

FINANCE AT A GLANCE

The accounting “books”

Lesson 47

Have you ever been in situation wherein you need a piece of information, and you seem to have to face an “unimpregnable fortress” built by the finance and accounting people of your company? This is quite common in organizations of more than 50 people who are split into functional units, and where the head of each unit builds his or her own empire. If only you know the way your accountants record data and process them into useful information, then you can ask the right question that will nail the answer, and you can say to yourself that you have breached their fortress.

To record accounting information, accounts use accounting “books”, which we have, from time to time, referred to. In this lesson, we shall look into what these “books” really are.

The general ledger and the chart of accounts

In the preceding lessons, we used the word **account** to mean not just the bank accounts in which the business entity lodges its cash, but also any of the elements of the company’s balance sheet (Cash, Accounts receivables, Accounts payables, Common stock, etc.) and of the income statement (Sales, Cost of goods sold, Salaries, Income taxes, etc.). Collectively these accounts make up the **general ledger** of a business entity. The general ledger is the main “reference book” of the accounting system, and is the basis for generating the financial statements.

The system that organizes the accounts in the general ledger is called the **chart of accounts**. The chart of accounts is an ordered list of a company’s general ledger accounts. It is tailor-fit to the company’s needs. In some companies, the chart of accounts may contain hundreds of items. At the most general level, “the major account groups are based on the balance sheet components (assets, liabilities, and equity) and income statement elements (revenue and expenses, “and non-operating revenues/gains and non-operating expenses/losses). Under each of highest-level accounts are put the various categories. For example, under Assets, there are these categories: Cash, Accounts receivables, Inventories, etc. Under each of these, in turn, there are sub-categories. For instance, under Cash, the various bank accounts are listed.

Aside from the name of each account, sub-account and sub-sub-account, a numbering system is used for easy identification of each item. This numbering system is defined by the company itself based on what it sees to be the most efficient. What is important, though, is to make the numbering system flexible enough to accommodate future accounts, sub-accounts and sub-sub-accounts.

- 1.0 Assets
 - 1.01 Cash
 - 1.01.01 USD Current account
 - 1.01.02 USD Savings account
 - etc.
 - 1.02 Accounts receivables
 - 1.02.01 xxxxxxxxx
 - 1.02.02 yyyyyyyyyy
 - etc.
 - etc.
- 2.0 Liabilities
 - etc.

In our discussions, we shall stay at the level of Cash, Accounts receivables, etc. and not go further into their sub-categories.

The simplest way of documenting each of the general ledger account is the so-called *T-account*, which as its name suggests, resembles the letter “T”. Here are the T-accounts for Cash, Accounts payables, Capital stock, Sales and Cost of goods sold, just to show a few examples. The account name (Cash) and the numerical designation (1.01) based on the chart of account’s numbering system are shown on top of the T-account. The debits to the account are posted on the left-hand column of the T-account. The credits are posted on the right-hand side.

| 1.01 Cash | | 2.01 Accounts payables | | 3.01 Capital stock | | 4.01 Sales | | 5.01 Cost of good sold | |
|--------------|---------------|------------------------|---------------|--------------------|---------------|--------------|---------------|------------------------|---------------|
| <i>Debit</i> | <i>Credit</i> | <i>Debit</i> | <i>Credit</i> | <i>Debit</i> | <i>Credit</i> | <i>Debit</i> | <i>Credit</i> | <i>Debit</i> | <i>Credit</i> |
| | | | | | | | | | |

We shall be posting the accounting entries of the illustrative transactions into the T-accounts later.

As a result of the widespread computerization of accounting, most of the tangible forms of the accounting documents have virtually disappeared. However, the logic behind these documents form the basis of computerized accounting. For that reason, we will still be using in our discussion these traditional documents, in order to visualize how the accounting programs work.

Until the next lesson,

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