

## Financial Terms Explained

**Accounting** The identification and recording of business transactions in such a way as to assist the management and planning of a business.

**Accounting Policies** The specific accounting bases selected and used by a business, and are generally governed by accounting standards. Accounting policies need to be appropriate to the circumstances of a business so that the information presents a true and fair view of the financial position. Note however, that some subjectivity is usually required when determining how to apply accounting policies.

**Accounting Standards** Statements of how particular types of transaction and other events should be reflected and recorded in financial statements. Compliance with accounting standards will normally be necessary for financial statements to give a true and fair view of the business.

**Accounts** The financial books of a company. These are prepared according to generally accepted accounting principles and are a legal requirement for all companies.

**Accounts Receivable** This is a term for trade debtors; it is the money owed to the company by its customers.

**Accounts Payable** This is a term for trade creditors; it is the money the company owes its suppliers.

**Accruals** Companies make accruals for items such as those shown below, in order to ensure that the accounts show a true and fair picture of what has happened during any particular accounting period. Accruals also show what is owed or owing at the balance sheet date.

- Expenses which were incurred in the accounting period but have not yet been invoiced;
- Cash received from customers for goods and/or services to be provided in a future accounting period;
- Invoices received from suppliers for goods and/or services to be provided in a future accounting period.

**Acid Test Ratio** Also known as the quick ratio. An accounting ratio that is concerned with business liquidity. It is defined as current assets excluding stocks divided by creditors falling due within one year. The acid test ratio is designed to test the short term solvency of a business, in a way similar to the current ratio. Stocks are excluded from current assets on the basis that it can often take several months to convert stocks into cash.

**Activity Based Costing** Sometimes referred to as ABC, it is a system which recognises that costs are incurred by each activity that takes place within a business, and that products (or customers) should bear costs according to the activities they use. The use of ABC requires the cost drivers (i.e. those activities that take place that cause costs to be incurred) to be identified and the allocation of these drivers to each activity.

**Administration** Under an administration order a court supervises the affairs of a company in financial difficulties with to the aim of securing it as a going concern or achieving a more favourable realisation of its assets than would be possible on liquidation. While the administration order is in force, the affairs of the company are managed by an administrator.

**Amortisation** This is a reduction in debt by periodic payments covering interest and part of the loan principal. The term is also used for the process of writing down intangible assets such as a lease.

**Annual Report & Accounts** All limited companies are required by company law to prepare an annual report containing their financial statements, directors' report and, for larger companies, the auditor's report. The annual report and accounts must be sent to shareholders and to the Registrar of Companies – the government department that maintains the public records of companies. Once sent to the Registrar, the annual report becomes a public document, available for anyone to view.

**Assets** Defined as everything that a company owns or that is due to the company. This includes:

- Current assets such as cash, investments, cash due, materials and stocks;
- Fixed assets such as land, buildings and machinery;
- Intangible assets such as patents and goodwill.

**Asset Turnover** This is a ratio which measures the effectiveness with which a business uses its assets to generate sales. It is calculated by dividing total sales by total assets.

**Associated Company** A company over which another company has significant influence. The company is called an associated company if the other company owns typically between 20 to 50%. Above 50%, the company becomes a subsidiary whereas if the ownership is less than 20% the holding becomes a trade investment.

**Audit** A systematic examination of the activities and status of an entity (e.g. a company), based primarily on investigation and analysis of its systems, controls and records. Note that not a requirement for all companies to undergo a financial audit as there are exemptions available for small companies provided that they meet certain criteria.

**Balance Sheet** A statement of the financial position of a business at a particular date. It shows the various categories of assets and liabilities, and how they have been financed. The things that have to balance or equal each other are assets on the one hand, and the sum of liabilities and shareholders' equity on the other.

**Book Value** The value of an asset as recorded in the accounts. Note that it is an accounting concept and does not necessarily represent the current value of the asset. For a fixed asset, the book value will generally be the original cost less accumulated depreciation. This is often called the written down value. The book value of an ordinary share is the sum of the ordinary share capital and reserves divided by the number shares which have been issued.

**Bond** A type of debt, it is a written promise to pay the holder a sum of money at a certain time at a stated rate of interest.

**Break-Even Point** The point at which income from sales is equal to total costs.

**Brokers** Intermediaries between buyers and sellers.

**Budget** An estimate of expenditure for a period of time and for a defined area such as a department or project. It is generally used as a means to help the business plan and control costs.

**Call Option** Gives the holder of the option the right to buy a share (or other asset) at the exercise price at some future time. See also put option.

**Capital Allowances** A tax allowance on capital expenditure on certain items such as plant and machinery, buildings, and some equipment.

**Capital Employed** This is essentially the asset base that a business needs to generate its profits. There are a variety of definitions according to different accounting standards. In one definition, capital employed is equal to the book value of fixed assets plus working capital. Because balance sheets balance, this will be equal to the book value of equity, minority interests and net debt. In another definition, capital employed is total assets less current liabilities. This is equal to the long term funds invested in the business in the form of long term liabilities, debt and equity. The difference between the definitions is that the latter treats short term borrowings as part of the working capital of the company rather than as part of its funding.

**Capital Expenditure** Expenditure on fixed assets such as plant, equipment and investments in acquiring other companies. Except for land, the original cost is spread over several accounting periods through the process of depreciation. The value of the fixed assets is shown in the balance sheet, and depreciation is charged each year as an operating cost in the profit and loss account.

**Capital Gains Tax** Profits from trading are taxed differently from the disposal of assets either by traders for whom the assets are not trading stock, or by individuals who do not trade (e.g. sales of shares by an investor). The latter type of tax is a capital gains tax.

**Capital Gearing** The proportion of total finance debt or borrowings in relation to shareholders' funds.

**Capital Market** This is the market where capital can be traded as a debt or equity, for example the stock exchange, the currency market and the derivative market.

With the compliments of CCG Solutions

Phone: 01454 299 782 E-mail: [info@ccg-solutions.co.uk](mailto:info@ccg-solutions.co.uk) Web: [www.ccg-solutions.co.uk](http://www.ccg-solutions.co.uk)

**Capitalisation** See market capitalisation.

**Cash Flow Budget** A cash flow budget or forecast summarises the forecast cash flows of a business over a budget period.

**Cash Flow** Usually means the generation of cash by a business through its operations. It is equal to: profits *plus* depreciation *plus* divestment proceeds *less* fresh working capital investment *plus* working capital reduction *less* capital expenditure.

**Cash Flow Statement** This is a statement which explains the impact of a company's trading, investment and other financial transactions on changes in the company's cash position between the opening and closing balance sheets.

**Closing Price** The last transaction price of the day on a stock exchange.

**Collection Period** See debtor days.

**Common Stock** See ordinary shares.

**Consolidated Accounts** The financial statements of a group of companies which have been aggregated to show the overall financial results and position of the group.

**Contingent Liability** A potential liability that arises from past events. The existence and amount of the liability is contingent on the occurrence of one or more uncertain future events not wholly within the control of the business. Where the amount and outcome of a contingent liability can reasonably be forecast, the business should make a provision for the liability in its accounts.

**Contribution** The amount of operating profit that has been earned before taking account of fixed costs or expenses of a business.

**Convertible** A bond, debenture, or preferred share that may be exchanged by the owner for ordinary shares in accordance with the terms of the issue.

**Corporation Tax** The taxation payable by companies on their profits. Companies can receive certain tax allowances to reduce the amount of corporation tax payable, for example capital allowances which provide an incentive to invest in fixed assets. Smaller companies also benefit from lower corporation tax rates.

**Cost** A charge against profits which is made for the use or consumption of resources during an accounting period. Note that cost is not necessarily the same as the cash spent during the accounting period because of adjustments for depreciation, accruals and provisions.

**Cost Centre** A production or service location, function, activity or item of equipment to which costs are charged and accumulated.

**Cost of Capital** The average cost of funds. These funds come from either debt or equity and the cost of capital can be thought of as the weighted average cost of these two sources of finance. Note that the cost of capital can be different for different enterprises.

**Cost of Goods Sold** See cost of sales.

**Cost of Sales** This is the cost to the business of the products and/or services sold to its customers.

**Cost of Sales Adjustment (COSA)** The difference between the replacement (i.e. the current) and the historical cost of sales. It is an adjustment which is used to help to strip out the impact of profits or losses arising from stock valuation movements.

**Creditors** Any person or organisation to whom (apart from shareholders) a business has a financial commitment. For example, trade creditors or payables are suppliers of goods and for whom unpaid bills are outstanding. Note that there is a requirement to distinguish between short term creditors (current liabilities; those due to be paid within 12 months of the balance sheet date) and long term creditors (amounts due to be paid after one year, for example bank loans).

**Creditor Days** A measure of how long it takes for the company to pay for the goods and/or services that it buys. It is defined as trade creditors multiply by the days per year (365) divided by the annual purchases on credit.

**Current Assets** Assets such as debtors and stocks, which can be converted into cash within 12 months of the balance sheet date. Cash balances and short term investments (such as stock market investments) are also part of current assets, and they are referred to as liquid resources.

**Current Cost** See replacement cost.

**Current Liabilities** Short term liabilities which have to be discharged normally within 12 months of the balance sheet date. Examples include trade creditors, bank overdrafts and accrued charges.

**Current Ratio** An indication of a company's ability to meet its short-term debt obligations. The current ratio is equal to current assets divided by current liabilities. If the current assets of a company are more than twice the current liabilities, then that company is generally considered to have good short-term financial strength. However, if current liabilities exceed current assets, then the company may have problems meeting its short-term obligations.

**Debentures** A specific asset which has a fixed repayment date, and a stated rate of interest is paid. Debentures may be traded on the Stock Exchange.

**Debt** Interest bearing liabilities such as short and long term bank loans. The market value of the debt is the value of the debt at current market interest rates. Note that this figure can be different from the original or face value of the debt if the debt pays a fixed rate of interest and interest rates have changed since the debt was issued.

**Debt Equity Ratio** The relationship of total interest bearing borrowings to shareholders' funds. It is also known as a gearing or leverage ratio.

**Debtors** Amounts due from third parties. The largest element is usually trade debtors, which are the amounts due from customers.

**Debtor Days** The average length of time taken for a customer to pay a sales invoice. It is calculated by dividing trade debtors or receivables by annual cost of sales times 365 days to give the average number of days for which the sales invoice has been outstanding.

**Deferred Taxation** This is caused by timing differences between when a transaction is recognised for accounting purposes and when it is recognised for tax purposes. One of the main sources of deferred taxation is the difference in timing of depreciation charges and the permitted allowances claimed against taxable profits.

**Deflation** The opposite of Inflation.

**Depreciation** Defined as charges against earnings to write off the cost (less salvage value) of an asset over its estimated useful life. Note that depreciation is a non-cash item, i.e. a bookkeeping entry which does not represent any cash outlay. The cash outlay occurred during the period when the asset was acquired.

**Direct Cost** A cost that can be directly related to producing specific goods or performing a specific service.

**Discounted Cash Flow (DCF)** Calculates the present value of future cash flow discounted at a discount rate. This is an investment appraisal method that takes into account the time value of money and the overall project cash flow. It measures the return on capital invested in a project or calculates the initial investment required to obtain a specific sum in the future. Note that the sum of discounted future cash flows is the net present value (NPV).

**Discount Factor** A figure which has been calculated from the appropriate discount rate to allow the present value of any future cash flow to be calculated. The present value is equal to the discount factor times the cash flow.

**Discount Rate** Used to ascertain the time value of money and is used in investment analysis. It is equal to the cost of capital and is expressed as a percentage.

**Discounted Payback** Indicates how many years it will require before the cumulative cash flows expected from a business or project are such as to allow a zero net present value (NPV) to be earned. See also NPV and IRR.

**Dividend** The share of the profits designated to be distributed to shareholders. On preferred shares, it is generally a fixed amount each year. On ordinary shares, the dividend generally varies with the fortunes of

the company and the amount of cash on hand. Sometimes a company will pay a dividend that is greater than its profit; the dividend is then said to be uncovered. Note that the dividend can serve as an important signal to the outside world about the future financial prospects of the company. Dividend cover measures the ability of the company to pay dividends at current profit levels, and it is the inverse of the dividend payout ratio.

**Dividend Cover** See earning / dividend ratio.

**Dividend Payout Ratio** Measures the amount of earnings that is paid out as dividends. It comes from dividend per share divided by earnings per share.

**Dividend Yield** The dividend per share divided by the market price of the share.

**Dividend Discount Model (DDM)** This model states that a share price will equal the present value of future dividends.

**Due Diligence** An investigation of the current financial and/or market position and future prospects of a business. Due diligence is often carried out by purchasers before buying a business.

**Earnings** Defined as the profit after taxation and all other charges less preference dividends and the minority interest and after exceptional and extraordinary items. It is the profit attributable to the ordinary shareholders.

**Earnings Per Share (EPS)** The earnings divided by the average number of issued ordinary shares.

**Earning / Dividend Ratio** Also called the dividend cover, the earnings/dividend ratio is the inverse of dividend payout ratio. This ratio indicates the percentage of dividend paid or covered by earnings.

**Earning / Interest Ratio** Also called interest cover, this ratio indicates the percentage of interest paid or covered by earnings.

**Earning / (Dividend + Interest) Ratio** This ratio indicates the percentage of dividend and interest paid or covered by earnings.

**Earnings Yield** The ratio of earnings per share after allowing for tax and interest payments to the current share price. It is also the inverse of the price/earnings ratio.

**EBITDA** Earnings before interest, tax, depreciation and amortisation and is a calculation of a business' profit that excludes financing costs, taxation and depreciation.

**Economic Value** The value of a business calculated by discounting to the present all of the expected future (after tax) cash flows. In the dividend discount model this value is what underpins the share price of a company.

**Economic Value Added (EVA)** A financial theory where the increase in the value of a company can be measured by the return on invested capital minus the weighted average cost of capital times the invested capital.

**Equity** The ownership interest of ordinary shareholders in a company.

**Exceptional Items** These consist of profits and losses on the disposal of operations and other items which need to be separately identified because of their materiality or significance for ongoing operations. Often these other items relate to fundamental restructuring costs. Exceptional items are reported separately in the profit and loss account, below operating profit.

**FIFO (First In First Out)** A method of stock valuation based on the assumption that the items remaining in stock are those which were purchased most recently. Note that this stock valuation method can give rise to so called stock profits or losses during periods when prices are changing. This is because the stock that is used is costed at its original price and not the current price. The method does, however, give a better picture of the worth of stock than the alternative of LIFO.

**Finance Cover** Calculated as the net cash inflow from operating activities for the period, adjusted for interest received, dividends and taxes paid, divided by the gross dividends plus total interest expense plus total interest paid in a period.

**Finance Lease** A lease where the lessor transfers substantially all the risks and rewards of ownership of the asset to the lessee.

**Finished Goods** Products that have completed the manufacturing process and are available for distribution to customers.

**Fixed Assets** These include property, plant and equipment, and are assets intended for use on an ongoing basis in the company activities.

**Fixed Costs** Costs which tend to be unaffected by changes in the volume of activity.

**Flotation** This is when a company lists shares for the first time. The first offer to the public is called Initial Public Offering (IPO). The formal written offer is called a Prospectus which contains the company background, future plans, and financial information.

**Futures and Forwards** Securities, commodities, foreign currency or other financial instruments which are bought or sold at current market price but their delivery or payment will be on a specific future date.

**Gearing** See capital gearing.

**Goodwill** An intangible asset defined as the excess paid by an acquiring company over the book value or fair value of the net assets of another company.

**Gross Margin** The profitability ratio calculated as gross profit divided by sales.

**Gross Profit** The difference between sales and the total cost of sales.

**Hedging** A technique for reducing risk through, for example options, futures and forwards.

**Historical Cost Accounting** In historical cost accounting the accounts record sales revenue, expenditure and asset acquisition and disposal at historical cost. Historical cost refers to the actual amounts cash received or paid to complete a transaction. Note that profit and loss determined under historical cost accounting includes stock holding gain or losses and, as a consequence does not necessarily reflect underlying trading results. Inflation can also distort the picture presented by historical cost accounts.

**Income** The US term used for profit. Net income is usually the equivalent of net profit after taxes.

**Income Statement** This is another name for the profit and loss account.

**Indirect Cost** Those costs such as labour, materials or services that are not directly linked to particular units or cost centres. In order to determine the full cost of production, such costs have to be allocated or assigned to a single cost unit, cost centre, or cost account or time period.

**Index** A financial index measures for example the changes in price of shares or bonds in the Capital Market. For example the FTSE-100 index shows how the price of the top 100 shares on the UK market has moved on average.

**Inflation** The rise in the price of goods and services. The inflation rate is the change in price between current and past years.

**Insolvency** Businesses are placed into insolvency when they are unable to pay debts in full after realisation of all their assets. The decision to place a business into insolvency is normally taken by the creditors of a business, and there are several different forms of insolvency – the main ones being administration, receivership and liquidation.

**Institutional Investors** These include pension funds, insurance funds, unit trusts, investment trusts and mutual funds.

**Intangible Assets** Items of value to a company that do not have a physical shape, for example patents and trade marks, goodwill and brand names.

**Intermediary or Financial Intermediary** Institutions which bring together interested parties, for example buyers and sellers. These institutions can be for example banks and brokers. The term intermediation or finance intermediation refers to a financial transaction undertaken through a third party.

**Internal Rate of Return (IRR)** The discount factor that will cause a project to have a zero net present value (NPV). It is also referred to as the discounted cash flow (DCF) rate of return or the real rate of return (RROR).

**Interest Cover** This is an indicator of solvency. It is calculated by expressing profit before interest, taxation and exceptional items, i.e. operating or trading profit, as a multiple of the interest charge.

**Inventory** Another name for stock.

**Investment Appraisal** A process whereby the revenues and costs expected to be generated by an investment are evaluated over the life of the project. The appraisal methodology usually includes an assessment of the risks of and the project sensitivity to changes in the underlying assumptions.

**Junk Bond** A bond with a low rating due to its risk, but in return for this high risk it will offer a higher yield.

**Leverage** See capital gearing.

**LIFO (Last In First Out)** A method of stock valuation which assumes that the last item delivered to stock is the first to be used. The cost charged against operations in this method is the most recent cost and, in times of inflation, will be higher than under first in first out (FIFO). It is not accepted as a method by the Inland Revenue, but is sometimes used in management accounts to maintain up-to-date costs.

**Liability** This refers to amounts owed by the business. Its usage varies; for example 'total liabilities' can mean the shareholders' interest plus amounts due to creditors, or it may be used to mean amounts owed to third parties (creditors) only.

**Liquidity** A measure of the ability of a business to meet its short term commitments. If expansion is too rapid trade debtors and stocks may increase to such an extent that creditors cannot be paid reasonably promptly due to insufficient cash flow.

**Liquid Resources** These refer to cash and bank balances plus short term investments which can be easily liquidated.

**Management Accounting** A broad term used to describe the process of collecting, analysing, and presenting financial and quantitative data within a business to facilitate decision making in areas such as business planning and performance management.

**Marginal Cost** The additional cost incurred as a result of the production of one additional unit of production.

**Market Capitalisation** Usually the value of a company based on the current market rates for its shares. It is equal to the number of shares issued times the market price for the share, summed for all the types of shares issued. This represents the market value of the net assets of the company less the market value of the debt.

**Minority Interest** Refers to the situation where minority shareholders hold shares in a subsidiary company. In such situations, all the assets, expenses, liabilities and revenues of subsidiaries are included in the parent group consolidated financial statements or accounts. This is because the group fully controls the subsidiary, even if it does not fully own it. However, the capital provided by the minority shareholders is separately recognised as minority interests.

**Money of the Day (MOD)** A term which is used to refer to the sums of money that will actually be spent at any point of time in the future or the past. An alternative is to express sums of money in real terms; the advantage of this is that it adjusts for the effects of inflation.

**Net Assets** Net assets are equal to total assets less all creditors. It is therefore equal to shareholders' funds or equity.

**Net Current Assets** See working capital.

**Net Present Value (NPV)** An important item in investment appraisal methodology. It is the sum of the present values of all the future cash flows that are associated with a business or project. Note that cash outflows are shown as negative while cash inflows are positive. See also IRR and discounted payback.

**Net Realisable Value (NRV)** The value that could be obtained by disposing of assets. It is normally not used in accounts, except in the valuation of stocks. If the realisable value is less than cost, then NRV should be the basis of stock valuation.

**Net Worth** Another expression for net assets, and therefore equity.

**Nominal Value** The face value of a security. In the case of a share, it is also known as the par value, and often reflects the price at which shares were originally issued. However, a new share issued later may be issued at a price well above the nominal value (see share premium). The nominal value normally has no significance for the market value at which a share is traded.

**Notes Payable** This is a US term for short term borrowing. US banks tend to lend based on a written promise to repay, rather than allowing a current account to become overdrawn.

**Operating Costs** All costs excluding interest charges and taxation. They represent the costs which are generally under direct management control.

**Operating Expenditure** See revenue expenditure.

**Operating Expense** See operating costs.

**Operating Margin** An accounting ratio that reflects profitability, and is calculated by dividing operating profit by total sales and expressing the result as a percentage.

**Operating Profit** See trading profit.

**Opportunity Cost** The value of a benefit sacrificed when one course of action is chosen, in preference to an alternative. Opportunity cost is a concept which is sometimes used in investment or project appraisal.

**Ordinary Shares** They usually make up the bulk or in many cases the entire share capital of a company. There may also be preferred shares and there can be different classes of ordinary shares.

**Options** Generally an option refers to a situation where you have the right but not the obligation to do something. For example, an option might be the right to buy a share for a set price for some period (called a call), or the right to require somebody else to purchase a share from you at a certain price for some period into the future (called a put).

**Overdraft** Money owed on a bank current account. This is a form of short term borrowing, which is repayable on demand.

**Overhead** An overhead cost is one that is not directly related to the production of a specific product and/or service.

**Payback** The concept of payback is often used in investment appraisal. The payback period represents the number of years it takes the cash inflows from a capital investment project to equal the cash outflows. One drawback with the payback method is that it does not reflect the time-value of money, so a discounted payback is sometimes also calculated.

**Par Value** See nominal value.

**Price / Cash Flow Ratio** This is the ratio of share price to cash flow.

**Price Earnings Ratio (P/E)** The market price of a share divided by the earnings per share (EPS). Different price/earnings ratios are sometimes quoted. Current P/E is share price divided by this year earnings; Prospective P/E is share price divided by potential future earnings; and Exit P/E is the acquisition price of the share divided by earnings.

**Preferred Shares** A type of share that is less risky than an ordinary share. It has a fixed level of dividend which must be paid before dividends can be paid on ordinary shares. Preferred shares are paid at a set percentage of the nominal value of the preferred share.

**Prepayment** Refers to a cash payment which includes an element covering a future accounting period. An example is rent paid in advance.

**Present Value (PV)** PV is the worth today of a sum of money in the future. See also discounted cash flow (DCF).

**Profit** The difference between sales and costs for a particular accounting period. Note that profit is usually not the same as cash since sales revenue is recognised when goods and/or services are supplied rather than when paid for by the customer and costs are incurred during the time period to which they relate rather than when they are paid in cash. See also income.

**Profit Centre** A part of the business that is accountable for both revenues and costs.

**Profit and Loss (P&L) Account** A summary of the revenue (turnover) and costs for a particular accounting period. Note that the P&L account is concerned with financial performance during a given time period whereas the balance sheet is concerned with the financial position on a particular date.

**Profit Margin** A measure of the profitability of sales. It is defined as the profit before or after interest and taxation expressed as a percentage of sales.

**Provision** An accounting entry for a cost or charge incurred but not paid for at the balance sheet date, or for a potential future charge. A provision is included as a cost in the profit and loss account and a liability in the balance sheet. See also accruals and accrued charges.

**Put Option** This gives the holder the right to sell a share or other asset at the exercise price at some future time. See also call option.

**Quick Ratio** A measure of liquidity, similar to the current ratio (current assets divided by current liabilities), except that stocks are excluded from the calculation of net current assets. This is because it may be some time before the cash value of the stocks can be realised. See also acid test ratio.

**Rating Agencies** Organisations that study company credit risk and the risk of their various debt securities.

**Realisable Asset Value** The price at which an asset, a group of assets or a business could be sold.

**Real Terms** A way of stating sums of money that adjusts for the impact of inflation. Money is stated in terms of units of constant purchasing power based on the inflation index that applies to the particular currency in question. When using the expression real terms it is always advisable to refer to the year concerned. For example, real 2005 pounds sterling means that all sums are expressed in terms of their purchasing power in pounds sterling in the year 2005.

**Replacement Cost Accounting** In replacement cost accounting, assets and liabilities are valued at their cost to replace. This is different from historical cost accounting where these costs are valued at actual cost. Replacement cost accounting is sometimes used in management accounts so that a business is charged with current rather than historic levels of cost.

**Replacement Cost Operating Profit (RCOP)** Profit before interest and tax after allowing for the extra or reduced cost of replacing stocks. Some companies use RCOP as important measure of profit excluding stock holding gain or losses and reflecting the average cost of supplies incurred during the period. This may be particularly relevant in situations where there can be significant changes in the cost of raw materials across an accounting period.

**Reserves** Reserves in this financial definition are realised and unrealised gains which have added value to the business, and which form part of the shareholders' investment. Realised gains are retained profit; unrealised gains arise from revaluation of assets.

**Residual Value** The residual value of an asset is the expected proceeds from the sale of the asset less any of the costs of sale, at the end of its estimated useful life. Residual value is used for calculating depreciation, and is also usually included in the final year's cash inflow in a discounted cash flow appraisal.

**Retained Profits** The profit for the accounting period after all charges and the distribution of dividends to shareholders. The figure for retained profit in the balance sheet will be the accumulated retained profit since the business started to trade. It may be also known as the revenue reserve, profit and loss account reserves, or retained earnings.

**Return On Average Capital Employed (ROACE)** The profit before or after taxation expressed as a percentage of average of opening and closing capital employed. It is a basic measure of profitability.

**Return On Capital Employed (ROCE)** The profit before or after taxation expressed as a percentage of opening or closing capital employed.

**Return On Equity (ROE)** One definition of ROE is profit after taxation divided by the shareholders' funds.

**Return On Fixed Assets (ROFA)** The ratio of profit to fixed assets, where fixed assets are the average of the last and the current accounting period.

**Return On Net Assets (RONA)** The ratio of profit to net assets, where net assets are the average of the last and the current accounting period.

**Return On Sales (ROS)** The ratio of profit to sales.

**Revenue** See sales.

**Revenue Expenditure** Expenditure charged to the profit and loss account or income statement during the accounting period in which the expenditure occurs. Note that this excludes capitalised expenditure.

**Revenue Reserve** See retained profits.

**Rights Issue** The sale of additional shares by a company to its existing shareholders. This sale often takes place at a discount to the prevailing stock market price in order to ensure a successful issue.

**Risk** Financial risk for an investor is often defined as the unexpected variability or volatility of returns. This includes both worse than expected as well as better than expected returns.

**Sales** The invoiced values of the goods and services provided to customers during the accounting period in question. This is often also called revenue or turnover.

**Secured Loan** A loan against which a certain asset or assets have been pledged. If the company with the loan falls into default, the lender will have the first available proceeds from the sale of these assets before any unsecured creditors.

**Securities** Papers, for example share certificates that prove the ownership position in company. The securities could be common shares, preferred shares, bonds, convertibles, options, rights, and warrants.

**Share** A share represents a portion of the company's equity, and (in total) gives the shareholders ownership of the company. Shares can be ordinary shares and/or preferred shares. Shares are also called stocks in the US.

**Share Capital** The permanent capital contributed by the owners (the shareholders) of a business at the start of trading.

**Share Dividend** A dividend which is paid in the form of extra shares rather than cash.

**Share Premium** The difference between the issue price and the nominal value of a share. When a premium is paid for new shares, a share premium reserve is created or increased.

**Shareholders Interest** The sum of share capital plus share premium plus retained profit plus other reserves, at the balance sheet date. This is the same as equity and net worth.

**Shareholders Funds** See shareholders interest.

**Shareholders Return** The change in price of the share plus any received dividends, expressed as a percentage by dividing by the initial investment. Shareholders return is often quoted on an annual basis. By looking at the history of past returns, a shareholder may get some information to help assess potential future returns.

**Shareholder Value** An approach to business management that focuses on maximising the value of a shareholder's equity above other business objectives. Shareholder value can be increased through dividend or cash payments to shareholders and share value appreciation.

**Solvency** The ability of a business to meet its long term commitments. See also debt equity ratio and interest cover.

**Standard Cost** The planned (as opposed to actual) unit cost of products and/or services produced in a period. Standard costs are useful for performance measurement, control and stock valuation purposes, as well as contributing to the setting of selling prices.

**Stock** The investment that a company makes in raw materials, work in progress, finished goods and supplies. It is normally valued at cost or net realisable value, whichever is less. The US term for stock is inventory.

**Stock Profit or Loss** Often there is a difference between the price paid for stock and the current price of the stock. When the current price is higher than the purchase price, the difference is called a stock profit;

and when the current price is lower than the purchase price, the difference is called a stock loss. See also cost of sales adjustment (COSA).

**Stock Turnover Rate** The average number of times each during the accounting period that stocks are turned over in the course of trading activity. It is calculated by dividing the cost of sales by average or closing stocks.

**Subsidiary Company** A company in which the organisation has a majority (over 50%) shareholding and/or has the right to exercise a dominant influence over the undertaking. See also associated company.

**Sunk Cost** Those costs which have already been incurred and which can no longer be recovered.

**Taxable Profits** The profits on which a business calculates its corporation tax charge during the appropriate accounting period.

**Trade Creditors** Amounts due to suppliers for goods and/or services received but not yet paid for. They are normally due for payment within a short period of the balance sheet date, and, therefore, form part of current liabilities.

**Trade Debtors** Amounts due from customers in respect of goods and/or services supplied but not yet paid for. Trade debtors are also known as receivables and are reported as current assets.

**Trading Profit** Profit after all charges except interest, taxation, and exceptional and extraordinary items. Trading profit is also known as operating profit.

**Turnover** See sales.

**Underwriter** An institution which gives a guarantee that particular securities will be purchased on issue. The underwriter receives a fee for this guarantee and in return has to purchase the security if there is inadequate demand from the market.

**Unit Trust** An investment institution in charge of investing a money from investors in securities. A unit trust is also sometimes known as mutual fund.

**Value** Value refers to the worth of an item. Value can be defined in economic terms (see economic value) or accounting terms (see book value).

**Variable Cost** Costs that vary directly with the volume of activity.

**Venture Capital** A potential source of finance that can be used during the start up phase of new companies. A venture capital enterprise invests the money with the promise of high return from company.

**Volatility** The fluctuation in the price of a security over a relatively short period of time.

**Working Capital** Current assets less current liabilities, and is also called net current assets.

**Work In Progress** The production of products or services which are in the process of completion.

**Weighted Average Cost of Capital (WACC)** See cost of capital.

**Write-Downs / Write-offs** When the market value of an asset is less than its book value, then it is written down (off) to its market value and the effect of this is charged directly to profits.

**Yield** See dividend yield.

**Zero Based Budget** A way of producing a budget which ignores what happened in the past, and instead the budget is built up from a set of new assumptions.