ACCOUNTS

Double Entry

The Meaning of Double Entry

Explain the meaning of double entry

Businesses need to keep records of their transactions. The process of keeping record is called **bookkeeping**. The simplest form of bookkeeping is single entry. Every transaction is recorded once. This is unreliable because:

- If an arithmetic mistake is made, it is very difficult to find and correct it

- If a transaction is omitted, it is difficult to find it

Now, a more reliable method of bookkeeping is *double entry*.

Different Types of Ledger

Explain different types of ledger

Businesses record their accounts in books called ledgers. A ledger is a main book that contains various accounts.

There are three main ledgers:

- The sales ledger

- The purchases ledger

- The general ledger

-The *sales ledger:* Is the ledger that records the accounts of debtors. The ledger is also known as the *debtors' ledger.* A *debtor* is a person who owes money to the business, that is a person to whom the business sold goods on credit. So when the business has a new customer, it will open an account in the sales ledger for that customer.

-The purchases ledger: Is the ledger that records the accounts of creditors. This ledger is also known as the *creditors' ledger.* A *creditor* is a person whom the business owes money, that is a person from whom the business bought goods on credit. When the business has a new supplier, it will open an account in the purchases ledger for that supplier.

-The general ledger: Is a ledger that records all accounts other than debtors' and creditors' accountants. Examples of accounts recorded all accounts other than debtors' and creditors' accounts are fixed assets and expense.

-Double entry: Is a bookkeeping system whereby every transaction is recorded twice in the ledger. It is recorded on the left as **debit (DR),** and on the right as **credit (CR).** Every transaction involves the giving and receiving of a benefit.

A Ledger

Construct a ledger

Suppose that a company takes 50,000/- from the bank to pay wages.

- The bank account gives the benefit, and so is credited 50,000/-

- The wages account receives the benefit, and so is debited 50,000/-

Suppose the company buys assets worth 100,000/- from ABC Limited.

- ABC Limited has given the benefit, and so is credited 100,000/-

- The fixed assets account has received the benefit, and so is debited 100,000/-

When transactions are written in a ledger, they are said to be posted to the ledger.

Posting Entries in the Ledger

Post entries in the ledger

Example 1

The transactions shown in the table below belong to XYZ Traders; Post them to the relevant ledgers.

June 1: Started business with capital	50,000
June 2: Bought furniture for cash	10,000
June 4: Purchased goods for cash	2,000
June 5: Bought goods from John on credit	4,000
June 5: Sold goods for cash	3,000
June 6: Paid rent	500
June 7: Sold goods to Pwagu on credit	5,000
June 8: Bought goods from Masatu on credit	6,000
June 9: Paid electricity bill in cash	1,000
June 10: Sold goods to Alyoce on credit	8,000
June 11: Received cash from Pwagu	2,000
June 12: Withdrew cash for personal use	7,000
June 15: Paid cash to Masatu	3,000

Solution

In the first transaction, money is taken from the capital account and placed cash account. Hence the capital account is credited and he cash account is debited. In the' Particular' column, write the other account involved in the transaction.

In the second transaction, furniture is bought for cash. So the cash account is credited and the furniture account is debited.

Pwagu and Aloyce are customers, so they each have accounts in the sales ledger, John and Masatu are suppliers, so they each have accounts in the purchases ledger.

Other items are capital, cash, furniture, purchases, sales, rent, electricity and drawing. They all have accounts in the general ledger.

GENERAL LEDGER

Capital account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
				June 1	Cash		50,000

Cash account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 1	Capital		50,000	June 2	Furniture		10,000
June 5	Sales		3,000	June 4	Purchases		2,000
June 11	Pwagu		2,000	June 6	Rent		500
				June 9	Electricity		1,000
				June 12	Drawings		7,000
				June 15	Masau		3,000

Furniture account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 2	Cash		10,000				

Purchases account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 4	Cash		2,000				
June 5	John		4,000				
June 8	Masatu		6,000				

Sales account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
				June 5	Cash		3,000
				June 7	Pwagu		5,000
				June 10	Aloyce		8,000

Rent account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 6	Cash		500				

Electricity account

_ _ _ _ _

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 9	Cash		1,000				

Drawing account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 12	Cash		7,000				

PURCHASES LEDGER

John account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
				June 5	Purchases		4,000

Masatu account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 15	Cash		3,000	June 8	Purchases		6,000

Sales ledger

Pwagu account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 7	Sales		5,000	June 11	Cash		2,000

Aloyce account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 10	Sales		8,000				

Note: Check that for each transaction there are two equal entries, one for debit and one for credit, for instance:

June 11: Received cash from Pwagu, 2,000

-Pwagu's account is credited 2,000

-The cash account is debited 2,000

This is what is meant by double entry.

Closing the Simple Accounts

Close the simple accounts

Closing the accounts is the process of balancing the accounts. This involves determining the totals of the debits and credits, and finding the difference between the two sides. The difference is ***the balancing figure***, which is placed in the side that is less. This makes the two sides equal.

Example 2

Consider the following account from Example 1. Close this account.

Cash account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 1	Capital		50,000	June 2	Furniture		10,000
June 5	Sales		3,000	June 4	Purchases		2,000
June 11	Pwagu		2,000	June 6	Rent		500
				June 9	Electricity		1,000
				June 12	Drawings		7,000
				June 15	Masatu		3,000

Solution
This account is closed as follows:
The total debit is 55,000/-
The total credit is 23,500/-
The difference is 31, 500/-
The credit side is less by 31, 500/-. Place this amount in the credit side using the words' balance c/d' (c/d means carried down) in the 'Particular' and 'Folio' columns. This is shown in the following table.

Cash account:

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 1	Capital		50,000	June 2	Furniture		10,000
June 5	Sales		3,000	June 4	Purchases		2,000
June 11	Pwagu		2,000	June 6	Rent		500
				June 9	Electricity		1,000
				June 12	Drawings		7,000
				June 15	Masatu		3,000
				June 30	Balance	c/d	31,500
			55,000				55,000
July 1	Balance	b/d	31,500				

The balance c/d shows the amount that stands on the account on the closing date. It appears as balance b/d (b/d means brought down) on the opening date of the next trading period, on the other side of the ledger.

Exercise 1

1. What is a ledger? Give an explanation of three ledgers you know, with an example of accounts kept in each ledger.

2. For each of the following transactions, name the ledger it would be posted to, and whether this would be as credit or debit.

1.   a lorry bought for cash

2.   goods sold to Mr. Sabaya for cash

Post the following transactions for MLN Traders in the ledger, closing them there

After

June 1:	Commenced business with	30,000/-
June 2:	Bought furniture	5,000/-
June 2:	Purchased goods for cash	8,000/-
June 3:	Bought motor vehicle	10,000/-
June 5:	Bought goods from Mambo on credit	15,000/-
June 7:	Sold goods for cash	40,000/-
June 8:	Paid rent in cash	2,000/-
June 10:	Sold goods for cash	13,000/-
June 11:	Bought goods for cash	10,000/-
June 13:	Paid insurance in cash	4,000/-
June 14:	Sold goods on credit to Abuu	20,000/-
June 15:	Paid cash to Mambo	5,000/-
June 20:	Sold goods for cash	12,000/-
June 21:	Paid salaries in cash	15,000/-
June 25:	Received cash from Abuu	8,000/-

Trial Balance

The Concept of Trial Balance

Explain the concept of trial balance

Trial balance is a statement which shows the balances of accounts extracted from the ledger. At the end of each trading period, the accounts in the ledger are closed, that is the balance of each account is determined. These balances are then shown in the trial balance.

Below is the format of a trial balance.

TRIAL BALANCE as at 30 June 2005

Account	DR	CR

Accounts with debit balances are posted in the DR column and those with credit balances in the CR column.

Functions of trial balance

The trial balance serves the following two major roles:

-It checks the arithmetical accuracy of the ledger. The double entry system requires posting equal amounts to debits and credits. Therefore the trial balance is expected to balance if the arithmetic was correct. If there is a difference in the totals of the debit and credit columns of the trial balance, then some errors were made.

-It simplifies the preparation of the final accounts. The trial balance contains all the accounts extracted from the ledgers. This makes it easy to post the accounts to the final accounts.

Construction of Trial Balance

Construct trial balance

Look again at Example 1 of XYZ Traders. The accounts, after being closed, appear as follows:

Capital account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 30	Balance	c/d	50,000	June 1	Cash		50,000
							50,000
			50,000	July 1	Balance	b/d	50,000

Cash account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 1	Capital		50,000	June 2	Furniture		10,000
June 5	Sales		3,000	June 4	Purchases		2,000
June 11	Pwagu		2,000	June 6	Rent		500
				June 9	Electricity		1,000
				June 12	Drawings		7,000
				June 15	Masatu		3,000
				June 30	Balance	c/d	31,500
			55,000				55,000
July 1	Balance	b/d	31,500				

Purchases account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 4	Cash		2,000	June 30	Balance	c/d	12,000
June 5	John		4,000				
Jun 8	Masatu		6,000				
			12,000				12,000
July 1	Balance	b/d	12,000				

Sales account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 30	Balance	c/d	16,000	June 5	Cash		3,000
				June 7	Pwagu		5,000
				June 10	Alyoce		8,000
			16,000				16,000
				July 1	Balance	b/d	16,000

Rent account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Account
June 6	Cash		500	June 30	Balance	c/d	500
			500				500
July 1	Balance	b/d	500				

Electricity account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Account
June 9	Cash		1,000	June 30	Balance	c/d	1,000
			1,000				1,000
July 1	Balance	b/d	1,000				

And other accounts closing.

NB. The balance b/d determines whether the account has a debit or credit balance.

Example 3

Construct the trial balance for XYZ Traders of Example 1.

Solution
XYZ TRADERS TRIAL BALANCE as at 30 June 2005

Account	DR	CR
Capital		50,000
Cash	31,500	
Furniture	10,000	
Purchases	12,000	
Sales		16,000
Rent	500	
Electricity	1,000	
Drawings	7,000	
Creditors: John		4,000
Masatu		3,000
Debtors: Pwagu	3,000	
Aloyce	8,000	
	73,000	73,000

The two columns balance. This confirms that the accounts are correct.

Exercise 2

1. Why is trial balance referred to as statement of arithmetical accuracy?

2. Trial balance is statement and not part of double entry. explain why?

3. The following balances were extracted from the ledgers of Doka traders on 30 June 2005.

Capital	50,000
Furniture	35,000
Motor vehicle	45,000
Sales	75,000
Purchases	44,000
Creditors	76,000
Debtors	45,000
Insurance	13,000
Cash	1,000
Discount Received	7,000
Discount allowed	4,000
Drawings	16,000
Electricity	7,000

Prepare a trial balance from the given balances.

Debit Balances and Credit Balances

Post debit balances and credit balances

DEBIT BALANCES:

Cash account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 1	Capital		50,000	June 2	Furniture		10,000
June 5	Sales		3,000	June 4	Purchases		2,000
June 11	Pwagu		2,000	June 6	Rent		500
				June 9	Electricity		1,000
				June 12	Drawings		7,000
				June 15	Masatu		3,000
				June 30	Balance	c/d	31,500
			55,000				55,000
July 1	Balance	b/d	31,500				

Furniture account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 2	Cash		10,000	June 30	Balance	c/d	10,000
			10,000				10,000
July 1	Balance	b/d	10,000				

Purchases account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 4	Cash		2,000	June 30	Balance	c/d	12,000
June 5	John		4,000				
Jun 8	Masatu		6,000				
			12,000				12,000
July 1	Balance	b/d	12,000				

CREDIT BALANCES:

John account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 30	Balance	c/d	4,000	June 5	Purchases		4,000
			4,000				4,000
				July 1	Balance	b/d	4,000

Masatu account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 15	Cash		3,000	June 8	Purchases		6,000
June 30	Balance	c/d	3,000				
			6,000				6,000
				July 1	Balance	b/d	3,000

Sales account

DR				CR			
Date	Particular	Folio	Amount	Date	Particular	Folio	Amount
June 30	Balance	c/d	16,000	June 5	Cash		3,000
				June 7	Pwagu		5,000
				June 10	Alyoce		8,000
			16,000				16,000
				July 1	Balance	b/d	16,000

Checking the Balances

Check the balances

Activity 1

Check the balances

Trading Profit and Loss

Gross Profit/Loss using Trading Account

Ascertain gross profit/loss using trading account

The trading and profit and loss A/C is an account that is composed of two accounts, the trading A/C, and the profit and loss A/C.

The trading A/C is used to determine the gross profit of the goods sold:

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Gross profit = sales – cost of goods sold

The profit and loss account (A/C) is the part of the account that determines the net profit loss:

Net profit = gross profit – expenses

Net loss = expenses – gross profit

-In the profit and loss A/C, the gross profit and other revenues are credited to the account while the operating expenses are debited.

-We have net profit if the credit is greater than the debit and net loss if the debit is greater than the credit.

Example 4

The following is the trial balance of FMHN Trading Co. as at 31 December 2004. Prepare the trading and profit and loss accounts for the year 2004.
FMHN TRADING CO.

TRIAL BALANCE as at 31 December 2004

Account	DR	CR
Capital		41,500
Machines	4,550	-
Motor vehicle	5,520	-
Stock	24,970	-
Debtors	20,960	-
Creditors	-	16,275
Cash	755	-
Purchases	71, 630	-
Sales	-	90,370
Salaries	8,417	-
Office expenses	1,370	
Discount allowed	563	
Drawings	9,500	
	148,235	148,235

The following information was available at 31 December 2004:
 (i) stock at 31 December 2004: 27, 340/-
 (ii) office expenses owing: 110/-
 (iii) Depreciation to be charged as motor vehicle 20% and machines 10%.

Solution

First, adjust the trial balance to include the three items above.
(i) Add the stock and the purchases, to obtain 96,600.
   Subtract the stock at the end of the period to obtain 69,260.
   This gives the cost of the stock sold.
(ii) Add 110 to the office expenses account, increasing it to 1,480.
(iii) Motor: 20% of 5,520 is1104.
      Machines: 10% of 4,550 is 455.
      Include these under depreciation.
Set out the account as shown below.
The gross profit of 21,110 is found to be subtracting the cost of the stock (69, 260) from the sales (90,370).
The net profit of 9,091 is found by subtracting the costs of the firm (salaries, office expenses, discount, and depreciation from the gross profit.

FMHN TRADING CO.
TRADING AND PROFIT AND LOSS A/C For the year ending 31ˢᵗ December 2004

Opening stock	24,970		
Purchases	71,630	Sales	90,370
Goods available for sale	96,600		
Less: Closing stock	27,340		
Cost of goods sold	69,260		
Gross profit c/d	21,110		
	90,370	90,370	
Salaries	8,417	Gross profit b/d 21,110	
Office expense 1,370			
Add: Owing 110	1,480		
Discount allowed	563		
Depreciation: Motor vehicle 1,104			
Machines	455		
Net profit	9,091		
	21,110	21,110	

Net Profit/Loss Account

Ascertain net profit/loss account

When net loss is recorded, the profit and loss A/C appears as shown in the following example.

PROFIT AND LOSS A/C

For the year ending …………………….

Salaries	1,500	Gross profit b/d	12,500
Electricity	3,400	Discount received	1,500
Rent	800		
Advertising	2,700		
Discount allowed	4,000	Net loss	4,000
Office expenses	5,600		18,000
	18,000		

Exercise 3

1. Explain the function of trading A/C.

2. The following is the trial balance of KOKU Traders as at 30th June 1990.

	DR	CR
Capital	-	
Land and Buildings	10,000	35,748
Advertisement	254	
Motor van	1,854	
Furniture and Equipment	2,200	
Debtors	9,772	
Creditors	-	16,810
Cash at hand	7,584	
Cash in hand	704	
Stock 1st July	24, 050	
Insurance	384	
Bad debts	52	
Sales	-	147,668
Purchases	136,970	
Postage & Telephone	344	
Electricity	384	
Wages	5,674	
	200, 226	
		200,226

You are further informed that:
-Wages unpaid at the end of the month amounted to 200/-
-Stock at 30th June 1990 was 21,575/-
-Depreciations are to be charged as:

        Motor van 2,500/-

        Furniture & equipment 800/-,

Prepare the trading and profit and loss A/C for the year ending 30th June 1990.

Balance Sheet

A Balance Sheet

Construct a balance sheet

A balance sheet is a statement which shows the financial position of a business at a particular date.

It shows the *assets* on one side and *liabilities* on the other.

Assets are divided into two: **fixed assets** and **current assets.**

-Fixed assets are possessions of the business that assist the business in its operations, and benefit the business for more than one accounting period.

-Current assets are assets of the business used in generating income during the accounting period.

Liabilities are also grouped into two: *long term liabilities*, which are payable in more than one accounting period and current liabilities, which are payable within the accounting period.

The following is the format of balance sheet showing the common items of the balance sheet.

XYZ TRADERS
BALANCE SHEET as at 31st December 2004

LONG TERM LIABILITIES			FIXED			
Capital	xxx		Motor vehicle	xxx		
Add: Net profit	xx		**Less**: Depreciation	xx	xxx	
	xxx					
Less: Drawings xxx		xxxx	Furniture	xxx		
			Less: Depreciation	xx	xxx	
Loan		xxxx				
CURRENT LIABILITIES			CURRENT ASSETS			
Creditors	xxx		Stock		xxx	
Owing expenses	xxx		Debtors		xxx	
	xxxx		Prepaid		xxx	
			Bank		xxx	
			Cash		xxxx	

NB: Net loss is subtracted from the capital. Stock appearing on the balance sheet is the stock at the date of the balance sheet.

Posting Entries in Balance Sheets

Post entries in balance sheets

Example 5

Considering FMHN Trading Co. from above example, the balance sheet will be as

FMHN TRADING CO.
BALANCE SHEET as at 31ˢᵗ December 2004

LONG TERM LIABILITIES

Capital	41,590	
Add: Net profit	9,091	
	50,681	
Less: Drawings	9,500	41,181

FIXED ASSESTS

Machines	4,550	
Less: Depreciation	455	4,095
Motor vehicle	5,520	
Less: depreciation	1,104	4,416

CURRENT LIABILITIES

Creditors	16,275
Office expenses owing	110
	57,566

CURRENT ASSETS

Stock	27,340
Debtors	20,960
Cash	755
	57,566

Generally, from the balance sheet, we get the equation:

$Assets = Capital + Liabilities$

This equation is called "*The balance sheet equation*".

Interpreting Information from the Balance Sheet

Interpret information from the balance sheet

From the balance sheet, useful information concerning the business can be extracted. The interpretation then depends on the use of the information.

The following are some of the useful information provided by the balance sheet.

1. **Capital:** The capital available at the data of the balance sheet is shown after adjusting the previous capital.
2. **Working capital:** Working capital or circulating capital is given by:
Current assets – current liabilities
3. **Liquidity ratio:** The ratio measures the ability of the business to repay current liabilities out of the current assets. The ratio can be shown in two ways:

(i) Current assets $= \dfrac{\text{current assets}}{\text{Current liabilities}}$

(ii) Quick ratio $= \dfrac{\text{current assets} - \text{stock}}{\text{Current liabilities}}$

The quick ratio measures the ability of the business to pay current liabilities out of current assets excluding stock which is considered less liquid.

From the balance sheet of FMHN Trading Co. we can find the following.

1. Capital at 31st December 2004 is 41. 181/-
2. Working capital is given by:
    Current assets – current liabilities = 49.055 – 16, 385
    $$= 32, 670/-$$

3. (i) current ratio $= \dfrac{\text{current assets}}{\text{Current liabilities}}$

$$= \dfrac{49,055}{16,385} = 2.9 \approx 3$$

(ii) Quick ratio $= \dfrac{\text{current assets - stock}}{\text{Current liabilities}}$

$$= \dfrac{49,055 - 27,340}{16,385}$$

$$= \dfrac{21,715}{16,385} = 1.3$$

Note: The liquidity ratio is favorable if it is greater than or equal to 1.

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Exercise 4

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1. Prepare the balance sheet for the balances given in the table below.

Capital	45,000
Drawings	28,000
Creditors	4,300
Stock	5,000
Debtors	8,000
Premises	16,000
Motor vehicle	8,000
Bank	4,000
Cash	9,000
Net profit	2,700
Bank overdraft	6,000

2. From the balance sheet constructed in question 2, determine the following.

a.   Working capital

b.   Quick ratio

c.   Current ratio

Summary

-In double entry bookkeeping, every transaction is recorded twice, once as credit and once as debit

Debit receives the benefit.

Credit provides the benefit.

-A trial balance finds the totals of the debits and credits in all the accounts. The total debit should equal the total credit. If they are not equal, a mistake has been made.

-The trading and profit and loss account determines there total profit or loss over a period.

-The balance sheet shows the financial position of business at a particular date.

Exercise 5

1. Explainan advantage of double entry bookkeeping over single entry bookkeeping.

2. Givethree accounts that would be kept in the general ledger.

3. Define the quick liquidity ratio.

4. Xis acustomer of company PQR. Below are the transaction made by X over a month.

Nov 3rd	Sold 34,000/- of goods to X on credits
Nov 5th	Sold 27,000/- - of goods to X on credit
Nov 10th	Received 55,000/- - cash from X
Nov 14th	Sold 29,000/- - of goods to X on credit
Nov 20th	Sold 44,000/- - of goods to X on credit
Nov 25th	Received 74,000/- - cash from X

(a) Post these transaction to X's account, the cash account and the sales account.

(b) Close X'S account

5. The following table shows the closing balances of company PQR of question 4.

Account	DR	CR
Capital		100,000
Cash	98,000	
Purchases	254,000	
Sales		179,000
Supplier A		88,000
Supplier B		102,000
Customer X	5,000	
Customer Y	12,000	

6. Below is a trial balance for Nyati Ltd. The closing stock was 1, 750,000/-, and the van was depreciated at 25%. Set up the trading and profit and loss account.

Account	DR	CR
Capital		61,000
Van	660,000	
Stock	1,220,000	
Debtors	155,000	
Creditors		160,000
Cash	86,000	
Purchases	2,100,000	
Sales		5,800,000
Office expenses and salaries	1,800,000	
	6,021, 000	6,021,000

7. Complete the balance sheet below for Nyati Ltd. of question 6.

NYATI LTD.

LONG TERM LIABLITIES   FIXED ASSETS
Capital   Van
Add: Net profit   **Less:** Depreciation

CURRENT LIABLITIES   CURRENT ASSETS
Creditors   Stock
Expenses   Cash

8. Use the balance sheet constructed in question 7 to find the following.

a.   capital

b.   working capital

c.   current liquidity

d.   quick liquidity rate