Chapter 2 — The Recording Process

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Watch the full video lecture on YouTube: youtube.com/@optionflowtracker — these notes follow the chapter section by section, with the same ideas and the same numbers, so you can read along or revise after watching.

1 · The big secret: debit means left, credit means right

Almost everyone freezes the first time they meet debits and credits. The instinct is to translate debit as "bad" and credit as "good," or to assume a debit always means an increase. Let all of that go. In accounting a debit is simply the LEFT side of an account, and a credit is simply the RIGHT side. That is the entire secret, and once it clicks the whole chapter opens up.

Debit: The left side of an account. Nothing more — it is not inherently good, bad, an increase, or a decrease.

Credit: The right side of an account. Whether it raises or lowers the account depends only on what type of account it is.

Stop reading debit and credit as increase and decrease, and Chapter 2 becomes easy — because a single rule, coming up in a moment, tells you exactly which side increases each kind of account.

2 · Every account has two sides

An account is just a record of everything that happens to one item — one account for Cash, one for Supplies, one for Service Revenue, and so on. Accountants sketch it as a capital T: the account name sits on top, the left side holds debits, the right side holds credits. That simple shape is why we call it a T-account.

T-account: A two-sided sketch of an account: the title on top, debits on the left, credits on the right.

Ledger: The entire group of accounts a business keeps, each holding the running balance of one item. The plain list of the account titles a company uses is its chart of accounts.

To find an account's balance, total each side and take the difference; the balance sits on the larger side. A Cash account with $20,000 of debits and $9,000 of credits has an $11,000 debit balance.

3 · DEALER: the one rule that decides every entry

Here is the rule that runs the whole chapter. Sort the six kinds of accounts by the side that INCREASES them, and remember them with one word: DEALER.

- D — Drawings increase with a DEBIT
- E — Expenses increase with a DEBIT
- A — Assets increase with a DEBIT
- L — Liabilities increase with a CREDIT
- E — Equity (Owner's Capital) increases with a CREDIT
- R — Revenue increases with a CREDIT

The left three — Drawings, Expenses, Assets — go up on the left (a debit). The right three — Liabilities, Equity, Revenue — go up on the right (a credit). To DECREASE any account, use the opposite side. That single sentence answers "debit or credit?" for every transaction you will ever face.

Normal balance: The side that increases an account — which is also the side its balance normally sits on. Drawings, Expenses, and Assets are debit-normal; Liabilities, Equity, and Revenue are credit-normal.

Watch the trap. Owner's Drawings reduces equity, yet it is debit-normal — it lives on the D of DEALER. Don't let "it lowers equity" trick you into crediting it; a withdrawal is a debit to Drawings.

4 · Double-entry: why debits always equal credits

Every transaction has two sides — something comes in, something goes out — so every entry touches at least two accounts. The golden rule: in every single entry, total debits must equal total credits. If they don't, the entry is wrong. This is the double-entry system, and it is exactly what keeps the accounting equation (Assets = Liabilities + Owner's Equity) in balance after each transaction.

The simplest entry. The owner invests $10,000 cash. Cash (an asset) goes up, so debit Cash $10,000. Owner's Capital (equity) goes up, so credit Owner's Capital $10,000. Debits $10,000 = credits $10,000 — perfectly balanced.

5 · Journalizing: recording the entry

The journal is the book of original entry — the very first place a transaction is written, in date order. Recording it there is called journalizing, and the format never changes: the account debited is written first at the left margin; the account credited is written next and indented to the right; a short explanation can go underneath.

Journal: The chronological record where each transaction is first entered, as a debit and an equal credit.

Compound entry: A single entry that involves three or more accounts — still with total debits equal to total credits.

A compound entry. Buy $8,000 of equipment, paying $3,000 cash and signing a $5,000 note. Debit Equipment $8,000; credit Cash $3,000; credit Notes Payable $5,000. One debit, two credits — and $8,000 = $8,000.

6 · Posting to the ledger

Journal entries do not update the accounts on their own. Posting is the step that copies each debit and each credit from the journal into the matching ledger (T-)account. After posting, every account shows its up-to-date balance. The order to remember is short and never changes: analyze the transaction, journalize it, then post it.

Finding a balance. If Cash is debited $10,000 (the investment) and later credited $3,000 (equipment) and $2,000 (rent), its ledger balance is $10,000 - $3,000 - $2,000 = $5,000 on the debit side.

7 · The trial balance: proving debits = credits

At the end of the period you list every account and its balance in two columns — debit balances on the left, credit balances on the right — and total each column. This is the trial balance, and its job is to prove that the ledger's debits equal its credits. Match totals mean the books are in balance; a mismatch tells you an error exists somewhere.

Trial balance: A list of all the ledger accounts and their balances, used to check that total debits equal total credits.

One warning that shows up on every exam: a balanced trial balance does NOT mean the books are error-free. If you skipped a whole entry, posted to the wrong account, or recorded the wrong amount on both sides, the two columns still match. The trial balance catches only the errors that knock debits and credits out of balance.

8 · Putting it together

Walk one business through the whole cycle. Suppose Northshore Design has three transactions in its first week: (1) the owner invests $15,000 cash; (2) the firm buys $2,000 of supplies on account; (3) it performs $4,000 of design work for cash.

- Invest cash: debit Cash $15,000, credit Owner's Capital $15,000.
- Supplies on account: debit Supplies $2,000, credit Accounts Payable $2,000.
- Services for cash: debit Cash $4,000, credit Service Revenue $4,000.

Post them and the balances are: Cash $19,000 debit, Supplies $2,000 debit, Accounts Payable $2,000 credit, Owner's Capital $15,000 credit, Service Revenue $4,000 credit. Now the trial balance — debit column $19,000 + $2,000 = $21,000; credit column $2,000 + $15,000 + $4,000 = $21,000. They match, which is exactly what DEALER and double-entry guarantee.