

Financial Glossary

Please also refer to the **Guide to Financial Statements in the Learning Centre** for a more detailed explanation of these terms.

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| Acid Test or Quick Ratio | Current assets less stocks (inventories), divided by current liabilities. A measure of a company's liquidity. |
| Accounting Policies | Specific accounting methods adopted by a company in the preparation of its financial statements. Under company law these have to be disclosed as part of the notes to the financial statements. |
| Accounting Standards | Detailed and authoritative statements issued by professional bodies setting out best accounting practice for a wide range of transactions. In the UK these are Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs) |
| Accounts Payable | Amounts a firm owes to its suppliers. U.S. term for creditors. |
| Accounts Receivable | Amounts owed to the firm by its customers. U.S. term for debtors. |
| Accounts Receivable Turnover | Credit sales divided by average accounts receivable. |
| Accruals | Recognition of revenues or expenses when earned or incurred, without regard to the actual time of the cash transaction. For example, a charge for the cost of power in the month of December would be accounted for in that month even though the quarterly bill might not be received and paid for until February. In this situation an accrued expense is shown on the balance sheet. The accruals concept is also called the matching concept. |
| Amortisation | The name given to the depreciation, or reduction in value of, non-tangible assets. |
| Annual Report | A report for shareholders and other interested parties prepared once a year. Includes a balance sheet, an income statement, a statement of cash flows, a reconciliation of changes in owners equity accounts, a summary of significant accounting principles, other explanatory notes, the auditor's report, and comments from management about the year's events |
| Annuity | A level stream of equal payments that last for a fixed time. |
| Arbitrage | Taking advantage of temporary differences in market prices. This is done by buying in the cheap market and then selling in the highest-priced market |
| Assets | Resources which a firm owns and which confer economic benefits in the future. |
| Asset Turnover | This ratio measuring the efficiency with which the assets are being used to produce sales. Total Sales divided by Total Assets. |

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| Associated Company | A company in which another company owns between 20 and 50% of the equity shares, and has a significant influence over its commercial decisions. |
| Authorised Share Capital | The maximum amount of share capital which a company is authorised by its Memorandum of Association to issue at any point in time. |
| Balance Sheet | An accounting statement that displays a snapshot of the assets, liabilities and equity of a firm at a point in time. |
| Beta | An indicator of the riskiness of a share's returns, as compared to the riskiness of general market returns. A beta of 1.0 indicates the same risk as the general market. |
| Bond | A long-term debt security issued by a borrower, either a public or private institution |
| Bond Rating | A published ranking of a bond developed by financial organisations to express its relative creditworthiness on a defined scale. |
| Book Value | The amount at which an asset is stated in the balance sheet as opposed to market value. Also means assets minus liabilities. |
| Break-even Approach | A method used to evaluate the point where sales equal operating costs. It serves as a guideline to determine the profitability of a firm. Breakeven is calculated by dividing the fixed costs of the business by the sales price per unit less the variable cost per unit (see also Contribution). |
| Called-up Share Capital | The issued share capital that the shareholders have been called upon to pay. |
| Capital Budgeting | A method of evaluating, comparing, and selecting projects to achieve the best long-term financial return. |
| Capital Employed | Broadly the resources used by a business to generate profit. It is commonly defined as ordinary share capital, preference shares, reserves and minority interests plus long-term liabilities. |
| Capital Expenditures | Long-term expenditures on fixed assets which are included on the balance sheet (as opposed to revenue expenditure). |
| Capitalise | To record an expenditure as an asset on the balance sheet rather than to treat the expenditure as an expense in the period of its occurrence on the profit and loss. |
| Capital Structure | The financing mix of a firm. The more debt in relation to equity, the more financial leverage or gearing the firm is said to have. |
| Cash Budget | A forecast of cash receipts and disbursements expected by a firm in the coming year. A short-term planning tool. |

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| Cash Conversion Cycle | The number of days between the purchase of raw materials and the collection of sales proceeds for finished goods. Commonly defined as the Collection Period plus Stock Days less the Payment Period. |
| Cash Flow | The positive (inflow) or negative (outflow) movements of cash caused by an activity over a specified period of time. |
| Cash Flow Statement | A financial statement showing the sources of cash for a business and the ways in which the cash has been used during the accounting period. |
| Cash Turnover | The number of times a firm's cash is collected in a year. |
| Collection Period | The number of days required to collect accounts receivable or trade debtors. Usually calculated as Receivables (or Trade Debtors) x 365 divided by Sales. |
| Consolidated Financial Statements | Statements issued by legally separate companies (parent company and its subsidiaries) that show the financial position as they would appear if the companies were one economic entity. |
| Contingent Liability | A liability, the crystallisation of which, is dependent on some future event occurring or not occurring. Examples include outcome of litigation costs, guarantees or commitments under operating leases. |
| Contribution | The amount by which sales revenue exceeds total variable costs |
| Cost Accounting | Classifying, summarizing, recording, reporting, and allocating current or predicted costs. |
| Cost of Capital | The rate a firm must pay to investors in order to induce them to purchase the firm's shares and/or bonds. |
| Cost of Goods Sold | Equals beginning inventory (stock) plus cost of goods purchased or manufactured minus ending inventory (stock). |
| Coupon Rate | The rate of interest received by a bondholder on an annual, semi-annual, or quarterly basis. |
| Creditors | Amounts owed to as business by those who have supplied it with goods. |
| Current Asset | Asset that is in the form of cash or that is expected to be converted into cash in the next 12 months. |
| Current Expenditures | Short-term expenditures that are completely charged to income in the year in which they occur. |
| Current Liabilities | Obligations that are expected to require cash payment within one year or the operating period. Also known as creditors: amounts due within one year. |

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| Current Ratio | Current assets divided by current liabilities. This is a measure of the liquidity of the firm. |
| Debenture | Usually a written agreement whereby a company grants a charge on its assets as security for funds advanced to it. |
| Debt Equity Ratio | The ratio of a firm's debt to its equity or shareholders' funds. The higher this ratio, the greater the financial leverage or gearing of the firm. |
| Debtors | Amounts owing to a business, normally from the sale of goods. Also referred to as accounts receivable |
| Debtor Turnover | The ratio between an entity's debtors and its sales on a credit basis. Usually expressed in terms of the average number of days credit sales that debtors represent. |
| Deferred Income | Money received in advance of goods delivered to the customer. The sale cannot be recognised until delivery occurs and so a liability to deliver the goods is recognised in the accounts |
| Depreciation | The allocation of part of an asset's cost to a particular accounting period. Normally done on a straight-line basis. Accumulated depreciation is the total cumulative amount of depreciation provided to date for assets still held by the company. |
| Dividend | Amount of profit distributed or proposed to be distributed to the shareholders. Directors decide periodically to declare dividends, and they set the amount to be paid. |
| Dividend Yield | The annual dividend payment divided by the market price of a share of the stock. |
| Earnings per Share | See EPS |
| EBIT(DA) | Earnings before interest and taxes (depreciation and amortisation). EBITDA is an attempt to take out some of the profit and loss statement items that distort comparisons across companies (e.g. interest costs). It also attempts to show an earnings measure that is closer to the company's cash flow from operations. This is because both depreciation and amortisation are included as expenses in the calculation of EBIT on the P & L but are actually non-cash charges. However EBITDA is not the same as operational cash flow. The key critical failing of EBITDA is that it ignores changes in net working assets and can overstate cash flow in periods of working capital growth. It can therefore create the appearance of stronger interest coverage and lower financial leverage. |
| Economic Life | The time span over which the benefits of an asset are expected to be received. |
| EPS | Earnings per share. Profit after tax divided by the number of shares in issue. |

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| Equity | See Shareholders' Funds |
| Exceptional Items | Arise from events that do not occur regularly but are within the ordinary activities of the business. |
| Financial Leverage | The magnifying (or diminishing) effect on return on equity from the use of debt in the capital structure. See also Gearing. |
| Finance lease | A lease that effectively transfers the risks and rewards of ownership of the leased asset from lessor to lessee. The lease usually lasts for nearly all the asset's economic life. |
| Fixed assets | Assets owned for long-term use and held on continuing basis. Tangible fixed assets have an underlying physical substance. See also intangible assets. |
| Fixed costs | Costs which do not vary with the level of production. |
| Gearing | The relationship between the amount of debt finance and the equity finance of a business. A company with high gearing is one which has a high proportion of debt to equity. |
| Going concern | A fundamental accounting concept which presumes that the business will continue to operate for the foreseeable future. |
| Goodwill | The intangible assets of a firm, calculated as the excess purchase price paid over book value. |
| Gross Margin or Profit | Net sales minus cost of goods sold. |
| Income Statement (Profit and Loss Statement) | An accounting statement of a firm's sales, operating costs, and financial charges. It reports the periodic revenues and matching costs and expenses for a specified period and derives the income for the period. |
| Insolvency | The inability to repay debt. |
| Intangible Assets | The term applied to a group of fixed assets that generally do not have physical existence, including patents, copyrights, and goodwill. |
| Interest Coverage Ratio | Earnings before interest and taxes divided by interest expense. Used to measure a firm's ability to pay interest. |
| Inventory | See Stock |
| Joint venture | A long-term arrangement in which no one venturer can control strategy. |
| Leverage Ratio | Compares the amount of funds invested by creditors to the amount of funds invested by owners. |

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| Liabilities | Amounts owed to organisations and individuals. |
| Liquidity | A measure of how easily assets can be converted into cash. |
| Long-Term Debt | Borrowing over a long period of time, usually through bank loans or the sale of bonds. On a balance sheet, any debt due for more than one year is classified as long term. |
| Matching | Another name for the accruals concept. |
| Minority interest | Arises when one company acquires another but acquires less than 100% of the shares. |
| Net Profit Margins | Net profits after taxes divided by sales. |
| Net Working Assets | Usually refers to trade debtors plus stock less trade creditors. Net working assets divided by sales gives a guide as to the additional working capital funding required from a given increase in sales i.e. a ratio of 15% indicates a company has to invest 15 pence in working capital for every incremental £1 of sales. |
| Net assets | The value of assets less liabilities |
| Net worth | The book value of a company's equity. |
| Operating Lease | Assets acquired under operating leases are not shown on the balance sheet (compare with Finance Lease). |
| Operating Leverage/Gearing | The degree to which a company's costs of operation are fixed as opposed to variable. High operating leverage means a high proportion of fixed costs to total expenses. |
| Operating Profits (Trading Profits) | Profits earned from operations, excluding taxes and interest from consideration. |
| Opportunity Cost | The rate of return on the best alternative investment that is not selected. |
| Ordinary Shares | Shares carrying one vote each and with an equal right to a proportionate share of the dividends. The most common class of share. |
| P & L | A financial statement giving details of a company's revenues and expenses. |
| Par Value | The nominal or face value of shares or bonds. For shares, it is a relatively unimportant value except for bookkeeping purposes. |
| Payables | Another term for creditors |
| Payment Period | The number of days within which a firm pays off its accounts payables or trade creditors. Usually calculated as Accounts Payable (or Trade Creditors) x 365 divided by Cost of Sales. |
| Perpetuity | An annuity forever; periodic payments or receipts on a continuous basis. |

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| Preference Shares | Shares which have prior claims over those of ordinary shares as regards either dividends or repayment of capital. Typically the amount of dividend is fixed. |
| Prepayments | A prepaid expense – an amount shown in the accounts as an asset representing goods paid for but not yet fully received. |
| Price Earnings (P/E) Ratio | The price of a firm's share divided by its EPS. |
| Profit and Loss Account | The financial statement that summarises the turnover (sales) and expenses of a business. See also Retained Earnings. |
| Provision | A liability representing amounts set aside for costs likely to arise in the future. |
| Quick Ratio | Current assets minus inventory (stock) divided by total current liabilities. Used to measure short-term solvency of a firm. |
| R & D | Research and Development. |
| Receivables | Another term for debtors |
| Reserves | These are either revenue reserves or capital reserves. Revenue reserves are accumulated retained profits which are available for distribution as dividends. Capital reserves include share premiums and revaluation reserves and are not available for distribution as dividends. |
| Retained Earnings | The excess of profit after tax over dividends paid out to shareholders. It can be in respect of a particular accounting period or the accumulated total over a company's whole life to date (shown in the shareholders' funds as the profit and loss account). |
| Return on Assets (ROA) | EBIT divided by total assets. This ratio helps a firm determine how effectively it generates profits from its assets. |
| Return on Net Assets (RONA) | The relationship of annual earnings before interest, after taxes to total assets less current liabilities. It is used as a measure of the productivity of a company's invested capital regardless of the amount of financial leverage employed. |
| Receivables | Another term for debtors |
| Revenue expenditure | Money spent on items such as wages and rent which will be consumed within the year. |
| Risk | The degree of uncertainty associated with the outcome of an investment. It is a measure of the volatility of returns obtained from a project, and takes into consideration the probability of loss in any investment venture. |
| Risk-Free Rate of Riskless Rate | A discount rate equal to the return on a riskless asset. It is usually equal to the return on debt issued by the government. |
| Risk Premium | An additional required rate of return that must be paid to investors who own risky assets. The riskier the asset, the higher the premium. |

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| Salvage Value | The estimated selling price of an asset once it has been fully depreciated. |
| Share capital | The nominal value of shares issued to shareholders. |
| Share premium | Shares issued at an amount exceeding their nominal (par) value |
| Shareholders' Funds | The amount that belongs to the shareholders. It consists of share capital, retained profits and other reserves. |
| Standard Cost | Anticipated cost of producing a unit of output; a predetermined cost to be assigned to products produced. Standard costs are used as the benchmark for gauging good and bad performance. |
| Stock | This refers to inventory held for resale and usually includes raw materials, work in progress and finished goods. |
| Stock Days | Measures the period for which stocks are being held. Usually calculated as $\text{Stock} \times 365$ divided by Cost of Sales. |
| Stock turnover | Ratio measuring relationship between a company's stock (inventory) and cost of sales. |
| Straight-Line Depreciation | Depreciating an asset by equal amounts each year over the life of the asset. |
| Subordinated Debt | Debt whose holders have a claim on the firm's assets, only after senior debt holder's claims have been satisfied. |
| Subsidiary | A company (B) which is controlled by another company (A). "Control" means that A owns more than 50% of the subsidiary's equity share capital. Formal name is subsidiary undertaking. |
| Sunk Cost | A cost that has already occurred and cannot be removed. Because sunk costs are in the past, such costs should be ignored when deciding whether to accept or reject a project. |
| Times Interest Earned Ratio (TIE) | EBIT divided by annual interest expense. It is a measure of how well the firm meets its interest payments. |
| Time Value of Money | An expression of the ability of money to earn interest. A dollar today has greater value than a dollar tomorrow. |
| Total Asset-Turnover Ratio | Total operating revenues divided by average total assets. Used to measure how effectively a firm is managing its assets. |
| Turnover | Another term for sales. Includes both cash sales and credit sales but not the sale of fixed assets. |
| Variable Costs | Costs that change as activity levels change. In accounting this term often means the sum of direct costs and variable overhead. |
| Variance | Difference between actual and standard costs or between budgeted and actual expenditures or, sometimes, expenses. |
| WIP | Work in progress. |
| Write-Offs/Depreciation | Accounting entries that allocate portions of past outlays into appropriate operating periods, such as depreciation and amortization. |

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| Working Capital | The money tied up in current assets but the term primarily refers to cash, stock (inventory) and accounts receivable. |
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