Chapter 1

**Accounting**

A system of providing "quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."

**American Institute of Certified Public Accountants (AICPA)**

The professional organization of certified public accountants in the United States.

**Balance Sheet**

Document which reports the resources of a company (the assets), the company's obligations (the liabilities), and the owners' equity, which represents how much money has been invested in the company by its owners.

**Bookkeeping**

The preservation of a systematic, quantitative record of an activity.

**Certified Public Accountant**

A person who has taken a minimum number of college-level accounting classes, has passed the dreaded CPA exam, and has met other requirements set by his or her state.

**Financial Accounting**

The name given to accounting information provided for and used by external users.

**Financial Accounting Standards Board (FASB)**

Private, non-profit body that sets accounting standards in the United States.

**Financial Statements**

The three primary financial information documents: the balance sheet, income statement, and statement of cash flows.

**Income Statement**

This document reports the amount of net income earned by a company during a period, with annual and quarterly income statements being the most common.

**Internal Revenue Service (IRS)**

The government agency responsible for tax collection and tax law enforcement.

**International Accounting Standards Board (IASB)**

An independent, international body formed to develop worldwide accounting standards.

**International Financial Reporting Standards (IFRS)**

The accounting standards produced by the IASB.

**Managerial Accounting**

The name given to accounting systems designed for internal users.

**Public Company Accounting Oversight Board (PCAOB)**

A private, non-profit organization that effectively serves as an arm of the SEC in registering, inspecting, and disciplining the auditors of all publicly traded companies.

**Statement of Cash Flows**

This document reports the amount of cash collected and paid out by a company in the following three types of activities: operating, investing, and financing.

Chapter 2

**Accounting Equation**

Assets = Liabilities + Owners' Equity

**Accumulated Other Comprehensive Income**

The source of these increased assets

**Assets**

Assets are the firm's economic resources, formally defined as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events

**Balance Sheet**

A statement of financial position shows the financial resources the company owns or controls and the claims on those resources

**Book Value**

The book value of an asset is the asset's cost minus the asset's accumulated depreciation.

**Comparability**

Tnformation that becomes much more useful when it can be related to a benchmark or standard

**Conservatism**

a pervasive factor in accounting, can be summarized as follows: When in doubt, recognize all losses but don't recognize any gains.

**Consistency**

The consistency principle states that, once you adopt an accounting principle or method, continue to follow it consistently in future accounting periods.

**Disclosure**

**Earnings Per Share (EPS)**

EPS tells the owner of one share of stock what he or she really wants to know

**Entity Concept**

The idea that personal financial activity is kept separate from business financial activity

**Expenses**

The amount of assets consumed from the performance of business operations and thus are the opposite of revenues

**External Audit**

audit conducted by external (independent) qualified accountant(s)

**Financing Activities**

Those activities whereby cash is obtained from, or repaid to, owners and creditors

**Gains**

Refers to money made on activities outside the normal business of a company

**Going Concern Assumption**

allows the readers of financial statements to assume that the company will continue on long enough to carry out its objectives and commitments.

**Historical Cost Convention**

An accounting technique that values an asset for balance sheet purposes at the price paid for the asset at the time of its acquisition

**Income Statement**

A company's financial performance for a specified period of time.

**Investing Activities**

The purchase and sale of land, buildings, and equipment. Investing activities also include buying and selling stocks of other companies

**Liabilities**

the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events

**Liquidity,**

the ease with which the item can be turned into cash

**Losses**

Refers to money lost on activities outside the normal business of a company

**Materiality**

the question of whether an item is large enough to make any difference to anyone

**Net Assets**

total assets minus total liabilities. In a sole proprietorship the amount of net assets is reported as owner's equity. In a corporation the amount of net assets is reported as stockholders' equity.

**Net Income**

the difference between revenues and expenses. If revenues exceed expenses, net income results. If, on the other hand, expenses exceed revenues, there will be a net loss

**Net Loss**

the difference between revenues and expenses. If revenues exceed expenses, net income results. If, on the other hand, expenses exceed revenues, there will be a net loss

**Notes to Financial Statements**

These provide additional information pertaining to a company's operations and financial position and are considered to be an integral part of the financial statements.

**Operating Activities**

Those activities involved in producing and selling goods and services and thus comprise the day-to-day business of a company

**Owners' Equity**

portion of the assets that the owners of the organization can really call their own

**Paid-in Capital**

The value of the assets given in exchange for shares of stock.

**Recognition**

**Relevance**

A qualitative characteristic in accounting. Relevance is associated with information that is timely, useful, has predictive value, and is going to make a difference to a decision maker.

**Reliability**

A qualitative characteristic in accounting. It is achieved when information is verifiable, objective (not subjective) and you can depend on it.

**Retained Earnings**

Represent the portion of stockholders' equity (resulting from cumulative profitable operations) that has not been paid to the owners as dividends

**Revenue**

The amount of assets created through the performance of business operations

**Revenue Recognition**

**Statement of Cash Flows**

Individual cash flow items that are classified according to three main activities: operating, investing, and financing.

**Stockholders' Equity**

The portion of the balance sheet that represents the capital received from investors in exchange for stock (paid-in capital), donated capital and retained earnings

**Time Period Concept**

The time period principle is the concept that a business should report the financial results of its activities over a standard time period, which is usually monthly, quarterly, or annually.

**Treasury Stock**

Shown as a subtraction in the stockholders' equity section of the balance sheet

Chapter 4

**"Other Assets"**

Long-term assets that are not suitable for reporting under any of the previous classifications

**Accounts Payable**

The flip side of accounts receivable—when one company sells on credit, creating for itself an account receivable, the company on the other side of the transaction is buying on credit, creating an account payable.

**Accounts Receivable**

Amounts owed to a business by its credit customers and are usually collected in cash within 10 to 60 days.

**Accumulated Depreciation**

Reflects the wear and tear, or depreciation, of these items since they were originally purchased.

**Accumulated Other Comprehensive Income**

The grouped together and reported changes which companies experience increases and decreases in equity each year because of the movement of market prices or exchange rates

**Additional Paid-in Capital**

Invested by stockholders that exceeds the par value of the issued shares.

**Asset**

Probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

**Asset Mix,**

The proportion of total assets in each asset category, is determined to a large degree by the industry in which the company operates.

**Balance Sheet**

A listing of an organization's assets and of its liabilities at a certain time.

**Capital Lease Obligations**

A long-term liability in the balance sheet.

**Cash**

Coins and currency as well as the balances in company checking and savings accounts.

**Common Stock**

Stockholders' equity investment

**Current Assets**

Cash, accounts receivable, and inventory.

**Current Liabilities**

Those obligations expected to be paid within one year, the most common being accounts payable.

**Current Portion of Long-term Debt**

Some liabilities, such as mortgages, are payable in equal monthly installments over a specified number of years. The portion of these liabilities that is payable within 12 months from the balance sheet date.

**Deferred Income Tax Liability**

The income tax expected to be paid in future years on income that has already been reported in the income statement but which, because of the tax law, has not yet been taxed.

**Derivative**

A financial instrument, such as an option or a future, that derives its value from the movement of a price, an exchange rate, or an interest rate associated with some other item.

**Disclosure**

Convey the details in a narrative note without ever including anything in the financial statements themselves.

**Equity**

Residual interest in the assets of an entity that remains after deducting its liabilities.

**Executory Contract,**

It is an exchange of promises about the future.

**Financing Mix**

The percentage of total financing (liabilities plus equity) in each individual category.

**Intangible Assets**

Assets that have no physical or tangible characteristics.

**Inventory**

The name given to goods held for sale in the normal course of business.

**Investment Securities**

Composed of publicly traded stocks and bonds.

**Liability**

Probable future sacrifice of economic benefit arising from a present obligation of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

**Long-term Debt**

Long-term notes, bonds, mortgages, and similar obligations on the balance sheet

**Long-term Investments**

Those assets that you expect to still be around next year when you prepare the balance sheet again.

**Noncontrolling Interest,**

Arises when a corporation has subsidiaries that are not 100 percent owned by the corporation.

**Par Value**

The market value of the shares at issuance.

**Preferred Stock**

Stockholders' equity investment

**Prepaid Expenses**

Payments in advance for business expenses.

**Property, Plant, and Equipment**

Exactly what the label implies: land, buildings, machinery, tools, furniture, fixtures, and vehicles used by a company in conducting its business activities.

**Recognition**

Boil down all the estimates and judgments into one number and report that one number in formal financial statements.

**Retained Earnings**

The cumulative amount of a corporation's profits that have been reinvested on behalf of the stockholders

**Short-term Loans Payable**

Formal, interest-bearing loans that are expected to be paid back within one year.

**Stockholders' Equity**

The difference between assets and liabilities in a corporation

**Transaction Analysis**

The process of determining how an economic event impacts the financial statements

**Treasury Stock**

The repurchased shares when a company buys back its own shares

**Unearned Revenue,**

Represents Sears's obligation to provide service to customers who have paid Sears for a service they have not yet received.

**Valuation**

Once it has been determined that an item should be recognized in financial statements, the question then arises about what dollar amount to assign to the item.

Chapter 5

**Accrual Accounting**

The process that accountants use in adjusting raw transaction data into refined measures of a firm’s economic performance.

**Comprehensive Income**

The number used to reflect an overall measure of the change in a company’s wealth during the period

**Cost of Goods Sold,**

When a business sells goods to customers, the cost of the goods sold is recorded as an expense

**Discontinued Operations**

Report the Hughes results in a separate category called income from discontinued operations.

**Earnings Per Share (EPS),**

The amount of net income associated with each share of stock.

**Economic Value Added,**

A system of earnings-based compensation

**Expanded Accounting Equation**

Assets = Liabilities + Paid-in Capital + (Revenues - Expenses - Dividends)

**Expenses**

The value of resources used in generating the reported revenue.

**Extraordinary Items**

Gains and losses that result from transactions that are both unusual in nature and infrequent in occurrence

**Financial Capital Maintenance**

The approach that accountants typically use in computing a company’s income is the first option described above in which inflation is ignored and a company is said to have income when its financial resources increase.

**Gain**

The amount of a company makes money on activities that are peripheral to its primary operations

**Gross Profit**

The difference between the selling price of the product and the cost of the product.

**Income From Continuing Operations**

the segments of a company's business that it considers to be normal, and expects to operate in for the foreseeable future

**Loss**

The amount of a company loses money on activities that are peripheral to its primary operations

**Matching**

The concept typically used in practice to determine when an expense should be recognized

**Multiple-step Income Statement**

The multi-step income statement includes multiple sub-totals within the income statement.

**Net Income**

The accountant’s attempt to summarize in one number the overall economic performance of a company for a given period.

**Operating Income**

The performance of the fundamental business operations conducted by a company

**Physical Capital Maintenance**

income is earned only when one experiences an increase in actual physical resources.

**Restructuring Charges**

The fact that companies have exercised considerable discretion in determining the amount and timing of a restructuring charge.

**Revenue**

The value of the goods and services provided by a company in its business operations.

**Revenue Recognition**

a cornerstone of accrual accounting together with matching principle. They both determine the accounting period, in which revenues and expenses are recognized.

**Single-step Income Statement**

With this format, all revenues are grouped together, all expenses are grouped together, and net income is computed as the difference between total revenues and total expenses.

Chapter 6

**Cash Equivalents**

Short-term, highly liquid investments such as Treasury bills, commercial paper, and money market funds.

**Direct Method**

reporting the information contained in the last column of the adjustment worksheet

**Financing Activities**

Obtaining resources from owners and providing them a return on their investment, and obtaining resources from creditors and repaying those borrowings

**Indirect Method**

A method for creating a statement of cash flows a company may use during any given reporting period. The indirect method uses accrual accounting information to present the cash flows from the operations section of the cash flow statement.

**Investing Activities**

Cash inflows and outflows from (1) acquiring and selling productive assets such as property, plant, and equipment, (2) acquiring and selling investment securities, and (3) lending money and collecting on those loans

**Non-cash Investing and Financing Activities**

Some investing and financing activities affect a company's financial position but not the company's cash flows during the period.

**Operating Activities**

All transactions relating to a company's delivering or producing its goods for sale and providing its services

**Pro Forma,**

A prediction of what the actual cash flow statement will look like in future years if the operating, investing, and financing plans are implemented.

**Statement of Cash Flows,**

Summarize a company's cash flows for a period of time.

Chapter 3

**Asset Turnover**

Sales divided by assets and is interpreted as the number of dollars in sales generated by each dollar of assets.

**Assets-to-equity Ratio**

Assets divided by equity and is interpreted as the number of dollars of assets acquired for each dollar invested by stockholders.

**Average Collection Period**

Shows the average number of days that elapse between sale and cash collection.

**Cash Flow Adequacy Ratio**

Cash from operations divided by expenditures for fixed asset additions and acquisitions of new businesses

**Cash Times Interest Earned Ratio**

A financial analysis tool that indicates the interest payment ability of an entity

**Common-size Financial Statements**

All amounts for a given year being shown as a percentage of that denominator for the year.

**Current Ratio**

A comparison of current assets (cash, receivables, and inventory) with current liabilities. It is computed by dividing total current assets by total current liabilities.

**Debt Ratio**

A frequently used measure of leverage, computed as total liabilities divided by total assets.

**Debt-to-equity Ratio**

Total liabilities divided by total equity and is interpreted as the number of dollars of borrowing for each dollar of equity investment

**DuPont Framework**

A systematic approach to identifying general factors causing ROE to deviate from normal.

**Financial Ratios**

Relationships between financial statement amounts

**Financial Statement Analysis**

Areas in which additional data must be gathered, including details of significant transactions, market share information, competitors' plans, and customer demand forecasts.

**Fixed Asset Turnover**

Sales divided by average fixed assets and is interpreted as the number of dollars in sales generated by each dollar of fixed assets.

**Leverage**

Borrowing that allows a company to purchase more assets than its stockholders are able to pay for through their own investment.

**Liquidity**

A company's ability to pay its debts in the short run

**Margin**

The profitability of each dollar in sales

**Number of Days' Sales in Inventories**

Calculated by dividing average inventory by average daily cost of goods sold and is interpreted as the average number of days of sales that can be made using only the supply of inventory on hand.

**Price-earnings Ratio**

an equity valuation multiple. It is defined as market price per share divided by annual earnings per share.

**Return On Assets**

Net income divided by total assets and is the number of pennies of net income generated by each dollar of assets.

**Return On Equity**

The overall measure of the performance of a company.

**Return On Sales**

Net income divided by sales and is interpreted as the number of pennies in profit generated from each dollar of sales.

**Turnover**

The degree to which assets are used to generate sales

Chapter 7

**Cash Budget**

An important tool in helping management plan its cash needs. This discussion briefly introduces you to budgeting cash receipts.

Chapter 8

**Audit Committee**

Members of a company’s board of directors who are responsible for dealing with the external and internal auditors.

**Control Activities**

Policies and procedures used by management to meet their objectives.

**Control Environment**

The actions, policies, and procedures that reflect the overall attitudes of top management about control and its importance to the entity.

**Control Procedures**

Policies and procedures used by management to meet their objectives.

**Detective Controls**

Internal control activities that are designed to detect the occurrence of errors and fraud.

**External Auditors**

Independent CPAs who are retained by organizations to perform audits of financial statements.

**GAAP Oval**

A diagram that represents the flexibility a manager has, within GAAP, to report one earnings number from among many possibilities based on different methods and assumptions.

**Generally Accepted Auditing Standards (GAAS)**

Auditing standards developed by the PCAOB for public companies and AICPA for private companies.

**Income Smoothing**

The practice of carefully timing the recognition of revenues and expenses to even out the amount of reported earnings from one year to the next.

**Independent Checks**

Procedures for continual internal verification of other controls.

**Internal Auditors**

An independent group of experts (in controls, accounting, and operations) who monitor operating results and financial records, evaluate internal controls, assist with increasing the efficiency and effectiveness of operations, and detect fraud.

**Internal Control Structure**

Policies and procedures established to provide management with reasonable assurance that the objectives of an entity will be achieved.

**Internal Earnings Targets**

Financial goals established within a company.

**Organizational Structure**

Lines of authority and responsibility.

**Physical Safeguards**

Physical precautions used to protect assets and records.

**Preventative Controls**

Internal control activities that are designed to prevent the occurrence of errors and fraud.

**Public Company Accounting Oversight Board (PCAOB)**

Board of five full-time members established by the Sarbanes-Oxley Act to oversee the accounting and auditing profession.

**Sarbanes-Oxley Act**

A law passed by Congress in 2002 that gives the SEC significant oversight responsibility and control over companies issuing financial statements and their external auditors.

**Securities and Exchange Commission (SEC)**

The government body responsible for regulating the financial reporting practices of most publicly owned corporations in connection with the buying and selling of stocks and bonds.

**Segregation of Duties**

A strategy to provide an internal check on performance through separation of authorization of transactions from custody of related assets, operational responsibilities from record-keeping responsibilities, and custody of assets from accounting personnel.

Chapter 9

**Capital Budgeting**

Systematic planning for long-term investments in operating assets.

**Controlling**

Implementing management plans and identifying how plans compare with actual performance.

**Cost-volume-profit (C-V-P) Analysis**

Techniques for determining how changes in revenues, costs, and level of activity affect the profitability of an organization.

**Differential Costs**

Future costs that change as a result of a decision; also called incremental or relevant costs.

**Direct Costs**

Costs that are specifically traceable to a unit of business or segment being analyzed.

**Direct Labor**

Wages paid to those who physically work on direct materials to transform them into a finished product and are traceable to specific products.

**Direct Materials**

Materials that become part of the product and are traceable to it.

**Evaluating**

Analyzing results, rewarding performance, and identifying problems.

**Fixed Costs**

Costs that remain constant in total, regardless of activity level, over a certain range of activity.

**Indirect Costs**

Costs normally incurred for the benefit of several segments within the organization; sometimes called common costs or joint costs.

**Indirect Labor**

Labor that is necessary to a manufacturing or service business but is not directly related to the actual production of the product.

**Indirect Materials**

Materials that are necessary to a manufacturing or service business but are not directly included in or are not a significant part of the actual product.

**Manufacturing Overhead**

All costs incurred in the manufacturing process other than direct materials and direct labor.

**Operational Budgeting**

Managerial planning decisions regarding current and immediate future (a year or less) operations that are characterized by regularity and frequency.

**Opportunity Costs**

The benefits lost or forfeited as a result of selecting one alternative course of action over another.

**Out-of-pocket Costs**

Costs that require an outlay of cash or other resources.

**Period Costs**

Costs not directly related to a product, service, or asset. They are charged as expenses to the income statement in the period in which they are incurred.

**Planning**

Outlining the activities that need to be performed for an organization to achieve its objectives.

**Product Costs**

Costs associated with products or services offered.

**Production Prioritizing**

Management's continual evaluation of various product lines and divisions' profitability in order to analyze and identify opportunities to improve profits.

**Return On Investment**

A measure of operating performance and efficiency in utilizing assets; computed in its simplest form by dividing net income by average total assets (also known as return on assets or ROA).

**Strategic Planning**

Broad, long-range planning usually conducted by top management.

**Sunk Costs**

Costs that are past costs and do not change as a result of a future decision.

**Variable Costs**

Costs that change in total in direct proportion to changes in activity level.

Chapter 10

**Activity-based Costing (ABC)**

A method of attributing overhead costs to products based on measurable factors that relate to activities that create overhead costs.

**Batch-level Activities**

Activities that take place in order to support a batch or production run, regardless of the size of the batch.

**Cost Drivers**

Numerical measure used to reflect the amount of a specific cost that is associated with a particular activity.

**Cost Pool**

Total cost being generated by a specific overhead cost activity.

**Facility Support Activities**

Activities necessary to have a facility in order to participate in the development and production of products or services; activities are not related to any particular line of products or services.

**Product-line Activities**

Activities that take place in order to support a product line, regardless of the number of batches or individual units produced.

**Unit-level Activities**

Activities that take place each time a unit of product is produced.

Chapter 11

**Break-even Point**

The amount of sales at which total costs of the number of units sold equal total revenues; the point at which there is no profit or loss.

**Contribution Margin**

The difference between total sales and variable costs; the portion of sales revenue available to cover fixed costs and provide a profit.

**Contribution Margin Ratio**

The percentage of net sales revenue left after variable costs are deducted; the contribution margin divided by net sales revenue.

**Cost Behavior**

The way a cost is affected by changes in activity levels.

**Cost-volume-profit (C-V-P) Analysis**

Techniques for determining how changes in revenues, costs, and level of activity affect the profitability of an organization.

**Fixed Costs**

Costs that remain constant in total, regardless of activity level, at least over a certain range of activity.

**High-low Method**

A method of segregating the fixed and variable components of a mixed cost by analyzing the costs at the highest and the lowest activity levels within a relevant range.

**Method**

A method of segregating the fixed and variable components of a mixed cost by plotting on total costs at several activity levels and drawing a regression line through the points.

**Mixed Costs**

Costs that contain both variable and fixed costs components.

**Operating Leverage**

The extent to which fixed costs replace variable costs as part of a company's cost structure; the higher the proportion of fixed costs to variable costs, the faster income increases or decreases with changes in sales volume.

**Per-unit Contribution Margin**

The excess of the sales price of one unit over its variable costs.

**Profit Graph**

A graph that shows how profits vary with changes in volume.

**Regression Line**

On a scattergraph, the straight line that most closely expresses the relationship between the variables.

**Relevant Range**

The range of operating level, or volume of activity, over which the relationship between total costs (variable plus fixed) and activity level is approximately linear.

**Return On Sales Revenue**

A measure of operating performance; computed by dividing net income by total sales revenue. Similar to profit margin.

**Sales Mix**

The relative proportion of total sales dollars (or total units sold) that is represented by each of a company's products.

**Scattergraph**

A method of segregating the fixed and variable components of a mixed cost by plotting on total costs at several activity levels and drawing a regression line through the points.

**Stepped Costs**

Costs that change in total in a stair-step fashion (in large amounts) with changes in volume of activity.

**Target Income**

A profit level desired by management.

**Variable Cost Rate**

The change in cost divided by the change in activity; the slope of the regression line.

**Variable Costs**

Costs that change in total in direct proportion to changes in activity level.

**Visual-fit**

A method of segregating the fixed and variable components of a mixed cost by plotting on total costs at several activity levels and drawing a regression line through the points.