

Unit 17 - The Three-Ledger System

General Ledger

As a business grows/increases in size, the system used to record accounting information must change. This is done to efficiently process the daily data. The General Ledger is one area that is affected by the growth.

Accounts Receivable

As a business grows so does the number of customers who purchase goods and services on account. Accounts must be kept for each customer to determine the amount owed and the date the payment is due. The increase in the number of accounts receivable makes it necessary to devise a more efficient system of ledger accounts

see fig. 8-1 pg. 404

Effect of the Balance Sheet

There is an effect on the balance sheet with the expanded number of accounts receivable. Individual totals for each customer are not listed on the balance sheet. A total for accounts receivable is more useful when preparing a balance sheet.

Accounts Payable

A similar situation develops with the accounts payable portion of the ledger of a expanding or large business. It is still necessary to keep individual accounts for each creditor. Businesses still have to know how much is owed and the payment due date for each creditor. If listed individually, this would make for a long balance sheet. A total for accounts payable is more useful when preparing a balance sheet.

Adapting the General Ledger

See fig. 8-2 pg. 405 shows T-accounts and how it would look with several accounts receivables and accounts payables. Could you imagine what it would look like if these accounts were in the hundreds or thousands. fig. 8-3 pg. 406. This makes the trial balance and balance sheet very lengthy. To reduce the number of accounts in the General Ledger, subsidiary ledgers are set up.

Subsidiary Ledgers

A *subsidiary ledger* is a group of accounts of one type usually organized in alphabetical order. The most common subsidiary ledgers are for accounts receivable and accounts payable but there could be one for a company with an extensive list of equipment. The whole list would be contained in the subsidiary ledger-Equipment Ledger.

Accounts Receivable Ledger is a subsidiary ledger containing only customers' accounts in alphabetical order. New accounts are inserted as required.

The Accounts Receivable control account replaces the individual customer accounts in the General Ledger.

see Fig. 8-4 pg. 408

Accounts Payable Ledger is a subsidiary ledger containing only creditors' accounts in alphabetical order.

The Accounts Payable control account replaces the individual creditor accounts in the General Ledger. see Fig. 8-4 pg. 408.

The total of all of the individual creditors' accounts in the Accounts Payable Ledger ($\$200 + \$50 + \$150$) should equal the balance of the Accounts Payable control account in the General Ledger ($\$400$).

Summary

For every subsidiary ledger, there is a control account in the General Ledger. The total of the accounts in the subsidiary ledger must equal the balance of the related control account in the General Ledger.

Verifying the Accuracy of the Ledgers

General Ledger Trial Balance

A *trial balance* is prepared to verify the mathematical accuracy of the *General Ledger*. The trial balance is prepared the same way as before but now with control account totals and not individual account receivable and payable amounts.

The General Ledger trial balance, Fig. 8-5 pg. 409, shows control account totals for the Accounts Receivable and the Accounts Payable instead of individual account amounts.

Schedule of Accounts Receivable

A schedule of accounts receivable is prepared to prove the mathematical accuracy of the Accounts Receivable Ledger. The schedule is a list of the customer accounts showing the balance of each account. The balances are totaled and must equal the value of the Accounts Receivable control account in the General Ledger.

Schedule of Accounts Payable

A schedule of accounts payable is prepared to prove the mathematical accuracy of the Accounts Payable Ledger. The schedule is a list of the creditor accounts showing the balance of each account. The balances are totaled and must equal the value of the Accounts Payable control account in the General Ledger.

Advantages of Subsidiary Ledgers

There are two main advantages of using subsidiary ledgers in an accounting system:

- Division of Labour
- Accounting Control

Division of Labour Principle

In a small firm one employee may handle all of the accounting tasks. In a large firm one person may not be able to handle all of the accounting tasks. Large firms find it more efficient to divide the work among several people. Each of whom specializes in an area of accounting (Accounts Receivable Clerk, Accounts Payable Clerk).

Accounting Control

In a small business the owner may be able to spot irregularities in the business but in a large business there are many people and irregularities may not be spotted.

A good accounting system controls the recording, the accuracy, and the honesty of people involved. The control account balances in the General Ledger must equal the totals of the account balances in each of the subsidiary ledgers. When different people are responsible for each of the ledgers, they act as a check on the accuracy of each other's work.