Accounting Concepts

(VERY) MINI-MANUAL FOR SMALL NON-PROFITS

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I. Basic concepts

GAAP: Generally Accepted Accounting Principles. These principles govern the recording and reporting of financial information.

Accrual vs. cash accounting: The accrual system recognizes income as soon as it is earned and expenses as soon as they are incurred. A cash system shows what's coming into and leaving the bank.

Double-entry accounting: The system in which every financial transaction has two parts—often, one that hits the profit-and-loss and one that hits the balance sheet.

II. Profit and loss

Profit & loss statement: Shows income and expense of an organization over time, resulting in a surplus or deficit (net income).

Profit & loss accounts: Those accounts that are used on a profit & loss statement, i.e. various income and expense accounts.

Ordinary income/expense: The typical financial transactions in your organization, e.g. bills paid, grants received.

Other income/expense: "Below the line" accounts that record non-typical financial transactions for your organization (for example, some transactions involving restricted funds, or interest on investments).

III. Balance sheet

Balance sheet: A summary of an organization's assets, liabilities, and equity. These are the three types of *balance sheet accounts.*

Assets: What you own or what is owed to you. Examples: cash, accounts receivable, prepaid expense, fixed assets.

Liabilities: What you owe to others or are liable for. Examples: accounts payable, accrued expenses.

Equity: The overall value of your business, also called *net assets*. Examples: restricted and unrestricted funds.

The financial equation: ASSETS = LIABILITIES + EQUITY. Naturally, it is also true that equity (the total value of your business) equals assets (what you have) less liabilities (what you owe).

IV. Debits and credits

Adelor: A mnemonic to help you remember how debits and credits work.

A D E	L O R
Assets • **D**raws • **E**xpenses	**L**iabilities • **O**wner's equity • **R**evenue
DEBIT to increase	CREDIT to increase
CREDIT to decrease	DEBIT to decrease

(Nonprofits don't have owner's equity, but if it were just "equity" the mnemonic would have two *E*s and that's not good.)

Since every transaction in double-entry bookkeeping involves two parts, and since the totals on each side of the transaction have to balance, every journal entry involves both a debit and a credit. Remember that in journal entries you always:

DEBIT on the left ‖ CREDIT on the right

Example: you make a payment for your organization with a debit card. This transaction decreases cash and increases expense.

- Cash is an asset, so credit it to decrease it.
- Debit expense to increase it.