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There are 10 most important accountancy/book-keeping terms one should definitely know as a business owner.

1. **ACCOUNTING METHODS**
2. **a. Mercantile (accrual) accounting**

This is one of two methods of accounting permitted under India's Income Tax Act.

Under this method, income and expenses are accounted for as and when the right to receive OR the right to pay arises. In other words, you record income as soon as you 'earn' it, even if you do not physically 'receive' any money. Similarly, you record expenses as soon as you incur them instead of when you actually pay for them.

Accrual accounting gives a fairly accurate picture of the long-term health of a business.

1. **b. Double entry book-keeping**
2. **c. Credit & Debit**

The double-entry bookkeeping method is used to record income and expenses under the accrual accounting method. You record two entries for every transaction your business makes, which are equal and opposite. One increases an account and the other entry decreases it. These increases and decreases are determined by recording credits and debits.

Some accounts are increased by debits and others are increased by credits. For example:

Account	**Increased by**	**Decreased by**
Assets	Debit	Credit
Liabilities	Credit	Debit
Expenses	Debit	Credit
Revenue	Credit	Debit
Equity	Credit	Debit

2. **Cash accounting**

Under this method, income and expenses are accounted on actual receipt of payment. It postpones a recipient's tax liability to the year of actual receipt of income, although it does not permanently reduce it.

1. **FINANCIAL STATEMENTS**
2. **a. Balance sheet**

A balance sheet is one of the most commonly-used financial statements by businesses everywhere.

It offers a snapshot of a company's financial status at a particular point in time. It is organised into two columns, with assets in one, and liabilities and equity in the other.

The two sides must always equal each other. In other words, they must 'balance'.

3. **b. Asset**

Anything your company owns (e.g. furniture, inventory, cash, real estate, etc) that has monetary value is counted as an asset. On a balance sheet, assets are usually listed from most liquid (cash) to least liquid (e.g. land or other immovable property).

Current Assets are those that are used within 12 months.

Fixed Assets are assets (e.g. furniture, land, property, etc) that are usually not used within a year and which usually depreciate in value (see #8 below).

Inventory is a type of asset that a company purchases or produces for sale but remains unsold at the time of accounting.

In simplest terms, a liability indicates something you OWN.

3. **c. Liabilities**

Liabilities are financial obligations owed by a company. These may include salaries, taxes, rents, utilities, interest payments, supplier payments, etc.

Liabilities can be short or long term.

In simplest terms, a liability indicates something you OWE.

3. **d. Equity**

Equity is the money invested in the company by its owners or shareholders plus any earnings that are retained (i.e. not 'paid out' to owners or shareholders) minus any liabilities or any money taken out in the form of draws.

Equity refers to your company's net worth.

Also,

Equity = Assets – Liabilities

3. **e. Accounts Payable (AP)**

AP includes all the expenses a business has incurred but not yet paid.

This account is recorded as a liability on the balance sheet because it is a debt owed by the company.

3. **f. Accounts Receivable (AR)**

AR includes all the revenues/sales that a company has provided but has not yet collected payment on. It is recorded as an asset on the balance sheet since it will likely convert to cash in the short-term.

4. **a. Income statement**

The income statement shows a company's revenues, expenses and profits for a *particular accounting period* (unlike a balance sheet which is a snapshot at a particular *point in time*). This period is often the *financial year (FY)*. In India, the financial year runs from 1st April to 31st March, which means that it does not correspond with the calendar year. For example, FY2020-21 refers to the period from 1st April 2020 to 31st March 2021.

Income statement is also known as a Profit and Loss (P&L) statement and shows whether or not a business is profitable at that point in time.

4. **b. Revenues**

A business' revenue is the sum of all monies generated through the sale of goods and services, interest earned, royalties, assets sales, rents, etc. In other words, it is any money earned by the business.

4. **c. Expenses or Costs**

Every company incurs some expenses as it tries to generate income.

Expenses are costs incurred by a company. They can be *fixed* (e.g. rents or salaries) or *variable* (e.g. utilities payments).

Costs can also be *overheads*. These are the expenses that relate to running the business but not to actual production or delivery. Rent, utilities and executive salaries are counted as overheads.

On an income statement,

Profit or Net Income (or Loss) = Revenues – Expenses

5. **General Ledger**

This is a complete recording of a company's financial transactions over its lifetime. It shows assets, liabilities, revenue, expenses and equity.

6. **Cash Flow Statement**

The cash flow statement shows the movements of cash (and cash equivalents) into and out of the business.

It is an important tool for evaluating the health of a business, as it is possible to show a profit on the income statement even though cash is draining out of the business. Many companies fold not because they fail to generate profits but because they suffer from chronic cash flow problems. In other words, it is possible for a company to fail even if it appears profitable.

OTHER MUST-KNOW TERMS

7. **Capital (aka Working Capital)**

Capital is the money available to a company to pay bills or salaries, or to reinvest. Like cash flow, capital is also considered a key measure of a business' health.

Working Capital = Current Assets – Current Liabilities

8. **Depreciation**

When business assets lose value over time, they are said to depreciate.

Depreciation is an important tax deduction. A percentage of the original value of the asset can be ‘written off’ every year based on the depreciation rate, which then lowers the company’s tax burden.

Asset Book Value = Original Value – Depreciation

9. **Dividend**

A dividend is the distributions of a portion of the company’s earnings to its owners or shareholders.

It can be issued on a regular or non-regular basis, and may consist of cash, additional shares in the business or both.

10. **Return on Investment (ROI)**

ROI refers to a company’s profits (return) divided by the investment made to generate those profits.

It is an important measure that is very useful for evaluating the efficiency of an investment (or investments). ROI is also used to compare the efficiency of different investments relative to their cost.

ROI is always expressed as a percentage or a ratio.

ROI = Current value of investment – Cost of investment

Cost of investment