Basic Accounting Terms

Accounts Payable (AP)

Accounts Payable include all of the expenses that a business has incurred but has not yet paid. This account is recorded as a liability on the Balance Sheet as it is a debt owed by the company.

Accounts Receivable (AR)

Accounts Receivable include all of the revenue (sales) that a company has provided but has not yet collected payment on. This account is on the Balance Sheet, recorded as an asset that will likely convert to cash in the short term.

Asset

Anything the company owns that has monetary value. These are listed in order of liquidity, from cash (the most liquid) to land (least liquid).

Balance Sheet

A financial statement that reports on all of a company's assets, liabilities, and equity. As suggested by its name, a balance sheet abides by the equation <Assets = Liabilities + Equity>.

Cash Flow

Cash Flow is the term that describes the inflow and outflow of cash in a business. The Net Cash Flow for a period of time is found by taking the Beginning Cash Balance and subtracting the Ending Cash Balance. A positive number indicates that more cash flowed into the business than out, whereas a negative number indicates the opposite.

Certified Public Accountant (CPA)

CPA is a professional designation that an accountant can earn by passing the CPA exam and fulfilling the requirements for both education and work experience, which vary by state.

Cost of Goods Sold (COGS)

Cost of Goods Sold are the expenses that directly relate to creating a product or service. Not included in this category are those costs needed to run the business. An example of COGS would be the cost of Materials, or the Direct Labor to provide a service.

Depreciation

Depreciation is the term that accounts for the loss of value in an asset over time. Generally, an asset has to have substantial value in order to warrant depreciating it. Common assets to be depreciated are automobiles and equipment. Depreciation appears on the Income Statement as an expense and is often categorized as a "Non-Cash Expense" since it doesn't have a direct impact on a company's cash position.

Equity

Equity denotes the value left over after liabilities have been removed. Recall the equation Assets = Liabilities + Equity. If you take your Assets and subtract your Liabilities, you are left with Equity, which is the portion of the company that is owned by the investors and owners.

Gross Profit

Gross Profit indicates the profitability of a company in dollars, without taking overhead expenses into account. It is calculated by subtracting the Cost of Goods Sold from Revenue for the same period.

Gross Profit Margin

Gross Margin is a percentage calculated by taking Gross Profit and dividing by Revenue for the same period. It represents the profitability of a company after deducting the Cost of Goods Sold.

Income Statement (Profit and Loss) (IS or P&L)

The Income Statement (often referred to as a Profit and Loss, or P&L) is the financial statement that shows the revenues, expenses, and profits over a given time period. Revenue earned is shown at the top of the report and various costs (expenses) are subtracted from it until all costs are accounted for; the result being Net Income.

Interest

Interest is the amount paid on a loan or line of credit that exceeds the repayment of the principal balance.

Inventory

Inventory is the term used to classify the assets that a company has purchased to sell to its customers that remain unsold. As these items are sold to customers, the inventory account will be lower.

Liability

All debts that a company has yet to pay are referred to as Liabilities. Common liabilities include Accounts Payable, Payroll, and Loans.

Liquidity

A term referencing how quickly something can be converted into cash. For example, stocks are more liquid than a house since you can sell stocks (turning it into cash) more quickly than real estate.

Net Income

Net Income is the dollar amount that is earned in profits. It is calculated by taking Revenue and subtracting all of the Expenses in a given period, including COGS, Overhead, Depreciation, and Taxes.

Net Profit Margin

Net Margin is the percentage amount that illustrates the profit of a company in relation to its Revenue. It is calculated by taking Net Income and dividing it by Revenue for a given period.

Return on Investment (ROI)

Originally, this term referred to the profit that a company was making (Return), divided by the Investment required. Today, the term is used more loosely to include returns on various projects and objectives. For example, if a company spent $1,000 on marketing, which produced $2,000 in profit, the company could state that its ROI on marketing spend is 50%.

Revenue (Sales)

Revenue is any money earned by the business.