



# Setting Up Your Chart of Accounts

It cannot be overstated the importance of a good Chart of Accounts to the accuracy of your financial statements. If you don't feel comfortable setting up your Chart of Accounts, please get help. The decisions you make now will follow you around for the life of your business!

---

Please, please don't just accept your accounting system's default chart of accounts!

It will usually leave you with too many unnecessary accounts and will leave off accounts you really need. Take the time to set up a Chart of Accounts that suits your business and the effort will pay for itself over and over as you get financial statements you can understand and truly help you run your business.

---

## Other Chart of Account Tips

1. **Watch the detail.** Try to make your [Chart of Accounts](#) detailed enough to be helpful, but not so detailed it is impossible for someone to [code](#) the transactions appropriately. For example, you may want to set up separate Sales Accounts for Service and Parts (for an auto shop) or for Food and Alcohol (for a restaurant). I would not suggest setting up separate sales accounts per product, per office location, per customer zip code or anything that results in more than 5 sales accounts. This information is more appropriately handled with sales reports from the accounting system. Remember, you can always add accounts later, so you don't have to cover every scenario now.
2. **Use account numbers.** You don't want your [accounts](#) to appear in default alphabetical order, because the expenses that start with "A" are not necessarily the most important to you. It also prevents a user from accidentally posting to a similarly named account.
3. **Set up departments, if applicable.** If you want to use departments make sure you know whether they need to be part of your chart of account numbering or not. For example, Quickbooks uses Classes, Xero uses Tracking Categories and both systems maintain that information separate from the account numbers. You can run reports by department. Microsoft Dynamics GP, on the other hand, requires

any department codes to be added to the account numbers. For example, Account Number 1020 would be set up for each department, such as 1020-10, 1020-20, 1020-30.

4. **No “junk” accounts.** I am really opposed to catch-all accounts (used when a bookkeeper doesn’t know where to code an item). I feel strongly it should be resolved at the time of coding or don’t enter it. If you feel compelled to set up a “Miscellaneous” or “Suspense” account, at the very least make it an **Income Statement** account, and possibly make it your very first one before Revenues. If you make it a **Balance Sheet** account, it may never get any attention and after a few years, you may discover you have misstated expenses by tens of thousands of dollars.

## Sample Chart of Accounts

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
1000	Cash and Other Deposit Accounts	BS	Heading	
1010	Cash in Bank	BS	Debit	Set up as many as you need for all your bank accounts. When changing banks, set up a new account number-- do not reuse an old one.
1020	Undeposited Funds	BS	Debit	A favorite of Quickbooks users- it’s the default account for checks or credit cards that have not yet hit the bank. (Are in transit or in the drawer.)
1200	Accounts Receivable	BS	Heading	
1210	Accounts Receivable	BS	Debit	Sales on credit, not yet collected. Not every business will have Accounts Receivable.
1220	Allowance for Uncollectible Accounts	BS	Credit	Usually, an estimate of uncollectible receivables booked on a monthly or annual basis.
1300	Inventory	BS	Heading	
1310	Inventory- Finished Goods	BS	Debit	Goods (products) held for resale.
1320	Inventory- Work-In-Progress	BS	Debit	Usually only needed in a manufacturing business.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
1330	Inventory- Raw Materials	BS	Debit	Usually only needed in a manufacturing business. The distinction is important because banks lend differently on raw materials, work-in-progress and finished goods.
1400	Prepaid Expenses & Other Current Assets	BS	Heading	
1410	Prepaid Insurance	BS	Debit	Any expenses that are paid in advance and then amortized (expensed over time). For example, if you pay your insurance annually in advance, you would code the entire premium to Prepaid Insurance and then expense 1/12 of it every month.
1410	Prepaid Rent	BS	Debit	Same as above prepaid.
1420	Prepaid Taxes	BS	Debit	Same as above prepaid.
1500	Property, Plant & Equipment	BS	Heading	
1510	Buildings	BS	Debit	Buildings owned by the business. This is booked at actual purchase price and will never change.
1511	Accumulated Depreciation- Buildings	BS	Credit	The amount of the purchase price depreciated to date. Depreciation is usually booked at least annually and is an attempt to reflect the declining value of an asset. Usually depreciated over 39 years.
1520	Machinery & Equipment	BS	Debit	Machinery owned by the business. This is booked at the actual purchase price and will never change.
1521	Accumulated Depreciation- Machine & Equipment	BS	Credit	The amount of the purchase price depreciated to date. Depreciation is usually booked at least annually and is an attempt to reflect the declining value of an asset. Machinery & equipment is usually depreciated over 7 years.
1530	Computer Equipment	BS	Debit	Computer Equipment owned by the business. This is booked at the actual purchase price and will never change.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
1531	Accumulated Depreciation- Computer Equipment	BS	Credit	The amount of the purchase price depreciated to date. Depreciation is usually booked at least annually and is an attempt to reflect the declining value of an asset. Computer equipment is usually depreciated over 5 years.
1540	Furniture & Fixtures	BS	Debit	Furniture & Fixtures owned by the business. This is booked at the actual purchase price and will never change.
1541	Accumulated Depreciation- Furniture & Fixtures	BS	Credit	The amount of the purchase price depreciated to date. Depreciation is usually booked at least annually and is an attempt to reflect the declining value of an asset. Furniture and fixtures are usually depreciated over 7 years.
1800	Other Non-Current Assets	BS	Heading	
1810	Security Deposits	BS	Debit	Deposits made on leased space or equipment.
1820	Notes Receivable	BS	Debit	Any long-term receivables (greater than one year). This is not common in most businesses.
1920	Patents & Licenses	BS	Debit	Any patents purchased by the business. Not common.
2100	Accounts Payable	BS	Heading	
2110	Accounts Payable- Trade	BS	Credit	Expenses incurred, but not yet paid. Only applicable if your vendors sell to you on credit terms.
2130	Current Maturities of Long-Term Debt	BS	Credit	The amount of any long-term debt due within the next 12 months. This account is usually updated once a year.
2200	Accrued Expenses	BS	Heading	
2210	Accrued Payroll	BS	Credit	Wages and payroll accrued, but not yet paid. For example, if January ends and you owe one week of payroll that will not be paid until February, you would book the one week here.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
2220	Accrued Commissions	BS	Credit	Commissions accrued by not yet paid.
2230	Accrued Payroll Taxes	BS	Credit	Payroll taxes withheld or accrued and not yet paid. You may see Chart of Accounts that list them all in detail (e.g. Federal Withholding, State Withholding, State Unemployment, etc.). I don't think that is necessary. First, you should NEVER have much money in accrued payroll taxes and your payroll reports should give you any detail you need. If you are using an outside payroll service and they remit the taxes for you each payroll, you would never have accrued payroll taxes.
2240	Accrued 401(k) Contributions	BS	Credit	401(k) contributions withheld or due and not yet paid.
2250	Accrued Rent	BS	Credit	Rent accrued and not paid. Not common.
2260	Accrued Sales Tax	BS	Credit	Sales taxes withheld from customers and not yet remitted. Sometimes called Sales Tax Payable.
2270	Accrued Interest	BS	Credit	Interest accrued and not yet paid. If you pay on a note quarterly, for example, you might accrue interest each month.
2500	Accrued Taxes	BS	Heading	
2510	Accrued Federal Income Taxes	BS	Credit	Federal income taxes due but not yet paid. Would normally be computed on a quarterly or annual basis.
2520	Accrued State Income Taxes	BS	Credit	State income taxes due but not yet paid. Would normally be computed on a quarterly or annual basis.
2530	Accrued Property Taxes	BS	Credit	Property taxes (aka ad valorem taxes) due by not yet paid. Would normally be computed on a quarterly or annual basis.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
2700	Notes Payable- Long-Term	BS	Heading	
2710	Notes Payable	BS		Payables that extend beyond one year. (Remember the current maturities portion above that is due within one year? This is the portion of that note that is due beyond one year.) I highly encourage setting up a separate Notes Payable account for each debt you incur.
3000	Owner's Equity	BS	Heading	
3100	Common Stock	BS	Credit	CORPORATIONS ONLY. The cash contributed to purchase the stock of the company. Will equal Par Value times Number of Outstanding Shares.
3200	Preferred Stock	BS	Credit	CORPORATIONS ONLY. Not common in small businesses. A "favored" class of corporate stock.
3300	Paid In Capital	BS	Credit	CORPORATIONS ONLY. The cash or property contributed by a shareholder beyond the par value of the stock (see above).
3400	Partners Capital	BS	Credit	PARTNERSHIPS ONLY. Usually one account for each partner. All contributions (cash or property) paid into the company by partners.
3500	Member Contributions	BS	Credit	LLCs ONLY. Usually one account for each member. All contributions (cash or property) paid into the company by members.
3800	Current Earnings	BS	Credit	Earnings for the current year. The accounting system usually does not let you touch this account and closes (resets to 0) to Retained Earnings at year-end.
3900	Retained Earnings	BS	Credit	Earnings over the life of the company prior to the current year. Generally, you will never post to this account.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
4000	Sales or Revenue	IS	Heading	
4010	Sales- Services	IS	Credit	The big one- Sales. Create as many sales accounts as you need to give yourself a good overview of the business, but be careful about setting up more than five.
4020	Sales- Products	IS	Credit	Sales are usually recorded at gross (full amount). Any returns or discounts are booked in the accounts below.
4040	Discounts	IS	Debit	Any discounts offered on sales. Can help you determine if you are experiencing pricing pressure on your sales.
4050	Sales Returns & Allowances	IS	Debit	Any products returned or refunds given. Why not just offset sales? Because, this gives you a way to assess quickly if sales are being made, but you are getting the goods back.
5000	Cost of Goods Sold (COGS)	IS	Heading	Fancy way of saying “the costs directly associated with the above sales”. The cost of a sold product goes here. Rent or overhead items- they go below in Operating Expenses
5010	Cost of Goods Sold (Product Costs)	IS	Debit	Usually the inventory cost of the item.
5020	Inbound Freight	IS	Debit	The cost of bringing in a product to sell.
5040	Outbound Freight	IS	Debit	The cost of shipping out a sold product.
5050	Other Cost of Goods Sold	IS	Debit	Other Cost of Goods Sold. Set up whatever accounts you need in this section to help track your costs.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
6000	Operating Expenses	IS	Heading	There aren't a lot of rules on how you need to set up your expenses. In fact, the default in many systems is alphabetically! Use the following as a guide, but feel free to change it to better reflect your business. I like to set up 5 to 8 major categories of expenses. These make it easy to create a summary income statement that really gives you an overview of major trends, without getting lost in the details of your bank service charges.
6100	Personnel Costs	IS	Heading	If personnel costs are not a big part of your business, you don't need as many accounts in this group.
6110	Salaries	IS	Debit	
6120	Bonuses	IS	Debit	
6130	Overtime Wages	IS	Debit	I like overtime separated to make it easier to watch for spikes in overtime usage. Depends on your business if it is worth separating or not.
6140	Paid Time Off	IS	Debit	
6160	Payroll Taxes	IS	Debit	
6170	Contract Labor	IS	Debit	
6180	Insurance Benefits	IS	Debit	Employer-paid medical, dental & vision
6190	401(k) Contributions- Employer Match	IS	Debit	
6180	Training	IS	Debit	
6190	Recruiting	IS	Debit	Job postings, background checks, etc.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
6200	Facilities & Vehicles	IS	Heading	If vehicle expenses are a big part of your business, separate them from buildings.
6210	Rent	IS	Debit	
6220	Utilities	IS	Debit	
6240	Janitorial	IS	Debit	
6260	Building Maintenance	IS	Debit	
6280	Property Insurance	IS	Debit	
6290	Property Tax	IS	Debit	
6350	Auto Leases	IS	Debit	
6360	Auto Maintenance	IS	Debit	
6370	Fuel & Tolls	IS	Debit	
6400	Office or Administrative Costs	IS	Heading	
6410	Office Supplies	IS	Debit	
6420	General Liability Insurance	IS	Debit	
6440	Equipment Repairs & Maintenance	IS	Debit	
6445	Dues & Subscriptions	IS	Debit	
6450	Telecommunications	IS	Debit	Phone, Cell phone, internet
6455	Hosted Software Services	IS	Debit	
6460	Legal Fees	IS	Debit	

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
6465	Accounting Fees	IS	Debit	I like to keep Legal and Accounting separate. If the number gets large, I like to easily see who is involved.
6470	Postage & Delivery	IS	Debit	
6475	Sales & Use Tax	IS	Debit	Any use tax you may pay on purchases. Usually not worth allocating to the actual expense category. Not for taxes withheld from customers waiting to be paid.
6500	Sales & Marketing	IS	Heading	
6510	Advertising	IS	Debit	Depending on your business, you might want to separate print advertising from digital.
6520	Promotional Materials	IS	Debit	Giveaways, notepads, etc.
6530	Design Work	IS	Debit	Graphic designers, etc.
6540	Trade Shows	IS	Debit	Depending on the amount of trade shows attended, you might want to break out travel, booth rental, hotel, etc.
6800	Travel & Entertainment	IS	Heading	Again, depending on how much travel your business incurs, you can add more accounts if helpful.
6810	Airline Travel	IS	Debit	
6820	Mileage	IS	Debit	
6830	Parking & Taxis	IS	Debit	
6840	Hotel	IS	Debit	
6850	Meals- Travel Related	IS	Debit	This is separated for tax purposes from meals that are only 50% deductible below.

Account Number	Account Name	Account Type	Increased by Debit or Credit	Description
6860	Meals- 50% Deductible	IS	Debit	This is separated for tax purposes. The cost of taking clients and others to lunch is only 50% deductible.
7000	Other Operating Expenses	IS	Heading	This can catch some of the smaller expense items.
7010	Bank Service Charges	IS	Debit	
7020	Credit Card Fees	IS	Debit	
7030	Tax Penalties	IS	Debit	These need to be separated for tax purposes. Tax penalties are not deductible on your tax return.
7100	Depreciation & Amortization	IS	Heading	
7110	Depreciation	IS	Debit	Depreciation is the expensing of assets such as buildings and equipment over a period of time.
7120	Amortization	IS	Debit	Amortization is the expensing of other assets such as computer software and organization expenses. Same concept as depreciation, just different terminology.
8000	Other Income/Expenses	IS	Heading	This is used for items that are considered non-operating income and expenses.
8010	Interest Income	IS	Credit	Interest earnings (from a savings account, for example).
8020	Interest Expense	IS	Debit	Interest on borrowings (on Notes Payable, for example).
8030	Miscellaneous Income	IS	Credit	For income that doesn't fit elsewhere and is not part of your core business- royalties or refunds. If this number is significant, I would set up a separate Revenue account for it.

# Glossary

Accounts	“Buckets” that hold numbers. Yes, that’s all they are. Easy to confuse with bank accounts or credit card accounts, but this word is not limited to those types.
Booked, Recorded, or Coded	All terms for how a transaction is entered into the accounting system.
BS or Balance Sheet	A financial statement that summarizes a company's assets, liabilities, and shareholders' equity at a specific point in time. That means it is “as of” as certain date, not for a range of dates. Balance Sheet accounts contain activity from the beginning of the life of the company. Assets will equal Liabilities plus Shareholders’ Equity.
Chart of Accounts	A report that lists all the buckets or Accounts you use to record your transactions.
General Ledger	A report that lists all of the accounts that make up your Chart of Accounts that includes all the transaction detail.
Gross	Refers to the total or unadjusted value of an account. E.g. Gross Sales or Gross Profit
IS or Income Statement	A financial statement that reports a company's financial performance (Sales less Expenses) over a specific accounting period. This report will be for a range of dates, usually a month or a year. Income Statement accounts are reset to zero every year.
Net	Refers to the Gross number less something. For example, Net Profit is Gross Profit less expenses. Net Sales is Gross Sales less Discounts and Returns.
Trial Balance	A report that is similar to the Chart of Accounts, but includes the account balances.

# Debits and Credits

Don't read this unless you are incredibly curious or just have to know. Don't say I didn't warn you!

In the old fashioned paper system, debits were traditionally shown on the left of the ledger, credits were shown on the right side of the ledger. (Debit is abbreviated dr and credit, cr.) With accounting software, right and left became obsolete. Now it is more commonly designated by entering a debit as a positive number and a credit as a negative number. Doesn't sound too confusing yet, right?

Well, it does when you look at accounts that are increased with a credit balance, such as Sales. When the system produces an income statement, for example, it converts that "negative" Sales number (or that credit balance) into a positive number for presentation purposes. Okay, not too bad either. But wait-- the formatting can change in the system depending on where you are viewing it. On a **trial balance**, the sales number will either show in a credit column (on the right side) or as a negative number. But on the income statement it will be converted to a positive. See the examples below.

So, credit accounts go against your basic instincts- a negative number (or credit) means your Sales increased. However, a negative number (or credit) to an expense account means the expense was reduced or went down. Many accounting systems attempt to hide debits and credits from the user, but sometimes it can't help itself and it has to show you.

I told you not to read it unless you really needed to know.

## Example:

How the numbers are:

Stored in the system		Displayed on the Income Statement		Displayed on the Trial Balance		
Sales	(\$10,000)	Sales	\$10,000		dr	cr
Expenses	\$5,000	Expenses	\$5,000		-----	-----
		Net Profit	<u>\$5,000</u>	Sales		\$10,000
				Expenses	\$5,000	