Accounting Definitions

Definitions

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- Definitions

Introduction

- This *training* contains definitions of common accounting terms.
- If you come across accounting or financial terms with which you are unfamiliar, a web search will usually provide a suitable definition.

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- Accounts – A separate, distinct record showing its increases or decreases. A record of distinct transactions within one of the major accounting elements: assets, liability, net worth (owners' equity), revenue and expense.
- Accounts Payable – Amounts owed by the business to its creditors on open account for goods purchased or services provided.
- Accounting Period – Typically each month throughout the financial (fiscal) year. The period of time covered by the income statement and other financials that report operating results

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- Accounts Receivable – Amounts owed to the business on open account as a result of extending credit to a customer for goods purchased or services provided.
- Accrual Method – Logs transactions at the time a promise (or contract) is made, whether or not cash is transferred
- Accrued Expenses – Expenses that have been incurred but not paid. (Merchandise or services received, but not yet invoiced.)
- Accrued Income – Income that has been earned but not received

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- Adjusting Entries – Unpaid, unrecorded transactions at the end of the accounting period
- Aging – The classification of accounts receivable according to the length of time they have been outstanding. An appropriate rate of loss can then be applied to each age group in order to estimate probable loss from uncollectible accounts.
- Assets – Everything owned by or owed to a business that has a cash value

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- Balance Sheet – A “snapshot” of the business’s Assets, Liabilities and Net Worth; a report of the company’s financial position at a particular moment in time
  - Assets – Business property; what the business owns
  - Liabilities – What the business owes
  - Net Worth – The difference between assets and liabilities

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- Balance Sheet, cont. – A financial statement that shows the financial position of a business as of a fixed date – usually at the close of an accounting period.
- Bottom Line – Net profits or loss after taxes for a specific accounting period
- Budget – A set of financial projections for cash inflow and outflow and other balance sheet items

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- Capital Expenditure – A purchase of an item of property, plant, or equipment that has a useful life more than one year (fixed assets) and in NAF, a purchase price of $2500 of more.
- Cash Flow Statement – See budget
- Cash Method – Logs transactions whenever you actually spend or receive cash
- Chart of Accounts – A list of numbers and titles of all general ledger accounts

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- Closing Entries – Entries made to zero-balance all temporary accounts (revenue and expense) at the end of the accounting period
- Closing Periods:
  - Monthly; month-end closing
  - Yearly; year-end closing
    - At year's end, revenue, expense and owner's withdrawals are "closed" so they start the next accounting period with a zero balance. (Their sum is transferred to an owner's capital account)

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- Cost of Goods Sold – The cost of inventory sold during an accounting period. It is equal to the beginning inventory for the period, plus the cost of purchases made during the period, minus the ending inventory for the period.

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- Credit – In double-entry accounting, a increase in liabilities or income, or an decrease in assets (possessions) or expenses.
  - An amount entered on the right side of an account in double-entry accounting.
  - A decrease in the asset and expense accounts.
  - An increase in the liability, capital and income accounts.

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- Current Assets – Cash, plus any assets that will be converted into cash within one year, plus any assets that you plan to use up within one year
- Current Liabilities – debts that must be paid within one year
- Current Ratio – A dependable indication of liquidity computed by dividing current assets by current liabilities. A ratio of 2.0 is acceptable for most businesses.

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- Debit – In double-entry accounting, a decrease in liabilities or income, or an increase in assets or expenses
- Declining Balance Method – An accelerated method of depreciation in which the book value of an asset at the beginning of the year is multiplied by an appropriate percentage to obtain the depreciation to be taken for that year.
- Depreciable Base – The cost of an asset used in computation of yearly depreciation expense

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- Direct Expense – Those expenses that relate directly to your product or service
- Double-entry Accounting – Logs each transaction as both a debit and as a credit; can be used with both cash and accrual methods. This is based on the premise that every transaction has two sides – at least one account must be debited and one account must be credited and the debit and credit totals must be equal.
- Expenses – The costs incurred through the sale or delivery of goods or services

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- FIFO – (First-In, First-Out) Tracks general quantities of inventory and calculates cost as if the oldest items in the inventory were sold first, so the existing inventory's value is based upon the most recent purchases
- Fiscal Year – Any 12-month accounting period used by a business

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- Fixed Asset – Items purchased for use in a business which are depreciable over a fixed period of time determined by the expected useful life of the purchase. Usually includes real property, vehicles and equipment not intended for resale. (Land is NOT depreciable, but is still listed as a fixed asset.)
- Fixed Asset Log – A record used to keep track of fixed assets purchased by a business during the financial year to be used to determine depreciation expense to be taken for tax purposes

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- Fixed Costs – Costs that do not vary in total during a period even though the volume of goods manufactured may be higher or lower than anticipated
- General Journal – Used to record, in chronological order, all transactions of a business.   These are then posted to the General Ledger.
- General Ledger – In double entry accounting, the master reference file for the accounting system. A permanent, classified record is kept for each business account. Each account is maintained on a separate page of the ledger. (Book, binder, of AIM system…)

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- Gross Profit On Sales – The difference between net sales and the cost of goods sold.
- Gross Profit Margin % – An indicator of the percentage of each sales dollar remaining after a business has paid for its goods. Calculated by dividing the gross profit by sales.
- Income Statement – A report presenting the profit and loss of a business, based on earnings less expenses for a period of time; usually one month

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- Indirect Expense – Operating expenses that are not directly related to the sale of your product or service
- Interest – The price charged or paid for the use of money or credit
- Inventory – The stock of goods on hand for sale

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- Invoice – A bill for the sale of goods or services sent by the seller to the purchaser
- Ledger – In double entry accounting, a permanent reference file for all accounts
- LIFO – (Last-In, First Out) Calculates cost of inventory as if you sold your most recent inventory first. It provides a higher reported cost and lower net income whenever your sales prices rise

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- Liabilities – Amounts owed by a business to its creditors. The debts of the business.
- Liquidity – The ability of a company to meet its financial obligations. A liquidity analysis focuses on the balance sheet relationships for current assets and current liabilities
- Long-Term Liabilities – Liabilities that will not be due for more than a year in the future

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- Net Profit Margin % – The measure of a business's success with respect to earnings on sales. It is derived by dividing net profit by sales. A higher margin means the firm is more profitable.
- Operating Expense – Normal expenses incurred in the running of a business

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- Operating Profit Margin % – The ratio representing the pure operations profits, ignoring interest and taxes. It is derived by dividing the income from operations by the sales. The higher the percentage of operating profit margin, the better.
- Other Expenses – Expenses that are not directly connected with the operation of the business. The most common is interest expense.

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- Other Income – Income that is earned from non-operating sources. The most common is interest income.
- Petty Cash Fund – A cash fund from which non-check expenditures are reimbursed.

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- Physical Inventory – The process of counting inventory on hand at the end of an accounting period. The number of units of each item is multiplied by the cost per item resulting in inventory value.
- Posting – The process of transferring data from the journal to the ledger
- Prepaid Expense – Expense items that are paid for prior to their use. E.g., insurance, rent, prepaid inventory, etc.)

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- Principal – The amount shown on the face of a note or bond. Unpaid principal is the portion of the face amount remaining at any given time.
- Profit and Loss Statement – See Income Statement
- Quarterly Budget Analysis – A method used to measure actual income and expenditures against projections for the current quarter of the fiscal year and for the total quarters completed. The difference is usually expressed as the amount and percentage over or under budget … variance!

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- Quick Ratio – A test of liquidity subtracting inventory form current assets and dividing the results by current liabilities. A quick ratio of 1.0 or greater is usually recommended.
- Property, Plant and Equipment – Assets such as land, buildings, vehicles and equipment that will be used for a number of years in the operations of the business and (with the exception of land) are subject to depreciation

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- Ratios: (using information from the financial statement and balance sheet)
  - Total liabilities divided by net worth is the debt to net worth ratio; a ratio over one is too high

    (net worth = assets – liabilities)
  - Net profit/loss divided by net worth is the return-on-investment ratio; a ratio of at least 12 indicates a healthy business

    (net profit/loss = revenues – expenses)

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- Real Property – Land, land improvements, buildings and other structures attached to the land
- Reconciling – The process used to bring the bank’s (or other’s) records, the accounts, and the business’s checkbook into agreement at the end of the banking period

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- Retained Earnings – Earnings of a corporation that are kept in the business and not paid out in dividends. This amount represents the accumulated, undistributed profits of the corporation.
- Return-On-Investment (ROI) – The rate of profit an investment will earn. The ROI is equal to the annual net income divided by total assets. The higher the ROI, the better.

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- Revenue – The income that results from the sale of products, services, or property or earned from investments
- Revenue and Expense Journal – In single-entry accounting, the record used to keep track of all checks written by the business and all income received for the sale of goods or services

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- Single-Entry Accounting – Small-business recordkeeping system that tracks only income and expense accounts; not used with accrual accounting
- Straight-Line Depreciation – A method of depreciating assets by allocating an equal amount of depreciation for each year of its useful life

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- Sum-of-the-Years' – An accelerated method of depreciation in which a fractional part of the depreciable cost of an asset is charged to expense each year. The denominator of the fraction is the sum of the numbers representing the years of the asset's useful life. The numerator is the number of years remaining in the asset's useful life.

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- Tangible Personal Property – Machinery, equipment, furniture and fixtures not attached to the land
- Three-Year Income Projection – A pro-forma (projected) income statement showing anticipated revenues and expenses for a business

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- Unearned Income – Revenue that has been received, but not yet earned
- Variable Costs – Expenses that vary in relationship to the volume of activity of a business
- Vertical Analysis – A percentage analysis used to show the relationship of the components in a single financial statement. In vertical analysis of an income statement each item on the statement is expressed as a percentage of net sales

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- Wholesale Business – A business that sells its products to other wholesalers, retailers or volume customer son discount
- Work in Progress – Manufactured products that are only partially competed at the end of the accounting cycle

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- Working Capital – Current assets minus current liabilities. This is a basic measurement of a company’s ability to pay its current obligations.