules for their debit and credit. Therefore, proper education, practical knowledge, and training is required in order to maintain accounts on the double entry system.
- 3) **Accounting Errors:** Under double entry system only the arithmetical accuracy of accounts can be checked by preparing a trial balance. Many accounting errors like,
 - i) **Errors of Omission:** In case the entire transaction is not recorded in the books of accounts.
 - ii) **Errors of Principle:** Double entry is based upon the fact that every debit has its corresponding credit.

- iii) **Compensating Errors:** If Ram's account is by mistake debited with ₹15 lesser and Mohan's account is also by mistake credited with ₹15 lesser, the trial balance will tally but mistake will remain in accounts.
- 4) **Harder to Understand:** Double entry book-keeping is harder to understand and difficult to learn.
- 5) **Unsuitable for Small Concern:** This system is not suitable for small concerns, because it requires the maintenance of a number of books of accounts which is not possible in small concerns.
- 6) **Time Consuming:** It is a bit more time-consuming, finding mistakes can take longer time.