Important Financial Terminology

Accounting Period

An accounting period is the time interval reflected by the data in a financial statement. An accounting period is a discrete and uniform length of time which serves as a basis for reporting and analyzing companies' financial performance. The uniformity of accounting periods also allows for comparative analysis between companies.

Firms prepare financial statements for publication and tax reporting based on an accounting period. Financial statements comprise data generated by a company's operations during the accounting period. The accounting period for publishing financial statements is usually a quarter (e.g. January 1st, 2009 through March 31st, 2009), while the accounting period for tax reporting is usually a year (e.g. January 1st, 2009 – December 31st, 2009).

Accounts Payable

Accounts payable are amounts owed to suppliers and other creditors for goods and services bought on credit. A/P is a current liability, and as such, it appears on the liability side of balance sheet. As it is current liability it is expected to be paid within the next 12 months. Accounts payable is an important factor in a company's working capital. If it's too high, the company may soon be struggling to find the cash to pay the bills; if it's too low, the company may be unwisely directing its cash toward paying the bills too soon rather than enjoying the full grace period and investing that cash in the business instead. The level of accounts payable also affects several important financial-performance measures, including working capital, days payable, the current ratio, and others.

Assume that Company XYZ orders Rs. 1,000,000 in mechanical parts from its supplier and has 60 days to pay for those parts. Once Company XYZ places its order and/or receives the parts, it will increase its inventory account by $1,000,000 and increase its accounts payable by $1,000,000. When 60 days has passed and Company XYZ pays the invoice, it will reduce cash by $1,000,000 and reduce its accounts payable by $1,000,000.

Accounts Receivable

Accounts receivable (A/R) are amounts owed by customers for goods and services a company allowed the customer to purchase on credit. A/R is a current asset, and as such, it appears on the assets side of the balance sheet. As it is current asset it is expected to be received within the next 12 months. Accounts receivable is an important factor in a company's working capital. If it's too high, the company may be lax in collecting what's owed too it and may soon be struggling to find the cash to pay the bills; if it's too low, the company may be unwisely harming customer
relationships or not offering competitive payment terms. In general, accounts receivable correspond to changes in sales levels.

Assume that Company XYZ sells $1,000,000 of mechanical parts to a manufacturer and gives that customer 60 days to pay for those parts. Once Company XYZ receives the order and/or sends the parts and/or sends the customer an invoice, it will decrease its inventory account by $1,000,000 and increase its accounts receivable by $1,000,000. When 60 days has passed and Company XYZ is paid, it will increase cash by $1,000,000 and reduce its accounts receivable by $1,000,000.

**Accrued Expense**

An accrued expense refers to any expense incurred and reported during an accounting period but for which payment has not yet been made.

Example: There are certain expenses which a company may incur over the course of an accounting period (usually a quarter), but which may not actually be paid until a later time. Such expenses are accounted for as short-term liabilities on a company's balance sheet and may include utilities, wages and salaries, rents, and periodic interest on outstanding loans.

**Amortization**

Amortization is the process of decreasing or accounting for, an amount over a period. In finance it usually deals with repayment of an installment loan by means of equal installments at periodic intervals.

An amortization schedule would show the payment that goes into the principal component and payment that goes into interest component, together with the outstanding loan balance after the payment is made.

**Annuity**

A series of payments of equal amounts occurring at fixed intervals for a specified number of periods. Annuities are classified by the frequency of payment dates. The payments (deposits) may be made weekly, monthly, quarterly, yearly, or at any other interval of time.

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Examples of annuities are regular deposits to a savings account, monthly home mortgage payments and monthly insurance payments.

An annuity is similar to a life insurance product, but there are important differences between the two. Under the terms of a life insurance policy, the insurer will generally make a payment upon the death of the insured. Under the terms of an annuity, the company makes its payments during the lifetime of the individual. In addition, unless the annuity contract specifies a beneficiary, most annuity payments cease upon the death of the recipient.

Audit

In terms of tax, an audit refers to the review of a taxpayer's tax return for accuracy. In term of accounting, an audit is the examination and verification of a company's financial statements and records.

Accounting professionals, usually Certified Public Accountants (CPAs) perform audits. These auditors must be independent, unbiased, and qualified to provide an auditor's report (also called an opinion).

There are four major steps in the audit process:

1. Defining the terms of the engagement between the auditor and the client
2. Planning the scope and conduct of the audit
3. Compiling the audited information
4. Reporting the results of the index audit.

Bad Debts

Bad debt is the portion of a loan or portfolio of loans a lender considers to be uncollectable. In personal finance, bad debt generally refers to high-interest consumer debt. Bad debt when it applies to transactions between companies is an inevitable part of doing business. Ultimately, not all payments owed to a company will be paid, so all companies have accounts for bad debt expenses and allowance for doubtful accounts (ADA). Therefore when investors and other outside people evaluate a company based on its income statement, the figure for net income has already been adjusted for bad debt.
Balance Sheet

The balance sheet is a financial report that lists a company's assets (what it owns) and liabilities (what it owes to others) the balance sheet has mainly two components. The first component gives a detailed list of a company's assets, including long-term assets (such as real estate and machinery), current assets (anything that can easily be converted to cash in less than a year), and cash. The second component is a list of company's liabilities, or what it owes others. This is always an important section for investors to read because even the most stable of companies will face problems if it has an unusually high amount of debt on its books. It outlines stockholders' equity, and provides information on common and preferred stock, retained earnings, and capital surplus.

Bonds

A bond is a long-term debt instrument. There are government bonds and corporate bonds. Bonds are issued by governments or corporations in order to raise funds. A firm issues bonds and receives money in return. For example, a firm may sell a 5-year bond and gets $1,000 right away. After the issue, the firm must pay interest to the bondholder. This interest payment is called coupon payment. It is a percentage of the face value of the bond, which is normally $1,000. The coupon payments are made either annually or semiannually. At the end of year 5, the firm will have to return the original $1,000 to the bondholder.

There can be many variations of bonds in terms of interest payments, denomination currency, place of issue and special provisions. As a result, you may hear people taking about all kinds of “bonds”: callable bond, convertible bond, Euro-bond, currency-bond, cocktail bond, discount bond, floating rate bond, to name a few.

Breakeven point

The break-even point is the point at which gains equal losses. The basic idea behind break-even point is to calculate the point at which revenues begin to exceed costs.

Capital

In economics, capital, capital goods, or real capital are those already-produced durable goods that are used in production of goods or services. The capital goods are not significantly

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consumed, though they may depreciate in the production process. Capital is distinct from land in that capital must itself be produced by human labor before it can be a factor of production. At any moment in time, total physical capital may be referred to as the capital stock (which is not to be confused with the capital stock of a business entity.)

In Marxian economics, capital is used to buy something only in order to sell it again to realize a financial profit, and for Marx capital only exists within the process of economic exchange—it is wealth that grows out of the process of circulation itself and forms the basis of the economic system of capitalism.

Financial capital can refer to money used by entrepreneurs and businesses to buy what they need to make their products or provide their services or to that sector of the economy based on its operation, i.e. retail, corporate, investment banking, etc.

**Cash Budget**

Cash budget is a review or projection of cash inflows and outflows. It can be used as a tool for analyzing the revenues and costs of a company or individual.

Example: A cash budget is a planning tool used by companies and individuals to evaluate projected cash flows during a specified period of time (e.g. monthly, quarterly, annually).

For example, if a company's cash budget forecasts itemized inflows (income) of Rs1,00,000 and itemized cash payments (expenses) of Rs.50,000, management can feel fairly certain that it will have enough cash to pay all of its bills.

**Cash flow**

Cash flow is the movement of money into and out of a business, project or financial product. It is a revenue or expense stream that changes a cash account over a given period. Cash inflows usually arise from one of the three activities- financing, operations or investing. Cash outflows result from expenses or investments in business as in personal finance, cash flow are essential for solvency. They can be presented as a record of something that has happened in the past, such as the sale of a particular product, or forecasted into the future, representing what a business or a person expects to take in and to spend.

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Credit

Credit is a contractual agreement in which a borrower receives something of value now, and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company. In a journal entry recording, it signifies an increase in assets. With cash basis accounting, credits are recorded when income is received. With accrual basis accounting, credits are recorded and recognized when income is earned.

Cost of goods sold

Cost of goods sold (COGS) is an accounting term to describe the direct expenses related to producing a good or service. For goods, COGS is primarily composed of the cost of the raw materials that physically constitute the item. But cost of goods sold does not include indirect expenses, such as utilities, office supplies, or items not associated with the production of a specific good or service.

Debit

Debit is an accounting entry which results in either an increase in assets or a decrease in liabilities on a company’s balance sheet or in your bank account.

Debentures

Debentures are bonds that are not secured by specific property or collateral. Instead, they are backed by the full faith and credit of the issuer, and bondholders have a general claim on assets that are not pledged to other debt. If Company XYZ is exceptionally creditworthy (let's say it has significant cash flow and has never defaulted on any of its other debt), then placing liens on Rs.100 million of assets (called encumbering the assets) may not be necessary to attract investors. Company XYZ could issue debentures instead. Holders of the Company XYZ debentures would have a claim to the assets not otherwise pledged to other bondholders. So, if Company XYZ had Rs.300 million of assets, but Rs.100 million were pledged in a previous bond issue, then the holders of the debentures could lay claim to the other Rs.200 million of assets in the occurrence of default.
Depreciation

It is a method of allocating the cost of a tangible asset over its useful life. Businesses depreciate long-term assets for both tax and accounting purposes. Depreciation indicates how much of an asset’s value has been used up. Depreciation is used in accounting to try to match the expense of an asset to the income that the asset helps the company earn.

For example, if a company buys a piece of equipment for $1 million and expects it to have a useful life of 10 years, it will be depreciated over 10 years. Every accounting year, the company will expense $100,000 (assuming straight-line depreciation), which will be matched with the money that the equipment helps to make each year.

Dividend

Dividends are payments made by a corporation to its shareholder members. It is the portion of corporate profits paid out to stockholders. When a corporation earns a profit or surplus, that money can be put to two uses: it can either be re-invested in the business (called retained earnings), or it can be distributed to shareholders. There are two ways to distribute cash to shareholders: share repurchases or dividends. Many corporations retain a portion of their earnings and pay the remainder as a dividend.

A dividend is allocated as a fixed amount per share. Therefore, a shareholder receives a dividend in proportion to their shareholding. For the joint stock company, paying dividends is not an expense; rather, it is the division of after tax profits among shareholders. Retained earnings (profits that have not been distributed as dividends) are shown in the shareholder equity section in the company's balance sheet - the same as its issued share capital. Public companies usually pay dividends on a fixed schedule, but may declare a dividend at any time, sometimes called a special dividend to distinguish it from the fixed schedule dividends.

Dividends are usually paid in the form of cash, store credits (common among retail consumers’ cooperatives) and shares in the company (either newly created shares or existing shares bought in the market.) Further, many public companies offer dividend reinvestment plans, which automatically use the cash dividend to purchase additional shares for the shareholder.

Earnings per share

The portion of a company's profit allocated to each outstanding share of common stock.

Calculated as:

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When calculating, it is more accurate to use a weighted average number of shares outstanding over the reporting term, because the number of shares outstanding can change over time. However, data sources sometimes simplify the calculation by using the number of shares outstanding at the end of the period.

**Economy of the scale**

It is a term that refers to the reduction of per-unit costs through an increase in production volume. This idea is also referred to as diminishing marginal cost.

The common sources of economies of scale are purchasing, managerial, financial (obtaining lower-interest charges when borrowing from banks and having access to a greater range of financial instruments), marketing (spreading the cost of advertising over a greater range of output in media markets), and technological (taking advantage of returns to scale in the production function).

Economies of scale is a practical concept that may explain real world phenomena such as patterns of international trade, the number of firms in a market, and how firms get "too big to fail".

**Equity**

In accounting and finance, equity is the residual claim or interest of the most junior class of investors in assets, after all liabilities are paid. If liability exceeds assets, negative equity exists. In an accounting context, Shareholders' equity (or stockholders' equity, shareholders' funds, shareholders' capital or similar terms) represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock.

**Fiscal Year**

A fiscal year (or financial year, or sometimes budget year) is a period used for calculating annual ("yearly") financial statements in businesses and other organizations. In many jurisdictions, regulatory laws regarding accounting and taxation require such reports once per twelve months, but do not require that the period reported on constitutes a calendar year (that is, 1 January
through 31 December). Fiscal years vary between businesses and countries. The "fiscal year" may also refer to the year used for income tax reporting.

**Goodwill**

Goodwill is an accounting concept meaning the value of an entity over and above the value of its assets. The term was originally used in accounting to express the intangible but quantifiable "prudent value" of an ongoing business beyond its assets, resulting perhaps from the reputation the firm enjoyed with its clients.

**Initial Public Offer**

An Initial Public Offering (IPO being the Stock Exchange and corporate acronym) is the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPOs can risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.

**Inventory**

Inventory is the collection of unsold products waiting to be sold. Inventory is listed as a current asset on a company's balance sheet.

Inventory is commonly thought of as the finished goods a company accumulates before selling them to end users. But inventory can also describe the raw materials used to produce the finished goods, goods as they go through the production process (referred to as "work-in-progress" or WIP), or goods that are "in transit."

**Ledger**

The general ledger is the main accounting record of a business which uses double-entry bookkeeping. It will usually include accounts for such items as current assets, fixed assets, liabilities, revenue and expense items, gains and losses. Each General Ledger is divided into...
debts and credits sections. The left hand side lists debit transactions and the right hand side lists credit transactions. This gives a 'T' shape to each individual general ledger account.

The general ledger is a collection of the group of accounts that supports the value items shown in the major financial statements. It is built up by posting transactions recorded in the sales daybook, purchases daybook, cash book and general journals daybook. The general ledger can be supported by one or more subsidiary ledgers that provide details for accounts in the general ledger. For instance, an accounts receivable subsidiary ledger would contain a separate account for each credit customer, tracking that customer's balance separately. This subsidiary ledger would then be totaled and compared with its controlling account (in this case, Accounts Receivable) to ensure accuracy as part of the process of preparing a trial balance.

**Liquidity**

It is the ease with which a security can be converted into cash. Stocks and bonds can be sold quickly for cash, so they are liquid assets; but antiques or real estate cannot be sold quickly for cash and they are illiquid assets. For corporations liquidity management is important because poor liquidity may mean a failure of meeting interest payments to creditors, which in turn can result in bankruptcy.

**Marginal cost and Marginal Revenue**

In economics and finance, marginal cost is the change in total cost that arises when the quantity produced changes by one unit. That is, it is the cost of producing one more unit of a good. If the good being produced is infinitely divisible, so the size of a marginal cost will change with volume, as a non-linear and non-proportional cost function includes the following:

1. variable terms dependent to volume,
2. Constant terms independent to volume and occurring with the respective lot size,
3. Jump fix cost increase or decrease dependent to steps of volume increase.

Marginal revenue (R') is the additional revenue that will be generated by increasing product sales by 1 unit. It can also be described as the Unit Revenue the last item sold has generated for the firm. More formally, marginal revenue is equal to the change in total revenue over the change in

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quantity when the change in quantity is equal to one unit. This can also be represented as a derivative when the units of output are arbitrarily small.

**Mutual fund**

Investment products offered by mutual fund companies. A mutual fund is a basket of shares. Suppose you invest with mutual fund company ABC. ABC gets money from you and turns around to invest the money in different shares. The type and proportion of shares to invest in are up to the mutual fund companies to decide. But generally speaking, funds are specialized. For example, a single mutual fund company (AGF, e.g.) can offer many specialized funds such as fixed-income funds, equity funds, and Asia funds. A fixed-income fund would invest in only fixed-income securities such as T-bills and bonds. Likewise, an Asia fund would invest in only stocks in Asia (e.g., Hong Kong, Japan and Singapore). Since a mutual fund is a basket of different securities, the fund value is more stable relative to a single share price.

**Net Present Value**

NPV is a significant measurement in business investment decisions. NPV is essentially a measurement of all future cash flows (revenues minus costs, also referred to as net benefits) that will be derived from a particular investment (whether in the form of a project, a new product line, a proposition, or an entire business), minus the cost of the investment. Logically if a proposition has a positive NPV then it is profitable and is worthy of consideration. If negative then it’s unprofitable and should not be pursued. While there are many other factors besides a positive NPV which influence investment decisions; NPV provides a consistent method of comparing propositions and investment opportunities from a simple capital/investment/profit perspective. There are different and complex ways to construct NPV formulae, largely due to the interpretation of the ‘discount rate’ used in the calculations to enable future values to be shown as a present value. Corporations generally develop their own rules for NPV calculations, including discount rate.

**Net worth**

Net worth refers to the total value of an individual or company expressed as total assets less total liabilities. The net worth of an individual is simply calculated as total assets (e.g. home equity and portfolio value) less total debt (e.g. mortgage, credit card debt, auto loans, and educational loans). For example, an individual with total assets of Rs.100,000 and Rs.30,000 of total debt.
would have a net worth of Rs.100,000 – Rs.30,000 = Rs.70,000. A company's net worth is calculated in a similar manner, but is referred to as stockholder equity.

**Prepaid Expenses**

A type of asset that arises on a balance sheet as a result of business making payments for goods and services to be received in the near future. While prepaid expenses are initially recorded as assets, their value is expensed over time as the benefit is received onto the income statement, because unlike conventional expenses, the business will receive something of value in the near future.

For example, insurance is a prepaid expense, because the purpose of purchasing insurance is to buy proactive protection in case something unfortunate happens. Clearly, no insurance company would sell insurance that covers the occurrence of an unfortunate event, after the fact, so insurance expenses must be pre-paid.

**Principle**

The amount of a loan or investment that does not include interest It's the amount borrowed, or the amount currently owed in a loan (including mortgages) and the amount invested (for investments.)

For example, if I loan you Rs.100 at 10% annual interest, the principle will be the Rs100.

**Recession**

A recession is two consecutive quarters of declining gross domestic product (GDP).

Example: Let's assume that there has been a significant decline in industrial production, employment, and wholesale or retail trade. These things may cause GDP to decline for a three-month period (a quarter). If the situation continues in the next quarter, most economists will declare that the economy is in a recession.
**Retained Earnings**

Retained earnings refer to the portion of net income which is retained by the corporation rather than distributed to its owners as dividends. Similarly, if the corporation takes a loss, then that loss is retained and called variously retained losses, accumulated losses or accumulated deficit. Retained earnings and losses are cumulative from year to year with losses offsetting earnings.

Retained earnings are reported in the shareholders' equity section of the balance sheet. Companies with net accumulated losses may refer to negative shareholders' equity as a shareholders’ deficit. A complete report of the retained earnings or retained losses is presented in the Statement of Retained Earnings or Statement of Retained Losses.

**Risk**

The probability that an actual return on an investment will be lower than the expected return is called Risk. Example: Changes in interest rates will cause interest-bearing liabilities (deposits) to reprice at a rate higher than that of the interest-bearing assets (loans).

**ROI**

Return on investment is one way of considering profits in relation to capital invested. Return on assets (ROA), return on net assets (RONA), return on capital (ROC) and return on invested capital (ROIC) are similar measures with variations on how 'investment' is defined.

Marketing not only influences net profits but also can affect investment levels too. New plants and equipment, inventories, and accounts receivable are three of the main categories of investments that can be affected by marketing decisions.

For example, a marketer may compare two different products by dividing the gross profit that each product has generated by its respective marketing expenses. A financial analyst, however, may compare the same two products using an entirely different ROI calculation, perhaps by dividing the net income of an investment by the total value of all resources that have been employed to make and sell the product.
Shares:

A share is a single unit of proprietorship in a corporation, mutual fund, or other organization.

A Joint Stock company divides its capital into shares, which are offered for sale to raise capital, termed as issuing shares. Thus, a share is an indivisible unit of capital, expressing the proprietary relationship between the company and the shareholder. The denominated value of a share is its face value: the total capital of a company is divided into number of shares.

The person who owns shares of a company is called shareholder or stakeholder.

Stock

An instrument that signifies an ownership position (called equity) in a corporation, and represents a claim on its proportional share in the corporation's assets and profits. Ownership in the company is determined by the number of shares a person owns divided by the total number of shares outstanding. For example, if a company has 1000 shares of stock outstanding and a person owns 50 of them, then he/she owns 5% of the company. Most stock also provides voting rights, which give shareholders a proportional vote in certain corporate decisions. Only a certain type of company called a corporation has stock; other types of companies such as sole proprietorships and limited partnerships do not issue stock. It's also called equity or equity securities or corporate stock.

Sunk Cost

Sunk costs are retrospective (past) costs that have already been incurred and cannot be recovered. Sunk costs are sometimes contrasted with prospective costs, which are future costs that may be incurred or changed if an action is taken. Both retrospective and prospective costs may be either fixed (continuous for as long as the business is in operation and unaffected by output volume) or variable (dependent on volume) costs.

Example: A Company that has spent $5 million building a factory that is not yet complete, has to consider the $5 million sunk, since it cannot get the money back. It must decide whether continuing construction to complete the project will help the company regain the sunk cost, or whether it should walk away from the incomplete project.

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**Trial balance**

A Trial Balance is a bookkeeping worksheet in which the balances of all ledgers are compiled into debit and credit columns. A company prepares a trial balance periodically, usually at the end of every reporting period. The general purpose of producing a trial balance is to ensure the entries in a company's bookkeeping system are mathematically correct. It is a tool for checking and testing the accuracy.

**Working capital**

Also called “Gross Working Capital”, it is simply the current assets of a firm. This type of capital “works” for the firm in that it ensures the smooth operation of the firm.

For individuals, we can think of the paddy cash in our wallet and the balance on our checking account as working capital, since they ensure that we can carry out our daily lives smoothly.

**Write down**

A write-down is the accounting term used to describe a reduction in the book value of an asset due to economic or fundamental changes in the asset. A write-down can be processed whenever a firm readjusts their balance sheet numbers which typically happens when a company files their quarterly earnings.

**Yield**

Yield refers to the cash return to the owner of a security or investment.

The term yield may refer to slightly different aspects of a return for variable types of investments.

Example: A yield on bonds, such as the coupon yield is the annual interest paid on the principal amount of the bond. Current yield is the coupon yield on a bond at a specific point in the time before the bond maturity. A yield to maturity of a bond is the internal rate of return on a bond's cash flow, including the cost of the bonds, period payments from the bonds, if any, and the return of the principal at redemption.

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