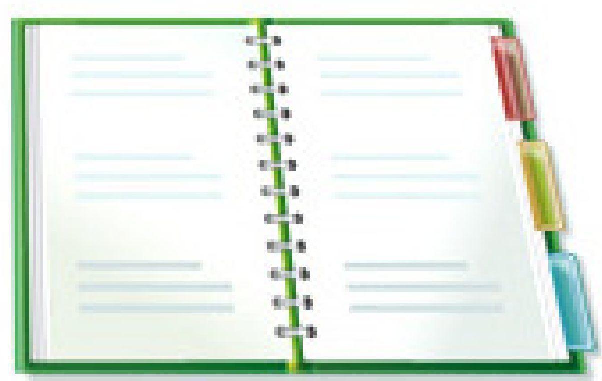
Introduction to Double Entry Account System & Trial Balance



Double-Entry Accounting System

What is double-entry accounting?

Bookkeeping system that balances the accounting equation by recording the dual effects of every financial transaction.

Transactions are entered to an account

The account is an individual record of increases and decreases in a particular asset, liability or owners equity during a period of time

Separate accounts are maintained – cash, debtors, creditors

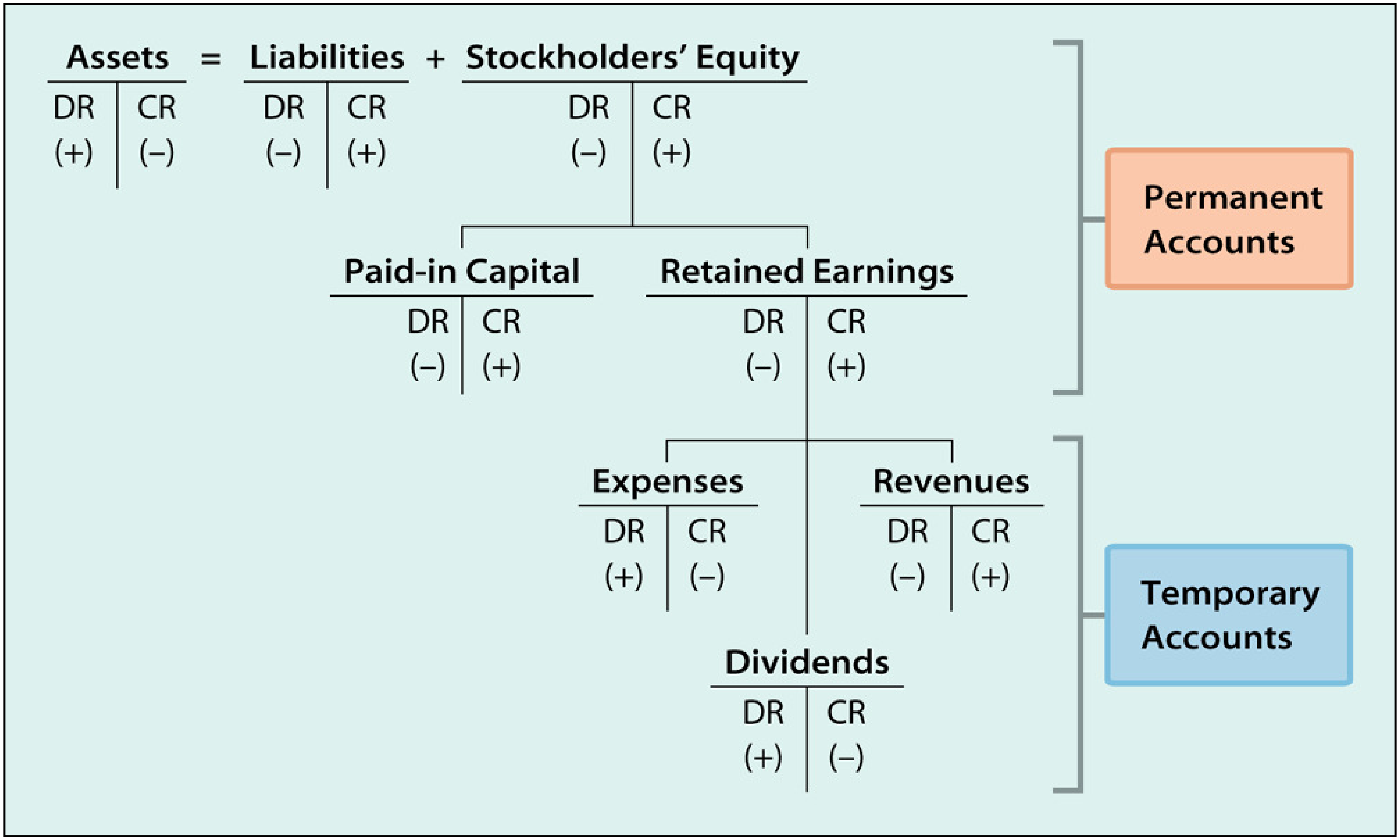
The ledger may be a bound book, a loose-leaf set of pages or a set of computer files which consist account information

The Accounting Equation

Asset = Liability + Owners' equity

- **Asset** is any economic resource expected to benefit a firm or an individual who owns it
- **Liability** is a debt owned by a firm to an outside organization or individual
- **Owners' equity** is the amount of money that owners would receive if they sold all of a firm's assets and paid all of its liabilities

Rules for Debiting and Crediting Accounts



The System of Debits & Credits

- **Debits** – Make an entry of the left side of the T-Account
- **Credits** - Make an entry of the right side of the T-Account
- **Debiting** – The act of making a debit entry in an account.
- **Crediting** - The act of making a credit entry in an account.

Example

A list of cash transaction will be entered in the T-Account.

List of cash transactions

Date		Description	Receipts	Payments
March	1	Invested cash in business	Rs. 1,000,000	
	2	Purchased building for cash		Rs. 850,000
	6	Paid for fire insurance in advance		12,000
	20	Paid to creditors		5,000
	27	Collected cash from debtors	25,000	
	28	Withdrew cash for owner's personal use		10,000
	30	Paid salaries		16,000
	31	Paid telephone and electricity charges		8,000
			Rs. 1,025,000	Rs. 901,000

Cash

Debit / *Credit*

March	1	Capital	Rs. 1,000,000	March	2	Building	Rs. 850,000
	27	Debtors	25,000		6	Insurance	12,000
					20	Creditors	5,000
					28	Withdrawal	10,000
					30	Salaries	16,000
					31	Telephone & electricity	8,000

The Double Entry System

- According to the debit and credit rules the total amount of debits must sequel to the total amount of credits.
- Recording each transaction by entries that have equal debits and equal credits called **double-entry system**
- Double-entry system keep the accounting equation in balance

Asset = Liability + Owners' equity

Example

- **The Asset** : decreased by Rs 850,000 in Land & building Account at the same time Increased by Rs 850,000 in Cash Account

Transaction (2). Purchase of land and building for cash: On 2 March, Mendis purchased a land with a furnished office building by paying cash Rs. 850,000.

Analysis	Rule	Entry
The asset (Land and Building) increased.	Increases in assets are recorded by debits.	Debit Land and Building Rs. 850,000
The asset (Cash) decreased.	Decreases in assets are recorded by credits.	Credit Cash Rs. 850,000

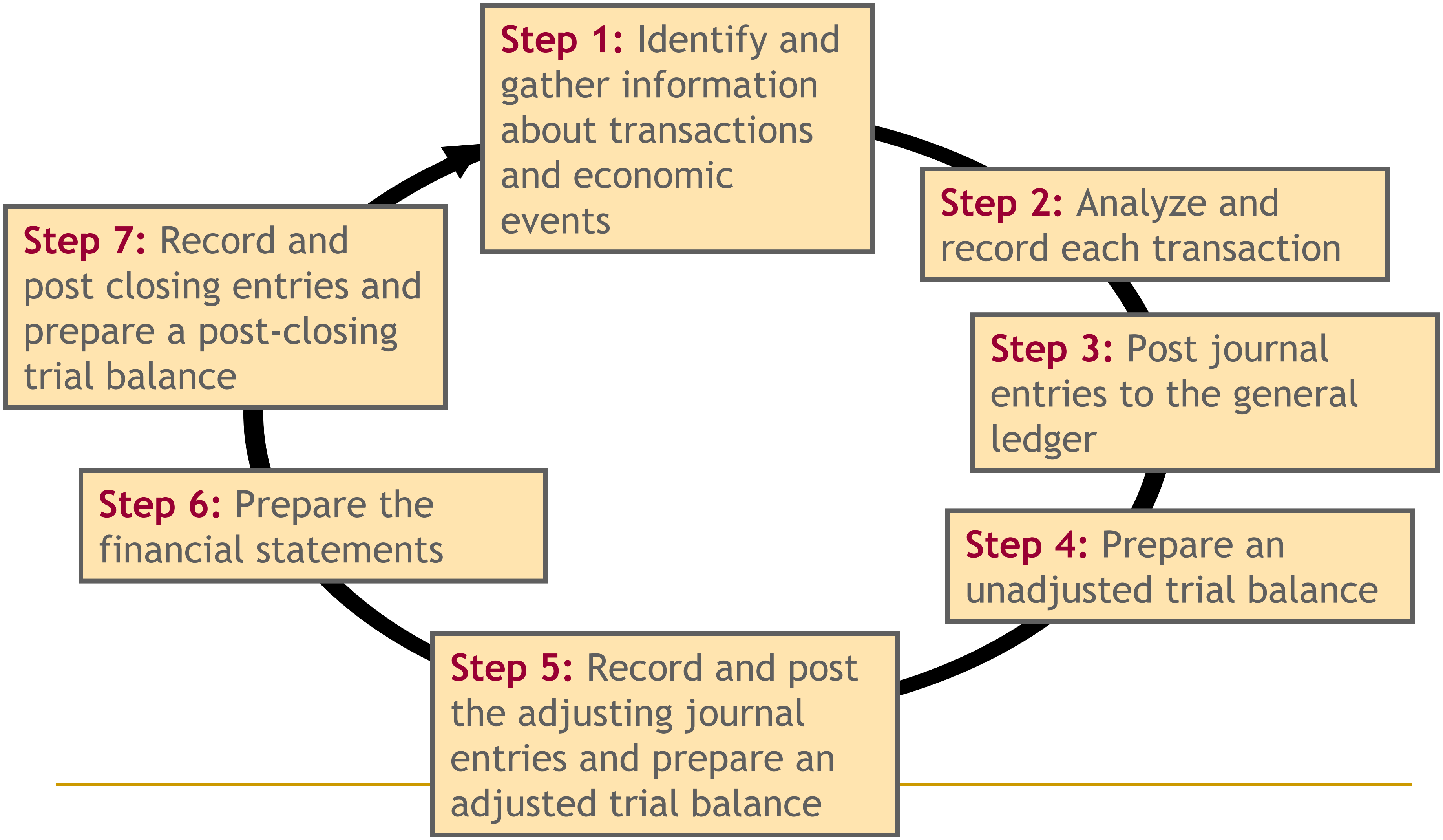
Land and Building

(2)	850,000		

Cash

(1)	1,000,000	(2)	850,000

The Accounting Cycle



Step 2: Analyze Transactions and Record in a Journal

- Determine the dollar amounts and accounts involved.
- Journalize the transaction including date, debits, credits, references and explanation.

Date	Account Title & Explanation	Debit	Credit
July 1	Land	$300,000	
	Cash		$300,000

To record the purchase of land for cash

Step 2: Analyze Transactions and Record in a Journal…

- Journal
  - Before a transaction is recorded in the ledger it is first entered in a book of prime entry, which is known as the journal
  - A journal is designed to show more details relating to each transaction than it appears in the ledger

Step 3: Post Journal Entries to the Ledger

Posting to T-accounts

Cash			Common Stock		
9/1	10,000			10,000	9/1

Step 5: Record and Post Adjusting Entries and Prepare Adjusted Trial Balance

- Adjust transactions or events that cover more than one period and to make estimates and other changes necessary to bring the accounts to their true balances.

Accruals:

- Recognized when an economic event occurs before cash is exchanged.

Deferrals:

- Recognized when cash is exchanged before an economic event occurs (prepaid rent).

Prepare Post-Closing Trial Balance

- Post-closing trial balance should contain only permanent accounts (all temporary accounts have been closed)
- Final check to ensure that total debits equal total credits

The Trial Balance

& Its Limitations.

The Trial Balance & Its Limitations

- The checking or testing of the equality of debit and credit balances is called a **trial balance**
- Two column schedule listing the **title** and **balances** as the same order in the ledger book.
- Debit balance is on the left, credit balance on the right and the **two amount must agree**.
- According to Sri Lankan accounting practices **Assets = Owner's Equity + Liabilities** hence the order will be Assets, Owners Equity and Liabilities.
- Shows the account balance at a **particular time point**
- Total of debtors' balances and creditors' balances are shown in trial balances and Balance Sheet instead of individual details.

Example

Trial Balance

Manjula Real Estate
Trial Balance
As at 31 March 20X1

Account Title	Debits	Credits
Land and Building	Rs. 850,000	
Office Supplies	12,500	
Prepaid Insurance	11,500	
Debtors	20,000	
Cash	124,000	
Capital, M. Mendis		Rs. 1,000,000
Drawings, M. Mendis	10,000	
Creditors		10,000
Commission Revenue		45,000
Salaries Expense	16,000	
Telephone and Electricity Expense	8,000	
Insurance Expense	500	
Supplies Expense	2,500	
	Rs. 1,055,000	Rs. 1,055,000

Limitations

- The Accounting Entity Principle – distinguishes each organizations from its owners and considering as individual business entity.
- The Historical Cost Principle – assets (resources) recorded at their actual costs or the price paid to purchase them.
- The Going Concern Principle – d assumed that the business entity will continue to operate I n the near future
- The Accounting Period Principle indefinite life can be assumed for most accounting entities, but the year has been adopted as the primary reporting period.
- The Matching Principle requires the matching against revenues of all the expenses incurred in earning the revenues during a specific time.

Limitations

- **The Trial Balance may balance even when there are recording errors** – certain record may be entered in both sides mistakenly.
- **The debit totals may differ from the credit totals** – assets (resources) recorded at their actual costs or the price paid to purchase them.

1. Listing a debit balance in credit column and vice versa
2. Omitting an account balance in the trial balance
3. Incorrectly recording a balance
4. Entering credit as a debit and vice versa
5. Arithmetic errors
6. Transposition or slide errors
7. Posting an incorrect amount from a ledger
8. Failing to post part of a journal entry to the ledger