IVEY | Publishing

9B19B006

NOTE ON FINANCIAL ACCOUNTING: THE FINANCIAL ACCOUNTING 'TERM SHEET'

Michael Saunders and Alex Solomos wrote this note under the supervision of Professor Matthew Sooy solely to provide material for class discussion. The authors do not intend to provide legal, tax, accounting or other professional advice. Such advice should be obtained from a qualified professional.

This publication may not be transmitted, photocopied, digitized, or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e) cases@ivey.ca; www.iveycases.com. Our goal is to publish materials of the highest quality; submit any errata to publishcases@ivey.ca.

Copyright © 2019, Ivey Business School Foundation *Version: 2019-05-24*

This technical note serves as a glossary constructed to ease students' transition into financial accounting courses. The glossary includes both foundational terms that are widely used and terms introduced in one or more common financial accounting cases. The terms are explained in a manner intended to inform both novice and advanced students.

The list has been constructed in part based on student-requested terms. Suggestions for additional unfamiliar terms that might benefit this glossary are welcomed. Please forward any suggested glossary terms to msooy@ivey.ca.

Do Not Copy or Post

Abstract for promotional use only. Full version available at www.iesepublishing.com

Distributed by IESE Publishing: www.iesepublishing.com. All rights reserved.

Abstract for promotional use only. Full version available at www.iesepublishing.com

GLOSSARY OF USEFUL AND VALUABLE TERMS (AND OTHER BUSINESS JARGON)

Term	Area of Study	What It Is	Why It Matters
Acid test	Evaluating investment targets	This measure of liquidity is calculated by adjusting the current ratio to remove illiquid assets (primarily, inventory), as follows: $\frac{Current\ Assets - Inventory}{Current\ Liabilities}$	Meeting short-term obligations is necessary to avoid insolvency or bankruptcy, even for large firms with valuable and productive assets. Both the acid test and the current ratio (see Current ratio) are reflective of companies' ability to meet short-term obligations. The acid test is a more conservative measure than the current ratio because it excludes certain current assets that may be difficult to liquidate.
Amortization versus depreciation	Evaluating investment targets	Broadly, both amortization and depreciation relate to an asset's loss of value over its life. Amortization and depreciation both spread out the cost of a long-lived asset across different reporting periods. Amortization usually describes *intangible* or *financial* assets, whereas depreciation is commonly used with *tangible* assets.	Almost all income statements, balance sheets, and cash-flow statements have some use for the terms amortization and depreciation, which allocate *lumpy* cash outlays across the asset's lifespan. With enhanced financial accounting study and increased learning about companies with higher intangible asset values, amortization plays a larger role, which must be fully understood and analyzed.
Annual run rate	Evaluating investment targets	The annual run rate is an estimate of what *will be* the total annual amount, based on partial year results. Annual run rate is typically calculated by extending current results to the end of the year. For example, if two of four quarters have passed, current results would be multiplied by 2 to arrive at the annual run rate, calculated as follows: $1\ year \div \frac{2\ quarters}{4\ quarters} = \frac{4}{2}$	Investors and managers often make projections for annual results based on partial-year results. The annual run rate is a term used to indicate that the figure is an estimate of the future based on incomplete results.

Do Not Copy or Post

Distributed by IESE Publishing: www.iesepublishing.com. All rights reserved.

Abstract for promotional use only. Full version available at www.iesepublishing.com

GLOSSARY (CONTINUED)

Term	Area of Study	What It Is	Why It Matters
Bank debt	General investing	Bank debt refers to loans issued by a commercial bank (or similar financial institution), typically referring to long-term loans. Bank debt typically has a lower interest rate than other forms of financing, but also requires some form of collateral that the lending institution has claim on if the debt cannot be repaid.	Bank debt is one of the most common forms of debt a company can obtain. It commonly appears in many financial statements. For individuals, it is the most likely type of debt obtained by borrowers for the purchase of a house. It is important to track the lifespan of an asset (short-term or long-term) and the funding used to finance that asset to avoid payments for the asset after the end of its productive life. Many ratios pertaining to debt are used in respect to both financial accounting and finance. It is sometimes helpful to distinguish between interest-bearing liabilities (such as bank debt) and liabilities that do not bear interest (such as wages payable).
Basis point	General investing	A basis point is a numerical value that represents 100th of 1 per cent. For example, 50 basis points represents 0.5 per cent (e.g., 0.0005).	Many securities and interest rates trade at values with many decimal places. When describing a price change, many analysts refer to basis points to more accurately describe the value of the asset or rate.
Book value	Evaluating investment targets	A company's book value is typically the carrying value of its total assets, which represent their net value, including all contra-asset accounts that offset original prices (e.g., depreciation and amortization).	It is helpful to compare a company's book value to its market cap (this ratio is called the market-to-book ratio). Generally, a company's market value is greater than its book value. The difference represents all of the future cash flows the company is projected to make (discounted because they occur in the future). In rare cases, a company's market value may drop to near or below its book value; however, these are typically firms approaching bankruptcy valued at the possibility of liquidation, rather than as a viable business.

Do Not Copy or Post

Distributed by IESE Publishing: www.iesepublishing.com. All rights reserved.