

Accounting terms cheat sheet: +20 concepts defined in plain language

Accounting

A system used to record more than just financial transactions. Done right, accounting (1) tracks and analyzes business transactions *in total*, (2) measures and improves the health of a business, as well as (3) reports financial results to investors, creditors, and regulators.

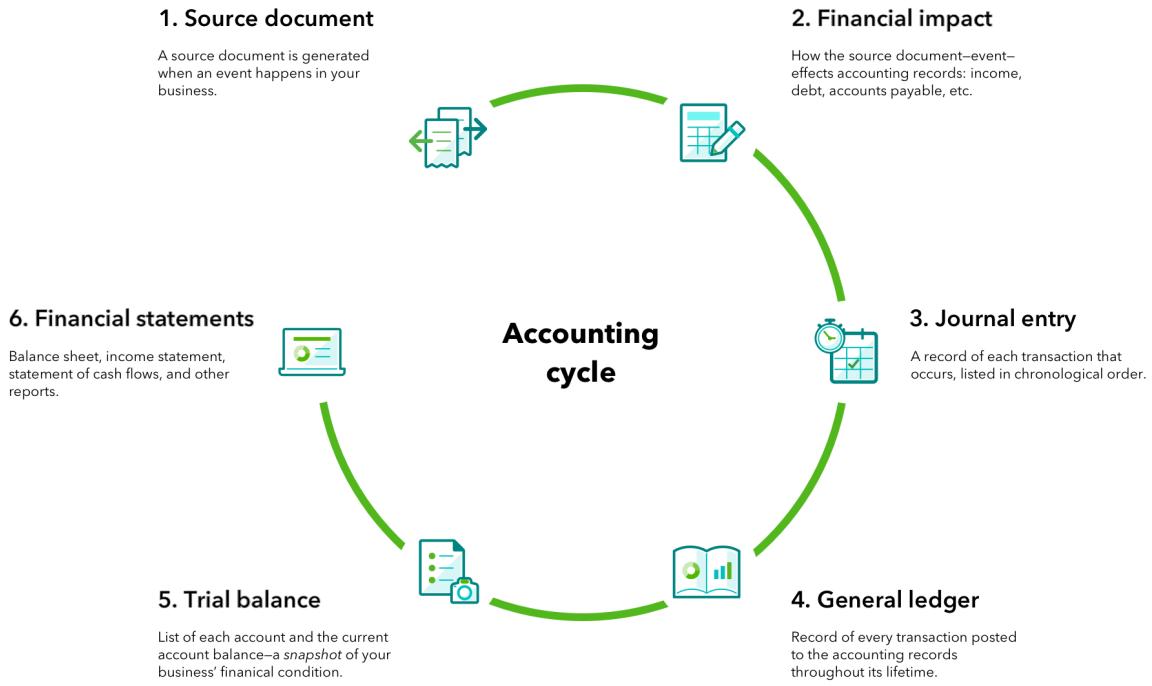
Your accounting system produces financial statements; such as ...

- Balance sheet: Financial position as of a specific date
- Income statement: Profit or loss for a stated time period
- Statement of cash flows: Inflows and outflows for a month or year

Accounting cycle

The cycle includes gathering information from source documents and deciding on the financial impact of a transaction. Next, you record the transaction using a journal entry, and the information is posted to general ledger.

Once all the transactions are posted, you generate a trial balance and use the data to produce financial statements.



Accrual method of accounting

A method that requires a business to post revenue when it is earned, and expenses when they are incurred. This method applies the matching principle, which matches revenue with the expenses that relate to producing the revenue.

Balance sheet

A snapshot of a company's financial position at a specific date. It reflects the company's assets, liabilities, and equity balances.

Cash method of accounting

A method that posts revenue when cash is received, and expenses when cash is paid. The cash method does not match revenue with expenses.

Chart of accounts

A list of each account needed to manage the business, and a corresponding account number.

Credit entries

Credit entries are posted on the right side of each journal entry. Liability and revenue accounts are increased with a credit entry, with some exceptions.

Current assets

Cash, and assets that will be converted into cash within 12 months.

Current liabilities

Amounts due to be paid within a year, such as accounts payable (amounts you owe suppliers), payroll liabilities, and amounts due on short-term business loans, such as a line of credit.

Debit entries

Debit entries are posted on the left side of each journal entry. Asset and expense accounts are increased with a debit entry, with some exceptions.

Double-entry bookkeeping

A system that uses the balance sheet equation (assets = liabilities + equity) and the concept of debits and credits to post accounting transactions.

Financial statements

A set of reports, including the balance sheet, income statement, and the statement of cash flows.

General ledger

A record of every transaction posted to the accounting records since business inception.

Income statement

Reports revenue, expenses, and net income (profit) or loss for a specified period. The statement is based on the income statement formula:

Revenue less expenses equals net income (or loss).

Journal

A record of each transaction that occurs, listed in chronological order, and accountants post activity using a journal entry.

Long-term liabilities

Amounts that are due to be paid in a year or more, including long-term loans, mortgage payments, and future employee benefits. These liabilities are non-current, but the category is often defined as “long-term” in the balance sheet.

Net income

Total revenue less expenses, for a month or year. Net income is calculated in the income statement, and the balance increases equity.

Non-current assets

Assets that will not be converted into cash within 12 months.

Retained earnings

This balance is defined as total company earnings (net income) since inception, less all dividends paid to owners since inception.

Statement of cash flows

Reports cash inflows and outflows for operating, financing, and investing activities.

Trial balance

A listing of each account used to post transactions, and the current account balance.