BCM-102

FINANCIAL ACCOUNTING

UNIT-3 ACCOUNTING EQUATION AND DOUBLE ENTRY SYSTEM

(B. COM. FIRST YEAR)

Compiled By

Dr. Gagan Singh

Double Entry System: Meaning

- The whole accounting system is based on double entry system. In 1494 Luca Pacioli, an Italian Mathematician introduces the Double Entry System of Account-keeping. The double entry system means every transaction has double effect i.e. When we receive some thing then we give some thing else in return. For example, in case of purchase of goods in cash we received goods and pay cash. These two aspects are called accounts. Of the two accounts one account is debited while the other account is credited with an equal amount. Thus, on a particular date the total of all debits must be equal to total of all credits because every debit has corresponding credit.

Merits of Double Entry System

- (i) The complete record of all transactions can be kept.
- (ii) The system provides complete information of all recorded transactions in the books.
- (iii) The arithmetical accuracy of the recorded transactions under this system can be ascertained.
- (iv) The operational results i.e. Profit / Loss of any period can be ascertained by the preparation of Profit and Loss Account.
- (v) The financial position on a particular date can be ascertained by the preparation of Balance Sheet.
- (vi) The mistakes and/ or frauds can be easily detected, rectified and prevented.
- (vii) The tail or made information can be obtained any time from the accounts for the purpose of taking various decisions from time to time.
- (viii) All types of organizations can keep accounts under this system.
- (ix) Cash Balance available in the business can be ascertained any time.
- (x) As this system is universally accepted, accounts maintained under this system become
- easily acceptable to all parties i.e. Income Tax, Trade Tax, financial institutions etc.
- (xi) The results of one period can be compared with another period because of the
- scientific system of maintaining accounts.

Demerits of Double Entry System

- (i) Under this system accounts book become voluminous because of elaborated record of transactions hence, involve more labour and paper work.
- (ii) It is expensive to keep detailed accounts.
- (iii) It is difficult for persons to keep accounts under this system, unless they have requisite knowledge of the system.
- (iv)Under this system, accounts are maintained by many persons, so secrecy of accounts cannot be maintained .

Classification of Accounts

- **Personal Accounts**
- These accounts record business dealings with natural person, artificial person and representative persons. For example, Accounts of Meera, Radha & co. etc.
- **Real Accounts**
- The accounts relating to all tangible and intangible real assets are called Real Accounts. For example, Goods, Cash, Land, Goodwill etc.
- **Nominal Accounts**
- The accounts related to expenses, losses, incomes, and gains are called Nominal Accounts. For example, Wages, Salaries, Dividend received, Commission earned etc.

Rules for Determining Debit and Credit

Rules of Debit and Credit

Type of Account	Debit	Credit
Personal Account	Receiver	Giver
Real Account	What comes in	What goes out
Nominal Account	Expenses and Losses	Incomes and gains

Accounting Equation

- The Debit and Credit can also be ascertained without the application of the Golden rules of Debit and Credit. This rule has been expressed with the help of Accounting Equation. Accounting Equation is a statement of equality between the debit and credit. It signifies that the assets of a business are always equal to the total liabilities of business and Owner's equity (capital). This relationship if represented in equation form is known as Accounting Equation.
- Assets = Liabilities + Owner's Equity (Capital)
- Or A = L+ C
- Or Resources = Outsiders' claim + owners claim
- The above equation can also be expressed as;
- C = A - L
- Or L = A - C
- This is also called Balance Sheet Equation because it represents the relationship between Balance Sheet items. Thus, this equation should always be in balance because the total of left hand side of the Balance Sheet must be equal to the right hand side of the Balance Sheet.

Rules of Debit and Credit as per Accounting Equation

- For deciding debit and credit, the Accounting Equation can also be shown as follows;
- $A + E = L + C + R$
- Where A =Asset, E = Expense, L = Liability, C = Capital, R = Revenue (Income)
- On the basis of above equation, the rules of debit and credit will be as follows:
- When the items on the left hand side of the equation (A and E) increase in value debit them and credit them when they decrease in value.
- When the items of the right hand side of the equation (L + C + R) increase in value credit them and debit them when they decrease value.

Summary

- The whole accounting system is based on Double Entry System. This system introduced by Lucas Pacioli in 1494. Double Entry System means every transaction has dual aspects. One aspect will be debit and other aspect will be credit. The aspects of the transactions related to person, asset, liability, income or expenditure is called an Account.
- The accounts related to natural, artificial or representative persons are called Personal Account. The accounts related to expenses or losses and incomes and gains are called Nominal Account. Accounting equation is statement of equality between Debit and Credit.

References

- SILM developed by Uttarakhand Open University for BCM-102 (Financial Accounting), Year 2017, ISBN: 978-93-85740-44-2