

The Bookkeeper's Secrets
Book 4
Double Entry Bookkeeping Procedural
Details

Book 4c - Journal Entries

Everyone has Secrets

The discoveries continue with the introduction of the General Journal (the General Ledgers younger twin friend), Inventory magic tricks and an Aggregated Statement Reconciliation process that will save you precious time for LIFE!

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Forward

See Book 1 for now...

Ch 1: Book 3b Review and Book 3c Introduction

In Book 3b:

1. We introduced the **THREE** Key reports everyone needs for small business, personal and household accounting. You realized it's really only two types of reports in three formats.
 - a. Net Worth Statement
 - b. Net Income Statement
 - c. Comparative Net Worth Statement
2. We provided **TWO** questions that everyone should be able to ask themselves and answer without emotion in order to assess their own financial health and that of those they might engage with or support commercially.
 - a. How much are you worth (financially)?
 - b. How much Money do you make each day, week or month?

We provided insight into the vagueness of question two and introduced the GROSS vs NET concepts that can be used to clarify those requests.

We showed the very direct connection between the financial health related questions and the three key accounting reports and we showed how the third report can be used as a cross check for the first two.

3. We demonstrated how **ONE** Data Table called a General Ledger could be used for all the reporting needs.
 - a. We discussed the somewhat odd way it was composed with two line items for each transaction and with an occasional sign flip that was not intuitive until you knew the rules
4. We introduced **ALIEE**, an acronym for the five major Account Types which are Assets, Liabilities, Income, Expense and Equity.
 - a. We also covered a sixth type called Cost of Goods Sold which is just an Expense Subset
5. We introduced one line Asset and Liability Journals. We provided practice converting one line Journal Entries into two line General Ledger Entries
6. We introduced a two line General Journal. You learned that Journal mimics the General Ledger behavior and simply feeds the General Ledger when no other Journals are a match for a transaction.

7. We introduced a new kind of Software for Accounting Education and Use.
8. We briefly discussed the lack of a formal need for Debits and Credits although they may come into play for some of you AFTER you master this without them.

And you got all of that in 35 pages of text. Nothing more and nothing less, with little distraction and no misdirection. Very refreshing for Accounting Education.

In Book 2, this book, we are going to cover

- Journal Entries that are confusing for some and advanced concepts..
- Owner Paychecks and Paychecks in general
- Owner Draws
- Adjusting entries for Inventory

Introduction to Schedule C...

Introduction to the Structured Chart of Accounts...

The Tax Account vs Cost Accounting divide...

Ch 2: Journals and General Ledger - A review

A Journal, be it for an Asset, a Liability or the General Journal, is like a diary or a notepad.

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Monthly Fee (Bank)	10_ Commissions and fees	-10	Decrease by 10

The General Ledger is a Magic Data table that helps with report generation. It's almost like a manual computer. One line Journal entries from single line journals have to be converted to stacked pairs for the system to work.

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Monthly Fee (Bank)	Checking 6677	-10	Asset
1/4/2016	Monthly Fee (Bank)	10_ Commissions and fees	10	Expense

There are typically three types of Journals used in Small Business Accounting:

1. Asset Journals For Checking Accounts and Accounts Receivable for example
2. Liability Journals For Credit Cards and Lines of Credit for example
3. General Journal For things that don't fit into other Asset and Liability Journals

You do NOT keep separate Journals for Income, Expense or Equity Accounts as all the information related to them is documented as a byproduct of the journals above.

This will make more sense with use.

Checking Journal

This is for review only. There is no new information here. The image below is a checking journal. This journal uses “signed amounts” instead of debits and credits. The signed amount associates with the Journal Master Account not necessarily with the category (account 2) for the transaction. The value associated with the category may or may not be the same sign.

	A	B	C	D	E	G	H	I	J	K
6	Chk6677_				01/27/2017 >> \$36,178.33 271 transactions	John Doe Acupuncture				
7						Row Count	ON	Chrono. Order	ON	
8	Post Date	Payor/Payee	Amount	s Acct2	Comment	txnID	Acct1	Row#		
10										
11	12/31/2015	Starting Balance	\$3,010.10	99_opening_bal	Asset	0	Chk6677_	11		
12	1/4/2016	Monthly Fee for Bu:	-\$16.00	10_ Commissions and fees		1	Chk6677_	12		
13	1/4/2016	Herbs R Us	-\$418.63	36_ COGs-Resell Items		2	Chk6677_	13		
14	1/8/2016	Check 3449	-\$475.00	20b_ Rent - not equipment	Bob Smith, Landlord	3	Chk6677_	14		
15	1/11/2016	Check 3462	-\$1,200.00	20b_ Rent - not equipment	Stephanie's Propertie	4	Chk6677_	15		
16	1/15/2016	Counter Credit	\$2,802.23	01_ Gross Receipts or Sales		5	Chk6677_	16		
17	1/15/2016	Online Banking trar	\$3,100.00	01_ Gross Receipts or Sales		6	Chk6677_	17		
18	1/15/2016	Online Banking trar	-\$2,300.00	Owner Draw-JD		7	Chk6677_	18		
19	1/20/2016	Counter Credit	\$1,699.80	01_ Gross Receipts or Sales		8	Chk6677_	19		
20	1/20/2016	Online Banking trar	\$2,000.00	01_ Gross Receipts or Sales		9	Chk6677_	20		

K	L	M	N	O	P
Chronological Order					
	Chrono Date	Payor/Payee	Amount	Running Bal	
	12/31/2015	Starting Balanc	3010.10	\$3,010.10	
	1/4/2016	Monthly Fee fo	-16.00	\$2,994.10	
	1/4/2016	Herbs R Us	-418.63	\$2,575.47	
	1/8/2016	Check 3449	-475.00	\$2,100.47	
	1/11/2016	Check 3462	-1200.00	\$900.47	
	1/15/2016	Counter Credit	2802.23	\$3,702.70	
	1/15/2016	Online Banking	3100.00	\$6,802.70	
	1/15/2016	Online Banking	-2300.00	\$4,502.70	
	1/20/2016	Counter Credit	1699.80	\$6,202.50	
	1/20/2016	Online Banking	2000.00	\$8,202.50	

The signed amount's association with the Master Account for the Journal makes sense when you look at the Running Balance column. You can see that positive or negative value affecting the running Balance.

Credit Card Journal

The image below is a credit card journal. The signed amount associates with the Journal Master Account not necessarily with the category (account 2) for the transaction. The signed amount associates with the Journal Master Account not necessarily with the category (account 2) for the transaction. The value associated with the category may or may not be the same sign.

6	CC8899_		12/02/2018 >> \$12,272.31 338 transactions		John Doe Acupuncture				
7			Row Count	ON	Chrono. Order	ON			
8	Post Date	Payor/Payee	Amount	Acct2	Comment	txnID	Acct1	Row#	
9	338	338	338	0	338	2	337	338	338
11	12/9/2015	Starting Balance	\$1,700.01	99_opening_bal_Liability		0	CC8899_	11	
12	12/10/2015	OFFICE DEPOT #999	\$271.65	18_Office Expenses		10	CC8899_	12	
13	12/21/2015	Tom's Catering Hallf	\$2,500.00	24b_Meals and Entertainr	jj	11	CC8899_	13	
14	12/28/2015	Online payment from Cl	-\$2,245.67	Chk6677_	no matching txn in cl	1	CC8899_	14	
15	1/4/2016	PANDORA*INTERNET	\$4.99	18_Office Expenses		12	CC8899_	15	
16	1/4/2016	ROUND TABLE PIZZA	\$14.16	24b_Meals and Entertainr		13	CC8899_	16	
17	1/5/2016	TLG*PRIVGRD52XXX2	\$14.99	18_Office Expenses		14	CC8899_	17	
18	1/7/2016	Amazon.com	\$6.46	18_Office Expenses		15	CC8899_	18	
19	1/8/2016	PURCHASE *FINANCE	\$68.11	16b_interest not mortgage		2	CC8899_	19	

This is a full repeat of the section prior except notice that the values next to expense items here (like office expenses) were recorded as positive instead of negative. That is because these values are associated with purchases made with a Credit Card (a Liability Account) as opposed to with a Check or Debit Card (an Asset Account). When the purchase is made, the 'outstanding balance' on the credit card went up, thus it's positive in this journal so it can affect the running balance properly.

Chronological List				
Date	Payor/Payee	Amount	Running Bal	
338	338	338	12272.31	
12/9/2015	Starting Balance	1700.01	\$1,700.01	
12/10/2015	OFFICE DEPOT #99	271.65	\$1,971.66	
12/21/2015	Tom's Catering Hallf	2500.00	\$4,471.66	
12/28/2015	Online payment from	-2245.67	\$2,225.99	
1/4/2016	PANDORA*INTERNET	4.99	\$2,230.98	
1/4/2016	ROUND TABLE PIZZ	14.16	\$2,245.14	
1/5/2016	TLG*PRIVGRD52XX	14.99	\$2,260.13	
1/7/2016	Amazon.com	6.46	\$2,266.59	
1/8/2016	PURCHASE *FINAN	68.11	\$2,334.70	

The signed amounts make sense when you look at the Running Balance column in context.

General Journal

This General Journal uses signed values and it is a two line entry system like the General Ledger which it feeds into along with all other Journals.

	A	B	C	D	G	H	I	J	K
6	General Journal								JOHN DOE
7	Next Journal Entry		2					Row Count	ON
8	Post Date	Description/ Payor/Payee	Account	Signed Amount	Acct Type	s	ZID	Comments	Journal Entry Id
10									
11	12/3/2018	Inv Adju	Inventory	2500	Asset				1
12	12/3/2018	Inv Adju	36_ COGs-Resell Items	-2500	COGS			NUTRITION	1

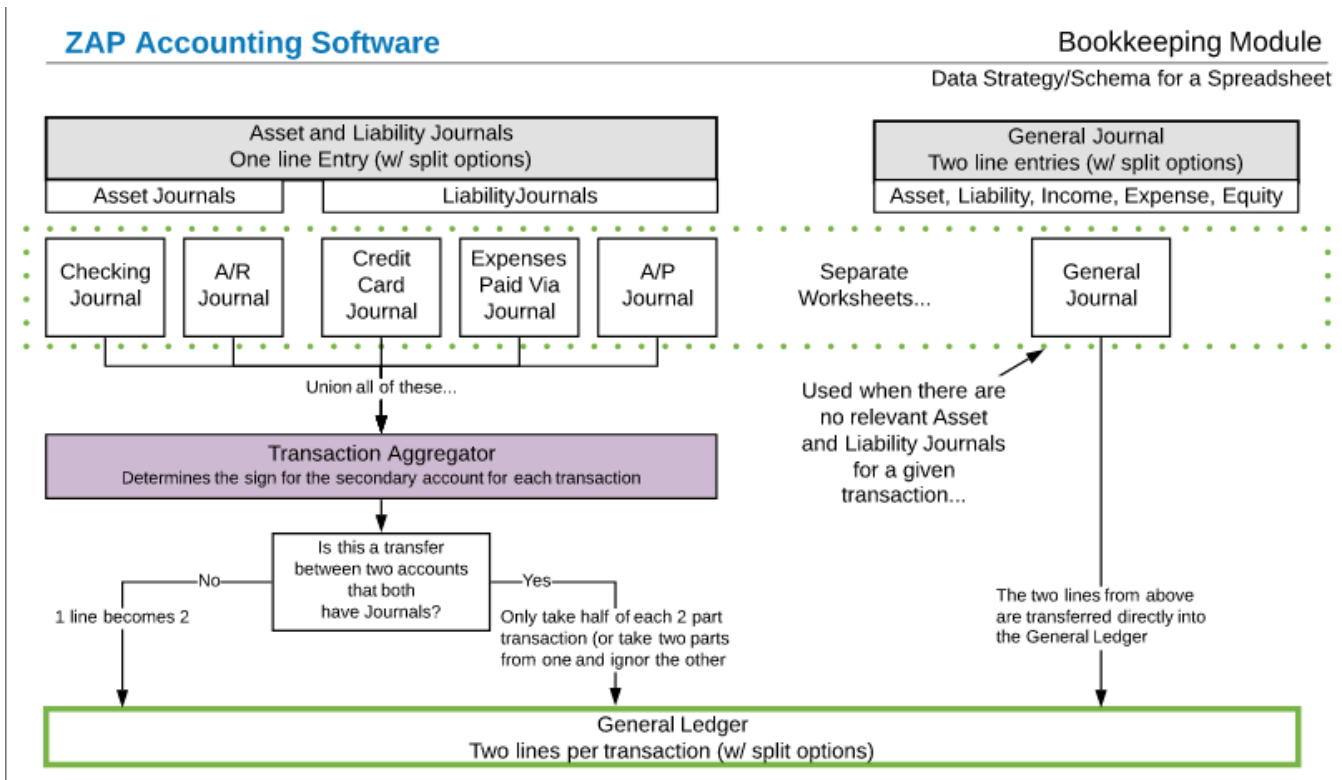
General Ledger

This general ledger uses signed values. The most important thing to note is the way in which there are two records for every transaction and remember that no transactions are entered in here directly. They are all fed into this from Journals.

	A	B	C	D	G
6	General Ledger				
7					
10	Post Date	Description Payor/Payee	Account	Signed Value	AcctType
12					
13					
25	1/2/2016	GOOGLE *SVCSAPPS_jol	ExpPaidVia	5.00	Liability
26	1/2/2016	GOOGLE *SVCSAPPS_jol	18_ Office Expenses	5.00	Expense
27	1/4/2016	Monthly Fee for Business F	Chk6677_	-16.00	Asset
28	1/4/2016	Monthly Fee for Business F	10_ Commissions and fee	16.00	Expense
29	1/4/2016	Herbs R Us	Chk6677_	-418.63	Asset
30	1/4/2016	Herbs R Us	36_ COGs-Resell Items	418.63	COGS
31	1/4/2016	PANDORA*INTERNET RA	CC8899_	4.99	Liability
32	1/4/2016	PANDORA*INTERNET RA	18_ Office Expenses	4.99	Expense
33	1/4/2016	ROUND TABLE PIZZA	CC8899_	14.16	Liability
34	1/4/2016	ROUND TABLE PIZZA	24b_ Meals and Entertain	14.16	Expense
35	1/5/2016	GOOGLE *Google Storage	ExpPaidVia	1.99	Liability
36	1/5/2016	GOOGLE *Google Storage	18_ Office Expenses	1.99	Expense

Ch 3: The DIAGRAM for Journals and the General Ledger

If you can remember this or read it, you should always be able to keep your understanding of the general flow of accounting data simple.



Ch 4: Key Journal Entries

Level 1 - Easy Journal Entries that are confusion free

The most common journal entries in order of frequency for most small businesses are below.

Description	Account 1 & Account 2	Journal Entry Sign	Logic for Acct 1 (Journal and General Ledger)	General Ledger Entry Signs	Logic for Acc2 in General Ledger
Credit Cards are used for expense items	Liability & Expense	Credit Card Journal +	The credit card balance goes up when you purchase something.	Liability + Expense +	"How much have you spent on expenses this year " - a positive value is referenced
Debit Cards or checks are used for expense items	Asset & Expense	Checking Journal -	The checking balance goes down when you purchase something	Asset - Expense +	"How much have you spent on expenses this year " - a positive value is referenced
Income deposited or transfered into a checking account	Asset & Income	Checking Journal +	The checking balance goes up when you deposit something	Asset + Income +	"How much have earned in income this year " - a positive value is referenced

These three types of entries were covered in detail in Book 1. Most people get the hang of these in just a minute or two. See Book 1 for examples of these.

Level 2 - Reversing Level 1 Entries...

Returning purchases is common. Reversing income is not nearly so common but we included here for completeness. That would happen if you were ever over paid for something and you had to return some of that money to the source.

Description	Account 1 & Account 2	Journal Entry Sign	Logic for Acct 1 (Journal and General Ledger)	General Ledger Entry Signs	Logic for Acc2 in General Ledger
Return of an expense item purchased with credit card	Liability & Expense	Credit Card Journal -	The credit card balance goes down when you return something because you owe the cc company less money. .	Liability - Expense -	"How much have you spend on expenses this year " - a positive value is referenced and you are reversing a prior increase.
Return of an expense item purchased with Debit Cards or checks	Asset & Expense	Checking Journal +	The checking balance goes up when you return something because you get money back.	Asset + Expense -	"How much have you spend on expenses this year " - a positive value is referenced and you are reversing a prior increase.
Return of Income from a checking account when you were overpaid	Asset & Income	Checking Journal -	The checking balance goes down when you return money that was given to you as income.	Asset - Income -	"How much have earned in income this year " - a positive value is referenced and you are reversing a prior increase.

Level 3 - Transfers between Asset and Liability Accounts

Something that happens all the time is transfers between Checking and Credit Card accounts for purposes of making a payment on the credit card balance.

Users will oftentimes get the Journal Entry for the Checking account correct. But when they get to the Credit Card Journal the wheels fall off for no good reason.

This was demonstrated in Book 1, but here it is again in Book 2.

Checking Journal reads...

Date	Pay To/Pay From/Description	Account	Amount	Running Balance
1/29/2016	To Credit Card for Payment	CreditCard 8899	-500	Decrease by 500

Credit Card Journal reads...

Date	Pay To/Pay From/Description	Account	Amount	Running Balance
1/29/2016	From Checking for credit Card Payment	Checking 6677	-500	Decrease by 500

The checking account entry references the credit card and visa versa for the other. If money is transferred from one checking account to the other, each account simply points to the other in a similar fashion.

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/16/2016	Credit Card Payment	Checking 6677	-500	Asset
1/16/2016	Credit Card Payment	CreditCard 8899	-500	Expense

!! VERY IMPORTANT - STOP THE PRESSES !! - ONLY THE JOURNAL ENTRY FROM THE PAYING ACCOUNT IS TRANSFERRED TO THE GENERAL LEDGER AS TWO RECORDS AND THE JOURNAL ENTRY IN THE RECEIVING ACCOUNT IS IGNORED!!! ANOTHER WAY TO LOOK AT THIS IS THAT ONLY ONE RECORD IS CREATED IN THE GENERAL LEDGER FOR EACH JOURNAL ENTRY NOT TWO AS IS ALWAYS THE CASE IN OTHER SITUATIONS!?! This is a big deal when it comes to software handling too. This situation when two Accounts with Journals affect each other is the only situation in which you get a duplicate journal entry management situation.

Note: Money flowing from the Credit Card to the Checking Account is very rare as that would be a cash advance and it is extremely costly as the credit card companies charge obscene rates in the 30% range for things like that. That would actually look the same but the values would both be positive.

Level 4 - Paid in Equity -- (Your Equity Account makes you The King of your Kingdom)

For small companies, the only time you might typically use a "Paid in Equity" Account allocation is with the very first deposit you use to open the account as you are starting the business. Think of it as a gift from the owner(s) of the company to the company to get going.

For larger companies, the Paid in Equity account or comparable would document the proceeds from initial stock sales. After they sell the stock once, they don't get to sell it again. That makes all stocks that do not pay any dividends at all a ponzi scheme by a definition provided by the SEC themselves, but that is for you to discover here (<https://twitter.com/theponzifactor>).

Description	Account 1 & Account 2	Journal Entry Sign	Logic for Acct 1 (Journal and General Ledger)	General Ledger Entry Signs	Logic for Acc2 in General Ledger
Money deposited into a checking account for establishing ownership stake in a company	Asset & Equity	Checking Journal +	The checking balance goes up when you deposit something	Asset + Equity +	" How much of a company's cash is from start up money or the sale of ownership " - a positive value is referenced.

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Startup Money from Owner	Paid in Equity	500	Increase by 500

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Startup Money from Owner	Checking 6677	500	Asset
1/4/2016	Startup Money from Owner	Paid in Equity - {Your initials}	500	Equity

!! IMPORTANT !! -- Business dogma says that once equity is paid in, you don't take it out. It's dogma and semantics, but try to hold to it from a bookkeeping perspective. If / when you take it out you won't reverse the transaction, you'll do it a different way as an "owner draw". We'll show that later. .

If you wanted to start a new business out with \$2000 make two deposits: one for \$100 and one for \$1900. Categorize the first deposit as "Paid in Equity" and categorize the second as "A Loan from you to the company that is intended to be repaid" . The account name given to self loans is traditionally called a "Due to" account. See next section for more on this. .

Level 5 - "Due to {YOU}" Account -- (Your Due To Account makes you your own banker!!)

When your company needs cash, like for startup or during lean times when your revenues aren't covering your expenses, one thing you can do is personally "lend money" to your company. This is typically done without interest, but I guess you could over complicate things by adding interest if you'd like.

From the company's perspective, the person lending the money to the company is the liability account owner. So, if you lend your company money, you are the banker for that loan, just like your bank is the banker for your credit card account in their name.

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Loan from me to my company	Due to John Doe	500	Increase by 500

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Loan from me to my company	Checking 6677	500	Asset
1/4/2016	Loan from me to my company	Due to {your initials}	500	Liability

!! IMPORTANT !! - The general nature of the entries for this and the Paid in Equity transaction in the prior section are identical down to all the signs and everything. The only difference is that "Paid in Equity" is an "Equity" account and not expected to be repaid and "Due to John Doe" is a liability account and expected to be repaid.

Notice how the liability shows up in the Top of the Comparative Net Worth Statement while the Equity will show up in the Bottom of the Comparative Net Worth Statement. Both just represent money in a checking account but its interesting how different they look on that Comparative Net Worth Statement.

A	B	C	D	E	H	I	J	K	L	M	P	AB
6	Balance Sheet											JOHN DOE ACUPUNCTURE
7	Printed: 2/29/2020											1010 Wellness Road, San Jose CA 95002
9	Balance Sheet Trial Balance											ON
10	Report Date		12/31/2016	NW1 (Assets - Liab)	\$22,784.11	NW2 (Equity)	\$22,784.11	Difference	\$0.00			
11	Company Net Worth (method 1)											
12	Assets											
13	Chk6677		\$34,174.19	GL sum as of COB 12/31/2016 (1)								
14	Chk0002		\$0.00	GL sum as of COB 12/31/2016 (1)								
15	Inventory		\$0.00	GL sum as of COB 12/31/2016 (2)								
16	Total Assets >>		\$34,174.19	Total Assets								
18	Liabilities											
19	CC8899		\$11,306.20	GL sum as of COB 12/31/2016 (1)								
20	CC0002		\$0.00	GL sum as of COB 12/31/2016 (1)								
21	Due to JD		\$0.00	GL sum as of COB 12/31/2016 (2)								
22	ExpPaidVia		\$53.88	GL sum as of COB 12/31/2016 (1)								
23	Total Liabilities >>		\$11,390.08	Total Liabilities								
25	Company Net Worth (Method 1) >>>		\$22,784.11	Total Assets - Liabilities (aka Equity)								
27	Company Net Worth (Method 2)											Report Dates: 10/1/2016 to 12/31/2016
28	Starting Net Worth	starting NW	\$20,853.97	GL sums as of OOB 10/01/2016								
29	Net Income	since then...	\$10,514.56	GL Sums (10/01/2016 - 12/31/2016)								
30	Paid In Equity-JD	since then...	\$0.00	GL Sum (10/01/2016 - 12/31/2016)								
31	Owner Draw-JD	since then...	-\$8,584.42	GL Sum (10/01/2016 - 12/31/2016)								
33	Company Net Worth (Method 2) >>>		\$22,784.11	Prior Equity Plus Deltas								

When you are ready to pay yourself back, it looks like this. In this case we are only repaying 200 of the 500 so there would still be a 300 balance in the Due To Account.

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Paydown of Loan Balance	Due to John Doe	-200	Increase by 500

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Paydown of Loan Balance	Checking 6677	-200	Asset
1/4/2016	Paydown of Loan Balance	Due to John Doe	-200	Liability

Level 6 - "Payroll to You" vs "Owner Draws" (Your first time being your own Controller too!!)

As the owner of a company you can take money out two ways. Actually there are more, but there are two common ways.

1. Payroll / Paycheck - You pay yourself via a paycheck. It is categorized as an "expense" and it is visible as an expense on the Net Income Statement for the Company.
2. Owner Draw - You pay yourself via check or transfer and categorize that as "an owner draw". Owner Draw is a counter-Equity account (aka a contra-equity account). These transactions are only visible on the bottom half of the Comparative Net Worth statement during the period in which they transpire.

All "paychecks" are subject to all applicable Federal taxes, State Taxes, and approximately 15% for the combined bundle of Social Security Tax (Insurance)/Unemployment Insurance/Medicare.

All "owner draws" are checks or transfers to the owner. They are NOT subject to the 15% tax bundle, but they are subject to the rest of the Federal and State Tax items.

Given that, as a small business owner, why would you ever want to take a paycheck right?!?

In summary the IRS requires you to take a minimum salary subject to social security. The amount isn't defined (isn't that odd?). Most folks seem to think the minimum is around \$2000/month but it's supposed to be enough to cover your basic home expenses, and it's up to you and your CPA to decide (again, kind of odd, huh?).

So, if you don't hire a payroll company and get paychecks or checks configured for less deductions as owner draws, you will still be subject to all federal, state and Social security bundle related taxes, so plan for that one way or another.

For a Paycheck...

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Pay check for JD/Self	26_ Wages	-2000	Increase by 2000

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Pay check for JD/Self	Checking 6677	-2000	Asset
1/4/2016	Pay check for JD/Self	Due to John Doe	2000	Expense

For an Owner Draw...

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Check for JD/Self	Owner Draw - JD	-2000	Increase by 2000

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Check for JD/Self	Checking 6677	-2000	Asset
1/4/2016	Check for JD/Self	Check for JD/Self	-2000	Equity

!! important !! - The negative value for the Equity may seem confusing if you don't take the proper perspective. Think about this from the perspective the company, not you the owner of it. The equity in the company was reduced by \$2000 when the owner took the money out for his/her self.

A SideBar on the Social Security Bundle

The actual rate for Social Security and Unemployment Insurance is approximately 15% of your wages. If you work for a company or get a check from your company for payroll, you'll notice that only around 7.5% of this part of your tax/insurance burden is noted on your paycheck. They call the other half payment from your company a "benefit". This is mental hog wash. This is designed to get you to forget about that 7.5% required tax/insurance burden that is being placed on your energy so you can't make apples to apples comparisons with more socialized systems where more seems to be taken out, but the government provided benefits far outweigh our government or private insurance benefits. This omission is what is referred to as a Psychological Operation (aka Psy Op) in action. Even if we talk about this now, and you get it now, you still won't include it in your future calculations easily as doing so will contradict your prior belief system that just let this belief in whonky benefits go.

Ch 5: Summary of Owner Deposits and Owner Withdrawals...

There are two ways you put money into your company.

1. Paid in Equity
2. Owner Loans to the Company

There are three ways an owner removes money from a company

1. Payroll Check
2. Owner Draw
3. Owner repayment of loans to the company

The owner draws are typically for funds beyond paychecks that one might think of as bonuses but this is also how one would properly remove equity they had initially paid in, although that is not typically done dogmatically.

Ch 6: Inventory and the General Journal Introduction

For small businesses that maintain inventory for resale,, learning to manage inventory from an accounting perspective is critical. If you don't over automate things in a way that hand ties you, it can be remarkably simple.

This was covered in an example in Book 1, so this is a second pass at this material.

Inventory Purchases

1. Inventory is an ASSET account, not an EXPENSE account. That might or might not make sense to you. In theory inventory can be sold and money can be recouped. BUT if you bought printer paper and ink for your printer but hadn't used that, that is an expense, but you could sell that for money too. Go with the flow here. Other types of expenses don't have this resale quality like an electric bill. In some very large companies, office supplies like paper and ink might actually be accounted for as assets until used. But keep it simple for now. Think of inventory as items you intend to buy and resell.

For Inventory purchase with a Checking Account

When you purchase an Inventory Item (Asset) with a Checking Account you are exchanging one asset for another

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Raul's Supplements	Inventory	-20	decrease by 20

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Raul's Supplements	Checking 6677	-20	Asset
1/4/2016	Raul's Supplements	Inventory	20	Asset

For Inventory purchase with a Credit Card

When you purchase an Asset with a Credit Card account you are increasing a liability while increasing an asset one asset for another

Credit Card Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
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1/4/2016	Raul's Supplements	Inventory	20	increase by 20
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General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Raul's Supplements	CC 8899	20	Liability
1/4/2016	Raul's Supplements	Inventory	20	Asset

Then, what?

Inventory Sales

When the Asset is sold, assume that money gets deposited into your checking account. And the books for this transaction look like this...

Checking Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Sale to Customer	01_ Revenue From Sales	20	increase by 20

General Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Sale	Inventory	-20	Asset
1/4/2016	Sale	Cost of Goods Sold	20	Expense

The General Ledger looks like this....

Date	Pay To/Pay From etc	Account	Amount	Account Type
1./4/2016	Sale	Checking	20	Asset
1./4/2016	Sale	01_ Gross Receipts or Sales	20	Income
1/4/2016	Sale	Inventory	-20	Asset
1/4/2016	Sale	Cost of Goods Sold	20	Expense

Can you imagine doing that for every sale?

There is another way to do it in an aggregated manner that is easier.

Ch 7: The Inventory Short Cut w/ a General Journal Adjustment for MaGiC time savings!

In Chapter 6 we showed the following:

1. Checking (Asset) or Credit Card (Liability) dollars are traded for another Asset (Inventory)
2. Checking Account (Asset) increases for the sale of an item (Income)
3. Inventory Account (Asset Account) decreases and Cost of Goods Sold (Expense Account) increases

Yikes. That's just too much stuff to do for every transaction, so here's what we are going to do...

When we purchase inventory we are going to claim right away it is a Cost of Goods Sold (an Expense).

1. In our accounting books, it looks like it was sold the day it was acquired.
2. In our account books, it looks like it's been sold before it's been sold.

Then, every quarter, six months or year we are going to take an inventory and we are going to "adjust" our inventory levels to what they actually are with a General Journal Entry.

This is far easier to understand with numbers...

Scenario 1 - You are new in business and your starting inventory is ZERO

You use your credit card to purchase \$500 in inventory

Credit Card Journal reads...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/4/2016	Raul's Supplements	Inventory	500	increase by 500

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/4/2016	Raul's Supplements	CC 8899	500	Liability
1/4/2016	Raul's Supplements	Cost of Goods Sold	500	Expense

At this point in time if we looked at your net income statement it would show zero in income and 500 in cost of goods sold expenses. Your net income would be NEGATIVE \$500.

If we looked at your Comparative Net Worth Statement, the top half would show an unaffected checking account, a Credit Card account that had gone up by \$500, but no other asset to show for the \$500. The bottom half would show a Net Income of 500 less than it should, and the Comparative Net Worth Statement would NOT be in balance...

On the day you want to do reporting -- let's assume it's 12/31, you will need to make an adjustment for the amount of inventory you did NOT sell and you do that by physically counting your inventory, not by tallying what you sold!!!

Assume on 12/31 you did a manual count of inventory and found you still had \$200 in inventory. That means you need to convert back \$200 of the Cost of Goods Sold Expense you estimated when you purchased to inventory for proper documentation.

The General JOURNAL needs to look something like this...

Date	Pay To/Pay From etc	Account	Amount	Account Type
12/31/2016	Inventory Adjustment	Cost of Goods Sold	-200	Expense
12/31//2016	Inventory Adjustment	Inventory	200	Asset

In English, "I had allocated all my inventory purchases directly to Cost of Goods Sold, expecting to sell them all. I didn't sell them all. At the end of the year I had \$200 left over, so I needed to reduce my Cost of Goods Sold account by 200 and increase my inventory by 200 to accurately reflect my current inventory levels.

The big deal here is this -- if you don't make this adjustment and just left this as is, you would have gotten to write off \$200 more in expenses this year than you were due to write off. This is why the tax man cares about these types of things with inventory. Money you put into inventory that you don't sell in the same year turns out to be TAXABLE INCOME because those inventory purchases do not show up on the Net Income Statement as expenses until they are allocated as Cost of Goods sold.

Do NOT try to memorize this. It's written down here for a reason. As you can see, it's easy to think through when needed.

Scenario 2 - The following year...

You start out with a \$200 inventory balance

You purchase \$300 in inventory that you allocate as Cost of Goods Sold at time of acquisition

At year end, you do a manual inventory and you only have \$100 left in inventory.

That means during the year you actually sold \$400 in inventory but you've only accounted for \$300 of it... thus you make an adjusting entry to convert some inventory into Cost of Goods Sold...

You've already allocated

The General JOURNAL needs to look something like this...

Date	Pay To/Pay From etc	Account	Amount	Account Type
12/31/2016	Inventory Adjustment	Inventory	-100	Asset
12/31/2016	Inventory Adjustment	Cost of Goods Sold	100	Expense

**When looked at like this, this is like a child's game of tit for tat.
It's just basic score keeping...**

Ch 6: The Inventory and General Journal Summary w/ a Tax EVASION & Tax SHOCK Example

The inventory examples prior give an exceptional working model of how things can work.

1. Inventory can be tracked and properly accounted for without ever associating individual sales directly with specific inventory sold
2. No automated tracking for inventory is required and in fact it is not suggested for most small businesses unless you somehow feel it will help with tracking shrinkage from employee theft and regular theft.
3. The General Journal is the place where "adjusting entries" are made that don't fit into other Journals logically and easily.
4. General Journal entries just flow into the General Ledger and they do that a little easier than other entries because they are already in a two line format.

Tax EVASION Example - Failing to make adjusting entries can bite you...

1. On 12/15 you write a check for \$30,000 for a new stocking order of supplements from a new vendor that arrived that day
2. You use the short cut system of accounting where you allocate everything to Cost of Goods Sold at the time of purchase
3. You went on vacation for two weeks starting on the 12/16 and you didn't sell any part of that order until the following year.

4. You failed to make the Adjusting entry in your accounting software that converted that \$30,000 expense to Inventory and thus, you benefitted from a \$30,000 expense reduction of income the following tax year that was not due to you...

If your effective tax rate is 20%, you actually under paid your taxes by \$6,000 and you committed tax fraud.

Tax SHOCK Example - Income Tax that is owed on Inventory Bought but not immediately sold...

Take the exact same scenario above, but this time, pretend on 12/31 you made the adjusting entry properly, reallocating the expense as an inventory.

You need to realize you will be paying Federal and State Taxes on that money you reinvested into inventory, so in fact, if you were planning correctly, to have purchased 30,000 in inventory you would have wanted to have had at least \$36,000 in the bank so when the tax bill came a few months later you had the \$6,000 to cover that reinvested income as well as any other net income you accumulated over the year...

Ch 7: Split Journal Entries

By working this way through the information, we have started with the end goal of the Critical Accounting Reports and worked our way backwards thru the General Ledger to the Journals because it's very easy to learn everything this way.

When done in reverse, it all builds on itself without any unnecessary information to remember. Instead you have a documented trail of logic to reference albeit in reverse.

Now we are going to circle back for some details that are provided first when education is reversed and you start out with Journal Entries with no idea where you are going with them.

In any accounting software program there should be a way to “split” single line journal entries up to provide more detail about a single transaction . This enables one fee to get allocated to multiple categories (accounts) or a single account with multiple, different notes. This is functionally a single transaction. It only appears on more than one line to add some clarity.

This functionality in cloud based spreadsheets is very manual and rudimentary as is the case in most other software, but it works just fine.

In the example below, a \$1000 debit card charge was made to the Director of Finance for Registration fees. That single charge was manually split over three line items in the journal to itemize the charges per Property. The Account 2 selections in this example were all the same Account 2, but they could have been different as well. That doesn't matter. The only thing that matters is that all the split items total the total charge for the transaction. A manual 's' was entered in the 's' column to bring attention to this.

Asset Journal (Checking Journal) - Split Transaction Example

	A	B	C	D	E	F	G	H
6	Chk6677_				01/27/2017 >> \$35,178.33 274 transactions			John Doe A
7							Row Count	ON
8	Post Date	Payor/Payee	Amount	s	Acct2	ZID	Comment	txnID
10								
283	1/27/2017	Dir of Finance	-\$200.00	s	10_ Commissions and fees	199_W. Lanvale St	-\$1000 txn, Reg Fees	270
284	1/27/2017	Dir of Finance	-\$300.00	s	10_ Commissions and fees	699_W. Lanvale St	-\$1000 txn, Reg Fees	270
285	1/27/2017	Dir of Finance	-\$500.00	s	10_ Commissions and fees	1699_N. Charles St	-\$1000 txn, Reg Fees	270

Checking Journal for this \$1000 transaction reads (duplicate of above in symbolic form)...

Date	Pay To/Pay From etc	Account	Amount	Running Balance
1/27/2017	Dir of Finance	10_ Commissions and Fees	-200	decrease by 200
1/27/2017	Dir of Finance	10_ Commissions and Fees	-300	decrease by 300
1/27/2017	Dir of Finance	10_ Commissions and Fees	-500	decrease by 500

General Ledger reads...

Date	Pay To/Pay From etc	Account	Amount	Account Type
1/27/2017	Dir of Finance	Checking 6677	-200	Asset
1/27/2017	Dir of Finance	10_ Commissions and Fees	200	Expense
1/27/2017	Dir of Finance	Checking 6677	-300	Asset
1/27/2017	Dir of Finance	10_ Commissions and Fees	300	Expense
1/27/2017	Dir of Finance	Checking 6677	-500	Asset
1/27/2017	Dir of Finance	10_ Commissions and Fees	500	Expense

Liability Journal (Credit Card Journal) Example

It would look identical to the prior section except the journal entries would have been positive as would have the first of the paired entries in the General Ledger

General Journal Split Transaction Example

You can take a typical two line transaction and split up one of the two parts into as many subparts as you'd like. It's still thought of as a double entry transaction as long as the two parts are equal, even if one part is comprised of subparts.

In this example the COGS part was split in two to further note the Nutrition and Herbs. Notice the Journal entry ID is the same for all three lines. That's what keeps them associated with each other. Likewise, there is an "s" in the column "s" column to denote that is a split entry. These three lines will transfer directly into the General Ledger with no changes.

	A	B	C	D	G	H	I	J	K
6	General Journal								JOHN DOE
7	Next Journal Entry		2					Row Count	ON
8	Post Date	Description/ Payor/Payee	Account	Signed Amount	Acct Type	s	ZID	Comments	Journal Entry Id
10									
11	12/3/2018	Inv Adju	Inventory	2500	Asset				1
12	12/3/2018	Inv Adju	36_ COGs-Resell Items	-2200	COGS	s		NUTRITION	1
13	12/3/2018	Inv Adju	36_ COGs-Resell Items	-300	COGS	s		HERBS	1