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## GLOSSARY

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**10-K.** See *Form 10-K*.

**10-Q.** See *Form 10-Q*.

**Accelerated depreciation** allocates a greater portion of the cost of a tangible asset to the earliest years of the asset's useful life, which typically offer the greatest, or most predictable, functionality. See also *depreciation, straight-line method, sum-of-the-years'-digits method*.

**Account** records changes in or transactions involving an individual asset or liability, component of equity, or revenue or expense. See also *T-account*.

**Accounting periods** artificially divide an enterprise's life into regular intervals so that the enterprise can assess its operating results and financial condition. See also *periodicity assumption*.

**Accounting equation.** See *fundamental accounting equation*.

**Accounts payable**, a current liability, shows the unpaid amount for the enterprise's purchases on credit. See also *current liabilities*.

**Accounts receivable**, a current asset, records uncollected revenue owed to an enterprise for sales on credit.

**Accrual** refers to the process whereby an enterprise recognizes a revenue earned or expense incurred, even though no payment actually occurred, during the current accounting period.

**Accrual accounting** seeks to portray an entity's operating results within a given period by allocating revenues and expenses to the period earned or incurred rather than when actually collected or paid. See also *cash method*.

**Accrued liabilities** refer to amounts owed for services already performed. See also *current liabilities*.

**Accumulated depreciation** cumulates all depreciation expenses related to a particular asset or group of assets in a contra-asset account.

**Acquisition costs** reflect the portion of the depletion cost base devoted to obtaining the right to search for productive natural resources. See also *cost base, development costs, exploration costs*.

**Active investments** enable the investor to exert significant influence over the investee, meaning that the investor typically owns twenty percent or more of the investee's voting shares. See also *passive investments*.

**Adjusted book value** attempts to eliminate bias from the historical cost assumption that generally underlies financial accounting by substituting some other amount, usually fair market value, but perhaps liquidation value or replacement cost, for an asset's book value in valuing the asset or a business. See also *liquidation value, replacement cost, tangible book value*.

**Adjusting entries** modify expenses and revenues at the end of an accounting period to reflect that period's activity, accounting for such things as prepaid expenses that span several periods or earned, but uncollected, income.

**Adverse opinions**, from independent auditors, report very material departures from GAAP, but rarely occur because an enterprise's management can usually correct the underlying circumstances. See also *disclaimer of opinion, qualified opinion, unqualified opinion*.

**Agging** of accounts receivable assesses the probability that the enterprise will collect the amount owed, based on experience that shows that as receivables become progressively overdue, the likelihood of non-payment increases dramatically.

**Allowance for doubtful accounts** offsets gross receivables to determine net receivables. This contra-account allows accounts receivable that become uncollectible in a later period to not affect that period's income. When bad debts arise, the enterprise can debit the allowance for doubtful accounts as an offset to the uncollectible account receivable.

**Amortization** allocates the cost of an intangible asset to the various accounting periods in its useful life. See also *depletion, depreciation*.

**Analytical procedures** compare financial data to corresponding data for prior periods to ascertain whether or not the data appears reasonable.

**Annuity** describes a sequence of periodic and equal amounts, such as a monthly deposit.

**Annuity due** requires the investor to make payments at the beginning of each period. See also *ordinary annuity*.

**Annuity in advance.** See *annuity due*.

**Annuity in arrears.** See *ordinary annuity*.

**Asset** means a future economic benefit that a particular enterprise owns or controls as the result of a past transaction or event. See also *current assets, long-term investments, fixed assets, intangible assets*.

**Audit** examines an enterprise's internal controls and financial records to obtain evidence as to whether the enterprise's financial statements fairly present its financial condition and operating results in accordance with generally accepted accounting principles. See also *compilation, review*.

**Audit committee**, as a subset of the board of directors, oversees both the accounting, financial reporting, and disclosure processes and the audits of an enterprise's financial statements.

**Audit inquiry letters** request an enterprise's attorney to list and describe information concerning the enterprise's potential legal liabilities for its auditor. See also *management letters*.

**Audit reports** opine whether financial statements fairly present the enterprise's financial position, results of operations, and cash flows in conformity with GAAP. See also *unqualified opinion, qualified opinion, adverse opinion*.

**Audit risk** expresses the chance that an auditor may erroneously fail to modify appropriately the audit opinion despite materially misleading financial statements.

**Authorized but unissued shares** represent additional shares that the articles of incorporation allow a corporation to issue.

**Available-for-sale securities** includes all debt and marketable equity securities that accounting rules do not classify as held-to-maturity debt or trading securities. See also *held-to-maturity debt securities, trading securities*.

**Average cost method**, an inventory method, eliminates the need to identify precise costs to purchase or manufacture items remaining unsold by dividing the total costs to acquire or manufacture goods during an accounting period by the total number available for sale or resale. See also *first-in first-out, last-in first-out, retail method, specific identification, standard costs*.

**Bad debts collected**, a typical subaccount of allowance for doubtful accounts, allows an enterprise to record the collection of previously written-off bad debts. See also *allowance for doubtful accounts*.

**Bad debt expense** records the likely losses resulting from either credit sales during an accounting period or worsening economic conditions during the period that impair an enterprise's ability to collect accounts receivable originating in an earlier period. See also *allowance for doubtful accounts*.

**Balance sheet** shows a business's assets, liabilities, and equity at a particular moment in time. See also *income statement, statement of cash flows, statement of changes in owner's equity*.

**Balance sheet test** weighs assets against liabilities to determine whether an enterprise is insolvent. See also *equity insolvency test*.

**Basic earnings per share** calculates the amount of earnings for the period attributable to each share of common stock outstanding during the period. See also *diluted earnings per share*.

**Big bath** refers to situations when an enterprise announces a huge write-down or write-off during an accounting period in an effort to lump losses into that period and improve future earnings.

**Bookkeeping** describes the process of recording and reporting transactions to convey an enterprise's financial condition and operating results.

**Book value.** See *net book value*.

**Buy-back arrangements.** See *right of return*.

**Capital accounts** record an owner's investment in the business.

**Capital assets.** See *fixed assets*.

**Capital expenditures** describe costs that an enterprise incurs to acquire or improve a long-lived asset, such as property, plant and equipment.

**Capitalized earnings method** attempts to value a business by first computing the business's average annual earnings for some number of years, and then capitalizing those average earnings by multiplying them by the reciprocal of the relevant interest or capitalization rate.

**Capital leases**, for the lessee, essentially transfer substantially all of the benefits and risks that accompany property ownership to the lessee. See also *direct financing leases, operating leases, sales-type leases*.

**Capital stock account**, usually denominated common shares or preferred shares, shows a balance that equals the product of the number of issued shares times the par value per share.

**Capital structure** conveys the total amount that an enterprise has borrowed via long-term debt or loans, raised by issuing its common or preferred shares, or accumulated as retained earnings.

**Capital surplus** equals the cumulative amount that shareholders paid for shares in excess of par value under the legal capital system.

**Cash** includes not only currency, but bank accounts that the enterprise can access easily.

**Cash equivalents** include short term, highly-liquid investments that mature 90 days or less after acquisition.

**Cash flow from operating activities.** See *operating cash flow*.

**Cash flow statement.** See *statement of cash flows*.

**Cash method** recognizes revenues when the enterprise actually receives cash or payment for goods or services and records expenses when actually paid. See also *accrual accounting*.

**Charge off.** See *write-off*.

**Chart of accounts** lists each account and the account number that identifies the account's location in the ledger.

**Classified balance sheet** arranges the balance sheet into useful categories, generally separately listing current assets, long-term investments, fixed assets, intangible assets, current liabilities, long-term liabilities, and owners' equity.

**Closing entries** transfer the ending balances in accounts for revenues, gains, expenses, and losses to owners' equity at the end of a period.

**Closing process** occurs when the bookkeeper transfers the balances in revenue, gain, expense, and loss accounts to owners' equity.

**Commitments** generally refer to quantifiable transactions that bind an enterprise in the future.

**Common shares** represent the residual ownership interest in a corporation. See also *preferred shares*.

**Common-sized analysis** reduces a financial statement, such as the income statement, to a series of percentages of a given base amount, such as net sales. See also *trend analysis*.

**Comparison method** extrapolates the value of a closely held business or division of a company from the values that the market has assigned to comparable publicly traded enterprises based on relevant financial measures.

**Comparative financial statements** present an enterprise's financial condition on separate dates and the results of operations for similar periods to convey a broader picture of an enterprise than a single financial statement.

**Compilation**, an alternative to an audit, simply reports data that management has supplied with no independent testing or review. See also *audit, review*.

**Completed project method**, a method of revenue recognition for long-term contracts, waits until the enterprise has fully, or at least substantially, finished its task under the agreement before recognizing any income. See also *program method*.

**Compound journal entries** compress multiple entries that credit or debit the same account into one entry to show the combined effect of a series of transactions on the common account.

**Compound interest** requires the borrower to pay interest on the unpaid interest of past periods as well as on the original principal amount. See also *simple interest*.

**Comprehensive income.** See also *net income, other comprehensive income*.

**Conformity requirement** requires an enterprise to use the LIFO method for financial accounting if adopted for federal income tax purposes.

**Conservatism** anticipates and records possible losses while ignoring potential income to offset the natural optimism of business owners or managers in reporting the results of an enterprise's operations or its financial condition.

**Consistency principle** requires that an enterprise give economic events the same accounting treatment from period to period.

**Consolidated financial statements** aggregate financial data for a parent company and its majority and wholly owned subsidiaries as if the parent and subsidiaries constitute a single economic entity.

**Contingent liabilities** rise when uncertainty exists as to whether the enterprise will incur an expense or loss.

**Contra-asset accounts** function as offsets to the balance in the related asset account. See also *accumulated depreciation*.

**Contributed capital** shows amounts that owners invested in an enterprise.

**Cost base** quantifies the total expended to develop a natural resource for the purpose of calculating depletion. See also *acquisition costs, depletion, development costs, exploration costs*.

**Cost collection methods** establish an asset's depletion base. See also *cost base, full-cost method, successful efforts accounting*.

**Cost method** entails recording an investment at historical cost and then treating any dividends distributed from subsequent earnings as income. See also *equity method*.

**Cost of goods sold** collects the costs attributable to items sold during an accounting period, which the enterprise previously purchased for resale or manufactured. These costs include direct materials and labor, other direct costs, and an allocable portion of indirect costs, such as factory overhead. These costs do not include office, selling, accounting, or advertising expenses.

**Cost recovery method**, a method for recognizing revenue with uncertain collectibles, treats payments as equal and offsetting amounts of revenue and expenses until the enterprise has recovered all its costs. See also *installment method*.

**Credit**, often abbreviated as “Cr.,” means nothing more than a right-hand entry in an account. See also *debit*.

**Current assets** include cash and other assets that the enterprise expects to convert into cash or use within one year. See also *long-term investments, fixed assets*, and *intangible assets*.

**Current liabilities** require payment or economic performance in one year or less. See also *accounts payable, accrued liabilities, notes payable, unearned revenues*.

**Current replacement cost**. See *replacement cost*.

**Debit**, often abbreviated as “Dr.,” means nothing more than a left-hand entry in an account. See also *credit*.

**Declining-balance methods** calculates accelerated depreciation by using a multiple of the straight-line depreciation rate. See also *accelerated depreciation*.

**Default premium** reflects the risk that the borrower will default on a loan and that the lender will lose the loan principal and any accrued interest. See also *illiquidity premium, inflation premium, maturity premium, pure rate of interest*.

**Deferred costs** delay treating cash expenditures as expenses until the accounting period when the enterprise enjoys the benefit of the expenditure. See also *deferred income*.

**Deferred income** reflects received but unearned revenue, such as customer deposits, and appears as a current liability on an enterprise’s balance sheet. See also *deferred costs*.

**Depletion** allocates the costs to acquire natural resources among the accounting periods in which an enterprise consumes those wasting assets. See also *amortization, cost base, depreciation*.

**Depreciation** systematically spreads the cost to acquire a tangible asset over the accounting periods that benefit from the asset’s expected useful life. See also *accelerated depreciation, amortization, depletion, straight-line method, units-of-activity method, sum-of-the-years’-digits method, useful life*.

**Depreciation base** equals a tangible asset’s original cost minus any salvage value.

**Depreciation expense** equals the portion of a tangible asset’s cost that an enterprise has allocated as an offset to revenues in a particular accounting period.

**Derivatives** base their value on the performance of some underlying asset, such as bonds or foreign currency.

**Development costs** reflect the portion of the depletion cost base devoted to extraction of discovered reserves and preparation of facilities necessary for that process. See also *acquisition costs, cost base, exploration costs*.

**Diluted earnings per share** shows the amount of net income for the period attributable to each share of common stock outstanding during the period and certain potential common shares arising from options, warrants, and convertible securities. See also *basic earnings per share*.

**Direct cost**, an inventory costing method, allocates only direct costs and variable overhead costs to inventory. See also *factory overhead costs, full absorption, prime cost*.

**Direct financing leases** describe capital leases that involve no dealer or manufacturer profit or loss for the lessor while essentially transferring ownership of the property to the lessee. See also *capital leases, operating leases, sales-type leases*.

**Disclaimer of opinion**, from an independent auditor, does not express an opinion as to whether the financial statements fairly present an enterprise's financial condition and operating results in accordance with generally accepted accounting principles. See also *adverse opinion, qualified opinion, unqualified opinion*.

**Discontinued operations** refers to a distinct business or other operational segment that an enterprise has decided to sell or eliminate.

**Dividend-payout ratio** shows the percentage of a company's net income that the firm paid out in dividends during a fiscal period.

**Dividends** entitle each shareholder to receive corporate earnings, typically paid in cash, on a pro rata basis. See also *redemptions*.

**Dividend yield** equals a company's per share dividend payout over the last twelve months divided by the share's market price.

**Double-entry bookkeeping** records each transaction's effect on assets, liabilities, and owners' equity so that the two sides of the fundamental accounting equation remain in balance. See also *single-entry bookkeeping*.

**Drawings** track an owner's total withdrawals from an enterprise during an accounting period.

**Earned capital** includes all of an enterprise's undistributed net earnings.

**Earned surplus** equals an enterprise's undistributed earnings that remain invested in the enterprise under the legal capital system.

**Earnings.** See *net income*.

**Earnings management** describes managerial actions that increase or decrease a business's current reported earnings without changing the unit's long-term economic prospects.

**Earnings per share.** See *basic earnings per share, diluted earnings per share*.

**Effective interest method** uses a constant interest rate to recognize interest income or expense.

**Equity** refers to the difference between an enterprise's assets and liabilities.

**Equity insolvency test** evaluates whether an enterprise can pay its debts as they come due in the usual course of business for purposes of determining the lawfulness of a distribution to the enterprise's owners. See also *balance sheet test*.

**Equity method** initially records an investment in another enterprise at cost and adjusts the investment's carrying amount to recognize the investor's share of the investee's earnings or losses after the acquisition date. See also *cost method*.

**Excess earnings method** estimates a value for goodwill even though no actual transaction has taken place by comparing average earnings to a fair return on the underlying identifiable assets. See also *goodwill*.

**Expectation gap** reflects the difference between investor expectations and auditor's ability to detect misstatements and fraud in financial statements.

**Expense accounts** record decreases in owners' equity arising from an enterprise's regular activities. See also *income accounts*.

**Expenses** represent decreases in assets, increases in liabilities, or both, resulting from using goods or services to produce revenue. See also *losses, revenues*.

**Explanatory language**, added to an unqualified opinion, allows the auditor to clarify the audit report. See also *unqualified opinion*.

**Exploration costs** reflect the portion of the depletion cost base devoted to finding natural resources, such as geological surveys, testing, and exploratory wells. See also *acquisition costs, cost base, development costs*.

**Extraordinary items** describe events or transactions that qualify as both unusual in nature and infrequent in occurrence and appear as a separate category on the income statement. See also *nonrecurring items*.

**Factory overhead costs** include the normal expenses of operating a factory, such as light, heat, depreciation, insurance, and property taxes. See also *direct cost, fixed costs, variable costs*.

**Fair value** means the price at which knowledgeable, unrelated parties would buy or sell an asset or settle a liability in a current, voluntary transaction.

**Fair value model** represents a new trend in financial accounting that records market values, rather than historical costs, in financial statements..

**Financial Accounting Standards Board**, or the FASB, serves as the most authoritative standard-setter for accounting principles in the United States.

**Financial statements** record and report financial information. See *balance sheet, income statement, statement of cash flows, statement of changes in owner's equity*.

**Financing activities** include the issuance and retirement of short- and long-term debt from creditors and also reflect additional investments by, and distributions to, owners. See also *statement of cash flows*.

**Financing cash flows.** See *financing activities*.

**Financing leases.** See *direct financing leases*.

**Fiscal year**, an accounting period of twelve months or fifty-two or fifty-three weeks, which often differs from the calendar year.

**First-In, First-Out**, or **FIFO**, accounting method, matches a business's oldest inventory costs with current revenues. See also *average cost method, last-in first-out, retail method, specific identification, standard costs*.

**Fixed assets** include tangible resources such as land, buildings, plant, equipment, machinery, furniture, and fixtures that an enterprise acquires for long-term use in the business. See also *current assets, long-term investments, intangible assets*.

**Fixed costs**, a portion of overhead costs, do not change within a specified production range. See also *factory overhead costs, variable costs*.

**Forensic accounting** combines accounting, auditing, and investigative skills, usually to detect fraud during audits, to prevent it in developing and assessing internal controls, or to support litigation.

**Form 8** discloses previously unreported material events and information regarding changes in a registrant's financial condition or operations to securities holders between periodic filings by public companies under SEC rules; sometimes referred to as a "current report."

**Form 10-K** contains an enterprise's annual report and related disclosures, and must be filed with the SEC after the end of each fiscal year.

**Form 10-Q** discloses financial information and must be filed by public companies quarterly with the SEC.

**Free cash flow** presents cash flow from operating activities minus several types of investments and dividend requirements, and has recently become an important figure for analyzing operating cash flows.

**Full absorption method** allocates both direct and indirect production costs to all goods that an enterprise produced during an accounting period, including those items that remain in inventory at the close of the period.

**Full-costing accounting**, a cost collection method, capitalizes all acquisition, exploration, and development costs, whether or not associated with the development of productive natural resources. See also *cost collection methods, successful efforts accounting*.

**Full disclosure principle** generally requires an accounting entity to set forth in the financial statements or related notes any fact important enough to influence an informed reader's judgment.

**Fundamental accounting equation** states that assets equals the sum of an enterprise's equity and liabilities.

**Future value** equals the sum that an amount or an annuity will grow to by a certain time when invested at a particular compound interest rate.

**Gain accounts.** See *income accounts*.

**Gain contingencies** represent existing conditions, situations, or sets of circumstances involving uncertainty as to possible gains. See also *loss contingencies*.

**Gains** increase assets or decrease liabilities from transactions peripheral or incidental to major or central operations. See also *losses, revenues*.

**General journal**, record of original entry, lists transactions chronologically and begins the bookkeeping process. See also *journal*.

**General ledger** contains all asset, liability, revenue, expense, and other equity accounts for a business.

**Generally accepted accounting principles**, or **GAAP**, reflect what the accounting profession and financial community consider legitimate accounting practices.

**Generally accepted auditing standards**, or **GAAS**, express the standards and procedures that accountants must follow and perform during an audit.

**Goodwill** describes the intangible asset equal to the price paid for a business above the sum of its identifiable assets, indicating a sum greater than its parts. See also *excess earnings method*, *residual method*.

**Going concern assumption** presumes that an accounting entity will continue normal operations into the future.

**Going concern value**, an unidentifiable intangible asset like goodwill, refers to the additional value that attaches to properties that comprise an ongoing business.

**Gross profit** appears as a separate line in a multiple-step income statement and shows the difference between net sales and the cost of goods sold.

**Gross profit percentage** reflects the business's profitability from selling its products, ignoring operating expenses, such as general, selling, and administrative expenses.

**Group method** treats a number of individual items together as a group and applies a single depreciation rate to the total cost of the assets in the group, less the total estimated salvage value.

**Held-to-maturity debt securities** require positive intent and ability to hold a debt obligation until the date when the issuer must repay unpaid principal and accrued interest. See also *available-for-sale securities*, *trading securities*.

**Historical cost** equals the purchase price of an asset at acquisition.

**Historical cost principle** indicates that the carrying value of an asset remains fixed at original cost or derived from that amount as long as the enterprise owns the asset.

**Illiquidity premium** compensates a lender for the price concession that the lender may have to grant if unexpected circumstances force the lender to sell the debt instrument without a readily available market. See also *default premium*, *inflation premium*, *maturity premium*, *pure rate of interest*.

**Income**. See *net income*, *other comprehensive income*.

**Income accounts** record increases in equity. See also *expense accounts*.

**Income smoothing**. See *earnings management*.

**Income statement** compares an enterprise's revenues to its expenses, showing how operations affected owners' equity. See also *balance sheet*, *statement of cash flows*, *statement of changes in owner's equity*.

**Indirect costs**. See *factory overhead costs*.

**Inflation premium** compensates the lender for the inflation that the lender expects over the loan's term. See also *default premium, illiquidity premium, maturity premium, pure rate of interest*.

**Inflation risk** refers to the general loss in purchasing power that rising prices cause.

**Insolvency tests** appear in corporate and creditors' rights statutes to determine whether an enterprise can lawfully distribute assets to an owner. See *balance sheet test, equity insolvency test*.

**Installment method**, a method of recognizing revenue when the circumstances do not reasonably assure that the seller will collect the sales price, requires the seller to allocate all cash received from the buyer between cost recovery and profit. See also *cost recovery method*.

**Intangible assets** include intellectual property, goodwill, and other non-physical resources. See also *current assets, fixed assets, long-term investments*.

**Interest** represents a charge for the use of money. See also *compound interest, simple interest*.

**Interim reports** present monthly or quarterly financial information.

**Internal controls** refer to those systems, procedures, and policies that an enterprise uses to help assure that an appropriate individual properly authorizes transactions and that the enterprise then appropriately executes and records the transaction.

**Inventory** comprises goods held for sale or resale in the ordinary course of business.

**Inventory turnover** measures how often an enterprise sells and replaces goods held for sale in a fiscal period by dividing average inventory into cost of goods sold.

**Investing activities** include this acquisition and disposition of long-term investments and long-lived assets. See also *statement of cash flows*.

**Investing cash flows** summarize the movement of cash from the acquisition and disposition of long-term investments and long-lived assets. See also *financing cash flows, operating cash flows*.

**Irregularities** euphemistically refer to accounting fraud.

**Issued but not outstanding shares.** See *treasury shares*.

**Issued shares** include those shares that the corporation has sold or otherwise transferred to shareholders. See also *shares*.

**Journal** records transactions chronologically, showing debits and credits to appropriate accounts. See also *general journal*.

**Junk bonds** fall into the below “investment grade” risk category because the borrower has a greater than average chance of default. See also *bonds*.

**Last-In, First-Out**, or **LIFO**, accounting method assumes that a business sells the most recently acquired goods first. See also *average cost method, first-in first-out, retail method, specific identification, standard costs*.

**Ledger** collects in one place all accounts that a business maintains and all information about changes in specific account balances.

**Legal capital** reflects the cumulative par value of all issued shares.

**Legal capital system**, prevalent in about a quarter of the states, refers to a set of rules that regulate the issuance of shares and distributions by corporations.

**Leverage** conveys the amount of debt, relative to equity or total assets, that a company carries.

**Leveraged buyouts** occur when a purchaser primarily uses borrowed money to acquire an enterprise.

**Liquidation value** typically represents the minimum value of an asset or business, being the amount a buyer would pay for scrap or in a “going-out-of-business” sale. See also *adjusted book value, tangible book value*.

**Liquidity** refers to the ability to convert an asset into cash.

**Long-lived assets** benefit several accounting periods, and include fixed assets.

**Long-term investments** include assets that an enterprise would not normally expect to convert into cash or use within one year. See also *current assets, fixed assets, intangible assets*.

**Loss accounts.** See *expense accounts*.

**Loss contingencies** represent existing conditions, situations, or sets of circumstances involving uncertainty as to possible losses. See also *gain contingencies*.

**Losses** decrease assets or increase liabilities from transactions peripheral or incidental to major or central operations. See also *gains, expenses*.

**Lower of cost or market** sets the value of inventory at the closing of a period to market value if that amount falls below the actual cost of that inventory, and uses conservatism to create an exception to the historical cost principle in accounting for inventories. See also *net realizable value, net realizable value less normal profit, replacement cost*.

**Management letters**, from an enterprise's management, furnish the auditor information regarding the enterprise's financial condition and operating results, especially asserted and unasserted legal claims against the enterprise. See also *audit inquiry letters*.

**Management's discussion and analysis**, or **MD&A**, requires a registrant to discuss and analyze the enterprise's financial condition and results of operations and gives investors the opportunity to see the company through the eyes of management. Auditors do not review this section of SEC filings.

**Market capitalization** multiplies the number of outstanding shares by the market price per share.

**Market discount** reflects the difference between the face value of a bond and its market value given the prevailing interest rate and occurs when the bond's market value falls below its face value. See also *market premium*.

**Market premium** describes the difference between the face value of a bond and its market value given the prevailing interest rate, when a decline in market interest rates causes the fair value of the bond to exceed its face value. See also *market discount*.

**Marketable security** refers to a current asset, such as a stock or bond, that the owner can easily sell.

**Matching principle** dictates that enterprises should record expenses in the same accounting period as the revenues they generate, when feasible.

**Materiality** permits the accountant to disregard otherwise applicable accounting principles and rules as to small and unimportant items.

**Maturity premium** offsets the risks associated with committing funds for longer periods. See also *default premium*, *illiquidity premium*, *inflation premium*, *pure rate of interest*.

**Minority interests**, in a consolidated financial statement, reflect the shares of a subsidiary that the parent corporation or other related subsidiaries do not own.

**Monetary unit assumption** asserts that the monetary unit best communicates economic information regarding exchanges of goods and services, as well as changes in owners' equity, and assists in rational, economic decision-making.

**Multiple-step**, or **multi-step**, **income statements** show gross profit as an intermediate figure in computing net income or loss. See also *single-step income statements*.

**Net book value** refers to the difference between an enterprise's assets and liabilities or the difference between an asset and a related contra-asset. The

term can also refer to the amount of equity per outstanding ownership interest.

**Net income** shows the difference between an enterprise's revenues and its cost of sales, operating expenses, and taxes during a particular time period. See also *comprehensive income, other comprehensive income*.

**Net profit margin**, sometimes referred to as return on sales, shows how much net income a company earns compared to its revenue.

**Net sales** shows the numerical difference between the 'Sales' and 'Sales Returns and Allowances' accounts.

**Net realizable value** subtracts the costs of sale from estimated selling price. See also *lower of cost or market*.

**Net worth.** See *equity*.

**Nimble dividends** may, by some state statutes, furnish dividend distributions from recent earnings even when the balance sheet does not show any surplus that would normally allow a distribution.

**Nonrecurring items** unusually affect the income statement in one period but most likely not subsequent periods. See also *extraordinary items*.

**Normal profit** reflects the anticipated gain upon the sale of inventory, normally equaling expected retail price minus costs.

**Notes payable** express a liability arising from a promissory note.

**Objectivity principle** seeks to assure that different qualified persons would reach essentially similar measures and conclusions upon examining the same data. See also *verifiability principle*.

**Operating activities** involve selling or providing the enterprise's products and services. See also *statement of cash flows*.

**Operating cash flows**, a residual category on the statement of cash flows, generally reflects the movement of cash from selling and providing the enterprise's products and services. See also *investing cash flows, financing cash flows*.

**Operating leases** describe leases that do not essentially transfer ownership of the leased property. See also *capital leases, direct financing leases, sales-type leases*.

**Operating profit margin** shows how much operating income, often before income taxes, interest, and other items, a company earns compared to its operating revenue.

**Ordinary annuity** requires the underlying payments at the end of each period. See also *annuity due*.

**Other comprehensive income** comprises the part of comprehensive income that includes unrealized gains or losses from holding certain investments in debt and equity securities, including related reclassification adjustments, foreign currency translation adjustments, and minimum pension liability adjustments. See also *comprehensive income, net income*.

**Outstanding shares** refers to those shares that shareholders continue to own. See also *shares*.

**Overhead costs.** See *factory overhead costs*.

**Owner's equity.** See *equity*.

**Par value** historically refers to a nominal value assigned to each share in the corporation's charter. Absent coincidence, this amount bears little or no relation to the share's market price or current value.

**Passive investments** do not convey significant influence over the investee, generally defined to be twenty percent of voting stock. See also *active investments*.

**Percentage of completion method** allows an enterprise to recognize a portion of the estimated profit on a long-term contract even though the enterprise has not substantially completed the project.

**Periods.** See *accounting periods*.

**Period costs** refer to those costs that both merchandisers and manufacturers incur, such as administrative salaries, that will generate revenues only in the current accounting period. See also *product costs*.

**Periodicity assumption** attributes an enterprise's activities to distinct accounting periods. See also *accounting periods*.

**Periodic inventory method** computes the cost of goods sold by subtracting ending inventory from the sum of beginning inventory and net purchases. See also *perpetual inventory method*.

**Perpetual inventory method** continuously shows the quantity and cost of the goods that the business holds as inventory at any time on the accounting records. See also *periodic inventory method*.

**Posting** records amounts reflected in journal entries in the appropriate accounts in the ledger.

**Preferred shares** give the shareholder priorities as to dividends or amounts at liquidation. See also *common shares*.

**Prepaid expenses**, better described as prepaid costs, appear as current assets and connote the fact that a future benefit has been paid in advance.

**Prime cost.** See *direct cost*.

**Product costs** include all expenditures directly or indirectly incurred in bringing inventory to its existing condition and location. See also *period costs*.

**Profit and loss account** serves as the consolidating account for all revenues, expenses, gains, and losses during an accounting period.

**Program method**, an accounting method for revenue recognition most often used in the aerospace-defense industry, averages the net profit of current and anticipated future contracts. See also *completed project method*.

**Property, plant and equipment.** See *fixed assets*.

**Proprietorship accounts** represent residual ownership in a sole proprietorship.

**Pure rate of interest** describes the rate a lender would charge a borrower for the use of money if the risks represented by the default, illiquidity, inflation, and maturity premiums did not exist. See also *default premium, illiquidity premium, inflation premium, maturity premium*.

**Qualified opinions** convey the independent auditor's belief that the financial statements do not fairly present the enterprise's financial position, operating results, and cash flows in conformity with generally accepted accounting principles. See also *adverse opinions, disqualified opinion, unqualified opinions*.

**Quick assets** generally include only cash, cash equivalents, marketable securities that the enterprise plans to sell in the near future, and accounts receivable, but the precise definition varies.

**Rate base** includes those assets viewed as devoted to providing utility services, and historically provides the starting point for determining the prices a utility can lawfully charge its customers.

**Reasonable assurance** describes the level of comfort that an unqualified opinion conveys, which falls well below a guarantee because the auditor only reviews a sample of an enterprise's total transactions.

**Redemptions** repurchase a corporation's own shares, which then become treasury shares or authorized but unissued shares. See also *dividends*.

**Related party transactions** involve dealings between parties who enjoy some close relationship to each other. Such transactions, if material, require disclosure in the financial statements.

**Regulation S-B** exempts qualifying small business issuers from certain requirements of Regulation S-X and S-K. See also *Regulation S-K*, *Regulation S-X*.

**Regulation S-K** presents standard instructions for filing forms with the SEC, including directions related to certain financial information that those forms require. See also *Regulation S-B*, *Regulation S-X*.

**Regulation S-X** prescribes the specific items that registrants not qualifying as small business issuers must disclose or address in financial statements. See also *Regulation S-B*, *Regulation S-K*.

**Replacement cost** estimates the amount an enterprise would pay to acquire a new asset as equally useful or productive as an asset that the enterprise currently has. See also *adjusted book value*, *lower of cost or market*.

**Reserve** refers to anticipated liabilities when uncertainty exists about the amount or timing of the transfer of the economic benefits that the obligations's payment or satisfaction will entail. When estimating a reserve, an enterprise treats the estimated amount necessary to resolve the matter as an expense or loss and records a liability or increases a contra-asset account to reflect the amount owed or the asset's impairment.

**Reserve for bad debts.** See *allowance for doubtful accounts*.

**Residual method** values goodwill at the difference between the purchase price to acquire an on-going business and the business's identifiable assets. See also *goodwill*.

**Restatements** amend previously issued financial statements to correct errors arising from mathematical mistakes, misapplying accounting principles, or overlooking or misapplying facts that existed when the enterprise prepared the original statements.

**Restrictive covenants** contractually protect lenders from default by prohibiting the borrower from taking certain actions, such as paying dividends, or requiring the borrower to do certain things, such as providing financial statements to the lender or maintaining certain financial ratios.

**Retail method** allows a merchandiser to estimate the business's inventory based on a ratio of inventory costs to their retail prices without counting and pricing individual items. See also *average cost method*, *first-in first-out*, *last-in first-out*, *specific identification*, *standard costs*.

**Retained earnings account** tracks all undistributed profits that remain invested in the enterprise.

**Revaluation surplus** may arise when a corporation's directors revalue assets to determine whether the board can lawfully distribute assets to shareholders.

**Revenues** consist of increases in assets, decreases in liabilities, or both, resulting from delivering goods, rendering services, or engaging in ongoing major or central operations. See also *expenses, gains*.

**Revenue recognition principle** delays recording revenue, with some exceptions, until an exchange transaction has occurred and when the enterprise has completed, or virtually completed, the earnings process.

**Reverse stock splits** combine a number of outstanding shares to form one new share.

**Review**, as an alternative to a full audit, offers only limited assurance that the financial statements fairly present the enterprise's financial position, operating results, and cash flows in conformity with generally accepted accounting principles. See also *compilation*.

**Right of return** implies that the selling enterprise has not entirely transferred all risks of ownership, and therefore should not immediately record the transaction as a sale.

**Rule of 72s** allows quick estimation of how long it will take an investment to double given a rate of compound interest by dividing the expected interest rate into 72. For example, at six percent interest, compounded annually, an investment will double in twelve years.

**Rule of 78s**, a method of recognizing interest income, offers lenders an advantage by treating a greater percentage of early payments as interest rather than as principal payments.

**Sales-type leases** describe capital leases that involve either a dealer or manufacturer profit or loss for the lessor while essentially transferring ownership of the property. See also *capital leases, operating leases, direct financing leases*.

**Salvage value** is the expected market value of an asset at the end of its useful life.

**Segment reporting** requires public companies to disaggregate in their periodic financial statements operating components that management regularly reviews separately when evaluating the company's performance and allocating resources.

**Shares** comprise the residual ownership of a corporation. See also *outstanding shares, treasury shares*.

**Simple interest** requires the borrower to pay interest on the original principal amount only, regardless of any unpaid interest attributable to past periods. See also *compound interest*.

**Single-entry bookkeeping** records each transaction affecting a particular asset, but does not track any other assets or liabilities. See also *double-entry bookkeeping*.

**Single-step income statements** classify all items into two categories: revenues, which includes both operating revenues and gains; and expenses, which includes cost of goods sold, operating expenses, losses, and taxes. See also *multiple-step income statements*.

**Six-column worksheet**, actually containing seven columns, lists accounts and credits and debits to each of the trial balance, income statement and balance sheet. See also *trial balance, worksheet*.

**Solvency tests.** See *insolvency tests*.

**Specific identification**, an inventory method, matches the precise cost to acquire or manufacture an item against its selling price to determine gross profit. Similarly, the costs of acquire or manufacture unsold items determine the ending inventory. This method offers the most accurate way to calculate gross profit and net income, but the time and expense necessary to record and track each item can overwhelm most enterprises. See also *average cost method, first-in first-out, last-in first-out, retail method, standard costs*.

**Standard costs**, an inventory method, assigns predetermined unit costs to materials, labor, and overhead, and then records variances when actual costs differ from the expected amount. See also *average cost method, first-in first-out, last-in first-out, retail method, specific identification*.

**Stated capital.** See *legal capital*.

**Stated value** conveys an amount that the board of directors arbitrarily assigns to shares before issuing them under the legal capital system. See *par value*.

**Statement of cash flows** reports and explains the changes in an enterprise's cash and cash equivalents during an accounting period. See also *balance sheet, income statement, statement of changes in owner's equity*.

**Statement of changes in owner's equity** fully reconciles the changes in net worth between balance sheet dates, including increases arising from owner investments and decreases from withdrawals. See also *balance sheet, income statement, statement of cash flows*.

**Statement of earnings.** See *income statement*.

**Statement of operations.** See *income statement*.

**Statement of financial condition.** See *balance sheet*.

**Statement of financial position.** See *balance sheet*.

**Statement of retained earnings.** See *statement of changes in owner's equity*.

**Stock.** See *shares*.

**Stock buyback.** See *redemptions*.

**Stock dividends** issue additional shares from a corporation to its shareholders without consideration on a pro rata basis. See also *stock splits*.

**Stock options** give corporate executives and employees the right to purchase the corporation's shares at a fixed price in the future, usually as a part of a compensation package.

**Stock splits** issue additional shares from a corporation to its shareholders without consideration and without changing the corporation's legal capital by adjusting par value as necessary to reflect the newly issued shares. For example, a stock split may leave a shareholder who owned 100 common shares, each with \$1 par value, with 200 shares at a par value of \$0.50 each. See also *stock dividend*.

**Straight-line method** allocates an item, such as depreciation or interest income, equally between any accounting periods involved. For depreciation, this method divides the asset's useful life into the depreciable basis to determine the depreciation for each period in the useful life. See also *depreciation*.

**Successful efforts accounting**, a cost collection method, capitalizes only those acquisition, exploration, and development costs directly associated with fruitful projects. See also *cost collection methods, full-costing accounting*.

**Sum-of-the-years'-digits method** produces a decreasing depreciation charge as a function of a decreasing fraction of the depreciation base. See also *accelerated depreciation, depreciation*.

**Surplus**, in a legal capital system, represents equity in excess of stated capital. See also *capital surplus, earned surplus*.

**Synthetic leases** refers to arrangements classified as operating leases for financial accounting purposes, but which qualify as conditional sales for federal and state income tax, bankruptcy, and commercial purposes.

**T-account** records changes in a given asset, liability, or component of equity. See also *account*.

**Tangible book value** modifies net book value by subtracting any recorded intangible assets from an enterprise's net assets. See also *net book value*.

**10-K.** See *Form 10-K*.

**10-Q.** See *Form 10-Q*.

**Tone-at-the-top** refers to the environment established by upper management that influences financial accounting practices.

**Tracing**, an auditing technique, follows a particular item of data through the accounting and bookkeeping process to determine whether the business has properly recorded and accounted for it. See also *vouching*.

**Trading securities** imply the intent to sell the debt or marketable equity securities in the near term. See also *available-for-sale securities, held-to-maturity debt securities*.

**Treasury shares** describe shares repurchased by the corporation. The modern trend treats such shares as authorized but unissued. See also *authorized but unissued shares, shares*.

**Trend analysis** involves comparing financial statements for an enterprise over several periods. See also *common-sized analysis, ratio analysis*.

**Trial balance** lists all accounts and their temporary balances. See also *six-column worksheet*.

**Unearned revenues** require the entity to refund the unearned amount if it does not perform certain services. See also *current liabilities*.

**Unexpired assets**. See *capital expenditures*.

**Units-of-activity method** bases an asset's depreciation on the estimated quantity of output or expected number of hours of productive capacity. See also *depreciation*.

**Unqualified opinions**, from independent auditors, reflect that the financial statements fairly present the enterprise's financial position, operating results, and cash flows in conformity with generally accepted accounting principles. See also *adverse opinions, disclaimer of opinion, explanatory language, qualified opinions*.

**Useful life** estimates the duration of the expected future benefits of a long-lived asset. See also *depreciation*.

**Variable costs**, such as raw materials and direct labor, change depending on production levels. See also *factory overhead costs, fixed costs*.

**Verifiability principle** prefers accounting treatments that available and reliable evidence can support. See also *objectivity principle*.

**Vertical analysis**. See *common-sized analysis*.

**Vouching**, an auditing technique, selects a transaction recorded in a business's books to determine whether underlying data supports the recorded entry. See also *tracing*.

**Wasting assets.** See *depletion*.

**Work-in-process inventory** describes unfinished, not-yet-marketable goods that an enterprise holds for completion.

**Working capital** measures the difference between current assets and current liabilities.

**Working papers** document the various procedures and findings in an audit.

**Working trial balance.** See *six-column worksheet*.

**Workpapers.** See *working papers*.

**Worksheet** separates the revenue, gain, expense, and loss accounts in the trial balance that flow into the income statement and the asset, liability, and equity accounts that appear on the balance sheet. See also *trial balance*, *six-column worksheet*.

**Write-down** transfers a portion of the balance in an asset account to an expense account, which reduces net income in the current period, reflecting a decrease in the asset's value. See also *write-offs*.

**Write-offs** eliminate assets that have become worthless from the balance sheet. See also *write-downs*.