Demonstration of Double Entry Method of Book Keeping

With double entry method of book keeping, it is important to realise that every international transaction is recorded twice in the Balance of Payment of Country – once on the credit side, and once on the debit side, because corresponding to every international economic transaction, something enters the country and something leaves the country. The Balance of Payment of a country has 2 broad sub accounts – a current A/c and a capital A/c. A single transaction depending upon its nature, can be recorded either on the two sides of the capital A/c, or on the two sides of current A/c, or on the two sides of current and capital A/c. Such method of entry ensure that at the end of the financial year, Balance of Payment of a country, which is the sum of current A/c and capital A/c, balances, i.e., debit side total is equal to the credit side total.

Let us consider the case of 2 countries say US and Singapore. Let us further suppose that the exchange rate between US Dollar and Singapore Dollar is $1= S$1. Let us next suppose that an individual based in US wants to purchase a camera worth S$1,00,000 from Singapore. So when this individual imports camera from Singapore, it pays in terms of S$. Hence the decision to import a camera from Singapore, will affect both the current A/c and the capital A/c of US, which we demonstrate by means of number of transactions.

First the individual has USD with him/ her. So he/she must first exchange USD for an equivalent amount of Singapore Dollar. Hence the individual purchases 1,00,000 worth of Singapore Dollar from the foreign exchange market of US with $1,00,000. This entry shows up in the capital A/c of US because purchase or sale of currency corresponds to transactions in assets. The currency exported from US is $1,00,000. This export of currency appears in the credit side of the capital A/c. The currency imported in to US is S$1,00,000, equivalent to $1,00,000. The import of currency is recorded in the debit side of the capital A/c.

Capital A/c of US

Credit		Debit	
US Dollar Export	$1,00,000	Singapore Dollar Import	$1,00,000
Singapore Dollar Export	$1,00,000		

The individual now purchases the camera from Singapore. The import of camera is a merchandise imports and hence is recorded as a debit item in the current A/c of US. But when the individual makes the payment in terms of Singapore Dollar, Singapore Dollar flows out of the US economy. This export of Singapore Dollar from the US economy is recorded in the credit side of the capital A/c.

Current A/c of US

Credit		Debit	
		Camera Import	$1,00,000

Now a consideration of both capital A/c and current A/c of US would reveal that the capital A/c is in surplus, while the current A/c is in deficit. But the surplus in capital A/c is equal to the deficit in the current A/c, such that the Balance of Payment of US is in balance, i.e., the credit side total (including both capital A/c and current A/c) is equal to the debit side total (including both current and capital A/c).