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# Double Entry System

"Every transaction involving money or money's worth has a two fold aspect — the receiving of a value on the one hand and the giving of the same value on the other. This two fold nature in all transactions must be recorded in the books, and this gives rise to the term Double Entry Book-Keeping". — **Munro and Palmer**

Double entry system is the most progressive, scientific and complete system of recording the financial transactions of a business. The rules of recording transactions under this system are so definite and clearly stated that the system is being used extensively in all countries. According to this system there are two accounts involved in every business transaction. One of them is debited and the other is credited. Under this system the accuracy of the accounts can be checked by preparing a trial balance with the help of balances of ledger accounts at any time and with the help of the trial balance a profit and loss account can be prepared in order to ascertain the profit earned or loss suffered during a particular period. Also, with the help of the trial balance a balance sheet can be prepared to ascertain the financial position of the firm.

A book on the double entry system was, first of all, written in 1494 by **'Luca Pacioli'**, a resident of the city of Venice in Italy. In this book he discussed the method of recording both the aspects of a transaction. The book became very popular in a very short period due to its characteristics. Afterwards, the book was translated into English by **Huge Old Castle** in 1544. Later on, many changes were incorporated in the system and finally a complete book named as 'English System of Book-Keeping' was written on this system by Edward Jones in 1785. It was in this book that the old system was completely revised and the use of purchase book, sales book and the preparation of a trial balance was discussed first of all. Due to its peculiarities this system has been adopted by all the progressive countries all over the world.

### Meaning of Double Entry System

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. It may, however, be noted that the double entry does not mean that a transaction is recorded twice. But it means that at least two accounts are affected by a transaction — one account receiving a benefit and the other account yielding a benefit. The person or the account receiving a benefit is debited and the person or the account who gives something to the business is credited. The amount of every transaction is written twice, once as a debit and again as a credit. For example, we received ₹20,000 from Mohan. This transaction affects two accounts — Cash Account and the Mohan's Account. Cash account is receiving a benefit (as cash is coming in) and hence Cash account will be debited, whereas Mohan is yielding a benefit and hence his account will be credited.

**Definitions** :— Double entry system may be defined as follows :—

1. "The Double Entry System seeks to record every transaction in money or money's worth in its double aspect — The receipt of a benefit by one account and the surrender of a like benefit by another account, the former entry being to the debit of the account receiving and the latter to the credit of that account surrendering."

   — **William Pickles**

2. "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."

   — **J.R. Batliboi**

### Principles or Characteristics of Double Entry System

Double Entry System is based upon the principle that "Every debit has a credit and every credit has a debit". Following are the important features or essentials of the double entry system :—

(1) **Every business transaction affects two accounts** :— Every business transaction has a two-fold effect, *i.e.*, it affects two accounts simultaneously. One of them is debited and the other is credited. Certain transactions may affect more than two accounts but the amount of the accounts to be debited and credited will always be equal.

(2) **Recording of both personal and impersonal aspects** :— Both personal and impersonal aspects of a transaction are recorded in Double Entry. It is possible that both the aspects of a transaction may be personal or both may be impersonal or one may be personal and the other may be impersonal.

(3) **Recording is made according to certain specified rules** :— In double entry one account is debited and the other is credited. It does not mean that any account may be debited and any account may be credited. There are certain rules for debiting and crediting and debits and credits are made on the basis of these rules.

(4) **Preparation of 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 the arithmetical accuracy of the accounting records. This is done by preparing a trial balance.

In order to keep a proper record of the two aspects of a transaction, accounts may be classified as shown below :—

**Classification of Accounts**

- Personal Accounts
- Impersonal Accounts
  - Real Accounts
  - Nominal Accounts

(1) **Personal Accounts** :— The accounts which relate to an individual, firm, company or an institution are called personal accounts. Account of Mohan, Account of Ram Chander Krishan Chander, Account of D.C.M. Limited, Account of Delhi University, Bank Account, Capital Account of the proprietor, Drawings Account of the proprietor etc. are examples of Personal Accounts.

**Rule** :— Rule for recording a transaction in personal accounts in simple words is 'Debit the receiver and credit the giver'. In other words, "Debit that person's account who receives something from the business and credit that person's account who gives something to the business".

**Example 1** :— Paid ₹10,000 to Hari :—

In this case, two accounts affected are Hari's A/c and Cash A/c. According to the rule of "Debit the receiver", Hari's Account will be debited in the entry as he is the receiver of Cash. Simultaneously, the account of cash will be credited, as cash has gone out. The entry will be :—

| | | | |
|---|---|---|---|
| Hari (Debit the receiver) | Dr.[1] | 10,000 | |
| To Cash A/c | | | 10,000 |

**Example 2** :— Received ₹5,000 from Mohan :—

In this case, cash account will be debited as cash has been received, and Mohan's account will be credited according to the rule of "Credit the Giver". The entry will be :—

| | | | |
|---|---|---|---|
| Cash A/c | Dr. | 5,000 | |
| To Mohan (Credit the Giver) | | | 5,000 |

**Objects** :— Object of preparing a personal account is to ascertain as to how much amount a personal account owes to the business *i.e.*, how much amount is due to be received from him and how much amount is owed to a personal account from the business, *i.e.*, how much amount is payable to him.

### Types or Classification of Personal Accounts

Personal accounts can be classified into the following three categories :—

Personal Accounts

- Natural Personal Accounts
- Artificial Personal Accounts
- Representative Personal Accounts

(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 are treated as artificial persons for the recording of business

(1) 'Dr.' is an abbreviation of addebitare and debere, the verb forms of debit used in Italian and Latin languages respectively.

transactions. 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, if the salaries for the month of December are not paid to the employees, the amount payable to these employees will be added and put under one common title "Salaries Outstanding Account". This account represents the accounts of all the persons to whom salaries have to be paid. This is therefore termed as 'Representative Personal Account'. Other examples of the Representative Personal Accounts are, Prepaid Insurance Account, Accrued Interest Account and Unearned Commission Account 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'.

According to this rule, whenever any property comes into the business, it is debited and when it goes outside the business, it is credited.

For example, if Furniture for ₹5,000 has been purchased for cash, furniture account should be debited according to the rule of "Debit what comes in", while cash account should be credited according to the rule of "Credit what goes out". Entry will be :—

| | | | |
|---|---|---|---|
| Furniture A/c (Debit what comes in) | Dr. | 5,000 | |
| To Cash A/c (Credit what goes out) | | | 5,000 |

**Objects** :— These accounts represent the value of various properties owned by a business in terms of money and indicate the financial position of the business.

**Types or Classification of Real Accounts**

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

Real Accounts

Tangible Real Accounts

Intangible Real Accounts

(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. It should be noted that Bank Account is not a real account but it is an Artificial Personal Account, since it represents the account of the Banking Company — an artificial person.

(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".

**Example 1** :— Paid ₹5,000 for Salaries. In this case the two accounts being affected are Salaries A/c and Cash A/c. Salaries represent expenses and as such, Salaries Account will be debited according to the rule of "Debit the expenses". On the other hand, Cash Account will be Credited according to the rule of "Credit what goes out". Entry will be :—

| | | | |
|---|---|---|---|
| Salary A/c (Debit the Expenses) | Dr. | 5,000 | |
| To Cash A/c (Credit what goes out) | | | 5,000 |

**Example 2** :— Received ₹1,000 for Commission. In this case the two accounts being affected are Commission A/c and Cash A/c. Commission A/c is a nominal account and represents an income. As such, Commission A/c will be credited according to the rule of "Credit the incomes". Cash A/c is a real account and as Cash is coming in, therefore Cash A/c will be debited according to the rule of "Debit what comes in". Entry will be :—

| | | | |
|---|---|---|---|
| Cash A/c (Debit what comes in) | Dr. | 1,000 | |
| To Commission A/c (Credit the incomes) | | | 1,000 |

**Objects** :— Nominal accounts are those accounts which are in name only and which do not really exist. These accounts are opened simply to explain the nature of head for which Cash has been paid. In the absence of nominal accounts it will be very difficult for the management to know the amount paid separately on account of salary, rent, commission etc. As such, the nominal accounts provide information regarding the following :—

(*i*) Amount spent on various heads in a particular period;
(*ii*) Income received on various heads in a particular period.

**IMPORTANT NOTE**

When any word (as a prefix or as a suffix) is added to a Nominal Account, it becomes a Personal Account.

| Nominal Account | Personal Account |
|---|---|
| 1. Rent A/c | Outstanding Rent A/c; Prepaid Rent A/c. |
| 2. Salary A/c | Outstanding Salaries A/c; Salaries Prepaid A/c. |
| 3. Commission A/c | Commission Outstanding A/c; Commission Received in Advance A/c. |
| 4. Interest A/c | Interest Outstanding A/c; Interest Accrued A/c. |

**ILLUSTRATION 1.**

Classify the following Accounts into Personal, Real or Nominal Accounts :

1. Capital; 2. Drawings; 3. Cash paid; 4. Cash received; 5. Commission paid; 6. Commission received; 7. Purchases A/c; 8. Sales A/c; 9. Furniture; 10. Cash A/c; 11. Bank A/c; 12. Bank Overdraft A/c; 13. Debtors A/c; 14. Creditors A/c; 15. Travelling Expenses; 16. Goodwill; 17. Patents; 18. Salary A/c; 19. Salary Outstanding A/c; 20. Insurance A/c; 21. Insurance Prepaid A/c; 22. Bad Debts written off; 23. Bad Debts recovered.

**SOLUTION :**

| *Personal Accounts* | *Real Accounts* | *Nominal Accounts* |
|---|---|---|
| 1. Capital | 3. Cash paid | 5. Commission paid |
| 2. Drawings | 4. Cash received | 6. Commission received |
| 11. Bank A/c | 9. Furniture A/c | 7. Purchases A/c |
| 12. Bank Overdraft A/c | 10. Cash A/c | 8. Sales A/c |
| 13. Debtors A/c | 16. Goodwill A/c | 15. Travelling Expenses A/c |
| 14. Creditors A/c | 17. Patents A/c | 18. Salary A/c |
| 19. Salary Outstanding A/c* | | 20. Insurance A/c |
| 21. Insurance Prepaid A/c* | | 22. Bad Debts written off |
| | | 23. Bad Debts Recovered |

* When a prefix or suffix is added to a Nominal A/c, it becomes a Personal A/c.

**Notes :** (*i*) Salary A/c is a nominal account whereas Salary Outstanding is a personal account because it is the account of some unnamed creditor.

(*ii*) Insurance A/c is a nominal account whereas Insurance Prepaid is a personal account because it is the account of some unnamed debtor.

(*iii*) Bank A/c is not a real account. It is a personal account since it is the account of some banking company or firm which is an artificial person.

(*iv*) Purchases A/c and Sales A/c are nominal accounts.

## 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'. Thus, recording in Journal or in its subsidiary books is the first stage of double entry system. 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'**. This book contains, on different pages, individual account heads under which all financial transactions of similar nature are collected at one place, so that the combined effect of all the transactions relating to a particular account may be ascertained. 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.** The total of the debit side of Trial balance must be equal to that of its credit side. If the two sides of the trial balance are equal, the arithmetical accuracy of the accounts is proved. 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.

### Advantages of Double Entry System or Causes of its Popularity

(1) **Scientific System** :— Under this system, the transactions are recorded according to certain specified rules and as such, the system is more scientific as compared to any other systems of Book-Keeping.

(2) **Complete record of every transaction** :— In double entry all the accounts are divided in three parts *i.e.*, personal accounts, real accounts and nominal accounts and both the debit and credit aspects of a transaction are recorded in these. Hence, the complete record of every transaction is maintained in this system, so that if the need arises full details of every transaction can be easily made available at any time in future.

(3) **Preparation of Trial Balance** :— In double entry system, the amount recorded to the debit sides of various accounts will always be equal to the amounts recorded on the credit sides of various accounts. As such, a trial balance can be prepared to check the arithmetical accuracy of the accounts.

(4) **Preparation of Trading and Profit & Loss Account** :— With the help of the trial balance, a Trader can prepare a Trading Account to find out the amount of gross profit or gross loss. Similarly, a profit and loss account can be prepared to find out the net profit earned or loss suffered during a particular period.

(5) **Knowledge of financial position of the business** :— At the end of each accounting period every businessman wants to know the financial position of his business *i.e.*, value of the assets, liabilities and capital of the business. In double entry system, separate accounts are opened for each and every asset and liability of the firm and as such, a Balance Sheet can be prepared which is a screen picture of the financial position of a business at a certain moment. A Balance Sheet reports the property values owned by the enterprise and the claims of the creditors and owners against these properties.

(6) **Knowledge of various informations** :— In double entry system the accounts are maintained in such a way that the information regarding the following is readily available at any point of time :—

(*i*) What is the amount of sales, purchase and closing stock?

(*ii*) What amount is due to be received from customers or in other words, the total number of debtors and the amount in each case.

(*iii*) What amount is due to be paid to suppliers or in other words, the total number of creditors and the amount in each case.

(*iv*) How much amount has been paid on account of each head of expenses separately?

(v) How much amount has been earned on account of each head of income separately?

(7) **Lesser possibility of fraud** : This system of book-keeping records each transaction in two accounts, as such there is hardly any scope of forgery and manipulation as compared to other systems. If at all some manipulation takes place, it can be easily detected.

(8) **Legal Approval** :— Complete record of each transaction is maintained under this system according to certain specified rules. As such, the system meets legal requirements and books of accounts maintained under this system are accepted as true and reliable by the Companies Act and various other Acts. It has been made compulsory for Joint Stock Companies, banks and insurance companies to maintain their accounts according to double entry system of accounts. Tax authorities also rely on the books maintained under this system and these are also accepted by the Court of Law as necessary documentary evidence.

(9) **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.

(10) **Helps management in Decision Making** :— Under the system, the management can obtain all the requisite information quickly and also the information provided by the system is most reliable. Hence, the management can use the information for making decisions.

(11) **Suitable for all Types of Businessmen** :— The system is so flexible that it can be conveniently introduced in small as well as big types of business.

## 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 :—

(*i*) **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.

An analysis of the above disadvantages reveals that these arise due to the inefficiency and carelessness of the person responsible for making records in the books. The system of double entry cannot be held responsible for omitting to record a transaction altogether or for recording some transaction wrongly. The system has proved to be so systematic, scientific and flexible that it is being used extensively in all countries.