

## 4.1. DOUBLE ENTRY SYSTEM

### 4.1.1. Meaning of Double Entry System

The double entry book-keeping refers to a system of accounting in which every transaction affects at least two accounts. This is the basis of the accounting equation also.

Recording dual aspects of business transactions in terms of 'Debit and Credit' is **Double Entry System**.

In accountancy, the double-entry bookkeeping (or double-entry accounting) system is the basis of the standard system used by businesses and other organizations to record financial transactions. It was first described by the Italian mathematician **Luca Pacioli**. Its premise is that a business's (or other organization's) financial condition and results of operations are best recorded in accounts. Each account maintains a history of changes in monetary values about a particular aspect of the business.

This system is called double-entry because each transaction is recorded in at least two accounts. Each transaction results in at least one account being debited and at least one account being credited, with the total debits of the transaction equal to the total credits.

**For example**, if business A sells an item to business B and business B pays business A by cheque, the bookkeeper of the business A would credit the account called "Sales" and debit the account called "Bank". Conversely, the bookkeeper of business B would debit the account called "Purchases" and credit the account called "Bank".

**For example**, Mr. B sold goods for cash ₹1,000 to Mr. C. In this case the dual aspects of this transaction for Mr. B and Mr. C are as follows:

Dual Aspects for Mr. B	Dual Aspects for Mr. C
1) Receipt of cash ₹1,000	1) Payment of Cash ₹1,000
2) Foregoing of goods of ₹1,000	2) Receipt of goods ₹1,000

**For example**, Mr. C sold goods for ₹ 1,000 to Mr. D on credit. In this case the dual aspects of this transaction for Mr. C and Mr. D are as follows:

Dual Aspects for Mr. C	Dual Aspects for Mr. D
1) Acquisition of right to recover ₹ 1,000	1) Assumption of obligation to pay ₹ 1,000
2) Foregoing of goods of ₹ 1,000	2) Receipt of goods ₹ 1,000



### 4.1.2. Characteristics of Double Entry System

Following are the characteristics of double entry system:

- 1) **Every Business Transaction Affects Two Accounts:** There are two accounts involved in every business transaction. One of them is debited and the other is credited. Certain transactions may involve more than two accounts but the amount of the accounts to be debited and credited will always be equal.
- 2) **Every Account is Divided in Two Parts:** All the ledger accounts prepared on the basis of books of original record, i.e., journal and subsidiary books have two sides. Left hand side is 'Debit' and the right hand side is 'Credit'.
- 3) **Division of Amount Column:** The amount column is also divided in two parts, i.e., Debit and Credit.
- 4) **Dual Aspect of Every Transaction:** The system is based upon this accounting truth that every debit has got its corresponding credit. This is why, all the business transactions are recorded simultaneously at the debit and credit side.
- 5) **Based upon Accounting Concepts and Conventions:** The double entry system is based upon universally accepted accounting concepts and convention which one must follow while maintaining our books of accounts.
- 6) **Preparing Trial Balance:** According to double entry system, business transactions are recorded first in the subsidiary books and journal proper. With these books of original record one can prepare ledger accounts, whose balances are used for preparing trial balance, which is test of arithmetical accuracy in accounting.
- 7) **Preparation of Final Accounts:** At the end of accounting year, final accounts are prepared to assess business income and financial position of the business. Trial balance, prepared with the balances of ledger accounts has also debit and credit balances. The total of these two balances are always equal showing the truth that every debit has its corresponding credit.

### 4.1.3. Classification of Accounts

Every accounting transaction has got two sides, the 'debit' and a 'credit'. These are the two signs used in accounting to present and report the financial effect of every transaction. All the business transactions must have debit and its corresponding credit of the same amount. The transactions in the journal are recorded on the basis of the rules of debit and credit.

For this purpose business transactions have been classified into two broad categories:

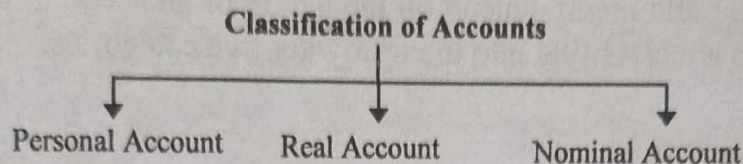
- 1) Transaction on the basis of Personal, Real and Nominal Account (Traditional Classification).
- 2) Transaction on the basis of Accounting Equation (Modern Classification).



#### 4.1.3.1. Traditional Classification of Accounts

The transactions in the journal are recorded on the basis of the rules of debit and credit. For this purpose business transactions have been classified into three categories:

- 1) Transactions relating to persons (Personal Accounts).
- 2) Transactions relating to properties and assets (Real Accounts).
- 3) Transactions relating to incomes and expenses (Nominal Accounts).



- 1) **Personal Accounts:** Personal accounts include the accounts of persons with whom the business deals. These accounts can be further classified into three categories:

- i) **Natural Personal Account:** The natural personal account means persons who are creations of God. For example, Vijay's account, Sanjay's account, Shubham's account.
- ii) **Artificial Personal Account:** These include accounts of corporate bodies or institutions, which are recognized as persons in business dealings, for example, government, club, limited company, co-operative society, etc.
- iii) **Representative Personal Account:** These are the accounts which represent a certain person or group of persons. For example, when the rent is due to landlord, outstanding rent account is opened in the books. Thus, the outstanding rent account represents the account of landlord to whom the rent is payable.

**Golden Rule: Debit the Receiver,  
Credit the Giver.**

- 2) **Real Accounts:** Real accounts may be of the following types:
  - i) **Tangible Real Account:** These are those which relate to such things which can be touched, felt and measured etc. For example, cash account, building account, furniture account, etc.
  - ii) **Intangible Real Account:** These accounts represent such things, which cannot be touched. However, they can be measured in terms of money. For example, patent account, goodwill account.

**Golden Rule: Debit what comes in,  
Credit what goes out.**

- 3) **Nominal Accounts:** These accounts are opened in the books of accounts to simply explain the nature of the transactions. They do not really exist. These accounts are also known as **Revenue and Expense Accounts** or **Temporary**

**Accounts.** For example, salary paid to employee, rent paid to landlord. Nominal accounts mainly include accounts of expenses, losses, income and gains.

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