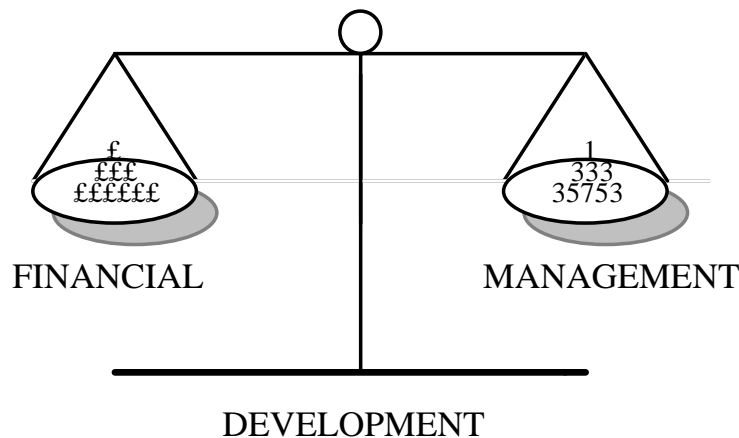


# FINANCIAL MANAGEMENT DEVELOPMENT

**NO 600**

## COMMON FINANCIAL TERMS



This document has been produced as a guide to the most common meaning for various financial terms. It has not been tailored to any one organisation and therefore some terms may have different uses or meanings for specific clients or suppliers. It is a guide rather than a definitive statement. Finance, like any language, is constantly changing.

**ONE OF A SERIES OF GUIDES FOR  
FINANCIAL MANAGEMENT DEVELOPMENT  
FROM**

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

<b>ACCRUALS</b>	Estimates of costs incurred but not yet invoiced. They are charged to the Profit and Loss Account and will also appear as liabilities in the Balance Sheet.
<b>ADDED VALUE</b>	The value added e.g. sales less bought-in materials and services.
<b>ASSETS</b>	Items owned by the business which are shown on the Balance Sheet. The value shown is normally cost (less depreciation if applicable) but could be a valuation.
<b>ASSET TURNOVER</b>	Sales divided by assets employed.
<b>AUDITORS</b>	External Auditors are External Accountants who report on the "truth and fairness" of the published financial statements. Internal Auditors co-operate with the External Auditors but also review management data and operational aspects of the business.
<b>BALANCE SHEET</b>	A financial statement which records assets, liabilities and shareholders' investment in the business at a point in time, normally the end of an accounting period.
<b>BOOK VALUE</b>	The value at which Fixed Assets are stated in the Balance Sheet i.e. cost less any depreciation (also called net book value).
<b>BORROWINGS</b>	Total amounts owing to those who have lent money to the company. This is often split in the Balance Sheet into short term i.e. due within one year and long term i.e. due in more than one year.
<b>BREAK-EVEN POINT</b>	Level of sales or volume where sales equals total variable and fixed costs i.e. profit is zero. It can also be defined as the level of sales at which contribution equals fixed costs.
<b>BUDGET</b>	General term for a short (normally one year) financial plan.
<b>BUDGETARY CONTROL</b>	The process by which actual performance is measured against the budget. This normally requires Variance Analysis.

<b>CAPITAL EMPLOYED</b>	Amount of financial (share or loan capital) put into a company and on which the management must make a return.
<b>CAPITAL EXPENDITURE</b>	Also called Capital Investment. Amounts spent on items of a long term nature i.e. which will be used in the business for more than one year and are therefore classed as fixed assets in the Balance Sheet.
<b>CASH FLOW</b>	The change in the cash position of a business during an accounting period or as a result of a particular event.
<b>CASH FLOW STATEMENT</b>	Also called Source and Use of Funds Statement. A financial statement identifying the change in cash resources of the business by highlighting changes in Balance Sheet items and analysing their causes. The format is set out in FRS1, the accounting standard.
<b>CAPITAL RESERVE</b>	Also called Revaluation Reserve, part of shareholders' funds arising from an increase in assets from a revaluation etc which was not recorded in the Profit and Loss Account.
<b>CAPITAL TURNOVER</b>	Also called Asset Turnover. Sales divided by capital employed.
<b>CONTRIBUTION</b>	The total after variable costs are taken away from sales. Can also be used to describe various profit levels after other categories of cost. Often expressed as a percentage of sales.
<b>COSTS</b>	Charges incurred, whether spent or accrued for, by a company which are charged to the Profit and Loss Account because they refer to the current year's operations.
<b>CREDITORS</b>	Amounts owing to suppliers for bills unpaid at a point in time e.g. at the end of a financial period.
<b>CURRENT ASSETS</b>	Those assets which are constantly moving around in the business and are therefore relatively easy to turn into cash or realise i.e. stocks, debtors, marketable investments and cash.

<b>CURRENT LIABILITIES</b>	Amount owing at the period end which will or could be required to be paid within twelve months.
<b>DEBT EQUITY RATIO</b>	Referred to as either Debt/Equity ratio or Gearing ratio. Ratio of borrowings to shareholders equity.
<b>DEBTORS</b>	An asset in the Balance Sheet which represents amounts owing by customers, e.g. sales invoices not yet paid.
<b>DEPRECIATION</b>	A book entry spreading capital expenditure over the estimated life of an asset by means of a charge which reduces both profits in the Profit and Loss Account and the value of assets in the Balance Sheet.
<b>DIRECT COSTS</b>	Those costs which can be directly identified with a product, business unit, department or other part of the business.
<b>DISCOUNTED CASH FLOW</b>	Referred to as either Discounted Cash Flow or DCF. A method of evaluating projects by discounting their projected future cash flows to their present values by reference to a given discount factor. Thereby reflecting the reduced value of future cashflows.
<b>DIVIDEND</b>	The amount of cash paid or payable to shareholders as a distribution of profits.
<b>EARNINGS</b>	Profit available to ordinary shareholders after all charges except dividend. Technically it is always after tax, but can sometimes be used to mean profits.
<b>EARNINGS PER SHARE (EPS)</b>	Referred to as either Earnings per Share or EPS. Earnings divided by number of shares issued. The earnings figure used is after tax but before extraordinary items.
<b>EQUITY</b>	The investment in the business by shareholders.
<b>EXPENSES</b>	Also known as Revenue Expenditure. This is another term for costs, sometimes only applied to those costs below the gross profit level.
<b>EXTRA-ORDINARY ITEM</b>	An item in the Profit and Loss Account which is unconnected with ordinary operations.

<b>FINANCIAL ACCOUNTS</b>	The accounts prepared for inclusion in the Annual Report to Shareholders.
<b>FIXED ASSETS</b>	Those assets which are retained for long term use in the business.
<b>FIXED COSTS</b>	Costs where the total amount spent does not vary directly with volume in the short-term.
<b>FINANCIAL REPORTING STANDARD</b>	Formerly call SSAP (Statements of Standard Accounting Practice) these set out the rules governing published financial statements in the UK.
<b>GEARING</b>	Also known as Leverage (more normally used outside the UK). The extent to which a company has used borrowing, as opposed to equity, finance to fund its assets employed.
<b>GEARING RATIO</b>	Referred to as either Debt/Equity ratio or Gearing Ratio. Ratio of borrowing to shareholders' equity.
<b>GOODWILL</b>	The excess of price paid over the value of net assets included in the combined Balance Sheet after the acquisition of a subsidiary company.
<b>GROSS MARGIN</b>	Another term for GROSS PROFIT (sales less production cost). It can be expressed as a percentage of sales.
<b>GROSS PROFIT</b>	Sales less production cost.
<b>HISTORICAL COST</b>	The original cost of the asset.
<b>INCOME</b>	Another term for sales, more frequently applied to service businesses. Also used to describe money coming from non-trading activities e.g. rent receivable. In the US, can be used to describe profit rather than sales.
<b>INCREMENTAL COST</b>	Also known as Marginal Cost. The increase in total cost as a result of a particular event or decision.
<b>INDIRECT COSTS</b>	Costs which cannot be classified as directly attributable to a product or process.
<b>INTEREST COVER</b>	Trading Profit divided by interest payable.

<b>INTEREST PAYABLE</b>	Interest payable on borrowings.
<b>INTEREST RECEIVABLE</b>	Interest received from investment of surplus funds.
<b>INTERNAL RATE OF RETURN (IRR)</b>	Referred to as either Internal Rate of Return or IRR. The rate at which future discounted cash flows will come to zero present value for a specific project.
<b>INVENTORIES</b>	The US term for stock.
<b>INVESTMENTS</b>	Shares in other companies shown as assets in the Balance Sheet.
<b>LIABILITIES</b>	Amounts owed by the business e.g. purchases not yet paid for.
<b>LOAN CAPITAL</b>	Long-term capital put into the business by lenders rather than shareholders.
<b>MANAGEMENT ACCOUNTING</b>	Financial information produced for the purpose of management decision making and control, rather than for reporting to shareholders.
<b>MARGIN OF SAFETY</b>	The amount by which sales can fall before profit equals zero, i.e. the amount above the Break Even Point.
<b>MARGINAL COST</b>	The short term increase in total cost as a result of a particular event or decision.
<b>MINORITY INTEREST</b>	Where outside shareholders hold a minority i.e. less than 50%, shareholding in a subsidiary company and are entitled to a share of profits.
<b>NET ASSETS</b>	Also known as Net Worth. Total assets in the Balance Sheet less all liabilities.
<b>NET CURRENT ASSETS</b>	Current Assets less Current Liabilities.
<b>NET PRESENT VALUE (NPV)</b>	The net amount of a project cash flow, after discounting at the appropriate cost of capital, i.e. after allowing for the time value of money.
<b>NET WORTH</b>	See NET ASSETS.

<b>OPERATING CASH FLOW</b>	The change in the cash position of a business as a result of trading operations for a particular period.
<b>OPERATING PROFIT</b>	Sales less all normal costs of running the business.
<b>OPPORTUNITY COST</b>	The amount foregone by utilising a resource i.e. its cost plus any profit it might otherwise have generated.
<b>ORDINARY SHAREHOLDERS</b>	Those who share equally in the profits and dividends of the business.
<b>OVERDRAFT</b>	Facility for short term borrowing available from bankers.
<b>PAYABLES</b>	The US term for Creditors.
<b>PAYBACK</b>	The number of years it takes to recover an initial amount invested. This may or may not be discounted.
<b>PREFERENCE SHARE-HOLDERS</b>	Those who have first claim on profits and dividends, usually only up to a fixed percentage of their investment.
<b>PROFIT</b>	The amount left after deducting total costs from total sales - the increased wealth generated during the relevant period. "Profit" normally requires qualifying e.g. Trading Profit, or Operating Profit.
<b>PROFIT AND LOSS ACCOUNT</b>	A financial statement which records the sales, the costs and therefore the profit for a stated accounting period.
<b>PROFIT BEFORE INTEREST AND TAX (PBIT)</b>	Referred to as Operating Profit, Profit Before Interest and Tax, PBIT, or Trading Profit it is effectively sales less operating costs.
<b>PROFIT MARGIN</b>	Also known as Return on Sales. Profit as a percentage of Sales Income.
<b>PROVISION</b>	Estimate of expenditure which is not yet fully ascertainable, but which is charged as a cost in the Profit and Loss Account. Similar to an accrual but less specific.

<b>PROVISION FOR BAD &amp; DOUBTFUL DEBTS</b>	An amount charged against profits to cover debtors who may not pay for the goods/services they have received; also the total of amounts set aside for this which is deducted from debtors in the Balance Sheet.
<b>RATE OF RETURN</b>	See INTERNAL RATE OF RETURN and YIELD.
<b>RECEIVABLES</b>	The US Term for DEBTORS (an asset in the Balance Sheet which represents amounts owing by customers).
<b>REPLACEMENT COST</b>	The current cost of replacing an existing fixed asset with a new asset.
<b>RESERVES</b>	Another term for Retained Profits. (All profits made since the company was formed which have not yet been distributed as dividends); also used to describe retained profits plus capital reserves.
<b>RETAINED PROFITS</b>	All profits made since the company was formed which have not yet been distributed as dividends.
<b>RETURN ON ASSETS (ROA)</b>	Also known as Return on Capital, ROC, Return on Capital Employed, ROCE, Return on Net Assets , RONA, Return on Investment or ROI. Trading Profit as a percentage of capital employed sometimes based on averages to give ROACE or ROAA etc.
<b>RETURN ON CAPITAL (ROC)</b>	An abbreviated term for Return on Capital Employed.
<b>RETURN ON CAPITAL EMPLOYED (ROCE)</b>	Trading Profit as a percentage of capital employed.
<b>RETURN ON INVESTMENT (ROI)</b>	Another term for Return on Capital Employed.
<b>RETURN ON SALES</b>	Referred to as either Profit Margin or Return on Sales. Trading Profit as a percentage of sales.
<b>REVALUATION RESERVE</b>	A capital reserve caused by an increase in shareholders' equity following a revaluation of existing assets in the Balance Sheet.

<b>REVENUE</b>	Referred to as Income or Revenue. Another term for sales, more often applied to service business. Also used to describe money coming from non-trading activities e.g. rent receivable. In US can be used to describe profit rather than sales.
<b>REVENUE EXPENDITURE</b>	Also known as Expenses. A term used to differentiate from Capital Expenditure This is another term for costs, more usually applied to those below the gross profit level.
<b>SALES</b>	Also known as Turnover. The amount charged for goods delivered in a particular period irrespective of whether cash has been collected.
<b>SENSITIVITY ANALYSIS</b>	The calculation of the impact on profit of changing assumptions.
<b>SHARE CAPITAL</b>	Money put into the business by shareholders by means of direct investment.
<b>SHAREHOLDERS CAPITAL EMPLOYED</b>	Also known as Shareholders Funds or Shareholders Equity. The total of share capital plus reserves including Retained Profit.
<b>SHAREHOLDERS EQUITY</b>	Another term for Shareholders Capital Employed.
<b>SHAREHOLDERS FUNDS</b>	Another term for Shareholders Equity.
<b>SHORT TERM BORROWING</b>	Borrowing which will or could need to be repaid within twelve months.
<b>SOURCE AND USE OF FUNDS STATEMENT</b>	Also known as a Cash Flow Statement. A financial statement identifying the change in cash resources of the business by highlighting changes in Balance Sheet items.
<b>STOCK</b>	The amount of money tied up in Raw materials, Work in Progress and Finished Goods.
<b>SUNK COST</b>	A cost which has already been paid and which therefore should be ignored when considering future actions.
<b>TRADE CREDITORS</b>	Amounts owing to suppliers in the normal course of trading.

<b>TRADE DEBTORS</b>	Amounts owing by customers in the normal course of trading.
<b>TRADING PROFIT</b>	Also known as Operating Profit, Profit before Interest and Tax, PBIT, Trading Results. Sales less all normal costs of running the business.
<b>TURNOVER</b>	Also known as Sales. The amount charged for goods delivered in a particular period irrespective of whether cash has been collected.
<b>VARIABLE COSTS</b>	Costs where the total amount spent varies directly with volume, in the short term.
<b>WORKING CAPITAL</b>	Current Assets less Current Liabilities i.e. another term for net current assets.
<b>WRITTEN DOWN VALUE</b>	The book value of fixed assets at historical cost less depreciation.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development.

He has worked as a Financial Controller and Company Secretary in the Finance Industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over thirty major organisations including Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco) and computer based training packages (The Post Office, Unilever and BP).

He is a prolific writer of case studies, role plays and course material, he has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants and the need for taxation awareness training for general managers.

He is married with one grown up daughter and his outside interests include being The Treasurer of the Hospice of St. Francis (Berkhamsted), and a member of the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).