Glossary of Accounting Terms

Account: A record that holds the results of financial transactions.

Accountant's Equation: The equation that is the basis of the Balance Sheet:
Assets = Liabilities + Owners' Equity.

Accounting: A service that oversees, measures, and evaluates financial information for decision making purposes.

Accounts Payable: Amounts due *from* your business *to* your creditors. Generally these are short term liabilities (30-120 days), and are shown under the Current Liabilities section in the Balance Sheet.

Accounts Receivable: Amounts due *to* your business *from* your customers. Generally these amounts are short term receivables (30-120 days), and are shown under Current Assets section in the Balance Sheet.

Accounts Receivable Turnover: A measure used to determine a company's average collection period for receivables. Usually computed by dividing net sales (or net credit sales) by average accounts receivable.

Accrual Basis Accounting: The practice of bookkeeping when income is recorded when earned and expenses are recorded when they are incurred.

Aging Schedule: A schedule showing the length of time an invoice has been outstanding or held. Aging schedules are normally created for Accounts Payable and Accounts Receivable. For example, an aging schedule for accounts receivable can show how many days an invoice has been outstanding. Aging schedules can also be created for inventory.

Amortization: The gradual and periodic reduction of an amount over time. It can apply to either the periodic write-down of an asset (see depreciation) or a gradual extinguishment of a debt (payments reducing loan principal).

Annual Percentage Rate (APR): Also known as effective annual rate, is used to put investments with varying interest compounding periods (daily, monthly, semiannually) on a common basis. It is computed as follows:

APR = $(1 + r/m)\ m - 1.0$ where r = the stated, nominal, or quoted rate, and m = the number of compounding periods per year.

Annual Report: A report prepared by a business entity at the end of its calendar or fiscal year. It presents a company's financial position and operating results for use by interested parties, including potential investors, creditors, stockholders, and employees.

Arm's-Length Transaction: Business dealings between independent and rational parties who are looking out for their own interests.

Assets: Economic resources owned or controlled by a person or company.

Audit: The result of an independent accountant's review of the financial statements and their footnotes to ensure compliance with generally accepted accounting principles (GAAP) and to express an opinion on the fairness of the financial statements.

Audit Opinion: The official result of an audit. A CPA's "unqualified opinion" means that the financial statements he/she has audited present fairly the financial position and operating results of the company in conformity with GAAP. A "qualified opinion" occurs under a number of circumstances, for instance, if the financial statements do not follow GAAP and the client refuses to make the needed changes. An "adverse opinion" happens when the financial statements are misleading and do not fairly represent a company's financial position. (Just because you passed an audit, it does not mean that your company is in good financial shape. It just means that your books are a fair representation of what you did.)

Bad Debt: An uncollectible Account Receivable.

Balance sheet: A balance sheet is an itemized statement which lists the total assets and the total liabilities of a given business to show its net worth at a given moment in time (like a snapshot).

Bank Reconciliation: Verification that your bank statement and your checkbook balance.

Bankruptcy: This involves a discharge of the debtor's obligations through court order. The purpose of bankruptcy is to provide the debtor with a fresh start and to have an equitable distribution of the debtor's assets among the creditors.

Board of Directors: Individuals elected by the stockholders to govern a corporation.

Bond: A contract between a borrower and a lender. The borrower promises to pay a specified rate of interest for each period the bond is outstanding and repay the principal at the maturity date.

Bookkeeping: The act of systematically recording the financial transactions affecting a business.

Book Value: The net amount (original value plus or minus any adjustments such as depreciation) shown in the accounts for an asset, liability, or owners' equity item.

Break-even point: The volume point of sales at which revenues and costs are equal; a combination of sales and costs that will yield a no profit/no loss operation.

Budget: A formal statement of management's expectations of sales, expenses, volume, and other financial transactions of an organization. A budget is a tool for planning and control. In the beginning it can act as a plan and in the end it can act as control to measure performance against so that future plans can be improved.

Business: An organization created with the objective of making a profit from the sale of goods or services.

Business Failure: According to law, business failure can be either "technical insolvency" or "bankruptcy." In technical insolvency a business is unable to meet current obligations even if the total assets exceed total liabilities. In bankruptcy, liabilities exceed the market value of the assets and a negative net worth exists. (See accountant's equation).

Calendar Year: An entity's reporting year, covering 12 months and ending on December 31. *(See: Fiscal year)*

Capital: Property or money used and owned by a business and used to acquire future income or benefits.

Capital Account: An account where an owner's or partners' interest in the business is recorded. It is increased by owner investment and net income and decreased by withdrawals and net losses.

Capital Gain or Loss: The difference between the market and book value at purchase or other acquisition realized at the sale or disposition of a capital asset.

Capital Expense: A capital expenditure is one that will benefit one year or more. It can increase the quantity or quality of services to be gained from the asset. It is charged to an asset account.

Capital Lease: Although the lessee does not legally own rental property, the property is theoretically acquired and recorded as an asset with the related liability.

Capital Stock: The ownership shares of a corporation authorized by its articles of incorporation, including preferred and common stock.

Cash Basis: A bookkeeping method that recognizes revenue and expenses at the time of cash receipt or payment. (Opposite of Accrual Basis.)

Cash Flow: Generally refers to the difference between cash receipts and disbursements over a specific period of time.

Certified Public Accountant: A designation given to an accountant who has passed a uniform CPA examination and has met other certifying requirements. CPA certificates are issued and monitored by state boards of accountancy or similar agencies.

Chart of Accounts: A listing (usually in account number order) of all accounts used by a company.

Charter: Also known as Articles of Incorporation. A document issued by a state that gives legal status to a corporation and details its specific rights, including the authority to issue a certain maximum number of shares of stock.

Common Stock: A class of stock issued by a corporation. It is the most frequently issued type of stock. It carries with it a voting right, however is secondary in priority to preferred stock in dividend and liquidation rights.

Compounding Period: The period of time for which interest is computed.

Consignment: In a consignment, the consignor (owner of the goods) transfers goods to the consignee. The consignor retains legal title and includes the goods in his inventory. The consignee is acting as an agent in an attempt to sell the goods. Although the consignee is temporarily holding the goods, the inventory is not an asset on his books. If a sale occurs, the consignee deducts from the selling price his commission and related expenses, remitting the balance to the consignor.

Corporation: A type of business organization chartered by a state and given many of the legal rights as a separate entity. Ownership is represented by transferable shares of stock.

Cost of Good Sold: COGS; The amount determined by subtracting the value of the ending merchandise inventory from the sum of the beginning merchandise inventory and the net purchases for the fiscal period.

Credit: An entry on the right side of a ledger account.

Current Assets: Current assets are those assets of a company that are expected to be converted to cash, sold, or consumed during the normal operating cycle of the business (usually one year). Examples are cash, accounts receivable, short-term investments, US government bonds, inventories, and prepaid expenses.

Current Liabilities: Liabilities to be paid within one year of the balance sheet date.

Current Ratio: Also known as Working Capital Ratio. A measure of liquidity of business. Equal to current assets divided by current liabilities.

Debit: An entry on the left side of a ledger account.

Depreciation: The expense recognized in writing off the cost of a plant or machine over its useful life, giving consideration to wear and tear, obsolescence, and salvage value. Methods vary. Examples are straight line (SL), accelerated methods such as sum-of-the-years digits (SYD), and double-declining balance (DDB) methods. Primarily accelerated depreciation is chosen for a business' tax expense but straight line is chosen for its financial reporting purposes.

Dividend: That portion of a corporation's earnings that is paid to the stockholders.

Drawings: Distribution to the owner(s) of a sole proprietorship or partnership.

Drawings Account: The account used to show the withdrawals of earnings by the owner(s) of a sole proprietorship or partnership.

Earnings per Share: The computation of a corporation's earnings based on the number of stock shares outstanding at a given point in time.

Embezzlement: The act of an employee stealing money or assets of the company.

Factor: To sell accounts receivable at a discount before they are due.

Fair Market Value: The price at which a willing seller will sell, and a willing buyer will buy, when neither is under compulsion to sell or buy and both have reasonable knowledge of relevant facts.

FASB: Financial Accounting Standards Board. The private organization responsible for establishing the standards for financial accounting and reporting in the United States.

FIFO: First In First Out type of inventory valuation. The first goods purchased are assumed to be the first goods sold.

Fiscal Year: A business' reporting year, covering a 12-month month period. (Not necessarily ending on December 31.)

Fixed Assets: Permanent assets of a company required for the regular conduct of business which will not be converted into cash during the next year. Examples are land, building, furniture and fixtures.

Fixed Cost: Fixed costs are operating expenses that are incurred when providing necessities for doing business and have no relation to the volume of production and sales (as opposed to "variable costs"). Examples are rent, property taxes, and interest expense.

FOB: Free-On-Board Destination. The seller of merchandise bears the shipping costs and maintains ownership until the merchandise is delivered to the buyer.

Franchise: A business that has been licensed to sell the product of a manufacturer or to offer a particular service in a given area.

GAAP: Generally Accepting Accounting Principles. A priority listing made up of statements of accounting principles issued by the AICPA (American Institute of Certified Public Accountants) and FASB (Financial Accounting Standards Board)

General Journal: (GJ) A book or original entry in a double-entry system. The journal lists transactions and indicated accounts to which they are posted. The general journal includes all transactions which aren't included in specialized journals used for cash receipts, cash disbursements, and other common transactions.

General Ledger: (GL) A book in which monetary transactions of a business are posted (in the form of debits and credits) from a journal. It is the final record from which financial statements are prepared. The general ledger accounts are often the control accounts which report totals of details included in subsidiary ledgers.

Goodwill: An intangible asset that exists when a business is valued at more than the fair market value of its net assets. Goodwill is usually due to reputation, good customer relations, etc.

Gross Profit: The amount by which the net sales exceed the cost of goods sold.

Gross Sales: Total recorded sales before deducting any sales discounts or sales returns and allowances.

Internal Control: Policies and procedures designed to provide reasonable assurance that a company's objectives will be achieved. It consists of control environment, risk assessment, control activities, information and communications and monitoring.

Interest: The cost of the use of money.

Interest Rate: The cost of money expressed as an annual percentage.

Inventory: Goods held for sale or resale.

Inventory Turnover Ratio: A measure of the management of inventory computed by dividing cost of goods sold (COGS) by the average inventory for a period of time.

Invoice: An itemized list of goods shipped or services rendered with cost.

Journal: A book or original entry in a double-entry bookkeeping system. The journal lists all transactions and indicates the accounts to which they are posted.

Journal Entry: A recording of a transaction where debits equal credits.

Just-in-time Inventory: An inventory system that minimizes inventory costs. It arranges for suppliers to deliver small quantities of raw materials just before those units are needed in production. Storing, insuring, and handling raw materials are costs that add no value to the product, and so are minimized in a just in time system.

Kiting: Drawing a bank check on insufficient funds to take advantage of the lag time (time interval) required for collection. *Certainly not ethical, and under some circumstances very illegal!*

Leases: Long-term non-cancelable commitments. In a lease, the lessee acquires the right to use property owned by the lessor. Even though no legal transfer of title occurs, many leases transfer substantially all the risks and ownership benefits.

LIFO: "Last In First Out" assumption of inventory valuation.

Limited Liability: The legal protection given to stockholders of a corporation. A stockholder's liability extends only to the total of his capital contribution.

Limited Partnership: A limited partnership is one in which one or more partners (but not all) have limited liability up to their investment to creditors in the event of the failure of the business. The general partner manages the business. Limited partners are not involved in daily activities.

Liquidation: The process of dissolving a business by selling the assets, paying the debts, and distributing the remaining equity to the owners.

Liquidity: The availability of cash or ability to obtain it quickly. Also used to determine debt repayment ability

Long-term Liabilities: These are liabilities in your business that are due in more than one year. For example mortgage payable.

Lower Cost or Market: LCM. A method of valuing assets at the lower of its original cost or current market value.

Modified Accrual: An accounting method that is a combination of cash and accrual basis. Recognition is given to revenue when it is available and measurable. Expenditures are usually reflected in the accounting period in which the liability is incurred.

Mutual Agency: The right of all partners in a partnership to act as agents for the normal business operations of the partnership, with the authority to bind it to business agreements.

Net Assets: Owners Equity. The ownership interest in the assets of an entity. Equals total assets minus total liabilities.

Net Income: The difference between your business' total revenues and its total expenses. This caption and amount is usually found at the bottom of a company Income Statement (also known as "The Bottom Line").

Net Operating Loss: A net operating loss results when business expenses exceed business income for the operating period.

Operating Lease: A simple rental agreement.

Operating Leverage: The extent to which fixed costs are part of a company's cost structure; the higher the proportion of fixed costs, the faster income increases or decreases with sales volumes.

Operating Performance Ratio: An overall measure of the efficiency of operations during a period computed by dividing net income by net sales.

Opportunity Cost: A basic term from the disciplines of economics and accounting. In these circles the acceptable definition of the word is, "The advantage forgone as the result of the acceptance of an alternative."

Outstanding Stock: Issued stock that is still being held by investors.

Owners' Equity. Net Assets. The ownership interest in the assets of an entity. Equals total assets minus total liabilities.

Partnership: A Partnership is an unincorporated business that has more than one owner.

Patent: An exclusive right granted for 17 years by the federal government to manufacture and sell an invention. Patents can cover all sorts of inventions, from physical devices to chemical processes, and even software algorithms. The only restrictions are that the invention be novel and not obvious to current practitioners of the art. Perpetual motion machines are specifically disallowed from getting a patent.

Petty Cash Fund: A small amount of cash kept on hand used for making miscellaneous payments.

Prepaid Expenses: Amounts paid in advance to a creditor or vendor for goods or services. Insurance premiums are a good example. Prepaid Expenses are a current asset because you paid for goods or services you have not yet received.

Present Value of $1: The value today of $1 to be received or paid at some future date given a specified interest rate.

Profitability: A company's ability to generate revenues in excess of the costs incurred in producing those revenues.

Profit and Loss Statement: Also known as an Income Statement, or P & L. This statement shows your revenues and expenses for a specific period of time.

Proprietorship: A business owned by one person.

Prospectus: A prospectus is prepared by an entity that wishes to issue securities to investors. Included in the prospectus are financial statements, disclosures (e.g. lawsuit), business plans, overview of corporate operations, and information regarding officers. A "red herring" is a preliminary prospectus that has not been finalized.

Public Companies: Corporations whose stock is publicly traded.

Qualified Opinion: An opinion issued when an auditor determines his audit has been limited in scope or the entity has not followed GAAP.

Reconciliation: A determination of the items necessary to bring the balances of two or more related accounts or statements into agreement.

Recovery Period: The time period designated by Congress for depreciating business assets. Can also be thought of as the "life" of an asset (but is usually shorter).

Retained Earnings: Profits of the business that have not been paid out to the owners as of the balance sheet date. The earnings have been "retained" for use in the business. Retained Earnings is an account in the equity section of the balance sheet.

Return: A key consideration in the investment decision. It is the reward for investing. The investor must compare the expected return for a given investment with the risk involved.

Return on Investment: ROI. A measure of operating performance and efficiency in using assets computed by dividing net income by average total assets.

Revenues: Increases in a company's resources from the sale of goods or services.

S-Corporations: Formerly known as Subchapter S Corporations. A corporation recognized as a regular corporation under state law but is granted special status for federal income tax purposes.

Salvage or Residual Value: Estimated value (or actual price) of an asset at the end of its useful life after disposal costs.

Shareholders or Stockholders: Individuals or organizations that own shares of stock of a corporation.

Solvency: A company's long-run ability to meet all financial obligations.

Sole Proprietorship: A business owned by one person.

Trade credit: Credit one firm grants to another firm for the purchase of goods or services.

Transactions: Exchange of goods or services between businesses or individuals. Can also be other events having an economic impact on a business.

Trial Balance: A listing of all account balances that provides a test of whether total debits equals total credits.

Unearned Revenue: Money received by a business before it is earned. It is a liability to your company until it is earned.

Useful Life: The life that an asset is expected to be useful to the company.

Value: The worth of something. Usually defined as the monetary or “street” value of an item, such as "Fair Market Value."

Working Capital: Current Assets minus Current Liabilities. Some business owners like to think of assets being a use of working capital, and liabilities and capital contributions as being a source of working capital.

Yield: The return on investment that an investor receives from dividends or interest expressed as a percentage of the current market price of the security (or if already owned, price paid).

Z-Score: A z-score is a total arrived at by combining several normal business ratios. The weight given each ratio produces a score which is said to indicate the health of a business. A z-score below 1.5 usually means that the company is close to bankruptcy.