GLOSSARY OF BUSINESS FINANCIAL TERMS

Accounts Payable. A current liability representing the amount owed by a business to trade creditors for merchandise or services purchased on open account (i.e., without the giving of a note or other evidence of debt).

Accounts Receivable. Money owed to a business enterprise for merchandise or services bought on open account.

Accrual Basis. The practice of record keeping by which income is recorded when earned and expenses are recorded when incurred, even though the cash may not be received or paid out until later.

Accrued Expenses. Expenses incurred during a fiscal period but not actually paid by the end of that fiscal period.

Administrative Expenses. Also referred to as *operating expenses* or *overhead*. They include rent, utilities, advertising, legal and accounting, etc.

Aging Accounts Receivable. Grouping customer accounts receivable according to due dates, such as current, 30-60, 60-90, and over 90 days.

Allowance (Reserve) for Depreciation. The allowance for depreciation is the accumulation of amounts charged to depreciation expense to write off the cost of a fixed asset over its estimated useful life. The allowance account does not necessarily measure the decline in value of the related asset, nor does it represent a specific fund of cash set aside to replace the related asset.

Amortization. The gradual reduction of a debt by means of equal periodic payments sufficient to meet current interest and liquidate the debt to maturity. When the debt involves real property, often the periodic payments include a sum sufficient to pay taxes and hazard insurance on the property. Also refers to the write-off of intangible assets such as copyrights or goodwill.

Appreciation. The increase in the value of an asset in excess of its cost or book value which is due to economic and other conditions, as distinguished from increases in value due to improvements or additions made to it.

Asset. Anything owned by an individual or a business which has commercial or exchange value. Assets may consist of specific property or claims against others.

Bad Debts. Bad debts are the amounts due on open account that have been proved uncollectible.

Balance Sheet. An itemized statement which lists all of the assets, liabilities and equity of a business at a given moment of time.

Book Value. Book value of a business is determined by adding all assets then deducting all liabilities. The sum arrived at is divided by the number of common shares outstanding to determine book value per common share. Book value of the assets of a company may have little or no significant relationship to fair market value.

Break-Even Point. The volume point at which revenues and costs are equal. A combination of sales and costs that will yield a no-profit, no-loss operation.

Budget. An itemized listing of the amount of all estimated revenue which a given business anticipates receiving, and the listing, and frequently the segregation, of the amount of all estimated costs and expenses that will be incurred in obtaining the above-mentioned income during a given period of time, such as a month, a year, etc.

Capital. The amount of money invested in the business by stockholders.

Capital Assets. A collective term which includes all fixed assets, consisting of vehicles, furniture and fixtures, land, buildings, machinery, etc.

Capital Budget. This is the estimated amount planned to be expended for capital.

Capital Gain or Loss. The difference (gain or loss), between the book value and that value realized from the sale or disposition of a capital asset.

Capital Stock. The shares of a corporation authorized by its articles of incorporation, including preferred and common stocks.

Capitalization Rate. The discount rate used to determine the present value of a stream of future earnings, usually a risk-free return plus a premium to reflect the risk of that specific investment.
Annual cash flow, generally measured by EBITDA, divided by the capital cost of the investment equals the capitalization rate.

Cash Basis. The practice of recording income and expenses only when cash is actually received or paid out.

Cash Flow. This term may have different meanings depending upon who is using the term and in what context. Bankers usually define it as net profits plus all non-cash expenses. But it can also be defined as the difference between cash receipts and disbursements over a specified period of time. Comprehensive cash flow consists of three elements: operating cash flow, investing cash flow and financing cash flow.

Contribution Margin. The difference between sales and variable costs. For example:

Sales	$400,000
Variable Costs	-$150,000
Contribution Margin	$250,000

Contribution Margin Ratio (CMR). The contribution margin expressed as a percentage of sales.

Sales	100.0%
Variable Cost Percentage	37.5%
Contribution Margin Ratio	62.5%

Corporation. A type of business organization chartered by a state and given legal rights as a separate entity.

Cost of Goods Sold. Expenses related directly to the production of revenue for a business. This usually includes raw materials, direct labor, freight, and factory overhead for a manufacturing company, and merchandise costs for a wholesaler or retailer.

Current Assets. Current assets are those assets of a company which are reasonably expected to be realized in cash, or sold, or consumed during the normal operating cycle of the business (usually one year). Such assets include cash, accounts receivable, inventories and prepaid expenses.

Current Liabilities. Liabilities that are due within one year.

Debt to Equity. See Safety Ratio

Depreciation Expense. The amount of expense charged against earnings by a company to write off the cost of fixed assets over their useful life. If the expense is assumed to be incurred in equal amounts in each business period over the life of the asset, the depreciation method used is straight line (SL). If the expense is assumed to be front loaded and incurred in decreasing amounts in each business period over the life of the asset, the method used is said to be accelerated. Frequently, accelerated depreciation is chosen because it is usually advantageous tax-wise to expense deductions as rapidly as possible.

Dividend. That portion of a corporation's earnings which is paid to the stockholders.

EBITDA. Net income before interest, taxes, depreciation and amortization. Is also a proxy for cash flow.

Enterprise Value. EBITDA or free cash flow (which includes funded debt) times a multiple.

Entrepreneur. One who assumes the financial risk of the initiation, operation and management of a given business or undertaking.

Equity. The net worth or ownership interest in a company. It is the difference between the assets and the liabilities of a company. In a corporation, net worth or owner's equity consists of capital stock, capital surplus and retained earnings.

Equity Value. Enterprise value less funded debt. A market-based measure of the value of a firm, accounting for all the ownership interest in a firm including the value of unexercised stock options and securities convertible to equity.

Estate. The entire group of assets owned by an individual at the time of his/her death. The estate includes all funds, personal effects, interests in business enterprises, real estate and chattels, and evidences of ownership such as stocks, bonds and mortgages owned, notes receivable, etc. All claims against an estate must be duly filed with the executor of the estate and approved by the court of law under which the will is being probated.

Estate Taxes. The federal taxes levied on the transfer of property from the deceased to his or her heirs.

Executor. An individual or a bank, who is named in the testator's will to carry out the desires of the deceased after his/her death as designated in the will. Executors must be approved by the court of law probating the will.

Fair Market Value. The price at which a willing seller will sell and a willing buyer will buy in an arm's-length transaction, when neither is under any compulsion to sell or buy and both have reasonable knowledge of all the relevant facts.

FIFO (First In First Out). The term relates to inventory valuations and assumes that the first items received are the first ones sold.

Financial Gap. Period of time where you have run out of money, are waiting for more money to come into your business. If there is a gap, you need money quickly to cover the gap.

Fixed Assets. Those assets of a permanent nature required for the normal conduct of a business, and which will not normally be converted into cash during the ensuing fiscal period. Examples: furniture and fixtures, land, buildings, etc.

Fixed Cost. Fixed cost is an operating expense that does not vary with business volume. Examples: interest, rent, property tax, depreciation, administrative salaries, legal and accounting, etc.

Forecasting. A projected financial picture of the sales, expenses and the resulting profit.

Free Cash Flow. The total of operating cash flow (EBITDA) less capital expenditures, representing the cash that a company is able to generate after laying out the money required to maintain or expand its asset base.

Goodwill. An intangible asset that arises when assets are purchased for more than their fair market value. Generally accepted accounting principles dictate that goodwill should be amortized over a period not less then four no more then forty years. This amortization is not deductible for tax purposes. Goodwill is created on the books of a newly purchased company to the extent that the purchase price of the company is greater than the fair market value of the assets.

Gross Profit. The difference between sales and the cost of goods sold.

Income Statement. The statement of income and expense of a given concern for a particular period of time.

Inheritance Taxes. Taxes levied by several states upon the right to receive property by inheritance.

Intangible Assets. Items of non-physical nature such as goodwill, patents, and trademarks that are of value to a company as a going concern, the value being dependent upon the rights and earning power they confer upon the owner.

Inventory Turnover. The number of times a business turns its inventory over during the period of a year.

Liabilities. Amounts owed by a person or a business.

LIFO (Last In First Out). This term relates to valuation of inventories and assumes that the last item purchased is the first one that is sold.

Line of Credit. An agreement between a bank and a customer whereby the bank agrees to lend the customer funds up to a previously agreed maximum amount. A line of credit is widely used by large organizations for seasonal needs to finance inventory and/or accounts receivable.

Liquidation Value. The value of a business that will be realized if all of the assets are sold and liabilities paid.

Liquidity. A term to describe the solvency of a business, and which has special reference to the degree to which assets can be converted into cash without loss.

Long-Term Debts. Obligations which will not be due for at least one year.

Margin. The difference between the cost and the selling price of merchandise. Expressed as a percentage, the difference is the numerator and the ***selling price*** is the denominator.

Markup. The difference between the cost and the selling price of merchandise. Expressed as a percentage, the difference is the numerator and the ***cost*** is the denominator.

Minimum Acceptable Rate of Return. A capital budgeting consideration when deciding whether a long-term investment should be made. It is the minimum return on a project a manager is willing to accept before starting a project, given its risk and the opportunity cost of foregoing other projects. MARR is calculated by applying a discount rate to the net present value of all cash flows from an investment, which to be acceptable, should equal 0 or greater.

Mis-financing. Using short-term debt to pay for long-term use (eg. buying large fixed asset with a credit card). This is remedied with proper debt structure.

Net Loss. The excess of the total expenses over the total income for a fiscal period.

Net Profit. The excess of total income over the total expenses for a fiscal period.

Note Payable. Written promises to persons or businesses to pay certain amounts at certain times.

Operating Expense. Those expenses pertaining to the normal operation of the business. Interest expense and non-recurring losses are not included.

Operating Profit. The difference between the gross profit and operating expenses.

Preferred Stock. Corporation stock which grants its owners certain preference rights over other stockholders on payments of dividends and the distribution of assets.

Present Value. The discounted value of a certain sum due and payable at a certain specified future date.

Profit & Loss Statement. See Income Statement

Quick Assets. Cash, accounts receivable and marketable securities.

Ratios: Cash Ratio. The cash ratio tells you how much cash you have to cover your current liabilities. (i.e.: What can I convert to cash this month?)

Ratios: Current Ratio. The current ratio tells you how much current assets you have to cover your current liabilities. (i.e.: What can I convert to cash within a year?)

Ratios: Quick Ratio. The quick ratio tells you how much Cash and AR you have to cover your current liabilities. (i.e.: What can I convert to cash within 90 days?)

Ratios: Safety Ratio. The ability of the firm to withstand adversity. Also know as your Debt to Equity ratio.

Return on Equity (ROE). Return on Equity is the ratio of profit (before taxes) to stockholders equity or net worth.

Revenue. Synonymous with sales. Usually used in a service business.

Secured Loan. A loan which is secured by some sort of collateral. Secured loans may be either long-term or short-term loans.

Self-Liquidating Loan. A short-term commercial loan, usually supported by a lien or a given product or commodities, which is liquidated from the proceeds of the sale of the product or commodities.

Stockholder. A person owning shares of the capital stock of a corporation.

Retained Earnings. Retained earnings represent an accumulation of earnings which have been retained in the business and not paid out to stockholders.

Term Loan. A long-term loan (over one year) with a tenure running usually not more than ten years.

Testamentary Trust. A trust which is established through a will. The executor or some other legal entity, such as a trust company, is specified in the will to take possession of certain property of the deceased, and to carry out this administration for the benefit of the parties named in the will as beneficiaries.

Variable Cost. An operating expense that varies directly with sales. It is an expense that is ***caused*** by sales. Examples include commissions, direct labor, raw materials and bad debts.

Working Capital. The amount of money remaining after current liabilities are paid as of previous month end. Also referred to as “the cushion”.