WHY DOUBLE ENTRY?

We have now taken two "runs" at accounting theory: first, a practical look at how paperwork is processed into financial statements via the accounting cycle; and second, a more theoretical examination of the logic of financial statements. This chapter addresses the mechanics of double-entry bookkeeping and financial statement preparation and provides you with a functional toolkit for understanding and analysing statements.

So why learn the nuts and bolts of double entry bookkeeping?

The best analogy I have found is music. We've all heard of someone who plays wonderfully by ear without ever having had a lesson. Our analog is the manager who has little or no accounting skill, but who nonetheless can glean useful information from accounting reports and apply their insight and common sense to make sound financial decisions. It's true that you can be hazy on the technique and still be a good **finance** manager. But how much better could you be if you understood the theoretical underpinnings?[49]

"Hell is full of musical amateurs."

—George Bernard Shaw, incisive music critic, amongst other things

Talent without skill is like a desert without an oasis.

—Old Arabian proverb

Formal study in arts management affords you the opportunity to learn the technical aspects of accounting — the scales and arpeggios of financial management, as it were. As a manager, you may never need to be the bookkeeper, but I expect you will find that studying the theory and gaining hands-on experience posting entries and preparing financial statements will enrich your ability to plan and make decisions by exposing you to the foundations of financial thinking.

This isn't to say that people can't improvise their way through the accounting cycle. Let's look at one practical — and successful — improvised system and discuss its strengths and weaknesses before tackling the standard method.

"SINGLE-ENTRY" BOOKKEEPING

The method I'm about to present was created by very small theatre organization, which I got to know a number of years ago when I served on their board. Their system has the advantages of meeting their needs without recourse to professional help — up to a point. By the end of this section, you will understand why I refer to it as "single **entry**," in contrast to the standard "double entry" method.

[49] No disrespect to musical heroes like The Beatles, Joni Mitchell and Carlos Santana — to name just seven (counting four Beatles) self-taught musical geniuses. This article on self-taught career musicians (https://files.eric.ed.gov/fulltext/EJ1146504.pdf) sheds some light on how mastery may be gained without formal education. Trial and error, and emulating the pros, can get you there — but kudos to you for pursuing a structured learning experience in the realm of accounting and finance!

Fred and Ginger's company works on a project-to-project basis. They are co-artistic directors, and they share the administrative chores, including financial records-keeping. They track their bank balance, **revenues** and **expenses** in a neatly kept notebook (their version of a journal), which looks something like this:

Date	Description	Amount	Bank
01-Jul-20	Opening balance, start of project		450.00
17-Jul-20	Ontario Arts Council	12,000.00	12,450.00
19-Jul-20	Factory Theatre	(2,500.00)	9,950.00
25-Jul-20	Gene	1,000.00	10,950.00
20-Aug-20	Donald	(1,750.00)	9,200.00
05-Sep-20	Debbie	(1,750.00)	7,450.00
10-Sep-20	Fred	(125.00)	7,325.00
01-Nov-20	BigMoney Foundation	4,000.00	11,325.00
04-Nov-20	Fred	(75.00)	11,250.00
13-Nov-20	Ginger	(55.00)	11,195.00

Throughout work on a project, they maintain this running tally of cash in and cash out and compare it monthly to the bank statement. They file **invoices** by type of expense — so all costume expenses go together, all administrative expenses go together, etc. At any given moment, they know how much cash they have, what revenues have arrived, and what money has been spent, and they are able to retrieve documentation. They are small enough that there generally aren't **outstanding** obligations — they settle things promptly — so the absence of a balance sheet is rarely an issue.

They have covered most of the essentials that any manager needs from their accounting system.

In Fred and Ginger's case, the challenge arose when they needed a formal post-project report for a funder. When I looked at their records, I identified the following deficiencies — all of which are corrected under the double-entry method:

- The co-artistic directors know everyone involved, plus what everyone was doing. An outsider would have no way of telling from this journal why money was changing hands. In formal terms, there is no indication of **classification** or **allocation**. As we discussed in Chapter 3 under the heading "Business Papers/Source Documents," this process is fundamental to the creation of meaningful financial statements.
- Revenue and expense items are blended in one document. Even when there are very few transactions, this can be visually confusing. It is faster and easier to assemble reports if revenues and expenses are recorded in separate places.
- It would be easy to miscalculate the running balance column, especially by "losing" a minus sign with those blended revenues and expenses! You would need to be diligent about reconciling to the bank, and/or habitually double-checking by adding the column a second time. (As you will see, double-entry bookkeeping incorporates a "self-checking" mechanism.)

- Their format focuses on the bank balance — indeed, it resembles a ledger page in that regard — but that's not what they needed for their report. They needed to pull together revenues, expenses and the bottom line. Everything's in there, and while the bank balance is clear, the operating result — this project's revenues minus expenses — is not apparent. Items must be sorted, organized and totalled in order to be meaningful.

The same information prepared using double-entry bookkeeping might look like this:

Cash Receipts Journal

Date	**Description**	**Bank**	**Individual**	**Foundation**	**Grants**
17-Jul-20	Ontario Arts Council	12,000.00			12,000.00
25-Jul-20	Gene	1,000.00	1,000.00		
01-Nov-20	BigMoney Foundation	4,000.00		4,000.00	
		17,000.00	1,000.00	4,000.00	12,000.00

Cash Disbursements Journal

Date	**Description**	**Chq #**	**Bank**	**Facility**	**Production**	**Admin**	**Fees**
19-Jul-20	Factory Theatre	234	2,500.00	2,500.00			
20-Aug-20	Donald	235	1,750.00		1,000.00		750.00
05-Sep-20	Debbie	236	1,750.00		1,000.00		750.00
10-Sep-20	Fred	237	125.00		75.00	50.00	
04-Nov-20	Fred	238	75.00			75.00	
13-Nov-20	Ginger	239	55.00			55.00	
			6,255.00	2,500.00	2,075.00	180.00	1,500.00

If you were doing this by hand, you'd start separate books for the cash receipts journal50 and cash disbursements journal.51 Office supply stores used to have an aisle full of manual journals — hardcover or spiral bound books, ruled in columns to accommodate the journal style illustrated above. This columnar format, although typical, was not the only possible format for journal entries. In the last chapter, you saw a different style, general journal format, where each entry was set out like a little paragraph. Columnar format was fast and efficient for recording numerous consistent entries, such as batches of **cheques** or deposits. Bookkeepers would set up columnar journals where possible, for speed, and reserve general journal format for miscellaneous entries that didn't fit with their usual column headings.

[50] The cash receipts journal captures all cash received by the organization. Cash in is mostly revenues but may include other items. For instance, if you borrowed from the bank, the loan would arrive as a cash receipt but it's not revenue, because you have to repay it.
[51] The cash disbursements journal captures all cash "disbursed" or spent by the organization. Note that "disburse" and "disperse" are commonly confused verbs. You may want to check your dictionary! Cash out is mostly expenses but may include other items. For instance, your loan repayment is not an expense.

Note the differences from the single-entry method:

Creating different journals for specific types of transactions, such as deposits and withdrawals, reduces the possibility of error and allows for easier retrieval of information.

- Segregating deposits and withdrawals in separate journals allows for easier retrieval of information. You know where to look!
- In the cash receipts journal, we are always adding deposits, and in the cash disbursements journal, we are always adding cheques, so we eliminate the possibility of "losing" minus signs. There is no need to switch between addition and subtraction. One of the benefits of separate journals is that there is no subtraction! You're always accumulating transactions.
- We no longer have a running bank balance. But, as described in Chapter 4, the running balance belongs in the general ledger — something that doesn't exist in Fred and Ginger's basic single-entry approach.
- We gain a new feature: the transaction amount appears twice on each line, once under the bank column and a second time under the appropriate **account** column(s). There you go — double entry.
- Each line in the double-entry journal indicates both the action of depositing or withdrawing and a description of why that happened. For instance, the first line in the cash receipts journal shows a $12,000 deposit. This is recorded once under "bank" to update our cash position and again under "**grants**," describing why we received the money. The description column provides space for a memo, so if the company received multiple grants, all could go into the grants column and the descriptions would identify the funding sources.
- The columnar format breaks down deposits or payments covering more than one category of activity. For instance, it is apparent from the cash disbursements journal that the cheques to Donald and Debbie combine two elements: fees for their services plus money for production expenses. My page width is limited; a real manual journal contained as many as 24 columns, so we could be more specific. For instance, we could title one column "production manager" for Donald's fees, and another "costume designer" for Debbie's fees. We could also itemize production expenses by assigning separate columns to "sets," "costumes," etc.
- Under Fred and Ginger's single-entry method, if they wanted to know how much they'd paid out in fees, they had to scan every line for peoples' names, then identify and subtract any production expense advances, and then add up the fee portion. The cash disbursements journal enables them to go directly to the fees column and identify the transactions as well as the total spent.

- My illustration omits some detail that a real organization might want to record, such as full names, invoice numbers and, perhaps, a brief note on the reason for the transaction. One of the advantages of a manual system is that you can decide how much detail to record. Accounting packages define the fields for you, which can be restrictive (although this does force consistency, which has other advantages).
- The totals at the foot of each column show total month-end activity in each account. For instance, the cash disbursements journal shows that the company has spent $6,255 so far, of which $2,075 was for production expenses over three transactions.
- A "self-checking" element is built right into the structure of the journal. As explained in earlier, the bank amount must be fully offset by account allocations, so that each line balances. When you have finished recording the month's activity, you add the columns. The column totals should balance in the same way. Thus, for the receipts journal:

  $$17{,}000 = 1{,}000 + 4{,}000 + 12{,}000$$

  And for the disbursements journal:

  $$6{,}255 = 2{,}500 + 2{,}075 + 180 + 1{,}500$$

The "double" in double entry consists of writing the amount twice to create a balanced entry. For instance, in the case of an entry to record a deposit, you need to show the amount under the bank account, and again under one or more revenue accounts.

When working by hand, it was essential to "foot" the columns and cross-check the totals in this way. If they didn't balance, you checked your work until you located the error.

KNOWLEDGE CHECK

Does this cross-checking of the column totals remind you of another verification step, introduced in Chapter 3, that was standard under manual bookkeeping?

Making sure that the column totals are balanced (and therefore that each **journal entry** is balanced, and that all additions are correct) is analogous to the trial balance. Indeed, if a manual bookkeeper found that their trial balance wouldn't balance, one of the first places they would check for error was the column footers.

For the sake of offering a condensed yet fairly realistic example, I have incorporated one non-standard element into my illustration. The dates on my entries show a few items spread out over several months — not unusual for a small company in the start-up phase of a new project. Traditional bookkeeping practice would start each month on a fresh journal page and total the activity for that