

CHAPTER - 3

BASIC ACCOUNTING PROCEDURES

DOUBLE ENTRY SYSTEM OF BOOK KEEPING

Learning Objectives

After studying this Chapter, you will be able to:

To understand the Meaning, Features and Advantages of Double Entry System.

To know the Meaning and Types of Accounts.

To identify the Accounting Rules.

Double entry system was introduced to the business world by an Italian merchant named Lucas Pacioli in 1494 A.D. Though the system of recording business transactions in a systematic manner has **originated in Italy, it was perfected in England** and other European countries during the 18th century only i.e., after the Industrial Revolution. Many countries have adopted this system today.

Double Entry System

There are numerous transactions in a business concern. Each transaction, when closely analyzed, reveals two aspects. One aspect will be “receiving aspect” or “incoming aspect” or “expenses/loss aspect”. This is termed as the “**Debit aspect**”. The other aspect will be “giving aspect” or “outgoing aspect” or “income/gain aspect”. This is termed as the “**Credit aspect**”. These two aspects namely “Debit aspect” and “Credit aspect” form the basis of Double Entry System.

The double entry system is so named since it records both the aspects of a transaction.

In short, the basic principle of this system is, for every debit, there must be a corresponding credit of equal amount and for every credit, there must be a corresponding debit of equal amount.

Definition

According to **J.R. Batliboi** “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”.

Features

- i. Every business transaction affects two accounts.*
- ii. Each transaction has two aspects, i.e., debit and credit.*
- iv. Helps in preparing trial balance which is a test of arithmetical accuracy in accounting.*
- v. Preparation of final accounts with the help of trial balance.*

Approaches of Recording

There are two approaches for recording a transaction.

- I. Accounting Equation Approach*
- II. Traditional Approach*

I. Accounting Equation Approach

*This approach is also called as the **American Approach**. Under this method transactions are recorded based on the accounting equation, i.e.*

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

II. Traditional Approach

*This approach is also called as the **British Approach**. Recording of business transactions under this method are formed on the basis of the existence of two aspects (debit and credit) in each of the transactions.*

All the business transactions are recorded in the books of accounts under the "Double Entry System".

Account

Every transaction has two aspects and each aspect has an account.

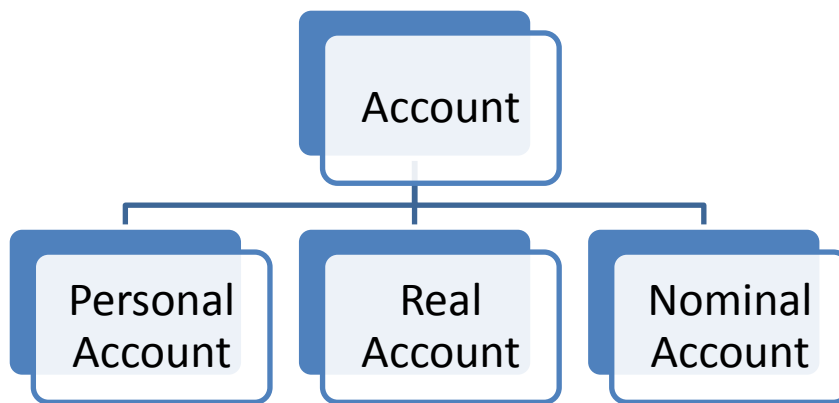
It is stated that 'an account is a summary of relevant transactions at one place relating to a particular head'.

Classification of Accounts

Transactions can be divided into three categories.

- i. Transactions relating to individuals and firms*
- ii. Transactions relating to properties, goods or cash*
- iii. Transactions relating to expenses or losses and incomes or gains.*

Therefore, accounts can also be classified into Personal, Real and Nominal. The classification may be illustrated as follows.



Personal Account:

The accounts relating to individuals, firms, associations or companies are known as personal account. For example, Mohammad, firm, company, association, bank, hospital, institutions, Outstanding expenses etc.

Real Account:

The accounts relating to all assets and properties are called real accounts. For example, cash, bank balance, car, building, furniture, land, goodwill, patent and copy-right etc.

Nominal Account:

The accounts relating to expenses, losses, incomes and gains are known as nominal accounts.

For example, wage, salary, rent, commission, freight, depreciation, advertisement and interest etc.

All the business transactions are recorded on the basis of the following rules.

S. No.	Name of Account	Debit Aspect	Credit Aspect
1.	Personal	The receiver	The giver
2.	Real	What comes in	What goes out
3.	Nominal	All expenses and losses	All incomes and gains.

Journalizing (Recording)

The specimen journal is as follows:

Journal entries in the book of..... (Name of the person)

Date	Particulars	L.F.	Amount (Dr.)	Amount (Cr.)
1	2	3	4	5

The journal has five columns, viz. (1) Date; (2) Particulars; (3) Ledger Folio; (4) Amount (Debit); and (5) Amount (Credit) and a brief explanation of the transaction by way of narration is given after passing the journal entry.

Illustration .1

Journalize the following transactions in the books of "Ahmad" for the month of Jan. 2017

Jan.1, Started business with cash SR. 10,000

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
2017 Jan- 01	Cash a/c Dr. To Capital a/c (Being business started with cash)		10,000	10,000

Jan. 1, Purchased goods SR. 1,000

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
2017 Jan-01				

Jan. 3, Purchased goods from Adel on credit SR. 1,100

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)

Jan. 4, Sold goods SR. 2,500

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 7, Sold goods to Mr. Mohammad on credit SR. 2,300

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 10, Cash paid to Adel SR. 1,100

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 13, Cash received from Mr. Mohammad SR. 2,300

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 15, Cash deposited into bank SR. 1,200

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 18, Cash withdrawn from bank SR. 90

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 19, Purchased furniture for cash SR. 5,000

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 22, Purchased building for cash SR. 6,000

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 24, Paid salaries SR. 3,500

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 25, Paid rent SR. 1,500

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 26, Paid wages SR. 800

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 28, Received interest SR. 600

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Jan. 30, Commission received SR. 500

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount(Dr.)</i>	<i>Amount(Cr.)</i>

Illustration .2

A Company was incorporated on January 1, 2017 with an initial capital of 5,000 shares of common stock having SR 20 par value. During the first month of its operations, the company engaged in following transactions:

<i>Date</i>	<i>Transactions</i>	<i>Amount</i>
<i>Jan.02</i>	<i>An amount was paid as advance rent for three months.</i>	<i>36,000</i>
<i>Jan.03</i>	<i>Paid SR 60,000 cash on the purchase of equipment costing SR 80,000.</i>	
<i>Jan.04</i>	<i>Purchased office supplies on account.</i>	<i>17,600</i>
<i>Jan.13</i>	<i>Provided services to its customers and received in cash.</i>	<i>28,500</i>
<i>Jan.13</i>	<i>Paid the accounts payable on the office supplies purchased on January 4.</i>	
<i>Jan.14</i>	<i>Paid wages to its employees for first two weeks of January, aggregating</i>	<i>19,100.</i>
<i>Jan.18</i>	<i>Provided SR 54,100 worth of services to its customers. They paid SR 32,900 and promised to pay the remaining amount.</i>	
<i>Jan.23</i>	<i>Received from customers for the services provided on January 18.</i>	<i>15,300</i>
<i>Jan.25</i>	<i>Received as an advance payment from customers.</i>	<i>4,000</i>
<i>Jan.26</i>	<i>Purchased office supplies on account.</i>	<i>5,200</i>
<i>Jan.28</i>	<i>Paid wages to its employees for the third and fourth week of January</i>	<i>19,100</i>
<i>Jan.31</i>	<i>Paid as dividends.</i>	<i>5,000</i>
<i>Jan.31</i>	<i>Received an electricity bill of (Due to pay)</i>	<i>2,470</i>
<i>Jan.31</i>	<i>Received a telephone bill of (Due to pay)</i>	<i>1,494</i>
<i>Jan.31</i>	<i>Miscellaneous expenses paid during the month totaled</i>	<i>3,470</i>

Solution.

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Illustration .3**Journalize the following transactions**

<i>Date</i>	<i>Transactions</i>	<i>Amount(SR)</i>
<i>2016.Oct. 01</i>	<i>Business started with cash</i>	<i>65,000</i>
<i>Oct. 01</i>	<i>Purchased goods for cash</i>	<i>50,000</i>
<i>Oct. 02</i>	<i>Purchased goods from Mr. Ahmad on credit</i>	<i>20,000</i>
<i>Oct. 03</i>	<i>Purchased goods for cash returned</i>	<i>5,000</i>
<i>Oct. 04</i>	<i>Purchased goods from Mr. Ahmad on credit returned</i>	<i>2,000</i>
<i>Oct. 05</i>	<i>Sold goods for cash</i>	<i>40,000</i>
<i>Oct. 06</i>	<i>Sold goods to Mr. Ali on credit</i>	<i>25,000</i>
<i>Oct. 08</i>	<i>Sold goods for cash returned</i>	<i>6,000</i>
<i>Oct. 11</i>	<i>Sold goods to Mr. Ali on credit returned</i>	<i>3,000</i>
<i>Oct. 12</i>	<i>Cash paid to Mr. Ahmad</i>	<i>18,000</i>
<i>Oct. 17</i>	<i>Cash received from Mr. Ali</i>	<i>22,000</i>
<i>Oct. 23</i>	<i>Machine purchase</i>	<i>10,000</i>
<i>Oct. 25</i>	<i>Furniture purchased</i>	<i>7,000</i>
<i>Oct. 28</i>	<i>Machine sold</i>	<i>10,000</i>
<i>Oct. 28</i>	<i>Furniture depreciated</i>	<i>100</i>
<i>Oct. 29</i>	<i>Salaries paid</i>	<i>1,200</i>
<i>Oct. 29</i>	<i>Rent received</i>	<i>150</i>
<i>Oct. 30</i>	<i>Cash deposited into bank</i>	<i>8,000</i>
<i>Oct. 30</i>	<i>Paid advertisement</i>	<i>3,500</i>
<i>Oct. 31</i>	<i>Cash withdrawn from business for personal use.</i>	<i>900</i>
<i>Oct. 31</i>	<i>Cash withdrawn from bank for office use.</i>	<i>1,450</i>

Solution. Journal entries in the book of for the month of Oct.2016

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Amount (Dr.)</i>	<i>Amount (Cr.)</i>
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QUESTIONS

I. Objective Type:

a) Fill in the blanks:

1. Every business transaction reveals _____ aspects.
2. The incoming aspect of a transaction is called _____ and the outgoing aspect of a transaction is called _____.
3. Traditional approach of accounting is also called as _____ approach.
4. The American approach is otherwise known as _____ approach.
5. Plant and machinery is an example of _____ account.
6. Capital account is an example of _____ account.
7. Commission received will be classified under _____ account.

b) Choose the correct answer:

1. The receiving aspect in a transaction is called as
a) Debit aspect b) credit aspect c) neither of the two
2. The giving aspect in a transaction is called as
a) Debit aspect b) credit aspect c) neither of the two
3. Mohammad account is an example for
a) Personal A/c b) real A/c c) nominal A/c
4. Capital account is classified under
a) Personal A/c b) real A/c c) nominal A/c
5. Goodwill is an example of
a) Tangible real A/c b) intangible real A/c c) nominal A/c
6. Commission received is an example of
a) Real A/c b) personal A/c c) nominal A/c
7. Outstanding rent A/c is an example for
a) Nominal account b) personal account
c) Real account
8. Drawings account is classified under
a) Real A/c. b) personal A/c. c) nominal A/c.

II. Other Questions: Classify the following items into real, personal and nominal accounts

- a. Capital
- b. Purchases
- c. Goodwill d. Copyright
- e. Mr. Ali
- f. Riyadh Bank
- g. Electricity Charges
- h. Dividend
- i. Ahmad
- j. Outstanding rent

10. From the following transactions prepare journal entries.

Date	Particulars	Amount
2015		
Jan.01	Business started with cash	50,000
02	Purchased goods for cash	40,000
03	Purchased goods from Abdullah on credit	10,000
04	Goods sold for cash	30,000
05	Goods sold to Ahmad on credit	8,000
06	Goods purchased for cash returned	3,000
10	Goods returned to Abdullah	1,000
13	Goods sold for cash returned	4,000
15	Goods returned by Ahmad	500
19	Paid to Abdullah	9,000
26	Cash received from Ahmad	7,500
28	Cash deposited into bank	5,000
29	Goods withdrawn for personal use	600
30	Cash withdrawn for personal use	1,200

11. From the following transactions prepare journal entries.

Date	Particulars	Amount
2015		
Feb.01	Business started with cash	80,000
02	Purchased goods for cash	60,000
03	Purchased goods from Adel	20,000
04	Goods sold for cash	25,000
05	Sold to Osman	8,000
06	Cash deposited into Samba	20,000
10	Paid carriage	500
13	Paid rent	700
15	Paid for advertisement	1,000
19	Commission received	400
26	Machinery purchased	6,000
28	Furniture purchased	3,000
28	Cash withdrawn from samba for personal use	800
28	Goods destroyed by fire	900

12. From the following information's prepare journal entries.

Date	Particulars	Amount
2015		
March.01	Business started with cash and goods (45,000+15,000)	60,000
02	Land purchased	20,000
03	Building purchased	10,000
04	Machinery purchased	5,000
05	Car purchased	6,000
06	Goods purchased	4,000
10	Sale of Machinery	8,000
13	Sale of Building	12,000
15	Goods sold for cash	3,000
19	Interest received	2,000
26	Rent paid	5,000
28	Salaries paid	6,000
29	Deposited into bank	8,000
30	Sale of land	30,000

13. From the following information's prepare journal entries.

Date	Particulars	Amount
2015		
Aprl.01	Purchase of plant and machinery	30,000
02	Furniture purchased	15,000
03	Goods destroyed by fire	2,000
04	Cash stolen by thief	2,500
05	Withdrawn from bank for office use	5,000
06	Building purchased	10,000
10	Furniture depreciated	2,000
13	Land purchased	25,000
15	Building appreciated	4,000
19	Mr. X (who owed SR 6000)paid only	3,500
26	Goods purchased from Mr. Y	5,000
28	Loan taken from bank	13,000
29	Investment purchased	20,000
30	Paid rent for the month	10,000

14. From the following information prepare journal entries.

Transactions	Amount-SR
Bought office machinery in cash	5,000
Bought lorry for cash	4,000
A loan is received by cheque from Earls	20,000
Paid stationery by cheque	200
Paid rates by cash	300
Owner wrote a cheque to himself	1,000
Owner put the additional capital into business	15,000

15. Journalize the following transactions of Mr. Abdullah

2016, June 1 Mr. Abdullah invested SR.500,000 cash in the business

June 3, Paid into Bank. SR 80,000

June 5, Purchased building for SR.300,000

June 7, Purchased goods for SR.70,000

June 10, Sold goods for SR.80,000

June 15, Withdrew cash from bank SR.10,000

June 25, Paid electric charges SR.3,000

June 30, Paid Salary SR. 15,000

16. Record the following transactions in the Journal of Mr. Amir

2017, Jan. 1 Mr. Amir commenced business with cash, SR. 1,500,000.

Jan 3, Paid into Bank SR. 500,000

Jan 5, Bought goods for SR. 360,000

Jan 7, Paid travelling charges SR. 5,000

Jan 10, Sold goods for SR. 2,50,000

Jan 15, Sold goods to Babar SR. 240,000

Jan 20, Purchased goods from Osama SR. 210,000

Jan 25, Withdrew cash SR. 60,000

17. Journalize the following transactions in the Journal of Mr. Mubarak.

2016, Aug. 1 Started business with SR. 450,000

Aug 3, Goods purchased SR. 70,000

Aug 5, Goods sold SR. 51,000

Aug 10, Goods purchased from Abdurrahman SR. 200,000

Aug 16, Goods returned to Abdurrahman SR. 5,000

Aug 23, Drew from bank SR. 30,000

Aug 26, Furniture purchased SR. 10,000

Aug 27, Settled Abdurrahman's account

Aug 31, Salaries paid SR. 12,000

18. Journalize the following transactions in the books of Abu Hamza

2017 Jan, 1 Abu Hamza commenced business with cash SR. 50,000

Jan 2, Purchased goods for cash 10,000

Jan 5, Purchased goods from Khalid on credit SR. 6,000

Jan 7, Paid into Bank SR. 5,000

Jan 10, Purchased furniture SR. 2,000

Jan 20, Sold goods to Hasan on credit SR. 500

Jan 25, Cash sales SR. 3,500

Jan 26, Paid to Khalid on account SR. 3,000

Jan 31, Paid salaries SR. 2,800