6 Dual Impact of Transactions

The following facts are discussed in this chapter.

6.1 Dual impact of business transactions

Many transactions occur daily in a business. As a result of these transactions, the values of assets, liabilities, equity, income and expenses are changed. In accounting these changes are identified as a dual impact of a transaction. As explained earlier, each transaction causes change to two items of the accounting equation. This is termed as the dual impact of a transaction.

Examples :-

Investing Capital	Cash increases	Equity increases
Purchase of furniture	Furniture increases	Cash decrease
Payment of Salary	Cash decreases	Equity decreases

Because of this dual impact of each transaction, the value of each transaction should be written in two places. This means there should be two entries for each transaction. However, when the business expands, a large number of transactions could take place. In such a case, recording those transactions in an accounting equation may not be practical. Even though we could record those transactions in the accounting equation, it is very difficult to obtain information clearly whenever necessary. Therefore, the dual impact of transactions are usually recorded in accounts according to the double entry system.

6.2 Double entry system

As mentioned above, there is a dual impact of each transaction to the accounting equation and this dual impact should be recorded in accounts. When recording the dual impact of a transaction, the same amount has to be recorded in two separate accounts. Each account has a debit and a credit side. If a value of a transaction is debited to a particular account, that value also should be credited to another account. The accounting system, which records the same amount in debit and credit sides of accounts is called as the double entry system.

6.3 Account

An account is a commonly accepted structure that is used to record the change (increase or decrease) of an asset, an equity, a liability, an income or an expense for a time period.

An account can be prepared as follows.

Dr. .... Account Cr.

Date	Description	L.F.	Value (Rs.)	Date	Description	L.F.	Value (Rs.)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

(1) and (5) - The date of the transaction

(2) and (6) - The name of the account which is used to record the other entry of the double entry.

The description in the credit side of an account is the name of the account which is used to record the debit entry of the transaction and vice versa.

(3) and (7) - The ledger folio (page number) of the account that is used to record the other entry of the transaction.

(4) and (8) - The value of the transaction.

6.4 Types of accounts

We already discussed that assets, equity, liabilities, income and expenses arise due to business transactions. Accounts are used to record the changes of assets, equity, liabilities, income and expenses due to transactions. All these accounts can be classified into five types.

- **Asset accounts**

Examples :- Building account, Debtors account, Cash account

- **Liability accounts**

Examples :- Bank loan account, Creditors account, Electricity expense payable account

- **Equity accounts**

Examples :- Capital account, Drawings account

- **Income accounts**

Examples :- Sales account, Sales commission income account, Interest income account

- **Expenses accounts**

Examples :- Salary account, Insurance charges account, Electricity expense account

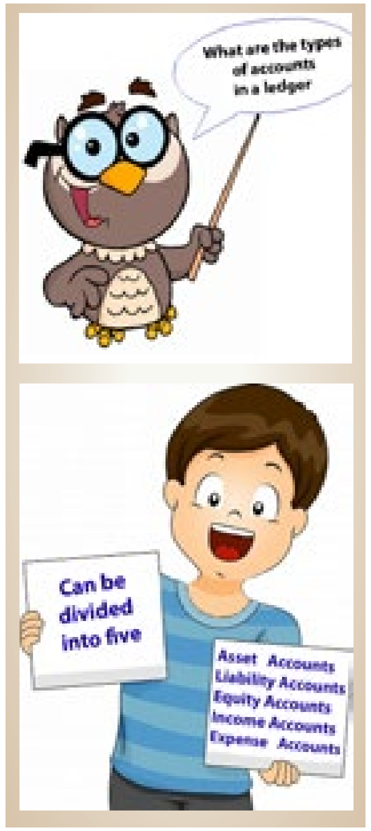

Figure - 6.1

When recording business transactions in accounts, the value of a transaction should be either recorded in the debit side or the credit side of the relevant account. Let us consider how to record such transactions in accounts.

6.5 Recording transactions in accounts

Accounts are debited or credited to show the increase or decrease of assets, equity, liabilities, income or expenses due to transactions. However, debiting to an account does not always mean an increase. To show an increase, some accounts are debited and also to show a decrease some accounts are debited. This is same for the crediting to an account. This creates a problem which is how to debit or how to credit accounts to show the increase or decrease of an accounting element due to a transaction. There are some generally accepted principles in accounting which address this problem. These principles are called as the principles of Double Entry. There are five principles for the five types of accounts. They are shown in the following table.

Type of account	Increase	Decrease
Asset accounts	Debit	Credit
Liability accounts	Credit	Debit
Equity accounts	Credit	Debit
Income accounts	Credit	Debit
Expenses accounts	Debit	Credit

Figure - 6.2

Example :-

Purchased a machine on 03. 01. 20xx at Rs. 500 000

Double entry Machinery account (Asset increases) Dr. Rs. 500 000
Cash book (Asset decreases) Cr. Rs. 500 000

Debit Machinery account Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
03.01.20xx	Cash book		500 000				

Debit Cash book Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F	Value Rs.
				03.01.20xx	Machinery account		500 000

Example :- Obtained a bank loan of to Rs. 200 000 on 04.01.20xx

Double entry Cash book (Asset increases) Dr. Rs. 200 000
Bank loan account (Liability increases) Cr. Rs. 200 000

Debit Cash book Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
03.01.20xx	Bank loan account		200 000				

Debit Bank loan account Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				03.01.20xx	Cash book		200 000

Example :- The owner invested Rs. 300 000 as the capital on 5.01.20xx

Double entry Cash book (Asset increases) Dr. Rs. 300 000
Capital account (Equity increases) Cr. Rs. 300 000

Debit Cash account Credit

Date	Description	L.F	Value Rs.	Date	Description	L.F	Value Rs.
05.01.20xx	Capital account		300 000				

Debit Capital account Credit

Date	Description	L.F	Value Rs.	Date	Description	L.F	Value Rs.
				05.01.20xx	Cash book		300 000

Example :- Received an interest income of Rs. 20 000 on 05.01.20xx

Double entry Cash account (Asset increases) Dr. Rs. 20 000
Interest income account (Income increases) Cr. Rs. 20 000

Debit Cash Account Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
05.01.20xx	Interest income account		20 000				

Debit Interest income account Credit

Date	Description	L.F.	Value Rs.	Date	Description	L.F.	Value Rs.
				05.01.20xx	Cash book		20 000

Example :- 06.01.20xx paid salaries Rs. 20 000

Double entry Salary account (Expense increases) Dr. Rs. 20 000
Cash account (Asset increases) Cr. Rs. 20 000

Debit Salary account Credit

Date	Description	Page No.	Value Rs.	Date	Description	Page No.	Value Rs.
06.01.20xx	Cash account		20 000				

Debit Cash account Credit

Date	Description	Page No.	Value Rs.	Date	Description	Page No.	Value Rs.
				06.01.20xx	Salary account		20 000

The Ledger

A separate account has to be maintained for each type of asset. Accordingly, there can be many asset accounts in a business such as motor vehicle account, furniture account, cash account, etc. Similarly, there can be many accounts for each type of equity, liability, income and expenses in a business. A collection of all accounts is called as the ledger. Therefore, recording business transactions in accounts is also named as recording business transactions in the ledger.

Figure - 6.3

Activity 01

Write whether the increase and decrease of each of following accounts should be written in the debit side or credit side of the account.

Serial No.	Account name	Increases	Decreases
1	Building account		
2	Bank loan account		
3	Sales account		
4	Electricity charges		
5	Interest received account		
6	Vehicle account		
7	Purchase account		
8	Capital account		
9	Drawings account		
10	Debtors account		

Activity 02

Following are the transactions that occurred in a business during the month of March of 20xx. Write the double entry of each transaction.

March 01. Introduced capital by the owner Rs. 200 000
02. Cash purchases Rs. 50 000
03. Paid the monthly rental Rs. 10 000
04. Cash sales Rs. 70 000
05. Purchased goods on credit Rs. 80 000
06. Withdrew money by the owner for personal use Rs. 10 000
07. Paid monthly salaries Rs. 20 000
08. Obtained a bank loan Rs. 200 000
09. Invested in a fixed deposit Rs. 10 000
10. Credit sales 60 000

Activity 03

Following are some transactions occurred in Namal's business

Jan 01. Introduced capital Rs. 300 000
02. Purchased equipment for use in the business Rs. 50 000
03. Purchase goods on credit Rs. 80 000
04. Paid telephone bill of the owner's house using cash of the business Rs. 5 000
05. Cash sales Rs. 50 000
06. Paid insurance Rs. 7 000
07. Cash purchases Rs. 40 000
08. Paid creditors Rs. 20 000

Record the above transactions in accounts.

Activity 04

Following cash book has been prepared by the account clerk of the Sameera's business by including transactions that have occurred during the month of January 20xx.

Debit Cash book Credit

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
Jan 01	Capital account		80 000	Jan 09	Purchases account		50 000
06	Sales account		60 000	12	Equipment account		80 000
07	Bank loan account		100 000	15	Electricity charges acc.		10 000
27	Interest income acc.		12 000	18	Investment account		40 000
30	Debtor's account		4 000	22	Bank loan interest acc.		10 000
				25	Creditor's account		5 000

You are required to :-

1. Describe the transaction for each entry listed in the cash account in chronological order.

2. Record the other entries relevant to the transactions listed in the above cash account in the respective other accounts in the ledger of sameera's business.