

Site Under Construction

Accounting - Basic Accounting Components of the Accounting System

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Components of the Accounting System

Think of the accounting system as a wheel whose hub is the general ledger (G/L). Feeding the hub information are the spokes of the wheel. These include

- Accounts receivable
- Accounts payable
- Order entry
- Inventory control
- Cost accounting
- Payroll
- Fixed assets accounting

These modules are ledgers themselves. We call them subledgers. Each contains the detailed entries of its specific field, such as accounts receivable. The subledgers summarize the entries, then send the summary up to the general ledger. For example, each day the receivables subledger records all credit sales and payments received. The transactions net together then go up to the G/L to increase or decrease A/R, increase cash and decrease inventory.

We'll always check to be sure that the balance of the subledger exactly equals the account balance for that subledger account in the G/L. If it doesn't, then there's a problem.

Differences between Manual and Automated Ledgers

Think of the G/L as a sheet of paper on which transactions from all four categories of accounts-assets, liabilities, income, and expenses-are recorded. Some of them flow up from various subledgers, and some are entered directly into the G/L through a general journal entry. An example of such a direct entry would be the payment on a loan.

The same concept of a sheet of paper holds for each subledger that feeds the general ledger. A computerized accounting system works the same way, except that the general ledger and subledgers are computer files instead of sheets of paper. Entries are posted to each and summarized, then the summary is sent up to the G/L for posting.

ORGANIZATION OF THE ACCOUNTING DEPARTMENT

Organize your small-business accounting system by function. Often there's just one person there to do all the transaction entries. From an internal control standpoint, this isn't desirable. Having too few people doing all the accounting opens the door for fraud and embezzlement. Companies with more people assign functions in such a way that those done by the same person don't pose a control threat.

Having the same person draft the checks and reconcile the checking account is a good example of how not to assign accounting duties. We'll talk extensively about internal control later. However, for now, small businesses often can't afford the number of people needed for an adequate separation of duties. The internal control structure that we'll install in your new accounting system helps mitigate that risk through mechanics and procedures rather than expensive people.

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Assignment of Duties

Here's your first assignment: Figure out who is going to do what in your new accounting system. The duties and areas of responsibility we need to assign include

- Overall responsibility for the accounting system
- Management of the computer system (if you're using one)
- Accounts receivable
- Accounts payable
- Order entry
- Cost accounting
- Monthly reporting
- Inventory control
- Payroll (even if you use an outside payroll service, someone must be in control and responsible)
- Internal accounting control
- Fixed assets

In many cases the same person will do many of these things. However, these are the areas we'll be dealing with in setting up the accounting system. The person you assign to be in overall charge of the system should be the one who is most familiar with accounting. If you are just starting your company, you might want to think about the background of some of your new employees. At least one should have the capacity to run the accounting system.

If you find it difficult to determine someone's expertise in a field with which you are unfamiliar, here are some solutions:

1. Have them interviewed by an expert. Your own CPA will probably be glad to interview a few for you.
2. Carefully check references from past jobs. Ask detailed questions on exactly what they did in the accounting function. Compare the answers with what they say they did.
3. Ask them some accounting questions. It may sound odd that you (of all people) should be asking such questions. However, even if you can't judge the technical merit of the answers, you can get a feel for how comfortable they are with the subject and the authority with which they answer.

* **Source** [Adams - Accounting for the New Business](#)

The Strategies and Practices You Need to Account
for Your Success by Christopher R. Malburg, CPA, MBA

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