Financial Accounting Combined Terminology/Cheat Sheets

Financial Ratios Cheat Sheet

Simplified for Small Organizations & Nonprofits

What Are Financial Ratios?

Financial ratios are simple math formulas that help you understand what the numbers on a balance sheet or income statement really mean. Instead of just seeing "Cash: $5,000," a ratio tells you whether that's healthy or concerning compared to other numbers.

Why ratios matter:

- They reveal hidden problems before they become serious
- They let you compare your organization to similar ones
- They help lenders and donors assess financial health
- They're required for loan applications and grant reports

Category 1: LIQUIDITY RATIOS

(Can your organization pay its bills?)

Current Ratio

Formula: Current Assets ÷ Current Liabilities

What it means: Do you have enough cash and items easily convertible to cash to pay what you owe in the next 12 months?

Example:

- Current Assets: $50,000
- Current Liabilities: $30,000
- Current Ratio = $50,000 ÷ $30,000 = **1.67**

Is it good?

- **1.0 to 2.0** = Healthy (you can cover your bills)
- **Below 1.0** = Danger (you owe more than you have)
- **Above 3.0** = Maybe too much cash sitting idle (could be used better)

Quick Ratio (Acid-Test Ratio)

Formula: (Current Assets – Inventory) ÷ Current Liabilities

What it means: Similar to current ratio, but stricter because it doesn't count inventory (which takes time to sell).

Example:

- Current Assets: $50,000
- Inventory: $10,000
- Current Liabilities: $30,000
- Quick Ratio = ($50,000 – $10,000) ÷ $30,000 = **1.33**

Is it good?

- **Above 1.0** = Good (even without selling inventory, you can pay bills)
- **Below 1.0** = Concerning (you'd struggle to pay bills quickly)

Cash Ratio

Formula: Cash ÷ Current Liabilities

What it means: Can you pay all current debts with just cash on hand?

Example:

- Cash: $15,000
- Current Liabilities: $30,000
- Cash Ratio = $15,000 ÷ $30,000 = **0.50**

Is it good?

- **0.20 to 0.50** = Normal for most small organizations
- **Below 0.20** = Tight cash position
- **Above 1.0** = Lots of cash; consider where it should go

Category 2: PROFITABILITY RATIOS

(Is your organization making money or breaking even?)

Net Profit Margin

Formula: Net Income ÷ Total Revenue

What it means: Of every dollar earned, how much is actual profit (or surplus for nonprofits)?

Example:

- Net Income: $10,000
- Total Revenue: $100,000
- Net Profit Margin = $10,000 ÷ $100,000 = **0.10 or 10%**

Is it good?

- **Nonprofits:** 5–15% is healthy (most operate on tight margins)
- **For-profits:** Depends on industry (retail: 2–5%, tech: 10–20%+)
- **Below 0%** = You're operating at a loss

Gross Profit Margin

Formula: (Revenue – COGS) ÷ Revenue

What it means: What percentage of sales is profit before paying operating expenses?

Example:

- Revenue: $100,000
- Cost of Goods Sold: $40,000
- Gross Profit Margin = ($100,000 – $40,000) ÷ $100,000 = **0.60 or 60%**

Is it good?

- **Depends on industry** (services often 60–80%, retail 20–40%)
- **Higher is better** (more room to cover operating expenses)

Operating Margin

Formula: Operating Income ÷ Revenue

What it means: What percentage of revenue remains after paying operating expenses (but before interest/taxes)?

Example:

- Operating Income: $15,000
- Revenue: $100,000
- Operating Margin = $15,000 ÷ $100,000 = **0.15 or 15%**

Is it good?

- **Above 10%** = Good (your core business is profitable)
- **5–10%** = Moderate
- **Below 5%** = Tight margins

Category 3: EFFICIENCY RATIOS

(How well are you using your assets?)

Asset Turnover Ratio

Formula: Revenue ÷ Average Total Assets

What it means: How much revenue are you generating for every dollar of assets you own?

Example:

- Revenue: $100,000
- Average Total Assets: $250,000
- Asset Turnover = $100,000 ÷ $250,000 = **0.40**

Is it good?

- **Higher is better** (you're using assets efficiently)
- **1.0+** = You're generating $1+ in revenue per asset dollar
- **Below 0.5** = You may have underutilized assets

Inventory Turnover Ratio

Formula: COGS ÷ Average Inventory

What it means: How many times per year you completely turn over (sell) your inventory?

Example:

- COGS: $50,000
- Average Inventory: $10,000
- Inventory Turnover = $50,000 ÷ $10,000 = **5 times/year**

Is it good?

- **Higher is better** (inventory sells faster; less cash tied up)
- **Seasonal** (retail may turn 8–12x/year; nonprofit thrift store 4–6x)
- **Very low** = Slow-moving inventory (consider donating/discounting)

Days Sales Outstanding (DSO)

Formula: (Accounts Receivable ÷ Revenue) × 365

What it means: On average, how many days does it take to collect payment from customers/donors?

Example:

- Accounts Receivable: $20,000
- Annual Revenue: $365,000
- DSO = ($20,000 ÷ $365,000) × 365 = **20 days**

Is it good?

- **30 days or less** = Excellent (you collect quickly)
- **30–60 days** = Normal for business sales
- **Over 90 days** = Problem (you're owed a lot for a long time)

Category 4: LEVERAGE/SOLVENCY RATIOS

(Can your organization handle long-term debt?)

Debt-to-Equity Ratio

Formula: Total Debt ÷ Total Equity

What it means: For every dollar of equity, how much debt do you have?

Example:

- Total Debt: $100,000
- Total Equity: $200,000
- Debt-to-Equity = $100,000 ÷ $200,000 = **0.50**

Is it good?

- **Below 1.0** = Healthy (more equity than debt)
- **1.0–2.0** = Moderate leverage
- **Above 2.0** = High debt risk
- **Nonprofits typically:** 0.20–0.60 (conservative)

Debt Ratio

Formula: Total Debt ÷ Total Assets

What it means: What percentage of your assets are financed by debt vs. equity?

Example:

- Total Debt: $100,000
- Total Assets: $300,000
- Debt Ratio = $100,000 ÷ $300,000 = **0.33 or 33%**

Is it good?

- **Below 50%** = Healthy (more assets financed by equity than debt)
- **50–70%** = Moderate
- **Above 70%** = High debt burden

Interest Coverage Ratio

Formula: Operating Income ÷ Interest Expense

What it means: How many times over can you pay your interest expense with operating income?

Example:

- Operating Income: $50,000
- Interest Expense: $5,000
- Interest Coverage = $50,000 ÷ $5,000 = **10 times**

Is it good?

- **Above 2.5** = Safe (comfortable ability to pay interest)
- **1.5–2.5** = Manageable but tight
- **Below 1.5** = Risk (you might struggle to pay interest)

Category 5: NONPROFIT-SPECIFIC RATIOS

Program Expense Ratio

Formula: Program Expenses ÷ Total Expenses

What it means: What percentage of your spending goes to your actual mission vs. administrative overhead?

Example:

- Program Expenses: $80,000
- Administrative Expenses: $20,000
- Total Expenses: $100,000
- Program Expense Ratio = $80,000 ÷ $100,000 = **0.80 or 80%**

Is it good?

- **70% or higher** = Good (most money goes to programs)
- **60–70%** = Acceptable
- **Below 50%** = Donors may question effectiveness

Fundraising Efficiency Ratio

Formula: Fundraising Expenses ÷ Contributions Received

What it means: How much do you spend to raise every dollar in donations?

Example:

- Fundraising Expenses: $5,000
- Contributions Received: $100,000
- Fundraising Efficiency = $5,000 ÷ $100,000 = **0.05 or $0.05**

Is it good?

- **Below $0.25 (25%)** = Excellent
- **$0.25–$0.50** = Good
- **Above $0.50** = Consider improving fundraising methods

Dependence on Largest Donor Ratio

Formula: Contribution from Largest Donor ÷ Total Contributions

What it means: What percentage of your donations come from your single largest donor?

Example:

- Largest Donor Contribution: $30,000
- Total Contributions: $100,000
- Dependence Ratio = $30,000 ÷ $100,000 = **0.30 or 30%**

Is it good?

- **Below 25%** = Healthy (diversified donor base)
- **25–50%** = Moderate risk (consider building other donors)
- **Above 50%** = High risk (vulnerable if this donor stops giving)

Quick Reference: Healthy Ratio Ranges

Ratio	Good Range	Warning Zone
Current Ratio	1.0–2.0	Below 0.8 or Above 3.0
Quick Ratio	0.8–1.5	Below 0.5
Net Profit Margin (Nonprofits)	5–15%	Below 0% (loss)
Debt-to-Equity	Below 1.0	Above 2.0
Program Expense Ratio	70%+	Below 50%

Ratio	Good Range	Warning Zone
Interest Coverage	Above 2.5x	Below 1.5x

How to Use These Ratios

1. **Calculate** the ratio for your organization
2. **Track over time** – Compare month-to-month or year-to-year to spot trends
3. **Compare** to similar organizations (if possible)
4. **Investigate** any concerning ratios – Ask "Why?" and look at underlying numbers
5. **Take action** – If a ratio is unhealthy, make changes (cut expenses, increase revenue, collect receivables faster, etc.)

Remember: Ratios are tools, not rules. Use multiple ratios together to understand the full financial picture.

Debit vs. Credit Cheat Sheet

With Real-World Examples for Quick Reference

The Basic Rule (Remember This!)

In double-entry accounting, every transaction affects two accounts:

DEBITS = Left side of account
CREDITS = Right side of account

The key is understanding which type of account gets debited and which gets credited.

The Golden Rule: DEBITS & CREDITS BY ACCOUNT TYPE

Account Type	Increases With	Decreases With
Asset (cash, inventory, equipment)	DEBIT	CREDIT
Liability (loans, accounts payable, taxes owed)	CREDIT	DEBIT
Equity (owner's capital, retained earnings)	CREDIT	DEBIT
Revenue (sales, service income)	CREDIT	DEBIT
Expense (rent, utilities, salaries)	DEBIT	CREDIT

Quick Memory Trick:
Think of your personal bank account. When you DEPOSIT money, the bank CREDITS your account (increases your assets from their view, but increases your assets from your view too). When you WITHDRAW, they DEBIT. This is why it feels backwards!

Real-World Examples

Example 1: You Buy Office Supplies with Cash

What happens: Your cash goes down, your office supplies go up.

The entry:

- DEBIT: Office Supplies Expense (expense increases) ... $50
- CREDIT: Cash (asset decreases) ... $50

Example 2: You Receive Payment from a Customer

What happens: Your cash goes up, your revenue goes up.

The entry:

- DEBIT: Cash (asset increases) ... $500
- CREDIT: Service Revenue (revenue increases) ... $500

Example 3: You Pay a Loan Payment

What happens: Your cash goes down, your loan liability decreases.

The entry:

- DEBIT: Loan Payable (liability decreases) ... $200
- CREDIT: Cash (asset decreases) ... $200

Example 4: You Buy Equipment on Credit (Loan)

What happens: Your equipment goes up, your liability goes up.

The entry:

- DEBIT: Equipment (asset increases) ... $3,000
- CREDIT: Accounts Payable (liability increases) ... $3,000

Example 5: You Record Monthly Rent Expense

What happens: Your rent expense goes up, your cash goes down.

The entry:

- DEBIT: Rent Expense (expense increases) ... $1,200
- CREDIT: Cash (asset decreases) ... $1,200

Example 6: You Earn Unearned Revenue (Advance Payment)

What happens: Your cash goes up, your liability goes up (you owe them service).

The entry:

- DEBIT: Cash (asset increases) ... $800
- CREDIT: Unearned Revenue (liability increases) ... $800

(Later, when you provide the service:)

- DEBIT: Unearned Revenue (liability decreases) ... $800
- CREDIT: Service Revenue (revenue increases) ... $800

Example 7: You Record Depreciation on Equipment

What happens: Your depreciation expense increases, equipment value decreases.

The entry:

- DEBIT: Depreciation Expense (expense increases) ... $100
- CREDIT: Accumulated Depreciation (asset contra account) ... $100

Example 8: You Withdraw Money from the Business (Owner's Draw)

What happens: Your cash goes down, your owner's equity goes down.

The entry:

- DEBIT: Owner's Drawings (equity decreases) ... $500
- CREDIT: Cash (asset decreases) ... $500

Example 9: You Write Off Uncollectible Accounts Receivable

What happens: Your accounts receivable go down, your bad debt expense goes up.

The entry:

- DEBIT: Bad Debt Expense (expense increases) ... $150
- CREDIT: Accounts Receivable (asset decreases) ... $150

Example 10: You Pay Employee Salaries

What happens: Your cash goes down, your salary expense goes up.

The entry:

- DEBIT: Salary Expense (expense increases) ... $2,500
- CREDIT: Cash (asset decreases) ... $2,500

Quick Cheat: T-Account Visual

Think of each account as a "T" shape:

```
            Account Name
      Left (Debit) | Right (Credit)
```

```
                    |
```

For Assets:

```
          Cash
   Debit  |  Credit
  (in)    |   (out)
$1,000    |   $500
```

For Liabilities:

```
       Accounts Payable
   Debit  |  Credit
  (pay)   |  (owe)
  $500    |  $1,000
```

For Revenue:

```
       Service Revenue
   Debit  |  Credit
 (rarely) |  (earn)
          |  $3,000
```

For Expenses:

```
         Rent Expense
   Debit  |  Credit
  (spend) | (rarely)
 $1,200   |
```

Accounting Equation Check

After every transaction, verify: **Assets = Liabilities + Equity**

Example: You buy $500 of supplies with cash

- Assets: Cash –$500, Supplies +$500 (net $0 change)
- Result: Equation stays balanced ✓

Example: You take a $5,000 loan

- Assets: Cash +$5,000
- Liabilities: Loan Payable +$5,000
- Result: Both sides increase equally ✓

Common Mistakes to Avoid

✕ **Mistake:** Debiting an expense and debiting cash (would mean the account is being entered on the same side twice)

✓ **Correct:** DEBIT Expense, CREDIT Cash (opposite sides)

✕ **Mistake:** Crediting revenue and crediting cash (same side)

✓ **Correct:** DEBIT Cash, CREDIT Revenue (opposite sides)

✕ **Mistake:** Forgetting that debits must equal credits

✓ **Correct:** Always verify your entry is balanced before recording

Summary

- **ASSETS increase with DEBITS** (decrease with credits)
- **LIABILITIES increase with CREDITS** (decrease with debits)
- **EQUITY increases with CREDITS** (decreases with debits)
- **REVENUE increases with CREDITS** (rarely decreases)
- **EXPENSES increase with DEBITS** (rarely decrease)

Every transaction = two entries that balance = accounting equation stays balanced

Chart of Accounts Cheat Sheet

What is a Chart of Accounts?

A **Chart of Accounts (CoA)** is a complete list of all accounts used by an organization to record financial transactions. It's organized by account type and numbered for easy reference.

Account Types

1. Assets

Items the organization owns that have value

Account	Definition	Example
Cash	Money on hand and in bank accounts	Checking account balance
Accounts Receivable	Money clients/customers owe	Invoice from a donor
Inventory	Goods available for sale or use	Office supplies in storage
Equipment	Long-term items used in operations	Computers, furniture
Building/Property	Real estate owned	Office building
Accumulated Depreciation	Reduction in asset value over time	Equipment losing value yearly

2. Liabilities

Money or obligations the organization owes

Account	Definition	Example
Accounts Payable	Money owed to vendors/suppliers	Invoice from an office supply company
Salaries Payable	Wages owed to employees	End-of-month employee pay
Loans Payable	Debt that must be repaid	Bank loan for equipment
Grant Liability	Money received with restrictions not yet earned	Grant funds for next year's programs

3. Equity/Net Assets

What remains after liabilities are subtracted from assets (for nonprofits: "Net Assets")

Account	Definition	Example
Unrestricted Net Assets	Funds with no donor restrictions	General operating funds
Temporarily Restricted Net Assets	Funds limited to specific use/time	Grant for 2025 programs only
Permanently Restricted Net Assets	Funds held forever; only income used	Endowment funds
Retained Earnings	Profits kept in the organization	Year-end surplus

4. Revenue/Income

Money coming into the organization

Account	Definition	Example
Donated Funds	Charitable contributions	Individual donations
Grant Revenue	Government or foundation grants	Federal grant received
Program Revenue	Money from services/programs	Fee for a class or workshop
Membership Dues	Membership payments	Annual membership fee
Investment Income	Interest, dividends, capital gains	Interest on savings account

5. Expenses

Money going out to operate the organization

Account	Definition	Example
Salaries & Wages	Employee compensation	Monthly payroll
Supplies	Non-capital items used up	Office paper, pens
Rent/Facilities	Building costs	Monthly office rent
Utilities	Electricity, water, internet	Monthly electric bill
Program Expenses	Costs directly tied to programs	Materials for workshops

Account	Definition	Example
Depreciation Expense	Non-cash reduction in asset value	Computer depreciating
Administrative	General overhead costs	HR, accounting, management
Fundraising	Costs to raise money	Event hosting fees

Basic Numbering System

Accounts are typically numbered by type (this varies by organization):

- **1000-1999**: Assets
- **2000-2999**: Liabilities
- **3000-3999**: Equity/Net Assets
- **4000-4999**: Revenue/Income
- **5000-5999**: Expenses

Example: - 1010 = Cash in Bank (Asset) - 2020 = Accounts Payable (Liability) - 4100 = Donated Funds (Revenue) - 5210 = Salaries & Wages (Expense)

Key Principle: The Accounting Equation

Assets = Liabilities + Equity

Every transaction affects at least two accounts and keeps this equation balanced.

Example: - Organization receives $5,000 donation - Cash (Asset) increases by $5,000 - Unrestricted Net Assets (Equity) increases by $5,000 - Equation stays balanced

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Tips for Using Your Chart of Accounts

Keep consistent naming across all accounts
Review and update annually
Use specific names (not just “Income” or “Expense”)
Don’t create accounts you won’t use
Group related accounts together by number

Basic Accounting Terms Sheet

1. Account – A record that tracks all increases and decreases for a specific item, like cash or sales.

2. Account Balance – The current total in an account after all additions and subtractions.

3. Accounting – The system of recording, summarizing, and reporting a business's financial information.

4. Accounting Period – The time span (month, quarter, year) covered by financial reports.

5. Accounts Payable (AP) – Money the business owes to suppliers and others for purchases on credit.

6. Accounts Receivable (AR) – Money customers owe the business for sales made on credit.

7. Accrual Basis Accounting – Method that records revenues and expenses when they happen, not when cash moves.

8. Accrued Expense – An expense that has been incurred but not yet paid in cash (like wages owed at month-end).

9. Asset – Anything the business owns that has value, such as cash, equipment, or inventory.

10. Current Asset – An asset expected to be used or turned into cash within one year, like inventory or receivables.

11. Noncurrent (Long-Term) Asset – An asset kept for more than one year, like buildings or machinery.

12. Fixed Asset – Long-term physical assets used to run the business, such as equipment or vehicles.

13. Intangible Asset – Non-physical assets like patents, trademarks, or goodwill.

14. Audit – An independent check of financial records to see if they are accurate and follow rules.

15. Balance Sheet – A report that shows a company's assets, liabilities, and equity at a specific date.

16. Bookkeeping – The day-to-day process of recording financial transactions.

17. Book Value – The value of an asset on the books: cost minus depreciation recorded so far.

18. Capital – Money or other resources invested into a business by owners or investors.

19. Working Capital – Current assets minus current liabilities; shows short-term financial strength.

20. Cash – Physical money and funds in bank accounts that are immediately available.

21. Cash Basis Accounting – Method that records revenues and expenses only when cash is actually received or paid.

22. Cash Flow – The movement of money into and out of the business over a period.

23. Cash Flow Statement – A report that shows cash inflows and outflows from operations, investing, and financing.

24. Chart of Accounts – The master list of all accounts used by a business to record transactions.

25. Closing Entries – Entries made at period end to move temporary account balances (like revenue and expenses) into equity.

26. Contra Account – An account that reduces the balance of a related account, such as accumulated depreciation.

27. Cost of Goods Sold (COGS) – Direct costs of making or buying the products sold, such as materials and direct labor.

28. Cost of Sales – Another term often used for COGS, especially for service or retail companies.

29. Credit (Cr) – An entry that usually increases liabilities and equity and decreases assets.

30. Debit (Dr) – An entry that usually increases assets and expenses and decreases liabilities and equity.

31. Current Liability – A debt or obligation due within one year, like accounts payable or short-term loans.

32. Long-Term Liability – A debt that is due in more than one year, like a long-term bank loan.

33. Liability – Money the business owes to others, such as loans, payables, and taxes.

34. Double-Entry Accounting – System where every transaction affects at least two accounts and debits must equal credits.

35. Equity – The owner's claim on the business: assets minus liabilities.

36. Owner's Equity – Equity for a sole proprietor; what the owner would receive if the business were closed today.

37. Shareholders' Equity – Equity for a corporation; owners' residual interest after liabilities.

38. Revenue – Income earned from selling goods or services.

39. Sales Revenue – Revenue specifically from selling products or services to customers.

40. Other Income – Income not from main operations, such as interest income or rental income.

41. Expense – Costs incurred to run the business and generate revenue.

42. Operating Expense – Day-to-day expenses like rent, utilities, and salaries.

43. Non-Operating Expense – Costs not related to core operations, such as interest expense.

44. Income Statement (Profit and Loss) – A report showing revenues, expenses, and profit or loss over a period.

45. Profit and Loss Statement (P&L) – Another name for the income statement.

46. Gross Profit – Sales revenue minus cost of goods sold.

47. Operating Income – Profit from core operations: gross profit minus operating expenses.

48. Net Income (Net Profit) – Final profit after all expenses, including taxes and interest, are deducted from revenue.

49. Net Loss – When total expenses are greater than total revenues.

50. Gross Margin – Gross profit expressed as a percentage of sales.

51. Profit Margin – Net income as a percentage of sales, showing how much profit is made from each dollar sold.

52. Return on Investment (ROI) – Net profit divided by the cost of an investment, shown as a percentage.

53. Retained Earnings – Cumulative profits kept in the business instead of being paid out as dividends.

54. Dividend – Part of a company's profit paid to shareholders.

55. Inventory – Goods a business holds for sale or for use in producing goods for sale.

56. Inventory Turnover – How many times inventory is sold and replaced during a period.

57. Depreciation – Spreading the cost of a long-term asset over its useful life as an expense each period.

58. Accumulated Depreciation – Total depreciation recorded so far on a specific asset.

59. Amortization – Spreading the cost of an intangible asset or a loan over time.

60. Prepaid Expense – A payment made in advance for services or benefits to be received later, like prepaid insurance.

61. Unearned (Deferred) Revenue – Money received before goods or services are provided; a liability until earned.

62. Payroll – The total wages, salaries, and related costs paid to employees.

63. Payroll Tax – Taxes related to employee pay, such as Social Security or income tax withholding.

64. Bank Reconciliation – Comparing the company's cash records to the bank statement to identify differences.

65. Bank Statement – A report from the bank listing all transactions and balances in an account for a period.

66. General Ledger (GL) – The main record that contains all accounts and all transactions.

67. Subsidiary Ledger – A detailed ledger that supports a main account, such as accounts receivable by customer.

68. Journal – The first place where transactions are recorded in date order.

69. Journal Entry – A specific record of a transaction showing date, accounts, debits, and credits.

70. Posting – Transferring information from journals to the accounts in the ledger.

71. Trial Balance – A list of all accounts and their balances to check that total debits equal total credits.

72. Fiscal Year – A 12-month accounting period chosen for reporting, which may differ from the calendar year.

73. Fiscal Quarter – A three-month segment of the fiscal year used for shorter reports.

74. GAAP (Generally Accepted Accounting Principles) – Standard rules and guidelines for financial reporting in the U.S.

75. Revenue Recognition Principle – Rule that revenue is recorded when it is earned, not when cash is received.

76. Matching Principle – Rule that expenses should be recorded in the same period as the revenues they help generate.

77. Consistency Principle – Idea that a company should use the same accounting methods from period to period.

78. Objectivity Principle – Rule that financial information should be based on reliable, verifiable evidence.

79. Materiality – The concept that only information big enough to affect decisions needs strict reporting.

80. Conservatism – Guideline to choose the option that is least likely to overstate assets or income.

81. Liquidity – How easily assets can be turned into cash without losing value.

82. Current Ratio – Current assets divided by current liabilities; measures short-term liquidity.

83. Working Capital Ratio – Another name for the current ratio.

84. Quick Ratio – A stricter liquidity ratio that excludes inventory from current assets.

85. Overhead – Ongoing costs to run the business that are not directly tied to specific products, like rent.

86. Variable Cost – A cost that changes with the level of production or sales, like materials.

87. Fixed Cost – A cost that stays the same regardless of production level, like monthly rent.

88. Break-Even Point – The sales level where total revenue equals total costs and profit is zero.

89. Budget – A financial plan that estimates future income and expenses.

90. Variance – The difference between budgeted amounts and actual results.

91. Variance Analysis – The process of examining why budget and actual results differ.

92. Internal Control – Policies and procedures to protect assets and ensure accurate reporting.

93. Internal Audit – An in-house review of processes and records to test internal controls.

94. External Audit – An independent review of financial statements by an outside auditor.

95. Financial Statement – A formal report that shows financial performance and position, such as the balance sheet or income statement.

96. Notes to Financial Statements – Extra explanations that give details behind the numbers in the statements.

97. Marketable Securities – Short-term investments that can be quickly sold for cash, like certain stocks or bonds.

98. Taxable Income – The amount of income on which a business must pay income tax.

99. Interest Income – Money earned from lending funds or from interest-bearing accounts.

100. Interest Expense – The cost of borrowing money, such as interest on loans or credit lines.

Common Accounting Mistakes Cheat Sheet

How to Identify and Avoid Them

Why This Matters

Accounting mistakes can:

- Misrepresent your financial health to lenders, donors, and investors
- Lead to incorrect tax filings and penalties
- Cause you to make poor business decisions based on wrong numbers
- Damage credibility and trust
- Create extra work correcting errors later

The good news: Most common mistakes are preventable with awareness and systems.

MISTAKE #1: Mixing Personal & Business Finances

The Problem

Using personal bank accounts for business expenses or personal credit cards for business purchases. This makes it impossible to track actual business profit/loss.

Real Example

Owner uses personal checking account to pay for office supplies, then wonders why business profit looks so low. The business actually profit was higher—some "personal" spending was really business expenses.

How to Avoid It

- ✓ Open a separate business bank account
- ✓ Use that account ONLY for business transactions
- ✓ Pay yourself a salary or draw (recorded as Owner's Distributions, not mixed income)
- ✓ Reimburse yourself for any personal-out-of-pocket business expenses with proper documentation

Red Flag

"My personal account shows $50,000 but I'm not sure how much is business vs. personal."

MISTAKE #2: Not Recording Transactions Right Away

The Problem

Delaying recording transactions until "later" leads to forgotten entries, double-counting, and incomplete financial statements.

Real Example

A nonprofit receives a $5,000 donation on June 15 but doesn't record it until August. By then, June's financial statement shows no donation revenue. The board makes decisions based on inaccurate data.

How to Avoid It

- ✓ Record transactions **within 1–2 days** of occurrence
- ✓ Use a systematic process (app, spreadsheet, or accounting software)
- ✓ Reconcile bank accounts monthly
- ✓ Keep receipts and supporting documents organized

Red Flag

"I'll catch up on bookkeeping at the end of the quarter."

MISTAKE #3: Forgetting Supporting Documentation

The Problem

Recording a $500 expense but having no receipt, invoice, or explanation. Later, you can't verify what it was for or whether it's deductible.

Real Example

A business records "travel expense – $200" but loses the receipt. During an audit, they can't prove it was a legitimate business expense. The IRS denies the deduction.

How to Avoid It

- ✓ Keep every receipt and invoice
- ✓ File them by date or category
- ✓ Note on the receipt: date, vendor, what was bought, business purpose
- ✓ Use digital tools (photo or scan receipts)
- ✓ Match each journal entry to a receipt

Red Flag

"Where's the receipt for that $300 conference registration?"

MISTAKE #4: Incorrectly Categorizing Transactions

The Problem

Recording an expense in the wrong category. This makes financial statements misleading and useful analysis impossible.

Real Example

Recording a $1,000 office furniture purchase as "Office Supplies Expense" instead of "Equipment (Asset)." Now your profit looks artificially low by $1,000, and your asset value is understated.

How to Avoid It

- ✓ Understand the difference between **expenses** (used up immediately) and **assets** (long-term value)
- ✓ Use a **Chart of Accounts** consistently
- ✓ When in doubt, ask: "Will this item have value beyond this month?" (If yes, it's an asset)
- ✓ Depreciate fixed assets over time, not expense them all at once

Correct	Incorrect
$50 pens → Office Supplies Expense	$50 pens → Equipment
$1,000 desk → Equipment (depreciate)	$1,000 desk → Office Supplies Expense
Monthly rent payment → Rent Expense	Monthly rent → Asset
Truck maintenance → Maintenance Expense	Truck maintenance → Equipment

Red Flag

"Why is our equipment account so high? We barely bought anything!"

MISTAKE #5: Not Reconciling Bank Accounts

The Problem

Your accounting records show $10,000 cash, but the bank says $9,500. You ignore the difference instead of finding the $500 error.

Real Example

A deposit of $500 was recorded in the accounting system but the bank doesn't show it. Later, you realize you deposited a check that bounced. Your cash is actually $500 less than recorded.

How to Avoid It

- ✓ Reconcile bank accounts **monthly**
- ✓ Compare bank statement to accounting records
- ✓ Investigate every difference
- ✓ Look for: outstanding checks, deposits not yet cleared, bank fees, errors
- ✓ Make adjusting entries to fix any mistakes

Red Flag

"The bank says we have $10,000 but our books say $11,500. Oh well, we'll figure it out later."

MISTAKE #6: Not Tracking Accounts Receivable (Money Owed to You)

The Problem

You invoice customers/donors for $20,000 in services but don't track who paid and who didn't. Now you can't follow up on unpaid invoices.

Real Example

A nonprofit sends invoices for grant reimbursement totaling $15,000 but loses track of which ones were paid. They don't follow up on overdue payments, losing $3,000 in unreturned funds.

How to Avoid It

- ✓ Keep an **Accounts Receivable list** or use accounting software
- ✓ Record invoice date, amount, customer/donor, and due date
- ✓ Track payment status (unpaid, partially paid, paid)
- ✓ Follow up on invoices overdue by 30+ days
- ✓ Write off truly uncollectible amounts with documentation

Red Flag

"I have no idea who hasn't paid their invoices. Let me search through emails."

MISTAKE #7: Recording Revenue Too Early or Too Late

The Problem

Violating the **Revenue Recognition Principle**: recording revenue when cash is received instead of when it's earned (or vice versa).

Real Example

Mistake: A client pays $5,000 in advance for a 6-month service contract. You record all $5,000 as revenue immediately. Now Month 1's revenue is overstated and the client hasn't even received service yet.

Correct: Record $833/month as revenue (as service is delivered over 6 months). The initial $5,000 is recorded as "Unearned Revenue" (liability) until service is delivered.

How to Avoid It

- ✓ Use the **Accrual Basis** (record when earned, not when paid)
- ✓ Record advance payments as liabilities ("Unearned Revenue"), not revenue
- ✓ Record the revenue in the period service is actually delivered
- ✓ For nonprofits: Record donations as revenue when received (unless donor specifies restrictions)

Red Flag

"All my invoices were paid this month, so my revenue is way up. Next month with no invoices, revenue will crash."

MISTAKE #8: Forgetting About Depreciation

The Problem

Buying a $10,000 piece of equipment and expensing the entire amount in one year, even though it will last 5+ years.

Real Example

A nonprofit buys a $5,000 computer and records it as an expense in Year 1. In Year 2, they buy another computer for $5,000 and expense it again. The financial statements show crazy high expenses in those two years and low expenses in others, making trends hard to see.

Correct: Depreciate the computer over 5 years, expensing $1,000/year. This matches the benefit received each year.

How to Avoid It

- ✅ Distinguish between **expenses** (used up quickly) and **assets** (long-term value)
- ✅ For assets with useful life > 1 year, calculate **depreciation**
- ✅ Common useful lives:
  - Vehicles: 5–7 years
  - Equipment: 5–10 years
  - Furniture: 7–10 years
  - Buildings: 25–40 years
- ✅ Deduct depreciation as an expense each year the asset is used

Red Flag

"Why is our profit all over the place year-to-year even though business is steady?"

MISTAKE #9: Not Recording Accrued Expenses

The Problem

Expenses that have been incurred but not yet paid are ignored until you actually pay them. This makes financial statements late and inaccurate.

Real Example

At the end of June, you've earned salaries for your employees totaling $8,000, but payroll doesn't process until July 5. If you don't record the accrued expense in June, June's profit looks too high by $8,000.

How to Avoid It

- ✓ At month-end, identify expenses that have been **incurred but not paid**
- ✓ Record them as **Accrued Expenses** (liability)
- ✓ Common accruals: salaries, utilities, interest, professional fees
- ✓ When you actually pay, reverse the accrual and record the payment

Red Flag

"Our profit looked great in June but dropped in July when we paid all those bills."

MISTAKE #10: Confusing Cash Flow with Profit

The Problem

Profit ≠ Cash. You can be profitable on paper but run out of cash (or have lots of cash but be losing money). Ignoring this difference leads to poor cash management.

Real Example

A consulting business is "profitable" on paper ($50,000 net income). But most clients haven't paid their invoices yet, so the business only has $5,000 in the bank. They can't pay rent next week because cash is low, even though profit is high.

How to Avoid It

- ✓ Track **profit** (using the Income Statement)
- ✓ Track **cash flow** separately (using the Cash Flow Statement)
- ✓ Profit ≠ Cash because of:
  - Unpaid invoices (profit recorded, cash not received)
  - Prepaid expenses (cash paid, expense not yet recorded)
  - Depreciation (expense recorded, no cash paid)
  - Loans (cash received, not recorded as profit)
- ✓ Monitor both metrics; they tell different stories

Red Flag

"We're profitable but we're out of cash. How is this possible?"

MISTAKE #11: Forgetting Prepaid Expenses

The Problem

Paying for something upfront (like insurance or a 12-month subscription) and immediately expensing the entire amount. This overstates expenses in that month and understates them in future months.

Real Example

You pay $1,200 for annual insurance in January and record it as an expense. January shows a $1,200 expense, but you also pay the same $1,200 each year. Comparing January to other months looks unfair.

Correct: Record $1,200 as an asset "Prepaid Insurance." Then each month, record $100 as insurance expense.

How to Avoid It

- ✓ When you pay for something upfront, ask: "Is this for future months?"
- ✓ If yes, record as an asset (Prepaid Expense), not an expense
- ✓ Each month, deduct it as an expense
- ✓ Common prepaid items: insurance, annual software subscriptions, annual memberships

Red Flag

"My January expenses were triple February's. Is something wrong?"

MISTAKE #12: Poor Record Organization

The Problem

Receipts scattered everywhere, invoices in random folders, no consistent naming system. When you need information, you can't find it.

Real Example

An audit happens and the accountant asks for documentation of all $500+ expenses in Q2. You have receipts, but they're in email, desk drawers, and a filing cabinet. You spend 20 hours searching and still can't find everything.

How to Avoid It

- ✓ Create a **filing system** (physical or digital)
  - By date (Year/Month/Transaction)
  - By category (Receipts, Invoices, Bank Statements, Tax Documents)
- ✓ Use consistent **naming conventions** for files

    - Example: 2025-01-15_Office-Depot_Supplies_$45.pdf
- ✓ Keep a **backup copy** (paper and digital)
- ✓ Retain documents for at least **7 years** for tax purposes
- ✓ Use tools: cloud storage (Google Drive, Dropbox), accounting software (QuickBooks, Wave)

Red Flag

"Where did I put that receipt? I have no idea."

MISTAKE #13: Wrong Application of the Matching Principle

The Problem

Recording revenue in one period but the related expense in another, making it impossible to see the true profit/loss of that specific transaction.

Real Example

Mistake: You deliver a service in June (earn $2,000 revenue) but don't invoice until July. You record the revenue in July but some of the costs were paid in June. Now June looks artificially low and July looks artificially high.

Correct: Record both the revenue AND the related costs in the same period (June), even if the invoice is sent in July.

How to Avoid It

- ✓ Record revenue and expenses in the **same period** when they're related
- ✓ Use **accrual accounting** (not cash accounting) to support this
- ✓ For service/project-based work: match revenue to the period service was delivered, costs to that period

Red Flag

"January was profitable but February was a loss, even though we did the same amount of work."

MISTAKE #14: Not Tracking Restricted vs. Unrestricted Funds (Nonprofits)

The Problem

Treating restricted donations (designated for a specific purpose) the same as unrestricted funds. This violates donor intent and can misrepresent available cash.

Real Example

A nonprofit receives a $10,000 grant "for the youth program" and treats it as general operating funds. They use $6,000 for youth and $4,000 for administrative costs. They've violated the grant terms and may need to repay it.

Correct: Track restricted funds separately. Youth program donation can only be spent on youth programs. Use unrestricted funds for administrative.

How to Avoid It

- ✓ Maintain **separate accounts** or careful records for restricted funds
- ✓ Track **donor restrictions** when donations arrive
- ✓ Never mix restricted and unrestricted funds in spending
- ✓ Report restricted funds separately in financial statements
- ✓ Review restricted fund balances monthly to ensure proper usage

Red Flag

"Did we spend that grant money on what it was supposed to be for? I'm not sure."

MISTAKE #15: No Regular Financial Review

The Problem

Financial statements are prepared quarterly or annually, but nobody actively reviews them. By the time you notice a problem, significant damage has occurred.

Real Example

A business's accounts payable quietly grow from $5,000 to $50,000 over 6 months. Nobody notices until year-end when the accountant sees it. Now they're in serious cash trouble.

How to Avoid It

- ✓ Review key numbers **monthly**: cash balance, revenue, expenses, accounts payable/receivable
- ✓ Create a simple **dashboard** with key metrics
- ✓ Compare to budget or last year (look for variances)
- ✓ Investigate any significant unexpected changes
- ✓ Meet with your accountant or finance team **monthly or quarterly**, not just year-end

Red Flag

"I'll look at the financial statements next month." (Repeated every month)

Quick Checklist: Avoiding These 15 Mistakes

- [ ] Separate personal and business finances completely
- [ ] Record transactions within 1–2 days
- [ ] Keep every receipt and supporting document
- [ ] Use a Chart of Accounts and categorize correctly
- [ ] Reconcile bank accounts monthly
- [ ] Maintain an Accounts Receivable log and follow up on overdue invoices
- [ ] Record revenue when earned, not when cash is received
- [ ] Depreciate long-term assets, don't expense them all at once
- [ ] Record accrued expenses at month-end
- [ ] Monitor both profit and cash flow separately
- [ ] Record prepaid expenses as assets, then deduct monthly
- [ ] Organize records in a consistent system with backups
- [ ] Match revenue and related expenses in the same period
- [ ] Track restricted vs. unrestricted funds separately (nonprofits)
- [ ] Review financial statements actively at least monthly

When to Seek Help

If you spot any of these mistakes, consider:

- **Small accounting errors:** Fix them yourself using your accounting software's edit feature, with proper documentation
- **Systematic issues:** Hire a bookkeeper or accountant to help set up correct systems
- **Legal/compliance questions:** Consult a CPA or tax professional
- **Audit issues:** Contact an external auditor if required or recommended

Prevention is cheaper than correction.