



23BAT605-FINANCIAL STATEMENT ANALYSIS

Double Entry System

There are numerous transactions in a business concern. Each transaction, when closely analysed, 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 of Double Entry System

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 of Double Entry System

- i. Every business transaction affects two accounts.
- ii. Each transaction has two aspects, i.e., debit and credit.
- iii. It is based upon accounting assumptions concepts and principles.
- 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.,

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

This will be discussed in detail in the next chapter.

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'.

Accounting Rules

- Personal Accounts (Natural person or Company)
 - Debit the receiver
 - Credit the giver
- Real Accounts (cash , property or asset)
 - Debit what comes in
 - Credit what goes out
- Nominal Accounts (Business expenses or losses and income or gains)
 - Debit all expenses and losses
 - Credit all income and gains