

Key Financial Definitions Glossary of Terms:

ACCOUNT: a record of increases, decreases and balance of an asset, liability or any other financial statement item.

ACCOUNTING: a system designed to record, and report useful financial information about an accounting or economic entity for decision-making purposes.

ACCOUNTING EQUATION: assets = liabilities plus owners equity.

ACCOUNTS PAYABLE: debts of a firm to outside vendors usually for goods and services purchased on an open account.

ACCOUNTS RECEIVABLE: claims against customers for goods and services sold on account.

ACCRUAL: recording a receivable and related revenue when earned or a liability and related expense when the liability is incurred without reference to an explicit event- for example, recognizing interest at the end of an accounting period.

ACCRUAL BASIS OF ACCOUNTING: a matching process of recognizing revenues when earned and related expenses when incurred, independent of when cash receipts and cash disbursements take place.

ACCUMULATED DEPRECIATION: the sum of all depreciation charges taken to date.

ACQUISITION COST: the original historical cost of an acquired asset.

ADDITIONAL PAID-IN CAPITAL: part of owners' equity representing contributed capital in excess of par or stated value of issued stock.

ALLOWANCE FOR DOUBTFUL ACCOUNTS: an estimate of accounts receivable a company expects not to collect.

AMORTIZATION: a system of reducing or writing off an original amount or account balance; for example, amortizing goodwill.

ANNUAL REPORT: a set of financial statements prepared annually according to generally accepted accounting principles (GAAP), together with notes, auditor's report and management's comments about the year's results and prospects for the future; issued once a year to shareholders.

ANNUITY: a series of equal periodic money receipts or payments continuing for a specified number of periods.

ASSETS: valuable economic resources of a firm. Assets represent future benefits controlled by a firm as a result of past events or transactions.

AUDIT: a systematic examination of records and statements. Company employees conduct internal audits. Independent accountants, usually CPAs, conduct external audits in accordance with GAAP.

AUDITOR'S REPORT: a written statement of the scope of an audit and the auditor's professional opinion of the financial statements.

BALANCE SHEET: a statement of financial position showing assets, liabilities and owners' equity as of a specific date.

BIG 4: the four largest international public accounting firms. For many years people referred to the "big eight" as the eight largest U. S. public accounting firms until mergers reduced the number to four.

BOND: a long-term debt instrument.

BOOK VALUE: the accounting carrying value of an asset, liability or owners' equity item.

BUDGET: a financial plan designed to forecast and control future operations.

CAPITAL: the owners' equity of a business firm. Also used to refer to the asset base of a company.

CAPITAL ASSET: an income tax expression for certain long-lived assets.

CAPITAL ASSET PRICING MODEL (CAPM): a technique for valuing a security or a firm in which value is determined by the relative risk of the security and the prevailing risk-free rate of return.

CAPITAL BUDGETING: a process of evaluating long- term investment proposals.

CAPITAL STRUCTURE: the relative proportions of debt, preferred stock and common stock equity.

CASH FLOW STATEMENT: a report listing cash receipts and cash disbursements of a firm from operating, investing and financing activities.

CERTIFIED MANAGEMENT ACCOUNTANT (CMA): a designation issued by the Institute of Certified Management Accountants to a person who has satisfied examination and program requirements of the National Association of Accountants (NAAI).

CERTIFIED PUBLIC ACCOUNTANT (CPA): in the U.S., a designation for a person who has satisfied examination, education and experience requirements and who has received a state certificate designating him or her as qualified to practice as a CPA.

CHARTERED ACCOUNTANT: the designation in the United Kingdom and certain other countries equivalent to the American CPA.

CHART OF ACCOUNTS: a list of names of all accounts of a firm, systematically organized by financial statement type and also usually using a numbering system.

COMMON STOCK: ownership shares in a corporation representing residual claims to earnings and assets after all creditors' and preferred stockholders' claims have been satisfied.

CONSERVATISM: an accounting convention requiring accountants, when faced with several different methods, to select that method which does not overstate net income or owners equity.

CONSISTENCY: a financial reporting policy of applying accounting procedures uniformly over consecutive periods.

CONSOLIDATED STATEMENTS: financial statements that treat parent and affiliated companies as if they are a single economic entity.

CONTINUITY: an assumption that a firm is a "going concern" which will continue to operate indefinitely or in the foreseeable future.

COST: the cash-equivalent price to acquire goods or services. "Cost" is used with modifiers that distinguish among many different meanings of the term.

COST OF CAPITAL: a weighted average cost of debt and equity funds supplied to a firm; also called marginal cost of capital, the required rate of return or discount rate on each new investment.

COST OF GOODS SOLD: an expense, the cost of merchandise or finished goods sold to customers; often calculated by formula: cost of goods sold equals beginning inventory plus purchases or goods manufactured less ending inventory.

CURRENT ASSETS: cash and other assets that a firm expects to convert into cash in the normal course of business during a relatively short period of time, usually one year.

CURRENT LIABILITIES: obligations of a firm that will become due for liquidation during the same time period used to define current assets and that will make a demand on current assets or require replacement by another current liability.

CURRENT RATIO: current assets divided by current liabilities; a liquidity measure.

DEBT-EQUITY RATIO: a measure of the extent to which company assets are financed by creditors and by owners; debt divided by assets or debt divided by owners equity, the numerator generally being long term debt.

DEFERRED INCOME TAX: an estimated asset or liability resulting from a timing difference between financial accounting and tax accounting treatment of certain items used in the calculation of accounting net income and of taxable income.

DEPRECIABLE VALUE: cost less estimated residual value or salvage value of a depreciable asset.

DEPRECIATION: the periodic allocation of the cost of certain long-lived assets to the periods of estimated useful life; also used to mean the amount so allocated.

DISCOUNTED CASH FLOW: a method to evaluate investment proposals or to estimate the value of a firm by discounting future cash flows to a present value.

DISCOUNTING: in finance, a process of calculating the present value of future cash flows.

DISCOUNT RATE: in capital budgeting, an interest rate used to reduce future cash flows to a present value.

DIVIDENDS: a distribution of assets or capital shares to stockholders based on earnings generated through operating activities. Liquidating dividends are asset distributions that represent return of paid-in capital; made upon a winding up of company affairs.

DOUBLE-DECLINING DEPRECIATION (DDB): an accelerated depreciation method.

EARNINGS: a term used to mean income or profit.

EARNINGS PER SHARE (EPS): income to common stockholders, divided by # shares of common stock outstanding.

FREE CASH FLOW (FCF): net cash inflow available for discretionary use such as new investment projects or new debt service.

FULL DISCLOSURE: an accounting policy that requires all significant or material information to be presented in financial statements or in accompanying notes.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP): broad guidelines and detailed practices, procedures, concepts and rules that define acceptable accounting practice at a given time.

GOING CONCERN ASSUMPTION: another name for the continuity assumption.

GOODWILL: an intangible asset representing the excess of the cost of an acquired company over the sum of the fair market values of the individual identifiable assets less liabilities.

GROSS MARGIN: net sales less cost of goods sold (percent); also called gross profit (in dollars).

GROSS MARGIN RATE: gross margin divided by net sales; also called gross profit rate.

HISTORICAL COST: acquisition price; original cost.

HORIZONTAL ANALYSIS: a technique for evaluating comparative financial statement data by measuring absolute and percentage changes over time; also called time-series or trend analysis.

HURDLE RATE: in capital budgeting, the minimum rate of return required on an investment proposal, often set at the cost of capital.

FISCAL PERIOD: a financial accounting period for which a company prepares an income statement. A fiscal year often is different from a calendar year. An interim period is less than one year (for example, a quarterly).

FIXED ASSETS: long-term property, plant and equipment.

FIXED COSTS: costs that remain constant during a given time period regardless of the level of activity.

FINANCIAL RISK: that portion of total corporate risk resulting from the use of fixed-cost financing. The variability in company earnings and cash flows, which increases the risk that a company will not be able to meet debt obligations as they fall due for payment.

FINANCING ACTIVITIES: obtaining cash through the issuance of long-term debt instruments and capital stock, repaying such long-term obligations and paying dividends on stock; a statement of cash flows classification.

FINISHED GOODS: final goods in a manufacturing process that are available for sale to customers.

FIRST-IN, FIRST-OUT (FIFO): a cost-flow assumption that requires oldest inventory costs incurred to be recognized first as cost of goods sold. Balance sheet inventory values consist of the most recent costs incurred.

EBIT: earnings before interest and taxes; revenues less expenses related to the normal continuing business activities of a company; operating income.

ECONOMIC LIFE: an estimate of the time period during which a company expects to receive benefits from an asset.

ENTITY: an economic unit for which accounting statements are prepared. Accounting entities are independent of outside parties, such as creditors, employees and stockholders, and are distinguished from legal entities.

EXPENSE: the cost of resources consumed in trying to generate revenues; an expired cost.

FINANCIAL ACCOUNTING: an information system, the end product of which is a set of financial reports prepared according to GAAP and designed to help stockholders and other outside parties make financial decisions.

FINANCIAL ACCOUNTING STANDARDS BOARD

(FASB): the primary private, independent board responsible for generating generally accepted accounting principles (GAAP) governing accounting practice in the United States.

FINANCIAL LEVERAGE: the degree to which company profitability generates a magnified rate of return on common stockholders' equity. The degree to which a given percentage changes in company profits (EBIT) generates a magnified percentage change in earnings per share of common stock.

INCOME FROM OPERATIONS (EBIT): earnings before interest and taxes; revenues less expenses related to the normal continuing business activities of a company; operating income.

INCOME STATEMENT: a financial report showing revenues, expenses and all other determinants of net income for a fiscal period.

INTANGIBLE ASSET: a long-term property right, such as patent and trademarks; a balance sheet asset classification.

INTEREST: the cost of using money, expressed in dollars.

INTEREST RATE: the cost of using money, expressed as a percentage per year or other period.

INTERNAL RATE OF RETURN (IRR): the effective annual rate of return of an investment project; the discount rate at which the present value of cash inflows equals the present value of cash outflows.

INVENTORY TURNOVER: cost of goods sold divided by average inventory; the number of times inventory is acquired and sold during a year.

INVESTING ACTIVITIES: acquisition and disposal of long-term investment and property assets; making and collecting on loans; a statement of cash flows classification.

JOURNAL: a chronological record of business transactions.

LAST-IN, FIRST-OUT (LIFO): a cash-flow assumption that requires the last, or most recent, inventory costs incurred to be recognized as cost of goods sold. Balance sheet inventory values consist of the oldest costs incurred.

LIABILITY: obligations of a company to creditors requiring the probable future payment of cash or delivery of goods or services as a result of past transactions.

LIQUID ASSETS: cash and current monetary assets, such as marketable securities and receivables, which are directly converted into cash in the normal course of activities; often used to refer to quick assets.

LIQUIDITY: cash or nearness to cash; short-term debt- paying ability.

LONG- TERM ASSETS: non-current assets from the use of which a company expects to receive benefits over a long period of time, usually more than one year.

LONG- TERM LIABILITIES: a company's non-current obligations that will not fall due for settlement within a short period of time, usually one year.

LOWER-OF-COST-OR-MARKET (LCM): a rule for valuation of certain assets that requires the value to be the lower of acquisition cost or current fair market value, usually replacement cost.

MANAGERIAL ACCOUNTING: processing and reporting data for internal decision-making purposes.

MATCHING CONVENTION: an accrual accounting concept that requires assigning expenses against related revenues of a period.

MATERIALITY: an accounting convention that requires disclosure of any item omission or misstatement of which would cause users of financial statement to reach different conclusions or judgments.

MERCHANDISE TURNOVER: inventory turnover.

NET ASSETS: total assets less total liabilities. Net assets equals owners' equity.

NET INCOME: the "bottom line" of an income statement; the excess of revenues and gains over expenses and losses of a period after income taxes.

NET LOSS: the excess of expenses and losses over revenues and gains of a period.

NET PRESENT VALUE (NPV): an evaluation tool in capital budgeting; the present value of cash inflows less the present value of cash outflows of an investment project.

NON-OPERATING EXPENSES: expenses that are not directly related to the main continuing business activities of a company.

NON-OPERATING REVENUES: revenues that are not directly related to the main continuing business activities of a company.

OPERATING ACTIVITIES: main continuing business activities related to acquiring, producing, selling and servicing transactions of a company; often used to mean revenues and expenses resulting from such activities; a statement of cash flows classification.

OPERATING CYCLE: a time period during which cash is used to acquire goods, which are held until sold to customer and converted into receivables, which then are collected as cash.

OPERATING INCOME: revenues less expenses of main continuing business activities of a company.

OPERATING LEVERAGE: the degree to which a given percentage change in sales generates a magnified percentage change in income from operations (EBIT). The relative importance of fixed operating costs determines the degree of operating leverage.

OWNERS' EQUITY: the residual financial interest of stockholders of a corporation. Owners' equity equals assets less liabilities. It consists of contributed (paid-in) capital and retained earnings.

PAID-IN CAPITAL: contributed capital consisting of par or stated value plus the excess over par or stated value or the additional paid-in capital.

PAYBACK PERIOD: the time required for net cash inflows to equal the investment expenditure of a project.

PERIOD CONVENTION: the requirement that financial statements must be issued at least once per year.

PLANT ASSETS: long-term tangible resources such as land, buildings, and equipment; often referred to as fixed assets or property, plant and equipment.

PREFERRED STOCK: a class of capital stock having claims to income and asset distributions before common stockholders but after bondholders and other creditors.

PREPAID EXPENSES: acquired assets that will provide future benefits. Prepaid expenses such as prepaid insurance and office supplies are classified as current assets.

PRESENT VALUE: the equivalent value today of a future money amount. The present value of a future cash flow varies inversely with the interest rate used in the calculation.

PRICE-EARNINGS RATIO (P-E RATIO): the market price per share of common stock divided by the annual earnings per share (EPS) of the stock.

PROFIT MARGIN: net income divided by net sales; this is a profitability ratio.

QUICK RATIO: the sum of cash, marketable securities and receivables divided by current liabilities; a liquidity measure.

REQUIRED RATE OF RETURN: in capital budgeting, a minimum hurdle rate usually equal to the cost of capital.

RETAINED EARNINGS: the cumulative undistributed net profits of a company; the cumulative sum of net income over net losses and dividends; the earned capital portion of owner's equity versus paid in capital.

RETURN ON ASSETS (ROA): net income divided by average assets; sometimes calculated by dividing EBIT by average operating assets.

RETURN ON COMMON STOCKHOLDERS' EQUITY (ROE): net income fewer dividends on preferred stock divided by average common stockholders' equity; a profitability measure.

RETURN ON INVESTMENT (ROI): usually means the same as return on assets (ROA), but it is sometimes used to refer to return on common shareholders' equity (ROE).

REVENUE: the increase in owners' equity resulting from the sale of goods and services to customers. Accrual accounting recognizes revenue when earned regardless of when cash is received.

RISK: deviations from expectations as, for example, deviation from expected returns. Risk is measured in terms of variability of returns. Risk is classified by type, such as business risk, market risk and financial risk.

RISK PREMIUM: the excess of a required rate of return over the rate of return on a risk-free alternative investment.

SERVICE POTENTIAL: the expected future benefit a company expects to receive from a resource.

STATEMENT OF CASH FLOWS: a report listing cash receipts and cash disbursements of a firm from operating, investing and financing activities.

STATEMENT OF FINANCIAL POSITION: a balance sheet listing assets, liabilities and owners' equity.

STATEMENT OF RETAINED EARNINGS: a portion of a statement of changes in stockholders' equity that shows the changes in retained earnings during a fiscal period.

STRAIGHT-LINE DEPRECIATION: a method of allocating the cost of certain long-lived assets equally to each of the periods of estimated useful life.

SUM-OF-THE-YEARS' DIGITS (SYD) DEPRECIATION: an accelerated depreciation method.

TREASURY STOCK: shares of company stock issued and then repurchased by the company but not formally retired. Treasury shares are held in the company "treasury" pending further disposition, usually re-issuance.

UNEXPIRED COST: an asset. When an asset is consumed, the cost expires and becomes an expense.

VERTICAL ANALYSIS: examining components of a financial statement in percentage terms (for example, as a percentage of total assets for balance sheet items or as a percentage of net sales for income statement items).

WEIGHTED AVERAGE COST METHOD: an inventory costing method.

WORKING CAPITAL: current assets less current liabilities.