Basic Accounting Terms

Here is a quick look at some important accounting terms.

**Accounting equation:** The accounting equation, the basis for the double-entry system (see below), is written as follows:

Assets = Liabilities + Stakeholders’ equity

This means that all the assets owned by a company have been financed from loans from creditors and from equity from investors. “Assets” here stands for cash, account receivables, inventory, etc., that a company possesses.

**Accounting methods:** Companies choose between two methods—cash accounting or accrual accounting. Under cash basis accounting, preferred by small businesses, all revenues and expenditures at the time when payments are actually received or sent are recorded. Under accrual basis accounting, income is recorded when earned and expenses are recorded when incurred.

**Account receivable:**The sum of money owed by your customers after goods or services have been delivered and/or used.

**Account payable:**The amount of money you owe creditors, suppliers, etc., in return for goods and/or services they have delivered.

**Assets (fixed and current):**Current assets are assets that will be used within one year.

For example, cash, inventory, and accounts receivable (see above). Fixed assets (non-current) may provide benefits to a company for more than one year—for example, land and machinery.

**Balance sheet:**A financial report that provides a gist of a company’s assets and liabilities and owner’s equity at a given time.

**Capital:**A financial asset and its value, such as cash and goods. Working capital is current assets minus current liabilities.

**Cash flow statement:** The cash flow statement of a business shows the balance between the amount of cash earned and the cash expenditure incurred.

**Credit and debit:** A credit is an accounting entry that either increases a liability or equity account, or decreases an asset or expense account. It is entered on the right in an accounting entry. A debit is an accounting entry that either increases an asset or expense account, or decreases a liability or equity account. It is entered on the left in an accounting entry.

**Double-entry bookkeeping:** Under double-entry bookkeeping, every transaction is recorded in at least two accounts—as a credit in one account and as a debit in another.

**Financial statement:** A financial statement is a document that reveals the financial transactions of a business or a person. The three most important financial statements for businesses are the balance sheet, cash flow statement, and profit and loss statement (all three listed here alphabetically).

**General ledger:**A complete record of financial transactions over the life of a company.

**Journal entry:** An entry in the journal that records financial transactions in the chronological order.

**Profit and loss statement (income statement):**A financial statement that summarises a company’s performance by reviewing revenues, costs and expenses during a specific period.

**Single-entry bookkeeping:** Under the single-entry bookkeeping, mainly used by small or businesses, incomes and expenses are recorded through daily and monthly summaries of cash receipts and disbursements. (Also see “double-entry bookkeeping,” above.)

**Types of accounting:** Financial accounting reports information about a company’s performance to investors and credits. Management accounting provides financial data to managers for business development.