

BLING LINGO

THE GLOSSARY OF ACCOUNTING TERMS

I was scratching my head over an accounting mess, for which the owner had paid a bookkeeper many dollars over many years. How did it happen? If you don't know the basics, you may be a sitting duck. You won't know when your accountant or bookkeeper doesn't know what he or she is doing. Do you think accountants do it on purpose? Do they use weird words to make you think that they are smarter than you are? To keep you in the dark? Probably not. They just inherited an industry vocabulary. And we didn't learn it. I didn't even learn it in business school and I graduated at the top of my class. Every industry has its language, a lingo, and it's a good idea for you to understand the lingo of business.

Good accountants and bookkeepers *want* you to learn the lingo. They want to help you make the bling, baby! So, read and learn. Keep this glossary handy as you work with your professional money managers. Use it to help you on your journey to financial literacy...and a rockin' business!

ACCOUNTING EQUATION: The Balance Sheet is based on the basic accounting equation. That is:

$$\text{Assets} = \text{Equities.}$$

Equity of the company can be held by someone other than the owner. That is called a liability. Because we usually have some liabilities, the accounting equation is usually written...

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$



ACCOUNTS: Business activities cause increases and decreases in your assets, liabilities and equity. Your accounting system records these activities in *accounts*. A number of accounts are needed to summarize the increases and decreases in each asset, liability and owner's equity account on the Balance Sheet and of each revenue and expense that appears on the Income Statement. You can have a few accounts or hundreds, depending on the kind of detailed information you need to run your business.

ACCOUNTS PAYABLE: Also called A/P. These are bills that your business owes to the government or your suppliers. If you have 'bought' it, but haven't paid for it yet (like when you buy 'on account') you create an account payable. These are found in the liability section of the Balance Sheet.

ACCOUNTS RECEIVABLE: Also called A/R. When you sell something to someone, and they don't pay you that minute, you create an account receivable. This is the amount of money your customers owe you for products and services that they bought from you...but haven't paid for yet. Accounts receivable are found in the current assets section of the Balance Sheet.

ACCRUAL BASIS ACCOUNTING: With accrual basis accounting, you 'account for' expenses and sales at the time the transaction occurs. This is the most accurate way of accounting for your business activities. If you sell something to Mrs. Fernwicky today, you would record the sale as of today, even if she plans on paying you in two months. If you buy some paint today, you account for it today, even if you will pay for it next month when the supply house statement comes. **Cash Basis accounting** records the sale when the cash is received and records the expense when the check goes out. Not as accurate a picture of what is happening at your company.

Your tax preparer may have suggested you use Cash Basis accounting for your tax return. That's fine. The point of Cash Basis accounting is to keep you from paying income tax associated with Sales you haven't collected yet. Visit with your accountant about the best way for you to structure your tax return.

You can make the switch from Accrual to Cash basis on your financial reports by backing out Sales and the associated Accounts Receivable and backing out Expenses and the associated Accounts Payable. QuickBooks has a toggle switch under "Modify Reports" that will do this for you...as long as you haven't messed up any of the data entry.

ASSETS: The 'stuff' the company owns. Anything of value - cash, accounts receivable, trucks, inventory, land. **Current assets** are those that could be converted into cash easily. (Officially, within a year's time.) The most current of current assets is cash, of course. Accounts receivable will be converted to cash as soon as the customer pays, hopefully within a month. So, accounts receivable are current assets. So is inventory.

Fixed assets are those things that you wouldn't want to convert into cash for operating money. For instance, you don't want to sell your building to cover the supply house bill. Assets are listed, in order of *liquidity* (how close it is to cash) on the Balance Sheet.



BALANCE SHEET: The Balance Sheet reflects the financial condition of the company on a specific date. The basic accounting formula is the basis for the Balance Sheet:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

The Balance Sheet doesn't start over. It is the cumulative score from day one of the business to the time the report is created.

CASH FLOW: The movement and timing of money, in and out of the business. In addition to the Balance Sheet and the Income Statement, you may want to report the flow of cash through your business. Your company could be profitable but 'cash poor' and unable to pay your bills. Not good!

A **cash flow statement** helps keep you aware of how much cash came and went for any period of time. A **cash flow projection** would be an educated guess at what the cash flow situation will be for the future.

Suppose you want to buy a new truck with cash. But that purchase will empty the bank account and leave you without any cash for payroll! For cash flow reasons, you might choose to buy a truck on payments instead.

CHART OF ACCOUNTS: A complete listing of every account in your accounting system. Every transaction in your business needs to be recorded, so that you can keep track of things. Think of the chart of accounts as the peg board on which you hang the business activities.

CREDIT: A credit is used in Double-Entry accounting to increase a liability or an equity account. A credit will decrease an asset account. For every credit there is a debit. These are the two balancing components of every journal entry. Credits and debits keep the basic accounting equation (Assets = Liabilities + Owner's Equity) in balance as you record business activities.

DEBIT: A debit is used in Double-Entry accounting to increase an asset account. A debit will decrease a liability or an equity account. For every debit there is a credit.

DIRECT COSTS: Also called **cost of goods sold, cost of sales or job site expenses**. These are expenses that include labor costs and materials. These expenses can be directly tracked to a specific job. If the job didn't happen, the direct costs wouldn't have been incurred. (Compare direct cost with indirect costs to get a better understanding of the term.) Direct costs are found on the Income Statement, right below the income accounts.

$$\text{Income} - \text{Direct Costs} = \text{Gross Margin.}$$

DOUBLE-ENTRY ACCOUNTING: An accounting system used to keep track of business activities. Double-Entry accounting maintains the Balance Sheet

Assets = Liabilities + Owner's Equity. When dollars are recorded in one account, they must be accounted for in another account in such a way that the activity is well documented and the Balance Sheet stays in balance.

You may not need to be an expert in Double-Entry accounting, but the person who is responsible for creating the financial statements better get pretty good at it. If that is you, go back through the book and focus on the 'gray' sheets. Study the examples and see how the Double-Entry method acts as a check and balance of your books.

Remember the law of the universe...what goes around, comes around. This is the essence of Double-Entry accounting.

EQUITY: Funds that have been supplied to the company to get the 'stuff'. Equities show ownership of the assets or claims against the assets. If someone other than the owner has claims on the assets, it is called a **liability**.

$$\text{Total Assets} - \text{Total Liabilities} = \text{Net Equity}$$

This is another way of stating the basic accounting equation that emphasizes how much of the assets you own. Net equity is also called **net worth**.

EXPENSE: Also called **costs**. Expenses are decreases in equity. These are dollars paid out to suppliers, vendors, Uncle Sam, employees, charities, etc. Remember to pay bills thankfully, because it takes money to make money. Expenses are listed on the Income Statement. They should be split into two categories, direct costs and indirect costs. The basic equation for the Income Statement is:

$$\text{Revenues} - \text{Expenses} = \text{Profit}$$

(You'll see a profit if there are more revenues than expenses!...or a loss, if expenses are more than revenues.)

Remember, all costs need to be included in your selling price. The customer pays for everything. In exchange, you give the customer your services. What a deal!

FINANCIAL STATEMENTS: refer to the **Balance Sheet** and the **Income Statement**. The Balance Sheet is a report that shows the financial condition of the company. The Income Statement (also called the Profit and Loss statement or the 'P&L') is the profit performance summary.

Financial Statements can include the supporting documents like cash flow reports, accounts receivable reports, transaction register, etc. Any report that measures the movement of money in your company.

Financial Statements are what the bank wants to **see** before it loans you money. The IRS insists that you share the score with them, and asks for your Financial Statements every year.

GENERAL LEDGER: Once upon a time, accounting systems were kept in a book that listed the increases and decreases in all the accounts of the company. That book was called the general ledger. Today, you probably have a computerized accounting system. Still, the general ledger is a collection of all Balance Sheet and Income Statement accounts...all the assets, liabilities and equity. It is the report that shows ALL the activity in the company. Often this listing is called a **detail trial balance** on the report menu of your accounting program. The detail trial balance is my favorite report when I am trying to find a mistake, or make sure that we have entered information in the right accounts.



GROSS PROFIT: This is how much money you have left after you have subtracted the direct costs from the selling price.

$\text{Income} - \text{Direct Costs} = \text{Gross Profit}$. When this is expressed as a percentage, it is called Gross Margin.

This is a good number to scrutinize each month, and to track in terms of percentage to total sales over the course of time. The higher the better with gross margin! You need to have enough money left at this point to pay all your indirect costs and still end up with a profit.

INCOME STATEMENT: (Also called the **Profit and Loss Statement**, or **P&L**, or **Statement of Operations**) This is a report that shows the changes in the equity of the company as a result of business operations. It lists the income (or revenues, or sales), subtracts the expenses and shows you the profit 😊! (Or loss 😞.) This report covers a period of time and summarizes the money in and the money out.

The Income Statement is like a magnifying glass that shows the detail of activities that cause changes in the equity section of the Balance Sheet.

INDIRECT COST: Also called **overhead or operating expenses**. These expenses are indirectly related to the services you provide to customers. Indirect costs include office salaries, rent, advertising, telephone, and utilities...Costs to keep a 'roof overhead'. Every cost that is not a direct cost is an indirect cost. Indirect costs *do not* go away when sales drop off.

INVENTORY: Also called **stock**. These are materials that you purchase with the intent to sell, but you haven't sold them yet. Inventory is found on the balance sheet under assets. It is considered a current asset because you will convert it into cash as soon as you sell it. Beware of turning cash into inventory. You may run out of cash. Work with your suppliers to keep inventory **SMALL**.

JOURNAL: This is the diary of your business. It keeps track of business activities chronologically. Each business activity is recorded as a journal entry. The Double-Entry will list the debit account and the credit account for each transaction on the day that it occurred. In your reports menu in your accounting system, the journal entries are listed in the **transaction register**.

LIABILITIES: Like equities, these are sources of assets - how you got the 'stuff'. These are claims against assets by someone other than the owner. This is what the company **owes!** Notes payable, taxes payable and loans are liabilities. Liabilities are categorized as **current liabilities** (need to pay off within a year's time, like payroll taxes) or **long term liabilities** (pay-back time is more than a year, like your building mortgage).

MONEY: Also called **moola, scratch, gold, coins, cash, change, chicken feed, green stuff, BLING, etc.** Money is the form we use to exchange energy, goods and services for other energy, goods and services. Used to buy things that you need or want. Beats trading for chickens in the global marketplace.

Money in and of itself is neither good nor bad. I want you to make lots of it, and do *great* things with it!



NET INCOME: Also called **net profit, net earnings, current earnings or bottom line**. (No wonder accounting is confusing - look at all those words that mean the same thing!)

After you have subtracted ALL expenses (including taxes) from revenues, you are left with net income. The word *net* means basic, fundamental. This is a very important item on the income statement because it tells you how much money is left after business operations. Think of net income like the score of a single basketball game in a series. Net income tells you if you won or lost, and by how much, for a given period of time.

By the way, if net income is a negative number, it's called a loss. You want to avoid those. The net income is reflected on the Balance Sheet in the equity section, under current earnings (or net profit). Net income results in an increase in owner's equity. A loss results in a decrease in owner's equity.

RETAINED EARNINGS: The amount of net income earned and retained by the business. If net income is like the score after a single basketball game, retained earnings is the lifetime statistic. Retained earnings are found in the equity section of the Balance Sheet. It keeps track of how much of the total owner's equity was earned and retained by the business versus how much capital has been invested from the owners (**paid-in capital**).

Each month, the net profits are reflected in the Balance Sheet as current earnings. At the end of the year, current earnings are added to the retained earnings account.