**Chapter 7. Accounting Information Systems, Special Journals and Subsidiary Ledgers**

**FUNDAMENTAL SYSTEM PRINCIPLES**

**Accounting information systems** collect and process data from transactions and events, organize them in useful reports, and communicate results to decision makers. With the increasing complexity of business and the growing need for information, accounting information systems are more important than ever. All decision makers need to have a basic knowledge of how accounting information systems work.. This section explains five basic principles of accounting information systems.



Managers need to control and monitor business activities. The **control principle** prescribes an accounting information system have internal controls. **Internal controls** are methods and procedures allowing managers to control and monitor business activities. They include policies to direct operations toward common goals, procedures to ensure reliable financial reports, safeguards to protect company assets, and methods to achieve compliance with laws and regulations.

**Relevance Principle**

Decision makers need relevant information to make informed decisions. The **relevance principle** prescribes an accounting information system report useful, understandable, timely, and pertinent information for effective decision making. The system must be designed to capture data that make a difference in decisions.

**Compatibility Principle**

Accounting information systems must be consistent with the aims of a company. The **compatibility principle** prescribes an accounting information system conform to a company's activities, personnel, and structure. It also must adapt to a company's unique characteristics.

**Flexibility Principle**

Accounting information systems must be able to adjust to changes. The **flexibility principle** prescribes that an accounting information system be able to adapt to changes in the company, business environment, and needs of decisions makers.

**Cost-Benefit Principle**

The **cost-benefit principle** prescribes that the benefits from an activity in an accounting information system outweigh the costs of that activity. The costs and benefits of an activity such as producing a specific report will impact the decisions of both external and internal users. Decisions regarding other systems principles (control, relevance, compatibility, and flexibility) are also affected by the cost-benefit principle.

**Special Journals and Subsidiary Ledgers**

Most large companies have four (4) special journals and a general journal

1. Purchases journal – records all purchases on credit
2. Cash Disbursements journal – records all disbursements of cash
3. Sales journal – records all sales on credit
4. Cash receipts journal – records all receipts of cash
5. When there are no credit or cash transactions, these transactions are recorded in the general journal, such as returns of merchandise purchase by the company or sales returns or allowances returned by customers of the company.

Most companies keep a three (3) subsidiary ledgers of

1. Accounts receivable by customer
2. Accounts payable by vendor
3. Inventory by type (The Perdisco project has all three)

Overall, subsidiary ledgers are applied in many different ways to ensure that the accounting system captures sufficient details to support analyses that decision makers need. At least four benefits derive from subsidiary ledgers:

1. Removal of excessive details, and detailed accounts, from the general ledger.
2. Up-to-date information readily available on specific customers and suppliers.
3. Aid in error identification for specific accounts.
4. Potential efficiencies in recordkeeping through division of labor in posting.
5. Segregation of duties

**Purchases Journal** – records all purchases **on credit** including inventory



Each credit transaction will have an amount in the “Accounts Payable Credit” column since the journal records all purchases on credit but the debit column accounts will vary depending upon what type of purchase is being made.

Every company decides the number of **debit** columns to use in the purchases journal (the columns after the “Accounts Payable Credit” column). Most will have debit columns for inventory and office supplies since these are purchased frequently on credit.

The “Other Accounts Debit” column would be used for infrequent purchases such as office equipment and store supplies. When the “Other Accounts Debit” column is used, the journal will often have the description of the type of purchase along with the vendor name in the “Vendor Name/Purpose”column.

**Posting the journal to ledger:**

1. **Immediate postings:** “Other Accounts Debit” column. Individual amounts in this column are immediately posted to their general ledger accounts. **This is a one-sided entry.** The corresponding accounts payable credit will be posted at the end of the period as a total.
2. **“**Accounts Payable Credit” column.
	1. **Immediate postings: Individual** vendor amounts in the accounts payable credit column are immediately posted to vendor accounts in the accounts payable subsidiary ledger. (See below for a description of the accounts payable subsidiary ledger).
	2. **End of the period postings:** At the end of the period, the accounts payable credit column **total** is posted to the accounts payable general ledger account.
3. **End of the period postings:** “Inventory Debit” column.The inventory debit column **total** is posted to the general ledger inventory account at the end of the period.
4. **End of the period postings:** “Office Supplies Debit” column.The office supplies column **total** is posted to the general ledger office supplies account at the end of the period.

**Accounts Payable Subsidiary Ledger.** This subsidiary ledger contains a detailed listing of specific vendors and amounts owed to them by the company. Using a subsidiary ledger frees the general ledger from carrying too much detail. It also allows the company to have up to date information on amounts owed to each vendor. The listing of vendors and amounts in the subsidiary ledger must agree to the total amount in the general ledger account. In accounting terminology, the general ledger account controls or is the “controlling” account over the subsidiary ledger.

**Purchase returns or allowances** – Generally, returns of inventory, equipment or supplies are recorded as journal entries in the general ledger and the individual accounts payable subsidiary ledger for the vendor is updated.



**Cash Disbursements Journal** - records all **cash** disbursements



Every company decides how many columns to use in addition to the “Cash Credit” column but the typical columns are “Inventory Purchase Discounts Credits,” “Accounts Payable Debit,” and “Other Accounts Debits.”

**NOTE:** The “Other Accounts” column is used for purchases of inventory with cash, salaries, office equipment, etc.--anything for which there is a **cash** disbursement and no specific column is dedicated to the disbursement.

**Posting the journal to ledger:**

1. **Immediate postings:** “Other Accounts Debit” column. Individual amounts in this column are immediately posted to their general ledger accounts. **This is a one-sided entry.** The corresponding cash credit will be posted at the end of the period as a total.
2. **“**Accounts Payable Debit” column.
	1. **Immediate postings: Individual** vendor amounts in the accounts payable debit column are immediately posted to vendor accounts in the accounts payable subsidiary ledger. (See below for a description of the accounts payable subsidiary ledger).
	2. **End of the period postings:** At the end of the period, the accounts payable debit column **total** is posted to the accounts payable general ledger account.
3. **End of the period postings:** “Inventory Purchase Discounts Credit” column.This column **total** is posted to its general ledger account at the end of the period.
4. **End of the period postings:** “Cash Credit” column.The **total** is posted to the general ledger cash account at the end of the period. The cash disbursements journal serves as a check register for the company.

**Accounts Payable Subsidiary Ledger.** This subsidiary ledger contains a detailed listing of specific vendors and amounts owed to them by the company. Using a subsidiary ledger frees the general ledger from carrying too much detail. It also allows the company to have up to date information on amounts owed to each vendor. The listing of vendors and amounts in the subsidiary ledger must agree to the total amount in the general ledger account. In accounting terminology, the general ledger account controls or is the “controlling” account over the subsidiary ledger.



**Sales Journal** – records all sales of inventory **on credit**



Sales of **non inventory** items is recorded as a journal entry in the **general ledger**.

Each credit sale of inventory will have a debit to accounts receivable and a credit to sales. For a perpetual system of inventory, the sales journal will also have a debit to cost of goods sold and a credit to inventory.

**Posting the journal to ledger:**

1. **“**Accounts Receivable Debit” amounts in “Accounts Receivable Debit and Sales Credit” column.
	1. **Immediate postings: Individual** customer amounts in the accounts receivable debit column are immediately posted to customer accounts in the accounts receivable subsidiary ledger. (See below for a description of the accounts receivable subsidiary ledger).
	2. **End of the period postings:** At the end of the period, the accounts receivable debit column **total** is posted to the accounts receivable general ledger account.
2. **End of the period postings:** **“**Sales Credit” amounts in “Accounts Receivable Debit and Sales Credit” column.This column **total** is posted to its general ledger account at the end of the period.
3. **End of the period postings:** “Cost of Goods Sold Debit and Inventory Credit” column.The **total** for each of these accounts are posted separately to their respective general ledger accounts at the end of the period.

**Accounts Receivable Subsidiary Ledger.** This subsidiary ledger contains a detailed listing of specific customers and amounts they owe the company. Using a subsidiary ledger frees the general ledger from carrying too much detail. It also allows the company to have up to date information on amounts owed by each customer. The listing of customers and amounts in the subsidiary ledger must agree to the total amount in the general ledger account. In accounting terminology, the general ledger account controls or is the “controlling” account over the subsidiary ledger.

**Sales returns and allowances:** Generally, sales returns and allowances are recorded as journal entry in the general ledger and the subsidiary accounts receivable ledger for the individual customer is updated for these amounts.



**Cash Receipts Journal** - records all cash receipts (even cash sales of inventory).



Cash receipts can come from

1. Customers who are paying their accounts receivable statements. When customers pay their bills, they make take advantage of a sales discount if they pay within the cash discount period. The full amount of the accounts receivable would be credited, cash debited for the amount received, and sales discounts debited for the amount of the discount.
	1. **Immediate postings:** The individual customer accounts receivable amounts are posted to the accounts receivable subsidiary ledger. (See below for an explanation of the accounts receivable subsidiary ledger).
	2. **End of the period postings:**
		1. The accounts receivable credit column **total** is posted to the accounts receivable general ledger account.
		2. The sales discount debit column **total** is posted to its general ledger account.
		3. See below for cash debit total
2. Cash sales of merchandise. These transactions would be recorded in the “Sales Credit” column with the corresponding “Cost of Goods Sold Debit and Inventory Credit” column.
	1. **End of the period postings:** “Sales Credit” and“Cost of Goods Sold Debit and Inventory Credit” columns.The **total** for each of these accounts are posted separately to their respective general ledger accounts at the end of the period.
3. Cash from other sources such as bank loans, interest earned on bank accounts, sale of non-inventory items are posted in the “Other Accounts” column.
	1. **Immediate postings:** These transactions are posted to their respective general ledger accounts. **This is a one-sided entry.** The corresponding cash debit will be posted at the end of the period as a total.

**“Cash Debit” column**. **End of the period posting:** The total in this column is posted in the general ledger at the end of the period.

**Accounts Receivable Subsidiary Ledger.** This subsidiary ledger contains a detailed listing of specific customers and amounts they owe the company. Using a subsidiary ledger frees the general ledger from carrying too much detail. It also allows the company to have up to date information on amounts owed by each customer. The listing of customers and amounts in the subsidiary ledger must agree to the total amount in the general ledger account. In accounting terminology, the general ledger account controls or is the “controlling” account over the subsidiary ledger.





**Inventory Subsidiary Ledger:** Normally, there is a subsidiary ledger of inventory which is kept for every type of inventory. This is not part of the Connect Lab Project 2 but will be in your Perdisco project.