

FINANCE AT A GLANCE

What is double-entry bookkeeping?

Lesson 48

In this lesson, we shall define the so-called *double-entry bookkeeping*. This is actually the process of steps which we have started explaining over the past several lessons. Most accounting courses define it at the very start. In our case, we opt to wait until this time. By now we have clarified basic concepts that are needed to understand the definition and logic of *double-entry bookkeeping*.

Double-entry bookkeeping is a system that ensures the integrity of the values recorded in financial accounting by having each transaction recorded in at least two different accounting books (called *ledgers*), thus implementing a double checking system for every transaction.

Briefly speaking, here is how the system works:

Every transaction, is written in terms of debits and credits, wherein the total debits equals the total credits. Thereafter, every single debit and credit is recorded in the book (or ledger) of the account that it belongs to. For example, the debits and credit to Cash are entered into the Cash ledger; the credits and debits to Accounts payable are entered into the Accounts payable ledger; and so forth.

If the total debits and total credits of every transactions balance, it follows that the summation of the debits of all transactions within a certain period (say from January 1, 2010 through December 31, 2010) must likewise balance the total credits of all transactions.

Now, if we say that the books are balanced at the beginning of the period (January 1, 2010), and during the period we added total debits equal to total credits from all transactions, then at the end of the period (December 31, 2010), the books must remain in balance. This state of balance is tested by getting the ending figure of each separate account book. Those that end with a net debit are added up. Those that ended up with a net credit are added up. If the total of the net debits equals the total of the net credits, then the conclusion is that no item was missed out in entering the debits and credits to the books.

Basically, the control point of the system is this: Every transaction is recorded in two ways: One way is a debit or debits, and the other way is a credit or credits. If these two ways balance for each transaction, then the combined debits from all transactions must balance the equal credits from all transactions, regardless of how many accounts the transactions have an effect on.

Everything will become clear as we move on to the next lessons.