General Ledger Theory of Operation

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Why do the accountants use accounting books with 2 columns ?

Before the advent of adding machines, it was much easier to add the column of debits, then add the column of credits and then make the difference of the two. If the accountant was lucky the difference was zero. It would have been nearly impossible even for a highly qualify accountant to add positive and negative amount in a single column. In the old days, the acid test for an accountant was to add 20 pages of phone numbers in less than 5 minutes. (I am that old)

The fundamental accounting equation reads like this : ***Assets = Liabilities + Ownwers' Equity***

Owners' Equity is also known as the Capital of an enterprise. So we could write ***Assets = Liabilities + Capital*** By algebraic transformations we could write : ***Assets - Liabilities = Capital***

We know that the Capital is made of paid-up capital plus retained earnings. Retained earnings are made of accumulated revenues minus accumulated expenses. So we could write : ***Assets - Liabilities = Capital + Revenues - Expenses Or Assets - Liabilities - Capital - Revenues + Expenses = 0*** Or ***Assets + (-Liabilities) + (-Capital) + (-Revenues) + Expenses = 0***

Hence balancing the accounting books consist of the algebraic addition of all the positive amounts (debits) and all the negative amounts(credits) and making sure the sum is always equal to zero.

This equation : ***Assets + (-Liabilities) + (-Capital) + (-Revenues) + Expenses = 0*** helps the non-accountant to remember the usual sign of an account. Assets and Expenses are positive (debit), Liabilities, Capital and Revenues are negative(credit) For example : to increase Liabilities we add a negative amount, to decrease Assets we add a negative amount, and so on.

Journal and ledger A Journal is a book of original entry. The accountant enters daily transactions in a journal. A journal is a chronological recording of financial transactions. A journal entry makes reference to 2 accounts or more and the sum of positive and negative amounts equals zero. Once the journal entry is completed, the accountant has to post each line of the journal to the appropriate page of the ledger. A ledger is a copy of journal entries sorted by accounts.

One day, a lazy accountant having to journalize 200 invoices, realises that all the invoices were posted to the same 3 accounts. He created a special journal with 3 columns, so he could add the amount of each column and do a once a day posting to the ledger. He had just invented the Sales Journal. Being very lazy, it was not long before he invented the Purchase Journal, the Cash Receipt Journal, the Cash Disbursement Journal, the Stock Receiving Journal, the Commitment Journal and so on. Getting lazier and lazier, he decided to do a once a month posting. One day, his boss asked for ledger page 300 to analyse raw material purchases. How comes Mr Accountant, I no more see the date of the transaction, the invoice number, the vendor name nor the type of material purchased ? Because I invented specialized journals to reduce my work load. You may have reduced your work load but you increased mine. How do I analyse my accounts now ? You are fired Mr Accountant ! ! !

Now lets try to rehabilitate Mr Lazy Accountant. To be continued ..