

Terminology

Accounting framework

This is a framework designed to bring uniformity in the production of financial statements and once adopted by the accounting body of a particular country is applied by the members of that accounting body. These frameworks usually require disclosure of any deviations from the set framework so that shareholders and other interested parties are aware of the policies adopted in preparing the financial statements.

Amortization

This is the term used in writing off the value of an asset for a specific purpose. The value of the asset may not have deteriorated but the interest of the incumbent user may have deteriorated due to limited access to that asset. In the case of leased assets, the interest may be limited to the period of the lease.

Balance Sheet

This is the final working in which the assets and liabilities of the entity are summarised in a format which has been in vogue for many years. The fixed assets grouped in the first section and then the current assets, the totals of these two groups are then totalled. In the second section of the balance sheet being the liability section, the share capital and the accumulated profit are grouped together and a total struck, the long term liabilities are grouped together

and a total struck, and then the current liabilities are totalled. These three groups are then totalled at the bottom of the liability section, and this total if the exercise has been performed correctly will agree with the total of the asset section. The balance sheet is the same document but by another name as the Statement of Financial Position.

Books of prime entry

The books of prime entry are used to accumulate the information to be posted into the general ledger. Examples of books of prime entry are the journal, petty cash book, cash book, purchase journal and sales journal. The journal is generally used for single entries and the other books of prime entry are used to accumulate repetitive entries so that only one entry needs to be made to say the sales account at the end of the month. Some computer systems record each entry whilst others record batch totals as the relevant main ledger account is updated.

Cash book

The cash book is used to record all entries recorded on the bank account. Sometime the entries are entered in the cash book as they take place, sometimes the entries are generated from the bank statement and in this case one needs to make sure that these are genuine transactions and not created as a result of fraud or errors of commission.

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Creditors ledger

It is common policy to split the creditors ledger from the general ledger because of the volume of creditor entries emanating from the purchase process and the payment process, resulting in the necessity of have having one or more persons involved in reconciling the individual ledger accounts and agreeing these with the invoices and monthly statements from suppliers.

This ledger is then agreed to a control account in the general ledger which is maintained from the totals of creditors posting columns in the cash book and purchase ledger and other books of prime entry.

Control accounts

Control accounts are used to group certain ledger accounts together when there are multiple ledger accounts of the same nature. Control accounts are used to group the debtors accounts together, and another control account for the creditor accounts. When businesses grow in size it usually becomes necessary to appoint a person or department to deal exclusively with debtors and another person or department with creditors. The same applies to stock in the case of a trading company.

Another reason for splitting the general ledger is to limit the number of employees with access to sensitive company trading results.

The subsidiary ledger accounts are agreed to the general ledger control accounts on a regular basis to ensure that these are in balance.

Current assets

The current assets are assets which have a life expectancy of less than one year, and are usually turned over very rapidly. Examples of current assets are the stock for sale, debtors for credit sales and money in the bank account and on hand.

Current liabilities

The current liabilities are liabilities which are discharged within a year of being incurred. These liabilities are usually discharged according to the credit terms negotiated with the provider of the goods and services. The long-term liabilities are usually separated into amounts due within one year and amounts due after one year and the shorter-term liability included in the current liability section. Bank overdrafts would also be included in this section together with taxation due within one year from the prior year end.

Debtors ledger

A separate debtors ledger is usually created as the number of debtor accounts increase in number and it becomes necessary for a specific person or department to deal with collection of outstanding monies and granting of credit and reconciliation of the various debtor accounts.

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The total of the debtor accounts is then agreed with the control account balance in the general on a regular basis.

Depreciation

Fixed assets which have a limited useful life expectancy due to constant use are subject to depreciation so that their value is not overstated in the financial statements. Depreciation is usually calculated according to their life expectancy. Electronic equipment usually has a shorter life expectancy than items of furniture because they are subject to power surges and are less durable in construction.

Derivative

This is a simple description of a more complicated combination of assets and liabilities and rights and obligations.

A simple example would be where one borrows money to increase the purchase of a specific asset class such as quoted shares. The stockbroker may provide a specific trading account so that the customer borrows say forty percent of the combined value of his shares on hand and cash holdings. The customer will then pay interest on the amount of his borrowings, and sell shares or infuse more cash to maintain the forty percent ratio of borrowings to shares and

cash on hand. This can prove to be a very costly arrangement in a falling share market. The actual arrangement is for the customer to receive interest on the money he pays into the account and the stockbroker to lend him the shares otherwise the stockbroker would lose control of the asset in the event of the customer going insolvent.

Another type of derivative situation would be where the customer borrows against foreign currency holdings to avoid having the cost of encashing the foreign currency one day and purchasing foreign currency, the following day. Such a loan could prove cheaper than the cost of buying and selling foreign currency at short intervals. Often businesses have import and export divisions with a view to eliminating foreign currency losses by maintaining a foreign currency bank account. In such a situation the foreign currency could be placed in a bank trust account and pledged to the loan provider.

Derivatives are made available to business entities with the view of providing some sort of security but also with a view to the derivative provider making a profit from the transaction.

Dividends

The return to shareholders is effected by the payment of dividends. The dividend is deducted in the financial statements in the " Statement of changes in equity " because the dividend is sourced from accumulated profits and it may be in excess of the net profit after tax earned in the year in which it is declared and paid.

Dividends may only be paid out of profits available for distribution.

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Download

The term used when entering data or programs into one's own computer electronically from another source via the internet.

Equity

Equity is the net value attributable to the shareholders in the case of a limited company and in the case of a single trader or partnership the value of their loan accounts and capital accounts if they maintain capital accounts. These are usually credit accounts but in the case of sole traders and partnerships nothing prevents them from operating debit loan accounts as their personal assets are at risk since there is no limited liability.

Fair value of assets and liabilities

This is value accorded to the assets and liabilities of the company at the end of each financial year and the values are determined according to the framework adopted by the accounting body in the country in which the company is registered.

Fixed assets

These are the assets one usually uses in earning one's income. Machinery, furniture and motor vehicles necessary to perform daily chores and produce the goods and services necessary to survive in the business environment. There are many other classes of assets not already mentioned according to the type of businesses being conducted.

Fixed asset registers

Limited companies must comply with the company act governing their conduct in the country in which they are registered. Most company acts provide for registers to be kept of the fixed assets belonging to the company. This is to ensure that assets belonging to the companies do not go missing. These registers generally provide for the fixed assets to be reflected in very precise detail, the dates of acquisition, the cost, an accurate description of the asset, depreciation provided each year, and the remaining balance at the end of each year.

Fixed costs

Fixed costs are the costs of operating the business regardless of the level of sales. These costs exclude any costs which vary according to the sales turnover.

Folio

Folio is the term used for a page reference number. In a manual system one cross references the

pages to each other. In a computer system this is sometimes done, at other times one of the entries may appear in a transaction listing for a particular day.

GAAP

GAAP is the abbreviation used for the " generally Accepted Accounting Principles " framework. These frameworks are generally computerized, and access is restricted to subscribers.

General ledger

The general ledger is the main ledger in which the entries from all the subsidiary books of prime entry are posted.

The trial balance is extracted from the general ledger once the general ledger is fully up to date and balanced.

It is important to review the general ledger to ensure that the postings have been correctly recorded.

Gross profit

This is the profit which is calculated by deducting the direct costs of selling or manufacturing goods from the selling price depending on whether the entity is in the retail and wholesale business or the manufacturing business. In the service industry one could also allocate some direct costs such as salaries and wages, transport, communication and other related costs.

IFRS

This is an accounting framework that has been adopted by several of countries in the Western World. The framework is amended year by year with new editions of its book of content being published, each edition is published with a different coloured outer cover and references are made to the green book or blue book according to the year of publication.

Journal

The journal is generally used for entries of an unusual nature and entries which are passed say, once a month or once a year and entries which do not involve cash payments.

Marginal costing

This is the function of determining the contribution to fixed costs and then net profit of the the business, by calculating the profit generated by each dollar of sales after deducting the cost of each dollar of variable expense. One first splits the business costs into fixed costs and variable costs. If for instance the profit earned by deducting the variable costs from the sales is fifty cents in the dollar,

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then your break even sales would be twice the fixed costs. There is a section on marginal costing in which the process is more fully explained.

Notional

For our purposes this is an estimate based on what one or more persons believe to be the answer to a particular problem. This is usually the monetary value to be placed on a particular asset or group of assets. This could also be the estimated outcome of certain events.

Net profit

This is the profit remaining after deducting all costs relating to the business other than the ordinary taxation due on the net profit plus any deferred taxation provisions due to timing differences.

Petty cash book

A petty cash book is usually maintained for small and unusual purchases and a recommended system of control is to reimburse the petty cash minder as and when the supporting vouchers are delivered to the person responsible for effecting cash book payments. Under this system of control the initial petty cash float would be reimbursed as the money is spent.

Post / posting

This is the term used when recording entries in the general ledger which originate from a book of prime entry. The entries from the cash book are cross posted as the cash book is regarded as a general ledger account. When posting from the other books of prime entry one enters from debit to debit and credit to credit. One can use the colour coded chart of accounts to confirm that the entries are posted correctly.

A computer ledger posting takes place once the update key is activated in the program menu of the section of the program being updated. An example being the recording of the entries on the bank statements in which case the cash book program would be used. When recording the sales invoices then the sales invoice program would be used. The program would have fields to be completed such as the date of the transaction, the general ledger account reference, the amount of the transaction and the name of the person or entity to which the relevant entry is to be debited or credited.

Profit and Loss Account

The Profit and Loss Account and the Statement of Income and Expenditure as it is referred to by one accounting framework are the same document. The income sources are displayed in the top section of this document and the expenses listed separately in the bottom section of the document. The difference between the income and expenses is defined as the profit and this amount is shown separately with the taxation then being deducted.

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Purchase journal

The purchase journal is generally used to record entries of a repetitive nature where there are agreed terms for the payment of the supplier. The entries could arise as a result of individual invoices or as a result of the invoices being agreed to the monthly statement and then entered in total for the month. When the invoices are entered as and when received then the entries in the creditors ledger need to be agreed to the statement for reconciliation purposes.

Quoted shares

Quoted shares are shares held in companies listed on recognised stock exchanges in various countries around the world. Certain companies are listed on more than one stock exchange and the quoted prices vary according to the fluctuating exchange rates of the countries in which the stock exchanges operate.

Sales journal

The sales journal is created by recording the sales invoices in the sequence in which they are created. Sales invoices are usually sequentially numbered and when an electronic invoicing system is being used this is standard practice.

An electronic invoicing system usually provides for the updating of the debtor accounts and if an inventory system is in operation, then the updating of the remaining inventory balances.

It would also give a listing of the invoices issued to update the sales data. These transactions would either be recorded real time as they are enacted or some real time and others from the reports created by the invoicing system.

Share capital

Limited companies usually issue shares to the persons providing the risk capital to enable the company to carry out trading operations. The person to whom the share is issued is designated as a shareholder.

A register is required to be maintained showing the name and address of the shareholder and the number of shares held by that shareholder. In the case of quoted companies, the share register is updated by a very sophisticated computer program which derives its information from the stock exchange transactions as these take place. Small companies maintain simple handwritten share registers.

Share certificates

The limited companies are required to issue share certificates to the shareholders reflecting the number of shares held by that shareholder. The share certificates are surrendered on disposal of the shares by the registered shareholder and a new share certificate issued to the acquirer of the shares.

In the case of quoted companies, it is no longer necessary to issue a paper document unless the shareholder specifically requests for such a document. Today the shares are held on behalf of the shareholder in an electronic format and this is linked to stockbroker's electronic account which reflects the shares held by each client of the stockbroker. The shareholder is then able to transact on his account, buying and selling shares at will but subject to the cash available to finance the transactions.

Statement of cash flows

This statement forms part of the financial statements under one accounting framework and its function is explained under the title of "Statement of source and application of funds " below.

Statement of source and application of funds

This is the statement showing the actual movement of cash rather than the profit or loss for the year. When preparing this statement all provisions are excluded as these are non-cash transactions. Regarding fixed assets, depreciation and profits or losses on disposal of fixed assets are adjusted against the profit, but the gross investment in fixed assets is shown plus the proceeds of any disposals of fixed assets.

It is doubtful if the layman looks at this document and it is even more doubtful if many people understand the document.

This document is now known as the "Statement of cash flows" under the one framework.

Statement of Financial Position

This is the same document as the Balance Sheet and for more information you need to refer to that document.

Statement of Income and Expenditure

This statement is the same document as the Profit and Loss Account and for more information you need to refer to that document.

Stockbroker

A stockbroker provides the service of buying and selling of quoted shares on a recognised stock exchange. The stockbroker needs to be a member in good standing of the stock exchange and in most advanced countries operates a computer system linked to the main trading system of the stock exchanges.

Taxation

The taxation rates and tax bands and a general appreciation of the principles applied to the various classes and types of taxpayers can be gleaned from the websites of the various tax authorities around the world provided one knows what one is looking for and the language does not present a problem.

There are various computerized and hard copy publications that one can access provided one purchases the book or subscribes to the publication.

Trial balance

This is the summarized account balance schedule or report extracted from the general ledger to prove the accuracy of all the postings to the general ledger and to ensure that it balances before using the trial balance for generating other reports to management.

Trust bank account

Certain businesses such as lawyers and solicitors, stockbrokers, estate agencies, advertising agencies and similar businesses are required to maintain trust bank accounts into which they deposit their client's funds and they may only withdraw money from these bank accounts once the services they provide have been provided in full and invoiced to the client.

Upload

Transfer data into someone else's computer system via an internet link from your computer.

Variable costs

The variable costs vary according to the variation in the gross turnover. Variable costs are in the case of a manufacturing entity the goods consumed in the direct production of the item being sold and the direct cost of selling the goods such as sales commission, delivery costs which are only incurred on delivery of a specific item.