



## CHAPTER V

### CHART OF ACCOUNTS DESIGN

#### 1. Accounts Defined

By the term, account is meant the entire or group of entries expressed in terms of debits or credits, or a combination of both, under a specific heading, reflecting the history and result of transactions pertaining thereto. A separate ledger leaf should be used for each account.

#### 2. Chart of Accounts Defined

By the term chart of accounts is meant the list of account titles to be maintained in the ledger which titles are descriptive of the nature and functions of the accounts concerned. The chart of accounts would be of valuable assistance in the preparation of the balance sheet and income statement. The accounts of the general ledger are normally arranged in the order in which they will appear in the financial statements, usually with the balance sheet items first. The Chart of accounts is an aid in the arrangement of a ledger, and the chart itself may be used as the guide and index. Provisions must be made for additional account titles. It frequently

happens that such allowance is inadequate resulting in the displacement of certain account titles.

### 3. Chart of Accounts must be Elastic

In the construction of chart of accounts for a concern, provisions should be made for future as well as present needs. More comprehensive classification must be made than is presently required.

### 4. Naming of Accounts

Accounting terminology is not standardized as in legal terminology. Differences of terminology even exist among leading practitioners. There are varied definitions and interpretations for the same account. It is, therefore, necessary that caution be taken in naming accounts. The best account title is one which is simple and descriptive of its true nature and function. It should be suggestive of its purpose and contents in order to avoid confusion and misinterpretation. In cases where special accounts are employed, care should be taken to explain its purpose and operation.

### 5. Numbering of Accounts

The number opposite the account titles in certain charts of accounts are used in the records

whenever it is necessary to indicate ledger accounts. This practice saves time which would be required in writing the full account title. The treatment of these ledger accounts is of general application in any commercial accounting system.

#### 6. Chart of Accounts, the Framework of Accounting Systems

The basis of the construction of an accounting system is the chart of accounts. It furnishes a plan for the accounting records, particularly as to arrangement and design. The chart of accounts is the basis for designing the books of original entry such as the cash receipts book, cash disbursements book, sales book, and a host of other books of record. Depending upon the nature of the business, the peculiar transactions to be recorded, and the requirements of the accounting, the books of record may be tabulated or columnar. Special columns may be provided in the books of original entry for accounts often times involved. The use of special columns facilitates classification of data and permits posting of column totals to the accounts affected in the General Ledger, hence a labor-saving device.

#### 7. The Principal Functions of a Chart of Account

The major functions of a chart of account may be stated as follows:

1. To provide the basis in designing the books of original entry to be used in the business.
2. To aid in determining the necessary accounts in the General Ledger for the purpose of summarizing accounts for comparison.
3. To guide in the preparation of financial statements, such as the Balance Sheet, Statement of Income, and other financial reports that may be required by the management.

#### 8. Methods of Classifying Accounts

Accounts may be classified in the following ways:

1. Functional basis
2. Departmental basis
3. Objective basis

Functional basis of classification is one in which the names of the principal accounts are based on function. Examples of functional accounts are:

1. Selling
2. Purchasing
3. Administrative

Departmental basis of classification is one in which the names of the principal accounts are

based on departments in operation. Examples of accounts classified under this basis, we have:

1. Merchandise "A"
2. Merchandise "B"
3. Merchandise "C"

Objective basis of classification is one in which the classification of the accounts is based on purpose. This objective basis of classification of accounts are often termed as the natural classification as the primary accounts in the General Ledger while others use them as secondary accounts.

Examples of accounts under this classification are:

1. Salaries and Wages
2. Advertising
3. Insurance
4. Depreciation

There is no doubt that a combination of the classification of accounts may produce better results in the analysis of certain data as well as in formulating sound business policies, but it must also take into consideration the number of people to work on the system, their capabilities and efficiency in running the system and the attendant expense attached to it.