Double-entry bookkeeping

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No topic is more essential to passing Paper F3 and CAT Papers 1, 3 and 6 than double-entry bookkeeping. Having an understanding of double entry can only assist your studies. I think part of the trouble is that most double-entry book keeping systems are computerised so there are fewer and fewer people who actually write up the books of account. However, the nature of professional accounting exams is that students are expected to be familiar with the principles of double-entry book keeping even if it is not something they have to do on a daily basis at work.

Computerisation

The double-entry bookkeeping system is well suited to computerisation because the initial capturing of volumes of repetitive data and the day-to-day recording of transactions involves the application of a set of rules; the subjective exercise of judgement in the determination of profit comes later. The computer system is able to post and balance all the accounts and produce a trial balance, ie a listing of all the balances in the accounts in the ledger. Accounting becomes more interesting when the income statement and balance sheet have to be prepared. At this stage decisions have to be made regarding the selection of accounting policies and an understanding is required as to how these affect the measurement of profit and reporting of assets and liabilities.

If double-entry booking can be computerised then it must be capable of being reduced down to a set of rules to follow.

Books of prime entry

Repetitive transactions may initially be captured in day books (also known as books of prime entry), eg all the sales invoices may be listed in the sales day book (also known as the sales journal). These day books are not part of the double-entry system but enable the number of double-entries to be reduced by ascertaining an aggregate.

The total of the day book, or the single transaction, is recorded in the double-entry system by being posted to the accounts. Each account (or T account) has two sides, the left hand side of which is called the debit side (DR) and the right hand side of which is called the credit side (CR).

A T account looks like this:

Title of the account

Date	Narrative	$	Date	Narrative	$
the date the transaction is recorded	stating where the double entry is posted		the date the transaction is recorded	stating where the double entry is posted	
This side is the	Debit (DR) side		This side is the	Credit side (CR)	

There is no limit to the number of accounts that can be opened or any restriction on their names. Accounts are normally opened for each asset and liability (or class thereof), and one for each type of expense and income. In addition a sole trader will also have an account for capital. Capital represents the proprietary interest in the net assets of the business. It is created when the owner introduces resources into the business entity and increases when the business generates a profit.

Of course, only transactions capable of being measured objectively in monetary terms can be recorded (this is known as the money measurement concept).

Double-entry rules

To record entries in a double-entry system there are three rules to learn. They require little understanding but by practice should become automatically applied without thinking.

Rule 1. The duality rule
Every transaction has two effects, one of which will be recorded as a debit in one account and the other which will be recorded as a credit in another account. If this rule is broken, the trial balance will not agree.

Rule 2. The when to DR and CR rule
The rules as to when to debit a T account and when to credit a T account can be summarised in the following table.

The DR/CR table

	increase	decrease
asset		
expense	Debit	Credit
purchases		
drawings		
liability		
income	Credit	Debit
sales		
capital		
provisions		

The table is logical in its construction. Starting from the premise that when the effect of a transaction is to increase an asset the entry to be posted to the asset account is a DR, it is appropriate that a decrease is a CR. Further as a liability is the opposite of an asset so it is appropriate that it behaves in the opposite way, ie that to record an increase in a liability, the entry to be posted to the liability account is a credit. Expenses behave in the same way as asset accounts as both will be recorded when they are paid for or a liability incurred.

Rule 3. Debit is on the left and credit is on the right

Living in the UK where cars always drive on the left hand side of the road, I can remember this rule by the phrase 'DRive on the left and CRash on the right'

These three rules can be applied to the following transactions:

Example 1

Land is bought for cash, $80,000.

The two effects are to:

• increase the asset of land which is a DR and an entry on the left hand side of the Land account;

• decrease the asset of cash which is a CR and an entry on the right hand side of the Cash account.

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DR Land account	$80,000	
CR Cash account		$80,000

This form of presentation is known as a journal entry. It is often followed by a brief description of the transaction.

The T accounts look like this:

Land account

	$000		$000
Cash	80		

Cash account

	$000		$000
		Land	80

Example 2

An item of plant and machinery is bought on credit, $65,000.

The two effects are to

• increase the asset of Plant which is a DR and an entry on the left hand side of the Plant account;

• increase the liability of payables which is a CR and an entry on the right hand side of the payables account.

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DR Plant account	$65,000	
CR Payables account		$65,000

The T accounts look like this

Plant account

	$000		$000
Payables	65		

Payables account

	$000		$000
		Plant	65

Example 3

A sale of goods on credit is made for $33,000

The two effects are to:

• increase the asset of receivables which is a DR and an entry on the left hand side of the receivables account;

• increase the income account of sales which is a CR and an entry on the right hand side Sales account.

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DR Receivables account	$33,000	
CR Sales account		$33,000

The T accounts look like this

Receivables account

	$000		$000
Sales	33		

Sales account

	$000		$000
		Debtor	33

Conclusion

To gain a proficiency in double-entry bookkeeping requires a lot of practice. A firm grasp of double entry booking is a vital skill to carry forward into further studies and is an invaluable tool in the work place. Remember all accounting issues (however complex) can be explained and boiled down to the debit and the credit.