

# Passport's General Ledger

## Highlights and Insights

### Introduction

#### □ Motivation for Webinar:

- We sometimes have the impression that, for some, the GL is basically a black box that produces financial statements.
- It is that, but it is also more and to understand that requires opening the black box and seeing the gears so to speak.

# Passport's General Ledger

## Highlights and Insights

### Introduction

- In this session we want to talk about some of the maybe not so obvious things that can be done in the GL. But, to do that, we need to take a look at some fundamentals of accounting and how the GL works with them so it can provide these features.

# Passport's General Ledger

## Highlights and Insights

### Introduction

This first part (today) will be the theoretical part so we can understand things like:

- Why transactions have to be balanced and how that affects dates?
- Why are some of the GL accounts “backward”, i.e., they are credits when you might think they should be debits?
- What things happen when you close the year?
- What does “Retained Earnings” represent?

# Passport's General Ledger

## Highlights and Insights

### Introduction

In later sessions we will talk about:

- What is out-of-period posting and why it can be a problem
- How to detect out-of-balance transactions
- Time shifting transactions via accruals
- Special ways of running the Trial Balance



# Passport's General Ledger

## Basics

- The BOX: From an accounting point of view a corporation is box (empty or filled).
- The box is just a container (think cardboard) – and has no inherent value. It is the contents that are put into the box and the ones that are taken out that count.
- This view may be a bit idiosyncratic but bear with me...

# Passport's General Ledger

## Basics

The BOX and its valuable contents:

(This might also represent the state of some people's record keeping.)



# Passport's General Ledger

## Basics

Any value coming into the corporation (asset) has to be offset by who or what that asset does (or will) belong to (liability). This is the principal of zero balance.

Two quick examples:

- Startup – equity partners lend 250K (**credit**/loan) => cash (**debit**/asset). We will revisit this later with respect to Retained Earnings.
- Purchase inventory - use/reduce (cash/**credit**) => increase Inventory (**asset**/debit)

# Passport's General Ledger

## Basics

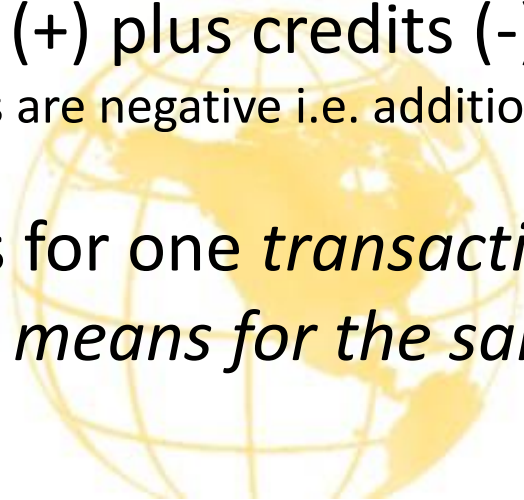
Box has two sections:

- Assets & Liabilities are in the Balance Sheet section
  - This is the value of the business:
  - If you were to sell the business at this minute, the net i.e. the sum, of all the Balance Sheet accounts would correspond to the value of the business. (Market factors not included).
- Operations section
  - The record of transactions – sales and costs and expenses that provide the statistics leading to the profitability of the enterprise for up to the minute info and for prior periods.
  - These can be actual or calculated (e.g. depreciation for a

# Passport's General Ledger

## Basics

- Since every individual transaction has to balance (debits = credits), that means that each transaction has to net to zero, i.e., debits (+) plus credits (-) = zero. (Remember debits are positive, credits are negative i.e. additions are signed)
- This always applies for one *transaction set* (debits and credits) *which also means for the same date.*



# Passport's General Ledger

## Basics

- If all transactions individually net to zero, then the sum of *all entries in the Trial Balance* must net to zero.
- Accruals are the way you can “time shift” transactions that actually take place over different dates --- later



# Passport's General Ledger

## Basics

Balance Sheet = negative Operations (Profit & Loss)  
or  $B/S + P\&L = 0$

### Three possibilities

- Transactions affecting just Bal/Sheet (e.g. Cash to Purchase inventory) will net to zero within the Balance Sheet i.e. no effect on the net B/S
- Similarly, transactions affecting only Operations (e.g. a payroll expense for regular salary reclassified to holiday pay) has no effect on Operations.
- Transactions that affect both always have the Bal/Sheet portion plus the Operations portion add to zero (e.g. a cash sale debits Cash (B/S asset) and credits Revenue (Operations)).

# Passport's General Ledger

## Basics

This leads to the “Master” equation; () means typical value:

$$\text{Assets (Db) + Liabilities (Cr) + Stockholder/Equity (Cr) + Operations (Cr) = 0}$$

Which just another way of saying the net of the Trial Balance must be zero as above.

We will return to this later in a later session in discussing Cash Flow/ SAF.

# Passport's General Ledger

## Basics

A “reclass” transaction takes one (or more) values in one or more accounts and reverses them (not necessarily for the same date). You then also put the value(s) back into other account(s) presumably with the same date as the reversal.

- Example reclassing a costing transaction from Cost of Sales to Overhead:
  - Existing trx :      Db CoS,                      Cr Inventory as of Date-1
  - Reversing entry: Cr CoS,                      Db Inventory as of Date-1 or Date-2
  - Make corr. entry: Db Inven Ovhd, Cr Inventory as of Date-1 or Date-2

# Passport's General Ledger

## Basics

- Besides fixing errors in account numbers or distribution dates, one common use of reclassing is to “park” a transaction that needs to be researched in a “holding account” and later move that value to the account it best fits.
- This is common when an expense entry is not clear as to its classification.
- Of course, reclass transactions must obey the net zero balance rule

# Passport's General Ledger

## Basics

### Puzzlements and Contradictions ???

- When I do a deposit to my account at the bank, that deposit is marked as a credit. And when I cut a check on my personal account that is marked as a debit. That is the opposite of what you have here. ????
- Revenue is a credit but because ultimately it becomes cash (asset) – that doesn't make sense. ????

# Passport's General Ledger

## Basics

### Puzzlements and Contradictions ??? - contd

- When I run my P&L Statement (net sum of the Operating accounts) why is a profitable period one that has a net credit value. ???
- What happens at year end closing ???  
Operations are summarized to a single figure (profit- Cr or loss-Db) for the year and that value is moved to the *Retained Earnings* account in the Balance Sheet. By moving a credit (profit) or debit (loss) to the Balance Sheet we are, in effect, posting an offsetting debit (or credit) to the P&L which effectively clears the P&L for that year's transactions.
- The Retained Earnings account is a form of Liability to the stockholders

# Passport's General Ledger

## Next Time(s)

- A brief review of the operational steps leading to ...
- Trial Balance
- Financial Statements (F/S)
  
- And possibly in a third installment - interesting things that you can do in the GL
  - Budgets Comparatives
  - Relation to F/S
  - Ratios in the F/S
  - Sleuthing problems
  - SAF/Cash reports



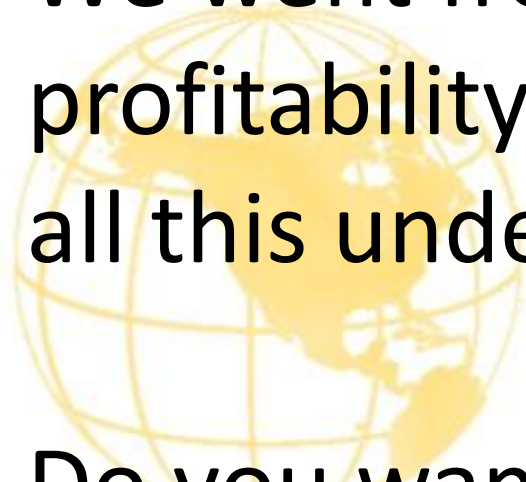
# Questions

How did we do on this?

We went from cat-in-the box\* to profitability as P&L credit. Was all this understandable?

Do you want to continue this discussion?

(\*apologies to Seuss)



# **Need some help?**

**Contact your Passport Partner!**

**Or call us at:**

**800-969-7900 Ext. 103**

**[psi@pass-port.com](mailto:psi@pass-port.com)**

