

Tips & Tricks #40 - Have you considered a General Ledger?

Every small business owner spends their day keeping many balls in the air. Some of these “balls” tend to be kept “in your head”. Having them there can be a problem not only in terms of increasing mistakes and misunderstandings about what the actual facts are, but also because a business runs better if the high-level functions and information are shared and communicated. General Ledger (GL) will do that. The GL can be both a repository for past financial periods - providing support for bank and government reporting - as well as tool for classifying and sharing objective data about the trends happening within the business. This makes it not only a useful tool to unload the “in-your-head” stuff, i.e., to share with others via reporting; but also makes it a predictive tool to spot changes happening in the recent past that point to further changes in the future i.e., trends and predictive help.

If you have thought about getting a General Ledger you may be asking yourself what it is – actually; what does it give me and what do I have to invest in it to use it productively. As a business owner, these are the basic ROI (Return on Investment) questions one should be asking about any investment. Let’s try to break this down.

What is it?

The General Ledger is the point of consolidation for all of the accounting transactions that you have been automatically creating in the various applications you are using such as Accounts Payable, Accounts Receivable, Inventory, and Order Entry. These applications are also referred to as “sub-ledger” applications because any transaction process that asks you to distribute the data to a GL account is creating data that can go into the GL. (If you don’t have the General Ledger, these distribution transactions can be listed in account and date sequence and sent to your accountant to prepare financial statements.) These GL distributions will ultimately be moved into the General Ledger where they take their place according the assigned account number and the distribution date. From there, with all the data for a month, you can have *in one place*, a list of all transactions that came from all the various sub-ledger applications that you use. Cash deposits from A/R and cash disbursements from AP combined, and manual cash transactions from the Check Book can all be together under one cash account. This gives you the net flow through each account (net change in period) as well as the individual contributions to that account from different sources (e.g., net debits from AR and net credits from AP).

The General Ledger is, in one sense, a passive application. With the relatively minor exception of adjustments and miscellaneous transactions entered directly into the GL, the GL’s primary function is to act as a collection point and repository from the sub-ledgers like AR, AP and PR, i.e., the financial transaction details - the distributions - from all the other applications. Once or more times per financial period you interface the distribution data produced out of each of the sub-ledgers and post it into the GL.

After that, you use the repository for analysis and reports of the company’s performance as a whole. This financial data is distinguished from production data coming out of the sub-ledger – data like shipments per day or weeks and inventory count data. In the GL your main tools are queries, Trial

Balance listings, and Financial Statements. Details on these functions are available at <https://pass-port.com/general-ledger>.

The net effect of the consolidation of the data from a number of applications for each month is the standard metrics that indicate the health of, or problems with, the business: Liabilities and how they have changed in the period, Receipts and their direction of change, Cash in bank, other Assets, Gross Profit, Net profit, Labor costs and a break-down of overheads by different categories.

These metrics become more powerful when you use the built-in Rationing function to calculate the Percentage Ratios that the individual reporting lines represent as a proportion of that month's gross sales. This way expenditures and overheads can be directly related to revenue.

Other features in the tool set include: Comparatives for comparison with prior years, Source and Application of Funds (SAF) reporting that allow you to see the movement of funding, liabilities and assets through the business and, if you are running multiple companies, a roll-up process allows you to pull together the individual Balance Sheets and Profit & Loss Statements from each of the individual companies. These and others are described in the above link.

What does it give you?

The General Ledger gives you the ability to recap a period (month or quarter or year) determining net change in assets and liabilities, gross and net profit. It provides sub-reports for both the Balance Sheet and the Profit and Loss statement that allow you to drill down into specific functional areas of the company e.g., what are my payroll or insurance expenses in comparison with changes in my sales volume.

Two additional benefits - the GL program aids the traditional accounting techniques in performing the period end and year end accounting closings (reconciliations and balancing etc.). In terms of security and integrity, the structure of PBS provides a clear line of descent between an initial transaction and its effect in the General Ledger. You can trace an AP voucher from the GL back into the Vendor History to see how a particular number got into the GL and, in reverse, from the Vendor History you can see how a particular vendor invoice and its payment were recorded as distributions in the GL.

Separately, diagnostic tools such as the Source Cross Reference report allows you to investigate specific sets of postings when closer scrutiny is needed or some research needs to be done.

What do you invest?

The main investments that the business owner will make will be a) the cost of obtaining the General Ledger module and installing it and b) the design of a consistent and organized chart of accounts – one that is suitable specifically for the business it is supporting.

For the first of these, a Return-on-Investment calculation can be done, and the GL software pays for itself in less than a year if it saves the staff one to two hours per month (assume a pay rate between \$50 and \$100 per hour.)



For the second, this will require some senior staff time to take a template type of Chart of Accounts (Passport has several available) and modify it for your specific use. This investment is significant – several man days overall – but actually should have already been done in some form and to some degree just as a matter of organizing the business and controlling the flow of costs and revenues. Some tweaking should be done with the aid of your accountant. (The Chart itself will be somewhat dynamic in the sense that, over time, there will almost always be additional accounts to be added and some existing accounts to be split or used differently from the original expectations.)

With the Chart in hand, Financial Statements will need to be designed and built. These can be no more than a simple Balance Sheet and P&L or they can be 20 or more reports and sub-ledgers providing an expansive and detailed look at the business. The process of making/revising financial statements can be dynamic in the sense of you can start small with a limited number of reports and then build reports, adding them to the month-end process as business needs and inspiration dictate. You, or a PSI Partner can create these and modify them as business requirements change.

Once these setups are done, the GL almost takes care of itself. This is why we referred to it as “passive” above; and this point is being made in the sense that, providing you regularly move the data that is automatically accumulated in the sub-ledgers like AR and AP into the General Ledger, and providing you verify that these data are correct, the Financial Statements can simply be run and the results should accurately summarize the state of business.

So why not?

There are various reasons why people think they don't need or can't use a GL. Some possible examples:

“My accountant does this for me.” You are paying your accountant to do this - money. As mentioned, since the GL is essentially a passive application, to a significant degree you are paying for something that, once set up, can be operated essentially for nothing. But there is also hidden cost that I have come across a number of times. With no central repository for the financial data, you either have to rely on your accountant and phone calls/emails to get this data or you have to (laboriously) construct the data from existing PBS reports. To put a point on this: if you are doing this late on a Sunday night to catch up to get your books current, you typically can't call your accountant.

“I don't know accounting.” This may be a partially good excuse; but ... As a business person you have to be aware of, and somewhat familiar with debits and credits. Realistically your competency will probably never be the equivalent of your account's but, in an hour or two of study you can learn the basics which will allow you to understand the flow of data into the GL, the different sections of a Chart of accounts and how they are used to create it, and how to read a financial statement. (Passport or your Passport Partner can help you with this.) If you already know this stuff, then you can already use the General Ledger. If you don't, this knowledge could be a major leg-up on seeing what is good and bad with your business processes.

“I don't have time”. Some combination of spread sheets and using your accountant to fill in the gaps may save you some time. However, the process is not formally solid – if you need more information for a bank loan, or if you are audited, a logical and known solid process with monthly controls and reconciliation leading to a Trial Balance and auditable Financial Statements puts you into a much better

position to take these on. This is over and above the issues already discussed relating to availability of reports to help running the business. Since the GL is “passive” and operationally requires the same or less monthly care for closings than what you are spending now, the real question is can you find the time to invest in getting the GL started? Most companies have a slow period in the year, and that might be a good time to consider getting your GL going.

“We are too small to be worth it”. Every business process has overheads and it is possible, especially if you are a small cash-based business with just a couple of people, that size may be the determining factor. However, once you are issuing a sufficient number of invoices with Terms so that you want an Accounts Receivable and, similarly, for expenses needing an AP, then you are in the “territory” where the GL should be useful. Recall that the main purpose of the GL is to consolidate data from sub-ledgers like AR and AP. Once you have two or more sub-ledgers, then the GL should be useful. And it will lighten the load that you carry around in your head or at least relieve it of details, allowing you to instead focus on making more business happen!