ACCOUNTING BASICS

Chapter 7 — Accounting Information Systems

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1 · What an accounting information system does

An accounting information system is the set of people, records, and procedures a business uses to collect transactions, record them, and turn them into useful financial information. This chapter is about the machinery underneath the statements: how a company records hundreds of routine transactions efficiently and keeps its customer and supplier balances straight.

Accounting information system (AIS): The system of collecting and processing transaction data and communicating financial information to decision-makers. It can be manual or computerized, but the underlying logic is the same.

- Cost-effectiveness — the benefit of the information must be worth the cost of producing it.
- Useful output — the reports must be understandable, relevant, reliable, and timely for the people who use them.
- Flexibility — the system should accommodate growth and change without being rebuilt from scratch.

Whether the records live in paper journals or in software, two tools make a high-volume system manageable: subsidiary ledgers and special journals. The rest of this chapter is about those two ideas.

2 · Subsidiary ledgers: the detail behind a total

Imagine a company with 300 credit customers. Keeping all 300 inside the general ledger's single Accounts Receivable account would make it impossible to answer a simple question — how much does one particular customer owe? The solution is a subsidiary ledger.

Subsidiary ledger: A group of accounts that share a common characteristic — one account per customer or per supplier. It keeps the detail out of the general ledger while still tracking each individual balance.

- Accounts receivable (customers') subsidiary ledger — one account for each credit customer.
- Accounts payable (creditors') subsidiary ledger — one account for each supplier the company buys from on account.

The subsidiary ledger gives you the who and how-much for every customer and supplier, without cluttering the general ledger. It also divides the recording work among people and makes errors easier to localize.

3 · Control accounts: the total that must agree

Each subsidiary ledger is summarized by a single account in the general ledger called a control account. The control account holds the total; the subsidiary ledger holds the pieces.

Control account: A general-ledger account (such as Accounts Receivable or Accounts Payable) whose balance equals the sum of all the individual account balances in its subsidiary ledger.

The control account equals the sum of its parts. Maplewood Distributors' Accounts Receivable control account shows $8,000 at March 31. Its receivable subsidiary ledger shows Aspen Co. $3,000, Birch Co. $0, and Cedar Co. $5,000. Those add to $8,000 — so the control account and the subsidiary ledger agree, which is exactly the check you run at month-end.

Postings are made so the two always stay in step: the same transactions that hit a customer's subsidiary account also flow (in total) into the control account. If they ever disagree, there's a posting error to find.

4 · Why special journals exist

Recording every transaction in one general journal — with a full debit-and-credit entry each time — is slow when the same kind of transaction happens over and over. Special journals group similar transactions so they can be recorded on one line and posted in totals.

Special journal: A journal used to record a particular type of transaction that occurs frequently. Most merchandisers use four of them.

- Sales journal — all sales of merchandise ON ACCOUNT (on credit).
- Cash receipts journal — all receipts of CASH (including cash sales and collections from customers).
- Purchases journal — all purchases of merchandise ON ACCOUNT (on credit).
- Cash payments journal — all payments of CASH.

Anything that doesn't fit one of the four still goes in the general journal. Used together, the special journals capture the vast majority of a merchandiser's transactions with far less writing and posting.

5 · The sales journal

The sales journal records only credit sales of merchandise. Cash sales go in the cash receipts journal; credit sales of anything other than merchandise (like equipment) go in the general journal.

Each credit sale is one line. Under a perpetual system, each line captures two effects: the selling price (Accounts Receivable and Sales Revenue) and the cost (Cost of Goods Sold and Inventory).

Posting the sales journal. Maplewood's sales journal for March lists Aspen $4,000, Birch $6,000, Cedar $5,000, and Aspen $3,000 — total $18,000. Each amount is posted DAILY to the customer's account in the receivable subsidiary ledger. At month-end the $18,000 total is posted ONCE to the general ledger as a debit to Accounts Receivable and a credit to Sales Revenue (and the total cost as a debit to Cost of Goods Sold and a credit to Inventory).

6 · The cash receipts journal

The cash receipts journal records every transaction in which cash comes in — cash sales, collections from customers on account, and less-common receipts like an owner investment or interest received.

Because receipts come from several sources, this journal has multiple money columns. Typical columns are Cash (debit), Sales Discounts (debit), Accounts Receivable (credit), Sales Revenue (credit), and Other Accounts (credit) — plus Cost of Goods Sold (debit) / Inventory (credit) for the cost side of cash sales.

- Column TOTALS (Cash, Sales Discounts, Accounts Receivable, Sales Revenue) are posted to the general ledger at month-end.
- Amounts in the Accounts Receivable column are also posted DAILY to each customer's subsidiary account.

- Amounts in the Other Accounts column are posted individually — there is no single account they all belong to.

7 · The purchases journal

The purchases journal records all purchases of merchandise on account. (A single-column purchases journal handles only credit merchandise purchases; a multi-column version can also record credit purchases of supplies or equipment.)

Posting the purchases journal. Maplewood's purchases journal for March lists Northwind $7,000, Summit $5,000, and Vale $4,000 — total $16,000. Each amount is posted DAILY to the supplier's account in the payable subsidiary ledger. At month-end the $16,000 total is posted ONCE as a debit to Inventory and a credit to Accounts Payable.

8 · The cash payments journal

The cash payments (cash disbursements) journal records every transaction in which cash goes out — paying suppliers, paying expenses, buying assets for cash, and owner withdrawals.

Like the cash receipts journal it is multi-column: typically Cash (credit), Inventory (credit, for purchase discounts taken), Accounts Payable (debit), and Other Accounts (debit). Column totals post monthly to the general ledger; Accounts Payable amounts post daily to each supplier; Other Accounts amounts post individually.

9 · Daily detail, monthly totals — then prove it

The posting rhythm is the key to special journals. Individual customer and supplier amounts are posted DAILY so each subsidiary balance stays current. The column totals are posted MONTHLY so the general ledger updates in summary.

Proving the ledgers: At the end of the month, prepare a schedule that lists every balance in a subsidiary ledger and total it. That total must equal the balance of the related control account. If it doesn't, there is a posting error.

Proving accounts receivable. Maplewood's receivable subsidiary schedule at March 31: Aspen $3,000 + Birch $0 + Cedar $5,000 = $8,000. The Accounts Receivable control account also shows $8,000. They agree, so the receivables are proved.

10 · What still goes in the general journal

Even with four special journals, some transactions don't fit any of them. Those go in the general journal — but you may still need to post to a subsidiary ledger by hand.

- Sales returns and allowances, and purchase returns and allowances.
- Purchases of assets (like equipment) on account.
- Correcting, adjusting, and closing entries.

A return in the general journal. A customer returns $400 of merchandise bought on account. The general-journal entry debits Sales Returns and Allowances and credits Accounts Receivable $400 — and because a specific customer owes $400 less, that $400 is ALSO posted to the customer's subsidiary account. Entries that touch a control account must also update the subsidiary ledger.

11 · Why the system is worth it

Special journals and subsidiary ledgers together deliver the three system goals from the start of the chapter. They save time by recording routine transactions on one line and posting in totals; they divide the work so several people can record at once; and they keep the general ledger uncluttered while still tracking every customer and supplier.

- Efficiency — one-line entries and monthly total postings replace hundreds of individual general-journal entries.
- Division of labor — different people can keep different journals and ledgers at the same time.
- Clean control accounts — the general ledger shows totals; the detail lives in the subsidiary ledgers and is proved each month.

Computerized systems automate the posting, but the concepts are unchanged: transactions are grouped by type, individual balances are tracked in subsidiary detail, and control totals are proved against that detail.