

Double entry

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The importance of understanding double entry book keeping is often referred to on this blog.

It is, in particular, noted that money cannot be understood without comprehending double entry, which underpins both the nature of money and all of banking.

The issue also needs to be understood by those discussing debt, most of who, the government debt is a private asset.

So what is double entry? A new glossary entry explores the issue.

Double entry is the system of recording income and expenditure and assets and liabilities for book-keeping purposes.

Book-keeping prepares what is called a general ledger that records all the transactions undertaken by a reporting entity. The old term for this ledger was the nominal ledger.

The principle that underpins double entry book-keeping is that for every transaction that a reporting entity undertakes there is also a reaction. There must, therefore, be two entries in its general ledger to record any transaction.

For example, if the reporting entity makes a sale then there is also an increase in its cash balances if the sale was for cash or in its trade debtor balances if the sale was on credit terms. One side of each transaction is called a debit and the other side is called a credit. The names are in themselves meaningless and can be the cause of confusion.

Credits are used to record:

- * Sales and other income received e.g., interest.
- * Liabilities of all sorts whether current liabilities (such as trade creditors) or long-term

liabilities such as borrowings, or provisions.

- * Share capital.
- * Profits and gains when they form part of shareholder funds on the balance sheet.
- * The reduction in any debit balance.

Debits are used to record:

- * Expenses.
- * Assets of all sorts.
- * Losses when they form part of shareholder funds on the balance sheet.
- * The reduction of any credit balance.

There is literally nothing more to double entry book-keeping than these very basic rules, despite which many people find it confusing.

This is most especially because of the last point noted in each category. Sales are recorded as credits in double entry book-keeping, but debits can also appear in a sales account, for example when a sale is cancelled and a credit note (which confusingly is recorded as a debit in double entry book-keeping) is issued.

Similarly, assets are recorded as debits. So a car appears as such in a fixed asset account, but when it is sold the record of ownership has to be cancelled by a credit entry (the recording of the sale of a fixed asset requires a particularly confusing set of double entries).

The point to note is that learning double entry is like learning the grammar of a language, but one where there appear to be plenty of irregular entries until the language is mastered. Mastering that language involves understanding that there is no value judgement applied to whether any entry is a debit or a credit. In themselves those terms are meaningless but it often takes time to overcome the feeling that one must be inherently superior to the other.

Accounts are prepared on the basis of the entries in the general ledger that are themselves based on double entry book-keeping. By definition all accounts must balance as a result: double entry requires that. As a result a balance sheet must balance.

The term 'balancing the books' dates back to the era when manual addition was used to calculate the balances in general ledgers and errors were commonplace. The adoption of this term for government accounting, suggesting that when the government claims to borrow it has unbalanced books, makes no sense in that case

and is another example of the so-called 'household analogy' in action.

It is important to note that a great deal of government accounting is not prepared on the basis of double entry. Very few Office for National Statistics reports on what are claimed to be the government's accounts are prepared on this basis. Estimates of GDP and the national debt are amongst the key accounting issues on which they ignore the disciplines of double entry accounting. Whether the resulting data is true and fair is open to serious doubt as a consequence.