

**DICTIONARY
OF
ACCOUNTING**

Ralph Estes

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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		CASH		
#1001				
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 *accrued liability*.

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:

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