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Accounting for Non-Financial Managers

Introduction
This resource on accounting is not designed to make you an accountant but to give you a basic understanding of some accounting terms, principles and reports that will assist you in running your business better.

The Accounting Entity
Your organization is an accounting entity. As your accountant will tell you, you must keep the accounts of your organization separate from your own personal accounts. The accounts are kept in terms of money, and the only mathematics used in accounting are: addition, subtraction, multiplication, and division. The common denominator for all accounting is money. Accounting can't tell you everything about your organization, but it can tell you more about performance and financial well being that any other source of information.

Accounting Concepts to Remember
There are three important concepts to remember about accounting. 1) Keep accounting records of your business separate from your personal ones. 2) Money is the common denominator of accounting. 3) Every transaction or every accounting event affects at least two items - accounting is properly called a double-entry system.

The third notion above made possible the following rule, to which there is absolutely no exception: for each transaction the debit amount must equal the credit amount. The debit and credit arrangement used in accounting provides a useful means of checking the accuracy with which the transactions have been recorded. Some say that this is a difficult notion to understand, especially if you have not had an accounting course. When you make entries into your accounting software, the debit/credit difficulty will be transparent to you.

Accounting Reports to Remember
Two main end products of an accounting system are the Balance Sheet which reports your organization's financial status at a specific frozen point in time and the Income Statement which measures your organization's financial performance for a period of time, called an accounting period. You will probably spend more time with your Income Statement than with your Balance Sheet.

The Balance Sheet
The Balance Sheet is a "snapshot" of the financial condition of your organization at a specific date. It is always dated "as of" a certain date, while the Income Statement states that it covers a certain period of time.

The Balance Sheet has two sides. The one on the left side is the Assets side (the Assets are the resources which are owned by the organization). The one on the right is the Equities side. Equities can be thought of as either a claim against the assets or the amount of funds, which have been supplied, to the organization from various sources (both definitions are correct) plus Retained Earning. The fundamental accounting equation is: Assets = Equities. The double entry principle of accounting is based on this equation.

Debits and Credits
Debits and Credits provide a very convenient way of applying the principle of double entry. They are the method in which increases and decreases are handled in the accounts.

There is another accounting equation to go along with the fundamental one, that is, Debits = Credits. There are two rules which apply to Debits and Credits. 1) An Asset is increased by a Debit and decreased by a Credit. 2) A Liability or Equity is increased by a Credit and decreased by a Debit.

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Property, Buildings and Equipment: This classification comprises assets used over a long period in the operation of a business. They are customarily listed on the balance sheet according to their degree of permanence, with the most permanent item listed first.

Land: Always listed separately. Although land and the buildings on the land are usually sold together, they are classified separately because the buildings will deteriorate through usage, whereas the land will not.

- Land is considered the most permanent asset.
- Buildings: Those owned by the business appear on the balance sheet. Rented buildings are not owned and are not assets.
- Equipment: Backhoes, trucks and other equipment owned by the business appear on the balance sheet.

Current Liabilities: This term designates obligations whose liquidation (in other words payment or settlement) is reasonably expected to require the use of current assets or the creation of other current liabilities. All liabilities to be paid within a one-year period are classified as current. They are generally listed in their probable order of liquidation.

- Accounts Payable: Purchases made on credit. They are the unpaid amounts owed to creditors from purchases on an account arrangement. They are usually due to be paid within 30 days and are also called open accounts.
- Notes Payable: Formal written promises by the organization to pay money to creditors. Trade notes payable derive from the purchases of material or services used in the course of business. Notes payable to a bank arise when a company borrows money for business use.
- Accrued Liabilities: Since the word accrue means to increase by growth or to accumulate in a standard manner, accrued liabilities are debts that have accumulated because of the passage of time and that are not yet due for payment. Accrued wages payable and accrued interest payable are typical accrued liabilities.

Glossary of Accounting Terms

Account: A recording device used for sorting accounting information into similar groupings.

Accounts Payable: Amounts which the organization owes to creditors for purchases made.

Accounts Receivable: Amounts due from customers for sales of goods or services to them.

Accrued: Accumulated over a period of time.

Accrual basis of accounting: The basis that assumes that revenue is realized at the time of the sale of goods or services, regardless of when the cash is received; expenses are recognized at the time the services are received and utilized or an asset is consumed in the production of revenue, regardless of when payment for these services or assets is made.

Asset: A thing of some known value owned by the organization.

Balance: The difference between the total of the debits and credits in an account.

Balance Sheet: The financial statement which summarizes the Assets, Liabilities and Equities of an organization. It is as of a specific date.

Budget: A financial plan for a period of time.

Cash: Currency, coins, traveler's checks, checks, and any other items that your bank will accept for deposit.

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Chart of Accounts: A list of all accounts in the general ledger which the organization anticipates using.

Credit: The right side of the T form of an account, the actual amount on the right side of an account, or the act of placing an amount on the right side of an account.

Creditors: Persons or organizations to whom debts are owed.

Current Assets: Cash and other assets that will be either consumed or converted into cash within twelve months.

Current Liabilities: Liabilities which will be paid within twelve months.

Debit: The left side of the T form of an account, the actual amount on the left side of an account, or the act of placing an amount on the left side of an account.

Disbursement: An actual payment by cash or check.

Double-entry Accounting: A system of recording both the debit and credit aspect of each transaction.

Entity: Your organization separate from you.

Equities: Claims against the total assets of a business.

Expense: Expired cost; the material used and service utilized in the production of revenue during the specific period.

Inventory: The stock of materials held by an organization either for conversion into products for sale to customers or for immediate sale to customers.

Liability: An obligation of an organization, or a creditor' claim against the assets of an organization.

Long-term Liabilities: Debts of an organization which are not due within the current year.

Matching Concept: An accounting principle which reflects the matching of incurred expenses and earned revenue for a given time period in order to determine net income for that period.

Mortgage Payable: A debt - normally long-term - for which specific assets are pledged as securities.

Net Assets: Total assets less total liabilities.

Notes Payable: Short-term notes to creditors, much more formal than Accounts Payable.

Owner's Equity: The owner's claim against the assets of the organization.

Prepaid Items: Unconsumed amounts of current assets that will normally be used in the operations of the firm and are not held for resale.

Property, Buildings and Equipment: Long-lived or long-term assets of an organization that are used in the operations of the firm and are not held for resale.

Transaction: A business activity or event which has taken place.

Trial Balance: A statement that shows the name and balance of all ledger accounts arranged according to whether they are debits or credits. The total of the debits must equal the total of the credits in this statement.

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Income Measurement by Income Statement
Being a profit-oriented organization, your success is reflected by changes (positive changes) in the Equity section of the balance sheet. The Equity section will increase by the amount of the profit your organization makes. Since the Balance Sheet is a snapshot, you can see that Equity has changed but you can't determine why Equity changed. That's where the Income Statement plays such an important role. Here you see exactly what your Revenues and Expenses were and how they affected your bottom line. Simply put, the Income Statement shows you the detail of why Retained Earnings Equity changed.

Explanation of Accounting Terms
Assets: The assets of a business are everything of value held by the business. The word value as used here means future usefulness to a continuing business enterprise. Cash, notes, and accounts receivable (amounts owed to the business by customers), land, buildings, and high-grade, readily marketable stocks or bonds of other companies are examples of assets in a business. An asset is recorded on the books of the acquiring entity as the actual full cost (historical cost), even though it has not been fully paid for in cash (referred to as the cost principle). The amount of any debt or claim against the asset is included in the liabilities.

Equities: Equities are claims against the total assets of a business. The two major classifications of individuals who have equities in a business are the creditors (the liability holders) and the owners. A business' liabilities are owed to its creditors.

Liabilities: These are the debts or claims of creditors against the assets of the business. Accounts payable, notes payable, and wages owed to employees are examples of liabilities.

Owner's Equity: This is the owner's claims against business assets. It is also called Net Worth and is the excess of total assets over total liabilities. Because creditor claims have priority over the claims of the owner of the organization, owner's equity claims are secondary (or residual).

The Balance Sheet: It is an expanded expression of the accounting equation, Assets = Liabilities + Owner's Equity. It summarizes the assets, liabilities and owner's equity of a business entity as of a specific point in time. The Balance Sheet is also called a statement of financial position.

Current Assets: They consist of cash and other assets that are expected to be converted into cash or to be used in the operation of the business within one year. Current assets are usually listed in descending order of their expected conversion into cash (liquidity).

- Cash: Any item that a bank will accept as a deposit and that is immediately available and acceptable as a means of payment.
- Accounts Receivable: Amounts due from customers for services rendered, for material, or for any asset sold on credit.
- Notes Receivable: Formal written promises to pay a fixed amount of money at a future date. Most notes can usually be exchanged for cash at a bank.
- Inventory: Material on hand to be used on jobs.
- Prepaid Items: Services and supplies acquired to be consumed during the next 12 months. They are assets because they are items of value that have future usefulness in business operations. An examples of a prepaid item is:
    - Prepaid Insurance: Businesses take out insurance policies for protection against hazards. The cost of this type of protection, an insurance premium, is paid in advance. The unexpired portion of the prepaid insurance premium is an asset.
- Office Supplies: Supplies such as stamps, stationery, and business forms required in an office are grouped under the title office supplies are current assets of the business.