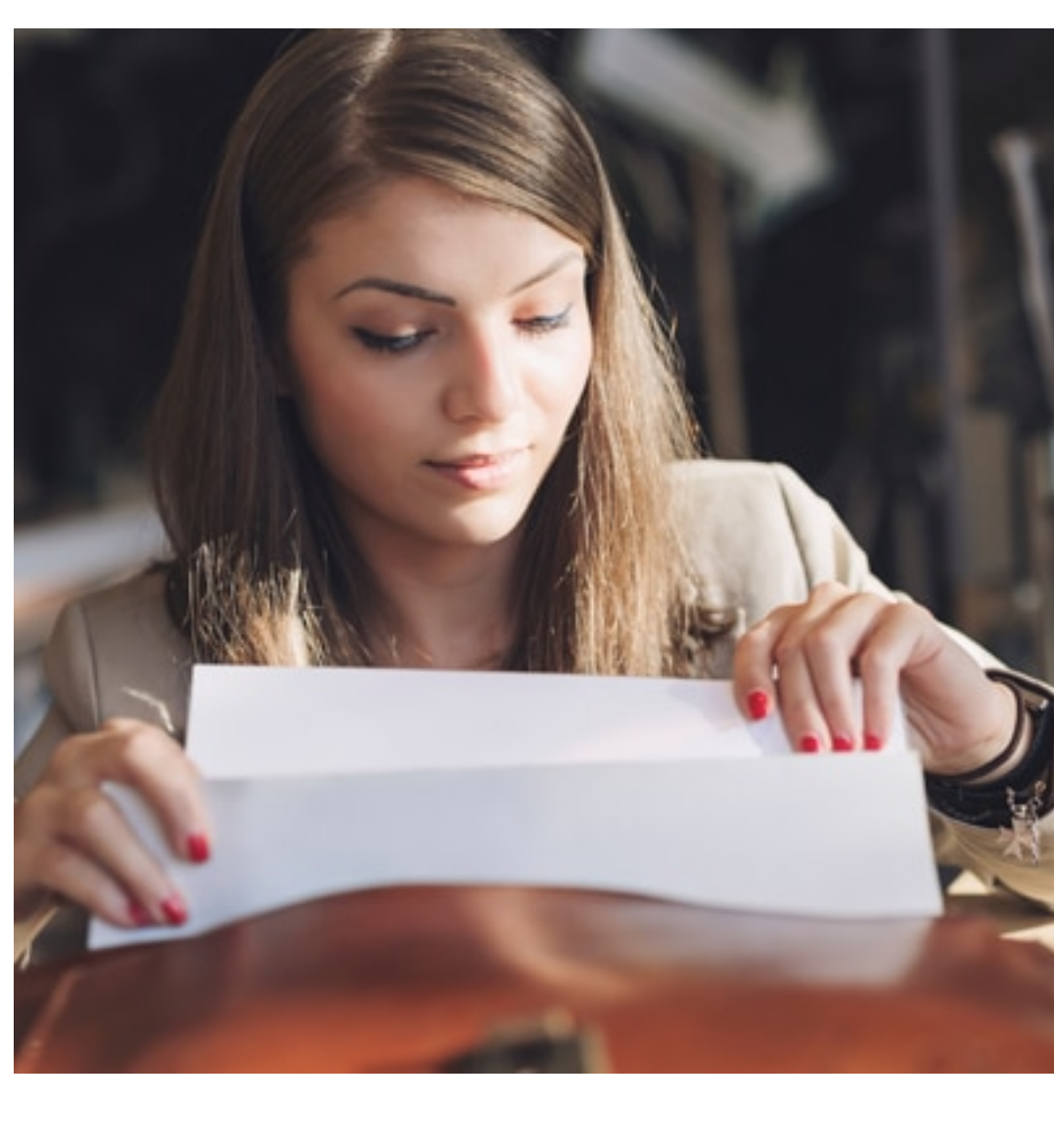


ACCOUNTING

# How to organize your chart of accounts

By QuickBooks April 29, 2019



A chart of accounts is a lot like the game Jenga. If you take a block away from one section of your business, you have to add it back someplace else.

Accounting systems by definition have a general ledger in which your asset accounts (what you own) match your liability accounts (what you owe).

While useful in theory, it's challenging to implement in reality. Because current assets never quite match current liabilities, accountants often use other account types that serve as the "missing Jenga blocks" to ensure an accurate general ledger.

To better understand the [balance sheet](#) and other relevant financial statements, you need to first understand the components that make up a chart of accounts. Knowing how to keep your company's chart organized can make it easier for you to access financial information.

## What is the chart of accounts?

The chart of accounts is a list of the account numbers and names relevant to your company. Typically, a chart of accounts will have four categories. The four primary groups in a standard chart of accounts are:

- Asset accounts
- Liability accounts
- Income accounts
- Expense accounts

Within each category, line items will distinguish the specific accounts. Each line item represents an account within each category.

Some may also display equity accounts on their company's chart. An equity account is a representation of anything that remains after accounting for all operating expenses and revenue accounts.

Here's a brief overview of those four specific accounts commonly associated with the chart of accounts.

### Asset accounts

Your asset accounts will include anything you own that has value, like a building, land, equipment, vehicles, valuables, and inventory. Unfortunately, your assets may not look as pretty on your chart of accounts as they would on a real estate agent's website. Asset accounts can be confusing because they not only track what you paid for the property, but they also follow things like depreciation.

Asset accounts also include things that are liquid, such as your checking account and other bank accounts. Additional asset accounts could be things like accounts receivable and notes receivable. The chart of account streamlines various asset accounts by organizing them into line items so that you can track multiple components easily.

### Liability accounts

Liability accounts include things like bank loans, mortgages, personal loans, promissory notes, income taxes payable, payroll taxes, credit card balances, and your bills, which most accountants classify under accounts payable.

When entering a loan into your company's chart, you should make sure that you only include the amount of the loan. Log just the principal amount and forgo the interest owed. When you make each monthly payment and enter the payment in your accounting system, you will split the payment into an amount subtracted from what you owe, and an amount of interest paid, which will go into an expense account.

### Income accounts

Income tends to be the category that business owners underutilize the most. Most new owners start with one or two broad categories, like "sales" and "services." While some types of income are easy and cheap to generate, others require considerable effort, time, and expense. It makes sense to create separate line items in your chart of accounts for different types of income.

Instead of lumping all your income into one account, consider what your various profitable activities may be and sort them by income type. When you can see which locations or events bring in the most [cash flow](#), you can manage your business more wisely.

For instance, imagine you have a store that sells an array of items. On your chart of accounts, you could create line items for "income from food sold" and "income from books sold." You can then compare the profit levels and cost of goods sold, allowing you to better determine your financial health. When compiling this category, consider anything that brings money into the company, including things like interest income.

### Expense accounts

Expense accounts represent any money that you've spent. For instance, if you rent, the money moves from your cash account to the rent expense account. Expense accounts allow you to keep track of money that you no longer have.

It's also a good idea to break up expenses into separate accounts. For instance, if you ship a lot of products, you may want to track your costs from different shipping carriers separately. Within each line account, you can create sub-categories for the various expenses associated with each carrier.

## Tips for organizing the chart of accounts

Many accounting systems come preset with a chart of accounts whose line items include numbered headers like "1430.2" and "530.8." These numbers could be practical for large accounting firms, but they are often unnecessary for entrepreneurs and small businesses.

When setting up your line items for the first time, keep it simple. Make sure that your line items have titles that make sense to you and your accountant. Use straightforward titles like "bank fees," or "bottling equipment."

As time goes by, you may find yourself wanting to create a new line item for each transaction. However, doing so could litter your company's chart and make it confusing to navigate. Instead, take advantage of your accounting software's sub-accounts.

For instance, imagine you need to create a new account for "PayPal fees." Instead of creating a new line on your chart of accounts, you can create a sub-account under "bank fees." Similarly, if you pay rent for a building or piece of equipment, you might set up a "rent expense" account with sub-accounts for "building rent" and "equipment rent."

## Accounting software can help manage your chart of accounts

As your business grows, so too will your need for accurate, fast, and legible reporting. Your chart of accounts helps you understand the past and look toward the future. A chart of accounts should keep your business accounting error-free and straightforward. This will allow you to quickly determine your financial health so that you can make intelligent decisions moving forward.

With [online accounting software](#), you can organize and track your balance sheet accounts. No matter if you're an entrepreneur [starting a business](#) or an owner looking to streamline your practices, accounting software can help you get the job done.

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