**Journal Entries**

Have you ever wondered how a business keeps track of all of their transactions? From your most-visited online stores such as Amazon to your favorite local businesses, each business owner must have a system for keeping track of every single transaction that they process each day.

Introducing the double-entry accounting system, the basis of accounting systems worldwide. Under the double-entry accounting system, businesses use journal entries to record debits and credits that account for all of their business activities. There are always at least two entries made for each transaction, one debit and one credit, to keep the books balanced. Whether that's accounting for financial reporting, tax reporting, profitability, inventory, or more, these journal entries are the most fundamental and universal system for bookkeeping.

The normal balance of an account is the side where increases to the account are recorded. If an account has a debit normal balance, that means any increases to the account will be recorded on the debit side. If an account has a credit normal balance, any increases to the account are recorded to the credit side.

The point of an account is to keep track of money. How much money do we have on hand? Did that number go up? Or did it go down. Think of the water level in a bucket, where the bucket is your account, the water is your money, and the water level is your account balance. In double-entry bookkeeping, we have two kinds of buckets that are mirror images: debit buckets, and credit buckets. Whenever we add water to a debit bucket, we debit it. When we take water out of a debit bucket, we credit it. Conversely, when we add water to a credit bucket, we credit it, and when we take water out of a credit bucket, we debit it. The bucket type is called the account's "normal balance". In other words, a debit to an account that has a debit normal balance will increase it, while a credit decreases it. And a credit to an account that has a credit normal balance will increase it, while a debit decreases it.

So which accounts will record increases to the debit side, and which ones will record increases to the credit side? Let's go back to our Basic Accounting Equation, where we learned that Assets equals Liabilities plus Stockholders' Equity, and first take a look at Asset and Liability accounts.

Asset accounts include accounts like Cash, Accounts Receivable, Prepaid Expenses, Inventory, and other assets the firm holds. All of these accounts will generally have a debit balance as a company accumulates cash, accounts receivable, and other assets during the period.

On the other hand, liability accounts generally have a credit balance. Liability accounts include Accounts Payable, Salaries and Wages Payable, Accrued Expenses, Deferred Revenues, loans and more. As a company incurs or increases more liabilities, they are recorded as credits under the Liabilities account.

Although asset accounts usually have a debit balance, and liability accounts a credit balance, there are exceptions. Consider the cash account, which is an asset account with a **debit** normal balance. Can you think of a situation where it might be in a credit balance?

A credit balance may occur in the Cash account if a company has overdrawn its bank balance by spending more than the amount they have in their bank account, so in this case, a cash account in credit, or negative, balance doesn't necessarily mean an error.

But remember, the Basic Accounting Equation has one last component - Stockholders' Equity. Here's the composition of Stockholders' equity: Add common stock, add retained earnings, add revenues, less expenses, less dividends

Of stockholders' equity, Common Stock, Retained Earnings, and Revenues are the components with a normal **credit** balance, like the Liabilities account. These are also the added contributions to the final Stockholders' Equity amount. Expenses and Dividends on the other hand, have a normal debit balance, like the Assets account. They are the contributions that are deductions under the Stockholders' Equity account.

Here's a quick summary of common accounts that you may see. Each of these follow their parent account's debit-credit rules for normal balances, where the basic equation will show us which debit-credit pair makes up each journal entry. Journal entries are made for each transaction a company processes, and each entry has a date, the account to be debited or credited, and the respective amounts debited and credited to each account. For many businesses, they will also include a description or comment explaining the transaction, but this is not always necessary.

So how do you determine which account to journal and which side it gets journaled on? At this point, we're bringing back the **basic accounting equation**, which is a crucial part of this journalizing process that can help guide our intuition. After every debit-credit entry, the **dollar amounts** of the Basic Accounting Equation should still be balanced, regardless of what new transactions occurred. Assets should still equal liabilities + stockholders' equity.

With the double entry system, we know that every transaction will have a dollar debit amount that equals a dollar credit amount. Although this may come in the form of one debit and one credit entry, that is not always going to be the case. So when we say "balanced," we refer to the dollar amount. And as assets will always equal liability plus stockholders' equity, any increase to one side of the equation will require an increase on the other, and the same for decreases. For example, a debited asset account increasing the asset side of the accounting equation will require an accompanying increase to either the liability + stockholders' side of the equation through crediting liabilities, common stock, retained earnings, or revenues accounts.

Let's demonstrate this intuition with a really basic example. Say a company makes a cash sale for $100. This sale of an item affects the cash and revenue accounts, as the firm will take a cash payment; and get revenue from the sale.

The cash account is an asset account, which means asset account rules will apply. The revenue account is a component of the stockholders' equity account, which tells us that revenues hold a credit normal balance.

In this example, the firm is receiving cash for the sale. The **increase in cash** is represented by **debiting** the cash account, and the **increase in sales revenue** is represented by **crediting** the revenue account.

We can confirm the correctness of this entry by checking to see that our accounting equation is balanced. We have first debited an asset account, which has a debit normal balance, so we've effectively increased the asset side of the equation. By subsequently crediting the revenue account, an account with a credit normal balance, we have also increased the stockholders' equity side of the equation.

Let's see this entry in the general ledger: Conventionally, journal entry formats always show the debits first, and credits indented and after.

We've seen how a sale appears in the journal, now let's take a look at a couple more transactions. Below are some more transactions Canada's Winterland saw in the month of January. Pause the video and try making journal entries for each of these.

Let's take a look at how these transactions will appear in the general ledger. Starting with the first transaction, the company is making a payment for the month on account. We will debit **prepaid expenses** and credit **accounts payable** under the date of January 3rd. As we are increasing the prepaid expense account, which is an asset account, journaling it on the debit side makes sense. On the other side, we are making this payment on accounts payable, which is a liability account. Increasing the account means it gets journaled on the credit side, so we see that both the asset and liability side of the basic accounting equation are increased by the same amount, and thus we can be confident that the equation is still satisfied.

So what just happened? For each transaction, we first look at the actual accounts affected. Every account is either a form of asset account, liability account, or shareholders' equity account. Recall that the point of an accounting system is to record transactions that have happened. We keep track of transaction amounts using debits and credits, which make up the two sides of the double entry accounting system. The components of the basic accounting equation break up into debit and credit normal balance accounts, where asset accounts normally have debit balances, and liability and equity accounts normally have credit balances. Every journal entry must have at least one debit and one credit, with total dollar amount debited equaling total dollar amount credited. Debit normal accounts are increased using debits and decreased using credits meanwhile credit normal accounts are increased using credits and are decreased using debits.