

Chart of Accounts

Once a company is established, entrepreneurs normally assume that just appointing an accountant or outsourcing the accounting function is the only role they need to play to ensure books of accounts are kept, taxes are paid and returns are filed. What they overlook is the requirement for structured information that must flow from accounted figures to back sound business decisions. Management Information System (MIS) is very critical, however small or big the organisation is. Financial information that is prepared based on well thought out and designed chart of accounts that is specific to the business and its needs is the bedrock of a good MIS.

So, what is Chart of Accounts ?

1. A Chart of Accounts is a **created list of accounts** of an organization which helps to segregate the accounts of assets, liabilities, income and expenses. It can be created for any type of organization viz., manufacturing, software, education etc.

Chart of Accounts can never be standardized and used for all organizations. It is unique to any business and is created based on the following parameters:

- Requirement of data sorting by the business
- Software that is being used

2. The **list of codes** used in a Chart of Accounts that are created should have characters that are alphabetic, numeric or alphanumeric. It should be structured in such a manner that it is logical, easy to comprehend and there is flexibility in its range to add new codes at any time. Also when codes are created it should be possible to retrieve data with ease.

We know that data in any organization is used differently by different functions. While customer data may be used by finance for ageing analysis, marketing department may use the same data to review/analyze the credit terms offered. Hence the design of the Chart of Accounts should consider all users of data.

3. During earlier days with the manual system of accounts the Chief Finance Officer (CFO) could request the Manager to retrieve the ledger of say “Mukund & Co.” Today “Mukund & Co.” would probably be represented by D001002. As ledgers increase with the business becoming larger and complex, it becomes difficult to retrieve accounts based only on names. Today the least any new enterprise does when they start operations is buying a “**Tally**” **accounting package**. Manual system of accounts is hardly to be seen these days.

If we examine the case of a manufacturing company, it can separate its suppliers based on the nature of materials supplied. If it has suppliers of products made up of different metals, it can have a category for say copper related items and another for steel. Such segregation will help in culling out data for analysis when market prices of such metals are subject to frequent fluctuations.

4. Let us take the **hypothetical case of a Dessert Bar** business located in 3 cities in India, say Delhi, Mumbai and Bangalore. We assume it has the following products on its menu list:

- Chocolate and coffee drinks
- Milkshakes
- Cocktails-alcoholic
- Cocktails- non alcoholic
- Desserts- chocolate

Its customers we assume can be broadly categorized as:

- Retail
- Corporate sales
- Business/dinner parties

One way in which such a company could think of sorting its Chart of Accounts could be:

- Level 1- The heads of the Balance Sheet and Profit & Loss Account
- Level 2- Types of products
- Level 3- Geographical location
- Level 4- Customer/ Supplier
- Level 5- Nature of expense/income

The **sorting will be unique** to the Dessert Bar and based on its requirement. Each level of sorting would mean that the data at that level is required for a purpose.

However this type of sorting would not work for an educational institution that gets grants from more than one source. If Central and State Government grants are received by an institution, assets purchased from such grants will need to be tracked separately. Hence the Chart of Accounts would be completely different from the Dessert Bar case.

5. The number of levels of sorting that can be done will depend on the software package in use. For instance Tally permits only 4 levels. One would need to be innovative in designing the Chart in Tally as flexibility is limited. One way of achieving the same is using separate set of codes for the Balance Sheet and Profit and Loss. Tally's 4 levels are pre-defined as:

- Group
- Ledger
- Cost category
- Cost centre

The groups are pre-defined but enable the user to add new groups. Cost centre definition of Tally is different from the general understanding of a cost centre. Tally uses cost centres for income and expense codes.

6. A well designed Chart of Accounts is not only an important financial process but also helps in:

- Reliable financial reporting
- Preparation of management reports for decision making and
- Meeting compliances with ease

For ease of understanding and also keeping in mind the penetration and wide acceptance of Tally as an accounting software package, reference has been made to Tally in the above analysis. It is not to be construed as an analysis of the merits and demerits of Tally. Intention is neither to endorse nor to dissuade businesses from using Tally as a package.

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