LET'S GET TECHNICAL

Gareth John explains the concept of double entry – the language of accountancy

I was recently sitting in a rather nice restaurant in France when I was approached by the waiter. "Voulez-vous un peu de vin avec votre repas?" he asked. I stared at him in silence before replying: "Eh?" If only I had understood the language!

In one of my classes recently I asked a final level student: "What's the double entry for a cash sale?". They stared at me in silence before replying: "Eh?" If only they had understood the language (they had clearly never learned the basics).

Double entry is the language of accountancy and it is critical to both your studies and your career that you become familiar with its workings.

Categories of transaction

As a starting point it is important to be familiar with the different types of transaction that businesses can undertake. Most of the transactions that you see in your studies will fall into one of six basic categories:

Income: this generally relates to the revenue generated by making sales to customers, but can also include interest received or dividends received.

Expenses: these are operating costs incurred by the business such as purchase costs, rent of premises or salaries.

Assets: these are things owned by the business such as vehicles, computer equipment or even cash in the bank.

Liabilities: these are things owed by the business to other people and include bank loans and trade payables owed to credit suppliers.

Capital: this represents amounts owed to the owner of the business (the sole trader) either for amounts invested in the business or for the profits earned by the business. Capital can be thought of as a specific type of liability.

Drawings: these are amounts withdrawn from the business by the owner and therefore reduce the capital balance.

The dual effect

Before even worrying about the double entry for a transaction it is really useful to consider the so-called 'dual effect' that it has on our accounting records. The dual effect says that any financial transaction will impact upon two balances in our accounts. This is a little simplified, as some transactions will impact upon more than two balances, but you can perhaps think that the dual effect means that every transaction impacts upon **at least two balances** in our accounts.

For example, a cash sale to a customer has the following dual effect:
1. The balance of cash (an asset of the business) will increase.
2. The value of sales made in the period (income for the business) will increase.

A cash purchase from a supplier has the following impact:
1. The balance of cash (asset) will now decrease.
2. The value of purchases made (an expense of the business) will increase.

How about a transaction that does not affect the balance of cash; perhaps a credit purchase where we have not yet paid for the goods bought:
1. The value of purchases made (expense) will increase just like for the cash purchase above. It does not matter if you have not paid yet, you have still incurred a cost.
2. We need to recognise a trade payables balance (a form of liability) for the amount still owed to the credit supplier.

Double entry

Using our knowledge of the dual effect we can start to construct the double entry for any given transaction. 'Double entry' again suggests that each transaction impacts upon at least two balances in our accounts ('dual' and 'double' have a similar meaning here).

Double entry is a system of Debit and Credit entries to describe the dual effect of a transaction. Every double entry must balance, with equal values on the Debit and Credit sides.

A useful mnemonic to help you remember your double entry basics is **DEAD CLIC**.

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DEAD

Debits increase:
Expenses
Assets
Drawings

CLIC

Credits increase:
Liabilities
Income
Captial

So for a cash sale to a customer we can follow on from our dual effect above as follows:
1. Increasing the balance of cash will require a Debit entry to the cash account since cash is an asset and included in DEAD.
2. Increasing the value of sales made will require a Credit to the sales account as sales are income and included in CLIC.

And that gives a balancing double entry of **Debit Cash, Credit Sales**.

Notice that DEAD CLIC reminds you of how to increase a category of transaction. To decrease them you do the opposite. So if you receive cash into your bank account (as shown above) you would Debit Cash, but if you pay cash out of the bank account you would need to Credit Cash.

Let's construct the double entry for a cash purchase from a supplier:
1. Decreasing the balance of cash will now require a Credit entry to the cash account as we need to do the opposite of DEAD.
2. Increasing the value of purchases will require a Debit to the purchases account as it is an expense and included in DEAD.

This gives the balancing double entry of **Debit Purchases, Credit Cash**. PQ

Why don't you have a go at this example task? When you have finished you can see me talk through my solution at www.firstintuition.co.uk/category/aat

Give the double entry for each of the following transactions:
1. A cash sale of £500
2. A credit sale of £1,000
3. A cash purchase of £800
4. A credit purchase of £1,200
5. Receiving £600 from a credit customer
6. Paying £900 to a credit supplier
7. Buying a motor vehicle for £2,000
8. Taking out a loan of £5,000 from a bank