

**DICTIONARY  
OF  
ACCOUNTING**

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**The MIT Press  
Cambridge, Massachusetts  
London, England**

Third printing, December 1981  
Second printing, July 1981  
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The Massachusetts Institute of  
Technology

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This book was set in VIP Baskerville by DEKR Corporation and printed and bound by The Murray Printing Co. in the United States of America.

Library of Congress Cataloging in Publication Data

Estes, Ralph W  
Dictionary of accounting.

1. Accounting—Dictionaries.

I. Title.

HF5621.E77 657'.03'21 80-26752

ISBN 0-262-05024-2 (hard)

ISBN 0-262-55009-1 (paper)

## To the reader

This dictionary is for business persons, students, accountants, attorneys, investors, administrators, and others who need accurate but not abstruse explanations of terms encountered in accounting and business. Accounting is a complex subject; nevertheless the definitions and examples have been kept as clear and understandable as possible. For technical terms, references have been given to authoritative sources:

APB Opinions—Accounting Principle Board Opinions, available from the American Institute of Certified Public Accountants (AICPA), 1211 Avenue of the Americas, New York, New York

ARB—Accounting Research Bulletin, available from the AICPA

FASB Statements—Financial Accounting Standards Board Statements, available from the Financial Accounting Standards Board, High Ridge Park, Stamford, Connecticut 06905

SAS—Statements on Auditing Standards, available from the AICPA

When more than one definition is given, the most common usage is presented first. Terms printed within a definition in italics are defined in this dictionary.

With a few exceptions, accounts have a normal balance, meaning that the condition of the account under usual, non-extraordinary conditions can be indicated. For example, a positive cash balance is normal; a negative or overdraft position is abnormal. Under normal conditions the cash account in the general ledger thus has a positive or debit balance. When possible, the normal balance condition is indicated in the definitions of accounts.

Journal entries are shown for most accounts, illustrating the most common transactions involving those accounts. As a further aid in understanding the meaning of different accounts and their relationships, formats for the most common financial statements are illustrated in the appendix.

**A**

**AAA**

American Accounting Association.

**abacus**

A device for performing calculations, primarily addition and subtraction but also multiplication and division, by sliding beads along rods or wires. The abacus has been especially popular in the Orient.

**ABC method**

An inventory control method that emphasizes the importance or value of the inventory items; often used when many inventory items are carried and detailed attention to each item is not feasible. Items are assigned to classes A, B, and C (even D in some companies). The most expensive or important items are assigned to class A, the least expensive to C, and the rest to B. The A and B classes are controlled more closely and ordered more frequently in smaller quantities; to minimize the inventory investment; perpetual records may also be maintained for the A and B items. The ABC method recognizes that a relatively small number of items usually account for a large percentage of total costs and that these items deserve tighter (and more costly) control.

**absolute value**

The magnitude of a number without regard to its algebraic (plus or minus) sign. Thus the absolute value of  $-12$  is simply 12.

**absorption costing**

A method of accounting for costs of production in which both variable and fixed manufacturing costs are treated as *product costs*. Contrast with *direct costing* in which only variable manufacturing costs

are treated as product costs and fixed manufacturing costs are deducted fully from income in the period incurred. *Generally accepted accounting principles* require the use of absorption costing for financial reporting purposes.

**accelerated depreciation**

A form of *depreciation* in which the largest proportion of an asset's cost is written off in the earliest years of its useful life. Contrast with *straight-line depreciation*. See also *declining balance depreciation*, *sum-of-the-years-digits depreciation*.

**account**

A record of the increases, decreases, and the *balance* of an item reported in financial statements (such as cash, inventory, sales revenue, telephone expense). Accounts allow for recording of *debits*, *credits*, and balances and may be located physically in *ledger* sheets, open files, computer tape, or computer random access storage. One common form of ledger account, showing a running balance, is illustrated. Notice the debit and credit entries and the running balance. Not illustrated is the *T-account*, in which debits are recorded on the left side of the page, credits on the right, and the balance noted periodically at the bottom of the appropriate side.

A/C #1001			CASH	
Date	Ref.	Debit	Credit	Balance
1/1/83	CR1	500		500
1/8	CR12	200		700
1/8	CD2		300	400
1/15	CR20	450		850
1/15	CD8		200	650
1/22	CR31	550		1200
1/22	CD17		400	800
1/29	CR40	400		1200
1/29	CD25		300	900

**account form**

A form of balance sheet presentation in which assets are shown on the left side, with liabilities and owners' equity on the right. Contrast with *report form*.

**accountancy**

The profession and practice of *accounting*.

**accountant**

A person who performs *accounting* work: a *certified public accountant*, performing independent audits of financial statements as well as tax and management advisory services; *controller*, supervising the design and functioning of an organization's information system and financial reporting; a *cost accountant*, concerned with accumulation and analysis of product costs; any other person performing accounting work and services.

**Accountants for the Public Interest (API)**

An organization of accountants, lawyers, and others that works, through its national and affiliate offices and through individual members, to provide objective analysis of public issues and to provide accounting services to persons and organizations that cannot afford to pay professional fees.

**Accountants International Study Group (AISG)**

An organization created by the American Institute of Certified Public Accountants and the Institutes of Chartered Accountants of Canada, England and Wales, Scotland, and Ireland, to identify and describe accepted accounting practices in those countries.

**accounting**

Activities that provide information, usually quantitative and often expressed in monetary units, for decision making, planning, evaluating performance, controlling resources and operations, and external financial reporting to investors, creditors, regulatory authorities, and the public.

**accounting cycle**

The accounting steps from initial recognition of transactions and events through production of financial statements. The accounting cycle includes making *journal entries* to record transactions and events; *posting* entries to *accounts* in *ledgers*; preparing a *trial balance*; making *adjusting entries*; preparing *financial statements*; recording *closing entries*.

**accounting equation**

An expression showing the equality of assets and interests, or equities, in those assets. The equation may be expressed in several forms:

$$A = E \text{ (Assets = Equities)}$$

$$A = L + P \text{ (Assets = Liabilities + Proprietorship)}$$

$$A = L + C \text{ (Assets = Liabilities + Capital)}$$

$$A = L + OE \text{ (Assets = Liabilities + Owners' Equity)}$$

$$A - L = P \text{ (Assets - Liabilities = Proprietorship)}$$

**accounting period**

The period of time covered by an *income statement* and other financial reports. Virtually all organizations prepare reports annually; many also prepare monthly, quarterly, or semiannual reports. See also *fiscal year*, *natural business year*.

accounting principles

See *generally accepted accounting principles*.

Accounting Principles Board (APB)

A group appointed by the American Institute of Certified Public Accountants to establish acceptable accounting principles, announced in *APB Opinions*. The Accounting Principles Board was discontinued upon the establishment of the *Financial Accounting Standards Board* in 1973.

Accounting Research Bulletin (ARB)

A statement on accounting principles issued by the American Institute of Certified Public Accountants' Committee on Accounting Procedure. The committee was replaced in 1959 by the *Accounting Principles Board*, in turn replaced in 1973 by the *Financial Accounting Standards Board*. ARBs that have not been modified, replaced, or rescinded remain in force as authoritative pronouncements on *generally accepted accounting principles*.

Accounting Series Release (ASR)

A statement issued by the Securities and Exchange Commission to specify or clarify accounting and auditing procedures to be followed in reports filed with the SEC.

accounting system

The set of rules, policies, records, standard procedures, and organizational relationships designed to control the operations and resources of an organization and to provide information for planning, decision making, and external reporting.

accounts payable

Amounts owed to others, often restricted to amounts due to suppliers. Accounts Payable is a *current liability* with a normal credit balance. The most common journal entries affecting the account occur when material is purchased: Purchases (or Materials

Inventory)	xxx
Accounts Payable	xxx
and when accounts are paid:	
Accounts Payable	xxx
Cash	xxx

accounts receivable

Amounts due from others, usually restricted to amounts due from the sale of goods or services. Accounts Receivable is a *current asset* with a normal debit balance. It is increased by sales on account recorded as follows:

Accounts Receivable	xxx
Sales	xxx
Collections from customers on account require the following journal entry:	
Cash	xxx
Accounts Receivable	xxx

accounts receivable turnover

See *receivables turnover*.

accrual accounting

A method of accounting in which revenue is recognized and recorded when earned, expenses are recognized when incurred, and other changes in the condition of an organization are recognized as they occur, without regard to the timing of related cash receipts and expenditures. For example, sales revenue is recognized when goods are delivered to or picked up by a customer even though payment for those goods may not be received for several weeks; interest ex-

pense on a note payable is recognized at the end of each *accounting period*, based on the time elapsed, even though the interest might not be paid until several months later; depreciation is recorded as an asset is used, while the cash expenditure for that asset may have occurred several years earlier. Accrual accounting is used by most larger companies. Contrast with *cash basis accounting*. See also *accrued income*, *accrued expense*.

accrued expense

An expense incurred but not yet paid; recorded in the accounts by debiting an expense account and crediting a liability account. For example, wages for work performed represent an accrued expense until they are paid and are recorded:

Salaries and Wages Expense	xxx
Accrued Salaries and Wages Payable	xxx
See also <i>accrued liability</i> .	

accrued income

Income earned but not yet received; recorded by debiting a receivable account and crediting an income or revenue account. For example, interest earned but not yet collected is recorded:

Interest Receivable	xxx
Interest Income	xxx

accrued liability

An obligation incurred over time but not yet paid. Examples include accrued income taxes, accrued salaries and wages, and accrued interest payable. An accrued liability has a normal credit balance and is classified as a *current liability* if due within one year. An example of a

journal entry for an accrued liability is: Provision for Income

Taxes	xxx
Income Taxes Payable	xxx

accumulated depreciation

The total *depreciation* recognized and recorded for an asset since its acquisition. Accumulated depreciation is a *contra asset* and is subtracted from the original cost of the asset to give *book value*.

Accumulated Depreciation has a normal credit balance. A journal entry to recognize depreciation is made each accounting period:

Depreciation Expense	xxx
Accumulated Depreciation	xxx

accumulated earnings tax

A federal tax designed to prevent taxpayers from using the corporate form of organization to avoid personal income taxes. Without such a tax, owners of a corporation might avoid personal income taxes on business earnings. For example, a majority shareholder of a corporation might refuse to declare any dividends until after retirement when the shareholder's personal income tax rate would probably be lower. The accumulated earnings tax is assessed on earnings retained (not paid out in dividends) in the business beyond reasonable and anticipated needs. The recent rate was 27½% on the first \$100,000 of taxable accumulated earnings and 38½% on any amount over \$100,000. The accumulated earnings tax is subject to various adjustments, deductions, and credits. Internal Revenue Service regulations should be consulted for current provisions.

**acid-test ratio**

The sum of cash, temporary investments in marketable securities, and current receivables, divided by current liabilities (also called the quick ratio). The acid-test ratio is a conservative measure of ability to meet current obligations.

**acquisition cost**

See *historical cost*.

**actuarial gain or loss**

A change in *pension cost* due to a change in actuarial assumptions such as mortality rate, employee turnover, and *pension fund earnings*.

**actuary**

A person who calculates risks, insurance premiums, and costs, based on life expectancy and mortality statistics.

**ad valorem tax**

A tax based on some measure of the value, such as cost or appraised value, of goods or property. A property tax is an ad valorem tax.

**addition**

An increase in the capacity of an existing asset through its enlargement or expansion, such as the construction of a new wing on a factory. See also *betterment*.

**additional first-year depreciation**

A provision in federal income tax regulations permitting taxpayers to deduct 20% of the cost of newly acquired machinery and equipment during the first year of use; this deduction is subject to certain limitations and is in addition to the regular depreciation on the remainder of the cost. For example, a taxpayer who pays \$50,000 for equipment with an

estimated ten-year useful life and no salvage value may deduct 20%, or \$10,000, as additional first-year depreciation and may also deduct regular depreciation of  $(\$50,000 - \$10,000) \div 10$ , or \$4,000. The total depreciation allowed in the first year, for tax purposes, is thus \$14,000. Additional first-year depreciation applies only to income tax reporting; it is not relevant for normal financial reporting.

**additional paid-in-capital**

*Paid-in-capital* in addition to the *par value* or *stated value* of stock issued. For example, a share of \$10 par value common stock issued at \$27 results in \$17 of additional paid-in capital. Additional paid-in capital may also include capital contributed from other sources (excluding earnings retained in the business), such as gifts or donations to the company. Additional Paid-In Capital is an *owner's equity* account with a normal credit balance. The journal entry to record issuance of a share of \$10 per value common stock at \$27 would be

Cash	27	
Common Stock		10
Additional Paid-In Capital		17

**adjusted gross income**

A subtotal, essentially gross income minus business deductions, used as a basis for calculating certain percentage deductions for federal income tax reporting.

**adjusting entry**

A *journal entry* made at the end of an accounting period to record previously unrecognized changes in assets, liabilities, revenue, and expenses. Examples

include entries to recognize depreciation, accrued liabilities and income, ending inventories (when the *periodic inventory method* is used), and uncollectible accounts expense.

**adjustment**

See *adjusting entry*.

**administrative expense**

A current deduction from revenue to reflect a *cost* of an organization's central office and general support services, as distinguished from a *manufacturing cost* or a *selling expense*; examples include office salaries, legal services, and office rent.

**ADR**

*Asset depreciation range*.

**adverse opinion**

An opinion by a *certified public accountant* that financial statements do not fairly present an organization's financial position, results of operations, and changes in financial position in accordance with *generally accepted accounting principles*; one form of an *audit opinion*.

**affiliate**

A member of a group of two or more companies related to one another through some form of control, usually stock ownership. A *parent company* and a *subsidiary company* have an affiliate relationship.

**AGA**

*Association of Government Accountants*.

**agency fund**

A set of resources, with related accounts and controls, administered but not

owned by a governmental unit, and typically held for a relatively short period of time. For example, a \$50,000 gift from a citizen to a city to be used for a public park would probably be accounted for in an agency fund until used for the designated purpose.

**aging of accounts**

A process in which transactions making up an account balance are classified according to the date on which each occurred, thus indicating the "age" of each transaction. Aging of accounts receivable is often accomplished by classifying the charges as current (30 days or less), 31–60 days, 61–90 days, over 90 days. This classification is useful for assessing the collectibility of accounts and for setting credit policies.

**AIA**

American Institute of Accountants, the former name of the *American Institute of Certified Public Accountants*.

**AICPA**

*American Institute of Certified Public Accountants*.

**AISG**

*Accountants International Study Group*.

**AJE**

Adjusting journal entry; see *adjusting entry*.

**all-inclusive method**

A method of reporting the results of operations in which extraordinary transactions and corrections of the results of prior periods are included in the determination of current income; the preferred method under current account-

ing standards. Contrast with *current operating performance method*. Ref.: FASB Statement No. 9.

### allocation

A systematic distribution or assignment of a total amount among several years, accounts, products, departments, or other elements.

### allowance

(1) An account deducted from an asset account to reflect a reduction in value or utility of the asset; a *contra asset*. *Allowance for doubtful accounts*, *allowance for depreciation* are examples. (2) A reduction in price or amount due; for example, an allowance for freight damage or for returned merchandise. See also *sales returns and allowances*.

### allowance for bad debts

See *allowance for doubtful accounts*.

### allowance for depreciation

See *accumulated depreciation*.

### allowance for doubtful accounts

The amount provided for notes and accounts receivable estimated to be uncollectible. Allowance for Doubtful Accounts is a *contra asset*, with a normal credit balance, deducted from notes and accounts receivable to give the net book value of receivables. The account is affected when the following periodic journal entry is made to record the estimated expense of uncollectible accounts:

Bad Debt Expense	xxx
Allowance for Doubtful Accounts	xxx

and when specific accounts are actually determined to be uncollectible:

Allowance for Doubtful	
------------------------	--

Accounts	xxx
Accounts Receivable	xxx

Also called allowance for bad debts, allowance for uncollectible accounts, reserve for doubtful accounts, reserve for bad debts.

### allowance for uncollectible accounts

See *allowance for doubtful accounts*.

### American Accounting Association (AAA)

An organization that seeks to advance accounting education and accounting research, largely through publication of the quarterly journal *The Accounting Review*, sponsorship of research, and working committees. Widely viewed as consisting primarily of accounting educators but includes a large proportion of accounting practitioners.

### American Institute of Accountants (AIA)

Former name of the *American Institute of Certified Public Accountants*.

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

A professional organization whose membership is restricted to *certified public accountants*. The AICPA publishes *The Journal of Accountancy* (monthly) and through its council and committees strongly influences U.S. accounting principles and auditing standards.

### American Society of Women Accountants (ASWA)

An organization that seeks to promote and assist women in the profession of accounting. The ASWA publishes *The Woman CPA* jointly with the *American Woman's Society of Certified Public Accountants*.

### American Woman's Society of Certified Public Accountants (AWSCPA)

An organization of certified public accountants, both women and men, that seeks to encourage women accountants in their professional advancement, increase the recognition of women in the accounting profession, and encourage the participation of women in technical and professional accounting programs. The AWSCPA publishes *The Woman CPA* jointly with the *American Society of Women Accountants*.

### amortization

The systematic reduction or writing off of an amount, such as an account *balance*, over a specific number of time periods. *Depreciation* is one form of amortization.

### amortize

To systematically reduce or write off an original amount or account *balance* over a specific number of time periods.

### analytical review

A review by an auditor of financial statement ratios, changes in balances from one period to the next, and trends in financial data in order to obtain a broad understanding of a client's financial position and results of operations, and to identify unusual fluctuations and questionable items for further investigation. Contrast with *test of transactions*.

### annual report

A document issued each year by a corporation and containing financial statements. A typical annual report consists of a letter from the chief executive officer summarizing the year's operations; financial statements including a balance sheet, income statement, and statement

of changes in financial position; an independent auditor's opinion on the financial statements; and often additional information about the company and its products.

### annuity

A fixed amount to be received or paid in each of a given number of time periods, such as \$100 per year for ten years.

### annuity method of depreciation

A method of recording *depreciation* that provides for an *imputed interest* return on the amount invested in an asset. A periodic depreciation charge (expense) is first calculated:

$$\text{Periodic depreciation charge} = \frac{\text{asset cost} - \frac{\text{salvage value}}{(1+i)^n}}{a\overline{n}|i}$$

where  $i$  = imputed interest rate,  $n$  = asset's useful life in years,  $a\overline{n}|i$  = present value of an annuity of \$1 for  $n$  years at an interest rate of  $i$ . Each period the *book value*, or undepreciated balance of the asset, is multiplied by the imputed interest rate. This amount is recorded as interest income and is subtracted from the calculated depreciation charge; the remainder of the calculated charge is credited to accumulated depreciation, reducing the asset's book value. For example, assume a periodic depreciation charge of \$158, asset book value at the beginning of the current period of \$1,000, and an imputed interest rate of 8%. Imputed interest income would thus be  $0.08 \times \$1,000$ , or \$80. The following journal entry would be made to record depreciation for the current period:

Depreciation Expense	158	
Interest Income		80
Accumulated Depreciation		78

**APB**

*Accounting Principles Board.*

**APB Opinion**

A statement issued by the *Accounting Principles Board* to resolve financial reporting controversies and to establish acceptable accounting principles. See also *FASB Statement*.

**API**

*Accountants for the Public Interest.*

**application of funds**

A use or expenditure of liquid resources (sometimes used more restrictively to refer to a use or decrease in *working capital*).

**appraisal**

An estimate of value, usually made by a person trained and experienced in making such estimates.

**appraisal capital**

A recorded increase in *owners' equity* resulting from an upward adjustment in the carrying value of an asset on the basis of an appraisal; rarely encountered in the United States, but more common in other countries. Appraisal Capital is an owners' equity account with a normal credit balance.

**appraisal surplus**

See *appraisal capital*.

**appraisal value**

See *appraised value*.

**appraised value**

An estimate of worth based on an *appraisal*.

**appreciation**

An increase in value or amount.

**appropriated retained earnings**

A portion of *retained earnings* identified, usually by a corporation's board of directors, for a specified purpose (such as plant expansion) and thus not available for dividends.

**appropriation**

An amount designated for a specified purpose, and not otherwise available.

**ARB**

*Accounting Research Bulletin.*

**ASR**

*Accounting Series Release.*

**asset**

An object, right, or claim that is expected to provide benefits to its owner. An asset appears on the *balance sheet* and has a normal debit balance.

**asset depreciation range (ADR)**

Upper and lower limits set by the Internal Revenue Service for asset lives; an asset may be depreciated, for federal income tax purposes, over a useful life selected from within this range, without further justification.

**asset turnover**

A statistic used to evaluate the revenue-producing power of assets, calculated by dividing sales revenue by average total assets for the period.

**Association of Government Accountants (AGA)**

An organization of accountants with a special interest in government account-

ing. Full membership is restricted to persons with a minimum of six years of accounting, auditing, budgeting, or financial management experience, although a college degree in accounting or business administration, or a CPA certificate may substitute for three years of the required experience. The AGA publishes, *The Government Accountants Journal* (quarterly).

**ASWA**

*American Society of Women Accountants.*

**attest**

To provide assurance with respect to specified information or assertions. Auditors attest to the fairness of financial statements by issuing an *audit opinion*.

**attestation**

A statement in support of the truth, validity, or fairness of specified information or assertions. An *audit opinion* is an attestation on the fairness of financial statements.

**attributes sampling**

See *sampling for attributes*.

**audit**

(1) A review to determine the accuracy and validity of records and reports or the conformity of procedures with established policies; especially, the examination of financial statements of a reporting company by an independent certified public accountant to determine whether, in the CPA's opinion, the statements fairly present the company's financial position, results of operations, and changes in financial position. (2) To perform such a review or examination.

**audit certificate**

See *audit opinion*.

**audit committee**

A board of directors committee that selects or participates in selection of the company's outside auditors. Major problems encountered by outside auditors during an audit, such as restrictions on audit procedures or differences of opinion with management over the presentation of financial statements, are usually brought to the attention of the audit committee.

**audit guides**

See *industry audit guides*.

**audit opinion**

The report given by a certified public accountant following an examination of financial statements, expressing an opinion on the fairness of presentation of those statements. The opinion may take one of the following forms: unqualified opinion (see *standard opinion*); qualified opinion (see "*except for*" *opinion* and "*subject to*" *opinion*); *adverse opinion*; *disclaimer of opinion*.

**audit program**

A list or description of objectives to be attained and procedures to be performed during an *audit*.

**audit report**

See *audit opinion*.

**audit trail**

A chain of evidence, provided through coding, cross references, and documentation, connecting account balances or other summary results to original transactions and calculations. For example,



the audit trail for total advertising expense for a period runs from the account balance back through individual entries in the account, to journal entries, and finally to documents supporting the journal entries such as paid invoices and canceled checks. The purposes of an audit trail are to permit verification of balances and to facilitate location and correction of errors.

**auditing**

The process of conducting an *audit*.

**auditing standards**

See *generally accepted auditing standards*.

**auditor**

One who performs an *audit*. External auditors examine financial statements of a client with a view to expressing an opinion on their fairness; internal auditors review the operating and managerial practices of their employer to determine conformity with established policies and to seek cost savings and operating efficiencies.

**auditor's opinion**

See *audit opinion*.

**auditor's report**

See *audit opinion*.

**average cost**

(1) Total cost divided by number of periods or units. (2) A method of costing inventory by dividing the sum of beginning inventory cost, plus cost of additions to inventory, by total units available during the period.

**AWSCPA**

*American Woman's Society of Certified Public Accountants.*

**B**

**back order**

A sales order received for goods or services that have not yet been delivered. Back orders are filled as the goods become available.

**bad check**

A check that is not covered by an adequate balance in the bank; an *NSF check*.

**bad debt**

An *account receivable* or *note receivable* that has become uncollectible, because of a creditor's inability or unwillingness to pay. Bad debts are recorded by either the direct writeoff method or the allowance method. With the former, a bad debt is not recognized until it becomes evident that the account will not be collected; at that time the following journal entry is made:

Bad Debt Expense	xxx	
Accounts Receivable		xxx

With the allowance method, which is preferred, a bad debt expense is recorded each period to reflect the estimated amount of that period's sales that will ultimately prove to be uncollectible, using the following journal entry:

Bad Debt Expense	xxx	
Allowance for Doubtful		xxx
Accounts		xxx

When specific accounts are determined to be uncollectible under the allowance method, the following entry is made:

Allowance for Doubtful		
Accounts	xxx	
Accounts Receivable		xxx

**bad debt expense**

An amount deducted in determining income to reflect the estimated portion of receivables arising from current sales that will not be collected. See *bad debt* for examples of journal entries.

**balance**

The remainder; in an *account*, the difference between *debits* and *credits*. For an asset or liability the balance is the *book value* or carrying value; for a revenue or expense account the balance is the total of that revenue or expense to date. When accounts or other sums are said to "balance," they are equal to each other.

**balance sheet**

A report of a company's assets, liabilities, and equities, also called the statement of financial position. The balance sheet gets its name from the fact that the sum of the assets equals the sum of the liabilities plus equities; the totals "balance." Refer to the appendix for an example.

**bank reconciliation**

An analysis of the items causing a difference between the balance in a bank account as shown in the depositor's records (check register, check stubs, or cash account) and the balance reported on the bank statement. Such items include *outstanding checks*, deposits in transit and not yet recorded by the bank, items collected for the depositor by the bank but not yet recorded by the depositor, and bank service charges.

**bankruptcy**

A condition under the Federal Bankruptcy Act in which an individual's or company's assets are assumed by a federal court official and used, to the extent possible, to pay off creditors. Bankruptcy may be either voluntary (elected by the individual or company) or involuntary (forced by creditors). The attraction of bankruptcy is the opportunity to be freed of oppressive debts and to start again, debt free.

**base stock**

A minimum level of inventory considered to be a more or less permanent investment; used in the *base-stock method* for costing inventory.

**base-stock method**

A procedure for determining the cost of inventory in which a *base stock* is valued at a so-called normal price and any additional quantity is valued on a *last-in, first-out* basis.

**BASIC**

(Beginner's All-purpose Symbolic Instruction Code) A simple and easily learned computer programming language designed primarily for *time-sharing* usage.

**basis**

The amount compared to (subtracted from) proceeds from sale of property to determine gain or loss for federal income tax purposes. For example, sale of an asset for \$12,000 that has a basis of \$10,000 results in a gain of \$2,000. The basis is usually the cost or the *book value*, but adjustments may be required or allowed by Internal Revenue Service regulations.

**batch processing**

A procedure in a computer system in which similar items are accumulated and processed as a group. Contrast with *time sharing*.

**beginning inventory**

The inventory balance at the beginning of an accounting period.

**benefit-cost analysis**

See *cost-benefit analysis*.

**betterment**

An improvement to an existing asset that results in increased productivity, better service, or longer life; see also *addition*. The cost of a betterment is *capitalized*, that is, added to the asset account to be depreciated over its future life.

**"Big 8"**

The eight largest accounting firms in the United States: Arthur Andersen & Co., Arthur Young & Co., Coopers & Lybrand, Deloitte, Haskins & Sells, Ernst & Whinney, Peat, Marwick, Mitchell & Co., Price Waterhouse & Co., Touche Ross & Co.

**bill of lading**

A document issued by a transportation or shipping company acknowledging the receipt of goods for shipment.

**bill of materials**

A listing of *raw material* specifications and quantities required for production of a unit or batch of finished product.

**bill of sale**

A document formally conveying title to goods or property from one party to another.

**bond**

(1) A written contract evidencing a long-term, interest-bearing loan. Bonds may be secured by mortgages on specific assets, or they may be debentures secured only by the earning power and un-mortgaged resources of the borrower. (2) A cash or property deposit made to guarantee performance. For example, a contractor may be required to deposit a performance bond to ensure completion of construction by a target date, after which

bond discount

all or part of the bond is forfeited. (3) A form of insurance policy providing for reimbursement to the employer for employee theft or *defalcation*.

### bond discount

See *discount on bonds payable*.

### bond premium

See *premium on bonds payable*.

### bond sinking fund

Resources accumulated, usually in the form of investments in securities, to be used for the retirement of bonds payable.

### bonds payable

A liability account showing the balance owed on *bonds* by the issuing company. The account Bonds Payable has a normal credit balance. Sale of bonds is recorded in the following journal entry:

Cash	xxx	
Bonds Payable		xxx
Bond redemption is recorded by:		
Bonds Payable	xxx	
Cash		xxx

See also *discount on bonds payable*, *premium on bonds payable*.

### book of original entry

The first place a transaction is recorded in an accounting system; a *journal*.

### book value

The amount at which an item is carried in accounting records and reported in financial statements. Book value of a *fixed asset* is original cost less *accumulated depreciation*. Book value per share of *common stock* is equal to total assets, minus total liabilities and any amount assignable to *preferred stock*, divided by the number of common shares outstanding.

16

### bookkeeper

A person who performs *bookkeeping* work, such as preparing journal entries, posting the general ledger, maintaining accounts receivable and accounts payable ledgers, and preparing payrolls. A bookkeeper is not required to exercise the same level of judgment as an *accountant* and is generally on a lower level in an organization.

### bookkeeping

The detailed, routine work of preparing and posting journal entries and maintaining accounts. Bookkeeping is one aspect of *accounting* but requires less education, creativity, judgment, and authority.

### books

*Journals*, *ledgers*, and other accounting records.

### boot

For federal income tax reporting purposes, any additional cash given in connection with a trade. For example, when a used truck plus \$5,000 cash are given for a new truck, the \$5,000 cash is boot.

### bottom line

A colloquial term referring to the end result, the ultimate objective, the net effect; derived from the location of net income as the last line on an income statement.

### breakeven analysis

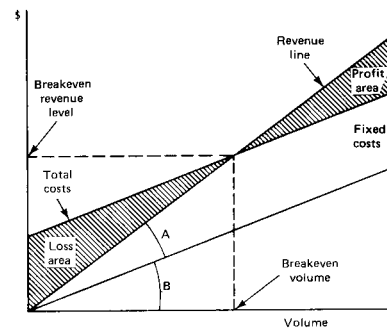
A form of *cost-volume-profit analysis* that focuses on the breakeven point, or point of zero profit or loss. The breakeven point is that volume (or level of revenue) at which total revenue equals total variable expenses plus total fixed expenses:

by product

$PX = VX + F$ , where  $P$  = unit sales price,  $X$  = volume,  $V$  = unit variable expense,  $F$  = total fixed expenses.

### breakeven chart

A chart used in *cost-volume-profit analysis* to show the interrelationship of fixed costs, variable costs, revenue, contribution margin, and profit or loss.



(A, contribution margin, B, variable costs)

### breakeven point

The volume of sales at which revenue is equal to total expenses. See also *breakeven analysis*.

### budget

A financial plan showing estimated or planned revenues and expenses. See *master budget*, *operating budget*, *capital budget*, *cash budget*.

### budget variance

The difference between actual results and amount budgeted; also used in a *standard cost system* to refer to the *overhead spending variance*.

### burden

See *factory overhead*.

17

### burden rate

See *overhead application rate*.

### business combination

The joining of two or more companies to form a single organization for the conduct of business activities. (According to APB Opinion 16, at least one of the original companies must be a corporation.) See also *consolidation*, *merger*, *purchase method*, *pooling-of-interest method*. Ref.: APB Opinion No. 16, as amended.

### by-product

A product whose total sales value is relatively minor in comparison with the sales value of the main product(s). For example, a shoe manufacturer may produce leather key fobs as a by-product from the leather scraps generated during the production of shoes.

C

**CA**

*Chartered accountant.*

**callable bond**

A *bond* that may be bought back or "called" by the issuer after a specified date and at a specified price; the call price is greater than the *par* value of the bond. The details of the call provision are spelled out in the bond contract, or *indenture*.

**callable preferred stock**

*Preferred stock* that may be bought back or "called" at a specified price by the issuing corporation, at its option.

**Canadian Institute of Chartered Accountants (CICA)**

A national professional organization of chartered accountants in Canada. The Canadian Institute publishes the monthly journal *CA*.

**cancelled check**

A check that has been paid by the bank on which it is drawn. In paying or "clearing" the check, the bank stamps its endorsement on the front or back, thus cancelling the check. A cancelled check is no longer negotiable.

**capacity**

The maximum quantity that may be produced in a manufacturing facility during a specified time period (usually a year) and under specified or assumed conditions.

**capacity variance**

*See volume variance.*

**capital**

(1) *Owners' equity*, or the interest of the owners of a company in its assets, includ-

ing both amounts paid in by the owners and profits retained in the business. (2) The long-term productive assets of an enterprise. Note that these two meanings refer to opposite sides of a balance sheet.

**capital asset**

A long-term, productive *asset*, such as a building or manufacturing equipment. For federal income tax purposes, capital assets are primarily long-term investments in other companies; consult Internal Revenue Service regulations.

**capital budget**

A plan for the acquisition of long-term assets (such as plant and equipment), showing planned expenditures by object and date.

**capital budgeting**

The analysis and planning of investments in long-term assets.

**capital expenditure**

An amount spent for purchase of long-term assets.

**capital gain**

For federal income tax purposes, an excess of proceeds over cost (or other *basis*) from the disposition of a *capital asset* (primarily long-term investments in other companies). Capital gains are taxed at a lower rate than ordinary income under current Internal Revenue Service regulations.

**capital lease**

A contract that transfers ownership of property to the *lessee* at the end of the lease term, covers a period of time equal to at least 75% of the life of the property, allows the lessee to purchase the prop-

erty for a price significantly lower than the fair value of the property (a "bargain" price), or provides for payments that in total approximate the value of the property. A capital lease should be accounted for as a sale or purchase of the property involved instead of as a lease. Ref.: FASB Statement No. 13.

**capital leverage**

A company's ability to generate an additional return for stockholders by borrowing, then using the borrowed funds to obtain a return greater than the interest rate; the excess thus accrues to the stockholders. For example, consider the following data for a company (assuming, for simplicity, a zero tax rate):

Total assets	\$100,000
Total liabilities	- 0 -
Total stockholders' equity	\$100,000
Net income	\$ 10,000
Return on stockholders' equity	10%

Now assume that the company borrows \$100,000 at interest of 8% and uses the proceeds to expand productive capacity. Assume further that the company continues to earn a 10% return on these additional assets. The data now appear as follows:

Total assets	\$200,000
Total liabilities	\$100,000
Total stockholders' equity	\$100,000
Net income before interest:	
10% of	
\$200,000 =	\$20,000
Less interest expense	8,000
	\$ 12,000
Return on stockholders' equity	12%

This is an example of positive leverage; negative leverage occurs when the after-tax cost of interest exceeds the aftertax return earned on the additional investment.

**capital loss**

For federal income tax purposes, an excess of cost or other *basis* over proceeds from the disposition of a *capital asset* (primarily long-term investments in other companies). Capital losses are subject to special treatment under Internal Revenue Service regulations.

**capital outlay**

*See capital expenditure.*

**capital stock**

Shares of ownership in a corporation, often used to describe *common stock* when only one class of stock is outstanding.

**capital surplus**

*See additional paid-in capital.* (Note: the term "surplus" is ambiguous and is now avoided by most accountants.)

**capitalization**

(1) The sum of long-term debt and *owners' equity*, representing the total long-term equity in a company. (2) The process of recording expenditures as long-term assets instead of as expenses; *see capitalize*.

**capitalize**

To record an expenditure as a long-term or *capital asset* instead of as an expense. For example, an addition to a building is capitalized while a repair to the building might be expensed. The choice depends on when the benefits from the expenditure are expected. If the benefits

are expected to be received over several future periods, the expenditure is capitalized and the cost allocated via *depreciation* charges in the future periods; if the benefits have already been received, the expenditure is recorded as an expense.

### carryback

See *loss carryback* and *carryforward*.

### carryforward

See *loss carryback* and *carryforward*.

### carrying charge

An amount periodically added to an outstanding balance, usually calculated as a percentage of that balance, to compensate the creditor for interest, risk, and expenses of processing the account. For example, the carrying charge on a credit card account is often  $1\frac{1}{2}\%$  per month.

### carrying value

See *book value*.

### carryover

See *loss carryback* and *carryforward*.

### CASB

*Cost Accounting Standards Board.*

### cash

Currency and coin, unrestricted balances in bank accounts, and instruments that are accepted for deposit by a bank (such as checks and drafts). The Cash account includes currency and coin plus other "near-cash" items that have the practical liquidity of currency. Cash is a *current asset* and has a normal debit balance.

### cash basis accounting

A method of accounting in which changes in the condition of an organi-

zation are recognized only in response to tangible, external transactions and events, generally involving either cash payments or receipts. Contrast with *accrual accounting*.

### cash budget

A plan or projection of cash receipts and expenditures for a given period of time. See also *statement of cash receipts and disbursements*.

### cash disbursements journal

A *special journal* used exclusively for recording cash disbursements. It typically includes columns for date, check number, and check amount, followed by a number of columns for the more common disbursement objects such as purchases, salaries expense, and supplies expense. The total of the check amount column is posted as a credit to the Cash account; the totals of the remaining columns are posted as debits to the respective accounts.

### cash discount

A reduction in the amount due from the purchase or sale of goods in return for payment in cash by the buyer within a specified period. Cash discounts are often stated in the form  $r/d_1$ , net/ $d_2$ , meaning that a discount of  $r\%$  is allowed for payment within  $d_1$  days, otherwise the full amount is due in  $d_2$  days. Thus 2/10, n/30 means that a 2% discount is allowed for payment within 10 days, or else the full amount is due within 30 days. See also *sales discount*, *purchase discount*.

### cash dividend

A *dividend* paid to stockholders in cash. Contrast with *stock dividend*, *property divi-*

*idend*. Cash dividends are recorded as follows:

Retained Earnings	xxx
Dividends Payable (or Cash)	xxx

Alternatively, a separate Dividends account may be debited and subsequently closed to the Retained Earnings account.

### cash equivalent

In an exchange of property, stock, and the like, the amount of cash that would have been required if cash had been given instead of property or stock. For example, if 1,000 shares of common stock with a quoted market price of \$8 per share are given in exchange for land, the cash equivalent is \$8,000.

### cash flow

The amount of cash generated by operations or by a specific project. This term sometimes refers to gross or total cash to be received, sometimes to net cash after payment of expenses; the specific meaning must be determined from the context.

### cash flow statement

See *statement of cash flow*.

### cash receipts journal

A *special journal* used exclusively for recording cash receipts. It typically includes columns for date, payee, Cash debit, Accounts Receivable credit, Sales credit, and miscellaneous credits.

### cash surrender value

The amount to be paid to a policyholder by an insurance company upon the cancellation of a life insurance policy. This amount is accumulated periodically as premiums are paid (which cover both

the insurance and an increase in cash surrender value) and is substantially less than the face value of the policy to be paid upon the death of the insured. Cash Surrender Value of Life Insurance is an *asset* usually reported among investments on the balance sheet. When periodic premiums are paid, the following journal entry is made:

Life Insurance Expense	xxx	
Cash Surrender Value of Life Insurance		xxx
Cash		xxx

### cashbook

In a simple accounting system, a record of cash receipts and disbursements with a running balance.

### casualty loss

For federal income tax purposes, a loss due to some sudden, unexpected, or unusual cause, such as a fire or tornado.

### cathode-ray tube (CRT)

An electronic vacuum tube (such as the picture tube in a television set) used for the visual presentation of data in a computer system.

### CDP

*Certificate in data processing.*

### central processing unit (CPU)

In a computer system the component that contains the arithmetic and logical elements, transfers data among the system components, and controls the input-output units.

### certificate in data processing (CDP)

A professional designation awarded by the Data Processing Management Association to persons who pass the CDP ex-

amination (covering data processing equipment, computer programming and software, principles of management, quantitative methods, and systems analysis and design), have a minimum of three years of experience in data processing, and hold a bachelor's degree.

### **certificate in management accounting (CMA)**

A professional designation awarded by the National Association of Accountants' Institute of Management Accounting, granted to an accountant who has met the requirements of the Institute, including satisfactory completion of a comprehensive examination in economics and business finance; organization and behavior, including ethical considerations; public reporting standards, auditing, and taxes; periodic reporting for internal and external purposes; decision analysis, including modeling and information systems.

### **certified internal auditor (CIA)**

A professional designation awarded by the *Institute of Internal Auditors* to persons who have three years of experience in internal auditing, a baccalaureate degree or its equivalent, and have passed an examination covering principles of internal auditing, internal auditing techniques, principles of management, and disciplines related to internal auditing (such as statistical sampling and electronic data processing).

### **certified public accountant (CPA)**

A person who has met state statutory requirements including passage of the Uniform Certified Public Accountants Examination prepared by the American Institute of Certified Public Account-

ants. Most states require a college degree in accounting plus either a master's degree or a minimum amount of acceptable experience. Only certified public accountants are allowed to use the identifying initials CPA and to perform the work of the CPA, including expression of an opinion on the fairness of financial statements.

### **CFA**

*Chartered financial analyst.*

### **changes in financial position**

See *statement of changes in financial position*.

### **charge**

(1) A *debit* to an account. (2) A sale on credit, where payment is not made immediately (a sale on credit results in a debit or *charge* to the customer's account in the seller's ledger).

### **charge and discharge statement**

A periodic report, prepared by a trustee, administrator of an estate, or other *fiduciary*, showing the receipt and disposition of resources by the trustee.

### **chart of accounts**

A list of the *accounts* used by an organization, with each account usually assigned a number or code.

### **chartered accountant (CA)**

A professional designation used in several countries outside the United States, and especially in British Commonwealth countries, to designate one who has a specified educational background and experience, has passed a comprehensive professional examination, and is thereby authorized to practice *public accounting*.

The *certified public accountant* and chartered accountant designations are usually considered equivalent.

### **chartered financial analyst (CFA)**

A professional designation awarded by the Institute of Chartered Financial Analysts to persons who have passed a series of three examinations, subscribe to the institute's Code of Ethics and Professional Conduct, and have five years of experience in financial analysis related to securities investment. Candidates for the examinations generally must have a college degree.

### **chattel mortgage**

A *mortgage* against any property other than real property. Thus a chattel mortgage might be used to convey an interest in automobiles, merchandise inventory, or stock certificates as security for a loan, but not an interest in land and buildings.

### **check**

A written order to a bank to pay a specified amount from the issuer's bank account to the holder of the check; a negotiable instrument, classified as *cash* for accounting purposes.

### **check register**

A record of checks written, usually showing check number, date, payee, amount, purpose of the payment, and a running balance for the bank account. Check registers may take several forms, ranging from check stubs (bound with the checks) to a separate book.

### **CIA**

*Certified internal auditor.*

### **CICA**

*Canadian Institute of Chartered Accountants.*

### **circularization**

The audit process of confirming accounts receivable and accounts payable balances by writing directly to customers and creditors; see *confirmation*.

### **"clean" opinion**

See *standard opinion*.

### **closely held corporation**

A corporation whose shares are owned by a small number of persons and are not traded publicly.

### **closing**

(1) Activities performed at the end of an accounting period or *fiscal year*, including preparation of *closing entries* and financial statements. (2) The act of finalizing a sale or contract.

### **closing entries**

*Journal entries* made at the end of a period to transfer the net effect of the income statement accounts (*nominal accounts*) to *owners' equity*. A summary closing account is used, typically called Profit and Loss Summary or Income Summary. The credit balances in revenue and income accounts (for example, Sales, Interest Income, Purchase Discounts) are eliminated by a debit to each of those accounts and a credit for the total to Income Summary. The debit balances in expense accounts are eliminated by a credit to each and a debit to Income Summary. The net balance in the Income Summary account is then eliminated by a debit (if a profit was realized) or a credit (if expenses exceed revenues

and a loss has occurred) to Income Summary and the opposite entry to Retained Earnings (for a corporation) or to individual owners' equity accounts.

### cluster sampling

A *sampling* method in which groups or clusters of items are identified, some of the clusters are selected at random, and all items in the selected clusters are examined. For example, in the audit of advertising expenses an auditor might define each month as a cluster, randomly select two months, and then examine all advertising expenses and supporting documents for those two months.

### CMA

*Certificate in management accounting.*

### COBOL

(C)ommon (B)usiness (O)riented (L)anguage A business-oriented computer programming language that uses common English nouns, verbs, and connectives.

### Code of Professional Ethics

A set of rules adopted by the membership of the *American Institute of Certified Public Accountants* for the guidance of CPAs in relations with other CPAs, with clients, and with the general public. Sanctions for violations of ethical rules by AICPA members include reprimands and expulsion from the AICPA.

### coinsurance

A provision in some insurance contracts requiring the insured party to insure property for at least a specified minimum percentage of its fair market value or share the loss proportionately with the insurance company.

### collateral

*Assets* pledged to secure a note or bond payable and to which the lender is entitled if the borrower does not repay the debt on time.

### collusion

Secret cooperation between two or more persons in the commission of fraud or other misdeeds.

### combination

See *business combination*.

### comfort letter

A statement by a certified public accountant in connection with a securities offering, given to the underwriter and legal counsel, asserting that the CPA has no information to indicate that the company's financial statements are false or misleading.

### committed cost

A *fixed cost* set by long-term decisions such as those concerning plant size and production layout. Committed costs are not readily reduced and are generally unaffected by short-run fluctuations in the level of production.

### common cost

See *joint cost*.

### common size statement

A financial statement with amounts expressed as percentages instead of in dollar amounts. For example, an income statement might show total revenue as 100% and all other amounts expressed as a percentage of total revenue.

### common stock

Shares of ownership in a corporation having voting rights (for election of

members of the board of directors, for example) but no special preference as to dividends. When only one class of stock is issued, it is common stock but is often called *capital stock*. *Preferred stock* has preference with respect to dividends (dividends must be paid on preferred stock before any can be paid on common stock) but no voting rights. Sometimes more than one class of common stock is issued, with the different classes having different contractual rights. Issuance of common stock for cash is recorded as follows:

Cash (total proceeds)	xxx
Common stock (total par value, or total proceeds if no par value)	xxx
Additional Paid-In Capital (excess of proceeds over par value)	xxx

Common Stock is an *owners' equity* account with a normal credit balance.

### common stock equivalent

A security, such as preferred stock or outstanding bonds, that may be viewed as essentially equivalent to common stock, usually because it may be converted into common stock. The concept is important in the calculation of *earnings per share*. Ref.: APB Opinion No. 15.

### completed-contract method.

A method of accounting for long-term projects, usually construction projects, in which profit on the project is recognized only when the project is complete. Contrast with the *percentage-of-completion method*.

### compliance audit

A review of an organization's activities related to a specific contract, program,

or period of time to determine whether these activities were performed in accordance with the requirements of applicable regulations, laws, or contract provisions.

### compliance test

See *test of compliance*.

### compound interest

*Interest* calculated by applying the stated interest rate to the original *principal* plus any accumulated interest. Contrast with *simple interest*. For example, \$100 loaned at 6% compound interest for three years would accumulate to \$119.10.

First year:  $\$100 + \$100(0.06) = \$106$

Second year:  $\$106 + \$106(0.06) = \$112.36$

Third year:  $\$112.36 + \$112.36(0.06) = \$119.10$

In contrast, the same amount invested at 6% simple interest would accumulate to only \$118.00.

First year:  $\$100 + \$100(0.06) = \$106$

Second year:  $\$106 + \$100(0.06) = \$112$

Third year:  $\$112 + \$100(0.06) = \$118$

### compound interest method of depreciation

A method of determining periodic *depreciation* expense that provides for an amount of assumed interest based on the decreasing asset *book value*. See *annuity method of depreciation* and *sinking fund method of depreciation* for examples.

### compound journal entry

A *journal entry* affecting three or more accounts.

### comptroller

An outmoded term for *controller*, rarely used outside of government agencies.



**Comptroller General**

The chief executive of the United States General Accounting Office.

**confirmation**

(1) The audit process of seeking assurance from third parties on certain balances, quantities, or other information known to the third parties. For example, letters are sent to customers asking them to verify the amount owed to the audited company, creditors are asked to verify the amount owed by the company, and banks are asked to verify the company's cash balance. (2) The letter or form used to provide such assurance.

**conservatism**

The practice of avoiding an overly optimistic presentation in financial statements by anticipating losses (recording losses when they are less than certain) but deferring gains (avoiding recognition of gains and profit until actually realized). Conservatism in accounting is intended to insure that assets, income, and owners' equity are not overstated, but the practice has at times resulted in significant understatement of these items.

**consignment**

A transfer of physical custody of goods from the owner to one who acts as an agent for the owner. Legal title is retained by the owner or consignor; physical possession passes to the agent or consignee. The consignee usually has specified authority to act for the owner, often by selling the goods on commission.

**consistency**

The use of the same accounting principles in the presentation of a company's financial statements from one period to

the next. Consistency in accounting does not refer to agreement in principles used by two different companies.

**consolidated balance sheet**

See *consolidated financial statements*.

**consolidated financial statements**

Financial statements that include the accounts of both a *parent company* and any controlled *subsidiary companies*; these include the consolidated balance sheet, consolidated income statement, and consolidated statement of changes in financial position. Since a parent company can usually control the affairs of its subsidiaries, statements prepared for the parent or for any of the individual subsidiaries do not reflect the activities of the entire entity, and are thus subject to manipulation. See also *consolidation*.

**consolidated income statement**

See *consolidated financial statements*.

**consolidated statement of changes in financial position**

See *consolidated financial statements*.

**consolidation**

The process of combining the accounts of a *parent company* and its *subsidiary companies* to produce *consolidated financial statements*. In the consolidation process balances due within the group (payables from parent to subsidiary and vice versa, payables from one subsidiary to another) offset each other and are thus eliminated, as are balances associated with intragroup investments (investment account on the owning company's books and equivalent owners' equity accounts on the affiliated company's books). Like accounts of parent and subsidiaries are then added together to produce consol-

idated accounts; for example, parent and subsidiary cash accounts are added together to arrive at consolidated cash, parent and subsidiary sales to outsiders are added to produce consolidated sales, and so forth. If a portion of the shares of any subsidiary is not owned by the parent, the *minority interest* of these remaining shareholders in earnings and in stockholders' equity is reported separately.

**contingency**

An event that may occur but cannot be predicted with any reasonable degree of certainty.

**contingent liability**

A liability that will develop if some specified event (*contingency*) occurs, such as an unfavorable judgment in a lawsuit. Contingent liabilities are reported parenthetically or in footnotes to financial statements (the amount of contingent liabilities is not added into the total for liabilities), and then only when there is a significant probability that the contingency will occur.

**continuing professional education (CPE)**

Educational activities such as courses, seminars, and workshops undertaken by professional accountants beyond formal academic degree programs. Many accountants continue their professional education throughout their careers, and several states now require continuing professional education to retain a license to practice as a CPA.

**contra account**

An *account* that is an offset to (or a deduction from) another account. The

contra account is used instead of reducing the primary account directly, in order to retain the original balance information shown in the primary account. Accumulated Depreciation, Allowance for Doubtful Accounts, and Discount on Bonds Payable are examples of contra accounts.

**contra asset**

An account balance deducted from an asset account to give net book value. Examples are Accumulated Depreciation (deducted from a fixed asset account) and Allowance for Doubtful Accounts (deducted from Notes and Accounts Receivable). A contra asset has a normal credit balance. See also *contra account*.

**contributed capital**

Either *paid-in-capital* or *donated capital*; the specific meaning must be inferred from the context.

**contribution approach**

A method of analyzing, evaluating, and reporting performance that emphasizes the relationship of *variable costs* to *revenue*. See also *contribution margin*, *contribution income statement*.

**contribution income statement**

A report on a company's operations for a period in which all *variable costs* are first deducted to give the *contribution margin* and then all *fixed costs* are deducted to give net income. Refer to the appendix for an example, which should be contrasted with the ordinary income statement, also illustrated in the appendix.

**contribution margin**

The excess of *revenue* over *variable costs* (including manufacturing, selling, and

administrative variable costs) for a product, department, company, or other *profit center*, indicating the contribution to *fixed costs* and profit.

### control account

A single account that summarizes ("controls") a number of *subsidiary accounts*. A control account is used to avoid cluttering the *chart of accounts* and *general ledger* with numerous individual accounts. For example, the control account may be supported by many (hundreds of thousands, in a large public utility) individual receivable accounts. The subsidiary accounts are maintained in a *subsidiary ledger*. Entries in subsidiary accounts must be matched by like entries in the control account (and vice versa), and the sum of the balances in the subsidiary ledger should equal the balance in the control account.

### controllable cost

A cost that can be affected ("controlled") by a given manager or at a given level of authority. Classification of costs as controllable or uncontrollable by given managers is an essential aspect of *responsibility accounting*.

### controller

The chief accounting officer of an organization (in some organizations the counterpart of a controller bears the title financial vice-president). The controller is usually responsible for the design and direction of the information system including *internal control*, *cost accounting*, *financial accounting*, tax planning and reporting, and external financial reporting. Sometimes spelled *comptroller*.

### conversion cost

A cost of transforming raw materials into finished products. In a cost accounting system the two categories of conversion costs are *direct labor* and *factory overhead*.

### convertible bond

A *bond* that may be exchanged, under prescribed conditions, for a specified number of shares of the issuing company's stock.

### convertible preferred stock

*Preferred stock* that may be exchanged, under prescribed conditions, for a specified number of shares of the issuing company's *common stock*.

### copyright

The exclusive right to publish and control specific literary material, granted under federal law for a prescribed period of time. A copyright is accounted for as an *intangible asset*.

### corporate readjustment

See *quasi reorganization*.

### corporate social accounting

See *social accounting*.

### corporation

An organization chartered under the laws of a state for a specified purpose (although the statement of purpose is usually very broad). Ownership interests in a corporation are represented by shares of *stock*; owners are called shareholders or stockholders.

### correlation

The degree of relationship or association between two or more variables. See also *correlation coefficient*.

### correlation coefficient

A statistical measure of the strength of the relationship between two or more variables. The formula for simple (two variable) correlation is

$$r = \frac{n(\Sigma XY) - (\Sigma X)(\Sigma Y)}{\sqrt{\{n(\Sigma X^2) - (\Sigma X)^2\} \{n(\Sigma Y^2) - (\Sigma Y)^2\}}}$$

Where  $r$  = coefficient of correlation,  $n$  = number of sets of observations,  $X$  = value of an independent variable,  $Y$  = value of the associated dependent variable,  $\Sigma$  = the summation operator (that is,  $\Sigma X$  means the sum of all the values of  $X$ ). The coefficient can assume values from  $-1$  to  $+1$ , with  $-1$  indicating a perfect negative relationship and  $+1$  indicating a perfect positive relationship. A coefficient value around  $0.0$  indicates no relationship between the two variables. See also *multiple correlation*.

### cost

The sacrifice made to acquire a good or service. The term is virtually meaningless without an indication of the type of cost, such as *incremental cost*, *variable cost*, *fixed cost*, *replacement cost*, *historical cost*. The terms *cost* and *expense* are often confused. Cost refers to the initial sacrifice that may be charged against income immediately or carried as an asset for some period of time, while expense is used only to indicate a current charge against income.

### cost accountant

A person whose work is primarily the measurement, accumulation, analysis, and control of costs, and especially product costs.

### cost accounting

A broad field of accounting concerned primarily with the measurement, accu-

mulation, and control of product costs. Contrast with *management accounting* which includes the field of cost accounting but is broader.

### Cost Accounting Standards Board (CASB)

A body established by Congress and headed by the *Comptroller General*, with responsibility for setting standards or rules to be followed by contractors in accounting for costs under defense contracts. The board's standards have also been adopted by the General Services Administration and thus apply to non-defense contracts executed by federal agencies.

### cost card

See *cost sheet*.

### cost center

Any element of an organization—a division, department, field office, plant, territory, function, product—for which costs may be separately accumulated.

### cost depletion

A *depletion* charge calculated by multiplying the cost of a natural resource by a fraction representing the proportion removed or consumed during the current period. For example, the depletion charge based on cost for 10,000 tons of coal mined from land that originally cost \$2,000,000 and is expected to provide 100,000 recoverable tons is  $10,000/100,000 \times \$2,000,000$ , or \$200,000. Contrast with *percentage depletion*.

### cost of capital

The sacrifice made to obtain the use of long-term funds, for example, interest

and financing charges on a bond issue. A weighted cost of capital is often calculated that takes into account the relative amounts of outstanding current and long-term debt, preferred stock, and common stock. This calculation can be quite complex; refer to a current finance text for details.

### cost of goods manufactured

The cost of goods completed during a period, including any costs in beginning work-in-process inventory but excluding costs in the ending work-in-process inventory. Refer to the appendix for an illustration of a statement of cost of goods manufactured, showing the full calculation.

### cost of goods sold

The sum of all costs required to acquire and prepare goods for sale. In a manufacturing concern these include the manufacturing costs of materials, labor, and overhead. In a merchandising organization cost of goods sold includes the purchase cost of merchandise plus costs such as transportation in, receiving and inspection, and storage. Cost of goods sold is often calculated as follows:

Beginning inventory	xxx
Add purchases (or <i>cost of goods manufactured</i> )	xxx
Goods available for sale	xxx
Less ending inventory	xxx
Cost of goods sold	xxx

### cost of manufacturing

All costs incurred in the manufacturing process during a period, whether the units involved were completed during the period or not. Cost of manufacturing consists of *direct material*, *direct labor*, and *factory overhead* costs. Compare *cost of goods manufactured*.

### cost of sales

See *cost of goods sold*.

### cost recovery method

A method of accounting for *installment sales* and other long-term contracts in which gross profit is recognized only after collections exceed the cost of the goods sold or other costs incurred under the contract; collections prior to that point are treated as recovery of cost with no profit component. Because of its extreme conservatism, this method is rarely used. See also *installment sales method*.

### cost sheet

A record of costs incurred on a single unit, job, or batch. The record usually provides for accumulation of data on *direct material* and *direct labor* used on the job along with an allocation of *factory overhead*.

### cost-benefit analysis

The systematic comparison of expected costs and benefits of a course of action. When benefits and costs are measured on the same scale, such as dollars, the benefits should exceed the costs for a given course of action to be taken. When benefits cannot be measured readily in dollars, cost-benefit analysis generally requires the comparison of two or more alternatives that are estimated to provide the same benefits (such as the same level of national defense) and selection of the alternative with the lowest cost.

### cost-plus pricing

A method of determining the price for work done under contract in which either a fixed amount or a percentage of cost is added to costs under the contract.

For example, the price for a job with accumulated costs of \$800 and a contract calling for a fixed fee or profit of \$100 would be \$900; if the contract called for cost plus profit equal to 10% of cost, the price would be \$800 + \$80, or \$880.

### cost-volume-profit analysis

A general method for investigating the interaction of changes in costs and volume on profit, used in evaluating alternatives such as a change in selling price, introduction of a product, opening a new territory, and expansion of capacity. The method relies on the identity:

$$\begin{aligned} (\text{Unit sales price})(\text{units sold}) = \\ (\text{Variable expense per unit})(\text{units sold}) \\ + (\text{fixed expenses}) + (\text{net profit}), \text{ or} \\ \text{Revenue} = \text{Variable expenses} + \text{fixed} \\ \text{expenses} + \text{net profit}. \end{aligned}$$

See also *breakeven analysis*.

### CPA

*Certified public accountant.*

### CPE

*Continuing professional education.*

### CPM

(1) Critical path method; see *program evaluation and review technique*. (2) In data processing operations, cards per minute.

### CPU

*Central processing unit.*

### credit

(1) An entry on the right side of an account. Credits increase liabilities, revenues, and owners' equity; they decrease assets and expenses. (2) To make an entry on the right side of an account. (3) The privilege of delaying payment on a purchase. Note that in everyday lan-

guage a "credit" is usually good, as in "a credit to her country." The term has no such connotation in accounting.

### credit balance

The status of an *account* when the sum of the *credit* entries exceeds the sum of the *debit* entries. Liability, owners' equity, and revenue accounts normally have a credit balance; so do certain *contra* accounts that offset assets, such as Allowance for Doubtful Accounts and Accumulated Depreciation.

### credit memorandum

An authorization to reduce a customer's account (a *credit* to Accounts Receivable) due to an error in pricing, an incomplete shipment, returned goods, and the like.

### credit sale

A sale on which payment is not made immediately. Credit terms may range from a few days to several months and may provide for a *cash discount*.

### creditor

One to whom an amount is owed.

### critical path method (CPM)

See *program evaluation and review technique*.

### crossfoot

To add a row of figures. See also *foot*.

### CRT

*Cathode-ray tube.*

### cumulative preferred stock

*Preferred stock* with a contractual provision that calls for all dividends in arrears on the preferred stock to be paid before any common stock dividends may be

paid. Dividends on cumulative preferred stock become in arrears when they are passed, or not declared, for any period.

#### **current asset**

An *asset* expected to be sold, used, or converted into cash within one year or one *operating period*, whichever is longer. A term of one year is often assumed without regard to the length of the operating period. Current assets typically include cash, marketable securities, notes and accounts receivable, inventories, and prepaid expenses.

#### **current liability**

An obligation expected to be paid or met by the use of *current assets*, often used to refer to obligations to be settled within one year. Current liabilities typically include short-term notes payable, accounts payable, salaries and wages payable, income taxes payable, payroll taxes payable, accrued expenses, and the portion of long-term debt payable within the current year.

#### **current operating performance method**

A method of reporting the results of operations in which extraordinary transactions or corrections of the results of prior periods are not included in the determination of current income but are instead shown as adjustments to *retained earnings*. The current operating performance method is not acceptable under current accounting standards. Contrast with *all-inclusive method*. Ref.: FASB Statement No. 9.

#### **current ratio**

Total *current assets* divided by total *current liabilities*; a rough indication of a com-

pany's ability to meet its short-term obligations.

#### **current value**

A value based on recent transactions or estimates. Three forms of current value are recognized: *replacement cost*, resale or *market value*, the *present value* of future cash flows or benefits. Contrast with *historical cost*.

#### **cutoff test**

An audit procedure to determine whether transactions occurring shortly before or after the end of a period have been recorded in the proper period.

#### **C-V-P analysis**

*Cost-volume-profit analysis*.

#### **cycle billing**

A procedure in which a certain number of customers' bills or statements are sent out each cycle (day, week). For example, one-third of the statements may be mailed on the 10th, the 20th and the 30th of each month. Cycle billing spreads the work load more evenly and results in a smoother flow of cash receipts.

# D

**data processing**

Recording, storing, manipulating, and reporting data, usually in a computerized or electronic system. See also *electronic data processing*.

**date of record**

The date, specified when dividends are declared, that is used to determine entitlement to dividends. Stockholders owning shares of stock on the date of record are entitled to the dividend; those acquiring shares after that date are not.

**days' sales in inventory**

A measure of the age or adequacy of inventory, calculated by dividing the ending inventory balance by average daily cost of goods sold (or used, if raw material inventory is being evaluated) for the preceding period. The following formula may be used:

$$\text{Days' sales in inventory} = \frac{\text{Ending inventory balance} \times \text{Number of working days in the year}}{\text{Cost of goods sold for the year}}$$

**days' sales in receivables**

A measure of the age or currency of receivables, calculated by dividing the ending receivables balance by average daily credit sales for the preceding period. The following formula may be used:

$$\text{Days' sales in receivables} = \frac{\text{Ending receivables balance} \times \text{Number of working days in the year}}{\text{Credit sales for the year}}$$

**DCAA**

Defense Contract Audit Agency.

**DDB**

Double declining balance; see *declining balance depreciation*.

**debenture**

A *bond* or long-term loan not separately backed or secured by specified assets. Debentures are sometimes inappropriately described as "unsecured," but they are actually secured by the total unmortgaged resources and the potential earning power of the borrowing company. Contrast with *mortgage bond*.

**debit**

(1) An entry on the left side of an account. Debits increase assets and expenses, and decrease liabilities, owners' equity, and revenues. (2) To make an entry on the left side of an account.

**debit balance**

The status of an account when the sum of the *debit* entries exceeds the sum of the *credit* entries. Asset and expense accounts normally have a debit balance; so do certain *contra* accounts that offset liabilities and owners' equity, such as Discount on Bonds Payable and Treasury Stock.

**debt**

An obligation to pay cash or other goods or to provide services to another; a liability.

**debt restructuring**

See *troubled debt restructuring*.

**debt service cost**

The amount needed during a given period to cover all payments necessary in connection with outstanding debt, including interest, payment on principal, and any required contribution to a *sinking fund*.

**debt-equity ratio**

The ratio of either total liabilities or total long-term debt to total stockholders' equity (the exact meaning must be determined in the context). The debt-equity ratio is a measure of the extent to which assets are financed by investors or by lenders.

**debtor**

One who owes or has an obligation to another. Contrast with *creditor*.

**debug**

To review and test a computer program in order to locate and correct errors.

**declining balance depreciation**

A form of *accelerated depreciation* in which each year's depreciation charge is calculated by applying a constant percentage to the asset's *book value*. See *double declining balance* for an example.

**defalcation**

See *embezzlement*.

**default**

To fail to make a payment when due.

**Defense Contract Audit Agency (DCAA)**

An agency of the US Department of Defense charged with conducting *audits* of work performed by firms under negotiated defense contracts, to ensure compliance with contract terms and with defense acquisition regulations.

**deferred charge**

An outlay not recognized as an immediate expense but carried forward as an asset, to be written off as an expense in future periods. *Prepaid expenses* and *organization costs* are examples. A deferred

charge is an *asset* with a normal debit balance.

**deferred credit**

*Unearned revenue*; the credit to the revenue account is deferred until the period in which it is to be earned. A rent payment received in advance is an example.

**deferred income tax liability**

An estimated amount of future income taxes that may become payable from income already earned but not yet recognized for tax reporting purposes. This is not an actual liability or present obligation but instead represents an attempt to compensate for timing differences in the recognition of certain income and expense items for tax reporting and for financial reporting purposes. A major source of this difference is a difference in depreciation methods, with *straight-line depreciation* often used for financial reporting but *accelerated depreciation* used for tax purposes (thus producing a larger current deduction and a lower current income amount for tax purposes). The Deferred Income Tax Liability account has a normal credit balance. It is first recognized through the following journal entry:

Income Tax Expense	xxx
Deferred Income Tax Liability	xxx
Theoretically an entry to write off the liability is made when the timing effect is reversed (when income reported for tax purposes exceeds income for financial reporting purposes):	
Deferred Income Tax Liability	xxx
Income Tax Expense	xxx
Some accountants argue that this latter entry will never be made in a company	

that is growing or regularly replacing its fixed assets. Ref.: APB Opinion No. 11.

### deficiency letter

A letter sent by the Securities and Exchange Commission to a company that has filed a *registration statement*, notifying the company of errors, omissions, or other problems with the statement.

### deficit

A negative or *debit* balance in *retained earnings*, indicating an excess of losses and dividend distributions over earnings since the business began.

### demand deposit

A deposit in a checking account in a bank.

### depletion

The reduction in quantity of natural resources such as mineral deposits and timber stands, due to mining, harvesting, recovery, and the like. Depletion is recognized by a periodic charge to expense accompanied by an equal reduction in the depletable asset balance. Depletion expense is recorded by the following journal entry:

Depletion Expense	xxx
Asset account (or Allow-	
ance for Depletion)	xxx

See also *percentage depletion*.

### depreciable

Subject to *depreciation*. Depreciable assets are those held for long periods of time, such as buildings, furniture, and equipment; they decline in value or utility over time through use or obsolescence. Non-depreciable assets are those whose value does not decline over time, for example, land, patent rights, and investments in shares of other companies.

### depreciation

The reduction in value of tangible, long-lived assets, from use or obsolescence. This decline in value is recognized in accounting by a periodic allocation of the original cost of the asset to current operations. While loss in value is the basis for recording depreciation, accountants maintain that the depreciation charge is not intended to recognize the actual periodic value loss but is merely a systematic allocation of original cost over the asset's useful life. See also *straight-line depreciation*, *declining balance depreciation*, *sum-of-the-years-digits depreciation*, *units of production depreciation*, *annuity method of depreciation*.

### depreciation expense

An amount deducted from revenue in determining income, based on an allocation of a long-lived asset's original cost over the years of its useful life. See also *depreciation*. Depreciation expense is recorded in the following journal entry:

Depreciation Expense	xxx
Accumulated Depreciation	xxx

### detailed audit

An *audit* in which all or virtually all transactions are examined by the auditor, usually performed at the request of a client concerned about a possible *embezzlement*. A normal audit involves sampling and examination of selected transactions.

### development cost

A cost incurred in the oil and gas industry to prepare well sites, drill wells, or install production and storage facilities. Ref.: FASB Statement No. 19.

### development stage enterprise

A business organization that is not yet earning significant revenue from its (anticipated) principal operations, and in which substantially all efforts are devoted to establishing the business rather than to conducting normal operations. Ref.: FASB Statement No. 7.

### differential cost

The additional cost of taking one alternative compared to the cost of another alternative (including the cost of taking an action compared to the cost of taking no action); the amount by which total costs will differ if a given alternative or course of action is taken.

### direct cost

A cost that can be readily identified with and traced to units of product manufactured or an organizational unit or activity. Raw materials and labor employed in the manufacturing process are two common forms of direct product costs (*direct labor* and *direct material*).

### direct costing

A method of accounting for the cost of manufactured products in which only variable manufacturing costs (direct materials, variable direct labor, variable factory overhead) are charged to products. Fixed factory overhead is not charged to products but is written off in (charged to) the accounting period in which it is incurred. The alternative to direct costing is *absorption costing*.

### direct labor

Factory labor that is significantly involved in the manufacture of a product and whose cost can be practically associated with specific units or batches of

product. The cost of *indirect labor*, on the other hand, cannot be readily assigned to units of product and so is charged to *factory overhead*.

### direct material

Raw material used in production that can be readily identified with and assigned to specific units or batches of product.

### disbursement

An expenditure or payment, in cash or by check.

### disclaimer

A statement by a certified public accountant that an *audit opinion* cannot be expressed on a company's financial statements. Disclaimers are rendered when the CPA is not independent with respect to the reporting company, when sufficient evidence on which to base an opinion is not available or cannot be obtained, or when the outcome of significant matters affecting the financial statements is so uncertain that the CPA cannot form an opinion.

### discount

(1) A reduction from an original amount such as *cash discount* and *sales discount*. (2) To reduce an amount due at some time in the future to its *present value* by applying a *discount rate*.

### discount on bonds payable

The amount by which proceeds from issuance of bonds fall short of the face amount, or *par value*. The discount is charged off, or amortized, against bond interest expense over the life of the bonds. The entry to record issuance of bonds at a discount is:

Cash	xxx
Discount on Bonds Payable	xxx
Bonds Payable	xxx
The entry to record periodic amortization of the discount is	
Bond Interest Expense	xxx
Discount on Bonds Payable	xxx
Discount on Bonds Payable is a <i>contra</i> account that is deducted from the balance of Bonds Payable on the balance sheet and has a normal debit balance.	

**discount rate**

The rate used to reduce an amount due in the future to its *present value*. The discount rate represents the alternative return sacrificed by the investor because of the commitment of resources to the investment under consideration.

**discounted cash flow**

(1) The method of evaluating a long-term project that explicitly takes into account the time value of money. (2) The *present value* of all expected net cash receipts from a project, discounted by an appropriate *discount rate*.

**discounted present value**

A method of evaluating a long-term project in which future cash receipts and expenditures (cash flows) are reduced to their *present value*, and the result is compared with the outlay required for the project.

**discovery sampling**

Sampling undertaken in order to estimate whether a given characteristic occurs in a group (population, in statistical terminology) at or above a specified rate. The sampling plan is designed to pro-

vide a prescribed level of assurance that at least one item with the given characteristic will be encountered if the actual rate of occurrence in the group is at or above the specified rate. For example, an auditor might develop a discovery sampling plan that will provide 95% assurance (or confidence) that at least one can of spoiled food is discovered if 0.02% of the cans in a batch are spoiled.

**discretionary cost**

A cost that may be changed or controlled by a given manager during a decision or planning period, for example, advertising and charitable contributions.

**disposal value**

The estimated amount of cash or other resources that can be obtained from the sale of an asset. See also *residual value*.

**distribution cost**

A cost incurred to market and ship a product.

**dividend**

A distribution of corporate earnings made to shareholders in proportion to the number of shares owed. The most common dividends are *cash dividends* and *stock dividends*.

**dividends in arrears**

Dividends that have been passed (not declared) on *cumulative preferred stock*. Dividends in arrears are not a liability to the corporation but must be paid before any dividends may be declared and paid on common stock.

**dividends payable**

The amount of dividends previously declared but not yet paid. Dividends pay-

able is a *liability* account with a normal credit balance. When dividends to be paid at a later date are declared, the following entry is made:

Dividends (or Retained Earnings)	xxx
Dividends Payable	xxx
When these dividends are actually paid, the entry is	
Dividends Payable	xxx
Cash	xxx

**donated capital**

Owners' equity arising from a gift of assets to a company. The donated assets are recorded at fair market value or appraised value and an equal amount is added to owners' equity. Although such donations are rare, they are occasionally made by government units, usually to induce a business to locate in a particular area, or by stockholders. Donated Capital is an *owners' equity* account with a normal credit balance. A donation is recorded by the following journal entry:

Asset account	xxx
Donated Capital	xxx

**double declining balance (DDB)**

A widely used version of *declining balance depreciation* in which the annual depreciation charge is calculated by applying double the *straight-line depreciation* percentage rate to the asset's remaining *book value*. For example, the straight-line rate for an asset that costs \$10,000 and has a ten-year expected useful life is 1/10, or 10%. With the double declining balance method a rate of 20% is used, and depreciation charges in the first three years are calculated as follows:

	Year		
	1	2	3
Book value	\$10,000	\$8,000	\$6,400
DDB rate	20%	20%	20%
Depreciation charge	2,000	1,600	1,280
New book value	8,000	6,400	5,120

**double-entry bookkeeping**

The system of bookkeeping in which every transaction calls for entries in at least two accounts to reflect the dual effect of each transaction on the organization. For example, when salaries are paid the effects are (1) a recognition of expense and (2) a reduction in cash.

**draft**

A written order from a *creditor* to a *debtor* to pay a specified amount to a third party; the debtor's liability for the draft arises when he signs his acceptance on the draft itself. A *check* is a draft drawn by a depositor (creditor) on a bank (debtor) and payable to a designated third party (payee).

E



### earned surplus

A term for *retained earnings*, no longer favored by most accountants.

### earnings per share

Net income for a year, divided by the average number of common shares outstanding during that year. Net income should first be reduced by any preferred stock dividends applicable to the period. Primary earnings per share are calculated by dividing net income by the average number of shares of common stock and *common stock equivalents* outstanding during the year. To determine fully diluted earnings per share, the number of shares that would have been issued if all convertible securities had been converted into common shares is added to the average number of shares outstanding during the year; net income is then divided by this total. Ref.: APB Opinion No. 15.

### economic lot size

See *economic order quantity*.

### economic order quantity (EOQ)

The order size or production run size that minimizes the total cost of ordering and carrying inventory. One formula used to calculate this quantity is  $EOQ = \sqrt{2QP/C}$ , where  $EOQ$  = economic order quantity,  $Q$  = quantity needed for the period,  $P$  = cost of placing one order,  $C$  = cost of carrying one unit, including sacrificed return on investment, for one period.

### EDP

*Electronic data processing.*

### efficiency variance

see *labor efficiency variance*, *overhead efficiency variance*.

### EFTS

*Electronic funds transfer system.*

### 8-K

A report that must be filed with the Securities and Exchange Commission by any company whose securities are traded on a national or over-the-counter market, giving the details on any material event, such as a change in external auditors. The report must be filed within ten days after the close of the month in which the event occurs and is available at the SEC for inspection by the public.

### electronic data processing (EDP)

The recording, storage, manipulation, transmission, and reporting of information using computers or other electronic equipment.

### electronic funds transfer system (EFTS)

A computerized communications and data processing system for bank accounting in which transactions data are transmitted electronically, instead of by documents such as checks. For example, a sale recorded on a terminal at a store could be transmitted electronically, resulting in an immediate reduction of the customer's bank account and an addition to the store's account.

### embezzle

To unlawfully take money or other property of another that is in one's custody. See also *embezzlement*.

### embezzlement

The unlawful taking of money or other property of another that has been placed in one's custody. A bank cashier who steals cash belonging to the bank, an ac-

counts receivable clerk who cashes customers' checks and retains the proceeds, and a stockroom clerk who steals supplies, are all embezzlers.

### embezzler

A person who unlawfully takes money or other property of another that has been placed in that person's custody; see also *embezzlement*.

### encumbrance

An internal commitment, expressed within a government agency, to use funds for a designated purpose. An encumbrance is not an external liability but an expression of intent designed to prevent limited funds from being overspent. See *reserve for encumbrances* for a detailed example.

### ending inventory

The inventory at the end of an accounting period.

### engagement letter

A letter from a certified public accountant or public accountant to a client specifying the details of and the accountant's responsibilities in connection with an engagement. For example, the engagement letter may state that the CPA will examine the company's financial statements as of December 31, 19xx, in accordance with generally accepted auditing standards, with the objective of expressing an opinion on the fairness of the presentation of the financial statements in conformity with generally accepted accounting principles; and the fee for the work will be based on normal per diem rates plus out-of-pocket expenses. The engagement letter is often signed by the client and returned to the accountant as a contract.

### enterprise fund

A governmental unit that provides goods or services to the public for a charge. An enterprise fund is accounted for much like a private business.

### entity

Any separately identifiable company, project, system, organization, person, or other economic unit. See also *entity concept*.

### entity concept

The notion that the financial position and activities of an economic unit such as a business firm can be accounted for separately from the affairs of its owners.

### entrepreneur

A person who provides the managerial and organizational thrust for a new business venture.

### entry

See *journal entry*.

### EOQ

*Economic order quantity.*

### equity

An interest in or claim against resources. Both creditors and owners of a company have an equity in the company's assets. See also *owners' equity*.

### equity method

A method of accounting for a significant investment in another company under which the carrying value of the investment is increased to reflect a proportional share of the owned company's earnings and decreased for dividends received. The investment's carrying value thus reflects the investor's share of

the change in the other company's net assets. For example, assume the Brown Company purchases 30% of the outstanding common stock of the White Company on December 31, 19x1 for \$10,000; the carrying value of the investment on Brown's books is \$10,000. During 19x1 the White Company earns \$4,000 of net income. Under the equity method Brown Company records a \$1,200 increase (30% of \$4,000) in its investment with the following journal entry:

Investment in White Company	1,200
Share of Income in White Company	1,200

On January 10, 19x2, White Company pays a dividend of \$3,000; Brown Company receives 30% or \$900, recorded as follows:

Cash	900
Investment in White Company	900

The carrying value of the investment after these transactions is \$10,300 (\$10,000 + \$1,200 - \$900). Ref.: APB Opinion No. 18.

### equivalent units

In a *process costing* system, the number of units of product that could have been produced if all work had been performed only on units that were started and completed during the period. For example, 12 units that are each one-third completed represent 4 equivalent (full) units.

### estate tax

A tax based on the value of property transferred to a person's estate upon death.

### estimation sampling

*Sampling* undertaken in order to develop an estimate concerning a larger group ("population," in statistical terminology). The estimate may be of a group value such as the total dollar amount of invoices in a file (*sampling for variables*), or it may be an estimate of the number or percentage of items having a certain characteristic, such as proper approval or arithmetic correctness (*sampling for attributes*).

### ethics

See *Code of Professional Ethics*.

### "except for" opinion

A certified public accountant's *audit opinion* on a company's financial statements that (1) the statements are not presented fully in accordance with *generally accepted accounting principles*; (2) the statements are not consistent with the preceding year's statements; or (3) the audit was not conducted fully in accordance with *generally accepted auditing standards*.

### exchange gain or loss

A difference or reconciling item that results from *translation*, from one currency to another, of financial statements for a period during which a change has occurred in the *exchange rate* between the two currencies.

### exchange rate

The relationship between two currencies, stating the number of units of one currency that must be given, under current conditions, for one unit of the other. For example, if the exchange rate of yen for dollars is 250, then 250 yen must be given in exchange for one dollar.

### excise tax

A tax assessed for carrying on certain business activities and using certain products. Taxes on the sale of tobacco and alcohol products are examples.

### ex-dividend

Not entitled to a recently declared dividend. When dividends are declared on stock, a *date of record* is specified; shares owned on the date of record are entitled to the dividend, while shares acquired after that date are "ex-dividend." Stock prices may be quoted on an ex-dividend basis a short time before the date of record to allow time for the transfer of shares.

### exemption

A deduction allowed to individual (non-corporate) taxpayers in computing taxable income for federal income tax purposes. One exemption is allowed for each dependent, one for being blind, and one for being age 65 or over. Thus a husband and his blind wife, both over 65 with no other dependents, would be entitled to five exemptions. The amount of the deduction per exemption may be changed by Congress; it was \$1,000 in 1979.

### expected value

A value or quantity associated with an outcome, multiplied by (weighted by) the probability of that outcome's occurring. The expected value of an alternative is the sum of the individual expected values for all the possible outcomes of that decision. For example, alternative A has two possible outcomes, depending on whether it rains; these outcomes, their estimated probabilities, the values (pay-offs) associated with the outcomes, and

their individual expected values are given:

Event	Probability	Payoff	Expected Value
Rain	0.30	\$3,000	\$ 900
No rain	0.70	8,000	5,600
Total	1.00		\$6,500

The expected value of alternative A is \$6,500; this may be compared with the expected values for other alternatives in deciding on a course of action.

### expenditure

Something of value spent, paid, or consumed, most commonly a payment of cash.

### expense

The *cost* of goods, services, and facilities used in the production of current revenue. Expenses are deducted from revenue in determining net income. See also *cost*, *loss*. Cash paid for supplies represents an *expenditure* to acquire an *asset* that is recorded in the accounting records at *cost*. As the supplies are used, the asset is converted into an *expense*. If some of the supplies are stolen, their cost is recorded as a *loss*, since the stolen supplies were not used in the production of revenue.

### expense account

(1) A record of an individual's advances, reimbursable expenses incurred, and reimbursements; more loosely, any expenditures by an individual that are reimbursable by the employer. (2) An account in which an *expense* is recorded, and which is deducted from *revenue* in determining net income.

**exploration cost**

A cost of searching for oil and gas, including the cost of drilling exploratory wells. Ref.: FASB Statement No. 19.

**external audit**

An *audit* by a certified public accountant with the objective of expressing an opinion on the fairness of the audited company's financial statements. Contrast with *internal auditing*.

**external auditor**

A *certified public accountant* (or a *public accountant*) who performs an *audit* or examination of an organization's financial statements in order to express an opinion on the fairness of those statements and their conformity with *generally accepted accounting principles*. Contrast with *internal auditor*.

**extraordinary gain**

A *gain* due to an unusual and infrequent event or transaction, such as the sale of a manufacturing plant.

**extraordinary gain or loss**

A *gain* or *loss* that is both unusual and infrequent, for example, the gain from sale of a significant part of a business, the loss resulting from an earthquake. Ref.: APB Opinion No. 30.

**extraordinary item**

See *extraordinary gain or loss*.

**extraordinary loss**

A *loss* due to an unusual and infrequent event or transaction, such as an earthquake.

**extraordinary repair**

A reconditioning or overhaul of plant or equipment that is expected to increase

the asset's utility or extend its useful life beyond that originally anticipated. An extraordinary repair that increases an asset's utility without extending its life is recorded by the following journal entry:

Asset	xxx
Cash (or Accounts Payable)	xxx
If the useful life is extended, the repair may be viewed as restoring a portion of the original utility and recorded as follows:	
Accumulated Depreciation	xxx
Cash (or Accounts Payable)	xxx

F

factor

**factor**

One who buys receivables at a discount and then undertakes collection.

**factoring**

The sale of trade receivables at a discount.

**factory overhead**

All manufacturing costs other than *direct costs* (costs that are assigned or allocated to specific units or batches of production). Factory overhead typically includes indirect labor, factory supplies, supervisors' salaries, maintenance, utilities, depreciation on plant and manufacturing equipment, and the like.

**FAF**

*Financial Analysts Federation.*

**fair market value**

The price for which property is expected to sell under normal conditions (willing seller, willing buyer, no compulsion or emergencies, no unusual shortages or excessive demand).

**fair value**

See *current value*.

**FASB**

*Financial Accounting Standards Board.*

**FASB Statement**

An official pronouncement of the *Financial Accounting Standards Board* establishing acceptable financial reporting practice. FASB Statements are at present the primary source for *generally accepted accounting principles*.

50

**Federal Insurance Contributions Act (FICA)**

The law that established the *Social Security* system. See also *FICA tax*.

**Federal Unemployment Tax Act (FUTA)**

See *unemployment tax*.

**federal withholding tax (FWT)**

A portion of an employee's gross earnings that is usually determined by reference to Internal Revenue Service tables and based on the employee's income and number of dependents, and is deducted from the employee's earnings each pay period and deposited in a federal depository. The amount deposited is credited to the employee's account and offsets the employee's federal income tax liability for the year.

**FEI**

*Financial Executives Institute.*

**FICA**

*Federal Insurance Contributions Act.*

**FICA tax**

The amount withheld from an employee's gross pay, or the employer's required contribution, under the *Federal Insurance Contributions Act*.

**fiduciary**

One who has responsibility for the assets or affairs of another, for example, a bank that manages the assets of an estate.

**fiduciary accounting**

Accounting and reporting for fiduciaries, such as estates and trusts. See also *fiduciary*.

finished goods inventory

**FIFO**

*First-in, first-out.*

**financial accounting**

A broad field of accounting concerned primarily with external financial reporting, including the normal financial statements (*balance sheet*, *income statement*, *statement of changes in financial position*) as well as required reports to the Securities and Exchange Commission and other regulatory agencies, and the accumulation of all data necessary for such reporting. Contrast with *management accounting*.

**Financial Accounting Foundation**

A body of nine trustees that is selected by the board of directors of the *American Institute of Certified Public Accountants* and which in turn appoints the members of the *Financial Accounting Standards Board*. The nine trustees are the president of the American Institute of Certified Public Accountants, four other CPAs in public practice, two financial executives, one financial analyst, and one accounting educator.

**Financial Accounting Standards Board (FASB)**

A nongovernmental body created by the accounting profession to establish acceptable accounting principles and financial reporting practices; these are published in a series of *FASB Statements*. The authority of the FASB rests on its acceptability to business and to the accounting profession and on a provision in the American Institute of Certified Public Accountants Code of Professional Ethics requiring its members to comply with FASB Statements or to justify departures. The members of the FASB are

51

appointed by the *Financial Accounting Foundation*.

**Financial Analysts Federation (FAF)**

A national organization of societies of financial analysts whose objectives are to contribute to the professionalization of financial analysis and to promote "sound and trustworthy principles, practices and conduct with regard to investments and financial management."

**financial condition**

See *financial position*.

**Financial Executives Institute (FEI)**

An organization of corporate *controllers*, *treasurers*, and other executives with responsibilities in finance and accounting. The FEI publishes *Financial Executive* (monthly).

**financial position**

The relationship among *assets*, *liabilities*, and *owners' equity* as of a given date. See also *balance sheet*.

**financial statement**

A report on the financial position or operations of an organization. The usual financial statements are the *balance sheet* (or *statement of financial position*), *income statement*, and *statement of changes in financial position*.

**finished goods inventory**

In a manufacturing firm, the stock of completed products available for sale. Finished Goods Inventory is a *current asset* with a normal debit balance. It is charged with the cost of goods manufactured by the following journal entry:  
Finished Goods Inventory    xxx

Work-in-Process Inventory      xxx  
 When the *perpetual inventory method* is used the following journal entry is made each time goods are sold:  
 Cost of Goods Sold              xxx  
     Finished Goods Inventory              xxx

However, with the *periodic inventory method* cost of goods sold is calculated at the end of the accounting period, and the finished goods inventory balance is adjusted at that time.

### first-in, first-out (FIFO)

A method of identifying the order in which items are used or sold, with the first items acquired assumed to be the first ones used or sold. As applied to inventory costing, the FIFO method assumes that the ending inventory consists of the last items produced or purchased. Contrast with *last-in, first-out* (LIFO).

### fiscal period

See *fiscal year*.

### fiscal year

The inclusive period used by an organization to budget, account for, and report on operations. Most business firms use a fiscal year ending December 31, although many use a *natural business year*. Governmental units often use a fiscal year ending June 30 or July 31.

### fixed asset

An *asset* expected to be used or held for a long term; any asset expected to be held for more than one year or one operating period, whichever is longer. In common usage, the term refers only to operating plant and equipment, not to long-term investments and other non-current assets.

### fixed asset turnover

A statistic used to evaluate the revenue-producing capability of fixed assets, calculated by dividing sales revenue by average fixed assets for the period.

### fixed cost

A *cost* that does not change, in total, as the level of activity increases or decreases within a limited range (the *relevant range*); usually refers to a manufacturing cost. Contrast with *fixed expense*, *variable cost*.

### fixed expense

An *expense* that does not change, in total, with the quantity of units produced or sold, within a limited range of production or sales (the *relevant range*); usually refers to a selling or administrative expense and not a manufacturing cost. Contrast with *fixed cost*, *variable expense*.

### fixed overhead

*Factory overhead* that is not expected to vary with limited changes in the level of production. Contrast with *variable overhead*.

### fixture

Something attached to a building, removable but not readily portable, for example, shelving, carpeting, lighting elements, and restroom components. Fixtures are *fixed assets* subject to *depreciation*.

### flexible budget

A *budget* that shows expected costs for different levels of production, sometimes expressed as a formula. For example, a budget with fixed costs of \$10,000 (for all relevant levels of production) and variable costs of \$27.42 per

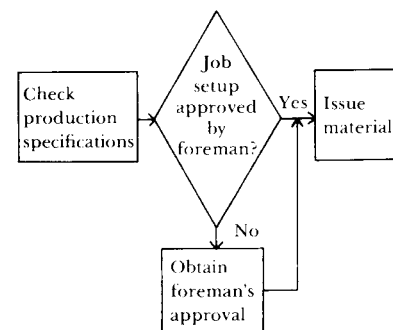
unit might be expressed  $\$10,000 + \$27.42X$ , where  $X$  = number of units produced.

### float

The period of time during which a check or other negotiable instrument is outstanding, released by the maker or signer but not yet cleared at the bank on which it is drawn.

### flow chart

A diagrammatic representation of a process using symbols and labels, highly abstracted from a full narrative description. A procedure for issue of materials for a production run is illustrated.



### FOAB

Federal old age benefits, sometimes used to refer to Social Security or *FICA* payroll deductions.

### f.o.b.

*Free on board*.

### foot

To add a column of figures. See also *crossfoot*.

### footnote

An explanation attached to and considered a part of financial statements, explaining an item in greater detail.

### Foreign Corrupt Practices Act

An act of Congress, passed in 1977, that amends the Securities Exchange Act of 1934 to require all publicly held companies to maintain accurate records and adequate systems of internal control, whether involved in international trade or not. The act also sets fines and penalties for any corporation and its officers and directors engaging in foreign bribery. The act's title does not adequately reflect its impact on accounting. Although the act's primary intent was apparently to prevent foreign bribery, the greatest effect on accounting has come from the requirements for internal control systems adequate to prevent or detect improper payments. Ref.: Sec. 102, Section 13(b) of the Securities Exchange Act of 1934, as amended.

### foreign currency translation

See *translation*.

### foreign exchange contract

An agreement to exchange, on a given date, two currencies at a specified rate of exchange. For example, a contract might call for the exchange of dollars and yen 90 days from the date of the contract at a *forward rate* of 0.005 (\$0.005 for 1 yen, or 200 yen for 1 dollar). Such contracts are used to hedge against rate fluctuations. Ref.: FASB Statement No. 8.

### foreign exchange gain or loss

See *exchange gain or loss*.

### Form 8-K

See *8-K*.

**Form S-1**See *S-1*.**Form 10-K**See *10-K*.**Form 10-Q**See *10-Q*.**FORTRAN (FORmula TRANslator)**

A computer programming language in which operations are expressed through the use of mathematical and similar symbols.

**forward rate**

The rate specified in a *foreign exchange contract* for the exchange of currencies at a future date. Ref.: FASB Statement No. 8.

**franchise**

A contractual right granted for a specified period, usually to operate a business. Costs of acquiring a franchise are accounted for as an *intangible asset*. Ref.: APB Opinion No. 17.

**fraud**

An act of deception undertaken for personal gain and intended to deprive another of property. See also *embezzlement*.

**free on board (f.o.b.)**

A term used with a location (such as "free on board Milwaukee" or "f.o.b. shipping point") to indicate the point at which title to shipped goods changes hands; shipping costs are borne by the seller to the f.o.b. point, by the buyer from there on.

**freight-in**

Shipping or transportation costs of goods borne by the purchaser. Freight-

In is an *expense* account with a normal debit balance and is typically added to the *Purchases* account balance to obtain delivered cost of goods purchased. Freight-In is recorded by the following journal entry:

Freight-In	xxx
Cash (or Accounts Payable)	xxx

**freight-out**

Shipping costs incurred by the seller on goods sold. Freight-Out is a *selling expense* with a normal debit balance. The journal entry for payment of a shipping bill on goods sold is

Freight-Out	xxx
Cash	xxx

**frequency distribution**

A classification of items showing the number that falls into each of several categories. For example, a frequency distribution of employees of a small company, classified by age, might appear as follows:

Age	Number of Employees
Under 20	10
20-29	28
30-39	41
40-49	18
50-59	14
60 and over	8

**full-cost method**

A method of accounting in the oil and gas industry, in which costs of unsuccessful acquisition and exploration activities are initially recorded as assets and then *amortized* as expenses as the total reserves in the country or area are produced. Contrast with the *successful efforts method*. Ref.: FASB Statement No. 19.

**fully diluted earnings per share**

Net income for a year divided by the average number of shares that would have been outstanding if all convertible securities had been converted into common shares. See also *earnings per share*. Ref.: APB Opinion No. 15.

**fund**

(1) Cash, securities, or other assets set aside or provided for a stated purpose.  
(2) In the context of funds flow or source and use of funds, funds are equivalent to *working capital*.

**fund accounting**

A system of accounting used in non-profit organizations, and especially in government, in which a self-balancing set of accounts is maintained for each of several subdivisions, called funds, of the organization.

**funds flow statement**

See *statement of changes in financial position*.

**funds statement**

See *statement of changes in financial position*.

**furniture and fixtures**

A *fixed asset* category on the *balance sheet* that includes accounts for depreciable furniture and for *fixtures*.

**FUTA**

Federal Unemployment Tax Act: see *unemployment tax*.

**FWT**

*Federal withholding tax*.

G

**GAAP**

*Generally accepted accounting principles.*

**GAAS**

*Generally accepted auditing standards.*

**gain**

The excess of value received over that given up in a transaction. A gain is recognized in accounting when the value received exceeds the *book value* of the asset given up.

**GAO**

*General Accounting Office.*

**General Accounting Office (GAO)**

An agency established by the US Congress that audits or reviews management performance, operations, and financial reports of federal agencies. The GAO is headed by the *Comptroller General* and is responsible to Congress rather than to the president.

**general fund**

The resources and related accounts and controls of a governmental unit that are not accounted for in another, more specialized fund. Most of the activities of a typical state or local government unit are supported by the general fund, and most tax revenue goes into it.

**general journal**

The record in which transactions and events affecting a company are first recorded in the form of *journal entries*. The general journal is an unspecialized *journal* that can accommodate any journal entry. Contrast with *special journal*.

**general ledger**

The collection of an entity's *accounts*. A general ledger may be a bound or loose-

leaf volume, a set of punched cards, magnetic tape, an area of computer memory, or another form. See also *subsidiary ledger*.

**generally accepted accounting principles (GAAP)**

The set of standards and conventions that guide accountants in the preparation of financial statements. Certified public accountants, in expressing opinions on financial statements, are required to indicate whether the statements were prepared in accordance with generally accepted accounting principles. These principles are defined in *FASB Statements* and *APB Opinions*, and include other practices sanctioned by the American Institute of Certified Public Accountants. GAAP may also include certain practices that are widely followed or commonly advocated in the accounting literature.

**generally accepted auditing standards (GAAS)**

A set of rules issued by the American Institute of Certified Public Accountants to guide CPAs in performing audits of financial statements. Failure to comply with generally accepted auditing standards is a breach of the AICPA's Code of Professional Ethics and subjects the CPA to sanctions.

**GIGO**

Garbage in, garbage out. A colloquial expression in data processing meaning that the output of a process can be no better than the quality of the input.

**going concern**

A business firm that is not expected to go out of business in the near future. A

going concern is able to pay its debts on time and is carrying on operations that generate revenue. For accounting purposes, a firm is assumed to be a going concern in the absence of evidence to the contrary.

**going-concern concept**

An assumption, made by accountants in the absence of evidence to the contrary, that a given company will not go out of business in the near future. The significance of this concept is that the company can be expected to realize value from its present assets through normal use or sale, instead of having to dispose of the assets under emergency and hardship conditions.

**goods in process**

See *work-in-process inventory*.

**goods-in-process inventory**

See *work-in-process inventory*.

**goods in progress**

See *work-in-process inventory*.

**goods-in-progress inventory**

See *work-in-process inventory*.

**goodwill**

The source of above-normal profits for a company due to good reputation, well-known brand names, superior location, loyal customers, and the like. For financial reporting purposes, goodwill is not recorded and reported in the financial statements unless it is "purchased" as part of a transaction in which the assets of a company are acquired by another company at a total price in excess of the total book value of the assets. Goodwill is often valued at the *discounted present*

*value* of expected above-normal earnings for some period of years. Goodwill is an *asset* account with a normal debit balance. Ref.: APB Opinions No. 16, 17.

**gross margin**

See *gross profit*.

**gross profit**

The excess of *revenue* over *cost of goods sold*. Gross profit on an individual sale is equal to the selling price minus the costs of acquiring and preparing the goods for sale but before subtracting selling and administrative expenses.

**gross profit margin**

See *gross profit*.

**gross profit method**

A method of estimating the cost of ending inventory by first applying the estimated gross profit ratio to sales to produce an estimate of cost of goods sold and then subtracting the cost of goods sold from goods available for sale (beginning inventory plus purchases, or plus *cost of goods manufactured* in a manufacturing firm). For example, if sales are \$100,000, estimated gross profit ratio is 30%, beginning inventory is \$15,000, and purchases are \$65,000, the estimated gross profit is 30% of \$100,000, or \$30,000; estimated cost of goods sold is \$100,000 minus \$30,000, or \$70,000. The total goods available for sale is \$15,000 plus \$65,000, or \$80,000. Goods available, \$80,000, less goods sold, \$70,000, produces an estimate of good still on hand (ending inventory) of \$10,000.

**gross profit ratio**

The dollar amount of *gross profit* divided by net sales revenue. Comparisons be-



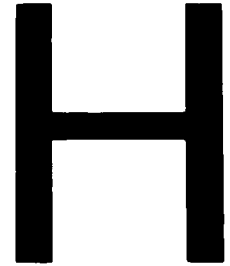
tween gross profit ratios for consecutive periods indicate changes in the relationship between selling price, quantity sold, and purchase cost of goods. The gross profit ratio is also used for estimating or verifying inventory quantities; see *gross profit method*.

**gross sales**

Sales revenue before deducting *sales discounts* and *sales returns and allowances*. Gross sales is usually the first item on an *income statement*. The account title used for gross sales is usually simply Sales, which is a *revenue* account with a normal credit balance.

**group depreciation**

A method of calculating depreciation in which similar assets that have approximately the same useful lives are combined and the periodic depreciation charge is then based on the balance for the group rather than on the value of each asset.

A large, bold, black letter 'H' is centered in the upper portion of a vertical rectangular frame. The frame is empty except for the letter.

hash total

### hash total

A sum with no inherent meaning, developed as a control (especially in computer systems) to guard against omission or loss of a record. For example, invoice numbers may be added to provide a hash total; if an invoice is lost, a summing of the invoice numbers will produce a different total and thus signal that one or more invoices are missing.

### hidden reserves

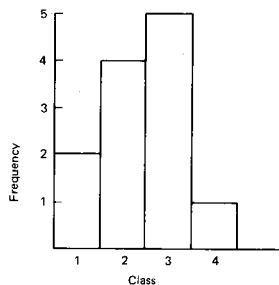
Unreported values in a balance sheet due to overstatement of liabilities, unwarranted writedown of assets, or excessive recognition of depreciation or other expenses. Hidden reserves may result from excessive *conservatism*.

### histogram

A graph of a *frequency distribution* in which frequencies in each class are indicated by the height (or area) of a rectangle. A distribution with the frequencies

Class	Frequency
1	2
2	4
3	5
4	1

would have the following histogram.



62

### historical cost

The amount originally paid for an asset, unadjusted for subsequent changes in value.

### HRA

*Human resource accounting.*

### human resource accounting (HRA)

The systematic recognition in an organization's accounting system of the value of employees. Three approaches have been advocated: (1) Recording human resource costs, such as the costs of recruiting and training, as assets, to be written off as expenses over the periods that benefit from these outlays. For example, costs of recruiting and training an engineer who might be expected, on the basis of past experience, to stay with the organization for ten years, may be amortized over a ten-year period. (2) Recording as assets the estimated costs of replacing present personnel with persons of equivalent capability. (3) Recording as assets the *discounted present value* of future services to be obtained from current employees. Human resource accounting is not acceptable for public financial reporting under *generally accepted accounting principles* but may be used for internal decision making, planning, and control.

### hurdle rate

The minimum acceptable rate of return. Companies often establish a hurdle rate and undertake only those projects or investments promising to provide a return in excess of that rate.

**IASC**

*International Accounting Standards Committee.*

**IIA**

*Institute of Internal Auditors.*

**immaterial**

Not *material*; not large enough to have an effect on decisions.

**imprest account**

An account or fund established at a set amount and periodically replenished to that amount. *Petty cash* is an example.

**imprest fund**

See *imprest account*.

**improvement**

See *betterment*.

**imputed cost**

An estimate, often subjective and not based on a specific market transaction, of a cost or sacrifice. Examples include the estimated amount of rent revenue foregone by the owner of a building who also occupies that building, and interest return sacrificed on money invested in manufacturing equipment. Imputed costs are used in analyses but are generally not recorded in accounting records nor reported in financial statements. (But see *imputed interest*.)

**imputed interest**

An amount of interest assumed to be included in the face amount due on a note when the note does not carry an explicit rate of interest. Generally accepted accounting principles require the recognition of imputed interest on notes receivable and payable that do not oth-

erwise call for an adequate interest payment. Ref.: APB Opinion No. 21.

**Inc.**

*Incorporated.*

**in-charge accountant**

*A senior accountant.*

**income**

The excess of revenue over associated expenses and losses for a period. In common usage, income refers to any inflow or receipt without reduction for associated expenses; the accounting meaning is more restrictive. See also *operating income*, *net income*.

**income account**

A colloquial term for a firm's operating results, virtually synonymous with *income statement*. The usage probably evolved from the fact that net income is recorded through *closing entries* in an account called Profit and Loss Summary or *Income Summary*.

**income averaging**

A procedure authorized in federal income tax law by which taxpayers with unusual fluctuations in annual income are allowed to average income over a five-year period and to base income tax calculations on such averaged income. Because larger incomes are subject to higher tax rates, taxpayers with widely fluctuating incomes would pay at a high rate one year and lower rates in other years, but the average rate paid over several years would be higher than if the income were earned more evenly over the same period. The purpose of the income averaging provision is to avoid unfairly penalizing taxpayers whose incomes fluctuate widely.

**income bond**

A *bond* on which interest is paid from the issuing company's current income. Interest in excess of current income is not paid but may, depending on the bond contract, be allowed to accumulate for a number of years.

**income statement**

A report of a company's revenues, associated expenses and losses, and resulting net income for a period of time, also called profit and loss statement or statement of operations. See the appendix for an example.

**income summary**

An *account* used only during the *closing* process to develop the *net income* for a period; also called the profit and loss summary. Revenue and expense accounts are first closed to the income summary, producing a balance in the account equal to the period's net income; this balance is then closed to *retained earnings*. Income Summary is a temporary account and does not have a normal balance. Balances in revenue accounts are closed to Income Summary with the following closing entry:

Various revenue and income accounts	xxx	
Income Summary		xxx

Expense accounts are closed with the following entry:

Income Summary	xxx	
Various expense accounts		xxx

The Income Summary balance is then closed to owners' equity if a profit has been realized:

Income Summary	xxx	
Retained Earnings		xxx

If a loss has occurred, the final entry is

Retained Earnings	xxx	
Income Summary		xxx

**income tax**

A tax levied on earned income.

**income tax expense**

A deduction from revenue to reflect the amount of *income tax* charged on current income, also called provision for income taxes. The account Income Tax Expense has a normal debit balance. The expense is recorded by the following journal entry:

Income Tax Expense	xxx	
Income Taxes Payable		xxx

**incorporated**

Chartered by a state as a *corporation*.

**incremental cost**

See *differential cost*.

**indenture**

A contract; in accounting and business usage, usually a bond contract, the agreement between the issuer of bonds and the purchasers (lenders) setting forth the responsibilities of the issuer, interest rate, call provisions, redemption schedule, and the like.

**independence**

The condition of being open-minded, neutral, and without bias for or against another party. Independence is of paramount importance for the certified public accountant (or the public accountant) performing an *external audit* and is required by *generally accepted auditing standards*. Generally, to be independent the external auditor should have no personal investment or other interest in the client, should not be related to any per-

son in a position of authority with the client, and should in all respects be able to render a fair and impartial opinion on the client's financial statements.

#### **independent accountant**

An accountant engaged in the practice of *public accounting* for clients, as opposed to an accountant on the client's staff. Independent accountant generally refers to the accounting firm or individual practitioner that performs an *external audit* of the firm's financial statements.

#### **independent auditor**

See *external auditor*.

#### **indirect cost**

A cost that cannot conveniently or economically be assigned to specific units or batches of units; a *factory overhead cost*.

#### **indirect labor**

Factory labor that cannot be practically identified with and assigned to specific units or batches of product and is therefore charged to *factory overhead*. Contrast with *direct labor*.

#### **individual retirement account (IRA)**

A retirement or pension fund established by an individual who is not an active participant in another, qualified plan or government plan. Contributions to this fund are deductible in calculating the individual's taxable income, although proceeds received after retirement are fully taxable at that time. An IRA permits an individual taxpayer to defer income taxes until retirement on the amount of the annual contributions to the plan. This deferral has two advantages: the taxpayer has the use for pos-

sibly many years, of money that would have been used to pay current income taxes on the amount of the contributions; and the taxpayer's tax rate is likely to be lower during retirement years when income is lower.

#### **industrial revenue bond**

A *bond* issued by a governmental authority but with proceeds going to, and principal and interest payments made by, a private firm. Thus city X may approve and issue industrial revenue bonds for company Y. The proceeds go to company Y, and company Y in turn makes payments over the life of the bonds to cover principal and interest. The company, not the city or its taxpayers, is responsible in case of default (although the city's bond rating could be damaged). Interest earned on industrial revenue bonds is exempt from the federal income tax since these bonds are issued by a governmental authority; the bonds are thus an attractive means of financing expansion because the interest rate is lower. Facilities acquired or constructed with industrial revenue bonds are often exempted from local property taxes for a number of years, although the private company may be required to contribute to the city or other governmental treasury an amount equal to the property taxes not paid.

#### **industry audit guides**

A series of publications issued by the American Institute of Certified Public Accountants that provide guidance for auditing specific industries, as well as information on industry practices and economic conditions.

#### **information system**

The collection of records, reports, responsibilities, personnel, and equipment through which information needed in an organization for planning, decision making, and control is recorded, stored, retrieved, analyzed, and communicated.

#### **inheritance tax**

A tax on inherited property, or property received upon the death of the original owner.

#### **insolvency**

The condition of having debts in excess of the current or realizable value of one's assets. A person who is unable to pay his liabilities with available resources is insolvent.

#### **installment sale**

A sale contract providing for a series of payments to be made over a period of time. In contrast to normal credit sales, installment sales usually provide for payments over a longer period of time, with the buyer receiving only a conditional title until payments are completed.

#### **installment sales method**

A method of accounting for *installment sales* in which each periodic payment received by the seller is treated as a partial recovery of cost and a partial recognition of gross profit. See also *cost recovery method*. To illustrate, a sale of merchandise for \$10,000 that cost the seller \$8,000 yields a gross profit of \$2,000, or 20% of the sales price; therefore 20% of each payment received from the buyer is recognized as realized gross profit under the installment sales method.

#### **Institute of Chartered Financial Analysts**

An organization created in 1962 by the Financial Analysts Federation to conduct tests for and award the designation *chartered financial analyst* (CFA).

#### **Institute of Internal Auditors (IIA)**

A professional organization that promotes standards, professional education, and research in *internal auditing*. The IIA awards the professional designation *certified internal auditor* and publishes the bimonthly journal *The Internal Auditor*.

#### **Institute of Management Accounting**

An organization established by the National Association of Accountants to conduct examinations for and award the *certificate in management accounting* (CMA).

#### **intangible asset**

An *asset* having no physical substance, such as a claim or a right; in accounting, noncurrent assets other than investments, such as *goodwill*, *organization costs*, and *patents*.

#### **interest**

(1) A charge for the use of money for a period of time. (2) An ownership or equity share in a company, venture, or resource.

#### **interest expense**

A deduction from revenue in determining income, to reflect the cost of using borrowed money during the current period. Interest Expense has a normal debit balance and is recorded by the following journal entry:

Interest Expense	xxx
Cash (or Interest Payable)	xxx

**interim report**

See *interim statements*.

**interim statements**

Financial statements prepared between year ends, such as the quarterly statements prepared at the end of the first, second, and third quarters of the *fiscal year*.

**internal auditing**

Procedures carried out by *internal auditors* that are designed to obtain compliance with company policies, insure implementation of good internal control practices, prevent or discover fraud, and achieve operating efficiencies.

**internal auditor**

An employee of an organization whose responsibilities may include seeking compliance with company policies, insuring implementation of good internal control practices, preventing or discovering fraud, and achieving operating efficiencies. Contrast with *external auditor*.

**internal check**

See *internal control*.

**internal control**

Methods and policies designed to prevent fraud, minimize errors, promote operating efficiency, and achieve compliance with established policies; more narrowly, procedures and policies designed to prevent or discover errors and fraud.

**internal rate of return**

(1) The effective annual *return on investment* over the life of a project. (2) A method of evaluating a long-term project in which a *discount rate* is calculated

that equates the *present value* of the future cash receipts and payments (cash flows) to the outlay required for the project; this discount rate can then be compared with the minimum desired rate of return to determine whether the project is worthwhile.

**Internal Revenue Code**

The U.S. federal tax law.

**Internal Revenue Service (IRS)**

The agency of the Treasury Department that administers and enforces federal tax law.

**international accounting**

A broad field of accounting study and practice, encompassing financial reporting, auditing, and tax laws in different countries, internal control and financial communication within multinational enterprises, and the setting of international accounting standards. See also *Statements of International Accounting Standards*.

**international accounting standards**

See *Statements of International Accounting Standards*.

**International Accounting Standards Committee (IASC)**

A group composed of representatives of accounting organizations in most of the major trading nations, with associate membership available to organizations in other countries. The committee's objectives are to formulate and to seek acceptance of and compliance with international standards of financial reporting and auditing. The objectives and goals of the committee parallel to a significant extent those of the *Financial Accounting Standards Board* in the United States.

**Interperiod income tax allocation**

Assignment of a given year's income tax liability to two or more years' operations, so that the related income tax expense is deducted from the revenue of two or more years in determining net income for those years. Interperiod income tax allocation is used to compensate for timing differences in the treatment of certain transactions for financial reporting and for income tax reporting purposes. For example, a company may use *straight-line depreciation* for financial reporting purposes and *accelerated depreciation* for income tax purposes; during the earlier years of an asset's useful life, the depreciation expense for financial reporting purposes is lower and the reported income is higher than for income tax purposes. If interperiod income tax allocation is used in this case, the income tax expense reported for financial statements is based on the straight-line depreciation deduction, thus producing a difference between the income tax expense and the actual income tax liability for the period. This difference is reported as a *deferred income tax liability*. Ref.: APB Opinion No. 11.

**inventory**

(1) The stock of supplies, raw materials, work in process, finished goods or merchandise held by a company at any point in time. An inventory account is a *current asset* account. (2) To make a physical count of the supply of any item or set of items.

**Inventory control**

A system of procedures designed to minimize costs of ordering and carrying inventory, usually including a procedure for determining *economic order quantity*, *reorder point*, and *safety stock*.

**Inventory observation**

An audit procedure in which the auditor observes the client's *physical inventory*. Typically the auditor reviews the client's written inventory counting instructions, observes the activities of client personnel in taking the inventory, and makes a number of test counts of inventory items to verify the quantities obtained by client personnel.

**inventory profit**

An excess of current replacement cost of inventory over the amount at which the inventory is carried in a company's accounting records. For example, a company carrying inventory at \$8,000 that would cost \$11,000 to replace might be said to have an unrealized "inventory profit" of \$3,000. This term is sometimes used to describe a situation in which the selling price of a company's products has increased, thus making the inventory implicitly more valuable whether the replacement cost has risen or not.

**inventory turnover**

A statistic indicating the age of inventory and the rapidity with which it is moving. For raw materials the turnover is calculated by dividing cost of materials used by the average inventory of raw materials for a period; turnover of merchandise inventory or finished goods is determined by dividing cost of goods sold for a period by the average merchandise or finished goods inventory for that period.

**invested capital**

The sum of resources provided to a business by its owners, often including earnings retained in the business (*retained earnings*).

### **investment**

Property—real or personal—acquired with the expectation of obtaining periodic earnings or a gain upon sale, and generally held for a relatively long period of time. Investments accounts include securities of other companies acquired on a long-term basis (more than one year) for the purpose of exercising control, establishing a continuing business relationship, or earning a return. An Investments account is a noncurrent *asset* with a normal debit balance.

### **investment credit**

A credit against, or reduction in, a taxpayer's federal income tax liability equal to a specified percentage of the cost of certain qualifying machinery and equipment acquired and placed in service during the current year. The amount and applicability of the investment credit is subject to change by Congress.

### **investment tax credit**

See *investment credit*.

### **invoice**

A document prepared as evidence of a sale, showing purchaser, terms, description of goods, prices, and shipping instructions. Of the several copies that may be prepared, one is usually provided to the purchaser and one is used as the source document for accounting entries.

### **IRA**

*Individual retirement account.*

### **IRS**

*Internal Revenue Service.*

### **itemized deductions**

Personal (nonbusiness) deductions, such as taxes, interest, medical expenses, and

charitable contributions, allowed by law in calculating federal income tax. Taxpayers may either itemize deductions or take the *standard deduction*, whichever is greater.

J

job cost sheet

**job cost sheet**

See *cost sheet*.

**job costing**

See *job order costing*.

**job order costing**

A *cost accounting* system or procedure in which costs are assigned to and accumulated by specific units or batches of product. Contrast with *process costing*.

**joint cost**

A cost that benefits two or more departments or products, such as rent on a building housing several departments; sometimes called common cost.

**joint products**

Two or more products that are the result of a single production process.

**joint return**

A single income tax return filed by a husband and wife, combining their income, deductions, exemptions, and credits.

**joint venture**

A *partnership* between two or more persons, corporations, or other entities formed for the purpose of carrying out a single project and usually dissolved upon completion of the project.

**journal**

The record in which financial transactions and events are first recorded as *journal entries*. In a manual accounting system a journal is likely to be a bound or looseleaf book with columnar pages; in a computerized system it may be on punched cards, punched paper tape, or magnetic tape. See also *general journal*, *special journal*.

72

**journal entry**

The device used to enter the details of a transaction or event into an accounting system. Journal entries are initially recorded in a *journal* and are subsequently *posted* to a *ledger*. They always include one or more *debits*, which are listed first, and one or more *credits*; the sum of the debits must equal the sum of the credits in each entry. A typical journal entry might appear as follows:

Jan 9	Office Equipment	1,200	
	Cash		1,200
	To record the purchase of an electric typewriter.		

**journal voucher**

A document supporting a *journal entry*. While the journal voucher has no special form, it shows the accounts debited and credited, provides detail and any appropriate calculations supporting the entry, and includes the signature or initials of the person approving the entry.

**journalize**

To make a *journal entry*.

**judgment sample**

A sample selected at least partially on the basis of personal judgment. Contrast with *probability sample*.

**junior accountant**

A staff member of a public accounting firm who has limited experience and assists a *senior accountant* on client engagements.

K

**KD**

Knocked down; unassembled.

**keypunch**

(1) A machine used to record data by punching holes in cards. (2) To use a keypunch machine; to record data in punched cards.

**kiting**

The process of exploiting the period required for a check to clear through the banking system by showing the same amount on deposit simultaneously in two banks. A check is written on one bank and deposited in another. Instead of recording both a disbursement and a receipt, the kiter records only the receipt, possibly identifying it falsely as a receipt on accounts receivable or from sales. If undetected, kiting can serve to inflate a company's cash balance reported in financial statements; consequently auditors investigate carefully deposits and bank transfers near the financial statement date.

A large, bold, black L-shaped graphic, resembling a corner bracket or a stylized letter 'L', positioned in the upper right quadrant of the page.



**labor efficiency variance**

In a *standard cost system*, the part of the difference between standard labor cost and actual labor cost attributable to the use of more or fewer labor hours than allowed for the units produced. The labor efficiency variance is calculated as the difference between actual hours worked and standard hours allowed for the units produced, multiplied by the standard labor rate per hour. The Labor Efficiency Variance account has a debit balance if the variance is unfavorable, a credit balance if favorable.

**labor rate variance**

In a *standard cost system*, the part of the difference between standard labor cost and actual labor cost attributable to an average wage rate that is higher or lower than allowed in the standard. The labor rate variance is calculated as the difference between actual average wage rate and standard rate, multiplied by the actual number of hours worked. The Labor Rate Variance account has a debit balance if the variance is unfavorable and a credit balance if it is favorable.

**lapping**

A form of *embezzlement* in which money received in payment on a customer's account is stolen. Subsequently a receipt from another customer is recorded as a payment from the first customer, a receipt from a third customer is recorded as a payment from the second, and so on. Typically the amount involved gets larger and larger and thus increasingly difficult to conceal. The result is often an excessive delay in posting receipts.

**last-in, first-out (LIFO)**

A method of identifying the order in which items are used or sold, with the

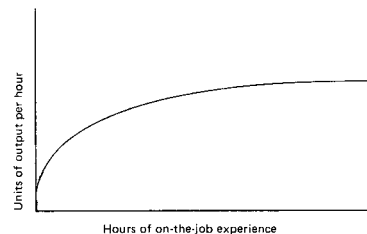
last items acquired assumed to be the first ones used or sold. As applied to inventory costing, the ending inventory is assumed to consist of the first units produced or purchased. Contrast with *first-in, first-out (FIFO)*.

**lead time**

The period of time from placing an order or commencing a production run to receipt of that order or completion of production.

**learning curve**

The curve or line on a chart that shows the relationship between the level of output and some measure of learning or experience; the latter measure may be total number of units produced to date, time on the job, amount of training, and so forth. While the relationship may be plotted in several ways, one common approach is shown in the following graph.

**lease**

A contract for the use by one party (the lessee) of specified real or personal property belonging to another party (the lessor). See also *operating lease*, *capital lease*.

**leaseback**

See *sale and leaseback*.

**leasehold**

Property held or used under a *lease*.

**leasehold improvement**

An improvement such as a parking lot, building, driveway, or landscaping made on or added to leased property; it belongs to the lessor (owner of the leased property) when the lease is terminated. Leasehold improvements are depreciated over the term of the lease or the life of the improvement, whichever is shorter. A Leasehold Improvements account is a long-term *asset* with a normal debit balance. Payment for a leasehold improvement may be recorded by the following journal entry:

Leasehold Improvements	xxx	
Cash		xxx

**least-squares analysis**

The most widely used form of *regression analysis*; a method of fitting a line to a set of points to meet the specific criterion of minimizing the sum of the squared deviations between the points and the line. Least-squares analysis is used to develop the equation that best defines the relationship between two variables. See also *simple regression analysis*.

**least-squares method**

See *least-squares analysis*.

**ledger**

A collection of *accounts*. A ledger may be a volume of columnar pages, the printed output of a posting machine, a set of punched cards, or a section of magnetic tape or disc. See also *general ledger*, *subsidiary ledger*.

**legal capital**

In a corporation the amount of *capital*, defined by state law, that must be retained for the protection of creditors and cannot be returned to stockholders

(through dividends, for example, or through the repurchase by the corporation of outstanding stock) as long as creditor claims remain outstanding. Legal capital is usually defined as the par value (or, in the absence of par value, the assigned or stated value) of all outstanding shares of stock. Also called *stated capital*.

**lessee**

One who obtains the use of property from another under a *lease*.

**lessor**

A property owner who grants the right to use that property to another under a *lease*.

**letter of credit**

A document expressing a bank's willingness to honor (pay) a draft (order to pay) upon presentation of evidence of satisfaction of prescribed conditions. A letter of credit is often obtained by a buyer of goods who has not established his own credit with the seller. The buyer then presents the letter of credit along with his order to the seller; the seller delivers the goods and sends a draft for payment to the bank, accompanied by evidence of shipment or delivery of the goods (such as a *bill of lading*). If the documents are in order, the bank pays the seller and then collects from the buyer, usually after the goods are resold by the buyer. Letters of credit are most widely used in international trade.

**letter of representation**

See *representation letter*.

**leverage**

See *capital leverage*, *operating leverage*.

**liability**

An obligation to pay an amount or perform a service. A liability appears on the *balance sheet* and has a normal credit balance.

**lien**

The right, under law, to retain property owned by another in satisfaction of a debt owed by the property owner to the lienholder.

**LIFO**

*Last-in, first-out.*

**limited company**

A form of business organization, especially in the British Commonwealth, in which the liability of the owners is limited much as it is for stockholders in US corporations. See also *limited liability*.

**limited liability**

A feature of the corporate form of organization whereby an owner's maximum loss from investment in a company is limited to the amount invested in its shares. In contrast, the owner of a *sole proprietorship* and a partner in a *partnership* may risk personal assets if the resources of the business are not sufficient to satisfy creditors.

**limited partnership**

A *partnership* in which one or more, but not all, of the partners is a limited partner, that is, one whose liability to the partnership's creditors is limited to that person's capital contribution.

**linear programming**

A mathematical approach to obtaining the best or optimal solution to a complex problem with (a) a specified objective,

such as maximization of profits, and (b) quantifiable constraints or limitations, such as budget limits and minimum quality specifications.

**linear regression**

Measurement of the amount of change in one variable (the dependent variable) associated with changes in one or more other variables (the independent variables), where the relationship between the dependent and the independent variables is linear, that is, can be represented by a straight line. See also *simple regression analysis*.

**liquid assets**

Cash, uncommitted bank accounts, and readily marketable securities.

**liquidating dividend**

A distribution to stockholders from the capital invested, rather than from earnings.

**liquidation**

The process of closing down a company including sale of assets, settlement of liabilities, and distribution of remaining cash or other assets to the owners.

**liquidation value**

The amount of cash or other resources that could be obtained upon sale of an asset during *liquidation* of a company. For an entire company the liquidation value is the net proceeds that could be realized from the sale of all assets and settlement of all liabilities. Since liquidation often occurs under emergency or forced circumstances, liquidation values are usually less than the amounts that could be obtained from the sale of assets in the normal course of business.

**liquidity**

The extent to which an organization has assets that are readily available to meet obligations. The *current ratio* is a widely used measure of liquidity.

**long-form report**

A report issued by an external auditor that contains explanations in addition to the financial statements and *audit opinion* included in the more usual short-form report. The additional material may or may not be included in the scope of the audit opinion.

**long-term debt**

See *long-term liabilities*

**long-term liabilities.**

Obligations and debts not classified as *current liabilities*; generally a liability that is not expected to be paid or settled within one year.

**loss**

(1) A sacrifice, usually in the form of expenditure or consumption of assets, that does not provide an equivalent benefit. (When equivalent benefits are obtained the sacrifice is an *expense*.) (2) An excess of expenses over revenues of a company for a period.

**loss carryback and carryforward**

A provision of federal income tax law that allows a taxpayer to offset a current year's net operating loss against the profits of three prior years and, if the loss is not thus absorbed, against the five following years. The effect of the provision is to allow the operator of a business to average net losses against profits over a period of several years.

**lower of cost or market**

A method of establishing a value for assets (such as inventories and marketable securities) to be reported in a *balance sheet* in which the asset's original cost and its market value (usually replacement cost or quoted selling price) are determined separately, and the lower of the two is used. The method is usually justified on the basis of *conservatism*.

**lump-sum purchase**

The purchase of a group of items for a given total amount, with no prices assigned to individual items in the group. For example, inventories of companies going out of business are often purchased for a lump sum.

**M**

**magnetic ink character recognition (MICR)**

A process by which magnetically encoded letters, numerals, and symbols are printed on checks and other documents processed by banks. The characters can be read by special equipment, permitting sorting and processing of the documents.

**management accounting**

A broad field of accounting concerned with the development and use of economic information within an organization for planning, decision making, and control. Management accounting includes *cost accounting*. Contrast with *financial accounting*.

**management advisory services (MAS)**

Consulting services provided to assist a company and its management in reducing costs, increasing efficiency, and generally improving performance. Examples include design of a computer system, a *PERT* analysis of a project, installation of a cost accounting system, review of production control procedures, and a *linear programming* analysis to determine the optimal combination of raw materials. Management advisory services represent one of the three major categories of services provided by public accounting firms, along with audits of financial statements and tax services.

**management audit**

A review and evaluation of management's performance. The management audit may take into account environmental conditions, decisions made, results obtained, and similar factors.

**management by exception**

An approach to management in which attention is focused on departures from standards or norms (exceptions). Effort is thus directed away from the overwhelming mass of detail and toward a small number of possible problem areas.

**management information system**

See *information system*.

**managerial accounting**

See *management accounting*.

**manufacturing cost**

Any of the costs incurred in the production of a product, usually classified into three categories: *direct materials* (raw materials used), *direct labor*, and *factory overhead*.

**manufacturing expense**

See *factory overhead*.

**manufacturing overhead**

See *factory overhead*.

**marginal cost**

The increase in total costs associated with an increase of one unit in quantity produced or sold. See also *variable cost*, *differential cost*.

**marginal revenue**

The increase in total revenue associated with the sale of one additional unit.

**markdown**

A reduction in selling price.

**market value**

Generally, the price at which an item can be sold. When inventories are valued at *lower of cost or market*, "market" means

current cost to replace an item, subject to two limits: it cannot be higher than normal selling price less costs to complete and sell; and it cannot be lower than normal selling price less costs to complete and sell *and* less a normal profit. See also *fair market value*.

**marketable securities**

Securities that may be readily sold because a ready market exists with quoted security prices. On a balance sheet the account Marketable Securities includes investments, usually in government bonds and corporate stocks and bonds, that may be sold without disrupting the normal operations of the investor; such investments are made initially to earn a return on excess or idle cash and are disposed of when more cash is needed. The Marketable Securities account is a *current asset* with a normal debit balance. Investment in marketable securities is recorded as follows:

Marketable Securities	xxx
Cash	xxx
Disposition of marketable securities at a gain results in the following entry:	
Cash	xxx
Gain on Sale of Marketable Securities	xxx
Marketable Securities	xxx
If marketable securities are sold for less than their cost, the entry is	
Cash	xxx
Loss on Sale of Marketable Securities	xxx
Marketable Securities	xxx

**markup**

(1) An amount added to the estimated cost of a product to arrive at its selling price. The markup may be expressed in dollars, or it may be expressed as a per-

centage of cost (markup on cost) or as a percentage of the selling price (markup on selling price). (2) An increase in selling price over the previous level.

**master budget**

The overall *budget* or financial plan for an organization that may include detailed budgets, such as a raw materials budget, labor budget, factory overhead budget, production budget, finished goods budget, operations budget, financial budget, and cash budget. The master budget is the end product of constructing and combining these subordinate budgets.

**matching**

The process of relating expenses to revenue in order to determine net income. Accountants attempt to assign expenses to the year or period that benefits from those expenses; the benefits are generally in the form of increased revenues. Thus effort (expenses) and benefits (revenue) are matched in the same time period, permitting a determination of net results (net income).

**material**

(1) Large enough to make a difference in decisions. Accountants are not concerned with the manner in which immaterial items are reported. (2) *Raw materials*.

**material price variance**

In a *standard cost system*, the part of the difference between actual and standard material cost attributable to actual prices paid for material that are greater or less than standard prices. The material price variance is calculated as the difference between actual and standard price per

unit of material, multiplied by the actual number of units of material used (or purchased). The Material Price Variance account has a debit balance if the variance is unfavorable, a credit balance if the variance is favorable.

### material quantity variance

In a *standard cost system*, the part of the difference between actual and standard material cost that is attributable to use of more or less material than the standard quantity allowed for the level of production achieved. The material quantity variance is calculated as the difference between actual quantity of material used and the standard quantity allowed, multiplied by the standard cost per unit. The Material Quantity Variance account has a debit balance if the variance is unfavorable, a credit balance if the variance is favorable.

### materiality

The quality of being *material*, of being large enough to affect decisions. Auditors are concerned with the materiality of errors discovered: an immaterial error may not require an adjustment.

### mean

The average of a set of values, calculated by dividing the sum of the values by the number of values. The mean of 5, 8, and 2 is  $(5 + 8 + 2) \div 3 = 5$ . Technically, this is the arithmetic mean.

### median

For a set of numbers, the value of the middle number (or the *mean* of the two middle numbers) when the numbers are arranged in ascending or descending order. The median for the set of numbers 17, 18, 23, 35, 40 is 23.

### merchandise inventory

The stock of goods acquired for resale. Contrast with *finished goods inventory*. Merchandise Inventory is a *current asset* account with a normal debit balance. Journal entries for merchandise inventory depend on whether the *periodic inventory method* or the *perpetual inventory method* is used. With the periodic inventory method entries in the merchandise inventory account are made only at the end of the period, when the old inventory balance is closed out and the new balance is set up; purchases are recorded by debits to the Purchases account. With the perpetual inventory method, purchases of goods are recorded as follows:

Merchandise Inventory	xxx
Cash (or Accounts Payable)	xxx

Sales of merchandise call for the normal sales entry (debiting Cash or Accounts Receivable and crediting Sales) plus the following entry to record the cost of sales:

Cost of Goods Sold	xxx
Merchandise Inventory	xxx

### merger

A combination of two or more companies, usually through an exchange of shares of stock. For example, a merger may be effected between company A and company B through the issuance of company A (the surviving company) stock to the shareholders of company B, who then turn their shares in company B over to company A. Company A then owns company B, and company B's former shareholders own stock in company A. After the merger, company B may continue as a *subsidiary* of company A or may be liquidated and its assets combined with those of company A.

### MFOA

*Municipal Finance Officers Association.*

### MICR

*Magnetic ink character recognition.*

### minimum wage

An amount set by statute that establishes the lowest hourly wage rate that may be paid to employees, with certain specified exceptions.

### minority interest

The proportional share or interest of shareowners who are outside a consolidated group of companies, in the earnings and stockholders' equity of the consolidated entity. A minority interest occurs when less than 100% of the shares of any affiliated company are owned by the *parent company* or a *subsidiary company* within the group. See also *consolidation*.

### MIS

*Management information system.*

### mixed cost

A cost with both *variable cost* and *fixed cost* components, for example, a utility bill with a basic charge plus an increment based on usage.

### mortgage

A claim against specified property given by a borrower as security for a loan and exercisable by the lender if the borrower fails to make the payments required by the loan contract. A bond secured by a mortgage claim may be called a mortgage bond.

### mortgage bond

A *bond* or long-term loan secured by a *mortgage* on, or claim against, certain specified assets.

### moving average method

An inventory costing method in which the average unit cost is updated after each transaction. The following example shows the calculation of unit costs on a moving average basis:

	Moving average cost
Purchased 10 units @ \$1.70, total \$17.00	\$1.70 (\$17.00 $\div$ 10)
Purchased 20 units @ \$2.00, total \$40.00	\$1.90 (\$57.00 $\div$ 30)
Sold 15 units; 15 units remain in inventory	\$1.90 (\$28.50 $\div$ 15)
Purchased 10 units @ \$2.20, total \$22.00	\$2.02 (\$50.50 $\div$ 25)
After these transactions the inventory consists of 25 units at an average cost of \$2.02.	

### multiple correlation

The degree of relationship or association among three or more variables. See also *correlation coefficient*.

### multiple regression analysis

Measurement of the amount of change in the dependent variable associated with changes in two or more independent variables. See also *simple regression analysis*.

**Municipal Finance Officers  
Association (MFOA)**

A professional service organization for government officials involved in public financial management. The MFOA seeks to establish standards in governmental accounting, auditing, and financial reporting, and publishes the quarterly journal *Governmental Finance*.

**N**

**NAA**

National Association of Accountants.

**National Association of Accountants (NAA)**

An organization oriented toward the practice of *management accounting* and *cost accounting*. Members come from all branches of accounting but are predominantly in industry. The NAA publishes the periodical *Management Accounting* and sponsors the professional designation CMA (*certificate in management accounting*).

**National Association of Accountants for the Public Interest (NAAPI)**

The former name of *Accountants for the Public Interest*.

**natural business year**

A period that ends during the low point in a business firm's activities, often selected as the *fiscal year* for financial reporting purposes because the cost of taking inventories, *closing* the books, and preparing financial statements at that time is minimized.

**negative assurance**

A report issued by an accountant stating that during the course of an examination or review of financial statements or procedures, nothing came to the accountant's attention that indicated the presence of irregularities or noncompliance with relevant regulations or contractual requirements. Contrast with the auditor's *standard opinion*.

**negative confirmation**

A letter or form mailed by a company on behalf of its *auditors* to selected customers with outstanding balances asking the customers to notify the auditors if

the balance shown is not correct; a response is not required if the balance is correct. Contrast with a *positive confirmation*.

**negative goodwill**

An excess of the assigned value of identifiable assets over the cost of an acquired company; a *goodwill* account with a credit balance. Ref.: APB Opinion No. 16.

**net assets**

Total assets minus total liabilities; *owner's equity*.

**net book value**

See *book value*.

**net income**

The excess of *revenues* over all related *expenses* for a given period. Refer to the illustration of the Income Statement in the appendix for the deductions usually made in determining net income.

**net loss**

The operating result produced when *expenses* exceed *revenues* for a given period. Contrast with *net income*.

**net operating income**

See *operating income*.

**net present value**

The algebraic sum of the *present values* of all outlays and inflows associated with a given project or investment. Calculation of net present value usually involves subtracting the initial outlay cost of an investment or project from the present value of all future cash flows.

**net profit**

See *net income*.

**net realizable value**

Estimated selling price minus expected costs of completion and disposal.

**net sales**

A subtotal on an *income statement* reflecting total sales revenue reduced by certain offsetting accounts, such as *sales returns and allowances* and *sales discounts*.

**net working capital**

The excess of *current assets* over *current liabilities*; also called *working capital*.

**net worth**

The owners' interest in the assets of a company; *owners' equity*.

**nominal account**

An account opened and used during a single accounting period and then closed into *owners' equity*; sometimes called a temporary proprietorship account. Nominal accounts include the accounts appearing on the income statement (except the inventory accounts), the Dividends account, and special *closing* accounts such as Income Summary.

**nominal capital**

The total *par value* or *stated value* of a corporation's issued stock. Nominal capital has little practical significance, since par or stated value is often set arbitrarily low and bears no direct relationship to the book value, market value, or intrinsic value of stock. See also *legal capital*.

**noncurrent assets**

Assets that are not expected to be used up or converted into cash within one year or one *operating period*, whichever is longer. Noncurrent assets include long-term investments; property, plant, and equipment; and intangible assets.

**noncurrent liabilities**

Liabilities that are not expected to be satisfied from *current assets*; *long-term liabilities*.

**nonprofit organization**

An organization, such as a unit of government, a church, or a charitable institution, that does not seek profit as its primary objective. A nonprofit organization may realize a profit (although it is usually called something else, such as surplus), but this is not its dominant goal.

**no-par stock**

*Stock* that does not carry a *par value*. No-par stock is recorded at the amount of the proceeds by the following journal entry:

Cash	xxx	
Common Stock		xxx

**normal balance**

The balance condition (*debit* or *credit*) of an *account* under normal circumstances. For example, the cash account, as an asset, has a normal debit balance, but it could have a credit balance in the abnormal circumstance of an overdrawn bank account.

**normal return**

The level of earnings expected from an investment, project, or company under usual, recurring conditions. For an industry, the normal return is generally considered to be the industry average.

**note**

(1) A written promise by one party to pay a specified amount to another party, usually indicating a due date for payment and often specifying an *interest* rate. (2) An explanation attached to a

note payable

financial statement explaining a referenced item in greater detail.

**note payable**

A written promise to pay a specified amount on or by a certain date, usually specifying an *interest* rate. Notes Payable is a *current liability* account with a normal credit balance. The execution of a note requires the following journal entry on the books of the borrower:

Cash	xxx	
Notes Payable		xxx

**note receivable**

An amount due from another, evidenced by a written promise to pay. The account Notes Receivable is a *current asset* with a normal debit balance. Notes receivable are often accepted in connection with sales; in such a case the following journal entry appears on the books of the seller:

Notes Receivable	xxx	
Sales		xxx

When a note is accepted in connection with a loan, the lender makes the following entry:

Notes Receivable	xxx	
Cash		xxx

**not-for-profit organization**

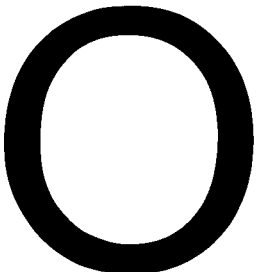
See *nonprofit organization*.

**NSF**

Not sufficient funds; see *NSF check*.

**NSF check**

A check that is not covered by an adequate balance in the bank account; a “bad” or “rubber” check. Such checks are returned to the issuer by the bank that they are drawn on, marked “NSF” (not sufficient funds).





**object classification**

A classification of expenses on the basis of the nature of the goods or services acquired, by the "object" of the original expenditure. Salaries and wages, advertising expense, and supplies expense are examples of expenses classified on an object basis.

**observation of inventory**

See *inventory observation*.

**obsolescence**

A decline in an asset's value due to changing technology or styles rather than wear and tear.

**occupancy cost**

One of the several costs of using space in a building, including rent, utilities, building depreciation, and building maintenance.

**OLRT**

*On-line, real-time.*

**one-write system**

A set of forms, backed with carbon strips and with a series of holes punched along one edge, along with a "pegboard" for aligning them, so that transactions and entries may be recorded on several documents simultaneously (in one writing). The pegboard contains a row of posts along one side, arranged so that the distance between two posts is the vertical distance of one line on the forms. The forms are aligned on the posts and the transaction is recorded by hand. One good application of a one-write system is the preparation of payrolls; the check, the check "stub" showing pay and withholding information, the payroll register, and the employee's individual pay-

roll record are arranged on the pegboard and each employee's pay data are recorded on all documents in a single writing.

**on-line, real-time (OLRT)**

A computer system configuration in which data are recorded as events occur (in real-time) through terminals or input devices that are connected by direct wiring (on-line) to the *central processing unit*.

**operating budget**

The *budget* or financial plan for revenue and expenses, that is, for operations. In essence, an operating budget is a projected *income statement*. See also *master budget*.

**operating cycle**

The series of steps involved in a company's operations, including purchase of raw materials, their conversion into finished products, sale of the finished products, and collection on the sale (or, in a merchandising firm that does not manufacture, the purchase and sale of merchandise and collection on account). See also *operating period*.

**operating expense**

An *expense* of carrying on normal activities, apart from the expenses of financing the business and other "nonoperating" expenses. Selling, general, and administrative expenses are included, but *cost of goods sold* is usually excluded.

**operating income**

The excess of *revenues* over *operating expenses*; income from normal and primary operations before adding or subtracting other income and expense items not associated with operations, such as *extraor-*

*dinary gains or losses*. The sample Income Statement in the appendix illustrates the calculation of operating income.

**operating lease**

The normal form of a lease contract, under which rent is paid for the use of property with the original owner retaining title to the property. Contrast with *capital lease*. Ref.: FASB Statement No. 13.

**operating leverage**

The effect on net income of *fixed costs* in a company's expense structure, resulting in a disproportionate increase in net income as revenue increases. For example, consider the following data for two companies:

	Company A	Company B
Sales	\$20,000	\$20,000
(1,000 units @ \$20)		
Variable costs		
A: 1,000 units @ \$5	\$ 5,000	
B: 1,000 units @ \$10		\$10,000
Fixed costs	10,000	5,000
Total costs	\$15,000	\$15,000
Net income	\$ 5,000	\$ 5,000

A 10% increase in sales volume for both companies gives the following results:

	Company A	Company B
Sales	\$22,000	\$22,000
(1,100 units @ \$20)		
Variable costs		
A: 1,100 units @ \$5	\$ 5,500	

units @ \$5		
B: 1,100 units @ \$10		\$11,000
Fixed costs	10,000	5,000
Total costs	\$15,500	\$16,000
Net income	\$ 6,500	\$ 6,000
Increase in net income	30%	20%

Thus, while both companies experience a percentage increase in net income that is greater than the percentage increase in sales, company A has the greater operating leverage.

**operating period**

The average period of time elapsing from the initial purchase of merchandise or raw materials through the manufacture of finished goods (in a manufacturing firm), sale of product, and collection of accounts receivable in cash.

**operating statement**

See *income statement*.

**operational audit**

An analysis and evaluation of an organization and its operations, often including reviews of structure, systems design, procedures, controls, and results. An operational audit is similar to a *management audit* but with more emphasis on the organization than on management.

**operations research (OR)**

The application of mathematical, statistical, and scientific techniques to the solution of organizational problems.

**opinion**

See *audit opinion*.

### opportunity cost

The amount or value of the sacrifice associated with any event, transaction, or activity; the opportunity cost from the use of a resource for a specific purpose is the benefit that could have been obtained by using that resource for the best alternative purpose. For example, if land that could have been rented out for \$1,000 is farmed instead, the opportunity cost of the land when used for farming is \$1,000.

### option, stock

See *stock option*.

### OR

*Operations research.*

### organization cost

A cost of incorporating and establishing a business, for example, legal fees, stock issue costs, and state incorporation fees and taxes. The account Organization Costs is an intangible, noncurrent *asset*, and has a normal debit balance. When an organization cost is incurred, the following entry is made:

Organization Costs	xxx
Cash (or a liability account)	xxx

### original cost

*Historical cost.*

### outgo

A colloquialism usually used to refer to an *expenditure* (or to expenditures collectively); may also refer to *expenses*.

### outlay

*An expenditure.*

### out-of-pocket expense

An *expense* associated with a particular activity; in the absence of the activity, the expense would not be expected to occur. For example, a consultant often charges a client a fee plus out-of-pocket expenses, meaning that in addition to the consultant's fee the client is expected to pay for the consultant's travel, lodging and meals while away from home, long distance telephone charges, and other incremental expenses that the consultant might incur while working on the engagement.

### outstanding check

A check that has been written and released by the maker but which has not cleared the bank on which it is drawn as of the date in question (usually the date of a *bank reconciliation*).

### outstanding stock

*Stock* that has been issued and is held by persons or organizations outside the issuing corporation.

### overapplied overhead

An excess of *factory overhead* applied (charged to *work-in-process inventory*) over the actual overhead for a period.

### overdraft

A check drawn on a bank account that reduces that account balance below zero. The bank may or may not choose to honor such a check. See also *NSF check*.

### overhead

See *factory overhead*.

### overhead application rate

An amount per unit of a base or application factor, used to assign *factory overhead* costs to manufactured products.

For example, if *direct labor* hours are chosen as the application factor, 20,000 direct labor hours are expected to be worked during the coming year, and total factory overhead for the year is estimated at \$30,000, then the overhead application rate would be \$30,000/20,000, or \$1.50 per direct labor hour. A job requiring 10 direct labor hours would be assigned  $10 \times \$1.50$ , or \$15 in factory overhead costs.

### overhead efficiency variance

In a *standard cost system*, the difference between standard units of the overhead application base factor (such as direct labor hours) allowed for production achieved and actual units of the base factor, multiplied by the standard variable overhead application rate. An unfavorable overhead efficiency variance suggests that additional overhead costs were incurred because of inefficient management of the base factor; a favorable variance suggests that overhead costs were reduced because of efficient management of the base factor.

### overhead rate

See *overhead application rate*.

### overhead spending variance

In a *standard cost system*, the difference between allowed and actual *variable overhead*, due to differences between actual and budgeted prices for overhead items and to efficient or inefficient consumption of overhead items.

### overtime

Hours worked beyond a normal shift or work period (usually eight hours per day).

### overtime premium

An amount in addition to the normal hourly rate for *overtime* hours worked. The overtime premium is usually one-half of the normal rate; that is, pay for overtime is one and one-half times the normal rate.

### owners' equity

The interest of the owners of a company in its assets, derived from amounts invested by the owners plus profits retained in the business. Owners' equity appears on the *balance sheet*; the accounts that make up owners' equity have normal credit balances.

P

**PA**

*Public accountant.*

**Pacioli**

Frater Luca Bartolomes Pacioli, the mathematician often referred to as the father of accounting because he published, in 1494, the first treatise synthesizing the practice of double-entry bookkeeping. Some controversy exists over the spelling of his name.

**paid-in capital**

The portion of *owners' equity* that has been paid in directly by the owners (generally through purchase of stock), as opposed to earned profits retained in the business (*retained earnings*). Paid-in capital includes proceeds from the sale of both preferred and common stock; the excess of these proceeds over par value of the stock is called *additional paid-in capital*.

**paid-in surplus**

See *additional paid-in capital*. Accountants generally avoid using the word "surplus" because of its confusing connotations.

**paper profits**

An excess of the current market value over the original cost of assets, especially securities and inventories. Paper profits may disappear if the market value declines or may be realized if the assets are sold while the market price is still above cost.

**par**

See *par value*.

**par value**

An arbitrary value set as the face amount of a security.

**parent company**

A company that owns a controlling interest (over 50% of the outstanding shares) of one or more *subsidiary companies*.

**participating preferred stock**

*Preferred stock* that is not limited in dividends to a stated rate but may instead "participate" with common stock in additional dividends declared. The usual provision is for preferred stock to receive a stated dividend rate, with any additional dividends that are declared to be shared proportionately by preferred and common stock.

**partnership**

A business owned by two or more persons who share authority and responsibility. A partnership may be distinguished from a *corporation* by the absence of transferable ownership shares and of a state charter and by the unlimited liability of each partner (each partner may be held fully liable for the partnership's debts, regardless of the amount of the partner's capital contribution).

**past service cost**

*Pension cost* related to service by employees for periods prior to the adoption of a pension plan. Ref.: APB Opinion No. 8.

**patent**

An exclusive right to the use, production, sale, and control of a product or process, granted by the US Patent Office for a period of 17 years. A patent is accounted for as an *intangible asset*.

**payback method**

A widely used technique for evaluating

**pension plan**

long-term investments (*capital expenditures*) in which the *payback period* is calculated by dividing the invested amount by the annual cash flow. For example, an investment costing \$10,000 with an expected annual cash flow of \$2,000 has a payback period of \$10,000/\$2,000, or five years.

**payback period**

The length of time required for recovery of the amount invested in a project. See also *payback method*.

**payroll costs**

Wages, salaries, and *payroll taxes*.

**payroll journal**

See *payroll register*.

**payroll register**

A record of payroll details including employee's name, hours worked (for hourly employees), gross pay, deductions, and net pay. Totals for a payroll period are posted to individual accounts such as Salaries Expense, Federal Income Tax Withheld, and Cash.

**payroll taxes**

The employer's share of taxes associated with employee compensation, including employer's Social Security contribution (see *FICA tax*) and *unemployment tax*.

**P/E ratio**

*Price-earnings ratio*.

**pegboard system**

See *one-write system*.

**pension cost**

The *cost of a pension plan* for the current period. The current pension cost in-

cludes an amount based on the estimated future pension payments to employees for current service and may include, for a relatively new plan, an amount to reflect any previously unrecorded obligation for the past service of employees. Journal entries for pension costs depend on whether the pension plan is funded or unfunded and on whether it is maintained by the company or by an outside agency or trustee. If the plan is unfunded, the periodic entry is

Pension Expense	xxx
-----------------	-----

Liability under Pension	
-------------------------	--

Plan	xxx
------	-----

A funded plan maintained internally requires the same entry to recognize expense, plus the following entry as payments are made into the fund:

Pension Fund	xxx
--------------	-----

Cash	xxx
------	-----

If the fund is maintained outside the company, periodic payments to the agency or trustee require the following entry:

Pension Expense	xxx
-----------------	-----

Cash	xxx
------	-----

Ref.: APB Opinion No. 8.

**pension fund**

Resources accumulated for the purpose of paying benefits to employees upon their retirement, disability, or death. The fund may be administered by the company establishing the *pension plan*, by a trustee, or by an insurance company or other agency.

**pension plan**

An arrangement for the accumulation of resources to be paid to employees upon their retirement, disability, or death. Resources may be contributed to a *pension fund* by the employer or by the employer and the employee.

**per diem**

A charge or allowance based on the number of days or hours involved. For example, a certified public accountant's per diem billing rate may be stated as \$100 per hour.

**percentage depletion**

*Depletion* based on a percentage of gross income earned during the period from a natural resource, without reference to the cost of the resource. Contrast with *cost depletion*.

**percentage-of-completion method.**

A method of accounting for long-term projects (usually construction projects) in which a portion of estimated total profit is recognized each period based on the estimated percentage of the project completed during that period. Contrast with the *completed-contract method*.

**performance audit**

A review of a governmental program to determine whether it is effectively meeting its objectives. For example, a training program for unskilled workers may be advocated in a city as a means of reducing unemployment and providing industry with more employable workers. A performance audit of such a program takes into consideration the promised benefits of the program in relation to the actual results and costs.

**period cost**

A cost of being in business during a time period, such as rent or insurance. Contrast with *product cost*.

**periodic inventory method**

An inventory accounting system in which inventory cost is determined at periodic intervals, usually monthly or annually, by first determining quantities by a *physical inventory* and then applying appropriate unit costs to arrive at a total inventory cost. Contrast with *perpetual inventory method*.

**periodicity concept**

A fundamental assumption in accounting that the life of a company or other entity may be divided into periods, such as years or months, for the purpose of determining and reporting the results of operations.

**permanent file**

A set of documents, notes, reports, and data accumulated for a continuing *audit* client, maintained as long as the client is retained, and used in planning and conducting each year's audit. The permanent file may contain prior years' financial statements, copies of the corporation's charter and bylaws, relevant extracts of board of directors and stockholders meetings, and similar material of continuing interest to the auditor.

**perpetual inventory method**

An inventory accounting system in which a running balance of inventory quantity and cost is maintained by updating the inventory record after each receipt and each usage or issuance of inventory. Contrast with *periodic inventory method*.

**personal financial statement**

A *financial statement* prepared for an individual, as distinguished from one prepared for a company or other organization.

**personal property**

All resources other than land, land improvements, and buildings (*real property*). Personal property includes all movable property, notes and accounts receivable, and other claims and rights.

**personal property tax**

A *property tax* assessed or charged on *personal property*.

**PERT**

*Program evaluation and review technique*.

**petty cash**

Any small fund of cash; usually maintained as an *imprest account* and reimbursed periodically up to a specified balance, the reimbursement being supported by petty cash vouchers and receipts for the amount spent since the previous reimbursement. Petty Cash is a *current asset* account with a normal debit balance.

**physical inventory**

A procedure for determining inventory quantities on hand by physically counting them; the quantities are then multiplied by unit costs to arrive at total inventory cost.

**piecemeal opinion**

An opinion given by an auditor on the fairness of presentation of identified individual items in financial statements. The piecemeal opinion was formerly used in certain cases where a *disclaimer* or *adverse opinion* was issued on the financial statements taken as a whole, but it is no longer allowed under *generally accepted auditing standards*.

**PL/1**

A computer programming language (*Programming Language 1*).

**planning-programming-budgeting**

See *planning-programming-budgeting system*.

**planning-programming-budgeting system (PPBS)**

A set of procedures used in government agencies that provide for the identification of objectives and goals, the design of programs to achieve these goals, and the development of *program budgets* in which each program is treated as an entity. For example, most university budgets classify expenditures by department and by object, such as salaries, supplies, utilities, travel. The objectives of a university generally include education, research, and service; but the budget is not classified in a way that would show the expenditures for each of these functions. With PPBS, separate budgets would be developed for the education, research, and service programs. Budgets could also be developed for subprograms, such as community extension services, undergraduate education, or accounting research.

**plant and equipment**

*Fixed assets* used in operations.

**plant capacity**

See *capacity*.

**pooling-of-interest method**

A method of accounting for a combination of two or more previously existing companies, by combining assets, liabilities, and owners' equity of the original companies. Contrast with the *purchase method*. Ref.: APB Opinion No. 16.

**position statement**

See *balance sheet*.

**positive confirmation**

A letter or form mailed by a company, on behalf of its *auditors*, asking selected customers with outstanding balances to compare the balance shown with their own records and to notify the auditors whether it is correct. A response is requested whether the balance is correct or not. Contrast with a *negative confirmation*.

**post**

To record an amount from a *journal entry* into an *account* in a *ledger*. See also *posting*.

**post closing trial balance**

A *trial balance* prepared after *closing entries* have been made and posted, to verify that the accounts still balance. The postclosing trial balance contains only balance sheet accounts, since the closing process reduces balances of revenue and expense accounts to zero.

**posting**

The process of recording amounts from *journal entries* into *accounts* in a *ledger*. For example, the journal entry

Cash	100
Accounts Receivable	100

would require posting \$100 on the debit side of the Cash account and \$100 on the credit side of the Accounts Receivable account.

**PPB**

Planning-programming-budgeting; see *planning-programming-budgeting system*.

**PPBS**

Planning-programming-budgeting system.

**predetermined overhead rate**

See *overhead application rate*.

**preemptive right**

A privilege usually possessed by a shareholder to purchase shares from any new issue, sufficient to maintain his ownership proportion. Thus a shareholder who owns 3% of a corporation's outstanding shares would have a preemptive right to purchase at least 3% of any new issue of stock.

**preferred creditor**

A *creditor* who has a right to payment or satisfaction before other, nonpreferred creditors are paid. Preference ranking of creditors is often set by statute and is important primarily during bankruptcy proceedings.

**preferred stock**

A class of *stock* that carries with it some form of preference over *common stock*, such as a right to dividends before any are paid on common stock or priority with respect to asset distribution upon liquidation of the company. On the other hand, voting rights, including the right to elect members of the board of directors, are often restricted to common stock.

**premium**

(1) An amount over and above a specified face, stated, or par value. For example, a share of \$10 par value stock issued at \$18 results in an \$8 premium. (2) A payment made for insurance coverage. (3) A prize used in a marketing program to stimulate sales.

**premium on bonds payable**

The amount by which proceeds from issuance of bonds exceed the face amount

or *par* value. The premium is written off or amortized over the life of the bonds by reducing periodic interest expense. The entry to record issuance of bonds at a premium is

Cash	xxx	
Premium on Bonds Payable		xxx
Bonds Payable		xxx

The entry to write off the premium each period is

Premium on Bonds Payable	xxx	
Bond Interest Expense		xxx

Premium on Bonds Payable is added to the balance of Bonds Payable on the balance sheet and has a normal credit balance.

**premium on common stock**

An amount received upon the issuance of *common stock* over and above the *par value* or *stated value* of the stock. The premium account constitutes *additional paid-in capital*. Premium on Common Stock is an *owners' equity* account with a normal credit balance. Issuance of common stock at a premium calls for the following journal entry:

Cash	xxx	
Common Stock		xxx
Premium on Common Stock		xxx

**premium on preferred stock**

An amount received upon the issuance of *preferred stock* over and above the *par value* of the stock. The premium account constitutes *additional paid-in capital*. Premium on Preferred Stock is an *owners' equity* account with a normal credit balance. Issuance of preferred stock at a premium calls for the following journal entry:

Cash	xxx	
Preferred Stock		xxx
Premium on Preferred Stock		xxx

**prepaid expense**

An expense paid in advance of its actual incurrence. For example, rent and insurance premiums are often paid in advance of the periods covered. Prepaid Expenses is a *current asset* account with a normal credit balance. When expenses are paid in advance, the following journal entry is made:

Prepaid Expenses	xxx	
Cash		xxx

**present value**

The result of discounting one or more amounts to be received or paid in the future by a *discount rate*; the amount that must be invested today at a specified interest rate to accumulate to one or more future payments. For example, \$100 invested today at 6% will amount to \$106 at the end of one year; therefore the *present value* of \$106 due at the end of one year is \$100. The present value of a single future amount is calculated by the formula

$PV = A \div (1 + r)^n$ , where PV = present value, A = amount to be received or paid in the future, r = discount rate, n = number of periods until the future amount is to be received or paid.

**present value analysis**

A method of evaluating long-term decisions, especially *capital expenditure* decisions, by explicitly taking into account the time value of money (recognizing that an amount due at any time in the future is worth less than that same amount due today as long as positive investment opportunities exist).

**price variance**

See *material price variance*.

**price-earnings ratio**

The market price of a share of stock divided by the company's *earnings per share* for the preceding year.

**price-level-adjusted statements**

Financial statements in which original data have been adjusted to reflect the effects of changing price levels.

**price-level adjustments**

Changes recorded in accounts and financial statements to reflect the effects of changing price levels.

**price-level gains and losses**

Gains and losses in purchasing power due to holding money and claims to fixed amounts of money, as well as owing money, during periods of changing price levels. For example, \$1,000 borrowed at a time when the price level was 100 and repaid at a later date when the price level had advanced to 110 would be repaid with dollars having less purchasing power and would thus result in a price-level gain.

**primary earnings per share**

Net income for a year divided by the average number of shares of common stock and *common stock equivalents* outstanding during the year. See also *earnings per share*. Ref.: APB Opinion No. 15.

**prime costs**

*Direct material* and *direct labor* costs.

**prime rate**

The interest rate charged by a commercial bank to customers presenting the

least risk (generally the largest customers with the best credit ratings). Other customers are charged a higher interest rate.

**principal**

The original or face amount of a loan or investment. Generally *interest* is earned on the principal amount.

**prior-period adjustment**

A change in the income of a prior period, reported in current financial statements. The use of prior-period adjustments is severely limited under *generally accepted accounting principles*. Ref.: APB Opinion No. 9, FASB Statement No. 16.

**probability sample**

A sample in which each item or member of a finite population has a known probability of being selected.

**process costing**

A *cost accounting* system or procedure in which costs are assigned to and accumulated by department or process. Further assignment of costs to units is accomplished through an averaging process in which total costs are divided by *equivalent units* of work produced to arrive at unit cost. Contrast with *job order costing*.

**product cost**

A cost associated with production of units of product and thus "inventoriable." Contrast with *period cost*.

**product line reporting**

See *segment reporting*.

**production cost**

In the oil and gas industry, a cost of operating a producing well. Ref.: FASB Statement No. 19.

**professional ethics**

See *Code of Professional Ethics*.

**profit**

The excess of selling price over cost or, for a company as a whole, the excess of revenue over all expenses.

**profit and loss statement**

See *income statement*.

**profit and loss summary**

See *income summary*.

**profit center**

A department, division, or other organizational unit that produces revenue and for which a profit may be calculated.

**profit planning**

A form of operations planning or budgeting in which a profit objective is first established, and operations (including expense levels) are planned to achieve that objective. Profit planning may be viewed as an active form of budgeting in which a company attempts to control its environment.

**pro forma statement**

A financial statement prepared on the basis of some assumed events or transactions that have not yet occurred. For example, pro forma statements might be prepared by a company considering acquisition of another company to show the combined results of the two companies as if they had already merged.

**program budget**

In government agencies, a budget in which a program or project, rather than the entire agency, is treated as the budget entity. Thus a given agency might develop several program budgets, one for each program. See also *planning-programming-budgeting system*.

**program evaluation and review technique (PERT)**

A procedure for planning a project that involves the preparation of a network showing events and processes in relational sequence, along with estimated process times. The analysis, usually performed on a computer, can identify the critical path, which cannot be shortened through acceleration of activities and events outside the critical path and thus provides an estimate of the minimum lead time necessary for the whole project. (Some analysts consider PERT and the *critical path method* synonymous, while others use the term PERT to refer to an analysis that includes costs.)

**programmed costs**

Expenditures that are committed for some period of time and cannot readily be reduced or avoided during that period.

**property dividend**

A *dividend* paid to stockholders with resources other than cash. For example, a company ordered by a court to dispose of its investment in another company might distribute its shares in that company to its own stockholders as a property dividend; or a company could distribute a portion of its inventory to stockholders as a property dividend, to acquaint stockholders with its product and to build additional sales demand.

property, plant, and equipment

### property, plant, and equipment

*Fixed assets* used in operations.

### property tax

A tax on the owners of property and based on the value of that property.

### proprietorship

Ownership interest in a company, see *owners' equity*. See also *sole proprietorship*.

### prospectus

A booklet containing information about a prospective securities offering and data on the offering company, including financial statements. The prospectus is included with the *registration statement* filed with the Securities and Exchange Commission in connection with the offering. A preliminary prospectus, called a *red herring* because of the label "Preliminary Prospectus" stamped in red ink across the front, may be made available to interested parties.

### provision

A term usually used in accounting to denote an expense. For example, "provision for income taxes" typically indicates the income tax expense for the period. Other meanings are possible and must be determined in the particular circumstances.

### provision for bad debts

See *bad debt expense*.

### provision for depreciation

See *depreciation expense*.

### provision for doubtful accounts

See *bad debt expense*.

### provision for income taxes

See *income tax expense*.

106

### provision for uncollectible accounts

See *bad debt expense*.

### proxy

Authority for one person to act for another. The management of a corporation usually solicits proxies from stockholders who do not expect to attend the corporation's annual stockholders' meeting. Occasionally opposing factions conduct a "proxy fight," each side soliciting proxies in support of its position.

### proxy statement

A statement required under Securities and Exchange Commission regulations whenever a *proxy* is solicited from stockholders of a corporation.

### public accountant

A person licensed by a state to use the designation PA and to practice *public accounting*. Requirements for licensing as a PA are less rigorous than those for a *certified public accountant*. While some states are still licensing new PAs, many are granting no new licenses while allowing those previously licensed to continue practicing.

### public accounting

The provision of accounting services, especially *audits* of financial statements, to the public (including individuals, partnerships, corporations, and other organizations) for a fee. In the United States public accounting can be practiced only by *certified public accountants* and licensed *public accountants*.

### public interest accounting

Accounting activities, usually performed by volunteer accountants at no charge, in behalf of individuals and organiza-

purchasing power

tions unable to pay a normal professional accounting fee; accounting analysis of issues affecting the public interest. Examples of public interest accounting include volunteer tax advice and assistance to low-income individuals, design of an accounting system for a small minority-owned business, analysis of the need for a proposed public utility rate increase, and estimation of the costs and benefits of a proposed public transportation system. See also *Accountants for the Public Interest*.

### purchase discount

A *cash discount* earned by a purchaser for payment within a specified period. The Purchases Discounts account has a normal credit balance and is deducted from the Purchases account balance or reported separately as Other Income on an income statement. Purchase discounts are recorded when the account is paid, as follows:

Accounts Payable	xxx
Purchases Discounts	xxx
Cash	xxx

### purchase method

A method of accounting for a combination of two or more previously existing companies, under which one company is considered to have purchased the assets of the other company or companies. Contrast with the *pooling-of-interest method*. Ref.: APB Opinion No. 16.

### purchase order

An order issued by a buyer to a seller for the purchase of specified goods or services. No journal entry is made by the buyer when the purchase order is issued; the journal entry is not made until the goods are received.

107

### purchases

An account used to record the acquisition of merchandise for resale or raw materials for use in the manufacturing process. The account Purchases has a normal debit balance. Acquisitions of merchandise or raw materials are recorded as follows:

Purchases	xxx
Accounts Payable (or Cash)	xxx

A Purchases account is used only in conjunction with a *periodic inventory* system; with a *perpetual inventory* system acquisitions are recorded directly in the inventory account.

### purchase journal

A *special journal* used exclusively for recording purchases of merchandise on account. The total of the purchases journal is posted as a debit to Purchases and a credit to Accounts Payable.

### purchasing power

The command over goods and services by a unit of money. During periods of inflation the purchasing power of the dollar (or other monetary unit) falls; thus a dollar in 1980 would purchase fewer goods and services than a dollar in 1960.



Q

qualification

**qualification**

A departure from the standard wording of the auditor's opinion. See also "*except for*" opinion, "*subject to*" opinion.

**qualified audit report**

See *qualified opinion*.

**qualified opinion**

A certified public accountant's *audit opinion* on a company's financial statements that departs from the *standard opinion* in some respect. See also "*except for*" opinion, "*subject to*" opinion.

**quantity discount**

A reduction in selling price granted for purchasing a specified minimum quantity.

**quantity variance**

See *material quantity variance*.

**quarterly report**

An abbreviated form of a company's *annual report*, issued every three months between annual reports; an *interim report*. A quarterly report usually includes unaudited financial statements and a brief, narrative review of operations.

**quasi reorganization**

A procedure, adopted by a corporation and approved by its stockholders, under which a deficit (negative balance) in *retained earnings* is eliminated by writing down the paid-in capital accounts. In the process any overvalued assets must also be written down. Ref.: ARB 43, chap. 7A.

**queuing theory**

A mathematical approach to problems that involve queues or lines waiting to

110

be serviced, such as the staffing of supermarket checkout counters or assembly line scheduling. Also called waiting-line theory.

**quick assets**

Cash, marketable securities, and receivables. Quick assets are highly liquid assets and are compared to current liabilities in calculating quick ratio, or *acid-test ratio*.

**quick ratio**

See *acid-test ratio*.

R

**random access**

A feature of a computer system that permits data to be written directly into and retrieved from a location in memory, without the necessity of proceeding serially through other data or memory locations.

**random sample**

A selection of items made in such a manner that all items in the group (population) have an equal chance of being selected. The significance of random sampling is that no item or characteristic is favored in advance. For example, in a class of students composed equally of men and women, a random sample would not favor either men or women.

**rate of exchange**

See *exchange rate*.

**rate variance**

See *labor rate variance*.

**raw materials**

Substances, such as sheet metal and lumber, used in the manufacture of products. See also *raw materials inventory*.

**raw materials inventory**

The supply of materials or substances, used in the manufacture of products, on hand and owned by a company. Raw Materials Inventory is a *current asset* with a normal debit balance. When the *perpetual inventory* method is used, two types of journal entries affect the account. Purchases of raw materials are recorded as follows:

Raw Materials Inventory	xxx
Accounts Payable (or	
Cash)	xxx

As materials are issued into production,

the entry is

Work-in-Process Inventory	xxx
Raw Materials Inventory	xxx

When the *periodic inventory method* is used, no entries are made affecting Raw Materials Inventory during the period; a *closing* entry is used to replace the beginning inventory with the ending inventory.

**RBP**

*Registered business programmer.*

**readjustment**

See *quasi reorganization*.

**real account**

An account that is continued from one period to the next; a balance sheet account. Contrast with a *nominal account*.

**real property**

Land, land improvements, and buildings. Contrast with *personal property*.

**realization**

The earning of *revenue*, accompanied by its recognition in the accounts. Many activities are involved in the production and sale of goods and the collection of the sale proceeds. Since these activities often occur over a period of time, several alternatives are presented for the timing of revenue recognition. In most cases revenue is considered to be realized when a sales agreement is reached between buyer and seller and the seller has met all the conditions imposed by that agreement (such as producing goods to specification, delivering goods, setting goods aside for the buyer to pick up, providing installation services). See also *percentage-of-completion method*, *installment sales method*.

**realize**

See *realization*.

**receivable**

A claim against another. See also *accounts receivable*, *note receivable*.

**receivables turnover**

A measure of the rapidity with which receivables are collected, calculated as follows:

$$\text{Receivables turnover} = \frac{\text{Net credit sales for the period}}{\text{Average net receivables}}$$

The denominator is net of any allowance for bad debts and includes trade notes and accounts receivable.

**reconciliation**

An analysis of the items causing a difference between two amounts, accounts, or balances. For an example, see *bank reconciliation*.

**record**

(1) Stored information, such as an *account*. (2) To enter information on a document or into a system, as in making a *journal entry*.

**record date**

See *date of record*.

**red herring**

A preliminary *prospectus*, omitting information on offering price, commissions to dealers, and other matters related to price. The red herring may be issued before a *registration statement* with the Securities and Exchange Commission becomes effective; it is so named because red ink is used to print or stamp the words "Preliminary Prospectus" across the front page.

**reducing balance depreciation**

See *declining balance depreciation*.

**registered business programmer (RBP)**

A professional designation awarded by the Data Processing Management Association to one who passes an examination covering principles of programming, programming language translators, problem-oriented languages, design of data processing systems, and computational topics.

**registrar**

An agent of a corporation who must approve the issuance of shares of stock and must authenticate the stock certificates. The registrar protects shareholders against fraudulent or improper issuance of stock. The registrar may also serve as *transfer agent*.

**registration statement**

A report filed by a corporation or a national security exchange with the *Securities and Exchange Commission*, providing information about the registering organization for public inspection. The most common registration forms for corporations are the *S-1*, *8-K*, *10-K* and *10-Q*.

**regression analysis**

Measurement of the amount of change in a dependent variable associated with changes in one or more independent variables. See also *simple regression analysis*.

**relevant cost**

A cost that should be considered in choosing among alternatives. Only those costs *yet to be incurred* (i.e., future costs)

that will differ among the alternatives (the *differential costs*) are relevant in decision making. Example 1: A manager is trying to choose between two pieces of equipment, both having the same monthly operating costs. Since the monthly operating costs are not differential, they are not relevant. Example 2: A machine that cost \$6,000 and has an undepreciated book value of \$2,000 requires a major repair costing \$3,000, after which the machine is expected to provide services worth \$4,000 over the remainder of its useful life. Alternatively the machine can be sold in its present condition for \$1,300. Since the original cost and the book value of the machine do not change, they are not relevant. The repair cost, expected value of future services, and present salvage value are relevant.

**relevant range**

The range of volume or activity for which estimates and projections are valid. For example, fixed costs may be projected at \$10,000 within the relevant range of 10,000 to 12,000 units. The cost projection would not necessarily hold at volume levels less than 10,000 or greater than 12,000 units.

**reorder point**

The point in time when materials or supplies are reordered, generally when materials or supplies reach a certain quantity level. This level should be sufficient to provide for usage during the *lead time* plus any desired *safety stock*.

**replacement cost**

The current cost to replace an item, taking into account normal quantity purchased, location of the purchaser, pos-

sible discounts, transportation charges, and similar factors.

**replacement value**

See *replacement cost*.

**report form**

A form of balance sheet presentation in which assets are listed at the top, followed by liabilities and owners' equity. Contrast with *account form*.

**representation letter**

A letter from an officer of a client company to the external auditor providing assertions or "representations" about certain matters of interest, such as acknowledgment of management's responsibility for the financial statements, completeness of minutes of board of directors' meetings provided to the auditor, and events subsequent to the financial statement date.

**research and development costs**

Costs of investigation, experimentation, analysis, testing, and the like, intended to create new products, improve existing products, develop better procedures, or discover useful information. Research and development costs should not be recorded as an asset but should be charged to expense as incurred. Ref.: FASB Statement No. 2.

**reserve**

Generally, an amount appropriated or allowed in anticipation of possible future events, such as a Reserve for Contingencies or Reserve for Warranty Claims. This term is much abused, and its specific meaning must always be determined from the context. For example, some companies report a Reserve for Depre-

ciation (preferred terms: Allowance for Depreciation or Accumulated Depreciation), Reserve for Bad Debts (preferred terms: Allowance for Doubtful Accounts or Allowance for Bad Debts), Reserve for Income Taxes (if this is an actual liability, the preferred term is Income Taxes Payable), and various appropriations of Retained Earnings (preferably, Appropriations).

**reserve for bad debts**

See *allowance for doubtful accounts*.

**reserve for contingencies**

An appropriation of retained earnings for possible future events of a negative nature, such as lawsuits or natural disasters. See *appropriated retained earnings*.

**reserve for depreciation**

See *accumulated depreciation*.

**reserve for encumbrances**

In government accounting, an account used to identify the portion of a fund balance that has been committed (encumbered) through purchase orders, contracts, salary agreements, and the like. As an illustration, assume that a fund was originally appropriated \$100,000 and that expenditures to date total \$60,000, leaving a "free" balance of \$40,000. The agency now contracts for building repairs at an estimated cost of \$10,000 and "encumbers" funds with the following journal entry:

Encumbrances	10,000
Reserve for Encumbrances	10,000

At this point the fund has a free balance, which may be committed further, of only \$30,000. The repairs are completed and a bill for \$9,250 is received, resulting in

these entries:

Reserve for Encumbrances	10,000	
Encumbrances		10,000
Expenditures	9,250	
Vouchers Payable		9,250

When the liability is paid, the final entry is made:

Vouchers Payable	9,250	
Cash		9,250

**residual income**

Income accruing to *common stock* after allowing for prior or senior claims such as *interest on bonds* and *dividends on preferred stock*.

**residual value**

The amount expected to be obtained when a *fixed asset* is disposed of at the end of its useful life (also called disposal value and salvage value). Residual value must be estimated in order to calculate periodic *depreciation*.

**responsibility accounting**

A system in which costs are allocated to and reports are prepared for *responsibility centers*, with the objective of controlling costs by assigning responsibility for specific costs to individual managers.

**responsibility center**

An organizational unit with responsibility for control of costs and, in some cases, revenue. See also *responsibility accounting*.

**restructuring of debt**

See *troubled debt restructuring*.

**retail method**

A procedure for estimating inventory cost using an estimated or historical markup rate. The inventory is first de-

terminated at retail value by deducting sales from the retail value of goods available for sale; this result is then reduced by the markup rate on sales price. The retail method is favored by retail establishments, such as department stores, for estimating inventory cost for *interim statements*. As an example, assume that the historical markup rate has been 20% of sales price, sales for the first quarter were \$10,000, and the retail value of goods available for sale (beginning inventory plus purchases) is \$14,000. The estimated retail value of ending inventory would be \$14,000 - \$10,000, or \$4,000; its estimated cost would then be \$4,000 - 0.20 (\$4,000), or \$3,200.

### retained earnings

The amount of earnings retained (reinvested) in a corporation and not distributed to stockholders in the form of dividends; sometimes called Earnings Retained in the Business or Earned Surplus (this latter term is not favored by accountants because it implies that there is a "surplus" over and above the company's needs). Retained Earnings is an owners' equity account with a normal credit balance. A number of journal entries can affect the account. The entry to close the period's net income into Retained Earnings is

Income Summary	xxx
Retained Earnings	xxx

A declaration of dividends is recorded:

Retained Earnings	xxx
Dividends Payable	xxx

(In the latter case, a Dividends account may first be debited and subsequently closed to the Retained Earnings account.)

### retained income

See *retained earnings*.

### retirement

Disposition of an asset at the end of its useful life. A retirement is recorded in the accounts by removing both the asset balance and the amount of accumulated depreciation related to the asset, recording any proceeds, and reflecting any gain or loss. If nothing is received upon retirement of a fully depreciated piece of equipment, the asset and accumulated depreciation accounts are simply offset, as follows (assuming \$10,000 original cost):

Accumulated Depreciation, Equipment	10,000	
Equipment		10,000

### return on investment (ROI)

The amount earned per year on an *investment*, usually expressed as a percentage:

$$ROI = \frac{\text{Earnings for the period}}{\text{Investment}} \times 100$$

### return on sales

The amount earned in relation to the level of sales for a period, usually expressed as a percentage:

$$\text{Return on sales} = \frac{\text{Net income for the period}}{\text{Net sales for the period}} \times 100$$

### revaluation surplus

An element of owners' equity arising when fixed assets are revalued upward. Revaluation Surplus is an *owners' equity* account with a normal credit balance. Ref.: APB Opinion No. 6, par. 17.

### revenue

The inflow of resources to a business for a period, from sale of goods or the provision of services. The resources are generally in the form of cash and notes or accounts receivable. Revenue does not include resources received from sources other than operations, such as the sale of fixed assets, issuance of stock, or borrowing.

### revenue bond

A *bond* issued by a governmental authority for which principal and interest payments are made from revenue earned by a specified government-owned enterprise. For example, a city-owned water utility might issue revenue bonds and pay principal and interest from revenue earned.

### revenue realization

See *realization*.

### reversing entry

A *journal entry* made to eliminate or undo the effect of a previous period's *adjusting entry* so that subsequent transactions may be recorded in a routine and consistent manner. For example, assume that the following adjusting entry has been made at the end of an accounting period to recognize unpaid salaries accrued:

Salaries Expense	xxx
Salaries Payable	xxx

The next payroll straddles two accounting periods and, without a reversing entry, requires the following journal entry:

Salaries Payable (for the amount previously accrued)	xxx
Salaries Expense (for the portion falling within the current accounting period)	xxx
Cash	xxx

This entry requires analysis of the payroll and attention to previous adjusting entries made and may be confusing to a bookkeeper. Consequently the company may reverse this kind of adjusting entry at the beginning of the subsequent period, as follows:

Salaries Payable	xxx
Salaries Expense	xxx

When the next payroll is prepared, the entire amount may be debited to Salaries Expense, with the result that the net expense shown in the succeeding period will be the correct amount for that period.

### right, stock

See *stock right*.

### RMA

*Robert Morris Associates*.

### Robert Morris Associates (RMA)

A national association of commercial bank loan and credit officers with the objective of promoting "continuous improvements in principles and practices of commercial lending, loan administration, and asset management in commercial banks." The organization takes its name from Robert Morris, a signer of the Declaration of Independence and a financier of the Revolutionary War.

### Robinson-Patman Act

An act of Congress passed in 1936 that specifies certain "unfair" and thus illegal business practices, including price discrimination that cannot be justified by cost differentials.

### ROI

*Return on investment*.

**royalty**

A share of revenue or profit derived from a property (such as a mine, patent, or book) paid to the owner or creator of the property.

**“rubber” check**

A check that is not covered by an adequate balance in the bank; an *NSF check*.

**rule**

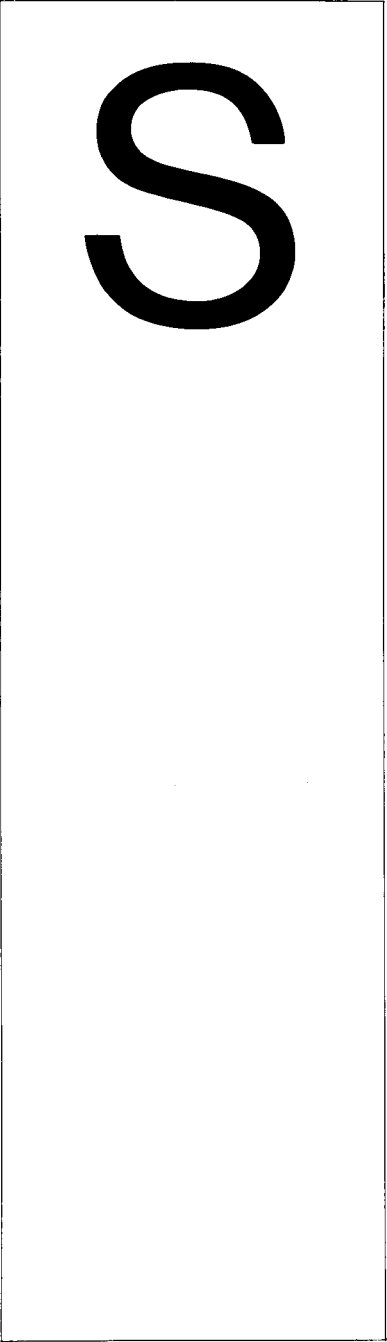
To indicate the bottom of a column of figures or the closing of a ledger *account* by drawing one or more lines across the bottom of number columns. A single ruling (one line) or a double ruling (two lines) may be used.

**rule of 72**

A technique for estimating the approximate number of years required for an amount invested at *compound interest* to double; simply divide 72 by the interest percentage. For example, an investment at 8% interest compounded annually will double in approximately nine years.

**ruling**

A line or lines drawn across the bottom of a column of figures. See also *rule*.



**S-1**

A form or statement that must be filed with the Securities and Exchange Commission before a company's securities may be listed and traded on a national securities exchange. The statement includes information on the nature and history of the company's business, its capital structure, important contracts, compensation of officers and directors, details of the securities being issued and the use to which the proceeds will be put, and financial statements. The S-1 is available for inspection by the public at the SEC.

**safety stock**

A reserve supply of material maintained to allow for above-normal usage during the *lead time* required for receipt of an order or completion of a production run.

**sale**

The delivery of goods in return for other resources, such as cash or a promise to pay cash (a receivable). The account Sales or Sales Revenue is a *revenue* account with a normal credit balance. A sale is recorded by the entry

Cash (or Accounts Receivable)	xxx
Sales	xxx

When a perpetual inventory system is used for goods available for sale, an additional entry is made to record the cost of the sale:

Cost of Goods Sold	xxx
Merchandise (or Finished-Goods) Inventory	xxx

**sale and leaseback**

A transaction in which property is sold and then leased back by the seller.

**sales**

An *account* reflecting *revenue* from the sale of goods for the period to date. Sales is a *revenue* account with a normal credit balance. See also *sale*.

**sales discount**

A *cash discount* granted by a seller for payment by the purchaser within a certain period. (On the books of the purchaser, a sales discount is called a *purchase discount*.) The Sales Discounts account has a normal debit balance and is reported in the seller's income statement as a deduction from gross sales. Sales discounts are recorded when payment is received on account, as follows:

Cash	xxx
Sales Discounts	xxx
Accounts Receivable	xxx

**sales journal**

A *special journal* used exclusively for recording sales on credit. The total of the sales journal is posted as a debit to Accounts Receivable and a credit to Sales.

**sales returns and allowances**

Refunds or credits granted to customers for goods that are returned, damaged in shipment, or do not meet quality specifications. The Sales Returns and Allowances account has a normal debit balance and is usually treated as a contra sales account and deducted from gross sales, although it is sometimes classified as a selling expense. A return or allowance is recorded as follows:

Sales Returns and Allowances	xxx
Cash (or Accounts Receivable)	xxx

**sales tax**

A tax based on the amount of a sale and collected by the seller from the customer; total collections (reduced by a fee allowed to the seller in some states) are periodically remitted to the state or other taxing authority. Sales taxes should be included by the buyer in the cost of goods acquired. They are not revenue to the seller, however, but should instead be recorded by the following journal entry:

Cash (or Accounts Receivable)	xxx
Sales Taxes Payable	xxx

**sales-type lease**

See *capital lease*.

**salvage value**

See *residual value*.

**sample**

(1) A selection of a limited number of items from a larger group (population).  
(2) To select items from a larger group. See also *random sample*.

**sampling**

The process of selecting a limited number of items (the sample) from a larger group (the population). See also *statistical sampling*, *sampling for variables*, *sampling for attributes*, *discovery sampling*, *random sample*.

**sampling for attributes**

*Sampling* undertaken to estimate the percentage of items in a group (population) that possess a specified attribute. Auditors, for example, might use sampling for attributes to estimate the number of invoices in a file that were not properly approved. Contrast with *sampling for variables*.

**sampling for variables**

Sampling undertaken to estimate the value of a specified variable for a group of items (population). The variables of interest are usually either the average value (mean) or the total for a population. An auditor might use sampling for variables to estimate the total cost of a large group of parts in inventory, by first selecting a small number (a sample), investigating the cost of each item selected, and then making prescribed statistical calculations to develop an estimated range or interval for the total value.

**SAS**

*Statement on Auditing Standards*.

**scrap value**

See *residual value*.

**scope**

The breadth of responsibility accepted by an auditor in performing an *audit*, expressed in the scope paragraph, usually the first paragraph, of an *audit opinion*.

**SEC**

*Securities and Exchange Commission*.

**secret reserves**

See *hidden reserves*.

**Securities and Exchange Commission (SEC)**

The federal agency with responsibility for overseeing and regulating financial reporting by larger corporations. The SEC was originally established by Securities Exchange Act of 1934, to enforce that law and the Securities Act of 1933.

**security**

(1) A bond, share of stock, or similar instrument providing an interest in or a claim against an enterprise and its resources. (2) Property that is pledged against a debt and which can be claimed by the lender if the borrower does not pay the debt when due.

**segment margin**

The contribution to company-wide profits provided by a segment (such as a product or product line, territory, department, division, or subsidiary company), reflecting the excess of segment revenue over expenses directly attributable to that segment.

**segment reporting**

A form of financial reporting in which information is provided for identifiable components, or segments, of a company. A manufacturer of motor vehicles, for example, might provide information for domestic and foreign sales; truck, automobile, bus, and utility vehicle product lines; government, industrial, and consumer sales. Information provided might include revenue, income, and assets for each segment, or complete financial statements might be presented for certain segments. Ref.: FASB Statement No. 14, APB Opinion No. 30.

**self insurance**

The practice of undertaking to absorb casualty and disaster losses internally, without buying insurance for such losses from an insurance company. Self-insurance is usually reflected in *appropriated retained earnings* or some other suitably titled owners' equity or liability account.

**selling and administrative expense**

A section often used on an income statement to show combined *selling expense* and *administrative expense*.

**selling expense**

An *expense* incurred in promotion, marketing, and distribution activities; examples include advertising, sales commissions, and product shipping costs. Contrast with *manufacturing cost*, *administrative expense*.

**semivariable cost**

See *mixed cost*.

**senior accountant**

An experienced staff member of a public accounting firm who has responsibility for directing and supervising engagements with one or more clients. A senior accountant is below the level of partner.

**senior security**

A security with rights that take precedence over those of other securities in a given capital structure. For example, in case of bankruptcy a bondholder is entitled to payment before any distribution is made to stockholders; bonds are thus senior to common stock. Contrast with *subordinate security*.

**serial bond**

A bond issued under a bond contract calling for redemption in a series of payments. For example, a \$100,000 serial bond issue might call for redemption of \$10,000 worth of bonds every year for ten years.

**share**

A unit of ownership interest in a corporation.

**shareholder**

See *stockholder*.

**shrinkage**

An inventory loss over time not due to normal use or to sale of goods. Inventory shrinkage may be caused by theft, evaporation, failure to empty containers completely, melting, and the like.

**significance test**

In statistics, a procedure for determining whether the difference between two or more statistics, or between a statistic and zero, is significant, that is, too large to be reasonably attributable to chance.

**simple interest**

An amount of *interest* calculated only on the *principal* and not compounded. Contrast with *compound interest*.

**simple linear regression**

See *simple regression analysis*.

**simple regression analysis**

*Regression analysis* involving one independent variable. In simple linear regression, the dependent variable  $Y$  is estimated with the equation  $Y = a + bX$ , where  $X$  is the independent variable,  $b$  is the change in  $Y$  associated with a change of one unit in  $X$ , and  $a$  is a constant, or the estimated value of  $Y$  when  $X = 0$ . Given a set of values for  $X$  and  $Y$ , the coefficients  $a$  and  $b$  can be estimated with the following equations:

$$a = \frac{(\Sigma Y)(\Sigma X^2) - (\Sigma X)(\Sigma XY)}{n(\Sigma X^2) - (\Sigma X)^2}$$

$$b = \frac{n(\Sigma XY) - (\Sigma X)(\Sigma Y)}{n(\Sigma X^2) - (\Sigma X)^2}$$

**simulation**

A technique in which the key elements of a system (such as a process, a machine, or an organization) are modeled, and the model variables are then manipulated to evaluate the effects of alternatives. One increasingly important form of simulation is the corporate financial model, in which the financial relationships of a corporation are estimated and manipulated by a computer program to investigate the effects on outcomes, such as net profit and cash balance, of actions such as price changes and changes in advertising budgets.

**single-entry bookkeeping**

A simple system of recordkeeping in which each transaction is recorded in a single record, such as a checkbook or a list of accounts receivable. Formal journals and ledgers are not maintained and journal entries are not made. A *balance sheet* and *income statement* cannot be prepared directly from single-entry records, but an accountant can usually review such records and make the summaries and adjustments necessary for the preparation of financial statements.

**single proprietorship**

See *sole proprietorship*.

**sinking fund**

A *fund* of cash, securities, or other assets accumulated by periodic contributions. Sinking funds are often established to provide for the replacement of major fixed assets (such as a plant) and for the retirement of debt.

**sinking fund method of depreciation**

A method of recording *depreciation* which allows for an interest return on



the amount invested in the asset. The sinking fund method is the same as the annuity method of depreciation except that the imputed interest is not separately recorded; refer to the example presented under *annuity method of depreciation*. With the sinking fund method the journal entry to record current depreciation would be

Depreciation Expense 78

Accumulated Depreciation 78

### slide

An error made in recording a number, due to mislocating the decimal point. For example, a slide occurs if \$122,940 is written \$12,294 or \$1,229,400.

### social accounting

(1) A field of accounting developed during the 1970s to measure and report on (a) a business or other entity's full impact on society, including effects such as pollution, discrimination, and product safety as well as financial effects; (b) the nature and impact of an entity's social responsibility activities (for example, aid to minority businesses, employee participation on company time in civic programs, and plant beautification efforts). See also *social impact statement*. (2) National income accounting, or accounting for the economic performance of a nation or society.

### social audit

A review and evaluation of a company's full impact on society or the nature and impact of its social responsibility activities. See also *social accounting*.

### social impact statement

A report of the positive and negative impacts (social benefits and social costs)

of an organization on society, including both financial impacts recognized in traditional financial statements and social impacts (such as environmental damage and discrimination). Refer to the appendix for an example.

### social responsibility accounting

See *social accounting*.

### social security

The system in the United States by which employees and employers both contribute a percentage of each period's gross pay to a national fund, which is then used to pay retirement benefits to all qualifying workers.

### social security tax

See *FICA tax*.

### socioeconomic accounting

See *social accounting*.

### software

Computer programs.

### sole proprietorship

A business firm owned entirely by one individual.

### solvency

The state of being able to pay debts as they become due. A company that is unable to meet its current obligations is said to be insolvent.

### source and application of funds

See *statement of changes in financial position*.

### source document

A document that provides the basis for a *journal entry*, such as a sales invoice or a materials requisition form.

### special journal

A record in which transactions of a specific type are recorded. Contrast with *general journal*. The most common special journals are cash receipts journal, cash disbursements journal, purchases journal, and sales journal.

### specific identification

A method of determining the cost of units sold or used in which units are uniquely and specifically identified, usually by a serial number. For example, assume that the inventory includes the following units:

Number	Cost
18A	\$325
27G	\$189

When a unit is sold, it is associated with its specific cost by the serial number; thus if unit 27G is sold first, \$189 would be charged to cost of goods sold. Contrast with *first-in, first-out*, *last-in, first-out*, and *average cost*, each of which requires a cost flow assumption.

### spending variance

See *overhead spending variance*.

### split

See *stock split*.

### spillage

In a manufacturing process, the loss due to processed units that do not meet acceptable quality standards and thus must be junked or sold for salvage or scrap.

### spread sheet

A multicolumned *worksheet* used by accountants and auditors for analysis of transactions, aging of accounts receivable, summarization of depreciation for several time periods, and similar purposes.

### SRA

Social responsibility accounting; see *social accounting*.

### standard

A target, goal, or norm. See also *standard cost*, *generally accepted auditing standards*.

### standard cost

A predetermined or budgeted cost for specific elements of production, such as direct material, direct labor, and factory overhead. See also *standard cost system*.

### standard cost accounting

See *standard cost system*.

### standard cost system

A method of accounting for production costs in which (a) standard costs are established in advance, usually based on a very good but not perfect level of performance; (b) actual costs of production are matched against standard costs and variances are developed; (c) variances are investigated, with the goal of improving future performance.

### standard cost variance

In a *standard cost system*, a statistic based on comparison of actual and standard material prices, material quantities, labor rates, labor hours, and the like. Refer to the specific variance, such as *material price variance*, *labor efficiency variance*, and *overhead spending variance*.

### standard costing

See *standard cost system*.

### standard deduction

An amount allowed as a deduction in calculating taxable income for federal income tax, for taxpayers who do not

itemize their deductions. The standard deduction is allowed even if the taxpayer has no deductible expenses.

### standard deviation

In statistics, a measure of the amount of variation in a set of data. For a population, the formula is

$\sigma = \sqrt{\sum(X - \bar{X})^2/N}$ , where

$X$  = the value of a single item in the population,

$\bar{X}$  = the mean of all items in the population,

$N$  = the number of items in the population, and

$\Sigma$  = the summation operator. (In this formula the mean is subtracted from each item, the resulting difference is squared, all the differences are summed, this sum is divided by  $N$ , and the square root of this result is calculated.)

The formula for the standard deviation of a sample is

$s = \sqrt{\sum(x - \bar{x})^2/(n - 1)}$ , where

$x$  = the value of a single observation in the sample,

$\bar{x}$  = the mean of all values in the sample,

$n$  = the number of items in the sample, and

$\Sigma$  = the summation operator.

### standard hours

See *standard labor hours*.

### standard labor hours

The number of hours of labor allowed in a *standard cost system* for production of one unit or batch of product.

### standard labor rate

The hourly wage rate allowed in a *standard cost system* for a given department or

production process. Standard labor rate multiplied by *standard labor hours* gives the total standard cost of labor for production of one unit or batch of finished goods.

### standard materials price

The cost allowed in a *standard cost system* for one unit of raw materials. Standard materials price multiplied by *standard materials quantity* gives the total standard cost of materials for production of one unit or batch of finished goods.

### standard materials quantity

The amount of a specified raw material allowed in a *standard cost system* for production of one unit or batch of finished product.

### standard opinion

The version of an *audit opinion* rendered when a certified public accountant is satisfied that the financial statements are fairly presented and are consistent with those of the preceding year, that excessive uncertainty is not present with respect to material transactions or events, and that the audit was performed in accordance with *generally accepted auditing standards*; also called a short-form opinion or a "clean" opinion. The wording recommended by the American Institute of Certified Public Accountants for the standard opinion is as follows:

We have examined the balance sheet of (company name) as of (date), and the related statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we consid-

ered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of (company name) as of (date) and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

### standard purchase price

See *standard materials price*.

### standard quantity

See *standard materials quantity*.

### standards

(1) A set of *standard costs*. (2) *Generally accepted auditing standards*.

### stated capital

*Legal capital*.

### stated value

An amount assigned, primarily for legal purposes, to common stock that does not carry a *par value*.

### statement of affairs

(1) A financial statement prepared for a company entering bankruptcy, showing assets and liabilities at expected liquidation values. (2) A set of questions that accompanies a voluntary bankruptcy petition.

### statement of cash flow

See *statement of cash receipts and disbursements*.

### statement of cash receipts and disbursements

A listing of cash receipts and expendi-

tures for a past or future period along with beginning and ending balances. Refer to the appendix for an example.

### statement of changes in financial position

A financial statement that shows the sources and uses of cash or *working capital* for a period. Refer to the appendix for an example.

### statement of changes in retained earnings

See *statement of retained earnings*.

### statement of financial condition

See *balance sheet*.

### statement of financial position

See *balance sheet*.

### statement of funds flow

See *statement of changes in financial position*.

### statement of income

See *income statement*.

### Statement of International Accounting Standards

One of a series of pronouncements issued by the *International Accounting Standards Committee* in an effort to encourage consistency in financial reporting throughout the world. Since actual financial reporting standards and requirements are established in each country, the authority of the Statements on International Accounting Standards rests on their acceptability to the International Accounting Standards Committee's organizational members.

**statement of operations**

See *income statement*.

**statement of realization and liquidation**

A report, filed with the bankruptcy court by the trustee of a company undergoing bankruptcy, showing the amounts realized from assets and the liabilities paid or settled during the current period.

**statement of retained earnings**

A report that accompanies a *balance sheet*, and shows the balance of retained earnings at the beginning of a period, the changes in retained earnings during the period (primarily income earned and dividends declared), and the ending balance. Refer to the appendix for an example.

**statement of source and application of funds**

See *statement of changes in financial position*.

**Statement on Auditing Standards (SAS)**

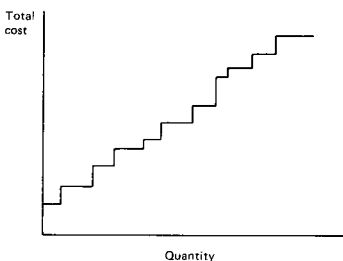
One of a series of statements issued by the American Institute of Certified Public Accountants to define and describe preferred auditing standards and practices.

**statistical sampling**

A manner of selecting a certain number of members of a group such that each member of the group has a specified probability or likelihood of being selected. Statistical sampling is used in applications such as selection of accounts receivable to be confirmed by auditors, inventory items to be counted, and finished product units to be tested.

**step cost**

A cost that changes by discrete amounts rather than continuously; also "step-variable cost." For example, the cost of salaried clerical employees cannot be varied in exact proportion to the amount of work to be done but must be increased by a lump amount each time a new person is hired. The behavior of step costs in relation to quantity of work or output is illustrated in the following graph:

**step-variable cost**

See *step cost*.

**stock**

(1) Ownership shares in a corporation. See also *common stock*, *preferred stock*. (2) Inventory of goods for sale.

**stock dividend**

A distribution of corporate earnings to stockholders, made in the form of additional shares of stock. The purpose usually given for a stock dividend is to give the shareholders evidence of earnings without the necessity of actually disbursing cash. The effect of a stock dividend is to "capitalize" retained earnings by converting a portion into paid-in capital. A stock dividend declared and issued simultaneously is recorded as follows:

Retained Earnings	xxx
Common Stock	xxx
Premium on Common Stock (if any)	xxx

**stock option**

A contractual privilege sometimes provided to a company's officers and other employees giving the holder the right to purchase a specified number of shares of the company's stock at a specified price, within a stated period of time. If the market price of the stock rises above the option price within the stated period, the employee can buy the stock from the company and resell it immediately on the stock market (although immediate resale is not mandatory), thus realizing a gain. If the market price of the stock fails to rise above the option price, the employee may simply refuse to exercise the option, thus realizing neither a gain nor a loss.

**stock purchase warrant**

See *warrant*.

**stock right**

A right to purchase a specified number of a company's shares at a prescribed price. See also *preemptive right*.

**stock split**

The process of replacing the existing number of outstanding shares with a larger number, simultaneously reducing *par value* by a proportionate amount. Stock splits are often in a ratio of 2 for 1 (two new shares for each old one). They are usually undertaken to reduce the market price per share, since a high price per share makes it more difficult to buy round lots of 100 shares and may thus discourage some investors from purchasing the stock.

**stock subscription**

An agreement to buy a specified number of shares of a corporation's stock at a specified price.

**stock warrant**

See *warrant*.

**stockholder**

One of the owners of a corporation, whose ownership interest is represented by shares of *stock*.

**stockholders' equity**

The interest of the owners of a corporation in the corporation's assets; net worth. Stockholders' equity is the sum of all stock accounts (preferred stock, common stock), additional paid-in capital, and retained earnings.

**stores**

See *raw materials inventory*.

**straight-line depreciation**

A form of *depreciation* in which an equal portion of an asset's cost is written off each period.

**Subchapter S corporation**

See *tax-option corporation*.

**"subject to" opinion**

The form of a certified public accountant's *audit opinion* on a company's financial statements rendered when such uncertainty exists with respect to future outcomes that the CPA cannot give the usual, *standard opinion*. The opinion states that the financial statements are fairly presented subject to the outcome of specified future events.

**subordinate security**

A security in a capital structure that includes one or more other security types with precedent or prior rights. For example, common stock is subordinate to bonds in case of bankruptcy, because the bondholders are entitled to payment before any distribution is made to common stock owners. Contrast with *senior security*.

**subscription**

A contract to take and pay for something, such as shares of stock of a corporation or a number of issues of a magazine. See also *stock subscription*.

**subsequent event**

An event that occurs between the balance-sheet date and the issuance of the financial statements and has a *material* effect on the financial statements. Ref.: SAS No. 1.

**subsidiary**

See *subsidiary company*.

**subsidiary account**

One of the accounts supporting a *control account*. The sum of the balances of subsidiary accounts should be equal to the balance of the control account. Individual accounts receivable accounts are examples of subsidiary accounts, supporting the accounts receivable control account.

**subsidiary company**

A company that is controlled by a *parent company*; such control is effected through the ownership by the parent company of a majority (over 50%) of the subsidiary's outstanding shares of stock.

**subsidiary ledger**

A set of several *subsidiary accounts* that support a single *control account*.

**successful efforts method**

A method of accounting in the oil and gas industry in which costs of unsuccessful acquisition and exploration activities are treated as expenses immediately instead of being recorded as assets. Contrast with the *full-cost method*. Ref.: FASB Statement No. 19.

**sum-of-the-years-digits depreciation**

A form of *accelerated depreciation* in which a fraction of an asset's depreciable cost is written off each year. The fraction is formed by a numerator representing the number corresponding to the current year, with the years numbered in descending order; and the denominator equal to the sum of the numbers of the years of the asset's life. For example, the fraction for the first year's depreciation for an asset with an eight-year life would be

$$\frac{8}{1 + 2 + 3 + 4 + 5 + 6 + 7 + 8} = \frac{8}{36}$$

For the second year it would be 7/36, and so on.

**sunk cost**

A previous outlay or sacrifice that cannot be changed by any future action.

**surplus**

A loosely used term often referring to earned surplus, or *retained earnings*. In a nonprofit organization, surplus may designate an accumulation of receipts over expenses during the life of the organization. Accountants generally try to avoid the term because of its ambiguity.

**suspense account**

An *account* in which items are recorded temporarily until their appropriate disposition is determined. For example, a portion of a complex transaction may be debited or credited to a suspense account until the transaction has been completed and all the details are available; at that time the amount would be removed from the suspense account and recorded in the proper account. Suspense accounts may appear in the *chart of accounts* and the *general ledger*, but they do not appear in financial statements; their balances should always be disposed of prior to the preparation of financial statements.

T

**T account**

An *account* in the form of a T with a debits section on the left and a credits section on the right. The T-account form is often used in textbooks for demonstrative purposes but is rarely used in business; instead an account form with three columns (for debits, credits, and balance) is used.

**tangible asset**

An *asset* having physical substance, such as a building or a piece of equipment. Contrast with *intangible asset*.

**tax benefit**

The reduction in income taxes attributable to a given event or transaction. See also *tax effect*.

**tax credit**

A reduction allowed in the amount of taxes otherwise owed. A tax credit is more advantageous to the taxpayer than a deduction of an equal amount, since a deduction only reduces the amount of taxable income on which taxes are calculated instead of reducing the taxes directly. See also *investment credit*.

**tax effect**

The difference in income taxes attributable to a given event or transaction. For example, a depreciation deduction of \$1,000 for a taxpayer in a 40% marginal tax bracket has a beneficial tax effect of \$400, since the deduction means that the amount of income taxes owed is \$400 less than they would be without the deduction.

**tax-option corporation**

A corporation with ten or fewer shareholders that is permitted under the In-

ternal Revenue Code to be taxed like a partnership; also called a Subchapter S corporation. Thus when certain conditions are met and an election is made by the corporation, income from the corporation is not subject to the corporate income tax but is treated immediately as income to the individual shareholders. The corporation retains the other advantages of the corporate form.

**tax shelter**

A business or activity that is allowed, for federal income tax purposes, to account for certain transactions in a manner not available to other businesses, thereby providing the taxpayer who invests in that business or activity an opportunity to shelter a portion of the income by deferring or avoiding taxation on it. For example, an investment in a farm allows the taxpayer to deduct immediately certain payments that would not be deductible until a later period in another business.

**temporary proprietorship account**

See *nominal account*.

**10-K**

A report that must be filed each year with the Securities and Exchange Commission by any company whose securities are traded on a national or over-the-counter market. The 10-K must contain complete, audited financial statements and is available at the SEC for inspection by the public.

**10-Q**

A quarterly report that must be filed with the Securities and Exchange Commission by any company whose securities are traded on a national or over-the-

counter market. The 10-Q contains financial statements (which may or may not be audited) and is available at the SEC for inspection by the public.

**test of compliance**

An audit procedure designed to determine whether, and to what extent, a client's *internal control* policies are being followed.

**test of significance**

See *significance test*.

**test of transactions**

An audit procedure designed to obtain evidence as a basis for an opinion on the accuracy and fairness of individual account balances. Tests of transactions involve procedures such as recomputation of amounts, examination of supporting documents (*vouching*), and tracing amounts from individual transactions through account balances into the financial statements. Tests of transactions may be contrasted with *analytical review* procedures, which are considerably more general.

**tick marks**

Symbols such as check marks and asterisks used by auditors in their *workpapers* to key explanations, provided in footnotes, to specific amounts or statements. For example, a check mark may be placed beside an amount in a column of figures and explained in a footnote that states, "Examined paid invoice in support of disbursement."

**time sharing**

A computer system in which a central processing unit is accessed more or less simultaneously by several remote terminal users. The typical system involves

processing a portion of each user's job and sequencing through the several users who may be on line at one time, so that the response time to each user is normally only a few seconds.

**times interest earned**

A statistic used to evaluate the ability of a company to meet required interest payments, calculated by dividing operating income before deducting interest expense and income taxes, by interest expense.

**"tracks"**

References and supporting calculations that show how a given amount (entry, balance, total) was obtained. See also *audit trail*.

**trade discount**

A reduction in selling price stated as one or a series of percentages. Thus a trade discount series of "10, 10, 20" would indicate that the listed price is reduced by 10%, by 10% again, and finally by 20% (giving a net price in this case of  $90\% \times 90\% \times 80\%$ , or 64.8% of the original price).

**trademark**

A symbol, insignia, or name that identifies a company or a product. Costs of developing and protecting a trademark are accounted for as an *intangible asset*.

**trading on the equity**

Using *leverage* to borrow funds that can be invested at a rate of return greater than the cost of borrowing. The term comes from the idea that the presence of stockholders' equity makes it possible to borrow, by providing lenders with a "cushion" against default.

**transaction**

Any single event that affects an organization's financial condition or operating results. The transaction is the basic element of accounting and gives rise to a *journal entry*. (This accounting definition is somewhat restrictive, since many events occur in and around an organization that are not recognized in the accounting system.)

**transactions test**

See *test of transactions*.

**transfer agent**

An agent of a corporation who maintains the records of stock ownership for dividend and voting purposes. The transfer agent may also serve as *registrar*.

**transfer price**

An "internal" price charged by one unit (such as a division, subsidiary, or department) of a company to another unit of the same company.

**translation**

The expression of amounts originally denoted in units of one currency in terms of a second currency, by applying the *exchange rate* between the two currencies. Ref.: FASB Statement No. 8.

**transportation-in**

See *freight-in*.

**treasurer**

The officer of an organization who is responsible for obtaining capital and managing cash and investments.

**treasury stock**

Shares of a company's own stock reacquired from stockholders and held by

the company (the shares are held in the corporate "treasury"). Treasury stock may ultimately be retired or resold. Treasury Stock is an owners' equity account with a normal debit balance and is deducted from stockholders' equity on the balance sheet. The entry for reacquisition of stock for cash is

Treasury Stock	xxx	
Cash		xxx

If treasury stock is resold the entry is

Cash	xxx	
Treasury Stock (credited for the amount paid by the corporation when the stock was reacquired)		xxx

In addition, a paid-in capital account such as Paid-In Capital from Treasury Stock Transactions is debited or credited for any difference between proceeds on resale and the amount paid by the corporation for the stock.

**trial balance**

A listing of all *accounts*, with their balances entered in *debit* or *credit* columns to determine whether the accounts balance, that is, whether total debits equal total credits. A trial balance is typically prepared at the end of an accounting period prior to preparing *adjusting entries* and *financial statements*.

**troubled debt restructuring**

A change in the terms of a debt in which some concession or advantage is granted by the creditor (lender) to the debtor (borrower). For example, the creditor may agree to stretch out the payment terms, temporarily defer some required payments, or to accept a smaller payment than is legally due. Ref.: FASB Statement No. 15

**trust fund**

A set of resources, with related accounts and controls, held by a governmental unit as custodian and usable only for the purpose prescribed in the trust indenture (the legal document establishing the trust). An employees' pension fund is an example of a trust fund.

**turnover**

(1) Total revenue. (2) One of several statistics used in financial analysis to evaluate assets. See also *receivables turnover*, *inventory turnover*, *fixed asset turnover*, *asset turnover*.

U



**unadjusted trial balance**

A *trial balance* or listing of account balances in debit and credit columns, taken before *adjusting entries* have been made.

**uncollectible account**

See *bad debt*.

**underapplied overhead**

The amount by which actual *factory overhead* for a period exceeds the overhead assigned or applied to *work-in-process inventory*.

**underwriter**

An organization, typically an investment firm, that buys all or a portion of a new security issue and resells it to the public. The underwriter seeks to make a profit on the resale, to compensate for the risk taken and for the marketing effort involved. Several underwriters are usually involved on a large security issue.

**unearned revenue**

Revenue received in advance of the period in which it will be earned, such as payment received for goods to be delivered in the future. The Unearned Revenue account is a *liability* with a normal credit balance. When a payment is received in advance, the journal entry is

Cash	xxx
------	-----

Unearned Revenue	xxx
------------------	-----

When the revenue is earned through delivery of goods or performance of services, the entry is

Unearned Revenue	xxx
Sales (or Services) Revenue	xxx

**unemployment tax**

A tax required by the Federal Unemployment Tax Act (FUTA) to cover the

cost of unemployment insurance. The federal statute provides for a tax based on a percentage of employee earnings but allows a credit for amounts paid in state unemployment taxes. A credit may also be earned for a favorable employment record (few or no dismissals over a given period, for example) so that some companies pay much less than the maximum.

**unit cost**

The cost of a single unit of product or service; total cost divided by number of units.

**units of output depreciation**

See *units of production depreciation*.

**units of production depreciation**

A method of determining the periodic depreciation charge, by multiplying the depreciable amount (original cost less estimated salvage value) by the percentage of the asset's expected total output that was produced during the period. For example, if a machine's cost less salvage value is \$10,000 and it is expected to produce 5,000 units over its useful life, production of 1,000 units during the current period calls for a depreciation charge of  $1,000/5,000 \times \$10,000$ , or \$2,000.

**unlimited liability**

A characteristic of unincorporated businesses, whereby the owner (in a sole proprietorship) or any general partner (in a partnership) may be held fully responsible for all the debts of the company even though these exceed the amount of the owner or partner's investment in the business.

**unqualified opinion**

See *standard opinion*.

**usage variance**

See *material quantity variance*.

**useful life**

The length of time that an asset is expected to be used by its present owner, often shorter than physical life.

**V**

**valuation account**

A *contra account*.

**value**

(1) The worth or utility of an object, claim, or right, expressed in units of money. Unmodified, the term "value" is subjective and must be interpreted in context. (2) To assign a number to an object, right, or claim, representing its worth in money.

**value added**

The addition to the original worth or utility of raw materials or components, as they are processed further in a manufacturing or assembly operation.

**value-added tax (VAT)**

A tax levied on the addition to product value at each level of the production and distribution process. For example, a business that buys raw materials for \$4,000 and converts them into finished products selling at \$7,000, might pay a value-added tax on \$3,000. Since the value-added tax is passed on to consumers, it is similar to a *sales tax*. The value-added tax is used in many European and South American countries and has been proposed for the United States.

**variable cost**

A *cost* that is expected to change in total more or less proportionately with a change in some base quantity, such as units produced or sold. Contrast with *fixed cost*.

**variable costing**

See *direct costing*.

**variable expense**

An *expense* that changes, in total, in re-

sponse to a change in quantity produced or sold.

**variable overhead**

*Factory overhead* that is expected to vary, in total, with the level of production. Contrast with *fixed overhead*.

**variables sampling**

See *sampling for variables*.

**variance**

(1) A *standard cost variance*. (2) In statistics, the *standard deviation* squared; for a population, the formula is  $\sigma^2 = \Sigma (X - \bar{X})^2 / N$ , where  $X$  = the value of a single item,  $\bar{X}$  = the mean of all the items in the population,  $N$  = the number of items in the population, and  $\Sigma$  = the summation operator.

(In this formula the mean is subtracted from each item, the resulting difference is squared, and the differences are summed before dividing by  $N$ .)

**variance analysis**

In a *standard cost system*, the investigation of the causes of *variances*, or differences between predetermined standard costs and actual costs; should not be confused with a procedure in statistics called analysis of variance, which breaks down the total variance in a set of data according to the source of the variation.

**VAT**

*Value-added tax*.

**volume variance**

An indication of the extent of capacity utilization, measured by a difference between *fixed overhead* originally budgeted

and that allowed for the level of production actually achieved. If the fixed overhead allowed for production achieved is less than that originally budgeted, an unfavorable volume variance results which indicates that the organization operated at less than the planned level of capacity. Since this term is subject to somewhat different meanings, one should be sure of the intended meaning in the context.

**vouch**

The *auditing* procedure of examining documentary support, such as a disbursements *voucher*, for an expenditure or other transaction.

**voucher**

A form prepared to establish control over and support for expenditures. See also *voucher register*.

**voucher register**

A *journal* in which accounts payable and their payment are recorded. A form called a *voucher* is prepared for each transaction as a means of establishing control and ensuring appropriate approval procedures for each disbursement.

**vouchers payable**

An account title used instead of *accounts payable* when a *voucher* system is used. In such a system, accounts payable are recorded in a *voucher register* and supported by a form called a voucher.

**vouching**

See *vouch*.

**W**

**W-2 form**

A statement of earnings and taxes withheld (including federal, state, and local income taxes and FICA tax) during the year, prepared for and provided to each employee and also filed with tax authorities.

**W-4 form**

The "Employee's Withholding Allowance Certificate," indicating the number of *exemptions* that the employee is claiming, used by the employer in determining the amount to be withheld for income taxes.

**waiting-line theory**

See *queuing theory*.

**warehouse receipt**

A written acknowledgment of receipt of and responsibility for goods given by a person or company engaged in storing goods for a fee.

**warrant**

A certificate granting a right to purchase shares of stock at a specified price.

**warranty**

An assurance that a product will perform its intended function for a stated period of time or be repaired or replaced by the warrantor (the seller or manufacturer).

**wasting asset**

A natural resource, such as ore, timber, or oil, that may be used up or consumed. A wasting asset is subject to *depletion*.

**watered stock**

Capital stock in a company with overvalued assets, or assets reported at amounts

in excess of their fair value; the stock is thus not adequately supported by the assets. The term originally derived from the practice of inducing cattle, just prior to sale, to ingest quantities of water until they appeared to be sleek and fat.

**weighted-average method**

An inventory costing method in which unit cost is obtained by dividing the total cost of all units available; thus, purchase cost of each unit is weighted by the number of units purchased at that amount.

For example,

Beginning inventory		
10 units @ \$2.00 =		\$ 20.00
Purchases		
8 units @ \$2.10 =	\$ 16.80	
11 units @ \$2.15 =	23.65	
84 units @ \$2.20 =	184.80	225.25
Goods available		
113 units		<u>\$245.25</u>

The weighted-average unit cost is \$245.25/113, or \$2.17. If the ending inventory consists of 8 units, its weighted-average cost is \$2.17 × 8, or \$17.36.

**"window dressing"**

An attempt to present a more favorable financial picture than that justified by the facts, by overstating revenue and understating liabilities and/or expenses in the financial statements.

**withholding tax**

An amount withheld by an employer from an employee's gross pay and deposited to the account of the taxing authority at an authorized depository bank, as partial prepayment on the employee's income tax liability.

**work in process**

See *work-in-process inventory*.

**work-in-process inventory**

Products being manufactured or assembled that have been started but not completed. Work-in-Process Inventory is a *current asset* with a normal debit balance. The usual journal entries affecting work-in-process inventory are the following:

Work-in-Process Inventory	xxx	
Raw Materials Inventory		xxx
To record the cost of raw materials used in production.		
Work-in-Process Inventory	xxx	
Accrued Payroll Payable (or Cash)		xxx
To record direct labor used in production.		
Work-in-Process Inventory	xxx	
Factory Overhead Applied		xxx
To apply estimated factory overhead to units manufactured		
Finished Goods Inventory	xxx	
Work-in-Process Inventory		xxx
To record the cost of units completed and transferred to finished goods.		

**work in progress**

See *work-in-process inventory*.

**work-in-progress inventory**

See *work-in-process inventory*.

**working capital**

The excess of *current assets* over *current liabilities*; also called net working capital.

**working papers**

See *workpapers*.

**workpapers**

An auditor's record of work done and conclusions reached in an *audit*.

**worksheet**

Generally any document or schedule used by accountants as an aid in organizing work. One common form is used at the end of an accounting period to facilitate adjusting and closing accounts and preparation of *financial statements*, with column headings such as trial balance, adjustments, adjusted trial balance (may be omitted), cost of goods manufactured (may be omitted), income summary, retained earnings (may be omitted), and balance sheet. Columns for debits and credits are provided for each heading. See also *spread sheet*.

**writedown**

A reduction in a balance or carrying value due to abnormal circumstances. See also *writeoff*.

**write-it-once system**

See *one-write system*.

**writeoff**

A reduction in an account or balance due to abnormal circumstances, such as a writeoff of an account receivable when it has become uncollectible, or a writeoff of inventory that has become obsolete and unsalable.

**X**

**Y**

**Z**

**yield**

The income earned on an investment during a period of time. For securities such as stocks and bonds the yield is the amount of dividends or interest earned during a year and is often expressed as a percentage of cost or market value.

**ZBB**

*Zero-base budgeting.*

**zero-base budgeting (ZBB)**

A budgeting approach in which each program or activity is evaluated anew each budget cycle (although the approach may be applied on a rotating basis, with several programs evaluated fully each cycle), as opposed to the incremental approach to budgeting in which critical evaluation is focused on additions to the prior period's budget. Zero-base budgeting, advocated primarily for government and nonprofit organizations, calls for each program or activity to be identified as a "decision package." These are ranked in order of their importance and are funded in order of ranked importance to the extent allowed by projected revenue. While much has been said about zero-base budgeting, actual (and successful) applications are difficult to find. It appears that the concept is more useful as a way of thinking about programs than as a procedure to be followed rigorously during the budgeting process.

XYZ Company  
Balance Sheet (also Statement of Financial Position)  
December 31, 19X1

Assets			
Current Assets:			
Cash		\$xxx	
Marketable Securities		xxx	
Notes and Accounts Receivable	\$xxx		
Less Allowance for Doubtful Accounts	xxx	xxx	
Inventories		xxx	
Prepaid Expenses		xxx	
Total Current Assets		\$xxx	
Investments			
		xxx	
Property, Plant and Equipment:			
Land	\$xxx		
Buildings, <i>less</i> accumulated depreciation of \$xxx	xxx		
Machinery and Equipment, <i>less</i> accumulated depreciation of \$xxx	xxx		
Total Property, Plant and Equipment		xxx	
Other Assets:			
Goodwill	\$xxx		
Organization Costs	xxx		
Patents and Copyrights	xxx		
Total Other Assets		xxx	
Total Assets		xxx	\$xxx
Liabilities and Owners' Equity			
Current Liabilities:			
Notes Payable		\$xxx	
Accounts Payable		xxx	
Federal and State Income Taxes Payable		xxx	
Payroll Payable		xxx	
Total Current Liabilities		\$xxx	
Long-Term Liabilities:			
Bonds Payable, 9%, maturing 1999		xxx	
Total Liabilities		xxx	\$xxx

Owners' Equity:			
Preferred Stock		\$xxx	
Common Stock		xxx	
Additional Paid-In Capital		xxx	
Retained Earnings		xxx	
		\$xxx	
Less Treasury Stock		xxx	
Total Owners' Equity			xxx
Total Liabilities and Owners' Equity			\$xxx

Note: Comparative balance sheets for two years are normally presented.

XYZ Company  
Contribution Income Statement  
For the Year Ended December 31, 19X1

Revenue		\$xxx	
Less Variable Expenses:			
Manufacturing		\$xxx	
Selling		xxx	
Administrative		xxx	xxx
Contribution Margin			\$xxx
Less Fixed expenses:			
Manufacturing		\$xxx	
Selling		xxx	
Administrative		xxx	xxx
Net Income			\$xxx



XYZ Company  
Cost of Goods Manufactured  
For the Year Ended December 31, 19X1

Direct Material:		
Beginning Inventory, January 1, 19X1	\$xxx	
Purchases	<u>xxx</u>	
Material Available for Use	\$xxx	
Less Ending Inventory, December 31, 19X1	<u>xxx</u>	
Direct Material Used		\$xxx
Direct Labor		xxx
Factory Overhead:		
Indirect Materials	\$xxx	
Indirect Labor	xxx	
Heat, Light and Power	xxx	
Depreciation	xxx	
Insurance	xxx	
Other Overhead	<u>xxx</u>	<u>xxx</u>
Cost of Manufacturing		\$xxx
Add Beginning Work-in-Process Inventory	<u>xxx</u>	
	\$xxx	
Less Ending Work-in-Process Inventory	<u>xxx</u>	
Cost of Goods Manufactured		<u>\$xxx</u>

Note: The total cost of goods manufactured is carried to the cost of goods sold section of the Income Statement, as an addition to goods available for sale.

XYZ Company  
Income Statement (also Profit and Loss Statement; Statement of Operations)  
For the Year Ended December 31, 19X1

Gross Sales			\$xxx
Less Sales Returns and Allowances			<u>xxx</u>
Net Sales			\$xxx
Cost of Goods Sold:			
Beginning Inventory, January 1, 19X1		\$xxx	
Purchases (or Cost of Goods Manufactured)		<u>xxx</u>	
Cost of Goods Available for Sale		\$xxx	
Less Ending Inventory, December 31, 19X1		<u>xxx</u>	<u>xxx</u>
Gross Profit (or Gross Margin)			\$xxx
Selling and Administrative Expenses:			
Selling Expenses:			
Sales Commissions and Salaries	\$xxx		
Delivery Expense	xxx		
Advertising	<u>xxx</u>	\$xxx	
Administrative Expenses:			
Administrative Salaries	\$xxx		
Utilities	xxx		
Supplies	xxx		
Travel and Entertainment	xxx		
Telephone	xxx		
Miscellaneous	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
Income from Operations			\$xxx
Other Income and Expenses:			
Dividend Income	\$xxx		
Interest Expense	<u>(xxx)</u>		
Net Other Income and Expenses			<u>xxx</u>
Net Income before Extraordinary Items and Income Taxes			\$xxx
Extraordinary Items:			
Extraordinary Gain from Sale of Subsidiary Company	\$xxx		
Less Income Tax Effect	<u>xxx</u>		<u>xxx</u>
Net Income before Income Taxes			\$xxx
Provision for Income Taxes			<u>xxx</u>
Net Income (to Retained Earnings)			<u>\$xxx</u>

Note: Comparative income statements for two years are normally presented.

XYZ Company  
Social Impact Statement  
For the Year Ended December 31, 19X1

## Social Benefits:

Products and Services Provided		\$xxx
Payments to Other Elements of Society:		
Employment Provided (Salaries and Wages)	\$xxx	
Payments for Goods and Other Services	xxx	
Tax Payments	xxx	
Contributions	xxx	
Dividend and Interest Payments	xxx	
Loans and Other Payments	xxx	xxx
Additional Direct Employee Benefits		xxx
Staff, Equipment, and Facility Services Donated		xxx
Environmental Improvements		xxx
Contribution to Foreign Exchange		xxx
Other Benefits		xxx
Total Social Benefits		\$xxx

## Social Costs:

Goods and Material Acquired	\$xxx	
Buildings and Equipment Purchased	xxx	
Labor and Services Used	xxx	
Discrimination:		
In Hiring (External)	xxx	
In Placement and Promotion (Internal)	xxx	xxx
Work-Related Injuries and Illness		xxx
Public Services and Facilities Used		xxx
Other Resources Used		xxx
Environmental Damage:		
Terrain Damage	\$xxx	
Air Pollution	xxx	
Water Pollution	xxx	
Noise Pollution	xxx	
Solid Waste	xxx	
Other Environmental Damage	xxx	xxx

## Payments from Other Elements of Society:

Payments for Goods and Services Provided	\$xxx		
Additional Capital Invested	xxx		
Loans	xxx		
Other Payments Received	xxx	xxx	
Other Costs		xxx	
Total Social Costs			xxx
Net Social Surplus (Deficit)			\$xxx

Source: Ralph Estes, *Corporate Social Accounting* (New York: John Wiley & Sons, 1976), p. 96.