

THEME: GETTING ORGANIZED

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ACCOUNTING TERM: Chart of Accounts

The Chart of Accounts is simply a list of all the names of the accounts found in the General Ledger whether there is an account balance or not.

FEATURE ARTICLE: Organization: The Key To Your Sanity

You've heard of the proverbial "shoe box" full of random receipts, checks, and other accounting records that a client brings to the accountant. Some "shoe box" contents are worse than others. Nonetheless, the accountant's first task is to organize the material. Failing to complete this first task inevitably brings frustration and confusion. Without a doubt "organization" is one of the most important tools of the accountant. Here are some suggestions on how to proceed:

Start by organizing the information you have received into categories. (If you are doing your own books, follow the same procedures.) I recommend that you, first, think about what you are trying to accomplish. For instance, you may need to: (1) Prepare a bank reconciliation; (2) Write adjusting general journal entries for bank adjustments, sales, and payroll, and any miscellaneous transactions; (3) Enter the check register into the computer; (4) Enter general journal entries into the computer; and, (5) Process the financial statements.

With this information you can now identify the categories. I would suggest that the first category be the Bank Reconciliation. Therefore, what material is required to complete a bank reconciliation? Bank statements, check register, bank reconciliation form, deposit information.

Let's make the second category Payroll. You will need the reports from the payroll service company relevant to the period you are working with.

The third category can be Sales information. The information could include a sales summary report, cash register tape, or simply the deposits from the bank statements.

The fourth category could be for all the miscellaneous transactions. This could come from correspondence, tax notices, etc.

I think you get the idea, so, depending on your unique circumstances, set up whatever categories you need. But here is an important tip: Be sure to scan all the documents in front of you. You are essentially working a jigsaw puzzle. When you are fitting the pieces together, your mind has an uncanny way of

reminding you that something you reviewed might just fit in a certain place. You make decisions based on what you know. It is very frustrating to find that you overlooked a vital piece of information after you have completed everything. Do that a few times, and you will quickly learn that it is worth spending the extra time to carefully review the raw data from the “getgo”.

I highly recommend that you first prepare the bank reconciliation. Doing this forces you to immediately become familiar with the primary information with which you are working. When the bank reconciliation is completed, you will have a pretty good idea of the month’s activity in terms of income and expense. This is why I don’t care for computerized bank reconciliations. The computer may tell you that the bank account is balanced, but you can’t readily see where the deposits came from, or what the adjustments were.

Bank reconciliations are easy to do manually. Once this is done, you are no longer working in the dark. You have a reference point, called the “bank balance”. If, when you are finished recording all your entries, the bank balance on the general ledger is not the same as on the bank reconciliation, you will know there is a discrepancy that has to be corrected.

Once the bank reconciliation is done, write your journal entries. When you can, format journal entries on your journal entry form for repetitive entries. Here is an example of a general journal template that is used in my online accounting course www.reallifeaccounting.com:

GENERAL JOURNAL	BE HAIR NOW		Date	20XX
Ref	Account & Description	Account#	Debit	Credit
[A]	Cash-in-Bank	1030		
	Services Rendered	4020		
	Taxable Sales	4010		
	Sales Tax Payable	2070		
	Accounts Receivable	1210		
	Interest Income	9010		
	Customer Deposits	2030		
[B]	Cash-in-Bank	1010		
	Cash-in-Bank MMK	1030		
[C]	Bank Charges	6080		
	Cash-in-Bank	1010		

[D]	Direct Labor	5020		
	Office Wages	6610		
	Federal & FICA	2052		
	State & SDI	2054		
	Payroll Clearing	1825		
	Employee Advance	1110		
[E]	Purchases	5050		
	Inventory	1310		
[F]	Inventory	1310		
	Accounts Payable	2010		
[G]	Accounts Receivable	1210		
	Services Rendered	4020		
[H]	Depreciation	9510		
	Accum Depreciation	1610		
	Amortization	9520		
	Accum Amortization	1910		
	To record monthly depreciation and amortization as sustained by the schedules			

All you have to do is put in the amounts. The general journal template also serves as a checklist and will help prevent missing a step. At this point, all the data is organized and ready to be entered into the computer. Enter your check register first, and then the general journal entries. Next, run your financial statements, check the cash balance with the bank reconciliation, and you are basically finished.

Organizing the accounting information before starting work and setting up a routine that you follow each month, saves time, avoids costly mistakes, and makes the job enjoyable and interesting rather than an exercise in frustration.

QUESTION: How Should The Chart of Accounts Be Organized?

Setting up your Chart of Accounts (COA) properly in the beginning saves many headaches in the future. As you probably already know, the basic format of the Chart of Accounts follows the same General Ledger (GL) format of Assets, Liabilities, Equity, Revenue, and Expense. I would encourage you to use numbers associated with the names of the GL accounts. This way you won't get mixed up using names that sound similar. But mainly, when you keypunch your check register into the computer, it is a lot easier to type in a number from a ten-key pad than type in the name of a category. (QuickBooks assumes you will use names so you have to go to the "preferences" section to choose to use numbers.)

Current Assets are organized by liquidity. This is why Cash is usually found at the beginning of the COA. Accounts Receivable, Inventory, and Notes Receivable come next because they are less liquid than Cash. Fixed Assets require no order. Other Assets, such as Prepaid Expenses, Miscellaneous Suspense, Payroll Clearing, and Goodwill also require no special order.

Current Liabilities are debts that will be paid off within one year. Most of the time you find Accounts Payable first, but it is not critical. Long-Term Liabilities come next, and include notes and leases that have a payoff longer than one year.

Equity accounts have no special order, but Net Profit or Loss is usually located on the last line.

Revenue accounts are usually organized according to the accounts that have the most activity first.

Expense accounts should be organized in loose alphabetical order. It's easier to find accounts that way.

Often I set up the numbers in series. For instance:

- Assets – 1000 series
- Liabilities – 2000 series
- Equity – 3000 series
- Revenue – 4000 series
- Cost of Goods Sold – 5000 series
- Operating Expenses – 6000 series
- Other Income or Expense – 7000 series

When you assign numbers, spread them out so if you need to add a new account you have room to do so. When you are done, print out a copy of the COA and

keep it near your check register for coding the GL numbers to the checks you have written.

TIP: Some General Ledger Account Tips & Tidbits.

Sometimes it is valuable to know the inside scoop on how some GL accounts work. There is not room here to discuss them all, however I've selected some that can be confusing.

Employee Advance – When writing a special check to an employee in advance of his/her regular payroll check, code it to Employee Advance. Don't code it to the wage account. Tell your payroll service this has been done so they can reduce the employee's net check amount. The advance goes into Employee Advance as a debit and is taken out as a credit when recording the actual payroll. Employee Advance is what is called a "wash" account in accounting jargon. In other words, the account should eventually clear.

Officer Advance – Use this "wash" account to record all the checks written to the corporate officer/stockholder (usually a one-owner operation such as a doctor, dentist, attorney, etc.). In a corporation, the officer/stockholder is required to be paid as an employee through a formal payroll system. If there is a cash-flow problem, often the owner will take a draw whenever the cash is available. Decrease these draws by the net amount due to the stockholder/employee when the payroll is run or at the end of the month when the books are done.

Due to Stockholder (an asset) or Due from Stockholder (a liability) – You can use these accounts when the stockholder loans money to the corporation or borrows money from the corporation on a short-term basis. The Internal Revenue Service (IRS) in the USA doesn't like this account because no formal note instrument has been created with interest being earned or paid on a regular basis. (There is a "rule of thumb" that the IRS doesn't get too excited about this as long as the amount does not exceed \$10,000.) However, these two accounts are a handy way to keep track of that kind of stockholder activity.

Current Portion of Long-Term Debt – This account belongs in the Current Liability section and the Long-Term Liability section of the Balance Sheet. The purpose of the account is to remove the principal that will be paid in the current year and move it into the Current Liability section. Therefore, the amount in the Long-Term Liabilities will be a debit (decrease), and the amount in the Current Liabilities will be a credit (increase). The result is a more accurate way of stating the condition of the liabilities.

Miscellaneous Expense – Don't overuse this account. Items posted to this account are for oddball transactions that don't have a common GL account to

use. You should be able to support each miscellaneous entry with a receipt in case of an audit.

Office Equipment vs. Office Supplies – There is no set rule on this, but the general idea is that if you buy a piece of equipment that costs \$200 to \$400 that will last longer than one year, then you need to “capitalize” it. Capitalize means to transfer it to a capital equipment account and spread the cost over its useful life. This is done through depreciation and there are special rules that indicate the useful life of a given item. So the little stuff goes in Office Expense and the bigger stuff should go to Office Equipment, which is a Fixed Asset account.

Obviously there are many more GL accounts to talk about, but that’s all the space I have for now. Let me know if you find this topic valuable and if the response is great enough I will devote another newsletter to the subject.

John W. Day, MBA is the author of two courses in accounting basics: Real Life Accounting for Non-Accountants (20-hr online) and The HEART of Accounting (4-hr PDF). Visit his website at <http://www.reallifeaccounting.com> to download his FREE e-book pertaining to small business accounting and his monthly newsletter on accounting issues. Ask John questions directly on his Accounting for Non-Accountants blog.