

*This glossary is intended to help the reader understand the language, jargon and common abbreviations of the field of finance. Like many words in the English language, financial terms can have slightly different meanings depending on the context in which they are used. Different kinds of businesses sometimes use different terms for similar items. This glossary will identify those situations and define commonly used terms.*

**Accounting** – The maintaining of financial records and preparing reports based on them, that a business can use to understand its status and changes over time. In the United States today it generally implies that the person doing the accounting is a Certified Public Accountant (CPA) or someone who has very high level bookkeeping skills.

**Accounts Payable** – The money that the business owes to its suppliers. For example, a retail store often orders inventory to stock the store from wholesalers and manufacturers under terms that allowed the business 30 days to pay. During these 30 days, the business has an accounts payable on its balance sheet.

**Accounts Receivable** – The money that customers owe the business. For example, a manufacturing business often sells its products to retailers under terms that allowed the business 30 days to pay. During these 30 days, the business has an accounts payable on its balance sheet.

**Anomaly** – Something out of the ordinary, an occurrence or data point that is strange, unusual, or unique. It can also be a discrepancy or deviation from a trend or pattern.

**APR** – Annual Percentage Rate, typically refers to the annual interest rate on a loan. The monthly interest rate would be approximately that rate divided by 12. For example, if the APR of a loan is 12%, the monthly interest rate would be approximately 1%.

**Assets** – The assets of a business are the things that the business owns, such as cash, money owed from customers, and equipment. These items make up the assets side of the balance sheets.

**Asset Turnover** – A measure of how efficiently the business uses its assets to generate revenue. This ratio is calculated by dividing revenue by total assets and measures how much revenue is generated in relation to the assets of the business.

**Balance Sheet** – The financial statement that shows all of a business's assets and liabilities at a single moment in time. Typically it is shown at the end of the month or the year. It is called a balance sheet because the two sides of the statement, the assets on one side and the liabilities on the other, must always balance, i.e. be equal to each other. If they do not balance, someone has made an error. There are places in the balance sheet that will force a balance. One of these is the owner's equity line on the liability side of the balance sheet. Business owners usually do not like to show this as a negative but it may be so and needs to be shown as such to make the balance sheet balance. It means that the owner has less than no value in the business, i.e. she owes more than she owns, kind of like being upside down on a car loan or a mortgage. Also called a Statement of Financial Position.

**Bank Bag** – The zippered bags that you keep deposits in until you make your deposit at the bank or credit union. Many businesses leave these bags with their deposits in night drop boxes at the bank or credit union to be tabulated by the bank or credit union the next day.

**Bankruptcy** – The situation when the business cannot pay its debts. It typically triggers a bankruptcy legal proceeding which may result in the dissolution of the business or the reorganization of the business, both directed by the court.

**Bookkeeping** – The systematic recording and tracking of a business's financial transactions. Bookkeeping is necessary and a precursor to accounting.

**Capital** – The cash that is invested in a business to start it up. In small businesses it is typically from the entrepreneur's savings, home equity loans, and other loans. Additional capital can be obtained by selling stock to additional investors.

**Cash** – The amount of paper currency, coins, checks to be deposited, and bank balances that the business owns.

**Cash Collection Cycle** – This figure usually expressed in terms of days is calculated by adding the days in inventory and the collection period and subtracting the payment period. Low-margin, high-volume businesses tend to have the shortest cash conversion cycles, while high-margin, low-volume businesses tend to have longer cash conversion cycles. In general a business would prefer to have a shorter cash collection cycle.

**Cash Flow** – The flow of money that comes into the business from revenues, loans and investment and flows out to expenses. The Cash Flow Statement is how these cash flows are shown.

**Collection Period** – This ratio is calculated by dividing ending accounts receivable by revenue per day. In general, a business would prefer to have a shorter collection period because it means the business receives the money it is owed sooner.

**Commodity** – A commodity is a product that is commonly available and is usually produced in large quantities in many places. Orange juice, pork bellies (bacon), and iron ore are examples. Very commonly manufactured goods can also become commodities. Examples would be DVD players and blank CDs.

**Cost of Goods Sold (COGS)** – The costs of producing or acquiring goods to be sold. COGS does not usually include overhead costs such as store rent, administrative expenses, and financing costs. Cost of Sales (COS) is another term for COGS.

**Cost of Services Provided (COSP)** – An expense that is mostly the wages and salaries paid to the staff that provide services to the customers in a service business. These are direct cost as opposed to indirect costs like the rent for the building that houses the business. This is similar to COGS except for a service business.

**Credit** – This term has several meanings. One sense is loans or lines of credit extended to a borrower. The accounting use of the term refers to an entry in the general ledger or financial statements that increases liabilities, owners' equity, revenue, and gains and decreases assets and expenses. Credit and debits are the foundation of accounting.

**Currency** – Paper bills like a one dollar bill, or a 10 Euro note, and coins.

**Current Assets** – Current assets typically include cash, account receivable, raw materials, work in process, and inventory.

**Current Liabilities** – Current liabilities typically include accounts payable and any other obligation to be paid within one year such as unpaid taxes, deferred dividends, etc.

**Current Ratio** – This liquidity ratio is calculated by dividing current assets by current liabilities. If current assets exceed current liabilities, the current ratio will be greater than 1.0. A current ratio greater than 1.0 indicates that the business has sufficient assets to pay its bills over the next year. If the current ratio is less than 1.0, this indicates the business doesn't have sufficient current assets to pay its bills in the coming year.

**Customer-Centric** – This refers to a company that focuses on providing real or perceived value to customers so they are willing to pay more for the business's products or services.

**Cyclicality** – This refers to something like a pattern of annual sales that have a regular and predictable cycle to them. Seasonality is a synonym.

**Debit** – This term has several meanings. One sense is in a debit balance representing money owed on a debt. The accounting use of the term refers to an entry in the general ledger or financial statements that decreases liabilities, owners' equity, revenue, and gains and increases assets and expenses. Debits and credits are the foundation of accounting.

**Days in Inventory** – This ratio is calculated by dividing the ending inventory by the cost of goods sold per day.

**Debt to Equity Ratio** – This leverage ratio measures the amount of debt a company has in comparison to the amount of equity invested in the company. A debt to equity ratio in excess of 1.0 means that the business has borrowed more money than the owners have invested. It's not uncommon for businesses to borrow two or three times more than their owners' investment.

**Depreciation** – The amortization of fixed assets, such as plant and equipment, so as to allocate the cost of their expected to depreciable life.

**EBIT** – Earnings before interest and taxes.

**EBITDA** – Earnings before interest payments, taxes, and

**Efficiency Ratios** – These are ratios that help a business determine how quickly its products and services are being converted to cash. Examples are Days in Inventory, Collection Period, Payment Period, and Inventory Turnover

**Expense** – An income statement term that refers to expenditures for things like salaries, supplies, utilities, insurance, etc.

**FFE** – Furniture, fixtures and equipment; typical start-up expenses for a small business.

**Financials** – A shorthand way of referring to financial statements, as in "I reviewed his financials and they look solid."

**Financial Institution** – This typically means a credit union or a bank where the business does its financial transactions like making deposits and withdrawals. Investment firms and insurance companies are also considered financial institutions in the general sense of the word.

**Fixed Costs** – These are costs that remain constant regardless of changes in sales volume. They include things like rent, interest expense, depreciation, computing, and insurance costs.

**Fixed Payment Coverage Ratio** – This leverage ratio measures the ability of the company to generate sufficient earnings to meet their fixed payment liabilities. If the ratio is greater than 1.0, the business has sufficient profits to make its fixed payments. If the ratio is less than 1.0, the business isn't earning sufficient profits to make the required fixed payments.

**Funds** – A synonym for money or cash. Sometimes it is used in a more general sense as assets that can be quickly turned into cash.

**Goodwill** – This is an accounting term that is used to make the balance sheet balance in the case of a buyout of the company. The easiest way to understand is this: If the company based on its' financial statements, is worth \$1,000, and a buyer is willing to pay \$1,200 to buy the company, then there is \$200 of goodwill in the company. Goodwill is mostly irrelevant to you unless you are buying another company.

**Gross Profit** – The difference between what you bought an item for, and what you sold it for. In a retail business, if you buy an item from a supplier for \$35, and you sell it for \$100 to a customer, you have a gross profit of \$65.

**Gross Profit Margin** – Sometimes shortened to gross margin. In a manufacturing business it is sales revenue minus cost of goods sold (COGS). If you sell your product for \$100, and it costs you \$30 in materials and labor to make it, you have a gross margin of 70%.

**Income** – This what the business treats as money coming in the door. It is not the same as cash flow because you don't always get them money immediately. A good example is

**Income Before Taxes (EBT)** – Earnings before Taxes

**Income Statement** – The financial statement that shows a summary of the revenues, costs, expenses, and net income of a company during a specific period, typically a month, quarter or year. Synonyms: Profit and Loss Statement; P&L Statement; Operating Statement; Income and Expense Statement; Statement of Profit and Loss

**Indirect Costs** – Also called direct overhead or fixed costs. They include things like rent, interest expense, depreciation, computing, and insurance costs.

**Intangible Assets** – These are assets that are an advantage to the company but are not tangible assets like cash, buildings, and equipment. They include things like patents, goodwill, computer programs, licenses, etc.

**Interest Coverage Ratio** – This leverage ratio shows the ratio of earnings before interest and taxes (aka operating profit) to annual interest costs. That is, it measures how many times larger the earnings before interest and taxes are than the annual interest costs. This is a measure of the company's ability to pay the interest costs. A ratio below 1.0 indicates that the company doesn't have sufficient earnings before interest and taxes to pay its interest costs and indicates that the company could soon be out of business unless it finds some way to pay the interest when it comes due.

**Inventory** – Products that have been either purchased or manufactured that are waiting to be sold or delivered. Typically they are stored in a business owned warehouse or with a third party. Inventory can also be in a retail locations referred to as in-store inventory.

**Inventory Turnover** – This ratio is a measure of how many times per year the inventory of a company turns over (i.e., is sold). The more often the inventory turns over, the better for the company. Since a business must use cash to purchase its inventory, the more frequently it's able to sell that inventory, the quicker cash is returned.

**Liabilities** – The liabilities of a business are the debts the business owes. These items make up the liabilities side of the balance sheet.

**Liquidation** – This word has several meanings. Liquidation of a business means the dismantling of the business, paying off the debts in priority order, and distributing the remaining assets, if any, to the business owners. This may happen through bankruptcy. Liquidation of a debt means the paying off of the debt.

**Margin** – In finance a margin is the difference between two numbers. For example, the difference between what a retailer buys a product for and what she sells it for is called the gross margin.

**Material Effect** – A meaningful or significant effect that is likely to noticeably affect the business's profit or other important margin or ratio.

**Net Income** – Gross revenues minus all expenses.

**Net Margin** – Also known as the profit margin, net profit margin or net profit ratio is the ratio of net income to gross revenues expressed as a percentage. This figure is often considered the best measure of the "bottom line" for a business.

**Non-Operating Expenses** – Expenses not directly related to the production and sale of goods or services produced by the business. Examples would be interest paid on a bank loan to the business, property taxes, and storm damages.

**Non-Operating Income** – Income not directly derived from the operations of the business. Examples would be interest earned on the business's accounts at the bank, a gain on foreign currency exchange, and a gain on the sale of a company asset like a truck.

**Operating Income** – Also known as operating profit or earnings before interest and taxes (EBIT).

**Operating Expenses** – Abbreviated OPEX, these are expenses directly related to operating the business. They typically include items like labor, materials, goods to be sold, building rental, etc. They do not include non-operating expenses like interest on a bank loan or taxes.

**Operating Profit (EBIT)** – Also referred to as operating income and net operating profit. This is, in its simplest sense, revenues minus expenses. More specifically it is operating revenue – operating expenses + non-operating income

**Operating Margin** – Also called the operating profit margin, it is the ratio of operating income divided by net sales and is usually presented as a percentage. It measures what proportion of a company's revenue is left over, before indirect costs (such as taxes, interest, etc.), after paying for variable costs of production as wages, raw materials, etc.

**Operational-Centric** – This refers to a business that is the opposite of a customer-centric business in many ways. Instead of focusing on differentiating their products to obtain a higher price, operational-centric businesses concentrate on manufacturing and distributing their products as efficiently as possible.

**Owners' Equity** – Owner's equity is the money that owners have invested in the business and the profits of the business that have not been distributed to the owners.

**Payment Period** – This ratio is calculated by dividing ending accounts payable by cost of goods sold per day. In general, a business would prefer to have a longer payment period because it means the business can stretch out the time it has to pay suppliers.

**P&L Statement** – Abbreviation of the profit and loss statement also known as the income statement.

**Profit** – This is an income statement term. In general, it means the total income of the business minus the expenses. The term is used loosely and sometimes people use the term and do not subtract taxes and amortized expenses.

**Profit & Loss Statement** – A synonym for the Income Statement.

**Quick Ratio** – This liquidity ratio is Current Assets minus Inventory divided by Current Liabilities. A quick ratio greater than 1.0 indicates that a business has sufficient cash assets to pay its bills over the coming year. A quick ratio less than 1.0 indicates that a business may be short of cash during the coming year. The quick ratio is also known as the acid test.

**R&D** – Research and Development, typically an expense for the business.

**ROA** – Return on Assets. A ratio that measures the profitability of the business based on the businesses total assets. To calculate ROA divide the annualized net income of the business and divide it by the total assets of the business. You can do this monthly by multiplying the monthly net income by 12 months and then dividing that figure by the total assets at the end of the month. Note: This is different than ROE or Return on Equity. To calculate ROE you divide by owner's equity not total assets.

**Receipts** – A written acknowledgment that money or something else of value, such as a product, has been received. Also, the act of receiving, for example, Cash will be needed to sustain the business it between the manufacture of the products and receipt of payment for the products.

**Returns** – There are two common meaning for this term in finance and business. First is as a synonym for profits, e.g. If the business generates sufficient returns, the business will probably be satisfying to the owner. The second meaning is product that are returned to the supplier or retailer for credit because they did not sell at the retail level.

**Return on Assets (ROA)** – A ratio that measures the profitability of the business based on the business's total assets. To calculate ROA divide the annualized net income of the business and divide it by the total assets of the business. You can do this monthly by multiplying the monthly net income by 12 months and then dividing that figure by the total assets at the end of the month. Note: This is different that ROE or Return on Equity. To calculate ROE you divide by owner's equity not total assets.

**Return on Equity (ROE)** – A ratio that measures the profitability of the business based on the business owners' equity. To calculate ROE divide the annualized net income of the business and divide it by the owner's equity in the business. You can do this monthly by multiplying the monthly net income by 12 months and then dividing that figure by the owner's equity at the end of the month. Note: This is *not* the same as ROA.

**ROE** – An abbreviation for return on equity.

**Statement of Earnings** – A synonym for the Profit and Loss Statement. Other synonyms are Statement of Income, Statement of Operations, and Statement of Operating Results.

**Tangible Assets** – These are physical assets that can be seen and touched such as real estate, buildings, machinery, and cash. If an asset does not have a physical form it is usually considered and intangible asset. There are some accounting exceptions to this rule, e.g., accounts receivable are considered tangible assets.

**Turnover** – In finance this term is usually used in connection with the number of times an asset is replaced during a given time period. For example, inventory turnover typically refers to the number of time a business's inventory is turned over, i.e. is sold per year.

**Variable Costs** – These are costs that vary with the manufacture or sale of a product or service. For example, to produce another handbag more leather or fabric must be purchased and assembled. The cost of the leather and fabric is a variable cost. Overhead costs are not variable costs because you have them whether or not you manufacture or sell another handbag.

**Working Capital** – This is the capital that the business has to operate with and is calculated as current assets minus current liabilities. Current assets typically include cash, account receivable, raw materials, work in process, and inventory. Current liabilities typically include accounts payable and any other obligation to be paid within one year such as unpaid taxes.