



AIA Best Practices:

Starting a firm: A glossary of essential financial terms

Contributed by Peter Piven, FAIA, and Bradford Perkins, FAIA. Excerpted from Architect's Essentials of Starting a Design Firm

Summary

A few fundamental financial management terms are defined in clear, concise language for the firm owner who needs a basic understanding of accounting terminology. Owners who understand and use this terminology increase their ability to effectively manage the firm's finances.

Unlocking the mysteries

Like architecture and all other professions, the discipline of accounting and financial management has its own vocabulary and language. Knowing the vocabulary is essential to understanding the language and, more importantly, the concepts of financial management. While this may seem obvious, few architects take the time to learn this vocabulary and, as a result, are rarely able to master even the fundamentals of financial management.

The following is a short list of important terms and clear, simple definitions. Knowledge is power; by understanding these terms, you increase your ability to manage your firm's finances effectively.

Accounts payable: Current liabilities—money that a business owes to others for any reason, including vendors, consultants, utility companies, landlords, mortgage holders, insurers, and tax authorities, for goods or services received by the firm.

Accounts receivable: Money owed to a business for any reason.

Accrual basis accounting: A method of accounting in which revenue is counted as having been earned as of the date an invoice is issued, and expenses are counted as having been paid as of the date of receipt of invoices from others. Accrual basis accounting is one of two methods of accounting; the other is cash basis accounting (see "cash basis" below). While most businesses operate on a cash basis, accrual basis accounting may provide a more accurate picture of the financial health of a firm.

Asset: A resource owned by a firm for which a monetary value can be determined.

Backlog: The value of contracts for which services have not yet been provided and revenue has not yet been earned.

Balance sheet: Among the most important financial terms that a business owner must know and understand, the balance sheet is a summary statement of a firm's financial condition as of a specific date. It shows the balance between the firm's assets and liabilities.

Book value: The difference between the firm's assets and liabilities. Also called net worth, equity, or owners' equity.

Cash basis accounting: A method of accounting in which revenue is counted as having been earned when it is actually received and expenses are counted as having been paid when they are actually paid.

Cash flow: A measure of the amount of money that actually flows in and out of a firm's accounts during a specified period. A positive cash flow means that more money has been received than expended. A negative cash flow means that more money has been spent than received.

Direct expenses: Costs that can be charged to specific projects, including staff time, consultants, and reimbursable expenses such as printing and travel.

Equity: the difference between the firm's assets and liabilities; also called book value, net worth, or owner's equity.

Gross revenue: The total amount earned by the firm for any reason and from any source before deducting expenses such as payments to vendors. (See "net revenue," below.)

Income: The profit that remains after all expenses have been deducted from revenues and before taxes are deducted.

Income statement: A summary statement showing the financial activity of the firm for a specified period. Also called a profit and loss statement.

Indirect expenses: Costs of operating the business that cannot be charged to specific projects. Also called overhead.

Liability: A debt or obligation of the firm owed to others.

Loss: The amount by which expenses exceed revenue in a specified accounting period.

Net income: The profit that remains after all expenses have been deducted from revenues and all taxes are deducted.

Net revenue: The total amount earned by the firm for any reason and from any source after deducting the portion of revenue that is owed to others, such as consultants and vendors. This is the value actually generated by the firm.

Net worth: The difference between the firm's assets and liabilities. Also called book value, equity, or owners' equity.

Operating cost: The total cost to operate the firm, including salaries, benefits, rent, supplies, and so on, usually expressed as a monthly sum.

Operating income: The revenue remaining after all direct and indirect expenses have been deducted. Also called operating profit.

Profit: The amount by which revenue exceeds expenses in a specified accounting period.

About the contributor

This article is excerpted and adapted from *Architect's Essentials of Starting a Design Firm*, by Peter Piven, FAIA, and Bradford Perkins, FAIA. This valuable resource addresses all aspects of starting and maintaining a successful design firm.

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